

Introduction to Personal Finance

Beginning Your Financial Journey

First Edition

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From the Authors

You have probably heard the phrase “Life is a journey.” This statement is particularly true when it comes to your financial life. Our goal in writing this text is so that everyone may be able to realize the life journey they envision for themselves without the constant distraction of financial stresses. Throughout this text, we refer to your lifetime financial journey as your interaction with and management of household financial resources across time. What does this mean? The concept is very simple. Take a moment and visualize yourself in 10, 20, or 30 years’ time. What will you be doing, where will you be living, and maybe most important

“This text was written to help you launch your financial journey or, for those already working and earning and spending money, create a clear financial roadmap that will help you realize not only your financial goals but also your life goals and dreams.”

of all, will your financial journey be supporting your greater life journey? Of course, no one knows for certain what the future holds, but life’s financial journey is often easier if you can visualize what your future self may be doing.

Imagine that instead of a lifetime vision, we asked you to tell us about a dream vacation. We want you to be specific. Where would you like to go? At what time of year do you see yourself embarking? Will you be driving, taking a train, riding a bus, cruising on a boat, flying, hiking, or maybe all of these? For how long do you see yourself staying on vacation? What will you be doing? And, of course, how much will this dream vacation cost? Once you have this information mapped out, you can begin to prepare for your vacation. Well, the same thing is true when it comes to your lifetime financial journey. Clearly, lifetime dreams and finances are more complicated than one vacation, but the basic idea of thinking about where you want to be, what you want to be doing, and determining a cost for your needs and wants is the same. As your vision for your life evolves, you will learn to prepare and adapt your finances to support your dreams and goals.

This text was written to help you launch your financial journey or, for those already working and earning and spending money, create a clear financial roadmap that will help you realize not only your financial goals but also your life goals and dreams. You will be learning about a variety of topics, including how to increase your income, lower household expenses and debts, manage taxes, navigate the insurance marketplace, invest wisely, and prepare for retirement and later life.

Some of the material you will be reading about will be new to you. Some concepts may challenge your current thinking. Both possibilities are by design. Our hope is that you will like reading this text and find the material helpful, and maybe even inspiring enough to move into the fast lane of your lifetime financial journey.

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John Grable teaches and conducts research in the Certified Financial Planner® Board of Standards Inc. undergraduate and graduate programs at the University of Georgia where he holds an Athletic Association Endowed Professorship. Prior to entering the academic profession, he worked as a pension/benefits administrator and later as a Registered Investment Adviser in an asset management firm. Dr. Grable has served the financial planning profession as the founding editor of the *Journal of Personal Finance* and co-founding editor of the *Journal of Financial Therapy* and *Financial Planning Review*. He is best known for his work in the areas of financial literacy and education, financial risk-tolerance assessment, behavioral financial planning, and evidence-based financial planning. He has been the recipient of numerous research and publication awards and grants, and is active in promoting the link between research and financial planning practice where he has published over 150 refereed papers, co-authored several textbooks, co-authored a financial planning communication book, and co-edited a financial planning and counseling scales book. Since earning his doctorate degree, Dr. Grable has served on the Board of Directors of the International Association of Registered Financial Consultants (IARFC), as Treasurer and President for the American Council on Consumer Interests (ACCI), and as Treasurer and board member for the Financial Therapy Association. He has received numerous awards, including the prestigious Cato Award for Distinguished Journalism in the Field of Financial Services, the IARFC Founders Award, the Dawley-Scholer Award for Faculty Excellence in Student Development, and the ACCI Mid-Career Award. He currently writes an economics and investing column for the *Journal of Financial Service Professionals* and provides research and consulting services through the Financial Planning Performance Lab.



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Lance Palmer received his bachelor's and MBA degrees from The University of Utah and his doctorate degree from Utah State University. He is a co-founder of the University of Georgia (UGA) Financial Planning major where he continues to teach courses in financial planning with a focus on tax planning. He is a Certified Financial Planner® professional. He has served on multiple editorial boards and as President of the Academy of Financial Services. He was selected as a 2007 Lilly Teaching Fellow, he is a recipient of the 2010 Richard B. Russell Excellence in Undergraduate Teaching Award, and he received the 2013 Engaged Scholar Award. Working closely with Georgia United Credit Union, Dr. Palmer has helped to expand the service-learning Volunteer Income Tax Assistance program in Athens, Georgia. Under his supervision, students studying financial planning and accounting complete approximately 1,300 tax returns for families in the local community each year. His students also provide thousands of hours of financial education and planning assistance to tax filers during the tax preparation process. Dr. Palmer is also affiliated with the University of Georgia ASPIRE Clinic. Dr. Palmer's research has focused on motivating savings among low- and moderate-income tax filers through brief intervention strategies. His research has also explored how service-learning participation helps to prepare students for professional work.

Unique Pedagogical Framework

A unique aspect of *Introduction to Personal Finance* is its pedagogical framework. Rather than force students to wade through page after page of densely written material that must fit within a limited number of chapters, this text offers fewer chapters with more topics. The point of a topic-based text is to make financial literacy topics fun to learn, easy to read, and quick to digest. The pedagogical features in our text include the following:

Learning Objectives

Learning objectives identify the most important material for students to understand while reading the chapter. At the end of the chapter, the Learning Objectives Review section summarizes the chapter content in the context of the learning objectives.

CHAPTER 5

Checking Accounts, Credit Scores, and Credit Cards

LEARNING OBJECTIVES

Once you have finished reading and working through the material in this chapter, you will be able to:

1. Explain the development and purpose of checks and checking accounts.
2. Identify the differences and similarities among debit cards, prepaid cards, electronic transfers, and checking accounts.
3. Determine the costs associated with borrowing money.
4. Know the purpose of a credit report.
5. Describe how credit scores are developed, calculated, and used.
6. Explain the role of credit cards as a financial-management tool.

An important task along your financial journey involves learning about and using tools and techniques to become a better consumer. In this chapter, you will be exposed to some strategies that you can use to better manage how you pay for things. In addition to learning about the importance of checking accounts, the use of debit cards, and how to manage your credit card use, you will also learn about credit reports and credit scores.

Credit Cards: Tools or Trouble?

You may not realize it, but your current spending behavior reflects your perception of risk. Some people are so fearful of losing control of their spending that they refuse to use financial tools that can help them improve their financial situation. Others don't fully grasp the negative outcomes associated with the misuse of some financial tools. In either case, perceptions may not always reflect factual information. Rather than fall into one of the extremes—fearful or fearless—it's better to seek out information that can shed light on your own perceptions of what is risky. Doing so will improve your decision-making skills.

Let's see how this works out in practice. The following questionnaire was designed to be a fun way to help you understand your perception of credit cards—a topic covered in detail later

5-2 CHAPTER 5 Checking Accounts, Credit Scores, and Credit Cards

In this chapter, this isn't a quiz, so there are no "correct" answers to worry about. All you need to do is mark the word choices that you most closely associate with credit cards. Go ahead and give it a try!

What Do You Think About Credit Cards?	
Column A	Column B
Freedom	Debt
Fun	Boring
Safe	Identify theft
Convenient	Hassle
Rewards	High interest rates
Necessary	Wasteful
Calm	Scary
Buying power	Overspending
Total: _____	Total: _____

Now that you've finished, add up the total number of marks in Column A and Column B. If you have more marks in Column A, you probably think of credit cards as a worthwhile financial tool. If you have more marks in Column B, you are likely a bit apprehensive about credit cards.

Regardless of your current perception of credit cards, you'll find this chapter helpful with managing your purchasing decisions and financial resources. By the way, if you have a negative perception about credit cards right now, that may change after working through this chapter. It turns out that once you know how to use credit cards wisely, you'll realize that they can be an efficient way both to manage your spending and make purchases more convenient and safe.

Chapter Opener Vignettes

Each chapter begins with a vignette that describes a personal application. The vignettes illustrate concepts that will be presented in the chapter and are meant to heighten student interest, motivate learning, and demonstrate the real-life relevance of the material in the chapter.

Chapter-Opening Questionnaires

Each chapter includes a quick and fun questionnaire, an immediate way to motivate and engage students. After completing the questionnaire, students will not only have a sense of their current knowledge of the chapter's topics but also how gaining more understanding will help them along their financial journey.

Concepts in Action

Your sister just graduated from college and wants to get a car loan. She would like to borrow \$10,000 and repay it over 5 years. She has three offers:

1. Great Bank is offering her a no-fee 1.99% APR loan.
2. Best Bank is offering her an interest rate of 1.89% with \$100 of loan fees (2.29% APR).
3. The car dealership is offering her a loan with an interest rate of 1.69% and only \$125 in loan fees (2.19% APR).

What is your advice to your sister?

Solution

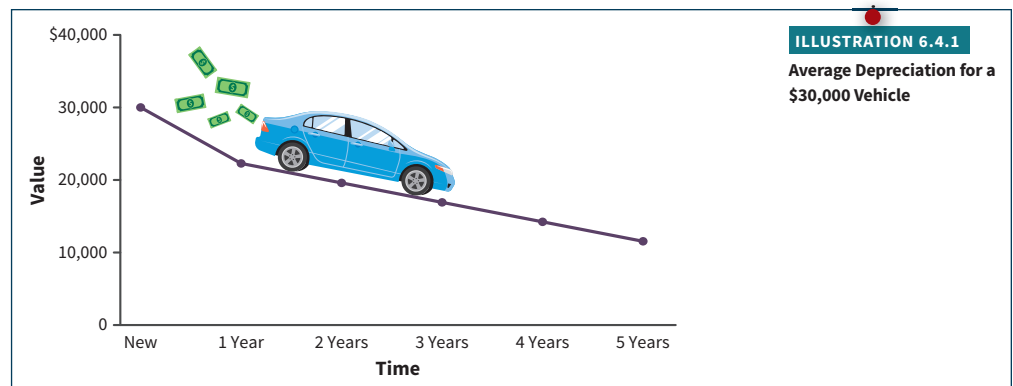
Compare the loans by reviewing the APR associated with each loan. The first loan has an interest rate and APR that are equal because there are no fees to finance the loan. The next two loans have fees to process the loan, which cause the APR to be higher than the interest rate because the APR incorporates these fees. Thus, even though the interest rate charged by Best Bank and the car dealership are lower than Great Bank's interest rate, Great Bank has the lowest APR when all of the fees are included and therefore is the lowest cost to borrow. Great Bank's total finance charge is \$514.03, Best Bank's total finance charge is \$592.69, and the car dealership's total finance charge is \$565.93.

Concepts in Action

Along with a generous number of in-text examples, every topic includes a Concepts in Action box. These realistic mini-cases with detailed solutions help students better understand how to apply their analytical skills to deal with the many financial issues they will encounter in the real-world.

Illustrations

Incorporating innovative ways to engage students and help them learn key personal finance topics is a key component of our approach. Throughout the text, carefully crafted illustrations visually reinforce each topic's main concepts in a fun, engaging manner.



The **Credit Card Accountability, Responsibility, and Disclosure Act of 2009 (CARD Act)** requires credit card lenders to inform borrowers on their monthly statement how much they should pay each month to have their credit card paid in full within 3 years. The CARD Act also requires credit card issuers to inform borrowers in their monthly statements how much interest the borrower will pay if they only make the minimum payments (see **Helpful Hint**).

Types of Credit Cards

Like most consumer products and services, credit cards come in all sorts of packages. Although most people first think of MasterCard®, Visa®, and Discover®, it's important to remember that there are other types of credit cards.

- Hotels, gas companies, and airlines issue credit cards, most of which are co-branded with a company like Visa®.
- Some credit cards are really **travel and entertainment cards**, such as American Express® and Carte Blanche®, which typically require cardholders to pay off their balance on a monthly basis (although American Express issues both credit cards and travel and entertainment cards).
- If you plan to pay off your credit card balance each month, you may want to consider **reward credit cards**, which provide benefits linked to how much the card holder purchases with their card. These benefits can include cash back, airline and hotel travel points, and other valuable benefits. These types of credit cards generally have higher interest rates and fees, as illustrated in **Illustration 5.6.3** (see **Helpful Hint**).

HELPFUL HINT

Congress is trying to equip borrowers with good information, but as a borrower, you have to put that good information to use and make the decision to pay off your credit card as quickly as you can.

HELPFUL HINT

If you plan to carry a monthly balance, reward credit cards may not be a good choice because of their higher interest rates and fees. However, if you don't carry a balance, reward cards may be just as affordable as regular credit cards.

Helpful Hints

Throughout the text, our approach is to present personal finance topics that are of the greatest value and benefit to the students. Helpful Hints offer specific guidance and suggestions for how to put that information into practice or where students might obtain additional assistance.

End-of-Topic Assessment

End-of-Topic Assessment ensures that students comprehend the material they just learned through Multiple-Choice, Short Answer, and Explore questions, as well as an Expanded Learning Activity. Much of this assessment material is identified as requiring calculation, writing, groupwork, and presentation skills.

End-of-Topic Assessment

Multiple-Choice Questions

1. A credit card requires you to:
 - a. make a fixed monthly payment until the loan is paid off.
 - b. make a minimum monthly payment based on the outstanding balance.
 - c. pay interest on all purchases.
 - d. obtain approval from the lender before making a purchase.
2. Which of the following statements is *true* regarding credit cards?
 - a. You may pay off a credit card balance at any time without penalty.
 - b. If you pay off a credit card balance early, you will pay a penalty APR.
 - c. You may not pay off a credit card balance unless you receive approval from the credit card company.
 - a. prepaid card.
 - b. co-signed card.
 - c. travel and entertainment card.
 - d. reward card.
7. **Calculate** Tula has a \$3,000 credit card balance that she revolves month to month. What is her minimum monthly payment if the credit card company calculates the payment based on 4% of the outstanding balance?
 - a. \$12.
 - b. \$120.
 - c. \$1,200.
 - d. \$1,440.
8. **Calculate** Tula has a \$3,000 credit card balance. This month Tula made the minimum payment of \$90. How much will she pay in interest this month if her credit card charges a 19% APR? Assume a 30-day billing period.

Adventures in Personal Finance

Short Answer

1. If Sally was to only pay the minimum payment on her credit card loan, how would that payment amount change over time?
2. There are several ways in which credit card lenders can make money from cardholders. Name three cardholder behaviors that will help minimize their costs as borrowers.

Explore

1. **Calculate** Making only the minimum payment on a credit card can be costly because you will pay much more in interest over the life of the loan. For this exercise, assume the following facts:
 - Credit card balance is \$1,000.
 - Credit card APR is 20%.
 - Minimum payment percentage is 2%.

Visit an online credit card calculator (such as that provided by the **Navy Federal Credit Union**) to answer the following questions.

- a. What is the minimum payment this month on the credit card?
 - b. How long will it take to pay off the credit card balance if only the minimum payment is made?
 - c. How much interest will be paid on the loan if only the minimum payment is made?
 - d. What is the best way to reduce the total cost of interest paid on a credit card loan?
4. **Writing Presentation** A national shift toward smart-chip technology (sometimes called EMV) is revolutionizing the credit card industry. Investigate the primary reasons credit card companies are moving toward smart-chip technology and away from traditional credit cards with a magnetic strip. Prepare a brief report and present your findings in class.

Expanded Learning Activity

Writing The Credit Card Accountability, Responsibility, and Disclosure (CARD) Act of 2009 took full effect on February 22, 2010. The **Consumer Financial Protection Bureau (CFPB)** administers it. Research this legislation using resources available on the CFPB website. Write a fact sheet that highlights the major consumer benefits provided by the act. Additionally, find a credit card disclosure statement and determine how easy it would be for someone without a credit card to understand the terms and conditions offered by the credit card issuer.

End-of-Chapter Problem Solving

Calculating the Cost of Life's Financial Journey

Calculating the Cost of Life's Financial Journey provides students with calculation-based questions that have been written to be fun and challenging. Through the process of addressing analytical questions, students will gain confidence in doing time value of money and other basic math calculations.

Planning for the Future

Each Planning for the Future case was written to be as close to real-life as possible. In this way, students can help solve true-to-life practice problems as a way to prepare for situations and events that they may one day face themselves.

End-of-Chapter Review and Problem-Solving 5-49

End-of-Chapter Review and Problem-Solving

Learning Objectives Review

5.1 Explain the development and purpose of checks and checking accounts. A check is a written order to a bank to pay a third party. Using bank routing numbers and account numbers, the Federal Reserve System allows checks to be processed from anywhere in the country. Checking accounts are insured by the FDIC, and mismanagement of checking accounts can result in heavy fees and being prevented from opening future bank accounts. Shop around for the best checking account and be sure to actively monitor your checking account balance (keep it positive) to avoid hefty bank fees.

5.2 Identify the differences and similarities among debit cards, prepaid cards, electronic transfers, and checking accounts. The development and use of debit cards has changed the way consumers make purchases. Debit cards are linked to a checking account and can be used with a PIN (personal identification number) or by signing a receipt. Electronic payments can also be authorized from a checking account and transferred to a third party. Prepaid cards, or stored value cards, are not connected to a bank account and simply represent the amount of money loaded onto a card in advance. Money is generally loaded onto prepaid cards through a cash or electronic payment. Debit cards have FDIC insurance and some consumer fraud protection backing them; however, prepaid cards do not enjoy these benefits.

5.3 Determine the costs associated with borrowing money. Just about everyone will need to borrow money at some time in their lives. Borrowing money from mainstream financial institutions is the lowest-cost way to borrow money. Borrowing through alternative financial service providers is a high-cost and wealth-depleting borrowing decision. Using debt to increase future income is a wise decision. Debt that does not lead to increased future income results in financial strain. When shopping for a loan, the most important number is the APR. Generally, the shorter the term of the loan, the less interest you will pay, even if the monthly payment is greater than a similar loan with a longer term.

5.4 Know the purpose of a credit report. Credit reports are a tool that lenders, employers, insurers, landlords, and others use to make financial decisions about you. A credit report is a record of your past financial dealings with others; it is essentially your financial reputation. Understanding what goes into a credit report will help you understand what factors drive your creditworthiness. Many credit reports contain errors. Consumers should check their credit reports for free at least once per year to verify that there are not any errors on their credit reports. Errors can be corrected by contacting the specific credit reporting bureau.

5.5 Describe how credit scores are developed, calculated, and used. Credit reports are used to generate credit scores about individuals. A credit score is a number generally ranging from 300 to 850, with higher numbers representing higher-quality borrowers (low risk to the lender). Lenders routinely make lending decisions based on the client's credit score. A FICO® score is the most common credit score; however, each credit bureau has also developed their own scoring mechanisms. High credit scores should be developed and maintained so that you can always have access to low-cost borrowing options. High credit scores are developed through paying debts and bills on time, borrowing less than the total amount approved (particularly applies to credit cards), having a long positive credit history, limiting the number of new credit applications submitted, and utilizing a variety of different types of loans.

5.6 Explain the role of credit cards as a financial-management tool. Credit cards are powerful borrowing and spending tools. A credit card is a loan that can be used at the borrower's discretion and convenience and has flexible repayment options. Credit cards have greater consumer protection features than debit and prepaid cards. Credit cards are nearly essential when renting cars, reserving hotel rooms, or booking airline and travel tickets. Wise use of a credit card allows individuals to build strong credit reports and credit scores, enjoy significant consumer fraud protection, build reward points with a chosen service provider, and avoid having to pay interest on any credit card purchases by paying the bill off in full each month.

5-50 CHAPTER 5 Checking Accounts, Credit Scores, and Credit Cards

Calculating the Cost of Life's Financial Journey

Belinda is in the process of choosing a credit card. She has narrowed her choice to two cards:

1. A credit card co-branded with a major airline. The card offers the following features:
 - 1 mile earned for every \$1 spent on eligible purchases.
 - A \$25 per bag fee will be waived for the first bag checked per flight and free priority seating.
 - The card charges an annual \$95 fee. The APR varies from 16.50% to 25.50% based on each borrower's credit score. Other fees, including balance transfer and late fees, apply. Card miles can be redeemed at the rate of \$50 for 5,000 miles.
2. A credit card that offers a 1% cash-back rebate on all purchases made with the card during the year. The card offers the following features:
 - The amount of cash earned never expires, and the cash earned may be redeemed or used to pay outstanding charges.
 - The card has no annual fee. The APR varies from 11.75% to 23.75% based on each borrower's credit score. Other fees, including balance transfer and late fees, apply.

Belinda plans to spend approximately \$45,000 per year on her credit card. Her plan is make purchases and then pay the balance in full each month. She is not particularly worried about the APR. She is primarily interested to know if the airline credit card is a good option if she plans to make two trips each year to see her family. (When making your calculations, assume that the cost of a flight is \$500 for a roundtrip ticket. If she uses the cash-back credit card, assume that she will pay a \$25 baggage fee for each leg of her trip.)

Instructions
Based on this information, which credit card should Belinda choose? What other factors should she consider when making her choice?

Planning for the Future

The Fair Credit Reporting Act (FCRA) gives each consumer living in the United States the right to obtain his or her credit report from one or more national credit reporting agencies. Under FCRA rules, you may order a free annual credit report from each of the three major credit bureaus each year. If you want more than one report from each bureau in a 12-month period, the credit reporting companies may charge a fee. Your credit report is a valuable tool you can use to manage your financial affairs. As such, it is important to make sure that the information used by the credit reporting agencies is correct. One way to do this is to get a copy of your report.

Instructions
Go to www.annualcreditreport.com or call a major credit bureau's toll-free number to get the reporting process started. You will be asked to provide personal information, such as your address and Social Security number. Although generally, you should never disclose this type of information, in this case it is safe to share these details.

Continuing Project: Your Financial Journey

Go to WileyPLUS for complete details and instructions.

Continuing Case: Tarek's Financial Journey

Tarek has been thinking about getting a credit card, but he is skeptical that a credit card can be a useful spending tool for him. Instead, Tarek has always used a debit card. His reasoning is that using a debit card provides protection from overspending; after all, he can only spend what is in his account.

Instructions

- Provide Tarek with at least three reasons he should consider adding a credit card as a spending tool rather than relying solely on a debit card.
- Assuming that Tarek is now convinced that he needs a credit card, provide him with guidance on choosing between cards with different APRs. Specifically, when does choosing a credit card with a low APR really matter?

- Tarek has heard that it is quite difficult to get a credit card. He had a friend whose credit score was 550 and was denied a credit card. This got Tarek scared, so he obtained a free credit report, used a free online resource to get his FICO credit score, and found out his credit score is 745. Based on this information, how difficult will it be for Tarek to obtain a credit card? What other advice do you have for Tarek if he decided to obtain a credit card?
- Assume Tarek now has a credit card and he carries a \$2,000 monthly balance. If the credit card company uses a 4% multiplier to determine the minimum monthly payment and the card has a 19% APR and 30-day billing cycle, what will be the minimum monthly payment? How much of the first payment will go toward paying interest?

Continuing Case

The Continuing Case tracks a recent college graduate (Tarek) as he begins his lifetime financial journey. Students will provide guidance on ways to increase Tarek's cash flow, decrease debts, pay taxes, purchase insurance, make saving and investing decisions, create an estate plan, and plan for the future in other meaningful ways.

Continuing Project

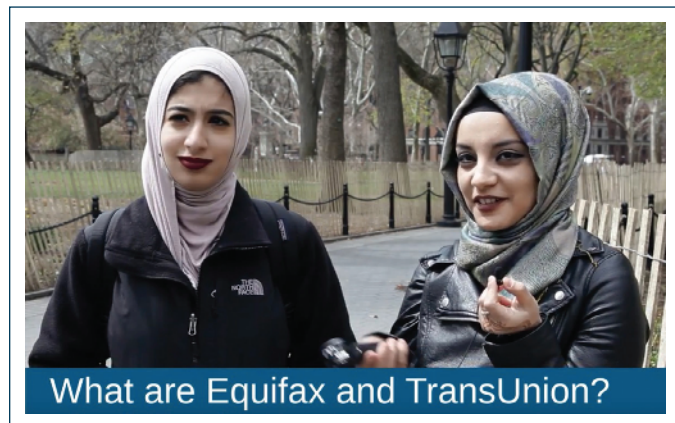
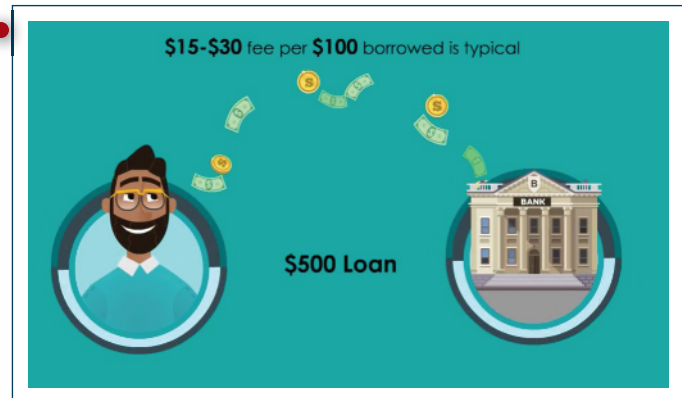
The Continuing Project helps students develop, implement, and monitor a spending plan. Students who follow the project from the first to last chapter will finish the course with a way to manage day-to-day financial questions and concerns.

Engaging Digitally

Introduction to Personal Finance is completely integrated with WileyPLUS, featuring a suite of teaching and learning resources developed under the close review of the authors. Driven by the same basic beliefs as the text, WileyPLUS allows students to create a personalized study plan, assess their progress along the way, and access the content and resources needed to master the material. Features of the WileyPLUS course include the following:

Animations

Animations review concepts discussed in the corresponding eTextbook for selected learning objectives and provide students with the option to read the text, watch the animation, or both.



What are Equifax and TransUnion?

Peer-to-Peer Videos

Integrated videos with discussion questions featuring students, peers, and professionals reinforce key concepts from selected learning objectives and illustrate how financial decisions impact their lives.

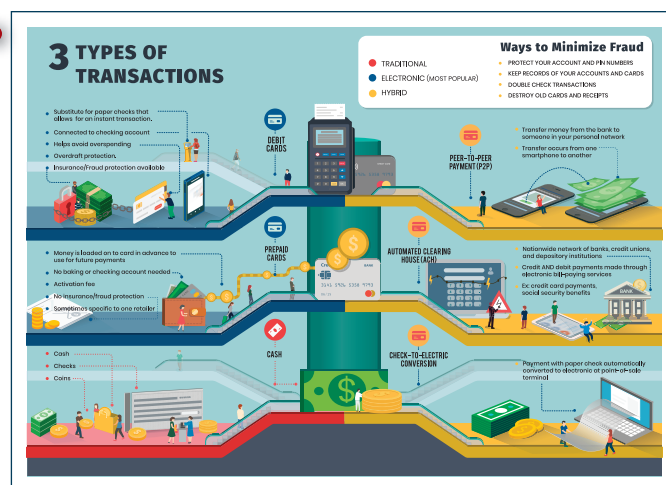
Budgeting Project Videos

Using the award-winning You Need a Budget app, students set up a personal budget with video guidance from experts.



Infographics

Approachable infographics increase student understanding of complicated topics by showing relationships between concepts within a learning objective.



In addition, other WileyPLUS learning opportunities include:

- **Interactive Surveys and Illustrations** engage students more actively with the content, and provide opportunities for active learning and critical thinking.
- **Wiley Finance Updates** (wileyfinanceupdates.com) provide faculty and students with curated news articles and suggested discussion questions weekly.
- **Flashcards and Crossword Puzzles** help students study and master basic vocabulary and concepts.
- **Section-Level Practice** quickly and effectively tests student understanding of the material they have just covered (at the learning objective level).
- **Adaptive Practice** helps students quickly understand what they know and what they don't know, and provides endless opportunities for practice to effectively prepare for class or quizzes and exams. Students can measure outcomes with visual reports to gauge problem areas. Instructors can assess real-time engagement and performance of each student to inform teaching decisions.

Acknowledgments

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