The Association of Investment Companies

Taking control of your future

A guide to Self-Invested Personal Pensions

May 2018

www.theaic.co.uk

Saving for your retirement is one of the longest and biggest financial commitments you will make. With access to investments that other funds cannot offer, and their long-term track record, investment companies make a compelling case as part of a balanced portfolio for retirement.

And with savers now having unprecedented freedom over how they can take their pension, now is the perfect time to learn about the unique advantages of investment companies in delivering a higher or growing income in retirement.

New to investment companies?
Read 'A guide to getting started' to learn the basics

Available at www.theaic.co.uk or by calling 0800 707 707

Introduction

There are many different types of pension scheme that offer people the chance to save for their retirement, in addition to state pensions. They fall into two broad groups:

- **Occupational pensions**
  These are pension schemes provided by your employer. They either provide you with a specific level of income in retirement depending on your salary and how long you work ('final salary' or 'defined benefit' schemes) or allow you to invest your contributions in funds or other investments to grow over time ('money purchase' or 'defined contribution' schemes).

- **Personal pensions**
  These are pension schemes which are set up by you (though sometimes employers also help to arrange them), for example if you are self-employed and don't have access to a company scheme. They work very much like a defined contribution occupational scheme.

  However, an increasingly popular choice of personal pension is the Self-Invested Personal Pension (SIPP). As its name suggests, this type of pension gives you much more freedom to choose and manage your investments. SIPPs are generally for more experienced investors that have larger sums to invest. If you are less experienced, you may be better off with another type of pension, such as a Stakeholder Pension.

If you are not sure which type of pension scheme is best for you, you should speak to a financial adviser or contact the Pensions Advisory Service (0300 123 1047 or www.pensionsadvisoryservice.org.uk).

The rest of the guide only considers SIPPs and is intended for UK residents under the age of 75.

Wide horizons
A SIPP gives you the freedom to search out and manage your own pension investments

The basics of SIPPs

SIPPs are similar to many other types of pension, in that you make contributions to a scheme which are then invested in assets to grow over time. Once you reach 55, you can use this fund to provide you with an income in retirement.

The main features of SIPPs are:

- **Tax relief on your contributions**
  If you make contributions to a SIPP, these will be boosted by basic rate tax which the SIPP provider will claim on your behalf. If you are a higher or additional-rate taxpayer, you can claim additional tax relief through your tax return.

  So, if you put £80 into a SIPP, the Government will add £20, making £100 in total. If you are a higher-rate taxpayer, you can claim a further £20 tax relief via your tax return. If you are an additional-rate payer, this rises to £25.

  You don't have to be a taxpayer to benefit from tax relief. Almost anyone can put up to £2,880 into a pension each year, and have this increased to £3,600. You can even set up a pension for your children.

- **Investment limits**
  Providing you have sufficient earnings, you can contribute up to £40,000 a year and benefit from tax relief, possibly more if you have not used up your annual allowance in the past three years. If you exceed the limits, you will normally be taxed on the excess.

  There is also a lifetime allowance of £1.03 million which applies to all your pensions. If you go above this limit, you could be charged up to 55% tax on the excess.

- **Investment flexibility**
  Today's SIPPs usually provide you with a wide range of investment options. So you can tailor your portfolio to your needs and your attitude to risk. You should check if the SIPP offers access to investment companies.

- **Tax-free growth**
  Investments within the SIPP are not subject to income tax or capital gains tax.

- **Tax-free lump sum**
  Once you have turned 55 (rising to 57 in 2028), you can take up to 25% of your fund tax free. Any withdrawals after this are taxed as income.

Thanks to tax relief, every £100 you put into a SIPP could cost you only £60, or even less

- **Income in retirement**
  At present, when you start to draw a pension, you can either purchase an annuity or go into what is called 'income drawdown'.

  An annuity provides a safe and predictable income, but can be inflexible as, once you have made your choice, you cannot change your mind. You also cannot pass on the money you use to purchase an annuity to your children when you die.

  With income drawdown, your pension remains invested and you draw an income off it. If you are uncertain of the implications, or have already drawn some of your pension, you should speak to a financial adviser.

FREEDOM IN PENSIONS

Since April 2015, you have had complete freedom over how you can take an income from your pension

Flexibility in retirement

Since April 2015, you have had much more freedom over how you take an income in retirement. No one is required to purchase an annuity, and the rules limiting how much you can take using income drawdown were scrapped.

Instead, you are allowed to take as much or as little money from your pension as you want at any time provided you are 55 or over. The first 25% remains tax free, and the rest will be taxed as income at your marginal rate of income tax.

You should be very careful to make sure that you have enough money for your retirement, and for some people an annuity may still be the best option. But if you have plenty to live on, you can choose to leave some of this to hand down to your children. Drawdown of pension income will be taxed at your normal income tax rate.

Because this is a complicated area, the Government organised that everyone nearing retirement gets access to free, impartial guidance to help them understand their options. The Pensions Advisory Service is the organisation that provides this guidance. You should make sure you take advantage of this, and possibly speak to an independent financial adviser to help you decide exactly what option is best for you.

Why consider investment companies for a SIPP?

Investment companies can offer advantages both while you are investing to build up capital in your SIPP – and also when you want to use it to provide a retirement income.

1. Building a fund for retirement

Long-term performance

A pension is probably the longest financial investment you will ever make. You could be investing for 30 years or more. Investment companies can be more risky, particularly in the short term, but often outperform in the long term.

A wider choice of investments

Investment companies offer access to a much wider choice of investments due to their closed-ended structure. This includes investments which, though often more risky, can outperform in the long term, such as private equity.

The ability to gear

Investment companies can borrow money to make additional investments (‘gearing’). Gearing increases the risks, but can increase profits over the long term. Bear in mind that not all investment companies use gearing and most only use modest levels.

2. Generating income in retirement

Investment companies can pay dividends out of their capital profits as well as their income – helping to maintain dividends even in difficult times

Access to a wider range of investments

Investment companies can invest in a wide range of other investments that can generate a higher income. Assets like commercial property, infrastructure and renewable energy can all offer a higher level of income and, being illiquid, are better suited to being held in a closed-ended fund like an investment company.

The ability to smooth dividends

Unlike some other funds, investment companies can hold back some income in good times to pay it out in leaner ones. This means that investment companies can maintain or increase their dividends even at times when the companies they invest in are reducing theirs.

Paying dividends out of capital profits

Investment companies, unlike some other funds, don't have to pay dividends just out of the income they receive from investments. They can also pay them out of the profits they make from buying and selling investments. This can be a useful tool to maintain or increase dividends in more difficult times.

The ability to gear

Just as investment companies can use gearing to magnify capital profits, they can also use it to boost income.

Things to consider

Some key issues to help you take your retirement planning in the right direction:

Is a SIPP right for me?

Because of their flexibility and choice, a SIPP is generally better suited to more experienced investors with larger sums to invest. If you are less experienced, you may be better off with another type of pension, such as a Stakeholder Pension. If you are not sure, speak to an independent financial adviser.

Risk

Generally, the longer the period you are investing over, the more risk you can take on, as your investments have time to recover from any setbacks in the short term. So you may be able to take on slightly more risk in a SIPP. Investment companies are primarily intended as long-term investments. You should be prepared to hold them for at least 5 years, and preferably 10 or more.

Saving on a regular basis, in addition to helping to spread the cost of saving for retirement, also helps to smooth out some of the ups and downs in the market. You should also think about moving into less risky assets as you approach retirement.

Steady approach
A balanced SIPP portfolio investing in a wide range of assets can help you navigate the ups and downs in investment markets

Costs

SIPPs vary in terms of their charges. The wider the range of investments they offer, the more expensive they tend to be. You should make sure you understand what the charges are, and that you are happy with them.

Building a balanced portfolio

You should aim to have a well-balanced portfolio, investing in a wide range of different assets and sectors. If you are just starting, you will probably want to start with more generalist funds with a UK or global mandate. Over time, when you have built up a solid 'core', you can think about adding some more specialist funds.

Key things to remember

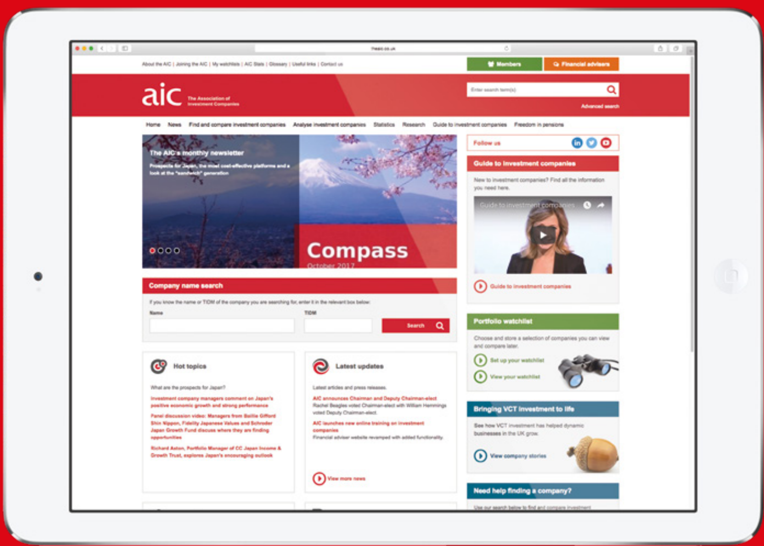
- A SIPP can be a very flexible way to save for retirement, but is generally for more experienced investors with larger sums to contribute.
- Make sure you understand what investments you can hold in any SIPP you are considering, whether this includes investment companies and what the charges are.
- Investment companies can help you to build capital for retirement, and have some unique advantages when it comes to delivering an income in retirement.
- Investment companies are intended as long-term investments and you should therefore be prepared to hold them for at least 5 years, and preferably 10 or longer.
- Your income, and capital, are at risk, and can fall as well as rise, and so they are not a substitute for deposit type investments and annuities.
- You should not invest in investment companies if you need a guaranteed income or if you cannot afford to lose your capital.
- If you are not sure whether a SIPP is suitable for you, and whether, or which, investment companies you should choose to put in one, speak to an independent financial adviser.

Don't forget
Check to see if your chosen SIPP includes investment companies among its range of available investments

With a SIPP, careful planning is essential to make sure you have enough money in retirement

Visit the AIC website to learn more about investment companies, find and compare companies and create your own ‘Watchlist’

www.theaic.co.uk



Association of Investment Companies

24 Chiswell Street
London EC1Y 4YY

Telephone 020 7282 5555
Fax 020 7282 5556
enquiries@theaic.co.uk
www.theaic.co.uk

May 2018

Issued by AIC Information Services Limited. A company registered in England and Wales, registered number 01910539