Accounting for Financial Institutions

Lecture 1

Financial Institutions

• Include, among others:
  • Banks (Main concern)
  • Insurance Companies (Secondary Concern)
  • Brokerages
  • Investment companies and investment banks
  • Mutual Funds
  • Credit Unions
The Competitive Challenge for Banks

• Leading Competitors with Banks

• Among the leading competitors with banks in wrestling for the loyalty of financial-service customers are such nonbank financial-service institutions as:

• 1. Savings associations: Specialize in selling savings deposits and granting home mortgage loans and other forms of credit to individuals and families.

• 2. Credit unions: Collect deposits from and make loans to their members as nonprofit associations of individuals sharing a common bond (such as the same employer), Ex.: Chicago Post Office Employees Credit Union (www.my-creditunion.com).

3. Mutual funds (investment companies): Sell shares to the public representing an interest in a professionally managed pool of stocks, bonds, and other securities, including such financial firms as The Vanguard Group (www.vanguard.com).

4. Security brokers and dealers: Buy and sell securities on behalf of their customers and for their own accounts, such as Charles Schwab (www.Schwab.com).

5. Investment banks: Provide professional advice to corporations and governments raising funds in the financial marketplace or seeking to make business acquisitions, including such prominent investment banking houses as Morgan Stanley (www.morganstanley.com).

6. Financial holding companies: (FHCs) Often include credit card companies, insurance and finance companies, and security broker/dealer firms under one corporate umbrella as highly diversified financial-service providers, including such leading financial conglomerates as UBSWarburg AG (www.ubswarburg.com).

7. Life and property/casualty insurance companies: Protect against risks to persons or property and manage the pension plans of businesses and the retirement funds of individuals, including such industry leaders as Prudential Insurance (www.prudential.com).
Roles of Banks

The modern bank has had to adopt many roles to remain competitive and responsive to public needs. Banking’s principal roles (and the roles performed by many of its competitors) today include:

<table>
<thead>
<tr>
<th>Role</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>The intermediation role</td>
<td>Transforming savings received primarily from households into credit (loans) for business firms and others in order to make investments in new buildings, equipment, and other goods.</td>
</tr>
<tr>
<td>The payments role</td>
<td>Carrying out payments for goods and services on behalf of customers (such as by issuing and clearing checks and providing a conduit for electronic payments).</td>
</tr>
<tr>
<td>The guarantor role</td>
<td>Standing behind their customers to pay off customer debts when those customers are unable to pay (such as by issuing letters of credit).</td>
</tr>
<tr>
<td>The risk management role</td>
<td>Assisting customers in preparing financially for the risk of loss to property, persons, and financial assets.</td>
</tr>
<tr>
<td>The investment banking role</td>
<td>Assisting corporations and governments in marketing securities and raising new funds.</td>
</tr>
<tr>
<td>The savings/investment advisor role</td>
<td>Aiding customers in fulfilling their long-range goals for a better life by building and investing savings.</td>
</tr>
<tr>
<td>The safekeeping/certification of value role</td>
<td>Safeguarding a customer’s valuables and certifying their true value.</td>
</tr>
<tr>
<td>The agency role</td>
<td>Acting on behalf of customers to manage and protect their property.</td>
</tr>
<tr>
<td>The policy role</td>
<td>Serving as a conduit for government policy in attempting to regulate the growth of the economy and pursue social goals.</td>
</tr>
</tbody>
</table>

Services Banks Have Offered throughout History

- Carrying Out Currency Exchanges
- Discounting Commercial Notes
- Making Business Loans
- Offering Savings Deposits
- Safekeeping of Valuables and Certification of Value
- Supporting Government Activities with Credit
- Offering Checking Accounts (Demand Deposits)
- Offering Trust Services (such as insurance and trust companies)
Services Banks Have Offered More Recently:

• Granting Consumer Loans
• Financial Advising
• Managing Cash (a financial intermediary agrees to handle cash collections and disbursements for a business firm and to invest any temporary cash surpluses in interest-bearing assets until cash is needed to pay bills.)
• Offering Equipment Leasing
• Making Venture Capital Loans (financing the start-up costs of new companies)
• Selling Insurance Policies
• Selling Retirement Plans
• Offering Mutual Funds and Annuities
• Offering Risk Management and Hedging Services
• Offering Merchant Banking Services (These consist of the temporary purchase of corporate stock to aid the launching of a new business venture or to support the expansion of an existing company).

End of Lecture 1