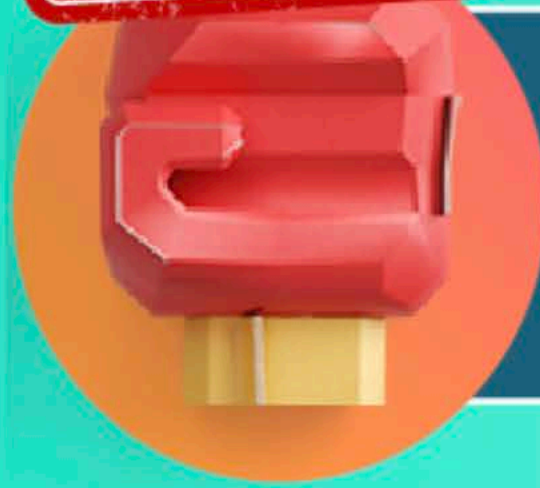

COMMON FINANCIAL TERMS
YOU NEED TO KNOW

Trying to get a grip on your finances, but scratching your head trying to figure out all the financial jargon out there? Financial institutions (and personal finance websites) often throw out acronyms and terms that are hard to understand.

Worry no more, here are common terms you'll run into – and what they actually mean.

What has the power to make you very wealthy, or very broke? No, the answer isn't gambling (that is never the answer). It's interest. You pay interest when you borrow money from the bank, but the bank also pays you interest for keeping money with them.

There are two types of interest:

1 INTEREST

COMPOUND INTEREST

Compound interest is calculated based on the principal amount of the loan/deposit plus any interest earned/charged at an earlier time during your tenure.

For example, if you earned interest in Month 1 in your deposit account, the interest you could earn in Month 2 is calculated based on the sum of the principal amount plus interest earned in Month 1.

In other words, you are getting interest on interest. This is great if you're earning interest, but not so great if you're paying it.

SIMPLE INTEREST

Simple interest is calculated on the principal (or original) amount of the loan or deposit.

2 HOW ARE INTEREST RATES SET?

Ever wonder how banks set your interest rates when you take out a loan or when you place a deposit? Your interest rates are dependent on a Base Rate(BR) which is generally influenced by the Overnight Policy Rate (OPR). That being said, banks can also review their BR based on their availability of funds. OPR is a rate set by Bank Negara Malaysia at which banks borrow funds from each other. Yes, banks may borrow funds from each other from time to time in order to balance any surplus or shortage of funds for the day from loans, withdrawals, and deposits made by customers.

3 DEBT SERVICE RATIO

When you apply for a loan, banks use the debt service ratio (DSR) to see if you can handle your loan commitments. The DSR is essentially a ratio of your income versus debts such as credit card bills, car loans, personal loans, etc. in order to determine your repayment ability.

If your DSR is too high, your bank may either offer you a lower maximum loan amount, or not lend to you at all. It never feels good to get rejected, but this is actually doing you a favour by helping you avoid piling on too much debt.

Banks will generally not lend you money if your DSR is at 60% to 70%. This means that if you are earning RM5,000 a month, you'll have trouble getting a loan if you already have debt commitments of RM3,000 to RM3,500 a month.

4 CREDIT SCORE

Did you know that every time you take out a loan, rack up a credit card balance, and make (or miss) a payment, they are recorded somewhere?

It's stored in a database called Central Credit Reference Information System (CCRIS). Credit reporting agencies like RAM Credit Information Sdn Bhd (RAMCI), CTOS, and the Credit Bureau Malaysia can access this information and come up with your credit score.

In other words, your credit score is a rating of your credit health.

A higher credit score = better = banks will love you more, and will be more likely to lend you money.

What's Next

Now that you are (hopefully) familiar with some of these financial jargon, check out our other guides!

Find out where you stand financially! Get your credit score report and tips on how to improve your financial health from Hong Leong Bank and iMoney today.

Click here for an easy-to-read explanation of credit card interest rates

Click here for terms you'll encounter when you apply for a home loan