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Brexit – What next?

Britain has a rich history in trade and diplomacy and over the next two years we are going to find out just how good Britain really is at negotiating, and in time, how history will rate our new leader, Theresa May. She has a tough task ahead.

Theresa May declared this week that after leaving the EU, Britain will seek a "unique" model that will confirm its place as "one of the great trading nations in the world". She has also been adamant that "Brexit means Brexit" and offered some vision on the structure in the new era.

The UK would seek "controls on the numbers of people who come to Britain from Europe" but also "a positive outcome for those who wish to trade goods and services". This is all pretty intuitive stuff, but tensions are already growing among ministers about the precise form Brexit will eventually take. The biggest divisions are over the balance between market access – through the EU customs union and the single market – and immigration, which is still at near-record levels.

Theresa May aims to invoke Article 50, the formal mechanism that triggers a negotiation period with the EU of up to two years, early in the new year and without a parliamentary vote. She has dismissed the prospect of holding a second referendum and intends to press ahead with Britain's exit from the EU.

Negotiations with the EU will have two related imperatives: getting the best deal for people at home, and getting the right deal for Britain abroad. Britain's membership of the single market, which involves tariff-free trade and the free movement of people, is also in question: British officials have suggested that the financial services industry's access to the single market should be the negotiators' main priority.

Anna Soubry, the former business minister and Remain campaigner, has stated that access to the single market was "absolutely critical to British business, and that means for the benefit of people across the United Kingdom". But European leaders have warned that this would involve permitting continued free movement as well as contributions to the EU's budget. Amber Rudd, the home secretary, is now under pressure to end unlimited migration from the EU – one of the main reasons voters backed Brexit and making it harder for her to support such a deal.

There is also pressure from the rest of the EU to hold out against British demands for a generous deal to prevent other countries from following it towards the exit. Sigmar Gabriel, Germany's deputy chancellor, said this week that the bloc could go "down the drain" if other countries saw Britain "keeping the nice things" relating to membership.

It is going to be a hugely interesting period in British, global and European politics – we will soon see if we have a real leader at the helm. And if what's going on this side of the pond isn't enough entertainment, we have the Clinton Trump feud heading to a November crescendo!

Theresa May – 'Brexit means Brexit'

This newsletter contains a number of articles on current topical industry and financial planning issues. Please do contact us if you wish to review any of the articles, or your own situation in the context of changing legislation.

Rob Sandwith | Chief Executive

About to draw your pension benefits?

If you are going to turn your pension fund into a retirement income in the near future, the outcome of the EU referendum has complicated matters.

One of the reasons George Osborne gave for the introduction of his radical pension flexibility reforms in March 2014 was that "the annuities market is currently not working in the best interests of all consumers." Yet the annuity rates of spring 2014 now look a bargain: by mid-June 2016 typical rates were around 15% lower than when the then Chancellor spoke. Rates have fallen further since, as a result of the Brexit vote driving down bond yields.

If you are at the stage of converting your pension fund into a retirement income, you may feel circumstances are conspiring against you. In fact, the new pension regime has given you more flexibility in how you can draw your benefits. This might not be immediately obvious because some pension providers do not offer full flexibility on their older pension arrangements. If you want to take advantage of more options than are available from your current provider, it is usually a reasonably straightforward matter to transfer to a new arrangement with greater flexibility.

Draw down

Under the new pension flexibility you can draw down part (or even the whole) of your pension fund as a lump sum, with 25% normally free of tax and the balance subject to income tax. Any undrawn portion remains invested and can be used to pay out more at a later date. Depending on your circumstances, you could use a series of payments to provide a stream of tax-efficient income. At a time when investment markets are volatile, it can make sense to draw from your pension plan only what you need and avoid making a large one-off sale and reinvestment, as would be the case with an outright annuity purchase.

Choose carefully

The so-called 'drawdown' approach is not right for everyone – you may want some guarantees built into your future income which drawing funds straight from you pension fund cannot supply. The key point is to work out what net income you require from your pension fund and then take advice on the ways in which this can be achieved. Sometimes a combination of methods may be appropriate. For instance, you may use part of your fund to buy an annuity giving you a basic level of guaranteed income; and then you could invest the remainder in funds from which you draw regularly or as needs arise.

This is an area in which individual, expert advice is essential. Choosing the wrong option can create some large tax bills or leave you locked into a poor value solution for the rest of your life. That can be a long time spent in regret: the average 65 year old has at least a one in four chance of reaching the age of 94.

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.

> “Under the new pension flexibility you can draw down part (or even the whole) of your pension fund as a lump sum, with 25% normally free of tax and the balance subject to income tax.”

Brexit fallout: what are the implications?

The implications for investors of the result of the UK referendum on EU membership will be played out over the months ahead and it is very likely that volatility will persist in the near term. Although we understand investors' concerns, you should not need to make dramatic changes, provided you have a well-diversified portfolio.

Financial risk needs a different reaction

Human evolution has made us instinctively averse to uncertainty and this is especially true in the financial markets, according to Professor Andrew Lo of MIT's Sloane School of Management. Dr Lo has said that our natural reaction to physical risk – what has been described as 'fight or flight' – may save our lives, but that the same reaction to financial markets tends to make us short-term investors and so miss out on the benefits that long-term investing can bring.

UK investors who moved into cash ahead of the Brexit results on 24 June will have seen the FTSE100 make a remarkable and unexpected climb of around 6% in the following month, leaving them well out of pocket. From a historical perspective we can see the dangers of moving out of the markets when the outlook seemed bleak. Investors who moved into cash in March 2003 or March 2009 risked missing out on a double digit rise in the FTSE100 within the following few months.

Duller growth is likely

The UK economy will be impacted by Brexit and uncertainty as to how this will show itself will prevail for some time. Cazenove Capital's Chief Investment Officer, Richard Jeffrey, has said "Whatever the long term may bring for the UK, it is hard not to conclude the UK economy will see duller growth for a couple of years, though quantifying 'duller' is impossible at the moment."

Is there a safe haven?

For some investors the solution will be to leave their money in cash, but as we have seen this has dangers as markets can move upwards very quickly. Inflation will also reduce the buying power of your capital over time. Many investors have been lured by the so called 'safe haven' of gold as the price spiked following Brexit. But gold has its risks too and its value in the first quarter of 2016 was down on three years ago.

> “Most people’s instinctive reaction to any kind of danger is often flight. But that could often be an expensive mistake.”

The best solution for investors

The answer to unexpected events like the Brexit result and the subsequent ups and downs of stock markets is to invest for the long term and to diversify. Investing for the long term means not panicking and bailing out when investments fall. And diversifying means spreading your investments – not putting all your investment eggs in one basket.

Diversification will help protect your investments from the full impact of the volatility of the UK stock market. What’s more, with the pound falling against other currencies, it means that your overseas investments produce an additional benefit for you when they are converted into sterling.

Your investments should not just consist of equities – that is share-based investments. Lower risk portfolios may have a quarter or more of the portfolio made up of fixed interest investments. It is often the case that when shares fall, as they did immediately after the Brexit vote, bonds – especially government bonds like gilts – rise in value. It doesn’t always happen like that, although bonds tend to be less volatile than shares.

Most people’s instinctive reaction to any kind of danger is often flight. But as we’ve seen, that could be an expensive mistake.

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.

A business loss you may not have considered

Do you run a business as a partnership or company along with other shareholder-directors? If so, have you considered what would happen if one of your fellow business owners was struck by a serious illness or died? You could find yourself having to accept a new – and unknown – partner/shareholder or even having to sell up at the worst moment. The key to avoiding such a situation is to have cash and the correct structure of agreement to buy out your colleague’s business interest. If you already have one in place, make sure it is regularly reviewed, as values change.

Single-tier pension blues

The Department for Work and Pensions is sending out bad news to over 100,000 people.

The new single-tier state pension started life in April 2016, marking the end of the basic state pension and the state second pension for anyone who had not already reached their state pension age (SPA). In the run up to the launch, the government publicity placed considerable emphasis on the amount of the new single-tier pension (£155.65 a week in 2016/17), which is £36.35 a week more than the current basic state pension. However, while the £155 succeeded in grabbing the headlines, it is far from the whole story, as is now becoming clear.

Earlier this year the House of Commons Work and Pensions Select Committee examined the "communication of the new state pension" and was critical of the emphasis placed on the £155.65 figure. The Committee echoed a crucial point made by many pension professionals for some time: in the early years of transition to the new system "the majority will not" receive the full amount. Even by 2030, almost one in five of those reaching their SPA will receive less than 100%.

Lower pensions

There are three groups in particular who stand to suffer most in the early years, because they could end up receiving less under the single-tier system than they would have got under the old regime, it it had continued:

1. **If you have a National Insurance contribution/credit record of fewer than 10 years by the time you reach your SPA**, then you will receive nothing from the single-tier pension regime. Under the old system, you started building up a pension after just one complete year of contributions. The Department for Work and Pensions has recently announced that it will be writing to over 100,000 people warning them that they will get no pension whatsoever because of this new 10-year rule.
2. **If your old regime pension entitlement relied upon your spouse's National Insurance contribution record**, then this is no longer available to you if your SPA is after 5 April 2016. The basis of the single-tier pension is strictly personal, both in terms of contribution record and benefits – there are no widow(er)'s pensions, other than in limited transitional circumstances.
3. **If you were a member of a contracted out final salary scheme between 1978/79 and 1987/88**, you would have accrued Guaranteed Minimum Pension (GMP) in place of SERPS. Under the old regime, the state provided full inflation-proofing for GMP from SPA – your employer provided none. While this pattern continues to apply for those who reached their SPA by 5 April 2016, there will be no state-funded increases if your SPA is later. A similar, though potentially much smaller loss occurs for contracted out scheme membership between 1988/89 and 1996/97. The employer is required to provide up to 3% inflation protection for GMP earned in that period with the state (formerly) responsible for any excess.

These cuts in pension benefits stem from deliberate government decisions made in dealing with the complexities of switching from the old to the new regime. In theory the reductions could have been avoided by specially targeted transitional measures for those affected, but this would have added to overall costs, which the government wanted to keep unchanged at worst.

The best way to find out your single-tier pension entitlement is to obtain a projection from the Department for Work and Pensions website (www.gov.uk/check-state-pension), which will also tell you when you reach your SPA – it may not be when you think! Once you have got the projection, your next step should be to talk to us about your retirement options.

Inheritance tax: the silent tax collector

The government's receipts from inheritance tax (IHT) have been rising much faster than the yield from other taxes.

In a recent report on the changing nature of UK tax revenues, the Institute for Fiscal Studies (IFS) noted that "There is an increased reliance on smaller taxes". It attributed this shift to the political difficulties in raising rates on the major taxes, such as VAT, fuel duty and income tax.

IHT is a good example of one of the "smaller taxes" that is quietly producing an increasing slice of the total tax take, as the chart below clearly shows. In 2016/17, IHT is projected to raise almost £5bn, more than double what it produced in 2009/10. There are many reasons why the Treasury's IHT income is outpacing the growth in overall revenue, but the most significant is probably the freezing since April 2009 of the nil rate band – broadly speaking the amount of your estate (after any exemptions) not subject to tax at a flat rate of 40%.

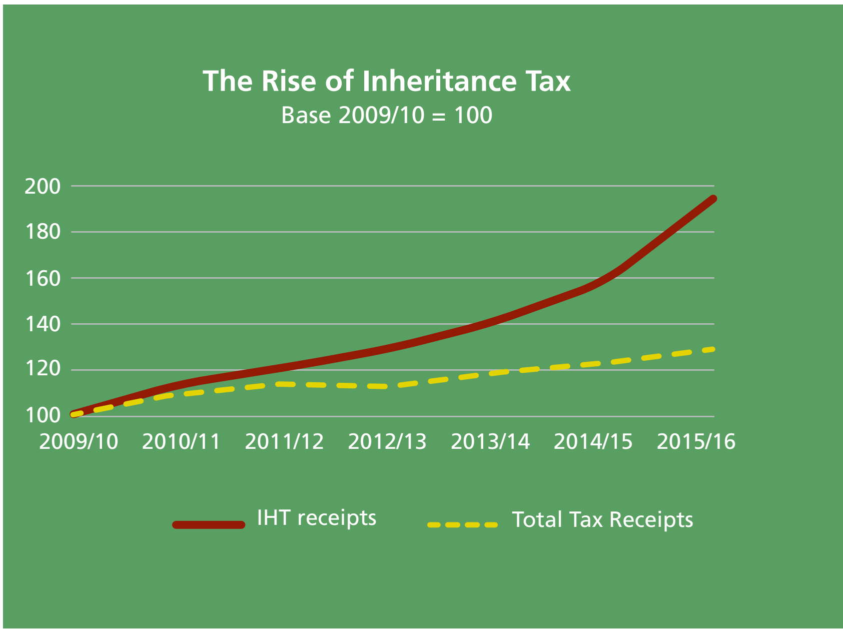
Average UK house prices have risen by more than 30% so far over the period that the nil rate band has been frozen, according to Nationwide. In Greater London the increase exceeds 85%. It's true that the government is introducing a main residence nil rate band (RNRB) in April 2017, initially at £100,000, rising to £175,000 by April 2020, but this will be of little or no help to some people.

The RNRB has also been criticised by the chairman of the Treasury Select Committee who said it failed to meet any of three requirements that: "Tax rules should aim to be simple, fair and clear". While the RNRB is being phased in, the ordinary nil rate band will continue to be frozen, meaning its first increase above the 2009 figure of £325,000 will not occur until at least April 2021. The net result is that the government's revenue from IHT is still forecast to rise over the period that the RNRB is introduced, according to the Office for Budgetary Responsibility.

If you do not want the Exchequer to be a major – or even the largest – beneficiary of your estate, then the sooner you begin planning, the better. The starting point is making sure your wills are up to date – or putting in place a will if you are currently relying on the vagaries of intestacy law. Once the structure of your will is settled, there are no simple rules of thumb for the next stage, other than to take expert advice.

Estate planning requires a clear, holistic approach and needs to be integrated with other aspects of your personal financial planning. For example, from an IHT viewpoint your pension plans may not be the wisest way of providing retirement income.

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



Can you take the risk?

The outcome of the EU referendum was a reminder that risk comes in many forms, including political risk.

The UK has experienced its fair share of political risk recently. Following the decision to leave the institution that has been a core part of our economic and political lives in one form or another for 43 years, we have also seen a change of Prime Minister in mid-term and a vote of no confidence in the leader of the main opposition party. On a national level, that's a lot of risk.

No one wishes to lose money on their investments, but most people are aware that for additional gain there is almost always increased risk. Understanding your attitude to risk and capacity to absorb loss is key to investment planning.

The process of establishing your attitude to risk will start with you completing a risk questionnaire. A psychometric questionnaire can be a good way to check how you view investment risk. That's usually a starting point for discussion of the nature of investment risk and your attitude to it. The extent to which you are prepared to take on investment risk could range from being exceedingly cautious, through being prepared to consider a moderate degree of risk to being adventurous in your approach.

But it is also important to consider what is called your 'capacity for loss' – how much risk you can afford to take. This is the degree to which your personal circumstances and opinions will have an impact on the specific investment recommendations. For instance, an investor may be willing to buy very risky investments but may have limited resources and a very short-term goal – for example to build up enough capital to pay for their children's school fees starting in four years' time. Their need to avoid risk because of their short time scale and modest means should outweigh their willingness to buy risky investments.

If you are having second thoughts about the basis of your investment approach, please ask us for a new risk review.

Auto-enrolment: the fines continue to grow

The latest report from the Pensions Regulator shows that as automatic enrolment spreads through smaller employers, warnings and fines for 'non-compliance' are soaring. In the second quarter of 2016 the regulator issued nearly 3,400 compliance notices, more than 850 fixed penalty notices of £400 a piece and nearly 38 escalating penalty notices (which can be as high as £10,000 a day). Make sure you are prepared for your employer responsibilities or you could be adding to those numbers in the future.