Navigating sudden wealth in clinical negligence settlement cases

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By Joe Sanders, Executive Director and Chartered Financial Planner at Informed Financial Planning, a member of *Legal Futures* Associate, SIFA Professional

As a follow up to last month's article from Josh Richardson of Informed Financial Planning on the generic advice considerations surrounding sudden wealth, Joe Sanders demonstrates the advice provided to one of their clients within this financially vulnerable situation.

Clinical negligence settlement cases can transform the financial landscape of individuals and families. While the compensation should help towards the necessary support for care and rehabilitation, it also brings the challenge of managing sudden wealth responsibly. There will often be a court appointed deputy involved to help make prudent decisions for the individual which will provide protection against the risk of becoming suddenly wealthy.

Whatever the source of sudden wealth, the acquisition of large sums of life-changing money can bring challenges and dangers, not just happiness and financial freedom. From anxiety, to being left feeling vulnerable and open to financial abuse, this can be avoided by choosing a qualified financial planner who is part of the Financial Vulnerability Taskforce (FVT) to guide you through the next steps. Without proper advice, clients may fall victim to lifestyle inflation, extravagant purchases, and ill-advised ventures, jeopardising their long-term financial security.

Adam is a client we have been working with for many years, this article will outline some of the challenges we have faced whilst working together. As well as the added value of financial advice for him and his future needs. Adam has severe physical and cognitive disabilities, his affairs are managed by a deputy who we work closely with.

Originally Adam was awarded a lump sum of £1,150,000, as well as periodical payments. His first payment (in 2014) was for £120,000 and most recently this had grown to £174,000, as the payments increase with inflation over his lifetime.

One of the primary challenges with larger settlements is exercising discipline in spending. Deputies play a pivotal role in instilling financial prudence and tempering clients', and their families, immediate desires with long-term considerations. Encouraging clients to resist the temptation of extravagant purchases and to adopt a disciplined approach to spending is crucial. Establishing a realistic budget and financial plan aligned with their future needs is paramount to safeguarding their financial future. Cashflow planning is a crucial tool that we utilise to instil discipline in spending for

clients who have received sudden wealth from clinical negligence settlements. By implementing cashflow planning strategies, families can visualise their financial future and with this information can prioritise their spending and make informed decisions to ensure long-term financial stability.

Initial expenditure was going to be between £500,000 and £700,000, we used cashflow analysis to show the damage of spending too much early and how that will likely see funds run out far sooner. This was particularly important for Adam given his likely care requirements. At the time of settlement, Adam was younger and had family around that could provide a good amount of the care required. This is still true, Adam has 3 carers and 2 of them are his parents which keeps the cost much lower. He is now in his late 20s and is much bigger but with the same physical impairments. His family around him are also 10 years older and the future worry is that care will be a struggle for them and additional care requirements will be needed. Even with regular periodical payments, annual care costs can be significant and therefore it is vital to 'save' as much as possible in the earlier years.

The importance of early investing is critical in clinical negligence settlement cases. While clients may be tempted to delay investment decisions, or spend more of the initial payments, we need to consider the benefits of compounding and the long-term growth potential of early investments. By starting early, clients can build a substantial 'nest egg' to fund future costs, such as care needs, and mitigate the financial impact of unforeseen circumstances. This led Adam to invest £650,000 of his initial settlement.

Beyond the initial investment, Adam, due to his parent's care, was going to have a surplus each year from his periodical payments. This has led to further investments of £350,000 for his future benefit, when income above his periodical payments isn't required.

Tax can significantly impact the net proceeds of a clinical negligence settlement, as investments grow over time. This is where initial advice and ongoing reviews add significant value. As we have seen over recent years, both the capital gains and dividend allowances have fallen significantly therefore collective investments are not as tax efficient for individuals as they previously have been. Whilst capital gains tax (CGT) is still at a lower rate, compared to income tax, holding some funds in these areas could be suitable but we must consider alternative wrappers. Utilising tax-efficient investment vehicles, such as ISAs and pensions can maximise after-tax returns and reduce the erosion of wealth.

Our initial recommendations included a collective investment, as well as maximising ISA and pension contributions for Adam. Adam's early reports suggested a life expectancy of 69 and therefore beyond pension access age. This created the opportunity to invest the minimum amount to pensions and receive tax relief for Adam, despite him being a non-taxpayer. This has been something we have continued annually for him, whether it be from surplus periodical payments or tax efficiently from other investments, we have ensured that his ISA and pension allowances have been used up.

With news of CGT thresholds and dividend tax reducing we saw the opportunity to utilise offshore bonds. Not only, given the investment term, can Adam benefit from gross roll up it will be possible to realise gains within the personal allowance, starting rate for savings and personal savings allowance. This could provide a vehicle that could realise gains, as well returning the original capital relevant to this, of up to £18,570 without incurring tax. We had continually realised gains, via bed and breakfasting, each year for Adam which meant we were able to surrender a significant proportion of his wealth without causing him to pay any CGT. This was reinvested within an offshore bond and creates a more tax efficient investment portfolio in the face of future tax regimes.

After securing a clinical negligence settlement, deputies must make prudent investment decisions to preserve and grow the individual's wealth. Adam is our client, therefore investment risk must be considered for his circumstances, not just how his Deputy feels about investment risk. However, even with an impaired life expectancy, there will be a significant investment term for some of these funds (potentially 40 years). Whilst investment risk is relevant, with an element of settlement, it is important to consider the asset classes that should outperform over the longer term. Equities will certainly provide more volatility, but these funds will not be accessed, therefore exposing some of their wealth to a higher risk environment could provide greater returns over the longer term.

Our advice led to a split of risk for his invested funds, the Deputy did not want to expose all his portfolio to a high level of risk. This was a wise choice as Adam's circumstances can change quickly and we also must respect the importance of these funds and why he was awarded this money. Nonetheless, through cashflow planning, we showed that at least 40% of his funds were not required in the next 10 years even if his care position changed drastically. This allowed us to invest this in a higher risk environment and hopefully benefit from a higher level of growth and increase the funds available to him in the future.

Where do we stand now? With the right ongoing advice, we have been able to sensibly add to these investments and move funds across various tax wrappers to reduce any likely taxation. We now have £1,400,000 invested across tax efficient products for Adam's future need. These investments are spread across a pension, ISA, collective and offshore bond. Furthermore, he has split of risk for his medium and long term benefit.

In summary, advising the suddenly wealthy, particularly for clinical negligence cases, is a complex area that has several specific pitfalls to be conscious of. Many of these exist at outset, but must continue to be monitored in line with any changes for the client or legislative changes that impact our financial plan.

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