ETHICAL INVESTORS

ETHICAL FINANCIAL MANAGEMENT

Personal Pensions Supplement:

The Pensions Credit

2015

Introduction

When the pension Minimum Income Guarantee was introduced in 1999, there was considerable press comment about whether it was worth some people saving via a personal pension at all. In particular, people on low earnings could be put off saving for their retirement because by having their own pension plan they may have lost out on means-tested state benefits, leaving them no better off than if they had not saved at all. The dilemma was often referred to as the "savings trap".

Many Financial Advisers were naturally cautious of arranging pensions for low-to-average earners because they could be accused of mis-selling if the individual effectively lost benefits under the Minimum Income Guarantee as a result – damned if you do, damned if you don't.

In November 2000 the then Chancellor unveiled proposals under the name of the "Pension Credit" to alleviate the problem of the savings trap. This Guide provides a summary of how this benefit works as well as considers the interaction between Government benefits and personal retirement planning.

The State Retirement Pension

Payment of the full basic state pension (£115.95 a week for a single person for 2015/16) depends on the payment of, or being credited with, National Insurance contributions for most of a person's working life. Currently, if you reach State Pension age on or after 6 April 2016, you will need 35 qualifying years for a full basic State Pension.

A reduction in the required number of 'qualifying years' is also allowed for people unable to work because of 'home responsibilities' - caring for children under 16 or the disabled. In general, payment of insufficient National Insurance contributions means payment of less than the full BSP (Basic State Pension) or even none at all. Married women, divorced people, widows and widowers may be able to claim a pension based on the spouse's or ex-spouse's record.

The Pension Credit

The Pensions Credit came into force for the 2003/04 tax year to increase the pension for those with a low income, and to remove the problem whereby an individual who has saved for retirement loses a government benefit that would have been available if that saving had not been made (due to means testing).

There are two parts, the Guarantee Credit and the Savings Credit. The "Guarantee Credit" aims to top up the total income received to £151.20 a week for a single person and £230.85 for a couple. The person who applies for the credit must be over 62.5 (but their partner can be under 62.5). The level of your existing savings and income will affect the entitlement to this credit, including other pension plans, savings, some investments and employment earnings. Since the 6th April 2010 the qualifying age for the Guaranteed Credit has started rising to 65 in line with the increase to women`s state pension age.

For people over the age of 65, the "Savings Credit" gives some reward for having made your own personal savings. This is a maximum of an additional £14.82 a week if you are single, and £17.43 a week if you are a couple (on top of the Guarantee Credit). People are unlikely to be entitled to qualify for some money from the Savings Credit if the money they have coming in is up to £151.2 a week if you are single or £230.85 a week for couples.

As Pension Credit is means-tested, all forms of income are taken into account. The first £10,000 of capital/savings will be ignored. For capital/savings over £10,000, the Pension Service will deem people to have an income of £1 a week for each £500 or part £500 over that amount.

Entitlement to Housing Benefit and/or Council Tax Benefit will still depend on total income being less than the amount of the Pensions Credit. Increasing income from below to above this amount could therefore result in loss of these benefits (as now), but Savings Credit can still be earned.

Obviously, these comments are based on the current Government intentions. Future increases in the benefits will be reliant upon Government policy and could change from one term to the next, as well as from one Party to the next. The problem with planning for one's retirement is that it is usually far enough away for many things to get in the way – and this includes Government policy.

For a 30-year-old to totally rely on the existence of the Pensions Credit and other State benefits when they are 65 could be considered naive at best. 35 years ago we had a small Basic State Pension and the Graduated Pension. SERPS was a glint in Barbara Castle's eye and Personal Pensions would have been thought impossible. Who knows what the next 35 years will bring? Well, at Ethical Investors we can be confident of one thing – the future will bring change, but we are not quite sure what sort of change!

Financial Advice

Without an effective and reliable crystal ball, financial advisers are placed in a position of being unable to give clear and reasoned advice to those on low to moderate incomes. If we do not know how big your private pension will be when you reach retirement age, how can we advise you on investing in a Pension or ISA, when this may have the effect of reducing your state pension benefits?

Perhaps one way to deal with the matter is to look at the level of income above which the Guarantee Credit is not paid and one loses entitlement. For an individual, this is £151.20 per week (£7862.40 per annum). Investors need to ask themselves whether their target is to retire on £6,450.60 per annum, or more. If the answer is more, then funds must be put aside to build a pot of money from which to draw in retirement.

This pot of money could be accumulated within a Personal pension, where tax relief is granted on each payment made (whether you pay tax or not). Alternatively, using an Individual Savings Account (ISA) may be more effective for some. In reality, a combination of the two is probably the best way of constructing a balanced long-term financial plan.

This is where independent financial advice is so important. With both Personal Pensions and ISAs offering low cost and flexibility, it is possible to change one's arrangements over the years to meet changing financial needs. In addition, investors will never be locked in to plans that may not perform as hoped, or which change their ethical profile.

Appointing an independent financial adviser to look after your financial arrangements and to recommend changes as appropriate will be a sound investment for everyone. Of course, we would say that, but the alternative is for individuals to undertake the research, education and constant monitoring themselves. Fine if you have the time, but impossible to do effectively if you have an already busy and hectic lifestyle.

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