FINANCIAL SERVICES NEWSLETTER

SIFA

June 2017

The ageing population

Government statistics are projecting that by the year 2020 there will be 12% more people in the UK aged 65 and over than there were in 2015. This compares with an overall population growth of just 3%.

Another prediction is that the number of retired people will have increased by 1.1 million in the three years after 2015, making this the fastest growing sector of the population.

Meanwhile we have become accustomed to the assumption that improvements in medical science will result in ever-increasing lifespans, with consequent pressure on family finances.

However, this assumption has been cast into doubt by research undertaken by the actuarial profession (actuaries are the number-crunchers who are said to have found accountancy too exciting).

Figures produced by the Continuous Mortality Investigation of the Institute and Faculty of Actuaries suggest that for a number of reasons lifespans may not be increasing as fast as had been thought.

What are the messages of these various statistics for retirees wondering how long their finances will last? Very often, the answer will depend on the type of pension scheme to which they belong.

Members of occupational pension schemes have the great benefit of certainty as to the income they can expect to receive. The investment risk in funding undefined periods of retirement falls on the employer, and many occupational schemes are suffering from massive financial deficits.

The employers who fund these schemes are offering what appear to be extremely attractive terms to employees who transfer to personal schemes, in which the investors bear the investment risk.

However, personal schemes enjoy the benefit of much greater flexibility as to the times at which and the ways in which benefits can be drawn.

Comparing the benefits of the two types of scheme is a complicated exercise and requires specialist professional advice.

The twin dilemma facing many personal pension holders is how long they will live and how long their funds will last. In this respect the actuaries' conclusions may give rise to mixed feelings

Missing out on ISA returns?

HM Revenue & Customs has reported that in the tax year 2015/16 80% of the 12.7 million people who invested in Individual Savings Accounts put their money into cash ISAs - a similar figure to that for 2014/15. This, despite historically low returns and with little current prospect of beating inflation.

Insurers Royal London have calculated that the consequence of investing in cash ISAs rather than stocks and shares ISAs is that investors have missed out on £100 billion of returns.

The term 'stocks and shares' ISA is somewhat misleading, because for most people the alternative to a cash ISA is to use the ISA allowance to invest in managed funds, rather than individual stocks and shares.

These can invest in widely diversified portfolios of stock and shares and bonds and thereby greatly reduce the risk of investing in individual shares.

For those wishing to switch their cash ISA to a stocks and shares ISA, it is important not simply to sell the ISA but to make a formal ISA transfer request, so as not to lose the ISA's tax-efficient status. If lost, this cannot later be reclaimed.

Lifetime ISAs v pensions

Lifetime ISAs became available as from 6 April 2017, though there are as yet few providers.

The government had two objectives in introducing the LISA – to assist would-be home owners to accrue sufficient funds to enter the housing market, and to provide an alternative or additional means of saving for retirement. In the latter context, some people will be wondering about the respective merits of personal pensions and LISAs.

Personal pensions offer tax relief on contributions, but apart from the 25% tax-free cash entitlement, withdrawals are subject to tax. LISAs, by contract, offer both a 25% up-lift on contributions and tax-free withdrawals. Provided that the conditions are satisfied, the government will contribute £1,000 for every £4,000 invested.

The conditions attaching to LISAs are that the funds must be used either to purchase a first home for less than £450,000 or, if encashed for any other purpose, that this is not before the age of 60. In addition, investors must be aged between 18 and 40. However, anyone who starts a LISA before the age of 40 can continue contributing until the age of 50.

Limits on maximum contributions still favour pensions. The £4,000 p.a. maximum which can be invested in a LISA compares with £40,000 for pensions (reduced to £10,000 for people who have already started drawing benefits)

So, who should be considering investing in LISAs? Certainly, first-time house buyers Also people wishing to provide for retirement and who do not have access to workplace pensions.

The self-employed are a principal target audience for LISAs. However, the current maximum age restriction of 40 is seen as inappropriate and may be one of the reasons why more providers have not yet entered the market.

An influential lobby group of banks and asset managers has been formed which has pointed out that according to the Office for National Statistics, 43% of the self-employed are aged over 50, compared with only 27% of those in employment. And significantly, one of the few providers already offering LISAs reported that nearly one fifth of applicants in the weeks following the launch were aged 39.

LISAs are unlikely to be attractive to higher rate taxpayers, who currently enjoy the great benefit of tax relief on pension contributions at their highest marginal rate. However, proposals for the equalisation of tax reliefs have been discussed and remain on the cards.

To complete the picture, we must not forget standard ISAs, for which the maximum annual contribution is now the very meaningful £20,000 p.a. per individual.

If, as suggested, the market for LISAs is the first-time home buyer and the self-employed, it is equally clear that other categories of taxpayer should be seeking to maximise their pension contributions while current limits are in force; and at the same time, taking their cue from the government's wish to reduce the cost of pension reliefs, to build up meaningful portfolios of stocks and shares ISAs.

Footnote

Change is inevitable – except from a vending machine

No responsibility can be accepted for the accuracy of the information in this newsletter and no action should be taken in reliance on it without advice. Please remember that past performance is not necessarily a guide to future returns. The value of units and the income from them may fall as well as rise. Investors may not get back the amount originally invested.