# GLOSSARY OF FINANCIAL TERMS

## A

**Adjustable Rate Mortgage (ARM)** — has an interest rate that varies, depending on changes in some outside standard such as prime rate, interest rate on United States Treasury securities, or the rate of inflation. The lender can increase (or decrease) the interest rate at specified intervals based on changing market conditions.

**Amortization** — The gradual and systematic reduction of debt by periodic payments. Payments must include interest due during the repayment period and repayment of the entire principal by the time the loan matures. An amortization schedule shows amounts of principal and interest due at regular intervals and the remaining unpaid principal balance at the time each installment payment is made.

**Annual Percentage Rate (APR)** — The full rate to be repaid, as required by Federal Truth in Lending laws. APR shows the total cost of credit, including interest, fees, finance, & service charges, and allows easier comparison of different loan options.

**Appraisal Fee** — The charge to estimate the value of property, such as a house, usually to verify value for insurance, investment, or mortgage contracts.

**Affinity Marketing and Affinity Fraud** — Affinity consists of mutual trust, friendship, and sympathy among people who share similar religious beliefs, ethnic background, language, culture, profession, or other characteristics. Salespeople try to gain trust within the group, and then market products/services that may be inappropriate, or worse, fraudulent. Once a group member invests in a service or product, more people come to trust the salesperson and decide that the product/ service is legitimate, even when it's not. Affinity fraud is typically perpetrated on a large scale, resulting in a devastated community and big payoffs for scamsters (until they get caught).

**Annuities** — Complex life insurance products with widely varying fees, costs, and features, and are designed to give a steady stream of income. Make sure to comparison shop, and that you understand how the annuity works, what fees and charges you will pay, and all terms and conditions.

**Arbitration** — is a dispute resolution process in which a neutral third person, the arbitrator, makes a decision after hearing both sides of a case. It is not part of the court system, but it is binding and subject to judicial review on a very limited basis.

## B

**Balance Inquiry** — A basic home banking function by which consumers can determine their balance of funds in an account via phone or personal computer.

**Balloon Payment** — An oversized payment due at the end of a loan, because the entire loan amount was not fully amortized, so the remaining balance is due in full.

**Bankruptcy** — The inability of a person or organization to pay debts. There are two kinds of bankruptcy: involuntary (one or more creditors petition to have a debtor judged insolvent by a court) and voluntary (the debtor brings the petition). In both cases, the objective is an orderly and equitable settlement of obligation.

**Bond** — An interest-bearing security that obligates the issuer to pay a specified amount of interest for a specified time, usually several years, and then repay the bondholder the face amount of the bond.

**Borrower** — Any person or organization that obtains funds from another for a period of time. The borrower usually signs a note as evidence of the indebtedness.

**Broker Dealers** — also called B/Ds, are salespeople or firms that buy and sell securities for themselves and others. B/Ds must be registered with the SEC and the CA Department of Business Oversight. They are duty bound to “know the customer” and make recommen¬dations in keeping with the client’s investment objectives and risk tolerance. B/Ds are not required to put the client’s interests ahead of their own.

## C

**Capital Gain (or Loss)** — The difference between the price at which you buy an investment and the price at which you sell it. There are frequently complex tax implications associated with capital gains or losses.

**Certificates of Deposit** — CDs, are a short – to medium – term investment (usually one to five years) issued by a bank or credit union to pay interest at a rate higher than that paid by a regular savings account.

**Certified Check** — A check which is guaranteed for payment. When a check is certified, it becomes an obligation of the bank, and the funds are immediately withdrawn from the account.

**Chapter 7** — A provision of bankruptcy laws wherein a company is required to liquidate its assets to pay off its creditors.

**Chapter 11** — A provision of bankruptcy laws allowing a bankrupt company to remain in business while its owners attempt to pay its debts.

**Chapter 13** — A provision of bankruptcy laws allowing adjustments of debts for an individual with regular income. This enables an individual debtor to repay creditors over an extended period, and usually allows the debtor to retain his/her property.

**Check Clearing** — The movement of checks from the bank or other depository institutions where they are deposited back to those on which they are written, and funds movement in the opposite direction. This process results in credits to accounts at the institutions of deposit and corresponding debits to the accounts at the paying institutions. The Federal Reserve participates in check clearing through its nationwide facilities, though many checks are cleared by private sector arrangements.

**Churning** — Excessive buying and selling in a customer’s account by a broker seeking to maximize commissions regardless of the client’s best interests.

**Collateral** — An asset (such as an automobile or a piece of property) that a person uses to take out a loan, promising to give the asset to the lender if loan payments cannot be met. Collateral also refers to the collection of receivables, such as mortgages, which are used to back the interest and/or principal security.

**Compound Interest** — Interest calculated on the original principal plus all interest accrued to a point in time. Since interest is paid on interest as well as the amount borrowed, the effective interest rate is greater than the nominal interest rate. The compound interest rate method is also used to determine the interest paid on savings deposits “loaned” to institutions by depositors.

**Co-Signer** — A person, other than the principal borrower, who also signs for a loan. The co-signer(s) assumes liability to repay the loan, if the principal borrower defaults.

**Credit** — The trust which allows one person (or company) to lend money (or goods or services) to another person, where the second person repays the debt at a later date.

**Credit Card** — A card that may be used repeatedly to buy goods and services on credit. A credit limit is predetermined and the borrower must make periodic payments to the lender (i.e. a bank, credit union, or business). The borrower's goal is to pay down the debt to a zero dollar balance. The lender's goal is to collect payments, plus interest.

**Credit History** — A record of how a person has borrowed and repaid debt.
**Credit Rating** — An estimate of the amount of credit that can be extended to an individual or business without undue risk to the lenders.
**Credit Report** — A loan and bill payment history, kept by a credit bureau and used by financial institutions and other potential creditors to determine the likelihood that a future debt will be repaid by a borrower.
**Credit Scoring System** — A statistical system used to determine whether to grant credit to a potential borrower by assigning numerical scores to various characteristics related to creditworthiness.
**Creditor** — A person, financial institution, or other business that lends money.
**Creditworthiness** — A creditor's measure of a consumer's past and future ability and willingness to repay debts.

## D

**Debit Card** — A card that resembles a credit card but which debits a checking account when the customer makes a purchase. A debit card may be used at automated teller machines or other automated payments equipment. Even if a debit card has a credit card logo, it does not function as a credit card (where the customer owes the purchase amount later).
**Debt Service** — Periodic payment of the principal and interest on a loan.
**Default** — Failure to meet the terms of a credit agreement.
**Delinquency** — Failure to make timely payments under a loan or other credit agreement.
**Diversification** — The method of balancing risk by investing in a variety of securities.
**Dividend** — A portion of company earnings paid to stockholders, usually in cash, but sometimes in the form of additional shares of stock.
**Dodd-Frank Act** — Passed in 2010 by the U.S. Congress as a response to the late-2000s economic crisis, it is the most sweeping change to financial regulation in the U.S. since the Great Depression. It affects all Federal financial regulatory agencies and almost every aspect of the nation's financial services industry.

## E

**Equity** — Ownership interest in an asset after liabilities are deducted.

## F

**Finance Charge** — The total dollar amount paid, including fees and interest, for a loan.
**Financing Fee** — The fee a lender charges to originate a loan. The fee is based on a percentage of the loan amount; one point is equivalent to one percent.
**Fixed Rate** — A "traditional" approach to interest charges on a loan. A predetermined and specified interest rate is applied to the principal over the life of the loan.
**Foreclosure** — The legal process used to force the payment of debt secured by collateral whereby the property is sold to satisfy the debt.
**Financial Planner** — An investment professional who helps clients set and achieve long-term financial goals, through investments, tax planning, asset alloca¬tion, risk management, retirement planning, and estate planning.

**401 (k) Plan** — An employer-sponsored retirement plan where employees invest part of their pay and avoid current taxes on that income. Employee contributions may be (partially) matched by the employer, and earnings are tax-deferred until withdrawal.

# G

**Graduated Payment** — Repayment terms calling for gradual increases in the payments on a closed-end obligation. A graduated payment loan usually involves what is called "negative amortization."

# H

**Home Equity** — The difference between what you paid for your home and what you get when you sell it. There may be complex tax implications (see Capital Gains).

**Individual Retirement Account (IRA)** — A tax-favored retirement plan. Contributions to an IRA may be tax deductible, depending on income and if whether a person also has a retirement plan at work. Earnings grow tax-deferred. In a Roth IRA, earnings grow tax-free, and contributions are made with after-tax dollars.

# I

**Installment Plan** — A plan requiring a borrower to make regular payments at specified intervals over the life of a loan.

**Interest** — A fee for the use of money over time. It is an expense to the borrower and generates revenue to the lender. Also money earned on a savings account.

**Interest Rate** — The percentage charged for a loan, usually a percentage of the amount loaned. Also, the percentage paid on a savings account.

**Investment Advisors** — Also called IAs, people or organizations in the business of managing their clients' secur¬ities portfolios or providing advice about investing in securities. IAs have a fiduciary responsibility to the client. Depending on the amount of assets under management, investment advisers are required to be registered with the SEC or the CA Department of Corporations.

# K

**Key Interest Rates** — The federal funds rate and the discount rate. These key interest rates are used as a cornerstone of monetary policy in the U.S.

# L

**Lien** — A creditor's claim against a property, which may entitle the creditor to seize the property if a debt is not repaid.

**Liquidity** — Quality that makes an asset easily convertible into cash with little loss of value in the conversion process.

**Liquidity Risk** — In banking, risk that a depository institution will not have sufficient cash or liquid assets to meet borrower and depositor demand.

**Load** — A sales commission charged on many mutual funds. Some are front-end loads (paid when shares are purchased) or back-end loads (fees paid shares are sold).

# M

**Maturity** — The time when a note, bond or other investment option comes due for payment to investors or creditors.

**Mortgage** — A temporary pledge of property to a creditor as security for the repayment of a loan.

**Money-Market Account** — Similar to checking accounts but usually pay higher interest rates. Minimum deposit levels are higher than checking, and access to the fund balance may be limited.
**Money-Market Fund** — A mutual fund that invests in short-term corporate and government debt and passes the interest payments on to shareholders.
**Mortgage-Backed Securities** — Issued by government-like agencies that buy up mortgage loans from banks and other financial institutions.
**Mutual Fund** — A professionally managed portfolio of stocks and bonds or other investments divided up into shares.

# N

**Negative Amortization** — When a loan payment for any period is less than the interest charged over that period, so the outstanding balance of the loan increases.
**Net Worth** — The difference between an individual's total assets and total liabilities.
**Nominal Interest Rates** — Current stated rates of interest paid or earned.

# O

**Office of the Comptroller of the Currency (OCC)** — Under the U.S. Treasury, the OCC regulates all national banks, federal branches, and agencies of foreign banks.
**Office of Thrift Supervision (OTS)** — Under the U.S. Treasury, the OTS oversees chartered federal thrift institutions and serve as the primary regulator of approximately 2,000 federal and state-chartered thrifts.
**Open-End Credit** — A line of credit that may be used repeatedly up to a certain limit, also called a charge account or revolving credit.
**Open-End Lease** — A lease that may involve a balloon payment based on the value of the property when it is returned. Also called finance lease.
**Overdraft Checking** — A checking account with a line of credit that allows a person to write checks for more than the actual balance in the account, with a finance charge on the overdraft.
**Opportunity Cost** — The cost of passing up on an investment in favor of another.

# P

**Points** — Points are a lump sum payment made by the borrower at the outset of the loan period. Generally, each point equals one percent of the loan amount.
**Prime Rate** — The lowest interest rate on bank loans, offered to preferred borrowers.
**Principal** — The unpaid balance on a loan, not including interest; the total amount of money invested or loaned.
**Promissory Note** — A written promise to repay the money plus interest.
**Ponzi/Pyramid Schemes** — Named after Charles Ponzi, these are fraudulent investment schemes with promised high returns and low risk. Promoters typically pay early investors by using money collected from newer investors. All Ponzi schemes eventually collapse because the number of new investors needed to pay earlier investors is unachievable, and later investors typically lose all of their money.
**Portfolio** — The collection of all your investments.

# R

**Real Interest Rates** — Interest rates adjusted for the expected erosion of purchasing power resulting from inflation. Technically defined as nominal interest rates minus the expected rate of inflation.

**Renegotiable Rate** — A type of variable rate involving a renewable short- term "balloon" note. The interest rate on the loan is generally fixed during the term of the note, but when the balloon comes due, the lender may refinance it at a higher rate. In order for the loan to be fully amortized, periodic refinancing may be necessary.

**Risk Tolerance** — The degree to which you are willing to risk losing some (or all) of your original investment in exchange for a chance to earn a higher rate of return. In general, the greater the potential gain from an investment, the greater the risk that you might lose money.

## S

**Seller's Points** — In reference to a loan, seller's points consist of a lump sum paid by the seller to the buyer's creditor to reduce the cost of the loan to the buyer. Generally, one point equals one percent of the loan amount.

**Service Charge** — A component of some finance charges, such as the fee for triggering an overdraft checking account into use.

**Short-term Interest Rates** — Interest rates on loan contracts or debt instruments such as Treasury bills, CDs or commercial loans, with maturities of less than one year.

**Simple Interest** — Interest that is paid only on the original amount borrowed for the length of time the borrower has use of the credit. The amount borrowed is referred to as the principal. In the simple interest rate calculation, interest is computed only on that portion of the original principal still owed.

**Securities** — Any investment opportunity in which the investor has a reasonable expectation of making a profit as a result of the managerial or entrepreneurial efforts of others, but where the investor generally has little power over management and limited access to the enterprise's business records. As a general rule, all securities and the people who sell them must be registered with the Department of Corporations.

**Stock** — A share that represents ownership in the company that issues it. The price of a stock goes up and down, depending on how the company performs and how investors think the company will perform in the future.

**Street name** — The term used to describe securities that are held in the name of a brokerage firm but actually belong to an individual investor.

## T

**Term** — The period from when a loan (or other contract) is issued until it is fully paid.

**Terms** — Provisions specified in a loan agreement (or other contract).

**Thrift Institution** — A general term encompassing savings banks, savings and loan associations, and credit unions.

**Transaction Account** — A checking or similar account from which transfers can be made to third parties. Demand-deposit accounts, negotiable order of withdrawal (NOW) accounts, automatic transfer service (ATS) accounts, and credit union share draft accounts are examples of transaction accounts at banks and other institutions.

**"Truth in Lending" Act**—The Federal Consumer Credit Protection Act passed in 1989, which requires disclosures of credit terms using a standard format.

**Time Value of Money** — The concept that money today is worth more than the same amount in the future, when inflation has reduced its value.

# V

**Variable Rate** — A variable-rate agreement, as distinguished from a fixed-rate agreement, has an interest rate that may fluctuate over the life of the loan. The rate is often tied to an index that reflects changes in market rates of interest. A fluctuation in the rate causes changes in either the payments or the length of the loan term. Limits are often placed on the degree to which the interest rate or the payments can vary.

# W

**Wraparound** — A financing device that permits an existing loan to be refinanced and new money to be advanced at an interest rate between the rate charged on the old loan and the current market interest rate. The creditor combines or "wraps" the remainder of the old loan with the new loan at the intermediate rate.

# Y

**Yield** — The return on a loan or investment, usually stated as a percentage of price.