

GLOSSARY

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Capital requirement: The amount of capital (assets minus liabilities, or “net worth”) a financial institution has relative to its loans and other assets. Banking regulators require banks to hold a certain minimum of equity capital against their “risk-weighted” assets. The Basel Committee on Bank Supervision, part of the Bank for International Settlements in Switzerland, supervises the administration of capital reserves for central bankers around the world.

Capitalization: market value of a company’s stock.

Central bank: a non-commercial bank, which may or may not be independent of government, which has some or all of the following functions: conduct monetary policy; oversee the stability of the financial system; issue currency notes; act as banker to the government; supervise financial institutions and regulate payments systems.

Credit default swaps (CDS): Insurance-like contracts that are sold as protection against default on loans, except that no insurance regulator checks to make sure that the “protection seller” (often a hedge fund) can pay up in the event of default. CDS are basically just bets, with the “protection seller” agreeing to pay if the underlying credit instrument goes into default, and the “protection buyer” agreeing to pay a premium for that protection.

Collateralized Debt Obligations (CDOs): sophisticated financial tools that repackage individual loans into a product that can be sold to investors. These packages consist of auto loans, credit card debt, or corporate debt. They are called collateralized because they have some type of collateral behind them.

Counterparties: parties to a contract, usually having a potential conflict of interest. Within the financial services sector, the term market counterparty is used to refer to national banks, governments, national monetary authorities and multinational monetary organizations such as the World Bank Group, which act as the ultimate guarantor for loans and indemnities. The term may also be applied to companies acting in that role.

Deflation: A contraction in the supply of money or credit that results in declining prices; the opposite of inflation.

Demand deposits: bank deposits that can be withdrawn on demand at any time without notice. Most checking and savings accounts are demand deposits.

Derivative: A financial instrument whose characteristics and value depend upon the characteristics and value of an “underlier,” typically a commodity, bond, equity or currency. Familiar examples of derivatives include “futures” and “options.”

Equity: ownership interest in a corporation.

Federal funds rate: the rate that banks charge each other on overnight loans made between them.

Federal Reserve: the central bank of the United States; a system of federal banks charged with regulating the U.S. money supply, mainly by buying and selling U.S. securities and setting the discount interest rate (the interest rate at which the Federal Reserve lends money to commercial banks).

Hedge funds: investment companies that use high-risk techniques, such as borrowing money and selling short, in an effort to make extraordinary capital gains for their investors.

Investment banks help companies and governments issue securities, help investors purchase securities, manage financial assets, trade securities and provide financial advice. Unlike commercial banks, they do not take deposits or make commercial loans; but the lines have blurred with the 1999 repeal of the Glass Steagall Act, which prohibited the same bank from taking deposits and underwriting securities. Leading investment banks include Merrill Lynch, Salomon Smith Barney, Morgan Stanley Dean Witter and Goldman Sachs.

Leveraging: buying with borrowed money. **Leverage** is the degree to which an investor or business is using borrowed money.

LIBOR (London Interbank Offered Rate): a daily reference rate based on the interest rates at which banks borrow unsecured funds from other banks in the London wholesale money market or interbank market.

Limited liability company (LLC): a business structure allowed by state statute. LLCs are popular because, similar to a corporation, owners have limited personal liability for the debts and actions of the LLC. Other features of LLCs are more like a partnership, providing management flexibility and the benefit of pass-through taxation.

Liquidity: the ability of an asset to be converted into cash quickly and without discount.

Monetize: to convert government debt from securities into currency that can be used to purchase goods and services.

Money market: the trade in short-term, low-risk securities, such as certificates of deposit and U.S. Treasury notes.

Money supply: the entire quantity of bills, coins, loans, credit, and other liquid instruments in a country's economy. "Liquid" instruments are those easily convertible to cash. The money supply has traditionally been reported by the Federal Reserve in three categories – M1, M2, and M3, although it quit reporting M3 after March 2006. M1 is what we usually think of as money – coins, dollar bills, and the money in our checking accounts. M2 is M1 plus savings accounts, money market funds, and other individual or "small" time deposits. M3 is M1 and M2 plus institutional and other larger time deposits (including institutional money market funds) and eurodollars (American dollars circulating abroad).

Multiplier effect: according to [Investopedia](#), "the expansion of a country's money supply that results from banks being able to lend."

Reserve requirement: The percentage of funds the Federal Reserve Board requires that member banks maintain on deposit at all times.

Time deposits: deposits that the depositor knows are being lent out and that he can't have back for a certain period of time.

Transaction deposit: a term used by the Federal Reserve for checkable deposits (deposits on which checks can be drawn) and other accounts that can be used directly as cash without withdrawal limits or restrictions. They are also called **demand deposits**, since they can be withdrawn on demand at any time without notice. Most checking and savings accounts are demand deposits.