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OVERDRAFT CREDIT: ITS HISTORY, FEATURES, TYPES, PROS AND CONS

Abstract

The asset operation of the bank is one of its primary functions. Banks fulfill their role as creditors by allocating the money they raise to charitable organizations and individuals in need. A relationship between a creditor and a debtor, in which money is put to use for a certain period of time on the condition of return and payment, is known as a credit transaction. One of the credit transaction products offered by banks world is overdraft loans, which have unique features.

People tend to overuse things, especially when it comes to money. We occasionally overspend beyond what is available in the account we have. However, the transaction in question is completed. This means overdraft in the financial world. The meaning of an overdraft has evolved over time, but the basic concepts remain the same. An overdraft occurs when a person doesn't have enough money to complete a transaction, but the bank nevertheless permits them to do so. When an account holder may make a transaction even though their account balance is zero, it is the standard definition of an overdraft. Taking out an overdraft loan is a better option than applying for a longer-term loan because it needs less paperwork. This is especially true for urgent situations when applying for a loan.

Keywords: *history of overdraft, characterization of the overdraft, short term lending, overdraft fee, pros and cons of overdraft*

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Overdraft krediti: tarixi, xüsusiyyətləri, növləri, müsbət və mənfi cəhətləri

Xülasə

Bankın aktiv əməliyyatları onun əsas funksiyalarından biridir. Banklar topladıqları pulları xeyriyyə təşkilatlarına və ehtiyacı olan şəxslərə ayırmaqla kreditor rolunu yerinə yetirirlər. Kreditorla borclu arasında pulun qaytarılması və ödənilməsi şərti ilə müəyyən müddətə istifadəyə verildiyi münasibət kredit əməliyyatı adlanır. Bankların təklif etdiyi kredit əməliyyatı məhsullarından biri də özünəməxsus xüsusiyyətlərə malik olan overdraft kreditləridir.

İnsanlar, xüsusən də pula gəldikdə, hər şeydən çox istifadə edirlər. Biz bəzən hesabda mövcud olandan artıq xərcləyirik. Bununla belə, sözügedən əməliyyat tamamlanır. Bu, maliyyə dünyasında overdraft mənasına gəlir. Overdraftın mənası illər ərzində dəyişsə də, əsas mahiyyət hələ də eynidir. Bir şəxsin əməliyyat üçün adekvat pulu olmadıqda, lakin hər halda bank onlara bunu etməyə icazə verərsə, bu, overdraft kimi tanınır. Hesab sahibinin hesab balansının sıfır olmasına baxmayaraq əməliyyatı icra edə bilməsi overdraftın standart tərifidir. Overdraft krediti digər uzunmüddətli əsaslı kreditlərə nisbətən daha az sənədləşmə işləri tələb edir, ona görə də xüsusilə təcili olduqda təsdiqlənməsi üçün daha çox vaxt aparan kreditə üstünlük verməkdənsə, overdraft krediti götürmək yaxşı fikirdir.

Açar sözlər: *overdraftın tarixi, overdraftın xarakteristikası, qısamüddətli kreditləşmə, overdraft haqqı, overdraftın müsbət və mənfi tərəfləri*

Introduction

Credit is a Latin phrase - greditam-gredere, it means to trust or believe. Credit is a form of payment that will be paid in the future and is based on trust (Məmmədov, İbrahimov, 2009: 24-25). The concept of credit agreement is defined in Article 743 of the Civil Code of the Republic of Azerbaijan. According to the credit agreement, the lender undertakes to give ownership rights to the funds to the borrower in the amount and under the conditions specified in the agreement, and the borrower undertakes to return the received funds to the lender for the period specified in the agreement, subject to the payment of interest and (or) other payments specified in the agreement. A creditor under a credit agreement can only be a person who has the right to grant loans in accordance with normative legal acts (Azərbaycan Respublikasının Mülki Məcəlləsi, maddə 743.1).

Article 1.0.9 of the Law of the Republic of Azerbaijan on Banks defines the concept of bank credit. Bank loan (hereinafter – loan) – cash funds, issued as a debt in a certain amount with or without a guarantee, subject to reimbursement at a predetermined date (with the right of prolongation of the term) and payment of interest and/or other payments specified in the agreement. The term loan also includes any undertaken commitment, guarantee, warranty on repayment of funds under conditions herein, purchase of debt securities through either a discount or interests purchase and another right, related to requirement on repayment of fund issued in any form under the agreement (“Banklar haqqında” Azərbaycan Respublikasının Qanunu, maddə 1.0.9).

Credit agreements differ from each other due to a number of characteristic features such as being targeted, secured, unsecured, due to the term, etc. Depending on the form of use, there are types of credit such as production credit, consumer credit and investment credit. Consumer credit – is used to provide goods that are consumers' reserves, that is, it gives consumers purchasing power. Consumer loans are loans granted to individuals for meeting their consumer needs, not for commercial purposes. This type of loan is not directed to the creation of new value by the population, but to the satisfaction of the borrower's consumption requirements. Through this loan, citizens' demand for expensive, long-term consumer goods is satisfied until their value is fully paid (Məmməd, 2015: 264).

Overdrafts are a type of short-term consumer credit and it's imperative to keep in mind that they're repayable “on demand”. This implies that the bank can inquire for the money back in full, at any time.

History of overdraft. The overdraft loan originated in the 18th century when merchant William Hog faced financial difficulties due to unreliable client payments. He sought a solution from the Royal Bank of Scotland, allowing him to temporarily fall into the red to pay his creditors. This led to a significant change in the banking industry, allowing for more flexible payment options (5).

When a transaction or withdrawal is authorized by the bank even if there isn't enough money in the account to support it, this is known as an overdraft. In essence, it's a credit extension given by almost all financial organizations, particularly banks and NBFCs (Non-Banking Financial Company) upon the closing of an account. An overdraft is essentially a loan that the bank permits its clients to take out up to a certain amount of money. The loan has interest attached to it, and each overdraft incurs fees.

Overdraft fee. When you use a check or debit card to spend more money than you have in your checking account, a bank or credit union may charge you an overdraft fee. Overdraft costs can also be triggered by automatic payments to credit cards, utilities, or other organizations. Like normal account maintenance fees, this fee will be routinely deducted by your bank from your checking account. An overdraft fee is not incurred for every excess. Only when the bank or credit union really covers the expense that puts you overdraft will you be charged an overdraft fee. Overdrafts on any or all of their checking accounts are prohibited by certain institutions. Rather, they charge you a "non-sufficient funds" (NSF) fee and decline to pay the charge you want to make. NSF costs can be quite problematic and may end up costing you more than overdraft fees, but they are often about the same as the overdraft fee assessed by the bank (6).

The "cash credit" facility and an overdraft facility are essentially the same. An arrangement with the bank that permits a current account holder to make withdrawals over and beyond the credit

balance in their account is known as an overdraft facility. Current account holders who manage their account with checks are eligible for this option. The customer may take out the maximum amount of overdraft as needed, and can refund the amount by making payments into the account whenever it's convenient for them. A bank would often issue an overdraft facility based on a written request from the customer. In order to guarantee the security of the money that the customer withdraws, the bank may occasionally also demand either a promissory note from the borrower or personal security. Overdraft interest rates are more than loan interest rates (Banking law and practices. 2014: 155.)

The two general types of bank account overdrafts are authorized and unauthorized overdrafts.

Authorized overdraft. The agreement between the account holder and their bank is formed well in advance when there is an approved overdraft. Both parties agree on a borrowing limit that is applicable to all standard payment methods. Naturally, there is a service charge associated with the arrangement, which differs from bank to bank. Typically, there is a daily, weekly, or monthly fee in addition to interest. An overdraft arrangement can be quite costly, especially if the borrowed amount is little, given the occasionally extremely high costs. Account holders should therefore use extreme caution to prevent overdrafts, even those that are allowed (8).

Unauthorized overdraft. As the name suggests, this indicates that the account holder has spent more than the amount that is still available in his account and that the overdraft was not prearranged. Even in cases when a prior agreement has been made, unauthorized overdrafts may still occur if the account holder exceeds the predetermined overdraft limit. Overdrafts from unapproved bank accounts are more costly since they come with higher costs (8).

Both types of overdrafts have related charges, including interest, which is determined by your account and can be viewed upon application. In banking practice, there are special types of overdraft such as Overdraft against Salary, Overdraft against Savings Account, Overdraft against Fixed Deposits, Overdraft against Insurance Policies (9).

Before taking an overdraft loan, there are a number of characteristics that we should know about it. Any bank account, current or savings, can have an overdraft account facility. An individual's overdraft interest rate is determined by their account value, credit score, and bank payment history. Essentially, an overdraft is a loan that has been sanctioned, with interest only being charged by the bank on the amount that has been used. The overdraft account is fully controlled by the bank, which also determines the repayment period. Consumers can choose to pay off their overdraft loan over time rather than having to pay it back in EMIs (equal monthly installments). Overdraft loans are available to joint borrowers, and repayment of the loan is the joint responsibility of both parties.

Pros of overdraft. Having an overdraft offers several advantages, such as the capacity to pay for unforeseen costs and the comfort that comes with knowing you have a safety net in place. Additionally, overdrafts are typically far less expensive than other lending options like payday loans or credit cards. But it's crucial to keep in mind that overdrafts are a type of debt, so you should use them responsibly and pay them back as soon as you can. An overdraft may be a useful tool if used properly, but it's crucial to know the dangers before taking out a loan. Refunds are flexible. You can change your overdraft amount (to increase or decrease) or cancel it at any time. There is no set period for repayment; you can return the money you borrowed whenever you like. As needed, you can take money out of and back into your overdraft (10).

Cons of overdraft. In most cases, there is an arrangement cost associated with having to prolong your overdraft. In the event that you exceed your overdraft limit without permission, your bank may charge you. While it is unlikely to occur until you get into financial difficulties, the bank is entitled to demand repayment of your overdraft amount at any moment. Assets owned by the company may be used to secure overdrafts. An overdraft is only available from the bank where you currently have an account, unlike loans. It is necessary to transfer your company bank account in order to obtain an overdraft elsewhere. The interest rate is almost constantly fluctuating, it might be challenging to determine your exact borrowing costs. The banks have the right to quickly lower unused overdraft limits, however this is unlikely to happen unless you run into financial trouble (11).

Applying for an overdraft loan. As is common knowledge, taking out an instant overdraft is equivalent to taking out a loan from a bank or NBFC. Certain clients are granted pre-approval by the lender to utilize an overdraft facility, while others require authorization. The pre-entitled clients' account balance becomes negative, and the overdraft facility is immediately enabled when they take out additional cash. Customers who want to use the temporary overdraft facility but need the lender's consent must do so in writing or online via the official lender's website. An unsecured overdraft is one that is taken out against a bank account without any security being submitted; a secured overdraft is one that requires collateral to be pledged (12).

Banks offer salary overdraft services, requiring a salary account and regular pay credit. Borrowers don't need security, but overdraft limits are more than account holder's salary (13).

Conclusion

A facility that permits a bank to take out more money than the credit balance in a customer's current account while the account is being maintained is known as an “overdraft" facility. Additionally, consumers may request temporary overdrafts. Nonetheless, regular overdraft limitations are approved against specific securities. The following are key characteristics of this kind of account:

- All guidelines that apply to current accounts also apply, mutatis mutandis, to overdraft accounts.
- Since an overdraft is a running account, debits and credits are permitted without restriction.
- Interest is charged daily based on the product and is deducted from the account once a month. Interest should be added to a temporary overdraft as soon as it is adjusted or at the end of the month, whichever comes first.
- Generally speaking, overdraft can be provided to customers both unsecured and secured.
- An overdraft occurs when a bank allows a current account holder to take out more money than what is available on his account. The banker may request collateral security or may advance funds based only on the borrower's personal security. The client may take the money out whenever he wants it and return it by depositing it into his account whenever it is practical for him to do so. Interest is assessed for the duration of the loan's real use and on the precise amount that the customer overdraws.

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