Week 5: Handout A
BASICS OF BANKING

In general, banking is the business of paying interest to customers for their deposits and then lending those deposits out at a higher interest rate. Whether it's a commercial bank or a credit union, the basic idea behind banks is the same. They are able to earn money by borrowing it at a lower rate and lending it at a higher rate. Banks also provide ancillary services that help you manage your money more easily, like being able to use a debit card or personal checks, but the main business of banks is in getting deposits and granting loans.

Commercial Banks and Credit Unions

The primary difference between a commercial bank and a credit union is that commercial banks exist to generate profits and credit unions exist to serve its members. This philosophical difference is translated into reality by the interest rates the banks offer on their deposit accounts and their loans. Commercial banks usually offer lower rates on their deposit accounts and higher rates on their loans. This is why people recommend having at least one credit union account because it will give you access to the lower interest rates for loans, such as mortgages and car loans.

Opening an account at a commercial bank is fairly straightforward. You'll need to visit a bank or apply online and be able to fill out all your personal details including your social security number. Opening an account at a credit union is a little trickier because a credit union, by law, has to have membership requirements. Sometimes they are open only to people living or working in a particular town or only to employees of a company or members of an organization. Whatever the rules are, you should be able to find a credit union that you are eligible to join. It's just a small hoop to jump through.

Types of Bank Accounts

There are four major "types" of deposit accounts at a bank: a checking account, a money market account, a savings account, and certificate of deposit. There are a few things you need to look out for whenever you open a deposit account at a bank. Always review the fee structure of the account. You always want to avoid paying any fee whatsoever. If an account has a maintenance fee that you can't get waived, don't open it. If it has fees you don't understand, ask about them. Also check for a minimum balance requirement and whether it's reasonable.

A **checking account**, also known as a share draft account at credit unions, is designed for you to use on a daily basis. You will be issued checks and an ATM debit card that draws from this account. Checking accounts typically will have a low or no interest and "unlimited" transactions each month (if there is a limit, it is usually very high).

A **money market account**, also known as a money market account at credit unions, is less flexible than a checking account but offers a higher interest rate. You may be issued a card and checks but you will be limited in how many transactions you can have each month (the limit is six and governed by Federal Reserve Regulation D).

A **savings account**, also known as regular shares account at credit unions, is less flexible than the checking and money market accounts. In return for this inflexibility, it will have higher interest rates and be limited to 6 external debit transactions each month (as required by Federal Reserve Regulation D). You can have an unlimited number of deposits, whether they are cash, credit, ACH, etc. You will never get checks for a savings account. External transfers are limited to ACH transfers, if any at all.

A **certificate of deposit**, also known as shares certificate at credit unions, is the most restrictive of the four account types. With this account, you are *guaranteed* interest rate for the term of the CD but you cannot move the money inside the CD. If you need access, the only option you have is to close the account before maturity and that will trigger an interest penalty. For example, if you open a 12-month 4% CD, you will earn 4% APY on your money in that account for twelve months (here are the best CD rates). The rate will not go up or down but you don't have access to it unless you close out the account. (Some banks are offering "liquid CDs" where you are allowed to deposit or withdraw a small amount without penalty)

ATM & ATM Cards

ATM stands for automated teller machine. When you visit a bank, the person behind the counter is called the teller, hence the name automated teller. With the ATM card, you will need to remember your PIN, or personal identification number. When you slide your card into the machine, you'll be prompted for your PIN as a way of proving you are who you say you are. Through the ATM, you can conduct very basic business transactions such as depositing money, withdrawing money, and checking your balance. Anything more complicated, like opening a new account, and you'll need to talk to a real teller.

Make sure you are using an ATM that is affiliated with your bank and won't charge you an ATM access fee. If you use a non-affiliate ATM to withdraw cash, you will often be charged two fees. First, the owner of the ATM will charge you a few dollars. Second, your bank will charge you a few dollars. It's an ugly double whammy that catches many people. If you're in a tight spot and have no choice, by all means get some cash; but if you can avoid it, please do and save yourself some money.

Many banks offer ATM fee refunds. If your bank offers this, you can save some money on fees even if you need to go to a non-affiliated ATM. Other banks may waive ATM fees altogether. Check with your bank to find out.

ATM cards sometimes may be used as a debit card. A debit card looks like a credit card, except when you spend money it gets immediately withdrawn from your checking account. It's safer than a credit card because you can't go into debt. You can only spend the money that's already in your account. It's more dangerous than a credit card because if you charge something and your account doesn't have the money, you may be charged an over-draft fee.

Personal Checks

A personal check is an IOU against funds in your checking account. If you look at the bottom of your checks, you should see a series of numbers separated by symbols that look like three boxes. Those numbers coincide with your bank's ABA routing number (a 9-digit number), your checking account number, and your check number (probably the smallest number of the three). The ABA routing number and your checking account number are two important things to know because you will need that to set up any automatic payments or electronic payment accounts.

It is important to keep an accurate record of the checks you write because they won't show up in your checking account until the person cashes it. Some people can hold checks for a few months before they remember to cash it. Just like debit cards, if someone tries to cash a check and you don't have enough money, you'll be charged a fee (NSF – Insufficient Funds Fee).

Don't buy checks from the bank. Some banks will give you checks for free, but some banks will charge you an absurd amount of money for checks. If you have to buy checks, buy them from a reputable company online like Checks Unlimited because you can get them for a fraction of the price.

Fees

- **Account Maintenance Fee:** Typically only a few dollars, it's a fee that is charged if you don't fulfill minimum balance requirements. You can avoid this fee by keeping your average daily balance above the requirements.
- **Overdraft & Insufficient Funds Fee:** If you, either through your debit card or a personal check, overdraw your account, you'll be hit with this fee. Overdrawing simply means you wrote a check or made a charge and your account didn't have enough money. Sometimes the bank will pay the charge, then charge you a fee, and require you to deposit more funds. Sometimes they reject the charge and then charge the fee. Avoid this by keeping a check register and having a clear idea of how much money you have in the account.
- **Stop Payment Fee:** Let's say you write a check and then want to stop the bank from paying it out (for any reason, perhaps fraud or a mistake). If you can't get the check back, you can initiate a Stop Payment.
- **ATM Fee:** If you use an ATM that isn't in your bank's network, you'll be charged a fee as described in the ATM & ATM Cards section above.
- **Check Enclosure Fee:** This is a fee you pay if you want your canceled checks returned. Canceled checks are those checks you wrote, someone else

cashed, and have been returned to your bank. You can avoid this fee by simply declining the check enclosure service.

Overdraft Protection

Overdraft protection is a service where your checking account is "protected" by your savings account. Should you make a charge to your debit card or write a check when your checking account doesn't have enough money to cover it, overdraft protection will transfer money or will give you a short term loan with interest until you can deposit funds to cover it. If you never use it, it doesn't cost you anything. If you slip up and have to use it, the interest you pay is always less than the Overdraft or Insufficient Funds Fee ($30-35). One thing to be wary of, watch out for transfer fees and check with your bank about the specifics of the protection.

Online Banks

In the last five years or so, online banks have emerged as a great place to save your money and earn a higher rate of return. Online banks can be standalone entities or be associated with well-known brands like ING, HSBC, FNBO, and the like. Whatever the case may be, it's important to always ensure that your funds are FDIC protected.

Online banks are able to give such a high interest rate because they keep their costs low by only offering an online interface and requiring you to accept paperless statements via email.

FDIC & NCUA Insurance

The FDIC is the Federal Deposit Insurance Corporation and they insure that your deposits at a bank are protected against a bank's failure. The NCUA is the National Credit Union Administration and is the FDIC-equivalent for the credit union industry. The FDIC protects up to $100,000 of your assets at an FDIC-insured institution. It doesn't matter if you have one account, two accounts, or eight accounts at a bank, the FDIC covers up to $100,000. If you have one account at Bank A and another at Bank B, then you have up to $200,000 of coverage; $100,000 at each bank.

Taxes

Finally, the least entertaining topic about banks has to deal with taxes. The interest that you earn on your deposit accounts is subject to income tax. At the end of the year, your bank will send you a form 1099-INT. That form will explain how much interest you've earned through the year and you will put that on the tax form or into your tax software. Be sure to get a 1099-INT from every one of your banks because you will have to declare all that as income. If you don't and the IRS audits you, they will penalize you on the taxes that you didn't pay but should have.

Week 5: Handout B
BASICS OF BUDGETING

<u>10 steps to making a financial budget</u>

1. Budgets are a helpful tool.

They're the only practical way to get a grip on your spending - and to make sure your money is being used the way you want it to be used.

2. Creating a budget generally requires three steps.

- Identify how you're spending money now.

- Evaluate your current spending and set goals that take into account your long-term financial objectives.

- Track your spending to make sure it stays within those guidelines.

3. Use software to save grief.

If you use a personal-finance program such as Quicken or Microsoft Money, the built-in budget-making tools can create your budget for you.

4. Don't drive yourself nuts.

One drawback of monitoring your spending by computer is that it encourages overzealous attention to detail. Once you determine which categories of spending can and should be cut (or expanded), concentrate on those categories and worry less about other aspects of your spending.

5. Watch out for cash leakage.

If withdrawals from the ATM machine evaporate from your pocket without apparent explanation, it's time to keep better records. In general, if you find yourself returning to the ATM more than once a week or so, you need to examine where that cash is going.

6. Spending beyond your limits is dangerous.

But if you do, you've got plenty of company. Government figures show that many households with total income of $50,000 or less are spending more than they bring in. This doesn't make you an automatic candidate for bankruptcy - but it's definitely a sign you need to make some serious spending cuts.

7. Beware of luxuries dressed up as necessities.

If your income doesn't cover your costs, then some of your spending is probably for luxuries - even if you've been considering them to be filling a real need.

8. Save for yourself.

Aim to spend no more than 90% of your income. That way, you'll have the other 10% left to save for your big-picture items.

9. Don't count on windfalls.

When projecting the amount of money you can live on, don't include dollars that you can't be sure you'll receive, such as year-end bonuses, tax refunds or investment gains.

10. Beware of spending creep.

As your annual income climbs from raises, promotions and smart investments, don't start spending for luxuries until you're sure that you're staying ahead of inflation. It's better to use those income increases as an excuse to save more.

COMMUNITY ACTION FINANCIAL EDUCATION CLASSES:

Ongoing schedule of free classes offered by Community Action can be found at

http://caowash.org/events/financialed.html

Classes are FREE and child care for children ages 2-6 years old will be provided at no cost. Participants must register one week in advance to guarantee child care and translation services.

You must pre-register by phone or email. Please call in advance if you require a translator.

To register contact: (503) 517-3198 or ida@caowash.org

Classes are held at: Community Action,1001 SW Baseline Street, Hillsboro OR