

Week 3 - Financial Intermediaries

What is financial intermediary?

It brings together providers and users of finance, either as Broker (an agent handling a transaction on behalf of others) or as principal (holding money balances of lenders for lending to borrowers).



The importance of financial intermediation is that it is easier for savings to be loaned to borrowers through an intermediary than directly.

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What is financial intermediary?

There is a set of specialized, highly efficient financial intermediaries that has evolved. The situation is changing rapidly. In US, they are as below:



(1) **Commercial Banks**

In the past, commercial banks were the major institutions that handled checking accounts and through central bank system expanded or contracted the money supply. Now, commercial banks are providing an ever-widening range of services including stock brokerage services and insurance.

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What is financial intermediary? (cont'd)

(2) **Savings and Loan Associations**

They serve individual savers and residential and commercial mortgage borrowers, take the funds of many small savers and then lend this money to home buyers and other types of borrowers.

(3) **Mutual Savings Bank**

It accepts savings from individual savers and lends mainly on a long term basis to home buyers and consumers.

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What is financial intermediary? (cont'd)

(4) **Credit Unions**

They are co-operative associations whose members are supposed to have a common bond such as being employees of the same firm. Its members' savings are loaned to other members.

(5) **Pension Funds**

They are retirement plans funded by corporations or government agencies for their workers and administered primarily by the trust - commercial bank, life insurance. They invest primarily on bonds, stocks, mortgages and real estates.

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What is financial intermediary? (cont'd)

(6) **Life Insurance Company**

It take savings in the form of premiums and invest these funds in stocks, bonds, real estates and mortgages. It makes payment to the beneficiary of the insured parties. Now, they also offer a variety of tax deferred savings plan designed to provide benefits to the participants when they retire.

(7) **Mutual Funds/ Unit Trusts**

They are corporations that accept money from savers and then use these funds to buy stocks, long term bonds, short

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What is financial intermediary? (cont'd)

term debt instruments issued by businesses or government units. They pool funds and thus reduce risk by diversification. They have to do some analyses of securities and manage portfolios to meet the objectives of different savers.

The individual savers' money will be used and invested in the equity and debts market. They will distribute the returns in the form of dividends.