Financial Institutions and Their Services

by Sophia

WHAT'S COVERED

What is it that banks do, and why do we have banks in the first place? What role do they play in finance in the U.S. economy? We looked at the role that the Federal Reserve—or the bank for banks—plays, but what do the rest of these institutions do? This tutorial will cover financial institutions and their services. Our discussion breaks down as follows:

1. Financial Institutions

Financial institutions help move money around the U.S; they serve as a means to move that means of exchange around the U.S. economy. They are regulated by the Federal Reserve and provide financial services to both businesses and customers. They impact the money supply in the United States, which in turn impacts the rate of growth and the overall general well-being of the economy.

There are many different types of financial institutions.

Financial Institutions	Description
Commercial bank	A bank that provides services to companies and individuals. Commercial banks make loans and accept deposits into the bank, and they also work to make a profit.
Savings and loan association	A financial institution that limits its services to making loans and accepting deposits. A legal limitation is that no more than 20% of its loans can be offered commercially. Therefore, these institutions focus on the individual consumers instead of the commercial business. Traditionally, savings and loan associations have been focused on home loans.
Mutual savings bank	A bank that is set up by a local government without capital stock and is maintained by members who contribute to a common fund. Being mutually held, this means that borrowers and depositors are members with voting rights on how the bank will run.
Credit union	A nonprofit cooperative that is set up for a specific membership who owns it. It provides a variety of banking services for its members. Now, a credit union will accept deposits and make loans like a regular bank, but the big difference is that its members must meet certain qualifications before they become a member of the credit union. For instance, members of a credit must be an employee of a

	particular company or organization, such as public school teachers or postal workers.
Non-deposit institution	An institution that offers some services, such as a mortgage, but cannot accept deposits. For example, pension funds, insurance companies, finance companies, and securities and investment dealers are all non-deposit institutions.

TERMS TO KNOW

Commercial Banks
A bank that provides services to companies and individuals.

Savings and Loan Associations
A financial institution that limits it's services to making loans and accepting deposits; a legal limitation is that no more than 20% of it's loans can be offered commercially.

Mutual Savings Bank
A bank that is set up by a local government, without capital stock and is maintained by with members who contribute to a common fund.

Credit Union
A cooperative that is nonprofit, set up for a specific membership who owns it and provides a variety of banking services for its members.

Non-Deposit Institutions
An institution that can offer some services, such as a mortgage, but cannot accept deposits.

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2. Banking Services

So, what are some of the banking services that these different institutions provide? These are services that banks, savings and loan associations, and credit unions will typically offer their customers or members:

- *Checking:* Checking is a transaction that allows a customer to deposit and withdraw money.
- *Certificate of deposit (CD):* This is an agreement in which is a deposit is kept for a specific amount of time with a specific return--a fixed interest rate--for that entire period, such as, for example, three months to five years, depending on the certificate of deposit.
- *Line of credit:* A line of credit is the maximum amount of money that has been promised to a business or person for a loan. So, you can draw on this line up to the limit of that particular line of credit throughout your business dealings with the bank.
- *Letter of credit:* This is a promise by the bank to pay a third party if certain conditions are met.
- *Revolving credit agreement:* This is a line of credit in which the terms are open-ended because there's not a set number of payments. Money can be re-borrowed up to the max on and off again in the form of credit cards, as an example.
- *Point of sale terminals:* A point of sale terminal is an electronic means for a business to process payments electronically. For example, think of the electronic cash register that you see at any store that you frequent.
- *Automated clearinghouses:* These are used by businesses to transfer wages and salaries from the bank to the different employees.

- *Electronic check conversion:* This refers to the ability to convert checks into more immediate payments. Instead of waiting for the check to move all the way through the system and back into a business's bank account, which can take several days, electronic check conversion facilitates it much more quickly.
- *Electronic funds transfer (EFT):* EFT is offered by banks, savings and loans, and credit unions, and involves moving money electronically, either within a bank or across banks. You don't have to wait for the physical money to move from place to place or rely on the mail to make this happen; EFT makes these funds available much faster.
- *Automated teller machines (ATM):* Automated teller machines--you're surely familiar with these--is a machine that allows people to access immediate cash and banking services at any time of day or night, in remote locations around the world.

You can see that services like checking, CDs, lines of credit, letters of credit, and revolving credit agreements comprise traditional banking services.
For the remaining services on the list, you can see how technology has changed banking. Point of sale terminals, electronic check conversion, and electronic funds transfer are services that weren't readily available even a few years ago. This has helped to speed up banking services and reduce the amount of time that companies or individuals have to wait in order for a payment to clear a particular bank and end up in their bank account.

SUMMARY

Today we learned about the different **financial institutions**, including commercial banks, savings and loan associations, mutual savings banks, credit unions, and non-deposit institutions. We also learned about the different **banking services** that these financial institutions offer, from the traditional to more recent services enabled by the use of technology.

Good luck!

Source: adapted from sophia instructor james howard

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