

# SOVEREIGN FINANCE

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## **THE SOVEREIGN NEWSLETTER**

### **COULD HAVE BEEN WORSE**

The new Coalition Government's Emergency Budget has now been thrust upon us. We would probably agree that it is tough but fair. Here are some highlights affecting the financial world:

1. Capital Gains Tax is now Higher for Higher Rate Taxpayers. From midnight on the 22<sup>nd</sup> of June higher rate taxpayers will now pay Capital Gains Tax at 28%. The old 18% rate, however, has been kept as it is for everyone else. The other good news was that the Capital Gains Tax Allowance of £10,100 has been left as it was. Much worse had been expected.
2. Pension Tax Relief for Higher Rate Taxpayers remains as it was – at least for now. The Government has announced that it will review existing arrangements with the industry and one possible change that has been mentioned would be to limit annual pension contributions. This does provide a window of opportunity in the coming months for those who can afford to take more out of their companies. A pension contribution can be made for up to £255,000.
3. An extra £1,000 has been added to the personal allowance from next April. This means that those earning up to £7,475 per annum will have no tax to pay at all.
4. Businesses will benefit from a reduction in Corporation Tax this year and in coming years.
5. The requirement to buy annuities by age 75 is to be ended. The Government will consult on the best way to do this, but as an interim measure they have raised the age to 77 so that nobody will be caught out while the consultations take place.
6. The State Pension will rise more rapidly than it has been doing in recent years. The increase in the State Pension from next year will be the highest of 3 measures – increase in earnings, increase in prices, or a flat 2.5% if that is higher.
7. Painful for all is the rise in VAT from the 4th of January 2011 to 20%. The only good news in that regard is that it will provide the shops with a "Buy Now" running up to Christmas and the New Year.

### **LIFE ASSURANCE – ITS HISTORY**

The concept of insurance generally goes back 3000 years or so when merchants in the Mediterranean spread their risks when sending goods by ship. Life assurance, however, is more recent. The original concept of life assurance arose with groups of people deciding to pool their monies together so that if someone died or ran into difficulty there would be assistance available. This was one of the reasons for the guilds that arose with the Greeks and Romans and carried on through the Middle Ages. The various Friendly Societies and Mutual Life Companies we have now developed from the same roots.

Life assurance as practised today is a business, which is underwritten to some degree by the Government. It is based on odds. If a thousand people pool their money, the odds are that only a small minority of these people will die during the agreed time period of the life assurance (excluding “acts of God”, terrorism, etc). So basically it is a gamble but because so many people are involved, it has proven to be successful and even profitable. The art is in working out how much each person needs to pay and that is the duty of the chief gambler and number cruncher – the actuary. Because records are so well kept these days it has become easier to establish the odds of dying at any given age very precisely. One of the main sources of data in this regard is the mortality tables. These tables give very precise data that allow calculations to be done as to how long an average male or female of a certain age is likely to survive

## **THE RISKS**

Life assurance has become very affordable and has enabled people to protect their families and businesses at a very reasonable cost. Straightforward life assurance is a simple concept. A person works out how much cover they feel they need and for how long. They then find out what that would cost. Costs for men and women differ as women statistically live longer than men. There are also different costs for smokers and non-smokers as smoking has been shown statistically to be a major reason for shorter life spans. Age clearly affects the cost and then there are questions about life style and medical history, all of which are taken into account when the life assurance companies work out the risk of your dying within the term of years you want.

Very recently life assurance companies have also added Critical Illness Insurance. Instead of paying out when you are dead, this pays out the agreed amount when it has been confirmed that you have been diagnosed with one of a specific number of serious diseases such as heart attack, stroke, serious cancers, etc. It has been the detailed records of reasons for death and illness that have enabled actuaries to work out the odds and, thereby, the costs to provide this type of insurance.

The cost of life assurance is constantly changing as the most up to date data is obtained on deaths, etc. In general terms we are living longer and the longer life expectancy generally means lower costs. In the case of Critical Illness Insurance, however, costs have gone up because the original odds as they were calculated were shown to not be consistent with the number of claims.

## **THE CHOICES**

**Cheap and Cheerful - Term Assurance.** The cheapest life assurance is term assurance. Term refers to the fact that the life assurance will be in force only for an agreed term of years. If you die within that term, the life assurance pays out. If you die after that term has expired, you receive nothing. The premium (cost per month) is usually fixed for the term.

**Level Term Assurance** – The amount you are covered for stays the same throughout the term.

**Decreasing Term Assurance (also referred to as Mortgage Protection)** – The amount that would be paid out on death decreases year by year on an agreed rate. Normally this is used in connection with a repayment mortgage where the amount owed goes down year by year.

**Family Income Benefit** – This pays a tax-free income to the end of the agreed term instead of a lump sum.

**Whole of Life Assurance** – This type of life insurance can go on for as long as you live. However, it is subject to 10 yearly reviews as regards the monthly cost, and the older you get, the more it costs per month. The policy usually allows for the level of cover to increase each year automatically without having to reapply. This is often used in planning to deal with Inheritance Tax and also to deal with business liabilities.

**Critical Illness Insurance (Benefit while you are Still Alive)** – This type of insurance will pay out an agreed amount if you are diagnosed with one of many critical illnesses such as a heart attack or a serious cancer, etc. So you receive the benefit while you are alive and in a position to use it – whether that is for paying for treatment or reducing outgoings or covering lost income or just for some enjoyment.

There are a variety of additional benefits that can be linked to life assurance policies and also a variety of trusts that can be used so that the monies can be dealt with exactly as you wish.

## **SO WHO NEEDS IT?**

Who would need or want life assurance? Quite a few people, in fact, including someone with a family; someone with a mortgage or other debts; someone with a business.

The usefulness and need for life assurance varies through one's life. A young person who is not married and has no financial responsibilities can quite properly do without. This begins to change when one marries or has children or starts buying a property. It is easy to see then that a person earning money or looking after children would leave a financial hole if they die early. At that age life assurance is very inexpensive and is the right time to start. It is interesting that law requires a person to take out insurance in case he has an accident with his car but no one requires a person to insure himself in the event of death.

As one grows older, normally responsibilities increase. Someone in business has to consider the consequences of his dying and what effect it would have on the business and any partners or employees he has. Personal financial commitments also normally increase. Those that are single may have seen friends or family die suddenly of cancer or heart attack and decide that they would like cover which would pay them a lump sum while they are alive if they contracted such a critical illness.

## **WE CAN HELP**

All in all life assurance in its various forms plays a useful and generally inexpensive roll in keeping society on an even keel. We at Sovereign would be happy to explore how the various options might relate to your own personal circumstances. Just give us a ring now on 01342 313302.

## **Leaseholds – Not Something You Can Afford to Forget About.**

Those owning flats will normally own them on a leasehold basis. This does not have the same permanency as owning the freehold of a property. A lease is an agreement to have and use the property for a number of years. Each year you own the property, there will be one year less on the remaining lease. For an extremely long lease this does not mean a great deal but as the number of years remaining approaches 80, you must take action or the value of your property can be adversely affected. Many lenders will not even offer mortgages on properties with leases with remaining terms of less than 60 or 70 years.

The person or company who own the freehold of the property are the only ones who can extend the term of your lease. You do have certain rights under law to require them to extend the term of the lease. This is easiest when the various leaseholders also have a share in the freehold through a management company set up for that purpose. In such a circumstance it is normally straightforward to ask for and arrange a longer term for the lease. The costs then usually are just the legal costs of preparing and executing the new paperwork.

However, if the freeholder is a separate person or company, you will have to negotiate with them. Under current legislation the freeholder is entitled to demand a cash sum for the renewal of any lease that falls below 80 years. Therefore, anyone approaching this 80-year mark should take advice. This

is especially significant now as the 99 year leases of homes built during the development boom of the mid 1990s are nearing this cut-off point. It is a good idea to leave yourself plenty of negotiating time.

Advice for leaseholders is available from Advice guide and Shelter or your local Citizens Advice Bureau. There is also a Leasehold Advisory Service (Lease) which includes a free calculator into which leaseholders can enter details of their home's value, the ground rent and the remaining term of the lease in order to get an estimate of how much an extension to their lease could cost.

## **EQUITY RELEASE – ACT NOW**

Equity release is usually a last option for those who have a lot of value in their property but insufficient income or an urgent need for a lump sum. But it remains a useful tool for those that need help in this regard. If this is something you had been considering, it is a good idea to act sooner rather than later. More and more providers have been leaving the market due to changes in Government rules affecting lenders. All lenders have to keep a certain amount of easily realised funds in reserve. Those who do Equity Release lending are being required to keep much more funds in reserve because of the long-term investment that Equity Release represents. This reduces the amount of funds they can lend or use for other purposes. Several, including Prudential, have decided to leave the market altogether. With fewer providers there is less competition and rates increase.

Do give us a ring if you would like to discuss the Equity Release options that might be available for you or a friend or family member.

## **RETIRING? WATCH YOUR STEP**

Those aged 55 or older do now have the option to take their pension benefits at any time. There are many options and choices and a wrong decision can mean significantly less income in retirement. Do contact us for independent advice.

**Yours sincerely**

**Tom Shuster and Trevor Tupholme**