Understanding the 9 Major Types of Financial Institutions

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In today's market, financial institutions help businesses and individuals with money services that range from deposits to withdrawals, money transfers, lending, investments, and so much more.

As consumers, people interact with 9 different types of financial institutions and they might not even recognize that each of these financial institutions provides a unique service.

As players in the financial services marketplace, we find it's important to distinguish between these 9 types of financial institutions so that both consumers and fintech entrepreneurs understand their purposes.

The Different Financial Institution Categories

The 9 types of financial institutions are:

i. Central Banks
ii. Retail and Commercial Banks
iii. Internet Banks
iv. Credit Unions
v. Savings and Loan Associations
vi. Investment Banks and Companies
vii. Brokerage Firms
viii. Insurance Companies
ix. Mortgage Companies

1. Central Banks

Central banks are primary banks that oversee and manage other banks. In the U.S., the central bank is called the Federal Reserve Bank. The Federal Reserve System is responsible for setting and enacting monetary policy, providing financial supervision, and regulating other financial instutitions.

The Federal Reserve monitors the money depositing and transfer system in the U.S. They interact with the Federal Deposit Insurance Corporation (FDIC) to provide deposit insurance for American commercial banks and savings banks. And they also interact with the Automated Clearing House to facilitate secure and compliant financial transfers.

Consumers in the U.S. and in other countries don't normally have interactions directly with the central bank. Instead, large financial institutions work with the central bank and then provide products and services to the public.

2. Retail and Commercial Banks

Retail and commercial banks are the banks that consumers mostly interact with. Retail banks offer products to individual consumers and commercial banks offer products to businesses.

The majority of retail/commercial banks offer deposit accounts, lending, and some financial advice. With a commercial bank you might get checking and savings accounts, certificates of deposit (CDs), loan association (both personal and mortgage), credit cards, and business banking accounts.

Banks are the primary facilitated for sending money globally from the U.S., receiving money, and sending and receiving ACH transfers in the U.S.

3. Internet Banks

Next up are internet banks. Internet banks are newer to the financial market but they provide many of the same services as retail banks. The biggest differentiator of internet banks is that they do not have a brick-and-mortar location and operate largely online.

Within the category of internet banks, there are also digital banks and neobanks. Digital banks are platforms that exist online-only but they are also affiliated with a traditional bank. Comparatively, neobanks don't have any affiliation with a traditional bank and considered digital native banks affiliated only to themselves.

4. Credit Unions

Credit unions are another popular choice for financial institutions. Historically, credit unions have helped specific demographics based on union membership, such as teachers, laborers, and members of the military.

Products in credit unions are very similar to those available at retail and commercial banks but they are actually owned by the members themselves, with a mission to operate for the benefit of members rather than profit.

5. Savings and Loan Associations

Another key category in the financial market is savings and loan associations. These financial institutions are mutually held and provide no more than 20% of total lending. Individuals might use this type of financial institution for personal loans, mortgage lending, and deposit accounts.

6. Investment Banks and Companies

Next, we have investment banks and other investment companies. These banks do not take any deposits but instead raise capital for individuals, businesses, and governments through securities. These are the companies where most of the American investment is held. They are traditionally known as mutual fund companies and they offer pooled investment fund accounts for individuals and institutional investors.

Investment banks allow individuals and investment companies access to broader securities in the market. Financial advisers usually act as account managers but now Robo-advisers are taking over this role. Investment banking has also transformed into mobile technology banking so that individuals can utilize investment services on their own and do so more cost-effectively.

7. Brokerage Firms

Not to be confused with investment banks, brokerage firms are separate entities that help individuals and institutions buy and sell securities. You may interact with a brokerage firm when you want to place trades of stock, bonds, exchange-traded funds (ETFs), mutual funds, and more.

8. Insurance Companies

Insurance companies are another type of financial institution that helps individuals transfer the risk of loss. Insurance is required for homes and vehicles, and other important investments, and by going with insurance companies, individuals and businesses can protect against financial loss due to accidents, property damage, death, disability, and significant misfortune.

9. Mortgage Companies

Finally, we have mortgage companies. Mortgage companies originate and fund mortgage loans and these companies serve the individual consumer market. Some specialize in lending for commercial real estate as well.

Understanding the Financial Market

As you can see, each of the different types of financial institutions serves a unique purpose. However, from the consumer standpoint, it is understandable that this unique purpose is not always clear.

Individual consumers might interact with their retail bank and never realize that they are also interacting with the central bank, an investment bank, brokerage firms, insurance companies, and mortgage companies. So while many services might go through one bank, like the retail bank or internet bank, they are actually interacting with a number of private banks and non-bank institutions.

As we move more into the digital financial market, consumers are being brought back behind the curtain more. Consumers with digital wallets can see how their commercial bank connects to the digital wallet platform, with this connection facilitated through a partnership like Plaid.

Other connections, like mortgage and lending services, can also be provided through those API connections as well, exposing more and more the major fintech players involved in providing digital banking.

If you're looking to enter into this financial market by creating your own insurance company or internet banking app, then it's important to get a clear picture of these different financial institutions and how they interact. Sila can help you here.