CHAPTER ONE
An Overview of Banks and the Financial Services Sector

In this chapter you will learn about the many roles banks and their financial service competitors play in the economy today. You will examine how and why the banking industry and the financial services marketplace as a whole is rapidly changing, becoming new and different as we move forward into the future.

What is a Bank? Legal versus functional definition
- The legal definition of a bank is an organization that makes loans, has FDIC-insured deposits, and has been granted banking powers either by the state or the federal government.
- Other types of financial institutions offer the same or similar services but are not subjected to the same regulations as banks.
- Credit unions accept deposits and make loans. Their deposits are not insured by FDIC.
- Similarly, finance companies make loans and money market mutual funds are deposit substitutes.

What purpose do banks serve?
- Banks are financial intermediaries.
- They facilitate the transfer of funds from savers to borrowers.
- Banks are the principal source of credit for millions of individuals, businesses, and government units.
- Banks are major suppliers of credit and debit cards and provide the backbone of the payment system.

What challenges do banks face?
- Competition: credit unions, finance companies, money market mutual funds, insurance companies
- Technology: internet-only banks, online banking, “teller-less society”
- Global Environment: customers increasingly access credit through global markets
- Consolidation: approximately 14,000 banks in 1980; approximately 8,000 banks in 2002

Financial Markets and Institutions
- The primary purpose of the financial system is to encourage individuals and institutions to save and to efficiently transfer those savings to those entities wishing to invest in new projects, products, and services.
- The result is economic growth.

Rules Have Changed
- Financial Services Modernization Act of 1999
- Allows banks to enter the securities and insurance industries and permits nonbank holding companies to acquire and control banks.
- The changes were necessary to help “level the playing field” for banks in their competition with other financial services participants.
### The Different Kinds of Banks Today

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<thead>
<tr>
<th>Type of Bank</th>
<th>Description</th>
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<td>Commercial Banks</td>
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<td>Cooperative Banks</td>
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<td>Community Banks</td>
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<td>Investment Banks</td>
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<td>International Banks</td>
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<td>Member Banks</td>
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<td>Fringe Banks</td>
<td>Universal Banks</td>
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### The Financial Service Competitors of Banks

<table>
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<th>Type of Service</th>
<th>Description</th>
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<td>Money Market Funds</td>
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<td>Mutual Funds (Investment Companies)</td>
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<td>Hedge Funds</td>
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<td>Security Brokers and Dealers</td>
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<td>Finance Companies</td>
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<td>Financial Holding Companies or Conglomerates</td>
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<td>Life and Property-Casualty Insurance Companies</td>
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### Traditional Services Offered By Banks

- Exchange of Currency
- Commercial Notes and Loans
- Offering Savings Deposits
- Safekeeping of Valuables
- Supporting Government Activities with Credit
- Checking Accounts
- Trust Services

### Recent Services of Banks

- Consumer Loans (individuals)
- Financial Advice (consulting, taxes, etc.)
- Cash Management (collections and disbursements)
- Equipment Leasing (lender buys then leases)
- Venture Capital Loans (often separate entity)
- Selling Insurance Products
- Security Underwriting and Brokerage Services
- Mutual Funds and Annuities
- Merchant Banking Services (temporary stockholder)

### The Roles of Commercial Banks and Their Closest Competitors

- Intermediation Role (transfer of funds)
- Payment Role (check clearing)
- Guarantor Role (letters of credit)
- Risk Management Role (financial risk control)
- Savings/Investment Advisor Role
- Safekeeping/Certification of Value Role
- Agency Role (trust department)
- Policy Role (conduit for government policy)

### Trends Affecting Banks and Other Financial Service Firms Today

- Service Proliferation
- Rising Competition
- Government Deregulation
- Increased Interest Rate Sensitivity
- Technological Change
- Consolidation and Geographic Expansion
- E-Banking and E-Commerce
- Convergence
- Globalization
- Increased Risk of Poor Performance and Failure