

GLOBAL  
EDITION



# Financial Markets and Institutions

NINTH EDITION

Frederic S. Mishkin • Stanley G. Eakins





# FINANCIAL MARKETS AND INSTITUTIONS

**Ninth Edition**

**Global Edition**

**Frederic S. Mishkin**

*Graduate School of Business, Columbia University*

**Stanley G. Eakins**

*East Carolina University*



---

Harlow, England • London • New York • Boston • San Francisco • Toronto • Sydney • Dubai • Singapore • Hong Kong  
Tokyo • Seoul • Taipei • New Delhi • Cape Town • Sao Paulo • Mexico City • Madrid • Amsterdam • Munich • Paris • Milan

# Financial Markets and Institutions, Global Edition

## Table of Contents

Cover

Title Page

Copyright Page

Contents in Brief

Contents in Detail

Contents on the Web

Preface

Acknowledgments

About the Authors

Part One: Introduction

Chapter 1: Why Study Financial Markets and Institutions?

Preview

Why Study Financial Markets?

Debt Markets and Interest Rates

The Stock Market

The Foreign Exchange Market

Why Study Financial Institutions?

Structure of the Financial System

Financial Crises

Central Banks and the Conduct of Monetary Policy

The International Financial System

Banks and Other Financial Institutions

Financial Innovation

Managing Risk in Financial Institutions

Applied Managerial Perspective

How We Will Study Financial Markets and Institutions

Exploring the Web

Collecting and Graphing Data

# Table of Contents

Web Exercise

Concluding Remarks

Summary

Key Terms

Questions

Quantitative Problems

Web Exercises

## Chapter 2: Overview of the Financial System

Preview

Function of Financial Markets

Structure of Financial Markets

Debt and Equity Markets

Primary and Secondary Markets

Exchanges and Over-the-Counter Markets

Money and Capital Markets

Internationalization of Financial Markets

International Bond Market, Eurobonds, and Eurocurrencies

Global: Are U.S. Capital Markets Losing Their Edge?

World Stock Markets

Function of Financial Intermediaries: Indirect Finance

Following the Financial News: Foreign Stock Market Indexes

Global: The Importance of Financial Intermediaries Relative to Securities Markets: An  
International Comparison

Transaction Costs

Risk Sharing

Asymmetric Information: Adverse Selection and Moral Hazard

Economies of Scope and Conflicts of Interest

Types of Financial Intermediaries

Depository Institutions

Contractual Savings Institutions

Investment Intermediaries

Regulation of the Financial System

Increasing Information Available to Investors

Ensuring the Soundness of Financial Intermediaries

Financial Regulation Abroad

Summary

# Table of Contents

Key Terms

Questions

Web Exercises

## Part Two: Fundamentals of Financial Markets

### Chapter 3: What Do Interest Rates Mean and What Is Their Role in Valuation?

Preview

Measuring Interest Rates

Present Value

Four Types of Credit Market Instruments

Yield to Maturity

Global: Negative Interest Rates? Japan First, Then the United States, Then Europe

The Distinction Between Real and Nominal Interest Rates

Mini-Case: With TIPS, Real Interest Rates Have Become Observable in the United States

The Distinction Between Interest Rates and Returns

Maturity and the Volatility of Bond Returns: Interest-Rate Risk

Mini-Case: Helping Investors Select Desired Interest-Rate Risk

Reinvestment Risk

Summary

The Practicing Manager: Calculating Duration to Measure Interest-Rate Risk

Calculating Duration

Duration and Interest-Rate Risk

Summary

Key Terms

Questions

Quantitative Problems

Web Exercises

### Chapter 4: Why Do Interest Rates Change?

Preview

Determinants of Asset Demand

Wealth

Expected Returns

Risk

Liquidity

Theory of Portfolio Choice

# **Table of Contents**

## Supply and Demand in the Bond Market

- Demand Curve
- Supply Curve
- Market Equilibrium
- Supply-and-Demand Analysis

## Changes in Equilibrium Interest Rates

- Shifts in the Demand for Bonds
- Shifts in the Supply of Bonds
- Case: Changes in the Interest Rate Due to Expected Inflation: The Fisher Effect
- Case: Changes in the Interest Rate Due to a Business Cycle Expansion
- Case: Explaining the Current Low Interest Rates in Europe, Japan, and the United States
- The Practicing Manager: Profiting from Interest-Rate Forecasts
- Following the Financial News: Forecasting Interest Rates

## Summary

## Key Terms

## Questions

## Quantitative Problems

## Web Exercises

## Web Appendices

## Chapter 5: How Do Risk and Term Structure Affect Interest Rates?

### Preview

### Risk Structure of Interest Rates

- Default Risk
- Liquidity
- Case: The Global Financial Crisis and the Baa-Treasury Spread
- Income Tax Considerations
- Summary
- Case: Effects of the Bush Tax Cut and the Obama Tax Increase on Bond Interest Rates

### Term Structure of Interest Rates

- Following the Financial News: Yield Curves
- Expectations Theory
- Market Segmentation Theory
- Liquidity Premium Theory
- Evidence on the Term Structure
- Summary
- Mini-Case: The Yield Curve as a Forecasting Tool for Inflation and the Business Cycle

# Table of Contents

Case: Interpreting Yield Curves, 19802016

The Practicing Manager: Using the Term Structure to Forecast Interest Rates

Summary

Key Terms

Questions

Quantitative Problems

Web Exercises

## Chapter 6: Are Financial Markets Efficient?

Preview

The Efficient Market Hypothesis

Rationale Behind the Hypothesis

Evidence on the Efficient Market Hypothesis

Evidence in Favor of Market Efficiency

Mini-Case: An Exception That Proves the Rule: Raj Rajaratnam and Galleon

Case: Should Foreign Exchange Rates Follow a Random Walk?

Evidence Against Market Efficiency

Overview of the Evidence on the Efficient Market Hypothesis

The Practicing Manager: Practical Guide to Investing in the Stock Market

How Valuable Are Published Reports by Investment Advisers?

Mini-Case: Should You Hire an Ape as Your Investment Adviser?

Should You Be Skeptical of Hot Tips?

Do Stock Prices Always Rise When There Is Good News?

Efficient Markets Prescription for the Investor

Why the Efficient Market Hypothesis Does Not Imply That Financial Markets Are Efficient

Case: What Do Stock Market Crashes Tell Us About the Efficient Market Hypothesis?

Behavioral Finance

Summary

Key Terms

Questions

Quantitative Problems

Web Exercises

## Part Three: Fundamentals of Financial Institutions

### Chapter 7: Why Do Financial Institutions Exist?

# Table of Contents

Preview

Basic Facts About Financial Structure Throughout the World

Transaction Costs

How Transaction Costs Influence Financial Structure

How Financial Intermediaries Reduce Transaction Costs

Asymmetric Information: Adverse Selection and Moral Hazard

The Lemons Problem: How Adverse Selection Influences Financial Structure

Lemons in the Stock and Bond Markets

Tools to Help Solve Adverse Selection Problems

Mini-Case: The Enron Implosion

How Moral Hazard Affects the Choice Between Debt and Equity Contracts

Moral Hazard in Equity Contracts: The Principal-Agent Problem

Tools to Help Solve the Principal-Agent Problem

How Moral Hazard Influences Financial Structure in Debt Markets

Tools to Help Solve Moral Hazard in Debt Contracts

Summary

Case: Financial Development and Economic Growth

Mini-Case: The Tyranny of Collateral

Case: Is China a Counter-Example to the Importance of Financial Development?

Conflicts of Interest

What Are Conflicts of Interest and Why Do We Care?

Why Do Conflicts of Interest Arise?

Mini-Case: The Demise of Arthur Andersen

Mini-Case: Credit-Rating Agencies and the 2007-2009 Financial Crisis

What Has Been Done to Remedy Conflicts of Interest?

Mini-Case: Has Sarbanes-Oxley Led to a Decline in U.S. Capital Markets?

Summary

Key Terms

Questions

Quantitative Problems

Web Exercises

Chapter 8: Why Do Financial Crises Occur and Why Are They So Damaging to the Economy?

Preview

What Is a Financial Crisis?



# Table of Contents

Agency Theory and the Definition of a Financial Crisis

## Dynamics of Financial Crises

Stage One: Initial Phase

Stage Two: Banking Crisis

Stage Three: Debt Deflation

Case: The Mother of All Financial Crises: The Great Depression

Stock Market Crash

Bank Panics

Continuing Decline in Stock Prices

Debt Deflation

International Dimensions

Case: The Global Financial Crisis of 2007-2009

Causes of the 2007-2009 Financial Crisis

Mini-Case: Collateralized Debt Obligations (CDOs)

Effects of the 2007-2009 Financial Crisis

Inside the Fed: Was the Fed to Blame for the Housing Price Bubble?

Global: The European Sovereign Debt Crisis

Height of the 2007-2009 Financial Crisis

Summary

Key Terms

Questions

Web Exercises

Web References

## Part Four: Central Banking and the Conduct of Monetary Policy

### Chapter 9: Central Banks

Preview

Origins of the Central Banking System

Global: Who Should Own Central Banks?

Variations in the Functions and Structures of Central Banks

The European Central Bank, the Euro System, and the European System of Central Banks

Decision-Making Bodies of the ECB

How Monetary Policy is Conducted within the ECB

Global: The Importance of the Bundesbank within the ECB

Global: Are Non-Euro Central Banks Constrained by Membership of the EU?

The Federal Reserve System

Difference between the ECB and the Fed

# **Table of Contents**

The Bank of England

Global: Brexit and the BoE

## **Structure of Central Banks of Larger Economies**

The Bank of Canada

The Bank of Japan

The Peoples Bank of China

## **Structure and Independence of Central Banks of Emerging Market Economies**

### **Central Banks and Independence**

The Case for Independence

The Case Against Independence

The Trend Toward Greater Independence

### **Summary**

### **Key Terms**

### **Questions and Problems**

### **Web Exercises**

## **Chapter 10: Conduct of Monetary Policy**

### **Preview**

### **How Fed Actions Affect Reserves in the Banking System**

Open Market Operations

Discount Lending

### **The Market for Reserves and the Federal Funds Rate**

Demand and Supply in the Market for Reserves

How Changes in the Tools of Monetary Policy Affect the Federal Funds Rate

Case: How the Federal Reserves Operating Procedures Limit Fluctuations in the Federal Funds Rate

### **Conventional Monetary Policy Tools**

Open Market Operations

Inside the Fed: A Day at the Trading Desk

Discount Policy and the Lender of Last Resort

Reserve Requirements

Interest on Reserves

### **Nonconventional Monetary Policy Tools and Quantitative Easing**

Liquidity Provision

Inside the Fed: Fed Lending Facilities During the Global Financial Crisis

Large-Scale Asset Purchases

Quantitative Easing Versus Credit Easing

# Table of Contents

Forward Guidance

Negative Interest Rates on Banks Deposits

## Monetary Policy Tools of the European Central Bank

Open Market Operations

Lending to Banks

Interest on Reserves

Reserve Requirements

## The Price Stability Goal and the Nominal Anchor

The Role of a Nominal Anchor

The Time-Inconsistency Problem

## Other Goals of Monetary Policy

High Employment and Output Stability

Economic Growth

Stability of Financial Markets

Interest-Rate Stability

Stability in Foreign Exchange Markets

## Should Price Stability Be the Primary Goal of Monetary Policy?

Hierarchical vs. Dual Mandates

Price Stability as the Primary, Long-Run Goal of Monetary Policy

Global: The European Central Banks Monetary Policy Strategy

## Inflation Targeting

Advantages of Inflation Targeting

Inside the Fed: Ben Bernanke and the Federal Reserves Adoption of Inflation Targeting

Disadvantages of Inflation Targeting

## Should Central Banks Respond to Asset-Price Bubbles? Lessons from the Global

Financial Crisis

Two Types of Asset-Price Bubbles

The Debate over Whether Central Banks Should Try to Pop Bubbles

The Practicing Manager: Using a Fed Watcher

Summary

Key Terms

Questions

Quantitative Problems

Web Exercises

## Part Five: Financial Markets

# **Table of Contents**

## **Chapter 11: The Money Markets**

Preview

The Money Markets Defined

Why Do We Need the Money Markets?

Money Market Cost Advantages

The Purpose of the Money Markets

Who Participates in the Money Markets?

U.S. Treasury Department

Federal Reserve System

Commercial Banks

Businesses

Investment and Securities Firms

Individuals

Money Market Instruments

Treasury Bills

Case: Discounting the Price of Treasury Securities to Pay the Interest

Mini-Case: Treasury Bill Auctions Go Haywire

Federal Funds

Repurchase Agreements

Negotiable Certificates of Deposit

Commercial Paper

Bankers Acceptances

Eurodollars

Global: Irony Birth of the Eurodollar Market

Comparing Money Market Securities

Interest Rates

Liquidity

How Money Market Securities Are Valued

Summary

Key Terms

Questions

Quantitative Problems

Web Exercises

## **Chapter 12: The Bond Market**

Preview

Purpose of the Capital Market

# **Table of Contents**

Capital Market Participants

Capital Market Trading

Types of Bonds

Treasury Notes and Bonds

- Treasury Bond Interest Rates

- Treasury Inflation-Protected Securities (TIPS)

- Treasury STRIPS

- Agency Bonds

- Case: The 2007/2009 Financial Crisis and the Bailout of Fannie Mae and Freddie Mac

Municipal Bonds

- Risk in the Municipal Bond Market

Corporate Bonds

- Characteristics of Corporate Bonds

- Types of Corporate Bonds

Financial Guarantees for Bonds

Oversight of the Bond Markets

Current Yield Calculation

- Current Yield

Finding the Value of Coupon Bonds

- Finding the Price of Semiannual Bonds

Investing in Bonds

Summary

Key Terms

Questions

Quantitative Problems

Web Exercise

## **Chapter 13: The Stock Market**

Preview

Investing in Stocks

- Common Stock vs. Preferred Stock

- How Stocks Are Sold

Computing the Price of Common Stock

- The One-Period Valuation Model

- The Generalized Dividend Valuation Model

- The Gordon Growth Model

# Table of Contents

Price Earnings Valuation Method

How the Market Sets Security Prices

Errors in Valuation

Problems with Estimating Growth

Problems with Estimating Risk

Problems with Forecasting Dividends

Case: The 2007/2009 Financial Crisis and the Stock Market

Case: The September 11 Terrorist Attack, the Enron Scandal, and the Stock Market

Stock Market Indexes

Mini-Case: History of the Dow Jones Industrial Average

Buying Foreign Stocks

Regulation of the Stock Market

The Securities and Exchange Commission

Summary

Key Terms

Questions

Quantitative Problems

Web Exercises

## Chapter 14: The Mortgage Markets

Preview

What Are Mortgages?

Characteristics of the Residential Mortgage

Mortgage Interest Rates

Case: The Discount Point Decision

Loan Terms

Mortgage Loan Amortization

Types of Mortgage Loans

Insured and Conventional Mortgages

Fixed- and Adjustable-Rate Mortgages

Other Types of Mortgages

Mortgage-Lending Institutions

Loan Servicing

E-Finance: Borrowers Shop the Web for Mortgages

Secondary Mortgage Market

Securitization of Mortgages

# Table of Contents

What Is a Mortgage-Backed Security?

Types of Pass-Through Securities

Subprime Mortgages and CDOs

The Real Estate Bubble

Summary

Key Terms

Questions

Quantitative Problems

Web Exercises

## Chapter 15: The Foreign Exchange Market

Preview

Foreign Exchange Market

What Are Foreign Exchange Rates?

Why Are Exchange Rates Important?

Following the Financial News: Foreign Exchange Rates

How Is Foreign Exchange Traded?

Exchange Rates in the Long Run

Law of One Price

Theory of Purchasing Power Parity

Why the Theory of Purchasing Power Parity Cannot Fully Explain Exchange Rates

Factors That Affect Exchange Rates in the Long Run

Exchange Rates in the Short Run: A Supply and Demand Analysis

Supply Curve for Domestic Assets

Demand Curve for Domestic Assets

Equilibrium in the Foreign Exchange Market

Explaining Changes in Exchange Rates

Shifts in the Demand for Domestic Assets

Recap: Factors That Change the Exchange Rate

Case: Effect of Changes in Interest Rates on the Equilibrium Exchange Rate

Case: Why Are Exchange Rates So Volatile?

Case: The Dollar and Interest Rates

Case: The Global Financial Crisis and the Dollar

The Practicing Manager: Profiting from Foreign Exchange Forecasts

Summary

Key Terms

Questions

# Table of Contents

Quantitative Problems

Web Exercises

Chapter 15: Appendix the Interest Parity Condition

Comparing Expected Returns on Domestic and Foreign Assets

Interest Parity Condition

Chapter 16: The International Financial System

Preview

Intervention in the Foreign Exchange Market

Foreign Exchange Intervention and Reserves in the Banking System

Inside the Fed: A Day at the Federal Reserve Bank of New York's Foreign Exchange Desk

Unsterilized Intervention

Sterilized Intervention

Balance of Payments

Global: Why the Large U.S. Current Account Deficit Worries Economists

Exchange Rate Regimes in the International Financial System

Fixed Exchange Rate Regimes

How a Fixed Exchange Rate Regime Works

The Policy Trilemma

Monetary Unions

Global: Will the Euro Survive?

Currency Boards and Dollarization

Speculative Attacks

Global: Argentina's Currency Board

Managed Float

Global: Dollarization

Case: The Foreign Exchange Crisis of September 1992

The Practicing Manager: Profiting from a Foreign Exchange Crisis

Case: How Did China Accumulate over \$3 Trillion of International Reserves?

Capital Controls

Controls on Capital Outflows

Controls on Capital Inflows

The Role of the IMF

Should the IMF Be an International Lender of Last Resort?

Summary

Key Terms

Questions



# Table of Contents

Quantitative Problems

Web Exercise

## Part Six: The Financial Institutions Industry

### Chapter 17: Banking and the Management of Financial Institutions

Preview

The Bank Balance Sheet

Liabilities

Assets

Basic Banking

General Principles of Bank Management

Liquidity Management and the Role of Reserves

Asset Management

Liability Management

Capital Adequacy Management

The Practicing Manager: Strategies for Managing Bank Capital

Case: How a Capital Crunch Caused a Credit Crunch During the Global Financial Crisis

Off-Balance-Sheet Activities

Loan Sales

Generation of Fee Income

Trading Activities and Risk Management Techniques

Conflicts of Interest: Barings, Daiwa, Sumitomo, Société Générale, and J.P. Morgan Chase:  
Rogue Traders and the Principal-Agent Problem

Measuring Bank Performance

Banks Income Statement

Measures of Bank Performance

Recent Trends in Bank Performance Measures

Summary

Key Terms

Questions

Quantitative Problems

Web Exercises

### Chapter 18: Financial Regulation

Preview

Asymmetric Information as a Rationale for Financial Regulation

Government Safety Net

# **Table of Contents**

Global: The Spread of Government Deposit Insurance Throughout the World: Is This a Good Thing?

## **Types of Financial Regulation**

Restrictions on Asset Holdings

Capital Requirements

Prompt Corrective Action

Financial Supervision: Chartering and Examination

Global: Where Is the Basel Accord Heading After the Global Financial Crisis?

Assessment of Risk Management

Disclosure Requirements

Consumer Protection

Mini-Case: Mark-to-Market Accounting and the Global Financial Crisis

Restrictions on Competition

Mini-Case: The Global Financial Crisis and Consumer Protection Regulation

Macroprudential Versus Microprudential Supervision

E-Finance: Electronic Banking: New Challenges for Bank Regulation

Summary

Global: International Financial Regulation

## **Banking Crises Throughout the World in Recent Years**

Déjà Vu All Over Again

## **The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010**

Dodd-Frank

## **Too-Big-to-Fail and Future Regulation**

What Can Be Done About the Too-Big-to-Fail Problem?

Other Issues for Future Regulation

Summary

Key Terms

Questions

Quantitative Problems

Web Exercises

Web Appendix

## **Chapter 19: Banking Industry: Structure and Competition**

Preview

Historical Development of the Banking System

Multiple Regulatory Agencies

Financial Innovation and the Growth of the Shadow Banking System

Responses to Changes in Demand Conditions: Interest Rate Volatility

# **Table of Contents**

Responses to Changes in Supply Conditions: Information Technology

E-Finance: Will Clicks Dominate Bricks in the Banking Industry?

E-Finance: Why Are Scandinavians So Far Ahead of Americans in Using Electronic Payments and Online Banking?

E-Finance: Are We Headed for a Cashless Society?

Securitization and the Shadow Banking System

Avoidance of Existing Regulations

Mini-Case: Bruce Bent and the Money Market Mutual Fund Panic of 2008

The Practicing Manager: Profiting from a New Financial Product: A Case: Study of Treasury Strips

Financial Innovation and the Decline of Traditional Banking

## **Structure of the U.S. Banking Industry**

Restrictions on Branching

Response to Branching Restrictions

## **Bank Consolidation and Nationwide Banking**

E-Finance: Information Technology and Bank Consolidation

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994

What Will the Structure of the U.S. Banking Industry Look Like in the Future?

Are Bank Consolidation and Nationwide Banking Good Things?

## **Separation of the Banking and Other Financial Service Industries**

Erosion of Glass-Steagall

The Gramm-Leach-Bliley Financial Services Modernization Act of 1999: Repeal of Glass-Steagall

Implications for Financial Consolidation

Mini-Case: The Global Financial Crisis and the Demise of Large, Free-Standing Investment Banks

Separation of Banking and Other Financial Services Industries Throughout the World

## **Thrift Industry**

Savings and Loan Associations

Mutual Savings Banks

Credit Unions

## **International Banking**

Eurodollar Market

Structure of U.S. Banking Overseas

Foreign Banks in the United States

## **Summary**

## **Key Terms**

## **Questions**

## **Web Exercises**

# **Table of Contents**

## **Chapter 20: The Mutual Fund Industry**

Preview

The Growth of Mutual Funds

The First Mutual Funds

Benefits of Mutual Funds

Ownership of Mutual Funds

Mutual Fund Structure

Open- Versus Closed-End Funds

Case: Calculating a Mutual Funds Net Asset Value

Organizational Structure

Investment Objective Classes

Equity Funds

Bond Funds

Hybrid Funds

Money Market Funds

Index Funds

Fee Structure of Investment Funds

Regulation of Mutual Funds

Hedge Funds

Mini-Case: The Long Term Capital Debacle

Conflicts of Interest in the Mutual Fund Industry

Sources of Conflicts of Interest

Mutual Fund Abuses

Conflicts of Interest: Many Mutual Funds Are Caught Ignoring Ethical Standards

Conflicts of Interest: SEC Survey Reports Mutual Fund Abuses Widespread

Government Response to Abuses

Summary

Key Terms

Questions

Quantitative Problems

Web Exercises

## **Chapter 21: Insurance Companies and Pension Funds**

Preview

Insurance Companies

Fundamentals of Insurance

# Table of Contents

Adverse Selection and Moral Hazard in Insurance

Selling Insurance

Mini-Case: Insurance Agent: The Customers Ally

## Growth and Organization of Insurance Companies

### Types of Insurance

Life Insurance

Health Insurance

Property and Casualty Insurance

Insurance Regulation

The Practicing Manager: Insurance Management

Screening

Risk-Based Premium

Restrictive Provisions

Prevention of Fraud

Cancellation of Insurance

Deductibles

Coinsurance

Limits on the Amount of Insurance

Summary

Credit Default Swaps

Conflicts of Interest: The AIG Blowup

### Pensions

Conflicts of Interest: The Subprime Financial Crisis and the Monoline Insurers

### Types of Pensions

Defined-Benefit Pension Plans

Defined-Contribution Pension Plans

Private and Public Pension Plans

Mini-Case: Power to the Pensions

### Regulation of Pension Plans

Employee Retirement Income Security Act

Individual Retirement Plans

### The Future of Pension Funds

Summary

Key Terms

Questions

Quantitative Problems

# **Table of Contents**

Web Exercises

## **Chapter 22: Investment Banks, Security Brokers and Dealers, and Venture Capital Firms**

Preview

Investment Banks

Background

Underwriting Stocks and Bonds

Equity Sales

Mergers and Acquisitions

Securities Brokers and Dealers

Brokerage Services

Securities Dealers

Mini-Case: Example of Using the Limit-Order Book

Regulation of Securities Firms

Relationship Between Securities Firms and Commercial Banks

Private Equity Investment

Venture Capital Firms

E-Finance: Venture Capitalists Lose Focus with Internet Companies

Private Equity Buyouts

Advantages to Private Equity Buyouts

Life Cycle of the Private Equity Buyout

Summary

Key Terms

Questions

Quantitative Problems

Web Exercises

## **Part Seven: The Management of Financial Institutions**

### **Chapter 23: Risk Management in Financial Institutions**

Preview

Managing Credit Risk

Screening and Monitoring

Long-Term Customer Relationships

Loan Commitments

Collateral

Compensating Balances

# Table of Contents

Credit Rationing

## Managing Interest-Rate Risk

Income Gap Analysis

Duration Gap Analysis

Example of a Nonbanking Financial Institution

Some Problems with Income Gap and Duration Gap Analyses

The Practicing Manager: Strategies for Managing Interest-Rate Risk

Summary

Key Terms

Questions

Quantitative Problems

Web Exercises

## Chapter 24: Hedging with Financial Derivatives

Preview

Hedging

Forward Markets

The Practicing Manager: Hedging Interest-Rate Risk with Forward Contracts

Interest-Rate Forward Contracts

Pros and Cons of Forward Contracts

Financial Futures Markets

Financial Futures Contracts

Following the Financial News: Financial Futures

The Practicing Manager: Hedging with Financial Futures

Organization of Trading in Financial Futures Markets

Globalization of Financial Futures Markets

Explaining the Success of Futures Markets

Mini-Case: The Hunt Brothers and the Silver Crash

The Practicing Manager: Hedging Foreign Exchange Risk with Forward and Futures Contracts

Hedging Foreign Exchange Risk with Forward Contracts

Hedging Foreign Exchange Risk with Futures Contracts

Stock Index Futures

Stock Index Futures Contracts

Following the Financial News: Stock Index Futures

The Practicing Manager: Hedging with Stock Index Futures

Options

# **Table of Contents**

Option Contracts

Profits and Losses on Option and Futures Contracts

Factors Affecting the Prices of Option Premiums

Summary

The Practicing Manager: Hedging with Futures Options

## **Interest-Rate Swaps**

Interest-Rate Swap Contracts

The Practicing Manager: Hedging with Interest-Rate Swaps

Advantages of Interest-Rate Swaps

Disadvantages of Interest-Rate Swaps

Financial Intermediaries in Interest-Rate Swaps

## **Credit Derivatives**

Credit Options

Credit Swaps

Credit-Linked Notes

Case: Lessons from the Global Financial Crisis: When Are Financial Derivatives Likely to Be a  
Worldwide Time Bomb?

Summary

Key Terms

Questions

Quantitative Problems

Web Exercise

Web Appendices

**Glossary**

**Index**

**Back Cover**