FBLA Personal Finance Study Guide

Financial Principles Related to Personal Decision Making

Consumer Protection Laws - created to ensure the rights of consumers, as well as fair trade, competition, and accurate information in the marketplace. Federal CP Laws are mainly enforced by the FTC, The Consumer Financial Protection Bureau, the FDA, and the U.S. Department of Justice.

- **Federal Food, Drug, and Cosmetic Act -** A set of laws that enable the FDA to oversee the safety of food, drugs, cosmetics
- **Fair Debt Collection Practices Act -** Prevents debt collectors from using abusive, deceptive, or unfair tactics to collect from you
- **Fair Credit Reporting Act -** Promotes the accuracy, fairness, and privacy of consumer information contained in the files of reporting agencies
- **Truth in Lending Act -** Promotes the informed use of credit by requiring disclosures about its terms and cost to standardize the manner in which costs are calculated and disclosed.
- **Fair Credit Billing Act -** Protects consumers from unfair credit billing practices by providing guidelines for consumers and creditors.
- **Gramm-Leach-Bliley Act -** Requires financial institutions to explain their information-sharing practices to their customers and to protect sensitive information.

When making major personal financial decisions, a family should base these decisions on their *annual income*. Decision-making at certain stages in your life can be costly or beneficial to your bank account. For example, if you bought a house in 2007 and lost your job in 2008 due to the financial crisis, you will have lost money. In contrast, if you bought your house during the financial crisis, and sold it ten years later, you will have gained a considerable amount of money.

Credit score is a number ranging from 300 to 850, that helps someone determine your likeliness to repay a loan. This number is created based on your financial information, such as your yearly income, monthly expenses, etc. and is sent to you once every 12 months.

- Three different credit reporting agencies, Equifax, Experian, and TransUnion.
- Your credit score is used to determine your loans for cars, your mortgage, your credit card, etc. If you have a low credit score and you are given a loan, you will

also be given very high interest rates, whereas if you have good credit and are given a loan, your interest rates will not be as high.

Wise financial planning can help you achieve your goals because you will have a baseline of what is necessary for you to do in order to reach your goals. For example, if I have a goal to save 40% of my $120,000 salary after tax, I know that I must put aside $4,000 every month.

The financial planning process:

1. Determine financial goals
2. Evaluate financial status
3. Develop financial goals
4. Implement goals
5. Monitor goals

The most basic economic principle is the law of supply and demand. Put simply, when supply for a product goes up, demand for it decreases. Oppositely, (if that's a word) when demand goes up, supply goes down. Economics literally means, "the science that deals with the production, distribution, and consumption of goods."

There are four types of economic systems, Traditional, Market, Command, and Mixed.

- **traditional** economy, decisions are made from customs handed down for generations. They are now very rare
- **market** economy, prices are determined by supply and demand, and individuals decide what they want to produce, how they want to produce it, and for whom they want to produce it.
- **command** economy, the government sets prices for goods and individuals have little to no say in economic decisions. *See communism.*
- **Mixed** economy, like the U.S., individuals make decisions, but the government regulates them. Most governments are currently mixed economies.

Fiat money - valueless objects used as money because of government decree
commodity money - money consisting of objects that have value in themselves and their use in money (think gold, silver, etc.)
Time Value of Money - the increase of an amount of money due to earned interest or dividends
Gold standard - the system by which the value of a currency was defined in terms of gold

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Managing Budgets and Finance

A short-term financial goal is one you would like to accomplish within the next one to two years.

- Example: buying a new recliner, or eliminating credit card debt.

A long-term goal would be anything beyond a two years

- Example: something along the lines of buying a new car/house, or saving up for your daughter's college education.

Budget: can be used for organizing yourself and making sure that you don't spend more than you earn/have in your bank account.You include all purchases or payments you plan on making, such as your housing, clothing, food, transportation, savings, etc.

- When preparing a budget, first you must calculate your expected income after tax. Once you make a budget, you must be prepared to adjust it. For example, your landlord decides to legally and unexpectedly increase your rent by $150 per month. Now you must decrease your budget for other categories in order to pay your rent.

Check Register - A personal record of your checking account activity

When you don't manage your finances correctly, serious issues can arise. Let's say you overspent on luxury goods and you don't have enough money to pay your mortgage for the fourth month in a row. You will then get a notice saying that you've defaulted on your loan for your home, thus starting the foreclosure process while leaving you homeless. Alternatively, you may not reach your financial goals or seriously damage your credit score, which is very difficult to fix.

Earning a Living

Personal income has two main components to it.

- **Gross personal income** means your salary, without deducting the many taxes you must pay.
- **Disposable income** is your income available for you to use at your discretion after deducting taxes.
- Example: David is making $1,000,000 and is in the highest tax bracket of 39.6% of his income. His gross personal income is one million dollars, but his disposable income is 60.4% of that, so approximately $604,000.

- Discretionary Income is your disposable income after you pay for necessities, such as insurance, food, mortgage

Employee benefits can increase disposable income because a person's employer will pay for necessities that would've had to come out of your disposable income, or decrease disposable income because an employer may say that they will take *x* amount of money out of your monthly paycheck and put it into a 401k or other retirement plan.

- **Overtime -** Additional compensation for any hours worked by nonexempt workers for more than forty hours
- **Cafeteria Benefit -** Allows staff to choose from a variety of benefits to formulate a plan that best suits their needs
- **Maternity Leave -** A temporary paid period of absence from employment given to new or expecting mothers during the months immediately before and after childbirth
- **Fringe Benefits -** Benefits provided by an employer to an employee, some of which are tax-exempt when certain requirements are met.

Income Tax: taxes on a person's yearly income
Excise Tax: taxes paid when purchases are made on a specific good
Property Tax: taxes based on the value of a person's property
Value-Added Tax: taxes on the amount by which the value of an article has been increased at each stage of its production/distribution
Sales Tax: regressive tax on sales or on the receipts from sales
Progressive Tax: taxes in which the tax rate increases as the taxable amount increases.
Regressive Tax: taxes imposed in a way where the tax rate decreases as the amount being taxed increases in value
Estate Tax: taxes on the net value of the estate of a deceased person before distribution to the heirs
Federal Insurance Contributions Act: taxes used to fund Social Security and Medicare
IRS: tax-collecting agency

1040EZ Form: Has the requirements that your income is less than $100k, you are filing as single or married filing jointly, you are under 65, you claim not dependents, you are not a debtor, and your income comes only from wages

1040A Form: Has many of the same requirements as the 1040EZ form, except the 1040A form allows you to claim credits for child and dependent care and education expenses, and you don't itemize deductions like your mortgage or charitable donations.
1099 Form: Details what kinds of income you may receive other than the salary you get from your employer
W-2 Form: Sent to the IRS by an employer and details annual salary and amount of taxes withheld from an employee's paycheck.
W-4 Form: Tells an employer what amount of taxes to withhold from an employee's paycheck based on their marital status, number of exemptions, dependents, etc
I-9 Form: Used to verify the identity and employment authorization of individuals hired for employment in the U.S. it must be filled out by both employees and employers

Mandatory Deductions: wages deducted from a paycheck to meet income tax and other required obligations
Voluntary Deductions: payments you make to retirement plan contributions, health and life insurance premiums, savings programs, and before-tax health savings
Dependent Exemptions: Can be used when children under 19 live with you for over half the year and provide for less than half of their financial support, as well as other relatives or your parents in some cases
Nontaxable Income: child support payments, welfare benefits, cash rebates, damage awards for personal injury or sickness, gifts, etc
Taxable Income: earned income (salary, tips, commissions, bonuses, etc.) and unearned income (rent, dividends, interest, winnings, etc.).

Job-sharing: when two part-time employees do a full-time job and share the remuneration.
Flextime: when the hours an employee has to work are set by the employer and agreed to by the employee.
Telecommuting: refers to simply as working from home. Piecework employment is work paid for according to the amount produced.

Having certain skill sets can be very beneficial for some people. The concept of supply and demand directly applies to skills in the workplace. The demand for certain skills may be very high, and thus will have a low supply. Because of this, if you have a certain skill in high demand, you will likely be paid more than your colleagues because a corporation will want/need your skills.

Being employed by a corporation can provide a lot of financial security because the company has a proven track record and is unlikely to fail. Inversely, being self-employed may not necessarily provide as much financial security as being employed by a big company. For example, if someone is a self-employed real estate developer, they don't have a set income and may be very successful one year, but not successful the next.

Buying Goods and Services

Renting

- PROS
  - You will likely have amenities to access, it is usually cheaper than buying, there are no maintenance or repair costs, no real estate tax, and there is no hefty down payment that is necessary.
  - Utilities and insurance are cheaper, and renting offers more flexibility than buying.
  - Can use a portion of money and put it towards paying the rent, while putting the rest into a savings account that offers high returns.
- CONS
  - When you buy a house and pay it off, you have equity in your life, and houses for the most part increase in value, so when the time comes to sell it, you can possibly make a hefty profit.
  - Your costs are also predictable and stable unlike renting, where rent can unexpectedly increase at any moment.
  - Also the interest and property tax portion of your mortgage is a tax deduction.

Monthly housing costs, including insurance, taxes, HOA fees, etc. should not exceed more than 30-33% of your monthly income at most.

- When buying a house, you must pay for taxes, repair costs, insurance, and possibly HOA fees. You are also obligated to pay for your utilities and all other expenses that come with the house

Many experts recommend that no more than 15% of your net monthly pay should be spent on your cars.

- Regarding cars, you must pay for taxes, repair costs, insurance, gas, etc.

When buying goods, paying with a credit card can be dangerous because you are just borrowing money, and not paying for it in cash as you would with a debit card or actual cash. With a credit card, it is very easy to exceed your budget, which would require you to either decrease your savings account or only pay a portion and pay off the rest later with interest.

Credit Cards: issued by a bank or business allowing the holder to purchase goods or services on credit
Debit Cards: issued by a bank or business allowing the holder to purchase goods or services through transferring money electronically from one account to another.
Overdraft Fee: fees charged when someone charges more to their debit card than they have in their bank account, typically around $35 per day until the amount is paid back
Annual Percentage Rate: the annual rate charged for borrowing or earned through an investment
Class-Action Lawsuit: one where a group of people with the same or similar injuries caused by the same product or action sue the defendant as a group
Arbitration: the abuse of an arbitrator to settle a dispute
Negotiation: when two or more parties discuss something and aim at reaching an agreement
Mediation: intervention in a dispute in order to resolve it; see arbitration
Warranties

- **Expressed:** a seller's promise or guarantee that a buyer relies on when they buy an item
- **Implied:** when a product is guaranteed to work if used for its intended purpose

Clearance items: a sale in which the vendor intends to get rid of all remaining inventory
Consumer reports: a series of reports on products and services used by consumers

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Saving and Investing

Risk Management: The forecasting and evaluation of financial risks together with the identification of procedures to avoid or minimize their impact
Yields: Income return on an investment
Rate of Return: The gain or loss on an investment over a specified period of time
Mutual Fund: An investment vehicle made up of a pool of funds collected from investors for the purpose of investing in stocks
Hedge Fund: A limited partnership of investors that uses high risk methods in hopes of realizing large capital gains
Bonds: Loaning money to a company or government
Expense Ratio: The annual fee of a mutual fund
Stock: A type of security that signifies ownership of a piece of a company

Common Stock: Issues the shareholder rights to dividends and voting rights at the shareholders meeting
Preferred Stock: Stock that doesn't offer voting rights but has a higher claim on assets and earnings than common stock
Dividends: A portion of a company's profits paid to stockholders
401k Fund: A retirement savings plan sponsored by your employer
Broker: A person who arranges transactions between a buyer and a seller for a commission
SEC: An agency that oversees securities transactions, financial activities, and mutual fund trading to prevent fraud and deception
Compound Interest: Interest calculated on the initial principal and also on the accumulated interest of previous periods of a deposit/loan
Simple Interest: A quick method of calculating the interest charge on a loan, by multiplying the daily interest rate by the principal by the number of days
Futures Market: A central financial exchange where people can trade futures contracts

Options for saving money are through a basic savings account, which is practically unhelpful because you will only make 10 cents a year with a $1,000 balance, a CD, which is only practical if you don't need the money during the agreed-upon term, or a Money Market Fund, which requires a fairly hefty minimum balance and usually offers a safe investment, although it's not insured by the FDIC

Among all of the latter ways of saving money, personally I find CD's and 401k accounts to be the best because 401k's are issued by your employer and you don't have to pay out-of-pocket, and CDs offer higher interest rates than basic savings accounts or Money Market Accounts/Funds.

To buy and sell stocks, simply make an investment account with a bank, such as Charles Schwab or hire a stock broker. For other kinds of investments, meet with specialists in that field to determine the best strategy for selling your investment.

Since returns on investments are not exempt from taxation, taxes may significantly decrease your overall return from an investment

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Banking and Insurance

Financial risk: the possibility of losing money due to an investment.
Credit risk: someone borrows money and is no longer able to pay off the loan.

Liquidity risk: involves securities and assets that can’t be bought or sold fast enough to cut losses.
Asset-backed risk: the risk that asset-backed securities may become volatile.
Foreign investment risk: involves changes in political and economic climates around the world.
Equity risk: covers the risk involved with buying and selling stocks.
Risk management: when firms use financial instruments to expose risks and get rid of them; see insurance

Property and Liability insurance: insures the structure and content of a property for its owner. It is used in the event of damage to a house, theft, etc.

- Property and Liability insurance consists of flood insurance, earthquake insurance, renters/homeowners insurance, etc.

Liabilities: Financial obligations

Co-Pay: the upfront cost you may have to pay, depending on your insurance plan
Premium: the money than an individual or business must pay for an insurance plan/policy
Deductible: the amount of money someone pays for expenses before his insurance plan starts to pay

Health Insurance: a type of insurance coverage that covers medical and surgical expenses

- Health Maintenance Organization: an organization to which people pay predetermined fees in return for a range of services from employees registered with the company
- Preferred Provider Organization: a type of insurance that allows insured people have flexibility with the doctors they choose
- Exclusive Provider Organization: a network of individual providers who have entered into agreements with an insurer to be a provider
- Point of Service plans: a type of managed health insurance plan
- High-Deductible Health Plan: a plan with lower premiums but higher deductibles than a normal health plan

Disability Insurance: insurance that offers income protection to people who have been disabled for a long period of time

Auto Insurance: protects your pocket from severe damage in the case of an auto accident

- Liability Coverage: protects insured person from the risks of liabilities imposed by lawsuits and others
- Collision Coverage: will reimburse the insured for any damage of their personal vehicle that is due to the fault of the insured driver
- Comprehensive Coverage: protects you against vehicle damages caused by a collision
- Personal Injury Protection: an extension that covers medical expenses due to collisions
- Gap Insurance: insurance car owners can buy to protect themselves against losses

Life Insurance: an insurance plan that pays out an amount of money to the dependents of the insured person at his/her death

- Term Life: when a benefit is paid in the event of a person's death
- Whole Life: insurance that pays a benefit and accumulates a cash value

When someone is more likely to die prematurely, their monthly insurance rates may be higher due to their higher risk. They may also have to pay a portion of the costs out-of-pocket.

Commercial Banks: A bank that offers services to the general public and companies
Savings and Loan Institutions: A financial institution that specializes in accepting savings, deposits, and making mortgage and other loans
Credit Unions: A cooperative where members can borrow from pooled deposits at low interest rates
Payday Lender: A short-term borrowing where an individual borrows a small amount at a very high rate of interest
Mortgages: An agreement where a person borrows money to buy a property and pays the money back during an agreed-upon term
Savings Account: A low-interest bank account, similar to a checking account, where money can be deposited, but is not very liquid
Money Mutual Account: A deposit account that pays interest based on current rates in money markets
Checking Account: A deposit account held at an institution that allows withdrawals and deposits
Certificate of Deposit: A savings vehicle with a fixed maturity date and fixed interest rate
FDIC: A U.S. Corporation insuring deposits in the U.S. against bank failure

NCUA: A federal agency created to regulate and supervise federal credit unions

Blank Endorsement: A signature by the creator of a check, enabling the holder of the check to claim payment
Special Endorsement: An endorsement authorizing payment to someone other than the entity it was originally meant for
Restrictive Endorsement: An endorsement putting a limitation of the use of a check
Conditional Endorsement: An endorsement where the endorser attaches one or more conditions to their check
Qualified Endorsement: An endorsement that passes title to a check with certain restrictions

There are three common banking institutions that are used: Commercial banks, community banks, and credit unions. Commercial banks provide a safe place for your money and provide common services such as depositing/withdrawing money, loaning money, etc. Community banks are very much the same as commercial banks, except commercial banks operate at the national level whereas community banks serve only within certain communities, and have a much more customer-relations orientation. Finally, there are credit unions, which are nonprofit cooperatives where members can borrow from pooled deposits at low interest rates.

There are many advantages to online banking, It is generally secure, more convenient, doesn’t require long lines, and offers 24 hour service to customers. However, it does have its disadvantages. While online banking is generally secure, it is not always fully secure and opens up the door to identity theft. Also, transactions may take several days to process and go through.

Credit and Debit

Credit is very important for your future. Credit determines the interest rates banks will give you for loans, and many other critical things in your life. Using a credit card versus a debit card can be good because you can build up your credit, making banks more likely to offer you loans at good interest rates. On the other hand, if you charge too much to your credit card and are unable to pay off the balance, your credit score may drop significantly.

Credit record: used by lenders to determine your financial worthiness of a loan and how likely you are to pay off that loan. Consumers are entitled to a free credit report once a year.

Credit reporting companies: Equifax, Experian, and TransUnion.
Credit Score: A number ranging from 300 to 850 that determines a person's creditworthiness

- Credit Score Components: Payment history, credit utilization, Length of credit history, credit mix, and new credit

Fair Credit Reporting Act: Legislation made to promote the accuracy, fairness, and privacy of consumer information
Equal Credit Opportunity Act: Legislation that makes it unlawful for any creditor to discriminate against any applicant
Fair Credit Billing Act: Legislation that provides guidelines for consumers and creditors to manage disputes regarding billing statements
Fair Debt Collection Practices Act: Legislation that limits the behavior and actions of third-party debt collectors who attempt to collect debts on another person's behalf

Chapter 7 Bankruptcy: When a company stops all operations and goes completely out of business; A trustee is then appointed to liquidate all assets in order to pay off debts; Individuals can also file for Chapter 7
Chapter 10 Bankruptcy: A corporate bankruptcy filing restricted to corporate debtors, and is intended for when a major restructuring or reorganization is necessary

Identity Theft: When someone uses another person's information, such as their name, credit card number, without their permission, to commit fraud or other crimes
Phishing: the attempt to obtain sensitive information, like usernames, passwords, credit card details, for malicious reasons

Line of Credit: An arrangement between a financial institution and a customer, that establishes a maximum loan balance

Debit Card:

- Pros: Paying out of pocket; No debt; immediate withdrawals of cash
- Cons: Overdraft fees can be expensive, although it can be avoided

Credit Card:

- Pros: Purchasing power; rewards; build credit; fraud protection
- Cons: Possibility of overspending. Just borrowing money, not spending money you have; interest; late fees; destroy credit

More Terms:

- **Loan Sharks:** Unlicensed lenders who charge illegally high rates
- **Liabilities:** A person's financial debt or obligations
- **Common Stock:** Publicly-traded security that represents ownership in a company
- **C's of Credit:** Capacity, Capital, Collateral, Conditions, Character
- **Mortgage:** Agreement where a debtor borrows money to purchase a property
- **Credit limits:** The maximum amount of credit extended to a client by a creditor
- **Usury laws:** State law sets maximum interest rate that may be charged for consumer loans
- **Small Claims court:** a special court where disputes are resolved quickly and inexpensively
- **Pawnbroker:** Business that makes high-interest loans based on the value of personal possessions pledged as collateral
- **Finance Charge:** The interest you pay for the use of a credit card
- **Finance Company:** Organization that makes high-risk consumer loans. high interest rates
- **Open-End Credit:** Credit whereby you can add purchases up to a set credit limit
- **Closed-End Credit:** A loan for a specific amount that must be repaid in full, including finance charge, by a stated due date
- **Service Credit:** Providing a service for which you will pay later
- **Credit Bureau:** Business that gathers, stores and sells credit information to other businesses
- **Subscribers:** Businesses that supply information to credit bureaus about the customers
- **Cosigner:** Someone who promises to pay if the borrower fails to pay
- **A-Rating:** Customers pay bills before the due dates
- **B-Rating:** Customers that pay bills on due date or within 10-day grace period