Are ISAs past their best-before dates?

The role of Individual Savings Accounts (ISAs) has changed since they were launched over 20 years ago, so are they still worth having?

Since ISAs were introduced in April 1999 the ISA portfolio has been extended to include:

- Junior ISAs (for the under-18s).
- Help to Buy ISAs (no longer on sale).
- Innovative Finance ISAs (for crowdfunding investors).
- Lifetime ISAs (for 18-39-year-olds and a partial replacement for the Help to Buy plans).

Despite the proliferation of ISAs, sales remain dominated by the two basic variants launched in 1999 – the cash ISAs and stocks and shares ISAs. However, tax changes in recent years have called the value of both into question:

- The Personal Savings Allowance (PSA) allows basic rate taxpayers to receive £1,000 of interest free of tax (£500 for higher rate taxpayers and nil for additional rate taxpayers). At current interest rates, exceeding those thresholds requires a substantial deposit (e.g. £100,000 @ 0.5% = £500). As a result, for many savers an ordinary bank/building society deposit is as tax-free as a cash ISA with fewer constraints.
- It is a similar story with stocks and shares ISAs and the dividend allowance, which allow all taxpayers to receive £2,000 of dividends free of tax. At the current average yield on UK shares, that threshold is breached at around £72,000.
- For stocks and shares ISAs, there is also the capital gains tax (CGT) annual exemption to consider. At the current level of £12,300, it makes the CGT freedom of ISAs academic for many investors.

So, are ISAs past their best-before dates? For some investors, they probably are, particularly if savings are modest. For others, ISAs can still offer benefits:

- They leave your PSA, dividend allowance and CGT exemptions unused.
- There is nothing to report on your tax return.
- If you invest regularly over a long term, the ISA tax freedoms can become highly valuable, as the growing band of stocks and shares ISA millionaires can testify.

An investment sector reshuffle

The fund performance league tables have gained over 530 new funds since April.

In the middle of April, the trade body of investment managers, the Investment Association, made a radical revamp to its fund sectors. As a result, many of the investment performance league tables have been changed subtly, even though the performance of the individual constituents is unaltered. The reform had two elements.

Addition of exchange traded funds

Until the change, the Investment Association's 39 investment sectors all contained two main types of fund:

- the traditional unit trusts; and
- more recently created open ended investment companies (OEICs).

To most investors, the two types looked virtually identical and over the years many unit trusts have converted to OEICs. A major feature of both is that the prices at which units/shares are purchased or sold by investors is calculated by the fund manager, based directly on the value of the underlying assets.

The Investment Association has added a third fund to this duo – exchange traded funds (ETFs), which are an increasingly common structure. ETFs are investment companies, similar in many ways to OEICs, but traded on the stock exchange. As a result, it is the market which sets the prices of ETFs, not those managing the funds. Managing is perhaps a generous word, as most ETFs are index funds, mirroring the constituents of a market index, such as the FTSE 100 or the S&P 500. Their structure is such that the number of shares in an ETF can expand and contract, depending upon demand, a factor that distinguishes them from investment trusts.

New sectors

The arrival of so many ETFs prompted the Investment Association to revise its Global Bonds sector, which would otherwise have had 125 new entrants. That sector has now been fragmented into 14 new bond sectors covering every niche from Global Inflation Linked Bonds to EUR High Yield.

Two Investment Association sectors, Specialist and Global, both had more than 70 new ETF entrants. In total, the Investment Association added over 530 ETFs to its sector listings. The new arrivals mean that funds can change their performance ranking merely because the sector size has been swollen by the influx.

More than ever, seeking advice is important when choosing from what are now over 4,100 funds spread across 52 sectors.

Lessons from London Capital & Finance

One of the last decade's more infamous financial scandals has finally reached a conclusion.

The name of London Capital & Finance Plc (LCF) sounds impressive, but the business behind it was anything but. In the late 2010s, LCF issued 'mini-bonds', raising capital from individual investors to lend on to small businesses. LCF offered rates of up to 8%, tax-free via ISAs, which unsurprisingly attracted a large inflow of cash. Then, in mid-December 2018, the Financial Conduct Authority (FCA) ordered LCF to withdraw its marketing material with immediate effect.

LCF's investors had a worrying Christmas followed by a grim new year in which the company went into administration before January had ended. Almost 12 months later, the Financial Services Compensation Scheme (FSCS) declared that LCF had failed. However, that did not mean investors received any immediate compensation. To add insult to injury, in March 2019, HMRC wrote to LCF's ISA holders saying that their plans did not satisfy the ISA regulations and therefore any income from them was taxable.

A raft of legal arguments followed involving both the FCA and FSCS about the nature of LCF's offerings and whether the company gave 'advice' when promoting its products. In mid-April 2021, 28 months after the FCA first blew the whistle, a resolution emerged. The FSCS has since paid full compensation to about 25% of LCF investors while the Treasury will pay the remaining 75% on their investment, capped at £68,000. This will ultimately cost you, the taxpayer, about £120 million.

The Treasury's payment will not be quick. The government first must pass primary legislation "as soon as parliamentary time allows", after which cheques will flow within the following six months. While that may seem painfully slow, in truth those 8,800 investors are lucky to receive anything. As the Treasury statement and the need for new legislation both underline, existing law should leave most LCF investors with nothing.

The whole acronym-laden saga is a classic example of the wisdom of the saying: "If it looks too good to be true, it probably is". Always take advice *before* parting with your money.

Retiring in 2021… or beyond

A recent survey of people who have or plan to retire in 2021 provides interesting insights, whatever your intended retirement year.

The average age of people planning to retire in 2021 is 60, according to a recently published survey by investment manager, Standard Life Aberdeen. That is six years before current state pension age, which will rise from 66 to 67 between 2026 and 2028. Those 2021 retirees will, on average, live for another 25 years if they are men, and 28 if they are women, according to the Office for National Statistics (ONS). A quarter will survive to age 92 and 94, respectively, implying over a third of their life is spent in retirement.

The *Class of 2021* report found that 37% of respondents had brought forward their retirement date because of the Covid-19 pandemic – a reminder of the importance of building flexibility into your retirement planning. Perhaps the acceleration of plans also explains why only about two in five felt very confident they were financially ready to finish working this year. The lack of financial confidence also showed up in other responses:

- Nearly half intended to cut their spending to support their retirement.
- Just over a quarter said they would work part-time for the same reason.
- One in five planned to sell their property or downsize to meet their retirement costs.

Those costs may have been underestimated, as the average planned retiree's household spending was £21,000 a year, almost a third less than the average 2020 household income, according to the ONS.

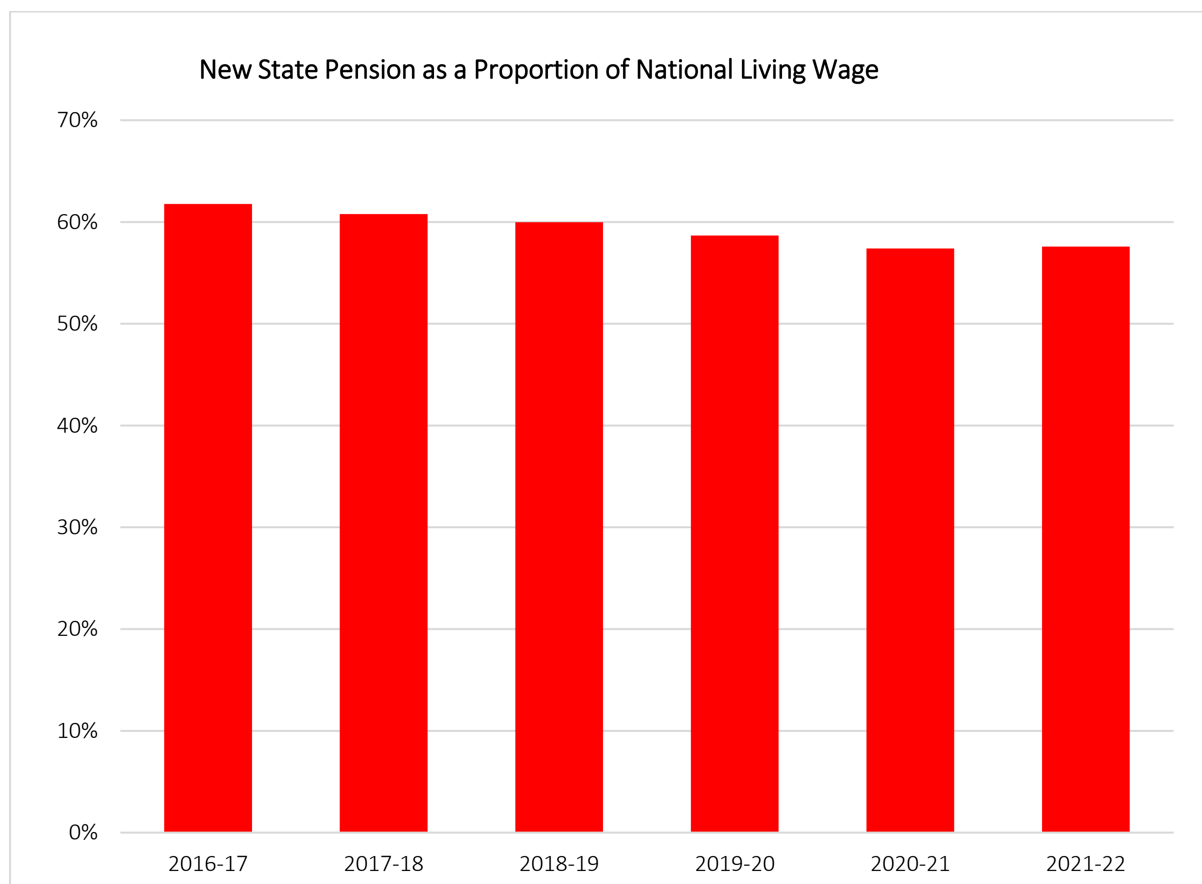
The most concerning statistic was not one directly supplied by the retirees, but the result of an assessment by the survey's sponsor, the Pensions and Lifetime Savings Association. The Association calculated that even using the £21,000 annual spending target and allowing for the eventual arrival of the state pension, two thirds of the 2021 retirees were at risk of running out of money. The association's estimate was that a savings pot of £390,000 was needed to cover 30 years of retirement expenditure.

All food for thought, whatever your planned year of retirement…

April is the month of benefit increases

State pensions and the National Living Wage both increased in April.

Still under 60%



April is the month when state benefits are uprated – unless they are subject to a freeze. It is also the month when the National Living Wage (NLW) and National Minimum Wage (NMW) are increased. In 2021, many social security benefits rose by 0.5%, as that was the annual rate of CPI inflation in September, the benchmark month.

The 0.5% increase applied to some state pensions, such as the additional state pension, but the main state pension, in both its old (pre 6 April 2016) and new (6 April 2016 onwards) guise rose by 2.5% – five times as much. This is because of the Triple Lock, which sets the minimum increase at 2.5%. As a result, the new state pension (currently payable from age 66, don't forget) is now £179.60 a week.

April also saw the old state pension rise to £137.60 a week. The lower amount reflects that the former state pension system also incorporated an additional earnings-related pension for employees, supplied by the state and/or private provision (often a final salary pension scheme).

The maximum payment under the state additional pension element rose by 0.5%, to £181.31, which mostly benefits high-income earners. Those who qualify for the maximum state basic and additional pension under the pre-April 2016 regime are now receiving £318.91 a week. The design of the post-April 2016 state pension system was skewed towards low-income earners and, without the additional element, is less costly for the Treasury.

One other way to think about the new state pension is to compare it with how much you would earn from a 35-hour week at the minimum wage, which is £311.85. As the graph illustrates, that leaves the new state pension at less than 60% of the theoretical NMW weekly pay.

If you do not think you could live on the NMW, you should make sure your private pension provision is adequate.