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Estate planning in an uncertain world

Jeremy Franks: Welcome to the HSBC Private Banking UK Podcast. Estate Planning in an Uncertain World. Today we will focus on will planning. We are recording this podcast from our homes, so apologies in advance for any background noise. My name is Jeremy Franks. I'm the head of Wealth Planning for Europe, Middle East and Africa. I'm joined by my colleague Patrick Power, who leads our Financial Planning Proposition in the UK.

Patrick Power: Hi there, pleasure to be here.

Jeremy: Good to have you Patrick. Clearly estate planning is a sensitive matter. What's been your experience of how clients are dealing with these issues?

Patrick: So, people tend to put it on the back burner. There comes a trigger point where it comes to the fore and people want to get organised. And the trigger points we typically see would be unfortunately the death of a family member or maybe the death of a friend, especially if it's unexpected. Or a global crisis like, for instance, 9/11 or the one we're living through at the moment. That can really bring into sharp focus, with all the terrible news we're getting every single day, are your affairs in order? And a will is one of the first things you should do.

Jeremy: What happens if you don't make a will, Patrick?

Patrick: Well, this is a very good point. If you don't make a will the rules of intestacy come into play. This is basically the state determines who gets what. So, that's not going to suit everyone. So, in a nutshell if you have a spouse and the spouse survives you by 28 days then they will get £270,000. Now, if you then have children, the residue is split between the surviving spouse and the children. This can be an issue, because if those children are under the age of 18 those funds will be held in a statutory trust. However, when the children obtain age 18 those funds are legally theirs. And when you're talking about substantial estates, that's a huge amount of wealth that can be delivered to them at perhaps not the most appropriate age. So, the first issue there is that it's going to put a family in a position where that family wealth is at risk because of the rules of intestacy, how they're drafted. There's no real protection for the children at that age.

Jeremy: Just in summary there, if you don't have a will and you've got minor children, they could receive very significant assets when they're 18 and there may not be any

controls in place to ensure that they, let's say, use those assets positively. Would that be a fair summary?

Patrick: Absolutely fair. And it gets worse. If you don't have a spouse, if you don't have children, or your children certainly haven't survived you and you don't have grandchildren for instance, then it would pass through like a batting order of relatives, starting with grandparents and then going through siblings, and it goes through the full-blood and the half-blood. But if you're not survived by anyone, ultimately your estate will go to the Crown, either the Duchy of Cornwall or the Duchy of Lancaster. So, if you're of a Republican persuasion, that might be a powerful motivator to actually make a will.

Jeremy: Absolutely, so in short, what you're saying Patrick, correct me if I'm wrong here, is that if you don't do a will you lose that ability to control and influence where your estate goes and who benefits from that estate.

Patrick: That's a fair summary. And also, we mustn't forget if you're not married ... I'm assuming here that you have a spouse or a civil partner. But if you're actually aren't married or you're cohabiting with a long-term partner, if you don't make a will then they really have no legal rights to your estate at all. Now, it may be that the property is owned maybe jointly. If it's not, then there may be certain rights they can exercise with regards to the first refusal on buying the property etc. But essentially they don't have any rights to your estate, so that's a powerful reason to make a will. And really, making a will just allows you complete control as to who ultimately you pass your estate to. It gives you the control aspect. Now, there are certain reasons that it's quite tax-efficient to make a will, because if you're married or you have a civil partnership, then the civil partner or the spouse is exempt from inheritance tax. So, you're delaying the inheritance tax trigger to the point of second death. But essentially, you're ensuring that your assets pass in accordance with your wishes. Now, family wealth, you want it to remain as family wealth through the generations and by carefully drafting a will you can ensure that that wealth isn't dissipated through potential remarriages, the future vulnerability of the survivor, or divorces in the second generation. These are all things you can actually exercise a degree of governance and control through carefully drafting the will.

Jeremy: I think you make a very good point there, Patrick, and certainly be very keen to pick that up later on in the conversation, how you can potentially protect your assets later on down the line post your death. I would probably just also add if you don't have a will in place, having to go through the rules of intestacy and make an application, that could involve significant expense and delay. And just from a sort of emotional perspective, I remember when my brother-in-law died, the hassle to an already emotional situation, it really aggravated matters. So, I think just from a practicality perspective and being sort of cognisant of people's emotions, by not having a will in place, it can really add to let's say the emotional distress of relatives. But also, it can delay matters, which I could imagine being particularly

important where for example businesses are involved or beneficiaries don't have access to significant liquidity and need to meet day-to-day expenses. And I think, as you say, the ability to minimise inheritance tax exposure and inheritance tax efficiency, it's far easier if you've got a will in place than not having a will in place.

Patrick: Yeah, and having a will in place allows you to cast roles. So there are very important roles to be fulfilled. Guardians, executors, trustees, if trustees are going to be used. Whereas if you die in an intestacy situation, those roles haven't been filled so, the rules of intestacy come into play and the government decides who's going to fulfil those roles. They may not be people you want to fulfil those roles. So, all sorts of reasons for actually getting organised and making a will.

Jeremy: Yeah, and I think, as you say, particularly if you have children under the age of 18, to make sure that appropriate provision has been made for them, guardians have been spoken to, because certainly those issues are very, very important. And if there isn't a will in place, ambiguity can make an already difficult situation even more difficult.

Patrick: Even if you do have a will in place, if it's not well drafted or it's a very, very basic will, you can have just as many problems. Because you could have, typically we see a lot of wills from a while ago, perhaps before a large degree of wealth was created, and they're very simple wills where each spouse is the main beneficiary and at second death the residual estate is divided equally between the children. Now, if the children are under 18, that means at age 18 once again they're going to get all that wealth. So, a badly drafted or a very basic will can cause just as many problems as not having a will at all. So, these are things to bear in mind, is how much you can achieve with a well drafted will.

Jeremy: I think, as you said, a key message there is to make sure that any existing wills are still relevant. Do they take into account any change in circumstances, maybe from your financial affairs but also your personal circumstances? Have relationships ended? Have you new children? If so, it certainly makes sense to at least revisit your will and see if it needs amending.

Patrick: Absolutely. Now, I know there are a number of scenarios where these problems can be very difficult to unpick. And I think you've got a few examples, given your experience, of various situations arising, either where there hasn't been a will or the will hasn't been drafted to take into account these potential situations.

Jeremy: Absolutely, I think you make a really important point there. As I alluded to in my last comment, I think making sure that wills take into account changes in circumstances. So, if you've married, what provision do you want to perhaps make for children from a previous marriage? Do you need to ringfence assets for them separate to those provisions you'd make for your current spouse? Those sorts of issues. Also, how do you potentially look to protect beneficiaries of your estate from potential liability issues. For example, bankruptcy, potential bankruptcy or divorce.

Is it possible to protect them in the circumstances that prevail? The answer often is yes. Often using trusts and different types of trusts. Another common scenario, a situation I frequently encountered when I was in private practice, was where clients who were often let's say in their mid to late 40s or early 50s and acknowledged or realised that if something were to happen to them prematurely and they were no longer around, chances are that the surviving spouse would remarry. Now, often a significant concern to individuals in that set of circumstances was often how to ringfence assets for their children, so that a new spouse or new partner effectively couldn't enjoy all the benefits of the deceased's estate. So, a frequent tool used in that set of circumstances was called an immediate post-death interest trust, and this effectively would carve out or ringfence assets for the surviving spouse until they remarried or until they died and then the assets would be available to the children. So, it's imperative to take advice from a well-qualified private client lawyer who's familiar with inheritance tax. But there are plenty of options available.

Patrick:

It's a very common scenario where you maybe have children from different marriages in a blended-family environment. One of the reasons the will hasn't been made perhaps or updated is because they have to address this quite complicated situation, and there may be a discussion with the spouse to say, "Well, will you look after my children if I go first?" Then you're relying on the spouse retaining mental capacity and not changing their mind or remarrying etc. And those issues can be dealt with a well drafted will and using those interest possession trusts where the surviving spouse has a right to the income, for instance, but the capital is preserved for your bloodline. There are other options such as things like mutual wills, but lawyers, they tend not to like those these days. I think the trust gives you probably a more flexible solution and it's more workable from a sort of governance point of view. So, there's no need to worry. These situations are very common. Estate planning lawyers are very good at teasing out different scenarios, throwing them at the clients and stress-testing their reactions and saying, "Well, if this happens, what would you do then?" But there's always a solution. So, it's something that is definitely worth going through. Even if ultimately you don't take up the solution, at least you're well-informed and you know what the options are before you make your final choice.

Jeremy:

I think that's a really great point, because to me it's about enabling the person who's looking to do their will to make a fully-informed decision and to gather all the information that's relevant to consider it. And, as we mentioned at the outset, now's actually a good time to consider it because many people perhaps have a little bit more bandwidth to consider these issues, consider the impact of the options available, and to make a decision in the round. But also, to potentially have conversations with impacted parties, potential beneficiaries, spouses, and to make sure that everyone's on the same page. Because I think a good will can also avoid what I call predictable conflict, and avoiding situations of conflict between family members or different parts of the family. So, I think that's another advantage. I'd

like to just explore with you, Patrick, the fact that not all assets are covered by a will. What assets aren't covered by a will?

Patrick: Well, this is important. Now, what I think, in this period you mentioned, there's a time to reflect at the moment, to maybe make use of this time. Certainly, by doing a bit of homework you can certainly save on those lawyers' bills, because if they charge by the hour, if you've done a lot of the deep thought prior to the meeting with the lawyers you can reduce the actual cost of implementing all of this. But one area I'd start with is setting down on a piece of paper or in a spreadsheet your personal balance sheet.

Jeremy: Great idea.

Patrick: Now, I would suggest you write all those assets down and you specifically focus on the ownership of each asset. Some assets will be in sole, individual names, others will be held jointly like the marital home for instance, bank accounts, investments, portfolios. And typically, most of these accounts and the way most properties are set up by default would be on a joint tenancy basis. Now, it's important to point out that those assets, upon the first death, they will not pass through the will because they pass on survivorship. Each owner of a joint account, for instance, owns 100% of the account. So, it won't go through the will, it'll pass onto survivorship. So, it's the second to die, it'll pass through their will. That's important to understand how to these assets will actually pass and flow, because if you're really interested in having complete control over the ultimate beneficiary, that's when these trusts would come into play. But there are other assets that don't pass through a will. Assets such as most pension assets. Not all, but most pension assets don't actually pass through the will. Anyone who's got death in service benefits, like a life cover through work, that does not pass through your will. Life cover that you set up individually in trust, that will not go through the will. That's already set up in trust. If it's not set up in trust it should be, because it all adds to your estate and potentially increases your inheritance tax liability. But importantly, you should note all these assets and then address, "Right, if the will doesn't cover these, how do I ensure that they get to the right beneficiary?" That's where you'd speak to your pension advisor or your pension company, and you'd complete a nomination of benefits instructions. With your death in service, you'd speak to your HR or go online and get a nomination or an expression of wishes form so that you can actually determine who gets what. And even better, speak to your lawyer when you're drafting a will about your death in service, because it sometimes can be much more efficient to actually have that benefit paid to a trust from which your spouse can benefit but without entering her estate or his estate. So, it can be very, very efficiently set up. So, certain assets you'll have to deal with separately because they won't pass through the will. You shouldn't assume that the will will be able to determine where that goes. Ultimately, if you don't leave any instructions behind, the trustees of those various plans, the pensions, the death in service, would look to

get an efficient outcome but it's much quicker if you actually take proactive action and set these plans up yourself with your instructions for the expression of wishes.

Jeremy: So, in short, look at it probably at the same time as doing your will.

Patrick: Definitely.

Jeremy: And make sure that your executors are familiar with let's say pension policies you may have from previous employers, life insurance policies you may have, just so that nothing's missed, again just to minimise admin disruption and to ensure efficiency of process.

Patrick: Yeah. And all the issues we've talked about with assets passing through your will, so the concerns about future vulnerability, mental capacity issues, divorce, remarriage etc., you can actually address with these pension assets and with the death in service, because if you're placing those for instance into a trust that can deal with those issues and provide protection measures against that. So, you have as much control, it's just you wouldn't do it through the will, you'd have to make separate arrangements. And the lawyer's there to help you with that as well. A good estate planning lawyer will cover all those areas.

Jeremy: You've mentioned previously that you've seen common mistakes over the years. What's been your observations around mistakes clients have made in respect to their wills and their will planning?

Patrick: A common one, going back to the balance sheet, if people can put their assets down, set them down on the balance sheet. If you can identify any assets there that are currently exempt from inheritance tax, and this would be assets that qualify for a thing called business relief where you get a hundred percent relief from inheritance tax, so a trading businesses for instance that's closely-held, those assets are exempt from inheritance tax but typically would not be dealt with any differently. So, they'd be left in the will to the surviving spouse. If the surviving spouse then doesn't want to run the business and decides to sell the business, then all that's happening is the surviving spouse is just inflating their estate with an inheritance taxable asset. So, the cash isn't exempt from inheritance tax like the business was, so you're increasing IHT liability. Whereas if you actually said, "Well, if I have any exempt assets ..." and word your will so that exempt assets are left to a separate trust, that way they can still be sold but it won't inflate the survivor's estate. The assets will be held outside that estate and therefore they won't be subject to the full rate of inheritance tax inside the survivor's estate. And then when the assets are sold in the trust, the survivor perhaps can borrow from that trust to fund lifestyle etc., or even defer the assets to the next generation because the trust will be set up with wide potential beneficiaries.

Jeremy: It would be fair to say make sure you don't duplicate exemptions and relief. So, if you are leaving an asset which is exempt, don't necessarily leave it to a spouse who

would also benefit from a spousal exemption. So, do not duplicate exemptions and relief in short.

Patrick: Ensure there's also enough liquidity for the survivor. If you have assets that are mainly say in your name, they will be subject to the will, and therefore before the will provisions can be executed, the executors have to apply for probate. That can take at least six months, and therefore all accounts in sole names are frozen, so the survivor might not have enough access to liquidity. So, always have some joint accounts where you've six to 12 months living costs at least so that they don't have that issue, or they've got sole assets that can see them through. So, those are common housekeeping issues there.

Jeremy: Okay. Just in respect of inheritance tax and donations to charities, certainly a common question from many, what are the reliefs that are available to someone who wants to leave a charity money as part of their estate?

Patrick: Well, it's a good point because we've assumed here that all of the estate is going to ultimately go through to family members. But you may have some philanthropic ambitions. You may want a charity to benefit from a proportion of your estate. Well, actually, if you leave 10% or more to a registered charity the rate of inheritance tax on the estate reduces. So, if in the will at second death, the assets are passed to the next generation or trusts are used but you also want to put 10% of the estate to a charity, then the IHT rate drops to 36% from the current rate of 40%. If you were thinking of making a donation to charity at second death anyway and you were slightly below the 10% mark, you could just dial it up a little bit and then qualify for that reduction in inheritance tax. So, that's a nice tax-efficient way of structuring things.

Jeremy: Yeah, no, absolutely. And I believe the net cost of leaving, as you say, over 10% of the free estate to a registered charity was I think 24p in the pound because of the 40% relief on the 10% left. And on the balancing 90% of the estate, that's reduced from 40% to 36%. So, I think by my calculations in my head, I think the net cost was 24p in the pound. So, it can be very tax-efficient to leave monies in as part of your will and your estate on death to charities. I think also what's certainly very nice for a lot of people is that they can leave a legacy, and they can perhaps ask future generations to support the charities that they have supported as part of their will. So, there can be nice, let's say softer, benefits to leaving monies as part of your will and your estate. One area I'm keen just to turn to is something called the lasting powers of attorney. What is a lasting power of attorney, for our listeners' benefit?

Patrick: So, a lasting power of attorney, this really deals with what happens in the event of the loss of mental capacity. So, not when someone dies, when someone is still alive but they lose mental capacity so they can no longer administer their financial affairs. There are actually two types of lasting powers of attorney. What you're doing here is you're appointing a trusted individual to be your attorney to look after your affairs. Those affairs would be either financial, with a financial lasting power of

attorney, or they'd be for your health and welfare, so to make decisions about your care and ultimately your medical situation. So, all that responsibility you're investing in that individual. You'd also appoint a substitute attorney, if the named attorney was unable to act. This is really important. Everyone in the UK should have one of these, because if you don't, then even if you're married, your spouse will not be able to act on any assets that are held in your sole name. Now, joint assets, as we mentioned before, you each equally own those so you can operate those no problem. But sole assets, even though you're married, you would not be able to operate financially the assets of your spouse if they lost mental capacity. You'd have to go to the Court of Protection, and that's a very bureaucratic, long-winded process. Six months at least, at a very stressful time. So, if you have a lasting power of attorney and register it immediately, hopefully it sits in your office gathering dust and is never, ever needed, but if it is needed, it's there and it can be used immediately.

Jeremy: So, the key message there is, if you are reviewing your will or perhaps establishing your will for the first time, it may make sense to also set up a lasting power of attorney at the same time as it, let's say naturally, compliments a will and can address, let's say, potentially important issues during your lifetime. So, it certainly makes sense to look at that at the same time. I'm just conscious of the time, Patrick, and I know we need to wrap up here. But just in summary, would it be fair to say that it's imperative that clients or listeners review their wills on a regular basis, to make sure that they take into account any change in circumstances, whether they be personal or financial? And also, would it be fair to say that it's important to establish a consensus, a shared vision, perhaps with your spouse or your civil partner, to make sure that there's agreement during lifetime?

Patrick: Absolutely, a hundred percent. There needs to be consensus. You also need to tease out any issues. If you can't agree on guardians, for instance, that's a common one, or if you have a blended-family, on what the split should be. You need to have these conversations to get everything squared away, have that shared vision. Now this can importantly, because the will deals with what happens when someone dies and hopefully that's not for a long time, so having these conversations, you can develop a shared vision for how you actually want to administer your estate during your life. So, succession planning, gifting to the next generation, how to support them, their whole wealth philosophy and attitude to money etc. It can really inform on those discussions you'd have and those actions you'd take when you're living a long life and managing the succession issue of the wealth to the next generation. So, doing that homework and having that deep thought is not only going to save ultimately on the amount of time you spend with your estate planning lawyer and actually drafting the provisions, but it's actually going to serve you well in your future thoughts about the succession question.

Jeremy: Some very good points there. I think also it can be a very helpful exercise as it can help identify issues, opportunities, around your balance sheet, your assets, but also your family relationships, who you feel needs help, who needs greater support and so on. And can also be very helpful during your lifetime, so that you can address some of those issues during your lifetime. All that remains is for me is to thank Patrick for his insight today.

Patrick: Thank you, Jeremy.

Jeremy: And finally, I'd like to thank all our listeners I hope they found it informative and useful. And if they would like to pick up any of the issues raised today, please do get in touch with your Relationship Manager and they will be delighted to arrange calls or video conferences with members of the Wealth Planning team to discuss these issues in greater detail. Keep well, keep safe, and look forward to you dialling in to future podcasts.