

# Section 3: Saving, Payment, and Credit

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# Financial Plan: Saving & Payment Account

# Section objectives

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1. Analyze factors that affect selection and use of financial services
2. Compare the types of financial institutions
3. Compare the costs and benefits of various savings plans
4. Identify the factors used to evaluate different savings plans
5. Compare the costs and benefits of different types of payment accounts

# Let's play game !!!

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- ▶ Each group will start the game with **100,000 bt** cash and 0 bt savings. Try to save as much as possible by the end of the class. Those groups who collect top3 savings will receive 10, 9, and 8 pts as participation score respectively.
- ▶ I will randomly call a group to answer a question unless any group is volunteered. If you answer correctly, you will have to choose a number from 1 to 20. Each number will represent a thing you have to buy.
- ▶ The group who gets the right answer will be able to assign any other group to buy that thing.
- ▶ Any group who all members show up today will receive
  1. 50% discount rate once that thing is assigned to your group
  2. “Push back privilege” (can be used only once)

# A cash management strategy

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- ▶ Banks, saving and loan associations, credit unions, and other financial institutions provide a **variety of financial services**
- ▶ Account services provide customers with online banking offering deposits, investments, credit cards, loans, mortgages, and rewards programs
- ▶ Cash, check, credit card, and debit cards are the most common payment choices

# Question 1: how common it would be?

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- ▶ How many students in this class have got
  - ▶ Only cash?
  - ▶ Cash and debit card?
  - ▶ Cash and credit card?
  - ▶ Cash, debit card, and credit card?
- ▶ Which choice is the most popular?

# A cash management strategy (2)

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Common mistakes in managing cash include...

1. Overspending from impulse buying and using credit cards
2. Not having enough liquid assets (cash and checking account) to pay current bills
3. Using savings or borrowing to pay for current expenses
4. Failing to put unneeded funds in an interest-earning savings account or investment plan

# A cash management strategy (3)

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## TYPES OF FINANCIAL SERVICES:

- ▶ **Savings**

- ▶ Time deposits in savings, CD's, fixed-deposits

- ▶ **Payment services**

- ▶ Checking accounts are called demand deposits
- ▶ Automatic payments

- ▶ **Borrowing** for the short- or long-term

- ▶ **Other** financial services:

- ▶ Insurance, investment, real estate purchases, tax assistance, and financial planning are additional services you may use

# A cash management strategy (4)

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## **Other** types of financial services

### ▶ **Asset management account**

- ▶ Also called a cash management account
- ▶ Offered by brokers and financial institutions
- ▶ Provides a complete financial service program for a single fee, benefits include:
  - Tracking money in one location
  - Consolidated statements
  - Lower fees due to higher balance aggregation
  - Ease for tax reporting
  - Ease for communicating financial issues to family

# Online banking

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- ▶ How many students in this class are aware of online banking?
- ▶ How many students in this class use online banking?
- ▶ Question: Will it be more than half of the class?

# A cash management strategy (5)

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## **ONLINE BANKING**

### ▶ Benefits

- ▶ Time and Money savings
- ▶ Convenience for customer
- ▶ No paper trail for identity thieves
- ▶ Online transfer of funds from one account to another
- ▶ E-mail notification regarding due dates

# A cash management strategy (6)

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## **ONLINE BANKING**

### ▶ Concerns

- ▶ Privacy and security
- ▶ Costly ATM fees
- ▶ Difficulty depositing checks and cash
- ▶ Overspending potential
- ▶ Online scams; phishing and e-mail scams

# A cash management strategy (7)

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## OPPORTUNITY COSTS OF FINANCIAL SERVICES

- ▶ Higher rate of return may be obtained at the cost of lower liquidity
- ▶ Convenience of a 24-hour ATM should be considered against service fees

## Question 3: Maximum withdrawal

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- ▶ Maximum daily withdrawal at branches is up to ..... Baht with presentation of your saving deposit passbook and national ID card
  
- ▶ Maximum daily withdrawal at ATM is ..... Baht

# A cash management strategy (8)

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## FINANCIAL SERVICES AND ECONOMIC CONDITIONS

1. Changing interest rates, rising consumer prices and other economic factors also influence financial services
2. Be aware of current trends and future prospects for interest rates
3. Read *Wall Street Journal*, business periodicals, such as *BusinessWeek*, and *Forbes*, and online resources.

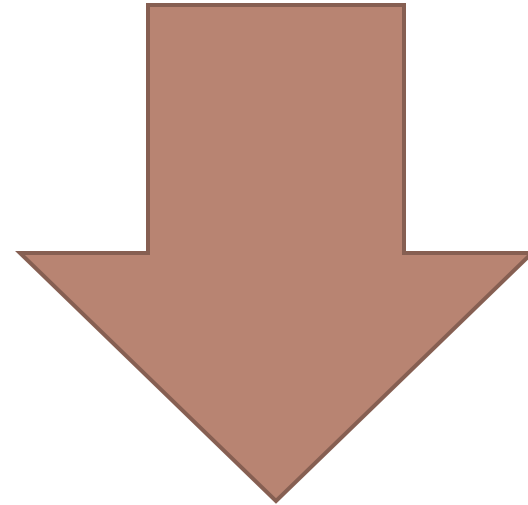
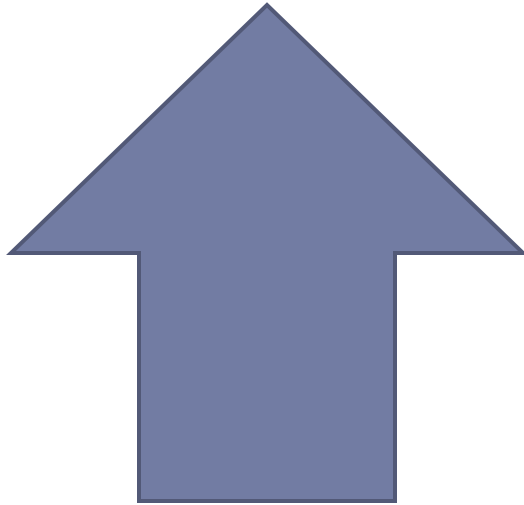
# What are opportunity costs?

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- ▶ **Three main trade-offs regarding cash management**
  1. Risk-return trade-off: higher liquidity means lower returns
  2. Spending/investment risk: cash on hand is easier to spend than other financial assets
  3. Return/time expended risk: since return are smaller with existing cash management assets, the time you spend on managing those assets should be much less than the time you spend managing other types of financial assets

# Changing interest rate

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<b>Interest rates are</b>	<b>Rising</b>	<b>Falling</b>
Loan maturity	Long-term	Short-term
Savings	Short-term	Long-term

# Financial institutions

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## ▶ **Commercial banks**

- ▶ Offer a full range of services including checking, savings, lending and other services

## ▶ **Savings and loan associations**

- ▶ Offer specialized savings plans, loans including mortgages, and other financial planning services

## ▶ **Mutual savings banks**

- ▶ specialize in savings accounts and mortgage loans: they are owned by their depositors

## ▶ **Credit unions**

- ▶ are user-owned, nonprofit cooperative financial institutions

# Financial institutions (2)

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- ▶ **Life insurance companies**

- ▶ Offer insurance, plus savings and investment features; some offer financial planning and retirement services

- ▶ **Investment companies**

- ▶ Are also referred to as Mutual Funds
- ▶ Offer a money market fund on which you can write a limited number of checks

- ▶ **Finance companies**

- ▶ Make short and medium term loans to consumers, but at higher rates

- ▶ **Mortgage companies**

- ▶ Provide loans to customers so they can purchase homes

# Financial institutions (3)

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## ▶ **Pawnshops**

- ▶ Make loans on possessions but charge higher fees than other financial institutions, used for quick cash

## ▶ **Check-cashing outlets**

- ▶ Charge 1-20% of the face value of a check: 2-3% is average

# How to choose a financial institution

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**Step 1:** Prepare a list of important features.

**Step 2:** Rank the top 3 or 4 features, for you.

**Step 3:** Prepare a list of financial institutions.

**Step 4:** Conduct research for decision.

**Step 5:** Make decision based upon above.

# Considering these questions

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- ▶ Are you looking for low costs, low fees, and high returns on deposit?
- ▶ What services are important to you?
- ▶ Do you need loans, mortgages, or working capital for a small business?
- ▶ How important is safety for your deposits?

## Question 4: Commercial banks in Thailand

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- ▶ Make a guess how many commercial banks registered in Thailand?
  - ▶ A. 15 banks
  - ▶ B. 16 banks
  - ▶ C. 17 banks
  - ▶ D. 18 banks
  
- ▶ Can you give me the list of 10 banks?
  
- ▶ Which commercial bank is currently giving the highest saving rate (range)? (As of Jan 25, 2013)

# Saving plans

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## REGULAR SAVINGS ACCOUNTS

- ▶ Usually involve a low or no minimum balance

## CERTIFICATES OF DEPOSITS

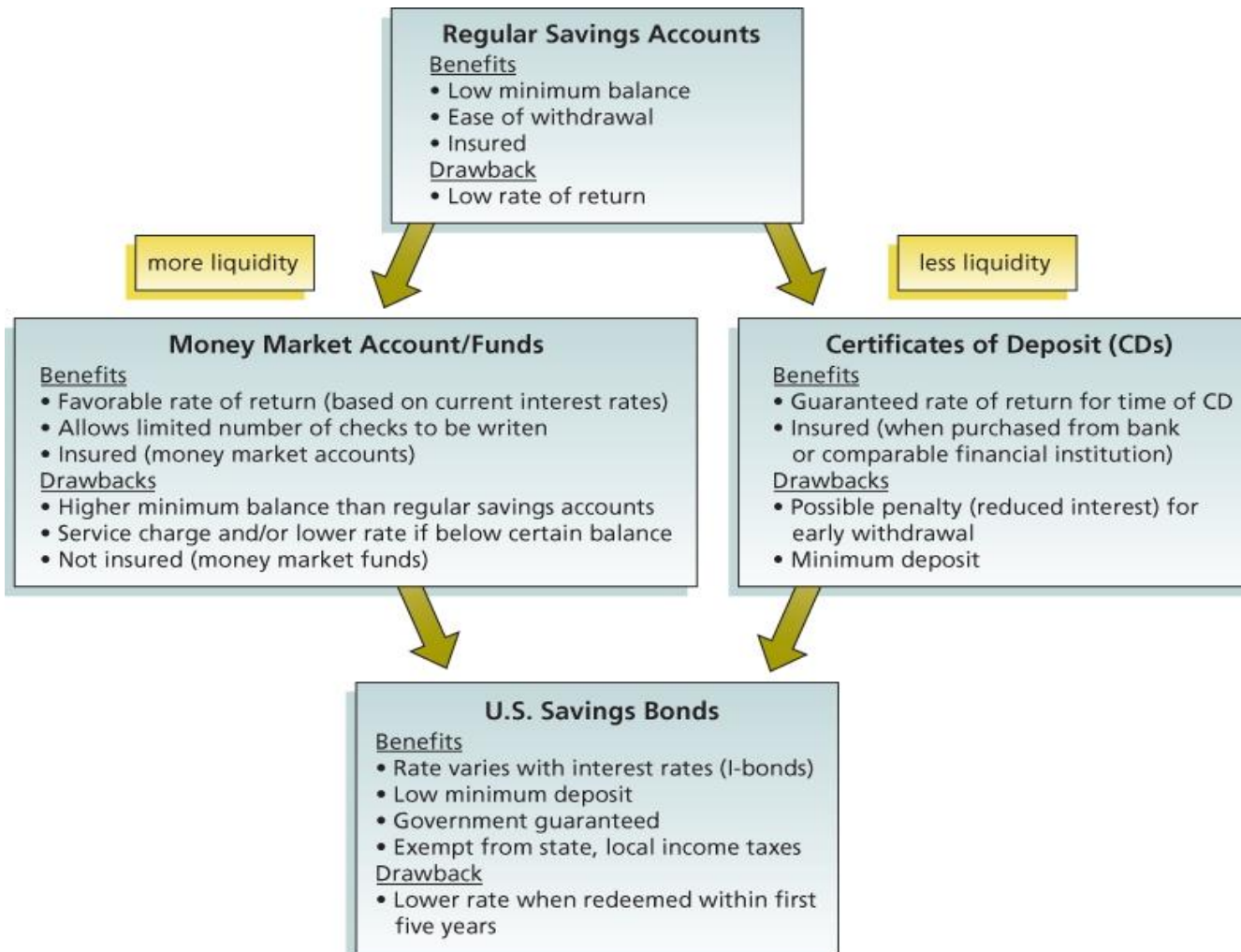
- ▶ Require you to leave your money on deposit for a set time period, otherwise you incur penalties
  - ▶ Several types to chose from
  - ▶ Consider all the earnings and all the costs

## Question 5: Bank account opening

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- ▶ What is the required minimum deposit of **fixed deposit account** opening?
  
- ▶ What is the required minimum deposit of **savings account** opening?

# Saving plans (2)



# Evaluate saving plans

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## RATE OF RETURN

- ▶ Percentage or **yield** is the increase in value due to interest
- ▶ Example: a \$100 savings account that earned \$5 has a yield of 5 percent

## COMPOUNDING

- ▶ More frequent compounding means earning more interest on interest previously earned

# Evaluate saving plans (2)

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## The annual percentage yield

- ▶ Purpose: to provide consistency when comparing different savings options.
- ▶ *Formula:*
  - ▶  $APY = 100 (\text{Interest}/\text{Principal})$ 
    - ▶ NOTE: Formula is applicable when the number of days in the term is 365 or when the account does not have a stated maturity.
  - ▶ Example: Interest of \$60 on principal of \$1,200
  - ▶  $= 100 (60/1200) = 5\%$  (APY)

# Evaluate saving plans (3)

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## INFLATION

- ▶ Compare your APY with inflation rate

## TAX CONSIDERATIONS

- ▶ Taxes reduce interest earned on savings
- ▶ Taxes are not withheld from savings and investments; you may owe additional taxes at year-end as a result of earnings on saving

## LIQUIDITY

- ▶ Allows you to withdraw money on short notice without penalty or fees

# After tax saving rate of return

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- ▶ Taxes reduce the actual rate of return
- ▶ Example: 6% savings yield, 28% tax rate
- ▶ Formula:  $(1 - \text{tax rate}) \times \text{yield on savings}$

$$= (1 - .28) \times .06$$

$$= .72 \times .06$$

$$= 4.32\%$$

- ▶ *Thus, an individual earning 6% on a savings account with a 28% marginal tax rate, would actually have an after tax rate of return of 4.32%.*

## Question 6: An illustration

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- ▶ Your buddy asks you about real returns. After showing him the correct method of calculating real returns, he wants to know what his real return is on his money market account. He shows you his brokerage statement, where he is earning a 4.5% yield. He also estimates that inflation will be 3.5% this year. Your buddy is in the 15% marginal tax bracket.
- ▶ What is his after-tax after-inflation return?
- ▶ What are the implications of this result for cash management decisions?

## An illustration (2)

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- ▶ After-tax return = before-tax return \* (1 - (tax rate))
- ▶  $4.5\% * (1 - (.15)) =$
- ▶ The after-tax return is 3.825%
- ▶ Real Return = (1 + after-tax return)/(1 + inflation) - 1
- ▶ The after tax, after inflation return is:
  - ▶  $(1.03825/1.035) - 1 = 0.31\%$
- ▶ Note: You must take out taxes first, before you take out the impact of inflation.

## An illustration (3)

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- ▶ **Recommendations:**
- ▶ It is very difficult to do much more than keep up with taxes and inflation with liquid assets.
- ▶ Only the amount needed to meet immediate emergency needs and short-term goals should be here.
- ▶ The final returns are even lower when you factor in the fact that you pay tithes on your increase, which is considered charitable giving.

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# **Class assignment 3**

## Comparing a saving plan



# Comparing a saving plan worksheet

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- ▶ Compare at least 4 commercial banks (personal account)
- ▶ Type of deposit
  - ▶ Fixed deposits
  - ▶ Savings account
  - ▶ Current account
  - ▶ Commitment deposit account
- ▶ Deposit rates
  - ▶ Before withholding tax
  - ▶ After withholding tax
- ▶ Which bank will you choose?

# Example

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Bank	Bank A	Bank B	Bank C
Current account			
Savings account			
Fixed-deposit account - 3 month (max/min amount) - 6 month (max/min)			
Committed deposit account - Amount limit - Time limit			
Remark			

# Payment method

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## **ELECTRONIC PAYMENTS**

- ▶ Debit Cards
- ▶ Online Payments –most credit cards now offer this service
- ▶ Stored-value cards
- ▶ Smart Cards

# Payment method (2)

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## EVALUATING CHECKING ACCOUNTS

- ▶ Need to be evaluated based on :
  - ▶ Restrictions
  - ▶ Fees and charges
  - ▶ Interest rate and computation method
  - ▶ Special services, such as overdraft protection

# Payment method (3)

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## ▶ Writing Checks

1. Record the date
2. Write the name
3. Record the amount
4. Write the amount in words
5. Sign the check
6. Note the reason for payment

# Payment method (4)

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## ▶ Reconciling your checking account

1. Used to compare the bank's balance and your checkbook balance.

### 2. Reasons for differences:

- a. Interest earned
- b. Checks that have not cleared
- c. Deposits not yet received by bank

# Payment method (5)

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## ▶ **Certified check**

- ▶ Personal check with guaranteed payment

## ▶ **Cashier's check**

- ▶ Check of a financial institution you get by paying the face amount plus a fee

## ▶ **Money order**

- ▶ Purchase at financial institution, post office, store

## ▶ **Traveler's check**

- ▶ Sign each check twice
- ▶ Electronic traveler's checks - prepaid travel card

# Introduction to consumer credit

# Section objectives

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1. Define consumer credit and analyze its advantages and disadvantages
2. Differentiate among various types of credit
3. Assess your credit capacity
4. Describe the information creditors look for when you apply for credit

# What is consumer credit?

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- ▶ **Credit** is an arrangement to receive cash, goods or services now, and pay for them in the future
- ▶ **Consumer credit** is the use of credit for personal needs, except a home mortgage, by individuals and families

# What is consumer credit? (2)

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- ▶ Three ways consumers can finance purchases
  - ▶ Draw on their savings
  - ▶ Use present earnings
  - ▶ Borrow against expected future income
- ▶ *Trade-offs with each alternative*
- ▶ Consumer credit: A major economic force

# What is consumer credit? (3)

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## USE AND MISUSES OF CREDIT

- ▶ Before you use credit for a major purchase, ask yourself some questions
  - ▶ Do I have the cash for the down payment?
  - ▶ Do I want to use my savings for this purchase?
  - ▶ Does this purchase fit my budget?
  - ▶ Could I use the credit I'll need in some better way?

# What is consumer credit? (4)

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## USE AND MISUSES OF CREDIT

- ▶ Before you use credit for a major purchase, ask yourself some questions
  - ▶ Can I postpone this purchase?
  - ▶ What are the opportunity costs of postponing this purchase?
  - ▶ What are the dollar and psychological costs of using credit for this purchase?

# Advantages of credit

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- ▶ Current use of goods and services
- ▶ Permits purchase even when funds are low
- ▶ A cushion for financial emergencies
- ▶ Advance notice of sales
- ▶ Easier to return merchandise
- ▶ Convenient when shopping

## Advantages of credit (2)

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- ▶ One monthly payment
- ▶ Safer than cash
- ▶ Needed for hotel, car reservations and shopping online
- ▶ Can take advantage of float time/grace period
- ▶ May get rebates, airline miles, or other bonuses
- ▶ Indicates financial stability

# Disadvantages of credit

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- ▶ Temptation to overspend
- ▶ Failure to repay loan may lead to loss of income
- ▶ It does not increase total purchasing power
- ▶ Credit costs money

# Type of credit

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## Closed-End Credit

- Mortgage loans
- Automobile loans
- Installment loans (installment sales contract, installment cash credit, single lump-sum credit)

## Open-End Credit

- Cards issued by department stores, bank cards (Visa, MasterCard)
- Travel and entertainment cards (Diners Club, American Express)
- Overdraft protection

## ▶ **Closed-End Credit**

- ▶ One-time loans for a specific purpose that you pay back in a specified period of time, and in payments of equal amounts
  - ▶ Mortgage, automobile, and installment loans for furniture, appliances and electronics

# Type of credit (2)

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## Closed-End Credit

- Mortgage loans
- Automobile loans
- Installment loans (installment sales contract, installment cash credit, single lump-sum credit)

## Open-End Credit

- Cards issued by department stores, bank cards (Visa, MasterCard)
- Travel and entertainment cards (Diners Club, American Express)
- Overdraft protection

## ▶ Open-End Credit

- ▶ Use as needed until reaching line of credit max
- ▶ Credit cards, departments store cards, bank credit cards, incidental credit
  - ▶ You pay interest and finance charges if you do not pay the bill in full when due

# Protecting yourself against debit/credit card fraud

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- ▶ Sign new cards when they arrive
- ▶ Treat cards like money - keep them secure
- ▶ Shred anything with your account number on it
- ▶ Don't give your number over the phone unless you initiate the call, and don't put it on postcards
- ▶ Get card & receipt after every transaction: compare receipts to bills when they arrive, checking for errors
- ▶ Notify the card issuer if you don't get your billing statement, or if your card is lost or stolen
  
- ▶ Check credit report regularly

# Measuring your credit capacity

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- ▶ Before you take out a loan, ask yourself
  - ▶ Can you afford the loan?
  - ▶ What do you plan to give up in order to make the payment?
    - ▶ Are you prepared to make this trade-off?
- ▶ GENERAL RULES OF CREDIT CAPACITY

Debt Payments-to-Income Ratio

monthly payments\*

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net monthly income

# Measuring your credit capacity (2)

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## GENERAL RULES OF CREDIT CAPACITY

### Debt To Equity Ratio

$$\frac{\text{total liabilities}}{\text{net worth}^*} = \text{Should be } < 1$$

# Credit cards important terms

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- ▶ Credit limit
- ▶ Interest rate: MRR +/-
- ▶ Grace period
- ▶ First entrance fee
- ▶ Annual fee

# Question 7: Credit card business in Thailand

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- ▶ Which bank does currently charge the highest interest rate?
  - ▶ A. BBL
  - ▶ B. Citibank
  - ▶ C. Standard Chartered
  - ▶ D. Krungsri
  
- ▶ Which bank does currently provide the longest grace period? (55 days)
  - ▶ A. BBL
  - ▶ B. Citibank
  - ▶ C. Standard Chartered
  - ▶ D. Krungsri

# Co-signing a loan

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- ▶ The creditor will give you a notice that tells you...
  - ▶ You are being asked to guarantee the debt, so consider if you can afford it if the borrower defaults.
  - ▶ If the borrower does not pay, you may have to pay up to the full amount and also any late or collection fees.
  - ▶ If a payment is missed the creditor can collect the debt from you without first trying to get it from the borrower.

## Co-signing a loan (2)

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### If you do co-sign, consider...

- ▶ Can you afford to pay the loan? If not, your credit rating could be damaged
- ▶ Liability for this debt may prevent you from getting other credit that you want
- ▶ If you put up collateral, you could lose it if the loan goes into default
- ▶ Check your state's law to learn about cosigner's rights
- ▶ Request that a copy of overdue payment notices be sent to you

# Apply for a credit

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## **What Creditors Look For: 5 Cs**

- ▶ **Character** - Do you pay bills on time?
- ▶ **Capacity** - Can you repay the loan?
- ▶ **Capital** - What are your assets and net worth?
- ▶ **Collateral** - What property do you have to pledge that the lender can repossess if you default on the loan?
- ▶ **Conditions** - What economic conditions could affect your ability to repay the loan?

# Class activities summary

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- ▶ Who win? Who lost?
- ▶ What is your strategy?