

How Does a Savings Account Work?

By Sharon Fabian

For many young people, a savings account is their first banking experience (unless you count those lollipops you got at the drive-up window with Mom or Dad). A bank account in which children deposit money and watch their savings grow can be an early lesson in the importance of making good financial decisions.

For teens, savings accounts can be especially important once they begin to earn money on their own. Those savings accounts might represent savings for a first car or for a college education. And for adults, savings accounts are a practical way to save for occasional large expenses such as an unexpected plumbing repair or a family trip to watch your favorite football team compete in a big game. So it is probably a good idea to know something about how a savings account works.

First of all, do you know what the bank does with your money after you deposit it? Banks don't just keep your money locked up in their safe until you ask for it back. They loan it out to other people. The money you deposit in your account might be passed on to someone for a new car loan or for a mortgage on their first house. From many years of doing business, bankers know how much money they will need to keep on hand for day-to-day business and how much they can lend out.

But why do the banks lend out your money? It is how they stay in business. When banks loan someone money, they charge interest - the interest they receive is their income.

Banks also pay interest to the people who keep their savings in their bank, but it is always a smaller amount than the interest they charge on their loans.

The amount of interest you can earn on a savings account has changed over the years along with the economy. When the economy is booming, banks can pay higher interest. When the economy is slow, banks pay less interest. Interest on a savings account has ranged from several percent to less than one percent.

The interest you earn on a savings account might not be much, but still it's free money - money that you wouldn't have had if you kept your money in a piggy bank on your dresser. And there are ways to earn even more money on your savings. Money Market Accounts and Certificates of Deposit are other types of savings plans that many people use. These plans pay more interest, but they have drawbacks, too. For example, you usually need a bigger deposit to open one, and you may have to wait months before you can take your money out.

If you are thinking about opening a savings account for the first time, you may wonder if your money will be safe in the bank. The answer is yes; savings accounts are one of the safest ways to save money. The money you deposit in a savings account is insured by an agency called the Federal Deposit Insurance Corporation, or FDIC for short. You can \$100,000 in a bank, and the FDIC will guarantee its safety. And the money that banks do keep on hand is kept locked up in a huge safe, protected from robbers much more securely than that piggy bank in your bedroom.

You're also a little bit less likely to spend money once you've deposited it in a savings account. It is still there for when you really want to use it, but it's not burning a hole in your pocket. Putting money away in a savings account from time to time can give you the feeling that you are making progress, saving for your future.



Name _____



Date _____

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Questions

- _____ 1. A savings account _____.
- A. pays you some interest
 - B. pays you high interest
 - C. pays higher interest than a Certificate of Deposit
 - D. charges you interest
- _____ 2. According to this article, _____ can be a good habit to get into.
- A. saving money in a bank
 - B. saving money at home
 - C. borrowing money
 - D. loaning money
- _____ 3. A savings account could be used for _____.
- A. saving money so you won't spend it so quickly
 - B. saving for a video game player
 - C. saving to buy birthday presents
 - D. all of the above
- _____ 4. The amount of interest banks pay on savings accounts _____.
- A. is usually about 0.5%
 - B. varies
 - C. is always 2%
 - D. is never more than 1%
- _____ 5. Which of the following is NOT a way of saving money in a bank?
- A. savings account
 - B. mortgage
 - C. Money Market Account
 - D. Certificate of Deposit
- _____ 6. The FDIC is an agency that _____.
- A. insures savings
 - B. pays interest on checking accounts
 - C. operates banks
 - D. loans money
7. Why do banks loan money and pay interest on savings accounts?
