SIMPLYMONEY

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YOUR WINDOW ON FINANCIAL MATTERS

INSIDE THIS ISSUE



# KEEP CALM – BUT THINK ABOUT YOUR PENSION

April's Pension Reform opened up more opportunities at retirement for those with defined contribution pension plans. But does this make the plans more attractive?

## WHY SAVE FOR RETIREMENT?

According to a recent survey[1], workers want around half their current income to be comfortable in retirement. However, two fifths claim they have no retirement plan and only one fifth claim to have one which is *"well developed"*.

This lack of planning is backed up by figures from the ABI suggesting the average annuity purchase in 2014 was around £34,000 – equivalent to an income of about £1,700 a year[2]. Is this enough (even when added to the State Pension) to achieve the retirement lifestyle you seek?

This 'gap' has been recognised by the Government. Auto enrolment is now becoming mandatory for all employers and unless you actively opt out, some of your salary will go into a pension. That contribution will then be matched by a combination of your employer and the Government (through tax relief).

There are limits to the amount your employer has to contribute – but you don't have to limit yourself. You can place up to 100% of your salary into a pension each year (subject to a maximum contributions total, including employer contributions of £40,000) and get tax relief. For a basic rate taxpayer, that means an additional £20 for every £80 invested; more if you pay higher rate tax.

## TAKING YOUR INCOME

Until April, you were limited in how you could turn your fund into income. Now, you are no longer tied to buying an annuity or putting your money in an investment plan. You have control of deciding how much you need, when you need it and what you spend it on, or leaving it untouched.

In terms of tax, as before, you can take up to 25% of that pension fund value tax free. After that, withdrawals are taxed as income at your marginal rate in the tax year that withdrawal is received.

This could make pensions more attractive as a savings vehicle for retirement. The priority is to target an income you are comfortable with – but why stop there? Why not contribute more[3] – for a new car or a luxury holiday? After all, there are some things in life that need the freedom of retirement for you to truly enjoy; and pensions might now be a way to help make that happen.

Notes:

[1] Aegon Retirement Ready Survey 2014

[2] ABI Retirement Income Statistics, update as at end Q4 2014 combined with William Burrows History of Annuity rates chart

[3] Pension funding is subject to a maximum lifetime allowance, currently £1.25m in 2015/16 and falling to £1m in 2016/17; otherwise tax penalties may apply

## BUDGET HIGHLIGHTS

- New National Living Wage of over £9 an hour for over 25s by 2020
- The tax-free Personal Allowance will rise from £10,600 in 2015-16 to £11,000 in April 2016
- Inheritance Tax – 'Family Home Allowance' introduced from April 2017 which will rise to £175,000 by April 2020, and is in addition to the existing £325,000 limit.
- Pensions – tax-relieved allowance will be reduced if income exceeds £150,000
- Higher rate threshold increases from £42,385 to £43,000 in 2016-17
- Buy-to-Let mortgage tax relief restricted to 20% by April 2020
- Dividend tax to be reformed – replaced by £5,000 tax-free dividend allowance for all taxpayers
- Green Paper to examine whether pension taxation can be aligned with ISA tax regime

# FINANCING YOUR FIRST MORTGAGE

All the signs indicate that 2015 will be another buoyant year in the property market. A stronger outlook for jobs and an increase in real earnings, continuing low interest rates and competitive mortgage deals all look set to boost first-time buyer activity in the coming months.

## MAKE SURE YOUR FINANCES ARE LENDER-FRIENDLY

The Financial Conduct Authority introduced its Mortgage Market Review (MMR) measures in April 2014. Under the MMR, mortgage lenders are required to ask potential homebuyers detailed questions about their lifestyles and spending habits to ensure that they can continue to meet monthly repayments if interest rates rise.

Lenders will scrutinise your outgoings looking for reassurance that your spending is under control; they will need to see a track-record of good budgeting and evidence that you're paying back any debts. They will ask about your future plans too, including how much you spend on holidays and entertainment. So it makes sense to look closely at your budget ahead of time and make sure your finances are in good shape. Think about cancelling regular payments you don't use any more, such as memberships or subscriptions.

## CASH TO GET YOU STARTED

You will need to provide a deposit, and having a larger deposit to put down can improve your chances of getting a better rate on your mortgage loan. At this point, parents and grandparents often step in to help, so it's worth discussing your plans with your family. You'll also need to have cash available for all the incidental costs such as structural surveys, legal and arrangement fees, moving costs and stamp duty.

From Autumn 2015, first-time buyers will be able to kick start their savings by putting up to £200 a month into a tax-free Help To Buy Individual Savings Account (ISA) as well as a £1,000 lump sum when opening an account. The Government will top up your contribution by 25% up to a maximum top-up of £3,000. Your Help to Buy ISA can be used for properties up to £450,000 in London or £250,000 elsewhere.

**Think carefully before securing other debts against your home. Your home may be repossessed if you do not keep up the repayments on your mortgage. A fee may apply for mortgage advice and, if applicable, you must ask your adviser for details before making any decision relating to a new mortgage as the actual amount will depend on your personal circumstances, but the typical amount is 1% of the loan value (on a typical £100,000 mortgage, this would be £1,000).**

# TO CTF OR JISA, THAT IS THE QUESTION

From their introduction in January 2005 to the issue of the final vouchers in 2012, 4.5 million Child Trust Funds (CTFs) were opened by parents[1]. However, in November 2011, this form of account was partially superseded by Junior Individual Savings Accounts (JISAs). Since April this year, you have had the option to transfer existing CTFs to the newer JISA.

The two savings plans are very similar. You can save up to £4,080 a year (tax year 2015/16) and have a choice between low risk cash deposit savings or higher risk investments. And the money saved can come from a variety of sources – not just the parents but from friends and relatives too, up to the maximum annual limit per child. The proceeds accumulated when the child reaches 18 are then free of additional tax on any growth or income received.

There are two potential issues. Firstly, Child Trust Funds were not very widely offered. In addition, following their closure to new business, they will basically become obsolete as more children for whom they were opened reach 18. The incentive for existing providers to offer attractive rates on these products is therefore low.

Secondly, CTFs only allow you to invest in EITHER cash OR investments. Given savings plans for children are normally long term (up to 18 years) you might want a combination of both – investments for their long term growth potential but some cash as well, for its underlying guarantees.

It may therefore be worthwhile considering a transfer to the newer product. If you have a cash CTF, for example, check the interest rate and see if a cash JISA might offer better returns. For investment CTFs, is there a JISA that might reduce the charges you pay, offers a wider range of funds to increase flexibility or offers other options with greater potential? And, there is also the chance that you might want to combine cash and investments, which your CTF will simply not allow.

[1] UK Government, based on number of accounts reported using issued vouchers, published August 2014.

# KEEPING IT IN THE FAMILY – PASSING YOUR PENSION ON

The new pension freedom that came into force in April 2015 brought with it welcome changes, allowing pensions to be passed to beneficiaries in a tax-efficient way. If you die before age 75 and before taking anything from your defined contribution pension, it will usually be paid to your beneficiaries as a tax-free lump sum.

## YOUR PENSION CASH

On your death, any unspent cash or other assets derived from your pension income will be considered as part of your estate, for Inheritance Tax purposes. Provided that you have a valid Will in place, you will be able to leave them to whoever you wish. However, if you haven't made a Will, then your estate will be distributed under the intestacy rules.

## ANNUITIES

On your death, annuity payments will stop unless you took out a joint life annuity or an annuity with a guarantee for a fixed number of years. If your annuity is a 'value-protected' policy, any remaining fund can now be paid as a tax-free lump sum.

## DEATH TAX RULES ON PENSION POTS

Under the new rules, if you die before the age of 75, your pension can be paid to the beneficiary of your choice as a tax-free lump sum. (As long as it is less than the lifetime allowance, £1.25 million in tax year 2015-16).

There will normally be no Inheritance Tax to pay.

## IF YOUR MONEY IS IN PENSION DRAWDOWN

If you die **before** age 75 with your money in drawdown, your spouse, partner, dependant or beneficiary can stay in drawdown and take the income tax-free, take a lump sum tax-free, or buy an annuity where income will be paid free of tax.

If you die **after** age 75 then they can take an income, subject to tax at their marginal rate, take the pension as a lump sum which will be taxed at 45% (expected to be at the beneficiary's marginal rate from 2016/2017) or buy an annuity where the income will be subject to tax at their marginal rate.

# PROTECTING YOUR FAMILY

Many people start a life policy when they take out a mortgage or start a family and think no more about it. However, life assurance can be combined with other cover, so as well as providing a lump sum on your death, you can also protect against loss of income due to unemployment, accident or critical illness. Policies can be tailored and cover combined into the right plan to meet your needs at any stage of your life.

## JOINT COMMITMENTS

If you marry or enter into a civil partnership you'll need to think about protecting your joint liabilities. You're likely to take on more financial commitments, and your partner might not be able to cope financially without your salary to rely on.

## BRICKS AND MORTAR

A mortgage is generally the biggest debt we take on. You should consider ensuring that you and your family have the peace of mind knowing your mortgage would be repaid should you die.

## FAMILIES NEED PROTECTION

Raising a family takes time and energy and life assurance isn't always top of the 'must-do' list. There may no longer be two incomes, and there will be extra expense. For the main earner it's a time to think about increasing life cover, and consider insuring against unwelcome and unexpected events such as a life-threatening illness, accident or unemployment.

If you're the main carer, it makes sense to ensure that money would be available on your death to meet the cost of the many services you provide for your family, like housekeeping and child care.

## LATER IN LIFE

When you retire, your children probably won't be as reliant on financial support and your mortgage may have been paid off or reduced. However, you may no longer have the benefit of any life cover as part of your employment package. If you have a spouse or partner who is reliant on your income, or if you want to ensure money is available for children or grandchildren on your death, you could still benefit from life cover.

Reviewing your insurance cover regularly will help protect your family from financial hardship. It's also an opportunity to check your existing policies are still right for you and represent good value for money.

# THE FUTURE FOR ANNUITIES

Pension freedom is now with us, and with it, the flexibility for us to choose what we do with our pension 'pot' at retirement – spend it, use it for an income, leave it invested, or any combination of all three[1].

What does this mean for annuities? Long a staple product for retirees, analysts have been widely predicting their demise ever since the Chancellor's 2014 Budget speech.

## IS THIS ASSESSMENT FAIR?

It is certainly true that the annuity market has declined since pension freedom was announced. According to the ABI[2], sales in Q4 2014 were over 60% lower than the previous year and figures from leading annuity providers in 2015 appear to confirm that this trend has continued[3].

Despite the headlines, however, there does still appear to be a place for annuities. Some annuity providers are maintaining sales at around 40% or more of previous levels – so many people must still appreciate what they offer.

## THE BENEFITS – AND DOWNSIDES

The main benefit of an annuity is that it offers a pre-agreed, fixed income for life, regardless of how long you live. In other words, even if you live past 100, you will still be receiving an income to help pay for some of the bills and small luxuries that make life enjoyable. Unlike other retirement income products, and with the exception of investment linked annuities, there is no stockmarket risk which might reduce your income in the future or even eat it up completely.

The downside, however, is that if you do not live as long as expected, the residual value of the annuity disappears with you. There is usually no return of capital to your estate if you are one of the unlucky ones.

## OPTIONS TO CONSIDER

However, there are ways to mitigate some of the downsides. You can opt to guarantee a minimum return, the equivalent of up to ten years income, in case the worst happens. If you are married or in a civil partnership, a joint life annuity would provide your partner with a continued income should you die first.

And if you are worried about the impact inflation could have on your income over 20, perhaps 30+ years, you can choose an escalating plan. These increase your income each year by a set or inflation related percentage. The initial income in all these instances will be lower than a policy without such options, but the long term guarantees are worth considering in case the worst did happen.

Finally, if you know you already have health issues or lifestyle habits that may reduce life expectancy, then investigate enhanced annuities. These will take account of your situation and pay you more than standard annuities if you are eligible.

Despite all the hype, therefore, the jury remains out on annuities and they could remain useful for many. Please get in touch if you want to discuss your retirement plans.

[1] Note that withdrawals from pension funds at or after retirement are tax free for the first 25%, but the balance is then taxable at your marginal income tax rate. Different rules apply to the tax treatment of lump sums and income passed to beneficiaries after your death, depending on what age you are when that happens.

[2] ABI Retirement Income statistics, Q4 2014, published 26 Feb 2015

[3] Interim Trading Statements for two leading London stock market listed specialist annuity providers, published May 2015.



## OTHER BUDGET NEWS

- Immediate change to pension input periods to align with tax years
- Pension lump-sum death benefits – from April 2016, tax payable after two years or post 75 will be based on recipient's marginal rate
- Right to withdraw and replace funds held in ISAs without counting towards ISA limit now applies to stocks and shares ISAs
- Insurance premium tax to rise to 9% from November
- Secondary annuity market delayed until 2017
- Permanent non-domiciled status to be abolished
- Student maintenance grants to be replaced with loans
- Working-age benefits, which include Tax Credits and Local Housing Allowance frozen for four years