KNOWLEDGE ORGANISER LIBF Unit 3 Topic 1 – Personal Financial Sustainability

What is sustainability?
Sustainability is maintaining and achieving a balance between income and expenditure.

Why is sustainability important?

For the short, medium and long terms – so that individuals can satisfy their needs and achieve as many of their wants and aspirations as they can afford within their budget.

House Repossessions

The number of properties repossessed each year over the same period also saw a huge increase, from just over 8,000 in 2004 to a peak of nearly 49,000 in 2009. Only the historically low interest rates that have prevailed since the Bank of England cut Bank rate to 0.5 per cent in March 2009 prevented further rises in repossessions.

How can personal sustainable finance be achieved?

1.Be aware of exactly how much money they are spending.
2.Use weekly or monthly budgets and cash-flow forecasts.
3.know the implications of future events and aspirations
4.Have a savings plan to build up the capital sums that they expect to need in the future.
5.Carefully plan any borrowing and only borrow amounts that they can pay back.
6.Have an adequate emergency fund to fall back on when there is an unexpected reduction in income (if they are made redundant, for example).
7.Pay into a pension scheme to ensure that they will have an adequate income in retirement.
8.Look for ways to increase their incomes – whether through promotion and career development, or by working overtime, taking on a second job.
9.Make use of appropriate insurance products to protect their incomes;

How can personal sustainable finance be achieved? (continued)

10.Regularly monitor, review and amend their financial plans.
11.Have clear, realistic contingency plans to deal with the unexpected events that can disrupt their carefully made plans completely.

Characteristics of a flexible financial plan

1. Balanced between time periods

The plan should look at income and expenditure in the short, medium and long terms, and there should be a good balance between these periods.

2. Informed

Like any other plan, a dynamic financial plan must be based on accurate information as far as possible.

3. Able to adapt to changing products and services

Several versions of budgets and cash-flow plans might be made to reflect potential changes in a product's features, terms or conditions.

4. Fluid

A dynamic plan must reflect any monthly, termly or seasonal variations in the personal circumstances of the person making it. Expenses are also likely to be higher at certain times of the year for most people.

5. Realistic

The person drawing up the plan should aim for a balance between being optimistic and pessimistic about the future. This is where many people go wrong when planning their finances. It is usually obvious that bigger purchases can lead to very significant problems.

What is mandatory expenditure?

It covers those costs that you have a legal obligation to pay. They do not necessarily apply to everyone, but if they do apply, they must be paid or you could risk legal action resulting in fines – or even a prison term.

What is essential expenditure

It covers costs that have to be paid to meet basic needs. Failing to pay for some of these items – those for which you have signed a contract that includes a commitment to make regular payments – may also result in legal action through the civil courts.

What is discretionary expenditure?

It is spending on items that are neither mandatory nor essential, but simply fulfil a want or aspiration.

What should your spending priorities be?

1. Pay all mandatory bills.
2. Meet basic needs.
3. Pay essential bills.
4. Divide any surplus between spending and saving.

Auto-enrolment pension rule

Employees are required to make regular pension contributions – unless they opt out of the scheme, which would not be wise for most people as they will need a pension in retirement. These savings could therefore be said to be mandatory.

What are the obstacles to personal sustainable finance?

1. Make short-term, medium-term and long-term financial plans that are flexible – ie that include the characteristics of flexible financial planning.
2. Compare actual weekly or monthly income and expenditure with the amounts predicted in forecasts (monitoring);
3.Amend plans when circumstances change or when monitoring reveals a significant difference between predicted and actual outcomes;
4. take appropriate steps (such as increasing income, reducing spending or arranging borrowing) to avoid predicted cash shortfalls; and / or
5. make adequate contingency plans (see below) to deal with unexpected changes in income or expenditure.

What is contingency planning?

It usually involves planning for undesirable or unfortunate events – although there can be pleasant surprises too. The following are just a few examples of the types of event that might arise.

What are examples of favourable events?

− Getting a job
− Being given a salary increase or promotion at work
− Winning money on the lottery
− An increase in the value of an asset, such as a house or money in a savings account
− Paying off a personal loan

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What are examples of unfavourable events?

– Losing a job or receiving a pay cut
– An increase in the rate of income tax
– Becoming ill and having to stop work for a period of time
– Major car repair costs

What is a current account?

Banks and building societies are the main providers of current accounts, which allow for the safe storage of money and can be used in a wide range of ways to make payments to, and receive payments from, other people. In addition to depositing and withdrawing cash.

What is a savings account?

By opening a savings account with a bank, building society or credit union, customers are effectively lending money to that financial institution, which the institution can then use to fund loans, overdrafts and credit cards to other customers. In return for being allowed to use the savers' money, the bank or building society will pay its customers interest on their savings. In addition to bank and building society savings accounts and tax-free cash 'individual savings accounts' (ISAs), all of which typically pay variable rates of interest.

What are the main borrowing products?

- ◆ overdrafts;
- ◆ personal loans;
- ◆ credit cards;
- ◆ store cards;
- ◆ hire purchase or retail credit; and
- ◆ mortgages.

What is a payday loan?

A payday loan is a type of loan that is instantly available online or from a high street loan shop. When someone applies for one of these loans, the lender carries out a quick credit check (based on a trust rating) and, if the customer is accepted, the money can be transferred into their account within 30 minutes. These loans are aimed at employed people who experience a cash-flow problem at the end of the month, but do not have an emergency fund or overdraft arrangement. They are for quite small amounts (hundreds, rather than thousands, of pounds) and are usually expected to be repaid as soon as the borrower's monthly salary is paid into their bank.

What is a logbook loan?

Logbook loans are available to car owners, who pass over the ownership documents of their car (the logbook plus the MOT certificate) to the lender as security for an instant loan. The borrower keeps the car in the meantime, but if they are unable to pay the loan back, the lender can take the car without a court order and will sell it so that it can recoup the sum loaned.

What is the purpose of insurance?

Selecting and maintaining an appropriate portfolio of financial protection products is one of the most important ways in which individuals can engage in contingency planning – that is, make medium-term and long-term financial plans that can withstand expected and unexpected changes in income and expenditure. Without adequate insurance, events such as a car crash, serious illness, redundancy or a house fire could all have a damaging impact on an individual's finances and leave their plans in ruins.

What is general insurance?

General insurance – usually short term (12 months or less), this insurance is designed to protect:
– your home (buildings and contents insurance covering loss, damage or theft);
– your car (comprehensive or third-party loss, damage and theft cover);
– your income and health (accident, sickness and unemployment cover; private
medical insurance); and / or
– your holidays (travel insurance to cover cancellation, medical care, injury, cash, etc)

What is life insurance?

Also called life assurance, this pays out a sum of money when someone dies, to protect their dependents from the financial consequences of their death. It can be arranged to provide cover for a fixed term (for example, the period of time when the policyholder is responsible for repaying a mortgage loan) or on a whole-of-life basis.

What is income protection insurance?

Also known as permanent health insurance (PHI), this provides a monthly income to replace salary or wages if you are unable to work as a result of illness or disability.

What is critical illness cover?

Under a CIC policy, a lump sum is paid out to protect you from the financial consequences of suffering an illness such as cancer, stroke, heart attack or multiple sclerosis.

What is a pension?

A pension is a long-term form of investment that has tax benefits for investors. People save in pension schemes throughout their working lives so that they will have an income in their retirement – that is, it is a way of achieving long- term personal financial sustainability.

What are shares and bonds?

Buying shares in companies, directly or indirectly, is the most common form of financial investment. Most investors use collective investment products such as unit trusts, investment trusts and open-ended investment companies (OEICs), often within a tax-free ISA 'wrapper'. These products can also be used to invest in government bonds (known as 'gilt-edged securities', or 'gilts') and corporate bonds.

What is a non financial investment?

Other ways of investing for capital growth are not strictly financial products. This is any physical asset that might be expected to increase in value over a period of years.