Money Wise

CYGNET
WEALTH MANAGEMENT

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A new style retirement for changing times?

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Inside...

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Income protection – the simple safety net

The pandemic has highlighted the importance of having a financial safety net. This may be in the form of savings to cover unexpected bills such as a new boiler, or a period of unemployment.

Insurance also has an important role to play, particularly when it comes to protecting your finances through periods of ill-health. Covid-19 has certainly shown the indiscriminate nature of illness, and how a 'it will never happen to me' attitude can be suddenly shattered.

State benefits

The pandemic has also highlighted the relatively low levels of help available from employers and the state. There is certainly no fallback furlough scheme paying 80% of wages for those who are unable to work through injury or illness. Although some do pay more, employers are only obliged to meet Statutory Sick Pay requirements, paying £96.35 per week for 28 weeks. Thereafter, those still unable to work have to apply for Universal Credit, currently just £411.51 a month for single claimants over 25 (including the £20 temporary uplift to the end of September).

Income protection

These policies insure a portion of your take-home salary and pay out if you are unable to work through ill-health. This can cover mental health conditions such as stress and depression, as well as physical conditions. Definitions and what is covered vary between product providers.

Payments start after a deferral period, so you can set up the insurance to kick in when support from your employer ends if you have one. If not, you may want payments to start sooner. You will need medical evidence to support a claim and money is paid monthly.

Critical illness

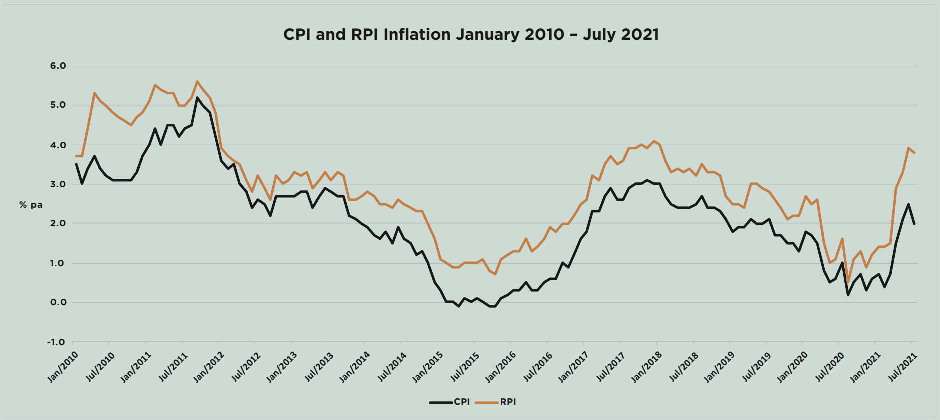
This pays out a one-off tax-free lump sum if you are diagnosed with one of the serious conditions listed in the policy. These include most cancers, heart disease and stroke. Payments can be used to pay off an outstanding mortgage or other debts, or simply to provide a financial buffer to give you time to recover from a serious illness.

✣ *Life Assurance plans typically have no cash in value at any time and cover will cease at the end of term. If premiums stop, then cover will lapse.*

> *“ Although some do pay more, employers are only obliged to meet Statutory Sick Pay requirements, paying £96.35 per week for 28 weeks.*

The return of inflation?

Inflation has picked up sharply in recent months, with a potential impact on investments.



Source: Office for National Statistics

UK annual inflation was just 0.4% in February 2021, as measured by the Consumer Prices Index (CPI), or 1.4% measured by the Retail Prices Index (RPI). By early August it stood at 2.0% CPI and 3.8% RPI.

The big question now is whether inflation will abate along with the pandemic. Some economists predict that the inflationary spike will prove 'transitory' and the pandemic distortions will disappear over the coming year. However, others fear that the price increases could lead to parallel wage rises, creating a wage/price spiral.

If you are an investor, rising inflation can often be bad news. With interest rates close to zero, the buying power of any cash you hold is being steadily eroded. If you have more cash than you need for your rainy day reserve, make sure you have a good reason.

Inflation also usually works against you if you hold fixed interest investments, such as bond funds, because the value of the future payments of interest and eventual return of capital are similarly eroded by inflation. On the other hand, the appeal – and value – of index-linked bonds typically rises when the spectre of inflation looms and investors seek cover.

In the long term, investment in shares has proven to provide better protection against inflation than either bonds or cash deposits. However, in the short term, inflation can be a drag on some companies' profits – think of those wage pressures – and depress their share price.

With inflation uncertainty set to remain for some while, it makes sense to review your investments now to make sure you are ready for whichever set of economists proves to be correct.

✢ *The value of your investment and any income from it 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.

A new style retirement for changing times?

The pandemic may be changing retirement alongside work patterns and expectations.

The acronym 'WFH' is now fully embedded in the 21st century lexicon. The working from home shift is already leading major employers to reconsider their office space and employees to review fitting work into their living space. The WFH experience could also accelerate an existing trend for retirement to move to a gradual, phased process rather than an abrupt end to working life.

There is much to be said for making a gentle transition into retirement instead of simply flicking off the work switch:

- It avoids the sudden lifestyle change which can be traumatic, both for the new retiree and their partner.
- Employers can retain valuable knowledge in the business that would otherwise be lost.
- The drop in net income for workers transitioning to part-time is proportionately less than the drop in the hours worked due to the way that income tax and national insurance operate.
- With the state pension age continuing to rise – the move to 67 begins in less than five years – gradual retirement may be an affordable option whereas full retirement is not.

A recent survey showed that 56% of people retiring in 2021 did not plan to give up work completely. Of those who had retired in 2020, 34% continued with some work, while another 21% said that they are now considering returning to work part-time. The latest statistics from the Office for National Statistics (ONS) show that at age 65 and above, 13.4% of men and 8.1% of women are still in work. The difference between the ONS and survey figures probably reflects the fact that the average surveyed age of those retiring in 2021 was just 60.

"Over a third sped up retirement plans in the preceding 12 months, citing Covid-19 related issues as important factors.

Credit: Roman Samborskyi/Shutterstock.com

Changing plans

The popularity of semi-retirement in the 2021 survey group is likely to be due, at least partially, to the disruption caused by the pandemic. Over a third had sped up their retirement plans in the preceding 12 months, citing Covid-19 related issues as important factors.

Bringing forward retirement will usually mean a lower pension income, hence the need to maintain some flow of earnings. That potential squeeze was reflected in responses to several other questions in the survey. For example, 48% said that they planned to reduce their spending habits to support themselves in retirement while 21% were intending to sell or downsize their property.

If the idea of a phased retirement appeals, but you want to avoid those lifestyle compromises, then the sooner you start planning the transition, the better. Assessing your income and expenditure as you move through to full retirement is key and not as simple as it might sound. For tax and other reasons, for example, it could make sense not to start drawing on your pension as soon as you stop full time work. Contact us to review your retirement options further.

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News in brief...

Stop Press: Tax rises and Autumn Budget

On 7 September the government announced their policy for the reform and funding of health and social care in England. The measures include an additional 1.25% levy on NICs from 2022/23. Tax on dividends will also rise by 1.25%. The Treasury also confirmed there will be an Autumn Budget and Spending Review on 27 October.

ISA cash boom

HMRC statistics from June show that close to £50bn was contributed to cash ISAs in 2019/20, more than double the amount placed in stocks and shares ISAs. However, the personal savings allowance (£1,000 for basic rate taxpayers) means those investors may not need an ISA to obtain tax-free interest.

HMRC loses HICBC case

The Upper Tribunal decided that a discovery assessment could not be used to collect the High Income Child Benefit Charge in a recent case brought by HMRC. HMRC could appeal, but either way more people will continue to be caught by the charge as its income threshold has been stuck at £50,000 since 2013.

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No fault divorce comes to England and Wales

An important legal change due next year could see a rise in divorce numbers.

The Divorce, Dissolution and Separation Act 2020 should have been implemented in autumn 2021 but has since been deferred to April 2022. The delay could mean a divorce boom in England and Wales next year.

At present divorce in England and Wales depends on one of five 'facts':

- two years' separation with the consent of the other spouse to divorce;
- five years' separation without consent;
- unreasonable behaviour;
- adultery; and
- desertion.

In 2019, around 44% of petitions for opposite-sex divorce were based on unreasonable behaviour.

Simplified rules

The Act replaces the five 'facts' with one requirement: to provide a statement of irretrievable breakdown, which can be made by one spouse or jointly. If it is made individually the other spouse will not be able to contest the divorce. The process should normally take about six months from the start of legal proceedings.

These changes will not affect Scotland, which revised its divorce law in 2006, or Northern Ireland, which has similar five 'facts' rules to England.

One key aspect of divorce is not changing: the need to reach a financial settlement. As well as the family home and investments, it also involves the pensions of both parties. In later life divorces, these can be the most valuable single asset – a £10,000 a year deferred pension could be worth close to £250,000.

Dealing with pensions is a complex area, which needs to be integrated with other, post-divorce financial planning. There is no one-size-fits-all solution, making personal financial advice essential.

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Occupational pension schemes are regulated by The Pensions Regulator.

Managing student **finance**

With Freshers' Week looming, another round of families will grapple with the prospect of financing a university degree.

Most students in England, Wales and Northern Ireland now take out loans to cover tuition fees and living costs, with an average debt of £45,000 for 2020 graduates. Focusing on this figure, however, can be misleading. The way these loans are structured means the majority will never repay the full amount, so the actual cost is far less.

Student debt is more akin to a tax, with graduates on higher salaries paying more. Students in England, Wales and Northern Ireland only start repaying their loans once their earnings reach a certain level – currently £27,295. In Scotland the rules are different – see below.

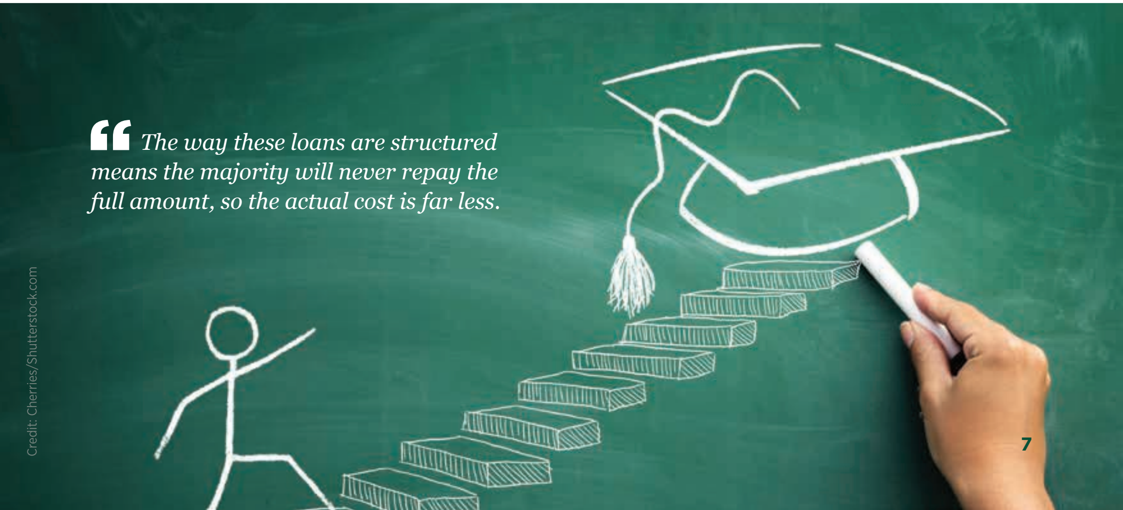
Repayments are equivalent to 9% of earnings above the threshold. Graduates earning £30,000, for example, repay 9% of £2,705 – £243.45 for that year. Any outstanding debt is cancelled after 30 years. Parents paying off part of a loan may simply be reducing a debt that would eventually be cancelled.

What can you borrow?

- *Tuition fees loan:* Students in England can apply for a loan of up to £9,250 a year to cover tuition fees.
- *Maintenance loan:* Students in England can apply for a maximum of £9,488 (£12,382 in London) to cover living costs if they are studying away from home. This is means-tested against parental income, so many will get significantly less.

Regional differences

- Scottish students don't pay tuition fees if they study at a Scottish institution. They can apply for a means-tested student loan and bursary to help with living costs. Repayment of the loan begins once earnings reach £25,000 a year for students taking out loans in 2021/22.
- The maximum tuition fee for Welsh students studying in Wales is £9,000.
- Northern Ireland residents studying in the country pay a maximum £4,530 in tuition fees. All outstanding debt is cancelled after 25 years.



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Pension triple lock falls to double

Next April's increases to State pensions will now follow a less expensive path.

What percentage increase should apply to State pensions in 2022?

For the last ten years, the triple lock has protected the old basic State pension and the new State pension, meaning the increase is the highest of the CPI change to September, earnings growth or 2.5%. However, the triple lock is not law: the statutory rules simply link rises to earnings growth.

Even that is not straightforward, because the method of measuring earnings growth is left for the Secretary of State at the Department for Work and Pensions (DWP) to determine. The practice to date has been to use the year-on-year increase in average weekly earnings (including bonuses) in the May–July period. In 2020 the pandemic produced a 1.0% drop in earnings.

As the UK economy has recovered, earnings have rebounded. Some of the rise is a statistical quirk, but the net result is dramatic. The latest (April-June) annual rise was no less than 8.8%. If that had been applied to the basic and new State pensions, the cost would have been over £4bn extra a year according to the DWP.

The Prime Minister was reluctant to renege on his triple lock manifesto pledge. It was perhaps no small coincidence, therefore, that on the day increases to national insurance contributions were announced to fund health and social care reforms, the DWP revealed next year's basic and new State pension increases would ignore earnings inflation: for 2022/23 only, the triple lock becomes a double lock.

You can check a forecast of your expected State pension on www.gov.uk/check-state-pension. Assuming 3% CPI inflation, the new State pension will rise to about £185 a week rather than the £195 it might have been. Even the latter is still a long way from enough for a comfortable retirement...

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