CHANGES TO INHERITANCE TAX?
Simplified rules could alter your estate planning

SPOTLIGHT ON STUDENT FINANCING
Post-18 education review may lead to a shake-up in university fees

MANAGING THE FLOW
Future-proofing your retirement finances

AUTUMN 2019 UPDATE

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Whither Brexit?

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To say we're living in interesting times may feel like an understatement. It's almost impossible to avoid the headlines whether you focus on Brexit, international markets or climate change. But can that focus actually harm your long-term investment strategy? Recent research has shown almost three-quarters of investors are influenced by short-term political developments. However, as our feature explores, taking a long-term view may be more productive for your portfolio, and less stressful. We also investigate some developments on inheritance tax which could have important implications for your estate planning. And for those sending children to university this autumn, a report on the structure of student finances could play a role in future funding. With additional pieces on pension contributions and cash flow planning into retirement, that long-term view may work in more ways than one.

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PLANNING

The lasting power of peace of mind

Many people choose to write a Power of Attorney (PoA) alongside a will, but they are not just for later life.

While a will sets out how your estate should be divided after your death, a PoA concerns who should look after your welfare and/or finances if you are no longer able to make decisions yourself.

They are not just relevant, however, for the elderly or those in failing health. PoAs can be set up years in advance before they are used – accidents and illness can happen at any time of life. Nor do you need substantial assets; at the simplest level PoAs can, for example, allow your designated attorney to access your bank account and ensure that bills get paid.

In Scotland, there are three types of PoA:

- A Continuing PoA, which deals with financial matters;
- A Welfare PoA, which concerns health and personal care decisions; and
- A Combined PoA, which covers both.

To be valid, a PoA certificate needs to be signed by a solicitor (registered to practice in Scotland), a member of the Faculty of Advocates or a medical doctor, and then registered with the Office of the Public Guardian (Scotland).

PoAs do not automatically give attorneys immediate access to your finances. You have to give express permission before an attorney can use these powers or be deemed mentally incapable of looking after your own affairs.

It's important to select someone as an attorney who you trust to put your interests first. You can appoint one or more who can be a spouse, relative or close friend. You can also appoint an organisation, such as a local solicitors' firm, but only to look after financial matters.

You may never need your PoA, but should your health fail at any point, it can provide peace of mind that a trusted friend or relative would look after your affairs.

✢ *The Financial Conduct Authority does not regulate will writing, trusts and some forms of estate planning.*

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TAX

Simplifying the inheritance tax rules

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Major changes to inheritance tax (IHT) are proposed by the government's Office of Tax Simplification (OTS) which could alter your estate planning.

Inheritance tax is certainly complicated – especially for a tax that generates relatively little revenue. The OTS has spent some 18 months looking at it and has now produced two linked reports. The second and more important one, dealing with the structure of the tax, was published in July 2019, just as the man who commissioned it, Chancellor Phillip Hammond, was about to leave office.

The latest OTS report contains a wide range of proposals that could have a big effect on your estate planning. These include:

- You should only have to live for five years – not seven, as now – before a lifetime gift ceases to be subject to IHT. At the same time, the little-understood taper relief should also be abolished. This can reduce the amount of tax payable on lifetime gifts made more than three years before death, but it applies to relatively few estates.
- The rules for IHT business property relief (BPR) should be brought in line with those for capital gains tax (CGT), which would result in fewer businesses qualifying for the relief. Alongside this change, the CGT rules at death should be reformed.
- The current £3,000 annual exemption and the marriage/civil partnership exemption (up to £5,000 for parents) should be replaced with a new single 'personal gifts allowance'. The OTS made no specific recommendation but it pointed out that the annual exemption would now be worth just under £12,000 if it had been inflation-proofed since its last increase.
- The level of the small gifts exemption (originally set at £250 in 1980) should be reconsidered. Again, the OTS made no specific recommendation but it did say that inflation-linking would have increased the amount to just over £1,000.
- The rules for normal expenditure gifts should be reformed or should be replaced by a higher personal gifts allowance. This exemption is potentially valuable, but according to the OTS is regarded as confusing, difficult to claim and often not included in planning.
- Pay-outs under term assurance policies should be free of IHT. Currently, it is necessary to write such contracts under trust to keep them out of the policyholder's estate on death.

The latest OTS report contains a wide range of proposals that could have a big effect on your estate planning.

Philip Hammond responded to the report by saying that "The government will consider the recommendations...and will respond in due course" The new Chancellor Sajid Javid will probably echo his view, although in the short term his priorities are likely revolve around Brexit.

Like most reforms, the OTS proposals would create winners and losers. To understand which category you would fall into, and any pre-emptive actions that can be taken with your financial planning, please talk to us.

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

The Financial Conduct Authority does not regulate will writing, trusts and some forms of estate planning.

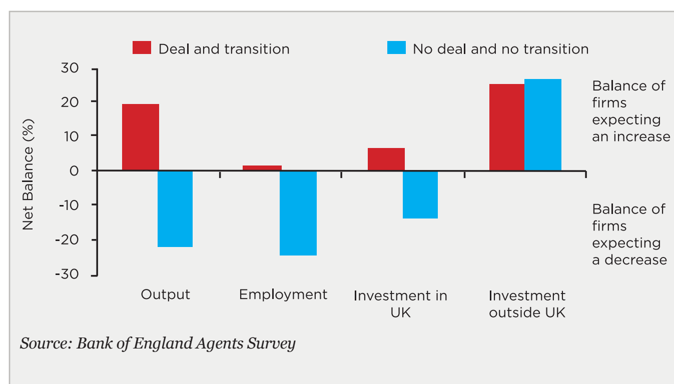
For specific tax advice please speak to your accountant or tax specialist.

Whither Brexit?

The UK was scheduled to leave the European Union (EU) at 23:00 UK time on 29th March 2019. However, after the UK parliament failed to approve the Withdrawal Agreement, it was granted an extension by the EU with a new deadline set for 31st October 2019.

The UK economy has remained relatively stable since the vote to leave and employment has reached historic highs.

Given the current fluidity of the political landscape in the UK, it is nigh impossible to forecast what the outcome of the Brexit process will be. In terms of the likely economic impact of possible different Brexit scenarios, the Bank of England Agents' survey of firms' expectations points toward probable short-run economic costs in the event of a no-deal and no transition scenario:



Source: Bank of England Agents Survey

AGENTS' SURVEY ON BREXIT EXPECTATIONS

[1]"The Economic Outlook: Fading global tailwinds, intensifying Brexit headwinds", speech given by G. Vlieghe, external member of the Monetary Policy Committee, 14th February 2019.

Since the Brexit referendum, the US dollar has increased in value by 21.89% compared to the pound, and the Euro has strengthened by 19.42%[2] . However, the sterling weakness has proved to be a boost for UK stocks, particularly those of larger companies.

The reason for this is that more than two thirds (70%) of the revenues of the companies listed on the FTSE All-Share index are generated overseas. When the profits from those revenues are converted from a strengthening currency back into sterling, they are worth more[3].

In the immediate aftermath of the referendum, the FTSE 100 and the FTSE 250 fell 9% and 12%, respectively. But since the close of the market on 23rd June 2016, UK shares, as measured by the FTSE All-Share, have risen 30.40%[4].

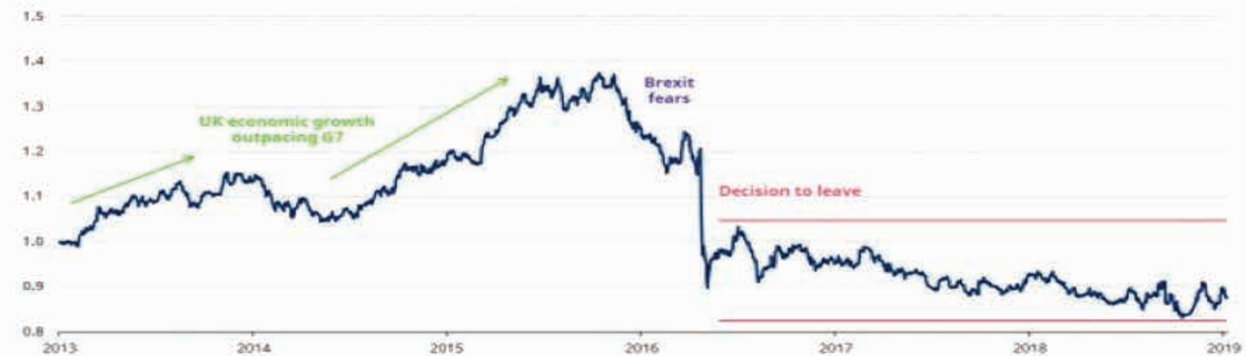
However, the UK stock market has lagged global stocks in the major economic areas. Since the Brexit vote, for instance, the S&P 500 Index in the US has returned 77.06% and the European Index of the major 600 companies, the Euro STOXX 600, has returned 44.69%. An index of global stock excluding the UK, the MSCI World ex UK, has returned 67.30% since the Brexit referendum[5].

During the period from mid-2013 through to the end of 2015, when the UK economy outperformed the global economy and sterling was strong on the foreign exchange market, UK domestic companies outperformed UK overseas earners. The situation was exactly reversed after the Brexit referendum, with UK domestics significantly underperforming since the vote to leave the EU. Exchange rates were a major driver of this reversal. However, it was also in large part due to UK domestic companies suffering a "de-rating" amid fears the UK economy would grow at a lower rate going forward outside the EU[6].

UK domestic shares have been most out of favour...

...and seen a significant de-rating

UK domestics / UK overseas earners relative price



Past performance is not a guide to future performance and may not be repeated.
Source: Thomson Reuters Datastream, Exane BNP Paribas estimates, data from 4 March 2013 to 11 March 2019.

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Schroders

As far as the impact on financial markets of different Brexit scenarios is concerned, it is likely that it will hinge on the movement of the pound compared to other major currencies, barring any unforeseen economic recession.

[2] Data sourced from FE Analytics, as of 2nd of August 2019.
[3] Schroders, In Focus – Markets, "Brexit three years on: markets and the economy in six charts", 21st June 2019.
[4] Data sourced from FE Analytics, as of 2nd of August 2019, cumulative total return in GBP.
[5] Data sourced from FE Analytics, as of 2nd of August 2019, cumulative total return in GBP.
[6] Schroders, In Focus – Markets, "Brexit three years on: markets and the economy in six charts", 21st June 2019.

Sterling weakness is likely to prove to be a boost or at least a support for companies generating most of their earnings overseas, whereas it might prove to continue to be a headwind for UK domestic companies.

Overall, the UK stock market still presents an opportunity as it is undervalued along many metrics, such as dividend yield and price to earnings ratio. Therefore, being invested in a diversified fashion along all market segments, i.e. large medium and small cap companies, should still prove to be the best approach to reap the opportunities and hedge the risks that Brexit will create.

In the final analysis, trying to time the market, especially around a political event of a magnitude such as Brexit, is a futile endeavour and it is important to remain invested for the long-term in order to reap the benefits of compounding returns.

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EDUCATION

Time for a university fees shake-up?

A review of post-18 education in England has put student financing under the spotlight yet again – and could be the subject of another bout of reform.

The review was partly in response to growing criticism of the level of university tuition fees. But it also comes as new National Statistics methods mean that student financing will soon account for a substantially larger proportion of the national debt.

Fees vary throughout the four constituent parts of the UK, with England having the highest overall. English students will pay up to £9,250 wherever they study in the UK, unless they go to Wales, in which case the maximum is £9,000. Scottish students studying in Scotland remain free of tuition fees, while those from Northern Ireland who stay home only pay £4,160.

The review, chaired by Dr Philip Augar, suggested several major reforms. While these focused on the system in England, they could well prompt a response from other parts of the UK as well.

- The cap on university tuition fees should be reduced to £7,500 a year by 2021/22, frozen for 2022/23 and then should be inflation-linked from 2023/24.
- For new students from 2021/22, the annual income threshold at which loans start to be repaid should be cut from £25,000 to £23,000 (in 2018/19 values). The loan repayment rate should remain at 9% of income above the threshold.
- The maximum repayment term for new students should be extended from 30 to 40 years.
- A cap should be put on lifetime repayments at 120% of the initial loan amount, adjusted for inflation.
- Means-tested maintenance grants should be reintroduced and the eligibility thresholds revalued in line with inflation.

A surprising consequence of the proposals is that the total repaid by the highest-earning graduates would be less than under the current rules. But those on 'middle of the range' graduate earnings could end up paying a lot more as a result of the ten-year extension of the repayment term.

These proposals would change important aspects of student financing, but most graduates would still start their working lives with a substantial amount of inflation-linked debt. Some will end their working lives 40 years' later in a similar situation.

If you have children or grandchildren heading for university in the coming years, you should factor their education costs into your planning.

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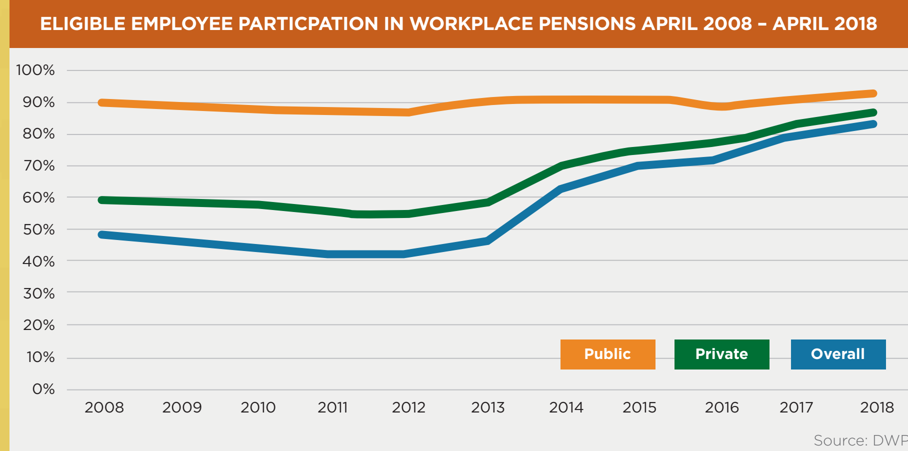
PENSIONS

Workplace pensions – good start but not enough

This October marks the seventh anniversary of the start of workplace pension auto-enrolment, perhaps proving that some grand government schemes can be a success.

There was much scepticism when the first phase of automatic enrolment into workplace pensions began in October 2012 – an earlier attempt to encourage workplace provision through the launch of stakeholder pensions had been a failure. After the initial phase focused on the largest employers, there was doubt around how small and micro-employers would handle the administrative burden.



INCREASED PARTICIPATION

As it turned out auto-enrolment has hugely increased the number of people in workplace pensions. Back in 2012, before the start of the initiative, only about four out of ten eligible private sector employees were members of workplace pension arrangements.

By April 2018, nearly nine out of ten eligible employees were workplace pension members (85% in the private sector, 93% in the public sector), according to recently issued figures from the Department for Work and Pensions (DWP). A sharp rise in the minimum level of overall contributions from April 2018 does not appear to have dented employee enthusiasm. Another minimum contribution increase took effect from this April, seemingly with similar acceptance, although there are no firm figures yet.

CONTRIBUTION GAP

Pension contributions for employees are still too low however and need to be increased, as the government acknowledged in a review issued in late 2017. The review suggested that around 12 million people were "under-saving for their retirement", with most of those under-savers earning more than £25,000 a year.

Higher earners are more likely to be not contributing enough because there is no longer any earnings-related element to the state pension. The new flat rate state pension introduced in April 2016 (£168.60 a week in 2019/20) represents a smaller proportion of earnings at retirement for those on higher pay.

However auto-enrolment has left one sector of the working population untouched – the self-employed. Their numbers have been growing rapidly – think gig economy – to the point where they account for about 15% of the UK labour force in 2017. Yet pension participation among the self-employed has fallen. According to the DWP, "the self-employed group has seen a continuous decline in [pension] participation from 27% in 2008/09 to 15% in 2017/18".

MEETING THE GOALS

The government will probably find some mechanism to raise minimum contributions again, although this may not happen until the middle of the next decade.
Meanwhile:

- If you are an **employer**, remember that every three years, or earlier if they meet certain criteria, you must re-enrol any employees who have left your pension scheme.

- If you are an **employee**, talk to us about whether you need to pre-empt that contribution increase to meet your retirement goals.

- If you are **self-employed**, make sure that you are not among the 85% who do not contribute into a pension.

✢ The value of your investments, and the income from them, 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 with your overall attitude to risk and financial circumstances.

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PROTECTION

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Mind the insurance gender gap

Women generally insure themselves for much smaller sums than men, although both buy life insurance and critical illness cover in roughly equal numbers.

The average level of cover for a man's life insurance policy is around £130,000, but only around £85,000 for women's policies, according to an analysis of policies by software company IRESS. The gap is even larger with critical illness policies, which pay out if you are diagnosed with one of the listed critical conditions. Here, the average cover taken out by women is, around half the average cover for men.

On average, women earn less than men, by about 10% according to the latest gender pay gap figures. But that isn't enough to explain the huge difference in levels of cover, which indicate that women seem at higher risk of being under-insured than men.

Insurance experts say couples tend to buy more life insurance for the higher-earner. But both partners should have adequate protection — most families depend on two incomes and a reasonably equal share of childcare.

PLANNING

Future-proofing your retirement finances

The unknowns in your financial outlook can always shift, especially when you come up to retirement.

One of the best tools for looking at the future is using long-term cash flow planning to project your expenditure and the income you'll need to meet it. You may not be able or wish to continue working to shore up against future financial challenges, so estimating your likely expenditure before considering your potential sources of income and capital over the coming years is a good place to start.

CHARTING EXPENDITURE

Balancing this equation becomes even more important as you think about how stopping or reducing work will impact on your lifestyle and spending habits. Housing is a major issue. You may have paid off your mortgage, but you might want to move to another property or even another area or country.

iStock/gilaxia

For many people, early retirement is a time for high activity levels in terms of travel, social life and pursuing interests; later this might reduce as they decide to take life easier.

Your expected levels of expenditure will vary as these assumptions change. It helps to define your expenditure as core and essential – such as utility bills which are unavoidable – and what could be dropped if the financial resources were not there to cover it, such as eating out regularly.

MAPPING INCOME SOURCES

The other side of the picture is assessing the income and capital resources with which to meet your expected outgoings. These could include earnings from work, state and other pensions and rental income, as well as total returns from savings and investments. It makes sense to explore a range of scenarios for investment performance across your different sources of income. Projections can range from the very positive to the more pessimistic.

The actual cash flow projections will map these potential expenditure and income outcomes to show whether you are likely to have a deficit or a surplus over your expected lifetime.

For a surplus, you might want to consider whether to increase your expenditure, which could include making gifts to your family. A deficit forecast may mean you should reconsider your spending plans and see where you can make cost savings. If you have the choice, you might want to rethink your retirement date and focus on additional pension or other saving.

It is hardly surprising that long-term cash flow modelling has grown into one of the most valuable tools for financial planning.

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KLO Financial Services Ltd
The Old Drill Hall
2 Trinity Mews, Priory Road,
Warwick CV34 4NA

t: 01926 492406

Grosvenor House
11 St Paul's Square
Birmingham
B3 1RB

t: 0121 726 4720

Unit 4.07, The Tea Building
56 Shoreditch High Street
London
E1 6IJ

t: 07837 359113

e: enquiries@klofinancialservices.com
e: enquiriesbirmingham@klofinancialservices.com
www.klofinancialservices.com

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