Business Essentials

An entrepreneur's guide to wealth structuring

Wealth Management

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Retirement planning beyond pensions

Your company may be your pension, but there are other strategies to consider.

01

To achieve success, business owners often devote most of their time and energy to securing the future of their companies. When it comes to their personal financial futures, many have found their attention focused elsewhere. As a result some business owners may be unaware of just how much preparation and planning it takes to ensure a comfortable life in retirement.

"Business owners tend to pride themselves on being in control and aware of business trends, but tend to overlook things on the personal front," says John Younger, managing director and head of client and business strategy at RBC Wealth Management in London.

"It is this focus on the business that leads to a lack of preparation for life after work, says Dion Lindskog, head of wealth structuring at RBC Wealth Management in London. "For most business owners, they say their business is their pension, so they are totally reliant on selling their business to pay for retirement."

While selling the business might be the solution, the concern is that those without a clear wealth plan could find themselves working longer or living more frugally in retirement than they had hoped. "Some business owners never plan to stop working, but the prudent advice is that you need to prepare for possible retirement," Younger says.

Plan for a future beyond the business

For some, retirement may be an unexpected decision, prompted by family or business events or even health reasons. It's this uncertainty that makes planning essential to understand what retirement might mean for you and your business. This includes making decisions on whether, and when, the business will be sold or transferred, in addition to plans for setting money aside for yourself, your family and any philanthropic intentions.

Given that many people want to maintain the same lifestyle in retirement as in their working life, income needs can often increase during the early years after

finishing work as people go on holiday while they are still physically active.

"It is about structuring your assets so they pay for the lifestyle you want," Lindskog says. Depending on which arrangements are already in place – such as salary and bonus packages, share schemes, complex deferred compensation schemes, as well as life insurance and medical plans – making the most of your assets is not always a straightforward process.

> *Many people are financially well off and don't need their pension benefits, therefore they think they don't have to worry about it.*
>
> Dion Lindskog

But as a first step, Lindskog says business owners should consider setting up their own pension plan, just as they would for their employees.

Pensions are frequently a small component of an overall wealth package, but this does not mean they should be overlooked. Indeed, it's important to understand how they work and use them where appropriate.

"Many people are financially well off and don't need their pension benefits, therefore they think they don't have to worry about it. But what they don't think about is that they can use them to help their family," says Lindskog. While the business might be the primary source of wealth, Lindskog says it is wise to have at least two options: the business and a pension on the side.

In certain pension arrangements, such as small self-administered schemes (SSASs), it is possible to buy bricks and mortar commercial property that can provide an attractive income stream. The scheme can also provide loans to the business, which can be beneficial if bank lending is not available.

Within a family business, however, selling up to fund retirement is not always an option. For example, you might choose to transfer or gift the company to a child or other family member, with the option to retain shares or draw income as an employee or consultant to help fund your retirement.

But not all children might want to continue with the family business, triggering further conversations around wealth transfer and succession planning.

In addition Lindskog warns, "Sometimes the business isn't going to provide the level of income you need, so you can end up with people having to work far longer than they'd ideally like to. You end up with a very disappointing retirement."

Make use of all your options

Retirement planning means taking a holistic view of your financial affairs to try to anticipate any future problems and how they can be solved. Three key questions to consider are:

- Will my assets provide the income I need to fund the lifestyle I desire?
- Do I need to take a higher level of investment risk than anticipated to maintain my lifestyle?
- How can I pass my remaining assets to my chosen beneficiaries efficiently on my death?

When creating a retirement plan, Lindskog likens it to orienteering; starting with where you are in your life right now, where you want to be when you stop working, and then determining if there will be any essential or desired stops along the way. The outcome will be a financial plan customised to your specific needs.

Regardless of circumstances, everyone should try to take full advantage of the available wrappers and allowances available to them, Lindskog says, starting with pensions and Individual Savings Accounts (ISAs). Additional options, depending on circumstances and attitude to

risk, could include enterprise investment schemes, venture capital trusts and property investments.

Even for high earners, using all of the available allowances and reliefs is not only shrewd, but can make a big difference over time. Spreading wealth across a range of different savings vehicles has its benefits, such as a degree of diversification. But the real advantage is that each one can be accessed at a different point in time to provide income when needed. When it comes to retirement income, "it's about knowing which taps to open and when," says Lindskog.

Leaving a legacy

Planning for life after work is not simply about covering living and leisure costs. For many people, it also means leaving a legacy, perhaps to the next generation or to a charity, which is an important factor to be considered.

"The reality is you often have more than enough money to fund retirement, so the real question is what you want to pass to your children and what your attitude might be to charities or philanthropic causes," Lindskog says.

This can include structuring your wealth in preparation for leaving it to the next generation as well as arranging for gifts and donations to be made during your lifetime and upon death.

In these ways retirement planning, even for the wealthy, can reap rewards. As no-one can put a price on the peace of mind that comes from knowing that you and your heirs are well provided for and that your legacy lives on.

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Diversifying your portfolio

Reviewing your investments and diversifying your portfolio away from concentrated holdings can help minimise the risk of losses.

02

For many business owners, it's not unusual to have a significant amount of wealth tied up in a single asset. Whether through the ownership or sale of a business, a large shareholding, or even an inheritance, the growth of a concentrated investment can be the source of generous rewards – as well as significant risks.

“Many people spend years focusing on their careers and then find they have amassed a large amount of wealth that is tied to a single asset,” says John Younger, managing director and head of client and business strategy at RBC Wealth Management in London. “It’s at this point that you want to know how to preserve it for the future.”

For most entrepreneurs, the primary source of wealth and income is their business. For anyone in this situation, it is important to take a holisitic view of your financial affairs and consider the different options available for protecting wealth in the event of a market or economic downturn. Similarly, for those who have concentrated investments in a single asset – perhaps through the sale of a business or the growth of an investment – steps should be taken to protect your wealth for the future.

While the growth of a concentrated investment might have created substantial wealth in the past, there is no guarantee this will continue in the future. Therefore it is important to be aware of the potential risks to this over the long term, says Guy Huntrods, head of investment specialists and execution at RBC Wealth Management in London.

"Those who hold onto these positions over time may experience downward price pressure from both company-specific and outside influences, which could derail future plans and exit strategies,” Huntrods says. “But with careful consideration and planning, your ride could be made smoother and more value could be derived from the asset."

Investments can fall as well as rise

Mitigating the risk of loss has its benefits during all market and economic conditions, although it is perhaps even more important in the current environment. Financial markets have experienced a prolonged

period of growth in the years following the 2008 financial crisis owing to ultra-low interest rates and aggressive stimulus measures.

> *Reducing concentration risk can play a vital role in protecting your wealth now and in the future.*
>
> John Younger

Frederique Carrier, head of investment strategy at RBC Wealth Management in London, says all business cycles eventually show signs of old age. "As the business cycle becomes more and more mature, the chances of a market correction become more likely and this can represent a large risk for anyone with a large position in a single company."

For some people, there is a disconnect between the work involved in building a business or amassing a large asset and the work to protect it from unforeseen events. "Many people know their company best, but what if something happens, such as an illness, a political event, a regulatory change or a market correction?" Huntrods says. "Threats can appear unexpectedly, so it is important for you to think about what you might need to do to protect or diversify your investments and be aware of the potential strategies available to you."

Sometimes it's hard to let go

The simplest solution to a concentrated investment is to sell some of your shares and invest elsewhere. But for some people this is neither possible nor desirable – especially business owners.

However, for those who have large shareholdings in listed companies, this may be because the securities cannot be sold until some point in the future, or because they want to retain certain privileges, such as voting rights. Others may be reluctant to sell as a result of an emotional attachment to the company or an expectation that the share price will rise in the future. For those whose wealth is tied to a successful but unlisted business or perhaps a large property portfolio, the situation is more challenging because it might not be desirable to sell a portion to outside investors.

"People can have several reasons for not wanting to sell the shares they hold in a company, whether it's because you are emotionally attached to them or because there may be negative financial implications from doing so," Younger says. "You need to find the most suitable solution or process, so that you can receive the best possible outcome."

Divesting entirely from an asset doesn't always make sense, particularly in the case of a family business. In situations where it is necessary to continue to hold the asset, hedging strategies can potentially act as insurance against any fall in the value of a stock. Alternatively, you could borrow against your portfolio and use the loan to invest in other assets. For business owners who do not want to sell shares in their company to investors, one option is to build a diversified investment portfolio from the income they draw from their business.

When wealth preservation becomes the priority

Concentrated investments pose plenty of challenges, and solving the problem is not always straightforward and will need to take into account your specific circumstances. But whether it means selling down a position and diversifying into other assets, or using hedging strategies, reducing concentration risk can play a vital role in protecting your wealth now and in the future.

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Successful entrepreneurs are known for building their businesses over the years with a combination of passion and hard work.

Naturally, there will come a point when you start to think about planning for the future, stepping back from your businesses and passing wealth to loved ones. A robust wealth transfer plan can help you to achieve all three.

An entrepreneur's assets are likely to be illiquid because they are tied up in the business, which can pose a challenge. This helps to explain why 39 percent of business owners who were surveyed as part of RBC Wealth Management's *Wealth Transfer Report 2017* had a full wealth transfer plan in place. This compares to 26 percent of employed professionals. The figure suggests wealth transfer planning is important for business owners because they have the extra dimension of thinking about an exit strategy from their company.

Nevertheless, RBC Wealth Management's research suggests there is room for improvement among some business owners; worryingly, one-fifth of the sample had not started planning for wealth transfer.

Planning for a wealth transfer as early as possible will provide you with the time and breathing space to make sure you have the right structures in place when you decide to step back from the business. The broader preparations are likely to span tax and estate planning, as well as retirement, inheritance and succession planning. Although it may feel like there is a lot to think about, try not to lose sight of the benefits a plan can bring.

First, make sure you have the right advisers on hand to formulate a plan and guide you through the process. Even if you have advisers in place, Adam Wereszczynski, a relationship manager at RBC Wealth Management in London, says it could be beneficial to get a second opinion from an external adviser. This will clarify whether your existing arrangements are appropriate for your circumstances. "It is never a bad idea to get a second or third pair of eyes on your existing arrangements," he says.

Planning your legacy

Once your advisers are in place, think about how much money will be required to achieve your objectives. This doesn't need to be as daunting as it sounds, as your wealth manager will be a resource in providing a cost-benefit analysis.

"The first stage of the process is to establish how much of your wealth you need to look after you for the rest of your life. This involves cash flow modelling to establish what your income needs are likely to be," says Dion Lindskog, head of wealth structuring at RBC Wealth Management.

> *I think everybody should have a will - regardless of what their wealth is.*
>
> Dion Lindskog

Given that your assets are likely to be tied up in the business, this is likely to bring another question to the fore: are you planning to pass your business on to the next generation? If so, how you can you do this tax-efficiently?

If the business is family-owned, you may be looking for another family member to buy you out. Whichever route you take, plan ahead to ensure the best possible outcome.

Gifting strategy

At this point, it is worth thinking about how much you wish to gift to any children and grandchildren – as well as the most appropriate route to do this.

One option is to provide direct gifts. While each UK taxpayer has a £3,000 annual exemption for gifts, which is removed from your estate immediately when used, you can also gift money or assets above this threshold that will be exempt from inheritance tax providing you live for at least seven years afterwards and you have no interest or link to the transferred assets.

"This route depends on the age of the children and what they are like. For some parents, giving their children too much money too young can cause problems, in terms of them squandering it or lacking motivation to pursue a career," Lindskog says.

If you wish to exert some control over how and when the money is allocated, gifting via a trust will allow you to do this. You can draft letters of wishes for beneficiaries (including charities), executed by trustees.

Bare trusts provide a neat solution for those who wish to pass on assets to minors. As a beneficiary, they will gain the right to capital and income within the trust from the age of 18.

Family investment companies represent another option to transfer assets to the next generation (via a limited liability company structure), while life insurance policies and offshore bonds can also be considered. Each option comes with its own tax implications, which need to be evaluated.

In order for your wealth transfer plan to take effect, it must be underpinned by an up-to-date will that accounts for assets held across different jurisdictions.

"I think everybody should have a will – regardless of what their wealth is," Lindskog says.

"For every report I write, the first question I ask is, 'have you got a will?'. If you do, I then ask if it is up to date. If you don't have a will, it will be a key priority to set one up. There is no point doing any clever financial planning if you haven't got a will," he says.

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