FINANCIAL PLANNING

A GUIDE TO
WEALTH PROTECTION

Interface

Independent Financial Advisers - Financial Life Planners

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Introduction

"Look after the downside and the upside will take care of itself"

The very best money managers and investors have an obsession and focus on preservation and exceptional risk management of their positions.

A trait which works right across the financial spectrum.

How exactly can you go about managing your wealth and your money to;

- Reduce risks?
- Protect against running out of funds?
- Protect you from having an experience which rips your finances to pieces?
- Protect your wealth through the rest of your life?
- Protect your family bloodline interests?

Our aim is help you work out what the major risks are and, from there, how you can put in place plans to protect yourself.

We look at how to protect a family against death or critical illness; how to keep your pension value intact; how to protect wealth against divorce in the family; how to protect monies in retirement; how to pay for care fees; how to protect your income and savings against inflation and tax rises.

We look at how all families and individuals can benefit from the use of trusts. We explore how and why such a simple mechanism – and solution to so many threats - is perceived as complex, when the reality is different.

Every section of this guide is dedicated to providing ideas and information to help you protect your wealth and assets.

Protecting Your Family

Life Cover and Critical Illness Cover

Anyone looking to protect their family wealth should look closely at how they can put in place life assurance to ensure that money is paid to beneficiaries on their death.

Life assurance costs are normally fairly modest and arranging a life policy relatively easy. There are two areas of life assurance planning which are particularly linked to family protection: paying off loans and covering taxes, especially Inheritance Tax.

Many families in this current age have high debts. Many of those same families afford the cost of debt through one wage earner. If that wage earner dies and their income ceases, the loans/debt can then become unaffordable for the beneficiaries or dependents, devastating the family that remain.

Putting in place life assurance to pay off debts is usually a sound position; creating a lump sum on death, over and above the debt, may well be crucial to keep a decent level of income available for the family.

For those who have very large Estates, wealth measured in hundreds of thousands or more, Inheritance Tax (IHT) is a factor. There are many ways IHT can be alleviated, including through the use of trusts. However life assurance can be used as an alternative - to pay the expected IHT bill.

Many Estates have a property as the main asset, in this respect; life assurance cover can be useful to save the property from having to be sold to pay the tax.

Separate to life cover, critical illness cover is a valuable part of wealth protection. Just as debts may cause problems on death, especially if income comes from one main source, so a critical illness can prove destructive to wealth. The possibility of an individual suffering a critical illness is many times higher than dying prior to retirement.

This may seem an obvious point, but very few people in proportion have critical illness protection, despite its greater likelihood. The critical illness definition is important: at a top level critical illness policies cover such things as cancer, heart disease (including heart attacks), strokes and diseases such as MS and Motor Neuron Disease. The definitions can vary although they have become more streamlined in recent years.

A critical illness plan can be put in place so that a lump sum pays out should an individual suffer one of the critical illnesses covered. This could be used to pay off debt, to cover loss of income or to provide for medical treatment to help the individual recover – all things that may keep wealth preserved.

LIFE ASSURANCE... FAMILY PROTECTION:

CAN HELP TO PAY OFF LOANS & COVER TAXES

How trusts can improve the position with life policies

Any policy which pays out a lump sum may present a problem.

Where is the money paid? What is the tax treatment?

Many people who wisely protect themselves against an untimely death or a critical illness, may do so neglecting to consider potential consequences.

In this day and age of high divorce rates amongst families, unmarried couples and second marriages the simple question of where the lump sum eventually 'ends up' may be difficult to answer.

If a lump sum is paid then there may be a question of whether it will be taxed. To some extent a well written Will could deal with some of this. However to properly protect the situation there is no better solution than a trust.

Adding a trust to the life assurance policy allows the individual to provide a clear direction on where, how and when the money is paid out.

A trust can also be used to take the lump sum away from any tax liability. There is no value paying for a policy if it pays out and then 40% is lost to the taxman. There may as well have been a smaller sum paid out if this was the case.

If a policy is written under a trust it will mean it can pay out without any reference to Probate. This could mean two things: one, it can speed up the payout of the life assurance cover. Two, it could save costs.

Trusts should always be used alongside life policies for these reasons. Yet most policies are set up without a trust in place.

OUR POSITION

We aim to ensure that all policies, wherever possible, have a trust alongside them to help direct where the lump sum should be payable. Existing policies that have been running for many years can have a trust added later. Putting a trust in place is one thing, making sure it is correctly worded and directed to the right beneficiaries and works from a tax efficiency point of view is another. We help our clients take care of all of this. Our professional advice is to cover 2 years' worth of your income. Our experience shows that the worst illnesses can take up to 2 years to recover so that is what we recommend, however income protection can offset some of this cost – this again shows why advice is so important.

Investments

Inflation and wealth destruction

Inflation is the hidden but very real threat to many savers and investors. If you have money invested then one of the most important elements is to factor in the real rate of return you are getting.

One of the cornerstones of all financial planning is to gain an understanding of the effects of compounding.

What may look a fairly benign number can be very dangerous when compounded. An inflation rate of, say, 3% may not seem much in any one year, but rolled up over 10 years it is a significant figure. 3% inflation year on year totals 34.5% after 10 years, which would have the effect of reducing the value of an investment by one third over this period. Many investors would consider a loss of one third unacceptable if it was a straight line loss but ignore it in terms of inflation.

At the time of writing inflation has generally been higher than a typical cash return, on average, for many years – therefore those savers/investors who hold cash are losing value because of this.

Losses

The loss of capital can be hard to make up e.g. A 30% loss requires a 43% recovery.

Most professional investors tend to have one thing in common: They look to minimize their downside. This is a position which stretches beyond mainstream investing: professional traders will focus on avoiding losses, professional poker players will be adept at getting away from poor hands.

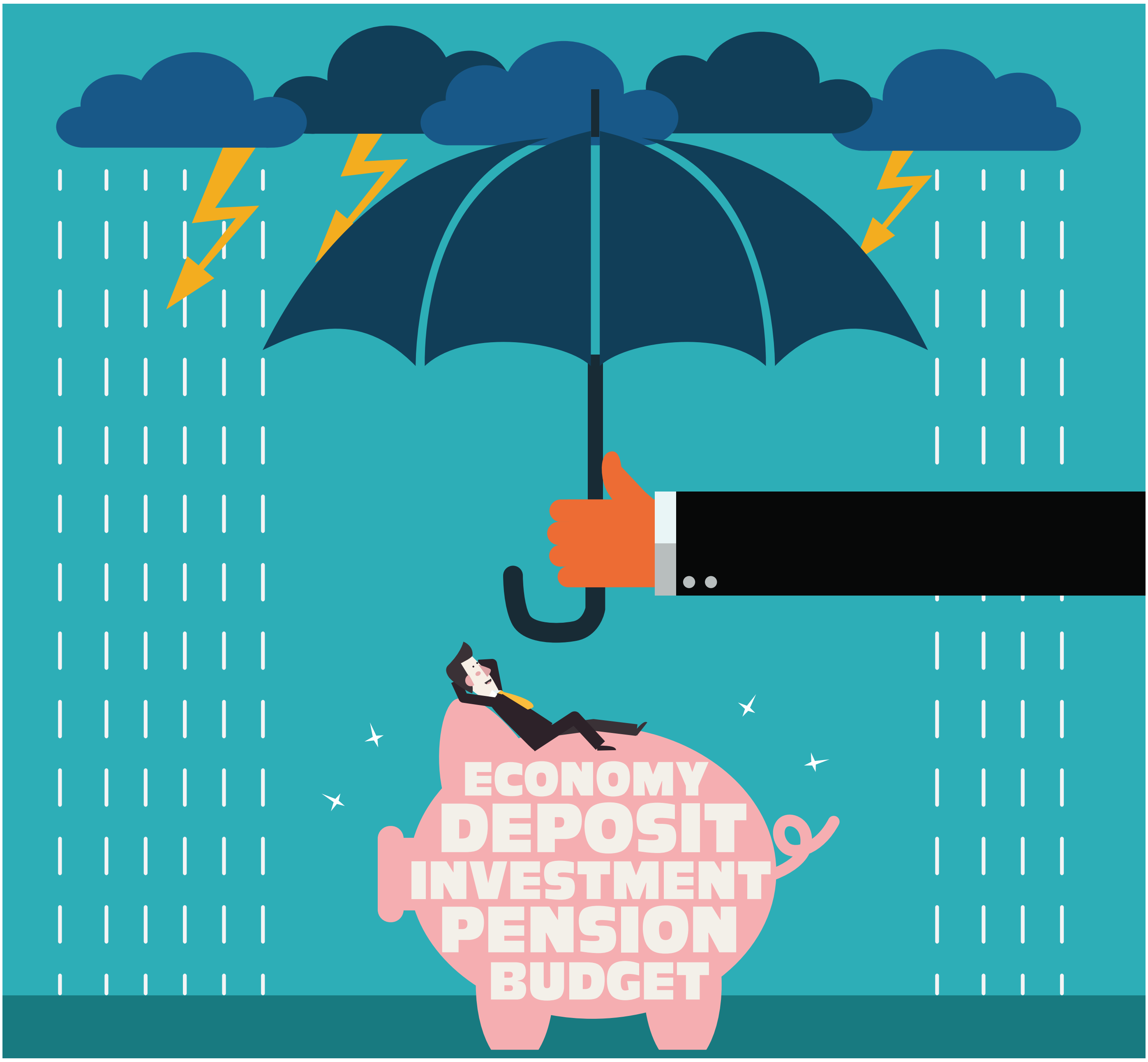
In terms of investing, the principle is quite easy to demonstrate: if you place money into an investment, for example £20,000, and it falls by 30%, it becomes worth £14,000. From that point on to get back to its starting value the investment needs to grow by £6,000. This is £6,000/£14,000 which is 43%.

This is just to get back to the starting position.

This is a very real issue for investors – particularly emphasized through 2008/2009 when many markets tumbled – and history shows this occurring time and time again across all asset areas.

There is a great deal written about "buy and hold" and "you cannot time the markets" – many investors have these (and similar) sayings uppermost in their thoughts. However whatever strategy is pursued in managing wealth the focus that is placed on managing the downside position has to be central. It should be the priority if you are seeking to protect your wealth.

3% INFLATION RATE OVER 10 YEARS WOULD... REDUCE INVESTMENT VALUE BY 1/3.


ECONOMY
DEPOSIT
INVESTMENT
PENSION
BUDGET

Investment Protection

There are many ways that the downside can be protected. These vary from holding cash (but the problem of inflation erosion exists), using structured methods and using highly diversified asset allocation portfolios. The exact method will be determined by your risk position and your tolerance to risk.

A paradox of investing is not to get too heavily focused on the downside to the point where there is no upside left. For example holding 100% cash for the long term is quite likely to protect the downside (certainly in nominal terms) but has little upside potential.

The way to deal with this and to handle this paradox is to start from the basis of a risk assessment. Historically the convention was to assess risk based on your "attitude to risk". This is a mistake, the importance of managing the downside should be built around your "tolerance to risk".

Once a tolerance to risk has been assessed then the downside protection can be fully considered and suitable investment products and plans put in place. There are many products which build in a "floor" to the downside and these may well be suitable; alternatively it may be the case that the position can be protected through a diversified asset allocation process.

Risk Management

There is a considerable amount of confusion around, and misuse of, the word 'risk'. Any financial plan will have an element of risk attached, which means things may not work out as expected.

In investment terms risk is most often used to describe the potential for loss; how likely is it that the investment you make will lose money? The problem for advisers and investors is that risk is hard to quantify and is easily misjudged (either up or down). Sometimes investors take on an investment not realizing how risky it is (i.e. how likely it is that they will lose money and/or how much they might lose) or they don't invest in something (which would otherwise be good to invest into) because they think it is too risky and overstate the risk element.

It is a central requirement of any strategy (which aims to protect wealth) that proper regard for risk, the level and the extent of the risk, is made. There are two key elements to this: risk measurement and due diligence.

If you are aiming to protect your wealth then you should make sure that whatever investment you make (and generally this applies to all financial transactions) should be subject to an assessment which involves measuring the risk and which contains a due diligence exercise.

Too many problem investments (structured products which went wrong, certain with-profits funds, fanciful investments such as exotic property schemes) could have been avoided by the prudent investor simply by undertaking these two steps: risk measurement and due diligence. Have you done this with each and every one of your financial holdings?

OUR POSITION

Over and above looking at our client's risk position with an assessment of their risk tolerance, we then aim to ensure that each investment type and holding we advise has been subjected to a due diligence exercise and also to assess the level of risk involved. This way we can advise investments that meet our client's risk position and ensure that this is with holdings (funds etc.) which have been properly audited.

Retirement Funds

Pre-retirement issues around death

The most consistent element of government policy is that it has been – inconsistent! The biggest outcome from this haphazard approach to pensions and the constant legislation shifts is that there are any number of different types of pension scheme floating around and held by investors.

Personal pensions, stakeholder schemes, section 32 buy outs, protected rights, final salary schemes, auto-enrolment and many more besides make up the various pension types that any individual may hold. And many may hold more than one type! It is a confusing picture, because different schemes or plans may have different rules applying. Not enough attention is given to the type of pension you may have and its structure.

This is important because the situation and treatment of the pension on death before retirement could be very different depending on the type of scheme. There are three ways this may be important to you:

1. Do you know who the residual pension value will be paid to should you die before you retire? This is especially important for single unmarried people, for those who have been divorced, for those who have children with different mothers or fathers, for those who may be facing bankruptcy and for anyone with specific requirements for money to be dealt with, in a particular way, on their death.
2. Do you know how the pension will be paid out? Will your beneficiaries receive a lump sum, a monthly pension or a combination of both (or possibly nothing at all???) and if so how does this relate to the value at the date of death?
3. Do you know how any payout will be taxed? Will Inheritance Tax be applied, will your beneficiaries pay income tax on the benefit they receive etc.?

It is simple to deal with all this: get the position reviewed and if there is something you are not happy with it is highly likely that you can amend the position exactly to your requirement with the use of simple trust forms or nomination forms. The use of such forms in these cases means that you can direct what you want to happen within the confines of relevant legislation.

OUR POSITION

We help clients review their pension position and view what would happen on death to the pension. From there we can advise on any suitable measures, such as putting a trust wording in place and/or adopting a suitable nomination form to ensure that the value of the pension is paid out in a timely fashion, to the desired people and in the most tax efficient way. Further to this we can then keep this under regular review in future years to ensure that the requirement is in keeping with any changing circumstances and legislation.

Protecting Your Pension

The investment strategy you adopt within your pension is key to the twin objectives you are likely to have: to grow your pension and to protect it. These are often seen as separate requirements, even, in many cases, conflicting requirements.

Is it possible, however, that they are complementary?

Too often investment planning (remember this section is about pensions - investment planning within pensions) is over-simplified by many commentators. For example, the trade off between risk and reward. To get better rewards you have to take more risk is the age- old and assumed underpin to most investment considerations. There are many investment experts who believe this is fundamentally wrong. Yes, often, high flying investments (in the sense that they aim for high double digit year on year percentage returns) are racier. Think Commodities and Emerging Markets for example.

Yet these same investments are subject to long down periods and/or sudden downturns of some magnitude. If you review the long term (and what is a pension? A long term investment structure) then over time it is more often than not the steadier, less racy investments that win the day.

Investors (and their advisers) rarely time the fluctuating prices of volatile, high risk investments, leaving them vulnerable to the downturns.

The lesson from this? Relatively reliable, but unspectacular, holdings generally do the trick and often end up producing higher returns. They are less volatile as well, suggesting lower risk.

Pensions are an ideal vehicle to build a balanced asset allocation investment portfolio, where risk is controlled but returns are still achievable. There is no reason to sacrifice risk for reward or reward for risk.

OUR POSITION

We believe that the central task of a good financial planner is to help their client find the right risk/reward ratio for their investments. Pensions are special in a number of ways: they are often crucial to future retirement income, they are inaccessible during the savings years, and they have special tax treatment.

Balancing this together we work on specifically targeting the best mix we can find between growth (and income - depending on age) and protecting the value of the fund/plan. Our strategies seek out high levels of protection but with good potential returns, in a way that is designed for the appropriate circumstances.

PENSIONS INVESTMENT: RISK CONTROLLED RETURNS... ACHIEVABLE

Post-retirement issues

Pensions have special rules applying to them and specific tax treatments and these vary depending on status and whether the pension is pre or post retirement point.

The driver for most people after retirement is to balance a number of different factors:

- to preserve their wealth
- to have a retirement income
- to ensure tax efficiency
- for dependents to be looked after once they die

As with the earlier section on how to invest within a pension there is a misconception about these requirements: they do not necessarily clash. It is perfectly feasible to construct a plan which protects the value of the money both for the pension holder and their dependents, to do so tax efficiently and to enjoy a good income in retirement. In many cases this is a reality, it is no utopia.

The key is a good structure. Too many people imbalance their positions via the structure of their post-retirement plan. For example many pensioners have to decide what structure their pension should be held and managed in. Historically, the majority plumped for annuities. There is strong anecdotal evidence that suggests this was often done without an examination or appreciation of all possible alternatives.

It is back to due diligence again; getting an appraisal of all possible options, the advantages and disadvantages, comparing and contrasting these. An annuity may be the best option, but it often comes with a destruction of one of the key factors in the list above: the money is not properly preserved for dependents and/or the income is stuck at a level and is inflexible.

The object of the exercise is to match the requirements and factors against each other, balanced against the individual's own circumstances, risk tolerance, requirements for income and tax position. Getting a perfect blend for such situations is normally achievable.

The current pension legislation suggests that, for many people, pensions will be seen, in the future, as more than a "retirement income generator" for the individual pension investor. Pensions, because of their new tax treatment on death, can be viewed as a family pot, where the value can be used for the pension investor in their lifetime – to support their income needs – but the pot survives beyond this to provide a valuable inheritance for the next generation.

OUR POSITION

Getting this post-retirement balance can normally be achieved for our clients through careful appraisal of a number of key factors. We stress that in this area there is often too little time spent on the various options and the way that these are measured. We spend many hours looking with our clients at these options and balancing points, aiming to construct a clear-cut plan which most commonly starts with preserving wealth.

Care and Care Fees

Protecting against care

The first thing to examine in this section is a non-cost factor. Surveys show the main worry people have in respect of future care is NOT cost.

The main worries tend to be:

- *I don't want to be a burden on my family*
- *I want to be somewhere nice and comfortable*
- *I want to stay in my own home*

Therefore the key element is to examine how long term care costs can impact on these.

If you have too much money (!) you probably can afford the fees, if you no money you probably have no choices. The fact is that most people sit somewhere in between these two positions. This is when the costs become a real worry both in terms of the money itself but also in relation to the sentiments as above.

An individual, age 80 for example, who suddenly needs care may require £40,000 per year – possibly out of the blue - to pay fees so that they are able to afford a comfortable care home and/or can avoid being a burden on their family. Let us say that the 80 year old is a widow with pensions of £12,000 per year and savings of £40,000 and a property worth £200,000; they will have limited ways of paying these fees without selling the home. And even if they do, then there is the prospect of the family having a rapidly depreciating inheritance, even if the lady herself does not need all the money in her lifetime.

10 years of care from this point can decimate the financial position for the family.

This cost cannot be avoided by the family looking after her (i.e. to reduce or save costs) without upsetting her greater concern i.e. not to be a burden. She may well want better care than £40,000 per year will "buy" (depending on region and facilities care costs could be much higher).

It is a desperate conundrum and one that nationwide is growing ever greater for more and more families.

Care can wipe out a generation of wealth in just a few years and will do so unless some other key drivers are sacrificed or some other way of mitigating the costs can be found.

Ways of mitigating and meeting care fees

There are few ways of paying for long term care that are not covered by one of the following:

- from income
- from savings
- through insurance
- through support from the government, either local or central or both

Trusts: The use of trusts is to help remove assets from an individual's control which could, in the right circumstances, legitimately take them out of any assessment made by a local authority as to care fees. This is a complex area where rules around deprivation of capital need to be carefully considered. However, for many individuals moving towards retirement or already retired, the value of using trusts (see section below on trusts) is considerable and wider than simply care fees management.

Insurance: Insurance is the "forgotten" route in the modern world. The Dilnot commission and its report on care in the UK could and should have found more reason to push insurance to the top of the list, it did not for reasons that were unclear. Although it could be because it was considered 'take up' would be poor.

Insurance is often the best answer, however at the time of writing there are limited insurance schemes available.

Enhanced Annuities: There are annuity (lifetime income) contracts available within the market which allow individuals to exchange a cash lump sum for a lifetime, guaranteed for life, income. Rates from such contracts can be very high (enhanced) for people with severe health difficulties which translate into shorter expected life spans.

These can produce exceptionally high levels of guaranteed income and, as they are lifetime income plans, they can be ideal for people in care.

Investment/income structures: For many people funding care fees can come down to working out how to balance income needs from their pensions and investments.

This can often entail converting or rearranging investment portfolios and taking a completely different approach to the pre-care investing.

The ability to make investments or savings last can vary from approach to approach. From the same pot of money different approaches and strategies can make years of difference in terms of how long income can be made to stretch and/or how much income can be derived from the same pot.

The concept can be described as 'decummulation' – the means by which investments are 'cashed' and converted into income – this is an especially skilled area of financial planning and one which is particularly relevant where very high care costs have to be met from a limited reserve or investment fund.

NHS Continuing Care: One of the cornerstones of paying for care could be support from the NHS, which is not means tested. This support is based on a health assessment. In simple terms if an individual is deemed to require their care due to health problems then the NHS will provide a level of funding support, which can be very significant.

This is an area which requires careful appraisal and if you think this affects you or a family member it is one of those areas where you must take professional advice. The application and assessment process is convoluted and needs to be undertaken carefully, as the assessment will dictate the outcome.

There is a part of the legal industry that specializes in helping families recover money from the NHS which should have been paid but hasn't. Recent legislation changes have restricted this back testing and recovery element. However it does evidence how many people "miss" this support. This appears to be for two main reasons:

1. Individual's requiring care or their families/friends/carers (i.e. those responsible for paying the fees or organizing the payment of the fees) don't know about the Continuing Care support and never make an application.
2. Individuals may go into care with their health position at a point where they would not qualify for support. Sometime later, maybe months, maybe years, their health has worsened and they could then apply. So when they start off in care they are not eligible for financial support from the NHS but later on, they are. Fresh appraisals are not made, again the financial support is not provided even though it could have been.

OUR POSITION

The way to mitigate Care fees is to plan ahead. We believe where (or if) possible insurance is a key plank in any planning. If this is not available or feasible then the central way to mitigate costs is to see if finances can be arranged to maximize the passing of monies – maybe through trust arrangements – through to beneficiaries before care costs hit home. There is no possibility of siphoning money away leaving a local authority to pick up the tab, this is prohibited and we ensure that clients do not fall foul of the rules here.

In many cases, probably most, the fees will have to be met out of income/savings. Again trusts can play an important role here in minimizing the wealth destruction. In addition the way that the income and savings arrangements are balanced and how the fees are paid can make a tremendous difference. We help clients structure their finances to their best effect in this regard.

We help suitable clients investigate enhanced annuities or their equivalents, income producing products which are available to those with poor health to get higher rates of income than normal rates. These can often help pay care fees at a much higher rate than any other income producing account or product.

There is considerable evidence that we have seen which indicates that individual's or their families are unaware of the availability of potential support from the NHS. This support is not means-tested. When we help individuals or families we can help with the process of identifying if NHS support is available either now or in the future.

The Use of Trusts

How trusts can support and protect wealth from Care Fees, IHT, other taxes, divorce and bankruptcy, probate costs and delays and ensure money goes where you want it to go.

Trusts are the cornerstone of many financial planning requirements. So why don't more people use trusts?

There appear to be reasons which include:

- Trusts are considered to be only relevant for wealthy people
- Trusts are solely there to avoid tax
- They are complex
- They are expensive

Each of these statements are misconceptions. In the main, trusts are simple, with any cosmetic complexity easily dealt with by a specialist.

Trusts are as much, if not more, about directing where, when and how monies are paid, rather than avoiding tax. Yes, they can be used for tax efficiency and should be wherever possible, but this is far from their only function. They can be put in place easily and as such - in many cases - are not expensive – indeed they often help save money either through wealth protection, tax reduction or through other efficiencies.

TRUSTS ARE SIMPLE...

Trusts vary considerably in their type and the rules which apply.

Different types of trust will have different rules applying to them around who can set one up, when, how they long they last, what the trustees can do (i.e. "their powers"), who the beneficiaries are, what, when and how changes can be made, how they are wound up, what income can or cannot be paid out (and to whom), the tax treatment in and around the trust and what happens on death.

There are many names applying to different trust types.

All of this is largely irrelevant to you, the reader, because you can adopt the basic principle of wanting to use trusts and leave the finer points to a competent financial planner to sort. The nitty gritty of how this is done is something they can take care of, just as many people leave their bookkeeping to a bookkeeper.

The essence of using trusts is about wrapping assets into a controlled area. In this way wealth can be protected. An example would be where an individual or family wishes to keep their assets within their own bloodline.

... COSMETIC COMPLEXITY
EASILY DEALT WITH BY A SPECIALIST

History, Structure, and Expertise

Interface Financial Planning started providing independent financial advice in 1992. From the beginning it had the aim of providing professional advice and quality service to people with modest income and wealth.

Its key value was putting people before profit, and contribution before reward. This mission statement has been our torch to light the path ahead and has been the reason that we have endured for over 24 years.

Alan has lead the company with his personal values of: Integrity, Compassion, Respect, & Loyalty, and he is proud that over the years he has worked with clients who share similar values. Like him they want to help others and make the world a little better.

Client care and service is important and he is proud that his first two clients from January 1990 remain his clients today.

We believe that every client should have access to highly qualified advice and expertise.

Technology is used to the full to maximise efficiency and engage expertise from throughout the UK. The business has been paperless for 10 years and for over 5 years has been 'cloud' based. This structure reduces costs and allows support staff to operate anywhere - from Colchester to Honiton to Leicester and elsewhere.

Clients are encouraged to access their online account where they can exchange messages and documents securely. They can view their investments and reports, and they have immediate access to their paper file. Clients love the transparency and openness of being able to view and print paperwork going back for years and many clients use it as a source of reference.

ALAN MORAN
Owner, Director
Interface Financial Planning

Alan Moran is one of the most highly qualified advisers in the UK. He became a Certified Financial Planner in 1995 and he was one of the first Chartered Financial Planners in 2005.

He is a Chartered FCSI, a holder of the IMC certificate and member of CFA UK. His expertise has been called upon by The CII, The IFP, The Kinder Institute, and others, where he has trained and examined other financial advisers.

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