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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 may 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 similar to money market mutual funds, but have the advantage of FDIC 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 over a certain level.

And you can usually make a limited number of cash transfers or write a limited number of checks—generally 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 open a CD 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 may earn. There may be a minimum deposit—often $500—and some banks may pay slightly higher rates for large deposits.

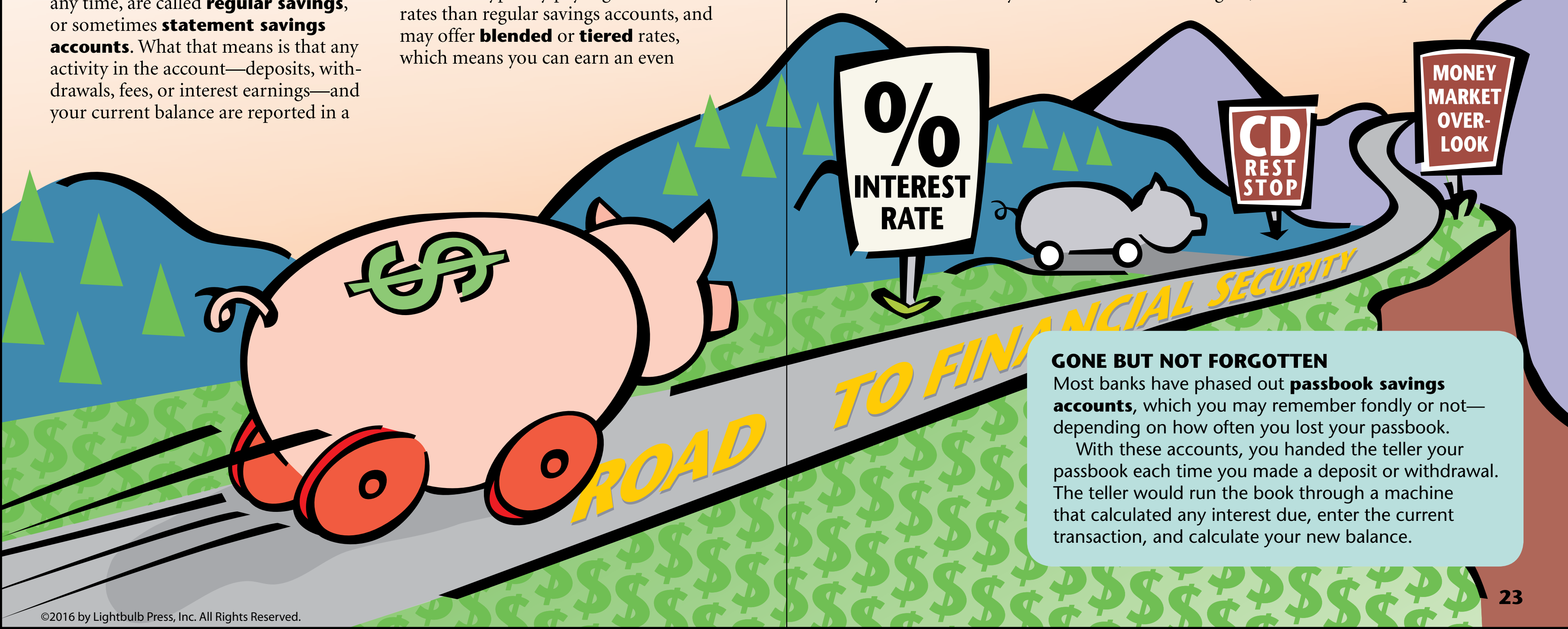
When a CD matures, you can roll over the money into another CD, transfer your money to a different account, or have the bank send you a check. But you must tell the bank what you want it to do by the deadline it sets, or the decision will be made for you. When the bank decides, your CD is usually renewed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

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, enter the current transaction, and calculate your new balance.

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Credit: Convenience with a Caution

Credit is handy, but it has some risks.

As you become financially independent, credit is likely to play a bigger and more important part in your economic life than it has before.

There's a lot that credit can do for you. If you need money—especially in an emergency—and you don't have the cash on hand, the immediate buying power of a credit card can be a lifesaver. And through longer-term arrangements like car loans and mortgages, credit makes it possible to pay for things you wouldn't otherwise be able to afford.

But there is another side to the story. Credit makes spending money easy—sometimes too easy. So you can get into credit trouble by spending more than you can easily repay.

THE BIG PAYBACK

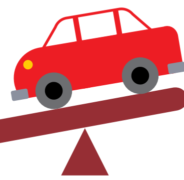
The flip side of the buying power that credit gives you is that you've got to pay back the money you spend. As obvious as this might seem, it can be surprisingly easy to forget how much you've charged when it seems like you have free money at your fingertips.

In return for the privilege of using credit, you're required to pay a **finance charge**. For credit cards, this means that **interest**, which is calculated as a percentage of the amount you owe, accumulates on any unpaid balance.

GIVE YOURSELF A LITTLE CREDIT

If you don't have a lot of cash, being able to buy things on credit can be a big help when you're furnishing an apartment or buying clothes to wear to work.

Using credit can also make your daily life a lot easier. Most merchants require a credit card number to reserve a hotel room, an airline flight, or a car rental, and having a credit card is often a prerequisite for shopping by phone and over the Internet.



Credit also allows you to get the most out of your money over time by taking advantage of the classic "buy now, pay later" philosophy. The most basic—and probably the most common—example is the **cash float** that credit cards provide. A cash float is the time between when you buy something with credit and when you pay the card issuer for that item.

For example, say you use a credit card to buy something online on October 10, and you receive a bill from your card company on November 5 that's due November 26. If you mail in a check to pay the bill on November 20, the check doesn't clear your bank until November 27, almost seven weeks after you spent the money.

CREDIT IS AS CREDIT DOES

You're probably already familiar with using credit. If you don't have a credit card in your own name—and many college students and recent graduates have at least one—you may have used a card linked to your parents' account.

And even if you haven't used a credit card or taken a loan, you've probably dealt with lots of transactions that work the same way.

Many meal plans and cards in school dining halls allow you to get food on a daily basis and pay for what you've spent at the end of the semester or year.

The CD and DVD clubs you see in magazines give you a large number of discs at essentially no cost based on the agreement that you'll purchase full-priced items in the future.

Magazine subscriptions that offer "pay later" options agree to send you the magazines you want and let you pay later.

For loans, the finance charge usually includes fees for the cost of arranging the credit, as well as the interest expense.

The problem with finance charges is that you can end up paying considerably more than your purchase originally cost. And while many credit cards don't impose a finance charge if you pay back the credit you've used within a certain period of time, most loans and some cards start charging from the moment you start spending.

Each credit arrangement has its own particular features, but one thing is true in every case: The longer you take to pay back what you've spent, the more using credit will cost. Interest can build up amazingly quickly, especially on big balances. And if you miss payments, you run the risk of having to pay late fees—at $25 or more a pop—and even ending up with a bad credit score, which can make it difficult to get credit later on.

Here's a tip: Don't live off your credit cards. If you've lost your job or the job hunt isn't going well, it's better to take a loan from your parents than to charge your living expenses.

—Jeanette V., 27

Of course, you don't want to get overly aggressive. If you try to stretch the float to the limit, your payment may be late. That could cost you a late fee on top of a finance charge.

By allowing you to buy large items now while taking years to pay off the full price, credit arrangements like mortgages and car loans use this cash float principal on a larger scale. Only in this case, the float is known as **leverage**, or using a small amount of your own money to buy something of much greater value.

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Repaying Student Loans

If you're on the ball, you can plan your repayment strategy.

More than half of all college graduates have a student loan to repay. For most, it's probably the first big, long-term debt they've had. So if the lingering cost of your education is causing you a little bit of panic, you're not alone.

Adjusting to the fact that you have thousands of dollars to pay back when you're just starting a career can seem like an impossible burden. Fortunately, it's not. There are a variety of ways to structure your payments, which can make student loans easier on your nerves as well as your pocketbook.

PICKING A PLAN

There are several ways to repay government-backed **Direct Stafford Loans**. Each one fits a slightly different financial situation, so you need to think seriously about what you can afford when you pick a repayment plan.

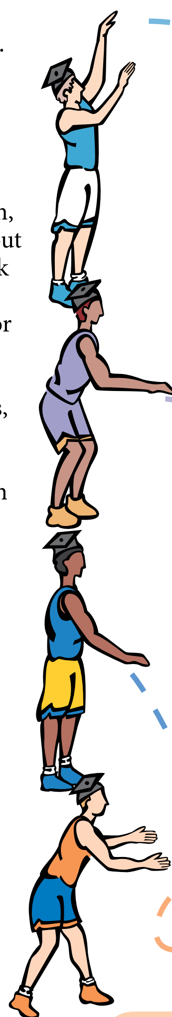
Remember that the best plan for you isn't necessarily the one with the lowest monthly payments—or the one with the highest payments, for that matter. Think about what you can afford now, and what you can reasonably expect to pay down the road.

You're not making an irrevocable decision. You can usually switch plans if you need to.

The **standard repayment plan** requires you to make fixed payments of at least $50 a month for a set period of time. The time repayment takes depends on how much you've borrowed, but it won't be more than ten years. This plan will probably let you pay back your loan quickest, and cost you the least overall, provided you have the money to keep up with the payments.

The **extended repayment plan** requires fixed or graduated payments for up to 25 years. And while your payments are still at least $50 a month, they're usually significantly less than what you'd pay using the standard plan. That's because your payments are stretched over a considerably longer period. Of course, this increases the overall interest you'll pay over time, but it can make your payments a little more manageable.

If you're not making a lot of money right now, but you're expecting to have a higher income in the fairly near future, the **graduated repayment plan** might be best for you. The repayment period is up to ten years, and the amount due increases every two years. No single payment will be more than three times larger than an earlier one. You may pay somewhat more interest than with a standard plan, but not as much as with longer plans.

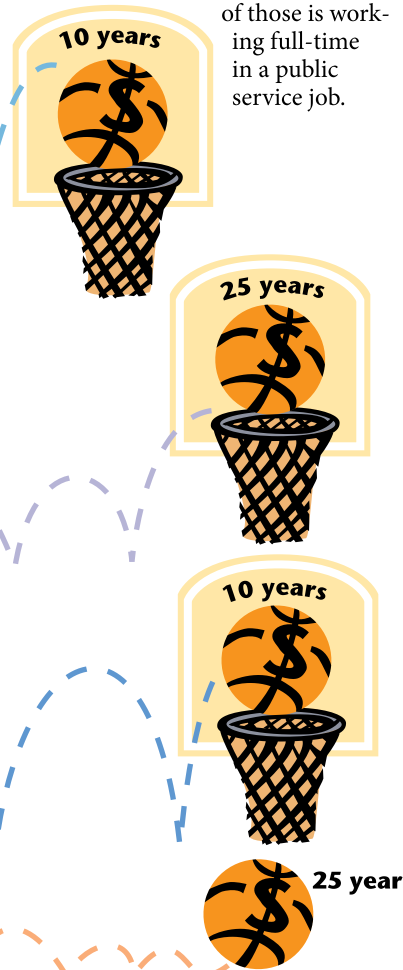


Standard
Fixed payments, fixed term

Extended
Lower payments, longer term

Graduated
Increasing payments over time

Income-Contingent
Varying payments for up to 25 years



To find current information on your Stafford Loans, go to the National Student Loan Data System website at www.nslds.ed.gov or call the Federal Student Aid Information Center at 800-4-FEDAID.

The **income-contingent repayment plan** resets your monthly payments each year based on your income, family size, and Direct Loan balances. If your payments aren't large enough to cover the interest due, it is capitalized and added to your principal. If you haven't paid off the loan after 25 years, you may qualify to have the balance discharged. But the discharged amount may be taxable.

You may qualify for the **income-based repayment plan (IBRP)** if your payment would be less than with a ten-year plan. The payment is based on income and family size, and may allow you to have any remaining balance forgiven if you meet the criteria. One of those is working full-time in a public service job.

HOLD ONTO THAT DEBT!

If you're not used to having debt, you my want to pay off your student loan as quickly as possible. But as crazy as it seems, it can actually be a good idea to pay off this debt on a long-term schedule.

That's because for many people, the interest is tax deductible. So if you've got extra cash you could use to repay the loans faster, it may make better sense to put the money into savings and investments, especially a tax-deferred savings plan, such as an IRA.

DEFERMENT, FORBEARANCE, AND FORGIVENESS

If something happens that makes it hard for you to pay back your student loans, you may be able to postpone payment for a set period of time. You can apply to **defer** your loans, for example, if you're in school at least half time, if you take a parental leave from work, or if you enter a public service organization, such as the armed forces or the Peace Corps. Unemployment, temporary disability, and other events that may keep you from earning money can also make you eligible for deferment. If your loans are deferred, your payments stop for as long as the deferral lasts. If you have a subsidized loan, no interest accumulates. If the loan is unsubsidized, interest does accumulate.

If you don't qualify for deferment but you still can't pay your loans, you can request a **forbearance**. If a forbearance is granted, you won't have to make payments until the forbearance ends, but your loans will continue to accumulate interest.

If you make at least 120 payments on your federal student loans under a qualifying repayment plan while you're working full time in a public service job, you may be eligible to have an outstanding balance forgiven. Amounts that are forgiven aren't taxable, which is an extra bonus. You can find more information at www.studentaid.gov by searching for loan forgiveness.

HANDLING MANY LOANS

If you've taken several loans to pay for your education, keeping track of what you owe and making your payments on time can be an even greater challenge. That's because the term, repayment schedule, and lender may vary for each loan.

One solution may be to consider **consolidation**. When you consolidate your federal loans, you take a new loan, the consolidator pays off your existing loans, and you make just one payment. The new rate is an average and can't be higher than 8.25%. You can choose a payment term up to 30 years, but a longer term means you pay more interest. Consolidating may make you eligible for forgiveness for public service work.

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