Financial Planning in Ireland:

A Simplified Guide

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Contents

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i

The purpose of this document is to provide a high-level overview of Personal Financial Planning. It does not constitute financial advice. See Disclaimer at end of document.

1. Why do I need a Financial Plan?

Creating a robust financial plan for you and your family will enable you to have a clear understanding of your financial affairs and your future financial roadmap.

Everybody's financial situation is unique and bespoke to them, so there is no off-the-shelf solution that can be taken.

A personal or family financial plan will help you to:

1. Calculate your existing financial position
   - assets vs liabilities
   - income vs outgoings

2. Put consideration into your main goals and objectives

3. Identify what your key financial concerns and risks are

4. Implement a robust but flexible financial planning strategy for the medium to long term
   - Financial planning covers every single area of your finances, all of which are interlinked, so it is essential to take a holistic view on all matters.

2. Cashflow Planning: Income vs Outgoings

Squeezed Middle

In today's Irish economic environment, we come across a lot of couples with young children experiencing ongoing cashflow issues. Generally, the main culprits are:

- Income tax rates at > 50% at the marginal rate
- Creche or childminding fees for young children
- Mortgage repayments: principal + interest repayments on a mortgage
- Pension contributions
- Living in an expensive country

My advice is to take a detailed look into what exactly is causing these cashflow issues and address them.

Sometimes the overall financial situation isn't as bad as you think. For example, even if your monthly cashflow is breaking even and the amount of cash in the current account never seems to increase, in certain cases your net capital position may be increasing each month due to:

- Paying down the principle on your mortgage
- Allocating cash monthly into your pension or a savings product

If your cashflow situation is poor but your net capital position is increasing, then that's nothing to be too concerned with, unless of course you need access to liquid capital.

50/20/30 Rule

Harvard bankruptcy expert and Presidential hopeful Elizabeth Warren came up with the 50/20/30 Rule for net, after-tax Income which I believe is a very appropriate target:

Bucket 1: 50% of your income should go on essentials such as mortgage/rent/utility bills, children's education, clothing etc.

Bucket 2: 20% of your income should go on meeting your financial goals i.e. saving, investing, pension contributions.

Bucket 3: 30% of your income should go on discretionary spending.

It is a very worthwhile exercise is to analyse the entirety of your outgoings and categorise them into the correct bucket.

We know that essentials are the day-to-day running of the house/home, paying down the mortgage and putting food on the table and clothing on our backs.

We also know that discretionary spending includes dinners, holidays etc.

It's important to remember that what may be discretionary for one person in bucket 3 (such as gym membership) may be essential for another, and that's totally fine.

Some expenses can arguably fall into any of the 3 buckets, such as educational costs; it's important to know which one is most appropriate for you.

3. Asset Allocation

When an individual or family has surplus Capital, there is an array of different options for what to do with these funds. What to do with your funds is completely bespoke to you, your financial circumstances and your main priorities and goals at a particular point in time.

The headings below outline the main options available from as Asset Allocation point of view.

Rainy Day Fund

The first thing any family should have is a nest egg/rainy day fund. This is simply readily accessible cash in a current account, with the purpose of offering liquidity and acting as your own mini-insurance fund.

I don't believe in prescribing a particular formula to the amount of a rainy day fund as it will depend on the security of your income, whether or not you have income protection in place, the level of outgoings such as mortgage repayments that you have. Oftentimes, we use 6 times net monthly income as a starting point and the amount of the nest egg can deviate off that as a reference point.

Either way, I believe that having an appropriate emergency fund of cash should be the first priority for any individual or family before they consider other financial priorities.

Debt Reduction

If you have expensive loans such as car loans, credit card loans or personal loans, then it may make sense to pay off these loans first and foremost with any surplus capital you have.

It may even make sense to prioritise paying down your mortgage, if your interest rate is high.

However, you need to be very conscious also of remaining somewhat liquid in the event of needing capital in the future.

One can benefit from 'interest rate arbitrage' by paying off high-interest loans with cash deposits that are earnings significantly less deposit interest.

Save for a Mortgage

If saving for a property purchase is on your radar, then this can become the single biggest financial priority for you.

Showing proof of savings and bringing up your cash savings to meet the Central Bank Mortgage deposit rules can become a priority ahead of all other priorities.

Maximise Pension AVCs

As you will see in the section on pensions below, maximising Additional Voluntary Contributions (AVCs) to pensions is very worthwhile from a tax point of view. Each contribution provides a saving of 40% tax relief at the marginal rate of tax.

Long Term Investing

Only when the above options have all been fulfilled do I recommend investing funds for the long-term. See next section.

4. Investment Management

The purpose here is to achieve a return in excess of what would be available on deposit over the long term. There are a number of considerations to take into account:

Risk Level

Ensure that your risk profile is aligned to the percentage asset allocation of the entirety of your investment portfolios.

Measuring the volatility of past performance of your Investment Portfolio is a good starting point to understand risk levels.

Professional advice is needed to consider your appetite to risk, tolerance for risk and financial ability to withstand risk.

Liquidity and Market Timing

Some investments such as property or private equity may have a 'liquidity premium' i.e. a better return by locking up your capital for longer. Furthermore, investment management fees are generally lower when a long-term commitment is made.

Investors need to consider liquidity in all investment decisions and ensure that their investments are appropriate in terms of the ability to get access to the funds.

While every investment decision should be considered as a minimum 5 year plan, having the ability to change your mind and liquidate your funds at the prevailing market prices is extremely important.

In terms of allocating a large lump sum into the markets, in times of high equity market valuations, timing in extremely important. Risk can be reduced by phasing into the market through 'Euro Cost Averaging'.

Taxation

The Irish tax system is extremely complicated with the different investment structures and instruments so advice needs to be taken before any investment portfolio is established.

Not only are there 2 different taxation outcomes when investing (Capital Gains Tax or 41% Exit Tax), but there are also different rules around utilising losses and declaring certain acquisitions that need to be disclosed in your tax returns.

Simple or Complex

Investors often feel that the more ‘complex’ their portfolio, the better structured they are as there is a perception that the portfolio is more sophisticated.

This is far from the truth and more often than not, a simpler portfolio will be lower cost, more transparent and will generate better performance over the long term with fewer headaches than an overly complicated portfolio.

5. Retirement Planning and Pensions

Overview

Simply speaking, if you don't prioritise building up a private pension fund in your working years, then when you're retired from work and trying to enjoy your twilight years, you will most likely regret not having built up a retirement fund.

In isolation, the state pension of circa €12k p.a. will be nowhere near sufficient enough to provide you with the financial freedom you deserve in retirement. The state Pension has been pushed from age 65 to 66 and 67 (from 2021) and 68 (from 2028).

Other than providing you and yours with a comfortable retirement, building a pension fund is also a tax-efficient way of passing assets on to the next generation(s) .

What are the tax advantages to pensions?

1. **Tax relief at the marginal rate of tax on contributing to a pension:**

- Company contributions attract a tax saving from Income Tax, USC and PRSI, so over 50% tax relief at the marginal rate personal contributions attract tax-relief at up to 40% at the marginal rate. An annual personal pension contribution or AVC of €12,000 p.a. for a marginal rate taxpayer will only cost €7,200 as tax relief of €4,800 is available
- Employer contributions are exempt from employers PRSI (up to 10.95%)

2. **Tax-free growth within a pension**

- There is no Income Tax, DIRT, CGT or USC within a pension
- The lack of taxes on growth means that pension funds could grow, all else being equal, at up to 1/3 faster than non-pension investments

3. Tax-efficient retirement of a pension

- 25% in a lump sum available on pension retirement, the first €200k of which is tax-free and the next €300k is taxed at 20%

  Of the 75% balance:

  – The first €63,500 goes into a post-retirement vehicle known as an Approved Minimum Retirement Fund (AMRF)

  – The balance, after the 25% lump sum and the first €63,500 to the AMRF, goes into an Approved Retirement Fund (ARF)

- On death, the A(M)RF can simply pass onto a surviving spouse tax-free. If there is no surviving spouse, the ARF gets taxed at a flat rate of 30% if inherited by children above the age of 21

How much can I contribute to a pension?

Employees or the self-employed (who are not incorporated)

These individuals can contribute a % of their salary, up to an earnings ceiling of €115,000.

The age-based limits are:

Age band	% Allowable
< 30	15%
30-39	20%
40-49	25%
50-54	30%
55-59	35%
60+	40%

The above table does not include employer contributions, which are separate to the age-based limits.

Company directors and owner managers

This class of worker has a lot more flexibility in terms of how much the company can contribute each year, both in single contributions and regular contributions.

The maximum amount allowable is carried out on a bespoke basis via a 'max funding calculation' on request. The pension threshold size upon which these calculations are based is currently €2m.

6. Protection

Why do we need protection cover?

The main purpose of protection is to provide for you or your dependents in the event of a certain event happening.

Without some form of financial protection, you and/or your dependents could be left financially destitute in the event of you dying or getting seriously ill.

The level of protection taken out should be commensurate to your personal and financial situation e.g. somebody with a dependent spouse and 3 young children needs life cover more than somebody who is single with nobody financially dependent on him/her.

Type of Protection Policies

There are 3 types of protection policies:

Life Cover (on death)

- Life cover will provide a lump sum to either pay off a mortgage or to simply provide a lump sum on death
- A lot of employees have 'Death-In Service' cover through their employment of 4x salary. This however ceases as soon as they leave employment

Specified Serious Illness Cover

- This type of cover pays out a one-off lump sum if you are diagnosed with a pre-defined 'serious illness'
- The list of specified serious illnesses in the contract with the life company needs to be closely looked at before committing to the plan

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Income Protection

- This pays out a monthly income in the event of you being unable to return to work after an injury or illness
- A 'deferred period' is selected from the outset and this can range from 1 month to 12 months. *This is the amount of time you need to be out of work before the benefit kicks in*
- Premiums to Income protection policies benefit as they are tax-deductible for the individual or company

At what stage of my life do I take out protection?

- When taking out a mortgage for a home-loan, the bank will insist on you taking out a life policy (known as a mortgage protection policy) as security against the loan. This way, the bank don't have to re-possess the property from your estate
- If your financial position is heavily reliant on your Income (which is very common), then income protection is essentially to protect against you the risk of becoming unwell and being unable to continue to earn
- As your number of dependents increases, then the importance of life cover increases

Simply speaking, the higher your income and the more dependents you have, the more important protection policies are. Note that if you have any pre-existing health conditions then your premium may be increased by the insurance company adding a 'loading'.

7. Succession Planning

As individuals move into their twilight years, putting funds aside tax-efficiently for the next generation becomes more relevant.

The most important priority here is to ensure that you have sufficient capital to provide an income for you and your spouse in your own retirement first and foremost.

When there are surplus funds available, then planning for passing these assets on in the most effective and tax-efficient manner is important.

An Estate Plan

Regularly reviewing your Will and having Enduring Powers of Attorney in place as part of an overall Estate plan is crucial in order for your wishes to be met when assets are passed on.

Reducing Gift or Inheritance Tax

Policies called Section 73 and Section 72 policies can be set-up to minimise Gift or Inheritance Tax respectively. This are very complex products and only relevant for a certain subset of people; however, when they are relevant, they are very relevant .

8. Simple Tips for Financial Planning

Tip 1: If you can't measure it, you can't manage it

- You need to pro-actively get 'under the bonnet' of your finances and work with a professional advisor in assisting you to understand all of the decisions you need to make
- Understanding your net capital position at all times is very helpful when making future financial decisions. Having a clear awareness of your cashflows (income vs outgoings) is also very worthwhile
- Know your Buckets: Ensure that you have clarity over your outgoings and which Bucket that fall into.
- A financial plan is only as good as the follow-up and regular reviews that need to be carried out. I recommend every 12 months in January, just when the New Years resolutions are peaking.

The more you understand your own appetite to risk and your investment objectives, the more your portfolio will be aligned to these metrics.

Tip 2: Diversify your pension and investment exposure

- Spreading your pension or investment allocation into different asset classes, geographies and sectors will help to reduce your risk and volatility and protect your portfolio in falling markets
- Well-diversified portfolios also have a healthy mix of funds so that the performance of them are not correlated to each other and/or general long-only markets
- Collating and consolidating all of your investment and pension portfolios into one overall asset allocation to independently analysis and review your level of diversification is a very worthwhile exercise.

Tip 3: Choose the right advisor

- Independence: Your financial advisor and investment manager cannot have any conflicts of interest in providing advice to you and recommending portfolio changes
- The remuneration your advisor will receive (fee or commission) from engaging with you should be made clear to you from the outset to ensure that there are no surprises and to ensure that your goals are aligned with those of the advisor
- Agencies: The more agency agreements your advisor has, the more choice that they will have in terms of financial policies. However, you need to ensure that the advisor isn't spread too thin also and has established the best products and providers for each solution

Getting access to the top global fund managers and portfolio strategies at the institutional level is possible and should be sought after.

Tip 4: Think long-term

- Consistent with almost every financial decision you make is that you have to accept 'short-term pain for long-term gain'
- With most major financial decisions, you won't reap the rewards for a number of years and you may always be tempted to revert to short-term temptations

When considering financial planning, always consider your retirement years when your earned income will be negligible and when you will be living off your pension and life savings.

Review Cycle for Pensions and Investments

Find out more

Talk to Compass Financial Planning today on:

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www.CompassPrivateWealth.ie

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