English for Financial Institutions

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By

Karol Siskind

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TO STUDENTS AND READERS

English for Financial Institutions can be used as a coursebook, self-study textbook, or lexicon/reference of financial English. It is suitable for students and readers whose level of English is upper-intermediate (CEFR level B2) or higher.

Who is this book for?

→ Employees of financial institutions (such as commercial and central banks, supervisory authorities, finance and economy ministries, government agencies, and persons seeking employment in these institutions) who use their native language at work, but wish to master the English terminology used in their field. In many institutions listed above, English language courses are organised for employees. This book will be an ideal coursebook for such English classes, for upper-intermediate and advanced levels;

→ Students of finance, banking, economics, etc. at colleges and universities – to be used as a coursebook or for self-study;

→ Persons looking for a self-study book to improve their knowledge of English financial terminology, their financial literacy or to have an authoritative reference book where they can research financial terms and phrases, and find clear and detailed information on topics they hear or read about in the media. In addition, all readers can benefit from learning terminology useful in everyday life, concerning e.g. banking, payment cards, insurance.

How does this book differ from other financial English textbooks?

→ The book presents a **comprehensive overview of the financial system** (financial institutions, markets, instruments, services, payment system, regulation and supervision), rather than narrow selection of topics found in most other financial English books;

→ It is **up-to-date**: it includes topics and developments that have come to the spotlight in recent years, such as cryptocurrencies, bailout and bail-in, the LIBOR scandal, quantitative easing, tax avoidance;

→ It includes **topics not found in any other financial English reference books** (e.g. hedge funds, pension funds, multilateral development banks, credit rating agencies, offshore financial centres).

Structure of the book

Each unit contains:

→ a text of around 1000 words, presenting the topic;

→ a "keyword" – a selected word particularly relevant to the topic; the word is explained in a separate box, to make it easy to memorise;

→ "Notes" with supplementary lexical or factual information;

→ two or three financial vocabulary exercises to help consolidate the terminology used in the text;

→ one or two general vocabulary exercises;

→ questions checking comprehension of the text;

→ discussion points, designed to stimulate discussion in the classroom, using the terminology appearing in the text;

→ "Direct Source Reading" – a text of around 500 words (concerning one of the sub-topics presented in the text), taken from publications of central banks, financial institutions, UK and US government institutions or agencies, international institutions; the purpose is to give readers the opportunity to read authentic texts, similar to those they might need to read for professional purposes. The text is accompanied by a comprehension exercise.

1. THE EURO

History

Before the idea of a common currency gained acceptance in Europe, considerable efforts were focused on dealing with currency *fluctuations*, a major economic headache that ensued after the collapse of the Bretton Woods system in 1971. The members of the European Economic Community (predecessor of the EU) decided to limit excessive exchange fluctuations by *pegging* the currencies to one another and the US dollar. The mechanism proved **unsustainable** and lasted only fifteen months. The next attempt at monetary cooperation was the European Monetary System (EMS), launched in 1979 and built on the concept of stable but adjustable exchange rates, defined in relation to the European Currency Unit (ECU) - a *currency basket* based on a weighted average of EMS currencies. The system functioned for twenty years and substantially reduced short-term *volatility* of exchange rates.

This success was an encouraging backdrop for the creation of a single European market, with the free movement of goods, people, capital and services across borders. In the late 1980s, most of the member states came to the view that harmonised macroeconomic and monetary policy, as well as a common currency, were necessary to realise the full potential of the single market. The procedures and timetable for the introduction of the common currency were laid down in the 1992 Maastricht Treaty on European Union. The treaty contained *provisions* – the convergence criteria (see Table 1) – that countries would have to meet to become members of the economic and monetary union (EMU). The criteria were designed to ensure that the single currency zone would be based on *sound* economic and monetary foundations.

On 31 December 1998, the conversion rates between the euro and the currencies of the participating Member States were irrevocably fixed. On 1 January 1999, the euro was introduced, replacing the ECU at par, that is, at a 1:1 ratio. The Eurosystem, composed of the European Central Bank and the national central banks of the euro area member states, took over responsibility for monetary policy in the new euro area. This was the beginning of a three-year transitional period during which the euro was used in cashless operations and for accounting purposes. For financial markets, this transition happened immediately — the ground was well prepared and trading in financial markets was conducted exclusively in euros.

On 1 January 2002, the greatest cash changeover in history took place. It was a tremendous logistic challenge that involved the banking sector, retailers, security firms and the general public. Thanks to thorough preparation, the changeover went very smoothly and was completed within two months. National banknotes and coins were withdrawn and ceased to be *legal tender* by the end of February 2002.

Benefits

Dealing with multiple currencies entails costs and makes price comparisons difficult. The single currency removes these disadvantages and brings benefits to both consumers and businesses.

- Foreign exchange transaction costs were eliminated, which in itself was a huge accomplishment when one considers that these costs were estimated at 20 to €25 billion per year in the EU.
- Before the euro, volatile interest rates meant unpredictable costs. With the euro, inflation has come down to a low and stable level, which also means low and stable interest rates. Consumer borrowing is less expensive and future repayments less uncertain, while businesses have more *incentives* for investment.
- The euro brings price *transparency* to the single market. Consumers and businesses can easily compare prices for goods and services across the EU. This has the effect of increasing competition among suppliers and keeping downward pressure on prices in the euro area.

- The costs of financial intermediation, such as bank *charges*, are lower. In the euro area as a whole, there are more banks and investment funds and thus there is more competition between them. Lower costs encourage more capital flows.

The euro in Europe and beyond

As of publication date, the euro is the official currency of 20 EU member states. Denmark negotiated an *opt-out* from the obligation to join. Sweden, despite being obliged by treaty, refuses to adopt the euro, and its citizens voted against the common currency in a referendum in 2003. Monaco, San Marino and the Vatican City adopted the euro as their national currency by virtue of agreements with the EU and may issue their own euro coins within certain limits. However, as they are not EU Member States, they are not part of the euro area. Kosovo and Montenegro in the Balkans also use the euro as a domestic currency without any agreements with the EU, following the tradition of the German mark, which had previously been the de facto currency in these areas. Outside Europe, the euro is legal tender in French overseas departments, such as Guadeloupe and Martinique. In addition, a number of currencies are pegged to the euro, as in the case of the Danish krone and the Bulgarian lev.

The euro is an attractive *reserve currency* for other countries. The share of the euro in official foreign exchange reserves held by central banks around the world stood at around 21% in 2023.

Appearance

Euro coins are *minted* in eight denominations, ranging in value from one cent to two euros. All coins have a common side (the reverse) featuring the denomination and a map of the euro area in the background. The national side bears an image specifically chosen by the country that issued the coin. Euro coins from any Member State may be freely used in any nation which has adopted the euro.

Euro banknotes are issued in denominations ranging from five to one hundred euros. The designs of both sides are uniform throughout the euro area and depict architectural styles from Europe's cultural history. All the structures represented on the banknotes are fictional syntheses of the relevant styles. Euro notes have advanced security features built into them, such as a hologram, watermark, security thread and a see-through number.

Notes

→ Like 'pound', 'dollar' and all other currency names in English, the word 'euro' is written in lower case with no initial capital. Where appropriate, it takes the plural 's' (as does 'cent').

→ In English-language use, like the dollar sign ($) and the pound sign (£), the euro sign (€) is generally placed before the figure, as is the abbreviation EUR.

→ One reason (and perhaps a major one) why the acronym ECU was not carried on for the common European currency in 1999 was the similarity in pronunciation of the German phrases *ein ECU* ("an ECU") and *eine Kuh* ("a cow").

→ The production and issuance of the €500 banknote was discontinued in April 2019, but it remains legal tender in the euro area.

Keyword: sustainability

"The mechanism proved unsustainable . . ."

Sustainability is a word used in several different contexts. Perhaps the most common is the ecological context, where it refers to the capacity of an ecosystem to maintain a balance. With regard to economic activity, it refers to the capacity to maintain economic growth without damaging the environment and depleting resources. This is often called sustainable development.

In a general sense, it means the ability to keep something (a state, system, etc.) in existence or function for an extended period of time.

Financial Vocabulary

1. *Match the words in italics from the text with the definitions*

1. _____ A foreign currency held by central banks and other major financial institutions as a means to pay off international debt obligations, or to influence their domestic exchange rate.
2. _____ Legally valid currency that may be offered in payment of a debt and that a creditor must accept
3. _____ To fix (e.g. a rate, price) at a certain level or within a certain range
4. _____ Financially secure or safe
5. _____ The ability to easily obtain information e.g. on prices
6. _____ Any factor (financial or non-financial) that enables or motivates a particular course of action
7. _____ The tendency to vary often and in an unpredictable manner
8. _____ A fee or payment
9. _____ A portfolio of specific amounts of individual currencies
10. _____ A condition or requirement specified in a legal instrument
11. _____ Variations in the value of a variable
12. _____ To make a coin out of metal
13. _____ To choose not to participate in something

2. *Use these words from the text to complete the sentences below*

cashless operations financial intermediation supplier capital flows ratio
denominations investment funds repayments

1. The _____ of government debt to GDP is one of the Maastricht convergence criteria.
2. In recent years _____ _____ to emerging markets have been increasing.
3. People who lose their jobs have may problems with their loan _____ .
4. Large _____ of banknotes are rarely used.
5. _____ _____ have become very common thanks to developments in technology.
6. Channelling funds from lenders to borrowers is called _____ _____ .
7. HP is a well-known _____ of office equipment.
8. _____ _____ usually invest in securities.

General Vocabulary

3. *Choose one correct answer*

1. To *cease* means to:
   a/ stop b/ start c/ continue

2. *irrevocable* means
   a/ for a certain time b/ in an effective way c/ impossible to change

3. When something is *depicted*, it is
   a/ listed b/ designed c/ presented

4. A *backdrop* is a
   a/ background b/ call-back c/ drawback

5. When something *ensues*, it
   a/ becomes worse b/ takes place c/ disappears

6. To *adopt* something means to
   a/ adjust it b/ accept formally c/ reject it

7. As an adjective, *uniform* means
   a/ varied b/ identical c/ formal

8. *Relevant* means important
   a/ in a practical sense b/ in a relative way c/ with regard to a certain matter

Questions

1. What was the ECU?
2. What are some of the advantages of having a common currency in Europe?
3. The text mentions the term *reverse*. What is the other side of a coin called in English?
4. How well do you know euro banknotes? Here's a little test: which architectural style is displayed on a €20 note? 1. Romanesque; 2. Gothic; 3. Renaissance.
5. Whose signature can you see on euro banknotes?

Discussion points

1. The EU's Single Market is based on four freedoms, i.e. four types of free movement; can you name all of them?
2. Do you know some arguments that have been used against having a common currency in the EU? Do you agree with them?
3. Look at the Maastricht convergence criteria below. Which of the criteria are known as *fiscal criteria*? Does your country have sound and sustainable public finances, according to the criteria? If a given country's 10-year government bond has a low yield (interest rate), what does this tell you about that country's economy?

The Maastricht convergence criteria:

What is measured	How it is measured	Convergence criteria
Price stability	Harmonised consumer price inflation rate	Not more than 1.5 percentage points above the rate of the three best performing Member States
Sound public finances	Government deficit as % of GDP	Reference value: not more than 3 %
Sustainable public finances	Government debt as % of GDP	Reference value: Not more than 60 %
Durability of convergence	Long-term interest rate	Not more than 2 percentage points above the rate of the three best performing Member States for 10-year government bonds
Exchange rate stability	Deviation from a central rate	Participation in ERM for two years without severe tensions

Direct source reading

INTERNATIONAL ROLE OF THE EURO

Although the euro was introduced for the benefit of the euro area population, it clearly also has implications for people and firms outside the euro area. Households, enterprises and governments outside the euro area can choose to use the euro in many of their daily economic and financial transactions. They may hold euro banknotes and coins, open bank accounts denominated in euros or take out bank loans in euros. They may issue financial instruments, such as bonds and notes, denominated in euros, invoice and pay in euros internationally. Authorities in third countries may also choose the euro as an anchor in their exchange rate regime or decide to invest part of their foreign exchange reserves in euros.

From a policy perspective, the Eurosystem has adopted a neutral stance on the international use of its currency. It does not pursue the internationalisation of the euro as a policy goal and neither fosters nor discourages its use by non-residents of the euro area. The currency's use outside the euro area's borders is and should remain the outcome of economic and financial developments, based on free private (and sometimes public) decisions. In any case, in a globalised world with deeply integrated and market-based financial systems, policy-makers have limited scope to influence the internationalisation of a currency, even if they want to do so. Deepening financial markets, fostering financial market integration, and promoting price stability are examples of policies that can indirectly promote the use of a currency abroad. For example, the use of a currency as a reserve currency appears to be related to such policies. But it is also clear that such policies have domestic, rather than international, objectives. The neutral policy towards the euro's international role does not imply a lack of interest by the Eurosystem. The ECB has monitored and analysed the international role of the euro and published the main findings in annual reviews from 2001 onwards.

These reviews have been marked by three broad themes. First, its role in international markets has increased somewhat over the years, but the pace of change has been gradual and appears to have levelled off in some market segments. Second, the international dimension is also partly driven by the euro area itself. Third, this role is geographically concentrated in the regions that are close to the euro area. From the start in 1999, the euro was "international" simply because it replaced 11 existing currencies. As a successor to the Deutsche Mark and the French franc, the euro was used immediately as a reserve currency by central banks and as an anchor for the exchange rate policy of some countries. However, the international role of the euro has grown beyond this legacy. For example, the current share of the euro in global official reserves is higher than the share of the sum of all legacy currencies of the euro – notably that of the Deutsche Mark – in global official reserves at the end of 1998, which was about 18%. In fact, according to the IMF, the share of the euro in global foreign exchange reserves with a known currency composition increased during the first five years of Economic and Monetary Union to around 25%. Since then, the euro's share has remained relatively stable. In response to its use as an international reserve currency, in January 2005 the Eurosystem introduced a framework for reserve management services for central banks and monetary authorities located outside the euro area as well as international organisations.

ECB Monthly Bulletin 10th Anniversary of the ECB (1998) (Reprinted with permission)

4. *Say if the sentences are true (T) or false (F).*

1. Countries outside the euro area may peg their currency to the euro.
2. The Eurosystem encourages the use of the euro outside the EU.
3. International use of the euro is the result of the ECB's policy decisions.
4. National governments may indirectly affect the euro's scope of use abroad.
5. The share of the euro in global currency reserves has been steady since 1999.
6. It took several years before the euro became a reserve currency.
7. The share of the euro is in global international currency reserves exceeds the Deutsche Mark's share just before the euro was introduced.
8. The Eurosystem provides assistance related to reserve management.

2. PAYMENT SYSTEMS

Structure

A payment system consists of the rules, procedures, instruments and technology that enable the transfer of funds between users of the system. Payment systems play a fundamental role in the economy by facilitating the exchange of goods and services. An essential component within such systems are payment service providers (PSPs), such as commercial banks or non-bank companies, who provide access to the system for the final users – the payer and payee.

To transfer funds between PSPs, a payment system requires an intermediary that operates an electronic network where payments are processed. One type of intermediary is a clearing house, usually established by a banking sector association in a given country. In the process of clearing that it performs, batches of payment orders are routed several times a day to the receiving PSPs with details of payments for their customers. The clearing house also calculates and transmits the *net positions* between PSPs to the settlement agent. This role is performed by the central bank, thanks to settlement accounts that each PSP holds there. The central bank makes adjustments in the settlement accounts, reducing or increasing the amount in a PSP's account depending on the net change.

In the second model, the central bank acts as an intermediary by operating a real-time gross **settlement** (RTGS) system. Its distinctive feature is that each payment order is settled individually upon its entry into the system in its entire (gross) amount, usually in a matter of seconds. RTGS systems used to handle a small number of high-value payments, but some central banks also make these systems available for retail payments.

Until recently, retail payment services normally took up to a few working days to *remit* funds to the end user. The introduction of instant payments in many countries, with the use of RTGS or other, dedicated systems, now offers the possibility of making funds immediately available to the payee.

Payment instruments

In order to carry out payment, the parties of a transaction must agree on a payment instrument. Cash has the advantage of instant finalisation of payment, however, its use has been steadily declining with the growing popularity of non-cash (cashless) instruments. The most frequently used are credit transfers, direct debits, cards and cheques.

Credit transfers (also called bank transfers or wire transfers) are instructions from the payer to debit his/her bank account and to credit the payee's account. One type of credit transfer is a standing order, which instructs the bank to pay a fixed amount at regular intervals to another bank account.

Direct debits are pre-authorised debits on the payer's bank account that are initiated by the payee. They are typically used to make recurring payments for utility bills, and unlike standing orders, which require the amounts to be fixed, direct debits can be used for varying amounts.

A cheque (or check in the US) is a signed written order from one *party* (the *drawer*) to another (the *drawee*, normally a bank), requiring the drawee to pay the indicated sum on demand to the drawer or to a third party specified by the drawer. The number of cheque payments has been declining to a point where they have almost disappeared in many countries, but continue to be widely used in the US and France. (Payment cards are discussed separately in the next unit)

Mobile payments

Mobile payments are an increasingly important segment of payments across the world. One popular tool for conducting such payments are payment apps for mobile devices. After registering one's credit/debit card, or bank account details, users can purchase goods, pay bills, transfer money (via *peer-to-peer payments*), or withdraw money from cash machines. Mobile payment apps may function on a standalone basis, or as an

integral part of a mobile wallet, i.e. a virtual wallet, which may also be used for storing electronic documents, such as tickets, boarding passes, ID cards, loyalty cards. Mobile wallet apps are often pre-installed on smartphones. Mobile devices can also be used for browser-based payments, where users visit an *e-commerce* website and make the payment using their card details.

Cross-currency payments

When carrying out a transaction that involves paying in a different currency than that in which the payer holds his/her account, it is necessary for the payer's bank to have a presence in the country of that currency. To facilitate such transactions, a system of correspondent banking was developed. Correspondent banks are authorised to act as an agent on behalf of a domestic bank, opening accounts in the local currency called *nostro accounts*. This allows banks to conduct business abroad and provide services to their clients without the expense of a physical presence.

Cross-currency payments also require a global financial messaging network that can exchange payment instructions between banks in different countries. The leading system of this type is SWIFT (Society for Worldwide Interbank Financial Communication), operating since 1977 as a bank-owned cooperative. SWIFT makes use of standardised bank addresses, known as BIC codes (Bank Identifier Code), which enable automated processing of payments.

Remittances

A remittance is a low-value transfer of money from individuals, migrant workers to their families who remain at home. As cross-currency payment services offered by banks are relatively expensive, and require the payee to have a bank account, a number of non-bank *entities* have become specialised in providing such services. Western Union, the most prominent remittance service provider, operates a global network of access points for paying and receiving funds.

Technological innovation has led to the development of new channels for remittances, e.g. using SMS messages which allow *beneficiaries* to withdraw the transferred amount at a cash machine. Card schemes have also entered the market with card-to-card transfer services. The remittance business has grown into a major industry, and for some countries, the inflow of remittances accounts for as much as one third of their GDP.

Notes

→ The terms *settle* and *settlement* are also used in a more general sense, e.g. in the phrase *to settle the bill*, which simply means "to pay the bill."

→ Instant payments are also known as fast payments or real-time payments.

→ In the context of payment instruments, the term *giro* is sometimes used. In a narrow sense, a *giro transfer* is a type of payment service traditionally provided in some European countries by post offices, which allows individuals to make payments and transfer funds. In a wider sense, the term *giro transfer* is used as a synonym of a credit transfer.

Keyword: **settlement**

" … *central banks act as intermediaries by operating a real time gross settlement system*"

Settlement is the completion of a payment transaction in a legal sense; it involves the transfer of funds carried out by a PSP to fulfil their obligations towards the counterparty PSP. It is worth noting that in some systems (called deferred settlement systems), the payee may receive the funds before settlement takes place.

Financial Vocabulary

1. *Match the words in italics with the definitions*

1. _____ A transfer of funds made from one person to another.
2. _____ A person to whom money is paid.
3. _____ The differences between assets and liabilities.
4. _____ The party directed to pay a cheque when it is presented for payment.
5. _____ A person or group participating in an action.
6. _____ A bank's deposit account held at another bank, usually a correspondent bank.
7. _____ Business organisations (corporations, partnerships, etc.)
8. _____ An institution that manages the settlement process.
9. _____ To transfer or send money.
10. _____ The party initiating a cheque.
11. _____ Buying and selling goods or services using the internet.

2. *Match the verbs and nouns*

1.	provide	a/	an order
2.	make	b/	on behalf
3.	debit	c/	a bill
4.	act	d/	funds
5.	operate	e/	services
6.	remit	f/	a network
7.	process	g/	an account
8.	settle	h/	an adjustment

3. *Complete the table, choosing RTGS or clearing house (CH) next to the feature*

Feature	**RTGS** or **clearing house (CH)**
1. batches of payments	
2. net positions calculated	
3. large value payments	
4. operated by banking sector	
5. individual payment orders	
6. gross amounts	
7. clearing	
8. operated by central bank	

General Vocabulary

4. *Choose one correct answer*

1. An *integral* part of something is essential for its … :
a/ value b/ quality c/ completeness

2. A *batch* is a(n):
a/ value b/ order c/ quantity, group or series

3. An *interval* is a:
a/ deposit b/ date c/ period of time between two events

4. *Instant* means
a/ immediate b/ temporary c/ permanent

5. If something is *recurring*, it is
a/ repeated b/ urgent c/ of low value

6. To *facilitate* means to make something:
a/ easier b/ possible c/ necessary

7. *Inflow* is a(n)
a/ amount b/ movement into a place c/ increase

Questions

1. What is the difference between clearing and settlement?
2. What are some tools for making mobile payments?
3. The text mentions *utility bills*. What kind of bills are they?
4. Can you name some non-bank payment service providers?

Discussion points

1. Do you think that cash will disappear one day?
2. Which mobile payment apps do you use?
3. Have you ever sent money abroad? How did you do it?
4. Why are cheques gradually disappearing in many countries?
5. Look at the table below. Describe the trends in different countries. In which countries are cheques still widely used?

Use of payment instruments by non-banks: number of transactions (millions, total for the year)

Credit transfers

	2006	2009	2012	2015	2018
France	2,617	2,789	3,097	3,358	4,037
Germany	7,262	5,830	6,151	6,000	6,453
Italy	1,066	1,204	1,261	1,360	1,450
Japan	1,362	1,414	1,499	1,582	1,647
Switzerland	619	703	928	976	1,035
UK	3,059	3,275	3,693	4,052	4,673
US	5,965	7,107	8,494	9,962	10,555

Cheques

	2006	2009	2012	2015	2018
France	3,827	3,302	2,805	2,239	1,747
Germany	109	57	34	21	10
Italy	454	335	276	209	152
Japan	134	96	77	64	51
Switzerland	1.5	0.7	0.3	0.2	n.a
UK	1,778	1,282	848	558	342
US	30,521	25,342	18,334	18,139	14,500

Source: *Statistics on payment and settlement systems in selected countries.* Bank for International Settlements (Reprinted with permission)

Direct source reading

THE FEDERAL RESERVE IN THE U.S. PAYMENTS SYSTEM

Fedwire Funds Service

The Fedwire Funds Service provides a real-time gross settlement system in which more than 9,500 participants are able to initiate electronic funds transfers that are immediate, final, and irrevocable. Depository institutions[1] that maintain an account with a Reserve Bank[2] are eligible to use the service to send payments directly to, or receive payments from, other participants. Depository institutions can also use a correspondent relationship with a Fedwire participant to make or receive transfers indirectly through the system. Participants generally use Fedwire to handle large-value, time-critical payments, such as payments to settle interbank purchases and sales of federal funds; to purchase, sell, or finance securities transactions; to disburse or repay large loans; and to settle real estate transactions. The Department of the Treasury, other federal agencies, and government-sponsored enterprises also use the Fedwire Funds Service to disburse and collect funds.

Fedwire funds transfers are processed individually, rather than in batches as Automated Clearing House (ACH) transfers are. The Federal Reserve uses secure, sophisticated data-communications and data-processing systems to ensure that each transfer is authorized by the sender and that it is not altered while it is under the control of a Reserve Bank. Although a few depository institutions use the telephone to initiate Fedwire payments, more than 99 percent of all Fedwire funds transfers are initiated electronically. The Federal Reserve processes Fedwire funds transfers in seconds, electronically debiting the account of the sending institution and crediting the account of the receiving institution. The Federal Reserve guarantees the payment, assuming any risk that the institution sending the payment has insufficient funds in its Federal Reserve account to complete the transfer.

Fedwire Securities Service

The Fedwire Securities Service provides safekeeping, transfer, and settlement services for securities issued by the Treasury, federal agencies, government-sponsored enterprises, and certain international organizations. The Reserve Banks perform these services as fiscal agents for these entities. Securities are safekept in the form of electronic records of securities held in custody accounts. Securities are transferred according to instructions provided by parties with access to the system. Access to the Fedwire Securities Service is limited to depository institutions that maintain accounts with a Reserve Bank, and a few other organizations, such as federal agencies, government-sponsored enterprises, and state government treasurer's offices (which are designated by the U.S. Treasury to hold securities accounts). Other parties, specifically brokers and dealers, typically hold and transfer securities through depository institutions that are Fedwire participants and that provide specialized government securities clearing services.

Fedwire securities are processed individually, in much the same way that Fedwire funds transfers are processed, and participants initiate securities transfers in the same manner, using either a computer connection or the telephone. When the Federal Reserve receives a request to transfer a security, for example

[1] In the US, a depository institution is a financial institution that makes loans and obtains its funds mainly through accepting deposits from the public.
[2] One of the twelve regional Federal Reserve Banks.

as a result of the sale of securities, it determines that the security is held in safekeeping for the institution requesting the transfer and withdraws the security from the institution's safekeeping account. It then electronically credits the proceeds of the sale to the account of the depository institution, deposits the book-entry security into the safekeeping account of the receiving institution, and electronically debits that institution's account for the purchase price. Most securities transfers involve the delivery of securities and the simultaneous exchange of payment, which is referred to as delivery versus payment.

National Settlement Service

The National Settlement Service allows participants in private-sector clearing arrangements to do multilateral funds settlements on a net basis using balances in their Federal Reserve accounts. The service provides an automated mechanism for submitting settlement information to the Reserve Banks. It improves operational efficiency and controls for this process and reduces settlement risk to participants by granting settlement finality for movements of funds on settlement day. The service also enables the Federal Reserve to manage and limit the financial risk posed by these arrangements because it incorporates risk controls that are as stringent as those used in the Fedwire Funds Service. Approximately seventy arrangements use the National Settlement Service—primarily check clearinghouse associations.

From *The Federal Reserve System. Purpose and Functions,* published by the Federal Reserve System (public domain)

Practice

5. *Answer the questions*

1. What are the similarities and differences between Fedwire and Fedwire Securities?
2. What is the role of the National Settlement Service?
3. Say if the sentences are true (T) or false (F)
   a) Fedwire Funds Service is only used by commercial banks.
   b) Fedwire is not an Automated Clearing House.
   c) The Federal Reserve may provide liquidity for Fedwire participants.
   d) Brokers and dealers are participants of Fedwire Securities.
   e) Corporate bonds may be transferred through Fedwire Securities.
   f) Commercial banks may settle their payments through the National Settlement Service.
   g) Cheques can be cleared through the NSS.

3. PAYMENT CARDS

Types of payment cards

A debit card is a payment card that is linked to a *deposit account* and allows the holder to withdraw funds from that account directly, at a cash machine, as well as indirectly, when a purchase is made. It is commonly **issued** by banks as part of a basic account package. In principle, use of a debit card is limited to the amount deposited in the account. However, some banks offer an optional or standard *overdraft facility*, subject to appropriate fees and interest.

A credit card provides revolving credit up to a specified limit according to the individual's *credit rating*. Credit cards offer the ability to either pay the purchase amount in full without incurring interest within a period of time called the *grace period* or to make regular monthly payments. If a monthly *balance* is not paid in full before the grace period is over, the card issuer can charge interest fees on the entire *outstanding* balance. Monthly payments can be greater but not less than the minimum payment based on the annual percentage rate (APR). Wealthy customers are offered so-called premium cards (gold, platinum, black, etc.) with benefits such as VIP access, concierge service and discounts on luxury products.

A charge card is a card that charges no interest but requires the holder to pay his/her balance in full upon receipt of the *statement*, usually on a monthly basis. The balance cannot be *rolled over* from one billing to the next and a penalty is charged if it is not paid in full. While similar to a credit card, the major benefit offered by a charge card is that it has much higher, often unrestricted, spending limits. For this reason, charge cards typically have higher requirements regarding credit rating and income.

Prepaid cards (also called stored-value cards) allow a set amount of money to be "loaded" onto a disposable card prior to use, or reloaded (recharged) multiple times. During a transaction, the purchase amount is withdrawn from the card's value. Closed system cards are only accepted by a single *merchant* (often performing the role of a gift certificate) or e.g. used in public transport systems, like the Oyster card in London. Open system prepaid cards are branded by a payment card company, which makes it possible for such cards to be processed similarly to traditional debit and credit cards. As a result, they are accepted at any merchant that accepts the brand on the card.

An electronic purse or wallet is a type of multipurpose prepaid card intended to facilitate small-value retail transactions. It is used in a number of countries as a substitute for cash at retail outlets, vending machines, car parks, ticket machines, etc. Another kind of prepaid card is the virtual card, which is specifically designed for use on the internet. Instead of a physical plastic card, the issuer generally provides details of a card account (number, expiry date, etc.) for online payments.

Card technologies

The traditional technology, in use since the 1970s, is a magnetic stripe at the back of a card, capable of storing data and read by physical contact when it is swiped through a point of sale (POS) terminal or inserted into a cash machine. Depending on the terminal, a *sales slip* is printed for signature or the card's personal identification number (PIN) is entered on the PIN pad.

A more sophisticated technology is the smart card (chip card), which has an embedded electronic chip that can store and process data. The cardholder's identity can easily be verified and information concerning withdrawals, sales, and bills can be processed immediately and transmitted to a central computer. Smart cards greatly improve the security of transactions and reduce the potential for *fraud*.

A contactless smart card (also known as a proximity card) is a card in which the chip communicates with the card reader through radio frequencies. Also used for purposes of identification and physical access control, these cards can be applied in public transport systems and as electronic purses. Major payment card companies, such as Visa and MasterCard, have introduced cards that make use of the technology.

Payment card networks

The success of payment card companies depends upon the creation of an extensive relationship with banks issuing the cards and merchants accepting them, which in turn guarantees availability of their services to customers. The most common type of payment card network currently in use is known as the four-party system. The four parties in the system are the consumer, the bank that issues the payment card to the consumer (the card issuer), the retail merchant, and the merchant's bank (the acquirer). The payment card company coordinates monetary transfers and the transmission of information between the issuing and acquiring sides. Examples include Visa, MasterCard, and all of the PIN debit networks.

Another type of network is the three-party system in which the credit card company itself both issues cards to consumers and provides card services to merchants. As a result, only three parties are involved in a card transaction: the consumer, the merchant, and the card company. Most payment cards in three-party networks are non-bank charge cards, issued by companies such as American Express, instead of a bank.

Various fees are involved in every payment card transaction. In a four-party system, an interchange fee is paid by the merchant's bank to the card issuer. The fee may take the form of a *flat fee* per transaction, a percentage of the purchase price, or a combination of the two. The interchange fee is generally passed on to merchants by their banks in the form of a merchant discount rate, i.e. a percentage of the merchant's sales volume. In a three-party system, the merchant pays the discount directly to the network.

As merchant discounts may be as high as 5%, some large retailers have developed a strategy to bypass the payment card network by issuing private cards, which can only be used at the retailer's outlets. The retailers offer the *incentive* of lower card costs to attract customers.

Notes

→ The two best-known card brands, Visa and MasterCard, previously functioned as a joint venture of banks on a membership basis, and therefore, were often called payment card *associations*. At present, both are publicly traded companies.

→ Concierge service offered by card companies generally refers to assistance provided with travel arrangements, shopping, car rental, etc.

→ A *cash machine* is also called a *cashpoint* or an *ATM* (Automated Teller Machine).

→ The verb *charge (for)* means to demand a certain amount as payment for something, while *charging a card* means loading it with a certain amount.

Keyword: **issue**

"It is commonly *issued* by banks …"

As a verb, *issue* can refer to distributing or circulating financial and payment instruments (e.g. banknotes, securities, payment cards). In a similar sense, it means publishing or distributing something, often in an official manner (e.g. *the government issued a warning*).

As a noun, *an issue* is a point or matter of discussion, debate, or dispute, as well as a problem or concern. It can also be a set or series of instruments listed above, or a single copy of a periodical (*the January issue of the magazine*).

Financial Vocabulary

1. *Match the words in italics with the definitions*

1. _____ The amount of a loan remaining to be paid.
2. _____ A factor that motivates or encourages.
3. _____ A retailer or service provider that accepts card payments.
4. _____ To renew a loan.
5. _____ A bank account that allows money to be deposited and withdrawn by the account holder.
6. _____ The period of time during which one is allowed to pay a credit card bill without incurring interest.
7. _____ The use of dishonesty or deception to gain material advantage.
8. _____ An amount owed to the card issuer.
9. _____ An evaluation of the ability to repay a loan.
10. _____ A single fixed fee regardless of usage.
11. _____ An arrangement with a bank which allows to withdraw funds in excess of the amount on deposit.
12. _____ A receipt or bill of sale.
13. _____ A list of transactions in a bank account.

2. *Choose from the list of features and match them with the appropriate type of card*

small-value transactions lower costs stored value deposit account
no physical card interest disposable or reloadable vending machine purchase
high spending limits grace period single retailer part of basic account package
only online payments balance paid in full

1. debit card		
2. credit card		
3. charge card		
4. prepaid card		
5. electronic purse		
6. virtual card		
7. private card		

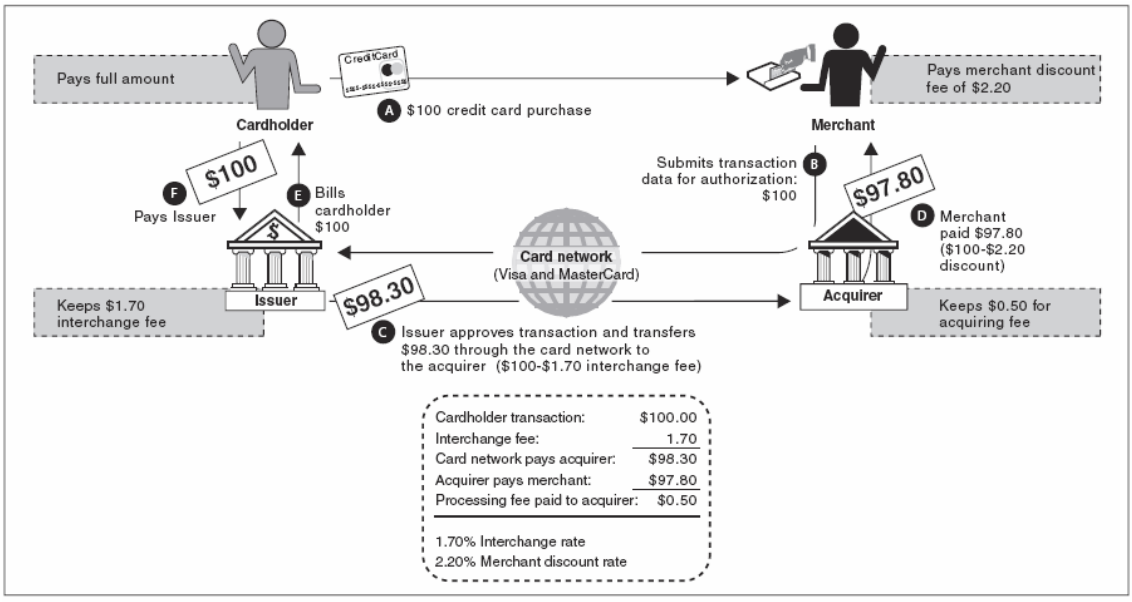
General vocabulary

3. *Fill in the missing words used in the text. The first letter is given.*

1. To s…….. means to slide a magnetic card through a reading device.
2. A place or shop where goods are sold is an o……... .
3. An e…….. network is one which is very wide.
4. If something is d……., it is thrown away after being used.
5. To b…….. means to avoid something by using an alternative route or channel.
6. E…….. is a synonym for *whole*.
7. Punishment for breaking a law or rule is a p…….. .
8. If something is e……., it is fixed in a surface or object.
9. A narrow piece of material is called a s…….. .
10. To s…….. means to keep something for later use.

Questions

1. What is the difference between a credit card and a charge card?
2. What is an open system prepaid card?
3. What is the role of a credit card company in a three-party network?
4. Why do some retailers issue private cards?
5. Describe the stages of a card transaction as presented below:



Source: US Government Accountability Office Report, November 2009

Discussion points

1. What type of payment cards do you use?
2. Experts urge consumers to use credit cards in a responsible way. What does this mean?
3. Is it possible to withdraw money from a cash machine using a credit card?

Direct source reading

SAMPLE CREDIT CARD AGREEMENT

Types of transactions

Credit may be obtained in the form of **Purchases, Balance Transfers**, and **Cash Advances**, by using cards, access cheques, account number, or other credit devices. Cards are all credit cards the Bank issues to you and any other person with authorization for use on this account pursuant to the present Agreement. An access cheque is a cheque the Bank provides to obtain credit on this account. All access cheques include an expiry date. We honour access cheques received for payment before the expiry date printed on the cheque, provided your account is open and in good standing, with available credit. Access cheques without a printed expiration date will not be honoured. Your credit card must be signed before it is used.

A **Purchase** is the use of your card or account number (including through the use of a mobile device) to: buy goods or services; buy wire transfers from a non-financial institution (Wire Transfer Purchase); make a transaction that is not otherwise a Cash Advance.

A **Balance Transfer is** a transfer of funds to another creditor initiated by the Bank at your request. A Balance Transfer does not include transactions that are otherwise a Cash Advance, except that any Direct Deposit completed at the time of your application for this account will be treated as a Balance Transfer.

A **Cash Advance** is the use of your account for a loan in the following ways:

1. **Direct Deposit:** by a transfer of funds through an ACH (Automated Clearing House) transaction to a deposit account initiated by the Bank at your request. A Direct Deposit does not include an Overdraft Protection Cash Advance or a Same-Day Online Cash Advance.

2. **Cheque Cash Advance:** by an access cheque you sign as drawer.

3. **Bank Cash Advance:** by loans accessed in the following manner:

   - **ATM Cash Advance:** at an automated teller machine;
   - **Over the Counter ("OTC") Cash Advance:** at any financial institution (e.g., to obtain cash, money orders, wire transfers, or travellers cheques), or at any non-financial institution (i.e., to obtain cash);
   - **Same-Day Online Cash Advance:** by a same day online funds transfer to a deposit account;
   - **Overdraft Protection Cash Advance:** by a transfer of funds to a deposit account pursuant to an overdraft protection program;
   - **Cash Equivalents:** by the purchase of money orders, travellers cheques or foreign currency from a non-financial institution, or person-to-person money transfers, bets, lottery tickets purchased outside the United States.

Paying interest

When applicable, interest accrues and compounds daily on new transactions, and balances remaining from previous billing cycles. Interest will continue to accrue even though the full amount of any related balances has been paid because the Bank includes any accrued but unpaid interest in the calculation of each Balance Subject to Interest Rate.

The Bank does not charge any interest on Purchases if the entire New Balance Total is always paid by the Payment Due Date. Specifically, you will not pay interest for an entire billing cycle on Purchases if you paid in full the two previous New Balance Totals on your account by their respective Payment Due Dates; otherwise, each Purchase begins to accrue interest on its transaction date or the first day of the billing cycle, whichever date is later.

The Bank starts accruing interest on Balance Transfers and Cash Advances on the transaction date. The transaction date for access cheques is the date the cheque is first deposited or cashed.

How to calculate variable rates

Variable Rates are calculated by adding together an index and a margin. This index is the highest U.S. Prime Rate as published in the "Money Rates" section of The Wall Street Journal on the last publication day of each month. An increase or decrease in the index will cause a corresponding increase or decrease in variable rates on the first day of your billing cycle that begins in the same month in which the index is published. An increase in the index means that you will pay higher interest charges and have a higher Total Minimum Payment Due.

Text based on extracts from credit card contracts

Practice

4. *Say if the following sentences are true or false.*

1. An access check is not valid without a printed expiry date.
2. You can pay for purchases using a balance transfer.
3. A cash advance makes it possible to purchase cash equivalents.
4. You can transfer money from your credit card account to a deposit account.
5. A direct deposit can only be made via an Automated Clearing House.
6. Access checks are used for check cash advances.
7. Interest is always charged on purchases during a billing cycle.
8. A reference rate published in a newspaper is used to calculate variable interest rates.

4. CRYPTOCURRENCIES

What are cryptocurrencies?

A cryptocurrency is a digital representation of value that relies on *cryptography* to ensure its functionality and security. Cryptocurrencies provide a means to make payments and transfer funds by using a decentralised *peer-to-peer* network that bypasses traditional bank intermediation. Since the creation of Bitcoin in 2009, the field of cryptocurrencies has expanded greatly, with over 16,000 in existence today.

Despite the reference to "currency" in their name, cryptocurrencies do not fulfil all the defining economic functions of money. Very few mainstream retailers accept cryptocurrencies, which limits their use as a *medium of exchange*. Cryptocurrencies are particularly vulnerable to volatility and fluctuation, which restricts their use as a store of value. And in turn, their unstable value makes it difficult to consider them as a reliable unit of account.

Cryptocurrencies do resemble **fiat currencies** in the sense that neither have any *intrinsic value*. However, the value of existing fiat currencies is backed by the creditworthiness of the central bank that issues them. The value of cryptocurrencies is solely based on what people are willing to pay for them in the market.

Blockchain and mining

Bitcoin and similar cryptocurrencies use blockchain technology to verify, update and store the record of transactions. A blockchain is a database that is shared across a network of computers. The smallest unit in that database is a block, which is a set of transactions conducted between the users of the cryptocurrency. A chain is then created from these blocks that contains the history of past transactions. Thus, a blockchain is like a *ledger* of all past transactions, with a new block acting as a new page where current transactions are recorded.

The whole process is possible thanks to members of the network, who validate transactions and arrange them into blocks – this activity is known as 'mining'. In order to add a new block to the chain, it is necessary to solve a computational problem – essentially guessing a very long, random number. The first 'miner' to find the solution announces it to others on the network, who verify the solution and the correctness of the transaction. The incentive for miners to be first is a financial reward in the form of transaction fees and newly created bitcoins (or other cryptocurrency).

In the early days of cryptocurrencies, mining could be performed competitively on standard desktop computers. But in recent years, the race for new bitcoins has led to the development of a whole new industry: so-called mining farms. Such a 'farm' is typically a warehouse where thousands of specialised processing units are linked together to increase the chances of success. The power consumption of such farms is so big that access to cheap electricity is a prerequisite for *profitability*. To compete with mining farms, individual miners can form pools to combine their computing power and split the mined cryptocurrencies between the pool members.

Bitcoin and altcoins

Bitcoin was launched by an anonymous developer and supported by a group of computer enthusiasts, keen on promoting a more transparent and equitable payment system. Its early popularity coincided with the global financial crisis, when a feeling of mistrust towards financial institutions was shared by many around the world. In 2011, Bitcoin attracted attention when it emerged that a notorious black market site selling drugs relied on the cryptocurrency's anonymity to function. Bitcoin's popularity rapidly accelerated when it became regarded as a profitable investment asset. Its price increased by 1,000% during the year 2017, which seemed a strong indication that a speculative bubble was growing. Bitcoin's value tumbled in early 2018, recovered in 2020 and proceeded to break new price records the following year. Another downturn in 2022 was sparked by rising interest rates, economic uncertainty and a string of high-profile bankruptcies. The volatility of cryptocurrencies continues to be very high.

Bitcoin's success has inspired competitors to create alternative cryptocurrencies, also known as altcoins. Many of them attempt to address some of Bitcoin's relative weaknesses. Thus, for example, altcoins may offer faster transactions, lower fees, larger amount of coins in circulation, or different mining methods. Several altcoins, such as Ethereum, XRP, and Binance Coin, have gained a considerable number of users and market share. Yet Bitcoin remains by far the most dominant cryptocurrency; it accounts for around 56% of total *market capitalisation*.

For normal users (as opposed to miners), the most popular way to obtain cryptocurrencies is purchasing them through online *exchange platforms*. However, cryptocurrencies cannot be deposited in a bank. They are held by their owners in a cryptocurrency wallet – a software application or hardware device that allows users to monitor their balance, send money and conduct other operations. Such a wallet stores the encryption keys used to digitally sign transactions, as well as the address of a particular asset on a blockchain.

Stablecoins

A stablecoin is a new type of cryptocurrency that attempts to overcome the main weakness of 'traditional' cryptocurrencies, i.e. significant price volatility. This is achieved by linking its value to a specified asset (e.g. the US dollar, cryptocurrencies, *precious metals*), or a basket of assets. This makes stablecoins potentially suitable for serving as a means of payment and store of value.

There are a few hundred stablecoins currently in existence, although they have not yet achieved a significant share of the cryptocurrency market. The most popular among them is Tether, which is *collateralised* primarily by US dollar reserves. It was launched in 2014 and has managed to maintain its position despite accusations of market manipulation, insufficient financial reserves, and lack of transparency.

Interest in this category of cryptocurrencies was amplified when social media giant Facebook announced in 2019 that it planned to create a stablecoin called Libra (later renamed Diem). Facebook's asserted aim was to provide a payment system accessible to anyone with a mobile phone.

Governments around the world criticised Facebook's project; its potentially global reach meant that Diem could have threatened national currencies. In addition, a wide range of concerns (security, consumer protection, potential money laundering, lack of regulation) remained unresolved, which is why the project failed – the association behind Diem sold its assets in early 2022. However, the threat of Libra/Diem, along with the gradual decline in cash payments, have prompted some central banks to explore the idea of creating their own digital currencies. As of 2023, several central banks (Nigeria, Jamaica, the Bahamas) have launched digital currencies. Other countries (e.g. China and India) have started pilot projects, with many more expected to follow.

Notes

→ Cryptocurrencies are often called *cryptos* for short.

→ "Bitcoin" is capitalised when referring to the entity or concept, while "bitcoin" is written in the lower case when referring to a quantity of the currency (e.g. "I bought 10 bitcoin") or the units themselves. The plural form can be either "bitcoin" or "bitcoins." Bitcoin's currency abbreviation is BTC.

→ New cryptocurrencies may be launched through an *initial coin offering*, or ICO. It is the first sale of a cryptocurrency to the public conducted for the purpose of raising funds.

→ In the world of cryptocurrencies, the terms *coins* and *tokens* are sometimes used interchangeably, but there is a technical difference. Coins operate on their own independent blockchain, while tokens are issued on existing networks and often give access to certain services (e.g. gaming tokens).