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SUMMER 2015

rosan helmsley quarterly

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Top UK earners warned on potential pension tax relief changes

Top earners should consider putting as much into their pensions as possible ahead of expected changes in the upcoming July 8th Budget that could restrict tax relief.

Much of the news on pensions over the last parliament has been good, particularly the additional freedoms on how we draw income from our retirement funds. No longer are we forced into annuity purchase – we can all choose how much and when we draw money from our pension funds, with withdrawals beyond the 25% tax free sum being taxed at our marginal income tax rates.

Behind many of the reforms was the former pensions minister Steve Webb, who is succeeded by Dr Ros Altmann, a passionate champion on pensions and a campaigner for further pension freedoms. Ros has been vocal on removing the individual limit on pension assets – the Lifetime Allowance or LTA. The LTA is currently set to be reduced from April 2016 to £1 million after a string of reductions from its peak at £1.8 million, so her appointment is a potential tonic for investors frustrated by this largely politically motivated savings reduction over the last parliament.

Not many were expecting a majority Conservative government and it is conceivable the budget statement on July 8th may contain further radical amendments – any new government will want to get politically sensitive changes (good or bad) dealt with early in the term. Part of the Conservative election manifesto pledge was to restrict pension tax relief for those earning over £150,000 and in the 45% tax rate.

We would therefore recommend those in this income bracket who are considering making a substantial contribution in this tax year to do it ahead of the budget. It is currently possible to invest up to £180,000 into a pension scheme this year using the 'carry forward' legislation, subject to having at least that amount of earned income in 2015/2016. After 45% income tax relief, this would cost the investor £99,000 – a great deal.

Rosan Helmsley Golf Day – St George's Hill Golf Club

On the 22 May we held our 8th consecutive golf day at St George's Hill Golf Club – a great day enjoyed by guests and hosts alike.

We hope you enjoy the articles in this newsletter. Please do contact the office shortly if you wish to consider large pension contributions ahead of the July 8th Budget.

Rob Sandwith | Chief Executive

The investment process – science, not art

Do you understand the way in which an investment portfolio is designed? If not, read on…

There are typically six stages to be worked through before your personal investment portfolio can be created:

1) **Risk profiling** All investment involves risk and understanding your risk profile is the key starting point to building your portfolio. It is important to establish the level of risk you are prepared to take. The profiling exercise involves two distinct elements:

   - An assessment of the investment risk you are psychologically prepared to accept, which is usually carried out with the help of a series of profiling questions; and
   - A calculation of the loss your finances could absorb. This has to be based on a detailed analysis of your income and expenditure as well as your assets and liabilities and could turn out to be more important than your psychological feelings about risk.

2) **Goal setting** Investment is ultimately a means to an end. There is always a reason – and often more than one – for investing. Understanding what the reason is will set the strategy for the investments we recommend and the subsequent measures of performance. For instance, if your goal is to build a capital sum in 15 years' time, then you clearly have a different investment perspective from somebody wanting to fund school fees starting in 2018.

3) **Asset allocation** Once we have understood your acceptable levels of risk and agreed your objectives, the first high-level stage of deciding what to buy begins. Asset allocation, as this stage is labelled, involves a review of the appropriate broad types of investment – such as shares, property and fixed interest investments. It also involves selecting the individual sectors in each sector in each category, e.g. in the fixed interest category, gilts, corporate bonds and emerging market bonds.

4) **Fund selection** Once the high level choices are made, the next decision is which funds to use in each chosen sector. This is more than a simple matter of choosing the top performers over the last three or five years. Fund selection requires a detailed analysis of a variety of performance measurements – including a fund's risk ratings – but also a qualitative assessment of the fund manager systems and track record.

5) **Tax considerations** Tax should never dictate investment, but it can determine how and where it is most tax-efficient to hold investments – the so-called investment wrappers. For example, it will usually make sense to hold high income funds in an ISA and/or pension to provide a tax shelter if you are a higher or additional rate taxpayer. On the other hand, capital growth funds may not need an ISA or pension wrapper given the (current) annual capital gains exemption of £11,100 and maximum rate of 28% (tax year 2015/16).

6) **Platform selection** The final part of the process before implementation is the selection of a platform through which to make the investment. What matters is overall value. A 'cheap' platform may be cutting corners on administrative support or slow to respond to market changes. Of course, some investors don't need to invest via a platform.

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

“Wide-ranging changes mean that that you probably need us to review your retirement planning.”

Pensions freedom: What’s in store?

The bulk of the pension reforms are now in place. After so much rapid change, here is a reminder of what’s in force and what may yet be to come.

The reforms to pensions which were first announced in March 2014 are now mostly in force. In the year after the 2014 Budget, there have been a variety of revisions and further announcements, with more emerging in this year’s Budget. As ever, there could be a difference between what is legislatively possible and what your pension provider is willing to administer:

Income flexibility For defined contribution pension schemes (or money purchase schemes as they are sometimes called) such as personal pensions, you now have complete freedom in how you draw your benefits once you reach minimum pension age (normally 55, but set to increase to 57 in 2028). In theory you can withdraw your entire pension fund as a lump sum.

The old ‘capped drawdown’ rules which placed a limit on the size of the yearly draw now only apply if the withdrawals started before 6 April 2015, although it is now possible to opt out of these limits and to apply the new rules.

In theory you can draw 25% of your fund as a lump sum free of income tax, with the balance taxable as income. However, the precise tax treatment of withdrawals is complicated and different ways of extracting cash can yield substantially different tax liabilities. Two issues have come to the fore:

- A large withdrawal can push you into another tax band (or bands) and, in some instances, mean loss of your personal allowance.
- Tax is deducted from pension income under the pay-as-you-earn (PAYE) system, which was never designed to deal with large one-off payments. As a result the tax taken from your lump sum payment can be more – or sometimes less – than your actual end-of-year liability.

Death benefits There is normally neither inheritance tax (IHT) nor any other tax charge on lump sum death benefits if death occurs before age 75: from that age a 45% flat rate applies (but again no IHT). The 45% rate is due to fall to the beneficiary’s marginal income tax rate from 2016/17, but the legislation for this has

not yet been passed. As an alternative to a lump sum, income payments (as withdrawals or an annuity) can be taken, which are also tax free if death occurs before age 75 – normal income tax applies thereafter.

Pension funds can now be passed down through generations, so if a beneficiary does not exhaust all of the fund through withdrawals, the residual amount can be handed onto their nominees, with the same tax rules applying.

Future changes The March 2015 Budget contained announcements of two further changes from April 2016. We may hear more of them in the second Budget.

- A further reduction in the lifetime allowance – the effective maximum tax-efficient pension fund value – to £1m; and
- An option for existing pension annuity holders to sell their right to income in exchange for a lump sum or other pension benefits.

These wide-ranging changes mean that you probably need us to review your retirement planning and/or your estate planning. Similarly, if you intend to extract money from your pension using the new flexibility, we would strongly recommend that you contact us before taking any action.

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Saving for the cost of wedding

A wedding can be expensive and many parents do still wish to contribute to this special occasion. According to a *Brides* magazine survey of their readers, the average total cost of a wedding is £24,716 but as they say, it is up to you whether you decide to save or splurge!
One of the best ways to save is via an individual savings account (ISA) as these are a flexible, tax-efficient way to save for your child's future. Many parents will be thankful that people are generally getting married later in life than their parents' generation.

Income protection: looking out for your vital resource

Your ability to work is a vital resource. It allows you to keep a roof over your head and also feed and clothe yourself and your family. Life expectancy has been steadily improving over the last 100 years so that today financial hardship is more likely to occur as a result of your inability to work for a significant period than as a result of death.

If you don't have a family or long-term partner financially dependent on you and your earnings, the key risk for you to insure against is likely to be your inability to work as the result of illness or disability. The type of insurance you need for this is called income protection – previously known as permanent health insurance.

What is the real threat?

We tend to think of cancer, heart attacks and strokes as the main health threats, but these are not necessarily the biggest threat to your income. The most common causes of long-term disability are stress-related issues and muscular-skeletal problems. This is not to minimise the suffering caused by conditions like cancer but to recognise the economic reality of the threat to your income.

It is very easy to undervalue your income. In terms of total sums at risk, the numbers can be very large and far exceed the lump sums you may arrange in a life insurance policy. For example, £1,500 a month of income benefit increasing by inflation of just 2% over 30 years, is equivalent to cover of £730,000.

An attractive product

The possibility of suffering from a prolonged disability is not something most of us want to dwell on. On the other hand it does not take long to work out your total monthly expenditure obligations, such as mortgage repayments and bills for household essentials. How long could you pay for these with your savings?

Income protection cover is an attractive product. If you cannot work because of illness or accident, then, after a set period, the policy is intended to pay you a monthly benefit to help replace some of your lost income. It will keep on paying until you return to work or the policy expires (usually between ages 55 and 65) or you die, whichever occurs first. If you recover and get back to work, the policy will pay out again if you suffer periods of illness or disability, providing you still meet the criteria for making a valid claim.

Benefits are tax free

The benefits from individual income protection are tax free under current tax rules and so insurers usually allow you to insure up to a maximum percentage (usually 50% to 65%) of your gross income or three-quarters less an allowance for any state benefits the claimant may qualify for. However, income protection can seem expensive because the total sum at risk for the insurance company is so high. It therefore makes sense to arrange enough income protection insurance to cover your basic minimum level of outgoings. It is not worth risking the loss of hundreds of thousands of pounds of future income for you and your family when there is a simple solution to hand.

What about state benefits?

The monthly benefit from an income protection policy may affect your claim to some means-tested state benefits. Your entitlement to employment related non-means tested state benefits (such as contributory Employment and Support Allowance) shouldn't be affected. However, state benefit rules may change.

Many people still seem to believe that the state will look after them if they suffer from a prolonged disability. In reality the level of state support is so low that anyone in work would find it extremely difficult to live on it. So a little planning ahead could make a big difference. Let us know if you wish to discuss your options.

Tax laws can change. The Financial Conduct Authority does not regulate tax advice.

Post-election financial planning

The surprise election result has removed some potential tax increases, but a variety of delayed tax measures and manifesto promises remain.

The Conservatives' unexpected victory on 7 May means that the threat of a mansion tax on properties valued at over £2m has disappeared and a return to a 50% additional rate is off the agenda. However, the UK's financial position is a constraint on the Chancellor (once again Mr Osborne). As a percentage of economic output, the government deficit is larger than Greece's according to the IMF, so any tax cuts will need to be balanced by increases elsewhere and/or further expenditure cuts.

There is already one subtle tax increase left over from the March Budget which is due to be legislated for and take effect from April 2016. The effective tax-efficient maximum value of pension benefits, the standard lifetime allowance, may drop by 20% to £1m. In addition, the Conservatives' manifesto promised another pension tax hit with a phased reduction in the annual allowance (broadly the maximum tax relieved total annual contribution) for those with income above £150,000. If either of these changes might affect your retirement planning, then talk to us as soon as possible: some pre-emptive planning may be possible and there will also be new transitional protection you may need to claim.

The manifesto said that the latest cut in the annual allowance was to finance a new main residence inheritance tax exemption of £175,000, transferable between married couples and civil partners. However, the relief would be phased out for estates above £2,000,000, with no relief at all for estates worth more than £2,700,000. The mechanics of how this will operate – particularly in the context of those who have to move into residential care – remain to be seen. It could be that, post-election, Mr Osborne opts for what would be a much simpler and not much more expensive alternative – an increase in the nil rate band to £500,000. While we wait to see what happens in the July Budget, in most instances estate planning – other than updating (or writing) wills – is best deferred.

The Conservatives' manifesto promised two reductions in income tax:

- The personal allowance will be £12,500 by 2020/21 (the end of this parliament). It is currently £10,600 and this year's Finance Act has legislated for increases of £200 in 2016/17 and 2017/18.
- Again by 2020/21, the higher rate threshold (equal to the personal allowance + the basic rate band) will be in this year's Finance Act at £42,385. The Finance Act 2015 has already set the threshold at £43,300 in 2017/18. However it was £43,875 as long ago as 2009/10, a reminder of how much the starting point for higher rate tax has been held down in recent years to raise much-needed revenue.

The personal savings allowance, giving basic rate taxpayers up to £1,000 of tax-free savings income and higher rate taxpayers up to £500 from 2016/17, was not put into law in the Finance Act 2015, but should now reach the statute book for next April. This can now be planned for, as can the continuation of the new marriage allowance (a concession not popular with the opposition, which they might have repealed).

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Investing for children

The Junior ISA (JISA) is an obvious starting point...

The JISA is very similar to its adult counterpart, other than the maximum contribution limit, which in 2015/16 is £4,080. It offers the same tax freedoms – no UK income tax on interest or dividends (although dividend tax credits cannot be reclaimed) and no capital gains tax. Importantly, the rules which can tax parents on the income of capital gifts to their minor children do not apply to JISAs.

Since 6 April 2015 it has also been possible to transfer from existing Child Trust Funds (CTFs) to JISAs.

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Using investment platforms

It is no exaggeration to say that investment platforms have revolutionised the relationship between advisers and their clients and have allowed for a greatly improved client experience.

Investment platforms are online services where we can administer clients' investment portfolios and where both we and our clients can obtain current valuations and other information at any time.

Easy access to information

As advisers, we are able to report, arrange transactions and monitor our clients' portfolios from one centralised online platform. We can perform a number of transactions on a client's behalf, such as withdrawing a lump sum, setting up an income, or switching funds. Clients are able to access their portfolio online from anywhere in the world using their personal ID and password.

A new level of control

The right asset allocation is the foundation of a good investment portfolio but it is not always easy to control this across a range of products. Using an investment platform to hold Individual Savings Accounts (ISAs), pension, investment bond and general accounts allows an overall asset allocation approach to be adopted across a portfolio, regardless of the investment type or tax wrapper being used. Portfolios held on an investment platform can easily be rebalanced at regular intervals. Research has shown that this has the twin benefits of increasing the long term returns and controlling the risk of the portfolio.

Tax efficiency

One of the most obvious benefits for investors is the availability of consolidated income tax and capital gains tax statements to help simplify completion of tax returns. Annual ISA and pension allowances can be used up by means of new investments or switching funds.

The limitations of investment platforms

At present platforms cannot cope well with some of the older investment plans and the only option would be to surrender the plan, which might not be in a client's interests. Some clients hold very large amounts on deposit and these are best spread amongst different banks and building societies. While platforms can hold a wide range of products, someone holding a structured product for six years may feel there is no benefit in holding this on a platform given the platform charges.

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Currency: the hidden investment risk

If the overseas market goes up, but your overseas fund goes down, currency may be the root cause. Many fund managers ignore currency risk, arguing that in the long run the fluctuations cancel each other out. To discover those managers with a more active approach in these volatile times, talk to us.

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Rosan Helmsley Limited, 3000 Cathedral Hill, Guildford, Surrey GU2 7YB
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