Financial Literacy Section Number 8 of 17

Taking control of your financial affairs:

‘The 3 Cornerstones of Intelligent Financial Planning’

Inspirational financial education and guidance to help you plan and create the life you want to live!

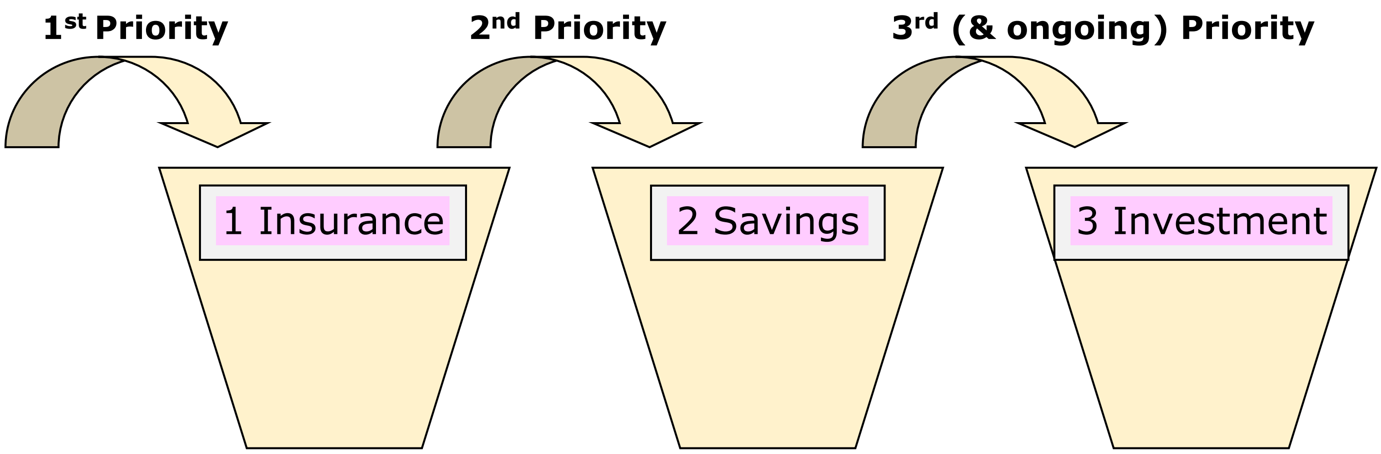
The 3 Cornerstones of Intelligent Financial Planning.

The cornerstones of good intelligent financial planning consists of 3 very key elements in priority order as follows:

1. Insurance
2. Savings
3. Investment

They are specifically placed in that order based on their priority in establishing your financial foundations.

Imagine you have 3 pots (as per the illustration below), you fill the first one until it adequately meets your needs and then move on to the second. Once the second one meets your needs you fill the third one and keep filling it indefinitely:



Insurance (1st priority)

Ok, time to address 'the elephant in the room' as none of us really want to take out insurance (we'd much rather spend the premiums on something nice), there I've said it!

What we really want is the **peace of mind** knowing that if anything untoward should happen to us, we (and our loved ones) are financially protected.

This is about approaching an important subject with the right mind-set. From this point forward, I want you to now substitute the word **insurance** for the phrase **'intelligent peace of mind planning'**.

Never trust to luck or chance when it comes to insurance. Many people ruin their entire lives, and that of their families, by trying to save on insurance.

Let's be honest, we all hate pushy sales people who have a vested interest (commission) in us taking out insurance. I'm now going to reveal a very simple way for you determine yourself, if you need any particular type of insurance of not.

The key to determining if you actually need a specific insurance.

You should insure against any loss, accident, emergency or circumstance that you can't write a cheque to cover without having to worry about the amount (only you can make that decision).

E.g. let's assume you want to buy a new DVD player for £60 and if it went wrong you could easily afford to replace it with a new one, its unlikely you would choose to take out an extended warranty.

To help you, there is just **one simple question** that will determine if you need any type of insurance. All you do is insert the insurance protection you're considering and answer the question in the green box below.

*Let's assume you were considering **income protection** insurance….*

Key Determination Question to Ask Yourself:

If I suffered a (*loss of income*) could I/my family continue as normal financially, with my/our current financial provisions & resources?

If the answer is YES, you don't really need insurance cover (although you still might want to consider it).

If the answer is NO, it is highly recommended you consider taking some cover to protect yourself/your family.

It's very easy to delude ourselves that we don't need certain of insurances and often rationalise "it will never happen to me" as we often see it as expensive and a waste of money until, god forbid, we actually need it.

Just apply the determination question above with an honest perspective and take it where necessary for peace of mind. If the premiums seem very expensive or unaffordable, consider taking part cover so you have some peace of mind.

Key areas to consider:

- Accident, Sickness & Unemployment cover
- Death (life) cover
- Serious/critical illness cover
- Income protection
- Car (theft) Insurance,
- Home and contents (including gadgets) cover
- Asset protection
- Pet insurance (very important ;-)

I highly recommend you go through all areas of your life where a loss, accident, illness or emergency could affect you, and then apply the key determination question.

Let's add some perspective

The truth is, when it comes to life insurance, millions of UK citizens are dangerously underinsured and loved ones usually find out when it's too late (i.e. after the event!).

Many insurances are widely misunderstood, I should know as I've witnessed clients change their perspective completely when they view the requirement in the proper context.

To demonstrate this, I'm now going to give you a different perspective on 3 of the most important insurances to help you appreciate their true purpose.

Example 1. Revolutionary new 'Instant Estate'

Why not give your loved one's absolute financial security and the best lifestyle you could possibly imagine for them if anything should happen to you?

Everything you could ever wish for them to have, suddenly becomes available for just a few pounds a month with **revolutionary new instant estate**.

All you do is choose the value of the estate you would like to leave them (perhaps a million?), fill in the questionnaire and pay the corresponding premium each month knowing that should something unforeseen happen to you, your instant estate will take care of them in the best way imaginable.

Wonderful peace of mind while you are alive, loved ones completely taken care of financially if you die, only when you buy some Instant Estate!

It's more commonly known as **life insurance.** Peace of mind ☺.

If anything were to happen to you, what would you prefer your family to hear?

a) "Here's a cheque which will solve your financial concerns"

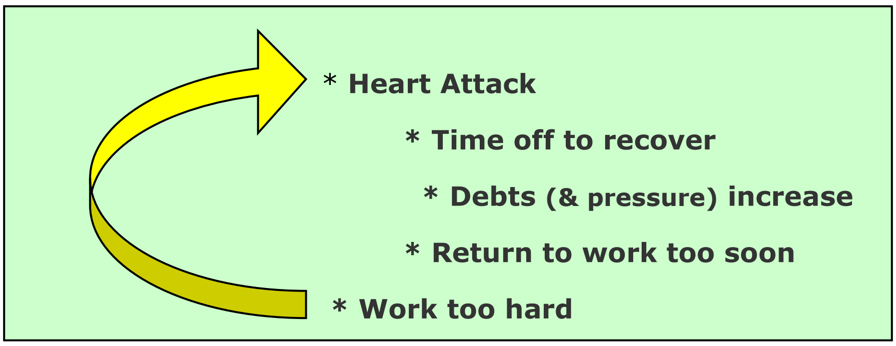
Or

b) "Unfortunately, the amount the state provides will not cover your current outgoings."

It's your life, your decision!

Example 2. Vicious 'illness' circle

It's a well-known fact that financial pressures can have a severe effect on those recovering from a serious illness. The graphic below shows a common cycle following a life changing or critical illness:



A life changing/critical illness is usually a time when people need to slow down or reduce their working hours, perhaps switch to a part time position.

Critical illness cover allows you to do this by taking care of your financial burdens during your greatest time of need.

Of course, nobody actually wants to claim on a critical illness policy, it's all about **peace of mind.**

Example 3. Personal cash machine

Scenario: Imagine you have a cash machine at home that only operates on the first day of the month. When you press the button on the first day, it produces enough money for you and your family to live comfortably for the month. Every single month without fuss it churns out the money you need.

Now, like all machines, it could break down and if it does you won't be able to get any money out. The Question is:

As your livelihood depends on this machine, would you insure against it breaking down if you could?

This scenario is a 'no brainer' of course you would (I hope!). Unfortunately, this machine hasn't been invented yet, but until then, you can create the same outcome through **income protection insurance.** Peace of mind ☺.

Remember its **'intelligent peace of mind planning'** and only for as long as you need it.

Wills & estate planning protection

Wills: If you have a valid will ~ congratulations, you're in the minority.

It is estimated that around 67% (2/3rds!) of UK citizens don't have a valid will! Let's be honest, we all know it is important to make a will, but it seems it's something we either keep putting off or keep making excuses.

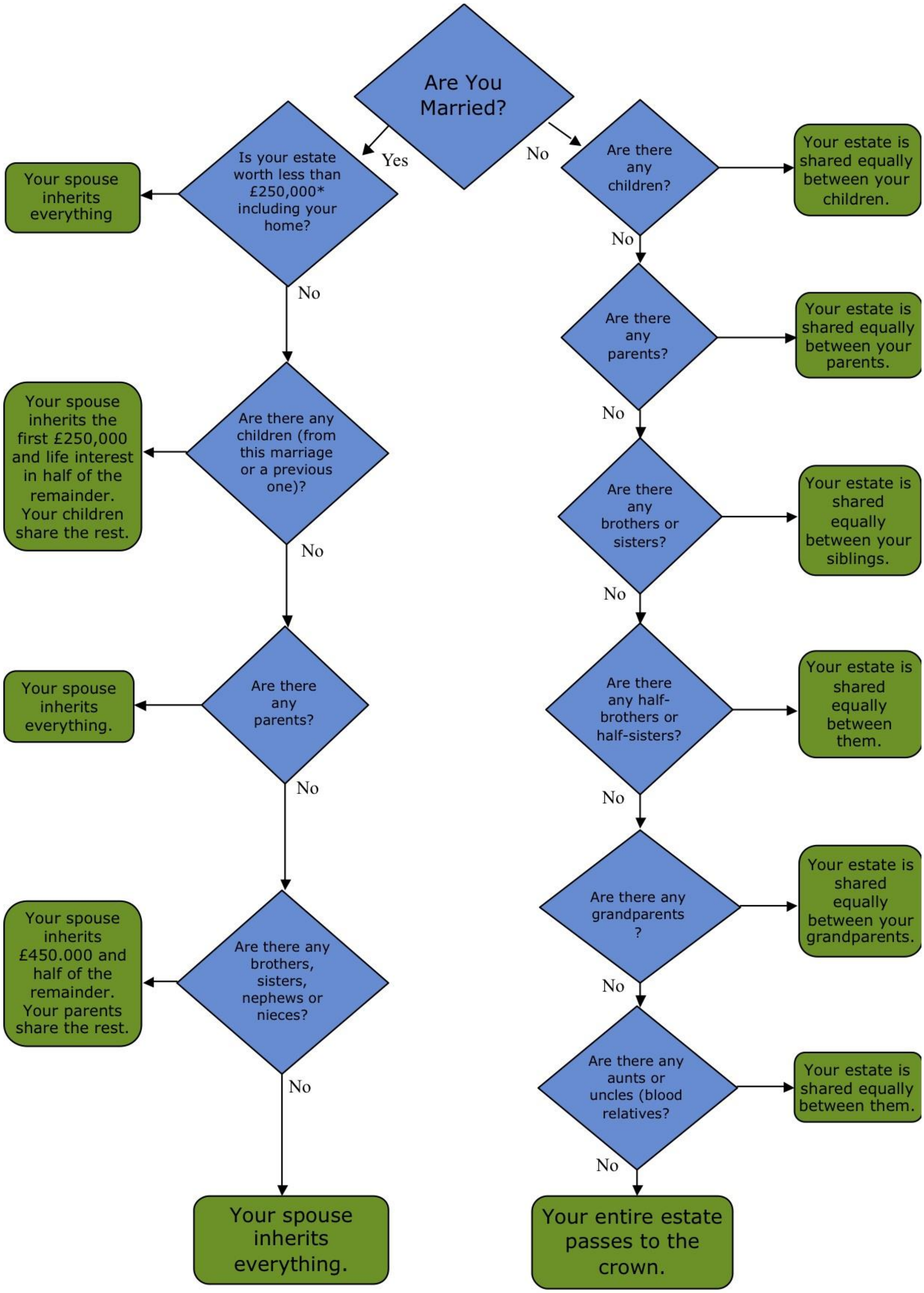
No one likes to think about what happens when they die. But if we don't, it can cause arguments, distress and hardship for our families, not the ideal legacy for a family in mourning. Making a Will is the only way to ensure that your wishes are carried out after your death.

What happens if you don't have a Will?

If you were to die and don't have a valid Will, this is known as intestate and your estate will pass according to the law of intestacy. This can take a lot longer to finalise than if you had made a will. During this time your beneficiaries may not be able to draw any money from your estate.

The flow diagram on page 6 walks you through the law of intestacy to show you what happens to your estate and who gets what depending on your personal situation.

The Law of Intestacy



Estate planning

This is another very important area of planning to make sure your loved ones get the full benefit of your personal property as per your wishes (and not the UK government) on your demise and during your lifetime. Here's a summary of the key elements:

Power of attorney: This makes sure that the people you appoint (e.g. close family members), decide what's best for you in the event of you (I have to say it) 'losing your marbles.'

Trust: This is used to protect personal property (subject to certain guidelines) for the benefit of others. E.g. Parents may put funds in a trust for a child that they can access at a certain age.

Inheritance tax: If your estate is valued above £325,000 the pesky UK government will tax the beneficiaries at rate of 40% on the difference. With some proper planning you can mitigate this tax liability.

Finally
That's the end of the insurance section, we've covered a lot! I very strongly recommend you seek professional independent advice on any areas of insurance protection and estate planning to make sure you are adequately covered to suit your needs. See the end of this Section for more details if you would like a personal recommendation.

Just remember, nobody actually wants insurance, its peace of mind that we're buying for as long as it's needed.

Savings (2nd Priority)

Part 1 (emergency fund savings)

This is pretty simple; you should accumulate an amount equal to 3 – 6 months living expenses as an 'emergency/rainy day' fund.

This money ideally should be put in an interest-bearing account with quick access in case of an emergency. If you are self-employed, you may want to consider accumulating 12 months of living expenses.

Just having this emergency fund in place will give you solid peace of mind; too many people are only one or two pay days away from severe financial distress. Once part 1 (emergency savings) is in place, we move on to part 2:

Part 2 (long term savings to spend)

N.b. This savings plan element is to be ongoing alongside your investment strategy (see next section on investments), don't put off starting your investment strategy, start it as soon as your emergency fund is in place.

This element of savings is the nice bit and can be described as your **long term savings to spend** pot as it’s all about saving it regularly to spend on larger one off items/events in the near future that you will purchase at some point, such as a new car, holiday, wedding etc.

This is all about putting a regular amount away each month (or whenever you can) preferably via standing order, to pay for those one-off items you will want/need at some point in your future.

It is very important that you segregate your long-term savings to spend funds from your emergency fund.

Section 9 **’How to Put Your Finances on Autopilot Towards Financial Freedom’** will cover this part in much greater detail.

Difference between Saving & Investing?

Just to clarify this so it all makes sense:

Saving by definition, involves the protection and preservation of money from loss.

Investing, by definition, means to make a long-term commitment of putting money away and letting it grow, but it involves an element of risk.

Once part 1 is done and you have a regular savings plan in place for part 2, you can now start putting your funds into investments to create long term wealth and ultimately financial freedom.

Investment (3rd & ongoing priority)

Now that your insurance and savings requirements are in place, you now start investing for your future financial wellbeing by building assets in accordance with your plans, resources and attitude to risk.

The general consensus is to have a series of investment that suit your needs/plans and not to ‘put all your eggs in one basket’ so to speak.

You often here the phase ‘risk/reward ratio’ which generally means the higher the reward the higher the risk. A sensible strategy is to have a balance of higher, medium and lower reward investments so you spread the risk whilst giving yourself the opportunity for ample rewards.

Your age will also affect the strategy required to achieve your financial goals, the younger you are the more capacity for risk as you have time to recover any unsavoury periods. Conversely as you get older and close to your chosen retirement or financial goals it’s wise to reduce the level of risk.

However, there is no right or wrong way strategy for investing as it’s a personal thing based on your plans and attitude to risk. **The 4 factors** which determine how much your investment strategy will amass are:

1. How much you contribute
2. The rate of return you achieve each year
3. The length of time you invest for (compounding is your best friend)
4. When you start

For more information and inspiration on investing, revisit sections 2, 3, 4 & 5.

Remember wealth creation is a team sport, grab all the help you need!

Need professional advice?

I strongly recommend you seek the advice and guidance of a suitably qualified professional adviser/specialist for any financial advice and expertise you require (see the website for all the different advisors available). They will take you through a set process to establish your requirements and make suitable recommendations.

Pretty much all professional advisers will offer you a free consultation to explain how they work and can help you, simply view these initial consultations as an interview process (you're the boss) to decide if the adviser is right for your needs.

Section 8 Summary

The 3 priorities of intelligent financial planning, in order, are as follows:

Insurance needs
Take out adequate cover against any accident, emergency or circumstance that you can't write a cheque to cover without having to worry about the amount. Make sure you have a valid will and protect your estate as required.

Savings (2 parts)
Part 1: Accumulate an amount equal to 3 – 6 months living expenses (or whatever feels right to you) as an 'emergency/rainy day' fund.
Part 2: Start and regularly contribute into a long term savings to spend account for those one-off purchases that will happen (e.g. new car, daughter's wedding etc) in your future.

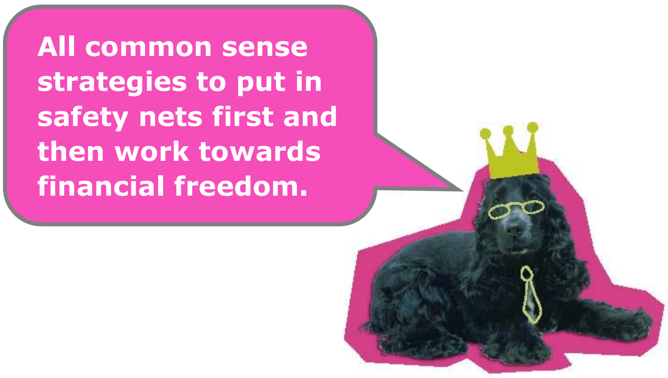
Investment needs
Start and continue to invest for your future financial wellbeing by building assets in accordance with your plans, resources and attitude to risk.

Final Thought:

Make sure you have all 3 elements in place, start by reviewing your arrangements and fill pot 1, then go to pot 2 and work at it until you get both parts filled, then just keep filling pot 3 indefinitely, you know it makes sense!

Wishing you all the best,

Asha x



Final Word:

"You cannot succeed by yourself, it's hard to find a rich hermit"