Money Wise

CYGNET
WEALTH MANAGEMENT

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Automatic enrolment ten years on

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Pensions freedom
Taking funds early could deplete future income

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Simplified rules still need good advice

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What price **pension freedom?**

Credit: Roman Samborskyi/Shutterstock.com

Inflation is driving many to raid their 'rainy day funds' to cover rising energy and fuel bills. But there are particular concerns around the long-term consequences for some older savers who are also cashing in pension funds early to help make ends meet.

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Since the introduction of pension freedoms, largely buoyant stock market gains combined with low inflation meant pension holders could draw money from these pots without seriously depleting the remaining, still growing funds.

However, a new report from actuaries AKG highlights how the return of high inflation and increased living costs could jeopardise many people's future retirement plans. Early pension fund withdrawals can lead to an unnecessary tax burden and the risk of running out of money later in life, exacerbated by increased inflation. With the Bank of England forecasting a potential tip into recession, further stock market volatility and dampened growth prospects would impact investment returns.

Those approaching retirement face complex decisions about how to use their pension funds and calculate a 'safe' amount to withdraw to maintain funds through to later life.

Financial advisers can help investors with these complex decisions, explaining how pension funds might fare under different economic conditions. Yet, data from the financial regulator suggests few people are taking this option. Please do get in touch if you are thinking about the most suitable way to access your pension funds or for guidance on how your long-term pension planning might be affected.

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

The value of your investment and the 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.

Occupational pension schemes are regulated by The Pensions Regulator.

Buy-to-let facing headwinds

Some buy-to-let (BTL) investors are facing a costly future.

Seven years ago, the then Chancellor announced a revised treatment of interest paid on BTL residential mortgages. Instead of the interest being fully offset against rent for income tax purposes, there would be a 20% tax credit for interest paid. This reduced the tax relief received by higher and additional rate taxpayers to basic rate. To limit the immediate effect of the change, the new system was phased in over four years, starting in April 2017.

In 2022, as interest rates have risen, the impact of these changes has been dramatic, compounded by sharply rising net interest costs, whose speed is not matched by increasing rents.

Energy ratings shift

Higher interest costs are not the only extra expenses that threaten BTL owners. A year ago, the Department for Business, Energy and Industrial Strategy (BEIS) launched a consultation on improving the energy performance of privately rented homes in England and Wales, with regulations originally expected this autumn. The BEIS's preferred option is:

- From 1 April 2025, a minimum energy performance certificate (EPC) rating of C would apply to properties with a new domestic tenancy or where an existing tenancy is renewed.
- From 1 April 2028, all tenancies would be subject to the EPC C rating.

The consultation estimated that the average landlord would spend £4,700 per property to achieve the C rating. It also proposed an upper spending limit of £10,000, beyond which an exemption would apply from the rules.

The combined effect of higher interest rates and higher EPC thresholds - and a six month rent freeze in Scotland – is something BTL investors should carefully assess now, and factor them into future planning.

✢ *The Financial Conduct Authority does not regulate buy to let mortgages or tax advice. Tax treatment varies according to individual circumstances and is subject to change.*

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Happy tenth anniversary to automatic enrolment

October marks ten years since the advent of automatic enrolment for workplace pensions. What's been learned in the last decade?

The automatic enrolment (AE) of employees and other workers into workplace pensions faced scepticism when its initial phasing in began in October 2012. Plenty of pension experts had witnessed the failure of earlier initiatives to increase take up of pension saving.

This time the outcome was dramatically different, with participation rising from around 47% in 2012 to 79% in 2021. Much of that is due to its design:

- Inertia plays a major role – membership is automatic, so deliberate personal action is required to opt out.
- Employer and employee contributions were initially pitched low, before being increased in two stages.
- The first schemes were set up by the largest employers, who were best equipped to organise the roll out.
- The default provider, the National Employment Savings Trust (NEST), is at arm's length from the government; it now has over 11 million members.

Contribution levels

The chances are that if your employer provides you with a pension, it is an auto-enrolled workplace pension. However, the success of automatic enrolment does not mean the issue of adequate retirement funding has been solved, either for you personally or the general workforce:

- The minimum level of contributions is still widely considered to be too low. The Association of British Insurers (ABI) recently suggested that to be adequate, total contributions should rise to 6% each for employer and employee, phased over the next ten years.

Credit: Arthimedes/Shutterstock.com

- No contributions are levied on the first £6,240 of earnings for 2022/23. This has a disproportionate impact on low earners. Without that restriction, contributions for someone earning £10,000 would be £500 more.
- At present, each employment is considered separately, meaning that many people with more than one job can earn more than £10,000 in total, but receive no employer pension contributions at all. If the £6,240 exclusion were removed, then the current earnings trigger of £10,000 would also disappear.

The current system also overlooks the self-employed, who represent about one in eight of the UK workforce. While some gig workers have become eligible for AE pensions following Employment Tribunal decisions, the self-employed generally are left to their own retirement planning devices. As a result, currently only 16% of self-employed workers now save in a private pension, down from 50% 20 years ago.

In the current economic environment, no government is likely to risk proposing an increase in the mandatory minimum contributions, so taking action yourself may be more prudent. To find out if your current level of pension contributions, whether automatic or otherwise, are sufficient to meet your retirement goals, please get in touch.

✢ *Workplace pensions are regulated by The Pensions Regulator. The Financial Conduct Authority does not regulate tax advice. Tax treatment varies according to individual circumstances and is subject to change.*

The value of your investment and the income from it can fall as well as rise. You may get back less than you invested

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News in brief...

STOP PRESS: Energy Price Guarantee

On 8 September the new Prime Minister Liz Truss announced an Energy Price Guarantee (EPG) set at an annual £2,500 for the next two years from 1 October 2022. This will apply on the same basis as the existing Ofgem cap, i.e. a regional based limit on standing and unit charges in England, Wales and Scotland, *not* on total bills. Northern Ireland will receive the same level of support. Businesses and other sectors will receive 'an equivalent guarantee' for six months, with additional targeted support thereafter.

NS&I increases rates

In July National Savings and Investments (NS&I) increased rates on its Income Bonds, Direct Saver, Direct ISA and Junior ISA, all of which are available to new investors. NS&I also blew the dust off its fixed rate Guaranteed Growth Bonds and Guaranteed Income Bonds, which are only available for customers who have a maturing bond to reinvest. The rates on these had languished unchanged since November 2020 and consequently some jumped sharply. For example, the two-year Growth Bond's return rose from 0.15% to 2.25%.

Key October dates

5 October is an important and oft-forgotten tax deadline date. If you have a new source of untaxed income, are in your second tax year of self-employment or have capital gains in excess of £12,300, you need to register for self-assessment.

31 October is the deadline for submitting a paper tax return for 2021/22, although you have another three months if you file online (which is over 95% of those completing tax returns).

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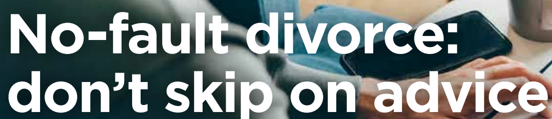

No-fault divorce: don't skip on advice

The number of couples filing for divorce or dissolution has surged after simpler no fault divorce laws came into force in April. But the simpler process shouldn't mean cutting corners on financial advice.

Credit: Mariia Korneeva/Shutterstock.com

Spouses or civil partners can now file for divorce (or dissolution for civil partners) jointly online, stating irretrievable differences. Before, one partner needed to prove the other had acted unreasonably or committed adultery. Online divorce applications have risen four-fold from a low of 2,000 a month to 8,000 a month.

While these divorces may be streamlined, separating couples should still seek financial advice, particularly if they are splitting assets like property and pensions.

Evidence suggests that fewer than two in ten divorces have pension sharing orders, although these are often the most valuable financial asset, after a family home.

CGT considerations

Couples who own property jointly may also have capital gains tax (CGT) considerations, particularly if one partner is transferring their share to their former spouse.

Although there is normally no CGT on the sale of a primary residence, if a couple splits, and one now lives elsewhere, this tax might apply. However, if the property is transferred within the tax year of separation no CGT is due. This makes it important to get the timing of a sale or transfer right, as it could potentially result in a saving of thousands of pounds.

New rules from April 2023 should make this aspect of life easier for divorcing couples. The parties will have up to three years to make what are known as 'no gain, no loss' transfers of assets between themselves after they stop living together.

These changes should make the CGT rules fairer and give spouses and partners more time to negotiate a fair split of assets, rather than rushing proceedings to meet an artificial tax timetable.

The new legislation will also introduce some rules for those who maintain a financial interest in the matrimonial home after separation. This will allow a spouse to claim private residence relief (PRR) when it is sold, meaning they won't have to pay CGT on this transaction.

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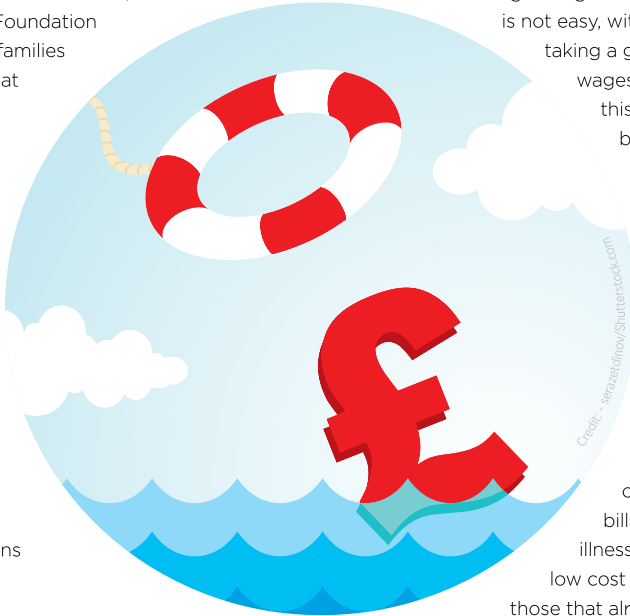
How much ready cash is enough?

As the economic strain ratchets up, what level of cash savings should you aim to keep to hand?

Building up a savings buffer is important to provide a resource should you lose your job, become ill, split from a partner, or simply need some reserves to dip into with bills rising far faster than earnings.

Many families do not have this, with The Resolution Foundation estimating 1.3m families have no savings at all. Research by Moneyfarm suggests that one in three people has less than £1,500 saved. This can leave them struggling to pay unexpected bills, and relying on expensive credit cards, overdrafts or loans instead.



Building a decent savings pot can underpin financial resilience, but the question remains, how much should you be looking to keep aside?

Financial experts say families need to think beyond a one-off large MOT bill, or boiler replacement and look to cover at least three or potentially up to six months of essential bills.

Saving enough to cover six months of mortgage repayments, energy and food bills may seem like a tall order, particularly when these costs are skyrocketing. For households with two earners, three months may be a more realistic target.

Boosting savings at the current time is not easy, with higher bills taking a greater slice of wages. But building this buffer should be a longer-term project.

It could also be worth considering insurance policies, such as income protection, which pay out an income to cover essential bills in case of illness. These are not low cost policies, but those that already have them should consider maintaining cover, as any short-term saving on premiums could remove a valuable longer-term benefit in difficult circumstances.

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Interest rate rises lift annuities

It is not only bank interest rates which are on the up.

So far 2022 has been a year of rising interest rates in most of the developed world. While the focus has been on increased central bank base rates and their knock-on effects, other interest rates have also been getting higher. The yields on medium and long-term government bonds (gilts) and corporate bonds, for example, have also increased.

One neglected sector has benefited markedly from the rise in bond yields: annuities. For any given age, the annuity rates that companies offer are largely determined by what they can earn by investing in long-term bonds; as bond yields go up, so do annuity rates, and the change has been greater than expected.

For example, at the end of last year the yield on the 15-year gilt was 1.15% whereas by late July it was almost 2.50%. Take a single level, no guarantee annuity rate for a 65-year-old, for instance. By late July, the top rate was around 6.25% compared with 5% in January: an increase in guaranteed income of a quarter. Similar rises apply at other ages, although the greatest impact is at younger ages. The jump in annuity rates has coincided with a bad first half for many of the world's investment markets. It is a reminder that the most popular route to drawing an income from a pension fund – flexi-access drawdown – is not the only option and comes with built-in investment risk. An annuity provides certainty, regardless of investment conditions or how long you live. To find out your potential income from an annuity please ask us for a personalised illustration.

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

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