Multiplying, Managing and Securing your Money

A bank is a financial institution licensed to receive deposits and make loans. Banks may also provide financial services, such as wealth management, currency exchange, and safe deposits. There are two types of banks: commercial/retail banks and investment banks. In most countries, banks are regulated by the national government or central bank. Banks act as payment agents by conducting checking or current accounts for customers, paying cheques drawn by customers in the bank, and collecting cheques deposited to customers' current accounts. Banks also enable customer payments via other payment methods such as Automated Clearing House (ACH), Wire transfers or telegraphic transfer, EFTPOS, and automated teller machines (ATMs).

Breaking down the different kind of 'Banks'

Commercial banks are typically concerned with managing withdrawals and receiving deposits as well as supplying short-term loans to individuals and small businesses. Consumers primarily use these banks for basic checking and saving accounts, certificates of deposits (CDs) and home mortgages. Examples of commercial banks include JPMorgan Chase & Co. and Bank of America Corp.

Investment banks focus on providing corporate clients with services such as underwriting and assisting with merger and acquisition (M&A) activity. Morgan Stanley and Goldman Sachs Group Inc. are examples of U.S. investment banks.

Central banks are chiefly responsible for currency stability, controlling inflation and monetary policy and overseeing money supply. Some of the world's major central banks include the U.S. Federal Reserve Bank, the European Central Bank, the Bank of England, the Bank of Japan, the Swiss National Bank and the People's Bank of China.

While many banks have both a brick-and-mortar and online presence, some banks have only an online presence. Online-only banks often offer consumers higher interest rates and lower fees. Convenience, interest rates and fees are the driving factors in consumers' decisions of which bank to do business with. As an alternative to banks, consumers can opt to use a credit union

Revenue Generation

A bank can generate revenue in a variety of different ways including interest, transaction fees, and financial advice. Traditionally, the most significant method is via charging interest on the capital it lends out to customers. The bank profits from the level of interest it pays for deposits and other sources of funds, and the level of interest it charges in its lending activities. This difference is referred to as the spread between the cost of funds and the loan interest rate. Historically, profitability from lending activities has been cyclical and dependent on the needs and strengths of loan customers and the stage of the economic cycle. Fees and financial advice constitute a more stable revenue stream and banks have therefore placed more emphasis on these revenue lines to smooth their financial performance. In the past 20 years, American banks have taken many measures to ensure that they remain profitable while responding to increasingly changing market conditions.

Liquidity Creation and Financial Fragility: A Theory of Banking

Loans are illiquid when a lender needs relationship-specific skills to collect them. Consequently, if the relationship lender needs funds before the loan matures, an individual may demand to liquidate early or require a return premium. Borrowers also risk losing funding. The costs of illiquidity are avoided if the relationship lender is a bank with a fragile capital structure, subject to runs. Fragility commits banks to create liquidity, enabling depositors to withdraw when needed, while buffering borrowers from depositors' liquidity needs. Stabilization policies, such as capital requirements, narrow banking, and suspension of convertibility, may reduce liquidity creation.

Battalion of Security

If you live paycheck to paycheck, the most you're ever at risk of losing or having stolen is the amount of your last paycheck – a sum you clearly can't afford to lose if money is tight. Keeping your money secure is paramount. And once you have more than a few hundred dollars to your name, you'll want to protect your savings.

The most secure place to put your money is a bank account. As long as you choose a legitimate bank that has Federal Deposit Insurance Corporation (FDIC) insurance (or a credit union that has National Credit Union Association insurance), any money you put in the bank (up to FDIC insurance limits) is protected. To date, the guarantee provided by the FDIC has proved to be completely reliable, even during times of financial crisis like the 2008 recession or the savings-and-loan crisis of the early 1990s.

Era of Investments

Once you are earning more money than you need to get by each month, you'll want to go beyond a checking account and start saving and investing your money to give yourself more financial security. With money in savings, you can handle irregular expenses like car repairs even if they don't fit into your monthly budget. A large enough emergency fund can tide you over during a period of unemployment. And once you have several months' worth of emergency savings, you'll want to transfer your extra savings into a retirement account. You simply can't take advantage of the opportunity to earn money in the stock market or earn interest on deposits if you're only willing to keep your money under your mattress or on a prepaid debit card.

Risk Management

As a general policy, banks hold on to customer deposits to protect themselves from fraud. When you look up your bank account balance at the ATM or online after making a deposit, you may see a difference between your account balance and your available balance. This lets you know that a deposit you've made hasn't cleared yet. It's extremely important to be aware of how your bank's deposit holds policy works so that you aren't penalized for trying to make a payment with money you don't yet have access to. The bank's hold policy will always apply to business days, not calendar days. A business day is any day that is not a Saturday, Sunday or federal holiday.

Automatic Saving Plans

Many banks offer automatic savings plans, and these can be a great way to develop a regular habit of saving money. At some banks, establishing such a plan is also a way to obtain lower banking fees. An automatic savings plan is something you need to set up. It simply involves choosing a specific sum of an amount that you're willing to have automatically transferred from your checking account to your savings account, usually once a month and on the same day every month (except when that day falls on a weekend or holiday). Although some people are nervous about the idea of committing to save a certain amount automatically each month, most of the investment leaders say that paying yourself first is a key component of building wealth. The other major benefit of establishing an automatic savings plan is that you don't have to remember to set aside money for savings each month – your bank will do it for you.

The Bottom Line

Banks provide security and convenience for managing your money and sometimes allow you to make money by earning interest. Convenience and fees are two of the most important things to consider when choosing a bank, whether you are opening a checking, savings or money market account or putting funds into a certificate of deposit. Be sure to develop methods to stay on top of your account balances in order to avoid fees, declined transactions and bounced payments. To protect your money from electronic theft, identity theft and other forms of fraud, it's important to implement basic precautions such as having complex passwords, safeguarding your PIN and only conducting online and mobile banking through secure internet connections.
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