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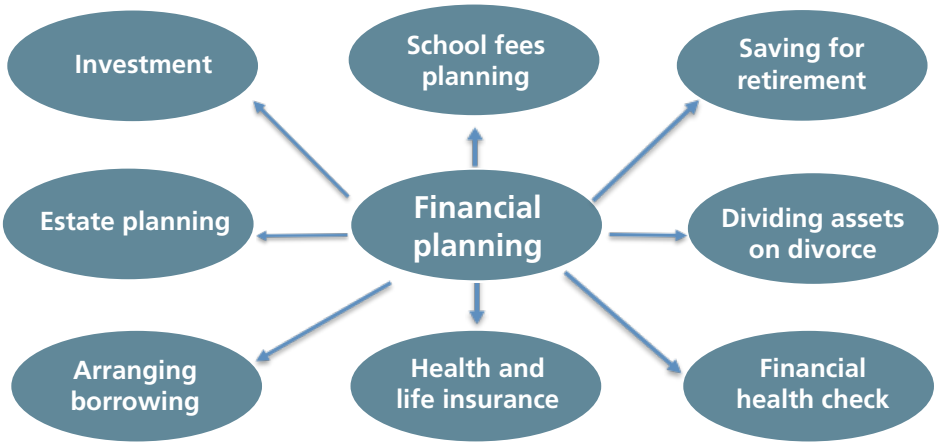
Accountants & Financial Advisors

KEY GUIDE

The key Stages of Financial Planning

What can financial planning do for you?

Financial planning has witnessed significant change, so it is not surprising that most people are unclear about what financial planners actually do. The aim of this guide is to explain the process in general terms and what financial planning can achieve for you. Some of the important recent changes to pensions and ISAs have made the need for financial planning even more crucial.



Financial planning addresses a wide range of issues. A financial planner can help you with such issues as: investing a lump sum, deciding how much you need to save in order to retire comfortably, estate planning and saving inheritance tax (IHT), dividing up pension entitlements on a divorce or separation, getting the right types and amounts of life and health insurance, planning to pay school or university fees, deciding how much to borrow and providing a general financial health check.

Action point

It is generally best to look at the whole of an individual's financial affairs across the board, not just the issue that is of most immediate concern.

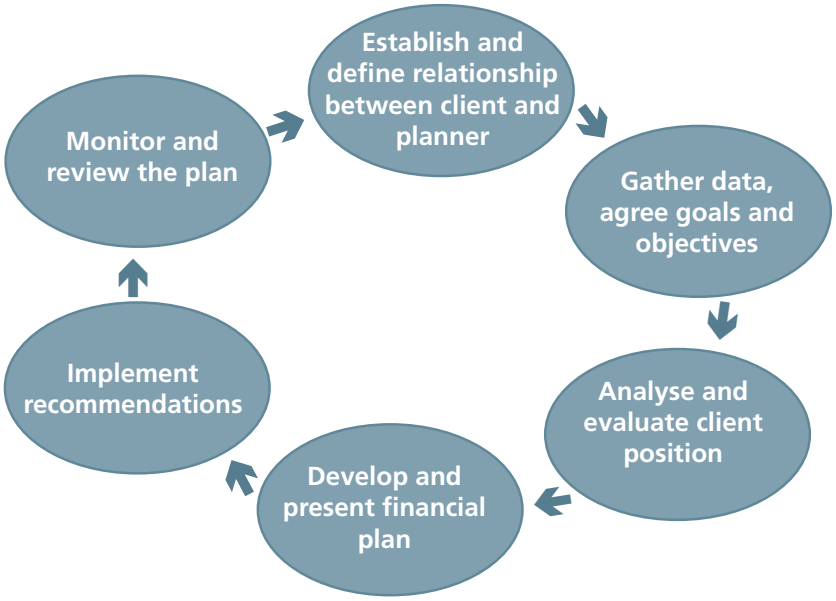
These are crucial issues for most people and their families and it is very important for the planner to have a thorough understanding of clients' aims, dreams and problems.

It is generally best to look at your financial affairs across the board, not just the issue that is of most immediate concern. For example, something as simple as buying a property will have an effect on a client's broader financial position with their income and expenditure as well as the size of their deposit impacting on their ability to borrow. The purchase of the property will also restrict the amount of disposable income available in the future to meet other objectives, such as paying for a child's school fees. Even then, if money can be found to pay the school fees in the short to medium term, this decision may have a longer term impact by restricting pension investment in the short term, thereby requiring the client to invest heavily in the medium/longer term to achieve a specific retirement objective.

It can sometimes be hard to deal with one particular issue in isolation because most of these financial planning areas are interconnected. But it is possible to provide focused or relatively limited advice, say on a pension or IHT liability.

The planning process and the ISO standard

The International Organisation for Standardisation (ISO) has set out a six-step model for financial planning. It may help you to understand how this works to see the disciplined approach that planners take to providing their services. Briefly, the six key steps are for the planner to:



That is the whole process. But in some cases, one or more steps might be omitted. In particular, a client might simply want a one-off consultation where the planner does not carry out any monitoring of their position in the future. The client is then free to return for further work with the planner when it seems to be required or perhaps after an agreed interval of months or years.

It is worth looking at each of the six steps in a little more detail, before considering a particular aspect of planning – the investment process.

1. Defining the relationship

Initially client and planner must get to know each other well enough to decide whether to take the relationship further and the best way for it to work. Either in the initial meeting or soon after, this will involve agreeing the broad content and scope of the service and crucially how much it will all cost.

The chemistry will need to be right. As a potential client, you should be asking yourself: do I trust this person and can I work with them? Many find the process of giving information about themselves to an adviser a little daunting and perhaps may feel rather exposed. Some may even feel that their adviser might pass judgement on them or make them feel uncomfortable about the previous life and financial decisions that they have made. It is important to talk to your adviser and satisfy yourself that you can trust them with this kind of information. It will never be the adviser's intention to make anyone feel uncomfortable and it is not their place to judge. Your adviser will be there for you, acting on your behalf and in your best interests.

It is important to settle the practicalities: does this adviser and the firm have the right expertise and can they provide what you are looking for?

The arrangements all have to be set out formally in the financial planning firm's **Initial Disclosure Documents**. This describes such key details such as the service the firm will provide, the frequency of the firm's contact with the client and how long the agreement will last.

Action point

The chemistry between a financial adviser and the client will need to be right. As a potential client, you should be asking yourself: do I trust this person and can I work with them? Your adviser will be there for you, acting on your behalf and in your best interests.

The cost of the service and its basis will depend on the firm and the circumstances. In many situations it will be calculated as a percentage of the value of the investments to be managed, reflecting the level of responsibility and the degree of complexity involved. But it might be a fixed fee or possibly an hourly charge with an estimated amount for the work envisaged. If your arrangements are complex it is often best to look for advice on a fixed fee basis so that costs do not spiral out of control. Your adviser should be able to tell you broadly how complex your given situation might be.

Action point

You might need to change your goals and aspirations and you might also need to adjust some of your current patterns of behaviour such as spending and saving.

2. Gathering the data

There is likely to be an enormous amount of information to be gathered about your circumstances. Think about your own financial history. You could have savings, investments, borrowings, property, loans, wills and other documents, pensions, life and health insurances, income and expenditure, tax and much more.

But that is only the start of this stage in the relationship. The planner's job is to find out what you want to achieve with your money now and in the future. That means gaining a thorough understanding of your views about such issues as borrowing, investing, spending now and in the future, retirement and estate planning. You may not have thought about these issues in great depth and you might well be encountering some of them for the first time. Most people do not think about their future very much – at least not in a very organised way and not from a financial perspective.

In investment terms, there will be specific questions about the level of risk you are prepared and able to take on. And that will lead to discussions about how various asset classes have behaved in the past and what they might do in the future. The aim is to build a portfolio of investments that will provide the returns you want and need and with which they are comfortable. This can sometimes take some time and we cover the subject in greater detail below.

When completing this sort of information it is important not to rush it, but think about how you might feel in certain situations. And it's fine to contact your adviser for guidance or to ask questions at this point.

3. Analysing the situation

The next step in the planning process is to make sense of all this information and come up with a range of preliminary conclusions and initial ideas for ways forward. The analysis stage involves such exercises as drawing up a balance sheet of assets and liabilities, making a breakdown of current income and expenditure, and calculating tax liabilities on income, potential capital gains tax (CGT) and IHT.

One of the most powerful tools is long term **cash flow modelling**. In essence the aim of this planning technique is to project your future income and expenditure throughout the whole of your lifetime. Obviously it's a guess about future developments but it should be based on reasonable assumptions about such matters as your income and how your pension and other investments may perform. By its nature it cannot be a precise forecast, but it can clearly demonstrate where the financial gaps are and especially whether and when you are likely to run out of money in retirement.

An important aim of the analysis stage is to identify these financial gaps or shortfalls. They could be between income and expenditure now or in the future, pension or

insurance provision and several others where some action is needed to bridge the gap between aspiration and reality.

You might need to change your goals and aspirations and you might also need to adjust some of your current patterns of behaviour such as spending and saving. A very important issue is clarity about priorities – what might have seemed to be a high priority at the start of the process might have to be replaced by another need.

Action point

It is a good idea to spend time going over the financial planning report at a meeting and make sure that it all makes sense and meets your agreed needs and aims, and that the recommendations are suitable.

Once these needs and wants have been identified, analysed and quantified, it is time to do some specific product research into funds, tax wrappers (like ISAs) and insurance products. There's a wide range of web-based resources to help the search for suitable solutions, based on features, price and service.

4. Developing and presenting you with the financial plan

So after all this preparation we get to the formulation of the detailed plan itself. This will contain both the broad strategy and the specific recommended solutions.

The **financial planning report** is a really key document setting out your objectives, financial gaps, the recommended strategies and specific solutions. The report should be as easy to read as possible, but there may be a lot to cover and some of it will inevitably have some technical or unfamiliar elements.

This is why it is a good idea to spend time going over the report at a meeting and make sure that it all makes sense and meets your agreed needs and aims, and that the recommendations are suitable. It may be necessary to make some changes to the report in the light of these in-depth discussions. The most important outcome of this part of the process is to decide what recommendations to go ahead with.

5. Implementing the recommendations

There is the planning part of the process, where the end result is a plan of action; and then there is the implementation, where the outcome is a set of actions that carry out the plan. It is vital that you understand what is needed on your part and that of the adviser to ensure your objectives can be met. If you are at all unclear or uncertain it is important to ask. Often, we see that those clients who are not quite clear about why a particular action is being taken, tend not to take that action and then the overall plan fails to meet their needs.

Financial planners are generally able to undertake both functions – for example, first recommending a suitable portfolio of investments and then executing the necessary purchases and sales. But sometimes planners will work with other professionals such as lawyers and accountants who can provide specialist legal and tax advice and help with the implementation of certain aspects of your plan.

Carrying out the agreed recommendations is usually the most straightforward aspect of the planning process, but it can be time-consuming for the financial planning team. Pensions need setting up, funds selling and buying, insurances arranging and trusts settling.

6. Monitoring and reviewing

Most clients want their adviser to keep an eye on their investments and other financial arrangements. Exactly how the financial planning firm will carry out this monitoring and reviewing in practice will depend on what has been agreed. So, for example, you could receive valuations on a quarterly basis, or perhaps more often or possibly less frequently. You could attend meetings or have phone calls on a regular basis or on a more ad hoc basis as and when needed. In any event you should have some form of meeting, say, once or twice a year.

The review process is intended to act as a catch up with what has changed – either in your own circumstances or in the financial world generally.

Much of the groundwork has already been done, and so the review is likely to be shorter and easier to carry out than the initial meeting and report. But this might not turn out to be the case where there have been some very substantial changes in circumstances like a marriage, divorce or a substantial inheritance.

Action point

Consider whether to invest in ethical or socially responsible funds, whether the funds should be held in a particular tax wrapper such as a pension, ISA, or life assurance bond.

Focusing on investment planning

The process for choosing investments is a key part of financial planning and it has its own specific requirements. So we have focused separately on this essential aspect of the process.

Investment aims, risk and resources

As with any financial planning, your financial planner must spend a good deal of time getting to understand your aims and attitudes. You might well be looking for income, growth or a combination of the two. What's more you might well be looking to achieve a specific target level of capital at a future point in time.

Alongside this is the issue of how much risk you are prepared and able to take – what is often called your **'risk profile'**. There are three main components to this risk profile:

Risk capacity – this is how much risk you can objectively afford to take. Some people have substantial wealth or there is a long period until they need access to their investments or they are not very dependent on their investments. If you are in this position, you can normally afford to take more risk with your investments than people who are relatively poor, need immediate access to their savings or are highly dependent on the income or capital.

Risk tolerance – this is the amount of risk that you are psychologically willing to take on. Some people are comfortable with investments fluctuating; others find it more difficult. One way to gain some insight into these attitudes is to use a psychometric questionnaire, but most financial planners follow up the issues with an in-depth discussion of the matters the answers generally raise.

Risk need – This is the actual amount of risk that would need to take, based on the assumptions previously agreed, in order to achieve your stated aims. This amount of risk may be more or less than the actual amount you are comfortable with. It means that you can clearly see what risk you would need to take. If, however, you were uncomfortable taking on that amount of risk, then amendments can be made. You

would need to re-think your objectives and the amount of money you are willing to invest towards them by reducing your expenditure. There are lots of options and your planner will discuss them all with you before proceeding with implementing the plan.

Asset allocation and fund selection

The way in which the investments are allocated between the main asset classes of shares, cash, bonds and property will depend on your risk profile and their aims. Asset allocation is by far the main determinant of a portfolio's risk and return. The more risk it is appropriate to take on, broadly the higher the proportion of the portfolio should be allocated to shares.

Then it is a question of choosing the right funds within the asset allocation, which could be undertaken in-house or it could be outsourced to a specialist fund manager.

Other issues to consider are whether to invest in ethical or socially responsible funds, whether the funds should be held in a particular tax wrapper such as a pension, ISA, or life assurance bond.

Action point

Successful do-it-yourself financial planning may be theoretically feasible if you have the knowledge, time, patience and self-discipline, but there are a number of points to consider.

Is it possible to carry out your own financial planning?

In theory, yes. Successful do-it-yourself financial planning may be theoretically feasible if you have the knowledge, time, patience and self-discipline. If you decide to take on this area yourself then you will need to think about the following points:

1. Quantify and qualify your objectives – that is to say, write down exactly what you are trying to achieve and over what timescale. For example; retiring at age 65 on an income of £20,000 per annum net of tax.
2. Establish how much risk you are prepared to take – this should include a percentage of assets you need to keep in cash and short dated investments (for shorter term objectives) as well as a percentage that you are prepared to put at calculated risk on equity markets.
3. Establish how much you have available to invest towards this goal for example, a lump sum of £10,000 or a monthly investment of £100 per month.
4. Assess any existing investments you have that you intend to use for this objective.
5. Think about the best types of wrappers for tax efficiency e.g. pensions, ISAs, etc
6. Review what you are doing regularly and have the discipline to rebalance your investments back to your original split of cash and equities to ensure the risk you are taking does not increase.

But there are good reasons why you probably won't want to conduct your own financial planning, even if you feel theoretically able.

There is a lot to learn and then keep up to date with. The legislation about tax and pensions is complicated and constantly changing. Investments and investment products and markets are also in a more or less permanent state of flux, and you would have to make critical decisions on your own and then implement them.

You may also find it hard to make these big decisions alone. Financial planners have the training and knowledge to undertake their own financial planning, but even they often use colleagues who are sufficiently detached to help them make sensible decisions. That's why we're here to help

The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Conduct Authority does not regulate tax advice.

The value of your investment can go down as well as up and you may not get back the full amount you invested. Past performance is not a reliable indicator of future performance. Investment in a registered pension fund is subject to many restrictions on access and how the funds can be used.

This publication is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking any action on the basis of the contents of this publication. The Financial Conduct Authority (FCA) does not regulate tax advice, so it is outside the investment protection rules of the Financial Services and Markets Act and the Financial Services Compensation Scheme. This publication represents our understanding of law and HM Revenue & Customs practice as at 5 September 2016.

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