Manulife Investments

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Simplify your banking. Simplify your life.

Everybody seems to have a fast-paced, needed-it yesterday lifestyle these days. Does the simple life still exist? Sure. And the good news is that when it comes to your valuable time, routine changes can free up precious hours and days. Some simplifications, like how you bank, can save both time and money.

Consider the financial and personal lifestyles of people in their mid-30s to early-50s. Their careers are demanding but fulfilling. They are able to afford things they struggled to get before. Still, they are stretched in every direction. They have full social calendars, and participate in their kids' schedules as well – whether those kids are joining every extracurricular activity imaginable, embarking on a university degree, enjoying "financially assisted" independent living or getting married. Many people in this age group also have parents who require more support and assistance as they grow older.

For this "sandwich" generation, the challenge is managing the present while keeping an eye to the future. They need to spend wisely, putting aside enough money to provide tomorrow's income while meeting their current obligations. A financial plan is important, and a trusted advisor can also help people change their banking and day-to-day finances.

THE WAY WE BANK TODAY

To save minutes in bank line-ups, many people have become self-serve bankers. However, an expanding range of financial transactions (such as debits, cheques, pre-authorized payments and transfers among accounts) is making the job more complex.

Many Canadians have a chequing account to manage daily expenses. Income goes into the account, while bills, mortgage payments and other monthly expenses flow back out. If there is anything left over at the end of the month, the money may be invested or put away in a "high-interest" savings account for a rainy day, emergency or vacation.


Many also have mortgages for their home and perhaps cottage. Loans or lines of credit (sometimes based on home equity) can be arranged for larger expenses, such as new cars, furniture or home renovations. And, of course, there are also credit cards that may provide benefits at a particular store, offer convenience or earn reward points.

SPAGHETTI PLATE MANAGEMENT

The bottom line is that, on average, Canadians likely have eight or nine separate banking products from two or more financial institutions. Sometimes, you may find yourself playing one product against another. For example, you might write a cheque on your chequing account to reduce a credit card balance, only to discover that you need to transfer funds from a savings account because payday is still two days away. Furthermore, you may use a credit card for smaller purchases because you're not sure there is enough money in your chequing account.

In fact, the management of so many different cards, debts and accounts can be such an onerous accounting process that it has been referred to as “spaghetti plate” banking. People often devote so much time and effort to untangling their finances that they resign themselves to muddling their way through. But the problems don't stop there.

DIVERSIFICATION OF DEBT

It's safe to assume that each product has its own set of administrative costs built into the pricing. Each product also has a different interest rate attached to it, based on the risk of defaulting payment to the lender or the benefit to the user.

For example, credit cards often carry an interest rate of 18 per cent or higher because they are unsecured debt. In other words, there's a greater risk a cardholder will not repay the balance because the debt isn't tied to a specific security. Credit cards may also be subject to higher rates because they can be susceptible to fraud. A mortgage, on the other hand, is secured by the property (i.e., the lender can force the sale of the home to recoup the money), so mortgages often offer the lowest rate around.

Professor Moshe Milevsky of York University conducted a study in 2005 that looked at the way Canadians manage their debt. His conclusions and recommendations were very clear: the strategies people use are costing them time and money.

  

He observed that Canadians diversify their debt by "space" (spreading debt over several different products) and by "time." In other words, because of the way people bank, they delay paying off debt even though sufficient money sits idle in their accounts. So they end up paying more in interest costs than necessary.

CONSOLIDATION OF DEBTS AND ASSETS

Professor Milevsky's advice is to eliminate as many banking products as possible by consolidating debts and making better use of short-term, non-registered assets.

For instance, if you can eliminate non-secured credit cards, personal loans, car loans and lines of credit and wrap them all into a single secured loan, such as a mortgage, you could significantly reduce the amount of money you're currently spending servicing the debt at higher interest rates.

As a simple example, if you had a $2,000 credit card debt attracting an 18 per cent interest rate and a personal loan of $8,000 at 7.5 per cent, your monthly interest costs would be roughly $80. If that debt were consolidated into a line of credit at six per cent, the monthly interest cost would be $50 - that's a reduction in cost of almost 40 per cent! Multiplied over time and larger loan amounts, this one change in how you manage your finances could save you thousands.

Milevsky also suggests that there is a more effective way to manage money than having special-purpose savings accounts. Even if your savings are earning three per cent interest, he advocates applying that money against your debt. The interest earned on your savings account is taxable, but using it to pay down your debt means everything you save goes straight into your pocket. How does this work? Taxes will reduce your savings account earnings, but reducing a debt that is charging six per cent means a six per cent after-tax benefit to you.

Why would someone want to use all their short-term assets to pay down their debt? Well, if you're using a line of credit, you can always take that money back out if you need it. Instead of having money sitting idly around earning virtually nothing in pre-tax dollars, you can apply it against debt and save some real money, until you need to use it.

THE IDEAL SOLUTION

Imagine the possible savings if you were able to combine all your debts into a lower interest rate product (such as a secured line of credit), but could also make that line of credit your chequing account. If every deposit into this account reduced your level of debt, then why not flow your income through the account as well?

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That's exactly what "all-in-one" accounts are designed for. An all-in-one account offers a host of advantages:

- It eliminates "spaghetti plate" banking, thereby reducing your banking time and effort
- It offers the potential to significantly reduce interest costs
- It provides a way to maximize the benefit of every dollar you have
- It gives you increased flexibility in monthly payments - now, instead of meeting fixed monthly obligations, you have the option to pay interest only, if you like
- It simplifies your financial life – just one account to worry about and a clear picture of your financial situation, while every banking receipt gives you a snapshot of your finances

Life can be exciting, chaotic and sometimes exhausting. That's why it makes sense to find ways to streamline your activities and reduce the demands on your time and money. A good place to start is by simplifying your banking. Not only can a few easy steps save you time, money and effort today, but this approach can go a long way to helping you get out of debt faster. And that's the first step towards sound retirement planning.

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