EMERGENCY CLOSING LEARNING PLAN

Economic and Personal Finance

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W!SE QUICK REVIEW

Banking Study Guide

BANKING

- Banks and Credit Unions provide many valuable services to help you pay bills, save money, and get loans for houses and cars. They also provide convenience with online and mobile banking.
- Banks and Credit Unions provide protection of your deposits – peace of mind to know your money is safe. **Bank** deposits are insured by the **FDIC** and **Credit Union** deposits by the **NCUA** for **$250,000**.
- Banks hold most of the money in our country called **M1 money** (coins, currency, & checking accounts). Banks are in the business of making loans. They earn a profit by charging **interest** on these loans.

FEDERAL RESERVE SYSTEM ("THE FED")

- The **Federal Reserve System** works to keep our economy and banking system healthy.
- The **Fractional Reserve System** requires banks to keep a fraction of their deposits on hand. This money is called **reserves.** Banks can lend out the remaining deposits which are called **excess reserves.** The **Federal Reserve** requires banks to keep **10%** of deposits as reserves. If the bank receives a $1,000 deposit, it must keep $100 as reserves (10%) and can loan out $900.
- The Fed is also responsible for **Monetary Policy** which controls the money supply. If there is too much money in the economy, it can create inflation. **Inflation** is the rising costs of goods & services. To control inflation, the Fed raises the **Federal Funds Rate.** This increases the interest rates on loans and reduces the money supply in the economy.

BANKS

- ADV: Banks provide **easy access** and **convenience** with many **national branches** around the country. Bank of America and Wells Fargo can be found around the United States.
- DISADV: Banks are **for-profit** institutions that serve the **best interests of their stockholders**. They often have **higher fees** than credit unions.

CREDIT UNIONS

- Credit Unions require you to **qualify for membership** (i.e. Navy Federal Credit Union requires their members to be associated with the military).
- ADV: Credit Unions are **not-for-profit, serve the best interest of their members** and often have **lower fees** & charge lower interest on loans.
- DISADV: Credit Unions are often **regional** so it may be **harder to find a branch** if you are travelling or move to another area of the country. *Virginia Credit Union would not have branches in Florida.*

CHECKING ACCOUNT

- Money in this account is **very safe** & **liquid** (can get your cash out quickly) and can be used to pay bills.
- You can set up your paycheck for **direct deposit** by providing your employer the bank's **routing number** & your checking **account number**.
- You need to **endorse** any checks that you want to deposit or cash. You do this by signing your name on the back of the check. This is called a **blank endorsement.**
  ** ***<u>NEVER SIGN</u>*** your check until you are at the bank. If you lose your check, someone else can cash it!
- Other types of **endorsements** can limit how a check is handled by the **payee** (person receiving check)
- **Restrictive endorsements** restrict what you can do. For example: "*For <u>Deposit Only</u> to Savings*."
- **Special endorsements** allow a payee to assign a new owner of the check. The payee endorses check, then transfer check to someone else by writing, "*Pay to the Order of (add name)*".

- It is important to manage you checkbook by **reconciling your account.** This means that you compare your **monthly bank statement** with your **checkbook register** to see if the balances match.
- When you reconcile your account, you will look for **outstanding checks –** checks that has been written but has not yet **cleared** your bank. This helps you to avoid bouncing checks for **insufficient funds**. **Bounced Check –** insufficient funds to cover check resulting in a penalty fee.
- **Debit cards** provide easy access to the cash in your checking account. It allows you carry less cash. Use your "cash back" feature on your debit to avoid **ATM fees**!!! To use your card as a debit card, you must enter a **PIN** (personal identification number). It is <u>not</u> a credit card – cash comes out of checking!

SAVINGS ACCOUNT

- **Savings accounts** are highly safe (FDIC-insured) and provide **compound interest**. Savings accounts include Regular savings, Certificates of Deposit (C.D.'s), and Money Market Accounts (MMA).
- **Regular savings** is **highly liquid** (<u>easy to withdraw, will not lose value</u>) and can be used for your **emergency fund** (to cover 3-6 months of living expenses). However, interest rates are very low.
- **Certificates of Deposit (C.D.)** earn **higher interest rates** than a regular savings account. CD's are very safe and guaranteed. You deposit money and promise not to withdraw it for a certain period of time. The longer you promise to leave it in the bank, the higher the interest rate. For example, a 5-year CD pays more interest than a 6-month CD. However, you cannot access this money without an **early withdrawal penalty,** so it has **liquidity risk**. CD's are not liquid accounts (illiquid).
- **Money Market Accounts** earn slightly more interest than a Regular Savings Account. You must deposit a minimum amount of money to open this account. You are allowed to write checks from this account.
- **Interest Rates** – this is the cost of borrowing money. You pay banks interest when you borrow money or have a balance on a credit card. Banks pay you interest when you deposit money in their bank.
- **Simple interest** is interest earned only on the original principal.
- **Compound Interest** is interest on your **principal** (the money you originally deposited) <u>AND</u> all **previously earned interest**. By investing early and regularly, compound interest will help your money grow faster over the years.
- **Rule of 72 –** helps you determine how quickly your money will <u>double</u> at different interest rates.
  Example: How many years will it take $10,000 to grow to $20,000 at 8% interest?
  Answer: 72/8% = 9 years. (NOTE – always put 72 on the top).
  Example: What interest rate do you need to earn for $20,000 to grow to $40,000 in 6 years?
  Answer: 72/6 years = 12% (NOTE – always put the percentage or the years at the bottom).

ONLINE BANKING

- **Online banking** and **mobile banking** (using your Smartphone) provide a convenient way to check your account balances, see if a check has cleared, transfer funds, pay your bills online, set up **automatic bill payment,** and to view your **monthly bank statement.**
- Avoid **identity theft** by never giving personal identifying information to anyone through email or over the phone.
- To reduce your personal liability for lost debit or credit cards, call your bank immediately. The most you can be liable for a lost/stolen debit card is **$50** if reported within 2 days and $500 if reported within 60 days.

W!SE QUICK REVIEW

Credit Study Guide

CREDIT SCORE/CREDIT REPORTS

- Your **credit score** is a number between **300 and 850**. A good credit score is **700 and higher**. Higher credit scores translate into lower interest rates on loans because you are considered less risky. The best way to keep your credit score high is to **pay your bills on time** (good payment history). The next best way is to keep you **credit card balances low**.
- Three agencies that collect credit information and place it in your **credit report**: **Equifax, Experian, and Transunion**. You are allowed **1 free credit report each year** from each of the agencies. You can also request a free credit report when you are denied credit. Use this website to request your free credit report (the others charge): **www.annualcreditreport.com/**
- When you need a loan, the bank will require that you answer many questions to determine the interest rate charged to you. These questions are called the "**C's of Credit**": **Character** asks, "Do you pay your bills on time? How have you handled previous credit? Do you move around a lot? Are you a job-hopper?" **Capacity** asks, "Can you repay this loan? How much debt do you already have? How much income is available for the new loan payment?" **Collateral** asks, "Is there an asset that goes with this loan, or do you have other assets that could be taken if you didn't repay this loan?" **Conditions** asks, "What are the current market conditions that might be affecting interest rates?"

CREDIT PROBLEMS

- **Chapter 7 Bankruptcy**: A legal process that provides a "fresh start" You will lose most of your possessions as they will be sold to pay off your creditors **(complete liquidation**). Your credit will be ruined for 7-10 years. You cannot file Chapter 7 bankruptcy if you make too much money (you must be lower than the median income in your area).
- The agency that can assist if you are in trouble with credit is called the **Consumer Credit Counseling Service (CCCS)**. Although this service does not offer to pay your bills, it can help you negotiate better interest rates with your **creditors** and set you up on a realistic **repayment plan**. You will likely use this service if you file for **Chapter 13 bankruptcy**. This type of bankruptcy allows you to keep your assets as long as you follow the repayment plan, but your **credit report** will show the bankruptcy, and your credit will be ruined for 7-10 years.
- If you are in trouble with credit, you can also call the credit card companies directly to negotiate lower payment options. Many companies are willing to work with you if you are making a good faith effort to repay your loan.
- When you don't repay your **mortgage**, the bank may take possession of the home in order to satisfy the loan. This is called **foreclosure**. If you don't pay your **car loan**, you will lose your car to **re-possession**. You can also have money withheld from your paycheck called a **wage garnishment** to pay off debts. Creditors (people you owe money to) can also put a **lien** on your assets which give them a legal claim to seize them.

CREDIT CARDS

- When you receive your credit card bill/statement, be prepared to pay the full **balance** (amount owed), or pay as much as you possibly can. If you only make the **minimum payment**, you will pay a huge **finance charge**, or interest, on the amount you did not pay. This charge will be added to your balance on your next bill/statement. This is called the **Minimum Payment Trap**, and it creates debt for you.
- The time between the date you receive your bill and the date the payment is due is called a **grace period**. You will not pay interest (no finance charge) during this time. **To avoid interest, pay your bill in full each month.**
- Interest rates on credit cards are very high. The highest interest rates are for **cash advances** on a credit card. Never use your credit card to get cash – very expensive way to borrow money!

PREDATORY LENDERS

- Be wary of places that offer loans but charge very high interest rates. This are called **predatory lenders.**
- **Pawn Shops** loan you cash in exchange for something you own, like a t.v. If you fail to re-pay the loan, they sell this item and keep all profits. **Payday lenders** loan you cash that you must repay with your next paycheck. **Title loan companies** like TitleMax loan you cash in exchange for the title of your car. If you fail to re-pay the loan, they sell your car. **Check Cashing** businesses charge a fee to cash your check. These predatory lenders all charge excessively high interest rates and fees (some as high as 900%) to people with poor credit and few options.

TYPES OF CREDIT

- **Open-end credit** – <u>credit cards</u> and other "**revolving" loans** that allow you to purchase a variety of goods and services. You swipe your credit card, you get a bill at the end of the month, you pay the bill, and the cycle continues until you cancel the card/account.
- **Closed-end credit –** this is a loan for a particular item that you repay in monthly installments. When all payments have been made, the loan is closed. Examples include **car loans, mortgages, and student loans**.
- **Secured Loans –** these are loans that have been **secured by collateral** (assets that lender can seize if you fail to re-pay the loan). Car loans (collateral – the car) and mortgages (collateral – the house) are examples. Interest rates on these loans are lower since they are secured by collateral.
- **Unsecured Loans –** these are loans that are <u>NOT</u> secured by collateral. Examples include as **credit cards** and **personal bank loans**. Interest rates are higher for these loans since it is not secured by collateral. Interest rates are determined by your credit score.

CONSUMER PROTECTION

- The government ensures that businesses offering loans are truthful and fair with consumers. The **Truth in Lending Act** requires that institutions offering loans tell you, the consumer, the **APR** (annual percentage rate) you are being charged as well as all of the terms and agreements of the loan.
- You are also protected if someone else uses your credit card without permission. You are not liable for unauthorized purchases as long as you notify the credit card company of the fraudulent charges within **45-60 days** of the fraudulent charge.

W!SE QUICK REVIEW

Insurance Study Guide

INSURANCE

- Insurance is a contract where you **transfer risk** to an insurance company. Major types of insurance include auto insurance, health insurance, homeowner insurance, and life insurance. Insurance protects against **perils** (risks) such as fire, illness, and death.
- You pay **premiums** to the insurance company to insure yourself again major losses that could financially ruin you. If you stop paying the premiums, you will lose your insurance coverage.
- An important concept is the **deductible**. You must pay this out-of-pocket expense first before your insurance company will pay anything. Assume you have an accident that is your fault, requiring $800 to repair your car. If your policy has a $500 deductible, you will pay $500 and the insurance company would pay $300.
- The insurance company will lower the cost of your insurance (premiums) if want to share more of the risk by raising your deductible. **The higher your deductible**, the **lower your premiums**. If you select a lower deductible, your premiums (cost) will increase.

AUTO INSURANCE

- **Liability insurance** provides insurance in the event that you cause an accident. Liability insurance only covers repairs to the other person's car. It does not repair your car. People driving an **older car with low value** often only have liability insurance to reduce premiums and save money.
- You can register your car at DMV without liability insurance by paying DMV a **$500 Uninsured Motorists Fee**. However, you will be personally responsible for any damages that you cause others.
- **Collision insurance** can be added to your policy for a higher premium. This coverage will repair damages to your car if you are at fault in an accident. Lenders require this if you are paying a car loan. This coverage is appropriate for **newer cars** (higher value).
- **Comprehensive insurance** can also be added to your policy for a higher premium. This will pay to repair **non-collision** damages (not caused by a car crash). Examples: a tree branch falls on your car; a rock cracks your windshield; damages from fire, theft, vandalism, etc…
- Collision and Comprehensive insurance requires you to pay your **deductible** before insurance will pay anything to fix your car.
- **Uninsured Motorist Insurance** coverage protects you in case your car is damaged by an uninsured driver. Your insurance company will pay to fix your car in this case.

HEALTH INSURANCE

- Health insurance can be obtained by individuals, but most people receive insurance from their **employers.** Employers enroll their employees into a **group plan**. These plans are less expensive than individual plans and everyone in the group is eligible.
- **Employers pay most** of the premiums in a group plan (about 80%) and employees pay the rest of the premiums as a payroll deduction.
- **Co-pays** are required each time you visit a doctor. The cost is generally around $20 - $40. It controls costs by encouraging you not to run to the doctor for every sniffle!
- **Basic health plans** cover the cost of doctor office visits (check-ups, treatment) and hospital/surgical expenses. **Elective surgery** (cosmetic surgery) is NOT covered.

- **Major medical insurance** provides **higher limits** of coverage which ensures you will not run out of insurance for serious conditions. You pay **higher premiums** for this higher coverage.
- **Managed health care plans** control the rising cost of healthcare. The <u>most common</u> managed care plan is the **HMO** (Health Maintenance Organization). Members must choose a **Primary Care Physician (PCP)** from a list of approved doctors in the **network.** The PCP is responsible for managing your health care. If you need to see a **specialist**, you must first see your **PCP** for a **referral**. Lower costs are an advantage of HMO's, but freedom of choice is more restrictive than other types of plans.
- Another managed care plan is the **PPO** (Preferred Provider Organization). With this plan, <u>you can see a doctor outside of the network</u> but you <u>will pay more money</u> for treatment.

HOMEOWNER'S INSURANCE (H.O.)

- Your **home and personal property** is protected from fire, wind, hail, smoke, tornado, theft, vandalism, etc… **Flooding damage** is <u>NOT</u> covered. You must buy a separate **flood insurance policy.**
- **Personal liability coverage** is provided in case someone gets hurt at your house and wants to sue you. For higher limits of liability coverage, you can add an **umbrella policy**.
- **Loss of Use coverage** pays for the expense of living away from your home during repairs.
- Homeowner's insurance policies require a **deductible.** There are special deductibles for **tornado or hurricane** damage that are <u>much higher</u> than your normal deductible.
- Expensive items can be added as a **floater (rider policy)** to insure these items at their appraised value. This includes expensive jewelry, art work, and other valuables.
- Document your belongings with a **Personal Property Inventory.** Make a list of all items and take pictures to prove to your insurance company what you lost.
- The best policies offer **replacement value** for your personal belongings. This ensures your belongings are replaced in full at today's cost without lowering their value for **depreciation**.
- **Renter's insurance** protects renters against losses for their personal property, personal liability, and loss of use. It does <u>not</u> cover damage to the building since the landlord's H.O. policy covers this.

LIFE INSURANCE & ESTATE PLANNING

- Two types of life insurance includes: **Term Life Insurance** and **Whole Life Insurance.**
- When the **insured** person dies, **beneficiaries** receive the policy's **death benefit**. Beneficiaries include a spouse or children with **insurable interest** (people who <u>financially depend</u> of the insured's support).
- **Term Life Insurance** provides protection for a specific period of time, such as 5, 10, 15, or 20 years. These policies are **less expensive**. However, once the term expires, there is no protection.
- **Whole Life Insurance** provides protection for the <u>insured's whole life</u>. **Premiums** are <u>higher</u> since your risk of dying increases with age. These policies include a **cash value account** (money you can borrow).
- **Estate Planning** <u>distributes assets</u> to beneficiaries as you wish & <u>reduces estate taxes</u> at your death.
- A **will** is a legal declaration of how you want to distribute your assets to beneficiaries at death. All wills go through the **probate process** in court to <u>pay off creditors first</u> before the beneficiaries get anything.
- An **executor** is a person chosen to distribute the assets of the estate. Assets placed in a **living trust** avoid the probate process**.** Once you die, the **trustee** (person you assigned to manage the trust) will enact the terms of the trust. **Guardians** can be named to provide care to your young children.
- **Living Wills** allow you to name someone to make end-of-life decisions with your doctor if you cannot.
- **Gift Taxes & Inheritance Taxes** are paid by beneficiaries for money received. People can **gift** up to $14,000 each year to reduce their estate size, and the beneficiaries will not have to pay a gift tax.

Investing Study Guide

STOCK MARKET

- The first time a company ever sells stock is called the **IPO (initial public offering)**. This sale takes place in the **primary market** between the stock buyer and the company. The next day, the stocks are traded in the **secondary market** between a buyer and seller of the stock on a stock exchange.
- The **New York Stock Exchange** is the oldest and largest **securities** exchange. It mainly trades stock of larger, well-established companies. Another stock exchange, the **NASDAQ**, typically trade stocks for technology companies and smaller companies.
- You can use a stock market index to see how well the stock market is doing. **The Dow Jones Industrial Average (DJIA)** tracks the performance of the 30 largest companies. If they are doing well, the stock market as a whole is usually doing well. The **S&P 500** is another index that tracks the performance of the 500 largest companies.
- When stock prices are increasing and investors are optimistic, it is called a **BULL** market. When stock prices drop, investors can hardly "bear" it!!! It is a **BEAR** market.
- Stocks are better for **long-term goals**. You don't want to have all of your money in stocks for a short-term goal – what if the market crashes at a time when you really need the money?!!

STOCKS

- Stocks represent **ownership** in a company. Stockholders can **vote** on company matters.
- Investment products like stocks, bonds, and mutual funds carry additional risk, but the **rate of return is higher**. Savings products offered through banks or credit unions are safer and guaranteed, but the rate of return on these products is usually <u>low</u>.
- **Risk vs. Reward**. The more risk you are willing to take, the higher the potential return.
- Corporations may decide to share profits with their stockholders. This pay-out is called a **dividend**. For example, if you have 1,000 shares of stock, and the company declares a $2.00 dividend, you will receive a $2,000 check. It is **taxable income**.
- **Blue Chip Stock** is considered the <u>safest stock</u> – it represents ownership in companies that are well-established with a record of steady earnings.
- **Growth Stock** is considered the <u>riskiest stock</u> – these companies are growing faster than the average stock and have a higher risk of slowing down in the future.
- **Income Stock** is stock from companies that pay a <u>dividend</u> (considered income).
- **Capital Gain** – when you make money on a stock, you have a capital gain. It is **taxable income**. If you lose money when you sell stock, it is called a **capital loss**.
- **Capital Gain Example** - you buy a stock for $40 and sell it two year later for $50. You have a capital gain of $10. You will also pay a tax on that capital gain. The tax will be higher if you buy and sell that stock in <u>less than one year</u>. **Buy and hold**: buy stocks, and hold onto them for the long term.
- **Illiquid/Not Liquid** – stocks are not considered liquid assets since the value changes so much. If the value of your stock is down when you need to sell them, you will lose money.

BONDS

- **Bonds** are a way to invest your money by <u>LOANING</u> money to a government or business in return for **interest**. The company will repay your loan when the bond **matures**.
- **U.S. Government bonds** are considered <u>extremely safe</u>. They include **Treasury bills, notes, and bonds**. Treasury bills (**T-bills**) mature in less than one year. **U.S. Savings Bonds** are purchased at one-half the face value and will mature to full face value over a specified period of time.
- **Municipal bonds** are sold by local governments like the City of Chesapeake to fund new roads and schools. Interest you earn on this investment is **tax-exempt**!!!
- Businesses that want to raise money sell **corporate bonds**. These are riskier than U.S. Government bonds, but pay more interest. The riskier the company, the more interest you earn.
- If a company goes out of business and owes people money (called creditors), **bond holders get paid back first**, then preferred stock holders, then common stock holders. This is another reason why bonds are less risky than stock.

MUTUAL FUNDS

- **Mutual funds** are a collection of stocks and bonds that investors can purchase. They are less risky than buying individual stocks and bonds and provide immediate diversification.
- **Diversification** means spreading out your investment dollars among various investments to reduce the risk of you losing all of your money. **Don't put all of your eggs in one basket!!!**

SPECULATIVE/RISKER INVESTMENTS

- **Penny stocks** are sold for **$5.00 or less**. These companies are highly volatile and can fail.
- **Junk bonds** are bonds sold by companies that are **rated very low** by bond rating agencies. These bonds are sold by high-risk companies that may **default** on paying back your loan.
- **Real Estate** – real estate investments are illiquid (**not liquid**). It takes several months or longer to sell real estate.
- **Collectibles** – stamp or coin collection, expensive artwork, etc…

REGULATION

- The **SEC (Securities and Exchange Commission)** is the government agency that oversees activity in the stock market. They enforce laws and ethical practices of stock brokers and brokerage firms that buy and sell stock for their clients.
- **Stock brokers** must be **licensed** to buy and sell stock. **Full-service brokers** also provide **investment advice** and charge **higher commissions** when they buy or sell stock for you. **Discount brokers** are <u>less expensive</u> but you make your own decisions on what to buy and sell.

EVALUATING STOCK (STOCK INDICATORS)

- **EPS** – *Earnings Per Share;* **The number one indicator of a company's profitability.**
- **P/E Ratio**-Price-to-Earnings Ratio; How expensive the stock is selling for (how "pricey")
- **Market capitalization** The total value of all outstanding stock being traded in a company.

W!SE QUICK REVIEW

w!se Financial Literacy CERTIFICATION

Money Management Study Guide

MONEY

- Money in the U.S. is **Fiat currency** – it is not backed by gold. It is backed by confidence in the U.S. Government.
- The U.S. is becoming more of a **cashless society** with debit cards, credit cards, and online banking.
- Money is a **medium of exchange** – money represents a **unit of value** and can be exchanged for goods and services. U.S. currency has a **stable value**; it is also **durable**, **portable**, and **easily divisible**.
- **M1** money is the most liquid type of money that includes coins, currency, & money in checking/savings accounts. **Liquid assets** can be quickly converted into cash without fear of it losing value.

NET WORTH

- **Net worth = Assets – Liabilities.** Example: What is your net worth if you own $50,000 worth of assets and owe $30,000? Answer: Net Worth = $50,000-$30,000 = $20,000. You are solvent in this example.
- **Assets** are anything of value that you own – money, cars, homes, jewelry, savings account, stock, etc…
- **Liabilities** are debts you have—money you owe—such as car loans, student loans, and credit card debt
- You are **insolvent** when your liabilities exceed your assets. This is not good. You will not likely receive a loan if you needed one to purchase something else. Avoid too much debt to remain **solvent**!
- **Depreciation** – decline in value of an asset. Most assets depreciate. A new car loses value as soon as you drive them off the lot! Some assets **appreciate** (gain value) such as collectibles (stamp collection, artwork). In most cases, houses appreciate over time.

SETTING GOALS

- **SMART** Goals are **Specific, Measurable**, Attainable, Relevant, and have a Timeframe.
- **Short-term** Goals –One year or less (money should be safe – savings account, short-term CD)
- **Mid-term** Goals – Around 5 years
- **Long-term** Goals – 10 Years or more (money can be invested with higher levels of risk –stocks/bonds)

BUDGETING

- A monthly **budget** is a plan for how you're going to spend your income. Include all sources of income in your budget. **Disposable income** is the money you have to pay your bills.
- Next, record your expenses. **Fixed expenses** stay the same each month, such as rent payments or car payments. These are easier to predict. **Variable expenses** change from month to month, such a food expenses, utility bills, new clothes, and entertainment. To get an accurate record of expenses, keep track of how you spend your money for a few months.
- **Pay Yourself First** means setting aside money from each paycheck before you pay any other expenses. Savings should be your first expense listed in your budget. Set aside **10% of your net income** each month to create an **emergency fund**. You should save at least **3-6 months' worth of living expenses**. If you lose your job, for example, you can still pay your bills without going into debt. An emergency fund helps to pay for **unanticipated expenses** that are unplanned (for example, your car breaks down)
- If your income exceeds your expenses, you have a **budget surplus.** This is a good thing! This extra money is called **discretionary income**. You can save or spend this money at your "discretion."
- A **budget deficit** occurs when you spend more money than you have coming in. This creates debt.

- **Live within your means** is a plan to spend less than you make. Remember to consider your **Needs vs. Wants**. Otherwise, you will accumulate debt, hurt your credit score, and make life more difficult!!!

MANAGING MONEY FOR RETIREMENT

- A traditional **pension plan** is a retirement plan offered by an employer that promises to pay a monthly payment for the rest of your life. It is also called a **defined benefit** plan. The amount of the payment is based on your **age** at retirement, **years of service**, and average **salary/wages.** This benefit is very expensive for employers and becoming less common. This plan favors <u>older workers</u>.
- The **401-K Plan** is more common today. It is called a **defined contribution** plan. Employees contribute most of their own money to this retirement plan, but employers also contribute some money. Money is contributed **before taxes (pre-tax)** so it reduces your taxable income. This plan is less expensive for employers to administer. It favors employees that tend to switch jobs a lot (<u>younger employees</u>).
- When an employee changes jobs, they can take their 401K money with them. The can "**roll over**" the money to the new employer's 401K plan, or they can roll the money into a **Traditional IRA (Individual Retirement Account)**. <u>Never receive this money directly</u> – if you do, you will have to pay a **10% early withdrawal penalty** and still owe taxes on all of the money received.
- In addition to retirement plans sponsored by employers, you can also save for retirement by setting up your own individual retirement plans, such as a **Traditional IRA**. Money saved in this plan is **tax deductible** – you will pay taxes on this money when you begin to withdraw it. You are required to start withdrawing this money at **age 70-1/2**. This is called **required minimum distributions.**
- Another type of retirement plan that you set up yourself is called a **Roth IRA**. You contribute money to this plan with **after-tax money** – this is money that has already been taxed. When you withdraw this money later, you <u>will not pay taxes</u> on any of the money. You are not required to remove your money at age 70-1/2 like the Traditional IRA.
- You can begin withdrawing retirement money at **age 59-1/2 without penalty**. If you withdraw retirement money before this age, you will receive an early withdrawal penalty.
- Another source of retirement money is **Social security.** This is a federal government retirement program for all citizens of the United States that have worked and paid taxes. You contribute to this retirement program through a payroll tax called **FICA.**

MANAGING YOUR TAXES

- The U.S. Income Tax system is **progressive**. The more you make, the more you pay.
- When you first start a job, you will complete a form called the **W4** to calculate your **allowances.** This lets your employer know how much they need to <u>withhold for taxes</u> on each paycheck.
- In order to file your taxes, you need your **W2** from your employer. This form is mailed to you in January. It provides information on your <u>total wages and taxes paid</u>.
- **Form 1040** is used to file your taxes with the IRS (Internal Revenue Service). Taxes are **due by April 15** each year. The short form is called the **1040 EZ** and is used mainly by young, single taxpayers.
- The government allows you to reduce your taxable income with **exemptions**. You can deduct a certain amount of money from your income for the size of your household (you, your spouse, & dependents).
- Your **gross pay** is the amount of money earned before **payroll deductions** for taxes, social security, and **employee benefits** (i.e. medical insurance). Your **net pay** is the actually amount of money you will receive (called your disposable income). This information is shown on you **earnings statement** (paycheck stub).