Layering Your Savings

First Layer – Save Items and Emergency Savings

Save Items are non-monthly expenses such as water bills, insurance payments, gifts, or taxes. For example, if your car insurance is $800 every 4 months, you would need to save $200 a month in order to have the $800 when the bill is due. On your spending plan, you would record $200 a month for car insurance and mark it with an "S" to identify it as a Save Item. Add together all your Save Items for the month and set aside this total every month.

Emergency Savings is money that is set aside for unplanned, one-time financial events that are not included in your spending plan. Without this money you won't be prepared for a major car repair, emergency veterinary bill, or travel for an unexpected family event. Put money for Save Items and Emergency Savings into containers that can be accessed quickly and without penalty. Examples include a Piggy Bank, passbook savings account, or money market deposit account.

Second Layer – Short Term Savings

The second layer is money put into short-term savings plans. This represents money set aside for short-term goals - a vacation, special purchase and protection from unexpected loss of income. One way to determine an amount for "Loss of Income Savings" is to decide how much money you would need to pay all your basic monthly living expenses and monthly debt payments for three to six months.

Short Term Savings should be kept in savings plans that yield interest because this money may not be utilized for months or years. Certificates of Deposit (CDs), Savings Bonds, or Treasury Bills would be representative places to put this layer of money. There may be a small penalty involved with early withdrawal with this kind of savings plan.

Third Layer – Long Term Savings

The third layer is money that is placed in long-term savings plans. It is there if you need it but its main purpose is to grow. Money in this layer would be used only after the previous layers have been accessed or when the purpose of this savings becomes relevant. This savings is designed for long-term goals such as a college education fund, buying a car, or a down payment for a house. There could be penalties or loss of value if you withdrew the funds in an untimely fashion. Investments in securities, property and/or business investments would be representative of this layer. A professional advisor such as a Certified Financial Planner ("CFP™ Practitioner") can be very helpful when making decisions about these kinds of investments.

Fourth Layer – Retirement Savings

The fourth layer – retirement savings – is money that is placed into a long-term, tax-deferred account such as an IRA, 401(k) plan or other qualified retirement plan. There are substantial penalties if the money were withdrawn early. The only purpose of this money is financial security during retirement. It would only be accessed early as a last resort. All your previous layers of savings protect this account. These plans have many rules attached to them. Your employer's benefits department, tax advisor or other professional financial advisor can help you understand these options and decisions.