The Wire

July 2017

It's an Equitable Life...

By Marcus Carlton

THE year is 1756. Widower and father of three dependent children James Dodson makes an application for life assurance at the Fleet Street offices of the Amicable Society.

Formed some 50 years earlier by the Bishop of Oxford, the society is regarded as the first life assurance company in the world.

Members (limited to 2000 in total) were each eligible to buy up to 3 shares at £6.4s each (£600 in today's money). The premiums were wisely invested in a portfolio of assets, including malt tallies, mine adventure bonds, hollow sword manufacturer bonds, deposits and State lotteries.

All these assets were safely deposited in a giant steel chest specially commissioned for the purpose. Despite the obvious security measures, society officials had on several occasions seen fit to enrich themselves personally by dipping into the funds.

The august society even found itself caught up in that great scandal of the day, the South Sea Island bubble

Nevertheless apart from those lapses the investment track record was sound and James Dodson was attracted to the society in order to provide a measure of security for his young family in the event of his early death.

When a member died, profits from the wisely invested portfolio were distributed each year to their widows and orphans. The society charged the same £6 4s for each share regardless of the member's age, although the maximum age permitted was 45.

Alas Mr Dodson was 46 so he was refused cover.

Now James did not take the matter lying down. Being an eminent member of the Royal Mathematical Society, he was known for his work on navigational calculations, wrote a highly regarded canon on logarithms and accounts of Edmond Halley's tables of lives, one of the earliest actuarial works.

Based on these studies of mortality, Dodson - who had a zeal for benevolent institutions - decided to launch a more equitable assurance company, one which would charge premiums based on the risk and age of the applicant with no upper limit.

Furthermore he decreed the society should distribute surplus profits to the members each year in the form of a bonus as it was to be mutually beneficial.

And so was born Equitable Life, the first modern life assurance company to be run on sound actuarial principals.

Over the years the society and its competitors developed into a world-wide industry which today in Britain alone accounts for premiums of around £150bn a year.

The largest life assurance policy ever arranged was for a Silicon Valley billionaire in the sum of $201m, not because the family would have been destitute without it, but to pay for death duties without having to wind up or sell the company.

Life assurance has many purposes beyond protecting loved ones, Estate planning, protecting a large loan, ensuring that surviving shareholders of a company have the means to purchase a deceased directors shares, for example. Life assurance puts cash in the hands of those who need it when they are most vulnerable.

We all know what happened to Equitable Life in the end, acquired by the Halifax after the society was unable to meet overly generous guaranteed annuity promises. However on no occasion did it ever default on a life assurance promise, and longer term contracts remain in force today.

Regrettably for James Dodson and his offspring he never did get round to taking out that policy, as James died a year after his great idea and a year before Equitable Life formally opened for business.

There was a happy ending of sorts however, as 15 years after his departure from this world, the society voted to make a healthy payment to his beneficiaries in recognition of his services.

Enlightened financial planning. It's worth more than you may think.

As a nation we need to further encourage investment in small enterprises. They are, after all, the backbone of employment and entrepreneurship in this country.

How government could get smart with pensions' freedom – a re-balancing act required

By Marcus Carlton

Here is a wish list for our prime minister and leading government advisers.

It seems to me that as a nation we suffer from an increasing issue of funding the NHS and also providing for our senior citizens as they form a rapidly growing proportion of our population and exert pressure on resources.

One obvious answer (to me at least) is to free up pension pots a little more:

Pension savings' laws should be adjusted so that we are free to use our pensions to pay directly to medical services, private health insurers and long term care providers.

At the moment a pension fund is outside the estate of the holder and therefore not subject to IHT, so there would be no net loss to the exchequer from IHT if, as often happens, wealthier pensioners die without ever accessing their pension pot.

We should also be emulating the US model and encouraging the private provision of health insurance, and therefore granting income tax relief on the premiums.

Assuming that £1 spent on private cover is £1 saved on the NHS, it seems the tax revenue foregone at 20 per cent to 45 per cent is good value.

Of course it is politically toxic for some parties to encourage private provision but there is an increasing crises developing in the private insurance market where costs are escalating in line with medical costs everywhere faster than the rate of earnings growth.

Pension savings' laws should be adjusted so that we are free to use our pensions to pay directly to medical services, private health insurers and long term care providers.

Private individuals are increasingly being priced out of the market and inevitably falling back on the already stretched resources of the NHS.

Our experience of clients who have saved and invested all their lives into private pensions is that they are not naturally profligate with their pension pots - but would welcome the ability to provide for their longer term care in this way.

Funding care costs from property equity is plain daft as it will reduce the IHT take accordingly.

As a nation we need to further encourage investment in small enterprises. They are after all the backbone of employment and entrepreneurship in this country.

And if laws governing all private holdings in un-quoted companies could be tweaked to ensure they qualify for entrepreneur's relief - not just those working for the company or owning more than 5% of the equity – this would be a major step forward. These investors are after all taking the same risk they should share in the tax incentives.

We also need to encourage housebuilding in this country. Everything about our property market seems in my view to be flawed, designed to constipate the natural flow of money.

House building concentrates expenditure within our economy, is a terrific employer of semi-skilled labour and yet there is a drastic shortage, leading to price distortions. Stamp duty now is a major deterrent to people moving and thus fewer cheaper properties are being made available as people tend to stay put.

Finally, it would be good to see planning restrictions eased and maybe landlords encouraged to sell to tenants by lowering the rate of capital gains tax they pay if they do.

HMRC has issued new guidelines which may affect clients who have investments or other assets in offshore accounts and jurisdictions. Offshore taxation arrangements can be very complex, so please read this latest bulletin from HMRC carefully. Remember, we are here to help. Contact your HFM Columbus financial adviser for more details.

HM Revenue & Customs

If you have money or other assets abroad, you could owe tax in the UK

Things are changing - the tax world is becoming more transparent

- HM Revenue and Customs (HMRC) is getting tougher on those not paying the right amount of tax across their offshore tax affairs.
- From 2016, HMRC is getting new_ _financial information about our customers from more than 100 jurisdictions – including details about overseas accounts, structures, trusts, and investments.
- HMRC is already using information, supplied by overseas banks, insurers, and wealth and assets managers, to identify the minority who are not paying what they owe.

Are you confident that your UK tax affairs are up-to-date?

You need to regularly check that you have declared all of your UK tax liabilities and, if needed, bring your tax affairs up-to-date. This is your responsibility.

Personal circumstances change. For example, you may have recently inherited assets overseas. Tax laws change too. All of this means that previous advice can be out-of-date, with costly consequences.

- If you are confident that your tax affairs are up-to-date and complete, then you don't need to do anything further.
- If you are unsure, we recommend that you speak to a tax adviser to find out if you need to take action now.
- If you find that you need to bring your tax affairs up-to-date, it can be easier than you think. You can choose to do this now using HMRC's straightforward online disclosure facility at www.gov.uk/guidance/worldwide-disclosure-facility-make-a-disclosure

If you have not paid the right amount of tax and choose not to take action now, you need to know that:

- HMRC will find out about your money and assets overseas through new_ _information from more than 100 jurisdictions.
- Penalties are increasing for those who are not paying the right amount of tax on their offshore assets, and you can even face criminal prosecution. Under new rules, you could face further penalties based on the value of the asset as well as the tax due, resulting in potentially life-changing consequences.

If you choose to delay in coming forward, it's very likely to cost you more and there is also more chance that HMRC will come for you.

Come to us before we come for you

Remember

- If you are confident that your tax affairs are up-to-date, and you have declared all of your UK tax liabilities, then you don't need to do anything further.

We are already using early financial information to identify the minority who are not paying what they owe. If you need to bring your tax affairs up-to-date, it is your responsibility to do so – act now at www.gov.uk/guidance/worldwide-disclosure-facility-make-a-disclosure

The Tortoise and the Hare

By James Tuson

(Blackadder is informed that a German spy is stealing battle plans)

General Melchett: You look surprised, Blackadder.

Captain Blackadder: I certainly am, sir. I didn't realise we had any battle plans.

General Melchett: Well, of course we have! How else do you think the battles are directed?

Captain Blackadder: Our battles are directed, sir?

General Melchett: Well, of course they are, Blackadder, directed according to the Grand Plan.

Captain Blackadder: Would that be the plan to continue with total slaughter until everyone's dead except Field Marshal Haig, Lady Haig and their tortoise, Alan?

General Melchett: Great Scott! Even you know it!

No doubt future economic scholars will argue at length about the central bank response to the global financial crisis and this period of ultra-low interest rates, now extending to almost 10 years since the Bank of England base rates started falling and queues started rising outside Northern Rock.

With fixed income yields so low, and equity yields declining (albeit on the wave of a welcome increase in capital values); a more-watertight plan than Melchett et al could muster is needed for investors seeking income in what is otherwise an income starved world.

To partially address this in our Quadrant Income discretionary model, we've increasingly turned to equity income funds that have the ability to enhance the level of income they can deliver. This can be done through using derivatives which trade some future, but uncertain level of capital growth for an upfront premium, which can then be used to deliver a higher than average dividend yield.

Whilst the process of enhancing the yield is very similar across the funds we use, this does not mean they are universally the same portfolios as the underlying stock selection process results in very different portfolios. What this does do is lend itself the opportunity to blend the characteristics of both, fitting our ambition to identify the Hares and 'Lady Haig's Alan' across each of the sectors we invest in.

The Tortoise

Fidelity Enhanced Income (yield 6.3%) -
A core UK Equity Income fund which targets a yield 150-200% to that of the FTSE All Share, through looking to invest in companies with simple to understand business models, predictable consistent cashflows, paying sustainable and attractive dividends.

Fidelity Global Enhanced Income (yield 4.7%) -
Investing in quality companies at attractive valuations with a focus on avoiding large losses as the foundation to maximise future returns. This is a core global equity income fund that aims to enhance the income by 1.5-2x that of the MSCI All Countries World Index.

The Hare

Premier Optimum Income (yield 6.7%) -
This is a flexible UK Equity Income Fund with significant small and mid-cap exposure that also typically holds up to 20% in European large-cap companies. Both attributes add a level of stock diversification when compared to a more typical UK Equity Income fund.

Schroder Income Maximiser (target yield 7%) -
with a contrarian, 'recovery' style of stock selection; this tacks a very different path and hence tends to be more volatile both in terms of performance and risk.

So with higher yields and solid track records for their respective brands of investing, is this a case of having your cake and eating it? No such luck.

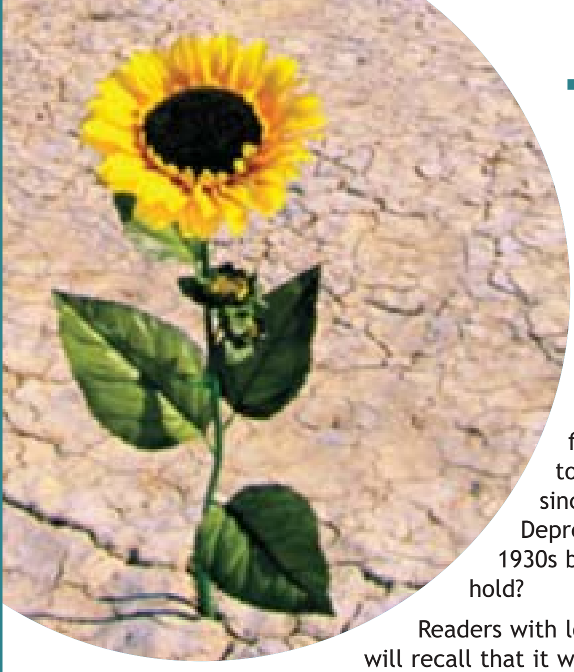
Quid pro quo applies and the drag in terms of total return (capital growth + income) versus the 'standard' version (funds run by the same manager with the same mandate, albeit without the enhanced income overlay) is small but undoubtedly exists.

This is due to the income enhancing process reducing the amount each fund can invest in its respective markets, compared to a 'standard' equity income fund, which can near-or-less always be fully invested.

So, whilst not a cure-all they do present a welcome relief for those preferring to maximise the income being delivered over and above capital growth.

. . . future economic scholars will argue at length about the central bank response to the global financial crisis and this period of ultra-low interest rates . . .

Tick tock, tick tock



TIME waits for no man, they say. Can it really be ten years since the most devastating financial crisis to hit the UK since the Great Depression of the 1930s begun to take hold?

Readers with long memories will recall that it was Northern Rock which first went cap in hand to the Bank of England on 14 September 2007. On that momentous day the once wildly successful lender sought and received a liquidity support facility from the Bank, when it realised it was badly exposed in global credit markets.

We all remember the queues of worried savers snaking down our high streets, looking to withdraw deposits from a lender once thought to be invincible.

Some may be thinking, hang on, surely the financial crisis was in 2008, when the big American investment banks – Lehmans et al – began their spectacular collapse? To be clear, yes, 2008 was when the really big boys started to go under, but the seeds were sown at least a year before, with the build-up of toxic borrowing pre-dating that by some margin.

Fools, as they say, are soon parted from their money. And Northern Rock proved no different. The bank was extending not just 100 per cent mortgages – but 130 per cent home loans. Even those with the most rudimentary grasp of basic economics could probably work out that this was a high risk strategy. And so it proved.

With the dawn of 2007, the pigeons were coming home to roost. As soon as the Northern Rock queues started to beam into our livings rooms, the fall out understandably put the frighteners on and consumer spending and borrowing – then at record levels – abruptly began to tail off. This was the Phoney War, the elongated death rattle of upstart lenders such as Northern Rock, fuelled by a belief that the hard landing tomorrow would never come. But of course it did.

When Lehman Brothers collapsed in September 2008, the reverberations almost brought down the world's financial system. It took huge taxpayer-financed bail-outs to shore up the industry.

Massive monetary and fiscal stimulus narrowly prevented a return to full scale Depression, and now, remarkably, despite everything that happened ten years ago, investors who stayed faithful to the markets have been rewarded, mostly handsomely.

Both equities and bonds have broadly performed well over the intervening decade, and far tighter financial regulatory controls have helped to ensure that we will not – hopefully – find ourselves reliving the grim financial scenarios of 2007/2008.

Back then, corporate raiders and financiers were guilty of taking terrible risks with other people's money. They claimed to have found a way to effectively banish risk when in reality they had simply lost track of it. The legions of central bankers and other regulators also must answer mea culpa, for it was they who oversaw this financial meltdown.

And for those worried that it could happen again, let's not forget to factor in the macroeconomic backdrop which framed those times of low inflation and stable growth— which ultimately triggered the wild risk-taking. Many European banks were guilty of leeching in American money markets before the crisis, using the funds to buy unstable securities.

But the crisis of course had its roots in the "subprime" US market, where borrowers with poor credit histories struggled to repay the loans, when interest rates mushroomed, typically a year or so into the debt cycle. These risky mortgages were passed on to the financial game-players at the big banks, who then turned them into supposedly low-risk securities by putting large numbers of them together in pools.

As we now know, that sub-prime market collapsed like a veritable pack of cards, and it has taken the best part of the last decade for the US housing market – and wider economy – to fully recover.

Today we are in a period of ultra-low base rates and rising inflation, the former an ongoing necessity designed to counter the ongoing fallout from the decade old financial crisis, the latter an inevitable consequence of Sterling's falling out against the Euro, caught in the slipstream of our Brexit destiny.

Contemporary markets appear to have comfortably factored in our impending severance from Europe, and investment banks have their sensible hats firmly in place. For those clients investing for the medium to longer term, a degree of stock market exposure is necessary if one is to keep ahead of inflation and enjoy reasonable returns. Most commentators agree that we could be in for a very long wait before interest rates rise to any meaningful level.

If you wish to review your portfolio's performance, contact your HFM Columbus financial adviser.

HFM Columbus' Caroline Richmond shortlisted for major industry paraplanning award

We are pleased to announce that HFM Columbus' Caroline Richmond was one of four finalists in this year's prestigious Professional Paraplanner of the Year competition results announced in June 2017. The nomination, from the UK's leading financial paraplanning professional body, reflects Caroline's terrific expertise in this keenly contested professional field. This is a notoriously difficult category and a mark of Caroline's assiduous attention to detail and wide financial planning knowledge in her day to day client engagement.

Equity release mortgages – are they right for you?

By Darren Johncock

A number of clients have been in touch in recent months asking our views on Equity Release Lifetime Mortgages.

These products are not for everyone: the minimum age requirement is 55, for example, and while there are many similarities to 'normal' mortgage arrangements, there are some key differences. Lending is based on your age, health and the value of the property. Once the amount to be borrowed has been agreed and approved, the interest rate is usually fixed for life. Borrowers do not have to take the full amount of the loan right away – a nominal sum, say £10k, could be taken initially, with a further reserve available to drawdown. Think of it as a reserve tank, the amount of which is dependent on circumstances and valuation.

Crucially, borrowers are not required to make any mortgage payments. They can if they wish simply add the mortgage payment to the loan and roll up the interest. You can however repay up to 10 per cent per year of the original amount drawn down, each year. So effectively it could be structured in a similar way to a standard repayment mortgage over 10 years, should you wish.

In our experience, most clients however do not overpay - even if they can afford to. We currently have access to lifetime fixed rates from as little as 3.85 per cent.

If you do not repay the loan however, the interest rolls up, creating an 'interest on interest' scenario, and the original loan would double in 19 years, based on a rate of 3.85 per cent.

So, what is the profile of a typical lifetime mortgage candidate?

- Clients who still have a mortgage to pay but one that is being called in by their current lender - and because of ageist policies the lenders won't lend them any money.
- Clients looking to help their children or grandchildren get on the property ladder or pay school fees – remember, "The Bank of Mum and Dad" is now the UK's 9th largest lender!
- Those wanting to reduce their IHT position by making gifts or using trusts: this not only can reduce the estate but the roll up of interest "helps" as well.
- Clients wanting to move house maybe to be near their grandchildren where properties cost more than where they live now.

- Those who wish to enjoy their lives in retirement, paying for holidays, maybe a holiday home, new car (we once raised money to buy a new Porsche for a 75 year old), upgrade the house or essential repairs.

And then of course there are simply some elderly clients or parents of clients who are just struggling to make ends meet where £10,000 would help - especially if they could draw more in the future.

Some may ask themselves, 'what is the point of sitting on a large asset and not being able to fulfil what you wish to do in later life?' And let's face it, selling and trading down is a very expensive exercise just to release some money.

Selling at £500,000 and buying at £400,000 may on paper seem to release £100,000 but in reality with fees of around £25,000, taking into account legal fees, surveys, stamp duty, estate agents' fees and removal costs, you are more likely to only end up with £75,000 and then there might be money to spend on improving the new property.

Whereas , at the time of writing this article to release £100,000 would cost you a total of around £1,500 in fees - and without the stress of selling and sorting out the new home.

At HFM Columbus we are fully qualified and have the expertise to help you with an enquiry of this nature and Gary Festa or Darren Johncock can be contacted on 01932 870060.

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