Money Wise

CYGNET WEALTH MANAGEMENT

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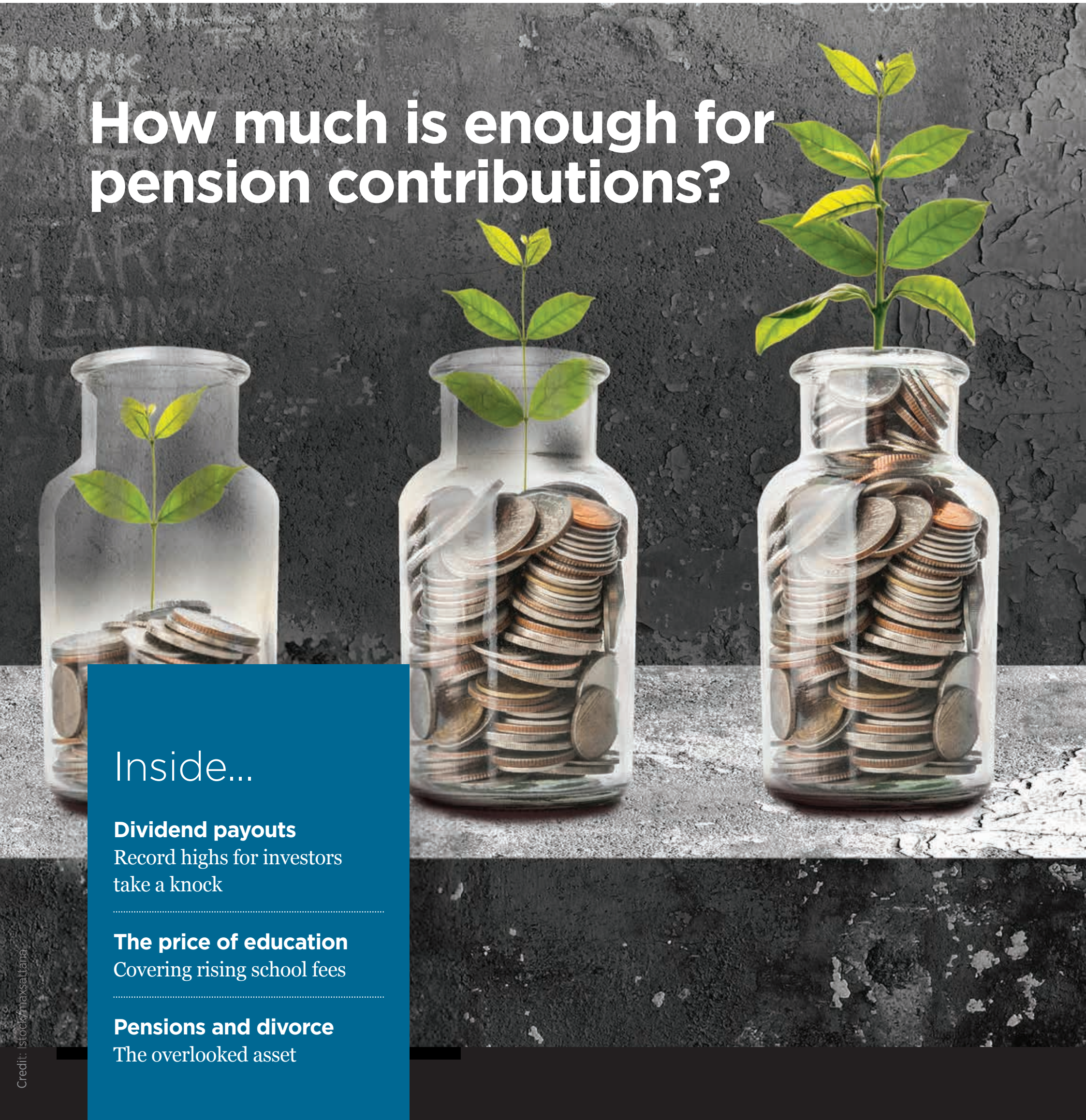
SUMMER 2019

How much is enough for pension contributions?



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Inside...

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Dividends riding high, but...

After enjoying bumper dividends earlier this year, shareholders faced the news that some high profile names have recently slashed their payouts.

UK-listed companies paid out £19.7 billion in the first three months of 2019 – a first quarter record according to Link Asset Services, with the value of dividends paid out through to 2018 rising by 85%. However in May, Vodaphone, Royal Mail and M&S all announced dividend cuts of 40%.

Companies usually share surplus profits as dividends twice a year. With any reductions having an impact on pension and ISA funds as well as individual shareholders, companies are reluctant to make dividend cuts, even when it may make economic sense to do so.

The early record figures have been attributed to several one-off ‘special’ dividends. For example, the global resources company BHP Group paid a huge £1.7 billion dividend following the sale of its US shale oil interests.

Oil giants, utilities, pharmaceutical, tobacco and financial companies traditionally have had good track records for paying dividends. In contrast, smaller, fast-growing companies often pay low – or no – dividends, as surplus profits tend to be reinvested in the business. Investors may also want to look at equity income funds, which focus on companies with good dividend track records.

> *“Many investors choose to reinvest these payments to benefit from higher compound returns.*

Reinvesting these payments can create benefits from higher compound returns. However, dividends can also be a useful way for investors to earn an attractive income from their investments without having to dip into their capital.

As so often in investment decisions, the devil is in the detail, now more than ever, so sound advice is crucial.

The value of your investments, and the income from them, can go down as well as up and you may not get back the full amount you invested.

Past performance is not a reliable indicator of future performance.

Investing in shares should be regarded as a long-term investment and should fit in with your overall attitude to risk and financial circumstances.

Balancing the school fees equation

School fees are rising faster than the rate of inflation, creating financial challenges for parents who want to educate their children privately.

Private school fees rose by 3.7% this year, according to the latest figures from the Independent Schools Council, with the average independent day school charging £14,289 a year in 2018. By contrast inflation, as measured by the consumer price index, was at 2.1% for April 2019.

The question for parents is how to fund rising fees. Some families may be able to meet costs out of earnings, but many parents will need to build reserves. When planning to accumulate a school fees fund:

1. **Plan ahead:** The sooner you start, the better chance you have of building a decent nest egg by whatever age your children will enter the private system.
2. **Make the most of tax-breaks:** ISAs allow each parent to save tax-efficiently up to £20,000 a year. Equity ISAs may be suitable for those with a 10-year plus savings horizon. Those with shorter time frames should stick with cash.
3. **Get family involved:** Relatives may be willing to make regular payments towards fees. This can potentially reduce their inheritance tax liability and one-off payments would normally be disregarded providing the donor survives a further seven years.
4. **Ask about bursaries and scholarships:** The ISC says the number of pupils being helped by these schemes has risen by 3% over the past year.
5. **Remember insurance:** income protection insurance, for example, could cover the fees if you were too ill to work.

Of course, for parents with children at state schools, these savings tips can also help meet future higher education costs.

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The FCA does not regulate tax advice. Levels and bases of taxation and tax reliefs are subject to change and their value depends on individual circumstances. Tax laws can change.

How much is enough for pension contributions?

Pension contributions have recently risen for many people, but the increase may still not be enough to fund a comfortable retirement.

The latest round of pre-planned increases to minimum contribution rates under automatic enrolment (AE) workplace pensions came into effect in April. If you are one of the 10 million people who have been automatically enrolled, then broadly speaking, provided your yearly earnings are at least £10,000:

- Your employer must now contribute a minimum of 3% of your 'band earnings' into a pension (band earnings in 2019/20 are between £6,136 and £50,000); and
- You must make up the balance to bring the total contribution to 8% of 'band earnings'.

The 8% total contribution figure is widely quoted, but the fact that it does not apply to all earnings is often overlooked. For example, based on the Office for National Statistics' latest (February) estimate of average pay of £528 a week (£27,508 per year), the true AE contribution is approximately 6.2% of total pay. There are similar effects across the pay scale.

In the foreword to a Department for Work and Pensions report on the future of AE pensions, published in December 2017, the then Secretary of State for Work and Pensions said, "...we recognise that contributions of 8 per cent are unlikely to give all individuals the retirement to which they aspire". His proposals included:

- Removing the lower limit on 'band earnings', so that the 8% was based on full earnings (up to £50,000);

"AE contributions of 8% only provide around half the level of savings needed for most people to enjoy an adequate retirement.

- Reducing the minimum age for inclusion in AE from 22 to 18; and
- Encouraging savings above the 8% level.

Eighteen months (and two new Secretaries of State) later there have been no further developments. AE contribution increases in both April 2018 and April 2019 may well have encouraged the government to pause, if only to see the reactions of employees.

How much to contribute?

So how much should your pension contributions be?

As far back as 2005, the Pensions Commission acknowledged that the state pension with additional AE contributions of 8% would only provide around half the level of savings needed for most people to enjoy an adequate retirement. The implication is that contributions should more than double for the average employee. But how much should your contribution levels increase? The amount will depend on several factors including:

- When you plan to retire and whether that is before you reach your state pension age;
- Your existing level of pension savings, including state benefits;
- Other savings on which you can draw in retirement; and
- Any limits imposed on you by the pension annual and lifetime allowances.

The calculation can become complex very quickly, so why not ask us to carry out an assessment of what your personal contribution rate should be?

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Credit: Istock/Gwengoat

New headaches for landlords?

Private landlords could find it harder to evict tenants in future, thanks to new government legislation.

Landlords will no longer be able to serve tenants with a 'section 21' notice, which effectively enables them to cancel the tenancy at the end of the term, without giving any formal reason. This change in legislation will affect England and Wales; the practice has already been outlawed in Scotland.

New rules will stipulate that landlords must provide a lawful reason for terminating the agreement. For example, tenants might have fallen into arrears with rent, or the landlord might want to sell the property.

There have been concerns that some unscrupulous landlords have served section 21 notices to tenants who simply complain about sub-standard housing.

However, some buy-to-let investors fear that the new law will make it harder for them to evict problem tenants. A 'section 8' notice can still be used for eviction, but it can be challenged in court. The government has tried to address these fears by pledging to improve court processes, to make it simpler to take swifter legal action against those who have broken the terms of their tenancy.

"New rules will stipulate that landlords must provide a lawful reason for terminating the agreement.

This is the latest in series of legislative changes to hit buy-to-let investors and private landlords. Profits have been increasingly squeezed as income tax relief has been curtailed and a 3% stamp duty surcharge (4% in Scotland) has been introduced on purchases of additional property.

If you think you may be affected, please let us know.

Property values can fluctuate in value and rental income is not guaranteed.

The Financial Conduct Authority does not regulate buy-to-let properties or tax advice.

Levels and bases of taxation and tax reliefs are subject to change and their value depends on individual circumstances. Tax laws can change.

Your home may be repossessed if you do not keep up repayments on a mortgage or other loans secured on it. Think carefully before securing other debts against your home.

Pensions and divorce – not just about the split

When it comes to dividing up assets on divorce, pension rights can turn out to be one of the most valuable elements – and often the most overlooked.

Last October, the Financial Conduct Authority reported that employee benefit consultancies were recording "the average size of transfer at over £250,000". Such large values mean that pensions can currently represent the greatest asset to be considered as part of a divorce settlement.


Credit: Istock/Deagreez

In the UK, there are currently three main ways of dealing with pensions on divorce:

- **Pension sharing** Under pension sharing the ex-spouse/civil partner's pension(s) are shared, with a percentage (or specified amount in Scotland) allocated to the ex-spouse/partner. The shared element is either retained in the existing pension scheme or, more often, transferred to the ex-spouse's/civil partner's scheme.
- **Pension offsetting** This option involves offsetting the transfer value against other assets. For example, one spouse might gain a larger share of the family home in exchange for receiving no pension benefit from the other spouse.
- **Pension attachment orders (pension earmarking in Scotland)** Under these arrangements, the ex-spouse/civil partner receives a proportion of the pension and/or lump sum when the divorced member starts to draw benefits (in Scotland it's just the lump sum that can be earmarked).

If you are involved in a divorce, expert guidance is essential to achieve a fair pension outcome. Contact us now and we can:

- Explain how each of the options would work for you.
- Assess the transfer value that has been calculated for any benefits.
- Advise on any pension transfers required.
- Explain how you can improve your financial position at retirement.

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Occupational pension schemes are regulated by The Pensions Regulator.

Embrace the joy of tidying

Prioritise peace in your life: extend the Marie Kondo tidiness craze from your home to your finances.

Have you ever looked at a room in your home and wondered how you accumulated so much stuff? You might well remember when you acquired each item, but the questions of why and whether you still need it can be more awkward to answer.

What applies to household surplus can be just as relevant to excess baggage in your personal finances. But working out what investments, savings and insurance cover you have, why each one is there and whether you still need it can be a daunting task. For example:

- Do you have any old stocks and shares ISAs – perhaps they were even once PEPs – bought in an end of tax year rush long ago?
- Do you have cash in bank or building society accounts opened more than two years ago?
- Do you have any pension plans where contributions have long since ceased and perhaps the provider has closed to new business?

We can help you tidy up your finances. The process can have a range of benefits, even if it is simply to bring your investment funds under a single umbrella. Charging structures now often favour bringing together holdings in one place, which can also make it easier to manage a portfolio.

For cash deposits, Financial Conduct Authority research from 2018 showed that accounts that were more than two and half years old typically paid less than half the interest rate offered by newly opened accounts.

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The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Conduct Authority does not regulate tax advice or cash deposits.

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