BUSINESS, ACCOUNTING AND FINANCIAL STUDIES

PERSONAL FINANCIAL PLANNING AND INVESTMENT

LEARNING OBJECTIVES

1. Explain the importance of personal financial planning at different life stages
2. State the features of different common financial instruments
3. Explain the relationship between risk and return with suitable risk management strategy
4. Draft a financial plan for different life stages
5. Describe employees' rights and responsibilities under the Mandatory Provident Fund System
6. Describe the rights and responsibilities of individual investors and consumers of financial services

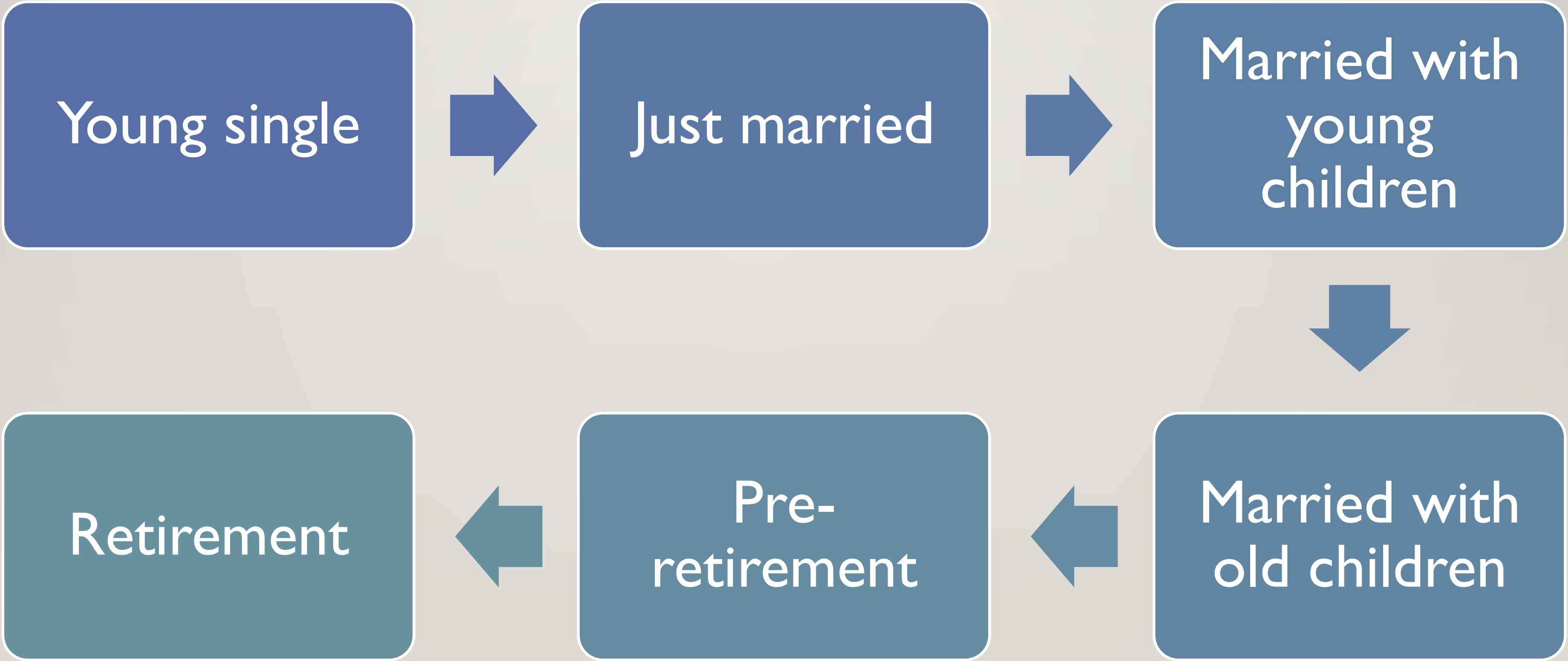
PERSONAL FINANCIAL PLANNING USING THE LIFE-CYCLE APPROACH

- Personal financial planning is the process of evaluating all aspects of an individual's financial needs in order to achieve his financial goals.

DISCUSSION: LIST THE IMPORTANT EVENTS IN ONE'S LIFE

PERSONAL FINANCIAL PLANNING USING THE LIFE-CYCLE APPROACH

- Life-cycle is the combination of different life stages in one's life. *(P.73)*



FINANCIAL NEEDS AT DIFFERENT LIFE STAGES *(P.74)*

Life stages	Financial needs
Young single	Savings for marriage/ salaries tax/ insurance/ down payment/ retirement
Just married	Savings for salaries tax/ insurance/ retirement/ repaying mortgage/ maternity fee
Married with young children	Savings for salaries tax/ insurance/ retirement/ repaying mortgage/ children's education fund
Married with older children	Savings for salaries tax/ insurance/ retirement/ repaying mortgage/ children's education fund
Pre-retirement	Savings for salaries tax/ insurance/ retirement
Retirement	Maintain desired lifestyle/ Estate planning

SELF-REFLECTION: WHAT ARE YOUR INCOME AND EXPENDITURE IN THE LAST MONTH?

Income	Expenditure		
Items	Items	Needs?	Wants?

SELF-REFLECTION: HOW DO YOU MAINTAIN YOUR LIVING STANDARD AFTER RETIREMENT?

INSURANCE FOR PROTECTION

- Saving is a method to store the fruits of our labour in good times in order that we may calmly handle adversities when they come.
- It helps with coping with unexpected changes, achieving future goals and preparing for retirement.

INSURANCE FOR PROTECTION

- How do we protect ourselves by insurance in the following situations?

Situation	Insurance
Travelling	Travel insurance
Having babies (prepare for future expenses)	Children education fund
Save for critical illness	Critical illness insurance

DIFFERENT TYPES OF INSURANCE

Insurance	Function	Targeted clients
Life insurance	Life insurance is a contract between an insurance policy holder and an insurer, where the insurer promises to pay a designated beneficiary a sum of money (the "benefits") upon the death of the insured person.	Everyone (especially for being employed)
Critical illness	Critical illness insurance or critical illness cover is an insurance product, where the insurer is contracted to typically make a lump sum cash payment if the policyholder is diagnosed with one of the critical illnesses listed in the insurance policy.	Everyone
Medical Care	Medical Care insurance is insurance against the risk of incurring medical expenses among individuals	Everyone
Education Fund	Education Fund is an insurance product, where the insurer can save money for the child education expenditure in the future.	Parents
Travel	Travel insurance is insurance that is intended to cover medical expenses, financial default of travel suppliers, and other losses incurred while traveling, either within one's own country.	When you go travel

DISCUSSION: WHAT KIND OF INSURANCE IN DIFFERENT LIFE STAGES?

Life stages	Insurance needed
Young single	Life insurance/ Critical illness insurance/ medical care insurance
Just married	Life insurance/ Critical illness insurance/ medical care insurance
Married with young children	Life insurance/ Critical illness insurance/ medical care insurance/ children education fund
Married with older children	Life insurance/ Critical illness insurance/ medical care insurance/ children education fund
Pre-retirement	Life insurance/ Critical illness insurance/ medical care insurance
Retirement	Life insurance/ Critical illness insurance/ medical care insurance

SELF-REFLECTION: WHAT KIND OF INSURANCE DO YOU NEED AT YOUR AGE?

RISK AND RETURN *(P.57)*

- Risk is the uncertainty of an outcome.
- Return (on investment) is the ratio of money gained or lost on an investment relative to the money invested.

DISCUSSION: WHY DO WE DO NOT LIKE TAKING RISK?

TYPES OF RISK *(P.59)*

Difference	Firm-specific risk	Market risk
Effect	It is the risk that is specific to a firm	It is the risk from the overall financial market
Can be diversified in overall investment?	Yes	No
Examples of cause	Strike/ bankruptcy/ government policies on specific industry	Changes in the general economy/ Major political events

RISK-RETURN TRADE-OFF *(P.60)*

- Risk-return trade-off means that if an investor wants to earn higher returns, he has to bear a greater risk.

DISCUSS THE FOLLOWING SITUATIONS AND ITS POTENTIAL PROBLEM

Life stage	Risk in investment portfolio	Potential problem
Young single	Mainly low-risk investment tools	He may not generate enough income for his future expenses
Retirement	Mainly high-risk investment tools	He does not have income to recover from loss as he has retired

RISK-RETURN TRADE OFF

- We should make investment choices according to risk-return trade-off and risk tolerance level
- <u>Risk tolerance level</u> is an indicator of the level of investment risk an investor is willing to assume

Investor's risk tolerance level	Action
Highly risk averse	Only invest in financial products with a very low level of risk, eg: guaranteed return
Does not mind taking an acceptable level of risk	May consider buying low-risk financial products
Willing to accept high level of risk	May invest in high-risk financial products

POINTS TO NOTE WHEN CONSIDERING OWN RISK-RETURN TRADE-OFF

1. High risk, high return
   - Risk and return are positively related in the long-term
2. High risk may also lead to huge loss
   - Risky investment products can produce high actual return, but also lead to huge losses
3. No risk, no return
   - Taking calculated and acceptable risks is a very important part of the financial decision-making process

DISCUSSION: RISK-RETURN TRADE-OFF AT DIFFERENT LIFE STAGE

Life stages	Risk-return trade-off
Young single	High
Just married	High
Married with young children	Medium
Married with older children	Medium
Pre-retirement	Low
Retirement	Low

RISK DIVERSIFICATION WHEN INVESTING IN DIFFERENT FINANCIAL PRODUCTS

Discussion: Rank the investment made by your family according to the level of risk

Highest risk	Lowest risk

COMMON FINANCIAL INSTRUMENT *(P.64)*

Financial instrument	Definition	Risk and return
Common Stocks	The common stockholders of a company have voting rights in important decisions made by the company and the right to receive dividends if declared.	High
Bonds	The long-term debts issued by government and companies. The bond-issuing institution has to pay back the principal to the bondholders on the due date.	Medium
Mutual fund	Mutual operate by pooling funds from investors and investing the money in different securities.	Medium
Gold & Silver	Of all the precious metals, gold is the most popular as an investment.	Low
Futures	These are standardised forward contracts that demand delivery of an asset (or cash value) at a specific date and price.	High
Time deposit	Time Deposits is a money deposit at a banking institution that cannot be withdrawn for a certain "term" or period of time. When the term is over it can be withdrawn. Generally speaking, the longer the term the better the yield on the money.	Low

DISCUSSION: WHAT IF AN INVESTMENT PORTFOLIO COMPRISES OF HIGH RISK OR LOW RISK FINANCIAL INSTRUMENT ONLY?

REFER TO P.4 OF THE NOTES, COMMENT ON YOUR FAMILY INVESTMENT PORTFOLIO IN:
1. CHOICE OF INVESTMENT PRODUCTS BY RISK-RETURN TRADE-OFF
2. PROPORTION OF THE INVESTMENT PRODUCTS

<table>
<tr><th colspan="2">Choice of investment products by risk-return trade-off</th><th>Proportion of the investment products</th></tr>
<tr><td>Financial instrument</td><td>Suitable?</td><td rowspan="5">There is too much ____________ risk/ balanced financial instrument. This is because
____
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____</td></tr>
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DRAFTING FINANCIAL PLAN

Self-reflection: What is your (financial) planning in coming year?

IMPORTANT REMINDERS WHEN MAKING INVESTMENT

1. Estimate the investment horizon
   - An investment horizon is the length of time that you invest to achieve an investment objective. It affects an investor s choice of financial products.
   - Long-term (10 years or more)
   - Mid-term (5-9 years)
   - Long-term (1-5 years)
   - The choice of financial products depends on the investment horizon, which in turn depends on an individual's investment objectives.

IMPORTANT REMINDERS WHEN MAKING INVESTMENT

2. Evaluate the risk tolerance level
   - Risk tolerance level is an indicator of the level of investment risk an investor is willing to assume.
   - One's risk tolerance level is a major factor determining the optimal level of risk-return trade-off for the investor and hence the types of financial products used.

IMPORTANT REMINDERS WHEN MAKING INVESTMENT

3. Risk diversification in financial plan
   - Risk diversification is the strategy used to reduce the risk of investment through a proper mix of high and low-risk securities.

STRUCTURE OF FINANCIAL PLAN

Analyse the financial background

Identify financial goals and needs

Choosing suitable insurance for protection

Choosing suitable financial instrument to generate revenue

EXHIBIT: FINANCIAL PLAN FOR MR. LAM

Background: Mr. Lam is a 30-year-old teacher, earning a monthly income of $40,000. He plans to get married in two years and having children in five years. He contributes 20% and 25% of his income to his family and saving respectively. He plans to buy a flat after his marriage.

Life stage	Young single		
Financial goals and needs	Short-term	Saving for marriage	
	Mid-term	Saving for down payment/ maternity fee	
	Long-term	Saving for children education fund/ retirement	
Income and expenditure	Income		Expenditure
	Monthly salary of $40,000		Contribution to family Travelling Entertainment
Saving	$10,000 each month		

Insurance	Name	Reason
	Life insurance	To provide protection upon the death in accident
	Critical illness insurance	To provide protection for incapacity result from critical illness
	Medical care insurance	To cover the medical fee

Investment (Based on Mr. Lam's investment horizon and risk tolerance level)	Risk tolerance level	High	
	Name	Level of risk	Reason
	Stocks	High	To generate more income for his expenditure in marriage
	Bonds	Medium	To provide fixed and higher return compare with time deposit
	Mutual fund	Medium	To diversify the risk and provide return from different financial products
	Time deposit	Low	To provide fixed return and low risk investment
	He has huge expenditure in the coming years, he needs high risk financial products to generate more income. At the same time, he needs balanced investment		

A MORE COMPLICATED EXHIBIT: FINANCIAL PLAN FOR MANDY

Background: Mandy is a mother of two children, one is three years old and the other is five years old. She is the human resources manager at a small company. Her husband died in a traffic accident last year. Mandy earns a monthly income of $25,000 which just covers the family expenses. To save for the children's educational expenses, Mandy is considering using her husband's estate, $500,000 to invest in one of the following financial products for 10 years:

	Mutual funds	Stock of an SME	Government bonds
Expected annual rate of return	8%	15%	3%
Risk (standard deviation)	5%	32%	1%

Life stage	Married with young children		
Financial goals and needs	Short-term	Saving for children education fund	
	Mid-term	Saving for children education fund	
	Long-term	Saving for retirement	
Income and expenditure	Income		Expenditure
	Monthly salary of $25000		Contribution to family Travelling Entertainment
Saving	nil		

Insurance	Name	Reason
	Life insurance	To provide protection upon the death in accident
	Critical illness insurance	To provide protection for incapacity result from critical illness
	Medical care insurance	To cover the medical fee
	Children education fund	To cover her children education expenditure

FOR RISK TOLERANCE LEVEL

- Response to the question: She has a low risk tolerance level.
- Definition of the concept: Risk tolerance level is medium
- Explanation:
  - She is the only income source of her family and she does not have any saving. She could not afford high investment risk. But she still needs more money for huge expenditure of her children. She needs both medium and low risk financial products.
- Based on Mandy's background and the nature of the financial product, suggest suitable financial product and insurance for her.

<table>
<tr><td rowspan="6">Investment
(Based on Mr. Lam’s investment horizon and risk tolerance level)</td><td>Risk tolerance level</td><td colspan="2">High</td></tr>
<tr><td>Name</td><td>Level of risk</td><td>Reason</td></tr>
<tr><td>Bonds</td><td>Medium</td><td>To provide fixed and higher return compare with time deposit</td></tr>
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</table>

HINTS ON ANALYSING THE INVESTMENT HORIZON AND RISK TOLERANCE LEVEL FOR MR. LAM

<u>The structure of answering a question:</u>

1. Response to the question

+

2. Definition of concept / Key point of the term

+

3. Explanation

DISCUSSION: FINANCIAL PLAN FOR DIFFERENT LIFE STAGES

1. Case 1 - Ivan is an accounting manager in a large accounting company He earns $20,000 per month. He planned to marry Lily. He estimates that he will need $200,000 for the down payment. His wife also has a stable job and her salary is $10,000.
2. Case 2 - Ben is 40 years old and a civil servant with $80,000 salary per month. He is married with 15 years old son. He plans to send his son to study oversea after DSE and his wife is a full time housewife. They have an apartment with monthly mortgage repayment of $21,000 and pay $10,000 to parent each month.
3. Case 3 – Joseph is 65 years old. He plans to retire. He is a composer. His son and daughter have their own family. He lives with his wife a domestic helper.

DISCUSSION: FINANCIAL PLAN FOR DIFFERENT LIFE STAGES

4. Case 4 – Chris is 70 years old. He already retired. He would like to have a fixed amount of income $6,000 regularly to maintain his present living standard. He has 3 million cash at bank.
5. Case 5 – John got married 7 years ago and has a 2 years old daughter. He would like to send her daughter to international kindergarten next year. The school fee is $100,000 per year.

IMPORTANCE OF PERSONAL FINANCIAL PLANNING *(P.70)*

1. Achieve financial goals in life
   - It helps setting realistic financial goals and to achieve by following workable plan
2. Avoid financial mistakes
   - It avoids overspending and misusing consumer credit
3. Maintain living standards
   - It helps prevent decline especially when income level is low and after retirement

INVESTORS' RIGHTS AND RESPONSIBILITIES *(P.79)*

Rights	Responsibilities
1. To be informed of the licence status of services providers	1. Do not allow others to trade on their accounts
2. To receive transactions documents and to ask for clarification of all documents that they sign	2. To monitor their investment account by reading transaction documents and account statements
3. To seek clarification about the rationale behind the recommendations of the broker or financial planner	3. To understand the features, risk and return characteristics of the investment products
4. To complain in case, their investment are mishandled by financial institutions or intermediaries	4. To give clear instructions to their broker or financial planner when placing an order

FEATURES AND CALCULATION OF MANDATORY PROVIDENT FUND (MPF) SYSTEM

- Discussion: How do we maintain our living standard after retirement?

PEOPLE WHO NEED TO MAKE MPF CONTRIBUTION *(P.82)*

1. All employees and self-employed persons aged 18 to 65
2. Being employed for a continuous period of not less than 60 days
3. Both employer and employee have to make contribution based on employee's relevant income each month
   - Relevant income includes: wages, salaries, bonuses, commission, housing allowance
   - If relevant income less than $7,100, only the employer has to make the contribution

CALCULATION OF MPF

- Mandatory contribution is 5% of the employee's relevant monthly income, and
- A maximum relevant monthly income of $30,000

FEATURES OF MPF

Employers	Employees
Both employer and employee can opt to make voluntary contributions	
Required to control their employees in an MPF scheme	Can choose funds provided under the scheme
	Can opt to transfer their portion of contributions and investment returns to another MPF trustee and scheme of their choice once every calendar year
	Accrued benefits can only be withdrawn as a lump sum at age 65