Course title: Selected economic and financial risks

Topic 4: Credit risk

T4 processors:

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Aim: The aim of the topic is to acquaint students with the products of commercial financial institutions and socio-pathological phenomena that are the result of financial problems in connection with risk .

Tasks for work:

Answer the following questions

1. Based on what criteria we can distinguish different groups of loans
2. What is the difference between financial and operational leasing?
3. How can we classify deposits in bank accounts?
4. How is execution related to financial risks?
5. How many execution cases are there in the Czech Republic in which parts of the Czech Republic do we record the most cases and how can this fact be caused?

Content:

- Credit risk
- Banking sector products
- Loan
- Saving
- Impacts associated with personal finance risks

Credit risk

Within the types of risks, according to the previously mentioned classification of financial risks, the main attention is focused on credit risk. This is a risk arising from reluctance or inability to repay liabilities. It is referred to as credit because the most well-known banking product that carries credit risk is a bank loan. Bank in the banking system verifies the client's request for a loan of this reason verifies called. Creditworthiness of the client. The scoring model is most often used to quantify this form of risk on the part of the bank.

Banking sector products [1]

LOANS

Loans and their classification

Loans can be defined as temporary funds provided.

For personal and family finances, the classification of loans according to:

- borrower,
- forms of loan provision,
- loan maturity,
- the purpose of using the loan,
- the method of securing the loan,
- currencies, etc.

Consumer loan

The definition of consumer credit can be based on two levels. The first level is the definition according to the *entities to which it is provided* . By consumer loan we therefore mean a loan whose recipient is a natural person. The second level is the *purpose* for which it is provided. For consumer credit, any non-business intention can be considered as the purpose. In principle, a credit that meets both definitions can be considered a consumer credit. However, the most important, and for us the most important definition, is the definition enshrined in the Consumer Credit Act . " *For the purposes of this Act, consumer credit means the provision of funds or deferred payment, for example in the form of a credit, loan or purchase of a leased item, for which the consumer is obliged to pay."*

Consumer loans can be divided into:

- direct and indirect consumer credit,
- short-term and long-term consumer loans,
- special-purpose and non-special-purpose consumer loans,

- secured and unsecured consumer loans.

The concept of APR (annual percentage rate of charge) is closely linked to consumer credit. Always when using interest rate data in the loan offer. (or even in advertising) the annual percentage rate of charge for consumer credit must be indicated. The APR must also always be in the loan agreement. The loan agreement must also contain the number of installments, their amount and distribution over time, the method of payment and the conditions for early termination of the contractual relationship. [2]

The annual percentage rate of charge for consumer credit (hereinafter referred to as APR) is one of a number of economic indicators that in a way indicate the level of payment terms of the credit. According to the APR, the profitability of individual, not only consumer, loans can be assessed. The obligation to inform consumers about a given level of APR is given by the above-mentioned law. Likewise, the formula for calculating the APR is included in the law. The annual percentage rate of charge includes both the interest rate and all costs related to the loan.

Mortgage loan

Act No. 190/2004 Coll., On bonds, defines a *mortgage loan as a loan, the repayment of which, including accessories, is secured by a lien on real estate, even under construction. The loan is considered a mortgage loan on the day the legal effects of the lien arise* .

The amount of a mortgage loan is limited by two criteria. The first criterion is the price of the collateral, the second criterion is the amount of available resources of the client.

The maturity of a mortgage loan is usually determined by the client's ability to repay the loan for the entire maturity period and, of course, is also limited by the life of the property used to secure the loan. A longer maturity of a mortgage loan determines smaller individual loan repayments, but at the cost of a higher volume of interest paid.

The mortgage loan can be drawn down once or gradually. *Repaying a mortgage loan* is the same as drawing it off, it can be either *one-time or ongoing* .

Installment sale

Installment sales can be considered a popular way of purchasing, usually consumer goods. Installment sale is the distribution of the payment of the price of goods over a longer period of time. Although installment sales primarily mean a smaller one-time burden on the wallet, these lower start-up costs are replaced by high interest rates.

Installment sale is one of the options for obtaining goods, where the client does not pay the full price, but only a certain percentage, the *so-called down payment* . The rest is paid in regular installments.

Credit Cards

A credit card is a payment card for which the holder does not have to pay his obligations immediately. The client is entitled, up to a pre-agreed amount, to draw a revolving consumer loan.[3] This loan can be taken out by the client at virtually any time, provided that it does not exceed the set credit limit. Repayment of a credit card loan may not be regular, but usually the bank sets a minimum monthly payment. The bank usually sets a deadline for interest-free settlement. For the client, this means that if he pays his obligation within a given, predetermined period, no interest on the loan will accrue.

Due to the fact that the client decides on the loan itself and that there is a relatively high risk for the bank with the credit card loan , the interest rate often exceeds the interest rates on consumer loans, which are quite expensive in themselves. Due to the given risk, the bank makes the issuance of a credit card conditional on sufficient creditworthiness [4] client.

Leasing

Leasing does not mean anything other than the lease of tangible and intangible assets and rights, where the lessor (the person who leases the property) provides the lessee (or the person) with the right to the thing (or right) for a period or other non-monetary consideration over time. rent to use. [5]

We distinguish between two types of leasing, financial leasing and operational leasing. Financial leasing means a lease in which the leased item is repurchased by the lessee after the end of the lease period . Financial leasing is usually of a longer-term nature, in terms of time it is longer than operating leasing. It usually covers the economic life of the leased property. In the case of financial leasing, the lessor transfers to the lessee all obligations related to the lease of property, whether it is maintenance, repairs, service or more.

We can define *operating leasing* negatively as financial leasing. Unlike financial leasing, the leased property is returned at the end of the lease term . Operating leases tend to be shorter and the lease term shorter than the economic life of the asset. Unlike financial leasing, where the lessor transfers to the lessee all obligations related to the lease of property, whether it is maintenance, repairs, service and others, here all service operations are paid by the lessor.

SAVING

Deposits and their classification

Unlike the previous section, which dealt with loans, the savings chapter takes the exact opposite position. The client does not borrow funds from the bank, but instead stores them in it. He collects interest on this deposit as a reward for allowing another person to use his funds temporarily.[6]

Deposits in bank accounts can be divided into:[7]

- current deposits,
- savings deposits,
- term deposits,
- other deposits.

Current accounts

By their nature, current accounts will not interfere much with the savings chapter, but in order to understand other concepts, it will be necessary to deal with them on at least a few lines. A current account can be considered a basic banking product. This product usually stands at the beginning of the relationship between the bank and the client and gives the premise of using other banking products. The current account is used by clients primarily to deposit temporarily free funds and to make non-cash payments.

Term accounts

Term deposits accounts are accounts on which the bank maintains term deposits of its clients.[8] Term deposits are deposits that usually amount to a fixed amount, and are usually limited by an agreed maturity or notice period. These accounts, as they are limited by maturity or notice, cannot be used in the ordinary course of payments. Term accounts are widely used by clients who have temporarily free funds at their disposal and want to increase their value. The interest rate, unlike current accounts, is higher, but when compared to savings accounts, we find that the interest rate is almost identical today.

Term accounts can be:

- short-term,
- medium term,
- long term.

Likewise, the following can be arranged:

- with a notice period,

- without notice.

The bank usually offers either one-off or revolving term deposits.

Savings accounts

Savings deposits arise in two ways:[9]

- without restrictions, ie according to the client's needs,
- in a certain regime agreed with the bank, which is characterized by regularity of deposit. The storage can be set to either fixed or minimal frame.

The first group of deposits, ie deposits without restrictions, can be further divided into two subgroups:

- so-called personal accounts,
- savings deposits without restriction with a notice period.

Building savings

Building savings according to the law[10] we mean the *acceptance of deposits from building savings participants, the provision of loans to these participants and the provision of state aid (contributions) to building savings participants.*

Building savings should be understood comprehensively (all three previous points together), but it should be noted that many participants in building savings use this product only for savings. This means that a building society provides its clients with two products:

- complete product,
- economical product.

Basic principle of building savings - As follows from the definition of building savings, building savings participants save for a certain period of time, then get back their interest-bearing funds and, if certain conditions are met, are entitled to a special-purpose building loan or state aid.

It can also be considered an advantage that the conditions of building savings are firmly enshrined in the concluded contract and cannot be changed during the duration of the contractual relationship. However, this restriction does not apply to the amount of fees.

The course of building savings - The focus of building savings is, on the one hand, on obtaining relatively cheap resources, which are invested by participants in building savings. On the other hand, building societies have to provide relatively cheap loans.

In principle, we can divide the course of building savings into three phases:

- saving,

- credit allocation,
- repayment of the loan.

Pension insurance

At retirement age, most people in advanced economies receive three types of pensions:[11]

- state pension benefits,
- income from individual old-age accounts,
- income from pension plans.

Supplementary pension insurance in the Czech Republic is optional and is based on the voluntary participation of a citizen of the Czech Republic who has reached the age of at least 18 years. A citizen of another Member State can also participate in supplementary pension insurance, but only if certain conditions are met.

For the purposes of the law, supplementary pension insurance means the collection of funds from participants in supplementary pension insurance and the state provided for the benefit of participants. Handling of these funds and payment of supplementary pension insurance benefits. Supplementary pension insurance may not be provided by persons other than pension funds.

Supplementary pension insurance is expected to fulfill the function of additional pension (income) in retirement age. If we participate in supplementary pension insurance, we regularly invest part of our income in the pension fund. The pension fund further enhances the funds entrusted by us by investing in the financial markets. The assessed amount of money will then be paid to the participants of the supplementary pension insurance at retirement age.

The main advantage of supplementary pension insurance can be considered the state contribution. The state contributes to all participants in a monthly amount from the state budget. The amount of state aid is shown in the following table.

Impacts associated with personal finance risks

One of the manifestations of poor risk management in personal finances is significant debt, which can throw an individual into the so-called debt trap, or a situation in which he is no longer able to meet his obligations. One of the indicators of the existence of such a situation is enforcement proceedings, which have the task of enforcing the fulfillment of legal obligations.

Execution

Execution is the forced performance of the duties of a specific person - the obligor (debtor), who voluntarily did not fulfill what the enforceable decision imposes on him. In other words, it can be said that the creditor (creditor) in execution proceedings, with the help of state coercion, demands the fulfillment of what imposes on the obligor the title of execution. Execution takes place regardless of the will of the liable person, resp. often against her will. A necessary condition for initiating state coercion proceedings, ie for the obligor (debtor) to fulfill the obligations imposed on him, is the existence of an execution title, which must define the entities whose rights are in execution, define what is the content of these rights and obligations and their scope. The content of the execution title is then a clear obligation, the fulfillment of which is to be enforced. [12]

Data on executions in the Czech Republic

As of 22 February 2020, 4,476,069 executions were carried out in the Czech Republic . There are 783,053 active execution cases as of this date . In 2019, 499,512 new executions were added . [13]

Interactive map of executions and crime:

- execution map:
    - http://mapaexekuci.cz/index.php/mapa-2/
    - https://statistiky.ekcr.info/?p=clanek&id=87&nadpis=statistiky&w
- crime map:
    - https://www.mapakriminality.cz/

Resources:

[1] This part of the text is taken over part 3 and 4 of the study support *Personal Finance* from the authors Petr Málek, Gabriela Oškrdalová and Petr Valouch. Source: MÁLEK, Petr; OŠKRDALOVÁ, Gabriela; VALOUCH, Petr. Personal finance. 1st ed. Brno: Masaryk University, 2010. 203 pp. ISBN 9788021051577. chapter 3.)

[2] PŮLPÁNOVÁ, S. *Commercial banking in the Czech Republic* . Prague: Oeconomica Publishing House, 2007, p. 299

[3] PŮLPÁNOVÁ, S. *Commercial banking in the Czech Republic* . Prague: Oeconomica Publishing House, 2007, p. 299

[4] Creditworthiness reflects the degree of ability, possibility or quality.

[5] VALOUCH, P. Leasing in practice. Prague: Grada publishing, 2009: p. 9

[6] PŮLPÁNOVÁ, S. Commercial banking in the Czech Republic. Prague: Oeconomica Publishing House, 2007, p. 256.

[7] ŠEVČÍK, A. Banking I. Brno: Masaryk University in Brno, 2005, p. 52.

[8] DVOŘÁK, P. Banking for bankers and clients. Prague: Linde Prague, 2005, p. 261

[9] PŮLPÁNOVÁ, S. Commercial banking in the Czech Republic. Prague: Oeconomica Publishing House, 2007, p. 259.

[10] Building Savings Act No. 96/1993 Coll.

[11] REVENDA, Z. et al. Monetary economics and banking. Prague: Management Press, 2005, p. 181.

[12] Ministry for Regional Development of the Czech Republic. Execution proceedings. Available [online] at: <https://www.mmr.cz/getmedia/d96d4621-9234-4abc-bb6a-9c1a3e217a3f/Exekuce_28_5_2015.pdf>

[13] Bailiffs' Chamber of the Czech Republic. Basic statistical data. Available [online] at: < https://statistiky.ekcr.info/statistiky>