Damietta University
Faculty of Commerce
English Program

جامعة دمياط
Damietta University

Financial Institutions, Markets, and Money

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Commercial Bank Operations

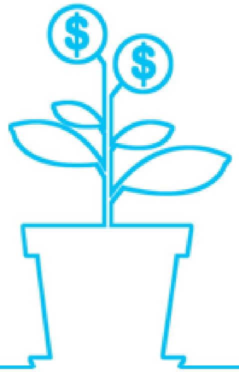
(Part One)

Note That:

- Commercial banks are among the most important types of financial institutions because of their size and role in indirect financial markets.

- Banks and other financial institutions are often called financial intermediaries because they buy financial claims (e.g., mortgages and automobile loans) with one set of characteristics and sell financial claims (e.g., checking account and certificates of deposit) with a different set of characteristics.

- Although, the number of banks has declined significantly as the industry has consolidated, the number of branches has increased dramatically.



Balance Sheet for a Commercial Bank

Left Side		Right Side
Assets (Use of Funds)	=	Liabilities + Capital (Source of Funds)
Cash Assets **Bank Investments** **Bank Loans** **Leasing Financing** **Other Assets**	VS	**Transaction Accounts (جاري)** • Demand Deposits • NOW Accounts **Savings Deposits (ادخار)** **Time Deposits (لأجل)** • Certificates of Deposit • Negotiable Certificates of Deposit **Borrowed Funds** **Capital Notes and Bonds** **Capital Accounts**

Notice that:

- The principal source of funds for most banks is deposit accounts.
- Bank loans and leases are the primary business activity of a commercial bank.

Right Side: Source of Funds

Transaction Accounts

(1) Demand Deposits

Checking accounts in which the owner is entitled to receive his or her funds on demand and to write checks on the account, which transfers legal ownership of funds to others.

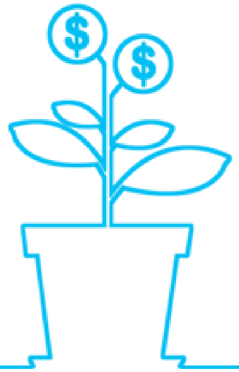
Available for individuals, government entities, and business organizations.

Held for transactional purposes.

Generally, do not pay any interest to the holder.

(2) Negotiable order of withdrawal (NOW) accounts

NOW accounts are just demand deposits that pay interest.



Savings Deposits

The traditional form of savings held by most individuals and nonprofit organizations.
There are two types of savings accounts are

<u>(1) Savings Accounts</u>
The passbook is the standard symbol of savings accounts.

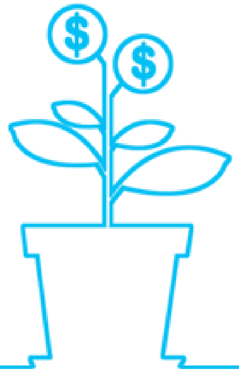
<u>(2) Money market deposit accounts</u>
Allow public to earn the rate of interest and offer limited check-writing ability.
They able to offer higher yields than traditional savings accounts

Time Deposits

The largest source of funds for banks.
Unlike demand deposits, time deposits are not available until their maturity date, and the funds cannot be transferred to another party by a written check.

(1) Certificates of Deposit.
CDs are bank liabilities issued in a designated amount, specifying a fixed rate of interest and maturity date.
They are an important source of funds for small, consumer-oriented banks.
The interest rate is generally higher than on savings accounts.
Usually under 100.000$
Terms of 30 days to 5 years.

(2) Negotiable Certificates of Deposit.
Referred to as jumbo CDs.
They have a fixed maturity date, pay an explicit rate of interest, and are negotiable if they meet certain legal specifications.
Issued by large, well-known commercial banks of the highest credit standing.



Borrowed Funds

Borrowed funds are typically short-term borrowings by commercial banks from the wholesale money markets or a Federal Reserve.

<u>(1) Federal Funds.</u>

The buying (borrowing) and selling (lending) of reserves on deposit at the Federal Reserve banks is called trading in federal funds (fed funds).

Most important non-deposit source of funds.

Trading units tend to be very large, generally $1 million or more.

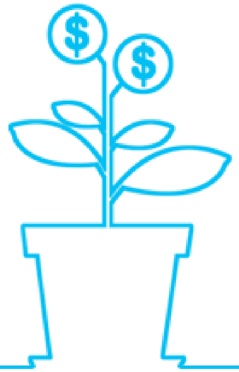
Banks buy and sell Fed Funds to adjust Liquidity.

Usual maturity 24 hours “overnight”.

<u>(2) Repurchase Agreements.</u>

Bank sells securities (usually T-Bills) to the lender but simultaneously contracts to repurchase the same securities either on call or on a specified date.

usually “overnight” but can last longer.



Capital Notes and Bonds

Issuing short-term capital notes or longer-term bond to raise funds.

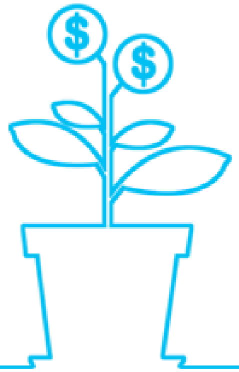
Capital Accounts

Bank capital represents the equity or ownership funds of a bank.
The greater the proportion of capital to total funds, the greater the protection to depositors and creditors.
Banks maintain much lower capital levels than other businesses, and currently bank capital accounts for 11 percent of total bank funds.

<u>(1) Capital Stock:</u> Direct investments of common or preferred equity

<u>(2) Undivided Profits (retained earnings):</u> Accumulated earnings not paid out in dividends.

<u>(3) Special Reserve Accounts:</u> are set up to cover anticipated losses on loans and investments.



Thank you