Personal Financial Planning

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Introduction

The major components for an individual financial planning include: budgeting and savings planning, credit and borrowing planning, tax planning, investment planning, insurance planning, retirement planning, and estate planning. I have written an article previously that addressed the issues related to budgeting and savings planning, credit and borrowing planning, and tax planning; this article will focus the discussions on investment planning, insurance planning, retirement planning, and estate planning.

Investment planning

There are four major factors that help shape the investment returns: the choice of asset mix, market timing, security selection, and pure chance or luck. The choice of asset mix, among cash equivalents, fixed income instruments and equity, can account for 80-90% of the return achieved. That's why your investment advisor keeps advocating the importance of asset allocations. A person may be able to weigh more in equity if he or she is young, has more wealth, is more risk tolerant, or has a longer investment horizon. On the other hand, the investments would need to shift more toward cash equivalents and debt instruments if the reverse becomes more of the reality.

Investment planning starts with working with your financial advisor throughout the investment management process, which involves defining the investment policy statement; determining the goals in terms of return requirements and risk tolerance; and reviewing the investment constraints, such as liquidity needs, horizon, taxes, legal constraints, and any unique circumstances. Investment management cannot be a one-time static exercise—rather, constant monitoring and a feedback cycle are required, as subjective situations and the outside environment evolve over time.

Although real estate investments are typically less liquid and draw heavier transaction costs, there are people who favour investing in real estate as a portion of their total investment portfolio, perhaps due to real estate's limited supply in nature and the strong likelihood of appreciation in the long run. There are several types of properties for a real estate investment, including residential complex, office buildings, shopping centres, warehouses, and raw land. Each property has different investment characteristics, risk profiles and factors affecting valuation, and thus attract different types of investors. Other than raw land, a real estate investment typically offers a good tax shelter from amortizing the costs of buildings.

Insurance planning

From a personal financial planning perspective, insurable objects include: life; properties, such as home and auto; and liability. Typically, property and liability insurances are more straightforward and involve selecting a suitable insurance company offering appropriate insurance policies. Life insurance, on the other hand, requires more analysis and understanding. Types of life insurance can include: term life, whole life or permanent insurance, universal life, and variable universal life. For an aged wealthy individual, universal life policies could become attractive at some point in his or her life, as these polices offer such values as tax exempt growth, and the flexibility in coverage, premium and investment.

Determining the appropriate amount of life insurance requires a capital-needs analysis, which is conducted by reviewing the assets available, estate obligations at death and income needs of survivors. You should work with your financial advisor in selecting the appropriate insurer and insurance policy. Choosing an insurer that is financially strong is important, as a life insurance policy deals with payouts that could be decades away. You do not want the insurer to become defunct before the time arrives for them to cut a big cheque for your policy. Carefully structured, life insurance can be a very tax-efficient way of passing wealth to next generations. When a person's sickness and disability are considered, the variables involving one's life start to kick in, and policies such as disability insurance, critical illness insurance, and long-term care insurance are offered. Also, group life insurance and extended health insurance, which are typically offered at your workplace, form part of the total consideration for insurance planning.

Retirement Planning

Retirement planning focuses on ensuring enough income is available to maintain the desired lifestyle after retirement. As a social security measure, government pension (Canada Pension Plan) and income security programs (Old Age Security and Guaranteed Income Supplement) could offer a partial safety net. However, these public pension and security plans may not provide adequate financial resources to maintain your pre-retirement lifestyle. Accordingly, private pension and savings such as RRSP (Registered Retirement Savings Plan) come to play a critical role as part of retirement planning. For a typical employed person, contributions to RRSP offer tax advantages during his or her working life while ensuring savings are accumulated on a tax-deferral basis. A rule of thumb is that during retirement you may need about 70% of the spending level you maintained before retirement. In essence, retirement planning involves determining the financial goals and resources that will be needed during retirement, and charting the paths to achieve them.

Estate Planning

Estate planning is about providing for others and thus deals with the final chapter of your life. It involves planning for the preservation and allocation of your wealth after your lifetime into the hands of your family, your business partners, charities, or anyone else you love and care for. People joke about the many uncertainties in one's life, yet two things are absolutely certain: death and tax. Acknowledging these certainties and organizing your thoughts and wishes goes a long way towards making sound plans for your estate. Having a well-thought-out will is the cornerstone of estate planning; it ensures that you do not die intestate and that your estate will be distributed in an orderly and efficient fashion according to your wishes. Strategies for not incurring probate fees include not dying intestate, designating beneficiaries and having assets held in joint ownership. Arguably, not everything needs to wait until a person's death. Therefore, gifting—distributing wealth during life—could be considered part of the holistic estate-planning process. Such considerations as purchasing life insurance policies, establishing trusts and being familiar with the constraints under Family Law are important vehicles in structuring your estate plans.

Power of attorney (POA) serves as a companion to a will. It deals with the situations calling for someone else to deal with your financial or medical affairs on your behalf. While wills deal with matters after life, POAs are important when one is still alive. Finally, planning for your funeral and other last expenses, such as final medical bills and unpaid taxes, is important if you do not wish to burden your loved ones with worrying about these arrangements when they are in their most sorrowful moments.

Final Words

Financial planning is a continuous process that requires periodic review and plan updates. A financial plan ensures that you are living within your means, preserving financial resources where legally permissible, preparing for the unexpected and investing for your future. Preparedness affords opportunities and helps you avoid crises—otherwise you could easily lose your direction and objectives in the financial jungle. Carefully constructed and updated periodically, a financial plan can help you take off and see more clearly where you are heading; it serves as a compass in dealing with your financial affairs so that you can let your money work for you, rather than keep yourself in the dire situation of always working for money.