

English for the Financial Sector

Listening exercise 1

Peter Sinclair is the former director of the Centre for Central Banking Studies at the Bank of England.

Check your understanding of these words by completing the blanks with one of the words listed at the top.

1. A **mortgage** is a loan to buy property
2. Money you put in the bank is called a **deposit**
3. Money paid to a retired person is called a **pension**
4. Securities representing part-ownership of a company are called **shares** and **stocks**
5. The money invested in a business is its **capital**
6. **Bonds** are interest-paying securities issued by companies that need to borrow money
7. A **takeover** is when a company gains control of another one by buying its stocks
8. A **merger** is when two separate companies join together.

Listen. Questions

1. Were most financial institutions national or international? national
2. Were most financial institutions specialized, or did they offer lots of services? Specialized
3. What kinds of financial institutions traditionally did the following types of business? Match the actions with the institutions

Actions:

Making loans **Retail banks**

Arranging mergers **Investment banks**

Providing pensions **Insurance companies**

Giving financial advice to companies **Investment banks**

Receiving deposits **Retail banks**

Issuing shares or bonds **Insurance companies**

Arranging mortgages **Building societies**

Arranging or fighting takeover bids **Insurance companies**

Offering life insurance **Insurance companies**

Institutions:

Retail banks

Building societies

Investment banks

Insurance companies

Listening 2. Going international

1. What has recently happened to banks in Britain and in other countries? **Many banks have become universal banks**
2. In what way does Peter Sinclair compare the City of London to the Wimbledon tennis tournament? **Great big international stage**
3. Which two words does Peter Sinclair use to summarize the two big recent trends in banking? **Internationalization and homogenization.**

Vocabulary for Listening 3 → **Lead in:** Match the words with definitions

A general development or change in a situation or in people's behaviour: **trend**

All the money received by a person during a particular period: **income**

Anything of value owned by a business; for a bank, the loans it has made: **Assets**

money that a company will have to pay to someone else one day; for a bank, its deposits: **liabilities**

profitable (an activity that makes a profit): **lucrative**

the money earned by a country's people in a particular period: **national income**

the money used in a particular country: **currency**

Listening 3

Are these statements true or false? Read the questions and try and answer them.

1. In the past, people used to keep more money in cash **TRUE**
2. Because of retail banks, national income is increasing in developing countries **FALSE**
3. Some people think that investment banking is more exciting than retail banking **TRUE**
4. Investment banking is more profitable than retail banking **FALSE**
5. There is more risk involved in investment banking than retail banking. **TRUE**

Well, I'm not sure that retail banking is declining. I think in many countries the size of bank deposits, that's the liabilities that the retail banks have, has been growing faster than national income – it's been rising. People are increasingly moving away from currency towards things like bank deposits, that's a slow gradual trend.

Types of bank

A commercial bank is defined as one whose main business is financial intermediation: accepting deposits and granting loans.

Customers of commercial banks include individuals, small businesses, and larger firms or corporations. Accordingly, commercial banks supply both retail banking and corporate banking services. Most commercial banks are owned by shareholders, and seek to earn a profit in order to provide shareholders with a return on their investment in the bank's capital (equity).

An investment bank specializes in providing investment banking services. Typically, an investment bank comprises an advisory division, specializing in underwriting, stock market flotations, and other consultancy services; and a trading division, specializing in trading on financial markets, and asset management. Most investment banks are also shareholder-owned and therefore profit-motivated.

In practice, the distinction between commercial banks and investment banks is not as clear as these definitions might suggest. In the US, the Glass-Steagall Act (1933) separated commercial banking from investment banking, by preventing affiliations between commercial and investment banks that would have allowed the latter to trade in funds raised from deposits taken by the former. This legal separation was eventually terminated by the Gramm-Leach-Bliley Act (1999). Subsequently, commercial banks have become involved in securities trading, and some investment banks have accepted deposits and granted loans. Several mergers between US commercial banks and investment banks have led to the creation of universal banks, providing the full range of commercial and investment banking services.

In many countries, retail banking services are supplied not only by commercial banks, but also by a range of mutually-owned, rather than shareholder-owned, institutions. The nature of the mutuals varies between the countries in which they operate: prominent examples include the few surviving UK building societies that avoided demutualization through acquisition or conversion to shareholder-owned banks; and the US S&Ls (thrifts). A defining characteristic of mutuals is that each institution is owned by its own members, who are also the depositors and borrowers. Mutuals earn surpluses, rather than profits, which are either distributed to the members or retained to finance expansion. In principle, since there is no shareholder profit, mutuals should be able to offer more competitive interest rates to depositors and borrowers than shareholder-owned commercial banks.

In 2016 the four largest US banks by total assets (the value of all outstanding loans, together with other investments including shares, bonds, property, and cash shown on their balance sheets) were JPMorgan Chase (\$2,424bn total assets in 2016), Bank of America (\$2,186bn), Wells Fargo (\$1,849bn), and Citigroup (\$1,801bn). These can all be described as universal banks. The next two, Goldman Sachs (\$878bn) and Morgan Stanley (\$807bn), are investment banks that hurriedly converted to deposit-taking status at the height of the financial crisis in 2008, in order to qualify for public bailout funds (see Chapter 7).

The UK banking industry is dominated by five large independent banks, HSBC (\$2,596bn total assets in 2016), Barclays (\$1,795bn), Royal Bank of Scotland (RBS) (\$1,269bn), Lloyds (\$1,185bn), and Standard Chartered (\$640bn). The first four from this list, together with the wholly-owned UK subsidiary of the Spanish banking group Banco Santander, dominate UK retail banking. The fifth independent bank, Standard Chartered, operates mainly overseas in Asia and the Middle East, Africa, and Latin America.

The universal banking model characterizes the largest shareholder-owned banks in several other European countries where, historically, there was no regulatory divide between commercial and investment banking. In 2016 the six largest Eurozone banks were BNP Paribas (France, \$2,404bn total assets in 2016), Deutsche Bank (Germany, \$1,973bn), Crédit Agricole (France, \$1,858bn), Société Générale (France, \$1,550bn), Banco Santander (Spain, \$1,501bn), and Groupe BPCE (France, \$1,357bn).

In 2016 HSBC, JPMorgan Chase, BNP Paribas, Bank of America, and Deutsche Bank were ranked sixth to tenth, respectively, in the list of the world's largest banks by asset size. Four of the top five banks were Chinese: Industrial and Commercial Bank of China (ICBC) (\$3,545bn total assets in 2016), China Construction Bank (\$2,966bn), Agricultural Bank of China (\$2,853bn), and Bank of

China (\$2,640bn). The list of the world's five largest banks is completed by the Japanese bank Mitsubishi UFJ Financial Group (\$2,655bn).

The shadow banking system

In addition to financial services providers that are licensed and regulated as banks, many other companies or other institutions are involved in financial intermediation activities, which take place outside the traditional banking system. In some cases, banks themselves have set up subsidiaries, known as Special Purpose Vehicles (SPVs) or Structured Investment Vehicles (SIVs), to transact business that would be regulated more intrusively if the activity was channelled through the parent bank, rather than the subsidiary. The term 'shadow banking' was coined by Paul McCulley of the asset management company PIMCO in 2007 to describe 'the whole alphabet soup of levered up non-bank investment conduits, vehicles, and structures'. The shadow banking sector includes the following types of institution.

A hedge fund pools the funds of its investors to purchase securities. Hedge funds may be structured as partnerships or limited liability companies. A hedge fund is administered by a professional management team, which may adopt a specific investment style or specialize in particular securities. Investors are charged a management fee. Unlike mutual funds, hedge funds can borrow and use leverage (see Chapter 2) to achieve a preferred combination of expected return and risk for investors.

An exchange-traded fund (ETF) purchases assets such as shares, bonds, or commodities on behalf of its investors. Most ETFs track a particular market index, guaranteeing to match the index's performance, and are traded in the relevant market. Since the investment strategy is passive, management fees are minimal.

2

An overview of different aspects of banking

Banks started out as fairly straightforward businesses, taking in deposits, making loans and providing a payment mechanism. But they grew. They now conduct a much wider range of activities, and it can be difficult to define banking activity in the modern world. Figure 2.1 provides some clarity by grouping the activities into four different types of banking. Some organisations concentrate on providing services in just one, or perhaps two, of the segments, others are **universal banks** offering a full range of banking. This classification is not perfect – there are many banks that do not neatly fit into these groups, and there are other ‘banking’ activities not listed here – but it does allow us some understanding of what it is that banks do.

Put at its simplest, the **retail banks** take (small) deposits from the public which are re-packaged and lent to small businesses and households. This is generally high-volume and low-value business which contrasts with **wholesale banking** which is low volume but each transaction is for a high value. For example, wholesale banks obtain a great deal of the money they use from the sale of financial instruments in the markets, in values of tens or hundreds of millions of pounds, dollars, euros, etc.

The retail banks operate branch networks and a subset of banks provide a cheque and electronic clearance system – transferring money from one account to another. These are the clearing banks. For example, in the UK the clearing banks are Bank of Scotland (part of Lloyds), Barclays, Clydesdale (part of National Australia), Co-operative, HSBC, Lloyds, National Westminster (part of RBS), Nationwide,¹ Royal Bank of Scotland and Santander. Until 2008 retail banks tended to reduce their reliance on retail deposits year by year, raising more wholesale funds from the financial markets. Northern Rock is an example of a bank that became over-reliant on wholesale funding. When those short-term loans became due for payment in 2008 it found that it could not obtain replacement funding. This caused its collapse.

Until recently the trend was toward the creation of increasing numbers of universal banks through the merger of banks. This was boosted by the panicky

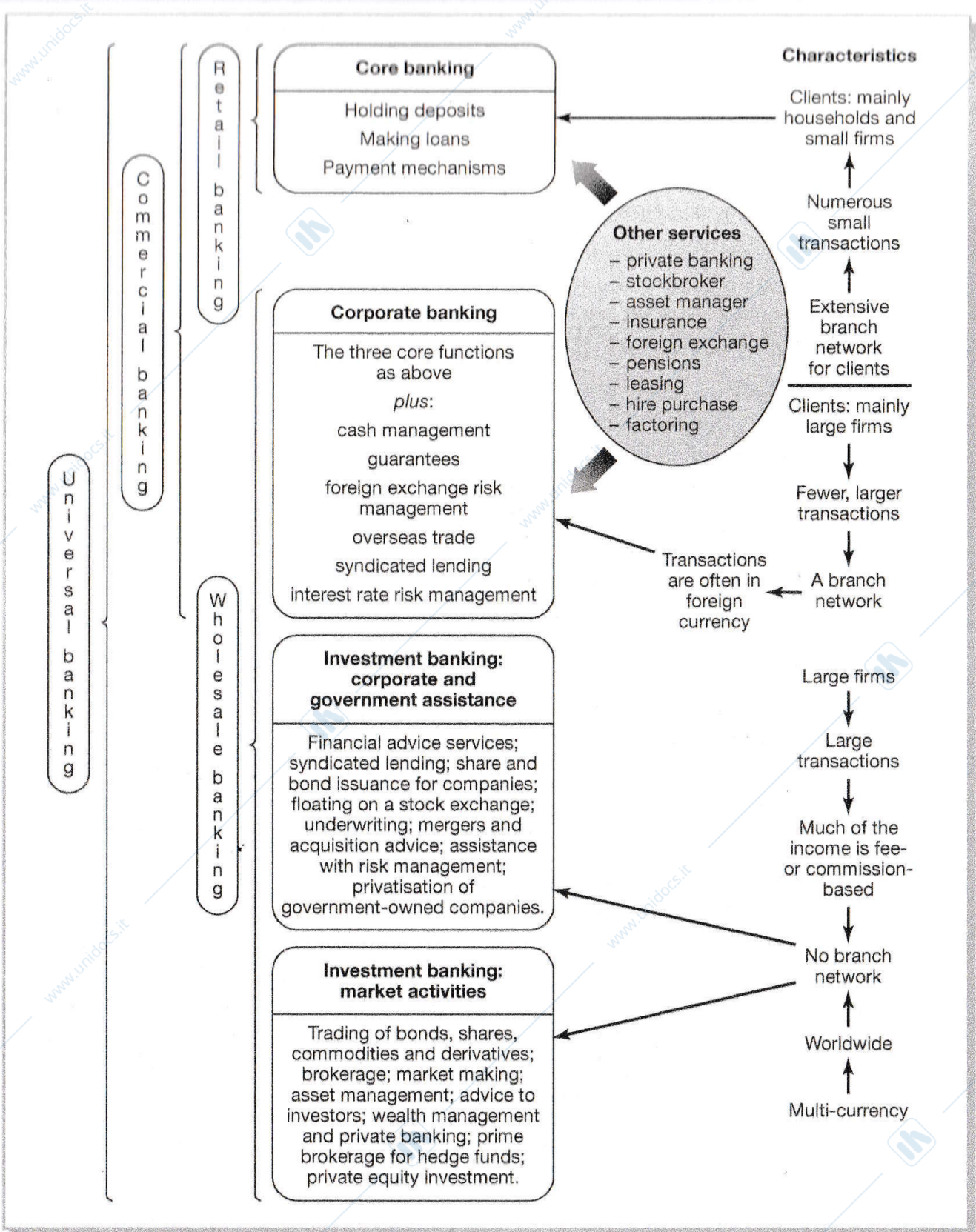


Figure 2.1 An overview of the different types of banking

STOCKBROKER: a broker who buys and sells securities on a stock exchange on behalf of clients.

authorities, who, in the midst of the financial crisis, encouraged mergers, and also by ambitious bankers thinking they could build overwhelmingly big empires to dominate banking segments and have diverse sources of income and thus greater stability. For example, we now have JPMorgan (investment bank) joined with Chase, Washington Mutual and Bear Stearns; Merrill Lynch (investment bank) joining Bank of America so that it could be the client's 'everyday banker as well as your big deal banker'; Lloyds absorbing Bank of Scotland and Halifax (mostly commercial banking).

Doubts about universal banking

However, a number of factors have made some banks think hard about whether being a universal bank is a good idea. UBS, the Swiss giant, has already decided to give up most of its bond trading and many other investment bank businesses to concentrate on retail and wealth management (looking after rich people's money – see Chapter 4) which is seen as more stable and profitable. The few investment banking operations remaining support its wealth management and commercial banking operations. The UK government has told RBS to move away from universal banking and become a more UK-focused commercial bank.

Factors weighing on the universal model are:

- **Capital reserves.** To embark on riskier investment banking activities, such as trading bonds, banks are now required to have more shareholders' money held in reserve to operate with a greater degree of safety, without needing bailouts. The raised amount of money kept in the businesses makes it more difficult to obtain a high enough return on shareholders' equity capital employed.
- **Scandal.** There have been a series of scandals due to rogue investment bankers losing vast amounts of money. The fines for manipulating LIBOR interest rates (see Chapter 6) are high enough, but the amount lost by, say, JPMorgan in a supposedly safe part of its operations, or UBS's investment bankers' loss on stock market bets run into billions. Bank directors are earnestly questioning whether the profits reported by their investment bank divisions are real, rather than just picking up nickels in front of steam-rollers. One day the risk will be manifest, resulting in one event wiping out years of supposed profits.
- **Splitting.** UK and European authorities are debating whether to insist that universal banks separate ('ring-fence') the retail/commercial banking operations from the investment bank/trading operations. These ring-fenced businesses will have separate boards of directors and separate pots of safety capital in case something goes wrong (but only one holding company). The idea

is that these pots of capital will be called on first in the event of a future crisis. As a back-up the regulators/government will come to the rescue of the commercial banking arms, but will leave the investment banking part to sink or swim. The danger remains that the investment bank part will bring down a substantial part of the financial system, as Lehman Brothers did in 2008. There are other safeguards put in place to counter this (see Chapters 25 and 26) but these impose even more cost on banks operating in many areas seen as higher risk.

- **Banned.** Even without ring-fencing the regulators are toughening up and banning many activities. In the USA banks are working under the '**Volcker Rule**' which imposes a ban on **proprietary trading** (buying and selling using the bank's money to try to make a profit from risk taking – see Chapter 10). The more limited definition of 'trading' permitted is that which is necessary to match buyers with sellers, rather than taking on the risk of one side of a trade. US investment banks are also banned from investing in hedge funds and private equity by more than 3% of the total assets of the fund or 3% of the bank's capital.
- **Poor economic conditions.** Many areas of banking have become unprofitable and so banks are withdrawing from product and geographical areas. In many cases they are focusing on their home markets and nearby countries, and no longer have serious global ambitions. Citigroup is one of the exceptions here. It gets the majority of its business from emerging markets, serving emerging-market multinational companies as well as a large cohort of developed market multinationals.
- **Running out of capital.** The dwindling of profitable activities on top of the massive write-offs of loans to clients has weakened many banks so that they simply cannot do as much as they want to.
- **Local capital required.** Many banks are withdrawing from operating in a number of countries because the regulators are insisting on a high level of capital and plenty of liquid assets being held in their areas. Dedicating capital and liquidity to multiple local subsidiaries is much more costly than drawing off a central pool of money and moving it around the world at will. (The regulators were stunned in 2008 when, allegedly, Lehman Brothers, transferred \$8bn of cash from Europe to the firm's New York headquarters days before the bankruptcy. Also, the government of Iceland agreed to reimburse local customers while leaving British and Dutch depositors trying to recoup more than \$5bn following the collapse of its banks.)

Glossary

'Banking. A very short introduction.'
J. Goddard and
J. O.S. Wilson OUP

Adjustable rate mortgage A mortgage with a variable interest rate that is adjusted periodically in line with a defined market rate.

The rate may be fixed for an initial period before any adjustments take place.

Adverse selection Occurs when a service is chosen predominantly by a group of buyers who offer a poor return to the seller. For example, borrowers know more about themselves than lenders, and may self-select in such a way that bank loans are taken out predominantly by high-risk borrowers.

Asset-backed commercial paper A short-term security issued by a bank or other financial institution. A company seeking to raise cash sells a stream of expected future revenues to a bank, which in turn sells ABCP to investors. As the revenues are collected by the company, these are passed on via the bank to the investors.

Asset-backed security A security with repayments generated from a pool of underlying assets such as mortgages or student loans. The cash flows emanating from the underlying assets are assigned to tranches bearing different levels of *credit risk*. Investors holding the senior tranches take priority over junior tranche-holders when repayments are made.

Asymmetric information A situation where one party to a transaction has more information than the other party, hindering the smooth functioning of markets. Financial markets are susceptible to asymmetric information problems in the form of *adverse selection* and *moral hazard*.

Broad money A money supply measure, comprising cash held by the non-bank public and commercial banks' *reserves*, and deposits with

banks or other financial institutions that can be converted into cash easily.

Capital The difference between a bank's total assets and its liabilities in the form of funds raised from depositors and investors. Capital, also known as equity or net worth, is the shareholders' ownership stake in the bank, providing the bank with a buffer against unanticipated losses.

Collateralized debt obligation A security constructed by repackaging a pool of cash-generating assets into tranches bearing different levels of *credit risk*. The assets might themselves be *asset-backed securities*.

Commercial bank A bank that accepts deposits and extends loans. Commercial banks supply both *retail banking* and *corporate banking* services.

Commercial paper A short-term unsecured security issued by a highly rated financial or non-financial company seeking to raise cash.

Corporate banking The provision of core banking services, including deposit-taking and lending, to large companies.

Corporate bond A fixed-interest security issued by a large company as a means of borrowing.

Credit default swap A *credit derivative*, under which the buyer makes a regular stream of payments to the seller to insure against the possible default of an underlying asset such as a *government bond* or *corporate bond*, or a *mortgage-backed security*. The seller agrees to cover the losses that would arise in the event that the insured asset defaults.

Credit derivative A derivative security which transfers the *credit risk* associated with an underlying asset from one party to another.

Credit easing An unconventional monetary policy pursued by a central bank, involving the purchase of long-term or high-risk securities through *open market operations*, and the sale of short-term or low-risk securities.

Credit rationing A situation when investors cannot obtain funding for viable projects, because banks are unwilling or reluctant to lend.

Credit risk The risk that a borrower or the issuer of a security will fail to meet his obligations to make repayments, causing the bank or security-holder to incur losses.

Credit-rating agency An agency that issues ratings reflecting the riskiness of securities, companies, or countries. Standard and Poor's, Moody's and Fitch IBCA dominate the credit-rating industry.

Currency risk The risk that foreign exchange rate movements cause the balance sheet value of assets to decrease, or the value of liabilities to increase, when banks hold assets and liabilities denominated in different currencies.

Deposit expansion multiplier The (multiple) increase in *broad money* arising from an increase in bank lending in response to an increase in bank deposits.

Deposit insurance A scheme guaranteeing that small depositors are reimbursed (normally to a specific limit) if a bank collapses. Deposit insurance may be funded by banks or by the government.

Deposit rate The interest rate paid by the central bank on deposits placed by commercial banks, known as *reserves*.

Derivative A security whose value is derived from the price of one or more underlying securities or indices.

Discount rate The interest rate charged by a central bank for lending to commercial banks.

Equity See *capital*.

Fire sale An enforced sale of assets at reduced prices, often when a bank encounters a *liquidity* or *capital* shortage.

Forward guidance A verbal commitment on the part of a central bank concerning the future conduct of monetary or interest rate policy.

Forward An *over-the-counter* contract between two parties for the sale and purchase of an asset at a specified price on a specified future date.

Future Similar to *forward*, but purchased and traded on an exchange (rather than *over-the-counter*).

Government bond A fixed-interest security issued by a government as a means of borrowing.

Government-sponsored enterprise In the US, a financial services corporation that facilitates the flow of credit to specific demographic groups or economic sectors. GSEs include the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), which help low- and medium-income households obtain mortgages.

Interbank market The market for borrowing and lending between banks.

Interest-rate risk The risk that interest rates might increase, obliging a bank to pay higher interest to depositors, while the interest received from loans with non-flexible rates remains unchanged.

Investment bank A bank that provides services to companies, governments, and wealthy private individuals, including assistance in arranging mergers, *underwriting* new security issues, and asset or wealth management. Investment banks also trade in securities, commodities, and derivatives.

Junk bond A *corporate bond* which offers a high return but carries a high *credit risk*.

Lender of last resort Refers to the role of the central bank in providing emergency lending to commercial banks that are temporarily unable to meet their depositors' demands for withdrawals.

Leverage Refers to the amount of debt a bank uses to finance its assets, including investments in securities and lending. Leverage magnifies risk. Borrowing to finance the acquisition of assets may be profitable if the acquired assets deliver returns as expected, but jeopardizes solvency if the assets default.

Liquidity The ease or speed at which an asset can be sold and converted into cash. A liquid asset can be sold easily and quickly.

Liquidity risk The risk that a bank might not hold sufficient liquid assets to be able to meet the demands of its depositors for withdrawal of their funds.

Market risk The risk that a bank's investments in securities might fail to deliver the returns expected, or the securities might fall in value.

Monetary base Cash held by the non-bank public and commercial banks' *reserves*. A narrower money supply measure than *broad money*, also known as narrow money.

Money market fund In the US, a mutual fund which invests in securities such as *commercial paper* and short-term *government bonds*.

Moral hazard A tendency for a person or entity to behave irresponsibly, in the knowledge that someone else will bear the cost of their risky or negligent behaviour. For example, if borrowed funds are not used responsibly, the lender may bear the cost in the event that the borrower defaults.

Mortgage-backed security An *asset-backed security* whose underlying asset is a pool of mortgages.

Narrow money See *monetary base*.

Net worth See *capital*.

Operational risk The risk of failure of a bank's physical or human resources, owing to events such as natural disasters, terrorist attacks, or negligence or fraud on the part of employees.

Option A contract which confers the right, but not the obligation, to either buy (call option) or sell (put option) an asset such as a security at a specified price on, or sometimes until, a specified date.

Over-the-counter market A market in which buyers and sellers negotiate and transact directly with each other, without the supervision or mediation of an exchange.

Quantitative easing A central bank policy of purchasing securities from banks and other financial institutions, and supplying *reserves* beyond the quantity required to reduce the target policy interest rate to zero.

Repo The sale of securities, with a commitment by the seller to repurchase at a slightly higher price after a specified period (often overnight). Widely used by banks as a source of short-term funding.

Reserves Highly liquid and secure deposits placed by commercial banks with the central bank.

Retail banking The provision of banking services to consumers, households, and small businesses.

Securitization A practice whereby a bank bundles a large number of loans together, and sells them to a *structured investment vehicle* (SIV). The SIV typically finances its acquisition of the loans by selling *asset-backed securities* or *mortgage-backed securities* to investors, backed by the anticipated future income from the loans.

Settlement risk The risk that one party may fail to meet its financial obligations to another at the time of settlement of a contract.

Shadow banking Refers to financial institutions that offer similar services to banks, but operate without banking licenses and largely beyond the scope of regulation.

Sovereign risk The risk of losses arising from actions taken by a sovereign nation, such as suspension or default on repayments on *government bonds*.

Special purpose vehicle A subsidiary of a financial institution with its own legal status. An SPV may be used by the institution to transfer assets from its own balance sheet, perhaps evading a regulatory requirement to hold capital against the assets concerned.

Stress test An investigation of a bank's capability to absorb losses arising from an unfavourable change in economic conditions, such as an increase in loan defaults or an adverse movement in the market interest rate.

Structured investment vehicle A type of *special purpose vehicle*, which deals in structured securities such as *asset-backed securities* or *mortgage-backed securities*.

Subordinated debt A form of debt which has lower priority, or is subordinate to, other (secured) debt in the queue for repayment in the event that the issuer defaults on its commitments to repay.

Subprime mortgage In the US, a residential mortgage extended to a class of borrower with a low credit rating, or poor credit history.

Swap A *derivative* security which commits the parties to a series of exchanges of cash flows at agreed dates in the future. Common examples are interest rate, currency, and commodity swaps.

Syndicated lending Refers to a large loan made by a group (syndicate) of banks to a large company or government.

Underwriting A commitment on the part of an *investment bank* to purchase any securities from a new issue that are not taken up by investors.

Wholesale banking The provision of financial services to large companies, including both *corporate banking* and *investment banking* services.

Financial Security: What Does It Actually Mean?

The term 'financial security' is used often, but its meaning changes from person to person.

By Emily Sherman (money.usnews.com)

Whether it's about the importance of [building an emergency fund](#), prioritizing retirement savings or paying down debt, you'll often hear financial experts refer to the importance of these goals for your financial security.

But what does financial security actually mean? Is there a magic number you can hit in a savings account to feel secure? How might that vary for people in different situations regarding income, cost of living and other circumstances?

The truth is, financial security is an important goal of cultivating healthy financial habits but what it actually means varies among individuals.

What Is Financial Security?

According to Brent Weiss, certified financial planner, co-founder and head of financial wellness at Facet, financial security is not about a particular number in a bank account but rather about feeling confident in your ability to navigate life's financial challenges. "It's the peace of mind, or what I call financial calm, that comes with the comfort of knowing you have the financial resilience to weather life's unpredictable storms," Weiss says.

This confidence is the first step toward achieving financial freedom, he adds, which represents the ability to choose how we use our money to better our lives.

Why Financial Security Is Important

When you have financial security, you feel like you have the resources you need to meet your needs and any unexpected challenges, Baruch Silvermann, founder and chief executive officer of The Smart Investor, says.

"It provides the freedom to make choices without being hindered by financial constraints and allows for peaceful sleep at night knowing that the future is secured," he adds.

Still, reaching this goal can be difficult.

According to the [Federal Reserve](#), only about 77% of American adults reported "doing okay" financially as of July 2020. Understandably, this number is much lower for those with lower annual incomes.

"Financial security is not something that can be achieved overnight," Silvermann says. "It requires dedication, discipline and time to attain."

Financial Security Differs for Everyone

Many situations can impact a person's ability to feel financially secure, including annual income, cost of living in their area, [gender](#), race and more.

"Financial insecurity doesn't discriminate. Neither does financial worry and stress. Good and bad events, the expected and unexpected, happen to everyone regardless of what your bank account says. However, how financial security manifests itself in your life does change," Weiss says.

For those with low [net worths](#) (patrimonio basso), financial security might mean simply [having consistent paychecks](#).

"For low net worth individuals, financial security may involve having a steady and reliable source of income that is sufficient to cover their basic needs such as housing, food and health care. Therefore, financial security for them may involve building an emergency fund and [saving for retirement](#) through 401(k)s or individual retirement accounts," Silvermann says

On the other hand, higher net worth individuals might be less stressed about basic needs but could be impacted by [lifestyle creep](#), (Creepy in =walk very quietly) being "house poor" or other circumstances that lead to them not feeling financially secure.

"For people with greater levels of assets, financial security is often related to their mindsets. They've built strong financial foundations but there can be beliefs (Do I have enough?) or values (Am I doing enough?) or aspirations (Can I achieve more?) that create a feeling of insecurity," Weiss says.

How to Achieve Financial Security

"Financial security, like life, is multifaceted – and you need several pieces to achieve it," Weiss says.

Because financial security is about meeting basic needs, prioritize these habits:

- **Get an accurate picture of your current financial situation.** According to Weiss, the first step is to get a complete picture of your financial situation. This involves outlining your debts, income and [current budget](#) and identifying if there are any places you can make changes.
- **Build an emergency fund.** An emergency fund is a critical tool to maintain financial security. It allows you to weather unexpected circumstances like a layoff, health emergency or other surprise expense. Most financial experts recommend having three to six months of expenses in savings, but getting started is most important.
- **Pay down high-interest debt.** "[Eliminating high interest debt](#) should be a priority. It's hard to move forward if you're always paying for the past," Weiss says. With credit card interest rates on the rise, it can be difficult to get out from under debt if other expenses arise.
- **Make sure you're insured in case of emergencies.** According to the Board of Governors of the Federal Reserve [data](#), 20% of adults in the U.S. had a major, unexpected health care expense in the last year but 24% had to forgo care because of cost. To maintain your peace of mind, it's critical you're insured in case of an emergency. This goes for health care as well as life and [pet insurance](#).
- **Don't forget to prioritize retirement.** "Achieving a high level of retirement savings can address many of the aspects we previously defined, such as providing peace of mind, securing one's future when they are no longer able to work and offering a safety net for unexpected events," Silvermann says.

If you haven't achieved financial security yet, don't worry: Just taking steps toward that goal will improve your financial health along the way.

"Remember, financial security is a journey, not a destination," Weiss says. "It's about creating a plan that evolves with your needs and keeps you on track toward your financial goals."

5

Loans and credit

AIMS

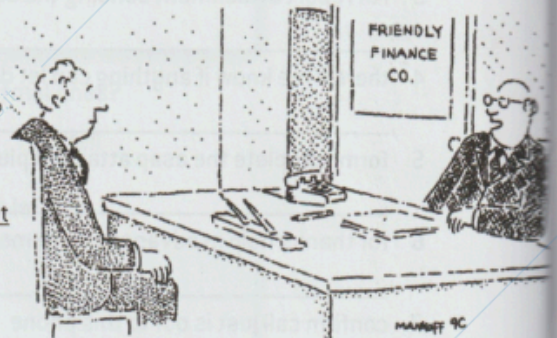
To learn about: lending decisions; key vocabulary of loans and credit

To learn how to: give advice and make suggestions

To practise: making lending decisions; giving advice to clients

Lead in

- How do commercial banks make a profit?
- How do banks decide who to lend money to?
- How do they decide what rates to lend at?
- How can large corporations raise finance?
- Why do large companies generally prefer not to borrow from banks?



"We'd like to lend you the money, but we're afraid we might lose you as a friend."

Reading: Banks and bonds

- 1 Read the texts below and then answer the questions on the opposite page.

FG Finance Glossary
www.finance-glossary.com

Corporate bonds are issued by companies to raise capital. They are an alternative to issuing new shares on the stock market (equity finance) and are a form of debt finance. A bond is basically an IOU (short for 'I owe you') – a promise to pay back your original investment (the 'principal') at a maturity date, plus interest payments (the 'yield' or 'coupon') at regular intervals between now and then. The bond is a tradeable instrument in its own right, which means that you can buy and sell it during its life, and its value will tend to rise and fall as interest rates change.

Thirty or forty years ago, large companies that wanted to borrow money generally got loans from banks. Then they discovered that they could borrow at a lower rate by raising money directly from the public (and from institutional investors like insurance companies and pension funds), by issuing bonds. This process of disintermediation – cutting out the intermediary (the bank) between the borrower and the lenders – is obviously *not* a good thing for commercial banks. They now have to lend their money to borrowers that are less secure than large corporations.

Companies and financial institutions are given investment ratings, reflecting their financial situation and performance, by ratings companies such as Standard & Poor's and Moody's. The highest rating (AAA or Aaa) is given only to top-quality institutions, with minimal credit risk. Today, only one of these is a bank (Rabobank, in the Netherlands). The only other AAA ratings – and there are very few – belong to large corporations.

On the other hand, companies use investment banks to issue their bonds for them, permitting banks to make money from fees rather than from interest.

- 1 What are the two main ways in which large companies and corporations raise capital?
- 2 What might explain why only one bank has a AAA rating?
- 3 What form of income do banks now get from large companies?

2 Use a word from each box to make word combinations from the text. You can use some words more than once. Then use some of the word combinations to complete the sentences below.

credit
debt
equity
financial
interest
investment
maturity
tradeable

date
finance
instruments
payments
performance
rating
risk
situation

- 1 Bondholders get _____ until the bond's _____.
- 2 Because bonds are _____ you can sell them at any time, but their price will depend on the company's _____ and the level of interest rates.
- 3 Only companies with hardly any _____ get a AAA _____.

Vocabulary

You are going to listen to an interview about lending decisions. Before you listen, check your understanding of the words and phrases in the box by matching them with their definitions (1–10).

collateral	credit rating	maturity	portfolio	cost of funds
EBIT	operating cash flow	credit limit	margin	overhead costs

- 1 the abbreviation for a company's earnings before interest and taxes
- 2 all the securities and financial assets held by a financial institution or an individual
- 3 an evaluation of a borrower's ability to pay interest and pay back a loan in the future
- 4 something of value that secures a loan or other credit; if the borrower cannot repay, the lender can sell it to pay off the loan
- 5 the date on which a loan must be repaid, or the length of time until this date
- 6 the difference between the interest rate a lender pays and the rate it charges its borrowers
- 7 the expenses of operating a business that are not directly related to individual products or services (e.g. electricity, telephones, administrative costs)
- 8 the maximum amount that a bank will lend to a customer
- 9 the money generated from a business's normal activities
- 10 the price (interest rate) that a financial institution must pay for the use of money

1. Getting loans from banks and raising money from the public.
2. Because is the bank that has a minimal credit risk.
3. Bonds

1. Bonholders get **interest payments** until the bond's **maturity date**.

2. Because bonds are **tradeable instruments**, you can sell them at any time, but their price will depend on the company's **financial performance** and the level of interest rates.
3. Only companies with hardly any **credit risk** get a AAA **financial rating**.

1. EBIT
2. PORTFOLIO
3. CREDIT RATING
4. COLLATERRAL
5. MATURITY
6. MARGIN
7. OVERHEAD COSTS
8. CREDIT LIMIT
9. OPERATING CASH FLOWS
10. COST OF FUNDS