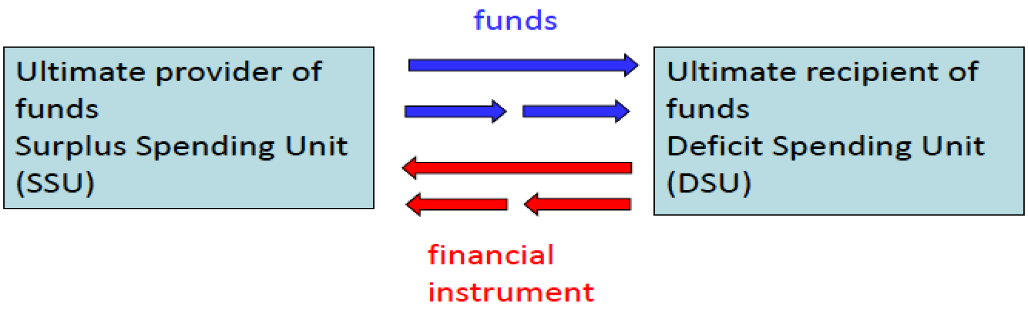
Lecture 1

1. Financial System

- Provides a payment mechanism
- Channels funds from ultimate lenders (SSU) to ultimate borrowers (DSU)

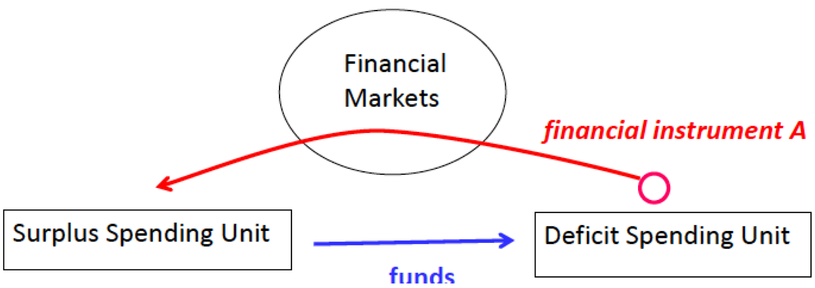


2. Deficit units and Surplus units

	Surplus Spending Unit (SSU)	Deficit Spending Unit (DSU)
	Ultimate provider of funds	Ultimate recipient of funds
	Gives funds generated by its income	Seeks funds in order to consume or make real investment
Return on funds	High as possible	Low as possible
Length of contract	Flexible and short	Inflexible and long
Risk exposure	Mainly risk averse	Risk taker
Amount of funds	Usually small	Usually large

3. Direct Finance

- One-step process
- Involving one single financial instrument to connect SSU and DSU
- SSUs hold a financial instrument issued by the DSUs (e.g. share)
- DSUs have a contractual link with the SSUs



- Direct finance in balance sheet

SSU

Asset	Liabilities/Equity
Bank deposits (funds): -	
Financial instrument A: +	

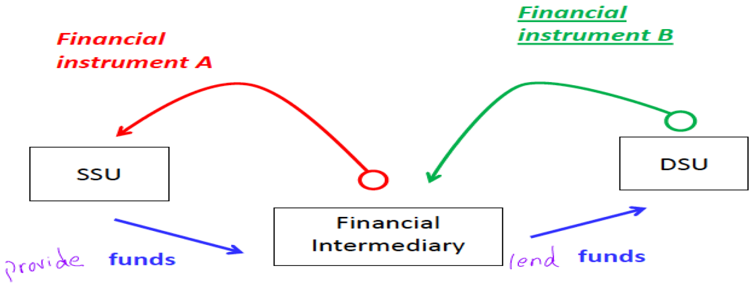
DSU

Bank deposits (funds): +	Financial instrument A: +

- Loan in direct finance
  - Can be made in Peer-to-Peer (P2P) platforms by non-licensed households or companies
- Corporate bonds in direct finance
  - Only can be part of direct finance if available in small value packages

4. Indirect Finance

- Intermediation
- Two-step process
- Two distinct financial instruments are involved in the channeling process
- Ultimate borrowers and ultimate lenders have no liability/asset with each other



- Indirect finance in balance sheet

SSU

Asset	Liabilities/Equity
Bank deposits (funds): -	
Financial instrument A: +	

DSU

Asset	Liabilities/Equity
Bank deposits (funds): +	financial instrument B: +

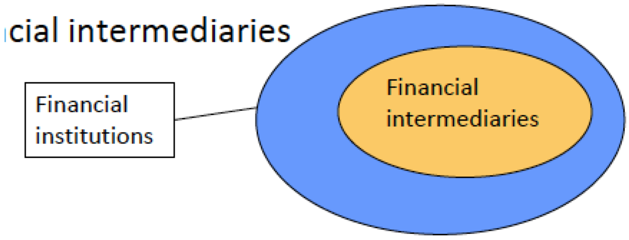
Financial Intermediary

Asset	Liabilities/Equity
Bank deposits (funds): +/-	financial instrument A: +
Financial instrument B: +	

- Intermediaries vs. Market Facilitators

Broker	Dealer
Marker facilitator (not a financial intermediary)	Intermediary
A third party simply helps an ultimate lender to buy an asset from another investor	A third party makes the transaction with each side
Is paid a commission fee	Is remunerated by the spread between the ask price and the bid price
Does not have any asset or liability in his/her balance sheet related to the transactions	Keeps a stock o that asset in the balance sheet only temporarily

- Financial intermediaries vs. Financial institutions



- Benefits of Financial Intermediation
  - Aggregation/demonization divisibility
    - Economies of scale
    - Credit risk diversification
  - Maturity transformation/liquidity
  - Currency transformation
  - Overcome informational asymmetries to reduce risks
    - Less adverse selection (as more expertise)
    - Less moral hazard
  - Cost less to look for information

5. Peer-To-Peer Lending

- Loans made investors who do not possess a financial service license or a credit license
- Matching borrowers/lenders is done through an online platform managed by a non-bank institution
- Personal loans: <$50,000
- Business loans: <$2 million
- Less than 5 years
- Benefits:

- Fast online application process
- Low fees
- Investors can diversify by having a portfolio of different loans
- Usually >interest rate than bank term deposits
- <loan by lending institutions

• Disadvantages:
  - Nothing is guaranteed
  - Only tend to lend to goods borrower (biased)

• Just a facilitator not a financial intermediary
• Receives a fee from both sides

6. Important points

- Shares and units are the only instruments that are equity.

  - A unit is equity as there is no maturity and funds may not have to be paid back. *Unlike shares, it can only be sold back to the issuer*.

7. Money Market

- Short term <u>'debt securities'</u> claims are issued and traded
- All instrument have high liquidity and low default risk
- No interest payments during life and no explicity interest at maturity: sold at discount
- Financial instrument:
  - Treasury notes (Treasury bills in US)
  - Commercial paper
  - Commercial bills
  - Certificates of deposit
  - Asset-backed commercial paper

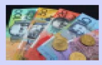
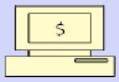
8. Capital Market

- <u>Longer term securities</u> are issued and traded
- Financial instrument:
  - Common stock (shares)
  - Corporate bonds
  - Treasury bonds
  - Asset-backed bonds
  - Capital notes

Lecture 2

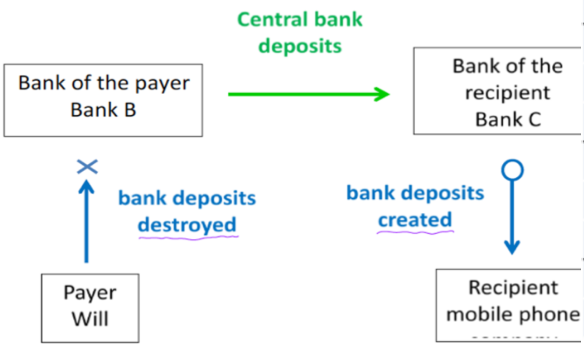
1. **ADIs' Role in The Payment System**
    - ADI (Authorized Deposit-taking Institutions)
        - banks, credit unions, building societies
    - Central Bank Deposits
        - Assets for ADIs
        - Liabilities for the central bank
    - ESF (Exchange Settlement funds)

- Central bank money

Type of money	Description	Symbol
Cash	Notes and coins	
Private bank deposits	Deposits in ADI accounts held by households and nonbank companies. Private money because managed by private ADIs on their liability side.	 Electronic money
Central bank deposits	Deposits in ESA accounts at the central bank held by ADIs. Central bank money because managed by central bank on its liability side.	 Electronic money

2. Settlement of payment

- Among households and non-ADI companies



Bank of Will B	
Deposit account at central bank: -	Deposits Will: -
Bank of mobile phone provider C	
Deposit account at central bank: +	Deposits mobile phone provider: +
RBA	
	Deposit account Bank C: +
	Deposit account Bank B: -