The Ultimate Guide to Financial Literacy for Adults

Learn the skills now that you need for a more financially secure life

By CALEB SILVER Updated April 01, 2024
Reviewed by DAVID KINDNESS
Fact checked by SUZANNE KVILHAUG

We know that the earlier you learn the basics of how money works, the more confident and successful you'll be with your finances later in life. It's never too late to start learning, but it pays to have a head start. The first steps into the world of money start with education.

Banking, budgeting, saving, credit, debt, and investing are the pillars that support most of the financial decisions that we'll make in our lives. At

Investopedia, we have more than 30,000 articles, terms, Frequently Asked Questions (FAQs), and videos that explore these topics. We've spent more than 20 years building and improving our resources to help you make smart financial and investing decisions.

This guide is a great place to start, and today is a great day to do it. Let's begin with financial literacy—what it is and how it can improve your life.

KEY TAKEAWAYS

- Financial literacy is the ability to understand and make use of a variety of financial skills.
- Those with higher levels of financial literacy are more likely to spend less income, create an emergency fund, and open a retirement account than those with lower levels.
- Some of the basics of financial literacy and its practical application in everyday life include banking, budgeting, handling debt and credit, and investing.

What Is Financial Literacy?

Financial literacy is the ability to understand and make use of a variety of financial skills, including personal financial management, budgeting, and investing. It also means comprehending certain financial principles and concepts, such as the time value of money, compound interest, managing debt, and financial planning.

Achieving financial literacy can help individuals to avoid making poor financial decisions. It can help them become self-sufficient and achieve financial stability. Key steps to attaining financial literacy include learning how to create a budget, track spending, pay off debt, and plan for retirement.

Educating yourself on these topics also involves learning how money works, setting and achieving financial goals, becoming aware of unethical/discriminatory financial practices, and managing financial challenges that life throws your way.

The Importance of Financial Literacy

In its National Financial Capability Study the Financial Industry Regulatory Authority (FINRA) found that Americans' with higher levels of financial literacy were more likely to make ends meet, spend less of their income, create a three-month emergency fund, and open a retirement account than those with lower financial literacy. [1]

Making informed financial decisions is more important than ever. Take retirement planning. Many workers once relied on pension plans to fund their retirement lives, with the financial burden and decision-making for pension funds borne by the companies or governments that sponsored them.

Today, few workers get pensions; instead some are offered the option of participating in a 401(k) plan. This involves decisions that employees themselves have to make about contribution levels and investment choices. Those without employer options need to actively seek out and open individual retirement accounts (IRAs) and other tax-advantaged retirement accounts.

Add to this people's increasing life spans (leading to longer retirements), Social Security benefits that barely support basic survival, complicated health and other insurance options, more complex savings and investment instruments to select from—and a plethora of choices from banks, credit unions, brokerage firms, credit card companies, and more.

It's clear that financial literacy is a must for making thoughtful and informed decisions, avoiding unnecessary levels of debt, helping family members through these complex decisions, and having adequate income in retirement.

Personal Finance Basics

Personal finance is where financial literacy translates into individual financial decision-making. How do you manage your money? Which savings and investment vehicles are you using? Personal finance is about making and meeting your financial goals, whether you want to own a home, help other members of your family, save for your children's college education, support causes that you care about, plan for retirement, or anything else.

Among other topics, it encompasses banking, budgeting, handling debt and credit, and investing. Let's take a look at these basics to get you started.

Introduction to Bank Accounts

A bank account is typically the first financial account that you'll open. Bank accounts can hold and build the money you'll need for major purchases and life events. Here's some background on bank accounts and why they are step one in creating a stable financial future.

Why Do I Need a Bank Account?

Though the majority of Americans do have bank accounts, 6% of households in the United States still don't have one.[2] Why is it so important to open a bank account? Because it's safer than holding cash. Assets held in a bank are harder to steal, and in the U.S., they're generally insured by the Federal Deposit Insurance Corporation (FDIC).[3] That means you should always have access to your cash, even if every customer decided to withdraw their money at the same time.

Many financial transactions require you to have a bank account to:

- Use a debit or credit card
- Use payment apps like Venmo or PayPal
- Write a check
- Use an ATM
- Buy or rent a home
- Receive your paycheck from your employer

- Earn interest on your money

Online vs. Brick-and-Mortar Banks

When you think of a bank, you probably picture a building. This is called a brick-and-mortar bank. Many brick-and-mortar banks also allow you to open accounts and manage your money online.

Some banks are only online and have no physical buildings. These banks typically offer the same services as brick-and-mortar banks, aside from the ability to visit them in person.

Which Type of Bank Can I Use?

Retail banks: This is the most common type of bank at which people have accounts. Retail banks are for-profit companies that offer checking and savings accounts, loans, credit cards, and insurance. Retail banks can have physical, in-person buildings that you can visit or they can be online only. Most offer both options. Banks' online technology tends to be advanced, and they often have more locations and ATMs nationwide than credit unions do.

Credit unions: Credit unions provide savings and checking accounts, issue loans, and offer other financial products, just like banks do. However, they are not-for-profit organizations owned by their members. Credit unions tend to have lower fees and better interest rates on savings accounts and loans. Credit unions are sometimes known for providing more personalized customer service, though they usually have far fewer branches and ATMs.

> FAST FACT
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> *Assets held in a credit union are insured by the National Credit Union Administration (NCUA), which is equivalent to the FDIC for banks.*[4]

What Types of Bank Accounts Can I Open?

There are three main types of bank accounts that the average person may want to open:

1. **Savings account**: A savings account is an interest-bearing deposit account held at a bank or other financial institution. Savings accounts typically pay a low interest rate, but their safety and reliability make them a sensible option for saving available cash for short-term needs.

They may have some legal limitations on how often you can withdraw money. However, they're generally very flexible so they're ideal for building an emergency fund, saving for a short-term goal like buying a car or going on vacation, or simply storing extra cash that you don't need in your checking account.

2. **Checking account**: A checking account is also a deposit account at a bank or other financial institution that allows you to make deposits and withdrawals. Checking accounts are very liquid, meaning that they allow numerous withdrawals per month (as opposed to less liquid savings or investment accounts) though they earn little to no interest.

Money can be deposited at banks and ATMs, through direct deposit, or through another type of electronic transfer. Account holders can withdraw funds via banks and ATMs, by writing checks, or using debit cards linked to their accounts.

You may be able to find a checking account with no fees. Others have monthly and other charges (such as for overdrafts or using an out-of-network ATM) based on, for example, how much you keep in the account or whether there's a direct deposit paycheck or automatic-withdrawal mortgage payment connected to the account.

Lifeline and second-chance accounts, available at some banks, can help those who have difficulty qualifying for a traditional checking account.

3. **High-yield savings account**: A high-yield savings account usually pays a much higher rate of interest than a standard savings account. The tradeoff for earning more interest on your money is that high-yield accounts tend to require bigger initial deposits, larger minimum balances, and higher fees.

> ★ **Tip:** You might be able to open a high-yield savings account at your current bank, but online banks tend to have the highest interest rates.

What's An Emergency Fund?

An emergency fund is not a specific type of bank account but can be any source of cash that you've saved to help you handle financial hardships like job losses, medical bills, or car repairs. Here's how they work:

- Most people use a separate savings account for their emergency savings.
- The account should eventually total enough to cover at least three to six months' worth of expenses.
- Emergency fund money should be off-limits for paying regular expenses.

Introduction to Credit Cards

You know them as the plastic cards that (almost) everyone carries in their wallets. Credit cards are accounts that let you borrow money from the credit card issuer and pay it back over time. For every month that you don't pay back the money in full, you'll be charged interest on your remaining balance. Note that some credit cards, called charge cards, require you to pay your balance in full each month. However, these are less common.

What's the Difference Between Credit and Debit Cards?

Here is the difference:

Debit cards take money directly out of your checking account. You can't borrow money with debit cards, which means that you can't spend more cash than you have in the bank. And debit cards don't help you to build a credit history and credit rating.

Credit cards allow you to borrow money and do not pull cash from your bank account. This can be helpful for large, unexpected purchases. But carrying a balance every month—not paying back in full the money that you borrowed—means that you'll owe interest to the credit card issuer. In fact, as of Q4 2022, Americans owed $986 billion in credit card debt.[5] So be very careful about spending more money than you have, because debt can build up quickly and become difficult to pay off.

On the other hand, using a credit card judiciously and paying your credit card bills on time helps you establish a credit history and a good credit rating. It's important to build a good credit rating not only to qualify for the best credit cards but also because you will get more favorable interest rates on car loans, personal loans, and mortgages.

What Is APR?

APR stands for annual percentage rate. This is the amount of interest that you'll owe the credit card issuer on any unpaid balance. You'll want to pay close attention to this number when you apply for a credit card. A higher number can cost you hundreds or even thousands of dollars if you carry a large balance over time. The median APR today is about 24%, but your rate may be higher if you have bad credit. Interest rates also tend to vary by the type of credit card.

Which Credit Card Should I Choose?

Credit scores have a big impact on your odds of getting approved for a credit card. Understanding what range your score falls into can help you narrow the options as you decide on the cards for which you may apply. Beyond your credit score, you'll also need to decide which perks best suit your lifestyle and spending habits.

If you've never had a credit card before, or if you have bad credit, you'll likely need to apply for either a secured credit card or a subprime credit card. By using one of these and paying back on time, you can raise your credit score and earn the right to credit at better rates.

If you have a fair to good credit score, you can choose from a variety of credit card types, such as:

- **Travel rewards cards.** These credit cards offer points redeemable for travel—including flights, hotels, and rental cars—with each dollar you spend.
- **Cash-back cards.** If you don't travel often—or don't want to deal with converting points into real-life perks—a cash-back card might be the best fit for you. Every month, you'll receive a small portion of your spending back, in

cash or as a credit to your statement.
- **Balance transfer cards.** If you have balances on other cards with high interest rates, transferring your balance to a lower-rate credit card could save you money, help you pay off balances, and help improve your credit score.
- **Low- or No-APR cards.** If you routinely carry a balance from month to month, switching to a credit card with a low or no APR could save you hundreds of dollars per year in interest payments.

Be aware of your protections under the Equal Credit Opportunity Act. Research credit opportunities and available interest rates, and be sure that you are offered the best rates for your particular credit history and financial situation.

How to Create a Budget

Creating a budget is one of the simplest and most effective ways to control your spending, saving, and investing. You can't begin to improve your financial health if you don't know where your money is going, so start tracking your expenses against your income. Then set clear goals.

> ★ **Tip:** One budget template that helps individuals reach their goals, manage their money, and save for emergencies and retirement is the 50/20/30 budget rule: spending 50% on needs, 20% on savings, and 30% on wants.

How Do I Create a Budget?

Budgeting starts with tracking how much money you receive and spend every month. You can do this in an Excel sheet, on paper, or with a budgeting app. It's up to you. However you decide to track, clearly lay out the following:

- **Income:** List all sources of money that you receive in a month, with the dollar amount. This can include paychecks, investment income, alimony, settlements, and money that you make from side jobs or other projects, such as selling crafts.
- **Expenses:** List every purchase that you make in a month, split into two categories: fixed expenses and discretionary spending. Review your bank

statements, credit card statements, and brokerage account statements to be sure to capture them all. ***Fixed expenses*** are the purchases that you must make every month. Their amounts don't change (or change very little) and are considered essential. They include rent/mortgage payments, loan payments, and utilities. ***Discretionary spending*** is nonessential spending or varying purchases for things like restaurant meals, shopping, clothes, and travel. Consider them wants rather than needs.
- **Savings**: Record the amount of money that you're able to save each month, whether it's in cash, cash deposited into a bank account, or money that you add to an investment account or retirement account like an IRA or 401(k) (if your employer offers one).

Subtract your total expenses from your total income to get the amount of money you have left at the end of the month. Now that you have a clear picture of money coming in, money going out, and money saved, you can identify which expenses you can cut back on, if necessary.

If you don't already have one, put your extra money into an emergency fund until you've saved at least three to six months' worth of expenses (in case of a job loss or other emergency). Don't use this money for discretionary spending. The key is to keep it safe and grow it for times when your income decreases or stops.

How to Start Investing

Once you have enough savings to start investing, you'll want to learn the basics of where and how to invest your money. Decide what to invest in and how much to invest by understanding the risks (and potential rewards) of different types of investments.

What Is the Stock Market?

The stock market refers to the collection of markets and exchanges where stock buying and selling takes place. The terms "stock market" and "stock exchange" can be used interchangeably. And even though it's called a stock market, other financial securities, such as exchange-traded funds (ETFs), corporate bonds, and derivatives based on stocks, commodities, currencies, and bonds, are also traded there. There are multiple stock trading venues. The leading stock exchanges in the U.S. include the New York Stock Exchange (NYSE), Nasdaq, and the Cboe Options Exchange.

How Do I Invest?

To buy stocks, you need to use a broker. This is a professional person or digital platform whose job it is to handle the transaction for you. For new investors, there are three basic categories of brokers:

1. A full-service broker who manages your investment transactions and provides advice for a fee.
2. An online/discount broker that executes your transactions and provides advice depending on how much you have invested. Examples include Fidelity, TD Ameritrade, and Charles Schwab.
3. A robo-advisor that executes your trades and can pick investments for you with little human assistance. Examples include Betterment, Wealthfront, and Schwab Intelligent Portfolios.

What Should I Invest in?

There's no right answer for everyone. Which securities you buy, and how much you buy, will depend on the amount of money that you have available for investing and how much risk you're willing to take to try to earn a higher return. Here are the most common securities to invest in, listed in descending order of risk:

Stocks: A stock (also known as "shares" or "equity") is a type of investment that signifies partial ownership in the issuing company. This entitles the stockholder to a proportion of the corporation's assets and earnings.

Owning stock gives you the right to vote in shareholder meetings, receive dividends (which come from the company's profits) if and when they are distributed, and sell your shares to somebody else.

The price of a stock fluctuates throughout the day and can depend on many factors, including the company's performance, the domestic economy, the global economy, the day's news, and more. Stocks can rise in value, fall in value, or even become worthless, making them more volatile and potentially riskier than many other types of investments.

ETFs: An exchange-traded fund, or ETF, consists of a collection of securities, such as stocks. It often tracks an underlying index. ETFs can invest in any number of industry sectors or use various strategies.

Think of an ETF as a pie containing many different securities. When you buy shares of an ETF, you're buying a slice of the pie, which contains slivers of the securities inside. This lets you purchase a variety of many stocks at once, with the ease and convenience of only one purchase—the ETF.

In many ways, ETFs are similar to mutual funds. For instance, they both offer instant diversification and are professionally managed. However, ETFs are listed on exchanges and ETF shares trade throughout the day just like ordinary stocks.

Investing in ETFs is considered less risky than investing in individual stocks because there are many securities inside the ETF. If some of those securities fall in value, others may stay steady or rise in value.

Mutual funds: A mutual fund is a type of investment consisting of a portfolio of stocks, bonds, or other securities. Mutual funds give small or individual investors access to diversified, professionally managed portfolios at a low price.

There are many categories of mutual funds, representing the kinds of securities in which they invest, their investment objectives, and the type of returns that they seek. Most employer-sponsored retirement plans invest in mutual funds.

Investing in shares of a mutual fund is different from investing in individual shares of stock because a mutual fund owns many different stocks (or other securities). Unlike stocks or ETFs that trade at varying prices throughout the day, mutual fund purchases and redemptions take place only at the end of each trading day and at a fund's net asset value (NAV). Similar to ETFs, mutual funds are considered less risky than stocks because of their diversification.

Important: Mutual funds charge annual fees, called expense ratios, and in some cases, commissions.

Bonds: Bonds are issued by companies, municipalities, states, and sovereign governments to finance projects and operations. When an investor buys a bond, they're effectively lending their money to the bond issuer, with the promise of repayment plus interest. A bond's coupon rate is the interest rate that the investor will earn.

A bond is referred to as a fixed-income instrument because bonds traditionally have paid a fixed interest rate to investors, although some bonds pay variable interest rates. Bond prices inversely correlate with interest rates. When rates go up, bond prices fall, and vice versa. Bonds have maturity dates, which are the point in time when the principal amount must be paid back to the investor in full or the issuer will risk default.

Bonds are rated by how likely the issuer is to pay you back. Higher-rated bonds, known as investment grade bonds, are viewed as safer and more stable. Such offerings are tied to publicly traded corporations and government entities that boast positive outlooks.

Investment grade bonds receive "AAA" to "BBB-" ratings from Standard and Poor's and "Aaa" to "Baa3" ratings from Moody's.[6] [7] Bonds with higher ratings will usually pay lower rates of interest than those with lower ratings. U.S. Treasury bonds are the most common AAA-rated bond securities.

Are Banks Safe?

Most bank accounts in the United States are insured by the Federal Deposit Insurance Corporation (FDIC) up to certain limits, currently defined as "up to at least $250,000 per depositor, per FDIC-insured bank, per ownership category." [8] If you have a great deal of money to put in the bank, you can make sure that it's all covered by opening multiple accounts.

Is It Safe to Invest in the Stock Market?

Stocks are inherently risky—some more than others—and you can lose money if their share prices fall. Brokerage accounts are insured by the Securities Investor Protection Corporation for up to $500,000 in securities and cash. However, that applies only if the brokerage firm fails and is unable to repay its customers. It does not cover normal investor losses.[9]

What Is the Safest Investment?

U.S. Treasury securities, including bonds, bills, and notes, are backed by the U.S. government and generally are considered the safest investments in the world.[10] However, these kinds of investments tend to pay low rates of interest, so investors do face a risk that inflation may erode the purchasing power of their money over time.

The Bottom Line

The topics in this article are just the beginning of a financial education, but they cover the most important and frequently used products, tools, and tips for getting started. If you're ready to learn more, check out these additional resources from Investopedia:

- Investopedia Academy
- Investopedia YouTube Channel
- Investopedia Dictionary
- Investopedia Stock Market Simulator

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What Is Personal Finance, and Why Is It Important?

Personal finance is about managing your budget and how best to put your money to work to realize your financial independence and goals. more

What Is a Certificate of Deposit (CD) and What Can It Do for You?

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What Is Online Banking? Definition and How It Works

Online banking allows a user to conduct financial transactions via the Internet. Online banking is also known as Internet banking or web banking. more