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More than half unprepared for retirement

Recent research by Aviva reveals more than half the UK population is financially unprepared for retirement. This is 12% higher than five years ago. (Source: Aviva survey – Consumer attitudes to saving.)

Worryingly, the research also showed that nearly half the population still believe their home will give them the financial security they need in retirement.

If you are worried about your retirement preparations, talk to your Positive Solutions IFA Partner.

Final-salary pension schemes – the future

There has been much coverage about the future of final-salary pension schemes in the media recently. In this article we look at what a final-salary scheme is, why they are in danger, and the impact on members of these schemes.

What is a final-salary scheme?

A final-salary scheme is an employer's occupational pension scheme. There are two types of occupational pension scheme.

- **Defined benefit schemes**

These schemes set out to provide a guaranteed retirement income, usually calculated as a fraction of salary for each year of pensionable service. The salary may be salary at the point a member retires, in other words final salary. But, other definitions of salary may apply, for example, career average salary.

A final-salary scheme is, therefore, a defined benefit scheme.

Because a final-salary scheme provides a guaranteed income, an employer must pay whatever it takes to meet the scheme's liabilities. We can, therefore, consider a final-salary scheme as 'known benefit – unknown cost'. This is what makes the employer's commitment open ended.

- **Defined contribution schemes**

Here an employer decides on the contribution, usually expressed as a percentage of salary. These contributions when added to any employee's contributions are invested to produce an individual pension pot for each employee. When an employee retires the pension fund that has built up provides an income for life. There are several ways of providing this income but this is outside the scope of this article.

You may sometimes hear these schemes called money purchase schemes.

Because the contribution is fixed but the eventual retirement benefits are not, we can consider a defined contribution scheme as 'known cost – unknown benefit'.

Advantages and disadvantages of final-salary schemes

Historically, membership of a final-salary scheme has been one of the most valuable perks an employer could offer. The eventual retirement income is guaranteed and it bears a real link to pre-retirement income.

From an employer's perspective, final-salary schemes are expensive and add up to a commitment to pay whatever it costs to provide the agreed scheme benefits. In the early days this wasn't too much

of an issue. Life expectancy was lower than today. Therefore, as the eventual benefit was merely a promise to pay at retirement, the scheme could assume that a certain proportion of the membership wouldn't survive until retirement. Those that did survive, on average, didn't live so long as today, so the cost of providing the retirement benefits was lower.

Added to this, years of higher interest rates and high rates of stock market growth resulted in final-salary schemes carrying surplus funds. Some employers were even able to suspend paying contributions.

So why are they suddenly an endangered species?

Increased life expectancy, layers of legislation that improved members' rights but added cost, lower interest rates and poor investment conditions combined to create a perfect storm. Suddenly, instead of projecting surpluses, final-salary schemes were projecting large shortfalls. Employers had to react as the cost of closing some of these funding gaps threatened to cripple some well-established companies.

The first step many employers took was to close their schemes to new members, setting up a defined contribution scheme for them while preserving the final-salary scheme for its existing members. However, lately, more and more employers have taken the ultimate step, closing their final-salary schemes altogether.

What about the members?

While these steps have safeguarded jobs and the future of some companies, there is an inevitable result for members of final-salary schemes. In one hit, employers have passed the investment risk and the longevity risk from themselves to their employees.

If you are in this position, the benefits you accrued while in your employer's final-salary scheme should be safe, providing the scheme is solvent or your employer is able to close any funding shortfall. What you have lost is any entitlement to accrue any more benefits.

Your employer may have replaced your final-salary scheme with a defined contribution scheme; if so you are still getting something. However, the onus is now on you to plan for the retirement income you need.

If your retirement plans are suddenly looking uncertain, contact your Positive Solutions IFA Partner for the right help and advice.

The guaranteed benefits rely on the financial strength of the employer and any pensions fund and their ability to fulfil their commitments. The failure (e.g. bankruptcy) of the employer or fund may result in the loss of some or all of the capital and/or income guarantees.



New ISA investment limits

In his 2009 budget, the Chancellor announced that, from 6 April 2010, he would increase the annual Individual Savings Account (ISA) savings limit to £10,200, of which up to £5,100 may be saved in cash. This means you can save up to £10,200 in the next tax year and pay no personal tax on any income or gains. However, the even better news is those of us already aged 50 or over don't have to wait until next April, but can use this higher limit now.

Now may be the perfect time to review your ISA savings for several reasons:

- if you are 50 or over, the new higher limit means you may invest money that you may have thought you had to wait until April to invest
- your current cash ISA may no longer offer a competitive interest rate – did you know you can transfer your ISA savings to one that does?
- be sure you are making the most of your ISA potential by investing in cash, shares or both.

With savings rates at record lows, make sure your money is working for you as hard as possible. Contact your Positive Solutions IFA Partner for a review.

Deposit accounts – look beyond the headline rate

In times of recession, people understandably choose to save far more of their disposable income than normal. This recession has been no different. In fact, the savings ratio – household savings as a percentage of income – is up to 5.6%, its highest since 2003. (Source: Office for National Statistics.)

However, one of the biggest challenges in these uncertain times is finding the best home for your savings.

Many people still rely on the interest from bank or building society accounts, even though the Bank of England base rate has fallen to its lowest level in the bank's 315-year history. If you're saving in a bank or building society account, is your money working as hard for you as it can?

You may still like the security of having money in the bank for a

'rainy day'. But if you have extra capital to invest, it's worth thinking about the range of other investment options available to suit your circumstances and attitude to risk. There are countless alternatives, whatever your savings objectives and attitude to investment risk. Some even offer guarantees.

If you want to discuss your savings, talk to your Positive Solutions IFA Partner.

The level of security of your deposits relies on the financial strength of the provider and any counterparties and their ability to repay the deposit on demand. The failure (e.g. bankruptcy) of the provider may result in the loss of some or all of the original capital and/or income.

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Gilts explained

When public spending exceeds the tax take, the government makes up the difference by borrowing.

One way in which the government borrows is by issuing bonds, or what we otherwise know as gilt-edged securities or gilts. Gilts are traded publicly on the stock market.

Gilts are viewed as being as close to a guarantee as you can get on the basis that the UK government has never defaulted. However, they can never be viewed as completely risk free as there is always the risk that a government may default in the future. In this article we try to shed some light on gilts and how they work.

Stock name

At issue, gilts carry a nominal, or par value, of £100. The stock name details its coupon and the year the government will redeem it. For example, 8% Treasury Stock 2015 carries a coupon of 8% and will be redeemed in 2015.

Coupon

The coupon is the rate of interest the government will pay. You will see this expressed as a percentage of the par value. So with the 8% Treasury Stock 2015, the government will pay £8 a year until 2015.

Redemption date

This is the year in which the government will redeem the gilt at its par value of £100. Some old gilts, such as 3.5% War Loan, have no redemption date and therefore the government is under no obligation to redeem them.

Interest yield

Gilts are heavily influenced by movements in interest rates. The current yield reflects the coupon as a percentage of the current price. Generally speaking, as interest rates rise gilt values fall; as interest rates fall gilt values rise. This happens to align the coupon more closely with prevailing interest rates.

Looking at 8% Treasury Stock 2015 again, at close of business on 9 November 2009 the price of this stock was £126.80

and the published interest yield was 6.33% (source: ft.com) This looks like an attractive return when compared with current interest rates, but you also need to consider the redemption yield.

Redemption yield

The redemption yield reflects the return you will achieve on the stock by holding it until its redemption date. Therefore, it considers the interest you will receive, and the £100 redemption value compared with the price you paid for it. Again, we will use 8% Treasury Stock 2015 as our example.

If you bought this stock on 9 November for £126.80 and hold it until redemption you will make a capital loss of £26.80. So although the current interest yield may be 6.33%, once you take your potential loss into account, your total return from when you bought it until redemption is much less. On 9 November 2009 the redemption yield of this stock was 3.12% – a more realistic return in the current climate but still better than many deposit accounts are paying.

Index-linked gilts

Unlike conventional gilts, index-linked gilts do not have a fixed coupon or redemption value as both of these are adjusted to take account of movements in the retail prices index. Because of this hedge against inflation, the coupon will tend to be lower than the coupon on a conventional gilt.

Gilts as an investment

Because of their low-risk nature, gilts are never going to offer spectacular returns. This is a simple risk versus reward comparison – low risk means low reward. However, gilts and other kinds of bonds do have a part to play in a balanced and diverse investment portfolio.

Rather than buying individual gilts, there are pooled investment funds that invest in a diverse mix of gilts and bonds, managed by experienced investment managers. If you think gilts may have a role to play in your investment strategy, talk to your Positive Solutions IFA Partner.



If you wish to discuss your financial planning needs, or any other content in this newsletter, please contact your Positive Solutions IFA Partner.

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