



**WAY
FINDER**

A brief guide to financial planning

by Jane Wheeler

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“Going through the Financial Planning process was like a lightbulb moment for me – I finally understood what I needed to do to achieve my life goals”

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Why plan?

We are living in very difficult financial times and life is a real struggle for lots of people. However difficult your situation, you will be better off addressing the situation, taking control and focussing on a realistic goal than allowing the situation to control you.

For all of us there are things that we would like to achieve in our lives: in order to achieve them we need to be focussed and financially 'organised'. This is the essence of Financial Planning.

Rather than just wishing that you could do something or have something that's important to you, why not apply yourself to make it happen using the process of Financial Planning? As well as realising your dreams at the end of the process, you will have a sense of achievement: in addition you will feel in control and have the comfort of knowing that your financial life is ordered.

Your plan will provide you with a financial roadmap which, if you follow it correctly, will lead you to where you want to go.

In order to be effective your plan must be:

- Agreed with your partner, if you have one. Are your goals also his/her goals? In order to be successful you will both need to be committed and to enjoy your achievements as you progress towards your goals.
- Realistic and achievable: you need to be sensible about what you are setting out to try and achieve if you want to avoid disappointment.
- Written down: if it's not written down, it doesn't exist!
- Regularly reviewed and updated: in order to keep your plan on track you need to regularly revisit it and repeat the whole planning process to keep it up to date.

Tools

If you are proficient in the use of spreadsheets you will find this very useful in the planning process but if not, you will be able to manage with a calculator and a file in which to record your goals, calculations and plans.

Setting Your Goals

Don't rush into this and remember that your goals must be realistic in the context of your circumstances and must be agreed with your partner in order to be achievable.

You may know already exactly what you want to achieve and it may be something as straightforward as ridding yourself of credit card debt within, say, 2 years. However, your goals may be more complex and related to retirement, to changing direction with your career (perhaps taking a drop in income to re-train), starting a family or buying a new home.

During this process, open your mind: the most worthwhile goals are not purely financial but money is the tool that we often need to facilitate the realisation of our dreams.

If you are having trouble focussing on what you really want to do, consider the following questions:

- If you knew you would die tomorrow, what would you most regret not having done in your life?
- If you knew your life would end in one year's time, what would you most like to do in the time available?
- Similarly, if you knew that you had 10 years to live, what would you like to achieve in the years that you had remaining?

Write down all the ideas that you have, discuss them and eliminate those that are of least value to you. Record your final list of goals and assign a timescale to each: keep this list somewhere visible where you can refer to it regularly for motivation to stick to your plan.

You are likely to have more than one goal for the:

- Short term - to be achieved in the next 5 years
- Medium term - to be achieved in the next 5 – 10 years
- Long term – more than 10 years

You will need to prioritise but try to make some progress towards all of your goals simultaneously.

Disclaimer

The contents of this brief document are not intended as advice but rather as general information on the making of a financial plan. Everybody's circumstances are different and what is appropriate for one may not be appropriate for another. If you are in doubt you should seek the advice of a professional Financial Planner.

Working out the cost of achieving your goals

This is the most difficult part of making a financial plan but it is do-able so don't be put off. In order to be able to plan, we need to put a cost on what it is we are trying to achieve. Take each goal, one by one, and calculate the amount of money you will need to be able to achieve them. Take note of the timescale for each goal: this is very important. You will then need to work out the best way of accumulating that amount of money by regular savings or by assigning capital that you already have to that purpose.

Any calculations that you make now can only be approximate as they inevitably rely on a number of assumptions. Don't worry too much about trying to be exact. They are valuable nonetheless and give a framework to work within and also provide a reality check.

There is some excellent information on the Financial Planning Week site at www.financialplanning.org.uk/tips-and-tools or go to www.moneyadvice.service.org.uk where you will find a lot of very useful information as well as calculators to enable you to estimate, for instance, how much you will need to save each month in order to provide a specific sum at some time in the future or to provide a pension of a particular amount, from a certain age.

Alternatively, this may be where your spreadsheet or calculator will come into its own.

You may need to make assumptions, for instance, the rate by which your investment or savings may grow between now and the time when you hope to realise the goal or the amount of pension income that you will need in retirement. You must also allow for inflation (the rise in the cost of living).

Inflation destroys value, so if the calculator that you are using doesn't automatically make an allowance for inflation when calculating the cost of each of your goals, you will need to allow for inflation over the timescale for that goal. To do this, take the cost that you have calculated for the goal and multiply that figure by, for instance, 1.04 for each year of the timescale. [This assumes an inflation rate of 4% - you can assume any rate that you feel is appropriate]. For more help understanding and calculating the effects of inflation, visit www.thisismoney.co.uk and look for the inflation savings danger calculator.

Shortlist

By now you should have a final list of goals that you and your partner have agreed and have calculated a very rough cost for each one, making allowance for inflation. This is an excellent start.

Where are you now?

Before you start on any journey, you need to understand where you are now. For this one, you need to understand:

- your net worth position: the difference between your assets (what you have) and your liabilities (what you owe)
- the relationship between your income and your expenditure (what you earn and what you currently spend it on)

Calculating your net worth

List out all the assets that you own together with a realistic value for each. This may include:

- your home
- your investments
- bank/savings accounts
- pension plans (for simplicity use the latest transfer value)

Now list out all your liabilities together with the amounts you owe on each. This may include:

- your mortgage
- other loans
- credit card debt
- hire purchase arrangements
- overdrafts

Your net worth is the total of your assets, less your liabilities. This may be a negative figure for some, at first: don't worry about this, for now. Your net worth is the figure that you will be working to improve in one way or another.

For each item in your net worth statement, you need to understand:

- What is it?
- What is it for? Do you need it?
- What does it cost?
- What is it worth / what do you owe?
- What commitment is there to future expenditure (loan payments / premiums)
- When will it end / mature?

Understanding your income and expenditure

For most of us, income is fairly easy to understand. It may include:

- your salary if you are employed or your profits/drawings if you are self-employed
- interest or dividends on investments
- State benefits of one sort or another
- income from pensions

It is simplest to try and work on income figures after deduction of tax. [The self-employed will need to make an allowance for tax payable.]

Understanding your expenditure is a more complicated matter. If you are prepared to put the time in to understand how you spend your money, there are enormous benefits to be had. You will be able to see where you can best make savings and where you are unknowingly wasting money. Get into the habit of keeping receipts, especially for cash purchases, and do your best to analyse all of your expenditure using your bank and credit card statements: you will learn a lot!

The difference between your net income, after tax, and your expenditure is your 'disposable income' - the amount that you have available to apply to the achievement of your goals. If you can increase this figure either by increasing your income or, more likely, by decreasing your expenditure then you will be able to realise your ambitions sooner.

If you are spending more than you earn then you must address this situation immediately: try to increase your income but certainly take drastic steps to reduce your expenditure.

Some practical ideas for increasing your disposable income

Increasing income

Some of these may be possible for you:

- You could look for a higher paid job or seek promotion although it is recognised that at present this may be very difficult.
- Take on an extra job at weekends or evenings – perhaps something completely different from your 'day job'.
- Rent a room. HMRC allows you to receive rent of up to £4,250pa, tax free, for letting out a furnished room in your house.
- State benefits. Check that you are receiving all the state benefits that you are entitled to. Go to www.direct.gov.uk for information.
- Clear out your loft or storage cupboards and do a car boot sale.

Reducing what you spend

Think about everything that you spend

If the purchase is non-essential and doesn't move you toward your goals, then don't make it!

- Cut out redundant outgoings. The analysis of your expenditure may have revealed some payments for things that you could simply do without. Stop them.
- Food shopping. Make a shopping list before you go to the supermarket and stick to it. Online shopping can be a good discipline and has the bonus that you don't have the hassle and cost of visiting the supermarket yourself.
- Eating out. Eat out less: eat at home more.
- Going to the pub. Drinks bought in pubs and restaurants are expensive! Rather than miss the opportunity to meet up with your friends, why not invite them to your home one night a week?
- Lunches. If you usually buy lunch every day at work, you could save pounds by taking a packed lunch instead.
- Smoking. If you are a smoker, you know what you need to do! Quite apart from the damage to your health, you could save well over £2,000 a year if you currently smoke 20 a day.
- Rent. Could you find a cheaper place to live or share with someone else? You may be able to save on rent as well as Council Tax, utility bills and the cost of travel to work.
- Mortgage. If you have one, check that the mortgage deal that you have is the best / cheapest available. However, look carefully at the costs of changing to another deal.
- Council Tax. [This applies to all domestic properties, whether owned or rented.] If you are a single adult living alone, disabled, a student or a nurse, you may be eligible to pay council tax at a reduced rate. Check with your local council.
- Cars. Cars are very expensive to buy, they depreciate rapidly in value and they are very costly to run. If you have more than one in the household, consider whether you could manage with less. Look into car-sharing schemes for getting to work and also car clubs in cities which are convenient and excellent value and mean that rather than owning a car yourself, you just rent one when you need it.
- Utility bills. These are an increasing part of all our household costs. You can compare gas and electricity prices from different suppliers on various different comparison websites and there is useful advice available from www.ofgem.gov.uk
- There are obvious practical steps that we could all take to reduce utility bills: reduce the temperature on your central heating thermostat by a few degrees, turn off the lights when you are not in a room and turn off electrical appliances rather than leaving them on standby.
- Make sure that your home is well insulated: grants of up to 100% of the cost are available. Check out www.government-grants.co.uk
- If you don't have a water meter fitted in your home and you are a moderate user of water, consider getting a meter fitted. You could save a lot.

- **Holidays.** Do you habitually spend a lot on holidays, perhaps travelling to exotic locations? Is this moving you towards your long term objectives? Could you have just as much fun and relaxation holidaying closer to home, perhaps camping or sharing self-catering accommodation with friends who are also trying to save money?
- **Insurances.** When your general insurances (household, car etc) come up for renewal, check whether you could get the same cover cheaper elsewhere. Try one of the comparison websites: you could save a lot with only a few minutes work.
- **Mobile phones.** When your contract comes up for renewal, don't just renew it without thinking: there may be an arrangement that's cheaper for you.
- **Public transport.** If you are planning to make a long journey by train, book well ahead and be prepared to stick to specific trains. Look out for deals and remember that travel by long distance bus may be cheaper than train travel.
- **Consider having a look in charity shops** when you want to buy something: you need to sort through a lot of stuff but there are some really good buys sometimes.
- **Credit cards.** If at all possible, pay off the balance every month to avoid interest charges. If you have a large balance owing on your credit card, look into options for switching to another card for a nil interest period during which you could try to repay the balance: however look very carefully at the terms. For more information check www.moneysavingexpert.com
- **Don't allow yourself to go into debt** if you can possibly help it (other than for fundamentals such as mortgages and student loans): it will cost you a lot to get out of it and interest paid is simply lost money.

For more ideas have a look around www.financialplanning.org.uk/wayfinder/tips-and-tools and visit www.moneyadviceservice.org.uk and www.moneysavingexpert.com

Expect the unexpected: a responsible approach

Before you go any further with the nitty-gritty of making plans for the future, there are a few fundamentals that you should address. Do not regard these as unwelcome distractions from your main objectives - they should be dealt with as the first step to bringing order to your financial life. Everybody's circumstances are different but, in general, you should do the following:

- Establish an emergency fund – instant access to cash when required
- Ensure that there is sufficient insurance cover in place to provide for your dependants in the event of your death and for yourself and your family in the event of either long term ill-health or the onset of a 'critical illness'
- Make sure that you and your partner have wills which reflect your wishes for the distribution of your estate in the event of your death. If you have young children, consider appointing Guardians to take care of them in the unlikely event that both parents die before the children are grown up. If you are older, you should consider appointing a trusted friend or relative to act as your Attorney in the event of you becoming unable to manage your own affairs: a solicitor will be able to advise on all these things.

Emergency fund

Set aside or build up an emergency fund sufficient to cover at least 3 months' outgoings in the event of loss of earnings, unpaid sick leave etc. The emergency fund should be in cash on instant access deposit with a bank or building society. This may conflict with your priority of achieving your goals but, by building up this financial cushion (and maintaining it), you will protect yourself in the event of things going wrong, at least for sufficient period of time for you to make arrangements to address the situation.

Life/health insurance

Imagine the unhappy scenario where you had died yesterday. Work out how much would be required to clear debts (including the mortgage) and provide a lump sum or income for your partner/children sufficient for their needs: ensure that, if at all possible, you have at least this amount of life cover in place. If you were to become ill long term, how much of your current income would continue and for how long? How much income would you need? If possible, take out insurance to cover any shortfall. In addition, if you are able to afford it, consider critical illness cover to repay major debts in the event that you are diagnosed with a major illness.

Make sure you understand the terms of any policy that you take out. Remember that the cost and availability of all of these types of insurance will depend upon your age and state of health at the time that you take them out. Take advice from an independent adviser or planner, or at the very least visit one of the comparison websites to get help.

Wills

A will is a legal document which sets out who is to benefit from your property and possessions (your estate) after your death. There are a number of ways of making a will but, to be on the safe side, it is advised that you ask a solicitor to draw up wills and powers of attorney, when these are required.

If you die 'intestate' (ie without having made a will), there is a danger that your assets will not end up in the hands of those that you would have wished to have them.

Depending on your circumstances, you may wish to include guardianship arrangements in your will so that, in the event that your children are left parentless, there will be someone to take care of them: you obviously need to get the agreement of the people you intend to name as guardian(s) beforehand.

Saving and investing

This is an important subject and beyond the scope of this brief guide. The following are meant only as very broad guidelines.

Your next step will be to work out what sort of savings or investment vehicle is most appropriate for the purpose.

- Money that is ear-marked as your emergency fund should be in cash on instant access deposit with a bank or building society to earn the best rate available.
- Money set aside for the realisation of short term (up to 5 years) goals should also be in cash on deposit.
- Money set aside for medium term (5 to 10 years) goals could be invested in collective investment vehicles (funds). If you are not an experienced investor or taking any professional advice, select a 'Balanced Managed' fund or a 'Cautious Managed' fund as appropriate to your appetite for investment risk which will provide a spread of different investment types appropriate for the medium term. Once within five years of your target date, gradually switch funds to 'Cautious Managed' and ultimately to cash at least two years before your target date.
- For long term objectives (more than 10 years), use collective investments perhaps within a stocks and shares ISA (Individual Savings Account) or pension plan. Consider using a 'Growth Managed' or a 'Balanced Managed' fund if you are selecting for yourself or even an 'Active Managed' fund if you are investing for a very long time. Once within 10 years of the target date, reduce the risk by moving to Growth, Balanced or Cautious as appropriate and then to cash for the final period before your target date.

No investment is completely risk-free. You need to decide how comfortable you are with the prospect of losing money, even if it is a short term loss on paper before values recover.

Remember that nothing is lost, or indeed gained, until the investment is sold so that to a great extent we can ignore the movements in value along the way. You should stay invested for the planned term.

Tolerance of risk or indeed capacity for loss is different for each of us and varies according to our personality, our circumstances and the investment term that we are considering as well as the possible consequences if the investment went bad. If you have very little money, do not gamble it on high risk investments - you cannot afford to lose it.

Creating your financial plan

All the work that you have done to date means that you already know:

- what goals, in order of priority, you are trying to achieve, over what timescales.
- the approximate cost of achieving those goals allowing for inflation
- what disposable income you have to apply to those objectives, having made provision for life assurance etc to protect yourself and your family.
- what assets you have already built up that you can apply towards your goals

The next step is to get the basics of your plan together – ie work out your strategies. How are you going to best apply the funds available to each of your goals? You will need to do some arithmetic but it won't be too difficult. Plan to :

1. reduce short term debt and establish an emergency fund (preferably at the same time but, if you cannot manage that, then reduce short term debt first)

Then separately, or preferably simultaneously:

2. fund for short term goals (less than five years)
3. fund for medium term goals, and (five to ten years)
4. fund for long term goals (10+ years)

How to work out strategies:

Take each goal, in priority order: **Will your available assets meet the cost of this goal?**

- If so, how much of your available assets will remain?
- If not, what is the shortfall? How much of your disposable income would you need to apply to this goal in order to achieve it in the timescale?

How much surplus disposable income, if any, is left after you have allocated what you need for the last goal?

If you still have available assets or surplus disposable income left after allocating resources to the first goal, then move on to the second and repeat the process. Keep doing this until you run out of goals (in which case you are in exceptionally good shape) or, more likely, resources. (Remember that the value of your pension plans can really only be applied to your retirement goals).

Write down the strategies: these form the basis of your plan.

Implementing your financial plan

'There's no time like the present.' You have worked out your strategies so, start now and don't look back!

- Make applications for any life or health insurance that may be required: you can do this on line or through an independent financial adviser.
- Make an appointment with a solicitor to get a will drawn up, if required.
- Address repayment of your short term debt
- Ring-fence some existing savings or commit to building up cash savings to form your emergency fund.
- Make the necessary arrangements for saving or investing the funds that are ear-marked for other longer term objectives.

Good housekeeping

- Keep up your record keeping so that you can track your income and expenditure.
- Keep your paperwork filed tidily and in a logical order.
- Keep the number of bank accounts, credit cards, savings accounts, investments accounts to a minimum: this will allow you to have a clearer idea of where you are.
- Ensure that if your partner pays income tax at a lower rate than you, savings accounts etc are in their name.
- Make best use of any tax saving schemes available to you (eg ISAs, pension plans etc). NB It is not possible to cover taxation considerations in this brief guide.

Understanding

Don't get involved in any complex investment schemes unless you are very experienced and confident or you have expert professional advice. If you don't understand it or it seems too good to be true then don't do it. The same goes for any financial product that you may consider.

It is also most important to understand your financial situation, how it came about and how you can make the best of it. Be prepared to put in the work to do this.

Review your plan regularly

At least once a year (more often if you are working towards short term goals) you should return to your financial plan to measure your progress and make adjustments as required.

Repeat the entire process again:

- Check that your goals are still appropriate, realistic and agreed with your partner. Write them down. Recalculate the cost of the goals.
- Recalculate your net worth. This should be increasing.
- Analyse your income and expenditure. Are you able to increase further the disposable income that you can apply towards your objectives?
- Check that you still have ample provision for emergencies, early death, ill-health etc.
- Check that your will still reflects your current wishes.
- Revisit your financial plan: update the strategies to take account of changes and any different assumptions that you wish to make. Write the revised plan down.
- Implement the new strategies.
- Ensure that you continue to keep control and that your financial arrangements are as efficient as possible.

Good luck!

About the Author

Jane Wheeler is now retired but previously worked in the field of financial advice and financial planning for almost 25 years and is a former President of the Institute of Financial Planning and director of the international Financial Planning Standards Board.

“I didn't realise that if I invested the money I used to spend on a daily coffee into my mortgage instead, I could take five years off my repayments!”



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