BANKING

Financing Questions: Frequently Asked Questions

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How Can I Raise Money For My Small Business?

Even though, raising capital is the most basic of all business activities, it can be a complex and frustrating process. There are several sources to consider when looking for financing. The primary source of capital for most new businesses comes from savings and other forms of personal resources. While credit cards are often used to finance business needs, there may be better options available, even for very small loans.

Many entrepreneurs also look to private sources such as friends and family when starting out in a business venture. Often, money is loaned interest-free or at a low-interest rate, which can be beneficial when getting started.

Outside of personal resources, the most common source of funding is a bank or credit union. Venture capital firms also help companies grow in exchange for equity or partial ownership.

What Types Of Loans Exist For Business Financing?

To successfully obtain a loan, you must know exactly how much money you need, why you need it, and how you will pay it back. Your written proposal must convince the lender that you are a good credit risk.

Terms of loans vary from lender to lender, but there are two basic types of loans: Short-term and long-term.

Generally, a short-term loan has a maturity of up one year. These include working capital loans, accounts receivable loans, and lines of credit

Long-term loans have maturities greater than one year but usually less than seven years. Real estate and equipment loans may have maturities of up to 25 years. Long-term loans are used for major business expenses such as purchasing real estate and facilities, construction, durable equipment, furniture and fixtures, vehicles, etc.

What Do Banks Look For When Considering A Loan Request?

When reviewing a loan request, the bank official is primarily concerned about repayment. To help determine this ability, many loan officers will order a copy of your business credit report from a credit-reporting agency.

Using the credit report and the information you have provided, the lending officer will consider the following issues:

- Have you invested savings or personal equity in your business totaling at least 25 to 50 percent of the loan you are requesting? Remember, a lender or investor will not finance 100 percent of your business.
- Do you have a sound record of credit-worthiness as indicated by your credit report, work history and letters of recommendation? This is very important.
- Do you have sufficient experience and training to operate a successful business?

- Have you prepared a loan proposal and business plan that demonstrate your understanding of and commitment to the success of the business?
- Does the business have sufficient cash flow to make the monthly payments on the amount of the loan request?

How Do I Write A Good Loan Proposal?

A good loan proposal contains the following key elements:

General Information

- Business name and address, names of principals and their social security numbers.
- Purpose of the loan: exactly what the loan will be used for and why it is needed.
- Amount of money required: the exact amount you need to achieve your purpose.

Business Description

- Details of what kind of business it is, how long it has existed, number of employees, and current business assets.
- Ownership structure: details on your company's legal structure.

Management Profile

Develop a short statement on each principal in your business, including background information such as education, experience, skills, and accomplishments.

Market Information

Clearly define your company's products as well as your markets, identify your competition, and explain how your business competes in the marketplace. Profile your customers and explain how your business can satisfy their needs.

Financial Information

- Financial statements: balance sheets and income statements for the past three years. If you are just starting out, provide a projected balance sheet and income statement.
- Personal financial statements on yourself and other principal owners of the business.
- Collateral you would be willing to pledge as security for the loan.

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Should I prepay my mortgage?

As a general rule, if you are able to prepay your mortgage (and if there is no penalty for doing so) you should prepay as much as you can every month. There are, however, two exceptions to the general rule:

1. You do not have an emergency fund of three to six months' worth of expenses stashed away. Any extra money you have should be put towards the emergency fund. Once you've achieved this essential financial goal, then you can begin paying down your mortgage.
2. You have a large amount of credit card debt. In such case, all of your extra funds should be used to pay down those debts.

In addition, there are a few individuals for whom paying down a mortgage earlier might not be as beneficial financially, particularly if they achieve a better return by investing that money elsewhere. Whether an investor fits into this category depends on his or her marginal tax rate, mortgage interest rate, the return they can get on an investment, and any long-term investment goals they might have.

When should I refinance my home?

Refinancing becomes worth your while if the current interest rate on your mortgage is at least 2 percentage points higher than the prevailing market rate. Talk to some lenders to determine what rates are available and the costs associated with refinancing. These costs include appraisals, attorney's fees, and points.

Once you know what the costs will be, figure out what your new payment would be if you refinanced. You can then estimate how long it will take to recover the costs of refinancing by dividing your closing costs by the difference between your new and old payments (your monthly savings).

Be aware that the amount you ultimately save depends on many factors, including your total refinancing costs, whether you sell your home in the near future, and the effects of refinancing on your taxes.

Should I borrow against my securities?

Borrowing against your securities can be a low-cost way to borrow money. No deduction is allowed for the interest unless the loan is used for investment or business purposes.

> **Tip:** If your margin debt exceeds 50 percent of the value of your securities, you will be subject to a margin call, which means that you will have to come up with cash or sell securities. If the market is falling at the time, a margin call can cause a financial disaster. Therefore, we recommend against the use of margin debt, unless the amount is kept way below 50 percent. Twenty-five percent is a much safer percentage.

What is a home equity line of credit?

A home equity line of credit is a form of revolving credit in which your home serves as collateral. Because a home is likely to be a consumer's largest asset, many homeowners use their credit lines only for major items such as education, home improvements, or medical bills and not for day-to-day expenses.

With a home equity line, you will be approved for a specific amount of credit, in other words, the maximum amount you can borrow at any one time while you have the plan.

Many lenders set the credit limit on a home equity line by taking a percentage (say, 75 percent) of the appraised value of the home and subtracting the balance owed on the existing mortgage. For example:

Appraisal of home	$100,000
Percentage	x 75%
Percentage of appraised value	$75,000
Less mortgage debt	-40,000
Potential credit line	**$35,000**

In determining your actual credit line, the lender will also consider your ability to repay by looking at your income, debts, and other financial obligations, as well as your credit history.

Once you're approved for a home equity loan, you will usually be able to borrow up to your credit limit whenever you want. Typically, you draw on your line of credit by using special checks, but under some plans, borrowers can use a credit card or other means to borrow money and make purchases. There may be limitations on how you use the line, however. Some plans may require you to borrow a minimum amount each time you draw on the line--for example, $300--and to keep a minimum amount outstanding.

What are the costs of obtaining a home equity line of credit?

Many of the costs in setting up a home equity line of credit are similar to those you pay when you buy a home. For example these fees may be charged:

- A fee for a property appraisal, which estimates the value of your home
- An application fee, which may not be refundable if you are turned down for credit
- Up-front charges, such as one or more points (one point equals one percent of the credit limit)
- Other closing costs, which include fees for attorneys, title search, mortgage preparation and filing, property and title insurance, as well as taxes
- Yearly membership or maintenance fees

You also may be charged a transaction fee every time you draw on the credit line.

What is an interest rate "lock-in"?

If you decide to apply for financing with a particular lender, and if you do not want to let the interest rate "float" until closing, then get a written statement guaranteeing the interest rate and the number of discount points that you will pay at closing. This binding commitment or "lock-in" ensures that the lender will not raise these costs even if rates increase before you settle on the new loan. You also may consider requesting an agreement where the interest rate can decrease (but not increase) before closing. If you cannot get the lender to put this information in writing, you may want to choose one that will.

Most lenders place a limit on the length of time (say, 60 days) that they will guarantee the interest rate. You must sign the loan during that time or lose the benefit of that particular rate. Because many people are refinancing their mortgages, there may be a delay in processing the papers. Therefore, it may be wise to contact your loan officer periodically to check on the progress of your loan approval and to see if information is needed.

What disclosures must a lender give you?

For a financing loan, the lender must give you a written statement of the costs and terms of the financing before you become legally obligated for the loan. This is required by the Truth in Lending Act and you usually receive the information around the time of settlement--although some lenders provide it earlier.

> **Tip:** Review this statement carefully before you sign the loan. The disclosure tells you what the APR, finance charge, amount financed, payment schedule, and other important credit terms are.

If you refinance with a different lender, or if you borrow beyond your unpaid balance with your current lender, you also must be given the right to rescind the loan. In these loans, you have the right to rescind or cancel the transaction within three business days following settlement, receipt of your Truth in Lending disclosures, or receipt of your cancellation notice, whichever occurs last.

What is a reverse mortgage?

A reverse mortgage is a type of home equity loan that allows you to convert some of the equity in your home into cash while you continue to own the home. Reverse mortgages operate like traditional mortgages, only in reverse. Rather than paying your lender each month, the lender pays you. Reverse mortgages differ from home equity loans in that most reverse mortgages do not require any repayment of principal, interest, or servicing fees as long as you live in the home.

The reverse mortgage's benefit is that it allows homeowners who are age 62 and over to keep living in their homes and to use their equity for whatever purpose they choose. A reverse mortgage might be used to cover the cost of home health care, or to pay off an existing mortgage to stop a foreclosure, or to support children or grandchildren.

When the homeowner dies or moves out, the loan is paid off by a sale of the property. Any leftover equity belongs to the homeowner or the heirs.

What loan interest is tax-deductible?

The deductibility of interest has been limited in recent years. The following types of interest are at least partially deductible:

- Mortgage interest
- Business interest
- Investment interest
- Education related interest

What are the limitations on deductibility of mortgage interest?

Generally, interest expense on the taxpayer's primary residence and second (but not a third) home, is deductible. Interest is only deductible on the first $1,000,000 of the acquisition loan ($500,000 if married filing jointly). As the loan is paid off the limit is reduced. In other words, you cannot refinance a loan for a higher amount than the current principal balance and increase the deduction. In addition interest on a home equity loan of up to $100,000 can be deducted.

Is interest expense incurred for business purposes deductible?

Yes. Interest expense incurred for a trade or business is deductible against the income of that business. For example, if you are self-employed the business interest would be deducted on Schedule C.

Is investment related interest expense deductible?

Yes. Investment interest is deductible up to the amount of investment income.

Is interest on educational loans tax deductible?

When can you stop paying private mortgage insurance?

Generally, if you make a down payment of less than 20 percent when buying a home, the lender will require you to buy private mortgage insurance (PMI). You can generally drop the PMI when you have attained 20 percent equity in the home, or when the value of your home goes up (due to a good real estate market) so that your equity constitutes 20 percent.

Under the Homeowner's Protection Act (HPA) of 1998 you have the right to request cancellation of PMI when you pay down your mortgage to the point that it equals 80 percent of the original purchase price or appraised value of your home at the time the loan was obtained, whichever is less. You also need a good payment history, meaning that you have not been 30 days late with your mortgage payment within a year of your request, or 60 days late within two years. Your lender may require evidence that the value of the property has not declined below its original value and that the property does not have a second mortgage, such as a home equity loan.

Under HPA, mortgage lenders or servicers must automatically cancel PMI coverage on most loans, once you pay down your mortgage to 78 percent of the value if you are current on your loan. If the loan is delinquent on the date of automatic termination, the lender must terminate the coverage as soon thereafter as the loan becomes current. Lenders must terminate the coverage within 30 days of cancellation or the automatic termination date, and are not permitted to require PMI premiums after this date. Any unearned premiums must be returned to you within 45 days of the cancellation or termination date.

For high-risk loans, mortgage lenders or servicers are required to automatically cancel PMI coverage once the mortgage is paid down to 77 percent of the original value of the property, provided you are current on your loan.

If PMI has not been canceled or otherwise terminated, coverage must be removed when the loan reaches the midpoint of the amortization period. On a 30-year loan with 360 monthly payments, for example, the chronological midpoint would occur after 180 payments. This provision also requires that the borrower must be current on the payments required by the terms of the mortgage. Final termination must occur within 30 days of this date.

HPA applies to residential mortgage transactions obtained on or after July 29, 1999, but it also has requirements for loans obtained before that date.

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What should I do if a friend or family member asks me to co-sign a loan?

Many people agree to co-sign loans for friends or relatives, as a favor, as a vote of confidence, or because they just can't say no. Unfortunately, their act of kindness often backfires because according to many finance companies most cosigners end up paying off the loans they've cosigned--along with late charges, legal fees and all. Not only is this an unwanted out-of-pocket expense, but it can also affect the cosigner's credit record.

While a lender will generally seek repayment from the debtor first, it can go after the cosigner at any time. When you agree to cosign a loan for a friend or family member, you are also responsible for its repayment along with the borrower.

Guaranteeing a loan is a better option than to cosign one in that where a loan is guaranteed, the lender can usually go after the guarantor only after the principal debtor has actually defaulted.

However, if you've decided you're willing to cosign a loan, at the very least you should seek the lender's agreement to refrain collecting from you until the borrower actually defaults, and try to limit your liability to the unpaid principal at the time of default. You should also plan on staying apprised of the borrower's financial situation to prevent him or her from defaulting on the loan. An example of this might be having the lender notify you whenever a payment is late.

Cosigning an Account. You may be asked to cosign an account to allow someone else to obtain a loan. With cosigning, your payment history and assets are used to qualify the cosigner for the loan.

> **Tip:** Cosigning a loan, whether for a family member, friend, or employee, is not recommended. Many have found out the hard way that cosigning a loan only leads to trouble.

It bears repeating that cosigning a loan is no different than taking out the loan yourself. When you cosign, you are signing a contract that makes you legally and financially responsible for the entire debt. If the other cosigner does not pay, or makes late payments, it will probably show up on your credit record. If the person for whom you cosigned does not pay the loan, the collection company will be entitled to try to collect from you.

If the cosigned loan is reported on your credit report, another lender will view the cosigned account as if it were your own debt. Further, if the information is correct, it will remain on your credit report for up to seven years.

> **Tip:** If someone asks you to cosign a loan, suggest other alternatives such as a secured credit card by which they can build a credit history. If you are asked to cosign for someone whose income is not high enough to qualify for a loan, you are actually doing them a favor by refusing because they will be less likely to be overwhelmed by too much debt. If you're still considering cosigning a loan, then you might want to consult an attorney before taking any action to find out what your liability is, if in fact the other person does default.

> **Tip:** If you have already cosigned for someone, and he or she is not making payments on time, consider making the payments yourself and asking the cosigner to pay you directly, in order to protect your credit rating.

How can I get the best deal on a home equity loan or an equity line of credit?

If you decide to apply for a home equity loan, look for the plan that best meets your particular needs. Look carefully at the credit agreement and examine the terms and conditions of various plans, including the annual percentage rate (APR) and the costs you'll pay to establish the plan.

> **Tip:** The disclosed APR will not reflect the closing costs and other fees and charges, so compare these costs, as well as the APRs, among lenders.

Interest Rates. Home equity plans typically involve variable interest rates rather than fixed rates. A variable rate must be based on a publicly available index (such as the prime rate published in some major daily newspapers or a U.S. Treasury bill rate). The interest rate will change, mirroring fluctuations in the index.

To figure the interest rate that you will pay, most lenders add a margin, such as 2 percentage points, to the index value.

> **Tip:** Because the cost of borrowing is tied directly to the index rate, find out what index and margin each lender uses, how often the index changes, and how high it has risen in the past.

Sometimes lenders advertise a **temporarily discounted rate** for home equity loans-a rate that is unusually low and often lasts only for an introductory period, such as six months.

Variable rate plans secured by a dwelling must have a ceiling (or cap) on how high your interest rate can climb over the life of the plan. Some variable-rate plans limit how much your payment may increase, and also how low your interest rate may fall.

Some lenders permit you to **convert a variable rate to a fixed interest rate** during the life of the plan, or to convert all or a portion of your line to a fixed-term installment loan.

Agreements generally permit the lender to freeze or reduce your credit line under certain circumstances, such as during any period the interest rate reaches the cap.

What are the costs of obtaining a home equity line of credit?

Many of the costs in setting up a home equity line of credit are similar to those you pay when you buy a home.

For example, these fees may be charged:

- A fee for a property appraisal, which estimates the value of your home
- An application fee, which may not be refundable if you are turned down for credit
- Up-front charges, such as one or more points (one point equals one percent of the credit limit)
- Other closing costs, which include fees for attorneys, title search, mortgage preparation and filing, property and title insurance, as well as taxes
- Yearly membership or maintenance fees

You also may be charged a transaction fee every time you draw on the credit line.

You could find yourself paying hundreds of dollars to establish the plan. If you were to draw only a small amount against your credit line, those charges and closing costs would substantially increase the cost of the funds borrowed.

On the other hand, the lender's risk is lower than for other forms of credit because your home serves as collateral. Thus, annual percentage rates for home equity lines are generally lower than rates for other types of credit.

The interest you save could offset the initial costs of obtaining the line. In addition, some lenders may waive a portion or all of the closing costs.

Should I obtain a home equity line of credit or a traditional second mortgage loan?

If you are thinking about a home equity line of credit you might also want to consider a traditional second mortgage loan. This type of loan provides you with a fixed amount of money repayable over a fixed period. Usually the payment schedule calls for equal payments that will pay off the entire loan within that time.

> **Tip:** Consider a traditional second mortgage loan instead of a home equity line if, for example, you need a set amount for a specific purpose, such as an addition to your home.

In deciding which type of loan best suits your needs, consider the costs under the two alternatives. Look at the APR and other charges.

> **Tip:** Do not simply compare the APR for a traditional mortgage loan with the APR for a home equity line because the APRs are figured differently. The APR for a traditional mortgage takes into account the interest rate charged plus points and other finance charges. The APR for a home equity line is based on the periodic interest rate alone. It does not include points or other charges.

How should I determine which of several loan alternatives is best?

Use the legally-required disclosures of loan terms to compare the costs of home equity loans.

The Truth in Lending Act requires lenders to disclose the important terms and costs of their home equity plans, including the APR, miscellaneous charges, the payment terms, and information about any variable-rate feature. In general, neither the lender nor anyone else may charge a fee until after you have this information.

You usually get these disclosures when you receive an application form, and you will get additional disclosures before the plan is opened. If any term has changed before the plan is opened (other than a variable-rate feature), the lender must return all fees if you decide not enter into the plan because of the changed term.

Credit costs vary. By remembering two terms, you can compare credit prices from different sources. Under Truth in Lending, the creditor must tell you-in writing and before you sign any agreement-the finance charge and the annual percentage rate.

The finance charge is the total dollar amount you pay to use credit. It includes interest costs, and other costs, such as service charges and some credit-related insurance premiums.

For example, borrowing $100 for a year might cost you $10 in interest. If there were also a service charge of $1, the finance charge would be $11.

The annual percentage rate (APR) is the percentage cost (or relative cost) of credit on a yearly basis. This is your key to comparing costs, regardless of the amount of credit or how long you have to repay it:

> **Example:** You borrow $100 for one year and pay a finance charge of $10. If you can keep the entire $100 for the whole year and then pay back $110 at the end of the year, you are paying an APR of 10 percent. But, if you repay the $100 and finance charge (a total of $110) in twelve equal monthly installments, you don't really get to use $100 for the whole year. In fact, you get to use less and less of that $100 each month. In this case, the $10 charge for credit amounts to an APR of 18 percent.

All creditors-banks, stores, car dealers, credit card companies, finance companies- must state the cost of their credit in terms of the finance charge and the APR. Federal law does not set interest rates or other credit charges. But it does require their disclosure--before you sign a credit contract or use a credit card--so you can compare costs.

Bank Accounts: Frequently Asked Questions

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What banking fees do you need to look out for when shopping for a bank account?

Fortunately, banks are required to give you a list of fees for their accounts. Even with interest, the best account is usually the one with the lowest fees.

Checking accounts are minefields for potential banking charges. Be sure you ask about monthly fees, fees for check processing, and ATM fees. A no-cost checking account may impose a charge if your balance drops below a minimum dollar amount. Check printing charges have sky-rocketed in recent years to as much as $24 at some banks. You can have your checks printed for much less by an outside financial printer.

It rarely makes sense anymore to park money in an old-fashioned "passbook" savings account. Monthly account fees may overshadow the small amount of interest you will earn. Put it in your checking account instead if you can refrain from spending it. If it's a big enough sum, you might want to put it in a money market account. You will earn more interest than in a savings account, but make sure you don't get hit with a monthly charge if your balance falls too low.

What are the different types of bank accounts available?

The accounts offered by depository institutions generally fall within one of these types:

- **Checking accounts.** With a checking account, you write checks to withdraw your deposited funds from the account. Checking accounts provide you with quick, convenient and frequent access to your money. You can make deposits as often as you like. Most institutions provide customers with access to an automated teller machine (ATM) for banking transactions or debits for purchases at stores.
  Some checking accounts pay interest; others do not. A regular checking account -usually called a demand deposit account-does not pay interest, while a negotiable order of withdrawal (NOW) account-does.
  Various fees are charged on checking accounts, in addition to the charge for the checks you order. Fees vary among institutions. Some charge a maintenance or flat monthly fee regardless of the balance in your account. Other institutions charge a monthly fee if the minimum balance in your account drops below a certain amount any day during the month or if the average balance for the month drops below the specified amount. Some charge a fee for every transaction, such as for each check you write or for each withdrawal you make at an ATM. Many institutions impose a combination of these fees.
- **Money market deposit accounts.** A money market deposit account (MMDA) is an interest-bearing account that allows you to write checks. An MMDA usually pays a higher rate of interest than a checking or savings account. MMDAs usually require a higher minimum balance to start earning interest, and often pay higher rates of interest for higher balances.
  Making withdrawals from an MMDA is less convenient than withdrawing from a checking account. You are limited to six transfers per month to another account or to other parties, and only three of these can be by check. Most institutions charge fees with MMDAs.
- **Savings accounts.** With savings accounts, you can make withdrawals, but you do not have the flexibility of checks. As with an MMDA, the number of withdrawals or transfers per month may be limited.
  Many banks offer more than one type of savings account, for example, passbook savings and statement savings. With passbook savings you get a record book in which deposits and withdrawals are entered; this record book must be presented

when making deposits and withdrawals. With statement savings, the bank mails you a regular statement showing withdrawals and deposits.
As with other accounts, various fees, such as minimum balance fees, may be charged on savings accounts.

- **Credit union accounts.** Credit union accounts are similar to those at banks, but have different names. Credit union members have share-draft (rather than checking) accounts, share (rather than savings) accounts, and share certificate (rather than certificate of deposit) accounts.
  Tip: Credit unions typically charge less for banking services than banks. Thus, if you have access to a credit union, it pays to use it.
- **Certificates of deposit.** Certificates of deposit, or CDs, are time deposits. CDs offer a guaranteed rate of interest for a specified term, such as one year. With CDs, you can choose from among various lengths of time that your money is on deposit, ranging from several days to several years.
  Once you pick the term you want, you will generally have to keep your money in the account until the term ends. Some banks allow you to withdraw the interest earned while leaving your initial deposit (the principal) in the CD. Because you are leaving your funds with the bank for a set period of time, the rate of interest is generally higher than for savings or other accounts. Typically, the longer the term, the higher the annual percentage yield.
  If you withdraw your principal before maturity, a penalty is usually charged. Penalties vary among institutions, and can be hefty-sometimes greater than the interest earned, eating into your principal.
  The bank will notify you before the maturity date for most CDs. Often CDs renew automatically.
  Tip: If you are going to take out your money at maturity, keep track of the maturity date and notify the institution that you wish to take out your money. Otherwise the CD will roll over for another term.
- **Basic or no-frills accounts.** Basic or no-frill accounts, which may be offered by some banks, give you limited services for a lower price. Basic accounts give you a convenient way to pay bills and cash checks for less than you might pay without any account at all. Basic accounts are checking accounts, but the number of checks you can write and the number of deposits and withdrawals you can make is limited. Interest generally is not paid.
  Tip: Compare basic and regular checking accounts, taking into account your check-writing needs, to get the best deal in low fees or low minimum balance requirements. If you don't write many checks and don't want to keep a minimum balance in the checking account, the basic account may be worth your while.

What type of account should I open?

The answer depends on how you plan to use the account. If you want to build up your savings and you won't need your money soon, a certificate of deposit will serve your purposes.

If you need to reach your money easily, however, a savings account may be a better choice. And if you want a way to pay bills, a checking account is probably best for you.

> **Tip:** If you usually write only two or three checks per month, an MMDA might be a better deal than a checking account. MMDAs pay a higher rate of interest than checking accounts, but require a higher minimum balance.

Checking accounts have other advantages. They simplify your recordkeeping. Canceled checks provide you with receipts at tax time, and the check register is a convenient way of keeping track of monthly expenses.

Account features and fees vary from one institution to the next. It's important to take the time to ask bank employees about any account features and fees before you open an account.

> **Tip:** To get the most out of a checking account, find out what the minimum balance for avoiding fees is, and keep that minimum in the account. Further, try to get a checking account that will pay you interest, or that looks to the combined balance in checking and savings accounts to arrive at the minimum required balance. This way, you will not be paying the bank for the checking services, and your money will be earning some interest-although not at a great rate.

How should I shop for a "best buy" bank account?

Choosing an account is a matter of comparing the features of accounts at various banks.

The features that should be compared are:

- **Interest Rates.** Determine the interest rate on an account. Find out whether the institution can change the rate after you open the account. In addition, find out the following:
    1. Does the institution pay different rates of interest depending on the amount of your account balance, and, if so, in what way is interest calculated? (See Tiered Interest Rates, below.)
    2. How often is interest compounded? In other words, when does the institution start paying interest on the interest you've already earned in the account?
    3. What is the annual percentage yield? The APY is a rate that reflects the amount of interest you will earn on a deposit.
    4. What is the minimum balance required before you earn interest?
       Tip: Find out how the bank calculates the minimum balance requirement. A calculation that is based on the minimum daily balance is best for you.
    5. Do you begin earning interest the day you deposit a check into your account-called "earning on your ledger balance"-- or do you begin earning interest later, when the institution receives credit for the check-known as "earning on your collected balance"?
- Institutions may pay different rates tied to different balance amounts.
  Example: An institution pays a 5 percent interest rate on balances up to $5,000 and 5.5 percent on balances above $5,000. If you deposit $8,000, the institution that pays interest on the entire balance pays you 5.5 percent on the entire $8,000. Other institutions may pay you 5 percent on the first $5,000 and 5.5 percent only on the remaining $3,000.
  Tip: To tell which method an institution uses, check the annual percentage yield (APY) disclosure. If it is a single figure for a balance level, you will be paid the stated interest rate for the entire balance. If the APY is stated as a range for each balance level, your earnings will depend on the balance you keep in each level. Of course, getting paid the stated interest rate on the entire balance is a better deal.
- **Fees.** Ask the following questions of each bank/account that you are considering:
    1. Will you pay a flat per-month fee? How much?
    2. Will you pay a fee if the balance in your account drops below a certain amount? How much?
    3. Is there a charge for each deposit and withdrawal you make? How much?
    4. How much will it cost you to use an ATM to make deposits and withdrawals on your account? Does it matter whether the transaction takes place at an ATM owned by the institution?

    Tip: You can cut ATM fees by limiting yourself to only one withdrawal per week, or by using only ATMs owned by your bank.

5. Is there a charge for bill payment by phone or modem? How much?
6. If you have a checking account or an MMDA, how much will new checks cost?

    Tip: You can save up to 50 percent on the cost of checks by ordering your checks from your own supplier, instead of letting the bank order them.

7. Will you be charged for each check you write? How much?
8. Are fees reduced if you have other accounts at the institution?
9. Are fees reduced or waived if you agree to directly deposit your paycheck or government payments (e.g., Social Security check)?
10. What is the fee for stopping payment on a check you have written?
11. Is there a charge for making a balance inquiry?
12. Does the institution charge a fee for closing an account soon after it is opened? If it does, when will the fee be imposed?
13. Are you charged to have canceled checks returned to you with your statement? How much?
14. What is the charge for writing a check that bounces (a check returned for insufficient funds)? And what happens if you deposit a check written by another person, and it bounces? Are you charged a fee?

- **Limitations.** Find out whether the following will apply to the account:
    1. Does the institution limit the number or the dollar amount of withdrawals or deposits you make?
    2. If you close the account before interest is credited to your account, will you be credited with the interest that has been earned?
    3. How long does it take for checks to clear? How soon does the institution allow you to withdraw funds that you have deposited to your account?
- *If you are looking into a CD, here are some questions to ask:*
    1. What is the term of the account (i.e., how long until maturity)?
    2. Will the account roll over automatically? Does the account renew unless you withdraw your money at maturity or during any grace period? A grace period is the time after maturity when you can withdraw your money without penalty. If there is a grace period, how long is it?
    3. If you are allowed to withdraw your money before maturity, is there a penalty? How much?
    4. Will the institution regularly send you the amount of interest you are earning on your account-or regularly credit it to another account of yours?

How much protection is provided by federal deposit insurance?

Federal deposit insurance sets apart deposit accounts from other savings choices. Only deposit accounts at federally insured depository institutions are protected by federal deposit insurance. Generally, the government protects the money you have on deposit to a limit of $100,000. Accounts for special relationships, such as trusts or co-owners, may also have some effect on the amount of insurance coverage you have.

> **Tip:** Ask the bank how the deposit insurance rules will apply to your deposit account. Federally insured depository institutions also offer products that are not protected by insurance. For example, you may purchase shares in a mutual fund or an annuity. These investments are not protected by the federal government.

How can I negotiate checking account fees with my current bank?

Here are some **tips for negotiating** with your current bank to try to get a better deal on your checking account.

- **Step One:** Take a look at your past three or four checking account statements. Find out what all of the fees and charges are, and make notes of them.
- **Step Two:** Figure out your checking account needs, and jot them down. How many checks do you write per month? How many ATM visits do you make? How many deposits do you make? How many times are you overdrawn? How often do you go below the minimum required balance?
- **Step Three:** Armed with this information, check with several other area banks to find out what they charge for the same services. Do this over the phone, if you have the time, or ask for the information to be sent to you in the mail.
- **Step Four:** Now you are ready to go to your own bank. Speak to a manager. Say that you are looking to reduce your banking costs. Ask them to cut fees, and if they won't budge, tell them what the competition is offering. They may move on certain fees if they sense they will lose your business. Ask whether you can lower costs by: using direct deposit, getting photocopies of canceled checks instead of the checks themselves, or opening another account or CD.

Tip: Many banks offer free checking to seniors, students, or the disabled, if the depositor asks for this service.

Tip: If you decide to take your business elsewhere, don't overlook smaller banks, which may be more eager for your business.

What questions should I ask when shopping for a Checking Account?

You need to know exactly how much a checking account will cost you. Get a list from your banker of all possible fees, including charges for maintaining the account, processing checks, bouncing checks, using the ATM, stopping payment, and transferring funds. Ask if the account will be cheaper if the bank does not return canceled checks. In the rare event that you need one, ask how much, if anything, it will cost to get a copy. To avoid bouncing checks, ask how long you have to wait after depositing funds to draw on them.

For interest checking accounts, ask how the bank calculates the interest. If the bank pays more on accounts with higher balances, be sure you get a "tiered" rate, which pays you the highest interest on all the money you have in the account. Be sure you know the charge for falling below the minimum balance, too. It might be more than the interest you will earn. Finally, some banks reduce charges on checking accounts if you take out a loan or buy a CD. Ask what deals are available.

What is overdraft protection and should I have it?

Many people overlook a valuable service offered by banks: the overdraft protection line of credit. With this protection, if you write a check which would overdraw your account a loan is automatically made from a line of credit. With this protection you will not bounce any checks.

This type of service is most valuable to a self-employed individual whose business is seasonal. If there are times during the year when you have cash flow problems, the overdraft protection line of credit can save you headaches-and at a lower interest rate than other forms of borrowing.

Starting in 2010, automatic overdraft protection is no longer provided by banks and bank customers must opt-in for this protection. Don't neglect to inquire about this service if it would suit your situation.

What is the Truth in Savings Act?

The **Truth in Savings Act,** a federal law, requires depository institutions to disclose to you the important terms of their consumer deposit accounts. Institutions must tell you:

- The annual percentage yield and interest rate
- Cost information, such as fees that may be charged
- Information about other features such as any minimum balance amount required to earn interest or to avoid fees

To help you shop for the best accounts, an institution must give you information about any consumer deposit account the institution offers, if you ask for it. You will also get disclosures before you actually open an account.

In addition, the Truth in Savings Act generally requires that interest and fee information be provided on any periodic statements sent to you. And if you have a roll-over CD that is longer than one month, the law requires also that you get a renewal notice before the CD matures.

ATM Transactions: Frequently Asked Questions

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How do automated teller machine (ATM) and other electronic transfer transactions work?

There are various transactions that fall under the umbrella term "electronic funds transfer."

Automated Teller Machines (ATMs). You can bank electronically and get cash, make deposits, pay bills, or transfer funds from one account to another. ATM machines are used with a debit or EFT card and a code, which is often called a personal identification number or "PIN."

Point-of-Sale (POS) Transactions. Some EFT cards can be used when shopping to allow the transfer of funds from your account to the merchant's. To pay for a purchase, you present an EFT card instead of a check or cash. Money is taken out of your account and put into the merchant's account electronically.

Preauthorized Transfers. This is a method of automatically depositing to or withdrawing funds from an individual's account, when the account holder authorizes the bank or a third party (such as an employer) to do so. For example, you can authorize direct electronic deposit of wages, Social Security, or dividend payments to their accounts. Or, you can authorize financial institutions to make regular, ongoing payments of insurance, mortgage, utility or other bills.

Telephone Transfers. You can transfer funds from one account to another-from savings to checking, for example-or order payment of specific bills by phone.

People who use EFT systems are often concerned about safeguards in the system. Since there is no check-no piece of paper with information that authorizes a bank to withdraw a certain amount of money from your account and pay that amount to another person-EFT users wonder about recordkeeping, errors, and theft:

Recordkeeping. When you use an ATM to withdraw money or make deposits, or a point-of-sale terminal to pay for a purchase, you get a written receipt--much like the sales receipt you get with a cash purchase- showing the amount of the transfer, the date it was made, and other information. This receipt is your record of transfers initiated at an electronic terminal.

Your periodic bank statement must also show all electronic transfers to and from your account, including those made with debit cards, by a pre-authorized arrangement, or under a telephone transfer plan. It will also name the party to whom payment has been made and show any fees for EFT services (or the total amount charged for account maintenance) and your opening and closing balances.

Your monthly statement is proof of payment to another person, your record for tax or other purposes, and your way of checking and reconciling EFT transactions with your bank balance.

What should I do if I find an error related to an electronic fund transfer or ATM transaction?

If you believe there has been an error in an electronic fund transfer relating to your account:

1. Write or call your financial institution immediately if possible, but no later than 60 days from the date the first statement that you think shows an error was mailed to you. Give your name and account number and explain why you believe there is an error, what kind of error, and the dollar amount and date in question. If you call, you may be asked to send this information in writing within 10 business days.
2. The financial institution must promptly investigate an error and resolve it within 45 days. However, if the financial institution takes longer than 10 business days to complete its investigation, generally it must put back into your account the amount in question while it finishes the investigation. Note: The time periods are longer for point-of-service debit card transactions and for any EFT transaction initiated outside the United States. In the meantime, you will have full use of the funds in question.
3. The financial institution must notify you of the results of its investigation. If there was an error, the institution must correct it promptly-for example, by making a re-credit final. If it finds no error, the financial institution must explain in writing why it believes no error occurred and let you know that it has deducted any amount re-credited during the investigation. You may ask for copies of documents relied on in the investigation.

What happens if my ATM card is lost or stolen?

It's important to be aware of the potential risk in using an ATM or other Electronic Funds Transfer card. Note that the risks differ from those involved with credit cards. On lost or stolen credit cards, your loss is limited to $50 per card. On an EFT card, your liability for an unauthorized withdrawal can vary:

- Your loss is limited to $50 if you notify the financial institution within two business days after learning of loss or theft of your card or code.
- But you could lose as much as $500 if you do not tell the card issuer within two business days after learning of the loss or theft.

If you do not report an unauthorized transfer that appears on your statement within 60 days after the statement is mailed to you, you risk unlimited loss on transfers made after the 60-day period. That means you could lose all the money in your account plus your maximum overdraft line of credit.

Will I be able to use my ATM card overseas?

There are now hundreds of thousands of ATMs in more than 100 countries in both major cities and more remote locations such as villages in the Peruvian Andes. Before you go however, check with your financial institution to be sure there is an ATM at your destination, especially in a developing country. You can also check online. Both Visa and Master Card have online services to pinpoint ATMs anywhere in the world.

ATM cards can be very useful to travelers. They are safer than carrying cash because card issuers often will absorb any unauthorized withdrawals if you report your card stolen or missing right away. You can withdraw cash in local currency at a better exchange rate than you can get with traveler's checks. And you have access to money after hours or on weekends when banks are closed. The down side is that the fees banks charge on ATM transactions may make it expensive to change small amounts of money. You also may be in trouble if the stripe on your card is demagnetized. To protect yourself use your ATM card in combination with credit cards and traveler's checks.

How will I know a pre-authorized credit (such as automatic payroll deposit) has been made?

There are various ways you may be notified. Notice may be given by your employer (or whoever is sending the funds) that the deposit has been sent to your financial institution. Otherwise, a financial institution may provide notice when it has received the credit or will send you a notice only when it has not received the funds. Financial institutions also have the option of giving you a telephone number you can call to check on a pre-authorized credit.

How do I stop a pre-authorized payment?

You may stop any pre-authorized payment by calling or writing the financial institution, so that your order is received at least three business days before the payment date. Written confirmation of a telephone notice to stop payment may be required.

How do I protect my ATM and Debit Cards against fraud?

1. Carry only those cards that you anticipate you'll need.

2. Don't carry your PIN in your wallet or purse or write it on your ATM or debit card.

3. Never write your PIN on the outside of a deposit slip, an envelope, or other papers that could be easily lost or seen.

4. Carefully check ATM or debit card transactions before you enter the PIN or before you sign the receipt; the funds for this item will be fairly quickly transferred out of your checking or other deposit account.

5. Periodically check your account activity. This is particularly important if you bank online. Compare the current balance and recent withdrawals or transfers to those you've recorded, including your current ATM and debit card withdrawals and purchases and your recent checks. If you notice transactions you didn't make, or if your balance has dropped suddenly without activity by you, immediately report the problem to your card issuer. Someone may have co-opted your account information to commit fraud.

6. Open monthly statements promptly and compare them with your receipts. Report mistakes or discrepancies as soon as possible to the special address listed on your statement for inquiries. Under the FCBA (credit cards) and the EFTA (ATM or debit cards), the card issuer must investigate errors reported to them within 60 days of the date your statement was mailed to you.