News – August 2015

Deposit protection to fall

The compensation for lost deposits is to be cut by £10,000.

On the first Friday in July, a few days before the Budget, the Prudential Regulatory Authority (PRA) announced that the level of Financial Services Compensation Scheme (FSCS) protection for depositors was to be cut with immediate effect from £85,000 to £75,000. The PRA, which is part of the Bank of England, blamed the change on the requirements of the European Deposit Guarantee Schemes Directive. The Directive says that non-Eurozone countries must recalculate their deposit protection limit every five years, setting it at the equivalent in their domestic currency to €100,000, albeit with some judicious rounding permitted.

As sterling has strengthened considerably against the euro since mid-2010, the protection given to deposits has dropped. However, as the Directive only sets a *minimum*, the Treasury did make some concessions:

- If your deposits were previously protected by the FSCS, you will continue to be covered at the old £85,000 level until the end of the year. Thus for most practical purposes the new limit will not bite until 1 January 2016.

- Temporary high balances of up to £1 million will be covered for six months from the date on which the money is transferred into the account, or the date on which the depositor becomes entitled to the amount, whichever is later. This covers money arising from a list of specified events, including property sales or funds received on redundancy, inheritance or divorce.

- The PRA is consulting on a way to allow depositors to withdraw funds between the old and new limits without penalty until 31 December 2015, if they experience a decrease in deposit protection as a result of the limit change. This could be something of a catch-22, as switching out of a fixed-term deposit could well mean accepting a lower interest rate elsewhere.

If the change affects you, now could be a good time to review with us whether you need to hold so much cash on deposit. After all, it is probably earning little more than 1% - and that's before tax.

Interest rates to rise

The Governor of the Bank of England (BoE) is hinting at interest rate rises again.

"It would not seem unreasonable to me to expect that once normalisation begins, interest rate increases would proceed slowly and rise to a level in the medium term that is perhaps about half as high as historical averages. In my view, the decision as to when to start such a process of adjustment will likely come into sharper relief around the turn of this year."

Those measured words, delivered by the BoE Governor Mark Carney in a lecture at Lincoln Cathedral, were the latest indication that the 0.5% base rate, born in March 2009, may not survive until its seventh birthday. Mr Carney has some unfortunate form in talking about interest rate rises, but in that all-too-dangerous phrase, this time it's different. For a start, the rate of inflation will begin to pick up towards the end of the year, as last year's sharp fuel price cuts drop out of the yearly figures. At the same time earnings growth has been increasing – the latest statistics show an annual increase (including bonuses) of 3.2%. Unemployment remains at relatively low levels and the figures for overall economic growth released in late July showed that the economy had bounced back from the first quarter's disappointing 0.4% growth.

A further factor, although probably not one that the Bank would own up to, is that US interest rates also look set to rise by the end of the year. In a July presentation to the US Congress, Janet Yellen, Mr Carney's American counterpart, suggested that the conditions for an interest rate increase (from a 0%-0.25% range) would arrive "sometime this year". She also echoed Mr Carney's view that once rates started to move upwards, the path would be gentle and rates would remain below the level viewed as "normal in the longer run".

All of which means that your bank and building society are unlikely to pay you very much more interest on your deposits in 2016. However, unless you are an additional rate taxpayer, changes due in 2016/17 will mean you have up to £200 less tax to pay on your interest. If your need is income, then there are plenty of other options that can provide a higher income return. For example, the 2016/17 dividend reform announced in July's Budget will allow you to receive up to £5,000 of dividend income with no tax to pay, regardless of your personal tax rate.

Doffing the care cost cap

The proposal for a care cost cap in England has been put on hold.

Back in 2011, the Dilnot Commission proposed a cap of £35,000 on lifetime personal liability for care costs. The Commission's report was the latest in a long line of government enquiries into the thorny issue of funding long term care in England and at one point looked destined to join its predecessors in the long grass. However, while the then government did not accept Dilnot's £35,000 figure, it did eventually propose a £72,000 ceiling on personal costs from April 2016. The necessary framework was legislated for in the Care Act 2014, along with a number of other important changes, notably a large increase in the upper capital limit for means testing to £118,000.

Less than ten months before these new rules were due to take effect, the Department of Health made a Friday announcement that they would be put on hold until April 2020. In a letter to the Chair of the Local Government Association, the Minister of State for Community and Social Care said "A time of consolidation is not the right moment to be implementing expensive new commitments such as this". The comment is all the stranger when you remember that in March 2013 the Chancellor extended a freeze on the inheritance tax nil rate band for three years as "part of the package to fund a cap on reasonable care costs". In the Summer Budget that freeze was extended for another three years to April 2021.

The Conservative's election manifesto had said "we will cap charges for residential social care from April 2016", so this was a serious U-turn. Some commentators suspect that the deferral was the first stage in a process of killing off the care cap completely. Ironically another government measure announced in the Summer Budget, the introduction of the Minimum Living Wage, is expected to push up social care costs significantly, adding to the long run cost of implementing the cap.

One of the lessons that can be drawn from this story is that your long term care is not something you can leave to the government: it needs to be integrated into your retirement planning so please get in touch with us – we can help.

The trouble with averages

Knowing what the average is may not be as helpful as you think.

One of the facts which often appears in personal finance surveys is that people tend to underestimate how long they will live. At a time when retirement provision is increasingly becoming a personal rather than state responsibility, that could mean running out of money before running out of life.

If you want an idea of what the average life expectancy for your age is, there are plenty of websites to help you. One of the simplest – and arguably most independent – comes from the Office for National Statistics (http://visual.ons.gov.uk/how-long-will-my-pension-need-to-last/), using the basis underlying UK population projections. For example, if you are a 55 year-old man, the site will tell you that your average life expectancy is 86 years. If you are a woman of the same age, you can add another three years to that figure.

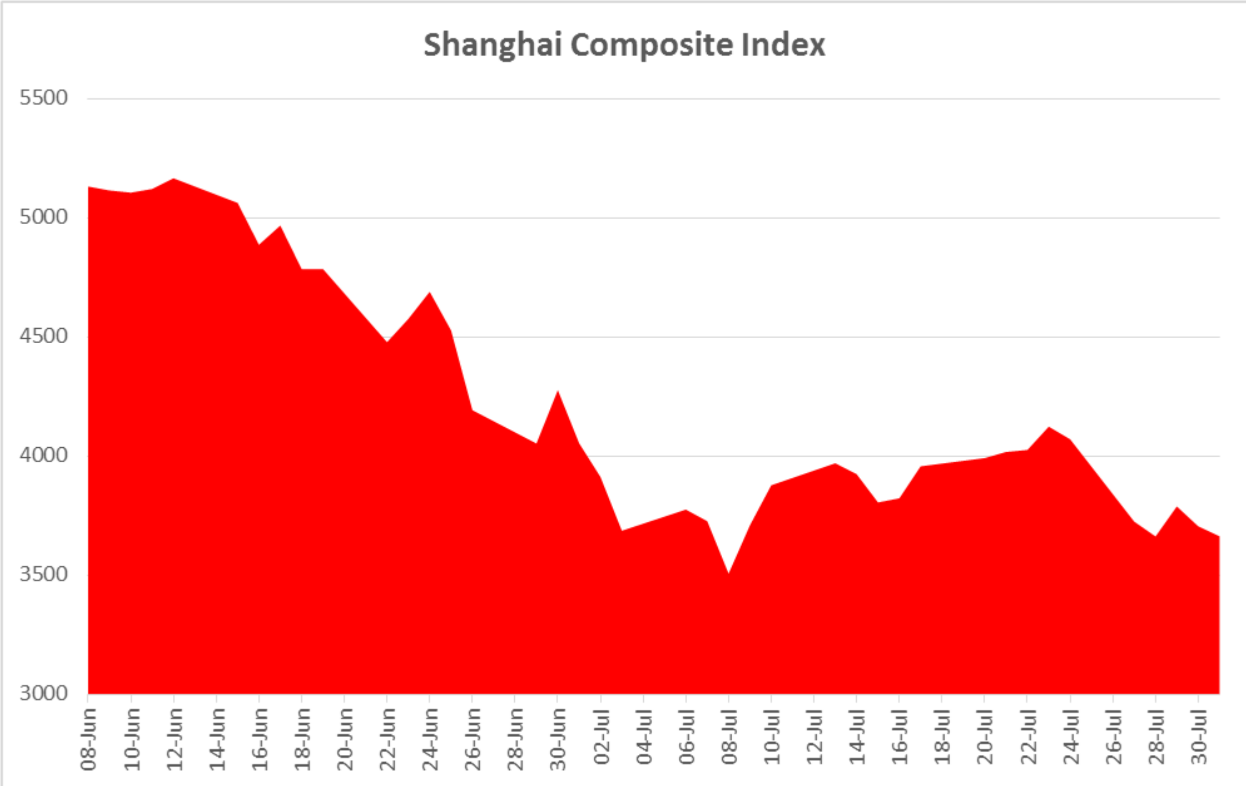
All well and good, but these are *averages* and that means there is roughly a 50% chance you will live longer. Just how much longer could be a significant period. The ONS number crunchers say that a 55 year-old man has a 1 in 4 chance of reaching age 95 and again a woman can add another three years, bringing her to 98. There is 17.2% chance – roughly 1 in 6 – that the longer-living sex will survive until 100: for men the odds are 10.9% – still about 1 in 11.

Today's 55 year-old will reach state pension age in about 11 years' time, so even on the average numbers they will spend 20 or 23 years in retirement. Adding another nine years – the 1 in 4 chance – means an increase of nearly half for men.

Would your current pension provision last that long..? We are here to help with your pension planning.

Chinese whimpers not whispers…

The Chinese mainland stock markets have had a torrid two months.



On 9 June MSCI, a major provider of global stock market indices, announced that this year it would not be including in its Emerging Markets Index mainland China shares (A-shares) listed in Shanghai and Shenzhen. The decision had been widely awaited and the two Chinese stock markets had rallied strongly, partly in anticipation that MSCI would say 'yes', which would have prompted a surge of buying from tracker funds.

With hindsight – a very useful tool for investment – MSCI's 'no' looks to have been the point at which Chinese investors – mainly private individuals, not institutions – took fright. As the graph shows, the Shanghai market dropped sharply after the MSCI news and despite a few brief rallies and the best efforts of the Chinese authorities, remains down substantially from its early June peak.

Whether the Chinese market is now a bargain is impossible to say. It is certainly a lot cheaper than it was two months ago. However, nobody is sure how much of the current price is built on government support and what would happen if and when that were taken away. In the longer term what is certain is that Chinese A-shares will indeed get the nod from MSCI and become an important part of the international investment scene.

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.