PART 2:
MANAGING YOUR MONEY

Chapter 5

Cash or Liquid Asset Management

Learning Objectives

- Manage your cash and understand why you need liquid assets.
- Automate your savings.
- Choose from among the different types of financial institutions that provide cash management services.
- Compare the various cash management alternatives.
- Compare rates on the different liquid investment alternatives.
- Establish and use a checking account.
- Transfer funds electronically and understand how electronic funds transfers (EFTs) work.

Managing Liquid Assets

- Cash management is deciding how much to keep in liquid assets and where to keep it.
- With less regulation and more competition, banks and other financial institutions offer an array of account types and investments.

Managing Liquid Assets

- Cash management means not only making choices from among alternatives, but maintaining and managing the results of those choices.
- Liquid assets have little risk and therefore a low expected return.

Automating Savings: Pay Yourself First

- Use cash management alternatives to have savings automatically deducted from your paycheck.
- Automating your savings means you are less likely to spend that money.
  - Remember Principle 13: Pay yourself first
- The earlier you start to save, the easier it is to achieve your goals.
  - Remember Principle 2: The time value of money

Financial Institutions

- Financial institutions are categorized as:
  - Deposit-type financial institutions – referred to as "banks"
  - Nondeposit-type financial institutions – such as mutual funds and brokerage firms

“Banks” or Deposit-Type Financial Institutions

- Financial institutions that provide traditional checking and savings accounts are called “banks” or deposit-type institutions.

"Banks" or Deposit-Type Financial Institutions

- Types of "banks":
  - Commercial Banks
  - Savings and Loan Associations
  - Savings Banks
  - Credit Unions

"Banks" or Deposit-Type Financial Institutions

- Commercial Banks – offer the widest variety of services including checking and savings accounts, credit cards, safety deposit boxes, and lending.
  - 15,000 commercial banks in 65,000 locations in U.S.
  - Offer online banking.

"Banks" or Deposit-Type Financial Institutions

- Savings and Loans – S&Ls or "thrifts" were originally established to provide mortgages to depositors.

“Banks” or Deposit-Type Financial Institutions

- Types of S&L’s:
  - Mutual S&L – depositors/owners receive dividends.
  - Corporate S&L – depositors receive interest.
  - 5,000 S&Ls in U.S. with 25,000 offices.
  - Higher interest on savings than commercial banks.

"Banks" or Deposit-Type Financial Institutions

- Savings Banks – most are depositor-owned and are found in the northeast part of U.S.
  - Are like a mutual S&L because they pay dividends rather than interest.
  - Primary purpose is to provide mortgages to depositors.

“Banks” or Deposit-Type Financial Institutions

- Credit Unions – not-for-profit cooperatives established by churches, schools, and corporations, opened only to members.
  - Tax-exempt status
  - Pay higher interest rates than commercial banks
  - Lower fees and more convenient locations

Nondeposit-Type Financial Institutions

- Mutual Fund – investment fund that raises money from investors, pools that money, invests it, and is professionally managed.

Nondeposit-Type Financial Institutions

- Stockbrokerage Firms – offer investments and a wide variety of cash management tools, including financial counseling, credit cards, and their own money market mutual funds.

What to Look For in a Financial Institution

- Choose among the alternatives by asking:
  - Which financial institution offers the kind of services you need and want?
  - Is your investment safe? Is it insured? Is the financial institution sound?
  - What are the costs and returns associated with the services you want? Are there minimum deposit requirements or hidden fees?

Cash Management Alternatives

- Cash management alternatives include:
  - Checking Accounts
    - Interest bearing – NOW accounts
    - Non-interest bearing – demand deposits
  - Savings Accounts – time deposit

Cash Management Alternatives

- Cash management alternatives include:
  - Money Market Deposit Account (MMDA) – variable interest rates
  - Certificates of Deposit (CD) - pays a fixed rate of interest while funds are on deposit for a period of time.

Money Market Mutual Funds

- Money Market Mutual Funds (MMMF's) - an alternative to traditional liquid investments.
  - Draws together the savings of many individuals, investing those funds in large, creditworthy debt.
  - Usually a higher yield than bank money market accounts and includes check writing privileges.
  - Shares are purchased at $1 per share, interest rate changes daily.

Asset Management Account

- A comprehensive financial services package offered by a brokerage firm, including a checking account, credit card, a MMMF, loans, and brokerage services.
- Advantages are the coordination of funds flowing in and out of the account, and one consolidated monthly statement.
- Annual service charge of $50 to $125 and a large minimum balance required.

U.S. Treasury Bills or T-Bills

- U.S. Treasury bills, or T-bills, are short-term debt issued by the federal government.
  - Maturities of 3-12 months
  - Minimum denomination of $1,000
  - Very liquid, safe investment
  - Pay less than face value, mature at full face value. Interest in the form of appreciation.

U.S. Series EE Bonds

- U.S. Series EE bonds are issued by the Treasury with low denominations and variable interest rates.
- Purchased at half the face value, from $50 to $10,000.
- Interest accrues until bonds reach face value at maturity.
- No state or local taxes due, interest is deferred until redeemed.
- Purchased at a bank, with no commission.

Comparing Cash Management Alternatives

- Comparable Interest Rates – use the annual percentage yield (APY) to easily compare.
- Tax Considerations – taxes affect the real rate of return on investments.
- Safety – some deposits are insured
  - FDIC insures banks
  - NCUA insures credit unions
  - MMMF – not insured but diversified

Establishing and Using a Checking Account

- When choosing a financial institution, consider:
  - Cost
  - Convenience
  - Consideration
- Balancing your checking account – compare monthly statement with register, then reconcile.

The Check Clearing Act for the 21st Century or Check 21

- Purpose of Check 21 was to improve efficiency by electronically shipping checks.
- How does Check 21 affect you?
  - Checks processed more quickly.
  - Items may differ on statement, listed by check number or name.
  - Cancelled checks may or may not be returned.

Other Types of Checks

- Cashier's Check - a check drawn on the bank's account.
- Certified Check – a personal check that has been certified as being good by the bank on which it is being drawn.

Other Types of Checks

- Money Order – a variation of cashier's check, but issued by non-banks (U.S. Postal Service).
- Traveler's Checks – similar to cashier's checks, except they don't specify a payee and have specific denominations.

Electronic Funds Transfer

- Electronic funds transfer (EFT) refers to any financial transaction that takes place electronically.
- Funds move instantly without paper.

Electronic Funds Transfer

- Examples of EFT include:
  - Debit card transactions
  - ATM transactions
  - Direct deposit of paycheck
  - Paying mortgage and utility bills

Automated Teller Machines

- An ATM or cash machine provides cash instantly and is accessed through a credit or debit card.
- Obvious appeal is convenience.
- To use ATM, just swipe card, enter PIN, and indicate amount of cash.

Debit Cards

- A debit card is a cross between a credit card and a checking account.
  - Looks like a credit card but acts like a checking account.
- With debit cards, you are spending your own money, as opposed to borrowing money with a credit card.

Smart Cards

- Smart cards, or “memory cards,” are a variation of a debit card. Instead of withdrawing funds from a designated bank account, you withdraw from an account that’s actually stored magnetically on the card.
  - Perform the same services as a debit or credit card
  - Allocated funds can run out
  - Some have limited issuer usage

Stored Value Cards – Another Way to Carry Cash

- Merchant gift cards and prepaid phone cards are examples of stored value cards.
- Stored value cards can be either:
  - Single purpose or “closed-loop” cards which can be used at only one store.
  - Multi-purpose or “open-loop” cards which can be used just like a credit card and can be reloaded.