

Glossary ??? financial markets and institutions assignment

[Business](#)



Glossary ??? Financial Markets & Institutions

_____ A advances A bank's borrowings from the Federal Reserve System. Also known as discount loans. adverse selection The problem created by asymmetric information before a transaction occurs: the people who are the most undesirable from the other party's point of view are the ones who are most likely to want to engage in the financial transaction. agency theory The analysis of how asymmetric information problems affect economic behavior. American depository receipts (ADR) A receipt for foreign stocks held by a trustee. The receipts trade on U. S. tock exchanges instead of the actual stock. American option An option that can be exercised at any time up to the expiration date of the contract. amortized Paid off in stages over a period of time. Each payment on a loan consists of the accrued interest and an amount that is applied to repay the principal. When all of the payments have been made, the loan is paid off (fully amortized). anchor currency The currency to which a coutry fixes its exchange rate. annuity An insurance product that provides a fixed stream of payments. appreciation Increase in a currency's value. arbitrage Elimination of a riskless profit opportunity in a market. asset A financial claim or piece of property that is a store of value. asset management The acquisition of assets that have a low rate of default and diversification of asset holdings to increase profits. asset market approach Determining asset prices using stocks of assets rather than flows. asset transformation The process by which financial intermediaries turn risky assets into safer assets for investors by creating and selling assets with risk characteristics that people are comfortable with and then use the funds they acquire by selling

these assets to purchase other assets that may have far more risk.

symmetric information The inequality of knowledge that each party to a transaction has about the other party. audits Certification by accounting firms that a business is adhering to standard accounting principles.

automated banking machine (ABM) An electronic machine that combines in one location an ATM, an Internet connection to the bank's Web site, and a telephone link to customer service. automated teller machine (ATM) An electronic machine that allows customers to get cash, make deposits, transfer funds from one account to another, and check balances.

B balance of payments A bookkeeping system for recording all payments that have a direct bearing on the movement of funds between a country and all other countries. balance-of-payments crisis A foreign exchange crisis stemming from problems in a country's balance of payments. balance sheet A list of the assets and liabilities of a bank (or firm) that balances: total assets equal total liabilities plus capital. balloon loan A loan on which the payments do not fully pay off the principal balance, meaning that the final payment must be larger than the rest. bank failure A situation in which a bank cannot satisfy its obligations to pay its depositors and other creditors and thus goes out of business. bank holding companies Companies that own one or more banks. bank panic The simultaneous failure of many banks, as during a financial crisis. bank supervision Overseeing who operates banks and how they are operated. banker's acceptance A short-term promissory note drawn by a company to pay for goods on which a bank guarantees payment at maturity. Usually used in international trade. banks

Financial institutions that accept deposits and make loans (such as commercial banks, savings and loan associations, and credit unions).
Basel Accord An agreement that requires that banks hold as capital at least 8% of their risk-weighted assets.
Basel Committee on Banking Supervision A committee that meets under the auspices of the Bank for International Settlements in Basel, Switzerland and that sets bank regulatory standards.
basis point One one-hundredth of a percentage point.
bearer instrument A security payable to the holder or "bearer" when presented.

No proof of ownership is required.
behavioral finance The field of study that applies concepts from other social sciences, such as anthropology, sociology, and particularly psychology, to understand the behavior of securities prices.

best-effort underwriting An approach to underwriting in which the underwriter does not take ownership of the security issue and does not commit to sell the issue at a given price. Instead, the underwriter solicits, offers, and attempts to market the security for the best price possible.
beta

A measure of sensitivity of an asset's return to changes in the value of the market portfolio, which is also a measure of the asset's marginal contribution to the risk of the market portfolio.
Board of Governors of the Federal Reserve System A board with seven governors (including the chairman) that plays an essential role in decision making within the Federal Reserve System.
bond A debt security that promises to make payments periodically for a specified period of time.
bond indenture Document accompanying a bond that spells out the details of the bond issue, such as covenants and sinking fund provisions.

It states the lender's rights and privileges and the borrower's obligations.

book entry A system of tracking securities ownership where no certificate is issued. Instead, the security issuer keeps records, usually electronically, of who holds outstanding securities. branches Additional offices of banks that conduct banking operations. Bretton Woods system The international monetary system in use from 1945 to 1971 in which exchange rates were fixed and the U. S. dollar was freely convertible into gold (by foreign governments and central banks only). brokered deposits

Deposits that enable depositors to circumvent the \$100, 000 limit at each bank so that the total amount deposited is fully insured. brokers Agents for investors who match buyers with sellers. bubble A situation in which the price of an asset differs from its fundamental market value. C call option An option contract that provides the right to buy a security at a specified price. call provision A right, usually included in the terms of a bond, that gives the issuer the ability to repurchase outstanding bonds before they mature. capital account An account that describes the flow of capital between the United States and other countries. capital adequacy management Managing the amount of capital the bank should maintain and then acquiring the needed capital. capital call A requirement of limited partners in a venture capital agreement to supply funds per their commitment with the partnership. capital market A financial market in which longer-term debt (maturity of greater than one year) and equity instruments are traded. capital mobility A situation in which foreigners can easily purchase a country's assets and the country's residents can easily purchase foreign assets. captive finance company

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A finance company that is owned by a retailer and makes loans to finance the purchase of goods from the retailer. cash flow The difference between cash receipts and cash expenditures. casualty (liability) insurance Protection against financial losses because of a claim of negligence. central bank The government agency that oversees the banking system and is responsible for the amount of money and credit supplied in the economy; in the United States, the Federal Reserve System. Central Liquidity Facility (CLF) The lender of last resort for credit unions, created in 1978 by the Financial Institutions Reform Act. certainty equivalent An amount that will be received or spent with certainty. An insurance payment is a certainty equivalent since it removes the risk that unexpected amounts will need to be spent. closed-end fund A fund that sells a fixed number of shares of stock and does not continue to accept investments. coinsurance An insurance policy under which the policyholder bears a percentage of the loss along with the insurance company. collateral Property that is pledged to the lender to guarantee payment in the event that the borrower should be unable to make debt payments. collateralized mortgage obligation (CMO)

Securities classified by when prepayment is likely to occur. Investors may buy a group of CMOs that are likely to mature at a time that meets the investors' needs. common bond membership A requirement that all members of credit unions share some common bond, such as working for the same employer. common stock A security that gives the holder an ownership interest in the issuing firm. This ownership interest includes the right to any residual cash flows and the right to vote on major corporate issues.

compensating balance A required minimum amount of funds that a firm

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receiving a loan must keep in a checking account at the bank. competitive bidding Competing in an auction against other potential buyers of Treasury securities. confidential memorandum A document that presents detailed financial information required by prospective buyers prior to making an offer to acquire a firm. conflicts of interest A manifestation of moral hazard in which one party in a financial contract has incentives to act in its own interest, rather than in the interests of the other party. conventional mortgages Mortgage contracts originated by banks and other mortgage lenders that are not guaranteed by the FHA or the VA.

They are often insured by private mortgage insurance. costly state verification Monitoring a firm's activities, an expensive process in both time and money. coupon bond A credit market instrument that pays the owner a fixed interest payment every year until the maturity date, when a specified final amount is paid. coupon rate The dollar amount of the yearly coupon payment expressed as a percentage of the face value of a coupon bond. credit-rating agencies Investment advisory firms that rate the quality of corporate and municipal bonds in terms of the probability of default. credit rationing

A lender's refusing to make loans even though borrowers are willing to pay the stated interest rate or even a higher rate or restricting the size of loans to less than the amount being sought. credit risk The risk arising from the possibility that the borrower will default. credit union A financial institution that focuses on servicing the banking and lending needs of its members, who must be linked by a common bond. Credit Union National Association (CUNA)

A central credit union facility that encourages establishing credit unions and provides information to its members. Credit Union National Extension Bureau (CUNEB)

A central credit union facility established in 1921 that was later replaced by the Credit Union National Association. creditor A lender or holder of debt.

currency swap A swap that involves the exchange of a set of payments in another currency. current account An account that shows international

transactions involving currently produced goods and services. current yield

An approximation of the yield to maturity that equals the yearly coupon

payment divided by the price of a coupon bond. D dealers People who link

buyers with sellers by buying and selling securities at stated prices. debt

deflation

A situation in which a substantial decline in the price level sets in, leading to a further deterioration in firms' net worth because of the increased burden of

indebtedness. deductible An amount of any loss that must be paid by the insured before the insurance company will pay anything. deep markets

Markets where there are many participants and a great deal of activity, thus ensuring that securities can be sold rapidly at fair prices. default A situation

in which the party issuing a debt instrument is unable to make interest payments or pay off the amount owed when the instrument matures.

default-free bonds

Bonds with no default risk, such as U. S. government bonds. default risk The risk that a loan customer may fail to repay a loan as promised. deferred load

A fee on a mutual fund investment that is charged only if the investment is

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withdrawn. The amount of the deferred load usually falls the longer the investment is left in the fund. defined-benefit plan A pension plan in which the benefits are stated up front and are paid regardless of how the investments perform. defined-contribution plan A pension plan in which the contributions are stated up front but the benefits paid depend on the performance of the investments. definitive agreement A legally binding contract that details the terms and conditions for an acquisition of one firm by another. demand curve A curve depicting the relationship between quantity demanded and price when all other economic variables are held constant. demand deposit A deposit held by a bank that must be paid to the depositor on demand. Demand deposits are more commonly called checking accounts. deposit outflows Losses of deposits when depositors make withdrawals or demand payment. deposit rate ceilings Restrictions on the maximum interest rates payable on deposits. depreciation

Decrease in a currency's value. devaluation Resetting of the par value of a currency at a lower level. direct placement An issuer's bypassing the dealer and selling the security directly to the investor. dirty float An exchange rate regime in which exchange rates fluctuate from day to day, but central banks attempt to influence their countries' exchange rate by buying and selling currencies. Also called a managed float regime. discount bond A credit market instrument that is bought at a price below its face value and whose face value is repaid at the maturity date; it does not make any interest payments.

Also known as a zero-coupon bond. discount loans A bank's borrowings from the Federal Reserve System. Also known as advances. discount points

Percentage of the total loan paid back immediately when a mortgage loan is obtained. Payment of discount points lowers the annual interest rate on the debt. discount rate The interest rate that the Federal Reserve charges banks on discount loans. discount window The Federal Reserve facility at which discount loans are made to banks. discount yield The measure of interest rates by which dealers in bill markets quote the interest rate on U.

S. Treasury bills. Also known as the yield on a discount basis.. discounting Reduction in the value of a security at purchase such that when it matures at full value, the investor receives a fair return. disintermediation A reduction in the flow of funds into the banking system that causes the amount of financial intermediation to decline. diversification Investing in a collection (portfolio) of assets whose returns do not always move together, with the result that overall risk is lower than for individual assets. Periodic payments made by equities to shareholders.

A monetary strategy in which a country abandons its currency altogether and adopts that of another country, typically the U. S. dollar. dividends Periodic payments made by equities to shareholders. dollarization A monetary strategy in which a country abandons its currency altogether and adopts that of another country, typically the U. S. dollar. down payment A portion of the original purchase price that is paid by the borrower so that the borrower will have equity (ownership interest) in the asset pledged as collateral. dual banking system

The system in the United States in which banks supervised by the federal government and banks supervised by the states operate side by side.

due diligence period A 20- to 40-day period used by the buyer of a firm to verify the accuracy of the information contained in the confidential memorandum.

duration The average lifetime of a debt security's stream of payments.

duration gap analysis A measurement of the sensitivity of the market value of a bank's assets and liabilities to changes in interest rates.

E early stage investing Investment by a venture capital firm in a company that is in the very beginning stage of its development.

-cash A second form of electronic money used on the Internet to pay for goods and services.

econometric model A model whose equations are estimated using statistical procedures.

economies of scale Savings that can be achieved through increased size.

economies of scope Increased business that can be achieved by offering many products in one easy-to-reach location.

Edge Act corporation A special subsidiary of a U. S. bank that is engaged primarily in international banking.

effective exchange rate index An index reflecting the value of a basket of representative foreign currencies.

efficient market hypothesis The hypothesis that prices of securities in financial markets fully reflect all available information.

e-finance A new means of delivering financial services electronically.

electronic money (or e-money) Money that exists only in electronic form and substitutes for cash as well.

Employee Retirement Income Security Act (ERISA) A comprehensive law passed in 1974 that set standards that must be followed by all pension plans.

equities Claims to share in the net income and assets of a corporation (such as common stock).

equity capital

The difference between a firm's assets (what it owns or is owed) and its liabilities (what it owes). Also called net worth.. equity multiplier The amount of assets per dollar of equity capital. Eurobonds Bonds denominated in a currency other than that of the country in which they are sold.

Eurocurrencies Foreign currencies deposited in banks outside the home country. Eurodollars U. S. dollars that are deposited in foreign banks outside of the United States or in foreign branches of U. S. banks. European option

An option that can be exercised only at the expiration date of the contract.

excess demand A situation in which quantity demanded is greater than quantity supplied. excess reserves Reserves in excess of required reserves.

excess supply A situation in which quantity supplied is greater than quantity demanded. exchange rate The price of one currency in terms of another.

exchange rate overshooting A phenomenon whereby the exchange rate changes by more in the short run than it does in the long run when the money supply changes.

exchanges Secondary markets in which buyers and sellers of securities (or their agents or brokers) meet in one central location to conduct trades. exercise price The price at which the purchaser of an option has the right to buy or sell the underlying financial instrument. Also

known as the strike price. expected return The return on an asset expected over the next period. F factoring The sale of accounts receivable to another firm, which takes responsibility for collections. Federal Credit Union Act Law

passed in 1934 that allowed federal chartering of credit unions in all states. federal funds Short-term deposits bought or sold between banks. federal

funds rate The interest rate on overnight loans of deposits at the Federal Reserve.

Federal Home Loan Bank Act of 1932 Law that created the Federal Home Loan Bank Board and a network of regional home loan banks.

Federal Home Loan Bank Board (FHLBB) Agency responsible for regulating and controlling savings and loan institutions, superseded by FIRREA in 1989.

Federal Open Market Committee (FOMC) The committee that makes decisions regarding the conduct of open market operations; composed of the seven members of the Board of Governors of the Federal Reserve System, the president of the Federal Reserve Bank of New York, and the presidents of four other Federal Reserve banks on a rotating basis.

Federal Reserve banks The 12 district banks in the Federal Reserve system.

Federal Reserve System (the Fed) The central banking authority responsible for monetary policy in the United States.

Federal Savings and Loan Insurance Corporation (FSLIC) An agency that provided deposit insurance to savings and loan similar to the Federal Deposit Insurance Corporation which insured banks. FSLIC was eliminated in 1989.

financial crisis A major disruption in financial markets, characterized by sharp declines in asset prices and the failures of many financial and non-financial firms.

financial derivatives Instruments that have payoffs that are linked to previously issued securities and are extremely useful risk reduction tools.

financial engineering The process of researching and developing new financial products and services that would meet customer needs and prove profitable.

financial futures contract A futures contract in which the standardized commodity is a particular type of financial instrument.

financial futures options Options in which the underlying instrument is a futures contract. Also called futures options.

financial guarantee A contract that guarantees that bond purchasers

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will be paid both principal and interest in the event the issuer defaults on the obligation. Financial Institutions Reform Act Law passed in 1978 that created the Central Liquidity Facility as the lender of last resort for credit unions.

Financial Institutions Reform, Recovery, and Enforcement Act Law passed in 1989 to stop losses in the savings and loan industry. It reversed much of the deregulation included in the Garn-St Germain Act of 1982. financial instrument

A claim on the borrower's future income that is sold by the borrower to the lender. Also called security. financial intermediaries Institutions (such as

banks, insurance companies, mutual funds, pension funds, and finance companies) that borrow funds from people who have saved and then make

loans to others. financial intermediation The process of indirect finance whereby financial intermediaries link lender-savers and borrower-spenders.

financial markets Markets in which funds are transferred from people who have a surplus of available funds to people who have a shortage of available

funds. financial panic The widespread collapse of financial markets and

intermediaries in an economy. firm-commitment underwriting Underwriting

in which the underwriter agrees to buy the entire security issue at a prespecified price and then to resell it. This method ensures that the entire

issue will be marketed. Fisher effect The outcome that when expected inflation occurs, interest rates will rise; named after economist Irving Fisher.

fixed exchange rate regime Policy under which central banks buy and sell their own currencies to keep their exchange rates fixed at a certain level.

fixed-payment loan A credit market instrument that provides a borrower with an amount of money that is repaid by making a fixed payment periodically

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(usually monthly) for a set number of years. floating exchange rate regime

An exchange rate regime in which the value of currencies are allowed to

fluctuate against one another. floor plan A type of loan for which inventory is

pledged as security and a portion of the loan is repaid each time an item of

inventory is sold. foreign bonds Bonds sold in a foreign country and

denominated in that country's currency. foreign exchange intervention

An international financial transaction in which a central bank buys or sells

currency to influence foreign exchange rates. foreign exchange market The

market in which exchange rates are determined. foreign exchange rate The

price of one currency in terms of another. forward contract An agreement by

two parties to engage in a financial transaction at a future (forward) point in

time. forward exchange rate The exchange rate for a forward transaction.

forward rate The interest rate predicted by pure expectations theory of the

term structure of interest rates to prevail in the future. forward transaction

An exchange rate transaction that involves the exchange of bank deposits

denominated in different currencies at some specified future date. free

reserves Excess reserves in the banking system minus the volume of

discount loans. free-rider problem The problem that occurs when people who

do not pay for information take advantage of the information that other

people have paid for. fully amortized loan A fixed payment loan in which the

lender provides the borrower with an amount of funds that must be repaid by

making the same payment every period, consisting of part of the principal

and interest for a set number of years. ully funded Describing a pension plan

in which the contributions to the plan and their earnings over the years are

sufficient to pay out the defined benefits when they come due. fully subscribed Describing a security issue for which all of the securities available have been spoken for before the issue date. futures contract A contract in which the seller agrees to provide a certain standardized commodity to the buyer on a specific future date at an agreed-on price. futures options Options in which the underlying instrument is a futures contract.

Also called financial futures options. G gap analysis A measurement of the sensitivity of bank profits to changes in interest rates, calculated by subtracting the amount of rate-sensitive assets. Also called income gap analysis. general obligation bonds Bonds that are secured by the full faith and credit of the issuer, which includes the taxing authority of municipalities. Glass-Steagall Act Law that made it illegal for commercial banks to underwrite securities for sale to the public. goal independence The ability of the central bank to set the goals of monetary policy. goodwill

An accounting entry to reflect value to the firm of its having special expertise or a particularly profitable business line. H hedge To protect oneself against risk. hybrid funds A mutual fund that is composed of both stocks and bonds. I incentive-compatible Aligning the incentives of both parties to a contract. income gap analysis A measurement of the sensitivity of bank profits to changes in interest rates, calculated by subtracting the amount of rate-sensitive assets. Also called gap analysis. index fund A mutual fund that is composed only of securities that are included in some popular stock index, such as the S 500.

The fund is designed to mimic the returns generated by the underlying index.

indexed bonds Bonds whose interest and principal payments are adjusted for changes in the price level and whose interest rate thus provides a direct measure of a real interest rate.

individual retirement account (IRA) Retirement account in which pretax dollars can be invested by individuals not covered by some other retirement plan.

initial public offering (IPO) A corporation's first sale of securities to the public.

insolvent In a situation in which the value of a firm's or bank's assets have fallen below its liabilities;

bankrupt.

installment credit A loan that requires the borrower to make a series of equal payments over some fixed length of time.

instrument independence The ability of the central bank to set monetary policy instruments.

insured mortgage Mortgages guaranteed by either the Federal Housing Administration or the Veterans Administration. These agencies guarantee that the bank making the loan will not suffer any losses if the borrower defaults.

interest parity condition The observation that the domestic interest rate equals the foreign interest rate plus the expected appreciation in the foreign currency.

interest rate The cost of borrowing or the price paid for the rental of funds (usually expressed as a percentage per year).

interest-rate forward contracts Forward contracts that are linked to debt instruments.

interest-rate risk The possible reduction in returns that is associated with changes in interest rates.

interest-rate swap A financial contract that allows one party to exchange (swap) a set of interest payments for another set of interest payments owned by another party.

intermediate target Any number of variables, such as monetary aggregates or interest rates, that have a direct effect on employment and the price level and that

the Fed seeks to influence. intermediate-term With reference to a debt instrument, having a maturity of between one and ten years. international banking facilities (IBFs) Banking establishments in the United States that can accept time deposits from foreigners but are not subject to either reserve requirements or restrictions on interest payments. International Monetary Fund (IMF) The international organization created by the Bretton Woods agreement whose objective is to promote the growth of world trade by making loans to countries experiencing balance-of-payments difficulties. nternational policy coordination Agreements among countries to enact policies cooperatively. international reserves Central bank holdings of assets denominated in foreign currencies. inverted yield curve A yield curve that is downward-sloping. investment banker A securities dealer who facilitates the transfer of securities from the original issuer to the public. investment banks Firms that assist in the initial sale of securities in the primary market. J January effect An abnormal rise in stock prices from December to January. junk bonds Bonds rated lower than BBB by bond-rating agencies.

Junk bonds are not investment grade and are considered speculative. They usually have a high yield to compensate investors for their high risk. L large, complex banking organizations (LCBOs) Large companies that provide banking as well as many other financial services. later stage investing Investment by a venture capital firm in a company to help the firm grow to a critical mass needed to attract public financing. law of large numbers The observation that when many people are insured, the probability distribution of the losses will assume a normal probability distribution. law of one price

The principle that if two or more countries produce an identical good, the price of this good should be the same no matter which country produces it.

leasing An arrangement whereby one party obtains the right to use an asset for a fee paid to another party for a predetermined length of time.

letter of intent A document issued by a prospective buyer that signals a desire to go forward with a purchase and that outlines the preliminary terms of the purchase.

leverage ratio A bank's capital divided by its assets.

liabilities IOUs or debts.

liability management The acquisition of funds at low cost to increase profits.

lien A legal claim against a piece of property that gives a lender the right to foreclose or seize the property if a loan on the property is not repaid as promised.

limit order An order placed by a customer to buy stock that specifies a maximum price or an order to sell stock that places a minimum acceptable price.

liquid Easily converted into cash.

liquidity The relative ease and speed with which an asset can be converted into cash.

liquidity management The decision made by a bank to maintain sufficient liquid assets to meet the bank's obligations to depositors.

liquidity preference framework A model developed by John Maynard Keynes that predicts the equilibrium interest rate on the basis of the supply of and demand for money.

liquidity premium theory The theory that the interest rate on a long-term bond will equal an average of short-term interest rates expected to occur over the life of the long-term bond plus a positive term (liquidity) premium.

liquidity risk The risk that a firm may run out of cash needed to pay bills and to keep the firm operating.

liquidity services Services that make it easier for customers to conduct transactions.

load fund

A mutual fund that charges a fee when money is added to or withdrawn from the fund. loan commitment A bank's commitment (for a specified future period of time) to provide a firm with loans up to a given amount at an interest rate that is tied to some market interest rate. loan sale The sale under a contract (also called a secondary loan participation) of all or part of the cash stream from a specific loan, thereby removing the loan from the bank's balance sheet. loanable funds The quantity of loans. loanable funds framework Determining the equilibrium interest rate by analyzing the supply of and demand for bonds (loanable funds).

London interbank bid rate (LIBID) The rate of interest large international banks charge on overnight loans among themselves. London interbank offer rate (LIBOR) The interest rate charged on short-term funds bought or sold between large international banks. long position A contractual obligation to take delivery of an underlying financial instrument. long-term With reference to a debt instrument, having a maturity of ten years or more. M macro hedge A hedge of interest-rate risk for a financial institution's entire portfolio. managed float regime

The current international financial environment in which exchange rates fluctuate from day to day, but central banks attempt to influence their countries' exchange rates by buying and selling currencies. Also known as a dirty float. margin credit Loans advanced by a brokerage house to help investors buy securities. margin requirement A sum of money that must be kept in an account (the margin account) at a brokerage firm. marked to market Repriced and settled in the margin account at the end of every

trading day to reflect any change in the value of the futures contract. arket
equilibrium A situation occurring when the quantity that people are willing to
buy (demand) equals the quantity that people are willing to sell (supply).
market fundamentals Items that have a direct impact on future income
streams of the security. market maker Dealers who buy or sell securities
from their own inventories, thereby ensuring that there is always a market in
which investors can buy or sell their securities. market order An order placed
by a customer to buy stock at the current market price. market
segmentation theory

A theory of the term structure that sees markets for different-maturity bonds
as completely separated and segmented such that the interest rate for
bonds of a given maturity is determined solely by supply and demand for
bonds of that maturity. maturity Time to the expiration date (maturity date)
of a debt instrument. mean reversion The phenomenon that stocks with low
returns today tend to have high returns in the future, and vice versa.
mergers and acquisitions market An informal and unorganized market where
firms are bought, sold, or merged with other firms. micro hedge A hedge for
a specific asset. onetary base The sum of the Fed's monetary liabilities
(currency in circulation and reserves) and the U. S. Treasury's monetary
liabilities (Treasury currency in circulation, primarily coins). monetary
neutrality A proposition that in the long run, a percentage rise in the money
supply is matched by the same percentage rise in the price level, leaving
unchanged the real money supply and all other economic variables such as
interest rates. monetary policy The management of the money supply and

interest rates. money Anything that is generally accepted in payment for goods or services or in the repayment of debts.

Also called money supply. money center banks Large banks in key financial centers. money market A financial market in which only short-term debt instruments (maturity of less than one year) are traded. money market mutual funds Funds that accumulate investment dollars from a large group of people and then invest in short-term securities such as Treasury bills and commercial paper. money market securities Securities that have an original maturity of less than one year, such as Treasury bills, commercial paper, banker's acceptances, and negotiable certificates of deposit. money supply Anything that is generally accepted in payment for goods or services or in the repayment of debts. Also called money. moral hazard The risk that one party to a transaction will engage in behavior that is undesirable from the other party's point of view. mortgage A long-term loan secured by real estate. mortgage-backed security A security that is collateralized by a pool of mortgage loans. Also called a securitized mortgage. mortgage pass-through A security that has the multiple borrower's mortgage payments pass through a trustee before being disbursed to the investors. mutual bank A bank owned by the depositors. mutual insurance company An insurance company that is owned by the policyholders and has the objective of providing insurance for the lowest possible price. N named-peril policy Insurance policy that protects against loss from perils that are specifically named in the policy. National Association of Securities Dealers Automated Quotation System (NASDAQ) A computerized network that links dealers around the country together and

provides price quotes on over-the-counter securities. national banks
Federally chartered banks.

National Credit Union Act of 1970 Law that established the National Credit Union Administration (NCUA), an independent agency charged with the task of regulating and supervising federally chartered credit unions and state-chartered credit unions that receive federal deposit insurance. National Credit Union Share Insurance Fund (NCUSIF) Agency established by the National Credit Union Act of 1970 that is controlled by the National Credit Union Administration and insures the deposits in credit unions for \$100, 000 per account. natural rate of unemployment

The rate of unemployment consistent with full employment at which the demand for labor equals the supply of labor. negotiable certificates of deposit A bank-issued short-term security that documents a deposit and specifies the interest rate and the maturity date. net asset value The total value of a mutual fund's assets minus any liabilities, divided by the number of shares outstanding. net interest margin (NIM) The difference between interest income and interest expense as a percentage of assets. net worth The difference between a firm's assets (what it owns or is owed) and its liabilities (what it owes).

Also called equity capital. no-load fund A mutual fund that does not charge a fee when funds are added to or withdrawn from the fund. nominal interest rate An interest rate that does not take inflation into account. nonbank banks Limited-service banks that either do not make commercial loans or do not take in deposits. noncompetitive bidding Offering to buy Treasury securities

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without specifying a price; the securities are ultimately sold at the weighted average of the competitive bids accepted at the same auction. notional principal The amount on which interest is being paid in a swap arrangement.

O off-balance-sheet activities Bank activities that involve trading financial instruments and the generation of income from fees and loan sales, all of which affect bank profits but are not visible on bank balance sheets. official reserve transactions balance The current account balance plus items in the capital account. open-end fund A mutual fund that accepts investments and allows investors to redeem shares at any time. The value of the shares is tied to the value of investment assets of the fund. open interest The number of contracts outstanding. operating expenses

The expenses incurred from a bank's ongoing operations. operating income The income earned on bank's ongoing operations. operating target Any of a set of variables, such as reserve aggregates or interest rates, that the Fed seeks to influence and that are responsive to its policy tools. opportunity cost The amount of interest (expected return) sacrificed by not holding an alternative asset. options Contracts that give the purchaser the option (right) to buy or sell the underlying financial instrument at a specified price, called the exercise price or strike price, within a specific period of time (the term to expiration). overfunded Describing a pension plan that has assets greater than needed to make the projected benefit payments owed by the plan. oversubscribed Having received more offers to buy than there are securities available for sale. over-the-counter (OTC) market A secondary market in which dealers at different locations who have an inventory of securities stand

ready to buy and sell securities to anyone who comes to them and is willing to accept their prices. P passbook savings account An interest-bearing savings account held at a commercial bank. pecking order hypothesis

The hypothesis that the larger and more established is a corporation, the more likely it will be to issue securities to raise funds. Pension Benefit Guarantee Corporation (Penny Benny) A government agency that performs a role similar to that of the FDIC, insuring pension benefits up to a limit if a company with an underfunded pension plan goes bankrupt. pension plan An asset pool that accumulates over an individual's working years and is paid out during the nonworking years. perpetuity A perpetual bond with no maturity date and no repayment of principal that makes periodic fixed payments forever. political business cycle

A business cycle caused by expansion policies before an election. portfolio A collection of assets. preferred stock Stock on which a fixed dividend must be paid before common dividends are distributed. It often does not mature and usually does not give the holder voting rights in the company. premium The amount paid for an option contract. present discounted value Today's value of a payment to be received in the future when the interest rate is i . Also called present value. present value Today's value of a payment to be received in the future when the interest rate is i . Also called present discounted value. primary market

A financial market in which new issues of a security are sold to initial buyers. principal-agent problem A moral hazard problem that occurs when the managers in control (the agents) act in their own interest rather than in the

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interest of the owners (the principals) due to differing sets of incentives.

private mortgage insurance (PMI) Insurance that protects the lender against losses from defaults on mortgage loans. private pension plan A pension plan sponsored by an employer, group, or individual. property insurance

Insurance that protects against losses from fire, theft, storm, explosion, and neglect. prospectus

A portion of a security registration statement that is filed with the Securities and Exchange Commission and made available to potential purchasers of the security.

prudent man rule This rule states that those with the responsibility of investing money for others should act with prudence, discretion,

intelligence, and regard for safety of capital as well as income. public

pension plan A pension plan sponsored by a government body. pure

expectations theory The theory that the interest rate on a long-term bond will equal the average of the short-term interest rates that people expect to

occur over the life of the bond. put option An option contract that provides the right to sell a security at a specified price. Q quotas Restrictions on the

quantity of foreign goods that can be imported. R random walk The

movements of a variable whose future changes cannot be predicted because, given today's value, the variable is just as likely to fall as to rise.

rate of capital gain The change in a security's price relative to the initial

purchase price. rate of return The payments to the owner of a security plus the change in the security's value, expressed as a fraction of its purchase

price; also called return. rational expectations

Expectations that reflect optimal forecasts (the best guess of the future) using all available information.

real bills doctrine A guiding principle (now discredited) for the conduct of monetary policy that states that as long as loans are made to support the production of goods and services, providing reserves to the banking system to make these loans will not be inflationary.

real interest rate The interest rate adjusted for expected changes in the price level (inflation) so that it more accurately reflects the true cost of borrowing.

real terms Terms reflecting actual goods and services one can buy.

registered bonds

Bonds requiring that their owners register with the company to receive interest payments. Registered bonds have largely replaced bearer bonds, which did not require registration.

registration statement Information about a firm's financial condition, management, competition, industry, and experience that must be filed with the Securities and Exchange Commission prior to the sale to the public of any security with a maturity of more than 270 days.

Regulation Q The regulation under which the Federal Reserve System has the power to set maximum interest rates that banks can pay on savings and time deposits.

Regulation Z The requirement that lenders disclose the full cost of a loan to the borrower; also known as the "truth in lending" regulation.

regulatory arbitrage An attempt to avoid regulatory capital requirements by keeping assets on banks' books that have the same risk-based capital requirement but are relatively risky, while taking off their books low-risk assets.

regulatory forbearance Refraining from exercising a regulatory right to put

insolvent savings and loans out of business. reinsurance Allocating a portion of the risk to another company in exchange for a portion of the premium.

reinvestment risk The interest-rate risk associated with the fact that the proceeds of short-term investments must be reinvested at a future interest rate that is uncertain. repossession The taking of an asset that has been

pledged as collateral for a loan when the borrower defaults. repurchase agreement A form of loan in which the borrower simultaneously contracts to sell securities and contracts to repurchase them, either on demand or on a specified date. required reserve ratio The fraction of deposits that the Fed requires be kept as reserves. required reserves

Reserves that are held to meet Fed requirements that a certain fraction of bank deposits be kept as reserves. reserve account An account used to make insurance and tax payments due on property securing a mortgage loan. A portion of each monthly loan payment goes into the reserve account. reserve currency A currency such as the U. S. dollar that is used by other countries to denominate the assets they hold as international reserves. reserve for loan

losses An account that offsets the loan accounts on a lender's books that reflects the lender's projected losses due to default. reserve requirements

Regulations making it obligatory for depository institutions to keep a certain fraction of their deposits in accounts with the Fed. reserves Banks' holding of deposits in accounts with the Fed, plus currency that is physically held by

banks (vault cash). Resolution Trust Corporation (RTC) A temporary agency created by FIRREA that was responsible for liquidating the assets of failed savings and loans. restrictive covenants Provisions that specify certain

activities that a borrower can and cannot engage in. return

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The payments to the owner of a security plus the change in the security's value, expressed as a fraction of its purchase price; more precisely called the rate of return. return on assets (ROA) Net profit after taxes per dollar of assets. return on equity (ROE) Net profit after taxes per dollar of equity capital. revaluation Resetting of the par value of a currency at a higher level. revenue bonds Bonds for which the source of income that is used to pay the interest and to retire the bonds is from a specific source, such as a toll road or an electric plant.

If this revenue source is unable to make the payments, the bonds can default, despite the issuing municipality's being otherwise healthy. risk The degree of uncertainty associated with the return on an asset. risk premium The spread between the interest rate on bonds with default risk and the interest rate on default-free bonds. risk sharing The process by which financial intermediaries create and sell assets with risk characteristics that people are comfortable with and then use the funds they acquire by selling these assets to purchase other assets that may have far more risk. risk structure of interest rates

The relationship among the various interest rates on bonds with the same term to maturity. roll over To renew a debt when it matures. S seasoned issues Securities that have been trading publicly long enough to have let the market clearly establish their value. secondary market A financial market in which securities that have previously been issued can be resold. secondary reserves U. S. government and agency securities held by banks. secured debt Debt guaranteed by collateral. secured loan A loan guaranteed by

collateral. securitization The process of transforming illiquid financial assets into marketable capital market instruments. securitized mortgage A security that is collateralized by a pool of mortgage loans. Also called a mortgaged-backed security. security A claim on the borrower's future income that is sold by the borrower to the lender. Also called a financial instrument. seed investing Investment by a venture capital firm in a company before it has a real product or is even clearly organized as a company. Separate Trading of Registered Interest and Principal Securities (STRIPS) Securities that have their periodic interest payments separated from the final maturity payment and the two cash flows are sold to different investors. share draft account Accounts at credit unions that are similar to checking accounts at banks. shelf registration An arrangement with the Securities and Exchange Commission that allows a single registration document to be filed that permits multiple securities issues. short position A contractual obligation to deliver an underlying financial instrument. short sell An arrangement with a broker to borrow and sell securities. The borrowed securities are replaced with securities purchased later. Short sells let investors earn profits from falling securities prices. short-term With reference to a debt instrument, having a maturity of one year or less. imple loan A credit market instrument providing the borrower with an amount of funds that must be repaid to the lender at the maturity date along with an additional payment (interest). sinking fund Fund created by a provision in many bond contracts that requires the issuer to set aside each year a portion of the final maturity payment so that investors can be certain that the funds will be available at maturity. smart card A more sophisticated stored-value card that contains its

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own computer chip so that it can be loaded with digital cash from the owner's bank account whenever needed. special drawing rights (SDRs) A paper substitute for gold issued by the International Monetary Fund that functions as international reserves. spot exchange rate The exchange rate at a given moment. spot transaction The immediate exchange of bank deposits denominated in different currencies. state banks Banks chartered by the state. sterilized foreign exchange intervention A foreign exchange intervention with an offsetting open market operation that leaves the monetary base unchanged. stock A security that is a claim on the earnings and assets of a corporation. stock company A firm that issues stock and has the objective of making a profit for its shareholders. stock market risk The risk associated with fluctuations in stock prices. stock option An option on an individual stock. stop loss order An order placed with a broker to buy or sell when a certain price is reached; designed to limit an investor's loss on a security position. strike price The price at which the purchaser of an option has the right to buy or sell the underlying financial instrument. Also known as the exercise price. superregional banks

Bank holding companies similar in size to money center banks whose headquarters are not based in one of the money center cities (New York, Chicago, San Francisco). supply curve A curve depicting the relationship between quantity supplied and price when all other economic variables are held constant. swap A financial contract that obligates one party to exchange (swap) a set of payments it owns for a set of payments owned by another party. syndicate A group of investment banks that come together for

the purpose of issuing a security. The syndicate spreads the risk of the issue among the members.

Each participant attempts to market the security and shares in losses.

systematic risk The component of an asset's risk that cannot be eliminated

by diversification. T T-account A simplified balance sheet with lines in the

form of a T that lists only the exchanges that occur in balance sheet times

starting from some initial balance sheet position. tariffs Taxes on imported

goods. term security A security with a specified maturity date. term structure

of interest rates The relationship among interest rates on bonds with

different terms to maturity. theory of efficient capital markets The theory that

prices of securities in financial markets fully reflect all available information.

theory of purchasing power parity (PPP) The theory that exchange rates

between any two currencies will adjust to reflect changes in the price levels

of the two countries. thrift institutions (thrifts) Savings and loan associations,

mutual savings banks, and credit unions. tombstone A large notice placed in

financial newspapers announcing that a security will be offered for sale by an

underwriter or group of underwriters. trade association

A group of credit unions organized to provide a variety of services to a large

number of credit unions. trade balance The difference between merchandise

exports and imports. transaction costs The time and money spent trying to

exchange financial assets, goods, or services. Treasury bills (T-bills)

Securities sold by the federal government with initial maturities of less than

one year. They are often considered the lowest-risk security available. U

underfunded Describing a pension plan in which the contributions and their

earnings are insufficient to pay out the defined benefits when they come due. undersubscribed Having received fewer offers to buy than there are securities available for sale. underwriters Investment banks that guarantee prices on securities to corporations and then sell the securities to the public. underwriting Guaranteeing prices on securities to corporations and then selling the securities to the public. unexploited profit opportunity A situation in which an investor can earn a higher-than-normal return. unsecured debt Debt not guaranteed by collateral. unsterilized foreign exchange intervention A foreign exchange intervention in which a central bank allows the purchase or sale of domestic currency to affect the monetary base. U. S. Central Credit Union A central bank for credit unions that was organized in 1974 and provides banking services to the state central credit unions. usury Charging an excessive or inordinate interest rate on a loan. V vault cash Currency that is physically held by banks and stored in vaults overnight. venture capital firm A financial intermediary that pools the resources of its partners and uses the funds to help entrepreneurs start up new businesses. W ealth All resources owned by an individual, including all assets. wholesale market Market where extremely large transactions occur, as for money market funds or foreign currency. World Bank The International Bank for Reconstruction and Redevelopment, an international organization that provides long-term loans to assist developing countries in building dams, roads, and other physical capital that would contribute to their economic development. World Trade Organization (WTO) The organization that monitors rules for the conduct of trade between countries (tariffs and quotas). Y yield curve

A plot of the interest rates for particular types of bonds with different terms to maturity. yield on a discount basis The measure of interest rates by which dealers in bill markets quote the interest rate on U. S. Treasury bills. Also known as the discount yield. yield to maturity The interest rate that equates the present value of payments received from a credit market instrument with its value today. Z zero-coupon bond A credit market instrument that is bought at a price below its face value and whose face value is repaid at the maturity date; it does not make any interest payments. Also known as a discount bond.