Newsletter for the outplacement industry Issue Seven

RDR - the end of commission based advice!

The investment of capital from redundancy or retirement is an important step for most people, particularly if they have not sought financial advice before.

Now the finishing touches are being put in place to the biggest shake-up in the investment industry in decades, designed to give consumers a retail investment market in which they can have confidence and trust at a time of increasing demand for help and advice with retirement and investment planning.

The Financial Services Authority's Retail Distribution Review (RDR), due to come into effect on 31 December 2012, will affect all advisers in the retail investment market, regardless of whether they work for banks, product providers, independent financial advisers, wealth managers, stockbrokers or other organisations. Key measures under RDR include:

- independent advice must be truly independent and reflect investors' needs
- advisers will no longer receive commission set by product providers, removing bias from the system
- investors will know upfront how much advice will cost and how they will pay for it
- all investment advisers must be qualified to a higher level.

However, there are potential loopholes in the RDR system and people seeking financial advice before and after its introduction will need to ensure they are working with appropriate advisers. Areas of concern include:

- trail commissioning - this occurs when investors buy products with ongoing annual charges, which can add up to substantial sums. Trail commissioning can continue to be paid after the end of 2012 for pre-RDR advice
- investment bonds - used as wrapper for other products
- hidden commission - some product providers are considering still making commission-type payments to advisers. The investor will need to agree to these fees but the advice they are getting may not be as free as it seems
- commission for execution-only operators - these operators (such as discount brokers and fund supermarkets, which buy and sell shares and securities without providing any investment advice) will still be able to receive undisclosed levels of commission post-RDR, potentially pushing the issues the reforms were meant to tackle into a different sector.

For complete peace of mind, clients need to be sure that they are working with advisers like Birchwood, where advisers are professionally qualified and have always been paid salaries. Birchwood clients also have the confidence of knowing that advisers' recommendations are based on market-wide research and advice.

Time ticking away to auto-enrolment

In less than 12 months' time, the first stages of a major change in pension arrangements in the UK will take effect.

From 1 October 2012, the first employers in a phased programme, expected to be completed in 2017, will start automatically enrolling all eligible workers – those who meet certain criteria relating to length of service, age and level of earnings – into a qualifying pension scheme, without workers having to take any active decision to join the scheme, although they will be able to opt-out.

Employers will be able to choose the qualifying scheme they use, which could include the National Employment Savings Trust, or NEST, a new, low-cost pension scheme. All qualifying schemes must meet minimum standards relating to the benefits it provides or the amount of contributions paid in to it.

With the Department for Work and Pensions estimating that around seven million people are currently not saving enough to deliver the pension income they are likely to want or expect in retirement, the government sees automatic enrolment as a key tool to inspire a culture of saving.

While the focus of auto-enrolment is on encouraging more people to save for retirement, as growing numbers of people are enrolled in pension schemes, more people affected by redundancy will also have decisions to make relating to their workplace pensions.

Depending on the scheme's rules, and how long the person affected has been a member, these might include a refund of contributions, a pension payable on retirement or a transfer of the pension funds to another scheme and there may also be an option of using redundancy money to boost pension funds. For people over 55, early retirement may also be an option.

For employers getting to grips with implementing auto-enrolment – and for employees deciding whether they want to remain in their workplace scheme, opt-out or what the best way forward is for retirement and redundancy – expert advice on the issues involved will become increasingly important.

Opt-out – or lose protection

From 6 April 2012, the lifetime allowance for pensions will be reduced from £1.8 million to £1.5 million.

Anyone who has currently, or who may have, total pensions valued at more than £1.5 million on that date, has the option of applying for fixed protection, to protect pension savings from the lifetime allowance charge, the tax charge on savings in excess of the lifetime allowance. HM Revenue & Customs (HMRC) must receive fixed protection applications by 5 April 2012.

With any amount over the lifetime allowance taken as a lump sum being taxed at 55 per cent or at 25 per cent if it is taken as a pension, fixed protection is an important step but there are a number of conditions that must be met to retain it after it has been granted. These are:

- no new contributions can be paid to a money purchase arrangement
- the amount of benefit that can be built up under a defined benefit arrangement will be limited
- a new pension arrangement cannot be set up unless it is only to receive a transfer or existing pension rights.

However, anyone who has fixed protection could risk losing the benefits under the auto-enrolment into workplace pensions that starts in October 2012.

Unless they opt-out of the new scheme within a month of the enrolment date – which means they will be treated as if they were never a member of that scheme – they will lose their fixed protection.

HMRC says: "If you have applied for fixed protection and think that auto-enrolment into a new scheme will mean that you will lose this then you should speak to your employer or prospective employer.

"You will be able to opt-out of membership and your employer will be able to tell you how you can do this.

"If you change employer your new employer may auto-enrol new employees into their pension scheme. If you have fixed protection you may need to 'opt-out' of the pension scheme before you have even joined it."

Redundancy payments hit £4.4bn

UK employers paid out an estimated £4.4 billion in redundancy payments in the last financial year, with the bulk of it tax-free, according to new figures.

Information released in 2011 by City law firm Wedlake Bell, following a Freedom of Information request to HM Revenue & Customs, also revealed that in the last three years, redundancy payments made by UK employers totalled £13.4 billion.

Wedlake Bell said that of the £4.4 billion paid out in redundancy payments in the 2010-2011 financial year, 86 per cent – or £3.8 billion – was paid to employees tax-free, because individual settlements fell below the £30,000 limit under which there is no tax on redundancy payments.

The figures also highlighted that the average redundancy payment was £9,362 in 2010-2011. Based on statutory redundancy payments, with rates calculated using a person's age and length of service, the average payment represented just over 15 years of service for someone aged over 41.

The relatively modest size of the average redundancy payment underlines the fact that careful financial planning is crucial for workers, as more people chase fewer jobs and redundancy payouts have to last longer.

For older workers, the position is particularly challenging. Research released in July 2011 showed that 46 per cent of over-50s who had been made redundant in the last three years were still trying to find a job, with 77 per cent of those who had been successful reporting they had had to take a pay cut to get back into full-time employment.

"Redundancy is tough at any age but the younger you are the longer you have to bounce back. We'd urge anyone made redundant in their 50s to take a careful look at their finances and to get advice", says Dean Mirfin of equity release specialists Key Retirement Solutions, which produced the data.