AF8-RETIREMENT INCOME PLANNING

ASSIGNMENT 2 COURSEWORK EXEMPLAR

Scope of Advice

Review all of Patrick and Jane's assets to see how they are positioned following the recent changes in circumstances, notably Patrick's health and impending retirement.

We have established that Patrick and Jane have an approximate shortfall of £180,000 of capital over the next three years although some of this can be met from existing income sources.

Annual Income for next three years:

Patrick - Depending on when he retires, Patrick may receive a limited salary for the current tax year. His pension from the Pension Protection Fund will commence payment within the next three years but I have assumed zero income for this as it will only be a minimal amount and it will only be a part- year payment within their three-year plan.

Jane - £30,000: (£10,000 x 3 years)

Income from Savings and Investments: £7,230

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

(£36,888 x 3)

Additional lump sum expenditure - £70,000 (for

travel plans) Shortfall = £180,664 - £37,230 =

£143,434

Following the review and recommendations to be made later in this assignment, their income from existing and new investments will increase to approximately £8,000 per annum. This will reduce the overall shortfall to £125,000. I have assumed that the ISAs and Collectives, valued at

£275,000 will produce a yield of 3% per annum.

Assumptions

- I have assumed Patrick will retire in September and therefore he will have earned income of
  £24,000 (gross) for the current tax year (£48,000 / 12 = £4,000 per month, therefore 6 months x £4,000 = £24,000).
- I have assumed Jane will reduce her hours with effect from September and will therefore have earned income of £14,000 for this tax year based on the assumption that her earnings drop to £10,000 (gross) per annum after September as follows: Up to September - £18,000 / 12 = £1,500 per month. After September - £10,000 / 12 = £833.33 per month.
- Therefore, Jane will have the following earnings: 6 months earning £1,500 (£1,500 x 6 =
  £9,000) + 6 months earning £833.33 (£833.33 x 6 = £5,000) = £14,000
- I have assumed that the Patrick and Jane have downsized their property and included the
  £200,000 surplus capital within their overall assets.
- Patrick and Jane require an emergency fund and accessible deposits monies totalling
  £40,000.
- Maximum tax relievable pension contributions available to them are as follows:
  Patrick £24,000 (gross) earned income
  Monthly contribution £4,000 x 5% = £200
  £200 x 6 = £1,200
  £24,000 - £1,200 = £22,880 gross
  £22,800 x 0.8 = £18,240 net contribution

  Jane £14,000 earned income
  Monthly contribution (£1,500 x 2% = £30 x 6 = £180) + (£833.33 x 2% = £16.66 x 6 =
  £100) = £280
  £14,000 - £280 = £13,720 gross
  £13,720 x 0.8 = £10,976 net contribution

Review of Existing Assets

As part of my analysis I have reviewed Patrick and Jane's assets and recommend the following actions:

Patrick				
Provider	Policy Type	Funds Held	Value	Action
S&S ISA	ISA	US Equity Tracker	£30,000	Switch all funds
UK Life Ltd	Pension	UK Equity Tracker (50%) UK Gilt & Fixed Interest (50%)	£81,000 £81,000	Switch all funds
Assure Bank	Cash Deposit	N/A	£3,000	Retain

Jane				
Provider	Policy Type	Funds Held	Value	Action
S&S ISA	ISA	UK FTSE 100 Tracker	£30,000	Switch all fund
Midlands Life Ltd	Pension	Cautious Managed Lifestyle	£33,000	Switch all fund
Assure Bank	Cash Deposit	N/A	£1,500	Retain

Joint Assets				
Provider	Policy Type	Funds Held	Value	Action
Assure Bank	Cash Deposit	N/A	£35,000	Retain
Assure Bank	Cash Deposit	N/A	£200,000	Invest £100,000 and retain £100,000
OEIC/Unit Trust	OEIC/Unit Trust	UK Recovery Emerging Markets Growth	£42,000 £33,000	Switch £55,600 and retain all remaining funds
Investment Bond	Investment Bond	Managed	£85,000	Surrender all funds

My Recommendations

Having reviewed your existing plans, the reasons for my recommended actions are detailed below:

- Patrick and Jane should retain £164,500 currently held with Assure Bank. This will provide sufficient capital of £125,000 to provide for regular spending and shortfall in funding for their travel plans as well as providing £40,000 as an emergency fund. This overall amount is also within the £85,000 per person FSCS limit so I am happy to hold it all with one provider. The interest generated will also be within each of their personal savings allowance.
- £100,000 of this deposit fund will come from the proceeds of the house sale. They already hold £40,000 on deposit and approximately £33,000 will come from an UFPLS payment from Patrick's pension of £16,666 per annum for the following two tax years to make full use of his Personal Allowance.
- They should retain £10,860 of the UK Recovery Fund and £8,540 of the Emerging Markets funds within their Unit Trusts/OEIC. Whilst both these funds are unsuitable as they are deemed higher risk than their assessed low to medium approach, they should be retained until next tax year so that no CGT liability is triggered by a fund disposal. Disposals from the Unit Trust will be taken in proportion to the current fund holdings: 56% from the UK Recovery fund and 44% from the Emerging Markets Growth fund as there is no preference for encashing either of the holdings in terms of priority over the other fund.
- Given the high-risk nature of the funds, I have considered whether it is more appropriate to encash and incur the liability. It is possible that the monies left in these funds could fall by more than the CGT liability and if this were to be the case, Patrick and Jane would be worse off. Given the size of the funds in relation to their overall portfolio, I would leave the funds invested and take the risk that the funds do not fall by 10% or more before the start of the new tax year which would leave them in a worse financial position.
- The following funds should all be switched as they are deemed higher risk than their revised attitude to risk of low to medium:

  Patrick: US Equity Tracker (ISA)
  UK Equity Tracker (Pension)
  UK Gilt & Fixed Interest (Pension)

  Jane: US FTSE 100 Tracker (ISA)

  Joint: UK Recovery (£31,140 – UT/OEIC)
  Emerging Markets Growth (£24,460 – UT/OEIC) Managed (Investment Bond)

- Jane should also switch the Cautious Managed Lifestyle fund within her Pension. Whilst this may currently match her attitude to risk, it should still be switched due to the investment strategy adopted by the fund. The fund mix automatically alters as Jane approaches her selected retirement age to reduce the risk and match the asset mix required to purchase an annuity. As she is not planning on purchasing an annuity at her retirement age, I recommend this is switched to ensure the asset allocation remains appropriate for her longer-term investment horizon. I have assumed that no annuity purchase is required as they have £20,000 guaranteed income which covers essential expenditure and therefore can afford to take a risk in accepting a fluctuating income with the remainder of their income requirements.

- I have not considered any specific IHT-mitigation products such as Trusts as they do not have a current IHT liability and I believe their withdrawal plans will reduce the value of their assets further over time, ensuring their estates remain below the IHT threshold.

Changes to existing assets

Following the review of existing investments, other than those to be retained, I recommend that they are invested into the following products:

Patrick	
Product	**Investment Amount**
Workplace Pension internal switch	£162,00 0
Workplace Pension top-up (net)	£18,240
Stocks and Shares ISA fund switch	£30,000
Stocks and Shares ISA top up	£20,000

Jane	
Product	**Investment Amount**
Workplace Pension internal switch	£33,000
Workplace Pension top-up (net)	£10,976
Stocks and Shares ISA fund switch	£30,000
Stocks and Shares ISA top up	£20,000

Joint	
Product	**Investment Amount**
OEIC / Unit Trust fund switch	£55,600
OEIC / Unit Trust fund top up	£115,784

Product Rationale

Pension

Patrick should invest £18,240 into a personal pension plan. His contribution will benefit from basic rate tax relief of 20% which is received at source. This means his net contribution will be grossed up to £22,800 by his pension provider.

Jane should invest £10,976 into a personal pension plan. Her contribution will benefit from basic rate tax relief of 20% which is received at source. This means her net contribution will be grossed up to £13,720 by her pension provider.

Pensions allow their monies to grow free of income tax and capital gains tax. When it comes to withdrawing the monies, 25% of the fund can be taken as a pension commencement lump sum (PCLS) and will be free of income tax. Withdrawals in excess of the PCLS will be liable to income tax at their marginal rates however, due to the tax relief received at outset and tax-efficient growth, this is still likely to be most favourable for their circumstances as they are likely to only pay basic rate tax on any taxable withdrawals.

Stocks and Shares ISA

Patrick and Jane should each invest £20,000 within a Stocks & Shares ISA.

ISAs are a tax-efficient investment vehicle as they are not subject to Income Tax or Capital Gains Tax on withdrawals from the investment.

Joint Unit Trust / OEIC

A further £115,784 should be invested within a UT/OEIC.

Based on the amounts any dividends produced will be within each of their £2,000 annual dividend allowance and therefore will not be liable to tax. Any excess dividend income will be taxable at 7.5%, based on the assumption that they remain basic rate taxpayers in retirement. Any gains in excess of their annual CGT exemption will be liable to tax at 10% if you are a basic rate tax payer or 20% if it pushes you into higher rate tax.

With further planning, it is possible to utilise future year's Pension & ISA allowances with monies currently held in Unit Trusts and OEICs.

Stakeholder Pension Plan

I have considered a Stakeholder Pension however the ongoing costs associated with this product are more expensive than the products I have recommended within both of your Workplace pension schemes and therefore I have discounted a Stakeholder.

Your Attitude to Risk

Following detailed discussions, it was established that Patrick and Jane's attitude to risk should be revised from 'adventurous' to low to medium risk. This takes into consideration their change in circumstances with Patrick's recent health issues as well as their impending retirement.

Investment Strategy & Fund Recommendations

My preferred investment strategy is a Multi-Asset approach as it is important for individuals to invest in a range of different asset classes (for example cash, gilts, corporate bonds, property and stock market based investments). Asset classes tend to have different correlation to each other and therefore it is difficult to predict which will be the best performing asset class each year. By investing in multi-asset funds, you are not reliant on the performance of one asset class and where one asset class performs well, it will reduce the impact of an asset class that hasn't performed as well over the same time-period. By investing in a range of asset classes it will provide diversification which should reduce the overall risk of their portfolio whilst providing the potential for the target level of growth.

Whilst Patrick and Jane could adopt a single asset allocation investment approach and rebalance these funds on an ongoing basis, it would be difficult to take account of any changes in the markets as quickly as a professional fund manager. Equally, Patrick and Jane have plans to travel extensively over the next few years and may be unable or unwilling to review their investment portfolio sufficiently to take into account economic and market changes. On this basis, I have decided that the multi-asset approach is more appropriate as the fund manager is able to make an immediate decision dependent upon market conditions.

The funds I have recommended have all been assessed and are considered appropriate for their objectives. When considering whether a fund is appropriate, it is important to consider a range of factors including the fund management group, manager ability/tenure, investment processes and overall charges (Total Expense Ratio). I also recommend a number of Multi-Asset funds to offer diversification across fund manager and fund manager group.

Overall, the funds I have used meet Patrick and Jane's risk profile and are well placed to help meet their objectives of providing an income and growing capital for use in retirement. I have recommended that all the investments are invested in a range of Cautious Managed Multi-Asset funds with the exception of £30,000 within Patrick's Pension, as this money will be withdrawn over the next two tax years and will be required to fund their spending and travel plans. I recommend that this amount is held within a Cash fund within the Pension.

The Cautious Managed funds will hold an element of cash within the funds and the fund manager will control the overall asset allocation. As Patrick and Jane will already hold £40,000 on deposit I do not feel that it is necessary to hold any further monies on deposit. This cash buffer will be reviewed at future annual reviews.

Once fully retired, they will be withdrawing in the region of £20,000 to £25,000 per annum from their investment portfolio of approximately £500,000. This equates to roughly 5% which the chosen funds have historically produced and have the potential to produce in the future.

Tax implications of surrenders and

fund switches Stocks & Shares ISAs

- Fund switches within their ISAs will be tax-free

Pensions

- Fund switches within their Pensions will be tax-free

Unit Trusts / OEIC

Capital Gains:

UK Recovery Fund: Value £42,000 - Invested £18,000 = £24,000 gains

Emerging Markets Growth fund: Value £33,000 - Invested £15,000 =

£18,000 gains Total: £24,000 + £18,000 = £42,000 / 2 = £21,000 each.

Maximum tax-free disposal this tax year: £24,600 (CGT allowance x 2) + £18,000 +

£15,000 = £57,600

Overall tax liability: £75,000 - £57,600 = £17,400 x 10% = £1740 / 2 = £870 each.

- Any gains on the Unit Trusts would be split between them as they are jointly held.
- Switches within their Unit Trusts would be liable to CGT but they could each offset their annual allowance of £12,300 against any gains.
- £57,600 can be switched tax-free
- Gains in excess of £57,600 would result in a further tax liability.
- Jane is currently a basic rate tax payer and she will pay 10% on any gains made in excess of their CGT exemption on encashment of the Unit Trusts. This would be a tax charge of £870 on her share.
- Patrick will pay the same rate as Jane unless the gains would take him into higher rate tax. If that were to happen he will pay 20% on any gains made in excess of their CGT allowance rather than 10%.
- Based on his expected earnings for the tax year it is unlikely Patrick will be a higher rate tax payer.
- If Patrick was a higher rate tax payer the Unit Trusts can be transferred to Jane prior to encashment so gains will be subject to 10% rather than 20%. This transfer would not trigger a disposal against Patrick as it would be deemed a spousal transfer and therefore be classed as a ‘no gain no loss’ transaction. Any future gains would then be assessed against Jane.

Investment Bond

Gain: Value £85,000 - £55,000 =

£30,000 Gain each: £30,000 / 2 =

£15,000

Top slicing: £30,000 / 7 = £4,285.71

Top sliced gain each: £4,285.71 / 2 =

£2,142.85 Jane Income: £14,000 +

£2,142.85 = £16,142.85

Patrick Income: £24,000 + £2,142.85 = £26,142.85

- Any gains on the bond would be split between them as it is jointly held
- 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
- The top-sliced gain would be added to Patrick and Jane's income
- Jane would not have any further tax liability on encashment of the investment bond due to the level of gains and the availability of top-slicing as she would remain within the basic rate threshold.
- Depending on Patrick's retirement date, he may have a further liability if the gain pushes his income into higher rate tax. If that were to happen, he would pay an additional 20% on any gains. He would not have top-slicing available, however based on his pension contribution and his anticipated income for this tax year it is unlikely the gains will take result a higher rate tax liability.
- In order to avoid any tax liability for Patrick, they could assign the bond to Jane prior to encashment which would remove the tax liability on Patrick and still not result in a further tax liability for Jane. If this were to happen, the resulting monies could only be invested in Jane's name to avoid an associated transaction occurring and Patrick subsequently incurring a tax liability as if the assignment had never taken place.

Summary

I believe the above changes will leave Patrick and Jane suitably positioned to achieve their retirement objectives for travelling over the next few years and to generate £45,000 per annum in retirement.

Examiner Comments

This assignment requires candidates to recommend and justify how Patrick and Jane's investment portfolio should be adjusted to reflect the change in their attitude to risk. This should cover both the asset allocation and the product selection. Candidates are expected to justify their recommendations and to take into consideration the tax implications of their suggested course of action.

The mark given to this assignment is 55.

Areas where the assignment scored highly include the following:

- Detailed consideration has been given to the tax implications that would result from the recommended courses of action and some calculations have been included to illustrate this.

- Assumptions have been clearly stated to justify potential levels of pension contributions and the required levels of emergency funds to meet their short-term needs.

- Good explanation and justification of recommended investment strategy. ***Candidates should note that a wide range of investment options would be suitable for Patrick and Jane and provided these are justified in detail, this will be rewarded.***

Areas for further improvement include the following:

- More detailed explanation of the risk associated with their existing investments and a clearer assessment of why these are unsuitable.

- Structure could be improved to aid understanding and clarity.

- Calculations could be set out in a more logical structure.

- Summary is very limited and could be improved.

- References should be included to illustrate further reading or sources of information.