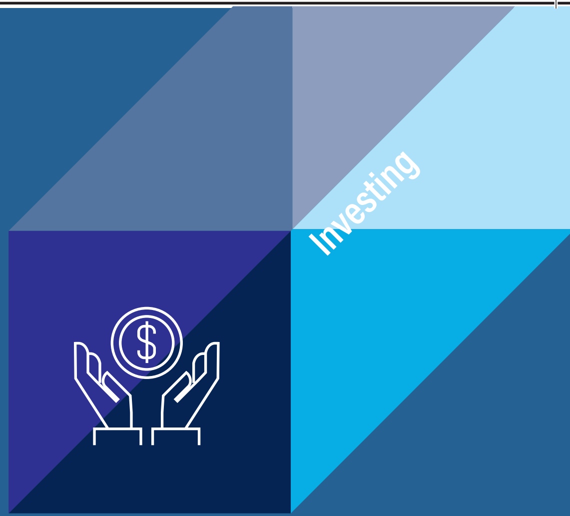
اتحاد مصارف الإمارات
UAE BANKS FEDERATION

FINANCIAL LITERACY
FOR INDIVIDUALS



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WHY IS FINANCIAL KNOWLEDGE IMPORTANT?

Financial literacy is defined as a basic understanding of the structure and functions of financial institutions, the products and services they offer, and the role they play in an individual's money-related plans and decisions. A person who knows how to manage personal finances — including budgeting, making investments, and planning for retirement — is considered financially literate.

Like any knowledge, an understanding of finances liberates and empowers a person. Such knowledge is essential for both individuals and businesses, helping them to manage their finances effectively. This report presents a comprehensive overview of financial knowledge, with best practices and tips for individuals on how to save, invest, and borrow funds effectively, based on their requirements. It also covers relevant aspects of financial crime — such as cybercrime and fraud — and recommends ways to avoid them or to mitigate their effect on an individual's financial position and goals.

How does an understanding of finances help?

Individuals armed with financial knowledge are empowered to make informed decisions that have an impact on their financial future. Being financially educated is the first important step towards becoming financially independent and secure.

The acquisition of financial knowledge has a number of benefits:

1. It encourages an individual to think about and plan for the future.

2. An understanding of debt management and the concepts of risk and return on investments promotes financial discipline.

3. It clarifies the role played by institutions such as banks in the financial life of a person.

4. The knowledge acquired becomes a framework within which individuals can make well-informed decisions about managing their wealth and planning for planning, among other things.

A SHORT DESCRIPTION OF THE BANKING SYSTEM

What is a bank?

A bank is a financial institution licensed to receive deposits and issue loans to its customers. Banks also provide services such as money transfers, currency exchange, trade finance, wealth management, and investment products.

What is a Central Bank?

The Central Bank is an overarching entity that regulates the activities of banks in a country. Central Banks are generally responsible for setting monetary policy, regulating banking operations, stabilizing the national currency, and promoting the overall stability of the country's financial system.

What are the types of banks?

Banks can be grouped under three major categories: conventional banks, Shariah-compliant banks, and investment banks.

TYPE 1

Conventional banks, also known as commercial or retail banks, accept deposits and extend credit facilities such as overdrafts, loans, and trade finance to business customers, as well as personal loans and mortgages to individuals. They also provide savings and investment products to help individuals manage and grow their wealth.

TYPE 2

Islamic banks also provide commercial or retail banking services, but in consonance with Islamic Shariah principles.

TYPE 3

Investment banks provide complex financial products and services to corporations. These include advisory and structuring services for mergers and acquisitions, as well as stock underwriting and trading. Investment banks also provide special investment products and services to high net worth individuals.

Why are banks important?

While an individual's interaction with a bank may be restricted to operating a savings or current account, processing check payments, and borrowing money to acquire big-ticket items for personal use, banks have a key role to play in maintaining a country's financial health.

1

Financial intermediation: A bank acts as an intermediary in the financial system to protect the deposits of individuals and businesses, process payments, and extend finance in the form of overdrafts, loans, and mortgages in a safe and secure environment.

2

Economic development: Banks play a key role in the development of the country's economy by providing finance to individuals as well as to businesses and corporations in diverse economic sectors. They also contribute to economic growth through providing employment opportunities to individuals.

WHAT IS ISLAMIC BANKING?

Islamic banking, a type of commercial financing, is based on the principles of Islamic Shariah. Its major principles are sharing of profit and loss, and, significantly, the prohibition on the collection and payment of interest by lenders and investors. Charging interest, or 'riba,' is not permitted under Islamic Shariah.

Like conventional banking, Islamic banking offers products for financing, savings, and investments. The main difference between conventional and Islamic banking products is that under the latter, conventional interest payments are replaced by profit-sharing arrangements.

In addition, all investments must be Shariah-compliant and must not include anything related to:

✖ Tobacco
✖ Impermissible Entertainment
✖ Alcohol
✖ Other non-halal business

All Islamic financial products undergo a strict review by a board of Shariah scholars to ensure they follow the tenets of Shariah.

Islamic products may include the following:

1. **Islamic current accounts** are non-interest bearing accounts that you deposit funds into, either at no fee or for a nominal fee.

2. **Islamic savings accounts** allow you to deposit funds without earning interest.

3. **Islamic investment accounts** allow you to invest in Shariah-compliant assets to increase income.

4. **Islamic loans** allow applicants to seek financing without paying interest. The bank purchases an asset on the customer's behalf and provides it in the form of a loan at cost-price plus a reasonable profit.

5. **Islamic insurance**, also known as takaful, allows contributors to pool their money in a fund that is used to compensate a participant in the event of a mishap covered by the policy.

WHAT DOES IT MEAN TO BE FINANCIALLY AWARE?

Being financially literate means having the knowledge and skills — and the ability to use them — to manage financial resources effectively, in order to ensure a lifetime of financial well-being. Such knowledge empowers individuals with the ability to make responsible financial decisions in any situation, while also instilling the discipline to save for short-term goals such as paying for a car or a vacation and investing intelligently to create and accumulate wealth.

What are the basic requirements?

Knowledge of the basics of accounting and arithmetic is essential for financial planning and budgeting. A lack of financial knowledge can lead to poorly informed decisions, which in turn can result in handling savings imperfectly and falling into debt. Having the basic financial knowledge helps to avoid these pitfalls and serves as a guide for appropriate decisions that build savings and wealth.

How can financial discipline be developed?

For financial planning to be effective, it is necessary to work in a disciplined manner towards your goal. Knowing the benefits of saving and investing goes a long way towards developing this discipline. A good financial plan clearly identifies a savings goal and outlines the granular steps to achieve it. Each goal requires its own financial strategy; cumulatively, such planning develops a long-term saving habit. Clearly, it is important to have financial knowledge but equally so to practice and implement.

What are the first steps?

The first step on the road to financial freedom is to examine one's finances and decide to save for a specific goal. Once a goal is identified, cataloging and analyzing income and expenses helps to create a road map to achieving the goal. If debt repayments are weighing on the ability to save enough to achieve the goal, explore refinancing options that could result in lower monthly payments and, consequently, more savings.

Conclusion

Constant learning and implementation are important on the road to creating a firm financial footing. Knowledge can be gleaned from reading the financial news and advice columns regularly, which helps to establish a clear plan to stay on top of debt management. This also provides information about investment products with the potential to grow wealth over time. Engaging the services of a financial planner often helps; such trained persons can enhance financial skills, provide guidance, and help achieve financial freedom over the long run.

THE COMPONENTS OF FINANCIAL PLANNING

Managing finances effectively requires planning. But planning itself is a process that requires multiple elements to be in place:

- **Get educated:**
  Take the time to learn about financial institutions and products and understand how to manage finances effectively to establish a secure financial future.

- **Set goals:**
  Forward thinking is the key to be prepared for any situation or contingency that could arise over a lifetime. Develop and implement different plans for medical or career emergencies, for instance. Make sure that every plan suits the individual's particular situation and takes eventual retirement into consideration.

- **Learn the time value of money:**
  The value of a dollar today is worth more than a dollar tomorrow. If they are chosen carefully, financial assets will appreciate in value over time. The value can come from interest payments or other forms of returns on an investment. On the other hand, keep in mind that the value of borrowed money will also expand over time, increasing the burden of repayment.

- **Maintain liquidity:**
  Always have enough funds to cater to short-term needs, even though long-term planning is the primary objective. Always plan for the unexpected and make sure there is enough cash available for surprise short-term expenses.

- **Understand risk and return:**
  It is best to build an investment portfolio with diverse risk levels. Higher-risk assets such as stocks have the potential to bring in high returns, but they may also be extremely sensitive to market and economic "black swan" events and lose significant value. Low-risk assets such as property or debt-market instruments offer lower returns, but also better withstand market risk. Understanding how each works and which to choose depends on an individual's financial position and risk appetite.

The benefits of financial planning

With financial planning, individuals can create plans detailing their own or their family's financial current and future needs and chart ways of meeting them. The plan can cover short-term goals such as buying a new TV set or a car, and longer-term goals such as paying school or university tuitions, or buying a home.

There are five clear benefits to financial planning. These are:

1. Tracking and managing monthly income to put aside money for expenses and savings

2. Increasing cash flow by effectively monitoring spending

3. Increasing personal capital and starting an investment portfolio

4. Building an emergency fund to provide for expenses due to accidents, illness, or other unexpected events

5. Creating a financial safety net in case of unemployment or other negative events

WHAT IS A BUDGET? WHY SHOULD ONE BUDGET?

A budget compares personal income against expenditure and functions as a guide for saving. An intelligently crafted budget can ensure that expenses never exceed income, which means there is always surplus available for regular savings.

How does a good budget help?

A budget will help:

- ✔ Create a spending plan tailored to all income levels
- ✔ Ensure a surplus fund for emergencies
- ✔ Give a clear view of short- and long-term projections based on the current financial situation
- ✔ Prevent falling into debt
- ✔ Promote a financially stable future

What are the steps involved in creating a budget?

1

Set goals: Clear goals help maintain discipline. Break down each goal to identify what is important. For instance, when buying a car, compare costs, models and features. Use projected savings from the monthly surplus to choose the best fit, and to create a timeline for saving or to research financing options.

2

Record all income and expenses: Create a spreadsheet to record all income and expense on a monthly or recurring basis. Recurring monthly expenses can range from personal shopping and groceries to utility bills, transport, rent, and loan repayments.

3

Categorize essentials and non-essentials: For a budget to be effective, distinguish clearly between expenses that are essential and those that are not. For example, rent, groceries, and electricity bills are essential. Non-essentials are usually leisure-related and can include entertainment, vacations, and luxury shopping, among other things.

4

Create a budget: With this financial data clearly laid out, it is time to actually create the budget. Prioritizing different expenses will help eliminate some and enable you to keep expenditure within the limits imposed by income. After completing the first draft, revisit each goal, and create the steps to fulfilling it.

5

Stay disciplined: Preparing a budget doesn't guarantee financial safety. This can only happen by strictly following the steps to your financial goals and carefully monitoring all income and expenses. Remember, the first budget need not be perfect. When using a budget for the first time, review it every month to make sure it still reflects actual income and spending habits, and introduce changes whenever necessary.

UNDERSTANDING THE BASICS OF SAVINGS

Savings essentially comprise the money left over after paying all necessary expenses such as rent, food, and transport.

However, some effort is necessary while planning and tracking expenses to ensure that money is saved every month. With planning, savings can grow into a nest-egg for a comfortable future.

Why are savings necessary?

There are three good reasons to save.

REASON 1

Saving for emergencies: From individual's perspective, unexpected events may arise at any time. Therefore, you should be prepared for such emergency events whether they are minor or major. Savings are recommended for major emergencies such as losing a job as well as for minor emergencies, such as needing to buy a new laptop. Being prepared for such events leaves you free to focus on the other, non-monetary aspects of crisis management. Personal savings are the most expedient source of such emergency funding.

REASON 2

Saving for the future: Plan regular investments to utilize your savings. There are multiple options and most require money to be deposited regularly. Your investments can grow over time so that the accumulated sum will be enough to meet basic future needs.

REASON 3

Saving for retirement: Timing your retirement poses the challenge of planning for expenses when you no longer have a steady salary. This means that money to cover expenses has to come from other sources. Savings can be accumulated regularly into your own retirement fund or retirement account. The earlier you establish a retirement plan, the larger the income you can expect after retirement.

Types of savings products

1

Recurring-deposit savings accounts help customers set aside a fixed amount of money every month. This account is ideal for individuals who want to meet a short-term financial goal.

2

Investment-linked savings accounts are where a portion of savings will be put into an investment fund linked to the account.

3

Fixed-deposit savings accounts allow customers to set a fixed amount to be deducted from a current account and shifted into a savings account every month.

4

Family savings accounts allow customers to save for long-term family goals such as children's education or buying a house.

5

Gold investment accounts convert a portion of savings into gold investments, enabling savings account-holders to earn profit from their gold investments over time.

Five tips for a secure financial future

PLAN A BUDGET:
To calculate how much you can save every month, carefully track all your monthly expenses. Create a long-term budget, which covers current and future expenses.

FOLLOW A SAVINGS PLAN:
A comprehensive budget makes it easier to follow a robust savings plan. Once recurring expenses have been tabulated, the rest of the money can be channeled into savings and investments. Financial planners recommend saving 10% to 15% of monthly income every month. To make this happen, categorize essential and non-essential expenses.

REDUCE DEBT:
No matter how much is saved, large loan repayments will eat into savings and leave very little for the future. If debt is unavoidable, financial planning experts suggest using 10% to 20% of monthly income for debt repayment.

AUTOMATE YOUR SAVINGS PLAN:
Because most people find it difficult to maintain the discipline of physically transferring money into a savings account every month, banks offer solutions to automatically transfer a recurring amount of money from the main (or salary) account into a savings account or into investments. Automating a monthly savings plan reduces the risk of accidentally going over-budget.

STICK TO A LONG-TERM STRATEGY:
Don't save with only immediate goals in mind. Plan for the future; start right now. Banks have various investment alternatives to suit varied risk appetites. Find the ones that best suit your financial profile.

UNDERSTANDING THE BASICS OF INVESTING

Investing involves purchasing an income-generating asset that may appreciate in value over time. Investments usually have different levels of risk and returns compared to a savings account.

What are the benefits of investing?

Investing in a carefully planned and structured manner helps with:

1

Financial security: A diverse investment portfolio increases financial security. More than one source of income, with different risk profiles, helps grow savings at a pace suited to each person.

2

Wealth creation: Investing a part of monthly savings in the stock and bonds markets, for example, may increase wealth at a much faster pace in the long run compared to the returns from a savings account.

3

Achieving financial goals: Investing is an important step toward meeting financial goals such as buying a house or a car, or paying for education.

4

Preparing for emergencies: Investing is a great way to grow an emergency fund. Emergencies such as illness, and unemployment, can leave one unable to meet expenses if there is no fund set aside for them.

What are the basic steps for investing?

STEP 1

Assess available finances: The first step is to determine the savings available for investment. A portion of savings may then be put into different investments such as stocks or funds. Investments can be made with even a very small amount of money or with large sums. Starting early gives one an opportunity to learn about different investing strategies.

STEP 2

Learn about investing: Get educated about basic investing terminology to make informed decisions. Learn about stocks, bonds, mutual funds, private equity, and certificates of deposit as a first step towards understanding more advanced terms such as portfolio management, diversification, and the relationship between risk and return.

STEP 3

Set investment goals: After identifying finances and learning the basics of investment, the next step is to set an investment goal. Identify long-term goals and start working towards them with an appropriately weighted investment portfolio.

STEP 4

Assess risk levels: Making a sensible investment means choosing assets with the right level of risk. Typically, younger investors tend to prefer riskier investment strategies. Even a balanced equity portfolio may lose value over the short term, but it will likely produce strong returns over decades. Older investors should weight their portfolio with more fixed-income securities to ensure steady value and income while minimizing risk.

STEP 5

Understand the cost of investing: Investments carry their own costs. Before building the investment portfolio, make a note of all related fees. For example, if the investment is being done through a broker, there will be a fee charged by the broker or the brokerage firm. All fees need to be factored into long-term projections.

Major investment products

STOCKS, or equities, are securities that represent a share in the ownership of a company listed on the stock market.

BONDS are long-term debt securities through which bond-holders loan money to a company, or to a government, for a specified period of time and receive regular income in return.

MUTUAL FUNDS are professionally managed portfolios of investments that pool money from a group of investors to purchase stocks, bonds, or other securities, thereby managing risk through diversification of assets.

HOW TO BORROW WISELY AND PRUDENTLY

Borrowing, in financial terms, refers to the act of taking external financing to fulfil short-term or long-term obligations with repayment at a mutually agreed maturity date. This money is usually taken against interest payment, which represents the cost of the money borrowed.

What is debt management?

Debt management is the method of reducing an existing debt burden through a repayment plan, as well as to better handle the debt.

What are the ways to manage debt?

The golden rule is to borrow wisely. Do not apply for a long-term loan for short-term needs. After identifying the need to borrow, ensure that you apply for the loan that meets the exact need — such as a home loan or car loan — and one that is within your means and capacity to repay.

Key pointers in debt management:

1 **Have a repayment plan:** The first step in any financial undertaking is to have a plan. A debt repayment plan should be a coherent part of the monthly budget to ensure that regular, on-time payments are made. This plan tracks the remaining debt and calculates the amount to be repaid each month.

2 **Get a credit counselor:** Seek advice from a credit counselor, who can develop a plan suitable for each financial situation.

3 **Avoid additional debt:** Don't seek additional debt to repay existing debt. This can create a vicious debt cycle, impairing your financial position. Instead, consider refinancing debt at a lower interest rate

4 **Avoid defaulting on the loan:** If you miss one or more monthly payments on a loan, you are considered to have defaulted on the loan. A default comes with penalties and negatively impacts your relationship with the lender. Defaulting on a loan will adversely affect an individual's credit history and score, making it difficult to seek bank financing in the future.

5 **Seek refinancing:** If the interest rate on the debt is too high to handle, consider refinancing as an option to obtain lower interest rates.

What are the customary types of consumer loans?

There are three primary types of loans:

TYPE 1

Personal loans allow individuals to seek financing for personal matters ranging from paying off medical bills to refurbishing a home or taking a vacation.

TYPE 2

Mortgage loans are dedicated to real estate purchases, for which banks request the title to the property as collateral during the repayment period.

TYPE 3

Auto loans help individuals purchase a vehicle and repay the bank over a defined period of time during which the lender holds a lien on the vehicle.

What to keep in mind while applying for a loan

- Submit an application with the required supporting documents.
- Clarify any issues with the bank's relationship officer.
- Read and understand the loan agreement before signing.
- Read the bank's consumer charter and understand your rights and responsibilities.

WHICH COMES FIRST, PAYING OFF DEBT OR SAVING?

Saving is one of the most important steps to achieving financial independence and security. An emergency savings fund is essential.

Taking on some form of debt — credit cards, mortgages, or loans — is common among many young adults. This money may have been used for expenses during emergencies such as unemployment or illness. However, heavy loan repayments can eat into savings, leaving very little to spare.

Should individuals prioritize savings or pay off their debt first? Several factors play into the decision:

1. Analyze your finances:

Understanding your financial position is the first step toward getting rid of debt. How much money are you saving every month after recurring expenses? If you use this money to clear the debt, how much will that leave for the emergency fund? Once you answer these questions, you can plan your payments to include a certain amount each month towards reducing debt, while still setting a little aside for savings. If there is no surplus after debt repayment and other expenses, focus on eliminating your debt. Don't indulge in any non-essential expenses until debt is reduced significantly or paid off entirely.

2. Create an emergency fund:

An emergency fund will help address minor emergencies, such as car repairs or home plumbing problems. An ideal emergency fund amount equals three to six months of monthly expenses. Without such a fund, you may need a credit card or other loans to meet unexpected expenses, which may leave you with a heavier debt burden. Set aside a small amount each month to set up a fund.

3. Understand interest rates:

What are the current interest rates on the existing debt? If the interest rate is high, pay off the debt as quickly as possible. While paying off debts, it is best to prioritize those with the highest interest rates. This will help reduce payments and increase savings. If paying off debts is not an option, consider seeking lower interest rates to refinance the debt.

4. Understand the debt cycle:

Delaying a debt payment in order to save often creates a vicious cycle that is difficult to break. For instance, using credit cards for expenses while putting aside money for savings causes a financial imbalance. A high debt equals high liabilities compared to your savings or assets, leading to a low or even negative net worth. Get out of the debt cycle and focus on building your net worth.

5. Strike a balance:

The optimum strategy is to create a payment plan robust enough to pay off debt and ensure savings. To achieve this, a tight budget is necessary. Consider using automated transfers from a regular salary or income account until the debt is paid off.

Once the debt is completely paid off, continue setting aside a monthly surplus. However, this time, the money should go into building up an emergency fund. Once substantial savings have been accumulated, consider shifting some into investments. This allows higher returns and also opens up additional, diverse revenue streams, adding to financial security.

FINANCIAL FRAUD AND HOW TO PREVENT IT

Fraud takes place when an individual or a group uses illegal or dishonest means to scam others for financial gain.

What are the common types of fraud?

1

Advance fee fraud takes place when a fraudster impersonating an agent requests a payment before a business deal is completed, promising an opportunity to earn money once the funds are transferred. After receiving funds from the victim, the fraudster cuts off communication.

2

Pyramid schemes are conducted on social media and via group presentations. Promoters lure investors into illegal multi-level marketing plans. The swindlers' modus operandi is to recruit as many people as possible to pay off earlier investors, while keeping large chunks of money for themselves.

3

Ponzi schemes are similar to pyramid schemes. Under this investment fraud, the first group of investors is paid from money taken from a new group of investors. Each victim believes their income comes from investments and not directly from others' payments.

4

Identity theft is when personal information is stolen online or offline using a method termed 'social engineering'. Criminals use deception and manipulation to obtain confidential information such as passwords and Personal Identification Numbers (PINs). These are used to assume the victim's identity and access bank accounts and credit cards to steal money or to use the information for other criminal activity.

5

Phishing scams are another method cyber criminals employ to obtain personal information such as passwords and PINs. This type of scam typically sends out spam emails that look like official bank messages requesting personal information. If the victim falls for the ploy, the criminal will obtain enough information to be able to steal money or commit other types of fraud.

Top tips to avoid being a victim:

1. BE AWARE:
Learn about the different types of online and offline scams. Knowing how these schemes work is the first step to protecting yourself against them.

2. KEEP YOUR PERSONAL INFORMATION SECURE:
Never share personal information with unknown contacts by phone, in person, or via email and on forms. If you receive a call requesting personal information, inform them that you will personally visit the bank, or take steps to verify that the call does, in fact, originate from the bank or a trusted authority. Always check the email address of senders to verify the identity of financial, commercial, or spam email. Do not click on insecure or suspicious links.

3. CHANGE PASSWORDS AND PINS FREQUENTLY:
Change online passwords and credit or debit card PINs frequently to prevent personal information from being stolen.

4. MONITOR EACH ACCOUNT AND CREDIT CARD:
Check account statements regularly to confirm there are no suspicious transactions. If there are any, inform your bank immediately and ask them to block your account or card.

5. PROTECT YOUR DATA:
Ensure the security of the internet networks that store your personal information. This will prevent hackers from gaining access and obtaining sensitive information.

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