

## LIGHTHOUSE CPA SOCIAL SCIENCES DEPARTMENT

### ECONOMICS - PERSONAL FINANCE WORKSHOPS

#### # 3 - BASICS OF BANKING AND SAVINGS



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*Vocabulary Keys : Words that are in **bold** = are terms that appear in one of the chapters , Words that are underlined = supplemental vocabulary . Ask questions about these words if you are not familiar with them !*

#### *Top Things To Know*

*1. Money in a bank account is safe.*

*A bank is one of the safest places to stash your cash since your account is insured against loss by the federal government for up to \$ 250,000 per depositor.*

*2. You pay for the convenience of a bank account.*

*Banks pay lower rates on interest-bearing accounts than **brokerages** and **mutual fund** companies that offer check-writing privileges. What's more, bank fees can be high -- account costs can easily add up to \$200 a year or more unless you keep a minimum required balance on deposit.*

*3. Inflation can eat what you earn from a bank.*

*Even at a low rate of inflation, the annual creep in the cost of goods and services usually outpaces what banks pay in interest-bearing accounts.*

*4. Not all interest rates are created equal.*

*Banks frequently use different methods to calculate interest. To compare how much money you'll earn from various accounts in a year, ask for each account's "**annual percentage yield.**" Banks typically quote both figures, but only APYs are calculated the same way everywhere.*

*5. You can get better rates ( but there's a hitch )*

***Certificates of deposit ( CDs )** offer some of the best guaranteed rates on your money and are insured up to \$100,000 each. The catch: you have to lock up your money for three months to five years or more. If interest rates fall before the CD expires, the bank is out of luck and must give you the rate it quoted. If rates climb, you're stuck with the lower rate.*

*6. ATM fees can take a significant bite out of your budget.*

*The convenience of using automated teller machines is an increasingly pricey one. On average, the fee your bank charges you to use an ATM of another institution is \$1.37, according to a Bankrate.com survey in fall 2004. That's on top of the average \$1.50 that other institution charges you to use its ATM.*

### *7. Getting the best deal takes work.*

*You won't get a great deal on a car if you just walk into a dealer and plunk your money down. Likewise, you won't get a great banking deal unless you comparison-shop and ask about price breaks. For example, a bank might offer free checking if you are a **shareholder** or if you direct deposit your paycheck.*

### *8. Use the Internet to shop for bank services.*

*You can use the Internet to compare fees, yields, and minimum deposit requirements nationwide. To find out what a local bank is offering, plug its name into any Internet search engine*

### *9. Banking online can make bill-paying easier.*

*Electronic bill-paying can save you the monthly hassle of paying your bills. And if you couple online banking with a personal-finance management program, such as Quicken or Microsoft Money, you'll be able to link your banking with your budgeting and financial planning as well.*

### *10. You can bank without a bank.*

*A number of financial institutions offer accounts that resemble bank services. The most common: **Credit union** accounts; mutual fund company money market funds; and brokerage cash-management accounts.*

## *Pick The Right Account*

*Knowing your money habits will help you find the best and least costly account .*

*Banks offer several different types of checking and savings accounts: Some pay interest, some don't. Some offer perks, some don't. Some are specifically for senior citizens or students, while others are geared to those with low incomes. They all share one thing in common, though. They each have restrictions, fees, and opportunities to waive fees if you meet certain requirements.*

*When shopping for a bank, consider:*

#### *1. How much money you plan to park at the bank.*

*The higher your average balance, the more likely you are to get "free" checking with interest. Though minimum balance requirements vary widely from bank to bank, in a fall 2004 survey Bankrate.com found the average balance required for a no-fee, interest-bearing account was \$2,087. If you settle for a non-interest bearing checking account, however, the average minimum balance is just \$206, according to the same study.*

#### *2. How many checks you write a month.*

*Some no-fee accounts limit the number of checks you may write and charge high fees if you exceed that limit. On the other hand, the consumer advocacy organization U.S. Public Interest Research Group suggests if you only write a few checks a month and probably won't meet the minimum balance required to avoid fees, you might benefit from a no-frills, flat-fee checking account.*

3. *How many related banking services you would most likely use.*

*If you want to direct-deposit your paycheck, ask if that entitles you to free or low-cost checking. If you use ATMs frequently, make sure the bank has plenty conveniently located near you. If you use another bank's ATM, you might pay \$3.00 or more for the privilege, once you combine the surcharge imposed by the other bank and the fee your bank charges for going to a competitor's machine.*

4. *How many different types of accounts you might want to set up at the bank.*

*The more accounts you have with your bank, the greater your chances of getting price breaks and perks on its services and products. So if you have a checking and savings account and are taking out a **mortgage** or signing up for the bank's credit card, be sure to ask if you're entitled to any discounts.*

*Using the Internet is one of the easiest ways to compare fees, yields, and minimum deposit requirements nationwide.*

### *Take An Interest In Interest*

*Consider CDs and money market accounts for higher yields .*

*Deciding to put your money in an interest-bearing account may seem like a no-brainer. But sometimes a no-interest checking account may be more cost-effective. Here's why:*

1. *Interest-bearing checking and savings accounts offer the lowest rates around.*

*Sometimes banks offer to add or increase the interest on your account if you maintain a higher average balance. As tempting as this may seem, make sure the expense of maintaining the account doesn't exceed the interest paid. Even if the bank waives its fees when you keep a high average balance, there is an opportunity cost to tying up all that cash in a low-yielding account.*

*Say you pay \$4 a month ( or \$48 a year ) in account and ATM fees. If you earn 2 percent interest, you need to keep at least \$2,400 in your account just to break even. And you'll have a hard time earning any real return on your deposits, even if you don't pay fees. That's because the interest rates you earn on a checking or savings account often don't exceed the average annual inflation rate, which was just a hair over 3 percent from 1926 through 2004. In short, you end up losing purchasing power.*

2 *Consider CDs*

*There are, however, other ways to get better returns at a bank. Instead of parking the majority of your cash in a savings account, you could open a certificate of deposit ( CD ). If you've opened one at your bank, ask if your CD, checking and savings accounts can be "linked" -- that way, you'll have an easier time meeting minimum balance requirements in your checking account. When you open a CD, you agree not to withdraw your money for a period of time ranging from three months to five years or more. The shorter the term of the CD, the lower the rate you'll get.*

*If interest rates fall, you're in luck because the bank must give you the rate it quoted when you bought the CD. If rates climb, however, you're stuck with the rate you agreed to even though it's*

*lower than one you could get if you bought a new CD. ( With inflation and interest rates near historic lows, be careful of locking in for too long a period. )*

*You can get money out of a CD prematurely, but you'll pay a penalty -- typically three months' interest. If you have more than \$100,000, you can put it into a so-called jumbo CD that pays even higher rates. However, any amount over \$100,000 isn't insured, so the excess is only as secure as the bank itself.*

*When opening a CD, be sure you understand whether the rate is fixed or variable, and how often the interest compounds. A CD interest rate can yield different sums of money depending on whether a rate is compounded daily, weekly, monthly, quarterly, or yearly.*

*Banks also offer **money market deposit accounts ( MMDAs )**, which typically invest your money in short-term loans to government agencies and corporations. Typically, they require you to keep around \$2,500 on deposit. Because the minimum is high, a money market account is often free, and you're likely to get free checks to write against your account's balance. However, there may be a minimum check-writing amount, and you may be limited to the number of checks you may write a month.*

*When shopping for an interest-bearing account, keep the following in mind:*

*1. Banks frequently review the yields they offer.*

*Yields are updated regularly, often on a weekly basis, and may lower or raise the rates quickly. That means the rate that's offered when you open your account may be dramatically different a year later, or even a month later.*

*2. Banks can quote rates that compound daily, weekly, monthly, quarterly, or yearly.*

*Over a period of 12 months, interest that compounds yearly could yield less money than a lower interest rate that compounds daily. To compare how much money you'll earn from various accounts in a year, ask for each account's "annual percentage yield" in addition to its interest rate. Banks typically quote both figures, but only APYs are calculated the same way everywhere.*

## *Beating Fees*

*Checking can cost \$200-plus a year, but you can pay less if you know how.*

*Few people would pay a bank \$15 or \$20 a month for an account that pays no interest if they knew how to avoid it, and if avoiding it didn't take too much work.*

*Here are several easy, cost-cutting tips:*

*1. Direct deposit your paycheck.*

*If you do, some banks will give you free checking -- but you might have to ask for it.*

2. *Buy cheap checks.*

*If you write a large number of checks, it may pay to shop around. Some banks charge \$24 or more for a box of 200 checks. You can get that same box for less than \$10 by ordering direct from the printer. There are a numerous services, including [Checks in the Mail](#) (800-733-4443) or [Checks Unlimited](#) ( 800-426-0822 ) for more information. The online services also offer a far wider range of designs on the checks than any bank.*

3. *Get overdraft protection.*

*It's usually free to set up. The average bounced check fee ranges from \$20 to \$30. If ever you write a check that exceeds your account balance, overdraft protection automatically covers the extra money needed. You'll be charged a fee -- usually \$5 -- for the service plus a high, credit-card-like interest rate for the loan, but in most cases since the loan is short-term it's likely to cost you much less than a bounced check.*

4. *Be proactive about asking for discounts.*

*Periodically check with your bank to see if there are better deals for your money. Over time, your financial situation changes, and you may qualify for a higher-interest, lower-cost account.*

5. *If you have a debit card, ask for cash.*

*Another way to dodge ATM surcharges is to ask for extra cash when you make a purchase with your bank's **debit card**. Just ask your grocer for an extra \$50 in cash, and you'll pay no fees in most cases. ( Most banks don't charge a fee, but make sure your bank is not in the minority, because you may be charged anywhere from 15 cents to \$1.50 per debit transaction. If this is the case with your bank, be more cautious with the card's use -- or get a new bank that doesn't charge for debits. )*

6. *Possibly invest in the bank.*

*Some small- and mid-size banks offer free checking and free checks to shareholders. Contact a few local banks and ask if they offer special deals to shareholders. If they do, invest in a single share and open an account. Use a discount broker to buy that share.*

7. *Limit your bank visits and transactions.*

*Some banks offer no-fee checking accounts if you agree to do all your banking at its ATMs. If you must visit a teller, make sure it's for a transaction that you couldn't perform at an ATM, otherwise you'll be charged a fee. Banks also may offer low-fee checking if you confine yourself to 10 or fewer transactions a month, including ATM withdrawals, checks, and debit card purchases.*

8. *Find out what "free" means.*

*Most banks will give you "free" checking if you maintain a balance of at least \$500 to \$2,500 in a low- or no-interest account. But say your bank requires a \$2,500 minimum to avoid fees, and you need only \$1,500 to cover your checks every month. The remaining \$1,000 could be earning more interest for you in a money market account at a brokerage or mutual fund company. Of course, the difference may be less than what you'd pay in checking fees if you didn't keep the required minimum balance, but "free" checking it's not.*

9. *Link your accounts.*

*One way around this hidden cost: Ask your bank to link your accounts. For example, if you have a high-yielding CD in addition to a checking account at the bank, you can satisfy the minimum balance requirement if your bank treats the money in all your accounts as one combined balance.*

10. *Look for surcharge-free ATMs.*

*If you do your banking at a small bank and have trouble finding ATM machines that don't hit you with a surcharge, try searching online for surcharge-free ATMs in your area. One place to try is [ATMsurcharges.com](http://ATMsurcharges.com).*

## *Online Banking*

*Banking online can reduce the time spent balancing a checkbook, transferring money and paying bills .*

*Roughly 3.9 million U.S. households already perform banking transactions online, and the penetration rate is rising. By 2006, according to estimates by Jupiter Research, more than half of all banking households will bank online.*

*To do your banking on the Internet, you'll need a computer, Web access, and in a few cases, bank-specific software. Most banks that offer online banking and electronic bill-payment do so for free.*

*If you pay your bills online, you will save on postage, of course. But if your bank doesn't offer electronic bill payment for free, those savings may be negated, since electronic bill-paying fees usually run between \$5 and \$8 a month ( \$60 to \$96 a year ).*

*To pay bills online, you first create an address book of payment recipients. When you get a bill, you select a payment amount, the date it should be sent and the recipient. The bank takes care of the rest. Most bill-paying programs let you schedule recurring payments if the amount you pay to a given recipient is the same every billing period.*

*If your bank doesn't provide electronic bill payment, others do, including brokerages like Charles Schwab, Internet portals such as Yahoo and AOL , and even the U.S. Postal Service. Typically, these are free services. But they do add a third-party middleman to your banking transactions.*

*The best bank Web sites go beyond bill payment and balance updates to let you check your credit card accounts, look at both your banking and brokerage accounts, make trades, and get free stock quotes.*

*Banks with online services commonly use the most secure data encryption available and offer consumer protection against liability for losses due to fraud, according to the Tower Group, a consulting firm that examines the impact of technology in the financial services industry.*

*If you think you'll do all your banking online and are in search of better rates, you might be considering an Internet bank. During the economic boom of the 1990s, Internet banks were able to offer higher yields on accounts and lower rates on loans than traditional banks.*

*Since then, however, many Internet banks have closed due to a weakened economy and the difficulty they faced acquiring customers for loans, which are the mainstay of bank revenue. What's more, the number of traditional banks offering online services has risen, creating a tougher competitive market.*

*Still, rates at Internet banks continue to beat those at their brick-and-mortar cousins, and their account fees are somewhat lower. But in exchange you forfeit some of the conveniences of a traditional bank.*

*Any transactions normally requiring a teller, for instance, may be more protracted online. And an Internet bank doesn't have its own ATMs, so you will pay surcharges every time you use one, although you may be offered some reimbursement for these fees by your bank.*

## *Alternatives To Traditional Banks*

*You can bank without a bank. Here's how.*

*Checking and savings accounts are not the exclusive domain of banks. They are also offered by some non-bank businesses. Here are three of the most common:*

### *1. Credit unions*

*Credit unions operate much like banks, and deposits are federally insured up to \$100,000 by the National Credit Union Share Insurance Fund. The key difference is this: credit unions are non-profit, member-owned **cooperatives** whose members share something in common, such as a labor union, college alumni association, employer, or community. Members' immediate family may also be allowed to join.*

*Since credit unions return profits to their members, interest rates for savings and checking accounts at credit unions tend to be higher than at commercial banks, while fees and minimums tend to be lower. But a credit union may offer fewer services than a bank and they may have more restricted access to ATMs.*

*To learn whether you are eligible to join a credit union, or to locate a credit union near you, visit the [Credit Union National Association](#) or call 800-358-5710.*

### *2. Money market mutual funds*

*Mutual fund companies offer money market accounts that tend to have higher yields than those on banks' money market deposit accounts ( MMDAs ). The mutual fund company accounts, however, are not insured against loss by the FDIC, whereas MMDAs are. Nevertheless, mutual fund companies make it a practice to kick in extra dollars whenever necessary to make sure that they maintain a constant price of \$1 per share, so in practice your chance of losing money is slim.*

*Mutual fund money market accounts require a minimum opening deposit -- typically \$500 to \$5,000 -- and may require that you maintain a minimum balance. Many also let you write checks on the account, though there may be a minimum check-writing amount ( typically \$100 to \$500 ) and / or a limit to the number of checks you can write per month or per year.*

### *3. Cash management accounts*

*A cash management account works like a combination bank / brokerage account, consolidating your investments with your day-to-day cash flow.*

*Cash-management accounts ( CMAs ) were originally offered by brokerages such as Merrill Lynch for affluent customers who had discretionary income to invest but also wanted a liquid, bank-like account that earned higher interest than a traditional bank account. Increasingly, however, banks have begun to offer CMAs as well.*

*In a CMA, your cash earns money market rates, and you get checking and credit card privileges, an ATM debit card, and often a line of credit or a margin account. If you overdraw your account, the interest you're charged on the loan is likely to be lower than that on a bank overdraft. In many instances, too, the interest may be characterized as margin interest, which can be tax-deductible.*

*The fee for a CMA typically ranges from \$50 to \$180 a year, though it may be waived if you have \$50,000 to \$100,000 or more in your account. In addition, you may pay fees if you make trades through your account or consult with an investment adviser at your brokerage or who is affiliated with a subsidiary of your bank. Cash up to \$100,000 in a brokerage CMA is protected by the Securities Investor Protection Corp., while cash up to \$100,000 in a deposit account is FDIC insured at a bank CMA.*