Case Study

Title: Capital structuring

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The Problem:

New clients are retiring from Public Sector employment and have to make decisions about how to structure the capital sum received from their pensions. With a decent combined income they have never adopted any savings habits. Both in their early fifties, they will continue with part-time employment but have to come to terms with a different income structure.

Issues to look out for:

- Advisers need to be mindful that whilst such planning may seem basic, it is far from simple for clients who have never had to undertake such planning exercises.
- Educating clients to the rationale behind each step will greatly improve their understanding and ensure their engagement in the advice process.
- More than ever advisers need to demonstrate they can add value and be remunerated without necessarily the need for a product sale.

The solution:

It is not uncommon for anyone to live right up to their means and not make any short, medium-term saving or retirement provision. This is particularly the case when both clients have relatively secure public sector jobs, decent combined income and very generous final salary occupational pension schemes. As such they make assumptions about their present and future financial security and as a consequence have not learned basic financial planning disciplines.

The first challenge was to get them to identify what their future, fixed and variable outgoings were and concentrate on making sure these could securely be met, rather than concentrating on what their previous levels of earnings were. This step is best achieved via the completion of a budget planner. This identified an existing interest-only mortgage supported by a mortgage endowment policy due to mature in three years' time. Furthermore, there were some significant commitments which would not last beyond four years in the shame of school fees for their children. All other outgoings would remain reasonably consistent up to full retirement and beyond.

The target income could be considerably reduced by advising them to repay the mortgage debt and put aside a sum equivalent to the known school fees. Consideration was given to the possibility of paying the entire school fees in full, in advance to obtain an attractive discount, and contrast this against the potential interest earned whilst the capital was on deposit. The other benefit of repaying the mortgage is of course to remove the risk of the endowment policy underperforming.

The reduced target income could then be contrasted against the known pension incomes. Projected State pension benefits were obtained and then gaps could be identified in relation to part-time income ceasing, State pensions commencing and the on-going monthly expenditure. Capital could be invested with the specific objective of producing future income to address identified income shortfall at specific dates.

Once any other anticipated capital expenditure has been ear-marked, further accessible, deposit-based capital needs to be put aside as an emergency fund and to allow for unforeseen expenditure.

Protection requirements need to be factored in at this stage, considering the effect disability, illness or death may have on future plans.

Once the basic foundations and future de-risking measures have been established, the clients can invest surplus capital, confident in the knowledge that their finances are on a sound footing and having been shown the value an adviser offers is not just about making product-lead investment recommendations.