Investing for income – compliantly

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There are two traditional choice of investment strategy – for growth or for income. Which one of these is most appropriate for a client is dependent on many factors. This is ascertained by basic fact finding and will include the following information.

- Client objectives
- Age.
- Marital status – age of partner, if applicable.
- Age of dependents, if applicable.
- Working status.
- Anticipated retirement age.
- How much is being invested?
- How long is the investment due to be in place?
- Overall wealth, including all assets and liabilities.
- Current income and expenditure.
- Anticipated income and expenditure at certain life stages.
- Attitude to investment risk – willingness to take risk, need to take risk and capacity for loss.

As ever, this list is not exclusive as other personal factors may be revealed by a good fact finder. This list appears to be basic fact finding that most advisers will reckon that they as a matter of course. However, at a recent FCA Live & Local Event on DB transfers, the FCA had found many fact finds to be insufficiently detailed to provide accurate advice.

The point most common missed covers the client objectives.

- What are the drivers for the investment?
- What are the client's priorities?
- What do the clients actually want/need? The want or need may be two different things.
- What would be the consequences of the client's objectives not being met?
- Can the objectives be met by the actions being taken?
- Does anything else need to be done to achieve the objectives?

The other most common issue is the lack of detail about client expenditure. Many advisers find this quite difficult as it can be considered to be patronising or insulting to go into great detail, particularly relating to discretionary spending. It is a difficult balance between being thorough and being intrusive.

But expenditure is at the heart of the fact finding and advice process. It needs to be carefully considered both on a current basis and looking at anticipated expenditure:

- whilst working.
- until the mortgage is cleared.
- clearing other debt.
- Until dependents become financially independent
- capital expenditure.
- in retirement.
- possible long-term care in the future.

There are some interesting software programs to provide projections of income and expenditure. I have seen Voyant and CashCalc in this respect. They both provide quite detailed report with nice looking graphics. Whether these are understood by the client is dependent on the familiarity of the adviser with the systems and how to interpret the graphs.

If this information has not been gathered, it is difficult to ascertain how much income is needed at any given stage for the client. **Without knowing how much income is needed, what is the advice going to be?**

Another issue with fact finding is the dating of documents and meeting notes. Dating of documents gives context. This is particularly important when considering valuations of investments or whether a breakdown of expenditure is before or after some event has happened eg. Retirement.

For example, which of these tables accurately shows the position of the Premier League?

Table 1	P	W	D	L	GD	Points
Chelsea	28	22	3	3	38	69
Tottenham	28	17	8	3	34	59
Manchester City	28	17	6	5	24	57
Liverpool	29	16	8	5	25	56

Table 2

Leicester City	29	17	9	3	21	60
Tottenham	29	15	10	4	27	55
Arsenal	29	15	5	8	16	52
Manchester City	28	15	5	8	21	5

Table 3

Manchester City	29	23	2	4	56	71
Liverpool	29	21	7	1	49	70
Tottenham	29	20	1	8	26	61
Manchester United	29	17	7	5	20	58

Table 4

Manchester City	29	25	3	1	63	78
Manchester United	29	19	5	5	34	62
Liverpool	29	17	9	3	35	60
Tottenham	29	17	7	5	31	58

Actually, they all do. Table 1 is from 2016/7, Table 2 shows 2015/6, Table 3 shows the current position 2018/9 Table 4 shows 2018/7. But in isolation their meaning is diluted or even totally inaccurate, if the information needs to be up to date now.

Following a good quality fact find, the gathered information then enables the adviser to move to the solution stage. The solution stage will involve the product choices:

- Pension
- Annuity
- Investment Bond

- Individual Savings Accounts
- Mutual funds
- Structured products
- Bank deposits

It may well be that the investment is split between these products.

If considering pension, investment bonds, ISAs or mutual funds, then the choice of funds within the wrapper will be governed by the client's attitude to risk. Although the attitude to risk consideration is also prevalent in the choice of annuity and/or bank deposits.

Investment bonds have traditionally been used for their ability to provide a tax-deferred income of up to 5% per year. Mutual funds offer the opportunity of using annual capital gains tax allowances. ISAs give tax-free withdrawals and income.

Structured products can provide income whilst retaining the capital value of the investment, dependant on how the underlying investment has been set up.

Bank deposits pay interest without risk to the underlying capital. The downside is that the institutions are not paying much interest. The interest is often lower than the rate of inflation, which effectively means that the capital in the account has less buying power than at the outset.

Annuities pay a definite level of income, either for a certain period or for life. However, annuity rates are lower now than they have been historically. These are a bet on client mortality and the capital can be lost when the client dies.

This pursuit of income also relates to pension transfers. For many years, the main choice at retirement was to buy an annuity. For some people, there was the option of income drawdown to give income up to certain levels. However, since Pension Freedom in 2014, it is now possible to use income drawdown without the previous limits and to be quite flexible about when and how much income is taken at any time. The main issue that may come out in the future will be when people run out of money because they have used up their pension savings.

I am amazed at the number of customers who transfer out of Defined Benefits schemes to buy into this income flexibility in retirement. Particularly those who have been employed for their entire career. They will have been paid on the 28th of the month for their whole life and are used to receiving that regular income. Why would clients suddenly want to move to a situation where the timing and amount of their income becomes irregular? If they direct their funds into capital expenditure or debt repayment, they run the risk of exhausting their funds quite quickly. This is a time bomb waiting to detonate in the not too distant future.

So, as ever, with financial planning, we come back to the dark art of fact finding. There is nothing so under-rated as a good fact find. Preferably with lots of dated explanatory notes giving details of client objectives. No compliance consultant will ever complain of having too much information in this respect.

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