Savings Accounts

by Sophia

WHAT'S COVERED

In this lesson, you will identify the use and benefits of savings accounts, money market savings accounts, and certificates of deposit. You will examine how agility and technology can help you save wisely and be as productive as possible. Specifically, this lesson will cover:

BEFORE YOU START

Throughout this course, you're learning concepts that will help you create your own personal financial plan. By developing your plan, organizing your spending, and prioritizing your financial goals, you'll be practicing your productivity skill . You'll be prepared to use your agility skill and adapt your plan when obstacles arise. You'll also be more comfortable and less stressed dealing with uncertainty because you know you can adjust. Keep these thoughts in mind as you work.

1. Overview of Savings

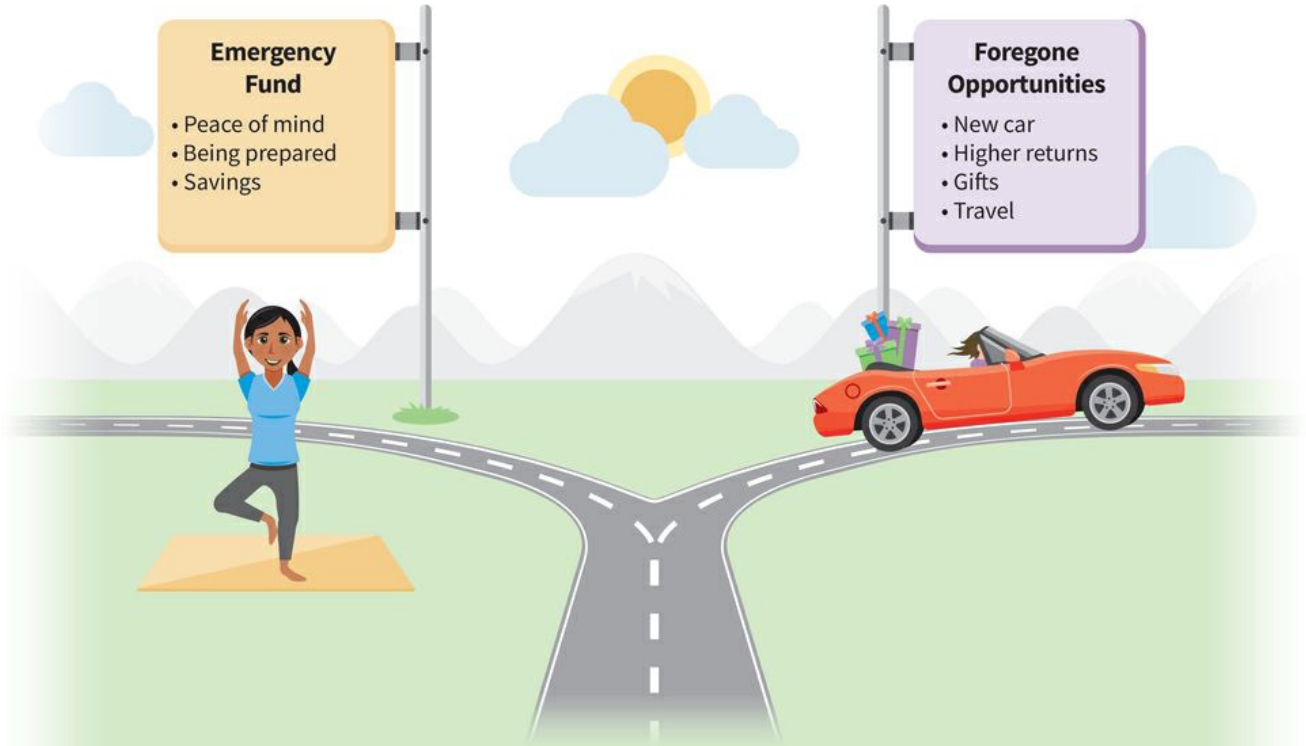
Saving money is important. If for no other reason, saving money and building an emergency fund can create peace of mind. With money in the bank, you will know that you are financially prepared, at least to some extent, for the unexpected. But what if you haven't established an emergency fund yet? Will you be able to manage the opportunity costs associated with creating and maintaining an emergency savings account?

- An opportunity cost is the loss of a benefit that you would have received by choosing another option.
- By putting aside money in your emergency fund, you won't be able to use the cash for other items, such as a longer vacation or a high-return (but high-risk) investment.

BIG IDEA

Failing to save also has an opportunity cost – potentially being unprepared to meet a financial emergency.

The following illustration shows some opportunity costs associated with building and maintaining your emergency savings.



Ideally, the peace of mind that comes from having an emergency fund is greater than "the next best thing." For some individuals, though, having easy access to several thousand dollars may prove to be an irresistible temptation. If you know someone like this, you should recommend that he or she consider different savings techniques, particularly those that "lock" away savings.

Productivity: Skill Reflect

Do you have a savings account or have you had one in the past? Have you ever used this money for something other than an emergency? Did it cause any stress or issues when you realized you no longer had the cash on hand needed for a potential emergency?

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2. Motivating Yourself to Save

Few people would argue that it takes initiative and discipline to save money. But did you know that setting money aside is directly tied to your productivity skill ? Saving money forces you to think ahead and keeps your life moving forward in the event of an unforeseen emergency.

2a. Visualization Techniques

What motivates people to save is as varied as individuals themselves.

HINT

Talking in generalities is never enough to change behavior.

- For some people to change their behavior significantly, it is helpful to use visualization techniques to imagine what the future will look like in real terms.

- Sometimes the reason that people begin saving money or purchasing insurance is because a devastating event has occurred to someone they know.

Until the possibilities of life become real, it is difficult to adjust what you are doing on a daily basis. Let's see how this can play out in terms of a general savings plan.

IN CONTEXT

Tessa has been dreaming of a trip to Paris. She can see herself walking the narrow streets, lingering for hours with friends in the open-air cafés enjoying coffee and conversations, crossing the historic bridges, seeing the museums, and visiting the Eiffel Tower at night. She has studied the street maps, the museums, and the language. Her vision has motivated her to set aside a portion of every paycheck and save all her extra money to fulfill her dream. Tessa is making progress toward achieving her goal because she can visualize with clarity her future plans.

2b. Applying Visualization Techniques to Your Savings Behavior

You can apply the visualization technique, as shown in the illustration below, to building an emergency fund by trying the following.

STEP BY STEP

1. Identify some emergencies that may occur.
2. Consider how these emergencies might affect you financially.
3. Think about how these emergencies could financially affect those you love.

Visualization techniques can help you find the determination to save. As you visualize possible emergencies, be sure to also visualize having the money necessary to meet an emergency, whatever it is. Try to sense the confidence and peace of mind that you feel as you see yourself overcoming any of the emergencies because you are prepared. Whatever your motivation, you should begin a savings fund for those unexpected events, if you haven't already. This advice applies to every adult, regardless of age or household status. Take action today to be financially prepared for the future!

3. Where to Save Your Money

Once you are motivated to save money, whether putting money aside for an emergency fund or other short-term savings, you need to find a safe place for your money. Let's start with the most obvious spot to hold your cash: somewhere in your house.

- You won't earn any interest on money hidden in your house.
- Further, like dieting, if your emergency fund consists of $10 and $20 bills hidden in your kitchen or in your dresser drawer at home and you need a little extra cash for an evening with friends, you may be very tempted to dip into your savings.
- Worse still, holding several thousand dollars of cash in your dresser drawer leaves you vulnerable to theft.

Okay, you can see that keeping money at home is not an optimal financial planning strategy. Fortunately, there are better places to stash your emergency fund. We will talk about these options next.

4. Safe Assets for an Emergency Fund and Short-Term Savings

In general, when deciding where to put your emergency fund and other short-term savings, there are four options from which to choose:

1. Savings account
2. Money market account
3. Certificate of deposit

4. Dedicated savings account

Although each can be obtained at a bank or credit union, these emergency fund alternatives serve different purposes.

4a. Savings Account

A **savings account** is an interest-bearing asset that allows you, as the account owner, to earn a small return on your deposit. Banks and credit unions are the most common places to find savings accounts.

- Savings accounts provide protection against theft and loss through the Federal Deposit Insurance Corporation (FDIC) or the National Credit Union Share Insurance Fund (NCUSIF). These agencies provide individuals with automatic deposit insurance, which guarantees that depositors get their money back (up to certain limits, generally $250,000 for individuals) even if the financial institution goes bankrupt.
- Savings accounts also allow for easy access to funds through ATM withdrawals or in-person withdrawals at the bank.
- Keep in mind that the interest you earn on any savings account is always taxable.

HINT

Taxes may not be an issue right now if you are in college, but as your income increases, you will want to keep an eye on the amount of taxes being paid.

Technology: Skill Tip

Recall from an earlier lesson, Understanding Taxes, that you can use your technology skills to calculate and track your taxes due.

TERM TO KNOW

Savings Account
An interest-bearing asset that allows you, as the account owner, to earn a small return on your deposit.

4b. Money Market Account

A **money market savings account (MMSA)** combines the benefits offered by savings and checking accounts, including FDIC and NCUSIF insurance protection up to $250,000 for individuals.

- MMSAs pay a higher interest rate on the money deposited as the amount in the account increases.
- Access to the money is easy but slightly more restrictive than a savings account. You are limited to the number of withdrawals you can make each month, but these withdrawals can be made using a check, an ATM, or in person at the bank or credit union.

TERM TO KNOW

Money Market Savings Account (MMSA)
Combines the benefits offered by savings and checking accounts, including FDIC and NCUSIF insurance protection up to $250,000 for individuals.

4c. Certificate of Deposit

A certificate of deposit (CD) is a savings product that is generally purchased with one lump-sum dollar amount. CDs are different from savings and checking accounts in that CDs restrict withdrawals from the account until some future date, referred to as the maturity date.

HINT

Don't forget to check online banks when looking for these accounts. Often, the interest you can earn will be higher online.

- CDs are also insured by the FDIC or NCUSIF.
- In exchange for restricted access (reduced liquidity), the financial institution agrees to pay a higher interest rate than what is offered on savings or money market accounts.
- If you withdraw the money on deposit before the maturity date, you will incur a penalty, which means you will lose some of the interest that you have earned (typically the last three to six months of interest credited to the account).

CDs provide a very safe place to keep an emergency fund for those who are worried about being tempted to spend money on relatively unimportant things. However, if an emergency does occur, the penalty is not so onerous that it would prevent someone from accessing the money.

TERM TO KNOW

Certificate of Deposit
A savings product that is generally purchased with one lump-sum dollar amount.

4d. Dedicated Savings Account

A popular variation of a traditional CD is called a **dedicated savings account**.

- The variation is that these accounts allow you to contribute additional money to the CD until the maturity date.
- Like traditional CDs, the early withdrawal penalty helps stop the impulse to purchase unnecessary items using emergency funds while also providing access to the funds in the event you do experience an emergency.
- Dedicated savings accounts pay interest rates similar to traditional CDs.

The illustration below compares the four approaches that you can use to hold emergency and short-term savings.

THINK ABOUT IT

Study the following illustration carefully to find the best savings approach for you!

Savings Account

- Very liquid
- Low returns
- Very flexible
- FDIC- or NCUSIF-insured

Money Market Savings Account

- Liquid, has monthly withdrawal limits, may have minimum balance requirements
- Higher returns than savings accounts but lower returns than CDs
- Limited flexibility
- FDIC- or NCUSIF-insured

Certificate of Deposit

- Reduced liquidity because of early withdrawal penalty
- Better returns
- Limited flexibility; requires lump-sum investment
- FDIC- or NCUSIF-insured

Dedicated Savings Account

- Reduced liquidity because of early withdrawal penalty
- Better returns
- Limited flexibility; allows multiple deposits
- FDIC- or NCUSIF-insured

TERM TO KNOW

Dedicated Savings Account

A popular variation of a traditional certificate of deposit.

SUMMARY

In this lesson, you experienced an **overview of savings** accounts. It's not always easy to **motivate yourself to save**, because everyone has different needs and priorities. Regardless of those specific needs and priorities, everyone should aim to be as productive as possible and consider using technology skills to plan. Fortunately, there are strategies you can use to encourage saving such as **visualization techniques**. By picturing life's future emergencies and being financially and mentally prepared for them, you'll build the discipline it takes to set money aside. You can also understand when you may need to use your agility skill.

All consumers must decide **where to save their money**. The good news is there are plenty of **safe assets for an emergency fund and short-term savings**. The more common assets include the following:

- **Savings Accounts**
- **Money Market Accounts**
- **Certificates of Deposit**
- **Dedicated Savings Accounts**

TERMS TO KNOW

Certificate of Deposit
A savings product that is generally purchased with one lump-sum dollar amount.

Dedicated Savings Account
A popular variation of a traditional certificate of deposit.

Money Market Savings Account (MMSA)
Combines the benefits offered by savings and checking accounts, including FDIC and NCUSIF insurance protection up to $250,000 for individuals.

Savings Account
An interest-bearing asset that allows you, as the account owner, to earn a small return on your deposit.