money management

Financial Planner Awards 2018

What should your Money Management Awards entry look like?

Your Money Management Awards entry should have all the components of a (mini) financial plan, which clearly splits the information out into appropriate sections and states things such as the client background and their objectives, with timescales for achieving them. You should also demonstrate that you have reviewed and analysed the client's existing arrangements and investments

In your 300 word accompaniment the judges would like to see a clear demonstration of your thought process. There may be several options you wish to explore with the client but the judges would like to see a brief explanation of these and a fuller explanation of the course of action you finally recommend.

In all situations you should clearly demonstrate that the clients can meet their objectives and that your recommendations are clearly affordable.

The example provided in the following pages is based on a theoretical example, and your submission does not necessarily need to be set out in this way.

You should simply provide:

1. The original plan that was written for your client - with personally identifiable information such as names, company names, pension schemes and addresses redacted. Due to data protection laws **we cannot accept entries containing anyone's personal information**.
2. A 300 word explanation of how your plan would attempt to meet the client's objectives, and how it fits the criteria for that category (the criteria can be found on the entry form for each category).
3. If your plan encompassed more than one Money Management Awards category, please submit a separate 300 word document for each category. The same financial plan can be used to enter multiple categories.

Your submission must also include a completed entry form.
Please email your completed entries to **mmawards@ft.com**

If you have any questions please contact **claire.harris@ft.com**

Example entry – Multi Asset

This client has inherited a substantial amount of cash from her deceased spouse, and as such it is important to assess whether the investments, in their current form, are still suitable for her own objectives.

Clearly, the most important thing to address is the fact that income falls short of expenditure. Failure to rectify this could force the client to draw from capital, which would erode the figure that she plans to pass to her son on her demise.

Secondly, there is a disconnect between her risk appetite and the risk within the existing portfolio. Given that the client has a limited understanding of investments, it is important to educate her on the potential risks involved which should be done prior to transaction and reviewed on a regular basis – at least annually. This will enable me to review and amend her portfolio should a change of situation, such as worsening health, occur.

By investing in a multi-asset income portfolio distributing dividends at roughly 4 per cent, her income shortfall will be met. The mixture and weightings of the underlying assets such as equities, property and bonds is aligned with her specific risk requirements. Again, this will be reviewed regularly to ensure that it continues to meet her needs. Also, as we will use Oeic and Isa wrappers, the full proceeds can be passed to her son on death, so long as her will is updated. I have recommended an appointment with a solicitor immediately.

Finally, in order to make full use of any tax efficient allowances, which can help secure a higher level of future income, we will consider using CGT allowances on an annual basis to switch Oeic funds into the Isa. However, this will be dependent on the client's tax position at the point of transaction.

[redacted]

[redacted]

MULTI-ASSET

[redacted]

OBJECTIVES

1. Ensure enough income to meet your expenditure of £30,000pa
2. Ensure you can pass on to your son [redacted] at least an amount equal to the total figure you inherited from [redacted] [£275,000]

Main Issues
1. Retired and recently widowed [June 2015]
2. In good health
3. You now find you have insufficient income to pay your rent and regular bills
4. You have not yet claimed the 80% of basic state pension to which you are entitled
5. [redacted] annuity ended on his death
6. You have not changed any of the investments since you inherited them from [redacted]
7. You are concerned that you do not understand how the investments work, and the risks involved
8. [redacted] wonders if there is a simpler way to give you an income to cover your expenditure in a tax-efficient and stress-free way
9. Your will gives 100% of your assets to [redacted]

Other Issues
1. ISA allowances not used
2. Possible spouse ISA allowance?
3. Annuity doesn't keep pace with inflation
4. No interest on instant access account
5. IHT implications

ASSUMPTIONS

Inflation : 3.0%
Above the Bank of England predicted rate and the recent average for both CPI and RPI, but more realistic : several items of normal expenditure increase by more than the official rate.

Savings Interest : 2.5%
Generally behind inflation over the long term.

Investment Growth :
[before charges]
- Gilts 3.5% : risk-free return based on redemption yields
- Index-Linked Gilts 4% : 0.5% over inflation
- Corporate Bonds 4.5% : Typically 1% over gilts, allowing for extra credit risk
- Equities 7.5% : Based on historic equity risk premium of 4%, the difference between the return expected on equities and the risk-free rate on gilts.
- Property Funds 5.0% : MSCI Property Fund Index suggests longer-term growth 2.1% above inflation

State pension 2.5%
Based on "triple lock" guarantee : highest of CPI / earnings / or 2.5%

Life Expectancy : 100

Higher than the life expectancy of 25.15 years for a 60 year-old female [ONS Life Expectancy Calculator] – but more cautious in calculating how long capital is needed.

Other :

1. State pension at 66
2. No ethical, social or environmental restrictions on your investments
3. Taxation rates remain unchanged, with allowances and exemptions increasing with inflation.

INVESTMENT RISK

[Subject to completing full Risk Profile]

1. You describe yourself as an "extremely cautious" investor.
2. Typical investors with this profile would accept up to 20% in growth assets [equities, property], and 80% defensive assets [bonds, cash], with anticipated returns c4.57% before charges.
3. They would feel uncomfortable if their investments fell more than 10%
4. However, you also appreciate that you need to take a little risk as you are in good health and may live for another 30-40 years before your remaining assets pass to Billy

Types of Investment Risk

1. Absolute risk : your investment may be less in value when you sell it than when you bought it.
2. Market risk : the risk within a geographical sector or market sector. International investments also carry the risk of currency fluctuations.
3. Specific risk : an individual part of your investment may fall in value.
4. Comparative risk : an asset may rise or fall in value compared to other assets, or to inflation.
5. Inflation risk : The possibility that the purchasing power of assets will be eroded.

There are 3 aspects of risk tolerance :

- Risk capacity : the extent to which you could sustain a market decline without affecting your lifestyle / plan
- Risk required : the investment risk you need to take in order to have a reasonable chance of reaching your objective
- Risk attitude : your willingness to take a certain risk in return for potential rewards

FINANCIAL POSITION

Net Worth 18/07/2015

£350,100 – All liquid assets

Estimated after-tax income:

- Annuity £11,000
- £11,000 personal allowance
- £0 tax
- £11,000 net

Investment Dividends

- £5970 paid out
- Reinvested dividends still taxable
- First £5,000 tax-free under new dividend allowance; rest taxable at 7.5%

State Pension At 66
£155.65 x80% : 124.52pw / £6475.04pa / £5180 net in today's terms

Cashflow

1. Without investment income, outgoings currently exceed income by £19,000 pa

2. State pension reduces the shortfall to £13,820, which represents 3.95% of your starting capital. This may be achievable within your risk profile, but it does not allow for inflation or preserving capital.

3. Based on your present investments, the initial cash-flow shows your capital would run out by age 88

4. Your main risk is inflation, as your highest income source does not increase

5. To provide the income shortfall for the rest of our assumed life expectancy, increasing with inflation and preserving £275,000, would need a return of 6.16%pa

EXISTING INVESTMENTS

Asset Allocation

1. The overall allocation is riskier than your profile suggests, with over 52.20% equities

2. Within this, emerging markets - normally regarded as higher risk – represent almost 20% of your portfolio [19.78%], increasing both market and specific risk

3. One of the main income-producing assets – fixed interest – is only 6.01% of the portfolio.

4. Cash in an OEIC is normally a "Money Market" fund : the best current yields average 0.52%, reducing to c0.36% after charges.

5. Your OEIC cash is 41.75% of total holdings, but makes little contribution to your required income

6. There are no property funds : while these can be "illiquid" [hard to sell], they are a good source of regular income.

7. You do not seem to have used your ISA allowances

8. It is not clear whether the UK is spread between large, mid and small cap shares

9. OEICs [Open Ended Investment Companies] are "collective" funds which pool investors' money to buy a diversified portfolio of shares and other asset classes, professionally managed. Diversification helps reduce the risk

Valuations & Gains – 31st July 2016

Fund	Purchase £	Valuation £	Gain £
OEIC1	30,000	55,000	25,000
OEIC2*	25,000	25,500	500
OEIC3*	20,000	20,000	0
OEIC4*	200,000	199,000	-1,000
Total			24,500

*Inherited

INCOME OPTIONS

There are two main options :

Natural Income

1. This involves withdrawing just the income ["yield"] generated by investments - dividends from shares, or interest from bonds and cash
2. Just taking the natural yield leaves the underlying capital intact : this may help your objective of leaving the inherited sums to [redacted]
3. The yield should increase over time to offset the effects of inflation; the underlying capital also needs to grow to maintain its real value
4. However, income payments can fluctuate – making it difficult to budget for fixed expenditure; and the value of underlying capital can fall.
5. Reinvested dividends contribute significantly to long-term returns [the "compounding effect"] : this advantage is lost when income is withdrawn

Drawing From Capital

1. This involves gradually selling investments to provide income.
2. It may be combined with natural yield where the yield does not provide sufficient income.
3. However, this can be more risky, especially in falling markets : selling when investment values have fallen makes it harder for the portfolio to recover losses.
4. Withdrawals also deplete the portfolio, which may leave insufficient for future income.

SIMPLIFYING INVESTMENTS

Multi-Asset Funds
These are portfolios which invest in a wide range of asset classes, sectors and countries within a single fund.

1. The major asset classes are equities [shares], fixed interest, property and cash.
2. These may be broken down further:
   - equities by geographical location, and by size [large-, mid- and small-cap];
   - fixed interest by type (government bonds or corporate bonds), and by quality.
   - property by location and nature (property company shares or actual property)
3. They may diversify further through alternatives such as commodities.
4. Multi-asset investing combines assets with different levels of risk and return, aiming to achieve a desired level of return at the lowest level of risk.
5. The funds usually have a target risk level : this puts constraints on the fund manager to ensure the risk within the portfolio does not exceed, or fall below, this target.
6. Others are given a risk rating at a point in time : the manager has more flexibility, but may diverge from the rated figure to improve returns. Investors may therefore be taking more risk without realising.

Multi-Manager
Multi-manager is a type of multi-asset fund.

1. Multi-asset funds can use any strategy to implement their market view. They tend to invest directly in individual shares and bonds, but can also buy collective funds – especially for more specialist sectors.

2. Multi-manager only buys funds, rather than the underlying asset, to invest in a particular sector.

3. Rather than try to manage an overall portfolio, multi-manager relies on specialist fund managers to select stocks within the different asset classes.

4. They offer a well-diversified portfolio : first by spreading across different funds, and secondly by each fund investing in a wide range of stocks

Advantages

1. Multi-asset creates a well-diversified portfolio

2. It can adapt to changing market conditions, changing the asset mix as appropriate.

3. Asset allocation and fund selection decisions are taken by a professional fund manager with the skills and technical resources to analyse the market.

4. By investing in a range of assets, it should achieve a steadier overall return : if the returns from some are falling, the returns from others may be stable or rising.

5. Exposure to specialised funds can add further diversification, and may help to improve returns

6. It rebalances the assets : for risk-target funds, this should mean your risk level remains consistent with the level required at outset.

7. The funds are structured as OEICs : when the fund manager sells assets at a gain [e.g. to rebalance] there is no capital gains tax [CGT]

Income

1. Multi-Asset Income funds invest in income-producing assets, with a targeted annual income or “yield”

2. Funds aim to provide both a rising income and underlying capital growth

Disadvantages

1. If a manager changes the asset allocation it applies to all investors in the fund, and may not suit your particular requirements

2. They have a broad range within each asset class – e.g. “20-60%” equities” – and can move anywhere between those limits : this means they could hold more or less than would be appropriate for your risk profile.

3. There is no guarantee that a target yield will be maintained or increased : if the capital value falls [as with OEIC4] your income also falls. You may then have to supplement it by withdrawing capital

4. Charges may be higher than buying individual assets / funds, especially Multi-manager which often has two layers of charges : on the fund itself, and on the underlying funds. On-going charges [OCF] can be as high as 1.5% - 2%pa.

5. You may not have the opportunity to use your CGT allowance, which currently allows you to withdraw up to £11,100 gains tax-free

6. You can't take advantage of "compounding".

RECOMMENDATIONS

Savings

1. Keep £5,000 as a contingency fund

2. Use the remaining £15,000 to make up your income shortfall for the next 10 months

3. Keep the notice account as a cash buffer for periods of market falls.

4. Any interest is likely to be within your £1,000 savings allowance.

Investment

1. Re-invest the remaining £300,100 in a multi-asset income fund that distributes c4% of its balance annually as dividends. Your own OEIC would have to be sold over more than one tax year to avoid CGT

2. The fund would have approximate allocations of 55% fixed interest / 35% equities / 8% commercial property, with the rest in cash for liquidity

3. It would use index-tracking funds, as a straightforward and low-cost way of replicating the performance of each market sector.

4. The first £15,240 should go into a stocks and shares ISA : this could be automatically topped up each year by selling / reinvesting ["bed/ISA"].

Charges
- Nil initial
- On-going Annual charges, taken from capital : 0.35%
- Financial planner fees invoiced directly

Capacity For Loss

1. The fund value would need to fall by 16%, and never recover, before it affects your income objective

2. Over the past 20 years, the worst fall in a portfolio with this asset allocation was 10.9%, recovering to its previous level after 21 months.

Spouse ISA
Check / confirm whether any of [redacted] OEICS were in ISAs

1. A surviving spouse now has an ISA allowance equal to the value of the deceased spouse's ISA holdings at date of death – the Additional Permitted Subscription (APS).

2. It can be used for up to 3 years from death

3. The allowance can be transferred to another provider : it does not have to remain with the deceased's ISA provider.

4. It doesn't affect your personal ISA allowance - £15,240 for tax year 2016/17.

State Pension
[If possible] : Pay voluntary NI to make up the other 20% : this would give an extra £1618 pa inflation-linked so you are less reliant on capital withdrawals

MEETING OBJECTIVES

1. You have an emergency sum for unforeseen expenses, but now generating interest.

2. The multi-asset fund provides c£12,000 “natural income” while leaving your capital intact

3. Your income will now be :
    - £11,000 pension - £16,180 from 66
    - £12,000 dividend yield / c£11,475 after tax
    - £7,525 from capital, reducing to c£2000 from 66

4. The fund aims to generate a stable income while maintaining the purchasing power of the capital : dividends would increase as the fund value increases

5. While the income may fluctuate, you have a cash reserve to make up shortfalls

6. The first 5 years’ capital withdrawals would come from cash, allowing the invested capital longer to grow

7. As the cash becomes depleted, it can be replaced by withdrawals from the main portfolio

8. The revised cash-flow shows the capital would need to grow at c3.3% to provide the remaining income.

9. The fund is properly diversified, and rebalanced periodically to ensure it maintains the original aims and risk level.

10. It offers the “simple” solution [redacted] required : you will only have to deal with one set of paperwork and valuations.

11. It is tax-efficient :
    - Within the fund there is no CGT when assets are sold at a gain e.g. to rebalance
    - CGT only becomes an issue if you sell units to provide income through capital withdrawals, but this would normally be within your annual allowance
    - The first £5,000 of dividends would be tax-free
    - Any holdings within an ISA are free of CGT and income tax.

12. However, because of capital withdrawals you would not be able to leave the full inheritance amount to [redacted] without taking more risk.

OTHER MATTERS
Lasting Power Of Attorney, in case you became mentally incapacitated and unable to make reasoned decisions about health and finances

IMPLEMENTATION

Within 1 month

<u>Clients / Planner</u>
Agree investment strategy
Check [redacted] ISAs & Voluntary NI

Within 2 months

<u>Clients / Planner</u>
OEIC sales
Interest-paying account
New income portfolio, including ISA

<u>With Solicitor</u>
Will
Lasting Power of Attorney

REVIEWS

Instigated by Financial Planner :

July 2017 then Annually

- Risk profile updated
- Investment performance
- Income paid out
- Any further income from capital