Accretion (of a Discount)

In portfolio accounting, a straight-line accumulation of capital gains on discount bonds in anticipation of receipt of par at maturity.

Accrued Interest

Interest due from issue or from the last coupon date to the present on an interest-bearing security. The buyer of the security pays the quoted dollar price plus accrued interest.

Active

A market in which there is much trading.

Actuals

The cash commodity as opposed to the futures contract. Also known as cash or the spot.

ACUs

*Asian currency units.* An expression for Eurodollars deposited in Far East centers.

Add-on Rate

A specific rate of interest to be paid. Stands in contrast to the rate on a discount security, such as a Treasury bill, that pays no interest. Repo rate is an add-on rate.

Adverse Selection problem

Banks have to be aware of a particular type of borrowers. Some borrowers will have hidden negative information not available to the bank. As the bank demands a higher interest rate, borrowers with safe projects will drop out. Hence, the fraction of borrowers with risky projects will depend on the interest rate. The higher the interest rate, the higher risk will be the pool of applicants. This is called the adverse selection problem.

Affiliate Risk

If the parent company of a one-bank holding company (OBHC) or one of the affiliate banks of multi-bank holding company (MBHC) fail, there is a risk that Federal Reserve or other private claim holders will sue the non-failing bank to recover their losses. Hence, failure of an affiliate presents contingent off-balance sheet risk.

After-tax Real Rate of Return

Money after-tax rate of return minus the inflation rate. Hence, this refers to the purchasing power increase.
Agencies

Federal agency securities. See also agency bank.

Agency bank

A form of organization commonly used by foreign banks to enter the U.S. market. An agency bank cannot accept deposits or extend loans in its own name; it acts as an agent for the parent bank. Term often used on the Street to refer to both foreign bank agencies and branches.

Agency Deals

Agency deals are when government sponsored agencies (GSEs) securitize mortgages.

Agent

A firm that executes orders for or otherwise acts on behalf of another (the principal) and is subject to its control and authority. The agent may receive a fee or commission.

All-in Cost

Total costs, explicit and other. Example: The all-in cost to a bank of CD money is the explicit rate of interest it pays on that deposit plus the FDIC premium it must pay on the deposit plus the hidden cost it incurs because it must hold some portion of that deposit in a non-interest-bearing reserve account at the Fed.

All or None (AON)

Requirement that none of an order be executed unless all of it can be executed at the specified price.

American Option

An option that may be exercised at any time during the life of the option. Stock options that trade in U.S. option exchanges, such as the CBOE, are of American types. Index options are of either American (option on S&P100 index, called OEX) or European types (option on S&P500 index, called SPX). See call and put options.

Amortize

In portfolio accounting, periodic charges made against interest income on premium bonds in anticipation of receipt of the call price at call or of par value at maturity. In the context of a loan, amortization means the annuity payments that pay off the loan in full.

Annual Percentage Rate (APR)
Referred to as APR. This is a standardized way of computing the interest rate. The exact method uses the actuarial methods. It reflects the true cost of interest after taking into account all costs such as fees, points, early payments and so on.

Annuity

Fixed number of identical cash flows that start one period from today. Typically, annuity products are used to provide income in retirement.

Arbitrage

Strictly defined, buying something where it is cheap and selling it where it is dear; for example, a bank buys 3-month CD money in the U.S. market and sells 3-month money at a higher rate in the Eurodollar market. In the money market, often refers: (1) to a situation in which a trader buys one security and sells a similar security in the expectation that the spread in yields between the two instruments will narrow or widen to his profit, (2) to a swap between two similar issues based on an anticipated change in yield spreads, and (3) to situations where a higher return (or lower cost) can be achieved in the money market for one currency by utilizing another currency and swapping it on a fully hedged basis through the foreign-exchange market.

ARM

Adjustable rate mortgages. There are loans whose interest is adjusted periodically depending of market conditions. Contrast with fixed rate mortgages.

Ask price

This is the price dealers are willing to sell securities at. This is typically higher than the price dealers are willing buy securities (called bid price). The difference between the ask and bid prices is called the bid-ask spread and represents the profit to the dealer for supplying immediate execution services.

Away

A trade, quote, or market that does not originate with the dealer in question, for example, "the bid is 98—10 away (from me)."

bp

Market abbreviation for basis points. 1/100th of 1%. Thus, 1 bp means 1 basis point, 10 bp means 10 basis points. Also referred to as beeps.

Back Contracts

Futures contracts farthest from expiration.

Back Discount Rate
Yield basis on which short-term, non-interest-bearing money market securities are quoted. A rate quoted on a discount basis understands bond equivalent yield. That must be calculated when comparing return against coupon securities.

**Back Up**

(1) when yields rise and prices fall, the market is said to back up. (2) When an investor swaps out of one security into another of shorter current maturity (e.g., out of a 2-year note into an 18-month note), he is said to back up.

**Bearish**

Pessimistic. Someone who is bearish may buy put options.

**Bull Market**

A period of optimism when increases in market prices are anticipated. (A way to remember "Bull ahead.")

**Bullet Loan**

A bank term loan that calls for no amortization. The term is commonly used in the Euromarket.

**Bullet (Loan or Security)**

All principal is due at maturity.

**Bullish**

Optimistic. Someone who is bullish may buy naked call options.

**Book Value**

The value at which a debt security is shown on the holder's balance sheet. Book value is often acquisition cost + amortization accretion, which may differ markedly from market value. It can be further defined as "tax book," "accreted book," or "amortized book" value.

**Book**

A banker, especially a Eurobanker, will refer to his bank's assets and liabilities as its "book." If the average maturity of the liabilities is less than that of the assets, the bank is running a **short** and **open** book.

**Book-entry Securities**

The Treasury and federal agencies are moving to a book-entry system in which securities are not represented by engraved pieces of paper but are maintained in computerized records at the Fed in
the names of member banks, which, in turn, keep records of the securities they own as well as those they are holding for customers. In the case of other securities for which there is a book-entry system, engraved securities do exist somewhere in quite a few cases. These securities do not move from holder to holder but are usually kept in a central clearinghouse or by another agent.

**Broker**

A broker brings buyers and sellers together for a commission paid by the initiator of the transaction or by both sides; he does not position. In the money market, brokers are active in markets in which banks buy and sell money and in interdealer markets.

**British Clearers**

The large clearing banks that dominate deposit taking and short-term lending in the domestic sterling market in Great Britain.

**Back-to-back Loan**

An example of a back-to-back loan would be IBM agreeing to lend dollars to British Petroleum in exchange for the latter lending pounds to IBM. Such agreements are struck only when exchange controls in one or more countries prevent normal capital flows.

**Balance Sheet**

The balance sheet of the Bank shows assets and liabilities. Assets include cash and equivalents, securities held, and loans. Liabilities include deposits, purchased funds, long-term debt and equity.

**Bank Line**

Line of credit granted by a bank to a customer.

**Bank Notes**

Unsecured notes issued by a bank in the form of an MTN. No FDIC premium is paid by the issuing bank.

**Bank of International Settlements**

This is an international consortium of banks that oversees international regulation of banks.

**Bank Runs**

Sudden and unexpected withdrawals from banks by depositors who worry about the health of the bank.

**Bank Wire**
A computer message system linking major banks. It is used not for effecting payments, but as a mechanism to advise the receiving bank of some action that has occurred, for example, the payment by a customer of funds into that bank's account.

**Bankers' Acceptance (BA)**

A draft or bill of exchange accepted by a bank or trust company. The accepting institution guarantees payment of the bill.

When the merchant presents a letter of credit to their bank, the bank discounts it and stamps ACCEPTED on it. Hence, a letter of credit then becomes a banker's acceptance. The banker's acceptances can be sold in the secondary market to money market mutual funds.

**Bankruptcy Prediction Models**

Bankruptcy Prediction Models refer to the quantitative models that estimate the probability of bankruptcy for a given firm or a bank.

**BANs**

Bond anticipation notes are issued by states and municipalities to obtain interim financing for projects that will eventually be funded long term through the sale of a bond issue.

**Barrier options.**

See knock-in and knock-out options.

**Base Rate**

Base Rate is quoted off a short term fluctuating rate such as LIBOR or Prime Rate. LIBOR denotes London InterBank Offered Rate. Prime is an administered rate announced by large banks. Hence a base rate may be quoted as LIBOR plus say 1%.

**Basis Point**

1/100\(^{th}\) of 1%.

**Basis Price**

Price expressed in terms of yield to maturity or annual rate of return.

**Basis Swap**

See **interest rate swap.**

**Basis**
(1) Number of days in the coupon period. (2) In commodities jargon, basis is the spread between a futures price and some other price. A money market participant would talk about spread rather than basis.

**BBA**

British Bankers Association.

**Bear Market**

A declining market or a period of pessimism when declines in the market are anticipated. (A way to remember: "Bear down.")

**Bearer Security**

A security the owner of which is not registered on the books of the issuer. A bearer security is payable to the holder.

**Best-efforts Basis**

Securities dealers do not underwrite a new issue, but sell it on the basis of what can be sold. In the money market, this usually refers to a firm order to buy or sell a given amount of securities or currency at the best price that can be found over a given period of time; it can also refer to a flexible amount (up to a limit) at a given rate.

**Bid**

The price the dealer offers to buy securities. The bid price is typically lower the ask price which represents the dealer’s selling price.

**Blind Broker**

A broker who acts as principal and does not give up names to either side of a brokered trade. Blind brokering of securities is common, whereas blind brokering of Fed funds and Euro time deposits would be infeasible.

**Bond Rating**

Denotes the safety of the bonds. Probability of default generally increases as the bond ratings decline. Bottom falls out as we go to below investment grade bonds. The highest bond rating is AAA followed by AA, A, and BBB. The lowest investment quality bond rating is BBB. All ratings below BBB are junk bonds. These are BB, B, and CCC. D denotes bonds that have already defaulted.

**Bond**

The term bond refer to long-term debt of companies or governments.
Brady Bonds

These are issued in conjunction with defaulted Latin American sovereign debt. Named after a Treasury secretary, Nicholas Brady. Brady bonds are debt-for-debt swaps.

Bridge Financing

Interim financing of one sort or another.

Broken Date

See cock date.

Bunds

German Treasuries.

Buy a Spread

Buy a near futures contract and sell a far one.

Buy-back

Another term for a repurchase agreement.

C&I

Commercial and Industrial loans are also known as C&I loans. They are issued to mining, manufacturing, trade, transport, construction, and services firms. They may be secured or unsecured. They may be made on the spot loan or as a loan commitment. They can involve revolving versus take-it-or-leave-it loans.

Calendar

List of new bond issues scheduled to come to market soon.

Call Money

Interest-bearing bank deposits that can be withdrawn on 24-hours' notice. Many Eurodeposits take the form of call money.

Call Option

A Call Option is the right to buy (but not the obligation) an underlying asset at a fixed price (called the exercise price) during a fixed time period. To obtain the call option, the buyer pays a premium to the seller. The seller of the call option has the obligation to deliver the asset and receive the exercise price.
An option that gives the holder the right to buy the underlying security at a specified price during a fixed time period.

**Callable Bond**

A bond that the issuer has the right to redeem prior to maturity by paying some specified call price.

**Canadian Agencies**

Agency banks established by Canadian banks in the U.S.

**Cap**

A Cap is a call option on interest rates. If the interest rates rise above the cap rate, then the seller compensates the buyer for the difference in interest rates times a notational amount. The cap can in effect convert floating rate liabilities into fixed rate liabilities. The cap on home mortgages is an example of an interest rate cap.

A series of options in which the writer guarantees the buyer, a payor of floating, that he will pay the buyer whatever additional interest he must pay on his loan if the rate on that loan goes above an agreed rate, $X$.

**Capital Adequacy**

Banks have to maintain sufficient capital to be able to meet unforeseen contingencies. The capital requirements involve minimum equity (Type I capital, currently 4% of assets), or equity and long-term debt (Type II capital, currently 8% of assets). The minimum capital requirements are stipulated by law.

**Carry**

The interest cost of financing securities held. (See also negative and positive carry.).

**Cash and carry**

The actual market price plus any carrying costs such as interest cost and storage costs. Typically used in futures and forwards to describe the fundamental value (or the warranted value) of the contract.

**Cash Commodity or Security**

The actual commodity or security as opposed to futures contracts for it.

**Cash Management Bill**

Very-short-maturity bills that the Treasury occasionally sells because its cash balances are down and it needs money for a few days.
Cash Market

Traditionally, this term has been used to denote the market in which commodities were traded, for immediate delivery, against cash. Since the inception of futures markets for T-bills and other debt securities, a distinction has been made between the cash markets in which these securities trade for immediate delivery and the futures markets in which they trade for future delivery.

Cash Price

Price quotation in the cash market (for immediate delivery).

Cash Settlement

In the money market, a transaction is said to be made for cash settlement if the securities purchased are delivered against payment in Fed funds on the same day the trade is made.

CBOE

Chicago Board Options Exchange.

CBT

Chicago Board of Trade, a futures exchange.

Certificate of Deposit (CD)

A time deposit with a specific maturity evidenced by a certificate. Large-denomination CDs are typically negotiable.

Certificates of Deposits (Cds)

This is a negotiable instrument. Involves fixed maturity, 2 weeks to 8 years. Face values under $100,000. The interest rates are competitive with T-Bill rates. Early withdrawals are subject to significant penalty. Holder must pay state and local taxes (unlike T-Bills). Explicitly covered by the deposit insurance.

CHIPS

The New York Clearing House's computerized Clearing House Interbank Payments System. Most Euro transactions are cleared and settled through CHIPS rather than over the Fed wire.

Circle

Underwriters, actual or potential as the case may be, often seek out and "circle" retail interest in a new issue before final pricing. The customer circled has basically made a commitment to purchase the note or bond or to purchase it if it comes at an agreed upon price. In the latter case, if the price is other than that stipulated, the customer supposedly has first offer at the actual price.
Clear

A trade carried out by the seller delivering securities and the buyer delivering funds in proper form. A trade that does not clear is said to fail.

Clearing House InterBank Payment System

Banks and other financial intermediaries send most of their wholesale payments electronically either through Fedwire or Clearing House InterBank Payment System (CHIPS). All claims sent on CHIPS clear at the end of the day.

Cock Date

In the Euromarket, an off-the-run period, for example, 28 days. Also referred to as a broken date. A cock date contrasts with a fixed date, which is 30, 60, 90, and so on, days hence.

Collar

Buy a call and sell a put. If a firm buys jet fuel and wants protection against jet fuel increases, it can buy a call option with a higher exercise price than the current price and sell a put option (with lower exercise price than the current price) and limit the price fluctuations to be in between the exercise price of the call and the exercise price of the put.

Collar

A Collar also refers to a combination of cap (call option on interest rates) and floor (put option on interest rates). An investor who holds a collar is in effect protected from interest rate increases or interest rate declines.

Collateral

Collateral is what the borrower pledges as security to the lender. In case of default, the lender can take possession of the collateral and sell it to cover the loan deficiency. The collateral can be viewed as the minimum payment in case of default on the loan.

Collateralized Mortgage Obligation

A Collateralized Mortgage Obligation (CMO) is a vehicle that repackages the cashflows in a way that redistributes prepayment risk.

Commercial and Industrial Loans (C&I Loans)

Loans made to mining, manufacturing, trade, transport, construction, and service firms. These can be secured and unsecured, spot loan or a loan commitment, revolving or take-it-or-leave it type of loan.

Commercial Lending
This term covers all banking activities that involve lending to corporations.

**Commercial Paper (CP)**

Bank holding companies issue commercial paper. This is a short-term uncollateralized borrowing by the parent firm.

**Commercial Paper**

An unsecured promissory note with a fixed maturity of no more than 270 days. Commercial paper is normally sold at a discount from face value. Interest rates are higher than CDs since CP is not insured. Interest rate is computed as follows:

\[
\text{Price} = 100 - \text{Actual discount}
\]

\[
\text{Actual discount} = (\text{Quoted discount}) \times \frac{M}{360}
\]

Where \( M \) is days to maturity.

Annualized interest rate = \((100 / \text{Price})^{365/M}\)

**Committed Facility**

A legal commitment undertaken by a bank to lend to a customer.

**Competitive Bid**

(1) Bid tendered in a Treasury action for a specific amount of securities at a specific yield or price. (2) Issuers, municipal and public utilities, often sell new issues by asking for competitive bids from one or more syndicates.

**Compounding**

The process of receiving interest on interest is called compounding.

**Confirmation**

A memorandum to the other side of a trade describing all relevant data.

**Consortium Banks**

A merchant banking subsidiary set up by several banks that may or may not be of the same nationality. Consortium banks are common in the Euromarket and are active in loan syndication.

**Convertible Bond**
A bond containing a provision that permits conversion to the issuer's common stock at the option of the bond holder at some fixed exchange ratio. Bondholder will only convert when stock prices have increased above the conversion price (break-even price).

**Convexity**

The slope of the price-yield relationship for a fixed-income security. Convexity is normally positive but can be negative.

**Core Deposits**

These are the small deposits (under $100,000) that are explicitly covered by deposit insurance. Because of the availability of deposits insurance, the depositors would not be too concerned about the profitability of the bank. It is expected that core deposits remain with the bank in good times and bad times.

**Corporate Bond Equivalent**

See equivalent bond yield.

**Corporate Bond**

This is the public debt (IOU) of corporations. Instead of taking a bank loan, corporations can directly borrow from institutions or individuals by selling them bonds. They pay interest with coupons attached to the bonds. They usually have long lives such as 20 or 30 years. They come in denominations of $1,000 and pay interest every 6 months.

**Corporate Taxable Equivalent**

Rate of return required on a par bond to produce the same after-tax yield to maturity that the premium or discount bond quoted would.

**Cost of Capital**

This is the price of capital. When corporations borrow, they pay interest, which is called the cost of debt capital. In the context of valuing firms, the discount rate is called the cost of capital.

**Cost of Debt**

Denotes the interest rate paid to bondholders. In the context of valuing firms, if the capital is debt, the cost of capital is called the cost of debt (synonymous with "yield").

**Cost of Equity**

This is the price companies pay to raise equity capital. Denotes dividends and capital gains paid to the shareholders. In the context of valuing firms, if the capital is equity, then the cost of capital is called cost of equity.
Country Risk Analysis Models

Country Risk Analysis Models incorporate variables such as Debt Service ratio, Import Ratio, Variance of Export Revenue, Domestic Money Supply Growth Rate and others to predict the probability of debt rescheduling problems.

Country Risk

See sovereign risk.

Coupon payments:

Bonds pay interest using coupons. For instance, if the stated interest rate on a $1,000 face value bonds is 8%, there are $40 coupons attached to the bond that can clipped and cashed every six months. Hence, the annual dollar interest will be $80 or 8% of the face value of the bond.

Coupon Swap

See interest rate swap.

Coupon

(1) The annual rate of interest on the bond's face value that a bond's issuer promises to pay the bondholder. (2) A certificate attached to a bond evidencing interest due on a payment date.

Cover

Eliminating a short position by buying the securities shorted.

Covered Call Write

Selling calls against securities owned by the call seller.

Covered Interest Arbitrage

Investing dollars in an instrument denominated in a foreign currency and hedging the resulting foreign-exchange risk by selling the proceeds of the investment forward for dollars.

Credit Crunch

If depositors in one location (say Michigan) can not provide deposits to fund loans in another location (say California), many good loans may go unfunded. This is a credit crunch.

Credit Enhancement

The backing of paper with collateral, a bank LOC, or some other device to achieve a higher rating for the paper.
The firm that securitizes mortgages guarantees against defaults on the underlying pool. This is called credit enhancement.

**Credit Risk**

Credit risk refers to the possibility that borrowers sometimes default on their promises.

**Credit Risk**

The risk that an issuer of debt securities or a borrower may default on his obligations, or that payment may not be made on sale of a negotiable instrument. (See **overnight delivery risk**.)

**Cross-currency Swap**

An interest-rate swap in which the interest payments due are denominated in different currencies.

**Credit Scoring Models**

These are quantitative models that predict bankruptcy. They establish which factors are important with regard to credit risk. They evaluate the relative importance of these risk factors, improve the estimation of default probability, automate the rejection of bad loan applicants, and improve the pricing of the loan. They also help calculate any potential future loan losses and possible revenues.

**Cross Hedge**

Hedging a risk in a cash market security by buying or selling a futures contract for a similar but not identical instrument.

**CRTs**

Abbreviation for the cathode-ray tubes used to display market quotes.

**Currency Swaps**

By entering into a currency swap institutions can hedge their currency risk exposure. In a fixed-fixed currency swap, one financial institution sends fixed interest rate dollar-denominated payments in exchange for say fixing interest rate sterling-denominated payments.

**Current Coupon**

A bond selling at or close to par; that is, a bond with a coupon close to the yield currently offered on new bonds of similar maturity and credit risk.

**Current Issue**

In Treasury bills and notes, the most recently auctioned issue. Trading is more active in current issues than in off-the-run issues.
Current Maturity

Current time to maturity on an outstanding note, bond, or other money market instrument; for example, a 5-year note one year after issue has a current maturity of four years.

Current Yield

Coupon payments on a security as a percentage of the security's market price. In many instances the price should be gross of accrued interest, particularly on instruments where no coupon is left to be paid until maturity.

Curve Trader

A trader who does arbitrages along the yield curve.

Cushion Bonds

High-coupon bonds that sell at only a moderate premium because they are callable at a price below that at which a comparable noncallable bond would sell. Cushion bonds offer considerable downside protection in a falling market.

Day Trading

Intraday trading in securities for profit as opposed to investing long-term for profit.

Daylight Overdraft

Being overdrawn (OD) in a deposit account during some of a day's business hours. Foreign banks typically run big daylight overdrafts with their U.S. correspondent bank. A daylight overdraft exposes the institution that extends it to a credit risk.

Dealer Loan

Overnight, collateralized loan made to a dealer financing his position by borrowing from a money market bank.

Dealer

A dealer, as opposed to a broker, acts as a principal in all transactions, buying and selling for his own account.

Debenture

A bond secured only by the general credit of the issuer.

Debt Covenants

Debt covenants spell out the details of the debt contract. For instance, the level and the timing of the promised interest rate and principal payments are explicitly stated. The covenants restrict the
ability of the borrower to increase the risk of the firm after debt is taken on, or drain the assets of
the firm. They are also designed to provide early warning signals if the health of the firm begins
to weaken.

**Debt Leverage**

The amplification in the return earned on equity funds when an investment is financed partly
with borrowed money.

**Debt Securities**

IOUs created through loan-type transactions—commercial paper, bank CDs, bills, bonds, and
other instruments.

**Debt**

**Debt** is a higher priority claim (in liquidation') compared to equity. These payments must be
made, otherwise the firm will be subject to court-ordered bankruptcy or liquidation. It is also
called leverage.

**Default Premium**

Default Premium is the promised payment times the probability of default. To calculate the
default premium we can compare the yield on the bonds with the yield on risk-free Treasury
bonds with the same maturity. For instance, if some bonds yield 11%, and the same maturity
Treasury bonds yield 10%, then the default premium is 1%.

**Default Risk: see Credit Risk**

**Default**

Default refers to the inability of the borrowers to honor their promises.

**Default**

Failure to make timely payment of interest or principal on a debt security or to otherwise comply
with the provisions of a bond indenture.

**Delivery Month**

A month in which a futures contract expires and delivery may be taken or made.

**Delta Hedge of an Option**

A hedge of an option with a position in the underlying asset where the hedge ratio is based on
the option's delta.

**Delta of an Option**
The rate of change of the value of an option with respect to the price of the underlier, evaluated at the current market price of the underlier.

**Demand deposits**

Basically checking accounts at banks. Deposit may be withdrawn at demand.

**Demand Line of Credit**

A bank line of credit that enables a customer to borrow on a daily or an on-demand basis.

**Deposit Note**

An FDIC-insured, negotiable time deposit issued by a bank, in the form of an MTN, always with a maturity at issue of 18 months or longer.

**Derivatives**

These are securities whose payoff depends (is derived from) the price of the underlying asset. There are two broad classes of derivatives, futures and forward contracts and options. A futures (or a forward) contract is an agreement to exchange an asset and pay for it sometime in the future. No cash is paid at the time of the agreement. The delivery price is determined at the time of the agreement.

An option gives the buyer the right (but not the obligation) to exchange the asset sometime in the future. A call option gives the buyer the right to buy the underlying asset at a fixed price. The put option gives the buyer the right to sell the underlying asset at a fixed price. See call and put.

**Direct Paper**

Commercial paper sold directly by the issuer to investors thereby by-passing the underwriters or banks.

**Direct Placement**

Selling a new issue not by offering it for sale publicly, but by placing it with one or several institutional investors.

**Discount Basis**

See **bank discount rate**.

**Discount Bond**
A bond selling below par.

**Discount House**

British institution that uses call and overnight money obtained from banks to invest in and trade money market instruments.

**Discount Paper**

See *discount securities*.

**Discount Rate**

In corporate finance this is the rate by which you divide the cash flows to obtain present value. Other names for discount rate would be hurdle rate, market rate of capitalization, and opportunity cost of capital. In banking, this is the rate of interest charged by the Fed to member banks that borrow at the discount window. The discount rate is an add-on interest rate.

**Discount Securities**

Non-interest-bearing money market instruments that are issued at a discount and redeemed at maturity for full face value; for example, U.S. Treasury bills.

**Discount Window Loans**

These are the loans Federal Reserve makes to the banks. The interest cost is below the Fed funds rate. Maybe used during temporary liquidity crunches as emergency borrowing. Fed may clamp down on excessive usage. Arbitraging the fed funds rate can potentially cost the bank its charter.

**Discount Window**

Facility provided by the Fed enabling member banks to borrow reserves against collateral in the form of governments or other acceptable paper.

**Discounting**

The present value calculation takes into account the fact that you will receive interest on interest. The process of calculating present value is called discounting. Discounted cash flow equals future cash flow divided by one plus the discount rate.

**Disintermediation**

It means by-passing the banks. It refers to corporations borrowing directly from institutions or individuals. Disintermediation occurs when corporations issue bonds or commercial paper
instead of taking a bank loan. Similarly, individual savers can disintermediate by putting money in mutual funds directly instead of using checking and savings accounts at the banks.

**Distributed**

After a Treasury auction, there will be many new issues in dealers' hands. As those securities are sold to retail, the issue is said to be distributed.

**Diversification**

It refers to spreading the risks. Diversification occurs when investors buy many different stocks and bonds instead of putting all of their money in a single stock. Similarly, banks can diversify their loans geographically by making loans across the globe instead of a single town.

**DM**

Deutsche (German) marks.

**Documented Discount Notes**

Commercial paper backed by normal bank lines plus a letter of credit from a bank stating that it will pay off the paper at maturity if the borrower does not. Such paper is also referred to as LOC (letter of credit) paper.

**Dollar Bonds**

Municipal revenue bonds for which quotes are given in dollar prices. Not to be confused with "U.S. Dollar" bonds, a common term of reference in the Eurobond market.

**Dollar Gap: see Repricing Gap.**

**Dollar Price of a Bond**

Percentage of face value at which a bond is quoted.

**Don't Know (DK, DKed)**

"Don't know the trade"—a Street expression used whenever one party lacks knowledge of a trade or receives conflicting instructions from the other party (for example, with respect to payment).

**Due Bill**

An instrument evidencing the obligation of a seller to deliver securities sold to the buyer. Occasionally used in the bill market.

**Duration Gap**
Duration Gap = Duration of the assets - Duration of the Liabilities. A positive duration gap means that the duration of assets is greater than the duration of the liabilities. When interest rates increase, all securities lose value, and the securities with longer durations will lose even more value. Hence, when interest rates increase, banks with positive duration gaps will lose value.

**Duration Mismatch**

This term refers to a situation where the bank maintains different durations for its assets and liabilities. This exposes the bank to interest rate risk.

**Duration**

A measure of the current maturity of a fixed-income instrument as the weighted average of the time to receipt of the payments thrown off by the instrument; the weights used are the present values of the future payments to be received.

**Dutch Auction**

Auction in which the lowest price necessary to sell the entire offering becomes the price at which all securities offered are sold. This technique has been used in Treasury auctions.

**Economies of Scale**

Economies of Scale is the reduction in per unit cost of production as more of an output is produced.

**Economies of Scope**

Economies of Scope is the reduction in per unit cost of production as related outputs are produced using the same inputs.

**Edge Act Corporation**

A subsidiary of a U.S. bank set up to carry out international banking business. Most such "subs" are located within the U.S.

**Either/or Facility**
An agreement permitting a bank customer to borrow either domestic dollars from the bank's head office or Eurodollars from one of its foreign branches.

**Either-way Market**

In the interbank Eurodollar deposit market, an either-way market is one in which the bid and asked rates are identical.

**Elbow**

The elbow in the yield curve is the maturity area considered to provide the most attractive short-term investment; for example, the maturity range in which to initiate a ride along the yield curve.

**Eligible Bankers' Acceptances**

In the BA market an acceptance may be referred to as eligible because it is acceptable by the Fed as collateral at the discount window and/or because the accepting bank can sell it without incurring a reserve requirement.

**Equitization**

Convert into equity. When mutual fund managers invest their cash in Treasury Bill and go long in S&P500 futures contract, they in effect have the liquidity of the cash yet the returns to the stock market. This is called equitization.

**Equivalent Bond Yield**

Annual yield on a short-term, non-interest-bearing security calculated so as to be comparable to yields quoted on coupon securities.

**Equivalent Taxable Yield**

The yield on a taxable security that would leave the investor with the same aftertax return he would earn by holding a tax-exempt municipal; for example, for an investor taxed at a 50% marginal rate, equivalent taxable yield on a muni note issued at 3% would be 6%.

**Euro CDs**

CDs issued by a U.S. bank branch or foreign bank located outside the U.S. Almost all Euro CDs are issued in London.

**Euro Feds**

Eurodollars transmitted over the Fed wire instead of through CHIPS. Normally Euro Feds move from a foreign branch of one U.S. bank to a foreign branch of another U.S. bank, for example, from Citi Nassau to Morgan London. Foreign banks use CHIPS, not the Fed wire, to pay and receive Euros because they may not run daylight overdrafts at the Fed.
Euro Lines

Lines of credit granted by banks (foreign or foreign branches of U.S. banks) for Eurocurrencies.

Euro MTNs

An MTN (mideum-term note) issued in the Euromarket. See MTNs.

Eurobonds

Bonds issued in Europe outside the confines of any national capital market. A Eurobond may or may not be denominated in the currency of the issuer.

Eurocurrency Deposits

Deposits made in a bank or bank branch that is not located in the country in whose currency the deposit is denominated. Dollars deposited in a London bank are Eurodollars; German marks deposited there are Euromarks.

Eurodollars

U.S. dollars deposited in a foreign bank or foreign branch of a U.S. bank. Maturities usually less than 6 months and interest rates are always fixed (expressed as LIBOR rates).

European Option

An option that may be exercised only at expiration of the option. Currency options trading in Philadelphia Exchange can be either European and American types. American types cost more than the European types.

Event Risk

The risk that a corporate bond will be downgraded, perhaps severely, due to some unpredictable outside event, principally a leveraged buy-out.

Excess Reserves

Balances held by a bank at the Fed in excess of those required.

Exchange Rate

The price at which one currency trades for another.

Exempt Securities
Instruments exempt from the registration requirements of the Securities Act of 1933 or the margin requirements of the Securities and Exchange Act of 1934. Such securities include governments, agencies, municipal securities, commercial paper, and private placements.

**Exercise Price**

The price at which an option holder may buy or sell the underlying security. Also called the strike price.

**Exercise**

To invoke the right to buy or sell granted under terms of a listed options contract.

**Expected Return**

Expected Return shows what the lender expects to earn after adjusting for the probability of missed payments, late payments, outright defaults, etc.

**Extension Swap**

Extending maturity through a swap, for example, selling a 2-year note and buying one with a slightly longer current maturity.

**Fail**

A trade is said to fail if on the settlement date either the seller fails to deliver securities in proper form or the buyer fails to deliver funds in proper form.

**Fed Funds**

See federal funds.

**Federal Credit Agencies**

Agencies of the federal government set up to supply credit to various classes of institutions and individuals; for example, S&Ls, small business firms, students, farmers, farm cooperatives, and exporters.

**Federal Deposit Insurance Corporation (FDIC)**

A federal institution that insures bank deposits, currently up to $100,000 per deposit.

**Federal Financing Bank**

A federal institution that lends to a wide array of federal credit agencies funds it obtains by borrowing from the U.S. Treasury.

**Federal Funds (Purchased Funds)**
This term refers to interbank borrowings or the amounts the banks borrow from each other. These liabilities are not subject to reserve requirements or deposit insurance. They are short-term uncollateralized loans. More than 90% has a maturity of 1 day. Costs reflect supply and demand. Subject to large volatility on the second Tuesday or Wednesday of the reserve maintenance period.

**Federal Funds Rate**

The rate of interest at which Fed funds are traded. This rate is currently pegged by the Federal Reserve through open market operations.

**Federal Funds**

(1) Non-interest-bearing deposits held by member banks at the Federal Reserve. (2) Used to denote "immediately available" funds in the clearing sense.

**Federal Home Loan Banks (FHLB)**

The institutions that regulate and lend to savings and loan associations. The Federal Home Loan Banks plays a role analogous to that played by the Federal Reserve Banks vis-a'-vis member commercial banks.

**Federal Home Loan Mortgage Corp.**

Federal Home Loan Mortgage Corp. is one of the three Government Sponsored Agencies, issues mortgage pass-throughs and provides guarantee against defaults.

**Federal National Mortgage Association**

Federal National Mortgage Association is one of the three Government Sponsored Agencies.

**Fedwire**

A computer system linking member banks to the Fed, used for making interbank payments of Fed funds and for making deliveries of and payments for Treasury and agency securities.

**Fedwire**

Banks and other financial intermediaries send most of their wholesale payments either through Fedwire or Clearing House InterBank Payment System.

**Figuring the Tail**

Calculating the yield at which a future money market instrument (one available some period hence) is purchased when that future security is created by buying an existing instrument and financing the initial portion of life with a term repo.

**Firm**

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Refers to an order to buy or sell that can be executed without confirmation for some fixed period.

**Fixed Dates**

In the Euromarket the standard periods for which Euros are traded (one month out to a year) are referred to as the fixed dates.

**Fixed-dollar Security**

A nonnegotiable debt security that can be redeemed at some fixed price or according to some schedule of fixed values (e.g., bank deposits and government savings bonds).

**Fixed-rate Loan**

A loan on which the rate paid by the borrower is fixed for the life of the loan.

**Flat Trades**

(1) A bond in default trades flat; that is, the price quoted covers both principal and unpaid, accrued interest. (2) Any security that trades without accrued interest or at a price that includes accrued interest is said to trade flat.

**Flex Repo**

A repo for a variable (usually declining) sum, done for some period, often several years.

**Float**

The difference between the credits given by the Fed to banks' reserve accounts on checks being cleared through the Fed and the debits made to banks' reserve accounts on the same checks. Float is always positive, because in the clearing of a check, the credit sometimes precedes the debit. Float adds to the money supply.

**Floating Supply**

The amount of securities believed to be available for immediate purchase, that is, in the hands of dealers and investors wanting to sell.

**Floating-rate Note**

A note that pays an interest rate tied to current money market rates. The holder may have the right to demand redemption at par on specified dates.

**Floor**

A floor is a put option on interest rates. If the interest rates fall below the floor rate, then the seller compensates the buyer for the difference in interest rates times a notational amount. If a
bank has fixed rate liabilities and floating rate assets, floor can effectively convert the fixed rate liabilities into floating rate liabilities in a selling interest rate environment. Also see cap.

A series of options in which the writer guarantees the buyer, a receiver of floating, that he will pay the buyer whatever interest he loses if the rate he is receiving goes below an agreed rate, Y.

Flower Bonds

Government bonds that are acceptable at par in payment of federal estate taxes when owned by the decedent at the time of death.

Footings

A British expression for the bottom line of an institution's balance sheet; total assets equal total liabilities plus net worth.

Foreign Bond

A bond issued by a nondomestic borrower in the domestic capital market.

Foreign Exchange Risk

This refers to the possibility of losing money due to changes in exchange rates. Net Foreign Exchange Exposure will create a FX risk even if the bank is perfectly hedged with respect to duration, credit risk, etc.

Foreign-Exchange Rate

The price at which one currency trades for another.

Foreign-Exchange (FX) Risk

The risk that a long or short position in a foreign currency might, due to an adverse movement in the relevant exchange rate, have to be closed out at a loss. The long or short position may arise out of a financial or commercial transaction.

Forward Contract

A forward contract is an agreement to exchange an asset (a commodity or a financial asset) at an agreed upon price at an agreed upon date later. Both the cash payment and the exchange of asset takes place in the future. No cash is exchanged at the time contract is made.

Forward Fed Funds

Fed funds traded for future delivery.

Forward Forward Contract
In Eurocurrencies, a contract under which a deposit of fixed maturity is agreed to at a fixed price for future delivery.

**Forward Market**

A market in which participants agree to trade some commodity, security, or foreign exchange at a fixed price at some future date.

**Forward Rate**

The rate at which forward transactions in some specific maturity are being made; for example, the dollar price at which DM can be bought for delivery three months hence.

**FRABBA**

The rate at which a FRA is to settle as established by the British Bankers Association.

**FRAs**

Under a FRA, one party agrees to pay another some fixed rate for some defined period on a Euro deposit having an agreed notional sum. If the FRA were for the 4s 5s, the agreement would concern a one-month rate to be paid four months hence. A FRA is settled at maturity via a cash payment, the amount and direction of which depends, *inter alia*, on the difference between the agreed forward rate and the prevailing market rate at the time of settlement.

**Free Reserves**

Excess reserves minus member bank borrowings at the Fed.

**Full-coupon Bond**

A bond with a coupon equal to the going market rate and consequently selling at or near par.

**Future Value**

Suppose you invest $100 at 10% for 1 year. At the end of one year, you will receive $100 + 0.1 \times 100 = (1 + 0.1) \times 100 = $110. This amount, $110 is called the **future value** of $100 invested at 10% for 1 year.

**Futures Contract**

A Futures Contract is very similar to the Forward Contract with the following exceptions:

i) Futures contracts normally trade on exchanges

ii) Futures contracts are marked to market. Hence, the futures price changes each day and changes are credited or debited into buyers' and sellers' accounts.

iii) Futures contracts require margin payments both by the buyer and seller. Moreover, the exchange guarantees the performance of the contract.
iv) Some futures contracts (such as Standards and Poor's 500 Index) are always settled in cash and not by delivering 500 stocks.
v) When the delivery of the commodity or the financial asset takes place the seller usually has a choice of delivering a number of alternatives.
vi) Maturities of futures contracts vary.

**Futures Market**

A market in which contracts for future delivery of a commodity or a security are bought and sold on an organized futures exchange such as CBOT, CME.

**FX Exposure**

Denotes the amount of real and financial assets owned denominated in a foreign currency. Net FX Exposure in currency i = Net Foreign Assets + Net FX Bought. If your exposure is positive, then you own more assets in currency i than you owe. In this case you benefit if the currency strengthens and lose if the currency weakens. The opposite is true if you have a negative exposure.

**Glass-Steagall Act**

Glass-Steagall Act separates commercial banking and securities-underwriting activities.

**Government National Mortgage Association**

Government National Mortgage Association is one of the three Government Sponsored Agencies.

**Gamma of an Option**

The rate of change of the option's delta with respect to a change in the price of the underlier. Gamma measures the sensitivity of a delta-hedged position in an option to changes in the price of the underlying asset.

**Gap Trade**

A market is said to gap trade when prices in it move discontinuously from range to range in response to announcements of economic numbers.

**Gap**

Mismatch between the maturities of a bank's assets and liabilities.

**Gapping**

Mismatching the maturities of a bank's assets and liabilities, usually by borrowing short and lending long.
General Obligation Bonds

Municipal securities secured by the issuer's pledge of its full faith, credit, and taxing power.

Gilts:

British Treasuries.

Give-up

The loss in yield that occurs when a block of bonds is swapped for another block of lower-coupon bonds. Can also be referred to as "after-tax give-up" when the implications of the profit (loss) on taxes are considered.

Glass-Steagall Act

A 1933 act in which Congress forbade commercial banks to own, underwrite, or deal in corporate stock and corporate bonds.

Go-around

When the Fed offers to buy securities, to sell securities, to do repo, or to do reverses, it solicits competitive bids or offers, as the case may be, from all primary dealers. This procedure is known as a go-around.

Good Delivery

A delivery in which everything—endorsement, any necessary attached legal papers, and so on—is in order.

Good Funds

A market expression for immediately available money, that is, Fed funds.

Good Trader

A Treasury coupon issue that can readily be bought and sold in size. If a trader can short $10 or $20 million of an issue and sleep at night, that issue is said to be a good trader.

Governments

Negotiable U.S. Treasury securities.

Gross Spread

The difference between the price that the issuer receives for its securities and the price that investors pay for them. This spread equals the selling concession plus the management and underwriting fees.
Growing perpetuity

This refers to a perpetuity that grows at a constant rate forever. Present value of such a growing perpetuity equals next year's cash flow divided by the difference between the market capitalization rate and the growth rate. To be sustainable, growth rate must be less than the market capitalization rate.

Growth rate

Growth rate equals the return on equity times the plowback ratio. To be sustainable, growth rate must be less than the market capitalization rate.

Guarantor/Swap Program

Freddie Mac takes a pool of mortgages from an originator and gives a PC that is backed by the mortgages in that pool. By doing so, the originator gets the Freddie Mac guarantee and Freddie Mac gets a fee (the difference between the cashflow from the mortgage pool and the payments promised to the originator).

Haircut

Margin in a repo transaction; that is, the difference between the actual market value measured at the bid side of the market and the value used in a repo agreement. Haircuts may range from 10 bps for overnight repos to 75 bps for a three-month repo.

Handle

The whole-dollar price of a bid or offer is referred to as the handle. For example, if a security is quoted 101-10 bid and 101-11 offered, 101 is the handle. Traders are assumed to know the handle, so a trader would quote that market to another by saying he was at 10-11. (The 10 and 11 refer to 32nds).

Hedge

To reduce risk, (1) by taking a position in futures equal and opposite to an existing or anticipated cash position, or (2) by shorting a security similar to one in which a long position has been established. Pre-sale or pre-purchases of anticipated future sales and purchases to lock-in a current price and avoid price fluctuations.

Hedging

Hedging refers to eliminating a risk (or a liability) the bank has.

Hit

A dealer who agrees to sell at the bid price quoted by another dealer is said to hit that bid.
Hot money

This refers to uninsured (jumbo) deposits currently over $100,000. Since they are uninsured, depositors are sensitive to the health of the bank and run at the first sign of distress.

IBFs (International Banking Facilities)

Shell branches that U.S. banks in a number of states may form at head office to do limited types of Eurobusiness.

IMM

International Monetary Market, a futures exchange.

In the Box

This means that a dealer has a wire receipt for securities indicating that effective delivery on them has been made. This jargon is a holdover from the time when Treasuries took the form of physical securities and were stored in a rack.

Indenture of a Bond

A legal statement spelling out the obligations of the bond issuer and the rights of the bondholder.

Interbank

When interbank refers to a rate, as in "Japanese BAs trade at a spread to interbank," the rate referred to is the interbank rate on Euro time deposits.

Interchange

These are the fees the banks earn when a merchant accepts a credit card payment. Merchants pay these fees to the banks in exchange for payment within a day or two of the transaction date by the customer. They vary from less than 1% to as much as 4-5% of the amount involved.

Interest rate parity theorem

Interest rates in different countries are generally different because of the differences in inflation rates. Interest rate parity holds if the differences in interest rates are exactly offset by differences in inflation rates and the resulting currency depreciation. Assume that the risk-free interest rate in the US is 5% and in Mexico 15%. Assume that it takes 10 pesos to USD now and one-year forward price is 10.952381 MP/USD. If you invest $1000 now, next year, you end up with $1050 USD. If you convert $1000 into pesos now, you end up with 10,000 MP, lend them at 15%, and end up with 11,500 MP, convert them back into USD at the forward price of 10.95,
you end up with exactly $1050 USD next year, which is exactly the same as if you lent in the US. This is an example of interest rate parity.

**Interest Rate Risk**

The risk of changes in value due to changes in interest rate is called interest rate risk. Long lived assets lose more of their value when interest rates rise than short lived assets. If a bank has more long-lived assets than liabilities, then the bank worries about interest rate increases.

**Interest Rate Risk Management**

If a bank expects a rise in interest rates, it increases the maturity of its liabilities and decreases the maturity of its assets. If a bank expects the interest rates to remain the same or decline, it holds more long term assets than liabilities.

**Interest Rate Swaps**

The buyer of the swap agrees to make a number of fixed interest rate payments periodically to the seller on some agreed upon notational amount. In return, the seller agrees to make floating rate interest payment on the same dates to the buyer on the same notational amount.

**Interest Rate**

This is the cost of borrowing. If the interest rate is 10% and you borrow $1,000, then $100 must be paid as interest payments at the end of each year.

**Interest-rate Exposure**

Risk of gain or loss to which an institution is exposed due to possible changes in interest-rate levels.

**Interest-rate Swap**

An exchange by borrowers or asset holders of interest-rate payments at two different rates (often one rate is fixed, the other floating). In a basis swap, both rates are floating.

**Internal Rate of Return (IRR)**

This shows the profitability of a project or a bond. It is computed by setting IRR equal to the discount rate that makes the net present value of the cash flows equal to zero.

**In-the-money Option**

An option selling at a price such that it has intrinsic value (i.e., you receive cash if you exercise now).
**Investment Banker**

A firm that engages in the origination, underwriting, and distribution of new issues.

**Investment Quality**

Denotes high quality bonds. Investment quality means BBB or higher bond rating. Banks are not allowed to invest in "predominantly speculative" securities (below BBB ratings).

**ISDA**

International Swap Dealers Association.

**JGBs**

Japanese government bonds.

**Joint Account**

An agreement between two or more firms to share risk and financing responsibility in purchasing or underwriting securities.

**Jumbo Loans**

Jumbo Loans are loans in excess of $240,00.

**Junk Bonds**

High-risk bonds that have low credit ratings or are in default.

**Knock-in and knock-out options.**

Types of barrier options. In up and in option, option is dead unless it hits the up barrier during its life. In up and out option, option is dead if it hits the up barrier during its life. In down and in option, option is dead unless it hits the down barrier during its life. In down and out option, option is dead if it hits the down barrier during its life.

**Letters of Credit**

Letters of Credit (LC) is an example of OBSAs (Off-Balance Sheet Activities). LC simply says that if a firm cannot make a promised payment within say 90 days, the bank will make the payment. There is no immediate liability that shows up on the balance sheet and the bank earns a fee income for the guarantee.

**Leverage**

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Debt is also called leverage.

**Leverage**

See debt leverage.

**Leveraged Lease**

The lessor provides only a minor portion of the cost of the leased equipment, borrowing the rest from another lender.

**LIBID**

The London inter-bank *bid* rate for Eurodollar time deposits of a given tenor.

**LIBOR** denotes London Inter Bank Offered Rate which is the rate on Eurodollar deposits traded between banks. There is a different LIBOR rate for each deposit maturity. Different banks may quote slightly different LIBOR rates because they use different reference banks.

**Liquidity Shocks**

Liquidity Shocks can occur when deposit drains are unusually large. Withdrawal shocks can occur if: investors have a concern about bank's solvency or if failure of a related bank leads to heightened concerns.

**LIFFE**


**Lifting a Leg**

Closing out one side of a long-short arbitrage before the other is closed.

**LIMEAN**

The average of LIBOR and LIBID for Eurodollar deposits of a given tenor.

**Line of Credit**

An arrangement by which a bank agrees to lend to the line holder during some specified period any amount up to the full amount of the line.

**Liquidity Diversification**
Investing in a variety of maturities to reduce the price risk to which holding long bonds exposes the investor.

**Liquidity Risk**

In banking, risk that monies needed to fund assets may not be available in sufficient quantities at some future date. Implies an imbalance in committed maturities of assets and liabilities.

**Liquidity**

A liquid asset is one that can be converted easily and rapidly into cash without a substantial loss of value. In the money market, a security is said to be liquid if the spread between bid and asked prices is narrow and reasonable size can be done at those quotes.

**Loan Commitments**

Loan commitments involve a promise by the bank to provide a loan at some (usually fixed) interest rate during a stated time period (say 1 year). The customer has the option of taking down a loan in the future at the agreed upon rate if he so chooses.

**Locked Market**

A market is said to be locked if the bid price equals the asked price. This can occur, for example, if the market is brokered and brokerange is paid by one side only, the initiator of the transaction.

**Lockup CDs**

CDs that are issued with the tacit understanding that the buyer will not trade the certificate. Quite often, the issuing bank will insist that it keep the certificate to ensure that the understanding is honored by the buyer.

**Long Bonds**

Bonds with a long current maturity.

**Long Coupons**

(1) Bonds or notes with a long current maturity. (2) A bond on which one of the coupon periods, usually the first, is longer than the others or than standard.

**Long Hedge**

*Purchase of a futures* contract to lock in the yield at which an anticipated cash inflow can be invested.

**Long**
(1) Owning a debt security, stock, or other asset. (2) Owning more than one has contracted to deliver.

**Make a Market**

A dealer is said to make a market when he quotes bid and offered prices at which he stands ready to buy and sell.

**Margin**

(1) In a repo or a reverse repurchase transaction, the amount by which the market value of the securities collateralizing the transaction exceeds the amount lent. (2) In futures markets, money buyers and seller must put up to ensure performance on the contracts. (3) In options, similar meaning as in futures for sellers of put and call options.

**Marginal Tax Rate**

The tax rate that would have to be paid on any additional dollars of taxable income earned.

**Market Value**

The price at which a security is trading and could presumably be purchased or sold. **Market Value accounting** reflects the current prices of all assets and liabilities.

**Marketability**

A negotiable security is said to have good marketability if there is an active secondary market in which it can easily be resold.

**Match Fund**

A bank is said to match fund a loan or other asset when it does so by buying (taking) a deposit of the same maturity. The term is commonly used in the Euromarket.

**Matched Book**

If the distribution of the maturities of a bank's liabilities equals that of its assets, it is said to be running a matched book. The term is commonly used in the Euromarket.

**Maturity Clienteles**

Maturity clienteles are investors who need to have bonds of a certain maturity.

**Maturity Gap**

Maturity Gap = Maturity of the Assets - Maturity of the Liabilities. Also see Duration Gap.
Maturity

Refers to the life of bonds. It is the last payment date.

Medium-term Notes (MTNs)

Continuously offered notes, having any or all of the features of corporate bonds and ranging in maturity from nine months out to 30 years. Bank deposit notes are a form of MTN.

Merchant Bank

A British term for a bank that specializes not in lending out its own funds, but in providing various financial services, such as accepting bills arising out of trade, underwriting new issues, and providing advice on acquisitions, mergers, foreign exchange, portfolio management, and so on.

Mismatch

A mismatch between the interest-rate maturities of a bank's assets and liabilities. See also gap and unmatched book.

MM

Market abbreviation for million. Thus, 1OMM means 10 million.

MOF

Multioption facility. A type of Euro bank line.

Money Market (Center) Bank

A bank that is one of the nation's largest and consequently plays an active and important role in every sector of the money market.

Money Market Certificates (MMCs)

Six-month certificates of deposit with a minimum denomination of $10,000 on which banks and thrifts may pay a maximum rate tied to the rate at which the U.S. Treasury has most recently auctioned 6-month bills.

Money Market Fund

Mutual fund that invests solely in money market instruments.

Money Market

The market in which short-term debt instruments (bills, commercial paper, bankers' acceptances, etc.) are issued and traded.
Money Rate of Return

Annual return as a percentage of asset value.

Money Supply Definitions Used By the Fed:

M-1: Currency in circulation plus demand deposits plus other checkable deposits including NOW accounts.
M-2: M-1 plus money market deposit accounts plus overnight repos and money market funds and savings and small (less than $100,000) time deposits at all depository institutions plus overnight repos at banks plus overnight Euros held by nonbank U.S. depositors in the Caribbean branches of U.S. banks plus balances at money funds (excluding institutions-only funds).
M-3: M-2 plus large (over $100,000) time deposits at all depository institutions, term repos at banks and S&Ls plus balances at institutions-only money funds.
L: M-3 plus other liquid assets such as term Eurodollars held by nonbank U.S. residents, bankers' acceptances, commercial paper, Treasury bills and other liquid governments, and U.S. savings bonds.

Money Supply

This denotes the total amount of money circulation in the economy. There are various components such as high powered money (also referred to as the base money), M1, M2 and M3.

Monetize

Simply means put your money where your mouth is. Take positions based on your views.

Moral Hazard

Some borrowers will take actions as a result of using the bank loan or an insurance contract that they would not do if they were using their own money. This is called the moral hazard. A person (who) does not maintain an insured asset or someone who purposefully causes an accident to collect on insurance is engaged in moral hazard.

Mortality Risk

The probability that the bond will default.

Mortgage Backed Securities

The pass-throughs issued by Ginnie Mae are referred to as Mortgage Backed Securities.

Mortgage Bond

Bond secured by a lien on property, equipment, or other real assets.

Mortgage
Refers to the collateral (an asset) that is pledged as security, against the loan.

**Mortgagor**

This is the party that will give up the pledged asset in case of default.

**MTNs**

See *medium-term notes*.

**Multicurrency Clause**

Such a clause on a Euro loan permits the borrower to switch from one currency to another on a rollover date.

**Municipal (Muni) Notes**

Short-term notes issued by municipalities in anticipation of tax receipts, proceeds from a bond issue, or other revenues.

**Municipals**

Securities issued by state and local governments and their agencies.

**Naked Option Position**

An unhedged sale of a put or call option.

**Naked Position**

An unhedged long or short position.

**Nearby Contract**

Futures contracts nearest to expiration.

**Negative Carry**

The net cost incurred when the cost of carry exceeds the yield on the securities being financed.

**Negotiable Certificate of Deposit**

A large-denomination (generally $1 million) CD that can be sold but cannot be cashed in before maturity.

**Negotiated Sale**

Situation in which the terms of an offering are determined by negotiation between the issuer and the underwriter rather than through competitive bidding by underwriting groups.
Net Present Value (NPV)

NPV shows the change in wealth as a result of taking a project. NPV is computed as the discounted cash flows. To maximize wealth, take all projects with positive NPV and reject all projects with negative NPV.

(Net) Working Capital

**Net Working Capital** refers to the net non-interest bearing short term assets: Hence, net working capital equals cash plus inventories plus accounts receivables minus accounts payables.

New Money

In a Treasury refunding, the amount by which the par value of the securities offered exceeds that of those maturing.

New-issues Market

The market in which a new issue of securities is first sold to investors.

NIF

Note issuance facility, a type of Euromarket bank line associated with the issuance of Euronotes and Euro commercial paper.

NOB

Note-bonds spread in futures contract.

Noncompetitive Bid

In a Treasury auction, bidding for a specific amount of securities at the price, whatever it may turn out to be, equal to the average price of the accepted competitive bids.

Note

Coupon issues with a relatively short original maturity are often called notes. Muni notes, however, have maturities ranging from a month to a year and pay interest only at maturity; Treasury notes are coupon securities that have an original maturity of up to 10 years.

NOW Accounts

**NOW Accounts** denotes Negotiable Orders of Withdrawal. They are similar to demand deposits. Some interest is paid, however, subject to minimum balance. There is less withdrawal risk. They are subject to reserve requirement of 10% and deposit insurance premium of 23 to 31 basis point (one-hundredth of a percent).
OATs
French Treasuries.

OCC
Options Clearing Corporation, the issuer of all listed options trading on national options exchanges.

Odd Lot
Less than a round lot (100 shares).

Off-Balance Sheet Activities (OBSAs)
These are the bank activities that do not show up on the balance sheet, such as options, swaps, forward and futures contracts and loan commitments. These involve contingent risks. The bank enters into a contract and promises to provide some guarantee. At the time the promise is made there is no explicit liability and nothing is recorded on the balance sheet.

Offer
Price asked by a seller of securities.

Off-the-run Issue
In Treasuries and agencies, an issue that is not included in dealer or broker runs. With bills and notes, normally only current issues are quoted.

One-man Picture
The price quoted is said to be a one-man picture if both the bid and ask come from the same source.

One-sided (One-way) Market
A market in which only one side, the bid or the asked, is quoted or firm.

Open Book
See unmatched book.

Open Repo
A repo with no definite term. The agreement is made on a day-to-day basis and either the borrower or the lender may choose to terminate. The rate paid is higher than on overnight repo and is subject to adjustment if rates move.

Operational Risk
A technology-operational risk occurs when investments in new technology do not produce the estimated cost savings.

**Opportunity Cost**

The cost of pursuing one course of action measured in terms of the foregone return offered by the most attractive alternative.

**Option**

(1) *Call option*: A contract sold for a price that gives the holder the right to buy from the writer of the option, over a specified period, a specified amount of securities at a specified price.

(2) *Put option*: A contract sold for a price that gives the holder the right to sell to the writer of the contract, over a specified period, specified amount of securities at a specified price.

**Options**

An option is the right to buy (Call Option) or to sell (Put Option) the underlying asset at a fixed price during a fixed time period.

**Original Maturity**

Maturity at issue. For example, a 5-year note has an original maturity at issue of five years; one year later, it has a current maturity of four years.

**Out-of-the-money Option**

An option selling at a price such that it has no intrinsic value.

**Overnight Delivery risk**

A risk brought about because differences in time zones between settlement centers require that payment or delivery on one side of a transaction be made without knowing until the next day whether funds have been received in account on the other side. Particularly apparent where delivery takes place in Europe for payment in dollars in New York.

**Over-the-counter (OTC) Market**

Market created by dealer trading as opposed to the auction market prevailing on organized exchanges.

**Paper Gain (Loss)**

Unrealized capital gain (loss) on securities held in portfolio, based on a comparison of current market price and original cost.

**Paper**
Money market instruments, commercial paper, and other.

**Par Bond**
A bond selling at par.

**Par**
(1) Price of 100%. (2) The principal amount at which the issuer of a debt security contracts to redeem that security at maturity, *face value*. A bond selling at par would have a market price equal to its par value or face value. In this case, the yield to maturity on the bond would equal to its coupon rate.

**Parallel Loan**
An example of a parallel loan would be IBM agreeing to lend dollars to a sub of British Petroleum in exchange for the latter lending pounds to an IBM British sub. Such agreements are struck only when exchange controls in one or more countries prevent normal capital flows.

**Participation Certificates**
The pass-throughs issued by Freddie Mac (Federal Home Loan Mortgage Corp.) are referred to as Participation Certificates (PCs).

**Passbook Savings Accounts**
These deposits are less liquid than demand deposits. They are noncheckable. Hence, withdrawal requires physical presence. Bank can legally delay early withdrawal up to a month. Interest paid is slightly higher than the NOW Accounts.

**Pass-through**
A mortgage-backed security on which payment of interest and principal on the underlying mortgages are passed through to the security holder by an agent.

**Pass-throughs**
The bonds are generically called pass-throughs since the cashflows from the pool are passed through the trust to the ultimate investor.

**Payout ratio**
This is the proportion of earnings paid out as dividends. The rest would be reinvested in the firm. It equals 1 – plowback ratio. If a corporation pays out 60% of its earnings as dividends, its payout ratio would be 60%.

**Paydown**
In a Treasury refunding, the amount by which the par value of the securities maturing exceeds that of those sold.

**Pay-up**

(1) The loss of cash resulting from a swap into higher-price bonds. (2) The need (or willingness) of a bank or other borrower to pay a higher rate to get funds.

**Perpetuity**

Infinitely many cash flows of identical magnitude. First cash flow starts next period. Examples of securities that provide cash flows in perpetuity would be perpetual preferred stocks, consol bonds (which have no maturity dates), and stock dividends if all dividends have the same magnitude.

**Pickup**

The gain in yield that occurs when a block of bonds is swapped for another block of higher-coupon bonds.

**Picture**

The bid and asked prices quoted by a broker for a given security.

**Placement**

A bank depositing Eurodollars with (selling Eurodollars to) another bank is often said to be making a placement.

**Plowback ratio**

This is the proportion of earnings reinvested in the firm. It equals 1 – the dividend payout rate. If a corporation pays out 60% of its earnings as dividends, its plowback ratio would be 40%.

**Plus**

Dealers in governments normally quote bids and offers in 32nds. To quote a bid or offer in 64ths, they use pluses; for example, a dealer who bids 4+ is bidding the handle plus 4/32 + 1/64, which equals the handle plus 9/64.

**PNs**

Project notes are issued by municipalities to finance federally sponsored programs in urban renewal and housing. They are guaranteed by the U.S. Department of Housing and Urban Development.

**Point**
(1) 100 bp = 1%. (2) One percent of the face value of a note or bond. (3) In the foreign-exchange market, the lowest level at which the currency is priced. Example: "One point" is the difference between sterling prices of $1,8080 and $1,8081.

**Portfolio**

Collection of securities held by an investor.

**Position**

(1) To go long or short in a security. (2) The amount of securities owned (long position) or owed (short position).

**Positive Carry**

The net gain earned when the cost of carry is less than the yield on the securities being financed.

**Preferred Stock**

This is similar to common stock, however, it pays a fixed preferred dividend similar to debt. They maybe cumulative or noncumulative. Also, the maturity may be fixed or perpetual.

**Premium Bond**

Bond selling above par.

**Premium**

(1) The amount by which the price at which an issue is trading exceeds the issue's par value. (2) The amount that must be paid in excess of par to call or refund an issue before maturity. (3) In money market parlance, the fact that a particular bank's CDs trade at a rate higher than others of its class, or that a bank has to pay up to acquire funds.

**Prepayment Option**

All mortgages contain a prepayment option. The prepayment option gives the mortgagor (i.e., the homeowner) the option to get out of the obligation of the mortgage by "prepaying" all of the remaining principal on the mortgage. The mortgagor can exercise this option at any time during the life of the mortgage.

**Prepayment Risk**

The existence of prepayment options makes the cashflow of a pool of mortgages uncertain. This uncertainty creates prepayment risk.

**Prepayment**

A payment made ahead of the scheduled payment date.
Present Value (of a Future Payment)

The value today of a future payment discounted at an appropriate rate of interest.

Present Value

Suppose you wish to receive $110 one year from now. How much must you invest today at 10%? We already know the answer: $100. $100 is called the present value of $110 at 10%.

Presold Issue

An issue that is sold out before the coupon announcement.

Price Risk

The risk that a debt security's price may change due to a rise or fall in the going level of interest rates.

Prime Rate

The rate at which banks lend to their (supposedly) best (prime) customers. The all-in cost of a bank loan to a prime credit equals the prime rate plus the cost of holding compensating balances.

Prime is an administered rate announced by large banks. Recently, banks have been making below-prime loans which makes prime rate pretty arbitrary.

Principal amount

This is the face value of the debt or the original amount borrowed. For most corporate bonds, the face value of the bonds are in $1,000.

Principal Collateralization Bonds

These bonds are issued in conjunction with defaulted Latin American Sovereign debt. The U.S. Government has issued Treasury bonds to collateralize (guarantee) the principal value of these bonds.

Principal

(1) The face amount or par value of a debt security. (2) One who acts as a dealer buying and selling for his own account.

Private Banking

Private banking deals with all financial services demanded by high net worth individuals. These individuals expect their relationship manager to be familiar with all aspects of their financial assets and be able to design a portfolio that meets their objectives and risk tolerance. High net
worth investors demand a high level of personal, confidential, and on-demand interaction with the private bank.

**Private Placement**

An issue that is offered to a single or a few investors as opposed to being publicly offered. Private placements do not have to be registered with the SEC.

**Private-Label Pass-throughs**

Thrifts, commercial banks and private conduits securitize non-conforming (or conventional) mortgages. The securities created are called private-label pass-throughs.

**Profitability**

Refers to the levels of profits the bank earns. For banks the interest rate spread, or the difference between what the banks earns on its loans and what it pays on its deposits, will affect the profitability.

**Promised Return**

*Promised Return* is what the borrower agrees to pay at the time loan is taken. For instance, if the loan amount is $1,000 and the agreed return is 10%, the borrower is promising to pay $100 in interest payments for the first year.

**Prospectus**

A detailed statement prepared by an issuer and filed with the SEC prior to the sale of a new issue. The prospectus gives detailed information on the issue and on the issuer's condition and prospects.

**Put Option**

A *Put Option* is the fight to sell (but not the obligation) to the underlying asset at a fixed price (the exercise price) during a fixed time period. To obtain the put option, the buyer pays a premium to the seller. The seller of the put option has the obligation to receive the asset and pay the exercise price.

**Put**

An option that gives the holder the right to sell the underlying security at a specified price during a fixed time period.

**Range Markets**

Markets with lots of sidewise motion.

**RANs (Revenue Anticipation Notes)**
These are issued by states and municipalities to finance current expenditures in anticipation of the future receipt of nontax revenues.

**Rate Risk**

In banking, the risk that profits may decline or losses occur because a rise in interest rates forces up the cost of funding fixed-rate loans or other fixed-rate assets. See interest rate risk.

**Rate Sensitive Assets**

For a given time horizon $t$, all assets whose return is not fixed but will be repriced with changes in interest rates are called Rate Sensitive Assets, or RSA.

**Rate Sensitive Liabilities**

*Rate Sensitive Liabilities* are all those liabilities scheduled to reprice or mature within one year. It includes domestic time certificates of deposits of $100,000 or more, all other domestic time deposits, total deposits in foreign offices, money market deposit accounts, Super NOWs and demand notes issued to the U.S. Treasury.

**Ratings**

An evaluation given by Moody's, Standard & Poor's, Fitch, or other rating services of a security's creditworthiness.

**Real Cash Flows**

Constant purchasing power cash flows. Typically, cash flows measured in today’s dollars. Another way to compute real cash flows is to divide the nominal future cash flows by the price level ($1+\text{expected inflation rate})$.

**Real Interest Rate**

The real interest rate is the interest rate that would prevail in an economy with no inflation and no risk. Real interest rate is determined by the propensity to save (supply of funds) and by the demand for capital. Real interest rate equals nominal interest rate minus expected inflation.

**Real Market**

The bid and offer prices at which a dealer could do size. Quotes in the brokers market may reflect not the real market, but pictures painted by dealers playing trading games.

"Red" Futures Contract Month

A futures contract in a month more than 12 months away; for example, in November, the Dec (pronounced Dees) bond contract would mature 1 month later, the red Dec contract 13 months later.
**Red Herring**

A preliminary prospectus containing all the information required by the Securities and Exchange Commission except the offering price and coupon of a new issue.

**Refunding**

Redemption of securities by funds raised through the sale of a new issue.

**Registered Bond**

A bond whose owner is registered with the issuer.

**Regular Way Settlement**

In the money and bond markets, the regular basis on which some security trades are settled is that delivery of the securities purchased is made against payment in Fed funds on the day following the transaction.

**Regulation D**

Fed regulation that required member banks to hold reserves against their net borrowings from foreign offices of other banks over a seven-day averaging period. Regulation D has been merged with Regulation M. Regulation D has also required member banks to hold reserves against Eurodollars lent by their foreign branches to domestic corporations for domestic purposes.

**Regulation Q**

Fed regulation imposing lids on the rates that banks may pay on savings and time deposits. Currently, time deposits with a denomination of $100,000 or more are exempt from Reg Q.

**Reinvestment Rate**

(1) The rate at which an investor assumes interest payments made on a debt security can be reinvested over the life of that security. (2) Also, the rate at which funds from a maturity or sale of a security can be reinvested. Often used in comparison to *give-up* yield.

**Relative Value**

The attractiveness—measured in terms of risk, liquidity, and return—of one instrument relative to another, or for a given instrument, of one maturity relative to another.

**Reopen an Issue**

The Treasury, when it wants to sell additional securities, will occasionally sell more of an existing issue (reopen it) rather than offer a new issue.

**Repo**
see repurchase agreement.

Repricing Gap

See Dollar Gap. For a time horizon say one year, identify all interest rate sensitive liabilities, and rate sensitive assets. Repricing Gap\(_t\) = RSA\(_t\) - RSL\(_t\). The Repricing Gap shows what happens to net interest income when interest rates change.

Repurchase Agreement (Repo or RP)

A holder of securities (dealer) sells these securities to an investor with an agreement to repurchase them at a fixed price on a fixed date. The security "buyer" in effect lends the "seller" money for the period of the agreement, and the terms of the agreement are structured to compensate him for this. Dealers use repo extensively to finance their positions. Exception: When the Fed is said to be doing repo, it is lending money, that is, increasing bank reserves. Usually done early in the day (before 2PM) to give time for agreement on collateral. Less costly and less volatile than the federal funds. Repo rate is an add-on rate. Annualized interest on repo transactions are computed as follows:

Annualized interest rate =

\[
(1 + \text{Quoted repo rate} \times \frac{M}{360})^{\frac{365}{M}} - 1
\]

where M is the maturity of the repo transaction. For overnight repos, M = 1.

Reserve Requirements

Reserve Requirements refer to the Federally mandated proportion of the deposits that must be kept at a noninterest earning account at the Federal Reserve. Hence, reserve requirements are in effect compensating balances dictated by the Fed. Currently at 10% for demand deposits and 0% for time deposits.

Revenue Bond

A municipal bond secured by revenue from tolls, user charges, or rents derived from the facility financed.
Reverse Repurchase Agreement

Most typically, a repurchase agreement initiated by the lender of funds. Reverses are used by dealers to borrow securities they have shorted. Exception: When the Fed is said to be doing reverses, it is borrowing money, that is, absorbing reserves. Also known as matched sales.

Reverse

See reverse repurchase agreement.

Revolver

See revolving line of credit.

Revolving Line of Credit

A bank line of credit on which the customer pays a commitment fee and can take down and repay funds according to his needs. Normally the line involves a firm commitment from the bank for a period of several years.

Revolving loans

These refer to a type of loan where the maximum amount is initially specified. The borrower can at any time borrow and repay any amounts as long as they stay below the maximum amount of the revolver credit. Credit cards are an example of revolver loans.

Rho of an Option

The rate of change of the value of an option with respect to the risk-free rate of interest.

Risk Premium

Risk Premium is the explicit amount added to the base rate to cover default and other risks. Hence, a loan might be quoted as 6-month LIBOR plus 150 basis points, which means that the interest due will start out at the current LIBOR plus 150bp. Each basis point is one-one hundredth of a percent. After 6 months, the interest rate will be revised to the LIBOR in effect at that time plus 150bp.

Risk

Degree of uncertainty of return on an asset.

Risk reversal

In option trading, buy a put and sell a call.

Roll Over
Reinvest funds received from a maturing security in a new issue of the same or a similar security.

**Rollover**

Most term loans in the Euromarket are made on a rollover basis, which means that the loan is periodically repriced at an agreed spread over the appropriate, currently prevailing LIBOR rate.

**Round Lot**

In the money market, round lot refers to the minimum amount for which dealers' quotes are good. This may range from $100,000 to $5 million, depending on the size and liquidity of the issue traded.

**RP**

See repurchase agreement.

**RR**

Reserve Requirements

**Seasonal Balances**

Seasonal Balances refer to revolvers that must be off the books (paid off completely) for a stated time period during the year.

**RUF**

A revolving underwritten facility; A type of Euro line associated with the issuance of Euro notes and of Euro commercial paper.

**Run**

A run consists of a series of bid and asked quotes for different securities or maturities. Dealers give to and ask for runs from each other.

**S&L**

See savings and loan association.

**Safekeep**

For a fee, banks will safekeep (i.e., hold in their vault, clip coupons on, and present for payment at maturity) bonds and money market instruments.

**Sale Repurchase Agreement**

See Repurchase Agreement.
Savings and Loan Association

Federal- or state-chartered institution that accepts savings deposits and invests the bulk of the funds thus received in mortgages.

Savings Deposit

Interest-bearing deposit at a savings institution that has no specific maturity.

Scale

A bank that offers to pay different rates of interest on CDs of varying maturities is said to "post a scale." Commercial paper issuers also post scales.

Scalper

A speculator who actively trades a futures contract in the hope of making small profits off transitory upticks and downticks in price.

Seasoned Issue

An issue that has been well distributed and trades well in the secondary market.

Secondary Market

The market in which previously issued securities are traded.

Sector

Refers to a group of securities that are similar with respect to maturity, type, rating, and/or coupon.

Secured Loans

These are the loans which require that certain assets must be pledged as security. In case of default, the lender will receive these assets. Once pledged, the same assets cannot be pledged to someone else. Most bank loans require that accounts receivables and inventory be pledged as security.

Securities and Exchange Commission (SEC)

Agency created by Congress to protect investors in securities transactions by administering securities legislation.

Securitization
Securitization occurs when a financial security is created which is a claim to the cashflows of a collection (or pool) of individual real or financial assets (typically loans originated by banks or S&Ls). Hence, securitization turns a loan (an illiquid asset) into a liquid asset or a security.

Security

Any claim that trades in the marketplace. Stocks, bonds, negotiable CDs, bankers acceptances are examples of securities. A bank loan is a private contract and it can not be bought or sold. Hence, it is not a security.

Sell a Spread

Sell a nearby futures contract and buy a far one.

Serial Bonds

A bond issue in which maturities are staggered over a number of years.

Settle

See clear.

Settlement Date

The date on which trade is cleared by delivery of securities against funds. The settlement data may be the trade date or a later date.

Settlement Risk

Banks and other financial intermediaries send most of their wholesale payments either through Fedwire or Clearing House InterBank Payment System (CHIPS). All claims sent on CHIPS clear at the end of the day. If a bank were to fail during the day, or send funds it does not yet have, this can create a chain of settlement problems for other banks who rely on these incoming funds.

Shell Branch

A foreign branch—usually in a tax haven—which engages in Eurocurrency business but is run out of a head office.

Shop

In street jargon, a money market or bond dealership.

Shopping

Seeking to obtain the best bid or offer available by calling a number of dealers and/or brokers.
**Short Bonds**

Bonds with a short current maturity.

**Short Book**

See unmatched book.

**Short Coupons**

Bonds or notes with a short current maturity.

**Short Hedge**

*Sale of a futures* contract to hedge, for example, a position in cash securities or an anticipated borrowing need.

**Short Sale**

The sale of securities not owned by the seller in the expectation that the price of these securities will fall or as part of an arbitrage. A short sale must eventually be covered by a purchase of the securities sold. Short seller borrow the asset (not owned), sells it and the later purchases the asset (hopefully at a lower price) and returns to the original party that the asset was borrowed from. One would do a short sale if you expect the price of the asset to fall and you do not own the asset to begin with.

**Short the Board**

Sell GNMA or T-bond futures on the CBT.

**Short**

A market participant assumes a short position by selling as security he does not own. The seller makes delivery by borrowing the security sold or reversing it in.

**Sinking Fund**

Indentures on corporate issues often require that the issuer make annual payments to a sinking fund, the proceeds of which are used to retire randomly selected bonds in the issue.

**Size**

Large in size, as in "size offering" or "in there for size." What constitutes size varies with the sector of the market.

**Skip-day Settlement**

The trade is settled one business day beyond what is normal.
Sovereign Risk

Sovereign Risk refers to the fact that a foreign government can default on its promises. Moreover, a foreign government can prohibit or restrict all domestic corporations and agencies from re-paying their foreign currency denominated interest and principle payment.

Sovereign Risk

The special risks, if any, that attach to a security (or deposit or loan) because the borrower's country of residence differs from that of the investor's. Also referred to as country risk.

Specific Issues Market

The market in which dealers reverse in securities they want to short.

Spectail

A dealer that does business with retail but concentrates more on acquiring and financing its own speculative position.

Speculation

Taking a position that involves risk with anticipation of profits. For instance, if I think interest rates will decline, I can buy long-term treasury bonds to monetize my view. This is speculation. If interest rates do fall as I expect, I can make a lot money. If I am wrong and the interest rates rise, I would lose money. The difference between gambling and speculation is that speculators usually have a mathematical expectation of positive profits.

Spot Market

Market for immediate as opposed to future delivery. In the spot market for foreign exchange, settlement is two business days ahead.

Spot Rate

The price prevailing in the spot market.

Spot Rates

These are the interest rates that are in effect at this time. If you want an immediate loan, you pay the spot rate. If you want a loan some time in the future, you can negotiate for a loan commitment.

Spread
(1) Difference between bid and asked prices on a security. (2) Difference between yields on or prices of two securities of differing sorts or differing maturities. (3) In underwriting, difference between price realized by the issuer and price paid by the investor. (4) Difference between two prices or two rates. What a commodities trader would refer to as the basis.

**Spread**

In the futures market, buying one futures contract and selling a nearby one to profit from an anticipated narrowing or widening of the spread over time.

**Standby Letters of Credit (SLC's)**

These provide default guarantees to back a commercial paper issue or a municipal revenue bond. They also provide performance bond guarantees to ensure that a real-estate development will be operational within a stated time period. They involve much larger amounts than the typical letters of credit.

**Stock**

Holders have residual claims to firm and they are the owners. Holders allowed to elect the board of directors which hires, fires, and sets the compensation of top executives. Returns to common stock occurs with dividends declared by the board and capital gains on sale of stock. *Preferred stock* has both debt and equity characteristics. Pays fixed dividends (like debt) and dividends may be skipped (like stocks). Holders of preferred stock do not vote at the annual shareholders meetings. All preferred dividends must be paid before common dividends can be paid.

**Stop-out Price**

The lowest price (highest yield) accepted by the Treasury in an auction of a new issue.

**Straddle**

In option trading, buying 1 call and 1 put with the same exercise price, maturity and underlying asset. This position benefits if the price of the underlying asset turns out to be volatile. Also referred to as buying volatility. Strangle is similar to a straddle except the exercise prices of the call and put are different.

**Strap**

In option trading, buying 2 calls and 1 put with same exercise price and maturity.

**Striking Price**

See exercise price.
**Strips**

Treasury strips refers to separate trading of the principle (corpus) and the interest coupons. Stripping means buying the bonds and selling the pieces. Reconstituting means buying the pieces and constructing the entire bonds.

**Strip**

In option trading, strip refers to two puts and one call.

**Sub Right**

Right of substitution—to change collateral—on a repo.

**Subject**

Refers to a bid or offer than cannot be executed without confirmation from the customer.

**Subordinated Debenture**

The claims of holders of this issue rank after those of holders of various other unsecured debts incurred by the issuer.

**Swap**

(1) In securities, selling one issue and buying another. (2) In foreign exchange, buying a currency spot and simultaneously selling it forward.

**Swap (Commodity)**

The buyer of the swap agrees to make a number of payments periodically tied to the price of a commodity such as oil and receive fixed payments. By entering into a commodity swap, both parties attempt to hedge their exposures to the commodity prices.

**Swap (Currency)**

The buyer of the swap agrees to make a number of fixed or floating interest rate payments periodically to the seller in one currency on some agreed upon notional amount and receive payments denoted in another currency. For instance, one party pays UD dollars and receives British pounds. By entering into a currency swap, both parties attempt to hedge their FX exposures.

**Swap (Equity)**

The buyer of the swap agrees to make a number of payments periodically tied to return on some equity index (such as S&P 500 index) and receive fixed payments (such as T-Bill rate). By entering into a equity swap, both parties attempt to hedge their exposures to stock market.
Swap (Interest rate)

The buyer of the Swap agrees to make a number of fixed interest rate payments periodically to the seller or some agreed upon notional amount. In return, the seller agrees to make floating rate interest payment on the same dates to the buyer on the same notional amount. By entering into the swap, both parties attempt to hedge their interest rate exposures.

Swap Rate

In the foreign-exchange market, the difference between the spot and forward rates at which a currency is traded.

Swaption

An option on an interest-rate swap.

Swing Line

See demand line of credit.

Swissy

Market jargon for Swiss francs.

Switch

British English for a swap; that is, buying a currency spot and selling it forward.

Synthetics

The process of creating identical payoffs to a given asset without using the asset itself. This is used in arbitrage.

TABs (tax anticipation bills)

Special bills that the Treasury occasionally issues. They mature on corporate quarterly income tax dates and can be used at face value by corporations to pay their tax liabilities.

Tail

(1) The difference between the average price in Treasury auctions and the stop-out price. (2) A future money market instrument (one available some period hence) created by buying an existing instrument and financing the initial portion of its life with term repo.

Take
(1) A dealer or customer who agrees to buy at another dealer's offered price is said to take that offer. (2) Eurobankers speak of taking deposits rather than buying money.

**Take-out**

(1) A cash surplus generated by the sale of one block of securities and the purchase of another, for example, selling a block of bonds at 99 and buying another block at 95. (2) A bid made to a seller of a security that is designed (and generally agreed) to take him out of the market.

**Taking a View**

A London expression for forming an opinion as to where interest rates are going and acting on it.

**TANs**

Tax anticipation notes issued by states or municipalities to finance current operations in anticipation of future tax receipts.

**Technical Condition of a Market**

Demand and supply factors affecting price, in particular the net position-long or short-of dealers.

**Technicals**

(1) Supply and demand factors influencing the cash market. (2) Value or shape of technical indicators.

**TED**

A spread trade

T-bill futures to CD futures.

**Tenor**

British term for maturity.

**Term Bonds**

A bond issue in which all bonds mature at the same time.

**Term Fed Funds**

Fed funds sold for a period of time longer than overnight.

**Term Loan**

Loan extended by a bank for more than the normal 90day period. A term loan might run five years or more.
Term Repo (RP)
Repo borrowings for a period longer than overnight; may be 7, 30, 60, or even 90 days.

Term Structure
Term structure denotes the relation between interest rates and maturity. They are also referred to as the yield curve.

The IMM swap
A swap of 1-year fixed against 3-month LIBOR, where the 3-month rate floats. The start, end, and intermediate reset dates are set to coincide with the dates on four successive IMM contracts for 3-month Eurodollars.

Theta
In options pricing, the rate at which the value of an option changes as time passes.

Thin Market
A market in which trading volume is low and in which consequently bid and asked quotes are wide and the liquidity of the instrument traded is low.

TIBOR
LIBOR as established in Tokyo.

Tick
Minimum price movement on a futures contract.

Tight Market
A tight market, as opposed to a thin market, is one in which volume is large, trading is active and highly competitive, and spreads between bid and ask prices are narrow.

Time Deposit
Interest-bearing deposit at a savings institution that has a specific maturity.

Times Interest Covered
Times Interest Covered refers to the earnings before interest and taxes (EBIT) divided by the interest payments. Higher interest coverage makes the firm less risky.

To Trade Numbers
To trade securities based on the release of a *new economic statistic (number)*, e.g., trading based on announcement of the latest number for the CPI, the U.S. trade deficit, etc.

**Tom Next**

In the interbank market in Eurodollar deposits and the foreign-exchange market, the value (delivery) date on a Tom next transaction is the next business day. (Refers to "tomorrow next.").

**Trade Date**

The date on which a transaction is initiated. The settlement date (the day cash and the asset officially changes ownership) may be the trade date or a later date.

**Trade On Top Of**

Trade at a narrow or no spread in basis points to some other instrument.

**Trading Paper**

CDs purchased by accounts that are likely to resell them. The term is commonly used in the Euromarket.

**Tranches**

A collateralized mortgage obligation (CMO) is created by issuing multiple bonds (called *tranches*) against the cashflows of the pool.

**Treasurer's Check**

A check issued by a bank to make a payment. Treasurer's checks outstanding are counted as part of a bank's reservable deposits and as part of the money supply.

**Treasury Bill**

A non-interest-bearing discount security issued by the U.S. Treasury to finance the national debt. **Treasury Bills** are government obligations with less than 1 year to maturity. Original maturities of 3 months, 6 months, and one year (actually 52 weeks or 364 days). They do not pay any coupon interest. Instead, interest is paid by selling these securities as a discount. The difference between the market price and face value provides interest payments.

\[
\text{Price} = 100(1 - \text{Actual discount})
\]

\[
\text{Actual discount} = (\text{Quoted discount}) \times \frac{M}{360}
\]

Where \( M \) is days to maturity.
Annualized interest rate = \((100 / \text{Price})^{(365/\text{M})}-1\)

**Treasury Bonds and Notes** are government obligations with more than 1 year to maturity. Notes have maturities between one and 10 years while the bonds have maturities between 10 years and 30 years. These pay interest semi-annually.

**TT&L Account**

Treasury tax and loan account at a bank.

**Turnaround Time**

The time available or needed to effect a turnaround.

**Turnaround**

Securities bought and sold for settlement on the same day.

**Two-sided Market**

A market in which both bid and asked prices, good for the standard unit of trading, are quoted.

**Two-way Market**

Market in which both a bid and an asked price are quoted.

**Underlier**

The asset against which an option is written. The underlier may be a stock, a bond, a futures contract, oil, land, whatever.

**Underwriter**

A dealer who purchases new issues from the issuer and distributes them to investors. Underwriting is one function of an investment banker.

**Unmatched Book**

If the average maturity of a bank's liabilities is less than that of its assets, it is said to be running an unmatched book. The term is commonly used in the Euromarket. Equivalent expressions are open book and short book.

**Value Date**
In the market for Eurodollar deposits and foreign exchange, value date refers to the delivery date of funds traded. Normally it is on spot transactions two days after a transaction is agreed upon and the future date in the case of a forward foreign-exchange trade.

**Variable-price Security**

A security, such as stocks and bonds, that sells at a fluctuating, market-determined price.

**Variable-rate CDs**

Short-term CDs that pay interest periodically on roll dates; on each roll date the coupon on the CD is adjusted to reflect current market rates.

**Variable-rate Loan**

Loan made at an interest rate that fluctuates with the prime.

**Visible Supply**

New municipal bond issues scheduled to come to market within the next 30 days.

**Weighted Average Cost of Capital**

The average cost of all capital used by a firm. In the context of valuing firms, if the capital is a mixture of debt and equity. The discount rate is called weighted average cost of capital.

\[
WACC = (1 - tc) \cdot Rd \cdot D/(D+E) + Re \cdot E/ (D+E)
\]

Where tc is the corporate tax rate , Rd is the contractual interest rate on (new) debt, Re is the discount rate on equity, D and E are the market values of debt and equity respectively. The return of all projects accepted by the corporation must exceed the weighted average cost of capital (WACC) to create value for the shareholders.

**When-issued Trades**

Typically there is a lag between the time a new bond is announced and sold and the time it is actually issued. During this interval, the security trades, wi, "when, as, and if issued."

**Wi**

When, as, and if issued. See *when-issued trades*.

**Wi Wi**

T bills trade on a wi basis between the day they are announced and the day they are settled. Late Tuesday and on Wednesday, two bills will trade wi, the bill just auctioned and the bill just
announced. The latter used to be called the wi wi bill. However, now it is common for dealers to speak of the just auctioned bill as the 3-month bill and of the newly announced bill and the wi bill. This change in jargon resulted from a change in the way interdealer brokers of bills list bills on their screens. Cantor Fitz still lists a new bill as the wi bill until it is settled.

**With Recourse**

If the loans are sold with recourse, then the bank has a contingent off-balance sheet liability. If the loans go bad, the buyer will sell the loans back to the originator. Hence, loans sold with recourse present a long-term potential liability.

**Without Recourse**

If the loans are sold without recourse, then the bank has no further potential liability with the loans sold. If the loans go bad, the buyer cannot ask the bank to make up the difference.

**Without**

If 70 were bid in the market and there was no offer, the quote would be "70 bid without." The expression without indicates a one-way market.

**Write**

To sell an option.

**Yankee Bond**

A foreign bond issued in the U.S. market, payable in dollars, and registered with the SEC.

**Yankee CD**

A CD issued in the domestic market (typically in New York) by a branch of a foreign bank.

**Yield**

The yield is the rate of return that investors require from the bond. Equivalently, it is the rate of return that they require from bonds of similar risk.

**Yield Curve**

A graph showing, for securities that all expose the investor to the same credit risk, the relationship at a given point in time between yield and current maturity. Yield curves are typically drawn using yields on governments of various maturities. It is also called the term-structure of interest rates. Typically the yield curve rises with maturity.

**Yield to Maturity (YTM)**
The rate of return yielded by a debt security held to maturity when both interest payments and the investor's capital gain or loss on the security are taken into account. For a risk-free bond, the YTM equals the market capitalization rate.

**Zero cost collar**

The price of call equals the price of put in a collar. See collars.