Bank Services

Know Your Options

CONTENT NOTE

Financial Education
FROM POVERTY TO PROSPERITY

Do you need a place to save your money? Do you need to borrow money? Do you need to send money to a relative in another country? Do you need a very secure place to store something valuable? If you answered "yes" to any of these questions, you need a bank; most people do. Banks are essential in our societies to ease the flow of money in financial transactions that occur at all levels, from the individual saver to the giant corporation.

For centuries, banks have been a place to save and borrow. In most communities they have been, traditionally, powerful institutions feared for their ability to take the homes and businesses of honest people who fall behind on their loan payments. However, the banking industry has changed dramatically in past decades. Banks now offer many products and services in addition to savings and loans. Increased competition from other financial institutions is driving them to be friendlier and more concerned about keeping customers happy. And new technologies, such as Automated Teller Machines (ATMs), are making banking faster and more convenient.

How Do Banks Work?

A bank takes in money from depositors—clients who save at the bank—and lends money to borrowers. It pays the saver to deposit her funds (in the form of interest paid on the amount of savings) but charges the borrower for using its funds (in the form of interest on each loan). Because the interest it charges for loans is higher than the interest it pays on savings, the bank makes a profit. It also earns income from the fees it charges customers for most bank transactions. These include application fees on loans, fees on ATM transactions, and fees for sending money to another person.

Banking can be a risky business. Banks need to lend money to borrowers in order to make a profit, but they also need to have some cash available for savers who want to withdraw their funds. Maintaining this balance is challenging. Banks also run the risk of making bad loans that are not repaid.

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Such risks, combined with the banks' key role in supporting the economy, have led governments to adopt rules and regulations that help manage these risks. Banks are required, by law, to have deposit insurance that protects savers and to hold enough capital to protect themselves from bankruptcy.

Government regulation distinguishes formal banks from other financial institutions that offer many of the same services. In addition to banks, sources of credit include NGO-sponsored microfinance programs, retail shop owners, employers and local moneylenders. Rotating savings and credit associations come in diverse forms and offer people a place to save and gain access to a larger sum of money. Many people save at home "under the mattress." These options for borrowing and saving range from semi-formal institutions to informal neighborhood groups, but none offer the same security that banks can. Government regulations force banks to be conservative in the way they handle money.

BOX 1: BANK FAILURES

Despite government regulation designed to protect banks and their customers, banks can and do sometimes fail. When a bank closes, customers may experience delays in retrieving their money because the bank's assets are frozen while its financial position is resolved. Often, customer accounts are transferred to another financial institution that purchases the assets from the failed bank.

What Are a Bank's Common Products and Services?

Banks offer savings and credit with different types of savings accounts and loans that are tailored to a variety of client needs. You can also purchase insurance through your bank, send money to a relative far away, and have the bank pay your regular bills with funds drawn from your account. For those with extra funds, banks offer investment services. Let's look more closely at the choices you have for those functions that most people go to a bank for—savings and loans.

OPTIONS FOR SAVING

Most banks offer savings accounts that respond to different savings goals—short, medium and long term.

Short-term savings. Those who need a place to make regular deposits and frequent withdrawals can choose a current or ordinary savings account. Such an account offers few restrictions. It also pays a very low interest rate. It enables you to avoid the risk of carrying large amounts of cash and helps you keep track of how your money is spent. This type of account is best for regular financial transactions (e.g., daily or weekly deposits or withdrawals). It offers an easy place to save for short-term needs such as household items, holidays, and periodic bills that you know you will have to pay.

Medium- and long-term savings. However, if you have longer-term goals for which you want to save, banks offer several “deposit” accounts designed to encourage deposits and discourage withdrawals. These accounts, known by different names in different areas of the world (e.g., fixed-deposit accounts, certificates of deposit) pay higher interest than the ordinary savings account. In fact, the interest rate goes up with the amount held on deposit, thus encouraging clients to save. They discourage withdrawals with a range of restrictions that vary from bank to bank, but include the following:

- Minimum balance in order to earn interest
- Minimum balance to avoid service charges
- Limited number of free withdrawals per month
- Penalties charged on withdrawals within a specified period

Generally, savers are rewarded for their discipline; the longer a saver is able to leave her funds on deposit, the more interest she will earn.

That banks offer multiple ways to save helps you manage your money and maximize your savings earnings. If you are hesitant to commit your savings to longer-term deposit account that restricts your withdrawals, start with an ordinary account and save a small amount each week or month. Gradually, you may accumulate a surplus that you don’t need for regular expenses which you can transfer to a deposit account that pays a higher interest rate.

CREDIT: MANY TYPES OF LOANS

Because banks earn their income on loans—from the interest borrowers pay for temporary use of the banks’ funds—they try to attract many clients with a variety of loan products. In fact, banks’ diversity of products is a significant advantage compared to other financial institutions. Banks offer loans for personal use, business investment, car purchases, construction and home purchases. Each type of loan comes with terms and conditions that correspond to the way the money is to be used. For example, a housing loan typically has a much longer term than a personal loan. In addition to specific loans from the bank to the borrower, bank clients can access credit through overdraft facilities on their checking account and bank-issued credit cards.

OTHER FINANCIAL SERVICES

Today banks can offer much more than a place to save and borrow. Financial professionals can help you develop a financial plan to meet your goals, write a will, transfer money to accounts in other countries, and take over payment of your regular bills. The bank charges a fee for each of these services.

BOX 2: COMMON CATEGORIES OF BANK LENDING

Personal loans are made for personal, family and household purposes—home improvements, travel, car repairs, and debt consolidation. To qualify for such a loan, you have to prove your ability to repay, offer good credit history, and provide some item of value as security to guarantee the loan.

Business loans can finance a business start-up or expansion. They include lines of credit for working-capital needs and term loans. Banks usually lend only to legally established businesses that can provide proper business and legal records as well as a business plan.

Banking is Electronic!

“Going to the bank” used to mean long lines in the bank hall, and long delays. However, the introduction and spread of electronic banking has transformed the meaning of that phrase. In many urban areas, you can do most of your banking at conveniently located Automatic Teller Machines (ATMs) whenever you want to, 24 hours a day.

With an ATM card issued by the bank, you can make deposits and withdrawals, get account balances, and transfer funds from one account to another at dozens of ATM kiosks. Each bank maintains its own network of ATMs, but for a higher transaction fee you can use your bank card to withdraw cash from any ATM.

ATM cards make banking much more convenient by enabling you to use your account in multiple locations at any time. But, if you use these cards to withdraw cash or buy something, you must have money in your account to cover the amount of the transaction.

Telephone banking services enable you to do your banking without leaving your home. To conduct routine transactions by telephone, you work through an automated voice recognition facility; for each transaction, it instructs you which numbers to press on your telephone keypad. Customer service representatives can help you with more complex questions. Banking via telephone is also available in some places.

And for those with access to computer, banking over the internet is likely in your future. Banks are investing heavily in this form of electronic banking and encourage their customers to use it. In fact, some newer banks exist only on the internet; they have no buildings or bank halls. If you have a recent computer that can run the necessary software, ask your bank about internet banking.

Debit cards are available to clients with current accounts. The debit card is linked to your account; you can use it to make purchases at many stores and to conduct banking transactions at ATMs. In fact, often the ATM and debit card are the same. Although the cashless purchases that a debit card permits make it seem like a credit card, it only allows you to spend the money you actually have available in your account. The amount of each purchase you make is deducted from your account immediately. If you don’t have enough money in your account for the purchase, the merchant will not accept the sale.

Electronic banking is convenient banking. It saves the customer time and is less expensive for the bank. You can do your banking at any time of the day or night and can avoid carrying large amount of cash. However, ATM and debit cards do have some disadvantages, as outlined in Box 3.

BOX 3: RISKS ASSOCIATED WITH ATMS AND DEBIT CARDS:

ATMs can malfunction or run out of cash.

You may forget your Personal Identification Number (PIN), and without it you cannot use the ATM.

Clients using an ATM, particularly in isolated locations and at night, are at risk for robbery as thieves assume anyone leaving an ATM has just withdrawn cash.

Banks charge a fee for each ATM transaction. These fees can add up.

It is more difficult to maintain saving discipline with such easy access to your account.

The Benefits of Banks

Many of us are afraid of banks. The bank offices are so formal and intimidating. The products, services and fees associated with them are confusing. Some of us assume that we are too poor to take advantage of them. However, banks are likely to offer ways to save and borrow that can be very helpful to you, including the following:

- As a saver, you can enjoy the security that banks offer while “growing” your savings with interest income.

- The selection of accounts enables you to manage different savings goals simultaneously.
- Using a bank imposes discipline that is difficult to maintain when you try to save at home.
- Saving at a bank keeps your money out of reach of others who will pressure you to spend it or who will be tempted to spend it themselves.
- As a borrower, you have a similar rich selection of loan products from which to choose.
- By borrowing from your bank, you can build an official credit history that is more widely recognized than credit experience with informal lenders.
- Banks are regulated by the government, minimizing your risk in depositing your funds with them.

Today, banks are easier and more convenient to use. Because they are eager for customers, you can "shop" for the bank that will both respond to your needs and serve you well. Invest time learning about your local banks; compare their terms on similar products of interest to you. Talk to the bank staff. Find out how they can help you. Remember, you choose the bank, the bank does not choose you.

BOX 4: ATM AND DEBIT CARDS ARE NOT CREDIT CARDS!

A **credit card** offers instant credit to qualified card holders. When you use a credit card to pay for goods, you are actually borrowing money from the bank which issued the card. Instead of deducting the amount of each purchase from your account at the time of purchase (as happens with ATM and debit cards), the bank will pay the vendors and send you a credit card bill every month showing all of the purchases you made with the credit card. If you do not pay this bill within 30 days, the credit card company will begin charging you interest on the unpaid balance.

Although credit cards offer instant credit and a convenient way to pay for most expenses, they also make it very easy and tempting to purchase items and spend money that you do not have. When this happens, the amount you owe on your credit card increases very quickly, compounding every month that you are unable to pay off the full balance due.

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