THE UNOFFICIAL GUIDE TO BANKING

LEARN THE JARGON

A glossary of incomprehensible banking jargon

Acquisition

The takeover of one company by another. This can be a friendly (agreed by the boards of both companies), hostile (where the board of the target company resists the takeover), reverse (a private company takes over a public company) or back flip takeover (where the acquiring company turns itself into a subsidiary of the target company).

Algorithmic trading

In its simplest terms this is trading without the involvement of humans. To take an example, when an investor-driven trader (such as a pension fund) wants to buy stocks in large quantities, to avoid affecting the market price they will often use specially developed computer algorithms to spread the investments in such a way that market prices remain unaffected as much as possible. It would be simply impossible for a human trader to respond as quickly to market information as a computer can.

Alternative investment

Traditional investments include stocks, bonds, cash or property. An alternative investment is basically anything else. The term includes art, wine and antiques, but most significantly financial assets such as private equity (stocks in a company not publicly traded on a stock exchange) and financial derivatives (agreements that derive their return from the performance of an underlying asset like a stock or bond).

Analyst

A specialist in a specific area, sector or function of the bank. Also a job title often used to describe graduates new to banking.

Arbitrage

The practice of making a profit from trading on two markets simultaneously. If the price of wheat in London is cheaper than in New York, you buy in London and simultaneously sell in New York. Sports arbitrage is the practice of placing bets on an event with a range of bookmakers, exploiting their different prices to guarantee a profit regardless of the outcome.

Assets

Predominantly used to describe anything owned by an individual or business which has monetary value. Within banking 'asset' is specifically used to describe a class of investment product, e.g. shares, property and bonds are all asset classes.

Asset Management

We have a whole section on this, but in brief, this is the professional management of investments. Fund managers/asset managers invest in the financial markets on behalf of their clients to achieve attractive returns. The asset manager will discuss with the investor (or client) what kinds of investments they would like to make and set realistic goals for returns. Once the funds have been transferred from the investor to the asset manager, then that asset manager will place those funds where he/she thinks the return will be maximized over a given period.

Audit

The professional examination and verification of a company's accounting data.

Automation

Used to describe the processing of transactions using technology rather than manual procedures. This is a big issue in financial services as cost and risk are greatly reduced by the use of computers.

Back office

The support functions of banks that are not directly involved in generating revenue, e.g. Technology, Operations and Human Resources. The back office is also responsible for the processing of transactions made by traders and fund managers.

Basel Committee

A group of representatives from central banks around the world that mandate regulation to ensure stability of global financial infrastructure; it is responsible for the Basel II regulatory framework. This sets down standards by which the Basel Committee can enforce how much capital banks must set aside to guard against financial and operational risks.

Basis point

Representing a hundredth of a percent, a basis point is used to measure rate changes in financial instruments like interest rates and bond yields.

Bear

An individual who expects the value of a commodity, bond, share, currency, sector or market to fall.

Bear market

Any market in which prices exhibit a declining trend for a prolonged period. Because a bear attacks by clawing down, this term is associated with a falling market.

Blue chip

A well-established company with a good record of earnings over a long period of time; these companies are sought by investors seeking relative safety and stability.

Book

The summary of positions held by a dealer, desk or room. Position refers to an investor's stake in a bond, share or market. A long position is the number of shares owned; a short position is the number of shares owed.

Bond

A long-term debt instrument with the promise to pay a specified amount of interest and to return the original investment on a specified maturity date; usually issued by governments and organizations in order to raise capital.

Broker

An individual or firm that charges a fee or commission for executing buy and sell orders submitted by another individual or firm.
Or, the role of a broker firm when it acts as an agent for a customer and charges the customer a commission for its service.

Bulge bracket

In common parlance, a bulge bracket firm is an investment bank considered to be one of the largest and most profitable in the world. The name comes from the practice of listing these banks at the top of the 'tombstone'. A tombstone is an advertisement formally announcing a particular transaction – perhaps an offering or placement of stock of a company. The bank's name at the top of the tombstone will typically be in a larger font and will therefore 'bulge' out.

Bull

An individual who expects the value of a commodity, bond, share, currency, sector or market to rise.

Bull market

A period during which share prices in a particular market (such as the stock market) are generally rising. Because a bull attacks by thrusting upward, this term is associated with a rising market.

Business risk

The risk that the cash flow of a business will be impaired because of adverse economic conditions, making it difficult for the company to meet its operating expenses.

Buy side

Institutional investors that hold their customer's money and make buy and sell decisions on their behalf i.e. mutual funds, pension funds and trust companies.

Call option

The right but not the obligation to buy stock, shares or futures at a specified price within a specified time period; the investor pays a premium in order to get the option.

Capital

Money put into a business by its shareholders; can also be used as a general term to describe liquidity/cash.

Capital markets

A general term encompassing all markets for financial instruments.

Capital raising

Mechanisms by which companies raise money.

Central Securities Depository (CSD)

An agency that clears and settles bonds and shares transactions. There is only one of these in each country for each financial product.

Chartered Financial Analyst (CFA)

A globally recognized qualification taken by a range of professionals in the financial services industry.

Chinese wall

The imaginary wall between different areas in the bank that may have a conflict of interest; it denotes a commitment not to disclose confidential information to one another. In many cases, bankers will be physically prevented from interacting with colleagues in conflicting parts of the bank by not having access to their area in the building. Blocks might also be put in place on emails and phone calls between these areas. This is a general business term, not unique to banking.

Clearing

Confirming the details of a transaction between traders as well as managing the transfer of payment and delivery of the relevant certificates and documentation.

Clearing house

A separate agency or corporation working with the commodity exchange (where commodities such as wheat, coffee and oil are traded as well as contracts based on these products, such as futures and options) to match up buy and sell orders. This means transferring funds, ensuring delivery of ownership rights and guaranteeing all obligations on the part of buyers and sellers.

Commission

Fees paid to banks by clients for carrying out transactions and providing other services.

Commodities

Physical items such as oil, gold or grain that are traded on exchanges.

Commodity exchange

An exchange where commodities such as wheat, coffee and oil are traded. A commodity exchange will also trade in contracts based on commodities, such as forwards, futures and options.

Convertible bonds

Bonds which may be converted, at the option of the holder, into shares of the issuing corporation during a specified time period and according to specified conditions.

Coupon

This denotes the amount of interest due on a debt product, such as a bond or a loan.

Counterparty

The opposite side of a financial transaction, typically another financial institution.

Credit

The supply of resources by one party to another for which repayment is delayed by agreement. Credit refers to an arrangement whereby a debt is agreed upon. In investment banking, a credit event is an occurrence relating to a debt obligation not being met. An obvious example is a company going bankrupt. Others include failure to pay, restructuring and moratorium (the law deciding that debt repayments can be delayed due to extenuating circumstances). Derivatives based on these credit events will payout to the investor if the company concerned exhibits one of these conditions.

Credit correlation

The measure of how the default risk of one company moves in relation to that of another.

Credit derivative

An agreement between two parties, whose payoff depends on whether or not a credit event occurs (i.e. bankruptcy, default, upgrade or downgrade). Credit derivatives are used to offset risk.

Credit risk

The risk that the issuer of a bond or share may default on interest and/or principle payments, or become bankrupt. In general, the better the rating, the lower the bond's coupon rate (rate of interest).

Custodian

A financial institution, usually a bank or trust company that holds a mutual fund's bonds, shares and cash in safekeeping.

Custody

The administering of bonds and shares by a financial institution. The custodian keeps a record of a client's investments and may also collect income, process tax reclaims and provide other services according to client instructions.

Debt

Money owed to creditors/lenders or buyers of debt securities (bonds, certificates, loans and leases).

Delivery

The transfer and receipt of ownership. More specifically, on a busy trading floor agreements are made that cannot be fully transacted there and then; delivery is the point at which the agreement is settled in full.

Derivative

An agreement that derives its value from an existing bond, share, currency or commodity (referred to as the base instrument or underlying investment). The price of a derivative will move in direct relationship to the price of the base instrument. Derivatives involve the trading of rights or obligations based on the underlying product, but do not directly transfer property. They are used to hedge risk or to exchange a floating rate of return (linked to a reference rate that is outside of the control of either party, such as LIBOR – the London Interbank Offered Rate) for fixed rate of return (an agreed rate that does not change).

Electronic trading platform

Electronic trading uses information technology to allow trading in securities to happen remotely in a virtual marketplace rather than a traditional trading floor. An electronic trading platform is the system which enables this to happen.

Emerging markets

The markets of developing countries: examples include Mexico, Malaysia, Chile, Thailand and the Philippines. Emerging market bonds and shares tend to be the most volatile in the world; they have tremendous growth potential but also pose significant risks – political upheaval, corruption and currency collapse to name just a few.

Equities

Shares in a corporation representing a claim over a proportion of its assets and profit.

Equity

The net worth of a company, it represents the ownership interest of the shareholders. For this reason, shares are often known as equities.

Equity Capital Markets (ECM)

The markets on which primary equity issues are traded (also known as IPOs – Initial Public Offering). These are new stocks entering the market for the first time, either from a brand new company or a newly public company. ECM is also the name of a division of an investment bank which helps clients structure, buy and sell primary equity.

Exchange

A place for companies to publicly and centrally offer their investment options to investors. For example a commodity exchange will trade in physical items such as gold, wheat or oil. More than simply offering these items to trade, investors will be able to purchase contracts based on these products – these will include things like futures, options and other more complex derivatives.

Exchange-traded fund (ETF)

An ETF is similar to a mutual fund, in that investors own a share of a pool of securities and other assets. The difference here is that shares in an ETF can be bought or sold throughout the day, much like normal stocks and shares.

Exotic/Hybrid

The most complex type of derivatives which are traded OTC (over the counter – that is to say they are not listed on an organized exchange). A derivative is an agreement that derives its payout from the performance of an underlying investment.

Financial restructuring

The reorganization of a company's finances; often employed when the company is experiencing financial difficulty.

Financial Services Authority (FSA)

The UK regulatory body for the financial services industry.

Fixed income

Debt instruments issued by corporations, governments or agencies characterized by a fixed interest rate and stated maturity date. An example of a fixed income investment is a bond, because a bond regularly pays a fixed amount of money (interest) to its holder until maturity.

Foreign exchange market

A market where buyers and sellers trade the currencies of different countries – also referred to as a forex or FX market.

Front office

The area or function of a bank which is revenue-generating; the front office will include Sales & Trading, and Corporate Finance amongst others.

Fund

A pool of money to be invested or a fiscal and accounting entity with a self-balancing set of accounts.

Fund manager

The individual or team of individuals that manages a fund of stocks, bonds and other securities. The fund manager decides when to buy or sell the bonds and shares held in the fund.

Futures contract

A legally binding agreement to buy or sell a commodity or asset at a later date. They are standardized according to the quality, quantity, delivery time and location for each commodity, the only variable is price.

G-20

The group of twenty nations (in fact 19 nations plus the European Union) which meets semi-annually to discuss and promote international financial stability.

Generally Accepted Accounting Principles (GAAP)

The methodology for preparing company accounts – it varies from country to country.

Hedge

Holding two opposing positions in two or more financial instruments (bonds, shares, commodities) in order to offset a loss in one by a gain in the other. A 16th century term, it refers to the practice of hedging land, i.e. securing boundaries and limiting size. In the markets, to hedge your bets is to adopt a more secure position by limiting your exposure to risk.

Hedge funds

A fund, usually used by wealthy individuals and institutions, which is allowed to use aggressive strategies (including leverage, swaps, arbitrage, and derivatives). They are not constrained by the same laws as mutual funds. Hedge funds look to generate returns to investors even when markets are volatile or performing poorly. However, because of the nature of these strategies, a high level of risk is involved.

High net worth individual

A person who is worth a lot of money.

Index

A price index lists an average price for a given class of goods or services in a specific place and time. The well-known indices such as Dow Jones and FTSE 100 list share prices for the largest companies within a particular country. So the Dow Jones index lists the share prices of the 30 largest US companies. The FTSE 100 is the share price list for the top 100 companies in the UK. The Nikkei 225 lists the share prices of the top 225 companies in Japan.

Initial public offering (IPO)

This is the initial, or first, offering of shares or common stock (a form of corporate equity ownership) to the public. Often referred to as 'flotation' or 'offering'.

Institutional investor

An organization that has sums of money available to invest e.g. a pension fund.

Instrument

An item which may be traded, e.g. stocks, bonds, futures, options, and currencies.

Interest rate

The cost of borrowing money expressed as a percentage, usually over a period of one year. The rate may be either fixed (unchanging) or variable (based upon an index or market condition).

Investment products

Different types of investments, e.g. stocks, bonds, futures, options and currencies.

Junk bond

Bonds that have little or no collateral value (what they might be worth as security for a loan) or liquidation value (what they could quickly be sold for) and are typically very risky. For this risk they offer a high rate of return. Also known as high yield bonds.

Ledger

A set of accounts in which financial transactions are recorded.

Leverage

The degree to which a company or individual is using borrowed money. A highly leveraged company may be at risk of bankruptcy if it cannot meet its financing commitments.

Leveraged buyout

Occurs when the controlling stake in a company's equity is obtained with a high proportion of the funds being acquired via debt or leverage. This leverage is usually secured on the assets of the company being bought out.

Leveraged finance

Finance which takes advantage of the ratio between a company's debt and equity, often associated with relatively high risk and return. Usually it takes the form of loans or high-yield bonds, like junk bonds. It is also the name of the group in an investment bank which provides advice on these opportunities.

Liquidity

The ease with which a financial asset can be exchanged for cash without the holder incurring financial loss. A currency like sterling is liquid whereas a life-insurance policy is not.

Liquidity risk

The risk stemming from an investment that cannot be bought or sold quickly enough to prevent or minimize a loss.

Long position

The purchase of a security with the expectation that it will rise in value. "[He/She] has a long position in [Company X]".

Mandate

When the client company agrees to use the bank for a specific service or transaction.

Market capitalization

The value of a company's stock which gives a picture of the company's size. It is calculated by multiplying the price of shares by the number of shares outstanding (in the hands of the public).

Market maker

A firm or individual who sets buy and sell prices in a financial instrument or commodity.

Market risk

The chance that a bond or share's value will decline. With debt securities, (loans and bonds) market risk is closely tied to interest rate risk – as interest rates rise, prices decline and vice versa.

Maturity

When an investment based on a fixed term, such as a bond, closes and repayment of the principal amount (original investment) is made.

Mergers & Acquisitions (M&A)

Negotiating the buying and selling of companies or parts of companies. This also describes an area in a bank that, among other things, advises companies on mergers and takeovers.

Middle office

This is the area or function of the bank that does not generate profit, but supports the front office in financial and legal matters. For example, Treasury is part of the middle office, alongside Legal and Risk Management.

Mutual fund

The larger the quantity of money, the better able a fund manager is to generate big returns. For this reason investors will often pool their resources in a collective fund, or a mutual fund, to maximize their potential. These funds are professionally managed and often have a board of directors or trustees to monitor the progress of the fund and to ensure it is being run to the greatest benefit for investors.

Nearshoring

Offshoring is the practice of moving a business service to a provider in another country. However, there are instances in which greater distance or time-lag is not desirable for the effective running of the service. In this case, nearshoring might be a better solution. This is when the service is outsourced to a business in a neighboring country – making contact easier and more efficient while also reducing overall running costs.

Operational risk

The risk of loss associated with inadequate or failed internal processes, staff, systems, external events or legal matters.

Options

Like a futures contract, however the purchaser pays a premium to have the choice (rather than the obligation) to complete the contract; the contract can be the right to buy (a call option) or to sell (a put option) a set number of shares at a fixed price.

Organization of Petroleum Exporting Countries (OPEC)

An organization that meets regularly, its stated aims including the stabilization of prices in international oil markets.

Outsourcing/Offshoring

When a business moves a service function of its business to an external provider in order to reduce costs. Offshoring is when that service is provided by an organization based abroad.

Over the counter (OTC)

The buying and selling of bonds and shares that are not listed on an organized exchange; trading is handled by dealers through negotiation.

Plain/Vanilla

The most basic, standardized trading instruments (agreements that derive their payout from the performance of an underlying investment). The term applied originally to exchange traded items, now commonly applied to any standard banking product.

Portfolio

A collection of investments (can be shares, bonds, convertibles, cash, property, art, etc.) belonging to an individual or institutional investor. The purpose of a portfolio is to reduce risk by diversifying investments (i.e. holding different types of investments and spreading out the risk).

Position

A trading view expressed by buying or selling. If the position is open it is exposed to market risk, if a position is closed the profit/loss has been realized.

Private clients

People with significant personal assets (cash, company stock, art, shares) requiring professional investment management; often referred to as high net worth individuals.

Private equity

Equity securities in companies that are not traded on a stock exchange. Venture capitalists are private equity investors, but investor groups are typically made up of institutions, pension funds, high net worth individuals and other organizations who invest in a private equity fund. This fund is then managed and monitored professionally to invest in the private equity market. The portfolio of a private equity fund will typically include traditional assets such as bonds, but also hedge funds, real estate and commodities.

Profit & Loss statement (P&L)

This is a document that details the revenue generated by a business and the various costs it has incurred to give an indication of its performance over a specific time period.

Project finance

A form of loan extension in which the interest payments and repayments in respect of the funds are made largely or exclusively from the earnings of the investment project concerned.

Proprietary trading

When a bank trades in the financial markets with its own capital in order to try to make money for the business.

Put option

The right to sell shares at an agreed price on a future date.

Rating services

Companies that specialize in giving credit ratings will assess a business for its ability to honor its debts. So if that business wants to borrow a million dollars, the lender needs to know that it can pay that money back. It will take many things into account including the credit history of the business and its current investments. Although a credit rating is only an opinion on the credit-worthiness of a business, ratings services providers build sophisticated systems and create bigger and better business for themselves by giving accurate, reliable credit assessments.

Retail investor

An investor who is an individual, not a company.

Rights issue

The issue of new equity (shares) in order to raise capital for the company.

Risk Management

The measurement of the possibility of losing or not gaining value, and structuring risks at an optimal risk/reward ratio. In other words, calculating the probability and effect of something bad happening and planning a course of action to minimize potential damage. Risk Management is also the term given to an area of the bank.

Securities

Collective noun for bonds and shares.

Securitization

A financial technique that pools assets together and, in effect, turns them into a tradable security.

Sell side

Used to describe brokers who sell bonds and shares to customers and the research departments of institutions that make recommendations to their clientele. See also ‘buy side’.

Settlement

The trial stage of a transaction after clearing; it involves making payment and transferring ownership/documentation.

Shares

A certificate issued by a company (for general purchase) entitling the holder to ownership rights including a share of the dividends (payments made by a company to its shareholders).

Short position

The practice of making money on a security whose value is expected to fall. A short seller identifies a security, let’s say a share in a company, which he or she thinks is about to fall in price. He/she borrows the share from a broker and sells it at the current price. If, as expected, the price of that share falls, he/she then buys the share back at the lower price and gives the share back to the broker. He/she will be subject to a borrowing fee charged by the broker, but if the share fell by a significant amount, the short seller has made money. All of this means the security being traded must be fungible: that is to say, the security’s value can be substituted by another security of the same type. Currency, for example, is fungible; if you borrow $10 from someone, you can give them back any $10 note – it doesn’t have to be the same one they gave you.

Spot market

A public financial market in which trades are completed for immediate delivery, as opposed to futures markets in which delivery is due at a specified later time. Most spot markets exist on the internet. An example is the spot energy market in which surplus energy is to be sold and delivered immediately.

Spread

The difference between the price at which a financial institution will buy a bond or share and the price at which it will sell.

Stockbroker

Those who advise people who want to buy/sell bonds and shares.

Stock

Another word for shares and equities.

Stress test

A test used by risk managers to see what the impact would be on particular stocks, companies or markets in hypothetical scenarios.

Structured products

A tailor-made investment package combining bonds with other types of assets, created using complex mathematical modeling techniques.

Swap

The exchange of one asset or liability for a similar asset or liability for the purpose of lengthening or shortening maturities (the time frame for the return of the original investment), or raising or lowering coupon rates (interest rates) to maximize revenue or minimize financing costs.

Tombstone

An advertisement placed in a newspaper or magazine detailing a new offering of stock and listing the syndicate members. It also refers to plastic or glass ornaments celebrating a completed transaction which bankers collect on their desks.

Trader

A person who buys and sells instruments in the financial markets.

Trading book

Details of an institution's total positions in the market. This is a resource used by the institution to track its trading activities. It includes currently held securities and the history of trades made.

Trading floor

The area where traders sit within an investment bank.

Underwriting

A guarantee (which is offered by a bank in return for a fee) to buy or to find the buyers for an entire issue of stocks and shares.

Value at Risk (VaR)

A measure of the potential changes in the portfolio value over a specified period of time. The VaR is calculated within a specific confidence interval, say 99% – that is to say "we are 99% confident that the portfolio returns over the next year will be within -6% and +7%".

Venture capitalist

These are investors in brand new companies, usually with some unique selling point or technological innovation that means the investment has the potential to yield high returns. But the risk is also great, so investors typically receive large stakes in the company they are investing in, or a high degree of control over the business model in return for their capital.