Davy Asset Management

Pensions Insight

Finance Bill 2015 – New Year Advice Opportunities

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FOR FINANCIAL ADVISORS ONLY

PAT RYAN

Head of Retirement Solutions, Davy Asset Management

E p.ryan@davy.ie

The recently published Finance Bill contains a number of interesting developments, in particular in the area of post-retirement planning. The changes in question came into effect on 1st January 2015 and relate to new drawdown rules for clients holding post-retirement assets in AMRF and ARF contracts and in vested PRSAs.

For once the news is good and most post retirement clients will find they have more flexibility in tailoring retirement income and managing tax bills.

AMRF Changes

Up to now, AMRF investors could only access income and gains earned on AMRF investments. Access to capital invested was denied until age 75 or earlier receipt of €12,700 p.a. specified income.

For many this proved problematic as an early loss in value meant no access to income facilities until losses could be recovered. For cautious investors, record low deposit rates meant income delivery well below retirement expectations.

From January 2015, new AMRF drawdown rules are introduced where drawdown is available each year up to a maximum of 4% of the AMRF fund value. The new provisions replace the previous income / growth drawdown rules and apply regardless of the AMRF fund value.

ARF & Vested PRSA Drawdown Changes

To date, ARF clients over the age of 61 were encouraged to take a minimum taxable drawdown of 5% of fund value each year. By doing so, clients avoided the generally more penal consequences of imputed drawdown tax. However, in doing so clients were often running down their funds at a faster rate than they were comfortable with and as a result were paying more income tax.

Since 1st January 2015, the drawdown requirement for ARFs under €2 million has been reduced from 5% to 4% for clients under the age of 71 throughout the year. Where the client is aged 71 or more during the year, the drawdown remains at 5%. Where ARF assets exceed €2 million the ARF drawdown requirement remains at 6%. The same conditions apply for vested PRSAs.

Advice Issues – who needs to know – what decisions need to be made?

AMRF Issues

Clients with AMRFs may for the first time consider taking a regular AMRF income of up to 4% p.a. of fund value. For example, if we take a client retiring at age 60 with an AMRF of €63,500, the income option now is up to €2,540 p.a. or an additional gross income of €212 per month.

Of course, income can only continue at this level if the AMRF assets are increasing at a net rate of return at least equal to the 4% rate of drawdown. For example, if this return is achieved then the client may benefit from gross income of €38,130 over the 15-year period from age 60 until the AMRF (still worth €63,500) converts to ARF status at age 75.

On the other hand, if the AMRF assets achieve a zero rate of return over the period, then the 4% income drawdown will decrease each year catering for a reduced gross income of €29,028 over the 15-year period. In this case, the AMRF will convert to ARF status at age 75 at a reduced value of only €34,422.

If income is not required and the AMRF achieves a net 4% p.a. return from age 60 to 75 then it will convert to an ARF at a value of €109,961. However, as the fund accumulates, access is only available to drawdown of 4% in any one year until age 75 or earlier receipt of specified income (currently €12,700 p.a.).

ARF Issues

The first question is who is affected by the new provisions? Potentially, the changes impact upon all ARF holders who also hold an AMRF. ARF only clients with funds of less than €2 million who are aged between 61 and 70 are also affected. This covers a very large proportion of post-retirement clients.

The next question is what level of drawdown is required? If 5% ARF drawdown is not required to cover basic living needs, then the likelihood is that the client will opt to reduce drawdown to a new 4% level in an attempt to preserve longevity of fund and reduce PAYE/USC exposure.

If an AMRF is also in place, now the client has a choice of taking income from the ARF only or from a combination of ARF and AMRF. Naturally, the quantum of ARF assets versus AMRF assets will have a bearing on this decision. Where ARF assets significantly outweigh AMRF assets, then the client may be happy to take current or reduced income solely from the ARF on the basis that capital preservation is currently the primary concern.

On the other hand, if income is the primary driver then taking income from the AMRF in addition to ARF income may be a key benefit going forward. Basically, the new changes allow clients make important post-retirement income decisions such as "do I take less or do I take more?"

Investment Issues

Most existing AMRFs were set up on the basis that funds could not be accessed until age 75 and that chances were slim of achieving a regular drawdown income in the interim. The goalposts have now been moved and AMRF investment strategies may now be revisited on the basis of providing for a regular income of 4%.

Likewise, most ARF investments have been structured to try to achieve a 5% return to cover annual drawdown. For ARF clients under the age of 71, the target is now to cover a 4% withdrawal and this may often include up to €2,540 p.a. from a corresponding AMRF. Many clients may now consider exposing ARF assets to greater growth opportunities because the risk of a premature bomb out due to income drawdown is reduced and because AMRF assets are now more accessible.

New Planning Opportunities

The new Finance Bill provisions will be welcomed by ARF and AMRF holders alike and by clients approaching retirement age. The changes pose new questions, requiring new decisions and new planning and investment strategies. The team at Davy Asset Management will be available countrywide to work with advisors in exploring these opportunities over the weeks and months ahead (see below for contact details).

Davy Asset Management offers a range of investment solutions that may benefit investors in pre and post retirement. For further information please refer to our website:
www.davy.ie/assetmanagement/fund-information

PLEASE CONTACT MY COLLEAGUES IF YOU HAVE ANY QUERIES:

Davy Asset Management
Davy House
49 Dawson Street
Dublin 2, Ireland
T +353 1 614 8874
assetmanagement@davy.ie

www.davy.ie/assetmanagement

Fearghal Lawlor
Investment Sales Manager
Dublin and Ulster
T +353 87 989 4120
E fearghal.lawlor@davy.ie

Alan Wiley
Investment Sales Manager
Munster and West
T +353 86 415 8822
E alan.wiley@davy.ie

Ann O'Connor
Investment Sales Manager
Leinster and South East
T +353 86 821 2282
E ann.o'connor@davy.ie

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