# Contents

List of Figures .......................... xvi
List of Tables ........................... xviii
List of Boxes ........................... xx
Preface ................................ xxii
Companion Website ..................... xxv
Acknowledgements ..................... xxvi
Abbreviations ........................... xxix

## PART 1: Introduction

1 The Money Merry-go-round .......... 2
   RAISON D'ÊTRE OF THE MARKETS ........ 2
   Lenders ................................ 2
   Borrowers ................................ 3
   Securities .............................. 4
   RAISING CAPITAL ....................... 5
   Bank Loans .............................. 5
   Bonds .................................. 5
   Equity .................................. 6
   Gearing/Leverage ....................... 6
   CONCLUSION ........................... 8
   SUMMARY ............................... 9
   REVISION QUESTIONS/ASSIGNMENTS ..... 9
   FURTHER READING ..................... 9

## PART 2: Banking

2 Banking Background ................. 11
   HISTORY ............................... 12
   BANKING SUPERVISION ................. 15
   TYPES OF BANK: DEFINITIONS ........ 16
   Central Banks ......................... 16
   Commercial Banks .................... 17
   Merchant/Investment Banks .......... 18
   Savings Banks .......................... 18
   Cooperative Banks ................... 20
   Mortgage Banks ....................... 21
   Giro Banks ............................. 22
   Credit Unions .......................... 23
   Islamic Banks ........................... 24
   OTHER BANKING TERMINOLOGY ......... 25
   Clearing Banks ....................... 25
   State or Public Banks ............... 26
   International Banking .............. 27
   Shadow Banking ...................... 27
<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>RETAIL BANKING</td>
<td>69</td>
</tr>
<tr>
<td>Types of Service</td>
<td>69</td>
</tr>
<tr>
<td>Money Banking: Deposits</td>
<td>70</td>
</tr>
<tr>
<td>New Payments Technologies</td>
<td>72</td>
</tr>
<tr>
<td>Loans</td>
<td>74</td>
</tr>
<tr>
<td>Other Services</td>
<td>76</td>
</tr>
<tr>
<td>Delivery Channels</td>
<td>78</td>
</tr>
<tr>
<td>Clearing Systems</td>
<td>82</td>
</tr>
<tr>
<td>Key Retail Banking Issues</td>
<td>84</td>
</tr>
<tr>
<td>Use of IT</td>
<td>90</td>
</tr>
<tr>
<td>WHOLESALE BANKING</td>
<td>91</td>
</tr>
<tr>
<td>Uncommitted Facilities</td>
<td>91</td>
</tr>
<tr>
<td>Committed Facilities</td>
<td>92</td>
</tr>
<tr>
<td>Syndicated Facilities</td>
<td>94</td>
</tr>
<tr>
<td>The Loan Agreement</td>
<td>98</td>
</tr>
<tr>
<td>WHOLESALE BANKING ISSUES</td>
<td>100</td>
</tr>
<tr>
<td>SUMMARY</td>
<td>101</td>
</tr>
<tr>
<td>REVISION QUESTIONS/ASSIGNMENTS</td>
<td>102</td>
</tr>
<tr>
<td>REFERENCES</td>
<td>102</td>
</tr>
<tr>
<td>FURTHER READING</td>
<td>102</td>
</tr>
</tbody>
</table>

5 Investment Banking | 103 |
| INTRODUCTION | 103 |
| INVESTMENT BANKING | 103 |
| Accepting | 103 |
| Corporate Finance | 106 |
| Securities Trading | 110 |
| Investment Management | 111 |
| Loan Arrangement | 112 |
| Foreign Exchange | 112 |
| Miscellaneous Activities | 112 |
| INVESTMENT BANKS AND THE CREDIT CRISIS | 113 |
| REGULATION | 114 |
| SHADOW BANKING | 115 |
| SUMMARY | 118 |
| REVISION QUESTIONS/ASSIGNMENTS | 118 |
| REFERENCE | 119 |
| FURTHER READING | 119 |

6 Regulation | 120 |
| AFTER THE CRISIS | 120 |
| FREQUENCY OF CRISIS AND THEIR COSTS | 120 |
| RATIONALE FOR BANK REGULATION | 121 |
| INFORMATION ASYMMETRIES IN BANKING AND FINANCE | 122 |
| GOVERNMENT SAFETY NET PROBLEMS FOR REGULATORS | 123 |
| THEORIES OF BANKING CRISIS | 124 |
| FEATURES OF SYSTEMIC RISK | 125 |
| What Is 'Systemic Risk'? | 125 |
| Solvency, Liquidity and Maturities | 125 |
| Funding Liquidity and the 'Domino Effect' | 126 |
CONTENTS

‘Mark to Market’ and Asset Price Effects 127
The ‘Haircut’ Spiral 127
Systemic Risk: Spirals and the Rationale for Regulation 128
THE RISE OF SYSTEMICALLY IMPORTANT FINANCIAL INSTITUTIONS (SIFIs) 128
Which Are the SIFIs? 129
Why Worry about Big Institutions? 129
US REGULATORY RESPONSE TO THE CRISIS: DODD-FRANK ACT 2010 133
UK REGULATORY RESPONSE TO THE CRISIS 135
EUROPEAN REGULATORY RESPONSE 135
INTERNATIONAL ACTION 141
SUMMARY 142
REVISION QUESTIONS/ASSIGNMENTS 143
REFERENCES 143
FURTHER READING 144

PART 3: Securities Markets and Investment Companies 145

7 The Money and Bond Markets 146

THE RATE OF INTEREST 146
Risk 146
Maturity 147
Expectations 148
Liquidity 148
Supply and Demand 148
Inflation 149
Yield 149
Par Values 149
Interest Yield 150
Gross Redemption Yield 150
Accrued Interest 152
CREDIT RATINGS 153
DOMESTIC MONEY MARKETS 155
Call Money 155
The Interbank Market 155
Money Market Securities 158
CENTRAL BANK ROLE 161
DOMESTIC BOND MARKETS 163
Government Bonds (Sovereigns) 165
Local Authority/Public Sector Bonds 168
Mortgage and Asset-backed Bonds 168
Corporate Bonds 171
Hybrid Bonds 174
Foreign Bonds 175
Junk Bonds (High-yield Debt) 176
Islamic Bonds 177
INTERNATIONAL MARKETS 177
Background: Eurocurrencies 177
The Syndicated Loan Market 179
The International Debt Crisis 179
The Eurobond Market 183
9 Hedge Funds and Private Equity 237
INTRODUCTION 237
Hedge Funds 238
Private Equity 239
HEDGE FUNDS 242
Leverage and Short Selling 243
Strategies 245
Range and Activities of Hedge Funds 248
Investors 250
Returns 251
Regulation 252
PRIVATE EQUITY 254
Investors 255
Leverage 257
Hedge Funds and Private Equity Coming Closer 258
Profits on Private Equity 258
SUMMARY 259
REVISION QUESTIONS/ASSIGNMENTS 260
REFERENCES 260
FURTHER READING 261

PART 4: Financial Crisis 263
10 Financial Crisis 264
INTRODUCTION 264
WHAT WENT WRONG? 265
Macroeconomic Factors 265
Microeconomic Factors 266
STAGES OF THE CRISIS 268
SEURITIZATION AND HOW IT FUELLED THE CRISIS 268
Start of Securitization 268
Role of the US Government-sponsored Enterprises 272
Sub-prime Lending 273
Modern Securitization Business 273
Securitizing the Securitizations: Recent Developments 276
The Role of Rating Agencies and Monoline Insurers 277
The Impact of Securitization and its Future 279
CREDIT CRISIS IN THE US 282
CREDIT CRISIS IN EUROPE 286
United Kingdom 286
Switzerland 288
Iceland 289
Germany 290
Spain 291
Belgium, the Netherlands and Luxembourg 291
Other European Countries 292
PART 6: Derivative Products

13 Traded Options

DERIVATIVE PRODUCTS

TRADED OPTIONS: EQUITIES

Calls and Puts
Option Writers
Trading Options
Intrinsic Value and Time Value
Calculation of the Premium
Exercise or Trade?
Other Terminology
Options on Indices

TRADED OPTIONS: OTHER OPTIONS

Currencies
Bonds
Interest Rates

OPTION STRATEGIES

SUMMARY

REVISION QUESTIONS/ASSIGNMENTS

FURTHER READING

14 Financial Futures

FUTURES TRADING

Background
Hedgers versus Speculators
Commodity Futures
Financial Futures
Index Futures
Bond Futures
Interest Rates
Currency Futures
Some Problems of Futures Exchanges
Open Outcry or Computers?
Contract Volumes

SUMMARY

REVISION QUESTIONS/ASSIGNMENTS

REFERENCE

FURTHER READING

15 Other Derivative Products

INTRODUCTION

FORWARD RATE AGREEMENTS

SWAPS

Comparative Advantage
Interest Rate Swaps
Making a Market in Swaps
Users of Swaps
Swaps and Futures
Other Swaps
Swapnotes and the Swaps Yield Curve