UNIT 24 – BANKING Important Banking Terms

Hello Readers,

On the account of upcoming SBI PO Exam, here we are providing you all the Important Banking Terms. Hope you all like the post!!!

Accrued interest: Interest due from issue date or from the last coupon payment date to the settlement date. Accrued interest on bonds must be added to their purchase price.

Arbitrage: Buying a financial instrument in one market in order to sell the same instrument at a higher price in another market.

Ask Price: The lowest price at which a dealer is willing to sell a given security.

Asset-Backed Securities (ABS): A type of security that is backed by a pool of bank loans, leases, and other assets. Most ABS are backed by auto loans and credit cards – these issues are very similar to mortgage-backed securities.

At-the-money: The exercise price of a derivative that is closest to the market price of the underlying instrument.

Basis Point: One hundredth of 1%. A measure normally used in the statement of interest rate e.g., a change from 5.75% to 5.81% is a change of 6 basis points.

Bear Markets: Unfavorable markets associated with falling prices and investor pessimism.

Bid-ask Spread: The difference between a dealer's bid and ask price.

Bid Price: The highest price offered by a dealer to purchase a given security.

Blue Chips: Blue chips are unsurpassed in quality and have a long and stable record of earnings and dividends. They are issued by large and well-established firms that have impeccable financial credentials.

Bond: Publicly traded long-term debt securities, issued by corporations and governments, whereby the issuer agrees to pay a fixed amount of interest over a specified period of time and to repay a fixed amount of principal at maturity.

Book Value: The amount of stockholders' equity in a firm equals the amount of the firm's assets minus the firm's liabilities and preferred stock

Broker: Individuals licensed by stock exchanges to enable investors to buy and sell securities.

Brokerage Fee: The commission charged by a broker.

Bull Markets: Favorable markets associated with rising prices and investor optimism.

Call Option: The right to buy the underlying securities at a specified exercise price on or before a specified expiration date.

Callable Bonds: Bonds that give the issuer the right to redeem the bonds before their stated maturity.

Capital Gain: The amount by which the proceeds from the sale of a capital asset exceed its original purchase price.

Capital Markets: The market in which long-term securities such as stocks and bonds are bought and sold.

Certificate of Deposits (CDs): Savings instrument in which funds must remain on deposit for a specified period, and premature withdrawals incur interest penalties.

Closed-end (Mutual) Fund: A fund with a fixed number of shares issued, and all trading is done between investors in the open market. The share prices are determined by market prices instead of their net asset value.

Collateral: A specific asset pledged against possible default on a bond. Mortgage bonds are backed by claims on property. Collateral trusts bonds are backed by claims on other securities. Equipment obligation bonds are backed by claims on equipment.

Commercial Paper: Short-term and unsecured promissory notes issued by corporations with very high credit standings.

Common Stock: Equity investment representing ownership in a corporation; each share represents a fractional ownership interest in the firm.

Compound Interest: Interest paid not only on the initial deposit but also on any interest accumulated from one period to the next.

Contract Note: A note which must accompany every security transaction which contains information such as the dealer's name (whether he is acting as principal or agent) and the date of contract.

Controlling Shareholder: Any person who is, or group of persons who together are, entitled to exercise or control the exercise of a certain amount of shares in a company at a level (which differs by jurisdiction) that triggers a mandatory general offer, or more of the voting power at general meetings of the issuer, or who is or are in a position to control the composition of a majority of the board of directors of the issuer.

Convertible Bond: A bond with an option, allowing the bondholder to exchange the bond for a specified number of shares of common stock in the firm. A conversion price is the specified value of the shares for which the bond may be exchanged. The conversion premium is the excess of the bond's value over the conversion price.

Corporate Bond: Long-term debt issued by private corporations.

Coupon: The feature on a bond that defines the amount of annual interest income.

Coupon Frequency: The number of coupon payments per year.

Coupon Rate: The annual rate of interest on the bond's face value that a bond's issuer promises to pay the bondholder. It is the bond's interest payment per dollar of par value.

Covered Warrants: Derivative call warrants on shares which have been separately deposited by the issuer so that they are available for delivery upon exercise.

Credit Rating: An assessment of the likelihood of an individual or business being able to meet its financial obligations. Credit ratings are provided by credit agencies or rating agencies to verify the financial strength of the issuer for investors.

Currency Board: A monetary system in which the monetary base is fully backed by foreign reserves. Any changes in the size of the monetary base has to be fully matched by corresponding changes in the foreign reserves.

Current Yield: A return measure that indicates the amount of current income a bond provides relative to its market price. It is shown as: Coupon Rate divided by Price multiplied by 100%.

Custody of Securities: Registration of securities in the name of the person to whom a bank is accountable, or in the name of the bank's nominee; plus deposition of securities in a designated account with the bank's bankers or with any other institution providing custodial services.

Default Risk: The possibility that a bond issuer will default ie, fail to repay principal and interest in a timely manner.

Derivative Call (Put) Warrants: Warrants issued by a third party which grant the holder the right to buy (sell) the shares of a listed company at a specified price.

Derivative Instrument: Financial instrument whose value depends on the value of another asset.

Discount Bond: A bond selling below par, as interest in-lieu to the bondholders.

Diversification: The inclusion of a number of different investment vehicles in a portfolio in order to increase returns or be exposed to less risk.

Duration: A measure of bond price volatility, it captures both price and reinvestment risks to indicate how a bond will react to different interest rate environments.

Earnings: The total profits of a company after taxation and interest.

Earnings per Share (EPS): The amount of annual earnings available to common stockholders as stated on a per share basis.

Earnings Yield: The ratio of earnings to price (E/P). The reciprocal is price earnings ratio (P/E).

Equity: Ownership of the company in the form of shares of common stock.

Equity Call Warrants: Warrants issued by a company which give the holder the right to acquire new shares in that company at a specified price and for a specified period of time.

Ex-dividend (XD): A security which no longer carries the right to the most recently declared dividend or the period of time between the announcement of the dividend and the payment (usually two days before the record date). For transactions during the ex-dividend period, the seller will receive the dividend, not the buyer. Ex-dividend status is usually indicated in newspapers with an (x) next to the stock's or unit trust's name.

Face Value/ Nominal Value: The value of a financial instrument as stated on the instrument. Interest is calculated on face/nominal value.

Fixed-income Securities: Investment vehicles that offer a fixed periodic return.

Fixed Rate Bonds: Bonds bearing fixed interest payments until maturity date.

Floating Rate Bonds: Bonds bearing interest payments that are tied to current interest rates.

Fundamental Analysis: Research to predict stock value that focuses on such determinants as earnings and dividends prospects, expectations for future interest rates and risk evaluation of the firm.

Future Value: The amount to which a current deposit will grow over a period of time when it is placed in an account paying compound interest.

Future Value of an Annuity: The amount to which a stream of equal cash flows that occur in equal intervals will grow over a period of time when it is placed in an account paying compound interest.

Futures Contract: A commitment to deliver a certain amount of some specified item at some specified date in the future.

Hedge: A combination of two or more securities into a single investment position for the purpose of reducing or eliminating risk.

Income: The amount of money an individual receives in a particular time period.

Index Fund: A mutual fund that holds shares in proportion to their representation in a market index, such as the S&P 500.

Initial Public Offering (IPO): An event where a company sells its shares to the public for the first time. The company can be referred to as an IPO for a period of time after the event.

Inside Information: Non-public knowledge about a company possessed by its officers, major owners, or other individuals with privileged access to information.

Insider Trading: The illegal use of non-public information about a company to make profitable securities transactions

Intrinsic Value: The difference of the exercise price over the market price of the underlying asset.

Investment: A vehicle for funds expected to increase its value and/or generate positive returns.

Investment Adviser: A person who carries on a business which provides investment advice with respect to securities and is registered with the relevant regulator as an investment adviser.

IPO price: The price of share set before being traded on the stock exchange. Once the company has gone Initial Public Offering, the stock price is determined by supply and demand.

Junk Bond: High-risk securities that have received low ratings (i.e. Standard & Poor's BBB rating or below; or Moody's BBB rating or below) and as such, produce high yields, so long as they do not go into default.

Leverage Ratio: Financial ratios that measure the amount of debt being used to support operations and the ability of the firm to service its debt.

Libor: The London Interbank Offered Rate (or LIBOR) is a daily reference rate based on the interest rates at which banks offer to lend unsecured funds to other banks in the London wholesale money market (or interbank market). The LIBOR rate is published daily by the British Banker's Association and will be slightly higher than the London Interbank Bid Rate (LIBID), the rate at which banks are prepared to accept deposits.

Limit Order: An order to buy (sell) securities which specifies the highest (lowest) price at which the order is to be transacted.

Limited Company: The passive investors in a partnership, who supply most of the capital and have liability limited to the amount of their capital contributions.

Liquidity: The ability to convert an investment into cash quickly and with little or no loss in value.

Listing: Quotation of the Initial Public Offering company's shares on the stock exchange for public trading.

Listing Date: The date on which Initial Public Offering stocks are first traded on the stock exchange by the public

Margin Call: A notice to a client that it must provide money to satisfy a minimum margin requirement set by an Exchange or by a bank / broking firm.

Market Capitalization: The product of the number of the company's outstanding ordinary shares and the market price of each share.

Market Maker: A dealer who maintains an inventory in one or more stocks and undertakes to make continuous two-sided quotes.

Market Order: An order to buy or an order to sell securities which is to be executed at the prevailing market price.

Money Market: Market in which short-term securities are bought and sold.

Mutual Fund: A company that invests in and professionally manages a diversified portfolio of securities and sells shares of the portfolio to investors.

Net Asset Value: The underlying value of a share of stock in a particular mutual fund; also used with preferred stock.

Offer for Sale: An offer to the public by, or on behalf of, the holders of securities already in issue.

Offer for Subscription: The offer of new securities to the public by the issuer or by someone on behalf of the issuer.

Open-end (Mutual) Fund: There is no limit to the number of shares the fund can issue. The fund issues new shares of stock and fills the purchase order with those new shares. Investors buy their shares from, and sell them back to, the mutual fund itself. The share prices are determined by their net asset value.

Open Offer: An offer to current holders of securities to subscribe for securities whether or not in proportion to their existing holdings.

Option: A security that gives the holder the right to buy or sell a certain amount of an underlying financial asset at a specified price for a specified period of time.

Oversubscribed: When an Initial Public Offering has more applications than actual shares available. Investors will often apply for more shares than required in anticipation of only receiving a fraction of the requested number. Investors and underwriters will often look to see if an IPO is oversubscribed as an indication of the public's perception of the business potential of the IPO company.

Par Bond: A bond selling at par (i.e. at its face value).

Par Value: The face value of a security.

Perpetual Bonds: Bonds which have no maturity date.

Placing: Obtaining subscriptions for, or the sale of, primary market, where the new securities of issuing companies are initially sold.

Portfolio: A collection of investment vehicles assembled to meet one or more investment goals.

Preference Shares: A corporate security that pays a fixed dividend each period. It is senior to ordinary shares but junior to bonds in its claims on corporate income and assets in case of bankruptcy.

Premium (Warrants): The difference of the market price of a warrant over its intrinsic value.

Premium Bond: Bond selling above par.

Present Value: The amount to which a future deposit will discount back to present when it is depreciated in an account paying compound interest.

Present Value of an Annuity: The amount to which a stream of equal cash flows that occur in equal intervals will discount back to present when it is depreciated in an account paying compound interest.

Price/Earnings Ratio (P/E): The measure to determine how the market is pricing the company's common stock. The price/earnings (P/E) ratio relates the company's earnings per share (EPS) to the market price of its stock.

Privatization: The sale of government-owned equity in nationalized industry or other commercial enterprises to private investors.

Prospectus: A detailed report published by the Initial Public Offering company, which includes all terms and conditions, application procedures, IPO prices etc, for the IPO

Put Option: The right to sell the underlying securities at a specified exercise price on of before a specified expiration date.

Rate of Return: A percentage showing the amount of investment gain or loss against the initial investment.

Real Interest Rate: The net interest rate over the inflation rate. The growth rate of purchasing power derived from an investment.

Redemption Value: The value of a bond when redeemed.

Reinvestment Value: The rate at which an investor assumes interest payments made on a bond which can be reinvested over the life of that security.

Relative Strength Index (RSI): A stock's price that changes over a period of time relative to that of a market index such as the Standard & Poor's 500, usually measured on a scale from 1 to 100, 1 being the worst and 100 being the best.

Repurchase Agreement: An arrangement in which a security is sold and later bought back at an agreed price and time.

Resistance Level: A price at which sellers consistently outnumber buyers, preventing further price rises.

Return: Amount of investment gain or loss.

Rights Issue: An offer by way of rights to current holders of securities that allows them to subscribe for securities in proportion to their existing holdings.

Risk-Averse, Risk-Neutral, Risk-Taking:

- Risk-averse describes an investor who requires greater return in exchange for greater risk.
- Risk-neutral describes an investor who does not require greater return in exchange for greater risk.
- Risk-taking describes an investor who will accept a lower return in exchange for greater risk.

Senior Bond: A bond that has priority over other bonds in claiming assets and dividends.

Short Hedge: A transaction that protects the value of an asset held by taking a short position in a futures contract.

Settlement: Conclusion of a securities transaction when a customer pays a broker/dealer for securities purchased or delivered, securities sold, and receives from the broker the proceeds of a sale.

Short Position: Investors sell securities in the hope that they will decrease in value and can be bought at a later date for profit.

Short Selling: The sale of borrowed securities, their eventual repurchase by the short seller at a lower price and their return to the lender.

Speculation: The process of buying investment vehicles in which the future value and level of expected earnings are highly uncertain.

Stock Splits: Wholesale changes in the number of shares. For example, a two for one split doubles the number of shares but does not change the share capital.

Subordinated Bond: An issue that ranks after secured debt, debenture, and other bonds, and after some general creditors in its claim on assets and earnings. Owners of this kind of bond stand last in line among creditors, but before equity holders, when an issuer fails financially.

Substantial Shareholder: A person acquires an interest in relevant share capital equal to, or exceeding, 10% of the share capital.

Support Level: A price at which buyers consistently outnumber sellers, preventing further price falls.

Technical Analysis: A method of evaluating securities by relying on the assumption that market data, such as charts of price, volume, and open interest, can help predict future (usually short-term) market trends. Contrasted with fundamental analysis which involves the study of financial accounts and other information about the company. (It is an attempt to predict movements in security prices from their trading volume history.)

Time Horizon: The duration of time an investment is intended for.

Trading Rules: Stipulation of parameters for opening and intra-day quotations, permissible spreads according to the prices of securities available for trading and board lot sizes for each security.

Trust Deed: A formal document that creates a trust. It states the purpose and terms of the name of the trustees and beneficiaries.

Underlying Security: The security subject to being purchased or sold upon exercise of the option contract.

Valuation: Process by which an investor determines the worth of a security using risk and return concept.

Warrant: An option for a longer period of time giving the buyer the right to buy a number of shares of common stock in company at a specified price for a specified period of time.

Window Dressing: Financial adjustments made solely for the purpose of accounting presentation, normally at the time of auditing of company accounts.

Yield (Internal rate of Return): The compound annual rate of return earned by an investment

Yield to Maturity: The rate of return yield by a bond held to maturity when both compound interest payments and the investor's capital gain or loss on the security are taken into account.

Zero Coupon Bond: A bond with no coupon that is sold at a deep discount from par value.