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financial FOCUS

The search for income

...three years on

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A new era for financial advice

The Retail Distribution Review (RDR) comes into force from 31 December 2012, and will lead to profound changes for consumer financial advice.

Higher standards and greater transparency in fee charging are among the aims of the RDR. The main aims of the RDR are to ensure that consumers:

- Are offered a transparent and fair charging system for the advice they receive.
- Are clear about the service they receive.
- Receive advice from highly respected professionals.

One of the key changes that will affect you is the move to charging fees, meaning that no financial advisers will receive commission on investment advice, including pensions and annuities.

All financial advisers must be RDR-compliant and adhere to a strict code of ethics. Each year, it will be necessary for individual advisers to qualify for an annual Statement of Professional Standing. An advisory firm must also ensure that clients understand the services being provided, namely whether they are independent or restricted. Independent firms will have to cover the whole market for retail financial products and meet certain other standards.

The RDR also means that all financial advisers need to be appropriately qualified at a higher minimum level than before. This has meant that many advisers have had to take further exams. Ongoing continual professional development is also essential. The minimum level of qualification encompasses six key planning areas:

- Financial services, regulation and ethics.
- Investment principles and risk.
- Personal taxation.
- Pensions and retirement planning.
- Financial protection.
- Financial planning.

The RDR is about putting the client's needs first. A number of firms have decided that the changes will make it uneconomic for them to provide financial advice.

Overall, there is a recognition that this is going to boost consumer confidence in taking competent financial advice and it will mean increased professionalism. It is also hoped that the RDR will improve the reputation of financial services across the board.

Consumer awareness of what the RDR means in practice could be greater. However, we will make sure you are informed and we will be pleased to answer any questions you may have.

Your retirement income options

If you are close to turning your pension fund into a retirement income, your options are changing.

The world of pensions never stands still, and 2012 comes to an end with a clear demonstration of this fact. It will not be possible for insurance companies to offer different annuity rates to men and women of the same age from 21 December 2012. The result will be that by that date every annuity provider will switch to quoting 'unisex' rates – the same rates for men and women. All other things being equal, if you are a man you will see the annuity income you can buy with your pension fund fall, while if you are a woman it should rise.

Whether you are on the winning or losing side, the annuity rates on offer will still be at historically low levels, reflecting the decline in long-term interest rates and increasing longevity. That makes it all the more important that you do not just accept the annuity quote from your pension plan provider. In the run-up to your retirement date, there is a variety of factors to consider.

Should I draw all my benefits now?

It could make sense to wait, while annuity rates are on the floor and many investment markets are still below their pre-financial crisis levels. There are obvious risks with such an approach – annuity rates and markets could both fall – but the opposite is an attractive possibility.

Am I choosing the right type of annuity?

Annuities are not all the same. For instance, you can choose a level or escalating income, different payment frequencies, guaranteed payment periods of up to ten years and various linked dependant's annuities. Each option has its own cost and it might not always be what you would expect.

Are there better annuity rates available in the market?

Your pension plan providers may well not be competitive in the annuity market. Remember that annuity tables quoted in the press are only a crude sketch. Rates change frequently and are now based on more than just age – for example, your postcode and marital status will often have a bearing on the figure you're quoted.

Do I qualify for an enhanced annuity rate?

If you smoke, have a chronic condition such as diabetes, or have suffered a serious illness, there are several annuity companies that will offer you special rates. Only in rare cases is there any need for a medical examination.

Would any of the annuity alternatives be more appropriate?

The past ten years have seen a steady development of annuity alternatives, such as income drawdown. The attraction of some alternatives has been increased by changes to the tax rules in 2011. However, none will avoid the unisex treatment from 21 December and all involve some degree of investment risk. Generally, these arrangements are likely to be unsuitable unless you have other sources of retirement income.

Finding an answer to these questions is best achieved with the help of expert advice, which we can offer. We have access to full annuity market information and can provide you with a range of quotes based on various options. If you wish to consider annuity alternatives, we are able to offer guidance, drawing on external professionals where necessary.

Past performance is not a reliable guide to future performance. The value of your investments and the income from them can go down as well as up and you may not get back the value of your investment. Tax and pensions laws can change.

The search for income... three years on

Interest rates look set to remain ultra-low following moves by the US, UK and European central banks.

The Bank of England base rate fell to 0.5% in March 2009 and has been unchanged ever since. Across the Atlantic, the US equivalent has remained at between 0% and 0.25% since December 2008. In the Eurozone, the European Central Bank's main rate was cut to 0.75% in July this year, having first arrived at 1% in May 2009 and then enjoyed a brief rise to the giddy heights of 1.5% in summer 2011.

Recent initiatives by the UK, US and the Eurozone central banks point to rates staying at these levels for the immediate future. All three central banks are either operating or planning to introduce new quantitative easing (QE), buying in government bonds and other fixed-interest securities to force down rates.

The US Federal Reserve has said 'exceptionally low levels...are likely to be warranted at least through mid-2015'. UK money markets expect a similar situation to prevail here, although the Bank of England has avoided making as bold a statement as its US counterpart.

Another three years of minimal rates is bad news if you depend upon interest from bank or building society deposits. Once tax is taken into account the interest you earn is probably not even keeping pace with inflation. However, if your primary need is income, there is plenty of scope to boost it, provided you are prepared to forgo the capital security offered by deposits. You may also lose much of the accessibility and liquidity generally offered by cash deposits.

Corporate bond funds invest in interest-paying securities issued by companies. While yields on UK government securities (gilts) have been driven down by QE in the last two years, the fall has not been as dramatic for corporate bonds.

Equity income funds invest in higher yielding shares. Traditionally these funds have concentrated on UK companies, but there is now a growing number of funds that invest internationally. One curious side effect of QE has been that the dividend yields on some major global companies' shares

are now higher than the yields on their corporate bonds. At the time of writing, the average yield on UK shares was more than double that of ten-year government bonds, and higher than the gross rate from the best-paying instant access accounts.

Property funds invest directly into UK commercial property, such as offices and warehouses. The downward slide in long-term interest rates has not been mirrored by any fall in property rental yields. As a result, average yields are over 6%, with some sectors offering more than 8%.

Corporate bond, equity income and property funds are all eligible investments for individual savings accounts (ISAs). In particular, corporate bond funds benefit from being wrapped in an ISA because there is no tax on the interest. Choosing an ISA for equity and property funds will protect you from higher or additional rate tax on their dividend income.

Past performance is not a reliable guide to future performance. The value of your investments and the income from them can go down as well as up and you may not get back the value of your investment. Investing in shares should be regarded as a long-term investment and should fit in with your overall attitude to risk and financial circumstances. If you invest in property there may be a delay in withdrawing your capital, even from a pooled investment. The value of tax reliefs depends on your individual circumstances. Tax laws can change.

Online tax return time

If you missed the 31 October deadline to file your paper 2011/12 self-assessment tax return then, with few exceptions, you must file online by 31 January 2013. Failure to file by the end of January now incurs an automatic £100 penalty – even if HMRC owes *you* money. Filing online is relatively straightforward, but you do need to sign up with HMRC first if you have not already done so – another reason not to leave things until the last moment. Once you start filing online, HMRC will no longer send you paper returns. Instead you will just receive a yearly reminder to file online.

The Dow Jones – this does not compute?

The Dow Jones Index is showing its age.

In August this year, Apple Inc became the most valuable company in the world, with a market capitalisation of over US$600 billion. With the release of the new iPhone 5 in September and the launch of the mini-iPad, at the time of writing the company shows little sign of relinquishing its top spot.

However, Apple is not a constituent of the widely-quoted Dow Jones Index, and 'the Dow' has therefore captured none of Apple's meteoric share price performance. Unless there is a revision in the way in which the Dow is calculated, there is now no way the company can be added to the index now because its share price is so big – over US$650.

The Apple-less Dow serves as a reminder that indices, and the index-tracking funds they spawn, are not always as straightforward as they seem.

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.

Time-out called on NS&I fixed rates

The days of penalty-free fixed-rate savings have come to an end.

The Government does not want National Savings & Investments (NS&I) to raise any fresh money in this financial year. As a result, NS&I have suspended sales of nearly all their fixed-rate offerings, including index-linked and fixed-rate savings certificates.

It was therefore surprising to see a mid-August announcement from NS&I that they were revising the terms of all their fixed-rate range for new issues from 20 September. Only one of the products mentioned, Children's Bonus Bonds (now rebranded Children's Bonds), was on general sale at the time. The most significant and unwelcome change was the introduction of an across-the-board 90-day interest penalty for early encashment.

NS&I automatically reinvest a maturing product in a new issue unless it receives instructions to the contrary, so this could come as a nasty surprise to existing investors in future if they fail to receive or act on their maturity packs. For example, if you have three-year index-linked savings certificates maturing next April, your 'renewed' certificates will have the 90-day interest penalty included in the terms and conditions. The message here is to keep NS&I up-to-date when you move, and not to ignore maturity packs. You may need to make a decision as to whether you can wait the two, three or five years before the next maturity to access your money.

The Financial Services Authority does not regulate National Savings & Investments.

A puzzling employment market

How would your business cope if it lost a key employee next week?

The UK may have only just emerged from a double-dip recession, but you would not think so to look at employment numbers. The latest data from the Office for National Statistics show that the employment rate is at its highest level since spring 2009. The resilience of the employment market has puzzled economists, but its impact is much wider.

For example, it could mean that if your business had to replace a key member of staff, suitable candidates might not be that easy to find. The recruitment process could be longer and more expensive than you would expect during a recession. While you may take some comfort from the idea that difficult economic conditions mean your senior employees are less likely to jump ship, not all employee departures are purely voluntary. A sudden serious illness or death could remove a key employee with no warning and no notice period.

The smaller the business, the more difficult it can be cope with such a disruption. You may need to hire an interim manager or consultant to fill the gap while you search for a long-term replacement, adding to overall recruitment costs. You probably have insurance in place for other unforeseen events that could affect your business, for example buildings insurance and loss of profits cover would usually deal with fire or flooding of your premises. But have you insured your key employees?

If the answer is 'No', why not ask us to provide you with details of the appropriate cover? This can be structured to provide a lump sum and/or a series of payments to your business in the event of the key person's death or serious illness. As a general rule, premiums will be a fully allowable business expense, while payments would be treated as taxable income. The term of the cover can be selected to suit your requirements, so if the employee is crucial to a project lasting for the next three years, then the insurance need only last three years.

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

Autumn (ish) Statement

The days of Pre-Budget Reports are over, but the Chancellor is still required to make an Autumn Statement on the UK's finances. This year Mr Osborne has pushed the exercise to Wednesday, 5 December. Most commentators are not expecting good news because borrowing has been higher than forecast in the March Budget. There is a growing consensus that Mr Osborne will acknowledge he cannot meet one of his debt targets. The Governor of the Bank of England has already helpfully said that such a miss would be 'acceptable'.

ESA U-turn for cancer patients

More people having cancer treatment will receive unconditional financial support following a government concession over the Employment and Support Allowance (ESA).

However, the bad news for cancer patients deemed to be in the 'work related activity group' (WRAG) has highlighted how unwise it is to hope that the state will support you if you're diagnosed with a serious illness.

The Department for Work and Pensions (DWP) announced a number of changes, including that people undergoing a broader range of cancer treatments will be treated the same. More people will now be placed in the ESA Support Group, where the benefits they receive are assured. Previously, some may have been placed in the WRAG, where they would have been expected to try and return to work.

At present only a specified group of those with cancer are treated as having 'limited capacity to work.' They are defined as cancer patients who are receiving or recovering from non-oral chemotherapy, or are likely to receive non-oral chemotherapy within six months. The DWP has accepted specialist evidence showing that it is no longer reasonable to differentiate between non-oral and oral chemotherapy, so it has recognised that all types of cancer treatment have the potential to be equally debilitating.

The cut-off point for ESA will now not start until 12 months after patients have recovered, rather than when they start treatment. The claims process is also being made easier for cancer patients with the introduction of a 'light touch' application process for ESA, instead of having to go through Work Capacity Assessments (WCAs).

The WCA procedure involves face-to-face assessments and lengthy questionnaires. The changes mean a GP's report will be sufficient to show someone with cancer is unfit for work. The move still highlights the overall squeeze on benefits – and there are concerns that those with other serious diseases may lose out. The Comprehensive Spending Review announced that from April 2012 that there would be a 12-month limit on contribution-based ESA for those in the WRAG.

Anyone who is on ESA in this group, and who has a partner who earns more than £150 a week, or has savings of over £16,000, will have their benefit withdrawn after one year. The Government has argued ESA is not meant to be a long-term benefit for those able to work. Income related ESA may still be claimed after the 12-month limit.

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