HAMPSTEAD SCHOOL
Learning together Achieving together

Y12 – Y13

Summer Bridging Tasks

2023

Finance

Name: ______________________________________

- You should spend some time during the summer holidays working on the activities in this booklet.
- You will be required to hand in this booklet in your first lesson at the start of Year 12 and the content will be used to form the basis of your first assessments.
- You should try your best and show commitment to your studies.

Topic 1
Personal financial sustainability

Learning outcomes

After studying this topic, students will be able to:

- explain the importance of personal financial sustainability for individuals; and
- identify the measures that can be taken to support an individual's financial sustainability.

Introduction

In this first topic, we develop further the themes around budgeting and financial planning that were introduced in Units 1 and 2. We will briefly recap the purpose and benefits of personal budgets and flexible financial plans, and explain how using these can help an individual to achieve and maintain sustainable personal finances. We then consider some of the financial products and services available to help individuals to achieve that goal.

1.1 The importance of sustainable personal finances

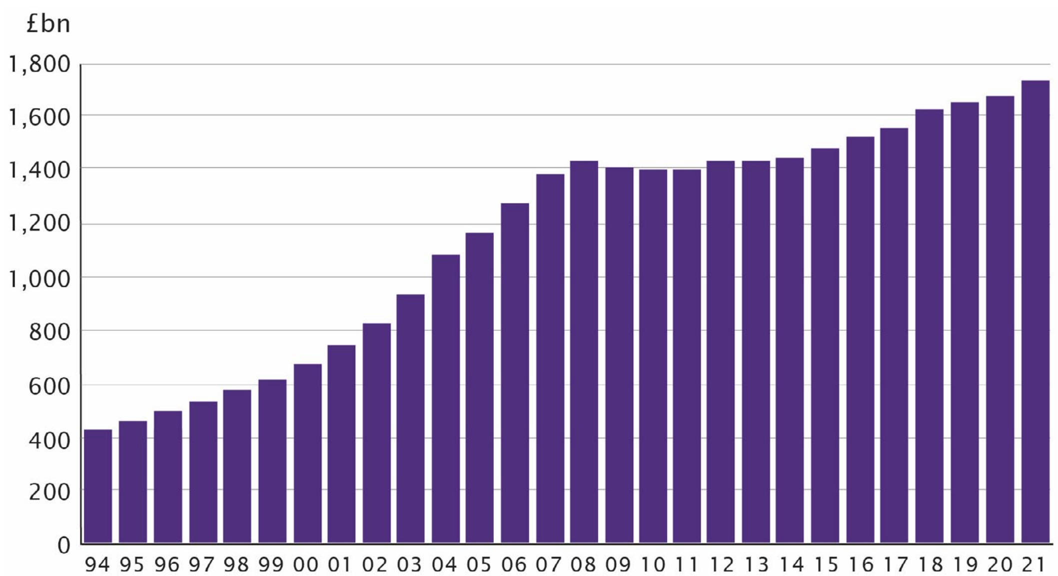
Sustainable personal finances are important not only for individuals, but also for the future financial and economic health of the country. Sustainability in this context means achieving and maintaining a balance between personal income and expenditure – for the short, medium and long terms – so that individuals can satisfy their needs and achieve as many of their wants and aspirations as they can afford within their budget.

Much of the blame for the financial crisis of 2007–08, which led to a worldwide economic recession from which many countries have yet to recover, is generally attributed to bankers who are accused of encouraging people to take on mortgage loans and other debts that they could not afford to repay.

Many economists would say, however, that the consumers who took advantage of these mortgages, credit cards, unsecured loans and hire purchase to pay for unsustainable levels of spending must also share the blame. These people should have been limiting their borrowing to amounts that they were confident they would be able to pay back.

While there may be disagreement about the root causes of the crisis, there can be no doubt that it followed a period of unprecedented growth in personal debt in the UK, dating back to the end of the previous economic recession in 1994. Total personal debt in the UK had doubled between 1994 and 2002 – from £400bn to £800bn – and reached £1,400bn in 2008. The credit crunch that resulted from the financial crisis – that is, the tightening of the conditions required to obtain the loans formerly so freely available – brought an almost complete halt to the increase in personal debt for years, but now debt is increasing and has passed £1,600bn.

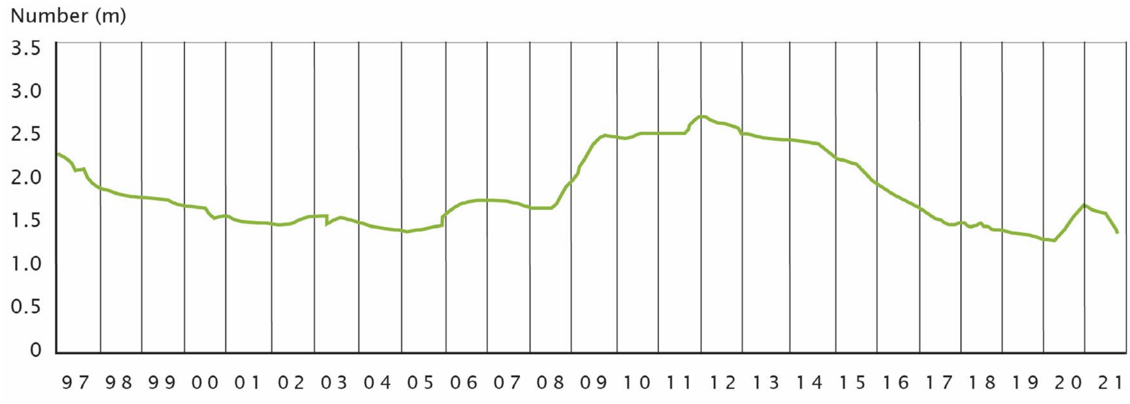
Figure 1.1 Personal debt in the UK, 1994–2021



Source: The Money Charity (2021)

Such a level of personal debt in the UK might be manageable as long as the economy is growing and unemployment is relatively low (as it had been from 1997 until 2008), but the recession that followed the financial crisis sent unemployment figures on a steep upward path. In January 2008, there were 1.62m unemployed UK workers; this figure had increased to 2.12m just one year later. Unemployment continued to rise until November 2011, when it peaked at 2.7m – more than 1m higher than it had been less than three years earlier (BBC News, 2015).

Figure 1.2 Unemployment in the UK, 1997–2021



Source: ONS (2021)

The consequences of getting deeper and deeper into debt, without making plans to ensure that they will be able to keep up the repayments even if they were to lose their job, are that many thousands of people have faced legal action from lenders seeking to recover bad debts, sometimes resulting in county court judgments (CCJs) against them, bankruptcy and having their homes repossessed. Figures from The Insolvency Service, for example, show that the number of people who became insolvent in England and Wales grew significantly between 2003 and 2010, increasing from a total of 35,604 in 2003 to 107,288 in 2006, then rising further before peaking at 135,045 in 2010 (GOV.UK, 2020).

> The rapid increases in new individual insolvency cases from 2004, in particular, are considered to be related to households taking on higher levels of debt from the early 2000s.
>
> (GOV.UK, 2014)

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 (GOV.UK, 2014). 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.

Growing levels of personal debt and rising unemployment have also resulted in government agencies, such as MoneyHelper (formerly the Money Advice Service), and non-government organisations, such as Citizens Advice, StepChange Debt Charity, The Money Charity (formerly Credit Action), Payplan and the Money Advice Trust's National Debtline service, reporting an increased demand for the help, advice and debt management counselling services that they offer to those who get into financial difficulties.

Citizens Advice, for example, reported that:

> [The organisation has] seen a dramatic 100 per cent increase in the number of debt enquiries [it has] dealt with over the last 10 years. Debt is now the number one advice issue in bureaux, accounting for one in three of all enquiries.
>
> (Citizens Advice, 2009)

Debt problems have changed in the last few years, with traditional credit problems being overtaken by arrears on household bills. At the same time, mainstream credit has fallen as a proportion of debt issues. There has also been a rise in the proportion of problems relating to high cost, short term 'payday' loans (Citizens Advice, no date).

In addition to providing practical advice and immediate help, a number of these agencies have also been promoting financial capability education in schools and colleges, as well as in adult education. Here, again, the stated objective is to help people to avoid the painful personal consequences of poor (or non-existent) financial planning – but this goes hand in hand with the need to manage the overall levels of personal and household debt in an effort to achieve and maintain a sustainable national financial and economic system.

As a result, financial capability has now been added to the National Curriculum, so that all pupils should leave school with at least a basic level of financial literacy, including a general understanding of the main financial products and services – such as bank accounts, mortgages, loans and credit cards – and an understanding of the importance of budgeting and cash flow planning.

Financial capability education has now been added to the National Curriculum.

Achieving sustainable personal finances over the long term requires active management of all aspects of an individual's financial plans. This means that individuals should aim to:

- be aware of exactly how much money they are spending and what they are spending it on;
- use weekly or monthly budgets and cash-flow forecasts to plan their spending;

- know the financial implications of future events and aspirations (from the time when they first become financially independent through to retirement);
- have a savings plan to build up the capital sums that they expect to need in the future;
- carefully plan any borrowing and only borrow amounts that they are confident they can pay back;
- have an adequate emergency fund to fall back on when there is an unexpected reduction in income (if they are made redundant, for example);
- pay into a pension scheme to ensure that they will have an adequate income in retirement;
- look for ways to increase their incomes – whether through promotion and career development, or by working overtime, taking on a second job, etc;
- make use of appropriate insurance products to protect their incomes;
- regularly monitor, review and amend their financial plans; and
- have clear, realistic contingency plans to deal with the unexpected events that can disrupt their carefully made plans completely.

1.2 Individual budgeting and financial planning

A budget can simply be the amount of money that someone has available to spend on a party, a holiday or a new kitchen. In the context of financial planning, however, it refers to short-term, medium-term and long-term plans detailing expected income and expenditure. The government publishes an annual Budget, which is an estimate or forecast of the income from taxation that it expects to receive over the coming year and what it expects to spend over the same time period (its expenditure). Company accountants similarly draw up annual budgets – estimating annual income from sales, and expenditure on wages, raw materials and other costs – which management will use to predict whether the company is going to make a profit or a loss. They also draw up detailed monthly or weekly cash-flow forecasts, which predict how much cash they will need at any given time to be able to pay their bills as they become due.

For individuals, drawing up short-term budgets and cash-flow forecasts, and medium-term or long-term financial plans, allows them to think about all of the things that they need or want over different time periods and how much these will all cost. They can then estimate their income – wages, benefits, gifts, allowances, etc – over the relevant period and work out whether that income is going to be enough to cover the expenditure. If the predicted income is going to be more than the expenditure, then individuals can plan what to do with the surplus. If, on the other hand, it looks as though they are heading towards a deficit – that is, it looks as though the planned expenditure will be more than the predicted income – then they can take steps, such as reducing planned expenditure, increasing income, or perhaps using an overdraft or other borrowing product, to balance the budget.

1.3 Flexible financial planning

Financial planning means planning future expenditure and deciding how this will be financed. Someone's anticipated future expenditure will reflect their needs, wants and aspirations. How people decide to finance this expenditure will depend on their anticipated future income, and their attitudes to savings, borrowing and other financial products, such as insurance. For example, from time to time, people will want to buy gifts for family and friends, to celebrate personal events or on festive occasions. Planning can help them to make sure that they have enough money to do so and it can tell them how much they can afford to spend.

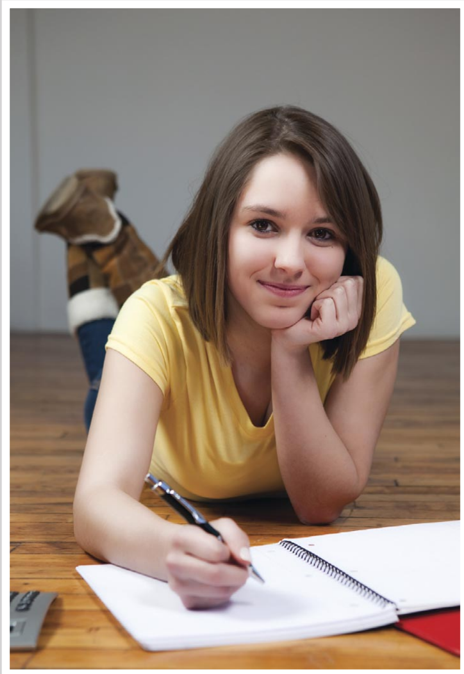
Many people use their monthly current account statements to make sure that they know what direct debits, standing orders and other regular payments are taken from their account each month. They can then ensure that enough money (eg from their earnings) is paid into the account at the right time to cover these regular outgoings. They can also get a good idea of how much money they take out of the account each month to pay for their grocery shopping, petrol, leisure activities and other variable expenditures.

But this is only the start of comprehensive, flexible planning. To maintain healthy, sustainable personal finances, people also need to plan to pay regular bills that do not fall due every month. Motor vehicle road tax, for example, can be paid either annually, six-monthly or monthly, and council tax can usually be paid either annually, quarterly or monthly (over ten months). People should also plan for expected car servicing bills, for the costs of routine household maintenance, for replacing worn-out or broken furniture, kitchen and laundry equipment, computers or telephones, and for other occasional bills.

Looking much further ahead, long-term financial planning takes into account the additional funds that may be needed to pay for the costs associated with raising a family, which might extend as far as supporting a child through further and higher education. Perhaps this might also include planning to pay for a luxury family holiday; certainly, it should include planning to ensure a comfortable retirement and to pay residential care home fees, should they become necessary. Calculations can then be made to work out the level of regular saving and investment that is likely to be required to make sure that the funds needed to achieve these goals and aspirations would be available at the appropriate time.

So what do we mean when we speak of flexible financial planning? The key principle is this: expect the unexpected. Even if people think that they are excellent at predicting their future income and expenditure, there are always going to be unexpected events or changes in circumstances that can have a serious negative impact on their carefully laid financial plans. Whether this comes in the form of losing a job, as lots of people experienced during the Covid-19 pandemic, or a large car repair bill, flexible financial planning means developing an appropriate mix of savings and insurance that allows the individual to cover the costs of these situations – and allows for future plans to be revised accordingly.

Financing a new life



Sarah is 18 and about to start a three-year BSc (Hons) in Finance, Investment and Risk course offered by The London Institute of Banking & Finance. This will mean a number of life changes for Sarah. Her income, which until now has been subsidised by her mum and dad, is going to come from different sources, including student loans and part-time work (although her parents have also said they will continue to pay her an allowance). Sarah's parents live in Birmingham, so she will have to rent student accommodation (or share a flat with others) in London; this means that she will now be paying not only her rent, but also other regular bills, such as electricity, gas, phone, TV licence, food and other household shopping (and ideally the occasional night out). Some of this expenditure will involve signing contractual arrangements requiring Sarah to make regular payments, including for rent, and perhaps for satellite television, mobile phone contracts and monthly credit card payments.

As she faces these new responsibilities, Sarah recognises that she needs to plan her short-term and medium-term finances carefully. She needs to monitor, review and, when necessary, amend these plans regularly; she needs also to have adequate contingency plans in place to ensure that unforeseen events will not cause her serious financial problems.

Putting some of her student maintenance loan and some of the money that her parents have given her into an easy-access savings account, which will provide her with an 'emergency fund' of readily available cash, is one way that Sarah can make provision for these unforeseen contingencies. She has also looked into taking out insurance against some common risks to her possessions (eg if her laptop, phone or television were to be stolen, accidentally damaged or destroyed in a fire). To her surprise, she has discovered that her parents have been able to amend their existing home contents insurance policy (for a small additional premium) to cover her possessions too.

When she graduates, Sarah is hoping to pursue a career in financial services. She will probably rent her own flat and her expenditure will be significantly more than it is now. Sarah hopes to have an adequate income from her job to meet these expenses, but because unexpected events can still happen, Sarah knows that, in the long term, she will still need to have a sufficient emergency fund and to take out her own insurance policies to protect her possessions.

1.4 The characteristics of a flexible financial plan

A flexible financial plan – sometimes also called a 'dynamic' financial plan – should include each of the following features.

Balanced between different 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. In the case study about Sarah, Sarah could achieve the right balance by drawing up:

- detailed weekly and monthly cash-flow plans;
- a less-defined budget for each academic term (remembering that student maintenance loans are paid in three instalments, one at the start of each term); and
- an outline budget for the whole year.

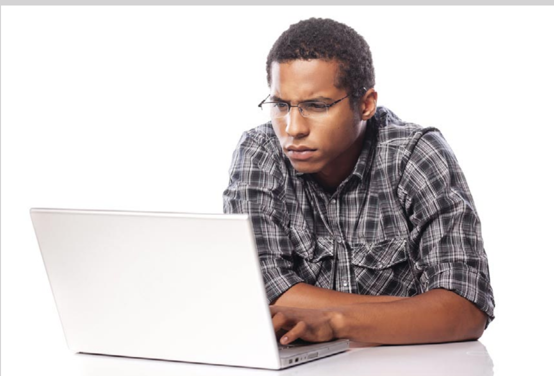
It would be good if she also had a plan for the future, encompassing her medium- and long-term aspirations, and if she were to take some action now, such as small, regular savings, to cover the cost of achieving those aspirations.

Informed

Like any other plan, a dynamic financial plan must be based on accurate information as far as possible. For example, someone aiming to make a purchase financed by a loan must be fully aware of:

- exactly how much the monthly repayment figure is going to be;
- the day of the month on which the direct debit (or standing order) payment will be paid from their account; and
- the fees or penalty charges payable if a monthly payment is missed or the loan is repaid early.

Similarly, planned spending should be based on up-to-date knowledge of the comparative prices of the goods or services that someone is planning to buy.



Comparison websites make it easier for consumers to find product details and compare products from a range of providers.

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. For example, someone aiming to take out a credit card or a variable-rate mortgage should consider the impact of several different monthly repayment figures on the plan, to take into account any future changes in the interest rate. They may be able to afford the repayments on a mortgage at today's 3 per cent interest, but will they be able to cope if the rate goes up to 8 per cent next year? Would they be able to reduce spending on other things or might there be opportunities to increase their income to cover expenditure that is suddenly higher than expected? Might it be possible to work overtime, to do extra shifts, to get a second job or to rent out the spare bedroom? These are sometimes called 'what if' calculations.

Fluid

A dynamic plan must reflect any monthly, termly or seasonal variations in the personal circumstances of the person making it. For example, students may have greater income at certain times of the year, such as during the summer holidays if they are able to get a temporary job, so they can plan to spend more or build up their savings at these times. Expenses are also likely to be higher at certain times of the year for most people, for example when going on holiday or coping with extra expenditure during Christmas or other festive periods, and flexible financial plans should take these variations in income and expenditure into account.

A fluid, flexible financial plan makes allowance for extra spending during a holiday.

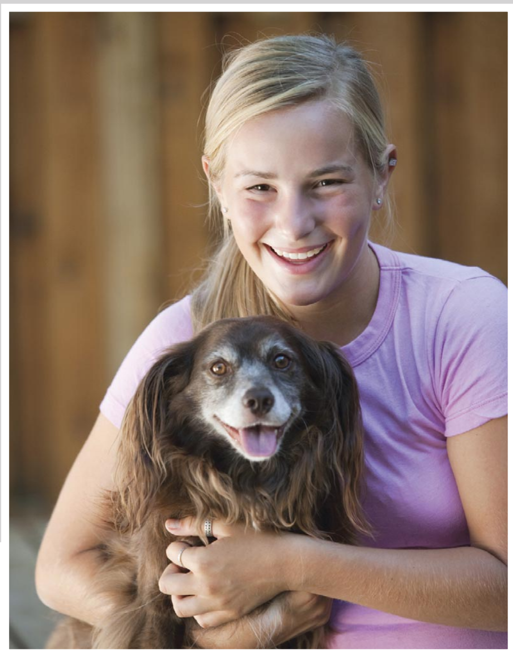
Realistic

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 very easy to make predictions and assumptions about future finances that are based on a 'best case' scenario. Most people will assume that their job is safe, that they will continue to work the same hours, that rates of income tax will not change and that they will therefore have the same take-home pay for the foreseeable future. They might also underestimate how much they spend on petrol, clothes, groceries, going out and so on, if they rely on rough guesses of how much they spend. These people need to complete a regular itemised assessment of exactly how much they spend each week or month.

It is usually obvious that bigger purchases can lead to very significant problems. Buying a house or a car, or even booking a holiday without working out exactly how much it is going to cost and how you are going to pay for it, are major causes of financial problems and lead many into unplanned debt. But even small items of expenditure need to be taken into account if they are regular and frequent. It is a good idea, from time to time, to keep a daily spending diary for a few weeks, recording every purchase no matter how small. This often reveals that people spend much more in total than they realise on regular small purchases, such as sweets, snack foods and takeaways.

Laurel's spending diary

Laurel is a 17-year-old college student. She has a part-time job in a dog grooming parlour and also gets an allowance from her parents. She opened a savings account six months ago, but never seems to have any surplus cash to put in it and she cannot understand why. She really wants to go on holiday with her friends in a year's time, but she will have to save £600 to pay for it. She discusses this with her parents, who suggest that she keeps a daily spending diary, to see where her money is going.



This is the result, presented as a weekly summary of the daily spending that Laurel records.

	Week 1	Week 2	Week 3	Week 4	Month
Income:	£	£	£	£	£
Wages	45	45	45	45	180
Allowance	40	40	40	40	160
Total					**340**
Expenditure:					
Bus fares	30	30	30	30	120
Lunch	10	10	10	10	40
Soft drinks	10	8	12	10	40
Sweets	8	12	6	14	40
Pay-as-you-go phone top-ups	10	15	5	10	40
Make-up	0	5	10	5	20
Toiletries	10	0	5	5	20
Magazines	5	7.50	5	7.50	25
Total	**83**	**87.50**	**83**	**91.50**	**345**

After completing the diary for a month, Laurel is surprised how much she is spending on soft drinks, sweets, phone top-ups, make-up, toiletries and magazines. She works out that, if she buys only one soft drink and one 80p chocolate bar a day, cuts her phone bills by sending more plain texts and making fewer calls, switches to cheaper supermarket 'own brand' make-up and toiletries, and takes out annual subscriptions to the online versions of her favourite magazines, she could save the £50 a month that she needs to pay for her holiday.

1.5 Setting priorities

The first step in drawing up a new financial plan is to make a list of all of the goods and services on which someone is likely to spend money over a given time frame (which might be a week, a month, a year or the next 40 years) and how much these purchases will cost. For medium-term or long-term plans, the list will comprise general headings and 'guesstimates' of likely cost, but short-term plans can start with a fairly detailed list based on recent experience.

The list can then be grouped into categories based on whether they are items that someone *needs* (because life would be impossible or, at best, difficult to sustain without them), those that someone simply *wants*, and *aspirations* – that is, items that someone wants to be able to fund in the future. (The concepts of needs, wants and aspirations were introduced in Unit 2.)

Different people have different views on what constitutes a need or a want – that is, a necessity or a luxury – depending on their circumstances, income, lifestyles, culture, values and attitudes. Everyone has to eat, but while a few of us might be able to get by on £50 a week in the supermarket, others might spend £50 per day. Each person's list of needs, wants, etc, will therefore be different, but in every case the list will provide an indication of which items have the highest priority – that is, those things that must be paid for first, before the money runs out.

Unit 1 explained that expenditure can be put into three categories, as follows.

Mandatory expenditure 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.

Mandatory expenditure includes costs such as:

- income tax and National Insurance contributions (NICs);
- workplace pension contributions (unless you have opted out);
- council tax;
- TV licence; and
- third-party car insurance, road tax and MOT certification.

Essential expenditure 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.

Essential expenditure includes the costs of:

- basic food and drink needs;
- rent or mortgage instalments;
- electricity, gas and water bills;
- adequate clothing;
- travel to and from work/college;
- a monthly mobile phone contract;
- minimum monthly payments on a credit card;
- monthly payments on a personal loan.

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

Regular discretionary expenditure might include the costs of:

- snack food and drinks;
- gym subscriptions, or karate or dance lessons;
- satellite or cable television; and
- takeaway food.

One-off discretionary expenditure might include the costs of:

- fashion (rather than basic) clothing or clothes for a special occasion;
- entertainment;
- eating at restaurants; and
- holidays.

For those on limited incomes, who may struggle even to be able to afford to buy all of the things that they really need, the task could be to decide which items are most necessary. Not paying the rent or mortgage payments could lead to eviction and homelessness. Not paying gas and electricity bills could mean that someone has no way of cooking food or of heating their home in winter. Not paying council tax, or credit card or loan payments, could lead to spiralling debts and court action. So often the only choice may be to reduce spending on food, drink and other discretionary items to the bare minimum.

Those with a higher income may be able to cover all of their essential and mandatory expenditure, and also have money left over to pay for some of the discretionary items that they want to buy – although most people still have to prioritise the purchases that they want most. Even millionaires have to make choices and decide on priorities. Consider the actions of some lottery winners, who have spent their windfalls on a lavish lifestyle without thought or planning, only to find that the money is quickly gone – often in a matter of months rather than years.

For the majority of people, however, spending priorities should always be as follows.

Figure 1.3 Spending priorities

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

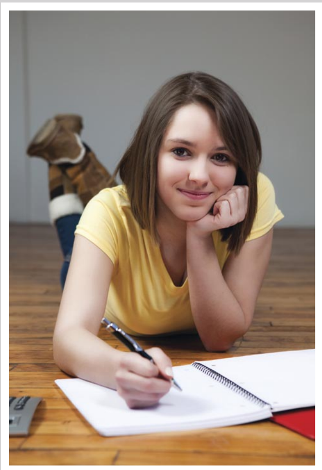
Dividing any surplus between spending and saving will demand that you make a difficult decision between buying the things that you want now and saving to pay for things that you want to buy in the future (aspirations).

We can also distinguish between different types of savings.

- Under the pension auto-enrolment rules, 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.
- Someone may choose to pay money into a savings account whenever there is some left over at the end of the month – these savings could therefore be said to be discretionary, or optional.

The amount that people save will, of course, be affected by their income, but it also depends on their attitudes to saving and borrowing. Post-war economic growth and prosperity in the 1950s and 1960s, and ever easier access to borrowing (mortgages, overdrafts, personal loans, credit cards), led to a widespread change in attitudes during the latter half of the twentieth century. People had previously relied on saving up to pay for the 'luxury' items they wanted and regarded borrowing as a 'last resort', to be avoided unless there was no other choice; in the post-war world, people became increasingly ready to borrow to pay for their growing consumption of consumer goods, clothes, cars, foreign holidays, etc.

Counting the costs



Sarah has taken the first step towards planning her finances by drawing up a cash-flow forecast for her first month and term at university. She has made sure that she has sufficient information by researching:

- how much she can get from a student maintenance loan (she discovered that her parents' income was too high for her to be eligible for anything other than the minimum amount);
- how much the rent will be for her student accommodation; and
- how much she will spend on bus or Tube fares.

She has also discussed with her parents the experiences of friends who are already at university and, based on that, how much she should realistically expect to spend on household shopping (groceries and bills, etc) and leisure activities.

Sarah's cash-flow forecast, Month 1

	Week 1	Week 2	Week 3	Week 4
Income:	**£**	**£**	**£**	**£**
Student maintenance loan (1)	1,200	–	–	–
Part-time job	150	150	150	150
Parents' monthly allowance	600	–	–	–
Total income	**1,950**	**150**	**150**	**150**
Expenditure (mandatory):				
TV licence (2)	12	–	–	–
Expenditure (essential):				
Food and household spending	150	150	150	150
Rent (includes gas, electricity and water bills) (3)	550	–	–	–
Bus / Tube fares (4)	95	–	–	–
Mobile phone	25	–	–	–
Expenditure (discretionary):				
Weekly night out (meal, bar, club, cinema, etc)	30	30	30	30
Monthly weekend home (5)	45	–	–	–
Total expenditure	**907**	**180**	**180**	**180**
Weekly balance	**1,020**	**(30)**	**(30)**	**(30)**
Balance brought forward	**–**	**1,043**	**1,013**	**983**
Net balance carried forward	**1,043**	**1,013**	**983**	**953**

Notes:

(1) A third of the total loan is paid into Sarah's account at the beginning of each term.

(2) TV licence paid by monthly direct debits (and rounded down to whole number).

(3) Student accommodation (rent includes utilities).

(4) Cost of a monthly season ticket.

(5) Return train fare for weekend visits back home in Birmingham.

Sarah's cash-flow forecast, autumn term [1]

	Month 1	Month 2	Month 3	Month 4
Income:	**£**	**£**	**£**	**£**
Student maintenance grant	1,200	–	–	–
Part-time job	600	600	600	600
Parents' monthly allowance	600	600	600	600
Total income	**2,400**	**1,200**	**1,200**	**1,200**
Expenditure (mandatory):				
TV licence	12	12	12	12
Expenditure (essential):				
Food and household spending	600	600	600	600
Rent (includes gas, electricity and water bills)	550	550	550	550
Bus / Tube fares	95	95	95	95
Mobile phone	25	25	25	25
Expenditure (discretionary):				
Nights out (meal, bar, club, cinema, etc)	120	120	120	120
Weekends home	45	45	45	45
Total expenditure	**1,447**	**1,447**	**1,447**	**1,447**
Monthly balance	**953**	**(247)**	**(247)**	**(247)**
Balance brought forward	**-**	**953**	**706**	**459**
Net balance carried forward	**953**	**706**	**459**	**212**

Notes:

(1) For simplicity, each month in the table is assumed to be four weeks long.

Sarah's monthly and termly forecasts suggest that she should have £212 left over at the end of term: enough to buy Christmas presents, perhaps, or she could save it to use when she goes back to university after the holidays. She must now draw up an outline annual budget to identify whether there might be times when she needs to have access to additional short-term borrowing – for example, an overdraft facility.

1.5.1 Cash-flow modelling

Sarah's cash-flow forecasts are short-term and relatively straightforward, which means that she can draw them up by hand or on a computer, using a basic spreadsheet program – or even using a smartphone app. For more complicated medium-term and long-term plans, however – such as those that include predicted and actual returns from investments and pension plans – cash-flow modelling software programs are available that allow individuals (or a financial adviser on an individual's behalf) to predict the medium-term and long-term effects that different decisions and events may have on their income, expenditure and savings plans. They can then produce 'what if' scenarios, asking themselves what the financial implications would be of a range of different decisions.

Figure 1.4 What if . . . ?

By comparing these detailed predictions of different potential outcomes, someone can change their spending, saving, investment and insurance plans to ensure (as far as possible) that they will be able to pay all of their mandatory and essential bills, and yet still also achieve their short-term, medium-term and long-term wants and aspirations.

1.6 The obstacles to sustainable personal finances

There are a number of obstacles that can prevent an individual from achieving sustainable personal finances over the long term. The most common include failing to:

- make short-term, medium-term and long-term financial plans that are flexible – ie that include the characteristics of flexible financial planning detailed at section 1.3;
- compare actual weekly or monthly income and expenditure with the amounts predicted in forecasts (monitoring);
- amend plans when circumstances change or when monitoring reveals a significant difference between predicted and actual outcomes;
- take appropriate steps (such as increasing income, reducing spending or arranging borrowing) to avoid predicted cash shortfalls; and
- make adequate contingency plans (see section 1.7) to deal with unexpected changes in income or expenditure.

1.7 Contingency planning

Sustainable personal financial plans need to evolve as an individual's circumstances change. A person's lifestyle changes every so often, such as when someone leaves home, goes to college or university, gets a first job, gets married or enters into a civil partnership, or has a child. To some extent, all of these events can be planned for. But unforeseen events also happen and these too should be included in a financial plan.

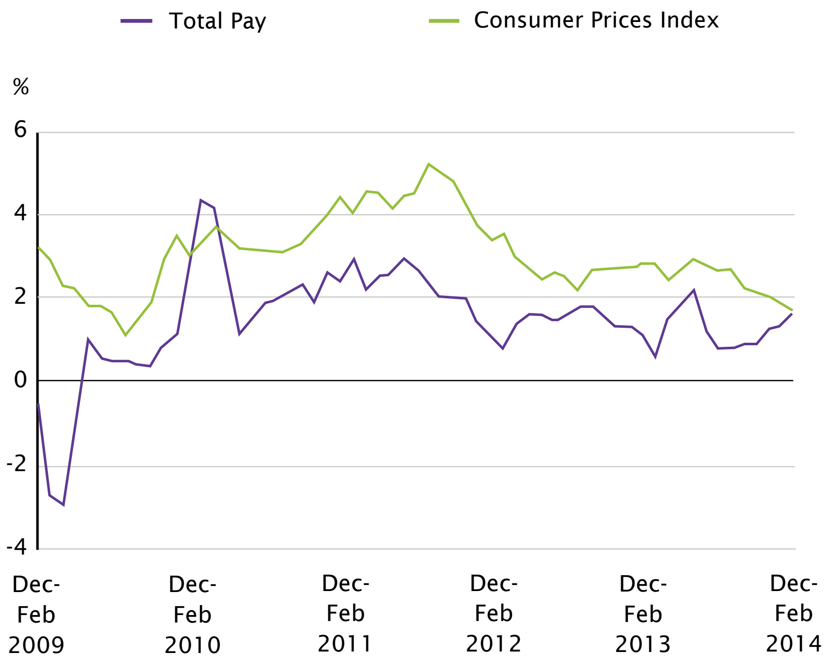
Attempting to plan for these unexpected events – or at least to take them into account when making financial plans – is called **contingency planning**. It usually involves planning for undesirable or unfortunate events – although there can be pleasant surprises too. The following are just a few examples of the types of event that might arise.

- **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
- **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

The 2007–08 financial crisis and the effects of the economic recession that followed it were major contingencies that resulted in many financial plans – including those of business and government – going awry. Many people lost money when their investments fell in value; others lost their jobs. Most people have been affected by prices rising faster than wages.

Investors – including millions of people paying into money-purchase pension schemes – were badly affected by falling share prices. The FTSE 100 – an index of the share prices of the top 100 companies traded on the London Stock Exchange – fell from 6730 in June 2007 to 3512 by March 2009: a fall of nearly 50 per cent (swanlowpark.co.uk, no date). And in the five years following the financial crisis, the real value of wages was squeezed by price inflation, which rose to a peak of 5 per cent in the second half of 2011, while the growth in wages was generally below 2 per cent a year (ONS, 2014).

Figure 1.5 Inflation and wage growth in the UK, 2009–14



Source: ONS (2014)

Although interest rates fell, making loans cheaper, banks tightened their lending policies (what is known as the 'credit crunch'), and so it became much more difficult for businesses and first-time buyers to get a loan. The governments of most Western countries have also taken 'austerity measures' – that is, have made large cuts in public spending in order to try to cut government debt by reducing the deficit between government income and expenditure. This policy has resulted in a lot more people losing their jobs (as we discussed at the start of this topic). Unemployment is a particular problem for someone who already owes money, because they will find it hard to pay their debts; it is also a problem for young people who are finding it harder to get their first job and so cannot even begin to earn money.

House hunters

Richard is 28 years old and he has a good job in a large bank, which he joined after graduating. While the bank was doing well, he was given a yearly bonus of a number of shares in the bank. The market value of these shares was around £5 each at the beginning of 2011 and Richard was happy to keep these shares, because he aimed to sell them in a few years' time and to use the cash for a deposit on a house. He also anticipated that he would be able to sell them at any time if he were to need extra cash to pay for an unexpected bill. Richard monitors the share price regularly and was shocked when the price fell dramatically towards the end of 2011, halving the value of his shareholding. He considered whether to sell the shares and put the money into a safer savings account, but, because he did not think he would be ready to buy a house for at least five years, he decided to hang on to the shares in the hope that the share price would recover.

Kevin and Marta are both aged 24, and have been married for three years; they do not have any children because they have decided that they cannot afford to start a family yet. They both have jobs and their joint net income is £32,000. They are renting a small flat and they put as much money as they can into a savings account each month to try to build up a deposit with which to buy a house. Kevin has just heard that a wealthy great-aunt, who died a few weeks ago, has left him £250,000 in her will. They have been discussing how to use this money sensibly and have decided to use £10,000 to pay off their outstanding loan, credit card and overdraft debts, to use up to £180,000 to buy a two-bedroom flat, to use £15,000 to buy a new car and to spend £5,000 on a luxury holiday. They will put another £5,000 into an easy-access savings account (to act as an 'emergency fund') and invest the remaining £35,000 for a period of between five and ten years, to help them to save towards upsizing to a three-bedroom or four-bedroom house when they are ready to start a family.

Karishma is 33 years old and, from 2011 until 2013, she had a very good management job with a large company, from which she was earning £50,000 a year plus bonuses. She bought a small house in a nice area in 2011, taking on a very big mortgage of £200,000, and she was just managing to meet her monthly repayments. She used all of her savings (£25,000) as a deposit to buy the flat and has not been able save any money since, but she did take the precaution of taking out mortgage payment protection insurance (MPPI). In 2013, the company for which Karishma was working went into liquidation and she was made redundant. She successfully claimed on her MPPI policy, but there was a 60-day waiting period before she started receiving the monthly payments. Fortunately, she was eligible for a £1,000 statutory redundancy payment and her parents were able to help her to pay her mortgage bill during that initial two-month period of unemployment. Karishma was unemployed for six months before she found a new job with the local council, but her new salary is only £30,000, so she is now planning to sell her house and buy a cheaper flat with a more affordable mortgage.

1.8 Financial products and services

The full range of financial products and services available from banks, building societies and other financial services providers, such as credit unions and friendly societies, offer many opportunities to help an individual to maintain sustainable personal finances. The most important of these products can be summarised as follows.

1.8.1 Current accounts

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, holders of current accounts can make payments using:

- cheques;
- standing orders;
- direct debits;
- debit cards;
- telephone banking;
- internet banking;
- mobile banking.

The widespread availability of online banking services in recent years has made it much easier for customers to monitor their accounts on a regular basis. Being able to access (whether by computer, tablet or phone) a current account statement that is constantly updated to show up-to-the-minute receipts, payments and balances allows customers to be aware of how closely their actual income and expenditure matches what they predicted. Customers can quickly spot any deviation from their short-term plans, and if a potential problem makes it necessary to transfer money from another account (eg a savings account), or to cancel a standing order or arrange a short-term overdraft using instant online money transfers, they can also do all of these things online.

1.8.2 Basic bank accounts

Some people are unable to open current accounts, for example if they have a poor credit history or do not have a permanent address. Banks and building societies therefore offer these customers basic bank accounts, which have fewer facilities than current accounts, but allow account holders to deposit and withdraw cash (see Topic 3, section 3.1.4.2 for more on basic bank accounts).

1.8.3 Savings accounts

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, the following savings products are also available:

- regular (monthly) savings accounts;
- notice savings accounts;
- fixed-term, fixed-interest savings bonds or deposit accounts;
- credit union savings accounts;
- Christmas or other festive saving clubs; and
- National Savings and Investments (NS&I) products, including:
  - the Direct Saver account (a variable interest online savings account);
  - Income Bonds (on which variable interest is paid monthly);
  - the Investment Account (on which variable interest is paid annually);
  - Premium Bonds (which gather no interest, but are entered into a monthly prize draw);
  - the Direct ISA (a variable-interest, tax-free cash savings account); and
  - Bonds (which pay a fixed interest rate for a fixed term of one or three years).

Details of all of these products and more can be found on the internet using comparison websites, such as Money Supermarket, Go Compare or Compare the Market. Alternatively, you might simply search for the type of account in which you are interested using an internet search engine.

As an aid to sustainable personal finances, instant or easy-access savings accounts are ideal products to use for an emergency fund. Financial advisers usually recommend saving an emergency or contingency fund that is roughly equal to three months' net (ie take-home) salary, so that if someone is made redundant or has to stop working because of a serious illness or disability, they will have enough money to continue paying their bills – rent/mortgage, loan payments, utility bills, etc – for three months, by which time they may have got a new job or recovered from the illness. A three-month emergency fund also means that if someone takes out appropriate income protection insurance policies (see section 1.8.4) they can choose a three-month waiting period before the policy starts to pay out benefits, which usually makes the policy's monthly premiums a lot cheaper.

Notice accounts and fixed-term, fixed-interest accounts and savings bonds are not suitable for emergency funds, because savers pay a penalty (or lose interest) if they withdraw money in an emergency without giving the required notice or before the 'maturity date' of the fixed-term savings product. These products are useful, however, for medium-term or long-term saving if someone can afford to save more than they need to as an emergency. They are ideal products to use when planning to save over a period of years to build up a deposit for a house purchase, or to pay for a wedding or a dream holiday, or to start a business.

1.8.4 Borrowing products

The majority of people will, at some time in their lives, need to borrow money from a bank, building society or other lender. If this borrowing is unplanned and the borrower fails to consider whether they will be able to afford to pay the regular monthly payments, and if there is no contingency plan in place for the borrower being made redundant, etc, then borrowing can lead to problems that might damage the sustainability of the individual's finances. Using the right borrowing product at the right time as part of a coherent financial plan, however, can be a way in which to achieve and maintain sustainability.

Using the right borrowing product at the right time – such as a mortgage to buy a house – can be a way of achieving and maintaining financial sustainability.

The main products that allow people to borrow money from financial institutions are:

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

Different borrowing products meet different needs. For example, credit cards are a convenient way for people to pay for purchases. They reduce the need to carry around large amounts of cash and, if the outstanding balance is repaid every month, can provide short-term borrowing, interest free. For individuals who have not been able to save up an emergency fund, credit cards (and overdrafts) provide an alternative way of paying unexpected bills. They are suitable for paying for items such as clothes, train fares and petrol, and for some consumer goods, such as a new television. But if they have allowed a credit card balance to build up to an amount that they cannot pay off in full at the end of the month, the cardholder should work out how much they can afford to pay off each month and incorporate these payments into their short-term and medium-term financial plans.

An overdraft on a bank or building society current account can be used in a similar way to a credit card. Neither an overdraft nor a credit card, however, will normally provide enough credit for a major 'big ticket' purchase such as a car or new kitchen, and the interest rates on these forms of credit are quite high. If a consumer is unable to save up the money that they need to pay for these kinds of purchase, they are therefore likely to turn to a personal loan from a bank, building society, credit union or other lender, or to sign up to a hire purchase or retail credit arrangement offered by the retailer.

If someone wants a substantial loan with which to buy a house or flat – the biggest single purchase that most people ever make – they will, of course, need to get a mortgage loan from a bank or building society. Mortgage loans normally have lower interest rates than other forms of borrowing and can be repaid over longer periods (25 years or more, depending on the borrower's age); these features make the monthly repayments on loans of £100,000 or more affordable for people on relatively modest incomes. Lenders can afford to take more risks with mortgage lending, such as the risk that the borrower might default on the repayments, because the loan is secured on the property being purchased: the borrower signs a mortgage deed, which gives the lender the right to take possession of the property if the monthly payments are not maintained.

Using the wrong borrowing product at the wrong time or in the wrong way can be a recipe for financial disaster.

During the adult stages of the personal financial life cycle, therefore, many people will have an overdraft, one or more personal loans or hire purchase agreements, one or more credit cards and a mortgage in their borrowing portfolio. To maintain sustainability, it is vital that borrowers regularly monitor and keep aware of both the total amount of all of their borrowing (their outstanding debt) and the total monthly repayments required to pay off these debts. They can use this information to ensure that they are going to be able to afford to make these payments each month and to work out if they can afford to take on any new debts to buy items that they want to buy now or in the future.

For sustainability, it is vitally important that people should use only borrowing products that are affordable and suited to their needs and financial circumstances. As noted at the beginning of this topic, total personal debt in the UK more than trebled from £400bn in 1994 to £1,400bn in 2008. When unemployment then began to rise as a result of the recession, borrowers who had not set aside an adequate emergency cash fund or made other contingency plans were unable to meet the repayments on their mortgages and personal loans after being made redundant. Some then made the mistake of using other borrowing products to meet the monthly payments that they could no longer pay from their monthly income.

Using a credit card to make monthly mortgage payments, for example, can make a financial situation worse rather than better, because it will not be long before the card balance hits the borrower's credit limit – at which point, the borrower will no longer be able either to make their monthly mortgage payments or to repay the balance owing on the card. The borrower's total debt will now be significantly higher and, because the interest on credit cards is very high compared with that on mortgages, the debt will be growing rapidly each month, making it harder and harder to repay.

The same problem also occurs with 'payday loans' – ie easily available, short-term loans at a very high interest rate (see section 1.8.4.1). A borrower might take out such a loan with every intention of repaying it within a matter of days, but then find themselves unable to do so. As the weeks or months roll by, and the sum borrowed and the unpaid interest accumulate, the borrower can find themselves with a debt that has rapidly grown. FCA rules introduced in 2015 addressed this issue to an extent by ensuring that no payday borrower will pay back more than twice the amount they borrowed (see section 1.8.4.1). However, payday lenders still charge exorbitant interest rates, and StepChange Debt Charity (2016) found that, in 2016, people with payday loans owed almost as much on average as before the FCA regulations came into force. In 2018, payday lender Wonga went bust as a result of the FCA rule changes and a spate of compensation claims (BBC, 2018).

Since the financial crisis of 2007–08, many people have been trying to reduce the total amount that they owe. Existing mortgage holders have benefited from a period of very low interest rates that have kept their monthly payments lower than they were expecting them to be. This has given them some 'spare' cash each month, which many people have used to bring down overdrafts and credit card balances, and/or 'overpay' on their mortgage payments. Paying more to the mortgage lender than you are required to pay each month reduces the outstanding amount owing and can be used either to reduce monthly payments for the remaining period of the mortgage or to pay off the mortgage more quickly than originally agreed.

At the same time, lenders tightened up their lending criteria – meaning that it is less easy now to borrow money from a financial institution than it was in the years leading up to 2007. This has led to a worrying development: the emergence of different types of lender who specialise in offering small, very short-term loans to people who are unable to borrow from a traditional lender because they do not have sufficient income or because they have a poor credit history.

'Payday loans' and 'logbook loans' are typical examples of these types of loan.

1.8.4.1 Payday and logbook loans

- 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.

- 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. (The ability to take away the property without a court order arises under the Bill of Sale Act 1878 and some people have argued that a new piece of legislation is necessary to protect people who take out these loans.)

The problem with this kind of borrowing is that the interest rates typically charged are extremely high. An example of a payday loan company is Lending Stream. As a representative example, someone borrowing £200 for 6 months would repay £386.61 – that is, £186.61 in interest and fees. The representative annual percentage rate (APR) is given as 1,333 per cent (Lending Stream, no date).

Borrowing in this way is clearly a very expensive way of solving a short-term problem, but it is attractive to some because the loans are instant and because virtually any employed person over the age of 18 will be offered a loan regardless of their circumstances. If the loan is taken out purely because someone has an unexpected bill that has to be paid now (eg a car repair bill) and they will definitely have enough spare cash to repay the loan when they get their wages in a week or two, then it can help them to resolve this kind of cash-flow problem.

Many people have run into difficulties with these loans, however, because the underlying problem is simply that their monthly income is less than their expenditure. By using a payday loan to make up for this monthly deficit, they are only adding to the problem, because even when they have been paid, they will not have any spare money to repay the loan – and they will have to borrow even more money to cover the next month's deficit. Payday loan lenders have been accused of encouraging people to take out more and more loans, or simply to 'roll over' the debt for another month, turning what are designed to be short-term loans into expensive long-term debt traps.

Some payday lenders are even known for using aggressive tactics to get their money back. In February 2012, for example, one payday lender, Minicredit, was compelled to apologise to customers after it sent them emails threatening to contact the customers' employers if they failed to pay their debts quickly.

Payday loans are, however, covered by the Consumer Credit Acts of 1974 and 2006. Until April 2014 lenders had to obtain a licence from the Office of Fair Trading (OFT) before they could trade and could lose that licence if they were found to be lending irresponsibly; from April 2014 the Financial Conduct Authority (FCA) took over responsibility for licensing and consumer credit legislation.

In February 2012, the OFT launched an extensive review of the payday lending sector and an investigation into whether the top 50 lenders were complying with consumer credit legislation. Its final report, published in March 2013, was critical of payday lending and 'included an action plan to tackle deep-rooted problems in the market' (OFT, 2013). The review identified a number of concerns regarding lending practices and aggressive debt collection. This resulted in more than 20 payday lenders having their licences taken away or volunteering to give them up and all 240 payday lenders were put on notice to improve their practices, or else face fines and closures.

The Financial Conduct Authority (FCA) has continued the work of the OFT in relation to payday lenders. In November 2014, it announced price caps for payday lenders: an initial cost cap of 0.8 per cent per day of the amount borrowed, a maximum default fee of £15 and a total cost cap of 100 per cent, meaning that borrowers will never have to pay back more than twice what they borrowed. The FCA also announced that it would do further work to find out if payday lenders were making adequate affordability checks on borrowers and the impact of repeat borrowing (FCA, 2014).

1.8.5 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.

Friends will help you through the emotional aftermath of a personal disaster – and appropriate financial protection products can help to relieve the financial impact.

The different types of insurance (as introduced in Unit 2) include the following.

- **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
  - your holidays (travel insurance to cover cancellation, medical care, injury, cash, etc).
- **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.
- **Income protection insurance (IPI)** – 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.
- **Accident, sickness and unemployment (ASU) insurance** – this pays out income for a limited time, typically up to 12 or 24 months, if you are unable to work due to accident or sickness or if you have lost your job through no fault of your own. The cost of ASU is usually lower than IPI because of the limited payout.
- **Critical illness cover (CIC)** – 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.

The type of insurance and amount of cover required under any of these policies depends on each individual’s personal circumstances. A young adult who is single, rents a small flat and has a good job with a multinational company (which offers a generous remuneration package to its employees, including good long-term sick pay, private medical insurance, an occupational pension, a company car and redundancy pay) may need only home contents (or personal possessions) insurance to complete a full financial protection package.

At the other end of the spectrum, a couple with young children, who own a house (with a mortgage) and who are working for employers who offer the bare minimum employee benefits, should take out as much insurance as they can afford to ensure a sustainable financial future.

1.8.6 Pensions

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.

There are several types of pension, including:

- state pension (a government benefit based on the individual's National Insurance contributions);
- occupational pensions (for those in employment);
- personal pension plans (set up by an individual);
- stakeholder pensions (a type of personal pension with low costs); and
- the National Employment Savings Trust (NEST).

NEST

From 1 October 2012, all employers have been obliged to enrol their workers into a qualifying workplace pension scheme that meets or exceeds certain legal standards. The NEST is a low-cost, trust-based pension scheme designed to make it easier for all employers to meet their new duties and to help more people to save for their retirements. It is also available to self-employed people.

State pension is covered in more detail in the next topic, but it is worth noting here that eligibility for full state pension relies on a person's National Insurance contribution (NIC) record. If someone has been out of the country for a number of years, or has not been in paid employment because they have been caring for children or a dependent relative, they may be entitled only to a reduced rate.

Even if someone is entitled to a full state pension, the amount paid is not generous and many pensioners presently struggle to make ends meet. Because of this, a sustainable personal financial plan should include making regular monthly payments into an occupational pension or a private pension plan, in order to top up pension income to an amount that will allow you to enjoy a reasonably comfortable retirement.

Employers now have to enrol all their employees (whether they are employed full-time or part-time) aged 22 years or over into an occupational pension scheme. The employer can either use the NEST scheme to meet its obligations, or can set up its own scheme through a pension provider as long as it meets certain minimum standards. There are minimum contribution levels that both the employer and the employee must pay into the scheme. For those people who are self-employed or who are not working at all, insurance companies offer a range of private pension plans that are also designed to provide a source of income after retirement additional to the state pension.

By incorporating adequate monthly pension contributions into short-term, medium-term and long-term financial plans, individuals can ensure that their personal finances will remain in good health until long after they retire.

1.8.7 Investments

People put money into investment products because of their potential to achieve very high returns. But the promise of high returns is balanced by the increased risk of losing some or all of the money invested. An investment usually entails buying an asset – shares in a company, or a house, or even art or antique furniture – which the investor expects to increase in value over time (capital growth) and/or to be a source of income (share dividends; rent from a house).

The main forms of investment for individuals are the following.

Shares and bonds

Buying shares in companies, directly or indirectly, is the most common form of financial investment. Wealthy investors use stockbrokers to buy and sell shares in particular companies, but 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.

Property

Most people buy a house or flat as a home for themselves, but it can also be the biggest investment that they ever make, and if house prices steadily rise each year at a rate higher than that of inflation, the buyer can achieve high capital growth returns. During the boom years before the credit crunch, the introduction of 'buy-to-let' mortgages also encouraged people to buy additional properties purely as investments. The rent received (after tax) was often sufficient to cover the monthly mortgage repayments, which meant that, while house prices were rising, this was a good investment. Following the financial crisis, house prices generally stagnated and even fell in many parts of the country, which made buying to let a less attractive investment option. At the time of writing, house prices are rising again, although there are wide variations across the country.

Non-financial investments

Other ways of investing for capital growth are not strictly financial products (and are not regulated by the FCA). These include buying works of art, fine wine, antique furniture, classic cars, memorabilia, or stamp or coin collections – any physical asset that might be expected to increase in value over a period of years.

For those people who have a regular monthly surplus or a cash lump sum, carefully planned investment in shares, bonds or property can be an important way of maintaining sustainable personal finances.

Long-term investment is an effective way of building up a capital sum (whether in a pension plan and/or any of the investments listed) which can help to ensure a comfortable retirement, but investors must make certain that they are fully aware of the risks involved with each investment. Asset prices can rise and fall dramatically in a matter of days, which means that investors must be able to leave their money invested – ideally, for at least ten years – to benefit from any underlying long-term growth in the asset's value. When it is closer to the time that the money is going to be needed – perhaps as the investor nears retirement – effective long-term planning would include moving money out of high-risk investment products and putting it into safer savings accounts or fixed-term savings bonds.

In the next topic, we will consider the help and advice available from the state to help an individual to maintain personal financial sustainability.

Key ideas in this topic

- Planning and achieving sustainable personal finances
- Flexible financial planning
- Budgets, cash flows and cash-flow modelling
- Setting priorities
- Planning for contingencies
- Using all appropriate financial products and services to help to maintain sustainable personal finances

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Personal financial sustainability - <u>Topic 1 Activities</u>

Activity 1.1

Link to study text	1.1
Write your own definition of personal financial sustainability.	

Activity 1.2

Link to study text	1.1
Consider how important personal financial sustainability is to you at this stage of your life. 1.Do you think your view will change as your circumstances change or do you think the views you have now will stay the same no matter what happens? Discuss the above with your parents/carers – what is their opinion as people who are in a significantly different life stage to you?	

Activity 1.3

Link to study text	1.4
A flexible financial plan should have the following five characteristics. Use the following recording sheet to make notes on what is meant by each characteristic.	

Activity 1.3 recording sheet

Characteristic	Notes
Balanced between different time periods	
Fluid	
Able to adapt to changing products and services	
Informed	
Realistic	

Activity 1.4

Link to study text	1.5

There are many free budget planners online. Take a look at the short promotional video for budgetpulse.com here: www.youtube.com/watch?v=24Ac-rQggR0 . Then reflect on or discuss its value. Identify at least 3 features you like and highlight any you dislike:

-

If you or your family use other budgeting tools then make a note of what it is. Be ready to share this information if you are in a group.

Activity 1.5

Link to study text	1.7

Our spending priorities are influenced not only by our attitudes to finance but also by external factors over which we have no control.

Have a look at the news story link below and find out how household expenditure in the UK changed as a result of the credit crisis.

news.sky.com/story/spending-squeeze-household-priorities-shift-10424983

Reflect on how (or if) the credit crisis affected you, your family and friends.

You	Family	Your friends

How are your experiences similar and to what extent they differ?

Activity 1.6

Link to study text	1.7

Review the following webpage, which gives an overview of 'Overcoming the barriers to longterm thinking', a report by Forum for the Future.

www.theguardian.com/sustainable-business/short-term-profit-long-term-losses

What disadvantages of short-term investment thinking does this overview identify?
How does the report recommend that longer-term thinking can be encouraged?

Consider how investors, investment companies and advisers would be affected by these changes. Do you think that implementing the recommendations would lead to a more sustainable financial system? Be prepared to discuss your ideas.

Activity 1.7

Link to study text	1.8.2

We are experiencing an extended period of increasing interest rates, which makes it easier for savers to get decent returns from their accounts, after a long period of minimal returns.

Use a comparison website to find the best interest rates for:

Type of Saving Account	**Company**	**Name of account**	**Rate offered**
easy access accounts;			
1 month notice accounts;			
3 month notice accounts;			
1 year fixed-term accounts;			
2 year fixed-term accounts;			
cash ISAs;			
Junior ISAs.			

Does the same bank or building society offer the best interest rates for all of these products or does it pay to shop around?

Activity 1.8

Link to study text	1.8.3

Payday lenders will have to make sure their customers can afford their loans, and they face having misleading adverts banned under rules to **more effectively control** the industry.

1.Take a look at the link below and make notes as to how effective you think the rules are at protecting consumers who find themselves in the position of needing to borrow:

www.moneysavingexpert.com/news/2014/02/payday-loan-firms-face-legal-crackdown-fromapril/

In January 2015, the FCA introduced caps on payday loans to limit the amount that borrowers will have to pay back at high interest rates. The rules had a significant effect on payday lenders.

2.Have a look at the two stories below and make notes on the different ways payday lenders and borrowers were affected by the FCA rules.

thefintechtimes.com/fcas-rules-payday-loan/

www.bbc.co.uk/news/business-45359395

Be prepared to discuss your thoughts if you are working in a group.

Activity 1.9

Link to study text	1.8.5

Watch the short video about pension auto-enrolment at the web address that follows (sound required): www.youtube.com/watch?v=SULgBOU8mOc

What is your opinion on auto-enrolment? Do you think it is a good or a bad thing for individuals and for society as a whole?

Advantages	**Disadvantages**

Activity 1.10

Link to study text	1.8.6

Make brief notes to explain each of the investments listed below:

Gilts	
Corporate bonds	
Shares	
Unit trusts	
OEICs	
Investment trusts	
Residential property	
Non-financial investments	

Key terms from Topic 1

Assets	Things that a person or a business owns. For a person their assets might include property, jewellery or financial products such as company shares.
Bank rate	The interest rate that the Bank of England uses when it lends money to other banks. Financial services providers take account of the Bank rate when they decide how to set interest rates on their own products.
Bankruptcy	A situation in which a person cannot pay their debts and is the subject of a court order that shares out their assets between their creditors.
Budget	A plan of expected incomings and outgoings over a set time period such as a month. The Budget is also the term given to the government's annual spending plan, which the Chancellor sets out in the House of Commons each year.
Cash-flow forecast	A plan of expected incomings and outgoings over several time periods, such as the next three months or a year.
Cash-flow modelling	A software program that can predict the medium- and long-term impact of different decisions and events on an individual's income, expenditure and savings plans.
Contingency plan	A plan to deal with unexpected changes in income or expenditure.
Coronavirus	Coronavirus disease, known as Covid-19, is a respiratory illness that causes mild to moderate symptoms in a majority of cases but proves debilitating or fatal for a significant minority. It caused a global pandemic with wide-ranging economic effects.
Credit card	A card that allows the holder to make purchases face to face, online or over the phone, and to withdraw cash from an ATM. Unlike a debit card, where the money is taken from the holder's own account, transactions are paid by the card provider. The card holder repays the amount owed to the provider either in one payment or in instalments. The provider charges interest on cash withdrawals from the time the withdrawal is made and on purchases after a certain period.
Credit union	A mutual organisation (that is, owned by its members) that provides a range of financial products to members, eg savings accounts and personal loans.
Deficit	Where expenditure exceeds income.
Discretionary expenditure	Spending on products and services that people want now, and savings towards items they aspire to buy in the future; it is spending or saving that people can choose to do or not.
Disposable income	The amount of money left over once mandatory and essential expenditure has been paid out.
Essential expenditure	Spending on items required to live, eg rent or mortgage repayments, food and drink, water supplier, gas and electricity.
Financial capability	Being able to manage personal finances effectively.
Fixed interest	Paying the same rate of interest until the end of the savings, investment or loan term.

Flexible financial planning	Making financial plans to cover wants, needs and aspirations over the medium to long term, which make allowance for unexpected expenses and changes in circumstance (eg by including saving and insurance).
Hire purchase	A type of secured consumer credit, to finance items such as cars and furniture, which involves the borrower repaying over a number of years.
Income protection insurance	A policy that allows people to manage the risk of loss of earnings over a long term. It pays out a monthly income to insured people who have suffered an accidental injury or long-term illness and who are therefore unable to work.
Individual savings account (ISA)	An account that pays interest tax-free on savings up to a certain level. In 2014 the rules were changed, with a higher limit on the amount that can be saved tax free. Savers can choose to save the entire amount in cash, or in stocks and shares, or in a mixture of the two.
Inflation	A general rise in prices, which means that the purchasing power of money falls.
Insolvency	A situation in which a person cannot repay what they owe because their debts are greater than their assets.
Insurance	Products that give financial protection against certain events. For example, someone who has travel insurance might be able to claim back the cost of a holiday if they have to cancel through illness.
Investments	Money paid into financial products; the aim is that the value of the product will grow over time and so the person will eventually receive back more money than they paid in. Investments are a way of saving over the medium or long term.
Mandatory expenditure	Compulsory outgoings; they do not necessarily apply to everyone but if they do apply, they must be paid.
Money-purchase pension scheme	A pension scheme in which the value of the fund available at retirement is based on the contributions made by an employee (and their employer, in workplace schemes), which are invested. Also known as defined-contribution schemes.
Mortgage	A loan taken out to pay for a property, usually over a long term such as 25 years.
Mortgage payment protection insurance	An insurance policy intended to cover mortgage payments in the event of illness or unemployment.
National Insurance contributions	Money deducted from the pay of people who are employed or self-employed and used by the government to fund state pensions and other benefits.
Non-financial investments	Investments in items such as fine wines, art and antiques, rather than financial products.
Notice account	An account for which the holder has to tell the provider in advance if they want to withdraw their money. If they do not give the provider the required amount of notice, they lose interest on their savings.
Pandemic	Where an infectious disease spreads rapidly to many people across a large region.
Pension	An income that people receive after retiring from work. In the UK people receive a pension from the state; some people also receive pension payments from schemes run by their former employers or arrangements that they have made for themselves.
Personal debt	The debt owed by individual consumers (as opposed to the debts of companies or governments).
Recession	A period of at least six months in which the amount of goods and services the country is producing is shrinking.

Repossession	A legal process whereby a financial institution (eg a mortgage lender) takes ownership of an asset, often a house, because loan repayments relating to that asset have not been met. Repossession is the last resort in the process of recovering money owed.
Savings bond	A savings product held for a fixed period, eg two years. The holder can only make a limited number of withdrawals, or none at all, during that period without incurring a penalty.
Shares	Also known as ‘equities’, investments that represent part-ownership in a company.
Surplus	Income that exceeds mandatory and essential expenditure, which means that an individual can choose how to save or spend it.
Sustainable personal finance	Achieving and maintaining a balance between personal income and expenditure to satisfy needs, wants and aspirations within a budget.

DipFS Unit 3 – Topic 1 – Personal Financial Stability – Summer Term & Holiday TASKS

TASK A - Actively Read Topic 1 chapter and use to help you complete tasks B&C

TASK B - Questions

1. Identify at least **7** effects of the 2007-8 financial crisis in the UK	
2. Give **6** factors that have contributed to increased levels of personal debt over the past 10 years	
3. Identify at least **6** consequences of increased debt levels	

4. Identify **11** ways in which people can achieve personal financial stability and **place them in logical order with 1 being "most important"**	1.
	2.
	3.
	4.
	5.
	6.
	7.
	8.
	9.
	10.
	11.
5. Identify **3** categories of expenditure	
6. Identify **7** criteria that may affect the priorities that someone may set when budgeting	

7. Identify **7** benefits of using a written budget or cash flow forecast?	
8. When and why might you or a financial advisor use a cash-flow modelling programme?	
9. Identify **5** reasons why people may fail to achieve personal financial stability	
10. What are the **5** characteristics of a flexible financial plan?	

11. Identify at least **6** benefits of flexible financial planning	
12. What other type of planning forms part of flexible financial planning?	

TASK C - Financial Products and Services Review Knowledge questions: AIM – To test your understanding of how financial products and the finance industry can support an individual's personal financial sustainability

1. **Payment Solutions** – identify at least 8 ways in which payments can be made

2. **What 3 items are classed as money:**____

3. **List at least 6 technological changes or developments in the past 10-15 years that have made it easier for people to manage and monitor their finances?**

1.
2.
3.
4.
5.
6.

4. **Savings & Investment solutions** – number these in order of the typical level of return (1 = highest 10 = lowest)

Level of return (1–10)	**Savings/Investment product**	**Short, Medium or Long-term product?**	**Level of risk - High, Medium or Low?**	**Initial capital required - High, Medium or Low?**	**How do you get returns?**	**Correct order** ***(leave blank)***
	Shares					
	Regular Savings Account					
	Postal notice savings account					
	Fixed rate ISA					
	Instant access ISA					
	Instant access savings account					
	Unit Trusts (Collective investments)					
	Branch only notice savings account					
	Web only notice savings account					
	Stocks and Shares ISA					

5. Which of the above would be best for an emergency fund?____

6. Which of the above would be classified as investments vs savings?

7. How much money should someone have in a contingency fund?____

____

8. Recommend the most appropriate savings, investment or insurance product that you might use to fund the following situations:

World cruise upon retirement	
Car written off in an accident	
Children’s university education	
Broken boiler	
Meeting mandatory and essential expenses having lost your job	
Deposit for your first flat	

9. What are 8 key features of investments?

1.
2.
3.
4.
5.
6.
7.
8.

10. NS&I Products – Go to their website and find the current interest rates on offer for the following NS&I products:

Product Type	**What type of interest is paid?** (variable or fixed)	**How often is interest paid?** (Daily, weekly, monthly, annually?)	**Current return/interest rate?**
Direct Saver Account			
Income Bond			
Investment Account			
Premium Bond			
Direct NISA			
Children's Bond			

11. Comparison website – Identify at least 4 that people can use to compare different types of financial products:

12. Borrowing solutions – put the following products in order of size of loan (1 = highest 6 = lowest):

Your order	**Borrowing product**	**Context** – example of when would it be used?	**Timescale of borrowing need** – long, medium or short term?	**Correct order** ***(leave blank)***
	Mortgage			
	Credit card			
	Personal loan			
	Store card			
	Overdraft			
	Hire Purchase			

13. What 2 key things can happen when people find themselves "over-indebted" and so find their personal financial stability affected?

1.
2.

14. What are 5 key features of a payday loan?

1.
2.
3.
4.
5.

15. What have been 5 disadvantages of payday loans into the borrowing market?

1.
2.
3.
4.
5.

16. What are 6 key features of a Logbook loan?

17. Protection solutions – what are 4 main categories of insurance and give examples of what they include

Type	**Examples**

18. Differences between protection solutions – complete the following table:

	When/why/what for would this type of insurance be purchased? **AND** What exactly is being covered?	**In what way is insurance paid?** (Lump sum or monthly payments?)	**How long for?** (Set term or indefinite?)
IPI (Income Protection Insurance)			
PPI (Payment Protection Insurance)			
ASU (Accident, Sickness & Unemployment Insurance)			
Critical Illness			

19. How do insurance products support personal financial sustainability?

20. Retirement solutions – what are 2 main benefits of a using a pension as a form of savings & investment for this stage of your life?

21. Pensions – identify 5 types & required information for each:

Type	Who provides or sets it up?	Who is it aimed for?	How are contributions made?	How expensive is it? or what level of contribution is put in?

22. Product Mixes – concerned with realistically assessing whether solution i.e. portfolio of different product groups meets a person's ___________, ___________, ______________________ & ________________________

23. What are the 3 levels of choice that a person needs to have in order to obtain the right portfolio for their financial requirements:

1.
2.
3.

When analysing product portfolios you need to:

1.	
2.	
3.	
4.	
5.	

24. Add in the correct Demand type to the definition and a financial example for each:

Demand Type	**Description**	**Example/scenario that illustrates demand type**
	When two or more commodities are jointly needed to satisfy a single want	
	When demand for a commodity gives rise to demand for another commodity	
	When two products/groups are substitutes of one another and only 1 can be chosen	

25. List 7 factors that can influence the mix of financial products chosen:

	Factor	Explain with example
a)		
b)		
c)		
d)		
e)		
f)		
g)		

26. Implications of Product Mixes/unbalanced financial portfolios (consider short to long term):

If portfolio has:	Possible positive and negative consequences
Higher/ too much borrowings	
Higher levels of savings	

Higher levels of protection	

27. What is ultimate aim when creating a financial portfolio? ____

28. Financial Portfolio evaluation– what 5 main criteria should you consider when **evaluating** a portfolio?

Criteria	Explanation

29. Financial portfolio creation - what 5 main criteria should one consider when **creating** a person's portfolio?

30. What are the key differences between Savings and Investments:

Savings	Investments	What are the costs involved in investing?
? risk	? risk	
? returns	? returns OR ?	
? rate of return	? rate of return	
? Capital Sum	? Capital sum	
? level of protection	? level of protection	
? term	? term	
Value ?	Value ?	

<u>Task D – Complete Topic 1 Activities</u>

<u>Task E - Learn all the Key Terms from Topic 1</u>