

F1 – PROJECT-STAGE 11: PERSONAL SAVINGS

TCHE322

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Schedule of lectures

Project topic covered

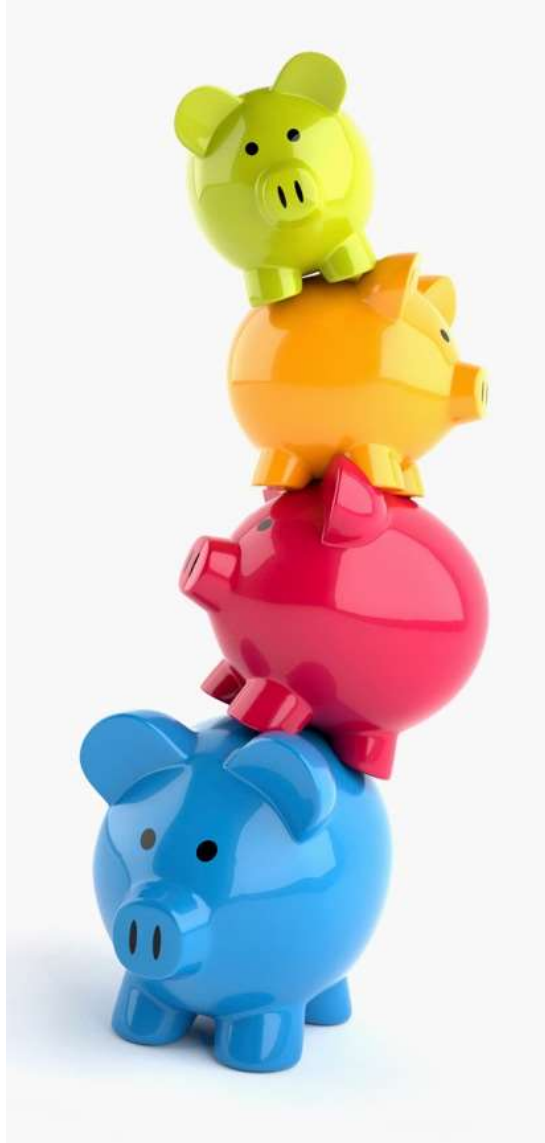
- Types of savings
- Interest rate calculation

Groupwork project activities

- Analyze different savings
- Make decision

PFIN

4



4

Managing Your Cash and Savings

LEARNING OUTCOMES

- 1 Understand the role of cash management in the personal financial planning process**
- 2 Describe today's financial services marketplace, both depository and nondepository financial institutions**
- 3 Select the checking, savings, electronic banking, and other bank services that meet your needs**

LEARNING OUTCOMES *(continued)*

- 4 Open and use a checking account**
- 5 Calculate the interest earned on your money using compound interest and future value techniques**
- 6 Develop a savings strategy that incorporates a variety of savings plans**



Cash Management (Liquid Assets)

- Routine administration of cash and near-cash resources
- Establishes savings program that is an important part of personal financial planning

Exhibit 4.1 Representative Rates of Return

| Type | Summer 2014 | Description |
|--------------------------------------|-----------------|---|
| Cash | 0% | Pocket money; the coin and currency in one's possession. |
| Checking account | 0.42% | A substitute for cash. Offered by commercial banks and other financial institutions such as savings and loans and credit unions. |
| Savings account/Money market deposit | 0.11% | Savings accounts are available at any time, but funds cannot be withdrawn by check. Money market deposit accounts (MMDAs) require a fairly large (typically \$1,000 or more) minimum deposit, and offer check-writing privileges. |
| Certificate of deposit (CD) | 0.68% (1-year) | A savings instrument where funds are left on deposit for a stipulated period (1 week to 1 year or more); imposes a penalty for withdrawing funds early. Market yields vary by size and maturity; no check-writing privileges. |
| U.S. Treasury bill (T-bill) | 0.02% (3-month) | Short-term, highly marketable security issued by the U.S. Treasury (originally issued with maturities of 13 and 26 weeks); smallest denomination is \$100. |
| U.S. Savings bond (EE) | 0.50% | Issued at a discount from face value by the U.S. Treasury; rate of interest is tied to U.S. Treasury securities. Long a popular savings vehicle (widely used with payroll deduction plans). Matures to face value in approximately 5 years; sold in denominations of \$25 and more. |



Low Interest Rates

- Have implications for personal finances by creating economic distortions
- Discourage savings and the reduction of debt levels
- Encourage investors to search for investments that pay income



Financial Products and Services

Financial products

- Checking and savings accounts
- Credit cards
- Loans and mortgages
- Insurance
- Mutual funds

Financial services

- Financial planning
- Securities brokerage
- Tax filing and planning
- Estate planning
- Trusts
- Retirement

Types of Financial Institutions

- Depository financial institutions
 - *Commercial banks, savings and loan associations (S&Ls), savings banks, and credit unions*
 - *Accept deposits*
- Nondepository financial institutions
 - *Other types of financial institutions that offer banking services*
 - *Do not accept deposits*

Exhibit 4.3 Federal Deposit Insurance Programs

Insurance on checking and savings accounts at federally insured institutions covers up to \$250,000.

| Savings Institution | Insuring Agency | Basic Insurance Amounts |
|------------------------------|--|---|
| Commercial bank | Federal Deposit Insurance Corporation (FDIC) | \$250,000/depositor through the Bank Insurance Fund (BIF) |
| Savings and loan association | FDIC | \$250,000/depositor through the Savings Association Insurance Fund (SAIF) |
| Savings bank | FDIC | \$250,000/depositor through the Bank Insurance Fund (BIF) |
| Credit union | National Credit Union Administration (NCUA) | \$250,000/depositor through the National Credit Union Share Insurance Fund (NCUSIF) |

Checking and Savings Accounts

Demand deposit

- Account from which funds can be withdrawn on demand by the account holder

Time deposits

- Savings deposit that remains deposit for a longer time than a demand deposit

Negotiable order of withdrawal (NOW) accounts

- Checking account on which the financial institution pays interest
- Have no legal minimum balance

Types of Accounts and Funds

Money market deposit accounts (MMDAs)

- Federally insured savings account, offered by banks and other depository institutions

Money market mutual fund (MMMF)

- Pools the funds of small investors and purchases high-return, short-term marketable securities

Asset management account (AMA)

- Comprehensive deposit account offered by brokerage houses and mutual funds



Electronic Funds Transfer Systems (EFTSs)

- Uses latest telecommunications and computer technology to electronically transfer funds into and out of customers' accounts

Debit Cards and Automated Teller Machines (ATMs)

Debit cards

- Coded plastic cards used to transfer funds from a customer's bank account to the recipient's account to pay for goods or services

ATMs

- Remote computer terminal that customers of depository institutions can use to make basic transactions 24 hours a day, 7 days a week



Services Offered by a Bank

- Preauthorized deposits and payments
- Bank-by-phone accounts
- Online banking and bill payment
- Safe-deposit boxes
- Trust services



Electronic Funds Transfer Act of 1978

- Federal act that describes the rights and responsibilities of an EFTS user
- Under the law, one cannot stop payment on a defective or questionable purchase

Maintaining a Checking Account

- Convenience, services, and cost influence the choice of where to maintain a checking account
 - *Checking account can be an individual or a joint account*
- **Overdraft:** Result of writing a check for an amount greater than the current account balance
 - ***Overdraft protection:*** Depository institution automatically pays a check that overdraws the account

Monthly Statements

- Itemized listing of all transactions in one's checking account
- **Account reconciliation**
 - *Verifying the accuracy of one's checking account balance in relation to the bank's records as reflected in the bank statement*

Types of Checks

Cashier's check

- Payable to a third party that is drawn by a bank on itself in exchange for the amount specified and a service fee

Traveller's check

- Sold by financial institutions that can be used for making purchases and exchanged for local currencies

Certified check

- Personal check guaranteed by the bank on which it is drawn



Establishing Savings Program

- Vital element of personal financial planning
- Develop specific saving plan to accumulate funds
- Consider risk preferences, period to retain money in deposits, level of interest rates

Types of Interests

Compound interest

- Earned in each subsequent period is determined by applying the nominal rate of interest to the sum of the initial deposit and the interest earned in each prior period

Simple interest

- Paid on the initial amount of the deposit

Types of Interests

Nominal (stated) rate of interest

- Promised rate of interest paid on a savings deposit or charged on a loan

Effective rate of interest

- Annual rate of return that is actually earned during the period the funds are held

Exhibit 4.6 The Magic of Compounding

The effective rate of interest you earn on a savings account will exceed the nominal (stated) rate if interest is compounded more than once a year (as are most savings and interest-paying accounts).

| Nominal Rate (%) | Effective Rate | | | | |
|------------------|----------------|------------------|---------------|-------------|-----------|
| | Annually (%) | Semiannually (%) | Quarterly (%) | Monthly (%) | Daily (%) |
| 3 | 3.00 | 3.02 | 3.03 | 3.04 | 3.05 |
| 4 | 4.00 | 4.04 | 4.06 | 4.07 | 4.08 |
| 5 | 5.00 | 5.06 | 5.09 | 5.12 | 5.13 |
| 6 | 6.00 | 6.09 | 6.14 | 6.17 | 6.18 |
| 7 | 7.00 | 7.12 | 7.19 | 7.23 | 7.25 |
| 8 | 8.00 | 8.16 | 8.24 | 8.30 | 8.33 |
| 9 | 9.00 | 9.20 | 9.31 | 9.38 | 9.42 |
| 10 | 10.00 | 10.25 | 10.38 | 10.47 | 10.52 |
| 11 | 11.00 | 11.30 | 11.46 | 11.57 | 11.62 |
| 12 | 12.00 | 12.36 | 12.55 | 12.68 | 12.74 |

Ways to Save

- **Certificates of deposit (CD)**
 - *Issued by financial institutions in exchange for a deposit*
- **U.S. Treasury bill (T-bill)**
 - *Issued at a discount by the U.S. Treasury in its ongoing process of funding the national debt*

Ways to Save

- **Series EE bonds**
 - *Issued in denominations by the U.S. Treasury*
- **I savings bonds**
 - *Issued at face value by the U.S. Treasury, whose fixed rates provide some inflation protection*

KEY TERMS

- Cash management
- Internet banks
- Share draft accounts
- Deposit insurance
- Demand deposit
- Time deposits
- Negotiable order of withdrawal (NOW) accounts
- Money market deposit accounts
- Money market mutual fund
- Asset management account
- Electronic funds transfer systems
- Automated teller machines
- Checkbook ledger
- Overdraft
- Overdraft protection

KEY TERMS

- Stop payment
- Account reconciliation
- Cashier's check
- Traveler's checks
- Certified check
- Time deposits
- Compound interest
- Nominal (stated) rate of interest
- Effective rate of interest
- Certificate of deposit
- U.S. Treasury bill
- Series EE bonds
- I savings bonds

SUMMARY

- Cash management involves managing liquid assets which can be either held in cash or can be readily converted into cash with little or no loss in value
- Financial services industry is evolving due to technological advancement and changing regulations
- Menu of cash management products helps in comparing different cash products and services offered by various financial institutions

