



Professional Development Programme on Contemporary Perspective of Personal Financial Management

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Course Content

Day Two AM Session

Part 1: Basic Concepts in Time Value of Money

Part 2: Personal Consumer Finance & Credit

Day Two PM Session

Part 1: Risks and Returns

Part 2: Lifecycle Financial Planning Approach

Personal Consumer Finance & Credit

- Major types of Personal Consumer Finance Products
- Selection of Products

Personal Consumer Finance & Credit

Major Types of Personal Consumer Finance Products

Personal Consumer Finance & Credit

- Credit is an arrangement to receive cash, goods or services now, and paying for them in the future
- Consumer Credit is the credit extended to individuals for personal or household use, rather than businesses.
- Broadly defined, consumer credit includes all forms of Installment Credit other than loans secured by real estate (home mortgages, for instance) plus Open-End Credit such as credit cards.
- New forms of credit, however, have blurred these distinctions; a Home Equity Credit line is a revolving line of credit secured by the borrower's home.

Personal Consumer Finance & Credit

- There are 3 ways consumers can finance current purchases, what are they?

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Major types of Personal Consumer Finance Products

- Mortgages
- Personal Loans
- Credit Cards

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What are mortgages?

- A long-term loan secured by real estate
- An amortized loan whereby a fixed payment pays both principal and interest each month
- Residential mortgage loans (RMLs), as defined by the HKMA, are loans (including refinancing loans) to private individuals for the purchase of residential properties, including uncompleted units, but other than those properties under the Home Ownership Scheme, the Private Sector Participation Scheme and the Tenants Purchase Scheme.
- Co-financing schemes refer to those schemes that involve provision of top-up finance by property developers or other co-financiers in addition to mortgage loans advanced by authorized institutions.

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Hong Kong Residential Mortgages Market

Residential Mortgage Survey Results of Survey for February 2007

	(Value in HK\$ million)	
	<u>February 2007</u>	<u>January 2007</u>
23 authorized institutions		
1. <u>New loans drawn down during month</u>		
a. Value	7,826	11,263
M-o-M % change	-30.5%	-19.4%
b. Number	4,731	7,020
2. <u>New loans approved during month</u>		
a. Value	10,357	12,478
M-o-M % change	-17.0%	-6.4%
b. Number	6,244	7,393
c. Average size	1.66	1.69
d. Loan-to-value ratio (%)	61.9	59.1
e. Contractual life (months)	237	239
3. <u>Outstanding loans</u>		
a. Value	529,448	530,208
M-o-M % change	-0.1%	0.2%
Y-o-Y % change	-0.3%	-0.3%

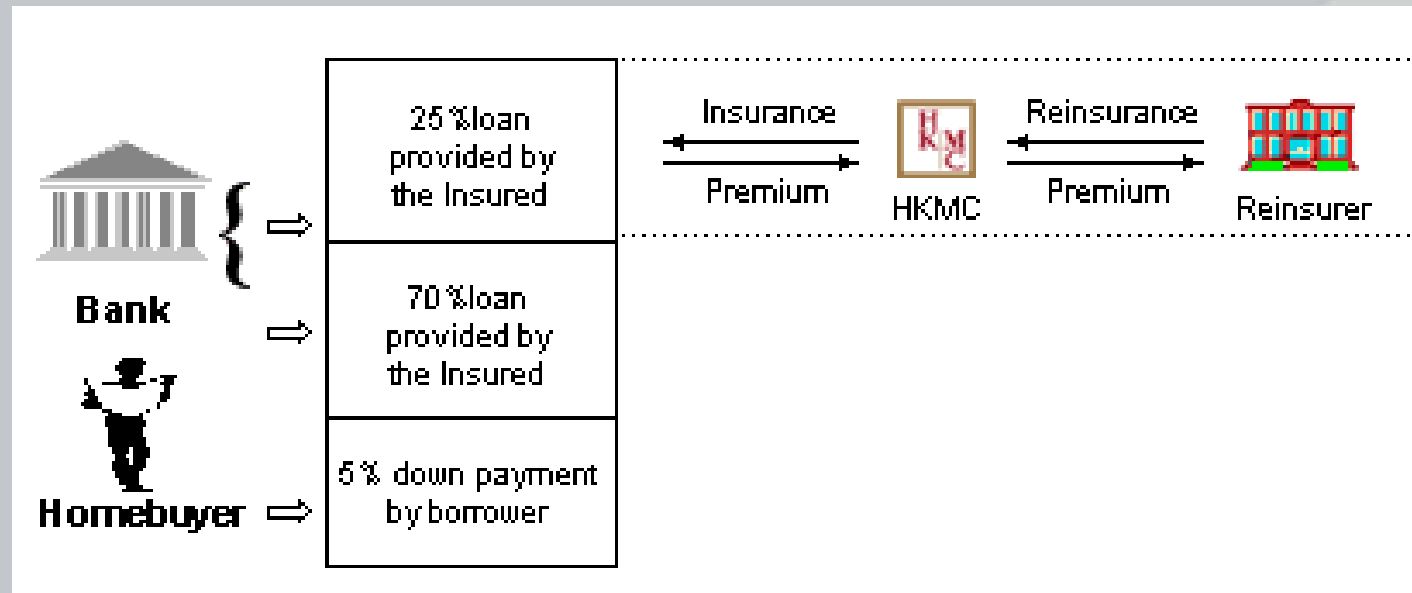
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Insured Versus Conventional Mortgages

- The Mortgage Insurance Programme (MIP) was launched by the Hong Kong Mortgage Corporation Limited in March 1999 with a view to promoting home ownership in Hong Kong.
- It provides insurance coverage to Approved Sellers (i.e. the banks) for an amount of up to 25% of the property value, enabling the banks to advance mortgage loans of up to 95% the property value.
- Through the use of mortgage insurance, the down payment requirement for potential homebuyers is effectively reduced without incurring additional risk to the banks (compared with a loan of up to 70% of the property value).

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Insured Mortgages



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Key Statistics of Mortgage Insurance Programme

	Jan-05	Feb-05	Mar-05
Number of Participating Banks	28	28	28
Accumulated Aggregate Applications Received			
Number of Applications	51,083	52,680	55,647
Total Amount of Mortgage Loans (HK\$ million)	95,247	98,629	104,959
Average Size of Mortgage Loan (HK\$ million)	1.9	1.9	1.9
LTV Ratio at Origination (%)			
80% or below	12	12	12
above 80% and up to 85%	22	22	21
above 85% and up to 90%	56	55	54
above 90% and up to 95%	10	11	13
Types of Property Transaction			
Primary (%)	27	27	27
Secondary (%)	73	73	73
Choice of Premium Payment Method			
Single Payment (%)	95	95	95
Annual Payment (%)	5	5	5

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Interest Rates of Mortgage Loans

- Fixed Rate Mortgages
- Floating Rate Mortgages
 1. Prime-Based Mortgages
 2. HIBOR-Based Mortgages
 3. Composite Interest Rate Mortgages

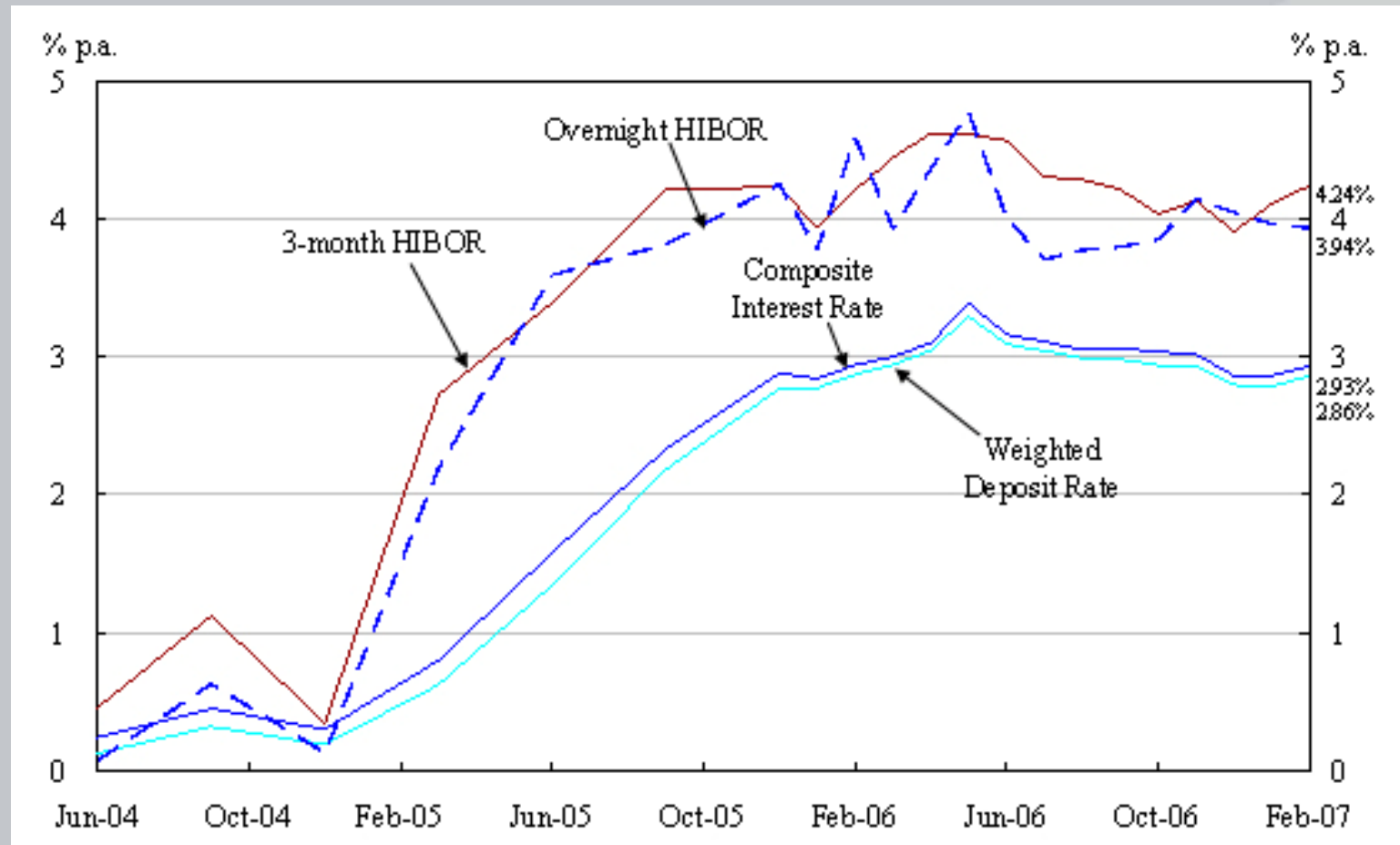
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Best Lending Rates

Effective Date	Best Lending Rates
5 July 2005	6.50%
11 August 2005	6.75%
23 September 2005	7.25%
4 November 2005	7.75%
15 December 2005	8.00%
30 March 2006	8.25%
8 November 2006	8.00%

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Hong Kong Inter-bank Offer Rates (HIBOR) & Composite Interest Rates



Source : HKMA – Press Release Composite Interest Rate (End of February 2007)

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Rates of Residential Mortgages

<u>Interest margin on new loans approved during month</u>	(Value in HK\$ million)	
	<u>February 2007</u>	<u>January 2007</u>
a. More than 2.5% below BLR	62.1%	61.6%
b. More than 2.25% and up to 2.5% below BLR	1.9%	1.6%
c. More than 2% and up to 2.25% below BLR	1.1%	1.1%
d. More than 1.75% and up to 2% below BLR	0.7%	1.0%
e. More than 1.5% and up to 1.75% below BLR	0.5%	0.3%
f. More than 1.25% and up to 1.5% below BLR	0.3%	0.2%
g. More than 1% and up to 1.25% below BLR	0.0%	0.1%
h. More than 0.75% and up to 1% below BLR	0.3%	0.3%
i. More than 0.5% and up to 0.75% below BLR	0.0%	0.0%
j. More than 0.25% and up to 0.5% below BLR	0.0%	0.0%
k. More than 0% and up to 0.25% below BLR	0.0%	0.0%
l. At BLR	0.1%	0.1%
m. Above BLR	0.1%	0.3%
n. Fixed rate	0.0%	0.0%
o. Others	32.9%	33.4%

Source: HKMA's Residential Mortgage Survey Results of Survey for February 2007

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Personal Loans & Credits

- Personal Installment Loan
 - A loan repaid with interest in equal periodic payments
- Revolving Credit Facility
 - A line of credit where the customer pays a commitment fee and is then allowed to use the funds when they are needed
- Overdrafts
 - An instant extension of credit from a lending institution
- Special Purpose Loans
 - Marriage; Tax; Education; Car and Travel etc

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Credit Cards

- Plastic card authorizing the account holder to charge purchases against a pre-approved credit line.
- Credit card purchases normally become payable after a Grace Period (up to 30 days) during which no finance charge is imposed.
- Afterward, the balance due may be paid in full or paid down in monthly installments of principal plus interest.
- Some issuers charge credit card interest from the purchase date if the cardholder's account has an outstanding balance.
- Credit card interest rates, annual fees, and repayment terms may vary considerably.
- Cash Advance is a common features for credit card. Finance charges are paid from the transaction date.

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Credit Cards - Co-Branded Cards

- A credit card can be jointly sponsored by a bank and retail merchant, such as a department store. Co-branded cards can be issued at less cost than conventional retail private label cards, and give issuing banks access to new customers.
- Cardholders may be given incentives, such as discounts on merchandise, rebates, or discounts off purchases.

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Credit Cards - Affinity Card

- Credit card promoted under a sponsoring agreement between an organization and a card issuing bank.
- In exchange for making available its membership list, the sponsor receives some compensation from the issuing bank, usually part of issuer's net interest income.
- The issuer may waive annual fees for affinity cardholders, or even offer the card at a lower rate than ordinary bank cards.

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Credit Cards - Debit Card

- It acts like checks when paying for goods and services or withdrawing cash at automated teller machines.
- Consumer purchases with a debit card, unlike a credit card, do not offer the convenience of paying over time, because funds are withdrawn immediately
- Debit card purchases are free of finance charges, making them advantageous for low-dollar purchases.

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Credit Cards - Travel & Entertainment (T&E) Card

- Card used to pay for hotel, airline, and other business related expenses.
- The first travel card was issued in 1950 by Diners Club, followed by American Express in 1958.

Credit Cards – Chip Card

- Chip cards are cards with an embedded microchip on the face of the card.
- Chip cards store encrypted and confidential information, and therefore offer greater security than magnetic stripe cards. The chip technology is more effective in preventing credit cards from being copied to produce counterfeit cards.

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Major Fees of Credit Cards

- Annual Fee
- Card Replacement Fee
- Late Charge / Finance Charge
- Overlimit Fee
- Cash Advance Charge

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Selection of Products

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Sources of Consumer Finance & Credits

- Credit costs money; therefore, always weigh the benefits of buying an item on credit now versus waiting until you have saved enough money to pay cash.
- Before borrowing money, ask yourself 3 questions:
 1. Do I need a loan?
 2. Can I afford a loan?
 3. Can I qualify for a loan?
- Avoiding credit in two situations:
 1. You do not need or really want a product that will require financing
 2. You can afford to pay cash

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What kind of loan should you seek?

Inexpensive Loans

- Parents or family members are often the source of the least expensive loans. However, such loans can complicate family relationships.
- Money borrowed on financial assets held by a lending institution, for example, the cash value of a whole life insurance policy.

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What kind of loan should you seek?

Medium-Priced Loans

- Often can obtain from licensed banks.

Expensive Loans

- Available from finance companies and banks through credit cards.
- Finance companies often lend to people who cannot obtain credit from banks.
- Any others?

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Cost of Credits

- Finance charge includes interest and fees
- The annualised percentage rate (APR) is the percentage cost of credit on a yearly basis
- The APR provides the true rate of interest for comparison with other sources of credit. This rate lets you compare like with like when shopping for rates

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Formula for APR under the Code of Banking Practice by HKMA

$$A = \sum_{k=1}^n \frac{X}{(1 + \text{APR})^{tk}} \quad \text{where}$$

A = original loan amount

n = number of installments

X = monthly installment amount

tk = time interval, expressed in years, between the relevant date and the date of the kth installment

k = number identifying a particular installment

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Interest Rates for Personal Loans (Sample)

Repayment Period (Month)	5,000 - 14,999		15,000 - 49,999		50,000 - 199,999	
	1.10% flat p.m.		0.85% flat p.m.		0.65% flat p.m.	
	Monthly Repayment* (HKD)	APR	Monthly Repayment* (HKD)	APR	Monthly Repayment* (HKD)	APR
6	178.60	26.90%	176.10	20.79%	174.10	16.07%
9	123.10	28.13%	120.60	21.77%	118.50	16.85%
12	95.30	28.68%	92.80	22.23%	90.80	17.23%
18	67.60	29.00%	65.10	22.57%	63.00	17.55%
24	53.80	28.95%	51.20	22.61%	49.20	17.63%
36	40.00	28.50%	37.40	22.42%	35.40	17.58%
48	33.20	27.96%	30.60	22.11%	28.50	17.42%

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Factors affecting the Cost of Credits

- Term (Length of loan)
- Fixed or Variable interest rates
- Any collateral
- Amount of Down payment

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Choosing and Using a Credit Card

- If you plan to pay each month in full
- Look for a low interest rate if you plan to carry a balance
- Avoid paying only the minimum

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END of this Session