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SIPPs

SELF INVESTED PERSONAL PENSIONS
THE COMMONSENSE WAY TO BUILD A PENSION

Hargreaves Lansdown

CONTENTS

SIPPs: A DIY investor's dream pension

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Nearly a million people have a SIPP (Self Invested Personal Pension) and there is no sign of demand slowing.

The most obvious reason for their popularity is in the name: 'self invested.' They give investors access to a huge range of investments so they can run their pension themselves. For many people their pension will be their second most valuable asset after their house; so this freedom really matters.

Simpler pension rules have helped too. It is now much easier to make a contribution and get your money out at retirement. For instance, there is no longer a compulsion to buy an annuity by age 75, and for some there will even be the option to take all the money out in one go, after meeting some conditions.

Technology has been a key factor. As many SIPPs have been launched in the 21st century they have been designed with the internet in mind. An array of online tools for SIPP investors have made them attractive to people who are comfortable making their own investment decisions.

There are two ways you can start a SIPP:

1. **New contributions** (such as monthly payments and one off lump sums) which attract tax relief at up to 45% depending on your circumstances.

2. **Transfers from other pensions** allow investors to move away from outdated arrangements or consolidate numerous plans under one roof.

With an age of austerity in public spending upon us and private companies providing less generous pensions, individuals will increasingly be required to make their own retirement provision. SIPPs will be the most attractive option for many.

This guide explains the pros and cons of SIPPs in plain English; indicates who can prosper and who may be more suited to a stakeholder pension. You should find it useful and if it raises any questions for you please do not hesitate to contact our Pensions Helpdesk on **0117 980 9926**. One of our specialists will be delighted to assist you. Please note tax rules can change.

SIPPs: What's all the fuss about?

A SIPP works in much the same way as any other personal or stakeholder pension, in terms of tax benefits, contribution limits and retirement options. You make contributions, have them boosted by basic rate tax relief and claim any higher rate relief via your tax return. You leave the contributions to grow, and then, at some point from age 55 you can convert part of the accumulated fund into a tax-free lump sum and take a taxable income from the remainder.

The main way in which SIPPs are superior to personal and stakeholder plans is in their investment choice.

Stakeholder pensions have low charges, but tend to offer a limited choice of funds. Traditional personal pensions, meanwhile, tend to offer a wider choice of funds than stakeholder schemes - between a dozen and several hundred - but can carry hefty charges, particularly on older plans. Both types are usually run by insurance companies, which generally only offer their own funds or a limited selection from other fund managers. The drawback is while a single company may have expertise in one area, it is unlikely to have the best record across all fund sectors. One might offer a good Far East fund, while another may be renowned for its expertise in picking European shares.

SIPPs offer the widest possible choice of investments, allowing holders to pick funds from across the market. You could choose a top UK smaller companies fund run by investment house A, a leading US manager at investment house B and a top fixed income manager at investment house C. With a personal pension, you usually have to choose from the investments offered by that particular pension provider. Some of the funds offered may be good, but it is unlikely that all of them will be.

A good way to think of a SIPP is as a shopping trolley into which you can place many different types of investment, including funds, shares, bonds, gilts, futures and options, commercial property and more. The SIPP itself is merely a tax-efficient wrapper around those investments.

More about the investments

With a personal pension you can choose from a limited selection of investment funds offered by your pension provider.

With a SIPP you can choose a wide variety of different investments, from a wide range of providers.

What investments can I choose?	Personal Pension	SIPP
Collective Investment Funds		
Unit trusts	–	✓
Investment trusts	–	✓
OEICs (Open Ended Investment Companies)	–	✓
Exchange Traded Funds (ETFs)	–	✓
Insurance company funds and their range of funds run by other managers	✓	✓
Stocks and Shares		
Individual UK equities	–	✓
Overseas equities, eg US or European shares	–	✓
UK Gilts	–	✓
Bonds and other fixed interest securities	–	✓
Futures and options	–	✓
PIBS - Permanent interest bearing shares	–	✓
Some of the other investments include:		
Cash and deposit	✓	✓
Traded Endowment Plans	–	✓
Commercial property and land	–	✓
Loans	–	✓

More about the investments

Collective investments are extremely popular and include unit trusts, investment trusts, OEICs and insurance company funds. Together they make up a range of thousands of different investment funds, offered by hundreds of different fund managers and insurers. Some invest widely around the world and across different types of asset, while others are more specialised, focusing on a particular region or type of share.

Investors can also hold individual UK and overseas stocks and shares, as well as UK gilts, corporate bonds and other fixed interest securities. Even futures and options can be included.

Whilst waiting to make an investment decision you may keep your SIPP in cash. Indeed some SIPP holders are happy with cash in the knowledge they have obtained tax relief.

In summary, you may invest across a whole spectrum. Some providers offer a more restricted choice.

Some SIPPs offer the choice of commercial property. They tend to be expensive. Low-cost SIPPs tend to exclude commercial property.

Remember that investments should be held for the long term as they do fall as well as rise in value. This means you could get back less than you invested. As you approach retirement you should normally reduce exposure to volatile and riskier investments in preparation for securing your retirement income.

Is a SIPP for you?

SIPPs aren't for everyone. Some investors do not require the huge investment choice, others may have adequate pension provision through their employer. Flexibility and broad investment choice are particular attractions for those taking responsibility and control of their pension.

If starting a personal pension look at all the options.

If investment choice and flexibility are not important to you, and your contributions are going to be low, then a stakeholder pension could be a cheaper and better option than a SIPP. If you want access to the best fund managers in the market a low-cost SIPP may be a better choice. If you want to invest directly in commercial property or more exotic investments these are normally offered by the more expensive SIPPs. With a SIPP you should have the desire and confidence to take control and make investment decisions.

If you already have a personal or stakeholder pension you should in any case regularly review your arrangements, although few people do.

Transferring to a SIPP is not difficult. People regularly change their car insurer or mortgage provider, few however take the trouble to re-examine their pension. Some old personal pension arrangements have cripplingly high fees. They sometimes suffer poor fund performance. However before transferring, you should ensure you will benefit from doing so, and check you will not incur excessive penalties or lose guarantees or other benefits.

Most pension plans are provided by insurance companies, which generally do not have the best record for investment performance. There are exceptions. Investment funds run by specialist companies have historically performed better, although past performance is not a guide to the future.

If you wish to escape from mediocre fund performance, and take control of your pension arrangements, SIPPs offer access to the funds of specialist investment companies. And if charges are blighting your pension fund you could try a low-cost SIPP.

Certain SIPPs, such as those offering investment in commercial property, are expensive but low-cost SIPPs can represent excellent value depending on the size of the fund and the investments chosen. Low-cost SIPPs may not include investments such as commercial property.

If you have any doubts about the suitability of a SIPP for your circumstances you should seek advice.

What are the tax advantages?

SIPPs have the same tax benefits as other personal pensions, including basic-rate tax relief added by the government for personal contributions. This boosts your initial contributions. It works like this:

For every 80p you pay into your personal pension, the government adds 20p, boosting it to a gross contribution of £1. This basic-rate tax relief is claimed by your pension provider, and will be added to your pension automatically. Almost every UK resident under 75 qualifies for this tax relief, even children and other non-taxpayers. Higher-rate taxpayers enjoy even greater tax relief, as they can claim back up to a further 20p of every £1 gross contribution through their tax return or local tax office. Additional-rate taxpayers can claim back up to a further 25p of every £1 gross contribution.

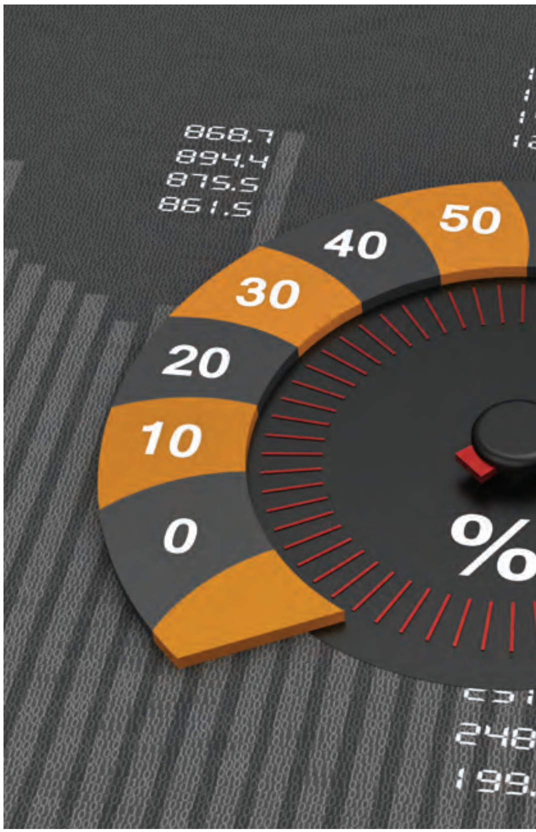
This means, for example, that a £10,000 contribution would ultimately cost you £8,000 if you are a basic rate taxpayer, from as little as £6,000 if you are a higher-rate taxpayer and from as little as £5,500 if you are an additional-rate taxpayer. You must pay sufficient tax at the higher/additional rate to claim the full relief at these rates.

In addition to the up-front tax relief, the investments within your SIPP can grow free of UK capital gains and further income taxes.

Employer contributions are paid gross, however if an employer pension contribution ranks as a valid business expense, it can be offset against the taxable profits of the business. Any contribution an employer pays on your behalf should not count as a taxable benefit so should not be liable to income tax or National Insurance.

You can normally take up to 25% of your fund as a tax-free lump sum usually from age 55. The rest must be made available to provide a taxable income. If you die before taking retirement benefits, the fund can be made available to provide a taxable income for your dependants or can normally be paid as a lump sum, free of tax, to your nominated beneficiary.

Information in this guide is based on our



understanding of current pension and tax rules and regulations and these are subject to change. The exact relief you are entitled to will depend on your circumstances.

What are the eligibility & investment limits?

Nearly everyone under 75 in the UK is eligible to start a SIPP or transfer in other pensions, even children.

To benefit from tax relief on contributions up to age 75, you need to be resident in the UK, or be a Crown Servant serving overseas, or their husband, wife or civil partner. If you meet these basic requirements you can usually pay in at least £2,880 per tax year, which with basic-rate tax-relief is boosted to £3,600, whether you are a taxpayer or not. This means that children, retired people, and non-working carers or parents can build up a pension pot.

Many people will be able to pay in more. Tax relief will only be given on the higher of £3,600 or an amount up to 100% of "relevant UK earnings" where this is a personal contribution. Generally this is earnings from employment or self employment.

Each year there is an annual allowance on contributions; this tax year it is £50,000. It is due to fall to £40,000 in the 2014/15 tax year. Where the total contributions (personal, employer and the value of benefits being built up in final salary schemes) exceed the annual allowance you will normally be taxed on the excess. It is also possible that you could be affected by this if combined contributions over two consecutive tax years exceed one year's annual allowance.

There is a facility to potentially carry forward any unused annual allowance from the three previous years. We have a factsheet on carry forward that can be requested on 0117 980 9926.

There is also a lifetime allowance. It is currently £1.5 million and is due to fall to £1.25 million from the 2014/15 tax year. This applies to all your pension savings. If your total pension benefits exceed the lifetime allowance when they are taken or you reach age 75, the excess could be hit with a lifetime allowance charge of up to 55%.

If you registered with HM Revenue & Customs for fixed or enhanced protection against the lifetime allowance then making any further pension contributions will normally mean you lose this protection.

What happens to your SIPP if you die before taking retirement benefits?

If you die before you have taken retirement benefits and before age 75, your SIPP will normally be passed as a lump sum to your nominated beneficiaries free of inheritance tax. If you have not taken retirement benefits by age 75 and your SIPP is paid as a lump sum a 55% tax charge is payable on your death.

How much should you be saving?

This will depend on your personal circumstances. We are unable to offer advice on these pages, but as a general rule of thumb, if you want to retire at 65, you should contribute an annual percentage of your earnings equivalent to half your age when you start saving. If you start saving when you are 20, for example, consider putting aside at least 10% of your salary until retirement, while if you start at 40, consider at least 20%; either as annual lump sums or regular monthly savings.

You should also make sure this percentage is maintained as your earnings increase. You may find our interactive pension calculator on our website **www.hl.co.uk** helpful.

Not everyone will retire at 65, so you should also consider how long you might be retired. A 40-year-old planning to retire at 65 would have the same time to retirement as a 30-year-old wanting to retire at 55. But the 30 year old would need to save much more each month, or hope that their investments grow much faster, as their retirement should be much longer. Because of this they would receive lower

annuity rates. They would also not get any State Pension for at least the first twelve years of their retirement.

How might you invest your pension?

Once you have started building up a pension you are a step ahead of many people, however it is easy to fall at the next hurdle: choosing a pension investment. Those who do take that important step of starting a pension often fail to take account of where it is invested, and sometimes end up in a mediocre default fund managed by an insurance company. In truth however, the performance of your pension investments can have a substantial effect on how affluent you are in retirement.

Those with more than 10 years to retirement can typically afford to take more risk with their pension investments, in search of higher rewards, because they have time to ride out the ups and downs of riskier investments. Typically this leads to a fund which invests predominantly or exclusively in equities. However SIPP investors can also choose to invest in bonds, gilts, property and cash as they see fit, depending on their circumstances and prevailing market conditions. The beauty of a SIPP is you can invest across different assets and markets, picking from some of the best managers in each area.

As you start to approach retirement it generally makes sense to decrease the risk in your pension fund to reduce the likelihood of big swings in the value of your pension just as you are about to retire. Again a SIPP gives you the flexibility to manage this transition as you see fit, giving you access to fixed interest funds and cash, among others, which could be used in the lead up to retirement.

What are the options at retirement?

Any investor who has taken advantage of tax relief and investment growth to accumulate a pension fund will want to make the best decision on retirement.

The options:

SIPP investors, like other personal pension savers, can currently take pension benefits from the age of 55. There is no upper age by which you have to take retirement benefits and therefore no requirement to take retirement benefits at all should you wish to keep your pension invested.

When you take benefits from a SIPP, you can normally take up to 25% of your fund as tax-free cash. The rest must be made available to provide a taxable income. You can either use the remaining fund to buy a lifetime annuity which pays a secure income for at least the rest of your life or it can be made available to provide a taxable income directly from your SIPP using income drawdown.

Lifetime Annuities

An annuity is an income for the rest of your life in exchange for your pension fund. Annuities come in two main varieties: **conventional**, where income is fixed, inflation-linked, or set to increase by a fixed percentage each year; and **investment-linked**, where income rises or falls depending on the performance of underlying funds. Conventional annuities are secure, however investment-linked annuities are more risky.

Once you have bought an annuity, the original pension fund can no longer be inherited by your family when you die (unless you have chosen value protection - see below). However, it is possible to buy joint annuities which will continue to pay out to a spouse or partner if you die before them, or to buy an annuity which is guaranteed to pay out for up to ten years, even if you die within that time.

Value Protected Annuities

These pay out a lump sum if you die before a specified age. The amount paid will represent the difference between the fund used to buy the annuity and the payments made so far, and will be taxed at 55%. They are more expensive than a simple lifetime annuity because of the cost of the protection. It is possible to protect a portion of your fund, for instance 50% value protection.

Income Drawdown

This allows you to take your tax-free cash and keep the fund invested, while drawing an income directly from your fund.

With a drawdown plan your fund is still invested, and therefore will suffer the volatility of markets. As any income withdrawals and charges will be a drain on the funds, income drawdown is usually suggested only for those with large funds (over £100,000) or other sources of income. It is certainly a riskier option than an annuity. Poor investment performance or large income withdrawals can quickly erode your fund's value. In a worst case scenario this could completely deplete your fund leaving you reliant on other sources of income. Remember, once in retirement you are unlikely to have the ability to earn money to make up for losses. One way to use income drawdown is to just take the natural yield of the underlying investment.

If you die while in drawdown the remaining money can be used to provide an income for your dependants or be paid as a lump sum to your nominated beneficiary less a 55% tax charge.

Unless you are in flexible drawdown the government has limits designed to restrict the amount of income to broadly 120% of the income from an annuity. There is no minimum income that must be taken.

Flexible Drawdown

This gives you control over the amount of taxable income that you take, unrestricted by the government defined limits. To qualify for this option you need to meet certain criteria including being in receipt of guaranteed pension income of at least £20,000. This could be state pension, pension annuities or final salary pension income, but cannot include any non-pension income. Once in flexible drawdown you are effectively prevented from making any further pension contributions or building up any further pension benefits in final salary pension schemes.

Phased Retirement

You don't have to convert all your pension fund into an annuity or income drawdown in one go. Instead you can split it into segments and convert the segments gradually, receiving a series of tax-free cash payments and an increasing income, until the fund is fully converted. This also enables you to split your fund between an annuity to fund your everyday basic expenses and drawdown for the luxuries.

Give your pension the attention it deserves

No-one should care more about your retirement planning than you.

A SIPP is a genuine enabler: it asks you to make choices but this need not be daunting. It takes a little work and some monitoring - but this is your money.

A SIPP gives you access to the top fund managers, and the power to change your investments when you want. Best of all, SIPPs need not be expensive. Low-cost SIPPs herald a new chapter in pension investing. With a SIPP, you have access to the best fund managers in all sectors.

Your pension is likely to be the most valuable asset after your house – in some cases the most valuable. Give it the attention it deserves. To find out more, call our Pensions Helpdesk on **0117 980 9926**.

Important investment notes

This guide is published to help clients make their own investment decisions. It does not constitute a personal recommendation in any way whatsoever. All investments should be held for the long term as their value does fall as well as rise, therefore you could get back less than you invested. Neither capital values, nor income, are guaranteed. Past performance is not a guide to the future.

If your employer offers a pension you should consider joining or making additional contributions to this first. Should you have any doubt as to the suitability of an investment for your circumstances you should contact our Financial Practitioners for individual advice.

Any tax reliefs referred to are those currently applying, but levels and the basis of, as well as reliefs from, taxation are subject to change. Their value depends on your individual circumstances.

The information in this guide is based on our understanding of existing and proposed legislation as at 27 March 2013 which may be subject to change. Unless otherwise specified, tax rates are those applicable to the 2013/14 tax year. The rules of a pension scheme may sometimes be more restrictive than the legislation.

Hargreaves Lansdown is authorised and regulated by the Financial Services Authority (FSA).

Contact us

Our specialist helpdesk can answer your queries.

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