Business, Accounting and Financial Studies

Basics of Personal Financial Management

Topic 3: Personal Financial Planning and Investments

Name: ____________________________ (   )

Class: ______________

Topic 3: Personal Financial Planning and Investments

Learning Objectives:

(i) Identify the basic characteristics and the relationship between risk and return for the following investments: saving/term deposits, bonds/debentures and stocks.

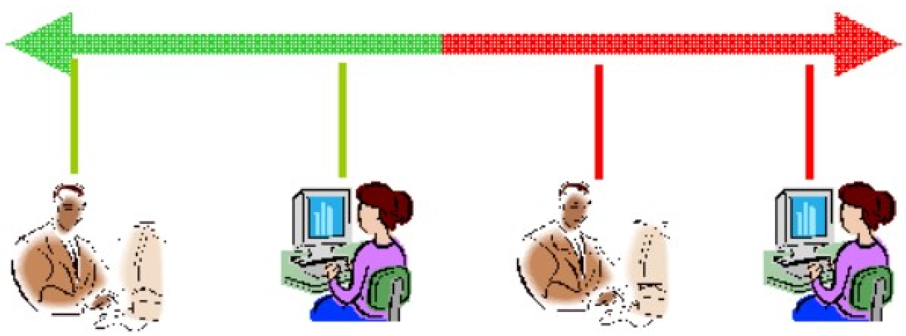
(ii) Explain the importance of personal financial planning at different life stages.

(iii) Describe the rights and responsibilities of employees and self-employed persons under Mandatory Provident Fund.

(iv) Describe the rights and responsibilities of individual investors and consumers of financial services.

Part 1: The characteristics and relationship between risk and return for saving, term deposits, bonds, debentures and stocks

Low Risk, Low Return High Risk, High Return



Conservative | Moderately Conservative | Aggressive | Very Aggressive

Risk and return are always positively related.

"The higher return offered by risky products is to compensate the investors for bearing greater risk."

Are you a risk taker or risk averse? Why?

Difference between saving and term deposit：

	Saving deposit	Term deposit/Time deposit
Liquidity	A saving deposit does not requires depositors to lock up their deposits for a period of time.	A term deposit requires depositors to lock up their deposits for a period of time.
Interest	Saving deposits usually earn a lower interest return than term deposits.	A Term deposit usually earns a higher interest return than saving.

Difference between bonds and stocks:

	Bonds	**Stocks/Shares**
What is it?	Bonds are **debt contracts** which represent claims for repayment at the **maturity date**. Bondholders are the creditors of the issuing institutions.	Stocks, which are also known as shares, represent **the ownership of a company**. Shareholders are the owners of the company. There are two common types of stock, namely preference shares and ordinary shares. They have the similar features, but preference shares have preference over ordinary share. - Preference shares receive dividends before ordinary shares. - The dividend rate is specified on preference shares.

		- The dividend is not guaranteed on ordinary shares. - When the company is liquidated, preference shareholders get back their investment before ordinary shares.
Investor's role	Creditor of firms	Owner of firms
Returns	- Coupon payments - Bond price appreciation	- Dividends - Share price appreciation
Get back the capital	The bondholders have the priority to get back their capital when the company is liquidated.	
Voting rights	No	Yes for ordinary shareholders No for preference shareholders

Risk and Return: (Circle the correct answers)

Products	Risk	Return
Saving deposits Term deposits/Time deposits	Very Low / Low / Medium / High / Very High	Very Low / Low / Medium / High / Very High
Bonds/Debentures	Very Low / Low / Medium / High / Very High	Very Low / Low / Medium / High / Very High
Stocks	Very Low / Low / Medium / High / Very High	Very Low / Low / Medium / High / Very High

Activity

Case 1

Mrs Lee is a housewife. She wants to use her saving of $200,000 to make an investment. She hopes to invest her savings in a financial product that can generate stable and long-term return to her.

Financial product recommended: ________________________

Reason: ____

____

Risk associated with the financial product recommended: _________________

Case 2

Iris is a 20-year-old university student. She has a saving of $30,000 that she earned by doing a part-time job. As she is still young, she does not mind getting her money back after a long period of time. She wants to invest in something that can bring a high return to her.

Financial product recommended: ________________________

Reason: ____

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Risk associated with the financial product recommended: _________________

3. Explain two advantages of investing in bonds over shares.

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4. “High risks of investment do not necessarily bring high returns”. Why?

Part 2: The importance of personal financial planning at different life stages

Individuals usually have different financial needs, priorities and objectives at different stages. Financial planning is important at different life stages because:

- *Deal with daily needs*

  People have different needs at different stages. With personal financial planning, people can set realistic financial goals for themselves and achieve them by following a workable plan.

- *Avoid financial mistakes*

  Proper financial planning can help minimize serious financial mistakes such as overspending and misuse of consumer credit. This enhances an individual's financial freedom.

- *Improve living standards*

  Financial planning helps prevent a decline in living standards when income levels are low.

Activity: What are their financial needs?

 Young single	●		●	Save for a down payment on a house
 Just married	●		●	Save for a wedding
 Married with children	●		●	Save for retirement
 Pre-retirement	●		●	Save for their children's educational expenses
 Retirement	●		●	Need to maintain their preferred lifestyle with a stable retirement income

Financial Needs for different stages:

A. Young single

Characteristic:

Just starts his career

Financial needs:

- Paying daily expenses
- Meeting contingencies
- Create and accumulate wealth
- Plan for buying a house
- Plan for later stages

Wants:

Home purchase, further education, marriage, support their parents, tax payment, etc.

B. Couple

Characteristic:

Two individuals get married

Financial needs:

- Paying daily expenses
- Meeting contingencies
- Create and accumulate wealth
- Plan for buying a house
- Plan for family expenses
- Plan for later stages

Wants:

Child bearing, home purchase, insurance against accidents, saving for retirement, etc.

C. Early family

Characteristic:

Extension of a couple with a newborn child

Financial needs:

- ☐ Paying daily expenses
- ☐ Meeting contingencies
- ☐ Plan for family expenses, e.g. child's education fund and stronger insurance coverage
- ☐ Create and accumulate wealth
- ☐ Plan for buying a house
- ☐ Plan for later stages

Wants:

Set up a fund for the child's education, home purchase, saving for retirement, etc.

D. Late family

Characteristic:

Newborn becomes a teenager.

Just bought a house.

Financial needs:

- ☐ Paying daily expenses
- ☐ Meeting contingencies
- ☐ Prepare money for child's university education
- ☐ Save for future medical expenses and retirement
- ☐ Create and accumulate wealth
- ☐ Plan for later stages

Wants:

Money for children's university education, home purchase, saving for retirement, etc.

E. Pre-retirement

Characteristic:

Children become young singles and financially independent

Financial needs:

- Paying daily expenses
- Meeting contingencies
- Direct more financial resources to retirement planning and medical coverage
- Need to maintain their preferred lifestyle with a stable retirement income
- Plan for later stages

Wants:

Retirement planning: Travel around the world, medical expenses, etc.

F. Retirement

Characteristic:

Final stage of financial planning

Financial needs:

- Estate planning
- Paying daily expenses
- Meeting contingencies
- Hold adequate health insurance

Wants:

Estate planning, travel around the world, medical expenses, etc.

Activity

1. John just finished his university degree and is working in the Tung Wah Hospital as a registered doctor. He is planning to buy a house 5 years later in Tai Po, but he does not have any financial plan so far. Explain to John why personal financial planning is important at different life stage.

Part 3: The rights and responsibilities of employees and self-employed persons under Mandatory Provident Fund

The MPF system is a compulsory employment-based retirement protection system. MPF schemes allow employees to make their own investment choices and enjoy potential capital gains.

Features of the MPF System

Target:

- Regular employees and self-employed
- Persons aged: 18 to under 65

Relevant income levels:

- HK$7,100-$30,000

(More than $30,000: Maximum contribution is $1,500 for employers and employees.)

Mandatory contributions of employees and employers:

- 5% of the employee's relevant income

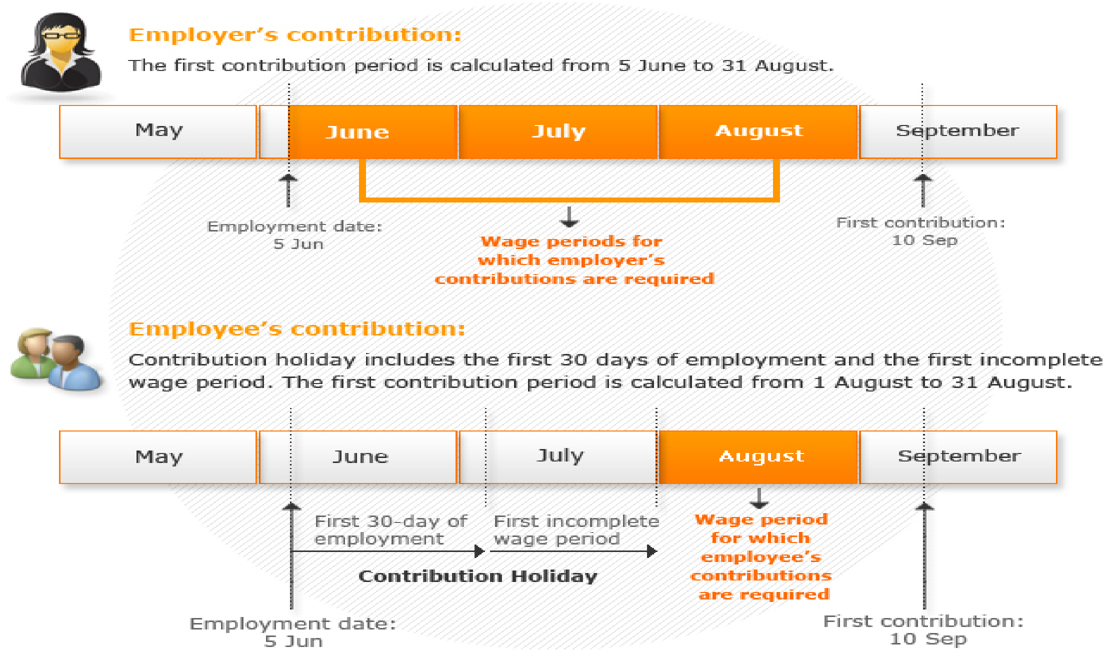
(Maximum contribution is $1,500 for employers and employees.)

Monthly Relevant Income	Mandatory Contributions	
	Employer Portion	Employee Portion
Less than $7,100	Relevant income x 5%	No contribution required
$7,100 to $30,000	Relevant income x 5%	Relevant income x 5%
More than $30,000	$1,500	$1,500

Voluntary contribution

- Employees can make extra voluntary contribution to the MPF account.

First contribution and contribution holiday:



Exempt persons for MPF scheme:

- Domestic employees
- Self-employed hawkers

Withdrawal of the MPF account:

MPF scheme members are only allowed to withdraw their money when they reach the retirement age of 65.

However, in some situations, members can withdraw their money before the retirement age. They are:

- Early retirement at the age of 60
- Permanent departure from Hong Kong
- Total incapacity
- A small balance account of $5,000 or less, and no contribution made to an MPF scheme for 12 months
- Death

Part 4: Rights and responsibilities of employees and self-employed persons under Mandatory Provident Fund (MPF)

	Employees	Self-employed persons
Rights	➢ Receive contributions from employers ➢ Change the scheme ➢ Change the allocations of their contributions in the MPF scheme	➢ Change the scheme ➢ Change the allocations of their contributions in the MPF scheme
Responsibilities	➢ Make mandatory contributions to the selected MPF scheme ➢ Manage their own MPF accounts well ➢ check whether contributions have been properly made ➢ check for any irregular movements in their accounts	➢ Join an MPF scheme ➢ Make contributions ➢ Update information regularly ➢ Inform the trustee of cessation of self-employment

Part 5: Rights and responsibilities of individual investors and consumers of financial services

Investors and customers need to understand their rights and responsibilities of financial services, so they can better protect their interests and avoid losses.

Rights:
1. right to ask for rationale behind an investment recommendation made by a broker or bank
2. right to file a complaint

Responsibilities:
1. duty to understand the terms of a contract before signing it
2. duty to monitor activities on own account by checking account statements, transaction documents

Exam Practice

Part 1: Multiple-choice questions

1. Which of the following is the purpose of personal financial planning?

   A. Diversify income sources from financial institutions
   B. Provide employment opportunities for society
   C. To achieve an individual's financial goals through proper consumption, investment, and retirement planning
   D. Meet the sales target of banks or investment funds while helping clients to make investments

2. The Mandatory Provident Fund Scheme in Hong Kong

   A. Helps employees save for their medical expenses during their retirement.
   B. Ensures that individuals save regularly for retirement before retirement.
   C. Guarantees that employees have sufficient funds for their retirement.
   D. Enables employees to retire any time as long as they have achieved sufficient savings.

3. Which of the following is not related to personal financial planning?

   A. A housewife considers an insurance protection plan for her family.
   B. A financial planner plans to pool money collected from his colleagues to buy Mark Six lottery tickets.
   C. A young married couple considers an investment-linked insurance plan.
   D. A family with a newborn baby compares mortgage loan plans offered by different banks.

4. Dicky considers investing his savings of $250,000 in one of the three financial products below.

	Stock A	Stock B	Stock C
Potential maximum loss	10%	15%	28%
Expected rate of return	10%	15%	25%

Suppose Dicky can afford a loss up to $40,000. Which financial product(s) should he choose?

   A. Stock A
   B. Stock B
   C. Stock A or Stock B
   D. Stock A, Stock B or Stock C

5. Which of the following MPF investments reflects the lowest risk tolerance?

   A. Alison's MPF portfolio has 70% in an equity fund and 30% in a bond fund.
   B. Ben's MPF portfolio has 50% in an equity fund and 50% in a bond fund.
   C. Carly's MPF portfolio has 30% in an equity fund and 70% in a bond fund.
   D. Daniel's MPF portfolio has 70% in a fixed deposit fund and 30% in a bond fund.

6. If Ronald decides to include stocks in his investment portfolio by selling some bonds and withdrawing some money from his bank deposit account, his portfolio is now best described as

   A. Having a higher risk-return trade-off.
   B. Having a lower risk-return trade-off.
   C. Having no risk-return trade-off.
   D. Remaining neutral on the overall portfolio of return and risk.

Part 2: Short Questions

1. Mrs Wong is 57 years old. She is married and has two children aged 18 and 25 respectively. She has already saved about $500,000. She is planning for making investment to prepare for her retirement life.

   (a) List two factors which may affect Mrs Wong's portfolio construction.
   (b) Mrs Wong wants to invest in financial products that can generate stable and guaranteed return to her. Suggest and explain two financial products which is suitable for her investment portfolio.

2. Explain with examples why personal financial planning is not just for rich people.

3. Mr Chan is an accountant and earns $100,000 per month. His wife is 55 years and a self-employed hawker. She earns $50,000 every month.

(a) How much should Mr Chan contribute to his MPF account each month?
(b) Besides the regular contributions, can Mr Chan make any extra contribution? Explain.
(c) Does Mrs Chan need to join MPF scheme? Explain.

Enjoy