MARYLAND COOPERATIVE EXTENSION
UNIVERSITY OF MARYLAND
COLLEGE PARK-EASTERN SHORE

Fact Sheet

Fact Sheet 302

Selecting Banking Institutions and Services

Changes over the last few years in the banking industry have caused banking institutions to be highly competitive. They set their own interest rates and minimum deposits. They also set penalties for early withdrawal on certificates of deposit (CD's). Electronic funds banking is widely available. Finally, the new interstate banking law allows large banks to open branches across state lines rather than the current practice of bank holding companies establishing separate companies in adjoining states. This change means that consumers will be able to use all banking services at any branch whether within or outside of Maryland. Additionally, if you currently bank at a small community bank, you may find that a larger bank has acquired or merged with your community bank to open a chain of branches. These changes have made choosing among banking institutions and services difficult. This fact sheet will help you select a safe banking institution that meets your needs.

Selection Factors

Selection of a particular banking institution depends on several factors. These include safety, type of bank, convenience, service, and costs.

Safety

Commercial banks and savings and loans (S&L's) are profit-making institutions. Without profits, they cannot exist for long. However, not all banks are equally profitable. The health of the banking system continues to improve, but if you happen to choose a banking institution that fails, your account could be affected. When this happens and a new bank does not take over the failed bank, the Federal Deposit Insurance Corporation (FDIC) usually makes your money available within a few days. However when a new banking institution purchases a failed bank, the terms relating to your accounts frequently change, usually making their banking services more expensive.

Safety is a primary concern for bank customers. The following questions can help you decide if the bank you are considering is safe. You can find the answers in the bank's annual report or by asking the bank manager.

1. How much does the bank have in (1) loans 90 days past due and (2) loans not earning interest (nonperforming assets)? Add these amounts together to show the risk the bank takes with depositors' money. The higher the number, the greater the risk.
2. How much stockholder equity does the bank have? This is money the stockholders put up to run the bank and to cover losses. Banks express this number in both dollars and percentage terms.
3. How much does the bank have in loan reserves? This is money the bank sets aside to pay bad loans. When loan losses rise, banks often set aside additional amounts.
4. What are the bank's total assets? This figure shows you the total size of the bank.

When you have answers to the questions above, you can calculate the following information.

First, determine how many cents in bad loans the bank has for every dollar in equity and loan loss reserves. To do this, divide bad loans (question 1) by stockholder equity plus loan loss reserves (questions 2 and 3). For example, if the bank had $39,900,000 in loans 90 days past due, $29,900,000 in loans not paying interest, $1,264,355 in stockholder equity, and $47,630,000 in loan reserves, then

the bad loans to equity ratio would be $0.05 ([$39,900,000 + 29,900,900] ÷ [$1,264,355 + $47,630,000] = $0.05). (Note: If you are using a calculator to determine these answers, you can drop the last three zeros in your calculations and not affect the ratio.) Your answer should be as few pennies as possible. Any amount more than 25 cents is a sign that the bank is using its capital to stay afloat. This reduces your margin of safety.

Then determine how many cents of stockholder equity the bank has in relation to its total assets by dividing stockholder equity (question 2) by total assets (question 4). For example, if stockholder equity is $1,264,355,000 and total assets are $14,952,156,000, then the ratio of stockholder equity to total assets is $0.084 ($1,264,355,000 ÷ $14,952,156,000 = $0.084). Eight cents is required. Ten cents provides the highest margin of safety. Judge all financial institutions in the same way. Some institutions may tell you that they use a different set of standards for questions 1 through 4. Make sure you receive the correct information for questions 1 through 4.

The banking institution you are considering may not have this rating information readily available. You can receive information on rating your commercial bank or S&L from FDIC, 550 17th Street, NW, Washington, DC. The National Credit Union Share Insurance Fund, 1776 G Street, NW, Washington, DC, rates credit unions. You also may purchase reports on the financial condition of banking institutions you are considering. Sources include Veribanc Inc. in Wakefield, Massachusetts, Sheshnunoff and Company in Austin, Texas, and the Federal Financial Institutions Examination Council in Chicago, Illinois.

Compare several banking institutions. Note the differences between banks. Some may be independent community banks. Others may be branches of regional or national money-center banks. An effect of the new interstate banking law may be that the number of commercial banks operating in Maryland is reduced. You are likely to find some institutions that are financially strong, others that are weak, and some that are between the two extremes.

Deposits at your institution must be insured by a Federal agency. This insurance covers each person's accounts up to $100,000 at the same bank. Accounts held jointly with another are insured separately. Amounts in Individual Retirement Accounts (IRA), Keogh accounts, and some other self-directed retirement accounts are combined and insured separately from other accounts in your name. Trust accounts are also insured separately from other accounts in your name. However, the rules on how they are insured are complicated, but the amount of insurance is generous if the rules are followed correctly. If your bank cannot give you a good explanation of how a complex written trust is insured and you have more than $100,000 to put in the trust, write to the FDIC Legal Division, 550 17th Street, NW, Washington, DC 20429. Be sure to provide full details with your inquiry.

Type of Bank

Commercial banks, S&L's, and credit unions compete for your business. Commercial banks offer a full range of services. These include checking accounts, savings plans, safe deposit boxes, and loans. They also offer U.S. Savings Bonds, money orders, traveler's checks, and credit cards. Other services include automatic teller machines (ATM's) and estate and trust services. Additionally, many large commercial banks offer investment service. Consumers should be aware that investments such as mutual funds, annuities, stocks, and bonds purchased from banks are *not* insured deposits.

Originally, S&L's only made home mortgage loans. They now compete with commercial banks in the services offered. They cannot offer regular checking accounts. However, they do offer negotiable order of withdrawal (NOW) accounts that serve the same purpose.

Credit unions are nonprofit cooperatives owned by their members. Thus, they are a good place to both borrow and save. In addition to savings accounts and loans, credit unions now offer more banking services. These include share drafts (checking accounts), home and second mortgages, and traveler's checks (possibly without fee). They also offer credit cards and usually ATM's. Normally, members of a credit union are members of a group, such as a business, church, club, or neighborhood association.

Convenience and Service

The banking institution should be in a location that is convenient to you. There should be branches across the state and in adjoining states if you travel or move frequently. Look for hours that are convenient to your schedule. Friday night and Saturday hours with all services avail-

able may be important conveniences. Drive-in or walk-up windows for deposits and withdrawals when the lobby is not open are useful. You may have need to get cash at odd hours. Make sure the ATM(s) has enough capacity to dispense cash at these times. Employees should be courteous and carry out their assigned duties without delay or error.

Costs

Examine costs carefully. Over the last few years, customer costs have risen greatly at some banking institutions. Be sure to look at and compare the differences in interest rates paid. Also look at rates charged for loans, checking accounts, and other services. Pay attention to required minimum balances and the method used for computation of interest. Many banks have separated their fees and charge for most services. Compare large and small commercial banks, S&L's, and credit unions. Find those that are most economical and provide you with needed service. Selection of a banking institution based on its general characteristics does not end your search. Banking institutions offer a variety of accounts to meet your needs for checking, savings, and loans.

Checking Services

Commercial banks target checking accounts to certain market segments of consumers. The price of a particular account depends on the number of checks written, deposits and withdrawals made, and monthly balance maintained. You can reduce costs by shopping for an account that matches your intended use. There are three kinds of checking accounts from which to choose.

Regular Checking Accounts

Regular checking accounts usually earn no interest. Some banking institutions charge no fee for this service. Others require a minimum amount in checking or savings to avoid a monthly service charge. If you write only a few checks each month, you may not be able to find an account without charges. See if the banking institution has a special account that charges a flat monthly fee.

Negotiable Order of Withdrawals (NOW's)

These accounts earn interest on balances. The bank may require you to maintain a minimum balance to avoid a monthly fee. This may offset the interest earned.

Super NOW's

These accounts pay one interest rate on balances up to a certain limit. They pay a higher percentage on the remaining balance. The rates on both NOW and Super NOW accounts can vary often with changes in market rates of interest.

Fees

Banking institutions vary on types of fees. Informed consumers ask for information on monthly fees, charges per check, and minimum balance amounts. They also ask about interest rates (including formulas used in figuring the rates), and compounding periods (continuously, daily, monthly, or quarterly). Finally, they ask for the cost of checks and fees for overdrafts.

Find out if your bank will return your canceled checks. If not, ask about the cost of getting a copy of a canceled check to prove you have paid a bill. All of this information should be available in printed form to allow you to compare various choices. If you expect to keep a balance of less than $1,000 in your account, you probably will have to pay charges. Financial institutions do not make a profit on small balances.

Deposits to checking accounts are not always immediately available for withdrawal. Banking institutions must make local checks deposited to your account available after 1 intervening business day. They must make nonlocal checks available within 4 intervening business days. Additionally, you must be able to use cash deposits; local, State, and Federal government checks; the first $100 of any check; cashier's checks; certified checks; and teller's checks the next business day.

Small banks, S&L's, and credit unions usually offer less expensive checking services. You may need a checking account that provides immediate access to your cash. One of the three accounts listed should satisfy. However, if building financial assets is your goal, investigate other forms of interest-bearing accounts.

Savings Services

Money not needed for everyday expenses should be earning as high a return as possible. To meet this need, banks offer several choices. The type of savings account you choose depends on the amount you expect to keep in your account. It also depends on how often you make withdrawals.

Savings Accounts

Savers of small amounts use these accounts. With a statement savings account, you receive a receipt for deposits and withdrawals. A summary of activity on your account appears on your statement at least quarterly. Your banking institution will send you a statement more often if you have made deposits or withdrawals. With a passbook account, deposits and withdrawals are entered in the passbook each time you deposit or withdraw funds. The advantage of these accounts is that you can always get your money when you need it. You should be aware that a banking institution may delay withdrawals for up to 4 days. Banks rarely enforce such a waiting period. Some banking institutions limit the number of withdrawals per month to prevent use of the savings account as a checking account.

Money Market Deposit Accounts (MMDA)

These accounts compete with money market accounts offered by investment companies. They differ from money market mutual fund accounts. They are fully insured against loss of principal within the customer's insurance limit. Most accounts require a minimum amount in the account before the banking institution pays the money market rate. An additional advantage is that each month you may write three checks and make three automatic transfers using an ATM.

Certificate of Deposits (CD's)

A CD differs from the savings accounts and MMDA's in that money must remain on deposit for a specified term. Most banking institutions offer terms of 7 to 30 days, 3 and 6 months, and 1, 3, and 5 years. As a rule, the longer the term, the higher the interest rate. Some banking institutions allow you to choose your own term. With this option you can target maturity dates to the time when you need funds to pay for a college education or your retirement.

Making comparisons between various interest rates has become easier since the Truth in Savings Act went into effect in 1993. This act requires banks, S&L's, and credit unions to advertise their annual percentage yield (APY). APY is the total amount of interest on a $100 deposit after 365 days. APY is a percentage and financial institutions can compute the interest in any manner—continuously, daily, quarterly, or annually. For example, if you receive $8 interest on $100 for 365 days, your APY is 8 percent. Your local financial institution will calculate your interest as a simple rate called a periodic percentage rate (PPR) for each compounding period. When you sum these amounts, you have the APY. For example, suppose your bank credits l.5 percent quarterly on your deposit on $100. Your interest by quarters would be as follows:

1st quarter	1.5% on $100.0000	= 1.5000
2nd quarter	1.5% on $101.5000	= 1.5225
3rd quarter	1.5% on $103.0225	= 1.5453
4th quarter	1.5% on $104.5678	= 1.5685
Years sum of interest		= $6.14
APY = 6.14%		

Banking institutions frequently advertise a special bonus rate for a short period. Be careful to note the APY before making a final choice. Because CD's are time deposits, banking institutions charge a penalty if you withdraw your money before the end of the term. Be sure to ask about the penalty. Each banking institution sets its own early-withdrawal penalty on CD's.

When the term of your CD is over, you must decide about renewal. If the renewal will be automatic, the bank tells you in advance and you have 10 days to withdraw your funds without penalty. If the renewal policy is not automatic, ask if the bank will send a reminder at renewal time. Also, find out what happens to your funds if you do not renew on time. Some banking institutions stop paying interest or put the funds in a statement savings account when a customer delays renewal.

Lending Services

If you need a loan, shop for the lowest annual percentage rate (APR). You will save many dollars in interest payments. Banking institutions offer the following types of loans: fixed rate mortgages, adjustable rate mortgages,

motor vehicle loans, personal loans, student loans, and home equity loans. They also offer credit cards, which are not discussed in this fact sheet.

Fixed Rate Mortgages

The cost of fixed rate mortgages can vary from one institution to another. The addition of points will add to the total cost. A point is a fee equal to 1 percent of the loan amount. You pay points at the time the financial institution grants the loan rather than over the term of the loan. By law, lenders do not have to include points when calculating the annual percentage rate (APR). However, each point charged increases the annual percentage rate by about 0.125 percent.

Points on a loan used to buy a principal residence are immediately tax-deductible if you itemize your income tax. To be tax-deductible, points also must be paid with funds that were not received from the mortgage lender. To lower your out-of-pocket costs, some lenders deduct the cost of the points from the loan. When this happens, you must deduct the points from your taxes over the term of the loan. You also deduct from your income tax loans used to repair or improve a principal residence over the term of the loan.

You can reduce the interest cost of your loan by taking a shorter term mortgage if you can afford the higher payments. Additionally, you can reduce the cost by making your mortgage payment every other week instead of monthly. The savings on every-other-week payments come from making 26 payments rather than 12 monthly payments (equivalent of 24 every-other-week) each year. A 15- instead of a 30-year loan reduces the total cost of your mortgage because you borrow the funds for a shorter period. The interest rate on a 15-year loan usually is lower than on a 30-year loan.

Adjustable Rate Mortgages (ARM's)

Interest rates on ARM's often are several percentage points lower than fixed rate mortgages. That is because the borrower accepts some of the risk of future interest rate changes. When considering an ARM, make sure there is a lifetime interest cap, which shows the maximum amount the mortgage interest can rise. Such caps typically are 5 percent. Make sure the lender bases the interest rate cap on the first year's interest. Beware of loans when the lender bases the cap on an outside index such as a 1-year treasury security rate. This could be more expensive. Read the terms on these loans carefully.

Motor Vehicle Loans

Some motor vehicle loans may run 5 years or longer. The longer the term of the motor vehicle loan, the smaller the monthly payment. However, you pay more interest. If you can afford a higher monthly payment, keep the term of the loan as short as possible to save interest costs. This is also a worthwhile goal because you can no longer deduct motor vehicle loan interest costs on your income tax return. Investigate credit unions and automobile companies before making a choice.

Personal Loans

Personal loans, often called signature or unsecured loans, differ from other types of loans in that the lender does not require collateral. Lenders usually limit these loans in both amount and term. The interest rate is higher than secured loans because the risk of nonpayment is greater. Most single payment loans are of this type.

Home Equity Loans

A home equity loan is similar to a second mortgage, which if not repaid can cause you to lose your home. Your banking institution may entice you to borrow the equity from your home instead of taking a personal or auto loan. Carefully consider such a decision as the equity in your home may be your primary source of savings. Although a personal or auto loan may cost more, you are not risking the loss of your home. On the other hand, a home equity loan is a good choice when you may have enough savings and investments and can deduct the interest from your income taxes. In this situation, a home equity loan enables you to save money.

Financial experts recommend that homeowners use home equity loans only for such expenses as home improvements and education or medical bills. Homeowners should not use them for consumable items, such as vacations. Home equity loans usually involve payment of expensive closing cost fees. In addition, few lenders offer fixed interest rates beyond the introductory period. Some loans require inter-

est-only loan payments subjecting the borrower to a future balloon (large lump sum) payment. Check with your tax adviser to make sure the home equity loan interest will be tax deductible. Also check that the savings in taxes will offset the loan costs.

Home equity loans also can be in the form of a line-of-credit. You can use this line-of-credit the same way as a revolving credit card. You borrow what you need and pay interest on the amount outstanding rather than the total line of credit.

For more information on getting credit, contact your county Extension office for Fact Sheet 434, "Acquiring Credit."

Electronic Services

Another service offered by banking institutions is electronic funds transfer (EFT). EFT is the automatic transfer of funds from one place to another by computer. Through EFT, the government or your employer can deposit your Social Security check or your pay automatically into your savings or checking account. You have no risk of loss. Also, you can arrange to pay recurring bills automatically.

You may use an ATM while at your banking institution and some retailers. An ATM is a computer used to complete financial transactions normally handled by a teller. Banking institutions often name these machines for marketing identification.

Many banking institutions tie their ATM's into a system. This allows use of your access or debit card to perform transfers at systemwide sites. These sites include other banking institutions, grocery stores, and gas stations.

Your access or debit card looks like a credit card. The automatic code allows you to gain access to the ATM. You use your debit card with your personal identification number (PIN). Protect your PIN as carefully as you protect your card. Never carry your PIN in your wallet where an unauthorized person could get it. The banking institution may give you a choice of numbers. Do not pick readily identifiable numbers that you carry in your wallet. These numbers include your house number, telephone number, or birth date.

The cost of EFT service depends on the location of the machine. If the ATM is at the banking institution where you have your account, there may be a monthly fee for its use. When you are using other compatible ATM's, there frequently is a charge. Fees may range as high as $2 for each transaction.

Each time you use an ATM to conduct a transaction, the ATM will provide you with a receipt of the transaction. The receipt issued by the ATM must list the date, amount of money transferred, type of transfer (withdrawal, deposit, or payment), and a truncated user's account number. It must also list the location of the terminal, and, in some cases, the name of the person or company involved in the payment. Keep these receipts to compare with your monthly statement. Additionally, the banking institution must send you a periodic statement. The statement must include the opening and closing balances, your account number, EFT charges, and a list of transactions.

Using an ATM is not difficult as long as you do not lose your card and make no mistakes. One or the other may occur. Congress has passed laws and the Federal Reserve Board has set up rules that end some consumer problems related to EFT's.

If you lose your debit card, you have some protection from unauthorized withdrawals from your bank account. The law protects when you act quickly. You must inform the banking institution of the loss within 2 business days after you miss the card, receive an overdraft notice, or discover an unauthorized charge on your monthly statement. If no charges were made, you lose nothing. If someone made an unauthorized charge on your account, your liability is $50.

If you do not report the loss after discovering it within the 2-day deadline, but report the loss within 60 days, your loss cannot exceed $500. However, you incur the total amount lost if you do not report an unauthorized transfer that appears on your monthly statement. You must report the loss within 60 days after the financial institution mails the statement to you. With this requirement in the law, it becomes critical that you review and reconcile monthly statements immediately after receiving them.

As with any system, occasionally inaccuracies with bookkeeping and other errors occur. There are regulations to provide remedies for these types of problems. If you have income payments deposited directly into your account, the bank provides a telephone number so you can check on these deposits. You also can use your ATM card for this purpose. Your monthly statement lists these deposits. Additionally, many employers forward the pay stub, which

Table 1. Checklist for Selecting Banking Services

Safety	**Bank 1**	**Bank 2**	**Bank 3**	**Bank 4**
1. Money in bad loans				
2. Stockholder equity				
3. Loan loss reserves				
4. Total assets Ratio of bad loans to stockholder equity plus loan loss reserves (¢) = bad loans / (stockholder equity + loan loss reserves)				
Ratio of equity to total assets (¢) = stockholder equity / total assets				
Checking Type of Account				
Cost				
Savings A. Type of Account				
Minimum balance				
APY				
Term				
B. Type of Account				
Minimum balance				
APY				
Term				
Loans Type of Loan				
Term				
APR				

allows you to record the amount of the deposit in your check register.

There are two types of automatic bill-paying plans. In one plan, you must authorize the payment and the amount each month. In the other, the bank pays recurring bills automatically. A problem arises when the payment is more than you authorized. When this happens, the banking institution must get authorization from you. You also can have an agreement that the banking institution can pay the bill if it does not exceed a prestated amount. You have the right to stop payment on an account. You must let the banking institution know up to 3 business days before you must make the scheduled payment. If you telephone the order, the bank may require you to file a written statement of your order within 10 days.

Final Selection of a Banking Institution

With this information you are becoming a wise consumer of the services offered by banking institutions. Now visit the banking institutions of your choice. Begin your analysis of their safe and economical services. On the previous page you will find a checklist to help you compare various banking institutions and services.

References and Further Reading

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