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BANKING SYSTEM: HOW BANKING WORKS, TYPES OF BANKING AND HOW TO CHOOSE THE BEST BANK FOR YOU

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ABSTRACT

This paper analyzes the relationship between banks' divergent strategies toward specialization and diversification of financial activities and their ability to withstand a banking sector crash. We first generate market-based measures of banks' systemic risk exposures using extreme value analysis. Systemic banking risk is measured as the tail beta, which equals the probability of a sharp decline in a bank's stock price conditional on a crash in a banking index. Subsequently, the impact of (the correlation between) interest income and the components of non-interest income on this risk measure is assessed. The heterogeneity in extreme bank risk is attributed to differences in the scope of non-traditional banking activities: non-interest generating activities increase banks' tail beta. In addition, smaller banks and better-capitalized banks are better able to withstand extremely adverse conditions. These relationships are stronger during turbulent times compared to normal economic conditions. Overall, diversifying financial activities under one umbrella institution does not improve banking system stability, which may explain why financial conglomerates trade at a discount.

A bank is a financial institution that is licensed to accept checking and savings deposits and make loans. Banks also provide related services such as individual retirement accounts (IRAs), certificates of deposit (CDs), currency exchange, and safe deposit boxes.

There are several types of banks including retail banks, commercial or corporate banks, and investment banks.

The bank is responsible for its own activity and nature to obtain economic and financial resources through a multitude of instruments created for such purposes, such as bonds, deposits, or obligations.

Alternatively, this system of entities is responsible for facilitating the access of its clients to these resources through banking tools such as loans and mortgages, in exchange for interest or commissions previously agreed upon in each operation.

In that sense, at a basic level of study, it can be defined that the interest collected is the profit of the bank, which at the same time faces a series of costs derived from the interests that in turn this one pays to its own creditors. The difference between both variables is known as the profit or margin of a bank, to give a simple example.

The evolution of the concept of banking has been developing throughout history, being present its nature in the different civilizations from ancient Egypt especially. However, the emergence of currency as a means of payment was the rapid evolution of the banking business, which reached its formal establishment in the modern age and the Renaissance.

The set of existing banks in the economic system conforms to the banking or banking system. Having said all this, there are different types of banks attending to the sector to which this entity is directed and the size of its action. Below are five different types of banking systems, which are commonly used nowadays in all over the world.

Private banking is a highly professionalized and global management of a client's assets. It seeks to meet the investment, wealth, financial and tax planning needs of individuals or family groups with high equity. Private banking is therefore dedicated to financial advisory and asset management.

For this, many variables are taken into account, for which it is essential to make a good profile of the client:

Risk profile.

Objectives of profitability.

Liquidity needs.

Temporal horizon.

Fiscal situation.

For a private banking service to be as such there must be a bank-client relationship that stands out for offering a personalized service. It is necessary to distinguish between customer banking and product banking:

Customer Banking: focuses on making profitable the relationship with the customer, seeing it as a whole and not as a sum of products and services.

Product Banking: The placement of products is not based on the client, but on the commercial campaigns, not taking into account the personalized service.

There are several ways to structure a Private Banking service: American style (private banking from investment banking), more focused on the corporate client from wholesale banking, and the Swiss-Spanish style**:** Private Banking plus patrimonialism, overturned in that A high-quality client who seeks above all quality of life and control over his assets, which he wants to keep away from taxes, inflation, investment costs, and invests in conservative products.

Main Features of Private Banking

It satisfies the global needs of the client's heritage through:

Patrimonial, financial and fiscal planning.

Intergenerational orientation.

Individualized management.

The best and most complete range of products and services.

Based on a strong interpersonal relationship with the client.

Main Private Banking Services

The range of services in private banking is very varied:

Family office services.

Investment in real estate assets.

Availability of a wide range of mutual funds.

SICAV and structured products.

Management of movable and non-movable assets.

Tax optimization of the estate.

Whenever a large number of entities or corporations join together and make up a system is known as the banking system. They carry out their specific job of raising funds and lending resources in the economic and financial markets.

The main purpose and explanation of the existence of this sector is the need for certain organizations to be in charge of carrying out financial inter-mediation operations. In this way, it is possible that the money moves from one place to another adjusting to certain risks and deadlines that mark the financial reality.

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Banks have existed since at least the 14th century. They provide a safe place for consumers and business owners to stow their cash and a source of loans for personal purchases and business ventures. In turn, the banks use the cash that is deposited to make loans and collect interest on them.

The basic business plan hasn't changed much since the Medici family started dabbling in banking during the Renaissance, but the range of products that banks offer has grown.

Banks offer various ways to stash your cash and various ways to borrow money.

Checking accounts are deposits used by consumers and businesses to pay their bills and make cash withdrawals. They pay little or no interest and typically come with monthly fees, usage fees, or both.

Today's consumers generally have their paychecks and any other regular payments automatically deposited in one of these accounts.

Savings accounts pay interest to the depositor. Depending on how long account holders hope to keep their money in the bank, they can open a regular savings account that pays a little interest or a certificate of deposit (CD) that pays a little more interest. The CDs can earn interest for as little as a few months or as long as five years or more.

Banks make loans to consumers and businesses. The cash that is deposited by their customers is lent out to other customers at a higher rate of interest than the depositor is paid.

At the highest level, this is the process that keeps the economy humming. People deposit their money in banks; the bank lends the money out in car loans, credit cards, mortgages, and business loans. The loan recipients spend the money they borrow, the bank earns interest on the loans, and the process keeps money moving through the system.

Just like any other business, the goal of a bank is to earn a profit for its owners. For most banks, the owners are their shareholders. Banks do this by charging more interest on the loans and other debt they issue to borrowers than they pay to people who use their savings vehicles.

For example, a bank may pay 1% interest on savings accounts and charge 6% interest for its mortgage loans, earning a gross profit of 5% for its owners.

Most banks can be categorized as retail, commercial or corporate, or investment banks. The big global banks often operate separate arms for each of these categories.

Retail banks offer their services to the general public and usually have branch offices as well as main offices for the convenience of their customers.

They provide a range of services such as checking and savings accounts, loan and mortgage services, financing for automobiles, and short-term loans such as overdraft protection. Many also offer credit cards.

They also offer access to investments in CDs, mutual funds, and individual retirement accounts (IRAs). The larger retail banks also cater to high-net-worth individuals with specialty services such as private banking and wealth management services.

Commercial or corporate banks tailor their services to business clients, from small business owners to large, corporate entities. Along with day-to-day business banking, these banks also offer credit services, cash management, commercial real estate services, employer services, and trade finance,

JPMorgan Chase and Bank of America are examples of commercial banks, though both have large retail banking divisions as well.

Investment banks focus on providing corporate clients with complex services and financial transactions such as underwriting and assisting with merger and acquisition (M&A) activity. They are primarily financial intermediaries in these transactions.

Their clients include large corporations, other financial institutions, pension funds, governments, and hedge funds.

Unlike the banks above, central banks does not deal directly with the public. A central bank is an independent institution authorized by a government to oversee the nation's money supply and its monetary policy.

As such, central banks are responsible for the stability of the currency and of the economic system as a whole. They also have a role in regulating the capital and reserve requirements of the nation's banks.

The U.S. Federal Reserve Bank is the central bank of the U.S. The European Central Bank, the Bank of England, the Bank of Japan, the Swiss National Bank, and the People’s Bank of China are among its counterparts in other nations.

Credit unions offer banking services but, unlike banks, they are not-for-profit institutions created for and managed by their members or customers. Credit unions provide routine banking services to their clients, who are generally called members.

Credit unions are created, owned, and operated by their clients, and are generally tax-exempt. Members purchase shares in the co-op, and that money is pooled together to fund the credit union's loans.

Moreover, it insures your money. The insurance maximum is $250,000 per depositor, per insured bank, for each account ownership category.

You don't have to purchase this insurance. If you open a deposit in an FDIC-insured bank, you are automatically covered.

The mission of the Securities Investor Protection Corporation (SIPC) is to recover cash and securities in the event a member brokerage firm fails. SIPC is a nonprofit corporation that Congress created in 1970. SIPC protects the customers of all registered brokerage firms in the U.S. This applies to stocks and bonds (securities) and cash that a brokerage firm holds. Brokerage firms rarely fail or close suddenly, but if this occurs, the SIPC helps close the firm through liquidation and establishes claims processes by which it can protect the investor. SIPC protects your account for up to $500,000 in securities. This includes a limit of $250,000 in cash in your account. This link will show you a list of all registered SIPC members.

You should consider whether you want to keep both business and personal accounts at the same bank, or whether you want them at separate banks. A retail bank, which has basic banking services for customers, is the most appropriate for everyday banking. You can choose a traditional bank, which has a physical building, or an online bank if you don't want or need to physically visit a bank branch. You might consider a credit union, which is a nonprofit institution and is available to serve the needs of people with a common employer, labor union, or professional interest.

Otherwise, you might find that a smaller bank would offer more personalized customer service and the products you prefer. A community bank, for example, takes deposits and lends locally, which could offer a more personalized banking relationship.

Choose a convenient location if you are choosing a bank with a brick-and-mortar location. If you have a financial emergency, you don't want to have to travel a long distance to get cash.

See if the bank you are choosing offers other services such as credit cards, loans, and safe deposit boxes. Some banks also offer smartphone apps, which can be useful.

Check the fees associated with the accounts you want to open. Banks charge interest on loans as well as monthly maintenance fees, overdraft fees, and wire transfer fees. Some large banks are moving to end overdraft fees in 2022, so that could be an important consideration.

At the very least, a bank is where you stash your cash until you use it to pay the bills or withdraw money. It can also be the place where you get a loan to buy a car or a mortgage to buy a house. If you're running a small business, it may be where you go to borrow money to expand or improve.

Before choosing a bank, you should make a comparison of the various fees and charges that come with your accounts or any loans you might need. A bit of research and comparison will ensure you find the right fit for safeguarding your money, establishing credit, making payments, applying for loans, receiving funds, and saving money for future needs such as retirement, emergencies, and homebuying.

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