

Glossary

3–6–3 rule A risk management-based approach from the 1980s under which banks paid 3 per cent on deposits, charged 6 per cent on loans and closed the branch at 3 pm

9 am batch The batch settlement made to each institution's exchange settlement account at 9 am based on the previous day's single net obligation for each institution

accumulation fund A superannuation fund that pays out the sum of the contributions made by the employee and the earnings on those funds

adjustable-rate preference shares Preferred shares issued with adjustable rates. The dividends are adjusted periodically in response to changing market interest rates.

adverse selection The situation in which those most likely to suffer a loss seek to purchase insurance

aggressive shares Shares with betas greater than 1.0 that carry greater systematic risk than the market

agricultural loans Loans to farmers to finance farming activities

allocational efficiency The market situation in which funds are allocated to their highest value use

allocative function of interest rates The function of interest rates in the economy to allocate funds between SSUs and DSUs in the financial markets

all-risks coverage Insurance that provides insurance against all losses except those that are specifically excluded

American depositary receipts Dollar-denominated claims issued by US banks, representing ownership of shares of a foreign company's stock held on deposit by the US bank in the issuing firm's home country

American option The right to buy (or sell) and receive (or deliver) the underlying asset at the strike price that exists over time until the option expires

angels Individuals who act as informal venture capitalists

ask price The bid price plus a price 'spread' that provides the dealer's profit; the lowest price at which the dealer is willing to sell the security

asset management Maintaining sufficient cash and noncash assets that can quickly be converted into cash with minimal value loss

Austraclear A feeder system to the RBA's payments system for CGS, semigovernment and private sector debt securities

Australian Competition and Consumer Commission The body responsible for maintaining competition in the Australian economy. In the financial sector, it will not allow any merger if it would result in a substantial lessening of competition, unless that is in the national interest.

Australian Uniform Credit Laws Agreement 1993 The Commonwealth legislation that contains the Uniform Consumer Credit Code

authorised deposit-taking institutions (ADIs) Institutions that are approved by APRA to conduct banking business (taking deposits and issuing loans) within the financial system

balance of payments A set of accounts that summarises a country's international balance of trade and the payments to and the receipts from foreigners

bank-accepted bill (two-name paper) A draft drawn on a bank by a corporation to pay for merchandise. The draft promises payment of a certain sum of money to its holder at some future date. In effect, the bank substitutes its credit standing for that of the issuing corporation.

bank bills held Commercial bills held as assets on the balance sheet

bank capital The equity or ownership funds of a bank; the account against which bank loan and security losses are charged

bank cheques Cheques drawn on a bank by a customer and used to facilitate payment

bank draft A financial instrument that provides an exporter with a written guarantee that a financial institution will honour payment once the goods have been delivered. Bank drafts are prepared by the exporter and sent to the importer as a request to pay before the actual export of the goods.

bank liquidity The bank's ability to accommodate deposit withdrawals and loan requests, and pay off other liabilities as they become due

bank panics The event that occurs when depositors lose confidence in banks in general and 'run' to redeem their deposits quickly

Banking Act 1959 The Commonwealth legislation that regulates who has authority to conduct a banking business

Banking and Financial Services Ombudsman An independent dispute resolution service that considers complaints made against banks and their affiliates that operate in Australia

bare-boat charter A charter in which the operating company is responsible for all operating, insurance and maintenance costs associated with the ship

basis risk A risk that exists because the value of an item being hedged may not always keep the same price relationship to contracts purchased or sold in the futures markets

best-efforts basis The distribution of securities in a process in which the investment banker promises only to make its best sales effort

beta The measurement of the extent to which a stock's returns are related to general market returns

bid-ask spread In over-the-counter markets, the difference between the bid price at which a dealer is willing to buy a security and the ask price at which he or she is willing to sell the security. Dealers make a profit by selling at a higher price than the price they pay.

bid price The price offered by a dealer to purchase a given security

bill of lading An international trade document that is a receipt issued to the exporter by a common carrier, which acknowledges possession of the goods described on the face of the bill; a contract between the exporter and the shipping company

bond A contractual obligation of a borrower to make cash payments to a lender for a fixed number of years; upon maturity, the lender is paid the face value of the security

bondholder The lender in a bond contract

bond issuer The borrower in a bond contract

bond price volatility The percentage change in bond price for a given change in yield

bond ratings The credit ratings of bonds, principally those issued by Standard & Poor's and Moody's, ranked in order of the perceived probability of their default and published as letter grades, with the highest-grade bonds being those with the lowest default risk

book build A system in which larger institutions submit bids for blocks of stock in an IPO and, from these bids, the firm and its advisers decide what price or prices to charge the public and the institutions

Bretton Woods Before 1971, a system of fixed currency exchange rates under which a government was obligated to intervene in the foreign exchange markets to keep the value of its currency within a narrow range

bridge loan A loan to supply cash for a specific transaction with repayment coming from an identifiable cash flow

broad money M3 plus borrowings from the private sector by nonbank financial institutions (NBFIs) less currency and bank deposits of NBFIs

brokers Those who act as intermediaries between buyers and sellers but do not take title to the securities traded

building societies ADIs that historically concentrated on consumer products predominately funded from deposits but have recently pursued corporate business to facilitate growth and product diversification

business overhead insurance Insurance that provides cover for 'eligible' business expenses (including interest, lease payments, rates, rent, taxes, telephones and insurance) as agreed when the policy is taken out, while the insured person is incapacitated

call interest premium The difference in interest rates between callable and comparable noncallable bonds

call option (call provision) The option of the bond issuer to buy back the bond at a specified price in advance of the maturity date. The price (call price) is usually set at the bond's par value or slightly above it.

call price The price at which a call option can be exercised

CAMELS A rating system to assess a bank's position in terms of the risk components capital adequacy, *asset* quality, *m*anagement, *e*arnings, *l*iquidity and *s*ensitivity to market risk

cap The purchase of a put option (that is, an option to sell) on a financial futures contract to limit increases in the cost of banks' liabilities without sacrificing the possibility of benefiting from interest rate declines

capital adequacy The maintenance of adequate levels of capital to enable an ADI to continue to operate in the event of unanticipated losses or problems

capital adequacy ratio (CAR) ARPA-regulated ADIs must hold a CAR of at least 8 per cent. CAR is calculated as capital/risk-adjusted assets

capital asset pricing model (CAPM) The CAPM postulates the relationship between the expected return from a security and its systematic risk

capital flight The transfer of wealth out of a country by its owners, typically in response to political instability

capital-gains yield The rate at which the value of the firm is expected to grow

capital markets Markets in which capital goods are financed with stock or long-term debt instruments

captive sales finance companies Finance companies that finance goods sold by their parent companies

cash assets Vault cash, cash items in the process of collection and balances held with the RBA and short-term investments

cash-flow underwriting The writing of insurance on just about any risk to get the premium dollars to invest at high interest rates

cash items in the process of collection An account representing the value of cheques drawn on other banks but not yet collected

cash market Another name for the spot market, which involves the exchange of securities or other financial claims for immediate payment

cash rate The overnight interest rate for unsecured loans between banks

cash settlement price The price at which an open futures contract is settled in lieu of delivery or physical purchase

CHESS-RTGS A feeder system to RITS that settles high-value transactions for the ASX for Australian equities trades

clearinghouse The back office that records, clears and settles contracts and acts as counterparty in futures trading

closed-end investment company A fund that initially sells its shares to the public to obtain cash to invest and then operates with a fixed number of shares outstanding

closed out Closing out is termination of a contract.

co-insurance A loss-sharing provision in insurance

collar The simultaneous buying of a cap and selling of a floor to limit the movement of a bank's liability costs within a specified range

commercial bills Short-term discount securities (bank-accepted bills and nonbank bills) that allow borrowers with good credit ratings to access funds from the money markets

commercial LOC An LOC in which the bank guarantees payment for goods in a commercial transaction

commercial paper The unsecured promissory note (IOU) of a large business

commercial paper An unsecured, short-term promissory note issued by a large creditworthy business or financial institution

commodity currency The currency being traded

common bond of association The traditional requirement of credit unions that members were of a particular occupation, association, residence or other specified group

compensating balances Minimum average deposit balances that bank customers must maintain at the bank, usually in the form of noninterest bearing demand deposits

competitive bidding An issuer of securities publicly announces a desire to sell securities and solicits offers from several investment banking firms

compounding The calculation of future value based on the assumption that all interest earned will be reinvested to earn additional interest

concentration ratios Measures of the percentage of loans or loan commitments allocated to a given geographic location, loan type or business type

consols Interest-bearing securities issued and bought back by the Bank of England from the eighteenth century to influence the supply of credit in the market

consumer finance companies Finance companies that specialise in making cash loans to consumers

contagion The phenomenon in which the financial difficulties of one organisation spread to others because of the complex interrelationships between institutions and the nature of the exchange settlement systems

continuous linked settlement A global settlements initiative linked to RITS' RTGS system, designed to mitigate risk in international currency settlements

contract or delivery month The month in which deliveries are made or contracts terminated

contract unit The standard quantity of a good in a futures or options contract

contributing shares Shares issued when partly paid for, so that there is an obligation on the holder to contribute the balance

conversion option The option allowing the investor to convert a security into another type of security at a predetermined price

conversion yield discount The difference in yield between convertible bonds and similar bonds without a conversion option

convertible notes Bonds that can be exchanged for common stock

convertible preference shares Preference shares that can be converted into ordinary shares at a predetermined ratio

convertible term insurance Insurance that permits the term coverage to be switched to whole-life insurance without providing evidence of insurability

convexity The curve representing bonds' price/yield relationship is convex. Therefore, convexity is the adjustment for the shape of the curve in the formula for estimating the percentage change in the price of the bond corresponding to a given change in the market interest rate.

corporate bonds Long-term IOUs that represent a claim against a firm's assets

correspondent banking A business arrangement between two banks in which one (the correspondent bank) agrees to provide the other (respondent bank) with special services, such as cheque-clearing or trust department services

counterparty In a forward market, the contracted party that exchanges one item for another for a predetermined price at a predetermined point in time. Ordinarily, both parties to the contract are bound by the contract.

counterparty risk The risk that the other party to an agreement will default or not meet its obligations

countertrade In international trade transactions, the practice of accepting locally produced merchandise in lieu of money as payment for goods and services

country risk The risk tied to political developments in a country that affect the return on loans or investments

coupon payments The periodic interest payments in a bond contract

coupon rate The amount of coupon payments received in a year stated as a percentage of the face value

covered options Option writers' positions if they already own the securities that they have agreed to sell or have already sold short the securities that they have agreed to buy

credit analysis Determination of whether a loan should be granted and to which credit risk category a customer should be assigned

credit derivatives Instruments (with an underlying asset) that lenders can use to minimise their credit risk exposure

credit risk The risk that the borrower will not pay back all or part of the interest or principal as specified in the loan agreement

credit risk weight A multiplier that weights the risk of an institution's assets

credit scoring A method for analysing a potential borrower's character by a score based on the information in the borrower's credit report

credit unions ADIs that are owned and operated democratically by their members

credit-wrapped bonds Bonds with financial guarantees

cross-hedging Hedging with a traded futures contract whose characteristics do not exactly match those of the hedger's risk exposure

cumulative A feature of preference shares that means the firm cannot pay a dividend on its ordinary shares until it has paid the preference shareholders the dividends in arrears

currency risk The risk resulting from changes in foreign exchange values that affect the return on loans or investments denominated in other currencies

current account The balance of payments account that summarises foreign trade in goods and services plus investment income and gifts or grants made to other countries

daily-settlement margin calls Margins called for daily after marking to market

dealer panel A small set of bond dealers that agree to buy semis from state governments in either closed auctions (where stock is assigned to the best bids) or through agreeing to buy a given amount at a given price

dealers Those who are in the security business acting as principals rather than agents. The dealer buys for his or her own account and sells to customers from his or her inventory.

debenture A bond secured by charges over the issuing firm's assets

debt consolidation companies Finance companies that target individuals with excessive levels of personal debt or those with several different loans, then consolidate these debts into one loan that is easier to manage or has a lower principal repayment than the individual debts when combined

debt funds Funds supplied in the form of a loan

debt issues Short- and long-term instruments that raise funds from public debt issues. Common forms are commercial paper, medium- to long term debentures and unsecured notes including euro notes and Eurobonds

default The failure on the part of the borrower to meet any condition of the bond contract

default risk The possibility that the borrower will not pay back all or part of the interest or principal as promised

default risk premium The amount of additional compensation investors must receive for purchasing securities that are not free of default risk

defensive shares Shares with betas less than 1.0 that carry less systematic risk than the market.

deficit spending unit (DSU) An economic unit whose expenditure in a period exceeds current income. A DSU sells financial claims on itself (liabilities) or sells equity to obtain needed funds

defined benefits plan A superannuation plan in which the employer states the benefit that the employee will receive at retirement

deliverable contracts Contracts in which the goods involved may be delivered or purchased

direct financing Financing in which DSUs issue financial claims on themselves and sell them for money directly to SSUs. The SSU's claim is against the DSU, not a financial intermediary.

discount bond A bond that sells below its par or face value. A bond sells at a discount when the market rate of interest is above the bond's fixed coupon rate.

discount broker Brokers that offer fewer brokerage services and pass the savings on to the investors

discount securities Securities issued at less than their face value (at a discount), for which the difference between the face value and the discounted issue price represents the return to the investor

discounting The calculation for finding the present value of some future sum of money

disintermediation The withdrawal of funds that were previously invested through financial intermediaries so that they can be invested directly in the financial markets

diversification The process of acquiring a portfolio of securities that have dissimilar risk–return characteristics to reduce overall portfolio risk

dividend reinvestment scheme A company scheme in which dividends are allowed to be reinvested into shares by shareholders, often at a discount to current market prices

dividend yield The expected dividend expressed as a proportion of the price of the stock

dividends Corporate payments to shareholders

dollarisation Some countries' practice of adopting the US currency as a medium of exchange

due diligence The legal requirement that investment bankers diligently seek out and disclose all relevant information about an issuer before securities are sold to the public

duration A measure of interest rate risk (or bond price volatility) that considers both coupon rate and maturity; it is the weighted average of the number of years until the present value of each of the bond's cash flows is received.

duration gap A measure of the difference between the duration of a bank's assets and the duration of its liabilities

EBAs and ECDs Electronic debt obligations, usually short term

eligible collateral Collateral that APRA recognises for the purposes of including in Tier 1 or Tier 2 capital calculations

equity funds Funds supplied in the form of the acquisition of an ownership share of a business

euro The common currency for the countries that are members of the European Monetary System

eurobond market The market for long-term borrowing or lending of large amounts of capital in the form of eurobonds: bonds denominated in currencies other than that of the market of issue

eurocurrency market The market for short-term borrowing or lending of large amounts of any currency held in a time deposit account outside its country of origin

eurodollars US-dollar denominated deposits held by banks located outside the United States

European option An option that can be exercised only at expiry. The buyer of the option pays the seller (writer) a premium. The writer keeps the premium regardless whether the option is exercised. An option need not be exercised if it is not to the buyer's advantage to do so.

excess The first portion of any loss that must be met by the insured

exchange rate The rate at which one nation's currency can be exchanged for another's at the present time

exchange settlement account (ESA) An account financial institutions hold with the central bank to transfer funds to settle transactions in the payments system

exchange settlement funds Funds held in accounts at the RBA to facilitate settlement between clearing banks

exchange summary fax A statement by institutions participating in the payment system that details obligations accrued during the course of the day against other institutions

expected yield The expected return on a bond at the end of a relevant holding period based on predictions made from interest rate forecasts

ex-rights After a rights issue is finalised

factoring The purchase by a finance company of a business firm's accounts receivable

FATF The Financial Action Task Force on Money Laundering, which examines and makes recommendations on action to combat money laundering

finance companies Companies that raise funds from wholesale markets and retail investors and then provide loans to households and small-to medium-sized enterprises

finance lease A longer-term arrangement, at the end of which ownership of the leased asset is usually transferred to the lessee

financial account That part of the balance of payments accounts that records capital transactions with other countries

financial claims Written promises to pay a specific sum of money (the principal) plus interest for the privilege of borrowing money over a period of time. Financial claims are issued by DSUs (liabilities) and purchased by SSUs (assets).

financial guarantees Unconditional offers from a private sector guarantor to cover the payment of principal and interest to investors in debt securities in the event of a default

financial intermediaries Institutions that issue liabilities to SSUs and use the funds so obtained to acquire liabilities of DSUs

financial intermediation The purchase of direct claims (IOUs) with one set of characteristics from DSUs and their transformation into indirect claims (IOUs) with a different set of characteristics

financial markets the markets for buying and selling financial instruments

Financial Ombudsman Service A single contact point for consumers, which covers ADIs, general and life insurers, financial planners, stockbrokers and managed funds

Financial Sector (Collection of Data) Act 2001 The Commonwealth legislation that empowers APRA to collect information from financial institutions

Financial Sector (Shareholdings) Act 1998 The Commonwealth legislation that regulates ownership of financial institutions

Financial Services Reform Act 2001 The Commonwealth legislation introduced to improve operations in the financial services sector (introduced in response to the Wallis Report)

first-stage financing Capital provided to initiate manufacturing and sales

Fisher equation $i = r + \Delta Pe$, where i = the observed nominal rate of interest (the contract rate), r = the real rate of interest and ΔPe = the expected annual percentage change in the average price level in the economy (expected inflation)

fixed-rate loan A loan on which the interest rate does not change over the loan's term

fixed exchange rates A constant rate of exchange between currencies. Governments try to fix their exchange rates by buying or selling their currency whenever its exchange value starts to vary.

flex options Option contracts that are custom designed for the parties concerned but still traded on an exchange

floating-rate loan A loan on which the interest rate is periodically adjusted to reflect changes in a designated short-term interest rate indicator such as the Australian BBSW rate

floor The sale of a call option (i.e. an option to buy) on a financial futures contract to set a lower limit for liability costs

floor-plan financing Financing of inventory available for sale for retailers of large-cost, low-volume items such as motor vehicles

Foreign Acquisitions and Takeovers Act 1975 The Commonwealth legislation that governs foreign acquisition of Australian assets

foreign branch A legal and operational part of a parent bank operating in a foreign country

foreign exchange markets The markets in which foreign currencies are bought and sold

foreign exchange risk The fluctuation in the earnings or value of a financial institution that arises from changes in exchange rates

Foreign Investment Review Board The body responsible for reviewing foreign investment proposals and making recommendations on them to the federal treasurer

foreign subsidiary A separately incorporated domestic bank owned entirely or in part by a foreign bank

forward contract A contract that guarantees delivery of a certain amount of goods, such as foreign currency, for exchange into a specific amount of another currency, such as dollars, on a specific day in the future

forward market A market in which parties agree to exchange a fixed amount of one currency for a fixed amount of a second currency, but actual delivery and exchange of the two currencies occurs at some time 'forward'

forward price In a forward contract, the price at which the purchaser will buy a specified amount of an asset from the seller at a fixed date sometime in the future

forward rate The interest rate that is expected to exist in the future

four pillars policy The Australian government ban on mergers and takeovers between the four major banks (National Australia Bank, Commonwealth Bank, ANZ, Westpac) aimed at maintaining competition within the sector

franking credits The tax amounts paid on dividends received

frictional unemployment Unemployment caused by being in transition between jobs

full employment The case in which every person of working age who wishes to work can find employment

fully franked dividend A dividend that has had the full rate of tax, 30 per cent, paid on it, so that every \$7 of dividend has a tax credit attached of \$3

futures contract A contract to buy (or sell) a particular type of security or commodity from (or to) the futures exchange during a predetermined future time period

futures exchange A place in which buyers and sellers can exchange futures contracts. The exchange keeps the books for buyers and sellers when contracts are initiated or liquidated.

futures market A market in which people trade contracts for future delivery of securities, cash goods or the value of securities sold in the cash market

future value The worth in the future of a currently held amount of money if it is invested and reinvested at known interest rates

gold standard The standard in which currency is valued in relation to the value of an ounce of gold

government bonds Long-term debt obligations of governments used to finance capital expenditure for things such as schools, highways and airports

health insurance Insurance to cover the medical costs associated with illness and injury

hedge funds Investment pools that use a combination of market philosophies and analytical techniques to develop financial models that identify, evaluate and execute trading decisions. The goal is to provide consistent, above-market rates of return while substantially reducing the risk of loss.

hedgers Individuals or firms that engage in financial market transactions to reduce price risk

high-value payments The low-volume, high-value transactions made with instruments such as bank cheques and warrants, and cleared in real time transaction by transaction

home equity loan Revolving credit secured with a second mortgage

housing loans Mortgage loans that finance the purchase, construction and remodelling of both residential housing and commercial facilities

hybrid security A financial product with characteristics of both debt and equity

implied forward rate The forward rate of interest is implied by the difference between a short-term rate and a longer-term interest rate. The implied forward rate is the rate necessary to make funds invested at the short rate and reinvested at the implied forward

rate generate a return equal to that which could be obtained by buying the longer-term security.

income protection insurance Insurance designed to provide regular payment to policyholders if they are unable to work for an extended period because of illness or accident

index funds Managed funds that aim to match the return from a particular market index, such as the ASX200

inflation The continuous rise in the average price level

informational efficiency The market situation in which market prices reflect all relevant information about the securities

initial margin A deposit of money or other valuable assets with a futures exchange to guarantee that buyers will keep their part of a bargain

initial public offering The primary offering of a company that has never before offered a particular type of security to the public, meaning the security is not currently trading in the secondary market; an unseasoned offering

insider trading Trading by one person or a few people with information not known to the general investing public

insurance The transfer of a pure risk to an entity that pools the risk of loss and provides payment if a loss occurs

interest income Income earned from deposits with financial institutions, interest from investment securities and interests on loans and advances made to clients

interest rate The rental price of money, usually expressed as an annual percentage of the nominal amount of money borrowed; the price of borrowing money for the use of its purchasing power

interest rate risk The risk that changes in interest rates will cause an asset's price and realised yield to differ from the purchase price and initially expected yield

interest withholding tax A 10 per cent tax levied on interest payments from bonds issued by Australian companies that are held by offshore investors

International banking Banking in which transactions involve one or more parties that are located outside of the bank's home country

Internet-based savings accounts Savings accounts that offer high interest with no or limited fees and limited transaction options

intraday margin calls A margin call made during the day rather than at the end of the day's trading

intrinsic value The value that could be realised by exercising an option immediately.

investment bank A bank that specialises in helping businesses and governments sell their new security issues in the primary markets to finance capital expenditures, and makes secondary markets for the securities as brokers and dealers

investment banker A person who provides financial advice and underwrites and distributes new investment securities

investment capital flows Either short-term money market flows motivated by differences in interest rates or long-term capital investments in a nation's real or financial assets

investment-grade bonds The bonds rated in the top four rating categories by Standard & Poor's ('BBB' and higher) and Moody's ('Baa' and higher)

investment risk The possibility that the investor's expected return will not be realised

investment savings accounts Savings accounts that pay higher interest than general savings accounts and have more restrictive limits on transactions, balance limits, regular deposit requirements and the like

kangaroo bonds Bonds issued by foreign entities in Australia. They are denominated in Australian dollars and must comply with the regulations imposed by the Corporations Law.

last trading day The last day on which trading occurs in a particular contract

law of large numbers As the number of insured risks (or anything that can be measured with a probability) increases, the deviation between actual and expected results will decline

lease A form of finance in which the owner of the asset (the lessor) allows a third party (the lessee) to use that asset, according to particular terms and conditions that are set out in a lease contract, in return for lease payments

legal tender Notes and coins issued by the government, which represent a store of value and the government promises to honour, and must be accepted in settlement of a transaction

lender of last resort A lender available to banks in difficulty to prevent them from failing when they are in financial difficulty, usually because of a lack of liquidity

letter of credit (LOC) A financial instrument issued by an importer's bank that obligates the bank to pay the exporter (or other designated beneficiary) a specified amount of money once certain conditions are fulfilled

leveraged buyout An acquisition strategy that involves buying a company using a large amount of debt to fund the purchase cost of the target company

liability insurance Insurance against the peril of legal liability

liability management Acquiring liquidity from the liability side of the balance sheet

LIBOR London Interbank Offered Rate. The 'prime rate' of international lending and the cheapest rate at which funds flow between international banks

limit order An order to buy or sell at a designated price or at any better price

limited liability A legal concept that means that losses of common shareholders are limited to the original amount of their investment. It also implies that the personal assets of a shareholder cannot be obtained to satisfy the obligations of the corporation.

line of credit An agreement under which a bank customer can borrow up to a predetermined limit on a short-term basis (less than a year)

liquidity The ease with which an asset may be converted to cash without a loss in value

liquidity management strategy A compulsory strategy an ADI must have to ensure it has adequate funds to meet its obligations as and when they fall due

liquidity premium Additional interest paid by borrowers who issue illiquid securities to obtain long-term funds; the interest premium compensates lenders who acquire a security that cannot be resold easily or quickly at par value

liquidity ratio The average number of times each bond is turned over each year

liquidity risk The risk that a financial institution will be unable to generate sufficient cash inflow to meet required cash outflows

loan capital Long-term, subordinated notes and debentures, some of which may be convertible into common stock

loan commitments Formal promises by a bank to lend money according to the terms outlined in the commitment

long Buying and holding shares in a portfolio

long position An agreement to buy in the futures market

long-term asset loans Loans that finance the acquisition of an asset or assets

low-value payments The high-volume cash and noncash payments that involve small transfers of value such as cash, EFTPOS and credit card transactions

M1 The definition of money that focuses on money as a ‘medium of exchange’. M1 consists of financial assets that people hold to buy things with (such as currency and current accounts at depository institutions).

M3 M1 plus all other bank deposits of the private nonbank sector (including savings deposits, money-market deposit accounts, overnight repurchase agreements, money-market managed funds and term deposits)

macro hedging Using instruments of risk management, such as financial futures, options on financial futures and interest rate swaps to reduce the interest rate risk of the firm’s entire balance sheet

management buyout The situation in which the managers of a business purchase a business from the owners or shareholders using resources provided by a third-party financier — often a venture capital firm

mandatory-settled contracts Contracts which are nondeliverable and are settled in cash

margin In futures markets, money posted to guarantee contracts will be honoured and to take account of gains or losses accruing from daily price movements

marketability The ease with which a financial claim can be resold. The greater the marketability of a financial security, the lower is its interest rate.

market breadth A feature of a secondary market if the orders that give the market depth exist in significant volume

market depth A feature of a secondary market if orders exist both above and below the price at which a security is currently trading

market maker A trader who makes a profit based on the difference between the bid and the ask prices of securities

market order An order to buy or sell at the best price available at the time the order reaches the exchange

market resilience A feature of a market if new orders pour in promptly in response to price changes resulting from temporary order imbalances

market risk The risk that the profitability or net worth of the bank will change because of movements in market prices

market risk premium The risk premium of the market portfolio

market segmentation theory The theory that maintains that market participants have strong preferences for securities of a particular maturity and holds that they buy and sell securities consistent with these maturity preferences, resulting in the yield curve being determined by the supply of and demand for securities at or near a particular maturity

market-sensitive information Information that could affect market prices

market value-weighted index A share market index that is computed by calculating the total market value of the firms in the index and the total market value of those firms on the previous trading day. The percentage change in the total market value from one day to the next represents the change in the index.

marking to market In futures markets, a requirement that gains or losses on futures positions be taken into account in determining the value of all contracts each day

matched funding The funding of fixed-rate loans with deposits or borrowed funds of the same maturity

maturity gap analysis A comparison of the value of assets that will either mature or be repriced within a given time interval with the value of liabilities that will either mature or be repriced during the same time period

membership share An ownership share in a credit union

mezzanine (bridge) financing Capital provided for a company that expects to go public within a year or so

micro hedging Hedging of a specific transaction

monetary policy The RBA's control of the level of funds in the market and the level of interest rates

money The medium of exchange used in the financial system

money base The value of currency held by the private sector plus the value of the deposits made by banks with the RBA and any other liabilities to the private sector held by the RBA

money laundering The processing of the financial proceeds of criminal activities to disguise the illegal origin of the funds

money markets Markets in which commercial banks and other businesses adjust their liquidity position by borrowing, lending or investing for short times

moral hazard The risk of immoral behaviour, leading to a negative outcome, increasing because the individual that causes the problem does not suffer the full (or any) consequences and may benefit

mortgage-backed securities A type of asset-backed security

mortgages Long-term loans secured by real estate 27

naked options Option writers' position if they do not own the securities that they have agreed to sell or have not sold short the securities that they have agreed to buy

named-perils coverage Insurance policies that provide a listing of perils that are covered. If a loss is caused by a peril not listed, the loss is not covered.

national collator That part of the payments system that compiles the exchange summary faxes from each ESA account holder and calculates a single net obligation for each institution

negotiable certificates of deposit (NCDs) Promissory notes in denominations of \$100 000 or more, which can be resold in secondary markets and are issued by banks rather than large corporations

negotiated offering An issuer of securities directly negotiates with a single investment banker

net asset value (NAV) The sum of the total current value of a fund's assets, less the value of any debts (liabilities) owed by the fund, divided by the number of fund shares outstanding

net interest income Interest income less interest expense

niche finance companies Finance companies that specialise in a particular type of finance product

nominal interest rate The interest rates that are observed in the marketplace

noninterest income Income derived from activities such as financial planning, charging fees on mortgages and other loans, commissions and dividends from investments

nonparticipating A feature of preference shares that means the preference dividend remains constant regardless of any increase in the firm's earnings

nonrenounceable rights Rights that cannot be sold on the market. Shareholders have the option to subscribe to the rights issue or let the offer lapse.

notional principal The face value amount for which interest payment obligations are computed under a 'swap' agreement. Because the principal is never repaid, it is only 'notional' for the duration of the swap.

novation The process of setting up a contract with a new party, such as occurs when clearinghouses insert themselves between the buyer and seller of a futures contract

objective risk The deviation between actual losses and expected losses

off-balance-sheet banking Activities that represent either contingent assets or contingent liabilities

offshore banking unit A foreign branch that has limited access to that country's domestic market

one-name paper Commercial paper and negotiable CDs

open-end investment companies A collective investment fund that allows additional investment from existing and new investors, and allows existing investors to withdraw funds. The fund manager must create new units in the fund when an investment is made and redeem units when a withdrawal is made.

open-market operations Trading operations undertaken in the financial markets to effect changes in the banks' ESAs

operating leases Short-term arrangements in which the asset is maintained by the lessor for the duration of the lease, with the asset returned to the lessor at the end of the lease

operational efficiency The market situation in which the costs of conducting transactions are as low as possible

operational risk The risk of loss from inadequate or failed internal processes, people and systems from external events

option contract A contract that allows the holder to buy (or sell) a specified asset at a predetermined price before its expiration date. The predetermined price is called the strike price.

option market A market in which options are traded

option premium The price of the option

ordinary shares The basic ownership claim in a corporation

overdraft facility An operating account that is approved to go into debit up to a certain limit

over-the-counter market Primarily a dealer market in which securities not sold on one of the organised exchanges are traded

P/E (price/earnings) ratio The ratio of price per share to the earnings of the firm per share

par bond A bond that is selling at its par value

participation loans Arrangements in which banks join together to provide the funds for loans and so directly reduce the risk exposure for each individual bank

payday lenders Finance companies that offer very short-term loans at exceedingly high interest rates

payments system The system that permits the settlement of transactions (i.e. the transfer of funds) within the financial system

perils The causes of loss

perpetuity A cash-flow stream that pays equal cash flows at the end of each period forever

personal loans Loans to individuals that usually have terms of up to five years for purchases such as cars, holidays, computers and boats

political capital flows International capital flows that respond to changed political conditions in a country

political risk Country or sovereign risks that can result in financial claims of foreigners being repudiated or becoming unenforceable because of a change of government or in government policy, in a country

pooling Spreading losses suffered by a few insured over the entire group so that insurance purchasers substitute the average loss (a small amount) for the uncertainty that they might suffer a large loss

position limits Maximum numbers of contracts that speculators may open on an exchange

positive time preference The preference of people to consume goods today rather than tomorrow

preference shares Shares that confer preference over common shares in terms of dividend payments and the claim against the firm's assets in the event of bankruptcy or liquidation

preferred-habitat theory The theory of the term structure of interest rates that suggests investors leave their preferred maturity range only if adequately compensated for the additional risk of investing in a security whose maturity does not match the investors' investment horizon. This theory is an extension of the market segmentation theory.

premature death Loss of life while others are financially dependent on you

premium bond A bond whose market value is above its par or face value. A bond sells at a premium when the market rate of interest is below the bond's fixed coupon rate.

premium or discount to NAV The variation of the market price from NAV for closed-end investment companies

present value The value today of a future stream of cash payments discounted at the appropriate discount rate

price risk Interest rate changes can cause the market price of a bond to rise or fall, resulting in gains or losses for an investor

price stability The stability of the average price of all goods and services in the economy

price-weighted index A share market index that is first computed by summing the prices of the individual shares comprising the index; then the sum of the prices is divided by a 'divisor' to yield the chosen base index value

price-yield profiles A plot of a bond's price (y-axis) versus its market yield (x-axis)

primary financial market A financial market in which financial claims are first sold as new issues. All financial claims have a primary market.

primary offerings Offerings of new issues of shares or bonds

primary reserves The cash assets on a bank's balance sheet. They consist of vault cash, deposits at correspondent banks and deposits held at the RBA

prime assets requirement Formerly, a regulatory requirement that banks in Australia hold 3 per cent of their liabilities in specific acceptable assets

principal, face value, par value The stated value of a bond. For debt instruments, the par value is usually the final principal payment.

private-label credit A credit plan operated by a finance company under a retailer's name

private placement The distribution of equity securities in which the investment banker acts only as the company's agent and receives a commission for placing the securities with investors

Probability and Impact Rating System APRA's system to assess the probability that a regulated institution will fail and the effect such a failure would have on the financial system

project finance The structuring and finance of large-scale projects and developments, such as mines, property developments, hotels and resorts, sports stadiums, heavy industry developments and infrastructure projects such as roads, tunnels, bridges and rail projects

promissory notes Unconditional promises made in writing by the borrower to pay the lender a specific amount of money, usually at some specified future date

property insurance Insurance against direct or indirect loss to property

property trust A trust that pools the resources of investors to purchase commercial, industrial and retail property with a view to generating both income and capital gains for the investors

proxy A process in which shareholders vote by absentee ballot

purchasing power parity An economic concept that says the purchasing power of a currency should be equal in every country if goods, services, labour, capital, and other resources can flow freely between countries. However, because there are impediments to free trade, purchasing power parity conditions often do not hold. Therefore, goods often cost more in one country than in another.

pure risks Situations in which two outcomes are possible: loss or no loss

put interest discount The difference in interest rates between puttable and similar nonputtable bonds

put option The option allowing the investor to sell an asset to the put issuer at a predetermined price

RBA's charter The statutory responsibilities of the RBA

real rate of interest The nominal rate of interest prevailing in the marketplace adjusted for the expected rate of inflation; the equilibrium rate of interest if no inflation occurs

realised rate of return The nominal rate of return on an investment adjusted for the actual rate of inflation that occurred after the investment was undertaken. The realised real rate can be either negative or positive.

realised yield The rate of return earned on a bond given the price paid and the cash flows actually received by the investor

real-time gross settlement (RTGS) system Part of RITS that settles high-value payments in real time

record date The date on which a company ceases to effect transfers of its shares

redeemable The right of the issuer to buy back shares from the holders

redeemed preference shares A capital account that represents the balance of credit union member shares that have been redeemed (because of member resignations)

rediscount facility The RBA buys back t-notes held by institutions at a penalty rate to provide them with same-day funds.

redlining The decision of insurance companies to refuse to issue insurance to individuals with particular characteristics, such as place of residence, age, gender, education and marital status

regulatory arbitrage The shifting of operations to jurisdictions, regulators or countries with the least restrictive regulations

regulatory capital Capital as defined by the prudential statements

regulatory dialectic The process in which regulations are evaded, new regulations are enacted to close the loopholes, new evasion strategies and products are developed, new regulations are adopted to curb the innovations and so on

reinsurance The process by which insurers shift some of the risk that they have insured to another insurance company

reinvestment risk The risk resulting from market interest rate changes that cause a bond investor to have to reinvest coupon payments at interest rates different from the bond's promised yield

renewable term insurance A policy that allows the insured to renew it without having to prove they are still insurable

renounceable rights Rights that may be sold on the market if shareholders do not want to subscribe to a rights issue and increase their shareholdings

representative offices Offices established in a foreign country primarily to assist the parent bank's customers in that country

reserve accounts Accounts set up to cover expected losses on loans and investments and to account for revaluation of assets

Reserve Bank Act 1959 The Commonwealth legislation governing the RBA

Reserve Bank Information and Transfer System (RITS) The RBA's system of settlement of cleared transactions, which results in transfers between exchange settlement accounts of financial institutions in Australia

Reserve Bank of Australia (RBA) Australia's central bank, responsible for monetary policy, financial system stability and the payments system

reserve currency The currency used as the international pricing currency for products traded in international markets

residual claim A feature of common stock that is a claim against the firm's cash flow or assets: if the firm is liquidated, those with prior claims are paid first and the common stockholders are entitled to what is left over, the residual

restrictive covenant A legal obligation imposed in a contract to do or not to do something

retained profits The accumulated portion of the bank's profit that has not been paid out to shareholders as dividends

return on investment The future additional real output generated by investment in productive capital projects

reverse repurchase agreement (reverse repo) The reverse (lending) side of a repo

revolving credit A formal legal agreement under which a bank agrees to lend up to a certain limit for a period exceeding a year, in which the lender can draw down and pay back the amount lent

riba The Arabic word for interest. Charging interest is prohibited by the Qur'an.

rights issue The issue of new shares to existing shareholders

risk premium Required (or expected) return on a risky security minus the return on a similar riskfree security

risk transfer Shifting the responsibility of bearing the risk from one party to another

rollover pricing Floating-rate loans that allow banks to fund credits in the eurocurrency market at the beginning of the period and lock in a lending spread for the coming period. At the end of this period, the loan will again 'roll over' and be repriced for the subsequent period.

Rule 144A A regulation that governs the US private placement market

sales finance companies Captive sales finance companies that are subsidiaries of major retailers and car manufacturers

same-day funds Funds that do not have to be cleared through the payments system and so can be used to increase ESA balances during the day

samurai bonds Yen-denominated bonds issued by foreign companies in Japan

savings accounts Interest-bearing accounts of individuals and partnerships

seasonal loan A loan that provides term financing to take care of temporary discrepancies between business revenues and expenses that arise because of the manufacturing or sales cycle of a business

seasoned offering The primary issue of securities of a type already trading in the secondary market

second-mortgage lending Lending secured by second mortgages over real estate

second-stage financing Capital used for initial expansion of a company that has already been producing and selling a product

secondary financial market A financial market in which participants buy or sell previously issued financial claims

secondary reserves Short-term assets that can be converted quickly into cash at a price near their purchase price

securitisation The process of taking illiquid assets and turning them into liquid securities sold to investors in the capital markets

securitisation of risk The transference of insurable risk to the capital markets through the creation of a financial instrument

security market line The linear relationship between systematic risk (beta) and expected return

seed financing Capital provided to a company at the idea stage

seigniorage The difference between the cost of the printed currency and its exchange value

semigovernment securities Bonds issued by state and territory borrowing authorities

senior debt Debt that has priority in the event of default

serial options Options that refer to noncontract months for the underlying futures contracts

settlement date In a forward contract, the future date on which the buyer pays the seller and the seller delivers the assets to the buyer

share amalgamations The revaluation and elimination of some of the firm's issued shares, resulting in a smaller number of shares of a higher value, with the overall market capitalisation of the company remaining unchanged

share capital The direct investment into the bank in the form of common or preferred stock

share-index futures contracts Futures that derive their value from averaging the prices of a 'basket' of underlying shares included in the share index

share splits The division of the entity's shares into a greater number of units of smaller value, maintaining the overall market capitalisation of the company

shares A financial instrument that represents an ownership claim on a firm's assets. Shareholders share in the distributed earnings and net worth of a company.

shell branches Booking offices for bank transactions located abroad with no contact with the public and no staff

ship financing The financing of large vessels for the purpose of transporting oil, containers, commodities such as coal and grain, and passengers

short position An agreement to sell in the futures market

short sale The process of selling a security before buying it, waiting for the market to fall and then buying the security to make the delivery required from his initial sale

sight draft A bank draft that requires payment when the goods are received

sinking fund A provision that requires that the bond issuer provide funds to a trustee to retire a specific dollar amount (face amount) of bonds each year

sovereign risk The possibility that a sovereign country as a borrower may become unable or unwilling to service its foreign obligations or meet guarantees of nongovernmental or private borrowings

special purpose vehicle A legal entity separate from the loan originator controlled by a trustee, in which the loan originator sells a pool of comparable assets, which all have similar maturity and risk profiles, as the first step in a securitisation

speculative-grade (junk) bonds The bonds that ratings agencies rate below 'BBB' (Standard & Poor's) or 'Baa' (Moody's)

speculative risks Situations in which there are three possible outcomes: loss, no loss or gain

speculators Those who assume price risk in the expectation of earning a high return

spot market The market in which securities are traded for immediate delivery and payment

spot price An observed price at which current transactions take place

spot rate An observed interest rate at which current transactions take place

spread (straddle) A position in options that combines two or more options (i.e. two or more calls or puts)

standby LOC An LOC in which the bank promises to pay a third party in the event the bank's customer fails to perform according to a contract the customer has with the third party

startup financing Capital used in product development and initial marketing

strike (exercise) price The price at which an option can be exercised

structural unemployment The case in which some of those who are unemployed are unemployed because there is a mismatch between their skill levels and available jobs, or there are jobs in one region of the country but few in another

subordinated debt Debt that ranks behind senior debt in the event of default

subscription price The amount that must be paid per share to buy a new issue

superannuation A government-controlled investment strategy aimed at providing resources that can be used upon retirement

Supervisory Oversight and Response System APRA's system to determine the response APRA should make to the outcomes of PAIRS ratings

surplus spending unit (SSU) An economic unit whose income in a period exceeds expenditure. SSUs often purchase financial claims issued by DSUs

swap An exchange of assets or income streams for equivalent assets or income streams with slightly different characteristics

SWIFT PDS A feeder system to RITS from the Society for Worldwide Interbank Financial Telecommunications, which settles the Australian dollar side of foreign exchange transactions

syndicated A form of loan in which several banks participate in funding a loan packaged by one or more lead banks

system queue A list of transactions currently in the process of being settled in RTGS

systematic risk The risk that tends to affect the entire market similarly; also known as market risk or nondiversifiable risk

term draft A bank draft that requires payment some time (usually 30, 60 or 90 days) after the goods are received

term insurance Pure life insurance for a specified period of time, less than all of life

term loan A formal legal agreement under which a bank will lend a customer a certain dollar amount for a period exceeding a year

term structure of interest rates The relationship between yield and term to maturity on securities that differ only in length of time to maturity; graphically approximated by the yield curve

term to maturity The length of time until the final payment of a debt security

terms currency The currency in which the price of another currency is quoted

thin A description of relatively infrequent secondary market trades of corporate bonds

third-stage financing Capital provided to fund major expansion such as plant expansion, product improvement or marketing

Tier 1 capital The sum of common stock, paid in-surplus, retained earnings, noncumulative perpetual preferred stock and minority interests in consolidated subsidiaries minus goodwill and other intangible assets

Tier 1 (core) capital High-quality capital items as defined by the prudential statements

Tier 2 capital Cumulative perpetual preferred stock, loan loss reserves, subordinated debt instruments, mandatory convertible debt instruments and other debt instruments that combine both debt and equity features

Tier 2 (supplementary) capital Items of capital other than Tier 1 capital. Comprises Upper Tier 2 and Lower Tier 2 capital.

time charter A charter in which the operator rents the ship for a specific period and the owner bears the costs and risk

time value of money A concept based on the belief that people have a positive time preference for consumption, preferring to consume goods today rather than consume similar goods in the future; therefore, a dollar today is worth more than a dollar received at some future date

total and permanent disablement insurance Insurance that provides a benefit if the insured becomes totally and permanently disabled through accident or injury, preventing him or her from working

trade accounts The simplest form of financing international trade, involving the importer paying for the goods only after they are received and title to them has been transferred

trade finance The short-term financing of importing and exporting activities across the globe

traders Individuals who buy or sell securities in the hope of profiting quickly from expected price movements

transaction account A demand deposit account in which the owner is entitled to receive his or her funds on demand which transfers legal ownership of funds to others

transfer credit Funding provided by larger parent companies

transfer risk The risk that domestic currency cannot be converted into foreign currency

trauma insurance Insurance that provides a lump sum payment if the insured suffers a specified trauma

treasury indexed bonds Commonwealth-issued bonds that adjust for inflation

treasury notes Promissory notes issued on behalf of the Commonwealth Government by the RBA that allow the government to borrow money from the money markets

trust operations Activities in which a bank acts in a fiduciary capacity for an individual or a legal entity, such as a corporation or the estate of a deceased person

turnaround financing Funds provided to rescue a company from financial distress

TWI (trade-weighted index) The price or value of the Australian dollar in terms of a weighted average of the currencies of Australia's trading partners

underpricing The initial sale of securities at less than their true market value

underwriting The risk-bearing function of the investment banker. Underwriting occurs when the investment banker guarantees fixed proceeds to security issuers while uncertain of the eventual resale price.

underwriting cycle A cyclical pattern observed in commercial property and liability insurance, in which property and liability insurance markets fluctuate between periods of high premiums and tight underwriting standards and periods of low premiums and loose underwriting standards

underwriting spread The difference between the fixed price paid for securities and the price at which they are resold, constituting the underwriter's gross profit

underwriting syndicate Groups of investment banking firms that take pro rata shares in primary issues with the aim of reducing price risk

underwritten issue The distribution of securities in a process in which the investment banker guarantees (underwrites) that the issuer will receive a fixed amount of money whether the securities are all sold to investors or not

Uniform Consumer Credit Code A legislative framework that applies minimum standards to all types and suppliers of credit across Australia

Uniform Consumer Credit Code Management Committee (UCCCMC) The body that monitors and coordinates all activities in relation to the Uniform Consumer Credit Code to ensure consistency across Australia

unit investment trust A trust with pro rata interests in an unmanaged pool of assets

universal bank An institution that can accept deposits, make loans, underwrite securities, engage in brokerage activities, and sell and manufacture other financial services such as insurance

unseasoned offering An initial public offering 594

unsecured note A bond for which there is no underlying specified security as collateral in the case of default

unsystematic risks The unique or security-specific risks that tend partly to offset one another in a portfolio

value at risk A statistical probability model commonly used to assess risk in financial firms' trading accounts and overall riskiness for banks

vault cash Coin and currency held in the bank's own vault

venture capital Equity financing provided to young businesses by investors who then play an active role in advising the management of the business

warrants Financial instruments used in direct payments between financial institutions

whole-life insurance Coverage for all of life, up to and in some cases beyond age 100

wholesale financing The process by which a finance company helps a dealer finance the purchase of goods

writer The seller of an option

yield curve The graph of the relationship between interest rates on particular securities and their yields to maturity. To construct yield curves, bonds must be as similar in as many other characteristics as possible.

yield to maturity (promised yield) The discount rate that equates the present value of all cash flows from a bond (interest payments plus principal) to the market price of the bond

zero-coupon bonds Bonds that have no coupon payment but promise a single payment at maturity