Lecture 23 will cover the following transparencies and Table 1 of the textbook.
# Financial Assets of Some U.S. Financial Institutions, 3/31/2005

<table>
<thead>
<tr>
<th>Institution</th>
<th>Trillions of Dollars</th>
</tr>
</thead>
<tbody>
<tr>
<td>Life Insurance Companies</td>
<td>4.1</td>
</tr>
<tr>
<td>Other Insurance Companies</td>
<td>1.2</td>
</tr>
<tr>
<td>Private Pension Funds</td>
<td>4.5</td>
</tr>
<tr>
<td>Government Retirement Funds</td>
<td>3.1</td>
</tr>
<tr>
<td>Mutual Funds</td>
<td>7.3</td>
</tr>
<tr>
<td>Finance Companies</td>
<td>1.5</td>
</tr>
<tr>
<td>Security Brokers and Dealers</td>
<td>1.8</td>
</tr>
</tbody>
</table>

**Source:** Flow of Funds Accounts
#### Table 1 Relative Shares of Total Financial Intermediary Assets, 1960–2002 (percent)

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td><strong>Insurance Companies</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Life insurance</td>
<td>19.6</td>
<td>15.3</td>
<td>11.5</td>
<td>12.5</td>
<td>13.6</td>
</tr>
<tr>
<td>Property and casualty</td>
<td>4.4</td>
<td>3.8</td>
<td>4.5</td>
<td>4.9</td>
<td>3.7</td>
</tr>
<tr>
<td><strong>Pension Funds</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private</td>
<td>6.4</td>
<td>8.4</td>
<td>12.5</td>
<td>14.9</td>
<td>14.7</td>
</tr>
<tr>
<td>Public (state and local government)</td>
<td>3.3</td>
<td>4.6</td>
<td>4.9</td>
<td>6.7</td>
<td>7.9</td>
</tr>
<tr>
<td><strong>Finance Companies</strong></td>
<td>4.7</td>
<td>4.9</td>
<td>5.1</td>
<td>5.6</td>
<td>3.2</td>
</tr>
<tr>
<td><strong>Mutual Funds</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stock and bond</td>
<td>2.9</td>
<td>3.6</td>
<td>1.7</td>
<td>5.9</td>
<td>10.6</td>
</tr>
<tr>
<td>Money market</td>
<td>0.0</td>
<td>0.0</td>
<td>1.9</td>
<td>4.6</td>
<td>8.8</td>
</tr>
<tr>
<td><strong>Depository Institutions (Banks)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commercial banks</td>
<td>38.6</td>
<td>38.5</td>
<td>36.7</td>
<td>30.4</td>
<td>29.8</td>
</tr>
<tr>
<td>S&amp;L and mutual savings banks</td>
<td>19.0</td>
<td>19.4</td>
<td>19.6</td>
<td>12.5</td>
<td>5.6</td>
</tr>
<tr>
<td>Credit unions</td>
<td>1.1</td>
<td>1.4</td>
<td>1.6</td>
<td>2.0</td>
<td>2.3</td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: Federal Reserve Flow of Funds Accounts.
Non-bank Financial Institutions

- Their products and services
- How they operate
- How they are regulated
Insurance Companies

Life Insurance Companies
1. Regulated by states
2. Hold illiquid long-term assets
3. Poor returns caused insurance demand ↓
4. Became managers of pension funds
5. Increased competition from banks
Life-Health Insurance Industry
Distribution of Assets as of December 31, 2003

Source: Best’s Aggregates and Averages
Insurance Companies

Property & Casualty Insurance Companies

1. Regulated by states
2. Hold more liquid assets
3. Insurance crisis
Property-Casualty Insurance Industry
Distribution of Assets as of December 31, 2003

Source: Best’s Aggregates and Averages
Insurance Management

1. Screening
2. Risk-based premiums
3. Restrictive provisions
4. Prevention of fraud
5. Cancellation of insurance
6. Deductibles
7. Coinsurance
8. Limits on amounts of insurance
Pension Funds

1. Rapid growth: encouraged by tax policy
2. Bigger role in stock market
3. Problem of under funding
4. Private: regulated by Dept. of Labor and insured by Penny Benny under ERISA Act of 1974
5. Public Plans
   A. Social Security
   B. State and local plans
Private Pension Funds
Percentage of Pension Fund Assets in Defined Contribution Plans

Source: Flow of Funds Accounts
 Defined Contribution Pension Plans
 Distribution of Assets as of December 31, 2004

- Corporate equities: 36%
- Mutual fund shares: 36%
- Miscellaneous assets: 16%
- Cash and short-term investments: 5%
- Credit market instruments: 7%

Source: Flow of Funds Accounts
Ratio of U.S. Corporate Defined Benefit Pension Assets to Liabilities, 1987-2004

Source: Compustat
Defined Benefit Pension Plans
Distribution of Assets as of December 31, 2004

Corporate equities 40%
Credit market instruments 29%
Cash and short-term investments 9%
Miscellaneous assets 11%
Mutual fund shares 11%

Source: Flow of Funds Accounts
Finance Companies

**Basic role:** Provide financing for purchases by consumers and firms

**Types of Finance Companies**
- Business
- Consumer
- Sales (Captive)

**Operation**
- Borrow by issuing debt, often short-term debt
- Use funds to make loans, purchase receivables, or purchase (and lease) equipment
- Collect interest, receivables, or rental income
- Repay and “roll over” debt

**Assets** - loans, equipment    **Liabilities** - Debt

**Regulation**
- Little overall - an advantage of finance companies
- Some market conduct regulations in the consumer market
  - disclosure of terms, limits on interest rates and collection practices
Mutual Funds

**Basic Role**: Facilitate investment in securities markets

**Basic Types**
- Stock funds
- Money market funds
- Bond funds
- “Hybrid” funds

**Operation**
- Collect funds from investors
- Invest in securities
- Open-end funds redeem investor claims on demand

**Regulation**
- Investment Company Act of 1940
  - Disclosure requirements, behavioral restrictions
  - Gives SEC supervisory authority
Mutual Funds
Distribution of Assets by Type of Fund as of December 31, 2004

- Stock funds: 41%
- Bond funds: 18%
- Hybrid funds: 5%
- Money market funds: 36%

Source: 2005 Mutual Fund Fact Book
Investment Banks

**Basic roles:**
1) Help corporations raise funds through underwriting
   - public offerings
   - private placements
2) Provide advice on M&A, divestitures, and other transactions
3) Other activities

Securities Brokers and Dealers

**Basic roles:**
1) Help investors buy and sell securities
2) Other services - advice, margin loans, check-writing, etc.,
3) Dealers trade and make markets in securities

Regulation of Securities Firms

SEC administers securities laws. Laws required disclosure of information, prevent misuse of information ("insider trading"), and prohibit market manipulation. SIPC established in 1970 to protect investors from losses due to fraud or insolvencies.
Non-bank Financial Institutions: A Glimpse at the Future

Gramm-Leach-Bliley (1999) and the partial repeal of Glass-Steagall (1933)

• Benefits of consolidation
  - “one-stop shopping”: cross-selling opportunities
  - production efficiencies (e.g., underwriting)
  - diversification; economizing on capital

• Benefits of specialization
  - focus
  - regulatory advantages