Name: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ Economic Skills Date: \_\_\_\_\_\_\_\_\_\_\_\_

Unit 2 - Independent Living

Banking Basics – Savings and Checking Accounts

By saving even small amounts of money, you can build wealth slowly but steadily over time. Savings accounts are one means of putting money aside and earning interest on it. Money placed in these accounts is not intended for everyday expenses like purchasing movie tickets or buying new music online. Instead, their purpose is to provide the individual with a safe place to save money that will be used at a later date to make a major purchase such as a car, or to fund a large expense such as a college education or a house.

**Savings Account Basics**

The goal of **saving** is to provide funds for emergencies, short-term goals and eventually investments. People save first, and when they have saved sufficiently, then they may choose to take some of their savings and begin **investing** it. As you start to think about developing habits that will lead to good financial health, keep in mind the difference between saving and investing.

**Deposits and Withdrawals**

Have you ever tried to save up for something you really wanted, only to be unsuccessful because you were constantly taking small amounts of cash out of the money you were “saving” in your dresser drawer? While most of us have good intentions about saving money and understand that it takes some time and effort to save up for a major purchase, many of us don’t have the willpower to keep our hands off the cash when we have access to it. Here’s where a savings account can be a real life saver. Whether you’re saving for a car, your college education or a home, a savings account provides you with a secure place to store your cash while earning a little something extra.

When learning new ideas, it is often helpful to relate something new that you don’t yet understand to something old and familiar that you do understand using an analogy. Many people find it helpful to think of a savings account like a pail of water. The amount of water in the pail represents the money you have placed in the savings account. When you place the pail under the tap and turn it on, the amount of water in the pail increases. The water from the tap is a **deposit**.

Let’s assume that your pail is fitted with a tap at the bottom of it. Each time you open the tap, the amount of water in the pail decreases. When you make a **withdrawal** from your savings account, you decrease its value. Just like keeping your pail full, the key to successful saving is making sure that you have more money going into the account than you do coming out of it.

In order for the amount of water in the pail to increase, water must flow into the pail faster than it flows out of the tap at the bottom of the pail. Similarly, to make your savings grow, the amount you deposit into the account should be greater than the amount you withdraw from the account. You also need to remember that with a savings account, there is a little extra in flow into the account coming from the interest earnings that are paid to you by the bank each month.

**Interest Payments**

Earlier we mentioned that by using a savings account, you can earn a little something extra. That “little something extra” is called **interest**. You are basically operating as a lender with the bank as your borrower. When you deposit money into a savings account, the bank has the use of your money until you choose to withdraw it. The bank can use your money to make loans to other people, and the bank pays you for giving up the use of your money while they hold it for you. The bank pays you interest each month on the amount of money in your savings account. The **interest rate** can vary from month to month. When you get your statement from the bank, it will list your **account balance** at the beginning and end of the statement period. Using the analogy of the pail of water, even if no additional water enters through the tap (no deposits are made) or leaves through the bottom tap (no withdrawals are made), there will be more water in the pail (the account balance will change) because of the interest payment made to you by the bank.

**The Rule of 72**

When people save money, the goal is to increase the worth of that savings. Using the Rule of 72, you can easily make decisions about the most effective way to save your money. Imagine you have a savings account of $1,000 earning an annual rate of 3% interest. Using the Rule of 72, you simply divide 72 by the interest rate (in this case, 3%) to determine the total number of years it will take to double your money. If you do the math, at a 3% annual interest rate it takes 24 years to double the initial $1,000 savings.

*There are a couple of caveats when using the Rule of 72. First, remember that it is an estimate, not an exact calculation. For example, if you are earning 8% interest on your money, the Rule of 72 indicates that it will take nine years to double your money. When you calculate the exact amount of time it would take, the figure is actually 9.01 years - quite close to the estimated amount of time, but not exact. Next, note that the Rule of 72 works best when estimating for interest compounded annually at rates below 20%. For interest rates higher than 20%, its accuracy diminishes.*

Practice estimating how long it will take to double your $1,000 savings using various interest rates. If the account is paid the rates listed below, how long would it take to double the beginning balance? Assume interest is paid annually. Remember, divide 72 by the interest rate to determine the total number of years it will take to double your money.

|  |  |  |  |
| --- | --- | --- | --- |
| **Beginning Balance** | **Interest Rate** | **Rule of 72** | **Time Needed to Double Beginning Balance** |
| $1,000 | 2% |  |  |
| $1,000 | 3% |  |  |
| $1,000 | 4% |  |  |
| $1,000 | 5% |  |  |
| $1,000 | 6% |  |  |

**Savings in the Real World**

While savings accounts are designed to be a place to put money for a fairly long period of time before it is withdrawn, these types of accounts typically have some deposits and withdrawals over the course of a year. Let’s create a more realistic example of savings account activity and find out how that changes the end result for the account.

Calculate the following scenario:

You start your account with a beginning balance of $1,000

You deposit $320 each month (half of the money you earn from your part-time job)

In month 4 you withdraw $45 to purchase a video game

In month 7 you deposit $50 you received for your birthday

In month 10 you withdraw $200 to pay a registration fee

**Interest Payment = Interest Rate x Beginning Account Balance**

**Ending Account Balance = Beginning Account Balance + Interest Payment + Deposits**

**Beginning Account Balance = Ending Account Balance from the previous month**

**– Withdrawals from the current month**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Month** | **Interest Rate** | **Withdrawals** | **Beginning Balance** | **Interest Payment** | **Deposits** | **Ending Balance** |
| 1 | 0.25% | $0.00 | $1,000.00 | $2.50 | $320.00 | $1,322.50 |
| 2 |  |  |  |  |  |  |
| 3 |  |  |  |  |  |  |
| 4 |  |  |  |  |  |  |
| 5 |  |  |  |  |  |  |
| 6 |  |  |  |  |  |  |
| 7 |  |  |  |  |  |  |
| 8 |  |  |  |  |  |  |
| 9 |  |  |  |  |  |  |
| 10 |  |  |  |  |  |  |
| 11 |  |  |  |  |  |  |
| 12 |  |  |  |  |  |  |

**Checking Account Basics**

Checking accounts provide account holders with a place to keep their money for a short time before it is spent. These accounts are designed to make it easy for people to pay their bills or purchase things without having to go to the bank and withdraw cash. Traditional checking accounts allow the account holder to make payments with **checks** to pay for items such as utilities, rent, mortgage payments, food and a variety of other expenses. Most checking accounts also offer debit cards, electronic funds transfer, and online banking. Unlike a savings account, the money in a checking account is meant to be used, so banks typically pay very little or no interest on checking account balances. In fact, banks often charge customers periodic or per-transaction fees for maintaining a checking account.

Let’s assume that you are paying your cell phone bill. The amount you owe the cell phone provider is $61.63 for your September bill. The sample check has been made out to “Cell Phone Provider.” In the appropriate places, you must write out the amount of the check both in words and in numbers (as shown on the sample check). You must indicate the date that you write the check and you must sign the check with your name. In this example, “Chris Student” signed the check on September 4, 2012. There is typically a line at the bottom left of the check so you can write a note about what the check was for. Our sample check’s Memo line indicates this is for the “Sept. cell phone bill.” If you completed the check correctly, it would look like the sample below.



**Checking Account Balances**

When tracking the balance in your checking account, you can use a spreadsheet similar to the one used with a savings account. Since there will be very little or no interest contributed to the account, you can eliminate that column on the spreadsheet. What is most important is to keep track of **deposits** or **credits** and **debits** from your account. As you would expect, the balance in a checking account gets larger when a deposit/credit is made and smaller when withdrawals/debits, in this case, checks, are written against the account. The bank will provide you with a check register to keep with your checks. In the check register you can record the date and amount of deposits as well as the date, check number, payee (the person to whom the check is written) and amount of each check as it is written.

At the end of each month, the bank will send you a statement which includes a **statement balance.** In addition to the balance, the statement will list all of the debits and credits for the account made before the statement date. It is important to remember that the statement balance may be different from the actual balance in the account because additional transactions have been made and because not all debits have cleared. At the end of each month, you should use your checkbook register and compare it to the statement to **balance** or **reconcile** your account.

Imagine you have a part-time job and you earn a paycheck every two weeks. You must use that money to pay some of your own expenses including school lunches and your monthly cell phone bill. In addition, you use the money in this account for day-to-day expenses such as leisure activities and purchasing items you want such as clothing, music, video games, etc. Suppose that your end of the month account balance in August was $143.68. This will be your start of the month balance for September. During September you make two deposits into the account when you receive your paychecks. The first is for $105.24 and the second for $108.78. You write nine checks totaling $289.44. What will your account balance be at the end of September?

|  |  |  |
| --- | --- | --- |
| **Check/Debit**  **Amount** | **Deposit/Credit**  **Amount** | **Balance** |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |

**Electronic, Online, and Smartphone Banking**

Over the past several years, electronic and online banking features offered by most checking accounts have gained popularity and become part of what consumers expect when they open a checking account. Rather than writing a paper check, many people prefer to utilize a **debit card** to pay for day-to-day transactions. When using a debit card, you will often be asked to enter your **Personal Identification Number,** or **PIN**, to verify your identity.

The main differences between traditional checks and debit cards are:

Debits are easily completed by swiping a card that looks like a credit card rather than writing a check.

Debit card funds are accessed immediately by the merchant and the funds are automatically deducted from the cardholder’s account, whereas checks must clear the bank before the merchant receives the funds.

Debit cards can be used at Automated Teller Machines (ATMs) to get cash immediately and directly from one’s account 24 hours a day, seven days a week.

Many people prefer to use debit cards for day-to-day purchases because they are the same as cash or checks, but provide much more convenience than carrying cash or writing a check. In addition, they can be used at a wide range of businesses including gas stations, restaurants, grocery stores, movie theaters and virtually any other location that accepts credit cards. Another type of transaction that is also gaining popularity is the **Electronic Funds Transfer**, also known as an **EFT.** Examples of ways that EFTs are used on an ongoing basis include: checking account, also known as direct deposit or a monthly utility bill

Rather than waiting for monthly bank statements and bills to arrive, many people have turned to **online banking** or using their smartphones. Online banking can be used to do things such as looking up account balances, transferring funds between accounts and paying bills. Online banking is fast and available 24 hours a day, seven days a week, regardless of the bank’s hours of operation. There are many advantages to online banking, including the fact that no checks need to be written by hand, transactions are automatic and the service is usually free to account holders.  Mobile phone users are able to utilize applications (or “apps”) for their banking needs. Most major banks now allow consumers to check their account balance, transfer funds between accounts, pay bills, deposit checks using the phone’s camera, locate the nearest banking retail location and receive text message alerts - all on their mobile phones.

Most banks offer ATM cards to their checking account customers; these are usually, but not always, debit cards. These cards (along with a personal identification number, or PIN) allow you to access your accounts through almost any ATM, whether it is owned by your bank or not. Some banks may require monthly or annual fees to use these cards; check with your bank to see if your card has any recurring or per-transaction fees attached.  If you use an ATM owned by another bank, you may have limited access to your account, perhaps only being able to withdraw money and check your balances. You will likely be charged a fee (typically between $1 and $3) for the privilege of using that other company’s machine. Remember to record this fee, along with your withdrawal amount, in your checking register!  If you use an ATM owned by your bank, you will probably have greater access to your accounts, including having the ability to make deposits and transfer funds between accounts; you will also likely not have to pay any fees for using the machine.

It is important to remember to record transactions in your checkbook register when using a debit card to pay a merchant, when you withdraw cash from an ATM, and when you use an EFT to pay a recurring expense. Failure to record such transactions, particularly debits, could result in your being **overdrawn.** When this happens, the bank will bounce checks and deny electronic debits. When a check bounces, it is returned to the merchant unpaid because you do not have sufficient funds in the account. This can not only be embarrassing, but it can also result in paying late fees to the merchant and an **overdraft** **penalty** to the bank. While every bank is different, banks commonly charge $25 or more per check for overdraft charges.

Many banks offer **overdraft** **protection.** Types of overdraft protection vary but can include:

Automatic transferring money from another account at the same bank (assuming you have one) to cover the amount you are deficient in your checking account to prevent you from overdrawing

Allowing you to overdraft your account up to a specified limit before assessing any penalties and bouncing your checks

Lending you the amount of money by which you have overdrawn your account and charging you a high rate of interest on this loan (you must pay interest until you repay the loan by depositing enough money into the checking account to correct the deficiency

In all of these cases, the bank may charge you a fee for these services.

**Identity Theft**

According to the Federal Trade Commission, as many as nine million Americans have their identities stolen each year. If someone finds a way to steal your private information, such as your social security number or credit card information, they may be able to make purchases, get a phone, rent an apartment, or order and use new credit cards – and it may be months before you find out. While some identity theft victims have been able to quickly resolve problems, many others take months to repair the damage done to their good name and to their credit rating.

Thieves can get your information in a number of ways, such as going through your trash to find old statements and receipts, posting online scams, using computer viruses, or simply stealing your wallet or purse. You should guard your personal and financial information carefully, taking common-sense steps such as:

Monitor your accounts closely, checking monthly and/or daily online statements and balances, and regularly checking your credit report

When buying online, make sure the company you’re buying from has a secure payment system

Shred old financial statements rather than throwing them away

Maintain computer security with firewalls and virus protection software

Don’t provide your personal information to people you don’t know, or to companies (particularly online) if they don’t seem legitimate

If you think that someone has stolen your personal information, take action immediately. If you see unauthorized charges on one of your credit cards or bank statements, contact your credit card provider or bank immediately to dispute such charges and alert them to the problem. Also contact one of the three credit reporting agencies to place a fraud alert on your credit report; this will prevent an identity thief from opening any new accounts in your name. (And note that if you notify one agency, they’re required to inform the other two.) You may also want to le an Identity Theft Report with the police, which will give you certain legal rights such as helping you prevent credit reporting agencies from listing fraudulent accounts on your report, and ensuring that collection agencies do not pursue you for charges you did not make.

**Definitions from this reading:**

**saving**

the process of setting money aside for a future date instead of spending it today

**investing**

the process of setting money aside to increase wealth over time and accumulate funds for long-term financial goals such as retirement

**deposit**

money you put into your savings account

**withdrawal**

money taken out of your savings account

**interest**

money paid to you by the bank for being able to use your money

**interest rate**

percentage you are paid for your money

**account balance**

total amount of money that is in the account at a given point in time

**compounding of interest** when money is earned on the total amount in the account including the initial deposit and interest that has already been credited to the account

**Rule of 72**

a formula designed to help people estimate how long it will take to double their money at a certain expected interest rate; divide 72 by the interest rate to determine the total number of years it will take to double your money

**credit**

money you put into your account

**debit**

withdrawal from your account

**balance/reconcile**

compare the amount of money in an account, equal to the net of credits and debits at that point in time for that account

**statement balance**

how much money you have in your checking account as of the statement date

**check**

handwritten or computer-generated order specifying the amount of money to be paid and the name of the person or company who should receive the funds

**debit card**

a card that allows the user to withdraw money from a bank account to obtain cash or make a purchase

**personal identification number/PIN**

four-digit code connected to the debit card; verifies your identity

**electronic funds transfer/EFT**

the movement of funds using computer systems, telephones or electronic terminals, or smartphones

**online and smartphone banking**

allows account holders to access their account information, view transaction history and perform banking transactions via the Internet or their mobile phone

**Automated Teller Machines (ATMs)**

a machine that allows you to perform basic banking functions without the help of a teller

**overdrawn**

having a negative balance in your account

**overdraft penalty**

a fee to cover the cost of processing your bad check

**overdraft protection**

arrangement with the bank to cover checks so they will not bounce; this can take on several forms:

automatic transferring of money from another account at the same bank to cover the amount you are deficient in your checking account to prevent you from overdrawing

allowing you to overdraft your account up to a specified limit before assessing any penalties and/or bouncing your checks

lending you the amount of money by which you have overdrawn your account and charging you a high rate of interest on this loan

**identity theft**

stealing someone’s personal, identifying information and using it to make purchases or to get other benefits