

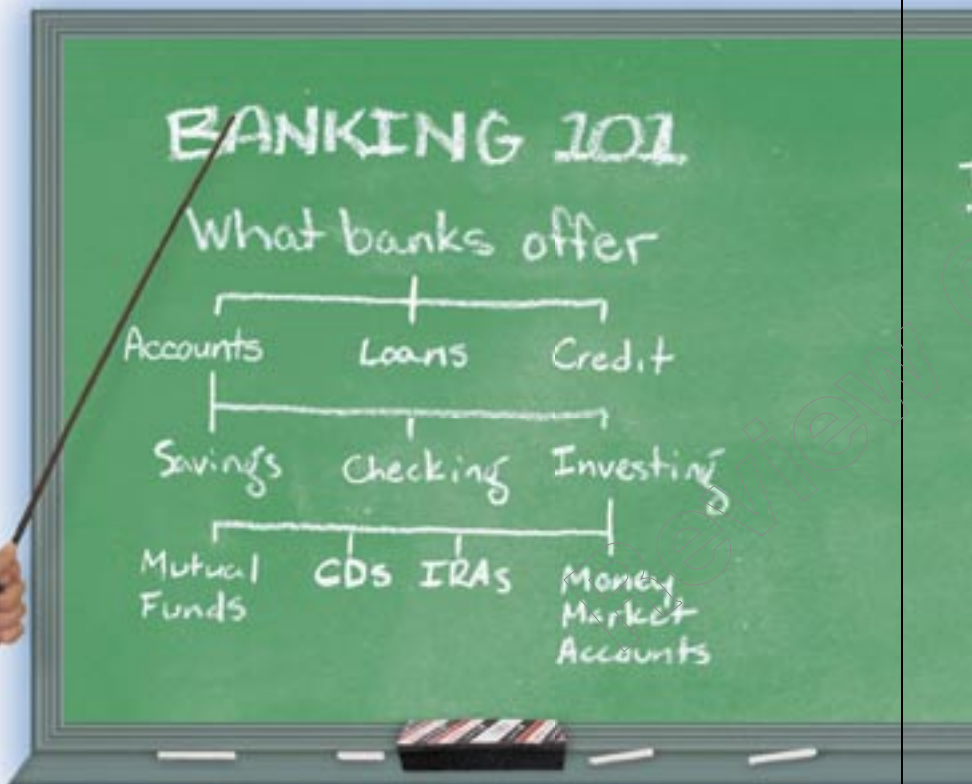
# Banking Basics

It's hard to get by without a bank account.

When you think about life's necessities, finding a bank probably isn't at the top of your list. In fact, the idea of putting a bank in the same category as having a place to live and enough to eat may seem downright bizarre. But unless you're paid in cash, pay all your bills in person, and aren't trying to save for the future, it's hard to think how you could get along

without a bank or its not-for-profit equivalent, the credit union.

The catch is that if you've seen one bank, you haven't necessarily seen them all. The services you can get, and what those services will cost you, vary significantly from bank to bank. So does the way you're treated if you've got questions or problems.



## THE BIG PICTURE

Banks are essential to making the economy work. They make loans, which you can use to pay college expenses, buy a car, or purchase a home. They issue credit cards, which let you buy products or services when you need or want them and pay for them over time. And banks provide financial services such as checking, savings, and investment accounts.

The money you deposit in your checking and savings accounts is an important source of funds that the bank uses to make loans. And the interest you pay on your loans pays for the interest you earn on your savings.

But banks don't fill the role of finan-

cial intermediary just because it's good for you, or for the economy. They want to make a profit. To do that, they charge you more to borrow than they pay you for keeping money in the bank. In fact, they rarely pay you anything for the money you have in your checking account—which you can withdraw at any time—and very little on regular savings accounts, which give you similar access.

And they charge fees on most of these accounts to help cover the cost of processing checks, providing account statements, tellers, ATMs, and multiple branches, plus the costs of advertising and promotion to attract your business.

## YOU CAN BANK ON IT

You may have some uncertainties where money is concerned, like whether you'll be able to live on what you earn and whether you'll be more financially secure in the future than you are today. Banks can't solve those problems, but putting your money in a bank will provide one safety net in an otherwise uncertain world. Banks promise that up to \$100,000 of your money, deposited in one or more of their accounts, is safe.

Here's the story: The **Federal Deposit Insurance Corporation (FDIC)**, a government agency, insures

accounts in its member banks, which include most banks in the US. (There's separate, comparable insurance for credit unions.)

The \$100,000 limit—which some have suggested should be increased to reflect the impact of inflation—applies per depositor per bank. For example, if you had \$100,000 in a **certificate of deposit (CD)** in one bank and another \$100,000 in a CD in another bank, both accounts would be covered. But if you had \$200,000 in one CD, only half would be insured.

You can actually qualify for more than the \$100,000 coverage at a single bank if your assets are in different types of accounts. For example, an **individual retirement account (IRA)** is insured separately from a taxable account. So is a trust account. And you qualify for up to \$50,000 coverage on an account you own jointly with someone else.

What's not insured is any money you invest through a bank that's not in a checking or savings account. For example, money in a mutual fund the bank sells is not insured, even if the name of the fund includes the name of the bank. But money in a bank money market account is. The bank is required to tell you which accounts are insured and which are not. Be sure you know which are which.

## HABITUAL BEHAVIOR

Finding a bank that will best meet your needs depends, in large part, on your spending and saving habits—or the ones you're trying to cultivate. The more you know about how you're likely to use your account, the more effective your search can be. To get started, ask yourself these questions:

- How many checks do you typically write each month, and how often do you withdraw cash at the ATM?
- Do you have enough cash available to meet a minimum balance requirement for a no-cost or interest-bearing checking account, and will you be able to keep that amount in your account?
- Do you have time to get to the bank during banking hours, or do you need a bank that's open nights and weekends?
- Would you like the option of banking online or over the phone?



## TERMS TO KNOW

interest  
fees  
FDIC  
return

## IN CASE OF EMERGENCY

Most financial advisers suggest creating an **emergency fund** with three to six months' worth of income. That way you'll have some backup if you face a major financial emergency, such as getting sick or being laid off.

Ideally, an emergency fund should be fairly **liquid**, which means the money is available as cash or can be converted to cash easily with little or no loss of value. But the fund should also produce some **return**, or increase in value. Certificates of deposit and money market accounts will probably fit these needs.

The goal of having your money make some money is one reason your emergency fund probably shouldn't be in a checking account. The other reason is that it's too easy to spend.

# Check It Out

Checking accounts take center stage in your day-to-day finances, and you can get them in several styles.

To pay your rent, cover your credit card, cable, and utility bills, buy your groceries, and repay your student loans, you almost certainly need a **checking account**. It's the only way to authorize the transfer of funds, whether you do it in writing or handle everything electronically.

Choosing the checking account that's best for you can be complicated, since accounts come in several varieties. Just look over the product offerings in a couple of banks or scroll through a few bank websites to get a sense of what's available.

## IN THE BANK

A **regular checking account** with a conventional or online bank is likely to cost you—unless you can find a way to avoid it. Most banks charge either a monthly fee, a fee for each check or ATM withdrawal, or sometimes a combination of monthly and per-use fees. Charges can range upward from 35 cents per check and \$1 per ATM withdrawal, and flat fees run, on average, from \$7.50 to \$15 a month.

Some banks may offer free checking and ATM use for a short time to attract your business. And most banks waive their fees if you keep a minimum balance in your checking account or in a combination of accounts in the bank. The catch here is the minimum can seem pretty maximum: \$3,500 to \$5,000 is fairly typical, though some banks—often the smaller ones—may require considerably less, and big banks may want more.

Though your money doesn't earn interest in a regular checking account, you can usually put the money in an interest-paying or investment account towards your minimum. Some banks also count your mortgage or other loan balance toward the minimum.

## A SCALE OF FRILLS

Some banks offer a scaled-down version of their regular checking account, called **no-frills** or **basic checking**. If you write only a few checks a month and you don't withdraw money very often, it's something to consider. But for many working people, it's too restrictive—and the fees can be steep if you go over the limits.

At the other end of the scale, some banks offer combined accounts, called **relationship accounts**, that provide

everything but the proverbial kitchen sink: no-fee credit cards, loan discounts, and the like. If the required minimum balance for this kind of account gets you free checking, there's probably nothing to lose, provided you need enough of the features the account offers.

## WORD CHECK

Checking accounts are actually transaction accounts. That means you can authorize the bank to transfer money from your account to another person or organization either by writing a check that includes the word "Pay to the order of" or by electronic transfer. In contrast, a savings account is a non-transaction account and the only things you can do are withdrawals or transfers—electronic or traditional—to another account in your name.



## CHECKING, CREDIT UNION STYLE

If you're banking at a **credit union**—which might sound like a contradiction, but there's not really any other way to say it—you handle transactions in the same way you do at a bank. But instead of writing checks, you write what are known as **share drafts**.

The big difference is in the cost. Most credit unions don't impose fees for checking beyond the modest annual fee for membership, which is sometimes as little as \$25. And if they require minimum deposits at all, it's much more likely to be hundreds rather than thousands of dollars.

## DOING DOUBLE DUTY

One way to manage a minimum balance requirement is to put the money you've set aside for your emergency fund in a bank CD or money market account.

The money is liquid, which meets one of the basic criteria for an emergency fund. And if you're ever in serious enough financial trouble to withdraw the money, the potential lost interest or below-minimum fees will probably be the least of your worries.

## WEIGHING IN

If you have to maintain a minimum balance to get free checking, you might want to ask yourself a few questions:

- How many checks are you going to write and how many times will you use the ATM?
- Would you make out better, financially speaking, by investing the minimum elsewhere and paying the fees for a basic, no-frills account?
- Should you investigate other banks, credit unions, virtual banks, or non-bank banks where you could get the same service and convenience at a lower cost?

## A NEW INTEREST IN CHECKING

Like regular checking, an **interest-bearing checking account** lets you write as many checks as you want each month and use the bank's ATMs. The added benefit of these accounts is that you earn interest on your balance at the rate the bank sets, often about the same as you'd earn on a savings account.

So why wouldn't you choose to earn while you spend? Well, unless you maintain the minimum balance—an amount the bank determines—you not only forfeit the interest but typically owe more—sometimes much more—in fees than you would for a regular account at the same bank. Those fees can kick in for any month your balance drops below the minimum, sometimes even if it's just for a day or two or just a few dollars.

In most cases, even one month of unexpected fees can outweigh what you could earn in interest over several months. So as great as interest-bearing accounts may sound, you'll want to figure out if you can earn as much some other way, without the pressure.

# The Savings Route

Opening a savings account can help pave the way to financial security.

If you're building an emergency fund, saving for a big purchase, or getting money together to invest, using an insured savings account can put you on the right road. Most banks offer a variety of savings accounts. So do credit unions.

In addition to these basic savings accounts, other popular bank savings options are **money market accounts**, which combine savings with limited check-writing privileges, and **certificates of deposit (CDs)**.

## GETTING INTERESTED

With a savings account, you make money on the money in your account by earning **interest**, or a percentage of your balance, at a specific rate on a regular schedule. What you earn depends on the interest rate the bank pays—typically about the same rate that other banks are paying on similar accounts. That rate, in turn, depends on the rate that banks are earning on the loans they make and on what it costs the banks to borrow from each other.

## REGULAR RULES

The most basic accounts, where you can deposit and withdraw money at any time, are called **regular savings**, or sometimes **statement savings accounts**. What that means is that any activity in the account—deposits, withdrawals, fees, or interest earnings—and your current balance are reported in a

printed or online account statement, usually once a month.

You earn interest on a regular savings account only if you keep at least the required minimum on deposit. If your balance is lower, some banks don't pay interest and others charge a fee for holding your money. Unless you qualify for exemption from the fee—by being a full-time student or older than 65—you're stuck. The alternative is to look for an account without a required minimum or wait until you have the \$500 or whatever is required.

In reality, though, you don't put money in a regular account for the earnings. Whatever the interest rate is, it's likely to be the lowest one the bank offers. You just want to avoid having to pay to keep your money on deposit.

## MONEY MARKET ACCOUNTS

Most banks offer hybrid accounts—part checking, part saving—called **money market accounts (MMAs)** or sometimes **money market deposit accounts**. They're comparable to money market mutual funds, but have the advantage of federal insurance.

MMAs typically pay higher interest rates than regular savings accounts, and may offer **blended** or **tiered** rates, which means you can earn an even

higher rate on large balances or on part of your balance past a certain level.

And you can usually make a limited number of cash transfers or write a limited number of checks—often a total of three—against your account each month.

The catch is that there are substantial service fees if your account falls below the bank's minimum required balance. You may also forfeit your interest if the balance drops below the minimum, or you may face both penalties.

## LUXURY MODELS

**Certificates of deposit (CDs)**—called **share certificates** at a credit union—are high-end savings accounts. They generally pay interest at a higher rate than other bank or credit union accounts, so it should come as no surprise that there are some strings attached.

What makes CDs different from regular savings accounts is that they're **time deposits**. That means that when you buy the certificate you agree to commit your money for a specific **term**, or period of time. You also agree that if you withdraw money from the CD before it **matures** when the term ends, you'll forfeit some or all of the interest you would have earned.

Typical terms include six months, a year, two and a half years, and five years. But the term may be any period you and the bank agree on. The longer the term, the slightly higher the interest you're likely to earn. There may be a

minimum deposit—often \$500—and some banks may pay slightly higher rates for large deposits.

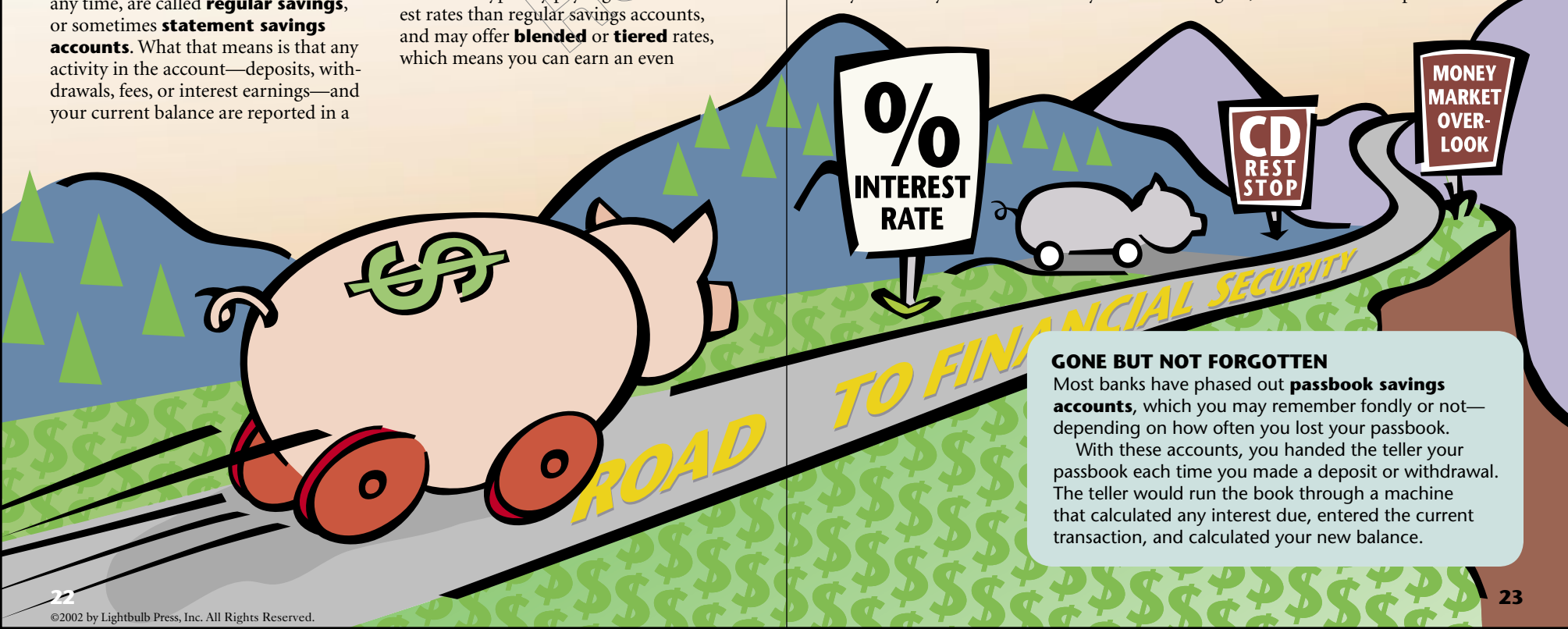
When a CD matures, you can roll over the money into another CD, transfer your money to a different account, or have the bank send you a check. But you must tell the bank what you want it to do by the deadline it sets, or the decision will be made for you. When the bank decides, your account is usually rolled over into a new CD of the same term as the expiring one at the bank's current rate.

## ISN'T IT INTERESTING?

When banks advertise the interest rates on their savings accounts, they tell you the **nominal rate** and the **annual percentage yield (APY)**. The nominal, or named rate, is the rate they pay. The APY is what you earn over the course of a year, expressed as a percentage of your principal.

What you actually earn depends on whether the account pays **simple** or **compound interest**. Simple interest is calculated annually on the amount you deposit. With compound interest, which can be paid daily, monthly, or quarterly, the interest is added to your principal to form a new base on which you earn the next round of interest.

How can you tell whether interest is simple or compound? If the nominal rate and the APY are the same, you're earning simple interest. If the APY is higher, the interest is compound.



## GONE BUT NOT FORGOTTEN

Most banks have phased out **passbook savings accounts**, which you may remember fondly or not—depending on how often you lost your passbook.

With these accounts, you handed the teller your passbook each time you made a deposit or withdrawal. The teller would run the book through a machine that calculated any interest due, entered the current transaction, and calculated your new balance.

# Building a Credit History

You start laying the foundation of your credit history the first time you borrow.

There's a vast—and constantly growing—amount of information about how consumers use credit. And you can be sure that when you apply for credit, whether it's as routine as asking for a new credit card or as significant as applying for a mortgage, potential creditors will check out your credit history.

## MAKING HISTORY

The three major national **credit bureaus**—Equifax, Experian, and TransUnion—collect two types of information about you. The first is how you use credit, from how much you owe on car loans, mortgages, and credit cards to the timeliness of your monthly payments. There's an incredible amount of data that falls into this category—about two billion items a month, which breaks down to an average of 11 items per credit user.

Credit bureaus also store public information about you that might influence the way lenders evaluate your creditworthiness. This can include anything from records of bankruptcies and foreclosures to court judgments and divorce proceedings.

But credit bureaus don't gather any personal information that isn't directly credit-related, such as how much you

make, what you spend on rent or utilities, or anything you pay for in cash.

Credit bureaus make the information they've collected available—at a price—to creditors, banks, potential employers, landlords, and others who have a legal right to evaluate you based on your use of credit. Most information remains on your report for quite a while. Damaging activity can appear for up to seven years even if the account is closed or inactive. And bankruptcies can stay on your report for up to ten years unless the state where you live imposes a shorter limit.

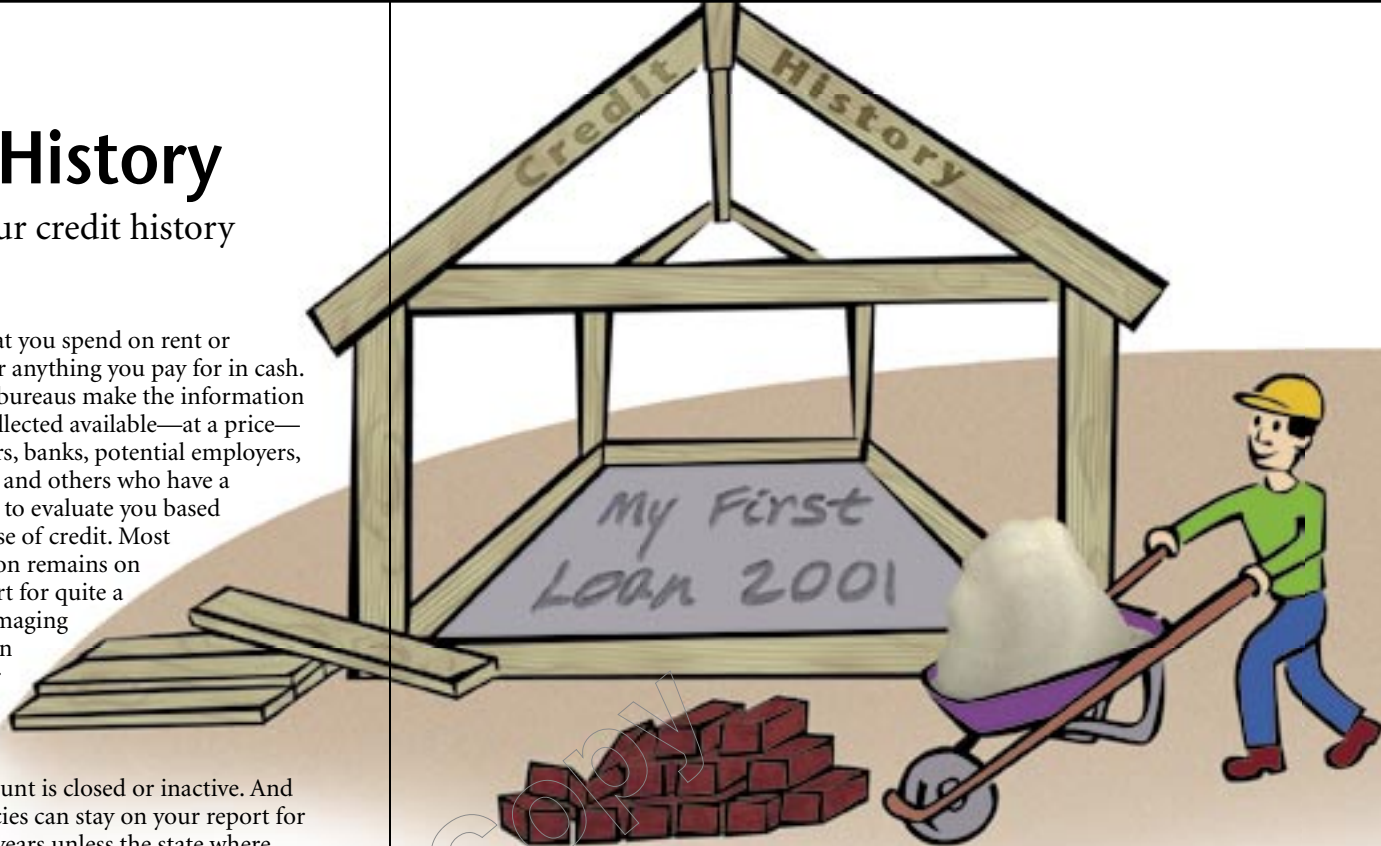
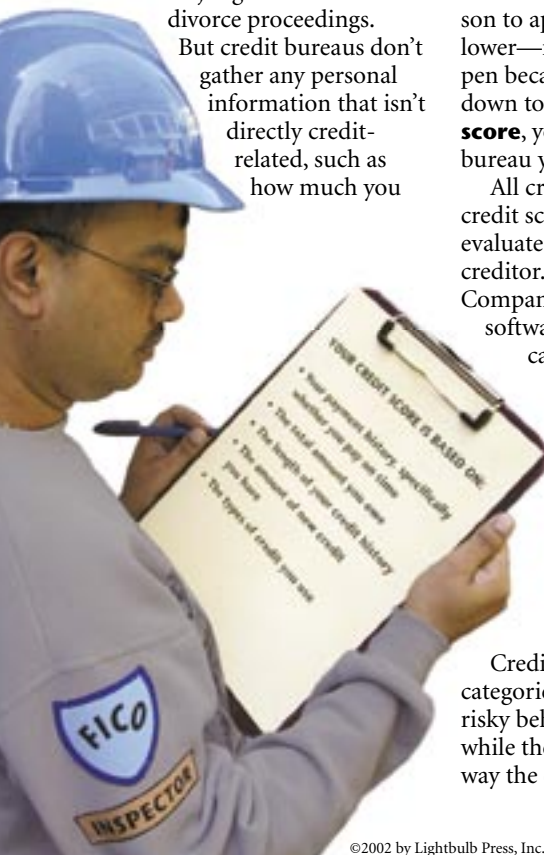
## WHO'S KEEPING SCORE?

Did you ever wonder why it takes a retail store or an online credit card company just a minute or two to approve your application for credit? Did you know that you may be quoted one interest rate on a car loan while the next person to apply is offered a higher—or lower—rate? These kinds of things happen because credit decisions often come down to the **credit score**, or **FICO score**, you're assigned by the credit bureau your potential creditor contacts.

All credit bureaus use a process called credit scoring, or credit modeling, to evaluate the risk you pose to a potential creditor. According to Fair, Isaac and Company, the firm that developed the software the bureaus use to do the calculation, the score depends on five main criteria:

- Your payment history, and specifically whether you pay on time
- The total amount you owe
- The length of your credit history
- The amount of new credit you have
- The types of credit you use

Creditworthy behavior in these categories works in your favor, while risky behavior works against you. And while there are general standards for the way the criteria are applied, there are no



fixed rules. Credit bureaus aren't required to explain the way they arrived at your particular score, and you shouldn't expect them to do so. All they are required to provide are up to four reasons for the score, which the lender must tell you if you ask why your application was denied.

## WHAT'S THE SCORE?

When you get a FICO credit score, you're going for a high number. The top 20% of reports that are evaluated get scores over 780, while the lowest 20% get scores under 620.

Each lender sets its own standard for what qualifies as an acceptable score, and determines the interest rate for which you qualify based on your score. The best rates—in this case, the lowest, or **prime rates**—go to applicants with the highest scores. Applicants with low scores, sometimes called **sub-prime borrowers**, may be offered credit at higher rates.

Credit scoring has its advocates and its detractors. Those in favor say that, in addition to the advantage of speed, lenders get a better picture of your creditworthiness with this timely snapshot. That, they say, makes the system fairer. Critics argue that reducing all the information about you to a single score can provide a distorted picture. They also say that a lender can find it easier to say no on the basis of what appears to be a value-neutral system.

## WHAT THE LENDER KNOWS

Lenders may go beyond your credit score in evaluating your application. For example, they may want to know the amount you earn, whether you've been at the same job for two years or more, and if you've lived at the same address for a while. In addition, a lender may be more willing to grant you credit if you already have banking or investment accounts with them.

## GOOD NEWS AND BAD

Building a good credit history means developing good credit habits:

- Get a credit card and use it regularly
- Make purchases every billing period, and pay them off in full and on time
- Apply gradually for additional credit

At the same time your potential creditors are looking for evidence that you've used credit wisely, they're also alert to danger signs. Those red flags can include:

- A large number of open credit accounts, especially if they have large credit limits
- Three or more payments more than 30 days late
- Loans in default

# Dealing with Debt

It's dangerously easy to fall into debt when you're young.

You're probably making more money now than you ever have before. But you've probably got more expenses too. That's a dangerous combination. It's far too easy to spend a lot more than you actually have. And that leads to trouble with debt.

Of course, getting sick, losing your job, and other things beyond your control can also land you in debt. But there are usually ways to prevent debt problems, as well as ways to improve your situation if you do get into trouble.

## WARNING SIGNS

The best way to handle debt is to avoid it. Spending within your means and watching how you use credit—especially credit cards—can help. But if you don't know what debt trouble looks like, it can sneak up on you. If you find yourself in any of these situations, it's time to start managing your finances more carefully:

- Regularly paying only the minimum on your credit cards or missing payments altogether
- Regularly hitting your credit limit on your credit cards
- Needing to withdraw money from your savings account to cover bills or basic expenses
- Having trouble paying for an unexpected expense, such as car repairs
- Depending on unpredictable income, such as overtime pay or money from a second job, to get by

## FINDING REMEDIES

To start dealing with debt, take a close look at your monthly spending and pinpoint some areas where you can cut

## BANKRUPTCY

Filing for **bankruptcy** is a last resort, something you should be considering only if you're looking at an extremely long period of debt repayment, usually five or more years. When you file for bankruptcy, the court where you file allows you to **discharge** your debts. Under such a plan, you pay less than the full amount you owe, and your lenders recover some of their money.

back to free up more money for your debts. Then make paying your bills every month a priority—not an afterthought.

## CAN YOUR CARDS

Since interest on credit cards is higher than on most other sources of credit, they're particularly dangerous if you're teetering on the brink of debt disaster. If you find yourself in such a situation, it might be time to get rid of your cards, especially if you've had problems with overspending. Even if you keep one card for emergencies, it's probably smart to pay in cash or with a debit card whenever you possibly can. That way you can keep a closer eye on where you stand financially.



## GET OUT OF DEBT

If you end up in serious debt trouble, don't give up. You can take a number of approaches to resolving debt problems, a process often known as **restructuring** debt.

The simplest thing you can do is to ask your creditors to rewrite the terms of your credit agreements so that your bills are easier for you to pay off. This often means smaller payments over a longer period of time, which of course means you'll end up paying more interest and increasing your overall cost. But that's usually a better deal in the long run than having to default or declare bankruptcy.

If you need help dealing with your creditors or figuring out the best way to handle your debts, a **non-profit credit counseling service** can help. For a relatively modest cost, they'll help you

By resolving your debt, bankruptcy allows you to get a new start. You're legally protected from creditors, so you know that your situation can't worsen. But bankruptcy damages your credit history, and you stand to lose many of your assets in order to repay your debts.

Remember, too, that bankruptcy doesn't wipe out amounts you owe the government for income taxes or student loans, or get rid of any alimony obligations you may have.



## WARNING SIGNS:

- Maxing out your credit cards
- Squeaking by on minimum payments
- Depending on overtime pay
- Dipping into your savings account



I needed a way to picture the debt I was in. What I did was take a big sheet of graph paper and plot out the monthly balances on all of my credit cards

in different colors. This worked for me—it was very helpful to pick a line and watch it head down to zero as I paid off the card.

Nowadays you can easily do this with a computer, and I recommend it.

—Holly D., 34

come up with a repayment plan that's feasible for you. Check out:

- The National Foundation for Consumer Credit at 800-547-5005 or [www.nfcc.org](http://www.nfcc.org)
- Credit Counseling Centers of America at 800-493-2222 or [www.cccamerica.org](http://www.cccamerica.org) or [www.debthelpnow.com](http://www.debthelpnow.com)
- American Consumer Credit Counseling at 800-769-3571 or [www.consumercredit.com](http://www.consumercredit.com)

## PUTTING IT TOGETHER

Using a loan consolidator is another way to handle debt. Consolidators lend you money to pay off your bills, and you repay the consolidator instead of your original lenders.

While debt consolidation may allow you to make a lower, more manageable monthly payment, the interest rates and fees that consolidators charge can be much higher than you'd otherwise pay. And since many of them impose heavy penalties for paying off your debt ahead of schedule, you might find yourself stuck with even more financial headaches than you had before.

## STUDENT LOAN DEFAULT

Because the government administers Direct Student Loans, there's a slightly different course of events if you fall behind on repaying student loans. If you don't make a payment on time, you're considered **delinquent** (although chances are you won't have too much trouble if you're only a day or two late). If you don't make any payments for 180 days, your loans go into **default**. The consequences can vary, from a damaged credit rating to having your federal tax refund withheld or even having your wages **garnished**.

If you're subject to garnishment, a percentage of your paycheck is withheld to pay your loans. Since that means your employer will find out about your situation, it can be embarrassing and potentially damaging to your job security as well as financially harmful. Default can also result in your having to pay any costs the Department of Education incurs in order to collect the outstanding money you owe. It's smart to contact the Department of Education to try to put together a feasible plan before you get into real trouble.