bannerjones

wealth management

Your money under your control –

The 8 key steps of financial planning

Introduction

Financial Planning is a way of describing how you organise your finances so that you may successfully navigate each stage of your life, knowing that you have your finances under control.

Planning is important in this context because your future financial prosperity is often dictated by decisions taken today, possibly many years in advance of the outcome you desire.

The challenge we all face is how best to bring a number of variable, possibly disparate, factors together into one coherent whole. Successful financial planning is the application of the process which brings all these factors into the equation and produces an overall plan of action and activity which meets the requirements of each part.

The difficulty for financial planners is that every client is different, which means that there is no 'one-size-fits-all' solution. Each and every client requires a unique outcome.

The other major aspect, based on our experience, is that most clients and individuals require financial planning advice and help, but wish to retain an element (often a significant element) of **control over their own finances**. This places an emphasis within the financial planning process to create a partnership between the financial planner and their client, so that the financial planner may provide the advice/service required but the client still has control over their own position.

We believe all of this can be achieved by following a consistent approach which is based on **eight key steps** and components.

The fact that this approach is consistent does not mean that there is any lack of scope to make the outcome unique, indeed the opposite is true: by following these eight steps, the result will be a financial planning approach which creates a unique, personalised and tailored plan for each individual client.

The 8 key steps

The steps outlined below are in an order – but the order is only relevant to a point.
The steps will have outcomes which overlap or interact. What is determined in one step may directly affect another, so there may be a case of working backward and forward.
The important point is that each step produces a component part of the overall financial planning requirement.

The fact-finding steps

Step one:
Who are you and where are you?

Step one requires answering the two questions above. 'Who are you?' relates to your nature and approach to your finances; 'where are you?' to your current life position.

The financial planning process will vary at different stages of one's life and will be heavily influenced by your nature. For example, the requirements of a 70 year old widow will likely be very different to that of a young professional couple.

Even at the same stage of life, different people have different lifestyle requirements and these can translate into very different expenditure patterns both now and in the future. Some of these differences will become more apparent through the later steps (see below) but in the first step they will be marked by looking at such things as your overall attitude and approach to your finances, as well as the stage of life you are at and your lifestyle position.

Step one needs to include an understanding of your family and work positions, your lifestyle (e.g, your hobbies, interests and what sort of things you like spending money on) and how this has changed and may change in the future. Many of the questions that will be addressed in this part will relate to 'soft' facts.

Soft facts are ones that don't necessarily have a hard and fast answer. A question such as, 'what is your approach to your money?' requires a subjective view, whereas, 'how much money have you in the bank?' is a matter of fact (and is a 'hard' fact).

Key point:
Financial planning involves understanding you – and this is about more than just your money.

The fact-finding steps

Step two:
What is your financial position?

Whereas step one is about you, step two is all about your money, or to be more precise, your finances.

Every individual, just like a government or a business, will have a set of figures that will produce a clear understanding of where they are financially. Individuals will have assets and liabilities, income and expenditure. Analysing these figures is the central part of step two.

Assets will typically comprise cash at hand and in the bank, savings accounts, investments (including assets within a pension) and property. Liabilities will include all borrowings, both short term (such as credit cards and bank loans / overdrafts) and long term (such as a mortgage).

Income will be the household income, broken down between partners (in a marriage or where two parties are living together) and will need to be assessed as to the extent the income varies, because of self-employment, dividends, bonuses and any other factors which may create a year on year fluctuation.

Expenditure will be the mix of mandatory spending (e.g. electricity, mortgage payments and community charges etc – those things that have to be paid) and discretionary spending (e.g. holidays, health clubs and so on – the items that are not necessary but desirable).

Although this step may seem bland, arguably **it is the most important step of all**. The overview and assessment of your personal balance sheet and profit and loss statements is the cornerstone to the planning process. An accurate and in depth analysis provides a foundation to build successful future plans.

Key point:
Your current financial position is the most important part of the process.

The fact-finding steps

Step three:
What are your goals, aims, ambitions, targets?

Having established your basic nature and your general attitude towards your finances, followed by the assessment of your current position, the third step is to look at your future plans.

This future view is a mix of factors that need to be assessed. It should include when you expect or plan to retire, how you expect your income and expenditure to change, whether you anticipate any windfalls, such as a pay-out from share options or an inheritance.

It is clear that many aspects will be uncertain, both in the context of when an event may occur (e.g. you may know that you are likely to inherit monies in the future but not when) or to what extent they will occur and how much money will be involved.

The future is also about your wishes and ambitions. Do you want to travel in retirement or are you looking to send your children to a private school?

As with the earlier step, where hard and soft facts needed to be combined in the view taken, so it is with the future view; some of the future map will be relatively certain and will comprise hard facts, some will be uncertain and will be made up of desires, wishes and 'life' targets - all things which are equivalent to soft facts.

Key point:
This step can be 'elastic'' - you can adjust your aims and targets based on the realistic expectations which are required to get you to your target points.

The discovery steps

Step four:
What type of investor are you? What is your Risk Tolerance?

These two questions interact with one another. The importance of the answers to these questions is that they will influence your plan of action and the shape it will take (step five – the next step).

The type of investor you are will largely be determined by your attitude to risk and how comfortable you are taking risks with your invested money. Can you accept that any long term plans and investing which aims to achieve reasonable levels of return will require an acceptance of a possible loss of money? Can you take risks without losing sleep or creating unwanted stress for yourself? Are you a safety first person? These and other questions will determine what your general nature is within the context of a financial planning programme.

However, it is your **tolerance to risk** which probably has the greatest impact on your future plan. The difference with your risk tolerance as opposed to your risk attitude, is that the former is a structural assessment of how significant risk and losses are to your current and future financial positions.

This takes away your nature, preferences and attitude from the consideration and focuses on what happens if you lose money: how much can you afford to lose, for how long, how easy is it for you to recover from losses and so on.

This combined view of your risk position is called risk profiling. This is a way of measuring your risk position as accurately as possible, with a view to ensuring that your future constructed plan of action is put together in a way that safeguards your overall finances at the same time as seeking to maximise the possible returns.

Key point:
Your risk attitude and risk tolerance both need to be factored in, with an emphasis on making sure you only invest according to the investment risk you can tolerate.

The discovery steps

Step five:
What shape should your plan take? Instigating your plan

The outcome of the first four steps is that you should have an accurate idea of where you currently are and where you are aiming to get to at various points in the future. We often use the word 'map' to describe the process. This is a strong analogy as the map is a good way to think of the progression that takes place between the stages in time.

The financial plan needs to create a connection – this can be done in a number of ways. One is to prepare a cash flow forecast. Again, as in the example earlier, this has a resonance with how a business may organise itself – businesses will typically have a future financial forecast, including projected profit and loss accounts and future cash flows. The individual financial plan can be developed similarly.

A cash flow financial plan is a way of projecting future income and expenditure to show exactly what money is required year by year and how this will be 'funded'. This is a useful exercise to help with highlighting future shortfalls and assessing the level of return that will be needed on invested monies, for example, within ISAs or Pensions.

Another way of preparing this forward looking projection is to capitalise your future expenditure, for example, if you know you will need £30,000 per year in retirement you can turn this into an estimated capital amount at your retirement date. You might project a state pension forward to provide £10,000 per year of this total, leaving £20,000 per year that you need to fund from your savings, pensions and investments. Capitalising this balance will create a lump sum figure (e.g. £400,000) that you deem is sufficient to provide this income. Therefore your plan will need to build this level of capital value over whatever time period is left until retirement.

There are many ways of producing a forward looking plan - the main requirement is to have a plan with all the numbers in it mapped out which can be reviewed regularly against staged benchmarks which will tell you if you are on target along the way.

Key point:
This step is about connecting your current financial position with your future targets and developing some form of 'map' which explains how you will get from A to B.

The discovery steps

Step six:
The financial plan

Once you have mapped out the plan of action, you need to put the plan into effect. This will include deciding the products, companies, fund managers and funds you will need to use within the ongoing plan.

Helping you source the right plans, accounts, products and companies is an area we can help with. Getting this structure right and the balance between savings and investments, ISAs and pensions, the right tax wrappers and such forth is our forte.

A good financial plan will sectionalise each part: for example dealing with pensions, savings, tax and life assurance separately but also bringing each section into a whole at the same time.

The plan should include what sums are going to be saved, what investment returns are needed on invested money and what the benchmarks and targets are for each section of the plan.

It is an important part of putting in place this plan that it is **written out**, **agreed** and **critical** to the overall future success – there should be future benchmarks that allow for a judgement to be made as to whether the plan is working or on target.

Key point:
You need to choose companies, funds, products and accounts to use – this stage will produce the detailed list of each of these. This creates the actual structure of your financial plan.

The action and activity steps

Step seven:
Reviews and rebalances

“The best laid plans…….”

Once the Financial Plan is in place it is highly likely that future events will conspire - at different times - to change the numbers and assumptions that the initial plan was built upon. Economic circumstances change, investments perform differently to expectations and, arguably, most crucially your own circumstances may change.

Marriage, divorce, ill health, employment changes, business issues and unforeseen expenditure are all examples of personal changes which can affect the current or future financial positions and affect future plans.

This places a premium on **regular reviews** being made of how the plan is progressing. Reviews should be undertaken at least once per year to judge the financial plan.

There is always a fine balance to be achieved here, because some parts of your plan may take time to work and investments, for example, should not necessarily be judged after a year or two if they are not performing as planned. This is why the benchmarking is so important, because it allows for some timelines to be applied which may help with these judgement calls. On the other hand, if something isn’t working, it will probably need to be changed.

We are here to help with the review process and assist you to differentiate between the things that simply aren’t going according to plan and those things that just need time.

Key point:
Your financial plan and financial planning is a multi-year exercise - making sure you regularly review how you are progressing is an essential part of achieving long term success.

The action and activity steps

Step eight:
Renewing your plans, starting afresh

The reviews will inevitably involve and require – from time to time – changes to be made. There are two types of changes. The first are tweaks, natural shuffles of the pack, where the overall financial plan remains in general terms as it did at the outset. For example, you may need to change a few funds or alter your asset allocation. You may need to think about your level of savings and increase the amount to remain on track. Each of these is an example of a 'natural' adjustment that a review will regularly entail.

The second type of change is where a fundamental **renewal** needs to take place. These are likely to be required if a major (probably unexpected) change takes place, such as a divorce or a business failing. If necessary, the previous financial plan may need to be reassessed in its entirety and a new course adopted.

There are so many examples where this may be required – renewing your plan is a step you may or may not need to take. However, if you do need to renew afresh this is a common occurrence. The earlier the steps can all be reassessed and a brand new plan put in from that point onwards, the better.

Key point:
There may be occasions where your plans are sent 'off course' by unexpected events; in these cases the financial plan should be renewed afresh.

Getting help and taking advice

The financial planning steps and the concluding financial plan that comes out of them require input from a third party. The result of going through each step will be better if there is an outside view applied.

Just as any individual aiming to get fit is more likely to succeed if they go to a gym and use a trainer; and just as a business will generally benefit from an accountant's help with its accounts and projections, so any individual going through the financial planning process will get a better plan in place if they use a financial planner.

Why? The reason is simple: a financial planner will be qualified to make the assessments required in each step and know how to tie these together into one comprehensive and meaningful plan. Plus, they will know the type of financial products to use and when, how to build an investment portfolio which has the right risk characteristics to meet your risk profile and how to map out your future financial income and expenditure.

A good financial planner will know how to investigate your current position and find the details you require about pension projections from existing pensions and how to assess different asset values (as a couple of examples). In other words, they can do the leg work for you.

These combined elements, an outside view, knowing each step, experience of financial planning and being able to offer practical help, makes using a professional financial planner a fundamental part of this overall process.

Conclusion

Financial planning is a process, one which normally spans a long period of time. When it is done well it can produce reliable results, even though it is far from an exact science. The eight steps we have outlined here will apply a significant degree of discipline and provide a clear structure, which we can work with together.

This 'partnership' method, following these steps and the methods outlined, provides for you to have complete control over your own finances and by definition your own future prosperity. In our experience, this is just about the most important factor people require when dealing with their finances.

Your Wealth...in Good Hands.

- Over 20 Years of financial planning and Wealth Management expertise
- Award winning financial planning
- We provide a continual review of your investments
- We can hold three way meetings with you and your legal advisor
- Your first consultation is free

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Future House
54 Ravenshorn Way
Renishaw
Sheffield S21 3WY

24 Glumangate
Chesterfield
Derbyshire S40 1UA

Tel: 01246 560 570
Email: info@bannerjoneswm.co.uk
www.bannerjoneswm.co.uk