



Low charges are saving grace

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The costs of running your pension are not always transparent and can make a huge difference to the size of the final pot, writes Ed Murray

THE concept of bundling may not mean much to the average pension saver but when returns are low it pays to know what you're forking out for your investments.

Pension charges are the subject of a BBC documentary next week and with the need for greater retirement savings becoming more urgent by the day, the way in which charges are structured is coming under growing scrutiny.

Aviva recently estimated that workers in the UK face a collective pension gap of some 318 billion that requires workers to put away an extra 10,300 in pension savings if it is to be bridged. But with few people likely to find the extra funds to plug the hole, it has never been more important to pay no more than necessary for pension plans.

Historically, personal pensions have levied a set annual management charge (AMC) for the investment funds held within the scheme. That charge makes provision for, amongst other things, the fund management, the administration of the pension and potentially the cost of advice if the individual had dealt through an IFA.

Much like a set gratuity charge on a restaurant bill, it is difficult to know exactly who gets what out of this charge and it has been very difficult for savers to break it down into its constituent parts.

Susan McDonald, a spokeswoman for Scottish Widows, said: "Many pension plans have a charging structure which is referred to as 'bundled'. This means that you may know the overall running cost of your pension, but that it may be difficult to tell which charges relate to which parts."

While the introduction of stakeholder pensions in 2001 went some way to restricting AMCs in the industry and made more low-cost options available to pension savers, many people continue to pay far more than they have to.

When stakeholder pensions came about, not all providers swapped existing customers onto the new lower AMCs that were put in place. As such, not all benefited from the reductions - those that are still paying the old rates could be paying anything up to 1 per cent more than others invested in the same fund with the same provider but using a more recent pension plan. And over time that can make a substantial difference to the size of the eventual pension pot. For someone with a fund of 20,000 this 1 per cent saving in fees would make a difference of 14,410 over 25 years, assuming a growth rate of 6 per cent (see graphic). The figures rise significantly where the individual is making ongoing contributions.

David Oliver, director at IFA Intelligent Capital, agreed that some of the older pensions carry inflated AMCs. He said they can also carry additional costs in the bid offer spreads for buying units in the chosen investment funds each month.

These spreads work like the different buying and selling prices offered at a currency exchange bureau and their impact can amount to as much as 5 per cent of monthly premiums.

Oliver said: "To be fair to many of the big life offices, many of them, when stakeholder was introduced, brought in a charge cap that was similar to stakeholder. However some providers did not and some also still have these bid offer spreads in place."

However Oliver also warns that some of these older pensions have punitive financial restrictions in place in regard to moving away or altering regular payments into the plan. As such they need to be examined in full before making a move.

For pension savers who do not seek or receive any professional advice on their existing arrangements, "bundled" charges may not offer them best value for money, due to their inclusion of IFA fees.

Instead it may be more beneficial to move current pension arrangements, and go through the sort of execution-only service provided by online discount brokers. One such broker, Cavendish Online, will not offer any advice to clients and will simply carry out their instructions to buy a particular pension and invest in particular funds. Because it works in this way, Cavendish does not take the commission that would otherwise be paid to an IFA.

Ian Williams, managing director of Cavendish, explained: "The most important action for anyone to take regarding their pension is to get started. There is no reason why anyone can't start a stakeholder pension using an execution only broker and keep the commission that would usually be paid out to a financial adviser. This drastically increases the size of the fund when it comes to buying a retirement annuity."

Williams points to an Aviva stakeholder pension that will levy an annual management charge of 1 per cent. Buying through a discount broker reduces the AMC to 0.5 per cent, although there is usually a one-off administration fee of around 30 to 50. For an individual making monthly contributions of 100, increasing by an inflation rate of 2.5 per cent over 25 years and assuming a growth rate of 7 per cent, this would make a difference of more than 31,000 to an individual's final pension pot.

Admittedly not all will be happy to operate on this execution only basis, and some will need the expertise and guidance provided by an IFA. However, by using some of the product platforms now available in the market, IFAs should be able to offer clients the same pension products and fund choices, and cover their own costs for the same sort of overall charges that many pension savers are already paying.

As an example, Stephen Hall, wealth manager at Cornerstone Asset Management, said establishing a pension account on a wrap platform attracts a set-up fee of 150 and an annual ongoing fee of 150. The Private Client Programme offered by Cornerstone Asset Management is powered by IFDL and attracts an annual charge of 0.35 per cent. Thereafter, individuals pay an AMC for each of the funds they are invested in. Invesco Perpetual's High Income fund, for example, comes with an annual management charge of 0.75 per cent.

Taking both the 0.75 per cent and the 0.35 per cent charges together, pension savers are paying 1.1 per cent annually, along with the ongoing 150 flat fee. On top of this Cornerstone will charge clients 1 per cent for providing ongoing financial advice, taking the total to slightly in excess of 2.1 per cent.

This compares with an AMC of around 2 per cent that pension savers would expect to pay for the Invesco Perpetual High Income fund through a standard personal pension. However, Hall believes that any difference is more than compensated for by the value of the financial advice provided.

He said: "By operating in this transparent way clients can see exactly what they are paying for and actually receive the advice they have paid for."

For those with a personal pension bubbling away on the back burner, simply expecting it to deliver on retirement is asking a lot. Equally the choices available and the different charging structures can often seem impenetrable. However, for those looking to manage their own affairs there are potential savings to be made, while those wishing advice should be able to secure it for little, if any, extra than they may already be paying.

Both options would seem worth investigating.

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