Chapter 7

Super Saving

Contents

1. Why should I save? 81
2. Where can I save? 82
3. What types of savings products are available? 83
4. What is investing? 84
5. How can I select the most suitable means of saving or investing? 85
Chapter Review 90

Learning Outcomes

1.2 1.3 1.5 1.8 1.9

Case Study **Where can I save?**

LO 1.2 1.3 1.5

1. Why should I save?

Developing and maintaining a good savings habit throughout your life is one of the smartest financial decisions anyone can make. Saving regularly is important in order to:

(a) **Protect against financial emergencies.** Everyone should save in order to have money available for unforeseen needs or events, such as unexpected medical expenses or car repairs.

(b) **Earn interest on money not currently needed.** Savings can earn interest.

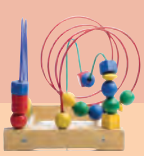
(c) **Purchase expensive items.** When you are young you might save to pay for toys or treats. As you get older you might save money for holidays, cars or for a deposit to buy a house.

(d) **Earn a credit rating for possible future borrowings.** Many financial institutions will only give you a loan if you can prove you are able to save regularly and will therefore have the ability to repay the loan.

(e) **Provide for your children's education.** This could include books, uniforms and college fees.

(f) **Provide for your retirement.** In retirement you will have a much reduced income.

Savings Needs at different stages of the Financial Life Cycle

	Main Reasons for saving	
Children	Toys and treats Most other needs are provided free by parents 	0-12
Teenage and young adults	Clothing Socialising Hobbies	10-20
Young adults starting a career	Major financial purchases such as travel or buying a car Unexpected financial emergencies 	18-30
Adults setting up a new home	Marriage House purchase Household goods Food and clothing Utility bills Holidays Unexpected financial emergencies 	25-35

	Main Reasons for saving	
Adults growing a career and family	Family food and clothing Utility bills Children's education costs Bigger car Holidays Unexpected financial emergencies 	30-65
Older adults in retirement	Food, utility bills Travel and recreation Hobbies Ongoing medical expenses Unexpected financial emergencies 	65+

LO 1.2 1.5 1.8

2. Where can I save?

There are many places where we can save our money

- **Save at home** in a piggy bank or other location. However, saving at home is risky. Firstly, it is guaranteed to lose value over time as the price of goods and services gradually rises. Secondly, there is the risk of theft or damage in a fire, flood or other accident.
- **Save in a financial institution** like a bank, a credit union, a building society or An Post.
- **Banks** like Bank of Ireland, AIB, Ulster Bank and Permanent TSB all offer different types of savings and investment accounts to suit different needs.
- **Credit unions and building societies** all offer savings accounts. **Credit Unions** *are not-for-profit financial institutions owned by the people who open savings accounts with them*. Building societies like the EBS are owned by their members and offer savings and investment accounts.
- **The Post Office** (An Post) offers more than postal services. An Post also provides financial services including different savings and investment accounts.

Advantages of having a savings account in a financial institution

- **Your savings are in a safe place.** Most financial institutions and credit unions are protected by the Central Bank's **Deposit Guarantee Scheme**. *This guarantees that if a financial institution fails, each saver will get back their money up to a certain limit.*
- **You earn interest** on your savings. Money in a savings account doesn't just sit there, it earns interest. The longer you leave it there, the more it grows. **Interest** *is a small amount of money added each year to the amount that you save. The longer you save the money, the more interest you earn.* You don't earn any interest if you save the money at home.
- **It is convenient** as lodgements and withdrawals are usually easy.

- **Loan approval is easier.** Regular savers with a credit union or a bank are more likely to be approved for a loan to purchase a car, home improvements or a holiday.

Research

Go to www.centralbank.ie in order to find out:

1. What amount of savings are protected by the Central Bank's Deposit Guarantee scheme?
2. Who funds this protection of savings?
3. Why do you think the Central Bank has a Deposit Guarantee Scheme? Think of at least **two** reasons.

Did you know?

Interest can describe two different things:

(a) Interest on savings

When putting money **into** a bank account, interest describes the money that you ***can earn*** on your savings.

Example: Saving €100 in a bank account at 5% interest per year would earn you an extra €5. This would bring your total savings to €105 after one year.

(b) Interest on loans

When borrowing money **from** a bank (or other financial institution), interest describes the extra money you have to ***pay back*** on the loan.

Example: You borrow €100 from a bank at 10% interest. You will have to repay the €100 plus €10 interest. This will make your total repayments €110.

Notice that you always repay more interest on loans than you earn in interest on savings. This is the main way that banks make a profit.

3. What types of savings products are available?

LO 1.2 1.3 1.5 1.8

Different financial institutions offer different ways to save your money. The following are the main types of personal savings products available:

(a) Banks and Building Societies

- **Instant Access Savings Accounts** (also known as Demand Savings Accounts): Money in these accounts earns interest and can be withdrawn at any time. These tend to offer the lowest rate of interest.
- **Regular Saver Accounts:** The saver must commit to saving a minimum amount on a regular basis to get the full rate of interest.
- **Notice Savings Accounts:** Money can be withdrawn only by giving a minimum amount of notice, e.g. seven days, one month or three months. These usually offer a higher rate of interest.
- **Fixed-term Savings Accounts:** Savings must be kept in these account for

a minimum period of time such as three, five or ten years. These offer the highest rates of interest for savers but if you withdraw your money before the term is up, you will lose out on interest.

(b) Credit Unions

Credit unions provide similar accounts to banks, including instant access, regular, notice and fixed-term savings accounts. They also offer Share Accounts.

- **Share Accounts** pay savers a share of the profits earned by the credit union.

(c) An Post

All savings in An Post earn tax-free interest. Unlike the Central Bank's Deposit Guarantee Scheme, all savings with An Post have an **unlimited** State guarantee that your money will be repaid.

- **Savings Certificates** are for people who want to save a lump sum of money.
- **Savings Bonds** are for people who want to save a lump sum for a shorter period of time.
- **Regular Instalment Savings Accounts** suit people who want to save a regular amount per month for a minimum of 12 months. If the money is left on deposit for a number of years, it can earn a higher rate of interest.

LO 1.2 1.3 1.5 1.8

4. What is investing?

Investing *means putting your money into shares, property, insurance policies and other potentially risky activities in the hope that you will earn more money than a regular savings account.*

Did you know?

Things people invest in include:

- company shares on the stock market
- government bonds
- property
- life assurance policies
- collectables like rare antiques, stamps, coins, toys or books

(a) Stock market

When you purchase shares **in a company on the stock market** you are buying a part ownership in a business. There are two ways to potentially make money from shares:

- Firstly, you may be able to sell these shares in the future at a greater price than you paid for them. This profit is called a **capital gain**. Of course, if the value of the shares goes down you will lose money.
- The second way to make money from shares is to get a dividend from them. A **dividend** *is a payment to a shareholder based on the amount of profit earned by the business.* If the business regularly makes big profits, then the dividend

may be greater than the annual interest rate earned on a similar sum of money in a savings deposit account. However, companies can also make losses and may be unable to afford to pay a dividend.

(b) Property market

Some people invest their money in buying property in addition to their home. They may rent out this property for income or hope that the property will rise in value. If so, the property can be resold at a larger profit than would have been generated if the money was just sitting in a bank account. However, the value of such investments can decrease if property prices fall or if the property suffers damage.

(c) Insurance companies

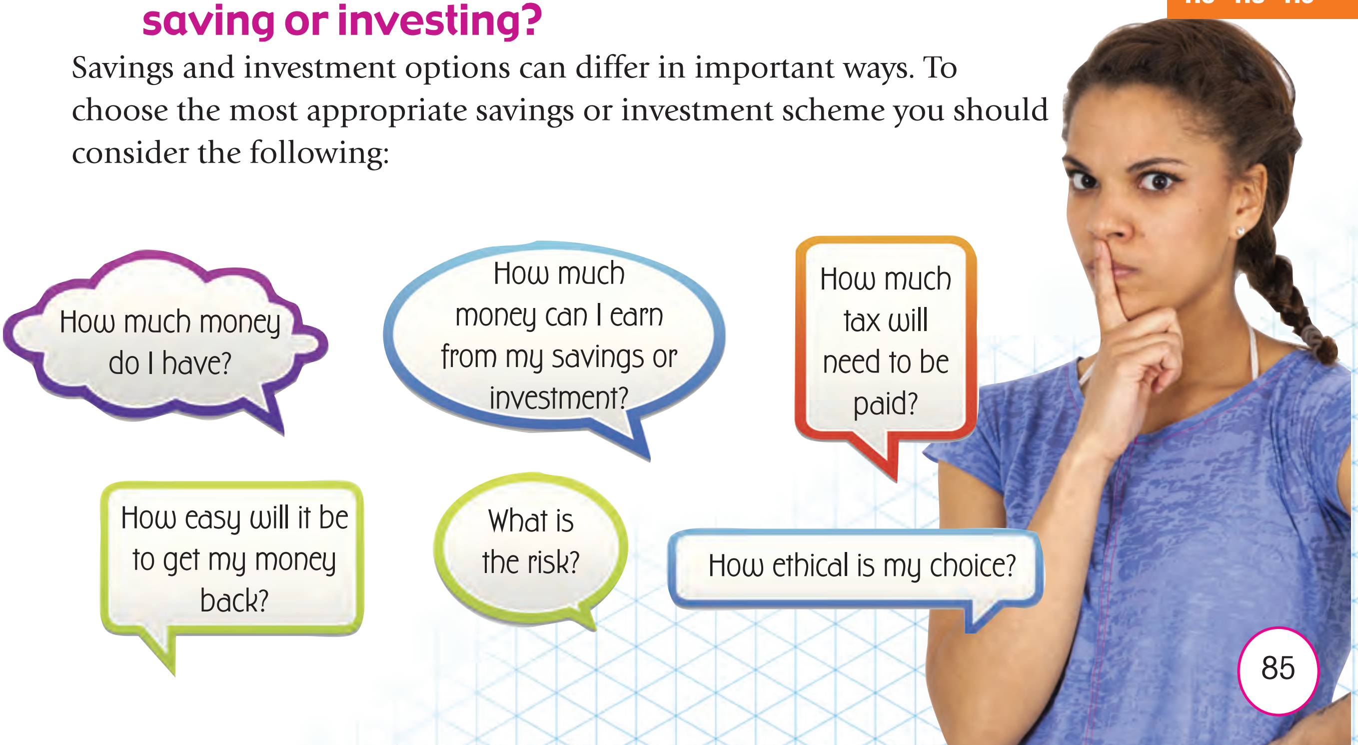
Endowment life assurance policies are a form of investment that you buy from a life assurance company. The life assurance company invests the premiums received from you in the stock and property markets. In return, you receive a share of the profits from these investments when the policy matures. It is similar to a fixed-term savings account but without any guaranteed interest rate. Endowment policies can have good returns if you are prepared to wait 20 or 30 years for a return. However, the value of these investments may decrease if share market prices fall.

> **Investment Tip** — Tips & Tricks
>
> If you have money to invest, don't put it all in one place. Wise investors spread their money and the risk by investing in a variety of places.

LO 1.2 1.3 1.5 1.8 1.9

5. How can I select the most suitable means of saving or investing?

Savings and investment options can differ in important ways. To choose the most appropriate savings or investment scheme you should consider the following:



(a) How much money do I have?

Some savings accounts require a minimum amount to be saved every month or every year in order to earn interest. If you can't meet this requirement, then the account is not suitable for you. Investing in shares can be done with a few hundred euro but investing in property requires a lot of money.

(b) How much money can I earn from my savings or investment?

How much interest you earn in a savings account depends on how much you save and how long you leave the money in the savings account. Interest can be calculated as **simple interest** or as **compound interest**.

- **Simple interest** *is paid each year only on the amount saved in that year.*
- **Compound interest** *is paid each year on the total sum of money accumulated in the account, i.e. the amount saved plus the amount previously earned in interest.* This means you earn interest on the interest you have already earned. It is often called the **Compound Annual Rate (CAR)**.

The difference between simple and compound interest

Assume you lodge €10,000 to a deposit account on 1 January and leave the money in the account for three years at an interest rate of 10%.

Interest earned using simple interest			**Interest earned using compound interest**		
	Amount	**Interest p.a.**		**Amount**	**Interest p.a.**
Year 1	€10,000	€1,000	Year 1	€10,000	€1,000
Year 2	€10,000	€1,000	Year 2	€11,000	€1,100
Year 3	€10,000	€1,000	Year 3	€12,100	€1,210
Total interest	**€3,000**		**Total interest**	**€3,310**	

Over three years you would earn €310 more interest using the compound rate of interest instead of simple interest. This is because you are also earning interest on the interest earned. Compound interest is a powerful way to grow your savings over time.

Annual Equivalent Rate (AER)

To avoid confusion when comparing simple and compound interest rates, many financial institutions display their interest using an AER percentage. The **Annual Equivalent Rate (AER)** *represents the true rate of interest on savings. The higher the AER, the more interest you will earn.*

Case Study Piggy Bank versus Savings Account

Lucy was thinking of saving €1 a day from the age of 13 to 55. She did the same calculations to see how much her savings would grow over the following 42 years.

If Lucy just saved her money at home using a piggy bank, over 42 years she wouldn't earn any interest and would save:

€15,330

(€1 X 365 days X 42 years)

If Lucy saved her money in a savings account earning AER compound interest of 4% AER over 42 years she would save:

€39,790

This is €24,460 extra compared to simply putting the money in a piggy bank!

Tips & Tricks

Smart Saving Tip

Having a savings account makes sense. By earning compound interest, you grow your money. You are also likely to spend less when your money is in a financial institution rather than in your pocket!

(c) How much tax will need to be paid?

Deposit Interest Retention Tax (DIRT) *is automatically deducted from all interest paid on bank, building society and credit union savings accounts.* It decreases the real rate of interest received on the savings.

Example of the effect of DIRT

Savings	€1,000
Interest earned at 10% (i.e. 10% of €1000)	€100
Less 30% DIRT (i.e. 30% of €100)	- €30
Actual Interest received	€70

Tax is also paid on other types of investments:

- Profits earned from investments in property are subject to **Capital Gains Tax.**
- **Income tax** must be paid on dividends earned from shares.

(d) How easy will it be to get my money back?

Instant access savings accounts tend to pay the least interest.
Notice and fixed-term savings accounts can pay higher interest rates. However, you should not put money into savings accounts with time limits if you think that you may need to withdraw the money early.

Bank location is a consideration. How far do you have to travel to a particular bank to get access to your savings? Do the opening hours of the bank suit you? Can the savings be accessed online instead?
Investments in shares can be sold easily if bought on the stock market.
Investment in property or other assets can take months to find a seller and get your money back.
Investments in life assurance policies can sometimes be cashed in early but usually at a high financial cost.

(e) What is the risk?

Savings and investments can differ significantly in terms of the risk to your money. You will need to know how safe your money will be.

- If it is a savings account, are your savings guaranteed to be repaid to you? Some savings schemes guarantee a minimum rate of interest. Others guarantee that you will not lose any of your investment. Some savings are covered by the Central Bank's Deposit Guarantee Scheme, while others, such as An Post products, come with a full and unlimited State guarantee.
- If you buy property or an insurance endowment policy you may lose some of your money. If you buy shares you could potentially lose all of your money.

Tips & Tricks

Investment Tip

When you buy Lotto tickets you are simply playing a game of chance. Don't buy Lotto tickets or scratch cards and think they are an investment. The odds of winning are tiny and you are guaranteed nothing. If you do win, you are just very, very lucky.

(f) How ethical is my choice?

There have been many scandals concerning banks that have behaved unethically by overcharging customers on fees and by over-lending to customers. These problems are most common with financial institutions that operate as for-profit businesses. Smart customers should look at the ethical reputation of a financial institution before deciding where to save or invest their money.

Research

Call into a local bank or credit union or building society and pick up some leaflets on the different types of savings accounts they have. (Alternatively go to their website and print out the information on their savings accounts). Use this information to find answers to the following questions:

1. What are the names of the different savings accounts?
2. Which account offers the best rate of interest? What conditions apply to this account?
3. Which account offers the lowest rate of interest?
4. If you had €100 to save for 12 months, which would be the best account to use? Give reasons for your answer.

Case Study Too Much of a Good Thing?

Have you ever eaten too much of something that you like and ended up feeling sick? Or played a piece of music over and over again so many times that you stopped liking it? You probably have – and this shows you can have too much of a good thing, even money.
Having enough money to meet your needs can be great. However, having far more than you need may not make your life any better. Too much money can lead to boredom and dissatisfaction. It can also make you spoilt and unpopular.

Some of the richest people in the world realise this. They invest their money in philanthropy, not to grow the money, but to give it away. **Philanthropy** *refers to the generous donation of money to good causes.*

Bill Gates, the billionaire founder of Microsoft set up a charity to give his money to good causes to reduce poverty and to improve health care and education. The Facebook founder Mark Zuckerberg and his wife Priscilla Chan have donated 99% of their shares in Facebook to a charity they set up. These shares are worth around $45 billion.

In Ireland, millionaires like Chuck Feeney and JP McManus have donated millions of euro to various charities, including Irish universities. Despite being rich, they want to put their money to good use helping others.

Pair work

1. If you had some money to spare, to which charities would you donate?
2. If you were a billionaire, what would you do with your money?
3. Compare your answers across the class.

Chapter Review

Key Terms Checklist

Using a pencil, place a ✓ in each box to indicate how well you know and understand each Key Term.

❑ I know and understand this Key Term.

❑ I am still a bit uncertain about what this Key Term means.

❑ I don't understand this Key Term yet.

When you revise each chapter, tick the boxes again to indicate how much you have learned.

1. **Credit Unions** are not-for-profit financial institutions owned by the people who open savings accounts with them. ❑ ❑ ❑
2. The Central Bank's **Deposit Guarantee Scheme** guarantees that if a financial institution fails, each saver will get back their money up to a certain limit. ❑ ❑ ❑
3. **Interest** on savings is a small amount of money added each year to the amount that you save. The longer you save, the more interest you earn. ❑ ❑ ❑
4. **Investing** means putting your money into shares, property, insurance policies and other potentially risky activities in the hope that you will earn more money than a regular savings account. ❑ ❑ ❑
5. A **dividend** is a payment to a shareholder based on the amount of profit earned by the business. ❑ ❑ ❑
6. **Simple interest** is paid each year only on the amount saved in that year. ❑ ❑ ❑
7. **Compound interest** is paid each year on the total sum of money accumulated in the account. Every year you earn interest on your interest. ❑ ❑ ❑
8. The **Annual Equivalent Rate (AER)** represents the true rate of interest on savings. ❑ ❑ ❑
9. **Deposit Interest Retention Tax (DIRT)** is the tax deducted by financial institutions from interest earned on money in savings accounts. ❑ ❑ ❑
10. **Philanthropy** refers to the generous donation of money to good causes. ❑ ❑ ❑

Key Concepts

1. List **five** reasons why everyone should save regularly.
2. Name **two** places where consumers can save their money.
3. Identify **three** advantages of saving with a financial institution.
4. What is the difference between a **fixed-term** and an **instant access savings** account?
5. (a) What are investments?
   (b) List three different places where people could invest their money.
6. Explain what is meant by **AER**.
7. What is **DIRT**?

Critical Thinking Skills

1. Identify **four questions** a consumer should ask before deciding where to save or invest their money.

Digital Resources are available for this chapter at mentorbooks.ie/resources