Financial Literacy

In A Nutshell

Debt
Examples of Debt

- Credit card
- Mortgage
- Education loan
- Retail charge accounts
- Vehicle loan
- Overdue bills
Key components of debt

Principal – amount of loan
Interest – usually quoted on an annualized term
Term of loan – loan length or “amortization period”
Amortization – process of gradually pay down loan
Prepayments – paying off your principal earlier
Collateral – what’s the safety net in case of default
Before taking on Debt...

Ask **Yourself** These Questions:

- What is the *purpose* of the loan?
- Does the loan *support my financial goals*?
- How much *total debt* do I have?
- What amount of *monthly payment* can I *comfortably* afford to make?
Before taking on Debt...

Questions to ask Your **Lender:**

- What is the *interest rate*?
- What *fees* are charged?
- What is the *term*, how long until it will be paid off?
- Can the loan be *paid off early*?
Most common form of debt in everyday life
**Credit card**

- Can be **used instead of cash** for purchases
- Liability created, **amount owed** to a third party
- Balance is due and **payable at a later date**
- Interest charged, rate **typically 18% - 20% annual**
- Purchases limited by **credit limit** imposed by bank
- Issued by bank after completed **application is approved**

**Debit card**

- Can be **used instead of cash** for purchases
- A **cash substitute**
- No balance carried, **cash immediately deducted**
- No interest charged
- Purchases **limited by balance** of funds in account
- Generally issued by bank upon opening of a **checking or savings account**
“Used well, a credit card is a secure and flexible way to pay and can be a good way to spread the cost of major purchases. But if you only make minimum payments or run up a bill you can’t pay back, credit cards can be costly.”
Credit Cards

- ...are essentially a loan if you do not pay off the balance each month
- ...have high interest rates due to the risk to the lender and high delinquency rates.
- You have already used the product/service purchased and there is no collateral for the bank.

Select a credit card limit that is reasonable and can be repaid in a short time period
Credit Card Example

Original Balance: $3,000
Interest Rate: 19.95%

The longer it takes to pay off, the larger the total interest paid.

<table>
<thead>
<tr>
<th>Principal and Interest Breakdown</th>
<th>90% Principal</th>
<th>82% Principal</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Principal Paid</td>
<td>$3,000</td>
<td>$3,000</td>
</tr>
<tr>
<td>Total Interest Paid</td>
<td>$333</td>
<td>$662</td>
</tr>
<tr>
<td>Monthly Payment</td>
<td>$277</td>
<td>$152</td>
</tr>
<tr>
<td>Months to payoff</td>
<td>12</td>
<td>24</td>
</tr>
</tbody>
</table>

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Mortgage Illustration

<table>
<thead>
<tr>
<th>Mortgage Details</th>
<th>Loan Summary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan amount</td>
<td>$500,000.00</td>
</tr>
<tr>
<td>Interest rate</td>
<td>6.35%</td>
</tr>
<tr>
<td>Loan term in years</td>
<td>25</td>
</tr>
<tr>
<td>Payments made per year</td>
<td>12</td>
</tr>
<tr>
<td>Loan repayment start date</td>
<td>1/31/2019</td>
</tr>
<tr>
<td>Scheduled payment</td>
<td>$3,329.32</td>
</tr>
<tr>
<td>Scheduled number of payments</td>
<td>300</td>
</tr>
<tr>
<td>Actual number of payments</td>
<td>300</td>
</tr>
<tr>
<td>Years saved off original loan term</td>
<td>0.00</td>
</tr>
<tr>
<td>Total early payments</td>
<td>$0.00</td>
</tr>
<tr>
<td>Total interest</td>
<td>$498,796.44</td>
</tr>
</tbody>
</table>

Payment 1:
- Interest: $2,645.83
- Principal: $683.49

After 5 Years:
- Interest: $2,604.98
- Principal: $724.34

After 15 Years:
- Interest: $1,456.40
- Principal: $1,872.92

Over time, payment remains the same but more is applied to principal (balance) and less to interest.
A $500k 25-year mortgage will result in interest charges as much as the loan. What can you do about this?

• Find the **best possible rate**
• Make a **larger down payment**
• **Prepayments** – pay down your balance ahead of schedule
Bad debt

- Decreases your net worth
- Has higher interest rates
- Can be avoided with good money management
- May hinder your goals and objectives

Good Debt

- Helps grow your assets
- Has lower interest rates
- Can be considered an investment for the future
- Furthers your goals and objectives

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