

## Finance Exam Revision:

**Security:** A financial contract that can be traded in a financial market (Debt + Equity)

**Risk:**

- **Credit Risk:** Risk that the borrower will not meet scheduled repayments (Default on loan obligations)
- **Shock:** E.g. GFC

**Information Asymmetry:** Parties that do not have equal access to information

**Moral Hazard:** Where one party does not act responsibly due to incentives

**Markets:**

- **Primary Markets:** The issuing of new securities
- **Secondary Markets:** Trading of existing securities
  - Provides liquidity (Enhances the securities value)
  - Price discovery (Investors that wish to issue securities know what prices to issue)

**Forms of finance:**

- **Debt:** Borrowed funds with agreed interest cost and repayment date (priority over equity payments e.g. dividends)
- **Equity:** Funds that acquire part ownership of a business (Riskier)
  - Paid dividends (cash received from holding shares)

**Financial Regulators:**

- **RBA:** Regulates monetary policy through interest rates and aim to maintain inflation at 2-3% over the business cycle
  - stability of the currency (low inflation rate)
  - Economic prosperity
  - To **increase** cash rate it sells securities -> reduction in funds in ESAs (since ADI's use ESA to buy securities) -> put upward pressure on cash rate to restore levels in ESA
- **Australian Securities and Investment Commission (ASIC):** Enforce economy and financial service law to protect consumers of financial services, investors and creditors.
- **Australian Prudential Regulation Authority (APRA):** Supervision of financial institutions
  - Provide help to improve bank improvement

**Financial Math's:**

- Prices of fixed interest security and their fixed yields move in opposite direction (Inverse relationship)
- **Annuity:** Series of equal payments (R) made at equal time intervals
- **House Loans:** Uses PVAF (Makes R payments that pay interest and principal)

**Perpetuities:** An annuity that does not end (e.g. value of shares)

**Payment System:**

Funds transferred between *Exchange Settlement Accounts (ESA)* with ADI's (Authority Deposit-taking institutions). 2 Steps Involved:

- **Clearing:** Institutions agree to the terms of a transaction
- **Settlement:** The exchange of money over the agreed terms

**Deferred Net Settlement:** Netting the payments and making them at the end of the day (Retail)