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Case Study 4 – Options in Retirement
Planner of the Year

1 INTRODUCTION

The case notes given have been used to prepare this report

2 OBJECTIVES AND PRIORITIES

1 Richard needs to achieve an immediate pension income of £40kpa net linked to rpi

2 Richard needs to fund the cost of the Ruby Wedding celebrations in 2013 from his pension plan

3 Annette requires advice on the investment of her capital sum from her pension

4 Annette needs advice on the investment of £1,000 per month to create a lump sum of £30,000 each for her children in 2015

3 ASSUMPTIONS

In this report the following assumptions will be made

(a) Returns after charges

Asset	Rate
Inflation	2.5%
Deposit rate	3%
Fixed interest	4.5%
Equities	7%
Annuity rate male 64 rpi link	4.33%
Annuity rate male 64 level	6.88%
Mortality rate female	19 years
Mortality rate male	22 years
Annuity rate female 62 3% increase PLA	3.87%

(b) expenditure will not increase at a faster rate than income

(c) Richard requires £40,000 per annum net income

(d) Tax rates for 2010/11 are applicable prior to any budget changes

(e) State Benefits will continue as at present

(f) Richard and Annette are UK resident and domiciled for tax purposes

(g) Current legislation remains unaltered

(h) Annette is a higher rate tax payer in the tax year 2010/11, basic rate taxpayer thereafter

(i) Richard is a higher rate tax payer

(j) Danny and Suzanne are aged 18+

(k) Although there is a family history of heart disease, both Annette and Richard are currently in good health

4 ATTITUDES AND ASSESSMENT

ATTITUDES

1 Richard wants his pension funds invested in a cautious fashion with the emphasis on income generation rather than growth

2 They are both cautious investors

3 They both wish to minimise tax now and in the future

4 They both wish to keep their finances separate

5 Richard does not wish to make provision for pension income for Annette on his death but he is interested in what death benefits may be available

6 Richard wishes to see forecasts for 5 years on the investment recommendations for Annette

ASSESSMENT

Keeping investments separate

Although Annette and Richard have kept their finances separate in the past, They need to draw up an income and expenditure statement and consider their joint income in retirement.

Long term retirement income

Hopefully the completion of an income and expenditure statement will satisfy Richard that he needs to provide for Annette's long term income needs. If he continues his wish not to provide for her, should he die first, Annette will lose an income of around £40,000 gross per annum. Statistics indicate that Richard is likely to die first and his family medical history increases this probability.

Level of retirement income for Richard

1 Richard has a retirement fund of £1m. He has the need to raise cash of £104,200 from his pension made up as follows

Money for Ruby Wedding in 3 years £60k inflation proofed £64,200

Capital for children's weddings £40,000

the tax free lump sum needs to be taken when the pension benefits crystalise

2 Richard has indicated a need for a pension of £40,000 **net** pa linked to rpi. The fund after tax free cash will amount to £895,800 Using the current annuity rates it is only just possible to provide £40,000per annum **gross**

3 Richard may need to take a pension without rpi linking, in which case the pension is quoted as £61,644 pa gross £47,057 pa net

4 Partial indexation of joint income will be possible, Annette's pension of £35,625pa will be index linked as will both State pensions and Richard's State Second pension

Method of achieving retirement income for Richard

Richard will have to consider which vehicle to use to provide his pension income. This could be

Conventional annuity – secured income

Income Drawdown or unsecured income

Short term annuity

The table outlines each option with particular reference to investment risk and possible funds available to Annette on his death prior to age 75(now 77)

Type of arrangement	**Flexibility**	**Risk**	**Situation on death**	**suitability**
Fixed annuity	Income cannot be varied if Richard's health deteriorates or he wants to provide a spouse's income	Guaranteed income but erosion of value of income by inflation if a level pension is selected	5 or 10 year guarantee of pension payments can be secured	Not sufficiently flexible
Income Drawdown	More flexible – allows for the incidents above	The Investment risk in this option does not suit Richard's attitude to risk	Fund available to Annette less 35% tax or an income/annuity	Not suitable because of Richard's attitude to risk
Short term annuity	Allows the situation to be reviewed in 5 years time	Guaranteed income for period suits attitude to risk.	Known Fund available to Annette on pre-mature death and	Suitable because suits attitude to risk and gives flexibility

		Capital at maturity may not purchase same level of income	at end of annuity term	

Pensions resulting from personal pension arrangements are not tax efficient (PLA) has a unique taxation status whereby only the interest content is taxed. Although Richard wants to limit his withdrawal of cash to £100k nevertheless if he took the full £250k, he could invest £145,600k in a PLA. If he invested in Annette's name the net return would be greater because she is a 20% tax payer and this would solve the problem of long term income for Annette if he dies first.

Annette's retirement income

1 **State Pension**. Annette was born in 1948 and is therefore eligible to withdraw state pension at age 60. As she deferred this she can now take an enhanced income. The enhancement is 10.4% per annum. This would mean an income of £119.01 per week. Alternatively Annette could take a taxable lump sum equivalent to the two years payments plus interest of 2% over base rate. In this case the pension falls to £97.65 per week. In 2010/11, Annette is a higher rate taxpayer because she will receive 5 months of her full salary and 7 months of her pension. Therefore the lump sum would be subject to tax at 40%

2 Annette will receive a pension from the Teacher's Pension Scheme based on 38/80ths of £75,000 = £ 35,625 per annum which will be index linked. This pension is fixed and cannot be altered should Annette suffer from a heart condition. In the event that she pre-deceases Richard he will receive 50% of her pension index linked from the date of her death .

3 Annette will receive a lump sum of 3n/80 x £75,000 which equals £106,875. She wants to invest this in a cautious fashion with minimal tax, so a portfolio of ISAS, national savings certificates and other deposit instruments will be recommended

4 Annette intends to save £1,000 per month for her children and give them £60,000 in 5 years time. Full details of Richard and Annette's assets are not known. However, Annette should gift the £500 per month to each child . The reason is that this money is excess income and as such would be treated as a gift out of normal expenditure and therefore not subject to IHT. Whereas the gift of £60,000 in 5 years time will be a "Potentially Exempt Transfer" and Annette may have to live to age 74 before the gift falls out of the estate for IHT purposes.

5 RECOMMENDATIONS

1 Annette should take the increased State Pension and not the cash sum and reduced income

2 Annette should invest £106,875 in a cautious portfolio of ISAS, National Savings Products and Deposit accounts

3 Annette should pass £500 per month each across to her children and set up cash and stocks and shares ISAS for them

4 Richard should take tax free cash of £250k from his fund, invest £104,400 in a portfolio and invest the balance in a PLA

5 Richard should invest the balance, £750,000 in a five year annuity with Living Time.

6 POINTS ARISING OUT OF THE RECOMMENDATIONS

Annette's investments

1 **State Pension**

Annette should arrange to receive the higher state pension

2 **Lump sum investment**

(a) Annette should invest Her lump sum (£106,875) in the following portfolio which matches her attitude to risk

Asset	Amount	Tax situation	Risk	charges	Access
National Savings Certificate index linked 3 yrs	£15,000	Tax free growth 1% above rpi	Low	Nil	Possible with penalty
National Savings Certificates 5 years	£15,000	Tax Free growth 1% above rpi	Low	Nil	Possible with penalty
Premium Bonds	£30,000	Tax free winnings	Low	Nil	yes
Cash ISA – Julian Hodge 2 year 3%	£5,100	Tax free interest	Low	Nil	no
Deposit structured product – Investec 5 years 37.5% ifFTSE100 higher than the commencement	£20,000	Interest taxable	Low capital guaranteed	Nil	no
Stocks and Shares ISA index linked bond fund M & G	£5,100	Tax free interest	Low/Medium	Initial 0% Amc 0.75%	yes
OEICS M & G index linked bond fund switch to ISAS 2011/12 and 2012/13	£16,675	Interest taxable in OEIC Tax free in the ISA	Low/Medium	Initial 0% Amc 0,&%%	yes

(b) Annette wants her investment to be as tax efficient as possible so Cash and Stocks and Shares ISAS and National Savings Certificates provide tax efficient investments now.

(c) Transfer of OEICS to ISAS in subsequent tax years, makes the portfolio tax efficient in the future

(d) Roll over of national savings certificates and transfer of cash/stocks ad shares ISAS helps to maintain the tax efficiency of the portfolio

(e) The portfolio has been constructed to give immediate access to just under 50% of funds should a need arise for capital

(f) Annette is a cautious investor so the risk has been kept low by the use of deposit investments. The National Savings Certificates and the index linked bond funds provide a hedge against inflation

(g) Capital is returned after 2/3 and 5 years to give opportunities for new investments depending on inflation and interest rate changes.

(h) As Annette is a cautious investor, the structured produce is deposit based and does not rely upon a counterparty. In the event of default of Investec Bank, she could claim compensation from the FSCS

(i) **Estimated performance of the portfolio over the next 5 years assuming inflation of 2.5%.** This assumes any winnings on the premium bonds are spent and the cash ISA and national savings certificates are rolled over at the same rate

Year	**National Savings Certificates**	**Premium Bond**	**Cash ISA**	**Deposit structured product**	**ISA/OEICS**	**Total**
2010	£30,000	£30,000	£5,100	£20,000	£21,775	£106,875
2011	£30,300	£30,000	£5,125	£20,000	£22,210	£107,635
2012	£30,600	£30,000	£5,151	£20,000	£22,646	£108,387
2013	£31,200	£30,000	£5,176	£20,000	£23,103	£109,479
2014	£31,530	£30,000	£5,202	£20,000	£23,560	£110,625
2015	£31,830	£30,000	£5,227	£27,500	£24,039	£118,596

3 **Investments for your children** – I recommend that £500 per month is paid into each child's bank account and direct debits set up to pay out

£400.00 **Cash Isa assume rate of 3% - in their name**

£100.00 **L & G UK index trust Stocks and shares ISA – in their name**

As this is only a five year investment and Annette is a cautious investor 80% is invested in cash but the investment into the tracker fund is a cheap way of obtaining exposure to the UK stock market and pound cost averaging allows advantage to be taken of volatility. There is a high probability of achieving the target £30k The estimated return for each child is shown below

Fund	Estimated return in 5 years after allowing for inflation
Cash fund	£24.308
Tracker fund	£6,639
TOTAL	£30.947

Richard's investments

(a)Richard should take £250,000 from his pension fund and invest as follows:

Amount	Reason	needed	comments
£40,200	Children's weddings	unknown	Easy access timing unknown
£64,200	Ruby wedding	2013	Includes an increase for inflation
£145,600	Purchased Life annuity	n/a	In Annette's name

(b) Recommendation for investment of £40,200

Investment	Amount	Term	Use	Access	Risk	Tax status
Premium Bonds	£30,000	n/a	For the children	Any time	Low	Tax free
Stocks and shares ISA M & G index linked bond fund	£10,200	n/a	For the children	Any time	Low/medium	Tax free

Note When Danny or Suzanne get married, Richard and Annette should make use of the IHT exemption for gifts in consideration of marriage (£5,000 per parent) as well as the annual allowance £3,000 each, if this has not been utilised

© Recommendation for the investment of £64,200

Investment	Amount	Term	Use	Access	Risk	Tax status
National Savings index linked certificates 3 year	£15,000	3 years	For the trip	3 years	Low	Tax free
National Savings fixed rate certificate	£15,000	3 years	For the trip	3 years	Low	Tax free
Investec 3 year Deposit structured product 16% if FTSE 100is higher at the end of the term	£34,200	3 years	For the trip	3 years	Low – maximum for FSCS	Interest taxable

(d) **Investment of £145,600 in a purchased life annuity** on a single life (Annette) basis including a 3% increase per annum. The annuity is £5,634 of which £3,640 is treated as capital. The net annuity is therefore £5,235pa.

Richard's pension

£750,000 is invested with Living Time in a five year annuity producing £46,598 gross pa (£38,029 net). To this can be added the net purchased life annuity of £5,235 to achieve an income in excess of £40k net

Capital of £590,089 is returned at the end of the term. At this point the capital can be used to purchase an annuity or a drawdown scheme ,this may produce a lower income but. If Richard or Annette's health has deteriorated an enhanced annuity may be available.

7 SUMMARY OF RECOMMENDATIONS

Problem	Solution	Affordability	Risk
Annette – investment of tax free cash	Portfolio of ISAS, Deposit accounts and National Savings	Capital investment	Risk profile is cautious
Funding £60k for the children in 2015	Monthly payments to cash and stocks and shares ISAS	From surplus income	Risk profile is cautious, 80% cash 20% equities
Richard obtaining a pension invested in a cautious manner which gives income generation rather than growth	5year term annuity with capital return guaranteed	From pension fund	Income guaranteed Amount of cash return guaranteed Death benefit 100% secure
Funding pension in a tax efficient fashion	Use of purchased life annuity in Annette's name. Only part of each payment is taxed at 20%	From pension fund	Guaranteed increasing income but loss of capital
Funding the trip from the pension fund	Use of the tax free cash. Use of a portfolio of national savings, deposit and ISA investments	From the pension fund	Risk profile is cautious 70% cash 30% fixed interest

8 ACTION POINTS AND NEXT STEP

1 Draw up an income and expenditure chart

2 Review capital/IHT/will situation

9 ANNUAL REVIEW OF:

1 Performance of investments/re-arrangement of maturing bonds/transfer of OEICS to ISAS

2 Tax situation

3 2013– preparing to access capital for trip

4 2015 – reviewing the pension options

5 2015 – preparing to advise children on investments

6 Attitude to risk

7 Economy/legislation

NUMBER OF WORDS 2,483

REPORT FOR R AND A WILSON