CHAPTER 5-THE BANKING SYSTEM

Section 2-
Savings
Accounts

THE PURPOSE OF SAVINGS

- To save money for your future wants and needs
- Helps you meet your financial goals
  - Every personal goal, should have financial goal

SAVINGS ACCOUNTS

- Savings Account: a demand deposit account designed for the accumulation of money.
  - Safe place to keep money
  - Helps you meet your financial goals
  - Liquid asset (easily accessible and can withdraw money without penalty)
  - FDIC insured
  - Help you prepare for emergencies
  - Can hold money temporarily while waiting to move it to an investment account
  - Can earn simple or compound interest
- Liquidity-the ability to withdraw your money at anytime without a penalty
  - How quickly an asset can be turned into cash without penalty

GROWING YOUR SAVINGS

- Growing your savings is an important part of your wealth
- Earning Interest on your savings will increase your wealth
- Computing Interest
  - Principal-sum of money set aside on which interest is paid
  - Interest-money earned on the principal
  - Higher rate of interest—more money is earned
  - Simple Interest-interest computed on the principal once during a certain time period
    - Interest=Principal x Rate x Time
  - Compound Interest-interest is earned on both principal and previously earned interest
    - Money grows faster with this type of interest

FUTURE VALUE OF MONEY

- Refers to what money will be worth in the future after interest is compounded.
- It can be calculated on a single deposit left in an account for a long time or on a series of deposits made over time.
- To compute future value you need to know three things:
  - How much money you can set aside.
  - How long the money will be set aside.
  - The interest rate it will earn.
- An example is an annuity
  - Annuity-A fixed amount set aside on a regular basis over time
  - Usually used for retirement

RULE OF 72

- A quick formula for computing how long it will take to double money invested at a given interest rate.
- To use the formula:
  - Divide the annual interest rate into 72
  - The answer is the number of years it will take at that rate to double the amount invested
  - Example: $50 invested at 6 percent will double to $100 in 12 years
    - (72/6=12)

METHODS OF SAVING

- You should consider your financial goals when choosing saving options and places to save.
- The amount of time you have to save and the interest you can earn determine how much money you need to save each month to meet your goals.
  - Money Market Accounts
  - Certificates of Deposit
  - U.S. Savings Bonds
  - IRA Accounts

MONEY MARKET ACCOUNTS

- Money Market Accounts-A type of savings account that earns the market rate of interest on the money deposited
  - Interest rate typically higher than a savings account
  - May require minimum balance
  - Number of withdrawals may be limited
  - FDIC insured
  - A liquid asset, but not as liquid as a savings account

CERTIFICATES OF DEPOSIT

- Certificates of Deposit (CD)-a time deposit that pays a fixed rate of interest for a specified length of time
  - Interest rate higher than a savings account
  - Penalty for early withdrawal
  - Minimum deposit required
  - Money must be invested for the term of the certificate (6 months, 12 months, etc.)
  - FDIC insured
  - Not a liquid asset

U.S SAVINGS BONDS

- U.S. Savings Bonds-a discount bond issued by the federal government that pays a guaranteed minimum rate of interest
  - Long-term investment choice (10 years or more)
  - Pay less than face value of bond ($50 bond would cost $25)
  - **Maturity Value**-a bond's future value as stated on its face
  - **Safe investment**—backed by the U.S. government's full faith and credit
  - If bond is cashed before its maturity date, you will forfeit a portion of the interest earned
  - Not a liquid asset
  - Series I and EE Bonds are not taxed when used for educational expenses (purchased after 1989)
  - Most bonds continue to earn interest for up to 30 years
  - Check value of bonds at Treasury Direct

IRA ACCOUNTS

- Individual Retirement Accounts (IRA)-individuals deposit money into an account during their working years
  - Taxes are delayed on the interest and money put into the account
  - Taxes paid when money is withdrawn from account at retirement
  - Individuals are typically in a lower tax bracket at this time, so they pay less taxes on the money that is withdrawn (tax-deferred investment)
  - FDIC insured
  - Not a liquid asset

PLACES TO SAVE YOUR MONEY

- Banks and Credit Unions most common places for consumers to save their money
  - FDIC insured
- Online Only Banks
  - Often pay higher rates of interest than a traditional bank on savings accounts
  - May or may not be FDIC insured
- Brokerage Firms
  - Often pay higher rates of interest than a traditional bank on savings accounts
  - Not FDIC insured
- International Banks
  - A bank in another country
  - Receive statements and account information online
  - Money insured through the bank’s financial network in its country of origin