MORLEY JAMES
ASSET MANAGEMENT

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In this issue:

Don’t fall foul of retirement pitfalls
Annuities - a guaranteed retirement income
The pros and cons of annuities
Inheritance tax (IHT) and nil rate discretionary funds

Inside this issue

Don’t fall foul of retirement pitfalls

A comfortable retirement requires an income, and it can be tricky to know how best to take your pension when you haven't done it before.

But there are some common pitfalls that could trip you up on the way.

Annuities - a guaranteed retirement income

Once you take out an annuity you can’t change your mind – and it’s just one of several options you have for providing a retirement income.

So it’s important to be sure it’s the right choice for you.

The pros and cons of annuities

If you are worried about your retirement, it may be worth evaluating the pros and cons of annuities.

Inheritance tax (IHT) and nil rate discretionary funds

A nil-rate band discretionary trust is a trust used in estate planning to reduce liability to Inheritance tax on the death of a surviving joint spouse or partner.

It can safeguard assets that otherwise could be liable to means testing if the survivor had to go into long-term care.

Welcome to the autumn edition of our quarterly client newsletter, which provides topical financial articles.

Please let us know if you’d like to discuss your financial situation or would like to find out more about our services.

Whatever your financial need, we are always pleased to speak with you.

Don’t fall foul of retirement planning pitfalls

Saving into a pension can be vital if you want to enjoy a comfortable retirement - but watch out for any pension pitfalls that could catch you out.

1. Misunderstanding the cost of living in retirement

It’s important when saving for retirement not to underestimate how much you need to set aside, otherwise you could be left with a significant shortfall once you stop working.

Everyone’s circumstances, needs and desires in retirement are different and it may be that you need more money than you think.

2. Underestimating the length of your retirement

The pension freedoms have given people the opportunity to take money from pension pots early, often before planned retirement ages. This could potentially be storing up trouble for the future, especially if people are underestimating how long these pensions need to last.

3. Relying on your home as your pension

Property can be a reasonable long-term investment, but you shouldn’t put all your money into your home at the expense of your pension. Pensions can have many advantages over property, including tax relief and employer contributions (in the case of most workplace pensions).

4. Not reviewing your pensions

Many people think that just having a pension means they will be financially prepared for retirement, but they don’t always understand that it’s necessary to review these plans on a regular basis in order to get the best return.

If you find you have a shortfall, you may still be able to take steps to increase the chances that your pension pot will be able to achieve the income you want when you retire.

A pension review with a financial adviser could be a wise move, it may give you the chance to go over everything to see if you are heading where you want to.

5. Not assessing all your retirement options

It’s important that you spend time assessing all your options and get good advice, it could be a wise move to seek professional financial advice.

To better understand the choices for using your pension pot, a useful start is Pension Wise – the free and impartial service backed by the government.

7. Thinking you have to stop work completely

Phased retirement can offer many advantages and not just financial. Winding down into retirement can give you time to build up new hobbies helping to enable a smooth transition into full retirement.

8. Falling victim to a scam

For most people in the UK, their pension savings can be one of their largest financial assets, saving towards their retirement over the course of their working lives.

Unfortunately, because of the size of individual pension pots, pension savings can be an attractive target for criminals.

It’s always best to check who you are dealing with and be on your guard if you’re approached about your pension.

The value of pensions and investments and the income they produce can fall as well as rise. You may get back less than you invested.

Annuities - a guaranteed income for life

You can use your pension pot to buy an insurance policy that gives you a guaranteed income for the rest of your life. This is called an annuity, there are many different types.

Type	How it works
Single life	Paid just to you, either for life or for a fixed number of years.
Joint life	Payments continue to your spouse or partner after you die.
Fixed term	Pays an income for a set number of years, then a guaranteed sum which you can invest or use to buy another annuity.
Short term	Stops paying at the end of a set number of years (up to 5 years) or when you die (whichever comes first).
Guaranteed period	Pays out for for at least a guaranteed minimum term even if you die within that term, e.g. you get a lifetime annuity with a 10 year guarantee and die after 7 years, your spouse or partner still gets payments for another 3 years.
Enhanced or Impaired	You may be paid more or you may receive a higher annuity than a standard annuity if you smoke or have a medical condition, e.g. diabetes or high blood pressure.
Escalating	The amount increases each year to reduce the effect of inflation.
Level	Pays a flat amount of income each year.
Investment linked	Tied to the stock market, the amount it pays can vary and depends on the success of the investments.
Capital protected	The amount used to buy the annuity less the annuity payments received to date of death is paid to whoever you leave it to (your beneficiary) if you die, subject to tax.

How an annuity is calculated

How much income you get each year from an annuity depends on things like:

- how much of your pension pot you have used to buy the annuity
- your age
- whether you want the income to increase each year
- whether you want the annuity to pay out to someone after you die
- your health and lifestyle

If the insurance company you bought your annuity with goes out of business the Financial Services Compensation Scheme will cover you in full.

Get advice before taking out an annuity

Once you take out an annuity you can't change your mind – and it's just one of several options you have for providing a retirement income. So it's important to be sure it's the right choice for you.

The value of pensions and investments and the income they produce can fall as well as rise. You may get back less than you invested.

The pros and cons of annuities

Until April 2015, the most common way for people to use their pensions to provide an income over the course of retirement was to buy an annuity.

An annuity can be used as part of a retirement strategy. Annuities are a popular choice for investors who want to receive a steady income stream in retirement.

Savers today have more freedom to choose how to use their funds – so if they don't want to buy an annuity they can invest their pension pot and make regular withdrawals to cover living expenses (income drawdown). With income drawdown the income you get will depend on the fund's performance. It isn't a guaranteed income for life.

Tax-free lump sum

If you decide to buy an annuity you can also usually pocket a tax-free 25 per cent lump sum from your retirement fund, although it may be worth considering not taking the lump sum and leaving your pension alone to continue growing or provide a higher income over the course of retirement.

If you're currently receiving a pension income it's likely that you've already bought an annuity or are taking an income from a final salary or career average (defined benefit) pension.

If you are concerned about paying for retirement, it is worth evaluating the pros and cons of annuities.

Pros of buying an annuity

Guaranteed income

The money you get from an annuity doesn't run out: the provider guarantees to pay you a certain amount at regular intervals. A lifetime annuity will continue for as long as you live (and longer if death benefits are included) whereas a fixed term annuity continues for the specified term.

Protection against inflation

Some annuities – known as index-linked annuities or increasing annuities – pay a higher amount every year in order to counter the effects of inflation. But this feature comes at a cost, and income in the early years will be lower than with a level annuity.

Income for your spouse, partner or chosen beneficiary

A joint-life annuity provides you with an income for life, but then transfers to your spouse, partner or any other chosen beneficiary when you die and pays them a regular income for the rest of their lives.

Cons of buying an annuity

Annuities are irreversible

Once you have entered into an annuity contract, you only have a short period when you can still change your mind (in most cases 30 days). After that you can't change the decision.

Rates can be low

Annuity rates fluctuate therefore if you buy when the rate is low your income is fixed at this rate

No further benefit from investment growth

If you left your money invested in the stock market, you could make considerable gains if the value of your assets rise – this could help provide a more comfortable retirement.

(Of course, the opposite is also true, and you could lose money and see your income and savings diminish.)

Inflation can eat away at your income

If you opt for a level annuity, your income can lose much of its spending power over time as a result of inflation.

The value of pensions and investments and the income they produce can fall as well as rise. You may get back less than you invested.

Nil-rate discretionary trusts to safeguard assets?

A nil-rate band discretionary trust (NRBT) is a trust used in estate planning to safeguard assets on the death of a surviving joint spouse or partner that otherwise could be liable to means testing if the survivor had to go into long-term care.

But you need to be careful of losing entitlement to the residence nil rate band/transferable residence nil rate band when placing some or all of a residence into a discretionary trust on first death.

If a surviving spouse or civil partner needs to go into a care home, quite often the family will need to sell the family home to pay the care fees. By putting a share of the property into trust you could protect the family home as the trust ring fences that amount and takes it out of the surviving spouse or civil partner's estate for means testing by a Local Authority.

Nil-rate band discretionary trusts can also be used to protect assets that are intended to go to particular beneficiaries (i.e. children from a previous relationship) in the event that the survivor remarries.

A discretionary trust is one whose trustees have discretion about how to use the income generated by the assets placed in trust and how eventually to distribute assets to beneficiaries.

Trust created after the first death

If spouses or civil partners whose families would benefit from such a scheme do not take the necessary steps before the first death, the surviving partner and their family can enter into a deed (often called a deed of family arrangement) to create one.

The deed will vary the disposition of the property comprised in the deceased's estate that has already taken place at the time of the death – whether effected by will, under the law relating to intestacy or otherwise (for example, under a right of survivorship in respect of joint property) – in order to put the appropriate scheme in place before the first death of a joint spouse or partner.

Provided this is done within the period of two years after the first death, tax law treats the arrangements as if they had been made by the partner who has died.

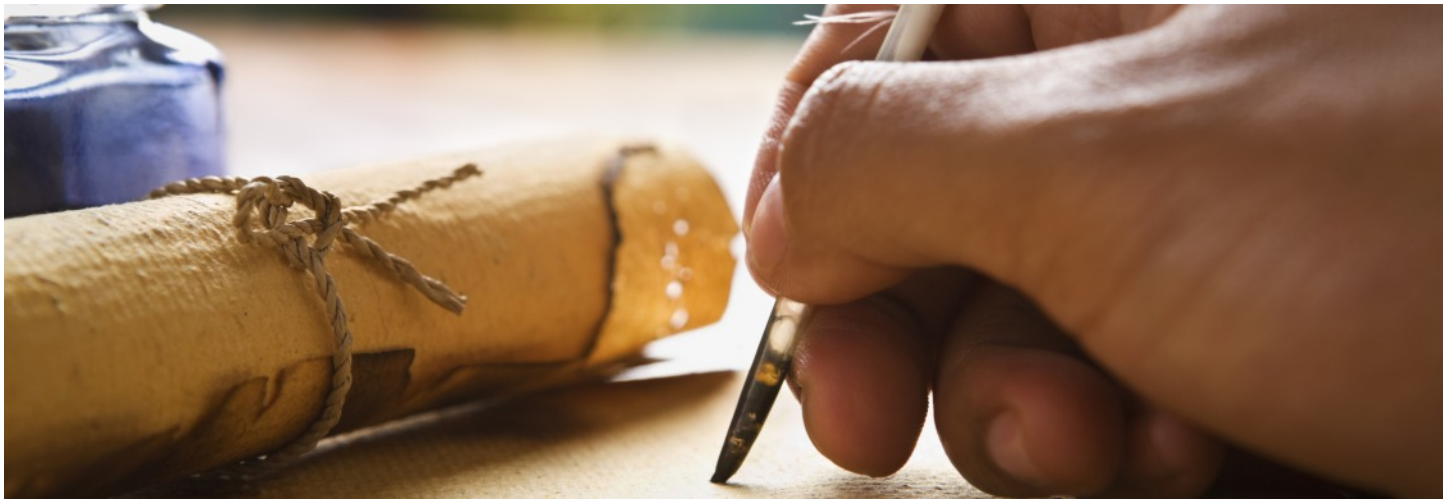
Pre-2007 popularity of NRBTs

Pre-2007 nil-rate band discretionary trusts were frequently included in wills but declined significantly following the introduction of the transferable nil rate band for spouses and civil partners.

In some circumstances it can still be advantageous to retain the trust in an existing will or add into a new will.

Tax treatment varies according to individual circumstances and is subject to change.

The Financial Conduct Authority does not regulate some aspects of auto-enrolment, tax advice, wills or trusts.



Morley James Asset Management

Avon House, 435 Stratford Road, Shirley,
Birmingham B90 4AA

Tel: 0121 746 3139
Mobile: 07802 290033
james@morleyjames.com

www.morleyjames.com

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