5
FINANCIAL SERVICES: SAVINGS PLANS AND PAYMENT ACCOUNTS

CHAPTER OVERVIEW

Using savings plans, checking accounts, and other financial services is a primary personal financial planning activity. This chapter starts with an overview of these services followed by a discussion of the changing environment of financial services caused by technology and economic conditions. Next, discussion of the different types of financial institutions is offered along with the factors to consider when selecting one. Coverage of choosing and using savings plans includes material on the types of accounts that are available. Finally, selection and use of checking and other payment accounts is presented.

LEARNING OBJECTIVES / CHAPTER SUMMARY

After studying this chapter, students will be able to:

Obj. 1	Analyze factors that affect selection and use of financial services.	Financial products such as savings plans, checking accounts, loans, and trust services are used for managing daily financial activities. Technology, opportunity costs, and economic conditions affect the selection and use of financial services.
Obj. 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, pawnshops, and check-cashing outlets may be compared on the basis of services offered, rates and fees, safety, convenience, and special programs available to customers.
Obj. 3	Compare the costs and benefits of various savings plans	Commonly used savings plans include regular savings accounts, club accounts, certificates of deposit, interest-earning checking accounts, money market accounts, money market funds, and U.S. savings bonds.
Obj. 4	Identify the factors used to evaluate different savings plans.	Savings plans may be evaluated on the basis of rate of return, inflation, tax considerations, liquidity, safety, restrictions, and fees.
Obj. 5	Compare the costs and benefits of different types of payment accounts.	Electronic payment methods include debit card transactions, online payments, stored-value cards, and smart cards. 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. Other payment alternatives include certified

checks, cashier's checks, money orders, and traveler's checks.

INTRODUCTORY ACTIVITIES

- Ask students to comment on their responses to the "My Life" chapter opening exercise (pp. 136-139).
- Point out the learning objectives (p. 139) in an effort to highlight the key points in the chapter.
- Ask students to provide examples of financial services that could be used to achieve various goals.
- Point out the opportunity costs associated with using various financial services (see text page 137).
- Obtain sample advertisements, brochures, or Web site printouts from financial institutions with information on their services, rates, and fees.

CHAPTER 5 OUTLINE

I. A Cash Management Strategy
  - A. Meeting Daily Money Needs
    1. Managing Cash
    2. Sources of Quick Cash
  - B. Types Financial Services
    1. Savings
    2. Payment Services
    3. Borrowing
    4. Other Financial Services
  - C. Online Banking
  - E. Opportunity Costs of Financial Services
  - F. Financial Services and Economic Conditions

II. Financial Institutions
  - A. Deposit Institutions
    1. Commercial Banks
    2. Savings and Loan Associations
    3. Mutual Savings Banks
    4. Credit Unions
  - B. Other Financial Institutions
    1. Life Insurance Companies
    2. Investment Companies
    3. Finance Companies
    4. Mortgage Companies
  - C. Comparing Financial Institutions

III. Savings Plans
- A. Regular Savings Accounts
- B. Certificates of Deposit
  1. Types of CDs
  2. Managing CDs
- C. Money Market Accounts and Funds
- D. U.S. Savings Bonds
  1. EE Bonds
  2. HH bonds
  3. I Bonds

IV. Evaluating Savings Plans
- A. Rate of Return
  1. Compounding
  2. Truth in Savings
- B. Inflation
- C. Tax Considerations
- D. Liquidity
- E. Safety
- F. FDIC Coverage
- G. Restrictions and Fees

V. Payment Methods
- A. Electronic Payments
  1. Debit Card Transactions
  2. Online Payments
  3. Stored-Value Cards
  4. Smart Cards
- B. Types of Checking Accounts
  1. Regular Checking Accounts
  2. Activity Accounts
  3. Interest-Earning Checking Accounts
- C. Evaluating Checking Accounts
  1. Restrictions
  2. Fees and Charges
  3. Interest
  4. Special Services

D. Managing Your Checking Account
    1. Opening a Checking Account
    2. Making Deposits
    3. Writing Checks
    4. Reconciling Your Checking Account
E. Other Payment Methods

CHAPTER 5 LECTURE OUTLINE

I. A CASH MANAGEMENT STRATEGY (p. 140)

- Daily buying activities require the use of financial services that facilitate business transactions as well as lead to the achievement of goals.

Meeting Daily Money Needs (p. 140)

- Cash, check, credit card, or cash machine card are the common payment choices.
- No matter how carefully you manage your money, there may be times when you will need more cash than you have currently available. To cope with that situation, you have two basic choices: liquidate savings or borrow.

Types of Financial Services (p. 141)

- Financial services may be viewed in four main categories:
  1. Savings involves safe storage of funds for future use.
  2. Payment services get you the ability to transfer money to others for conducting business.
  3. Borrowing refers to credit alternatives available for short- and long-term needs.
  4. Other financial services include insurance protection, investments, real estate purchases, tax assistance, and financial planning
- A **trust** is a legal agreement that provides for the management and control of assets by one party for the benefit of another.
- An **asset management account,** also referred to as a cash management account, provides a complete financial services program for a single fee.

Instructional Suggestions

- **Use PPT slides 5-2 to 5-9.**
- **Current Example:** When considering an asset management account, check into:
  * What types of credit cards are involved?
  * What is the annual fee and interest rate?
  * What amount is swept into a money market account?
  * What amount receives little or no interest?
  * Where is your money invested?
  * Are there fees for writing checks?
  * Are canceled checks returned?

Online Banking (p. 142)

- Computerized financial services (see Exhibit 5-2) provide fast, convenient, and efficient systems for recording inflows and outflows of funds.
- Direct Deposit. Each year, more and more workers are only receiving a pay stub on payday. Their earnings are being automatically deposited into their checking or savings accounts.
- Automatic Payments. Many utility companies, loan payments, and other businesses allow customers to use an automatic payment system with bills paid through direct withdrawal from a bank account.

- **Use PPT slides 5-10 and 5-11.**
- **Current Example:** To reduce ATM fees: (1) compare ATM fees at different financial institutions before opening an account; (2) use your own bank's ATM whenever possible to avoid surcharge imposed when using the ATM of another financial institution; (3) withdraw larger cash amounts, as needed, to avoid fees on several small transactions; (4) consider using personal checks, traveler's checks, and credit cards when away from home.

- An **automatic teller machine (ATM),** or simply cash machine, is a computer terminal that allows customers to conduct banking transactions. In addition, some ATMs sell bus passes, postage stamps, gift certificates, and mutual funds.
- A **debit card,** or *cash card*, activates ATM transactions and is linked to a bank account. ATM convenience can be expensive.
- A lost or stolen debit card can be expensive. If you notify the financial institution within two days of losing the card, your liability for authorized use is $50. If you wait any longer, you can be liable for up to $500 of unauthorized use for up to 60 days. Beyond that time, your liability is unlimited.

- **Current Example:** Face-recognition and voice-recognition software are being tested to activate ATM transactions. This same software is being used for border crossings and airport security.

Opportunity Costs of Financial Services (p. 143)

- As in all decisions, opportunity cost is what you give up when evaluating, selecting, and using financial services.
- Opportunity costs associated with financial services may include higher return with low liquidity, higher costs for convenience of 24-hour electronic banking, or lost interest when a "free" checking account requires that you maintain a minimum balance.

- **Use PPT slide 5-12.**
- **PPT slide 5-9** (based on Exhibit 5-3) shows how changing interest rates should be considered when using financial services.
- **Assignment:** Using *The Wall Street Journal* or http://www.federalreserve.gov, have students update the interest rates on page 146.

Financial Services and Economic Conditions (p. 144)

- Changing interest rates, fluctuating consumer prices, and other economic factors influence the availability and use of financial services.

- **Use PPT slide 5-13.**
- **Concept Check 5-1** (p. 144)

CHAPTER 5 LECTURE OUTLINE

II. FINANCIAL INSTITUTIONS (p. 144)

- Financial institutions may be viewed in two major categories.

Deposit Institutions (p. 145)

- Traditionally, **commercial banks** have offered the widest range of financial services.
- The **savings and loan association** traditionally specialized in savings accounts and loans for mortgages
- **Mutual savings banks**, which are owned by depositors, specialize in savings and mortgage loans.
- **Credit unions** are user-owner, nonprofit, cooperative financial institutions that offer a wide range of services.

Other Financial Institutions (p. 148)

- Many **life insurance companies** offer policies that contain savings and investment features.
- **Investment companies**, also referred to as *mutual funds*, have become involved in banking-type activities. A common service of these organizations is the **money market fund**, a combination savings-investment plan in which the investment company uses your money to purchase a variety of financial instruments.
- Making loans to consumers and small businesses is the main function of **finance companies**.
- **Mortgage companies** are organized to provide loans for home purchases.

Beware of High-Cost Financial Services (p. 147)

- **Pawnshops** make loans based on the value of some tangible possession, such as jewelry or other valuable items. Many low- and moderate-income families use these organizations to quickly obtain cash loans. Pawnshops charge higher fees than other financial institutions.
- Many U.S. households do not have bank accounts, and most financial institutions won't cash a check unless you have an account. The over 6,000 **check-cashing outlets** (CCO) can charge anywhere from 1% to 20% of the face value of a check; the average cost is between 2% and 3%.

Instructional Suggestions

- **Use PPT slides 5-14 to 5-19.**
- **Assignment:** Have students survey three to five people to determine the main factors that influenced their selection of a financial institution with which they do business.
- **Current Example:** Surveys of consumers consistently givs credit unions the highest satisfaction rating of all financial service providers.

CHAPTER 5 LECTURE OUTLINE

Comparing Financial Institutions (p. 146)

- The major factors to consider when selecting a financial institution are:
  * services offered
  * convenience/location
  * safety/deposit insurance
  * interest rates
  * fees and charges

Instructional Suggestions

- **Text Highlight:** The "How To.." feature on page 149 suggests factors to consider when selecting a financial institution.
- **Concept Check 5-2** (p. 150)

CHAPTER 5 LECTURE OUTLINE

III. SAVINGS PLANS (p. 150)

- The basis for your attainment of financial goals is the accumulation of funds that results from an effective savings and investment program.

Regular Savings Plans (p. 150)

- Regular savings accounts, traditionally referred to as passbook accounts, involve a low or no minimum balance and allow savers to withdraw money as needed.
- At a credit union, these savings plans are called **share accounts**.

Certificates of Deposit (p. 150)

- A **certificate of deposit (CD)** is a savings plan that requires you to leave a certain amount on deposit for a set time period (ranging from 30 days to 5, 10 or more years) in order to earn a specified interest rate.
- *Rising rate* or *bump-up* CDs may give savers higher rates at various intervals, such as every six months. However, beware of ads that highlight a higher rate in the future, which may only be in effect for the last couple of months of an 18- or 24-month savings certificate. Also, some bump-ups may require a rather large minimum investment.
- *Indexed* CDs have earnings based on the stock market. In times of strong stock performance, your CD earnings can be higher than other CDs. However, at other times you may not earn any interest and may even lose part of your savings. A CD based on the consumer price index can result in higher returns as inflation increases.
- *Callable CDs* start with higher rates and usually have long-term maturities, as high as 10-15 years. These savings plans also have the benefit of federal deposit insurance. However, the bank may "call" the account after a stipulated period, such as one or two years, if interest rates drop.
- *Promotional CDs* attempt to attract savers with gifts or special rates. A Boulder, Colorado, bank offered Rolex watches, archery equipment, and Zodiac inflatable boats in lieu of interest.
- Current information about CD rates at various financial institutions may be obtained at http://www.bankrate.com.
- Consider creating a CD *portfolio* with CDs maturing at different times. For example, $2,000 in a three-

Instructional Suggestions

- **Use PPT slides 5-20 to 5-22**.

CHAPTER 5 LECTURE OUTLINE | **Instructional Suggestions**

month CD, $2,000 in a six-month CD, $2,000 in a one-year CD, and $2,000 in a two-year CD. This will give you some degree of liquidity and flexibility when reinvesting your funds.

oney Market Accounts and Funds (p. 152)

- A **money market account** is a savings account that requires a minimum balance and bases earnings on market interest rates. Money market accounts allow savers to write a limited number of checks to make large payments or to transfer money to other accounts.

U.S. Savings Bonds (p. 152)

- Years ago, the low return on savings bonds made their purchase a patriotic act rather than a wise saving choice. In recent years, however, the Treasury Department has offered various programs to make buying savings bonds more attractive.
- Series EE bonds (called Patriot Bonds after the September 11, 2001, terrorist attacks) may be purchased for amounts ranging from $25 to $5,000 (face values of $50 to $10,000, respectively).
- EE bonds increase in value every month as interest accrues monthly and compounds semiannually. If you redeem EE Bonds before five years, you forfeit the latest three months of interest; after five years, you are not penalized.
- EE bonds purchased between 1997 and 2005 earned market-based interest. Since that time, a fixed interest rate has been paid. Series EE bonds continue to earn interest for 30 years, well beyond the time at which the face value is reached.
- The main tax advantages of Series EE bonds are that (1) the interest earned is exempt from state and local taxes and (2) you do not have to pay federal income tax on earnings until the bonds are redeemed.
- Redeemed Series EE bonds may be exempt from federal income tax if the funds are used to pay tuition and fees at a college, university, or qualified technical school for yourself or a dependent.

- Series HH bonds, which are no longer sold, were *current-income* bonds with interest deposited

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electronically to your bank account every six months.

- This interest was taxed as current income on a person's federal tax return, but exempt from state and local taxes.
- The I bond earns a combined rate consisting of: (1) a fixed rate for the life of the bond, and (2) an inflation rate that changes twice a year. Every six months a new, fixed base rate is set for new bonds. The additional interest payment is recalculated twice a year, based on the current annual inflation rate.
- I bonds are sold in the same denominations as EE bonds, but are purchased at face value, not discount. Also, as with EE bonds, the minimum holding period is one year.
- Additional information and current value calculations for savings bonds values may be obtained at www.savingsbonds.gov.

Instructional Suggestions

- **Concept Check 5-3** (p. 154)

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Instructional Suggestions

IV. EVALUATING SAVINGS PLANS (p. 154)

Rate of Return (p. 154)

- **Use PPT slide 5-23.**

- **Rate of return**, or **yield**, is the percentage of increase in the value of your savings due to earned interest.
- **Compounding** refers to interest that is earned on previously earned interest. The more frequent the compounding, the higher your rate of return will be.
- In 1993, *Truth in Savings* (Federal Reserve Regulation DD) became effective. This law requires financial institutions to disclose the following information on savings account plans they offer:
  - fees on deposit accounts
  - the interest rate
  - the annual percentage yield (APY)
  - other terms and conditions of the savings plan

- **Use PPT slides 5-24 and 5-25.**

- Truth in savings (TIS) defines **annual percentage yield (APY)** as 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. (See "Financial Calculations" for additional information on APY.) (p. 155)

Inflation (p. 156)

- The rate of return you earn on your savings should be compared with the inflation rate.
- In general, as the inflation rate increases, the interest rates offered to savers also increase. This gives you an opportunity to select a savings option that will minimize the erosion of your dollars on deposit.

Tax Considerations (p. 156)

- **Use PPT slides 5-26 to 5-28.**

- Taxes reduce your earnings on savings. For example, a 6.25 percent return for a saver in a 28 percent tax bracket means a real return of only 4.5 percent. (See "Financial Planning Calculations" feature on page 157.)

Liquidity (p. 156)

- Liquidity allows you to withdraw your money on short notice.

Safety (p. 157)

- Most savings plans at banks, savings and loan associations, and credit unions are insured by

CHAPTER 5 LECTURE OUTLINE | **Instructional Suggestions**

agencies affiliated with the federal government.

- The Federal Deposit Insurance Corporation (FDIC) provides deposit insurance for banks and savings and loan associations. The FDIC administers separate insurance funds, the Bank Insurance Fund and the Savings Association Insurance Fund. Credit unions may still obtain deposit insurance through the National Credit Union Association (NCUA).

The FDIC insures deposits of up to $250,000 per person per financial institution; a joint account is considered to belong proportionally to each name on the account. However, by using combinations of individual, joint, and trust ownership accounts in different financial institutions, it is possible to have federal deposit insurance cover amounts that exceed $250,000.

Restrictions and Fees (p. 158)

- Restrictions and costs may include a delay between the time interest is earned and the time it is added to your account. Also, some institutions charge a transaction fee for each deposit or withdrawal.

- **Concept Check 5-4** (p. 158)

CHAPTER 5 LECTURE OUTLINE

V. PAYMENT METHODS (p. 158)

Electronic Payments (p. 158)

- Transactions not involving cash, checks, or credit cards have expanded with technology, improved security, and increased consumer acceptance.
- Debit Card Transactions. Most retail stores, restaurants, and other businesses accept check cards issued by Visa and MasterCard. When the debit card transaction is processed, the amount of the purchase is deducted from your checking account.
- Most debit cards can be used two ways: (1) with your signature, like a credit card, and (2) with your personal identification number (PIN), like an ATM card.
- Online Payments. Banks and Internet companies are serving as third parties to facilitate online bill payments. Some of these include http://www.paypal.com, http://www.mycheckfree.com, http://www.paytrust.com, and Google checkout. When using these services, be sure to consider the monthly charge as well as online security and customer service availability.
- Stored-Value Cards. Prepaid cards for telephone service, transit fares, highway tolls, laundry service, and school lunches are very common. While some of these stored-value cards are disposable, others can be reloaded with an additional amount.
- Smart Cards. These "electronic wallets' are similar to other ATM cards. However, their imbedded microchip stores prepaid amounts as well as information with account balances, transaction records, insurance information, and medical history.

Types of Checking Accounts (p. 159)

- With a major portion of business transactions conducted by check, a checking account is a necessity for most people.
- The main types of checking accounts are:

Instructional Suggestions

- **Use PPT slide 5-29.**
- **Use PPT slides 5-30 and 5-31.**
- **Transparency Master 5-1** offers a framework for assessing the costs associated with using a checking account.

- *regular checking accounts* are likely to have a monthly service charge or a minimum balance to avoid the fee
- *activity accounts* charge for each check written and sometimes for each deposit made

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- *interest-earning checking accounts*, also referred to as NOW accounts

Evaluating Checking Accounts (p. 160)

- The most common limitation on checking accounts is the amount that must be kept on deposit to earn interest or avoid a service charge.
- Nearly all financial institutions require a minimum balance or service charges for checking accounts.
- The interest rate, frequency of compounding, and interest computation method will affect the earnings on your checking account.
- Financial institutions may offer checking account customers such extra services as 24-hour teller machines and home banking services.
- **Overdraft protection** is an automatic loan made to checking customers to cover the amount of checks written in excess of the available balance.

Managing Your Checking Account (p. 162)

- Opening a Checking Account. Start by deciding whether to open an individual account or joint account.
- Making Deposits. Depositing checks may be done with a blank endorsement, a restrictive endorsement, or a special endorsement.
- Writing Checks. The information needed when completing a check includes: (1) the date; (2) the name of person or organization receiving the check; (3) the amount in figures; (4) the amount in words; (5) your signature; (6) note the reason for the payment.
- Maintaining a Checking Account. A *bank statement* is a summary of the transactions for a checking account. A *bank reconciliation* is prepared to determine the true checking account balance since a difference between the checkbook and bank statement

Instructional Suggestions

- **Transparency Master 5-2** presents a sample deposit ticket
- **Transparency Master 5-3** presents a sample check
- **Transparency Master 5-4** presents the steps involved in reconciling a checking account.
- **Use PPT slides 5-32, 5-33, and 5-34.**

balance is likely.

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Other Payment Methods (p. 164)

- A **certified check** is a personal check with guaranteed payment.
- A **cashier's check** is the check of a financial institution.
- A **money order** is a payment device purchased from financial institutions, post offices, or stores.
- **Traveler's checks** allow you to make payments when away from home.

Instructional Suggestions

- **Use PPT slides 5-35 and 5-36.**
- **Discussion Question:** Why do traveler's check companies encourage people to save their unused checks after vacation rather than spending them?
- **Concept Check 5-5** (p. 164)

CONCLUDING ACTIVITIES

- Point out the chapter summary (p. 165) and key terms in the text margin.
- Use the "My Life Stage" feature (p.165) to highlight the main financial planning activities from the chapter for various ages and life situations.
- Discuss selected end-of-chapter Financial Planning Problems, Financial Planning Activities, Life Situation Case, and Digital Case.
- Use the Chapter Quiz in the *Instructor's Manual*.
- Refer students to activities and readings in the *Student Resource Manual* for Chapter 5.

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WORKSHEETS FROM *PERSONAL FINANCIAL PLANNER* FOR USE WITH CHAPTER 5

Use the "Your Personal Financial Planner in Action" (p. 168) activities to encourage students to plan and implement various personal financial decisions.

Sheet 23	Planning the Use of Financial Services
Sheet 24	Using Savings to Achieve Financial Goals
Sheet 25	Savings Plan Comparison
Sheet 26	Checking Account Comparison
Sheet 27	Checking Account Cost Analysis
Sheet 28	Checking Account Reconciliation

CHAPTER 5 QUIZ ANSWERS

True-False	*Multiple Choice*
1. T (p. 140)	6. D (p. 148)
2. F (p. 141)	7. A (p. 154)
3. F (pp. 146, 148)	8. B (p. 150)
4. T (pp. 154)	9. A (p. 164)
5. F (pp. 150)	10. C (p. 162)

Name____ Date____________________________

CHAPTER 5 QUIZ

TRUE-FALSE

_____1. A quick source of cash is to liquidate savings.

_____2. Demand deposits refer to money deposited in savings accounts.

_____3. A credit union usually offers a wider range of financial services than a commercial bank.

_____4. A savings account with daily compounding will have higher earnings than an account with quarterly compounding.

_____5. A CD account is a checking account that earns interest.

MULTIPLE CHOICE

_____6. The fewest financial services would probably be offered by a(n)
a. credit union.
b. savings and loan association.
c. commercial bank.
d. investment company.

_____7. The rate of return on a savings account may also be referred to as
a. yield.
b. compounding.
c. liquidity.
d. equity.

_____8. The savings plan that is likely to have a set rate of return is a
- a. money market account.
- b. certificate of deposit.
- c. debit card account.
- d. money market fund.

_____9. A personal check with guaranteed payment is a
- a. certified check.
- b. bank draft.
- c. cashier's check.
- d. money order.

_____10. A __________ endorsement is most useful when depositing checks by mail.
- a. special
- b. blank
- c. restrictive
- d. multiple

SUPPLEMENTARY LECTURE

Are You an Informed User of Financial Services?

For each of the following statements indicate a "Yes" or "No" answer.

Yes	No	
_____	_____	1. Do you know a financial institution in your community that has safe-deposit boxes?
_____	_____	2. Do you know the current rate of return on your savings account?
_____	_____	3. Do you know the frequency of compounding for your savings account?
_____	_____	4. Do you know where you can buy U.S. savings bonds in your community?
_____	_____	5. Do you know if there is a credit union in your community?
_____	_____	6. Do you know the location of your financial institution's 24-hour automatic teller machines?
_____	_____	7. Do you know the monthly service charge on your checking account and the fees on your ATM withdrawals?
_____	_____	8. Do you know the minimum balance on your checking account to avoid a service charge?

_____ _____ 9. Do you know the charge for an overdraft on your checking account?

_____ _____ 10. Do you know the annual percentage rate charged on your credit cards and charge accounts?

_____ _____ 11. Do you know the annual fee for your bank credit card?

_____ _____ 12. Do you know the interest rate for automobile loans at your financial institution?

ANSWERS TO CONCEPT QUESTIONS, PROBLEMS, FINANCIAL PLANNING ACTIVITIES, FINANCIAL PLANNING CASE, AND CONTINUING CASE

CONCEPT QUESTIONS

Concept Check 5-1 (p. 144)

1. What is the relationship between financial services and overall financial planning?

   Financial services are used to manage financial activities and to achieve financial goals. See Exhibit 5-1 (p. 141) for an overview of this relationship.

2. What are the major categories of financial services?

   The major financial services are savings plans, payment services, credit plans, and other services such as investments, tax assistance, financial planning, and trusts. (pp. 141-142)

3. What financial services are available through electronic banking systems?

   Common electronic banking transactions include obtaining cash, point of purchase payment, direct deposit, preauthorized payments, and transfer of funds between checking, savings, and loans. (pp. 142-143)

4. Why shouldn't you select financial services only on the basis of monetary factors?

   Certain factors such as convenience and personal service may not be easily measured in terms of money. (p. 143)

5. How do changing economic conditions affect the use of financial services?

   As interest rates rise you are more likely to save and borrow less. When interest rates decline, spending and borrowing increase. See Exhibit 5-3 (p. 144) for additional information on the effect of interest rates on financial services use.

Action Application: This activity can provide students with expanded awareness of various online banking services.

Concept Check 5-2 (p. 150)

1. What are the examples of deposit financial institutions?

   Deposit-type financial institutions include commercial banks, savings and loan associations, mutual savings banks, and credit unions. (pp. 145-147)

2. What factors do consumers usually consider when selecting a financial institution to meet their saving and checking needs?

   When selecting a financial institution, a person should consider the services available, convenience (location, hours, branch offices, banking by mail, automatic teller machines), safety, personal service, rates charged, and interest paid to savers. (pp. 149-150)

Action Application: Credit unions can provide a valuable source for financial services. Encourage students to become aware of these organizations.

Concept Check 5-3 (p. 154)

1. What are the main types of savings plans offered by financial institutions?

   The main types of savings plans are regular savings accounts, certificates of deposit, money market accounts, money market funds, and U.S. savings bonds. (pp. 150-153)

2. How does a money market *account* differ from a money market *fund*?

   A money market account is a savings account at a bank or other insured financial institution, usually with a minimum balance, earning a rate that varies based on current interest rates. A money market fund is a savings-investment plan with an investment company. (p. 152)

3. What are the benefits of U.S. savings bonds?

   One benefit of U.S. savings bonds is safety. They are guaranteed by the federal government. Also, the floating rate on I-bonds can result in higher returns as inflation increase; the interest earned is exempt from state and local taxes; federal income tax on interest earned does not have to be paid until bonds are redeemed; and bonds may be exempt from federal taxes if the funds are used for college tuition. (pp. 152-153)

Action Application: Student awareness of current interest rates can result in wiser financial decisions both in the short-term and long-term.

Concept Check 5-4 (p. 158)

1. When would a savings plan with high liquidity be preferred over one with a high rate of return?

   If a person will need to have access to savings funds in the near future, liquidity would be preferred over a high rate of return since a penalty for early withdrawal may be involved to get the higher yield.

2. What is the relationship between compounding and calculating the future value of an amount?

   Future value calculations can also be referred to as *compounding* since the process involves determining interest on the initial deposit plus any previously-earned interest. (p. 154)

3. How do inflation and taxes affect earnings on savings?

   Inflation and taxes reduce the real rate of return earned on savings. (pp. 156-157)

Action Application: This will allow students to be better informed about current rates of return for various types of savings plans.

Concept Check 5-5 (p. 165)

1. What factors are commonly considered when selecting a checking account?

   When selecting a checking account consider restrictions (such as minimum balance and holding period for deposited checks), fees and charges, special features, and interest earned. (pp. 160-162)

2. Are checking accounts that earn interest better than regular checking accounts? Why or why not?

   This depends on the minimum balance required to earn interest and the fees charged.

Action Application: This field research activity can provide the basis for interesting class discussion related to payment behaviors.

PROBLEMS (p. 167)

1. If a person has ATM fees each month of $18 for 8 years, what would be the total cost of those banking fees?

   Solution: $18 X 12 months X 8 years = $1,728
   LO: 1
   Topic: Calculating the Cost of ATM Fees.
   LOD: Easy
   Bloom tag: Application

2. A payday loan company charges 4 percent interest for a two-week period. What would be the annual interest rate from that company?

   Solution: 52 weeks / 2-week period = 26 periods X .04 = 1.04 (annual period of 104 percent)
   LO: 2
   Topic: Determining an Annual Interest Rate
   LOD: Medium
   Bloom tag: Application

3. What would be common savings goals for a person who buys a five-year CD paying 5.5 percent instead of an 18-month savings certificate paying 4.75 percent?

Solution: A person saving for a longer-term goal such as children's education, retirement, or purchase of a vacation home may make use of a five-year savings certificate. A person who will need the funds in less than two years would use an 18-month savings certificate. Also, if you believe interest rates will be dropping, use of a long-term certificate will guarantee a higher savings rate over this time period.
LO: 4
Topic: Determining Savings Goals.
LOD: Medium
Bloom tag: Analysis

4. A certificate of deposit will often result in a penalty for withdrawing funds before the maturity date. If the penalty involves two months of interest, what would be the amount for early withdrawal on a $20,000, 6 percent CD?

Solution: $20,000 X .06 X (2/12) = $200
LO: 4
Topic: Computing CD Interest.
LOD: Easy
Bloom tag: Application

5. What would be the value of a savings account started with $1,200, earning 4 percent (compounded annually) after 10 years?

Solution: $1,200 × 1.480 = $1,776
LO: 4
Topic: Computing Future Value.
LOD: Easy
Bloom tag: Application

6. Brenda Young desires to have $10,000 eight years from now for her daughter's college fund. If she will earn 6 percent (compounded annually) on her money, what amount should she deposit now? Use the present value of a single amount calculation.

Solution: $10,000 × 0.627 = $6,270
LO: 4
Topic: Calculating Present Value
LOD: Easy
Bloom tag: Application

7. What amount would you have if you deposited $2,500 a year for 30 years at 7 percent (compounded annually)? (Use the Chapter 1 appendix.)

Solution: $2,500 × 94.462 = $236,155
LO: 4
Topic: Computing Future Value of Annual Deposits
LOD: Easy
Bloom tag: Application

8. With a 28 percent marginal tax rate, would a tax-free yield of 7 percent or a taxable yield of 9.5 percent give you a better return on your savings? Why?

Solution: The 7 percent tax-free yield is better since 9.5 percent after taxes comes to 6.84 percent (9.5% × 0.72).
LO: 4
Topic: Comparing Taxable and Tax-Free Yields.
LOD: Hard
Bloom tag: Application, analysis

9. What would be the annual percentage yield for a savings account that earned $56 in interest on $800 over the past 365 days?

Solution: $56 / $800 = .07 = 7 percent
LO: 4
Topic: Computing APY
LOD: Medium
Bloom tag: Application

10. What is the annual opportunity cost of a checking account that requires a $500 minimum balance to avoid service charges? Assume an interest rate of 3 percent.

Solution: $500 × .03 = $15
LO: 5
Topic: Calculating Opportunity Cost
LOD: Easy
Bloom tag: Application

11. What would be the net annual cost of the following checking accounts?
a. Monthly fee, $3.75; processing fee, $0.25 cents per check; checks written, an average of 22 a month.
b. Interest earnings of 6 percent with a $500 minimum balance; average monthly balance, $600; monthly service charge of $15 for falling below the minimum balance, which occurs three times a year (no interest earned in these months).

Solution:
a. (22 checks × 12 months × $0.25) + ($3.75 × 12 months) = $111 cost
b. $600 × .06 = 36 × 9/12 = $27 less $45 services charge = $18 net cost
LO: 5
Topic: Comparing Costs of Checking Accounts
LOD: Medium
Bloom tag: Application

12. Based on the following information, determine the true balance in your checking account.
(See page _____163)

Balance in your checkbook, $356	Interest earned on the account, $4
Balance on bank statement, $472	Total of outstanding checks, $187
Service charge and other fees, $15	Deposits in transit, $60

Solution: $345 is the reconciled balance.
(Checkbook: $356 – 15 + 4 = $345; Bank statement $472 – 187 + 60 =$345)
LO: 5
Topic: Computing Checking Account Balance
LOD: Medium
Bloom tag: Application

FINANCIAL PLANNING ACTIVITIES (p. 167)

1. Research current economic conditions (interest rates, inflation) using *The Wall Street Journal*, other library resources, or the World Wide Web. Based on current economic conditions, what actions would you recommend to people who are saving and borrowing money?

   Have students obtain current interest rate information on commonly reported items (see text p. 143). Also, each month changes in the Consumer Price Index are reported in the news. You can obtain a copy of the current Consumer Price Index from the U. S. Department of Labor, Bureau of Labor Statistics, 600 E. Street, NW, Washington, DC 20212 (http://www.bls.gov/oco). Changes in interest rates and consumer prices will benefit savers when they are low, but higher interest rates will increase costs of borrowing.

2. Collect advertisements and promotional information from several financial institutions, or locate the Web sites of financial institutions. Create a list of factors that a person might consider when comparing costs and benefits of various savings plans and checking accounts.

   Advertising for financial services has expanded significantly over the past few years. Have students analyze these ads and Web sites in relation to the factors discussed in the chapter.

3. Collect online information from several financial institutions with information about the savings plans they offer. Using Sheet 25 in the *Personal Financial Planner*, compare the features and potential earnings of two or three savings plan.

   Have students report on the information obtained for various savings plans.

4. Using Sheets 26 and 27 in the *Personal Financial Planner*, compare the features and costs of checking accounts at two different financial institutions. Online searches of bank Web sites may be useful.

   This activity can help students better understand the costs and services associated with checking accounts in their community.

5. Several states require that banks offer basic checking accounts. For example, in Illinois, New York, New Jersey, and Minnesota, check services with minimal fees must be made available for consumers making a limited number of transactions. Obtain information about the availability of these types in *lifeline* accounts in your area.

   Higher costs for checking accounts have forced some low-income consumers to close their accounts or to spend many more dollars for financial services. Those who close their accounts are usually forced to use higher cost money orders when a payment must be made by mail; this can be quite expensive when several payments are made each month. While this situation may seem to be one that could be solved by government involvement, the cost of these accounts for low-income consumers would be paid for by other customers. Some argue that this would be appropriate since middle and upper income consumers are in a better financial position to pay these fees. No easy answers exist for this controversy.

FINANCIAL PLANNING CASE

"Press 1 to Withdraw Cash, Press 2 to Deposit, Press 3 for Higher Fees" (p. 168)

1. What benefits might Lisa gain when using online banking services?

   Benefits might include easy access, lower costs, and improved computerized information records.

2. What factors should Lisa consider when selecting various banking services?

   Answers will vary. Common responses will include costs and fees, convenience, services offered, the reputation of the financial institution, and other factors.

3. What actions might you take to better understand the concerns associated with using online banking?

   Online research and talking with others will help student better understand common concerns such as online security, privacy rights, identity theft, and cyber fraud.

CONTINUING CASE

Banking Services (p. 169)

Questions

1. Given her current situation, list some suggestions on what Shelby should do to increase her emergency fund.

   Most financial advisors recommend an emergency fund of 3 to 6 months of living expenses ($3,630 to $7,260 in Shelby's case). In order to overcome the decrease in her savings due to the illness and establish an adequate emergency fund, Shelby may consider reducing some of her living expenses (eating out less, spending less on gasoline, etc.) or increase her monthly income by taking on extra work.

2. Based on her current and future life situation, what other money management and financial planning activities would you recommend for Shelby?

   Although student responses may vary, some good answers to this question are:
   - Set up an automatic withdrawal from her paycheck that is deposited into a savings account
   - Assess the costs of her current checking account versus ones at other institutions
   - Compare the rate earned on her current savings account with ones at other institutions
   - Consider online banking to handle finances; online banking assists in tracking daily spending and helps with budgeting; online bill pay is convenient and reduces car wear and tear and gasoline expenses; online banking gives direct access to ATMs, savings accounts, loan services, etc.

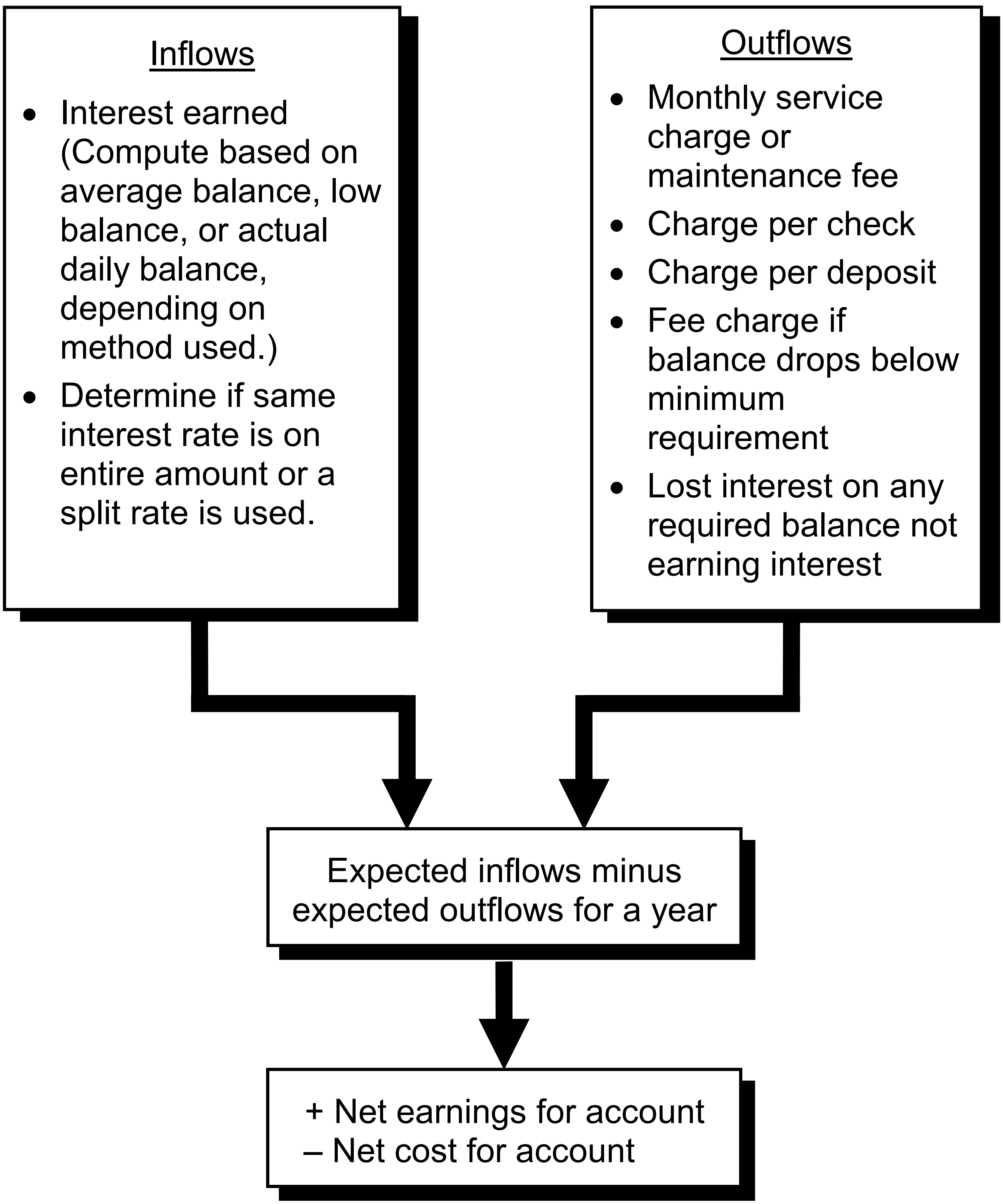
3. Describe how Shelby might use the following Personal Financial Planner sheets (Payment Account Comparison and Checking Account Reconciliation).

   Although student responses may vary, some good answers to this question are:
   a. Payment Account Comparison
      Shelby can use this form to compare the benefits and costs associated with different checking and payment accounts from various financial institutions (banks, savings and loan associations, or credit unions).
   b. Checking Account Reconciliation
      Shelby can use this form to identify any differences between her checkbook and her bank statement records.

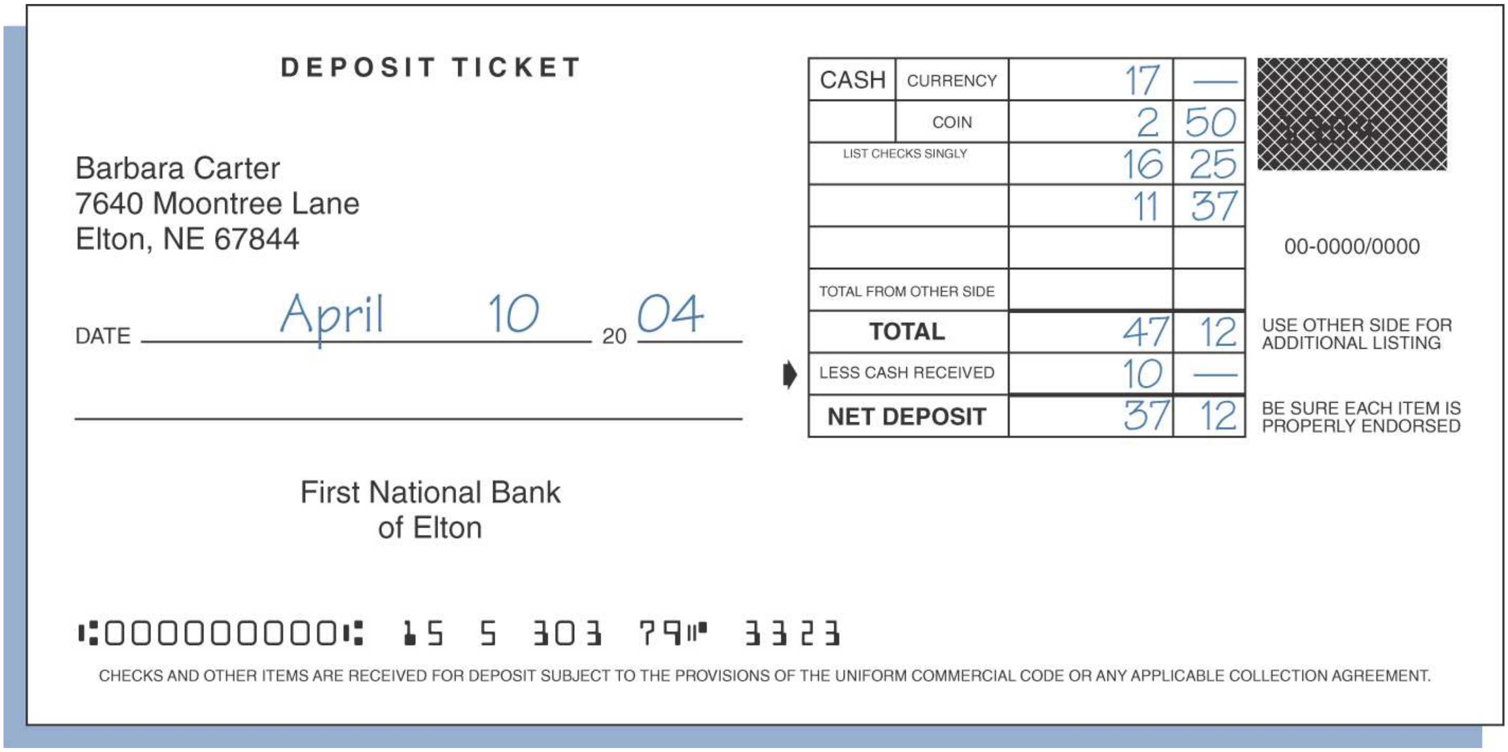
DAILY SPENDING DAIRY (p. 169)

This activity will help students better plan the use of various financial services as well as spending for short-term and long-term financial decisions.

TM 5-1 Comparing Costs of Checking Accounts



TM 5-2 Deposit Ticket



DEPOSIT TICKET

Barbara Carter
7640 Moontree Lane
Elton, NE 67844

DATE April 10 20 04

First National Bank
of Elton

CASH	CURRENCY	17	—
	COIN	2	50
LIST CHECKS SINGLY		16	25
		11	37
TOTAL FROM OTHER SIDE			
TOTAL		47	12
LESS CASH RECEIVED		10	—
NET DEPOSIT		37	12

[redacted]

00-0000/0000

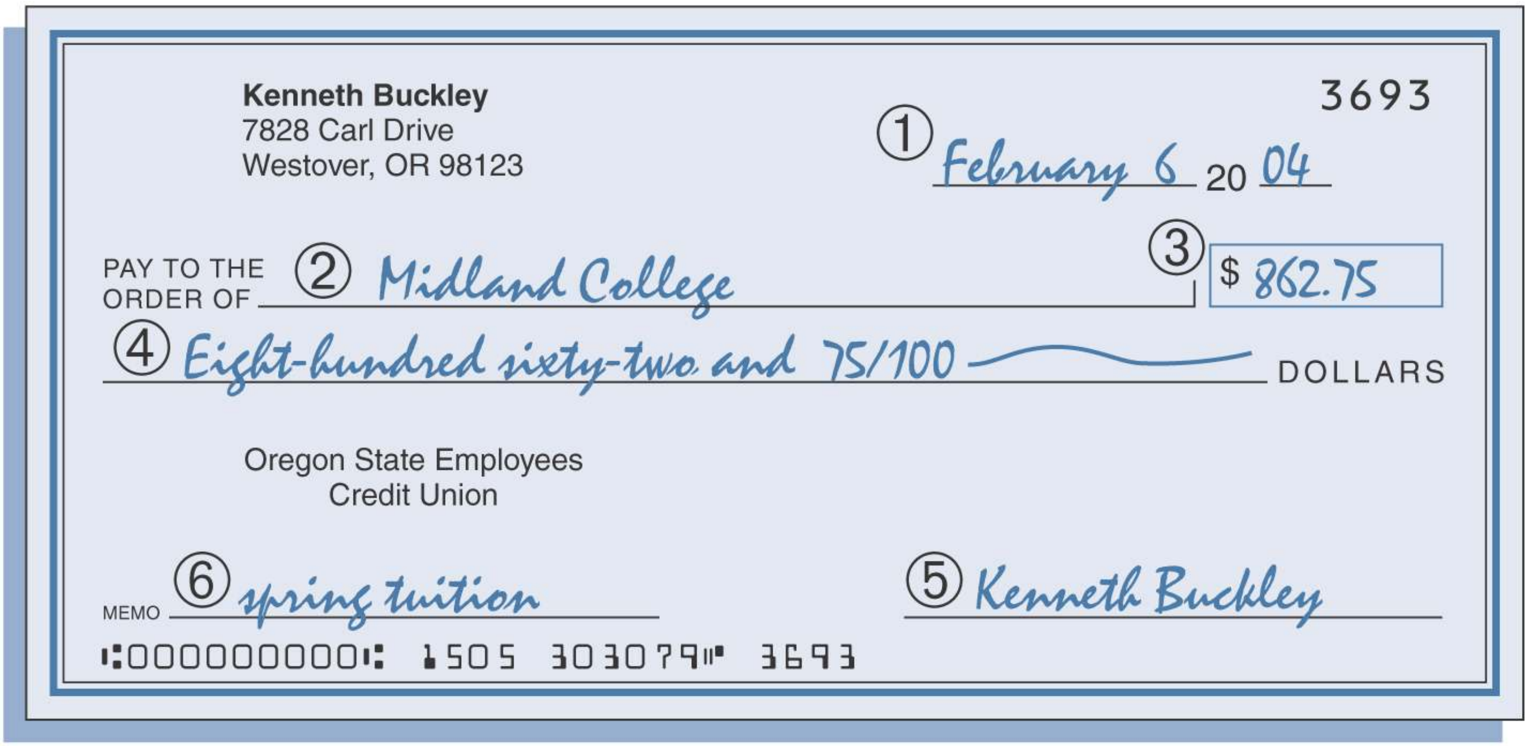
USE OTHER SIDE FOR ADDITIONAL LISTING

BE SURE EACH ITEM IS PROPERLY ENDORSED

000000000 15 5 303 79 3323

CHECKS AND OTHER ITEMS ARE RECEIVED FOR DEPOSIT SUBJECT TO THE PROVISIONS OF THE UNIFORM COMMERCIAL CODE OR ANY APPLICABLE COLLECTION AGREEMENT.

TM 5-3 A Personal Check



TM 5-4 Reconciling Your Checking Account

The Bank Statement

Balance on current bank statement	$ 643.96

Step 1.

Add up outstanding checks

Date	Amount
10-4	70.00
10-6	130.00
10-7	111.62

Subtract the total	$ – 311.62

Step 2.

Add up deposits in transit

Date	Amount
10-2	60.00
10-5	90.00

Add the total	$ + 150.00
Adjusted bank balance	$ 482.34

Your Checkbook

Current balance in your checkbook	$ 295.91

Step 3.

Subtract total of fees or other charges listed on bank statement	$ 215.75
Subtract ATM withdrawal	$ – 100.00

Step 4.

Add interest earned	$ + 2.18
Add direct deposits	$ + 300.00
Adjusted checkbook balance	$ 482.34