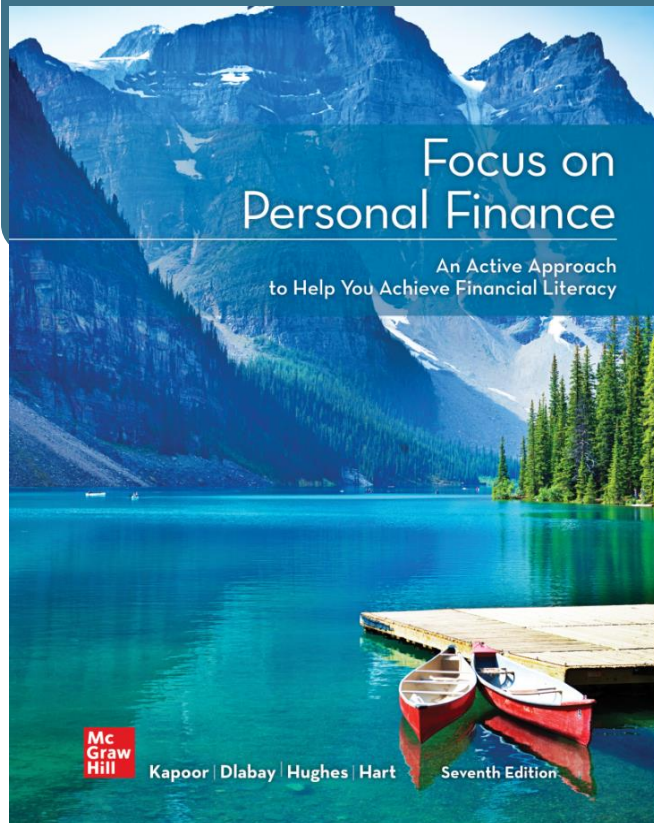




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Chapter 4

Financial Services: Savings Plans and Payment Accounts



Chapter Learning Objectives

- LO4.1** Identify commonly used financial services.
- LO4.2** Compare the types of financial institutions.
- LO4.3** Assess various types of savings plans.
- LO4.4** Evaluate different types of payment methods.



Planning Your Use of Financial Services

LO4.1

- In recent years, banking activities have changed:
 - from talking with a human teller...to connecting with a video teller at a bank cafe
 - from writing a check...to transferring money with an app
 - from sending in a deposit by mail...to clicking a picture for a remote check deposit
 - from obtaining a loan from a bank...to borrowing from a peer-to-peer lender

Financial Institutions and Banking Services

Exhibit 4-1
Financial Institutions
and Banking Services

DEPOSIT INSTITUTIONS

- Commercial bank
- Credit union
- Savings and loan association
- Mutual savings bank

NON-DEPOSIT INSTITUTIONS

- Life insurance company
- Investment company
- Brokerage firm
- Credit card company
- Finance company
- Mortgage company

TYPES OF FINANCIAL SERVICES

Cash Availability • Check cashing • ATM/debit cards • Traveler's checks • Foreign currency exchange	Payment Services • Checking account • Online payments • Cashier's checks • Money orders
Savings Services • Regular savings account • Money market account • Certificates of deposit • U.S. savings bonds	Credit Services • Credit cards, cash advances • Auto loans, education loans • Mortgages • Home equity loans
Investment Services • Individual retirement accounts (IRAs) • Brokerage service • Investment advice • Mutual funds	Other Services • Insurance; trust service • Tax preparation • Safe deposit boxes • Budget counseling • Estate planning

OTHER FINANCIAL SERVICE PROVIDERS

- Pawnshop
- Check-cashing outlet
- Payday loan company
- Rent-to-own center
- Car title loan company

NON-BANK FINANCIAL SERVICE PROVIDERS

- Retailer stores (prepaid debit cards, other services)
- Online, mobile banks (E*Trade Bank, Varo Money)
- Online payment services (PayPal)
- P2P (peer-to-peer) lending intermediaries



Managing Daily Money Needs

- Frequent mistakes when managing current cash needs include the following:
 1. Overspending due to impulse buying and overusing credit;
 2. Having insufficient liquid assets to pay current bills;
 3. Using savings or borrowing to pay for current expenses; and
 4. Failing to place funds not needed for current expenses in a savings account or investment plan



Sources of Quick Cash

- Two main choices when you need more cash than you have available:
 1. Liquidate savings (e.g., savings account, mutual fund, or other investment)
 2. Borrow (e.g., credit card cash advance or personal loan)
- Remember, the use of savings and increased borrowing reduce your net worth and your potential long-term financial security



Types of Financial Services

1. *Savings* provides safe storage of funds for future use
 - E.g., money in savings accounts and certificates of deposit
2. *Payment services* allow you to transfer money to pay expenses and for other business activities
3. *Borrowing* is used by most people at some time during their lives
 - Options range from short-term accounts, such as credit cards and cash loans, to long-term borrowing, such as a home mortgage
4. *Other financial services* include insurance, investments, tax assistance, and financial planning
 - **Trust** is a legal agreement that provides for the management and control of assets by one party for the benefit of another



Types of Financial Services

(Continued)

- To simplify financial services, many financial businesses offer consolidated accounts
- An **asset management account** (i.e., cash management account) provides a complete financial services program for a single fee



Online and Mobile Banking

- Banking online and through mobile systems are used for most financial services
 - More traditional electronic banking occurs through an **automatic teller machine (ATM)**, which is a computer terminal that is used to conduct banking transactions
 - The **debit card** that activates ATM transactions is also used for purchases
 - Differs from a credit card in that you are spending *your own funds* rather than borrowing money
 - Wireless transactions, such as cardless ATM access and in-store purchases, will likely reduce debit and credit card purchases

Mobile Banking Services

Exhibit 4-2



McGraw Hill



Prepaid Debit Cards

- Have become very popular for payments
 - Replace traditional banking services for many consumers
- Issued by many financial service providers
 - Banks, credit card companies, retailers (e.g., Walmart), and nonbank companies
- “Loading” (adding funds to) prepaid debit cards may occur using any of the following methods:
 - Cash, check, direct deposit, online transfer, app check photo, or credit card cash advance
- Extensive fees are often associated with these cards
- Resulted in lower consumer debt in some cases

Financial Services and Economic Conditions

- Several factors influence financial services, such as changing interest rates, rising consumer prices, and other economic factors

When interest rates are rising...

- Use long-term loans to take advantage of current low rates.
- Select short-term savings instruments to take advantage of higher rates when they mature.

- Use short-term loans to take advantage of lower rates when you refinance the loans.
- Select long-term savings instruments to “lock in” earnings at current high rates.

When interest rates are falling...



Sources of Financial Services

LO4.2

- Many types of businesses offer financial services that were once exclusive to banks
- When selecting a financial service provider, consider the following questions:
 - Where can I get the best return on my savings?
 - How can I minimize the cost of checking, payments services, and other fees?
 - Will I be able to borrow money if I need to?

Selecting a Financial Institution

Exhibit 4-4

STEP 1. Identify your most important features for a financial institution, related to:

Services	Fees, earnings	Convenience	Online, mobile
• types of accounts • deposit insurance • loans; investments • app/online service	• account minimum balance, ATM fees • loans rates • savings rates	• branch, ATM locations, hours • customer service • rewards program	• ease of operation • services • privacy, security • app features

STEP 2. Rank the top features based on importance and your lifesituation:

College student	Young family	Older consumer
• low minimum balance • ATM access; app features • waived monthly fee	• low fee, minimum balance • savings plans for future • low-cost auto, home loans	• cash withdrawal limit and fraud detection notifications • large-font documents

STEP 3. Prepare a list of local, national, and online banks and credit unions (include the name, address, phone, website, services offered).

STEP 4. Conduct online and in-person research:

- talk with people who have used various financial institutions
- search online for services, policies, fees, and customer reviews
- if appropriate, visit the financial institution to observe and talk with staff members
- obtain a fee disclosure statement, savings rate sheet, and sample loan application

STEP 5. Based on the information collected:

- decide where to do business; you may use more than one financial institution
- take advantage of the best services at several (possibly “institutions”?) for flexibility in the future
- before changing banks, ask about fees and charges you consider unfair
- use a “switch kit” (available online) with letters and forms to change banks

Selecting a Financial Institution (Continued)

Exhibit 4-4

The following comparison of financial service providers can guide your decision:

Financial Institution	Benefits	Drawbacks
Large-scale bank	• Many branches, fee-free ATMs • Latest digital banking services	• Limited personal service, higher fees • Potential security concerns
Regional, community bank	• High customer satisfaction • Strong personal service	• Limited numbers of branches • May not be in ATM network
Credit union	• Strong personal service • Higher savings rates, lower fees	• Few branches, limited fee-free ATMs • May have membership eligibility
Online bank, FinTech company, neobank	• High customer satisfaction • Higher yields on savings	• Limited personal contact; no branches • May lack regulation; security concerns



Types of Financial Institutions

Deposit Institutions

- **Commercial banks** offer a full range of financial services to individuals, businesses, and government agencies
 - Organized as corporations
 - Exist in several types: national banks, regional banks, community banks, and online-only banks
- **Savings and loan associations (S&L)** traditionally specialized in savings accounts and mortgage loans
 - Have expanded to offer financial services comparable to those of a bank



Types of Financial Institutions

Deposit Institutions (Continued)

- **Mutual savings banks** are owned by depositors and specialize in savings accounts and mortgage loans
 - Located mainly in the northeastern U.S.
 - Profits are shared by depositors, usually through higher earnings on savings
- **Credit unions** are user-owned, nonprofit, cooperative financial institutions that are organized for the benefit of their members
 - Membership is more flexible today
 - Lower fees and lower loan rates, with higher satisfaction levels, compared to other FIs



Types of Financial Institutions

Nondeposit Institutions

- *Life insurance companies* provide financial security for dependents with various insurance policies, some containing savings and investment features
 - Some life insurance companies offer investment and retirement planning, as well
- *Investment companies* (i.e., mutual funds)
 - Offer a **money market fund**, a savings-investment plan with earnings based on investments in various short-term financial instruments
 - Not covered by federal deposit insurance



Types of Financial Institutions

Nondeposit Institutions (Continued)

- *Brokerage firms* employ investment advisers and financial planners
 - Serve as agent for buying and selling stocks, bonds, and other investment securities
- *Credit card companies* specialize in funding short-term retail lending
 - E.g., VISA, MasterCard, and Discover
- *Finance companies* provide loans to consumers and small businesses
 - Short and intermediate terms with higher rates than most other lenders charge
- *Mortgage companies* are organized primarily to provide loans for home purchases



Problematic Financial Businesses

- Pawnshops
 - Loans are based on a proportional value of a tangible item such as jewelry, antiques, tools, or musical instruments
 - Viewed as “neighborhood bankers”
- Check-cashing outlets (CCOs)
 - Most FIs will not cash a check unless you have an account
 - CCOs charge anywhere from 1 to 20 percent of the face value of a check; average cost is 2 to 3 percent



Problematic Financial Businesses (Continued)

- Payday loan companies
 - Annual interest rates could be as much as 780 percent
 - Some state and federal regulations exist to reduce the potential exploitation of payday loan clients
- Rent-to-own centers
 - Lease products to consumers who can own the item if they complete a certain number of payments
- Car title loan companies
 - People with poor credit may use car titles as security for a cash advance
 - High interest, often exceeding 200%



Comparing Savings Plans

LO4.3

- *Regular savings accounts* usually involve a low or no minimum balance and allow you to withdraw money as needed
 - Offered by banks, savings and loan associations, and other financial institutions
 - Called *share accounts* at credit unions
 - High-yield savings accounts are available with various restrictions for initial deposit requirements, interest rates, minimum balance, and any possible fees



Certificates of Deposit (CD)

- **Certificates of deposit (CDs)** require a certain amount be left on deposit for a stated time period to earn a specified interest rate
- Time period of CD may range from 30 days to five or more years
- Most FIs impose a penalty for early withdrawal of CD funds



Types of CDs

- *Rising-rate or bump-up CDs* may have higher rates at various intervals, such as every six months
- *Liquid CDs* offer an opportunity to withdraw money without a penalty
- *Zero-coupon CD* is purchased at a deep discount with no interest payments
- *Indexed CDs* have earnings based on the stock market
- *Callable CDs* start with higher rates and usually have longer maturities, as high as 10 to 15 years
- Beware of *promotional CDs*

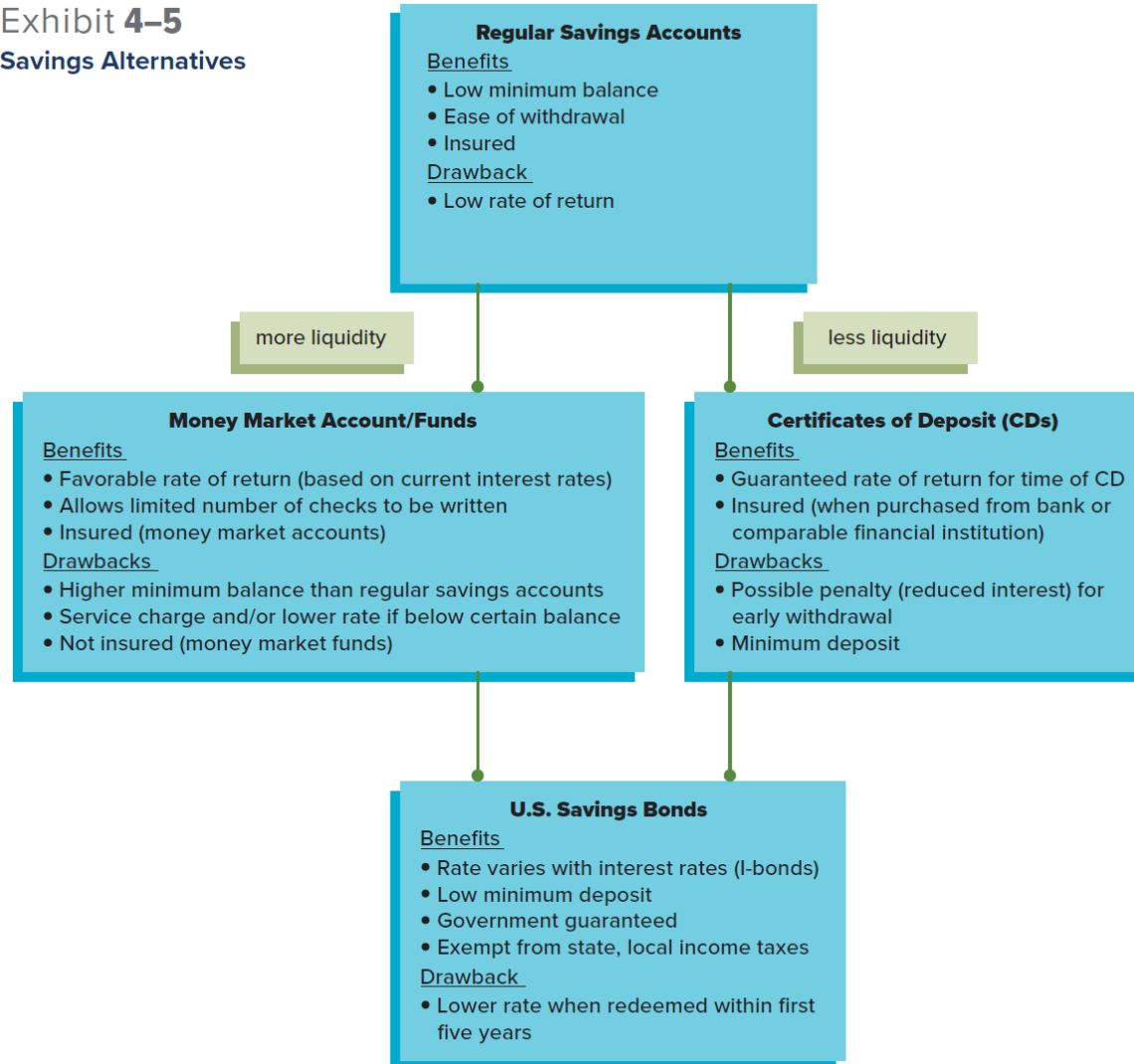


Managing CDs

- When first buying or *rolling over* a CD (buying a new one at maturity), investigate potential earnings and costs
 - Do not allow your FI to automatically roll over your money into another CD for the same term
- Consider creating a CD *portfolio* with CDs maturing at different times
 - For example; \$2,000 in a three-month CD, \$2,000 in a six-month CD, \$2,000 in a one-year CD, and \$2,000 in a two-year CD

Savings Alternatives

Exhibit 4-5
Savings Alternatives





Money Market Accounts and Funds

- A **money market account** is a savings account that requires a minimum balance with earnings based on the changing market level of interest rates
 - May allow a limited number of checks and transfers
 - May impose a fee when the account balance goes below the required minimum, usually \$1,000
- Money market *accounts* vs. money market *funds*
 - Both offer earnings based on current interest rates, have minimum-balance restrictions, and allow check writing
 - Money market *accounts* are covered by federal deposit insurance, unlike money market *funds*



U.S. Savings Bonds

- U.S. savings bonds are a low-risk savings program guaranteed by the federal government
 - *Series EE bonds* are the most common, involving amounts greater than \$25
 - Bought and managed online
 - Must be held for one year before it can be cashed
 - *I bonds* allow you to earn interest based on a fixed rate and an inflation rate
 - Every six months, a new rate is set
 - Purchased at face value for an amount starting at \$25

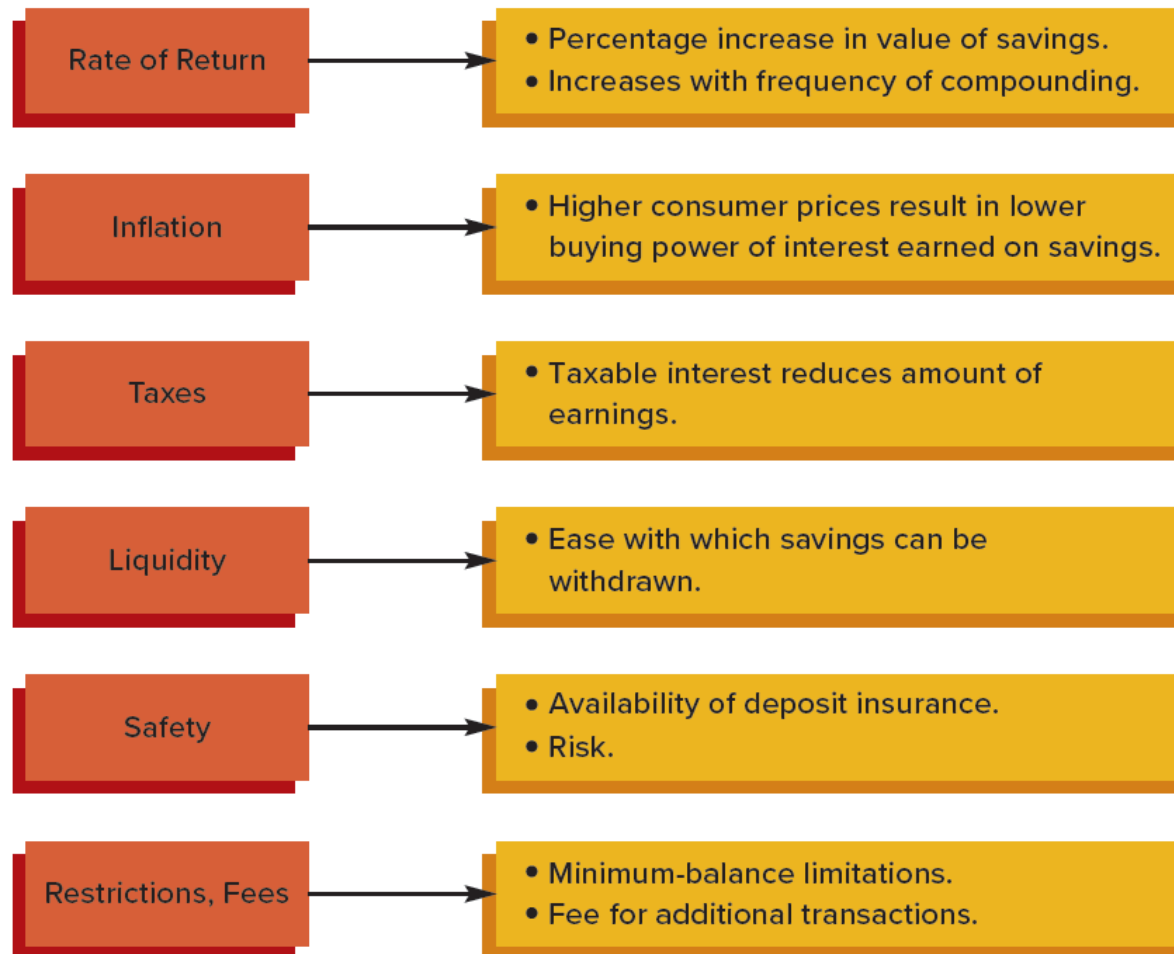


Evaluating Savings Plans

- Selection of a savings plan is most often influenced by the rate of return, inflation, tax considerations, liquidity, safety, restrictions, and fees
 - **Rate of return** is the percentage of increase in the value of savings as a result of interest earned
 - **Compounding** is a process that calculates interest based on previously earned interest
- *Truth in Savings Act* requires disclosure of the following information on savings accounts:
 - Fees on deposit accounts; the interest rate; the annual percentage yield (APY); and other terms and conditions

Selecting a Savings Plan

Exhibit 4-6



Compounding Frequency Affects the Savings Yield

Exhibit 4-7

Shorter compounding periods result in higher yields. This chart shows the growth of \$10,000, earning a rate of 4 percent, but with different compounding methods.

COMPOUNDING METHOD				
End of year	Daily	Monthly	Quarterly	Annually
1	\$10,408	\$10,407	\$10,406	\$10,400
2	10,833	10,831	10,829	10,816
3	11,275	11,273	11,268	11,249
4	11,735	11,732	11,726	11,699
5	12,214	12,210	12,202	12,167
10	14,918	14,908	14,889	14,802
15	18,221	18,203	18,167	18,009
20	22,254	22,203	22,167	21,911
Annual yield	4.08%	4.07%	4.05%	4.00%

Annual Percentage Yield

- **Annual percentage yield (APY)** is the percentage rate expressing the total amount of interest that would be received on a \$100 deposit based on the annual rate and frequency of compounding for a 365-day period

EXAMPLE: Annual Percentage Yield.

When the number of days in the term is 365 (that is, where the stated maturity is 365 days) or where the account does not have a stated maturity, the APY formula is simply.

$$\begin{aligned} \text{APY} &= 100 \left(\frac{\text{Interest}}{\text{Principal}} \right) \\ &= 100 \left(\frac{66}{1,200} \right) \\ &= 100 (0.055) = 5.5, \text{ or } 5.5\% \end{aligned}$$



Evaluating Savings Plans (Continued)

- As the **inflation** rate increases, the interest rate earned also increases
- **Taxes** reduce interest earned on savings
- **Liquidity** allows you to withdraw money on short notice without a loss of value or payment of fees
- **Safety** is often provided through FDIC or NCUA
- **Restrictions and fees** may limit the number of transfers and withdrawals you can make each month from a savings or money market account

Comparing Payment Methods

LO4.4

- Each year, paper checks become a smaller portion of payments made, but checking accounts are still the main source for most debit card and online payments

Digital Payments	Checking Accounts	Other Payment Methods
Debit (cash) and credit cards	Regular checking account	Certified check
Online, mobile transfers	Activity checking account	Cashier's check
Stored-value (prepaid) cards	Interest-earning checking account	Money order
Smart cards ("digital wallet")		Money transfer service
		Traveler's checks



Digital Payments

- *Debit card transactions* involve an amount deducted from your checking or other bank account
- *Online payments* may be facilitated by banks or online companies; consumers may use a credit card or bank account, or they may make a purchase and then pay cash at a local store
- *Mobile transfers* involve transferring money to another person over smartphones, tablets, or other wireless devices (e.g., PayPal, Venmo, and Zelle)
- *Stored-value cards* are prepaid cards; may be used for telephone service, transit fares, or highway tolls
- *Smart cards* are “digital wallets” similar to other ATM cards with an embedded microchip



Credit Cards vs. Debit Cards

Use a credit card to...

- Delay the payment for a purchase
- Build a credit history with wise buying
- Buy online or for major purchases
- Earn more rewards points for spending

Use a debit card to ...

- Limit your spending to available money
- Avoid bills that will be paid in the future
- Avoid interest payment or an annual fee
- Obtain better protection by processing a debit card transaction as a credit card



Checking Accounts

- Checking accounts fall into three major categories:
 - *Regular checking accounts* usually have a monthly service charge that you may avoid by keeping a minimum balance in the account
 - *Activity accounts* charge a fee for each check written and sometimes a fee for each deposit in addition to a monthly service charge
 - No minimum balance required
 - *Interest-earning checking accounts* usually have a minimum balance
 - If the balance goes below the minimum required, you may not earn interest and will likely incur a service charge
 - Called *share draft accounts* at credit unions

Checking Account Selection Factors

Exhibit 4-9

CHECKING ACCOUNT SELECTION FACTORS	
Restrictions • Minimum balance • Federal deposit insurance • Hours and location of branch offices • Holding period for deposited checks	Fees and Charges • Monthly fee • Fees for each check or deposit • Fee for printing of checks • Fee to obtain canceled check copy • Overdraft, stop-payment order, certified check fee • Fees for online banking

Special Services • Direct deposit • Availability of ATMs • Overdraft protection • Discounts or free checking for certain groups (students, senior citizens) • Free or discounted services	Interest • Interest rate • Minimum deposit to earn interest • Method of compounding • Portion of balance for computing interest • Fee charged for falling below necessary balance to earn interest
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Evaluating Checking and Payment Accounts

- **Restrictions**

- Most common limitation on a checking account is the minimum balance to earn interest or avoid a service charge

- **Fees and charges**

- Compare your earnings with any monthly service charge, and consider the cost of lost or reduced interest resulting from maintaining the minimum balance

- **Interest**

- Interest rate, frequency of compounding, and interest computation method affect earnings on checking accounts

- **Special services**

- **Overdraft protection**



Other Payment Methods

- *Certified check* is a personal check with guaranteed payment
- *Cashier's check* is a check issued by a financial institution
 - You may purchase one by paying the amount of the check plus a fee
 - *Money orders* may be purchased in a similar manner from financial institutions
- *Traveler's checks* allowed payments when away from home and were popular before ATMs
 - Required you to sign each check twice, first when purchased and again when you used them



Managing Your Checking Account

Opening a Checking Account and Making Deposits

- Opening a checking account
 - Decide on account ownership
 - *Individual account vs. joint account*
- Making deposits
 - *Deposit ticket* is used for adding funds to your checking account
 - Each check you deposit requires an *endorsement*, your signature on the back of the check



Common Endorsement Forms

- *Blank endorsement* is just your signature
 - Should be used only when you are actually depositing or cashing a check
- *Restrictive endorsement* consists of the words *for deposit only*, followed by your signature
- *Special endorsement* allows you to transfer a check to someone else with the words *pay to the order of* followed by the name of the other person and then your signature
- *Remote deposit capture* allows you to deposit a check with an app photo and may require the words *for remote deposit* followed by your signature and account number



Managing Your Checking Account

Writing Checks

- Before writing a check, record the information in your check register and deduct the amount of the check from your balance
- Procedure for proper check writing:
 1. Record the date;
 2. Write the name of the person/organization receiving the payment;
 3. Record the amount of the check in numerals;
 4. Write the amount of check in words;
 5. Sign the check;
 6. Note the reason for the payment



Managing Your Checking Account

Reconciling Your Checking Account

- A *bank reconciliation* accounts for differences between the bank statement and your checkbook balance and may be accomplished with the following steps:
 1. Compare the checks written with those reported as paid on the statement; *subtract* from the bank statement balance the total of the checks written but not yet cleared
 2. Determine whether any deposits made are not on the statement; *add* the amount of the outstanding deposits to the *bank statement balance*
 3. *Subtract* fees or charges on the bank statement and ATM withdrawals from your *checkbook balance*
 4. *Add* any interest to your *checkbook balance*

Example: Bank Reconciliation

EXAMPLE: Bank Reconciliation

To determine the true balance in your checking account:

<u>Bank Statement</u>		<u>Your Checkbook</u>	
Bank balance	\$920	Checkbook balance	\$1,041
Subtract: Outstanding checks	-187	Subtract: Fees, ATM withdrawals	-271
Add: Deposit in transit	+200	Add: Interest earned, direct deposits	+163
Adjusted bank statement balance	933	Adjusted checkbook balance	933



Chapter Summary

LO4.1: Identify commonly used financial services.

- Financial products such as savings plans, checking accounts, loans, trust services, and electronic banking are used for managing daily financial activities.



Chapter Summary

LO4.2: Compare the types of financial institutions.

- Commercial banks, savings and loan associations, mutual savings banks, credit unions, life insurance companies, investment companies, finance companies, mortgage companies, pawn shops, and check-cashing outlets may be compared on the basis of services offered, rates and fees, safety, convenience, and special programs available to customers.



Chapter Summary

LO4.3: Assess various types of savings plans.

- Commonly used savings plans include regular savings accounts, certificates or deposit, interest-earning checking accounts, money market accounts, money market funds, and U.S. savings bonds.
- Savings plans may be evaluated on the basis of rate of return, inflation, tax considerations, liquidity, safety, restrictions, and fees.



Chapter Summary

LO4.4: Evaluate different types of payment methods.

- Debit cards, online and mobile payment systems, and stored-value cards are increasing in use for payment activities.
- Regular checking accounts, activity accounts, and interest-earning checking accounts can be compared with regard to restrictions (such as a minimum balance), fees and charges, interest, and special services.