

A Changing World: Pensions: The impact of 2020 on retirement plans

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Learning objectives

- ▶ The dynamics of retirement income planning
- ▶ Identifying and supporting vulnerable clients
- ▶ The benefits of cashflow modelling and wider financial planning
- ▶ Adapting ongoing adviser service to the changing needs of the client

Dynamics of retirement income - decisions

- ▶ Moved from a society where employer & state will provide, to requiring the individual to be responsible for their income in retirement
- ▶ Individual decides:
 - ▶ Contributions
 - ▶ Asset allocation, investment profile including any environmental, social or governance screening
 - ▶ Retirement age
 - ▶ Profile of the benefits package - certainty, flexibility, sustainability

Dynamics - the risks

- ▶ Longevity risk - how long will I live? Who do I need to provide for?
- ▶ Morbidity risk - the financial consequences of being unable to work or needing long term care in retirement
- ▶ Inflation risk - Will inflation remain low? Higher inflation reduces the purchasing power of income it is corrosive
- ▶ Investment risk - markets rise and fall, asset allocations are important, rebalancing is important - how will an investment be selected and managed
- ▶ Sequencing risk - the timing of investment market rises and falls can be beneficial when accumulating a pension fund and devastating when accessing benefits
- ▶ Taxation risk - annual allowance and lifetime allowance charges erode value
- ▶ Scams - the number is increasing and becoming more refined

Dynamics - the effects of Covid

- ▶ Employment, investment risk, health and premature death brought to the fore
- ▶ Rising unemployment
- ▶ Dependency rate changing - working/retired
- ▶ Working longer - the “young old”
- ▶ Impact of remote working - artificial intelligence and robotics
- ▶ Changing buying habits
- ▶ Changing profiles of companies, supply chains and the investment options
- ▶ Property investments
- ▶ Psychology of investing - are the markets friend or foe?

Vulnerability

- ▶ Not just clients - work colleagues and you
- ▶ The Mindful Business Charter
- ▶ Difficult situations create a curve of emotions - shock, denial, anger, blame, guilt, dejection, calmness
- ▶ Recognising unusual behaviours - having “reasonable belief”
- ▶ Coping mechanisms
- ▶ Importance of lasting powers of attorney - the 5 principles of the Mental Capacity Act 2005
- ▶ Two stage test:
 - ▶ Is there an impairment of, or disturbance in the functioning of the person’s mind or brain sufficient that they lack capacity to decide?
 - ▶ Unable to decide if they cannot understand, retain and weigh up information and communicate a decision

Cashflow modelling and financial planning practicalities

	Inflation	Fall in fund value	Fund at 90 (today's money)	Age at which fund runs out	Sustainable withdrawal (today's money)	Yield
Annuity					17,799	
Scenario 1	2.5%	0%	133,170	99	21,456	2.7%
Scenario 2	3.5%	0%	25,703	92	21,029	3.7%
Scenario 3	4.5%	0%	n/a	88	16,078	4.7%
Scenario 4	2.5%	25%	n/a	88	16,610	4.5%
Scenario 5	3.5%	25%	n/a	84	14,419	5.5%
Scenario 6	4.5%	25%	n/a	82	12,447	6.4%

Assumed growth rate 4% pa net of all charges

Yield = growth required for fund to sustain income to age 90

Accumulation stage

- ▶ Cash flow helps to project possible shortfall due to gaps in contributions
- ▶ 2028 pension age rises to 57
- ▶ Encourage high equity content, use of emerging markets, benefits of pound cost averaging
- ▶ Younger investors more committed to environmental, social and governance issues
- ▶ Staying invested and reducing investment costs
- ▶ Paying down debt
- ▶ Premature death and long-term loss of income

Decumulation stage

- ▶ Avoid triggering money purchase annual allowance and recycling lump sum rules if trying a short term income fix
- ▶ Lifetime Allowance crystallise and take cash to mitigate LTA charge
- ▶ Two pools
 - ▶ Safety pool - income X number of years - low risk investment
 - ▶ Long term pool - higher risk investment
- ▶ Death benefits - update expression of wishes
- ▶ Death benefits - ill health transfers within 2 years of death - Staveley Case
- ▶ LPAs for drawdown clients
- ▶ Use of life insurance
- ▶ Equity release
- ▶ Retiring to EU - new rules from 2021?

LTA charge calculation

Already crystallised	£35,329		
LTA at time of crystallisation	£1,030,000		
% of LTA used	3.43%		
% of LTA available	96.57%		
Value at crystallisation - take as lump sum		Value at crystallisation - take as income	
AYZ Ltd pension plan	£1,070,404.02		
Available LTA 2020/21 - 96.57% of £1,073,100	<u>£1,036,292.67</u>		
Excess benefits value	£34,111.35		
Lifetime allowance charge (£34,111.35 x 55%)	<u>£18,761.24</u>	Lifetime allowance charge (£34,111.35 x 25%)	£8,527.84
Net excess benefits value	£15,350.11	Net excess benefits	£25,583.51
		Saving in LTA charge (£18,761.24 - £8,527.84)	£10,233.40
Tax free cash (TFC) is the lesser of:			
25% of plan value at crystallisation (£1,070,404.02 x 25%)	£267,601.01		
or			
25% of LTA at crystallisation (£1,036,292 x 25%)	£259,073.17		
Benefits taken			
TFC (£1,036,292 x 25%)	£259,073.17	TFC (£1,036,292 x 25%)	£259,073.17
Net excess benefits - lump sum	<u>£15,350.11</u>		
Total lump sum	£274,423.28	Total lump sum	£259,073.17
Plus remaining benefits available for taxable income (subject to personal allowance)		Plus remaining benefits available for taxable income (subject to personal allowance - £12,500 for tax years 2019/20 & 2020/21)	
	<u>£777,219.50</u>		<u>£802,803.02</u>
		withdrawals above personal allowance taxed at 20% or 40%	
25.64% of plan value £1,070,404.02		24.20% of £1,070,404.02	

Adapting service and fees

- ▶ Ongoing reviews - agree in advance any changes to investment mix/withdrawal if markets move dramatically
- ▶ Set reviewable fees based on time, experience, complexity and your knowledge.
- ▶ Ongoing adviser fee should vary pre and post decumulation
- ▶ Work of a financial planner does not correlate with the size of the investment pot
- ▶ Record time spent
- ▶ Lives are becoming more multi stage and Covid has speeded this change
- ▶ Products and services need to change from rigid 3 stage life cycle

Questions?

- ▶ **BOOKS:**
- ▶ “Beyond Greed and Fear” Hersh Sheffrin - Oxford University Press
- ▶ “The Four Pillars of Investing” William Bernstein
- ▶ “A Random Walk down Wall Street” - Burton Malkiel
- ▶ “Common Sense on Mutual funds” - John Bogle
- ▶ “Grandpa on a skateboard” - Tim Farmer
- ▶ “Paying for residential care: a guide for private client practitioners” - Austin Thornton - Wrigleys Solicitors Sheffield