

CHAPTER 12

Nonbank Finance

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

Property & Casualty Insurance Companies

1. Regulated by states
2. Hold more liquid assets
3. Insurance crisis

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

Market Share of Financial Intermediaries

Table 1 Relative Shares of Total Financial Intermediary Assets, 1960-2002 (percent)

	1960	1970	1980	1990	2002
Insurance Companies					
Life insurance	19.6	15.3	11.5	12.5	13.6
Property and casualty	4.4	3.8	4.5	4.9	3.7
Pension Funds					
Private	6.4	8.4	12.5	14.9	14.7
Public (state and local government)	3.3	4.6	4.9	6.7	7.9
Finance Companies	4.7	4.9	5.1	5.6	3.2
Mutual Funds					
Stock and bond	2.9	3.6	1.7	5.9	10.6
Money market	0.0	0.0	1.9	4.6	8.8
Depository Institutions (Banks)					
Commercial banks	38.6	38.5	36.7	30.4	29.8
S&I and mutual savings banks	19.0	19.4	19.6	12.5	5.6
Credit unions	1.1	1.4	1.6	2.0	2.3
Total	100.0	100.0	100.0	100.0	100.0

Source: Federal Reserve Flow of Funds Accounts.

Other Institutions

Pension Funds

1. Rapid growth: encouraged by tax policy
2. Bigger role in stock market
3. Problem of underfunding
4. Private: regulated by Dept. of Labor and insured by Pension Benefits Guaranty Act of 1974
5. Public Plans
 - A. Social Security
 - B. State and local plans

Finance Companies

1. Minimal regulation by states
2. Rapid growth
3. Three types:
 - A. Sales finance companies
 - B. Consumer finance companies
 - C. Business finance companies

Other Institutions

Mutual Funds

1. Regulated by SEC
2. Open-end vs. closed-end
3. Load vs. no-load
4. Money market mutual funds
5. Hedge funds

Government Financial Intermediation

1. Federal credit agencies:
FNMA, GNMA, FHLMC, Farm Credit System, SLMA
2. Moral hazard problem of government loan guarantees

Securities Market Institutions

1. Investment banks
2. Securities brokers and dealers
3. Organized exchanges
4. All are regulated by SEC
