INCOME PROTECTION
The simple safety net for peace of mind

INFLATION RETURNS
The potential impact of rising prices on your investments

NO FAULT DIVORCE
New legislation will simplify process in 2022

The IEP Financial Review

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AUTUMN 2021

A new style retirement for changing times?

Phasing the transition out of work is becoming the new norm

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As we settle into autumn after a difficult summer worldwide, challenging decisions on managing the fallout from the pandemic remain. Whether we will have a Budget this year is still uncertain, but there are a number of developments to continue to factor into your planning. One central issue for many is of course looking towards retirement. In our feature this issue, we look at the adjustments to end of work patterns made over the last year and consider the positives of a gradual transition from full time work to full time retirement. The Covid-19 support benefits, vital to many over the past 18 months, are coming to an end so we consider the benefits of income protection to help cover unforeseen events such as future health issues. And as the new intake of freshers arrive at university, we look closely at student loan schemes and repayment schedules – perhaps not as onerous as you may have thought.

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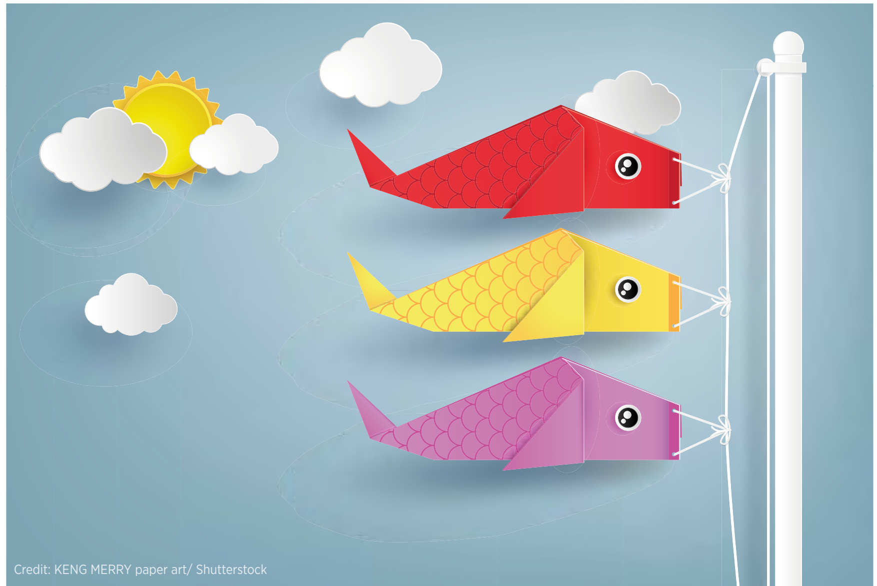
PENSIONS

Pension triple lock falls to double

Next April's increases to State pensions will now follow a less expected, and less expensive, path.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What percentage increase should apply to State pensions in 2022?

For all but the old basic State pension and the new State pension the answer is simple: the annual rate of CPI inflation to September 2021. For the last ten years, however, the triple lock has applied to the basic and new State pensions, meaning the increase has been the highest of the CPI change, earnings growth or 2.5%. From the 2015 election onwards, all the major political parties signed up to maintaining the triple lock, although there is no legislation behind it. The law simply links the two pensions to earnings growth.

Even that is not straightforward, because the method of measuring earnings growth is not spelled out but instead left as a decision for the Secretary of State at the Department for Work and Pensions (DWP). The practice in previous years has been to use the annual increase in average weekly earnings (including bonuses) in the May–July period. In 2020, there was no increase: Covid-19 meant a drop in earnings of 1.0% over the year. CPI inflation to September 2020 was only 0.5%, so the April 2021 increase was the 2.5% minimum.

As the UK economy emerges from the pandemic, earnings have rebounded. Some of the rise stems from statistical quirks, such as fewer low-paid jobs increasing average pay, 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 the new State pension, the cost would have been over £4bn extra a year according to the DWP.

A MANIFEST DIFFICULTY

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

Assuming 3% CPI inflation, that means the new State pension will rise to about £185 a week, rather than the £195 that it might have been. Even the latter is still a long way from enough for a comfortable retirement.

You can check a forecast of your expected State pension on www.gov.uk/check-state-pension.

PROTECTION

Income protection – the simple safety net

Calls to 'build back better' after the Covid-19 pandemic don't just apply to the UK economy. Families can use this moment to look at their own finances and take steps to put them on a more stable footing.

One of the cornerstones of financial resilience is ensuring you have a financial safety net should things go wrong. This can be in the form of savings to cover unexpected bills, such as a new boiler, or a period of unemployment.

But insurance also has an important role to play, particularly in covering your income 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.

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.

After this period, 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).

As this is unlikely to cover even essential mortgage or rental payments and food and utility bills, income protection insurance could be a wise investment.

HOW DOES IT WORK?

As the name suggests, income protection insures a portion of your take-home salary and will pay out if you are unable to work through ill-health. This can be for any number of reasons and will include mental health conditions such as anxiety and depression — the most common cause of long-term work absence — as well as physical problems, such as slipped discs, sport injuries or more serious problems such as recovery from cancer, stroke or heart disease. Definitions and what is covered vary between product providers.

Typically payments start after a deferral period. The longer this period, the lower the premiums will be. Those who are employees may want to check their employment benefits to clarify if their employer offers more than just statutory sick pay. You can then set up your own insurance so it kicks in when support from your employer ends. Those who are self-employed clearly don't have this option.

If you are signed off sick from work you will need medical evidence to support your claim so the insurance can start to pay out within the terms of your policy. Once you return to work the payments stop, but you can still keep the policy and it will cover any future periods of ill-health.

OTHER TYPES OF INSURANCE

Income protection isn't the only type of health insurance that can provide a safety net. Critical illness insurance pays out a one-off tax-free lump sum if you are diagnosed with one of the serious conditions listed in the policy. These will include most cancers, heart disease and stroke. The payment can be used to pay off an outstanding mortgage or any other debts, or simply to provide a financial buffer to give you time to recover from a serious illness.

Please get in touch to discuss your requirements.

✣ *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.*

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PENSIONS

A new style retirement for changing times?

Alongside adaptations to working life, the pandemic may also be changing retirement patterns and expectations.

The acronym 'WFH' is now fully embedded in the 21st century lexicon. Whether 18 months of working from home will reshape the future of work for office-based employees is not yet clear, but major employers are now reconsidering office spaces as employees also review fitting work within living space.

The WFH experience could also accelerate an existing trend for retirement to shift to a gradual, phased process rather than the traditionally abrupt end to working life.

PHASING DOWN

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

- It avoids a 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 may not.
- Part-time earnings should mean less needs to be drawn from the pension pot or, in some cases, further contributions can be made. Either way, the eventual full retirement should be better financed.

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 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 half a decade before their state pension begins to be paid.

CHANGED PLANS

The popularity of semi-retirement in the 2021 survey group is likely to be due, at least partially, to the disruption to retirement plans caused by the pandemic. Over a third had sped up their retirement plans in the preceding 12 months due to Covid-19 related issues, with lockdown and job uncertainty important factors. The pandemic has been a reminder of the need to build flexibility into your retirement plans.

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.

Credit: Roman Samborskyi/Shutterstock.com

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 from work 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.

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

The Financial Conduct Authority does not regulate tax advice, and levels and bases of taxation and tax reliefs are subject to change and their value depends on individual circumstances. Tax laws can change.

TAX

Important changes for the self-employed

It was a busy summer for government announcements for the self-employed.

As well as details of the fifth and final Self-Employed Income Support Grant (closed as of the end of September), additional changes to taxation - actual and potential - came out which are worth bearing in mind for the future.

LOSS CARRY BACK

Guidance was issued on the new extended loss carry back provisions. For trade losses made in 2020/21 and 2021/22 tax years only, unrelieved losses can be carried back and set against profits of the same trade for *three* years before the tax year of the loss. The previous maximum period was one year.

TAX BASIS FOR SELF-EMPLOYED

HMRC launched a consultation on changing the basis of self-employed taxation. At present your tax liability is generally based on your profits in the 12 months ending on your accounting date, e.g. if that date was 30 June, then your 2021/22 assessment would use your profits for the year to 30 June 2021.

From 2023/24, HMRC wants to tax actual profits made in the tax year. The result could be a large tax bill covering the 2022/23 transitional year – for profits from 30 June 2021 to 5 April 2023 for a 30 June accounting date.

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

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INVESTMENT

The return of inflation?

Inflation has picked up sharply in recent months, with a potential knock-on for investments.

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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). Five months later , after a blip downwards in July, CPI inflation was 2.0% and RPI inflation 3.8%. For once inflation was not just a British disease: the US inflation rate leapt from 1.7% to 5.4% over the same brief period. Even in the Eurozone, where annual inflation was negative for the last five months of 2020, by July 2021 it was 2.2%.

The sudden and widespread jump has been blamed on several factors, many of which relate to the developed world's economic recovery from the pandemic. A significant jump in the cost of second-hand cars on both sides of the Atlantic, for example, is one sign of the economic fallout. This price rise has its roots in a shortage of new vehicles which in turn is due to reduced orders from manufacturers for microchips during the pandemic.

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. This view is also shared by the central bankers in the UK, US and Eurozone.

The Bank rate was held again in August and interest rates are not expected to rise in the near term. However, many economists fear that the price increases could lead to parallel wage rises – already evident in some sectors – creating a wage/price inflationary spiral, once a familiar feature of the UK economy.

IMPACT ON INVESTMENTS

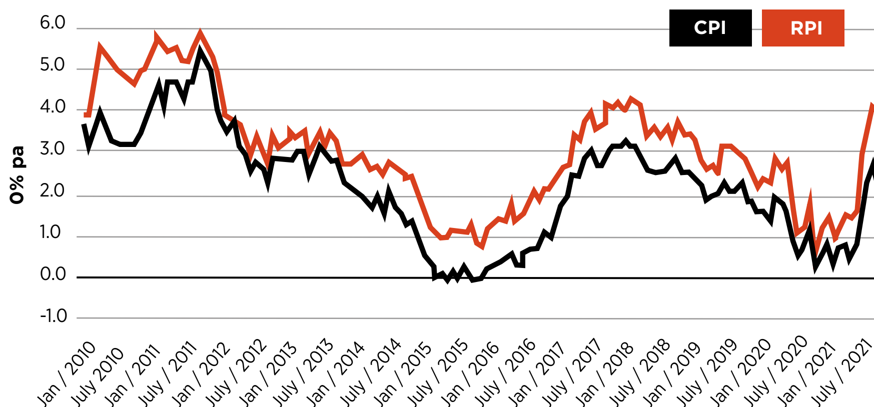
If you are an investor, rising inflation can often be bad news. With interest rates close to zero, the buying power of any cash you hold is being steadily eroded. At the time of writing, there were no savings accounts that matched or beat the 2.5% inflation rate, other than a couple of specialist children's accounts. If you have more cash than you need for your rainy day reserve, make sure you have a good reason, e.g. an impending tax bill.

Inflation also 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 is 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 can depress their share prices.

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.

CPI AND RPI INFLATION JANUARY 2010 – JULY 2021



Source: Office for National Statistics

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PLANNING

No fault divorce comes to England and Wales

With divorce petitions and enquiries ticking up in early 2021, an important change to divorce law due next year may see figures increase further.

The Divorce, Dissolution and Separation Act 2020 should have been implemented in autumn 2021. However, in June the government pushed back the start date to April 2022. The delay, plus the after-effects of lockdown, could mean a divorce boom in England and Wales next year.

The Act removes the existing requirements for requesting divorce in England and Wales which currently must fulfil 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, the most common ground for opposite-sex divorce was unreasonable behaviour, covering 35% of petitions from men and 49% from women (who accounted for close to two thirds of divorce applications in 2019).

This has consistently been the most common reason given for wives petitioning for divorce since the late 1970s and for husbands since 2006. However, unreasonable behaviour, like adultery and desertion, can be contested, leading to potentially ugly and expensive court battles.

SIMPLIFIED RULES

The Act replaces the five 'facts' with a single 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. Many couples contemplating divorce either on separation or other grounds may now be waiting for April 2022.

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

FINANCIAL SETTLEMENTS

One key aspect of divorce is not changing: the need to reach a financial settlement. This not only involves the family home and investments, but also 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, so taking personal financial advice is essential.

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Occupational pension schemes are regulated by The Pensions Regulator

Credit: Anna Tigra/Shutterstock.com

INVESTMENT

National Savings Green Bond

National Savings & Investments (NS&I) has released more details of its Green Savings Bond, originally announced in the spring Budget. The bond will have a fixed term of three years with no early encashment options. It will be open to all investors from age 16 upwards, with a maximum investment of £100,000 and a minimum of £100. Interest will be added to the bond every year with no tax deducted at source and paid on maturity. However, the interest will be taxable, meaning that investors could face a tax liability each year, but no corresponding income payment.

Frustratingly the one piece of information NS&I did not supply was the interest rate the bond would pay – that "will be available later in the year". It is unlikely to be a chart-topping figure. NS&I is currently offering just 0.4% for reinvestment on maturing three-year Guaranteed Growth Bonds and three-year government bonds yield under 0.2%.

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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 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 is currently fixed at £50,000.

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EDUCATION

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.

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GRADUATE TAX

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 and any outstanding debt is cancelled after 30 years.

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

The rules differ within the UK depending on where you reside.

- 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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