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## Table of contents

[What is a Financial Intermediary?](#)[Functions of Financial Intermediaries](#)[Benefits of Financial Intermediaries](#)[Examples of Financial Intermediaries](#)[Additional Resources](#)

# Financial Intermediary

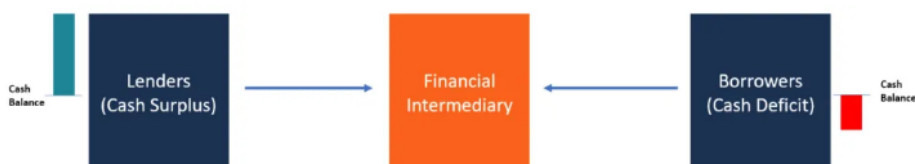
An institution that acts as a middleman between two parties to facilitate a financial transaction

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## What is a Financial Intermediary?

A financial intermediary refers to an institution that acts as a middleman between two parties in order to facilitate a financial transaction. The institutions that are commonly referred to as financial intermediaries include [commercial banks](#), investment banks, [mutual funds](#), and [pension funds](#). They reallocate uninvested capital to productive sectors of the economy through debts and equity.



In simple terms, financial intermediaries channel funds from individuals or [corporations](#) with surplus capital to other individuals or corporations that require cash to carry out certain economic activities.

## Functions of Financial Intermediaries

A financial intermediary performs the following functions:

### Asset storage

Commercial banks provide safe storage for both cash (notes and coins), as well as precious metals such as gold and silver. Depositors are issued deposit cards, deposit slips, checks, and credit cards that they can use to access their funds. The bank also provides depositors with records of withdrawals, deposits, and direct payments they have authorized. To ensure the depositors' funds are safe, the [Federal Deposit](#)

precious metals such as gold and silver. Depositors are issued deposit cards, deposit slips, checks, and credit cards that they can use to access their funds. The bank also provides depositors with records of withdrawals, deposits, and direct payments they have authorized. To ensure the depositors' funds are safe, the [Federal Deposit Insurance Corporation \(FDIC\)](#) requires deposit-taking financial intermediaries to insure the funds deposited with them.

### Providing loans

Advancing short-term and long-term loans is the core business of financial intermediaries. They channel funds from depositors with surplus cash to individuals who are looking to borrow money. Borrowers typically take out loans to purchase capital-intensive assets such as business premises, automobiles, and factory equipment.

Intermediaries advance the loans at interest, some of which they pay the depositors whose funds have been used. The remaining amount of interest is retained as profits. Borrowers undergo [screening](#) to determine their creditworthiness and their ability to repay the loan.

### Investments

Some financial intermediaries, such as mutual funds and investment banks, employ in-house investment specialists who help clients grow their investments. The firms leverage their industry experience and dozens of investment portfolios to find the right investments that maximize returns and reduce risk.

The types of investments range from stocks to real estate, Treasury bills, and financial derivatives. Sometimes, intermediaries invest their clients' funds and pay them an annual interest for a pre-agreed period of time. Apart from managing client funds, they also provide investment and financial advice to help them choose ideal investments.

## Benefits of Financial Intermediaries

Financial intermediaries offer the following advantages:

### Spreading risk

Financial intermediaries provide a platform where individuals with surplus cash can spread their risk by lending to several people rather than to only one individual. Lending to just one person comes with a higher level of risk. Depositing surplus funds with a financial intermediary allows institutions to lend to various screened borrowers. This reduces the risk of loss through default. The same risk reduction model applies to insurance companies. They collect premiums from clients and provide policy benefits if clients are affected by unforeseeable events like accidents, death, and disease.

### Economies of scale

Financial intermediaries enjoy [economies of scale](#) since they can take deposits from

death, and disease.

## Table of contents

What is a Financial  
Intermediary?

Functions of Financial  
Intermediaries

Benefits of Financial  
Intermediaries

Examples of Financial  
Intermediaries

Additional Resources

## Economies of scale

Financial intermediaries enjoy [economies of scale](#) since they can take deposits from a large number of customers and lend money to multiple borrowers. The practice helps to reduce the overall operating costs that they incur in their normal business routines. Unlike borrowing from individuals with inadequate funds to loan the requested amount, financial institutions can often access large amounts of liquid cash that they can loan to individuals with a strong credit rating.

## Economies of scope

Intermediaries often offer a range of specialized services to clients. This enables them to enhance their products to cater to the requirements of different types of clients. For example, when commercial banks are lending out money, they can customize the loan packages to suit small and large borrowers. Small and medium enterprises often make up the bulk of borrowers. Preparing packages that suit their needs can help banks grow their customer base.

Similarly, insurance companies enjoy [economies of scope](#) in offering insurance packages. It allows them to enhance their products and services to satisfy the needs of a specific category of customers such as people suffering from chronic illnesses or senior citizens.

## Examples of Financial Intermediaries

### Bank

A bank is a financial intermediary that is licensed to accept deposits from the public and create credit products for borrowers. Banks are highly regulated by governments, due to the role they play in economic stability. They are also subject to minimum capital requirements based on a set of international standards known as the Basel Accords.

### Credit union

A credit union is a type of bank that is member-owned. It operates on the principle of helping members access credit at competitive rates. Unlike banks, credit unions are established to serve their members and not necessarily for profit purposes. Credit unions claim to provide a wide variety of loan and saving products at a relatively lower price than other financial institutions offer. They are governed by a board of directors, who are elected by the members.

### Mutual funds

Mutual funds pool savings from individual investors. They are managed by fund managers who identify investments with the potential of earning a high rate of return and who allocate the shareholders' funds to the various investments. This enables individual investors to benefit from returns that they would not have earned had they invested independently.

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## Financial advisors

A financial advisor is an intermediary who provides financial services to clients. In most countries, financial advisors must undergo special training and obtain licenses before they can offer consultancy services. In the U.S., the Financial Industry Regulatory Authority provides the series 65 or 66 licenses for investment professionals, including financial advisors.

## Additional Resources

Thank you for reading CFI's explanation of a financial Intermediary. CFI is a leading provider of accounting, financial analysis, and modeling courses, including the [Financial Modeling & Valuation Analyst \(FMVA\)™](#) certification program. To help advance your career, check out the additional CFI resources below:

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