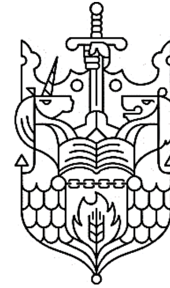


**AF8-RETIREMENT INCOME PLANNING**

**ASSIGNMENT 1 COURSEWORK EXEMPLAR**

## Summary of current circumstances

Patrick is aged 62 and was recently diagnosed with a heart condition which will require ongoing long-term treatment. Patrick will retire in the next few months so that he and Jane can spend some time travelling to visit family members overseas over the next few years. Jane is aged 60 and may continue to work part-time as a physiotherapist for the next five years. Her employer is willing to provide continuing employment to Jane on a flexible basis to fit in with her travel arrangements. Jane expects to earn a salary of £10,000 per annum (gross) from this continuing employment due to her reduced working hours.

Patrick and Jane are planning to sell their current home to release funds of approximately £200,000 to provide additional income in retirement. Their home is on the market and they expect to sell this and purchase a new property with a value of £400,000 in the next few years. Patrick and Jane have always had an adventurous attitude to risk but now feel that this level of risk is no longer appropriate. They believe that a more cautious investment approach is now necessary and would like to review their current investments, taking into consideration their change of position following Patrick's early retirement.

They estimate that their travel plans will cost £70,000 in total over the course of the next three years and once they are fully retired they estimate that they will require £45,000 per annum.

## Summary of current income position

Patrick currently earns £48,000 per annum (gross) and receives £450 ISA income per annum. Jane currently earns £18,000 per annum (gross) and receives £900 per annum from her ISA. They also receive £350 per annum in deposit interest and £710 per annum from jointly-held Unit Trusts. When Patrick retires and Jane reduces her hours, their income will drop by £56,000 per annum.

**Summary of Total Assets**

| Asset | Client 1 £ | Client 2 £ | Joint £ |
|---|---|---|---|
| Main residence | 650,000 | | |
| Contents/car | | | 55,000 |
| Current account – Assure Bank | 3,000 | 1,500 | |
| Savings Account – Assure Bank | | | 35,000 |
| OEIC/Unit Trust holdings – UK Recovery funds | | | 42,000 |
| OEIC/Unit Trust holdings – Emerging Markets Growth fund | | | 33,000 |
| Stocks & Shares ISAs –US Equity Tracker fund | 30,000 | | |
| Stocks & Shares ISAs – UK FTSE-100 Tracker fund | | 30,000 | |
| Investment Bond (onshore) – Managed fund | | | 85,000 |
| Money purchase pension plans | 162,000 | 33,000 | |
| | | | |
| Total illiquid assets | 650,000 | | 55,000 |
| Total liquid assets | 195,000 | 64,500 | 195,000 |
| **Total** | **845,000** | **64,500** | **250,000** |

**Patrick and Jane's immediate objectives are as follows**

- To ensure that Patrick and Jane have sufficient capital for the next few years to accommodate their travel plans.
- To ensure their existing investments and pension arrangements are suitable following their recent change in circumstances.

**Strengths of their current financial position**

- They have a substantial wealth of approximately £1.16 million, of which £454,500 is held in liquid assets.
- They are prepared to take some risk with their capital in order to achieve their objectives although they now wish to reduce the level of risk within their pension and investment portfolios.
- They have no outstanding liabilities.
- They don't appear to have any protection needs.
- Their children are no longer financially dependent on them.
- Both have sufficient NI record for State Pensions which will become payable from age 66 and will provide a guaranteed income along with some inflation-proofing.
- Patrick has a pension payable by the Pension Protection Fund which comes into payment from age 65. This will also provide a guaranteed inflation-linked income and also includes a 50% spouse's pension.
- Savings interest received from deposit holdings is within their personal savings allowance and will not therefore not be subject to tax
- They each hold monies in ISAs which are tax-efficient as the gains are free from CGT and the dividends received from their Unit Trusts are within their

£2,000 dividend allowance and therefore also not subject to tax.

- They don't appear to have utilised their CGT allowance for this tax year
- Both are currently contributing to pensions which will provide basic rate tax relief for Jane and higher rate tax relief for Patrick. Pensions are also tax-efficient as the growth within the pensions will be free of CGT and Income Tax. The pension will also provide the option to take a PCLS of up to 25% which will also be tax-free.
- Due to their future spending plans, both for the next 3 years and also during retirement, it is unlikely they will have an IHT liability going forward although they will have a small liability at present.
- They don't appear to have accessed benefits flexibly so are not constrained by the Money Purchase Annual Allowance (MPAA), so both can maximise pension contributions for this tax year
- In future tax years Patrick can contribute £3,600 gross and Jane can contribute £10,000 gross to a pension
- Neither are likely to breach the Lifetime Allowance with pensions so no tax charges will apply on benefit crystallisation
- They currently have IHT nil rate bands of £325,000 each and a residence nil rate band of

£175,000, so a total of £1,000,000 in allowances. The value of their property would allow them to fully benefit from the main residence allowance, even after they have downsized.

**Weaknesses of their current financial position**

- The house sale may not proceed which would reduce their liquid capital or they may have to consider alternatives such as equity release
- They have limited guaranteed income in retirement, both State Pensions and pension from the Pension Protection Fund will only provide approximately £25,000 which is less than their desired £45,000 per annum
- Both State Pensions will commence at age 66 which doesn't match either of their selected retirement ages
- They do not expect to receive any further inheritances
- Patrick may not have earned enough to receive higher rate tax relief on pension contributions, depending on when he retires
- Neither of them fully fund pensions each tax year, and have therefore missed out on the valuable tax benefits associated with a pension
- They also haven't fully funded ISA's each tax year, and have therefore missed out on the valuable tax benefits associated with an ISA
- They currently have no IHT liability as their estate value is £964,500, which falls within their total allowance of £1,000,000.
- Their overall ISA & Unit Trust asset allocation does not meet their attitude to risk.
- Their overall ISA & Unit Trust asset allocation does not offer sufficient diversification

**Objectives**

**1. Fund travel plans for next 3 years**

Annual Income for next 3 years:

Patrick will have no salary once he retires. He will start to receive his pension from the Pension Protection Fund within the next 3 years. I have assumed this will only be a minimal amount as it will only be a part-year payment within their 3 year plan.

Jane: £30,000 (£10,000 x 3 years)

Income from Savings and Investments: £7,230

(£2,410 x 3 years) Regular expenditure: £110,664

(£36,888 x 3 years)

Additional lump sum expenditure: £70,000

(for travel) Shortfall: £180,664 - £37,905 =

£142,759.

If the house sale didn't proceed then Patrick and Jane would need to use existing assets to fund the shortfall.

Pensions

From a taxation perspective, as Patrick will be a non-taxpayer for the next two tax years, it would be beneficial to withdraw monies from his pension to utilise his available personal allowance of
£12,500. Withdrawals from pensions are typically 25% tax free and the remaining 75% is taxable under PAYE. I would recommend this is done via UFPLS to ensure he crystallises less of his overall benefits. In order to achieve an amount equal to his personal allowance he would require a lump sum of £12,500. He would need to crystallise approx £16,666 each year which would provide
£33,332 of their required shortfall.

Patrick currently earns £4,000 per month, so he wouldn't be able to do this for the current tax year or once his State Pension and pension from the Pension Protection Fund commence. These payments will utilise his personal allowance and therefore any amounts taken in excess of 25% will be liable to tax under PAYE.

As Patrick is currently planning to retire, he would do this from next tax year. Whilst it will count as benefit crystallisation and therefore trigger the Money Purchase Annual Allowance, this won't affect him because he will have no ability to contribute more than £3,600 per annum to a pension and therefore the Money Purchase Annual Allowance cap is not an issue. It is likely that they will require approximately £20,000 per annum from their savings and investments once fully retired. As they do not have an IHT liability at present, withdrawing monies from a pension instead of an ISA shouldn't have any impact from an IHT perspective.

Patrick would also need to check with his pension provider to ensure they allow benefits to be accessed flexibly. Any amount above this should be left in his pension for future years.

As Jane will continue to have earnings of £10,000, she has limited scope to do this but could do the same for the £2,500 remaining of her personal allowance. As Jane is still contributing to the workplace scheme though, it is unlikely to be an option available for her. Her pension should be left in situ for the moment.

Investment Bond

As the Investment Bond is less tax-efficient than their Pensions, ISAs & Unit Trusts it should be surrendered and the £85,000 can be used towards their shortfall. There will be no further tax to pay on surrender as covered in the second objective section. Whilst it could be used for 5% tax-deferred withdrawals, it is unlikely these will be required as Patrick will no longer be a higher rate tax-payer so won't need any withdrawals to be tax-deferred. The small element of life assurance usually associated with Bonds is not a valuable form of life cover and would have no impact on the decision to surrender the bond.

Unit Trusts

As these are less tax-efficient than their ISAs, they should take the remaining shortfall from these holdings. They could each use their £12,300 CGT allowance which when added to their original investment amounts, they could take at least £24,600 without incurring a tax liability.

**Summary of withdrawals**

| | |
|---|---|
| Patrick Pension: | £33,332 |
| Investment Bond: | £85,000 |
| Unit Trusts: | £24,600 |
| **Total:** | **£142,932** |

I'm not sure whether inflation has already been factored into Jane's salary or their £70,000 travel plan funds. Equally I am unsure if their annual income requirements will need to increase with inflation. I have not increased the figures by inflation but it would take an extra £10,000 on top of what they already require and this could be taken from deposits or their Unit Trusts.

I would not look to use any of their existing deposits as they already have a large amount of their liquid assets invested. The deposits should be retained for emergency purposes and to add further diversification to their overall portfolio.

This course of action would reduce their liquid assets to approximately £300,000 to use towards future retirement income planning.

Assuming the house sale went ahead, it would free up an additional £200,000 which could easily provide for the shortfall over the next 3 years. Patrick should still access his pension to ensure he maximises his personal allowance when taking withdrawals as he will lose this opportunity in the future when his Pension Protection Fund pension and State Pension come into payment. The remaining shortfall could be then taken from deposits and all their investments and pensions could be left intact.

Based on an estimated longevity of age 100 for both Patrick and Jane, their liquid assets could provide a relatively safe rate of return of 3.5% per annum to generate an annual income of just under £20,000 before tax. If additional funds were required in later life, they could release further monies from their home by either sale or some form of equity release.

**2. Ensure existing investments remain appropriate following change in circumstances**

Due to Patrick's health condition and planned retirement, they feel it is no longer appropriate to take an adventurous risk approach with their portfolio. They now believe that a more cautious investment approach is necessary and would like to review their current investments. With this in mind, I would make the following comments:

**Patrick**

- US Equity Tracker ISA does not offer sufficient asset diversification. This fund is high risk and does not match his revised attitude to risk. This fund should be switched to an appropriate fund with the correct risk and asset allocation.
- Group Personal Pension UK Equity Tracker fund does not offer sufficient asset diversification. This is too high risk and does not match his revised attitude to risk. This fund should be switched to an appropriate fund with the correct risk and asset allocation.
- Group Personal Pension Balanced Managed fund is sufficiently diversified but does not match his revised attitude to risk . This fund should be switched to an appropriate fund with the correct risk and asset allocation.

**Jane**

- UK FTSE 100 Tracker ISA does not offer sufficient asset diversification. This fund is high risk and does not match her revised attitude to risk. This fund should be switched to an appropriate fund with the correct risk and asset allocation.
- Group Personal Pension Cautious Managed Lifestyle fund is sufficiently diversified and matches her attitude to risk. The investment approach is not appropriate as they don't appear to be planning to purchase an annuity. This fund should be switched to an appropriate fund with the correct risk and asset allocation.

**Joint holdings**

- UK Recovery Unit Trust does not offer sufficient asset diversification. This fund is high risk and does not match their revised attitude to risk. This fund should be switched to an appropriate fund with the correct risk and asset allocation.
- Emerging Markets Unit Trust does not offer sufficient asset diversification. This fund is too high risk and does not match their revised attitude to risk. This fund should be switched to an appropriate fund with the correct risk and asset allocation.

- Investment Bond Managed fund is sufficiently diversified but it may not match their revised attitude to risk. They should consider switching to an appropriate fund with the correct risk and asset allocation.

**Tax considerations**

- Fund switches within their ISAs will be tax-free
- Fund switches within their Pensions will also be tax-free
- Any capital gains on the Unit Trusts would be split between them
- Switches within their Unit Trusts would be liable to CGT but they could each offset their annual exemption of £12,300 against any gains.
- As Patrick is currently a higher rate taxpayer he will pay 20% on any gains made in excess of their CGT exemption on encashment of the Unit Trusts
- Jane is currently a basic rate taxpayer and she will pay 10% on any gains made in excess of their CGT exemption on encashment of the Unit Trusts
- The Unit Trusts can be transferred to Jane prior to encashment so gains will be subject to 10% rather than 20% Capital Gains Tax.
- The investment bond has tax deducted at source and therefore is not as tax-efficient as the pensions, ISA or Unit Trusts
- Any gains on the Investment Bond would be split between them
- Jane would not have any tax liability on encashment of the Investment Bond due to the level of gains and the availability of top-slicing as she is a basic rate taxpayer.
- As Patrick is currently a higher rate tax payer he will pay 20% on any gains and will not have top-slicing available
- It is possible to assign the Bond to Jane prior to encashment which would remove the tax liability on Patrick.
- The pension contributions that Patrick and Jane are currently making will extend their basic rate tax threshold and therefore reduce the tax liability when considering encashment of the Investment Bond or Unit Trusts

**Overall summary**

On balance, I feel Patrick and Jane have adequate provisions to meet their immediate objectives without jeopardising their longer-term objectives. They could achieve their immediate objectives even if the house sale doesn't go ahead in the next few years and still have sufficient assets to provide for their longer-term retirement objectives. This assumes that the house sale happens at a later date or they use equity release. Obviously, their income requirements both now and in retirement would reduce the amount of assets that are available for their beneficiaries to inherit.

**Examiner Comments**

The assignments cover the retirement income planning process and take into consideration all assets to achieve the income goals of the clients throughout retirement.

This particular assignment is focused on the initial assessment of the client's current arrangements to meet their immediate needs and objectives and asks candidates to analyse any strengths and weaknesses in Patrick and Jane's current arrangements.

**The mark given to this assignment is 60.**

**Areas where the assignment scored highly include the following:**

- There is a clear and concise review of their current financial position including their income from all sources and identification of liquid and non-liquid assets
- There is a detailed exploration of the strengths and weaknesses in their current arrangements.
- Consideration has been given to tax-efficiency and interaction with tax allowances e.g. the Money Purchase Annual Allowance.
- Consideration has been given to the suitability of their individual pension and investment funds following their change in circumstances.
- Attention has been given to Patrick and Jane's other objectives and the interaction of these various objectives in their longer-term planning strategy.

**Areas for further improvement include the following:**

- A cashflow illustration or more detailed calculations could have been included to demonstrate the adequacy of their current arrangements.
- Some references or suitable examples should have been included to demonstrate further reading, e.g. HMRC regulations on the Money Purchase Annual Allowance.
- Structure could have been enhanced through use of tables and visual representations, i.e. graphs, pie charts.