Bank On It:

The No Risk Way to Boost Your Savings

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Chapter 1
The Time Value of Money

Since 2008, the record low rates set by the Federal Reserve have made it exceedingly difficult for savers to earn a decent return on money deposited into the bank. Many banks offer savings rates that hover around 0%, hardly enticing for someone who wants to increase their nest egg or pad their bank account with interest.

Savings and CD rates are at record lows. If you are in one of these categories then you are most likely impacted:

- A retiree living on a fixed income who depends on income from FDIC insured savings and CD accounts to pay expenses.
- A teenager savings for college who has put some of the money into an FDIC insured account (a survey by Sallie Mae showed that FDIC insured accounts are the most popular savings vehicles for those savings for college).
- A future homeowner who has put their down payment into the bank.
- An individual of any age who is savings for a big-ticket item like a wedding, a vacation, or a home addition.
- Anyone who has cash in the bank.

While BestCashCow can't make bank rates go back to their 2008 levels of 6% or higher, we can provide you with information that can help make the best of a bad savings environment. There are differences in bank rates and these differences can make a substantial difference over time to your savings.

How much of a difference can it make?

So, you're skeptical about whether it really is worth your time to continue reading. Let's take an example. Let's assume you have $200,000 in the bank that you are saving for some big ticket item. Maybe it's a down payment, or college tuition, or retirement savings.

Now, let's assume you need the money in five years and can't afford to lose any of it. That means no stock market or mutual funds since either of these can go down, costing you some of your savings. So, let's put the money into a five year CD. *These rates are from September 2018. If you're reading this at some later date, the rates may have changed but the difference between the average and the best should not have changed much.*

5 Year CD Rate at a Big Bank:	1.63% APY
Top 5 Year CD Rate from BestCashCow:	3.25% APY

That's a pretty significant difference.

Now, let's see what happens when we look at this difference in $200,000 invested over the life of the five-year CD and assume a 30% tax rate:

Income with money in the big bank:	$11,788
Income with money in top rate bank:	$24,278
Savings Difference:	$12,490

So, just by moving the money from a bank that pays low interest to one that pays high interest, you could save an additional $12,490 over five years after-tax. This is money that is free and clear and that you can use to buy furniture for the house, stay in a 5-star hotel on vacation, pay for the DJ and more at a wedding. You get the picture. And remember, because both banks are FDIC-insured, you didn't have to take any additional risk.

You can do the calculation yourself on the BestCashCow Savings

Calculator:https://www.bestcashcow.com/savings-cd-calculator

Compounding Value of Money

Over more than five years, this difference will grow even larger because the compounding value of money becomes magnified over time.

If you are making money and saving money, time is on your side. When you take a couple of moments to find the best rates on a comparison site like https:www.bestcashcow.com you are applying best practices to your finances to avoid unnecessary underperformance and earn more over time without increased risk.

Chapter 2
How Much Money Should Be in Savings?

Now that you know that your safe money should be in a higher rate account, the question is how much of your money should be in cash? How much safe, FDIC insured money should you hold?

We all know the expression that cash is king. But with rates on savings, checking accounts, and CDs in the low single digits, the question is, how much of a king? How much money should an individual hold in cash?

Most investment advisors recommend that individuals hold enough money in cash to handle six to nine months of fixed expenses. This money should be liquid which means that a savings account or money market account is the best vehicle to use.

Phil Demuth, a frequently consulted investment advisor to high net worth individuals, believes cash has two functions: One, it allows holders peace of mind and the ability to sleep soundly. This is especially true in difficult economic times (think back to 2008). Two, cash provides individuals with flexibility so that they do not need to sell volatile assets when prices drop and they can maintain liquidity in a bear market. Cash also allows individuals to take advantage of buying opportunities when markets are down. Individuals with lots of cash do not need to panic in hard times.

The downside of cash is the opportunity cost. Money invested in an FDIC-insured savings or CD account paying 2% APY is losing ground when the stock market goes up 10% or more in a year. Several investment advisors BestCashCow spoke with didn't like the idea of including cash in a retirement portfolio. David Houle, CFA from Seasons Investments stated that:

"In my opinion there's very little reason to hold cash in a retirement portfolio, especially given the low yields to be had on cash holdings. What's implied by the term "portfolio" is that it's the pool of savings that have been set aside to be invested for capital gain and income. That money, in general, should remain fully invested in assets that are going to generate a return. There are periods of time where one might want to hold cash temporarily for tactical reasons, but this is different than carving out a permanent allocation dedicated to cash."

Ilene Davis, a Certified Financial Planner echoed David's comments, saying:

"*First, to clarify, what some people consider their- 'retirement portfolio' - are the qualified plans they have. A true retirement portfolio should include anything that is likely to be liquidated to provide funds through the retirement years.*

"Therefore, instead of focusing on a percentage that should be in cash, I would recommend that the focus be on how many months of expenses, plus emergency fund, should be in cash."

Brian Frederick, a CFP from Stillwater Financial Partners told us that:

The cash portion of a portfolio depends on someone's age and what their work status is. For people in retirement, I typically like to see one to two years of living expenses held in cash or CDs as it will provide a risk free source of money if they need to tap into it unexpectedly. For people still working, I encourage them to have 3-6 months of cash set aside for emergencies. Ideally, this would be in a separate bank account but I've also had clients do it inside of a Roth IRA if that's their only money.

He continued to say:

Interest rates fell off a cliff around Thanksgiving 2008. As a result, cash should be viewed more as a safety net than an income producing asset class. The other side of the coin is that it is dangerous to reach for yield by using bonds – bond prices go down when interest rates go up.

Almost all of the experts agreed that at a minimum, those in retirement should have at least 3-6 months of living expenses in cash, while many think that 1-3 years is more appropriate.

In our opinion, it makes sense to hold cash if you have a big impending expense coming. We have all heard stories about friends, or friends of friends who planned to buy a home and the down payment evaporated along with the stock market. In this case, a savings or money market account, or a certificate of deposit might be the right fit.

Warren Buffett keeps an enormous amount of cash on hand to be ready and liquid should the right investment opportunities arise. Because Buffett had cash-on-hand, he was able to loan Goldman Sachs and Bank of America money at very advantageous terms during the financial crisis in 2008. Having cash when others don't can be a big advantage.

Building a Cash Fund

Here's one way to think about how much cash you should hold:

Emergency Fund: Six to nine months of fixed living expenses.

Major Purchase Fund: Any major purchases you plan to make over the next one to two years. This could include paying for a wedding, paying for college tuition, putting a down payment on a home, house renovation costs, etc.

Opportunity Fund: A small portion of the investable portfolio that is kept in reserve should a good investment opportunity arise quickly.

Peace of Mind Fund: A portion of the funds that are set aside for peace of mind. The older the investor, the larger this might be. Remember, the purchasing power of this fund may shrink over time if inflation exceeds the savings rate so this peace of mind may comes with a price.

No matter what percent you put in cash, make sure to get the best rate on the money in the bank. By being prudent, a cash investment can still grow.

Chapter 3
The Scourge of Inflation

One concept that is important for every saver to understand is the inflation-adjusted value of an investment choice. Inflation erodes the value of money in the bank. What does this mean exactly?

Assume that you have $100,000 that is earning 2% APY in the bank. And let's assume that the inflation rate as stated by the government is at 3% APY. This inflation rate means that every year, the cost to purchase goods and services increases by 3%. In this scenario, while your money in the bank is earning 2%, the amount of goods and services it can buy is decreasing by 1% (the 3% inflation rate minus the 2% bank rate). So, every year, your purchasing power for that money is decreasing by 1%.

This type of rate environment has been in existence since the financial crisis in 2008. It does not always exist. Pre-crisis, a depositor could earn up to 6% APY in the bank with an inflation rate of around 3%. In this case, the inflation-adjusted rate is a positive at 3%.

This dynamic is one explanation for why savers have been so hard hit over the last seven years. There has been a significant price for keeping money safe in the bank. Still, losing 1% a year on money you need is better than losing 10-20% of your investment portfolio if the stock market enters a correction or even a bear market. This can and does happen, as we have seen multiple times, even over the last few years.

Finding the highest paying deposit rate is the best antidote to the corrosive effects of inflation.

Chapter 4
Savings, CDs, & Checking

There are two three general types of interest-bearing bank products that individuals put their money into to generate a return: savings accounts, certificates of deposit (CDs), and checking accounts. We will now briefly discuss the advantages and disadvantages of each type of account:

Savings Accounts

Savings accounts and money market accounts (for all practical purposes the two are the same for a depositor) offer depositors flexibility along with the stability of FDIC insurance (when deposit amounts are within FDIC limits). Savings accounts are a good place for money that is needed in the next 6-18 months and that the depositor wants to keep safe. Individuals often use savings accounts for a home down payment, a vacation, a wedding, a car, an emergency fund, or other near-term expenditures.

While online savings account have grown in popularity over the past ten years, some consumers prefer opening an account in a branch and having a personal relationship with the people who safeguard their money. Physical branches also provide an easy way to get cash instantly, to deposit checks and access to notaries and coffee and donuts. Online savings accounts do offer higher yields.

Savings Account Advantages:
- Higher interest rate than a checking account, usually.
- Liquidity. Depositors can withdraw their money at any time.
- Safety. Savings accounts are FDIC insured.

Savings Account Disadvantages:
- A variable interest rate. Rates can change at any time. In a falling rate environment, this is a negative. In a rising rate environment, this is a positive.
- Often, a lower rate than a CD. A good savings account rate is generally the equivalent of a 2-3 year CD. Four and five year CDs almost always pay more.

The variability between savings account rates is enormous. In the BestCashCow.com database, the difference between the highest paying savings account and lowest is over 1 percentage point. Keep in mind that an extra 1% per year on a $100,000 investment generates an extra $1,000 per year. As we discussed before, over time, the compounding effects of this can be very significant.

Certificates of Deposit (CDs)

A CD is bank instrument in which a depositor and a bank (or credit union) enter into an agreement. The depositor agrees to keep their money in the institution for a certain period of time and the institution agrees to keep the money safe and to provide a fixed rate of return. Provided the bank is FDIC insured (or, if a credit union, NCUA insured) and the deposit amount is within FDIC limits, the principal is also secured by an agency of the United Stated federal government.

CD Risk

While the principal of a CD is safe and insured within FDIC limits, the main risk of a CD is inflation. Because CDs are such a safe investment, they often do not pay much over the rate of inflation, and often pay under this rate. In these cases, the inflation adjusted value of the CD drops over time. Be sure to think about how CDs fit into your overall portfolio objectives.

How Interest is Paid

The method of distributing the interest earned on a CD varies by bank. Some banks pay interest monthly, other semi-annually, and others at the maturity of the CD. In general, online banks pay the interest electronically with a transfer back to the depositor's primary linked checking account. Other online banks may pay via a check in the mail. All online banks generally pay interest monthly by crediting it to the CD principal.

How a bank pays has tax consequences. Even though a bank may not send any money accrued, the IRS still requires an individual to report each year’s year's interest that is accrued as income. Most banks or credit unions will send a 1099-INT form specifying what this amount is. But be aware you could pay taxes on income you have not yet physically received.

Interest Rate

The general rule of thumb is that the longer the CD term, the more a CD will pay. This is not always true though as some banks and credit unions offer attractive CD specials on shorter-term money. In general with a CD, anything less than 12 months is short-term, 12 months to 36 months is medium-term, and anything over 36 months is long-term. Most 36 month and more CDs pay a premium over a savings account rate.

In a rising rate environment, it is generally better to keep money flexible and liquid and put it into either short term CDs or savings or money market accounts. In a falling rate environment, it is generally better to lock the rate using a CD or some other fixed rate investment.

Advantages and Disadvantages

The advantages of a CD are:

- Funds deposited in FDIC banks and within insurance limits are protected by the full faith and credit of the United States government.
- Longer-term CDs often provide a 1-2% premium over savings account rates.
- CD interest rates are fixed and will not drop if interest rates go down.

The disadvantages of a CD are:

- It is possible that the CD principal cannot be withdrawn early from a bank or credit union at all, and if it can be withdrawn early, there may a significant early termination fee. You should always check the terms early termination fees before initiating a CD. Online banks are generally much more accommodating than physical banks in the case of early withdrawal. We have seen penalties as low as 3 months interest on a one year CD and 6 months on a 5 year CD. In some cases, it may make sense to open a 5-year CD with the knowledge you might break it, and still come out ahead. In this case, you have a flexible CD that earns a higher rate of return.
- CD rates are generally fixed and will not go up if interest rates go up. Some banks do offer rising rate CDs that give depositors the option of raising the rate on their CD once or twice during the term of the product.
- CDs may lock money in at below the rate of inflation.

Checking Accounts

Checking accounts are the third main class of deposit accounts that can be opened in a bank. Checking accounts are transactional, meaning that they are setup so that an individual can easily deposit money into the account and then withdraw money by visiting a teller, using an ATM or debit card, or sending money via some electronic means (ACH, iPhone, person-to-person payment, bill pay, etc.). Most checking accounts do not offer high rates of interest, but a few, like online checking accounts and rewards checking accounts provide competitive rates.

Interest Checking - Branch

Interest checking accounts opened from a branch generally offer modest rates in return for the convenience of being able to step into a bank branch. Most branch-based interest checking accounts have fees if minimum balance levels are not met. These accounts are good for consumers who want the convenience of opening an account from a bank around the corner, plan to store some money in their checking account, and want to earn a little bit of interest.

View interest checking accounts from branches in your area

Online Checking Accounts

Online Checking Accounts are accounts which can only be accessed via the Internet. Because these accounts do not have the cost of bank branches associated with them, the banks can return some of that savings in the form of higher interest rates. In general, the rate on an online savings account is just slightly lower than an online savings account. Like their savings brethren, these accounts generally carry low or no fees.

Without a branch network, these accounts are usually funded via direct deposit and now increasingly electronic deposit capture, where a smartphone or other device can be used to take a picture of a check and then electronically deposit it. Foreign ATM fees are often reimbursed and customer service is provided via secure messaging or over the phone.

Online checking accounts are a good option for individuals who feel comfortable performing their banking online and don't feel the need to walk into a physical branch.

View online checking accounts

Reward Checking Accounts

Rewards checking accounts offer some of the highest rates on a deposit account but with a catch (isn't there always a catch). First, the high interest rate is usually only good up to a certain dollar amount - usually between $10,000 and $25,000 depending on the bank. Second, in order to get that rate, you must do certain activities on a monthly basis. The typical rewards account generally requires holders to sign up for direct deposit, receive bank statements online, use online bill pay, and use their debit card a certain number of times each month. If you do not fulfill these requirements, then the interest rate will drop precipitously. But if you plan to use direct deposit, use a debit card frequently, pay bills via online banking, and don't mind electronic statements, then Rewards Checking accounts might be for you.

View rewards checking accounts in your area.

Free Checking Accounts

Free checking accounts do not have any fees associated with them. Depositors do not need to meet minimum balance levels or do a certain number of transactions in order to prevent fees. In general, these accounts are offered by smaller banks and credit unions as a competitive tool. The downside to a free checking account is that because they are offered by smaller institutions, you may have to pay ATM fees if you go to a machine not affiliates with the bank. But if extensive ATM coverage is not an issue for you, then a free checking account might be worth it.

On BestCashCow, we provide a free checking finder that also shows the banks offering free checking in your area.

Find a free checking account in your area.

Chapter 5
Higher Rates Do Not Mean More Risk

In the investment world, one of the key maxims is that a higher return is almost always associated with a higher risk of losing your money. You can invest in an Internet start-up, and potentially earn a windfall, or lose it all.

One question I frequently get asked when discussing bank rates is whether a bank that offers higher rates is riskier than one that doesn't. After all, this is generally how it works. The thinking goes that distressed banks need to hang on to deposit dollars in order to stay afloat and as a result, they offer higher rates in order to attract new money and convince depositors to keep money in the bank. Anecdotally, this is the kind of behavior we saw at the height of the financial crisis, when mega-banks like Countrywide and Indymac offered some of the highest rates in the country right before they were closed.

The question is whether a bank's rates and its underlying financial condition are correlated?

First, it's important to understand that banks that are highly distressed may not have high rates. Once a bank appears on the FDIC's less than capitalized list, the agency generally prohibits it from offering rates above a national rate cap it has established.

But that still doesn't answer the question of whether banks that offer higher rates are less financially secure. The answer is important. If high rates are usually offered by distressed banks then it may not be worth the extra yield the bank offers.

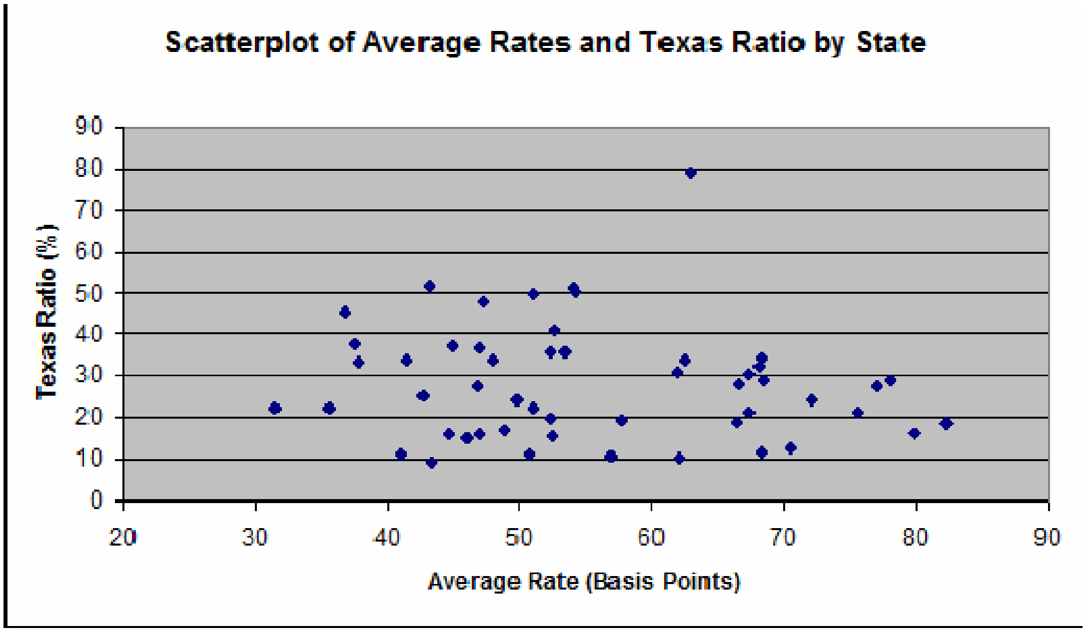
The Analysis

BestCashCow conducted two analyses to answer this question using data for FDIC insured banks. It's important to note that this analysis only covers FDIC insured banks. Extremely high rates offered by non-FDIC institutions should be an immediate warning signal.

The first analyzed the correlation between average 1 year CD rates and the average Texas ratios for each state using data from BestCashCow's database of 7,000 banks and 2,000,000 product rates. The Texas ratio compares the amount of loans at risk and the amount of owned real estate with the amount a bank has on hand to cover any losses.

While it is not a definitive guide to bank risk and soundness, it has been found to be a good indicator in the past.

The data was graphed on the scatterplot below.



The scatterplot shows a low negative correlation between average state 12-month CD rates and state average Texas ratios which is confirmed with a coefficient of -0.12393 (with +1 showing a high positive correlation and -1 showing a high negative correlation). A negative correlation means that as the average rate rises, the average Texas ratio drops. Lower Texas ratios are a sign of a healthier bank, so on average according to this analysis, higher rates are offered by healthier banks.

Analysis 2

As a next step, I used the BestCashCow database to pull the top 100 CD rates in the country and then examined the Texas ratios of the respective banks. The average Texas ratio for this group of banks was 25.56% versus an average Texas ratio for all banks of 24.44%. While slightly higher, this is not enough to warrant concern. Distressed banks usually have Texas ratios above 100%, and the 25.56% number is not even close. This analysis shows again that banks that offer high rates are not less financially sound than the average bank.

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While anecdotally, it may appear that high rates are offered by distressed banks, a thorough review of the data shows that in aggregate, higher rates are not a sign of a distressed bank and if anything, may be a sign of a more secure bank. With bank rates, you can have your cake and eat it.

Chapter 6
FDIC Insurance and Keeping Your Money Safe

Banks that offer higher rates are not less secure, but there is always that possibility, however remote, that a bank could fail. If it does, what happens? Will you get your money back?

Almost everyone who puts money in a bank has heard the term FDIC. It stands for Federal Deposit Insurance Corporation and it's a federal agency created by Congress to maintain stability in the country's banking system. Credit Unions have a similar agency called the National Credit Union Administration. Both the FDIC and the NCUA insure money put into accounts at banks that participate in their programs up to $250,000 per individual, per institution.

For details on FDIC insurance rules, click here.

No depositor who has stayed within FDIC or NCUA limits has ever lost money.

The less known answer is what happens if an FDIC insured bank actually fails? How does the FDIC protect depositors' money? How quickly is the lost money paid back?

The FDICs website states the following:

Q: What happens when a bank fails?
A: *Though unlikely, bank failures do occur and the FDIC responds in two capacities. First, as the insurer of the bank's deposits, the FDIC pays insurance to depositors up to the insurance limit. Historically, the FDIC pays insurance within a few days after a bank closing, usually the next business day, by either (1) providing each depositor with a new account at another insured bank in an amount equal to the insured balance of their account at the failed bank, or (2) by issuing a check to each depositor for the insured balance of their account at the failed bank.*

For money above the $250,000 limit, the FDIC website says the following:

Second, as the receiver of the failed bank, the FDIC assumes the task of selling/collecting the assets of the failed bank and settling its debts, including claims for deposits in excess of the insured limit. If a depositor has uninsured funds they receive the insured portion of their funds quickly, as described above. They may also, however, recover some portion of their uninsured funds (their remaining claim on the failed bank) from the proceeds from the sale of failed bank assets. It can take several years to sell off the assets of a failed bank. As assets are sold, however, depositors who had uninsured funds usually receive periodic payments (on a pro-rata "cents on the dollar" basis) on their remaining claim.

Having watched many banks fail and be put into receivership by the FDIC, BestCashCow has noticed a pattern emerge. Generally, a failed bank is closed by the FDIC on a Friday and withdrawals are frozen over the weekend. The bank is either taken over by another solvent bank at this point or put into receivership by the FDIC. In either case, the bank reopens on Monday and depositors are allowed to withdraw their money up to the $250,000 limit. To be sure your money is protected, do not exceed the $250,000 FDIC limit per person, per institution.

The Drawback of a Failed Bank

Even if you have FDIC insurance and your money is safe, there are several drawbacks of failed banks that aren't mitigated by FDIC insurance coverage.

- A depositor may lose some or all of the money above FDIC limits if a bank fails.
- Any CD or CD IRA that a consumer holds in a failed bank may be reset once the bank's assets are transferred to another bank or cashed out by the FDIC. For example, a depositor who holds a 5-year CD paying 6% APY from 2007 might find the CD called, resulting in a loss of a favorable interest rate.
- Failing banks may not have the time and money needed to provide top-notch customer service and support. They are fighting for their survival.
- The cost of bank failures is ultimately borne by the consumer. Money spent by the FDIC to insure bank deposits comes from a fee levied on all banks. The fee that a bank pays is passed through to the consumer in the form of higher account fees, bank charges, and interest rates on loans. Ultimately, if the bank failure is big enough or systemic enough, the general public must come up with the funds to bail out the banks, as with the TARP and the S&L bailout in the 1980s.

How to Check the Health of Your Bank

To see if your bank or prospective bank is in any danger of failing, BestCashCow provides the Texas Ratio for every bank and credit union. To find it, go to any bank and credit union and click on the Financial Details tab. What is the Texas Ratio and what does it show about a bank or credit union's health?

The Texas Ratio helps assess the health of a bank. It compares the amount of loan risk a bank has by the amount of reserves and capital a bank has at its disposal to cover those losses. Let's take a look at a simplified example. Suppose you had lent $100,000 to five friends and two of the friends were late paying you back. That means that $200,000 that you put into loans is at risk. You don't know if your friends will be able to pay the loan back. Now suppose you have set aside $100,000 in anticipation of one friend defaulting and you have another $100,000 in savings. That means that you have $200,000 at risk and $200,000 to cover these losses. That would give you a Texas ratio of 100% ($200,000/$200,000)*100.

The concept with banks is the same. Calculating the Texas Ratio for banks means taking the amount of delinquent loans, adding the amount of owned assets, which include repossessed cars, foreclosed homes, etc. and then dividing this by the amount of reserves a bank has set aside to cover bad loans and the amount of capital a bank has available. So if a bank has a Texas Ratio above 100%, it has just enough reserves and capital to cover potential bad loans. A Texas Ratio over 100% means a bank does not have enough to cover delinquent loans if they go bad. The average Texas Ratio for all banks has varied between 9-26% over the last five years. That means that on average, banks have between five to ten dollars of reserves and capital for every dollar of potential bad loans.

Generally, not all delinquent loans go bad, and banks are able to sell property they have foreclosed on, so usually while a Texas Ratio of 100% is a warning sign, it's not a signal of impending trouble. Ratios above 200% though are big warning signs.

To find the Texas Ratio for any bank or credit union, go to that institution's page on BestCashCow and click the Financial Details sub-tab.

Conclusion

There are many ways for you to save and earn more money. You can take another job, cut back on spending, work harder. Or, you can move your money into riskier investments and hope that it pans out.

The one simple thing you can do that involves no extra risk is to move your money into a savings, CD, or checking account that pays more interest. It will take very little of your time and could generate tens of thousands of dollars over time.

With a database of over 2,000,000 rates, BestCashCow makes it easy to find the best place to put the money you want to keep safe. Whether you are comfortable using an online bank, or want to stay brick-and-mortar, there is an account that will pay you more. There is competition for your money!

Visit BestCashCow to start saving and earning more.