Coping with compensation

You've won the case, and your client has become an instant millionaire: what now?

Becoming a millionaire is one thing, but some people who receive sizeable compensation payouts learn that staying one is quite another. Unfortunately, the day your client receives a cheque, they also become a target for every money-making venture under the sun. Claims of high returns and 'can't-go-wrong' schemes can be hard to resist. But many such schemes lead to financial ruin or, at the very least, the failure to preserve capital and stay ahead of inflation. For someone whose ability to earn a regular income into the future has been affected, this is particularly important.

As a lawyer, you can do one of two things. You may consider your job done, congratulate your client and wish them the best of luck. Or, you may choose to take a more active interest in the long-term future of your client. Before deciding, let's consider some of the things that can go wrong.

Dangers and traps for compensation clients

The worst case scenario is that your client simply invests their entire payout in an obscure venture. Often (but not always), these will be property deals or farming ventures in which the sky is impossibly blue. Most people don't fall into these traps with their whole compensation payment, but it does happen.

Some clients concentrate their money in a few individual investments and, while perhaps not going broke, almost certainly take more risk than they need to. Others will finance business ventures or distribute their money into complex arrays of funds, incurring big transaction fees and providing little assurance of a reasonable return over time.

Perhaps the most likely outcome, however, is that the client will start by placing their money in a term deposit or interest-bearing equivalent. While this may be a sensible place to 'park' funds while deciding on a long-term plan, it is likely to become a big problem if the client leaves it in there for too long. The biggest financial losses faced by most investors occur in suburban bank branches, through accounts that pay too little interest to get ahead of inflation.

While your client does not expect you to be a financial planner, those who receive specialist advice generally do better ▶

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Most personal injuries are orthopaedic in nature and our Practice has three Consultant Orthopaedic Surgeons and one Consultant General Surgeon.

The Practice also handles medical negligence/malpractice cases and Dr Thomson is a professional member of APLA, and also a member of the Medical Negligence/Malpractice Special Interest Group of APLA. We also undertake file reviews.

The rooms are located at **3 Bruce Street, Crows Nest, Sydney**, close to major railway stations, with ample car parking nearby, and there are also regular attendances at Parramatta, Newcastle and Wollongong.

There is currently little waiting time, urgent assessments can be reported same or following day, and block bookings are available.

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over the long-term. So referring clients to a reputable financial planner will help them to make sure that their money lasts, and help you to feel sure that you have acted in their best interests. In particular, people who receive compensation payments may be eligible for benefits that they may not otherwise know about.

Superannuation sometimes available to compensation clients

Most people think of superannuation as a tax-effective way of investing for employees. But most don't realise that it can also form part of an investment strategy for people who have become permanently incapacitated. People like Jim Murray*, who was severely injured in an industrial accident.

Before his accident, Jim was a specialist in set construction for major stage productions, directing a highly skilled team. He often worked at heights of up to thirty metres, and it was from this height that he fell in 1998. Jim was left totally and permanently incapacitated, aged 37. Jim's doctors confirm that he is 'unable to ever work in any occupation for which he is suited by training or experience'.

Keeping ahead of inflation

Jim and his wife Diana own a house with only a modest mortgage, and have no other debts. Jim recently received a compensation lump sum of $1,600,000, but he is conscious that his medical costs are likely to be considerable over the years.

A dollar today buys less than it did in the past because of inflation. So Jim and Diana need to earn an investment return that is *significantly greater than the rate of inflation*. To achieve this, most investors need some exposure to growth assets - like Australian shares, international shares and property. Although they are likely to be more volatile than interest-bearing investments over short periods of time, over the long-term, growth investments are more likely to produce higher returns.

Setting goals and priorities

Jim and Diana estimate they will need an income of $50,000 a year - in addition to other income - to support their lifestyle. (Most people find that they need an annual retirement income of at least 75% of their final salary). They want their money to last in case Jim reaches the age of 100, and to be able to cash in their funds at short notice. Because they are still recovering from the emotional drain of the accident itself, they also want some short-term flexibility. For this reason, they want to put $400,000 into cash for six months only. The couple don't want to take any more risk than is absolutely necessary to achieve their goals.

To achieve $50,000 in real income each year, Jim and Diana need to receive a return of six per cent above inflation over the long-term. The couple have $1.2 million to invest. It is not widely known that people with a disability such as Jim's are able to access the benefits of superannuation, usually available only to people who are retired and over the age of 55.

Jim can benefit from a valuable structure called an allocated pension, which provides a regular income, plus some growth. The main benefits are:

- Earnings accumulating within the allocated pension fund are tax-free (under current law), so the life of the lump sum is maximised. No other investment structure allows investors to compound wealth tax-free in Australia.
- Because of concessions in the tax treatment of income from allocated pensions, Jim will pay tax on his regular income at less than his marginal rate.

Of the $1.2 million available immediately, Jim makes an undeducted contribution of $700,000 into an allocated pension and $500,000 into a managed investment fund. The money is split between the two in order to produce a reliable regular income for Jim and Diana, while maximising tax efficiency.

Achieving a reliable return

Jim and Diana's financial adviser recommends a diversified strategy - through a pooled master trust - with the following allocations:

Cash: 7%
Australian Property: 13%
Australian Fixed Interest: 10%
International Property & Infrastructure: 2%
International Fixed Interest: 2%
International Smaller Companies: 5%
Australian Shares: 40%
Global Emerging Markets: 3%
International Shares: 18%

These allocations are based on research data, and the current investment outlook. The strategy is structured to deliver an average real return of five to seven per cent above inflation each year, over periods of five years. With this strategy in place, the value of Jim's portfolio at the age of 65 is estimated at almost $3.5 million. The portfolio would be worth far less if the money were maintained in term deposits, and superannuation was not used.

While it will never compensate Jim for his injuries, the strategy provides the couple with a reliable return that will fund the lifestyle that they want. It is also helping Jim and Diana to start a new life, secure in the knowledge that - barring any unforeseen catastrophe - their money will last.

Action steps for lawyers

A reputable financial planner will plan a long-term strategy for clients, and help them to avoid the common investment traps and pitfalls. They should also know of any specific benefits that a compensation client may be eligible for. Lawyers can assist their compensation clients by:

- **Explaining** some of the traps and pitfalls in investing compensation payments;
- **Alerting** clients to the fact that in specific circumstances they may be eligible for specific benefits;
- **Identifying** a reputable financial planning firm in advance; and
- **Referring** clients who wish to receive specialist advice to that firm.

Further information:

To learn how your clients can benefit from **ipac**'s approach to financial planning, please call Chris Westacott or Faye Horn on 1800 262 618 or (02) 9373 7000 ■

** Jim Murray is not his real name. Although the background has been changed to protect Jim's identity, the essence of the story is unchanged.*