

Financial Institutions, Instruments & Markets

9TH EDITION



CHRISTOPHER VINEY
PETER PHILLIPS

BRIEF CONTENTS

PART 1	FINANCIAL INSTITUTIONS	1
Chapter 1	A modern financial system: an overview	3
Chapter 2	Commercial banks	41
Chapter 3	Non-bank financial institutions	87
PART 2	EQUITY MARKETS	129
Chapter 4	The share market and the corporation.....	132
Chapter 5	Corporations issuing equity in the share market.....	161
Chapter 6	Investors in the share market.....	191
Chapter 7	Forecasting share price movements.....	222
PART 3	THE CORPORATE DEBT MARKET	257
Chapter 8	Mathematics of finance: an introduction to basic concepts and calculations.....	259
Chapter 9	Short-term debt.....	287
Chapter 10	Medium- to long-term debt.....	315
Chapter 11	International debt markets.....	347
PART 4	GOVERNMENT DEBT, MONETARY POLICY, THE PAYMENTS SYSTEM AND INTEREST RATES	385
Chapter 12	Government debt, monetary policy and the payments system	388
Chapter 13	An introduction to interest rate determination and forecasting.....	417
Chapter 14	Interest rate risk measurement.....	453
PART 5	THE FOREIGN EXCHANGE MARKET	483
Chapter 15	Foreign exchange: the structure and operation of the FX market.....	485
Chapter 16	Foreign exchange: factors that influence the exchange rate	513
Chapter 17	Foreign exchange: risk identification and management.....	538
PART 6	DERIVATIVE MARKETS AND RISK MANAGEMENT	563
Chapter 18	An introduction to risk management and derivatives.....	565
Chapter 19	Futures contracts and forward rate agreements	594
Chapter 20	Options	626
Chapter 21	Interest rate swaps, cross-currency swaps and credit default swaps	663

CONTENTS

<i>Preface</i>	<i>xx</i>	<i>Text at a glance</i>	<i>xxv</i>
<i>About the authors</i>	<i>xxi</i>	<i>Connect</i>	<i>xxviii</i>
<i>Acknowledgments</i>	<i>xxi</i>	<i>Exploring finance on the web</i>	<i>xxx</i>
<i>Highlights of the ninth edition</i>	<i>xxii</i>	<i>Careers in finance</i>	<i>xxxii</i>

PART 1

FINANCIAL INSTITUTIONS

1

CHAPTER 1	A MODERN FINANCIAL SYSTEM: AN OVERVIEW	3
1.1	Theory and facts in finance	4
1.2	The financial system and financial institutions	6
1.3	Financial instruments	11
	1.3.1 Equity	11
	1.3.2 Debt	12
	1.3.3 Derivatives	12
1.4	Financial markets	13
	1.4.1 Matching principle	14
	1.4.2 Primary and secondary market transactions	14
	1.4.3 Direct finance and intermediated finance	16
	1.4.4 Wholesale and retail markets	20
	1.4.5 Money markets	20
	1.4.6 Capital markets	24
1.5	Flow of funds, market relationships and stability	27
	Case study: The next global financial crisis?	28
	<i>Master before you move on</i>	30
	<i>Extended learning A: The global financial crisis of 2008</i>	32
	<i>Extended learning B: The impact of the Asian financial crisis on the financial system</i>	35
	<i>Questions</i>	38
	<i>Key terms</i>	39
CHAPTER 2	COMMERCIAL BANKS	41
2.1	The main activities of commercial banking	43
2.2	Sources of funds	44
	2.2.1 Current account deposits	44
	2.2.2 Call or demand deposits	45
	2.2.3 Term deposits	45
	2.2.4 Negotiable certificates of deposit	45
	2.2.5 Bill acceptance liabilities	46
	2.2.6 Debt liabilities	46
	2.2.7 Foreign currency liabilities	47
	2.2.8 Loan capital and shareholders' equity	47

2.3	Uses of funds	48
	2.3.1 Personal and housing finance	48
	2.3.2 Commercial lending	50
	2.3.3 Lending to government	51
	2.3.4 Other bank assets	51
2.4	Off-balance-sheet business	52
	2.4.1 Direct credit substitutes	53
	2.4.2 Trade- and performance-related items	53
	2.4.3 Commitments	53
	2.4.4 Foreign exchange contracts, interest rate contracts and other market-rate-related contracts	54
	2.4.5 Volume of off-balance-sheet business	54
2.5	Regulation and prudential supervision of commercial banks	56
2.6	A background to the capital adequacy standards	57
2.7	The Basel accords: evolution from Basel I to Basel III	59
	2.7.1 Minimum capital adequacy requirement	59
	2.7.2 The definition of capital	60
	2.7.3 Basel III structural framework	60
	2.7.4 Basel III and bank liquidity	67
2.8	Liquidity management and other supervisory controls	69
	2.8.1 Other regulatory and supervisory controls	70
	Case study: Basel III reforms	71
	<i>Summary</i>	72
	<i>Extended learning A: The standardised approach to credit risk</i>	74
	<i>Extended learning B: Business continuity risk management</i>	77
	<i>Extended learning C: Corporate governance and ethics</i>	82
	<i>Questions</i>	84
	<i>Key terms</i>	85

CHAPTER 3

	NON-BANK FINANCIAL INSTITUTIONS	87
3.1	Investment banks	89
	3.1.1 Sources of funds and uses of funds	89
	3.1.2 Off-balance-sheet business	90
3.2	Managed funds	94
	3.2.1 Structure of the managed funds sector	95
	3.2.2 Sources and uses of funds	95
	3.2.3 Capital guaranteed funds	97
	3.2.4 Capital stable funds	97
	3.2.5 Balanced growth funds	97
	3.2.6 Managed growth or capital growth funds	97

3.3	Cash management trusts	98
3.4	Public unit trusts	99
3.5	Superannuation funds	101
	3.5.1 Sources of funds	102
	3.5.2 Defined benefit funds and accumulation funds	105
	3.5.3 Regulation	106
3.6	Life insurance offices	107
	3.6.1 Life insurance policies	108
3.7	General insurance offices	110
	3.7.1 General insurance policies	110
3.8	Hedge funds	112
3.9	Finance companies and general financiers	113
	3.9.1 Sources of funds and uses of funds	113
	3.9.2 Sector structure	114
3.10	Building societies	115
3.11	Credit unions	116
3.12	Export finance corporations	116
	Case study: The hedge fund sector	117
	<i>Master before you move on</i>	119
	<i>Extended learning: Project finance and structured finance</i>	121
	<i>Questions</i>	125
	<i>Key terms</i>	127

PART 2 EQUITY MARKETS

129

CHAPTER 4	THE SHARE MARKET AND THE CORPORATION	132
4.1	The nature of a corporation	134
	4.1.1 Advantages of the corporate form of business organisation	135
	4.1.2 Disadvantages of the corporate form of business organisation	135
4.2	The stock exchange	137
4.3	The primary market role of a stock exchange	138
4.4	The secondary market role of a stock exchange	140
4.5	The managed product and derivative product roles of a stock exchange	141
	4.5.1 Exchange traded funds	142
	4.5.2 Contracts for difference	143
	4.5.3 Real estate investment trusts (REIT)	144
	4.5.4 Infrastructure funds	144
	4.5.5 Options	144
	4.5.6 Warrants	145
	4.5.7 Futures contracts	145

4.6	The interest rate market role of a stock exchange	146
4.7	The trading and settlement roles of a stock exchange	148
4.8	The information role of a stock exchange	150
4.9	The regulatory role of a stock exchange	152
4.10	The private equity market	153
	Case study: Development of industrial scale blockchain in Australia	154
	<i>Master before you move on</i>	155
	<i>Questions</i>	159
	<i>Key terms</i>	160
CHAPTER 5	CORPORATIONS ISSUING EQUITY IN THE SHARE MARKET	161
5.1	The investment decision: capital budgeting	163
	5.1.1 Net present value	163
	5.1.2 Internal rate of return	165
5.2	The financing decision: equity, debt and risk	166
	5.2.1 Financial risk and the debt-to-equity ratio	167
	5.2.2 What is the appropriate debt-to-equity ratio?	168
5.3	Initial public offering	169
	5.3.1 Ordinary shares: limited liability companies	171
	5.3.2 Ordinary shares: no liability companies	171
5.4	Listing a business on a stock exchange	172
5.5	Equity-funding alternatives for listed companies	174
	5.5.1 Rights issue or share purchase plan	174
	5.5.2 Placements	175
	5.5.3 Takeover issues	176
	5.5.4 Dividend reinvestment schemes	176
	5.5.5 Preference shares	177
	5.5.6 Convertible notes and other quasi-equity securities	178
	Case study: Covenant-lite loans—risk implications	180
	<i>Master before you move on</i>	181
	<i>Extended learning: Australian Securities Exchange (ASX) listing rule requirements</i>	183
	<i>Questions</i>	188
	<i>Key terms</i>	190
CHAPTER 6	INVESTORS IN THE SHARE MARKET	191
6.1	Share-market investment	193
6.2	Buying and selling shares	196
6.3	Taxation	198
6.4	Financial performance indicators	201
	6.4.1 Capital structure	201
	6.4.2 Liquidity	201

6.4.3 Debt servicing	202
6.4.4 Profitability	203
6.4.5 Share price	203
6.4.6 Risk	205
6.5 Pricing of shares	206
6.5.1 Estimating the price of a share	207
6.5.2 Cum-dividend and ex-dividend share prices	208
6.5.3 Bonus share issues	209
6.5.4 Share splits	209
6.5.5 Pro-rata rights issues	210
6.6 Stock-market indices and published share information	211
Case study: Private equity firms, angel investors and exit strategies	215
<i>Master before you move on</i>	216
<i>Questions</i>	219
<i>Key terms</i>	221

CHAPTER 7

FORECASTING SHARE PRICE MOVEMENTS	222
7.1 Fundamental analysis: the top-down approach	224
7.1.1 International economies	225
7.1.2 The rate of growth of an economy	225
7.1.3 Exchange rates	226
7.1.4 Interest rates	227
7.1.5 The balance of payments current account	227
7.1.6 Inflationary pressures	228
7.1.7 Wages growth	229
7.1.8 Understanding the interrelationships of economic fundamentals	229
7.2 Fundamental analysis: the bottom-up approach	230
7.3 Technical analysis	232
7.3.1 Moving-averages models	232
7.3.2 Charting	235
7.4 Electronic trading	240
7.5 The random walk, efficient market and behavioural finance hypotheses	242
7.5.1 The random walk hypothesis	243
7.5.2 The efficient market hypothesis	243
7.5.3 The behavioural finance hypothesis	245
Case study: The effects of scandals on the market	249
<i>Master before you move on</i>	250
<i>Questions</i>	253
<i>Key terms</i>	255

PART 3

THE CORPORATE DEBT MARKET

257

CHAPTER 8

MATHEMATICS OF FINANCE: AN INTRODUCTION TO BASIC CONCEPTS AND CALCULATIONS

259

8.1	Simple interest	261
	8.1.1 Simple interest accumulation	262
	8.1.2 Present value with simple interest	263
	8.1.3 Calculation of yields	266
	8.1.4 Holding period yield	267
8.2	Compound interest	268
	8.2.1 Compound interest accumulation (future value)	269
	8.2.2 Present value with compound interest	271
	8.2.3 Present value of an annuity	272
	8.2.4 Accumulated value of an annuity (future value)	276
	8.2.5 Effective rates of interest	277
	Case study: The retirement dream	279
	<i>Master before you move on</i>	280
	<i>Questions</i>	283
	<i>Key terms</i>	286

CHAPTER 9

SHORT-TERM DEBT

287

9.1	Trade credit	289
9.2	Bank overdrafts	290
9.3	Commercial bills	292
	9.3.1 Features of commercial bills	292
	9.3.2 The flow of funds and bill financing	294
	9.3.3 Establishing a bill financing facility	295
	9.3.4 Advantages of commercial bill financing	296
9.4	Calculations: discount securities	297
	9.4.1 Calculating the price where the yield is known	297
	9.4.2 Calculating the face value where the issue price and yield are known	299
	9.4.3 Calculating the yield	299
	9.4.4 Calculating the price where the discount rate is known	300
	9.4.5 Calculating the discount rate	301
9.5	Promissory notes	302
	9.5.1 Establishing a P-note issue program	303
	9.5.2 Underwritten P-note issues	304
	9.5.3 Non-underwritten issues	304
9.6	Negotiable certificates of deposit	305

9.7	Inventory finance, accounts receivable financing and factoring	306
	9.7.1 Inventory finance	306
	9.7.2 Accounts receivable financing and factoring	306
	Case study: The demise of LIBOR?	308
	<i>Master before you move on</i>	309
	<i>Questions</i>	312
	<i>Key terms</i>	314

CHAPTER 10 MEDIUM- TO LONG-TERM DEBT 315

10.1	Term loans or fully drawn advances	317
	10.1.1 Term loan structures	317
	10.1.2 Loan covenants	319
	10.1.3 Calculating the instalment on a term loan	320
10.2	Mortgage finance	322
	10.2.1 Calculating the instalment on a mortgage loan	323
	10.2.2 Securitisation and mortgage finance	324
10.3	The bond market: debentures, unsecured notes and subordinated debt	325
	10.3.1 Debentures and unsecured notes	327
	10.3.2 Issuing debentures and notes	328
	10.3.3 Subordinated debt	329
10.4	Calculations: fixed-interest securities	330
	10.4.1 Bond price/yield relationship	330
	10.4.2 Price of a fixed-interest bond at a coupon date	330
	10.4.3 Price of a fixed-interest bond between coupon dates	332
10.5	Leasing	333
	10.5.1 Types of leases	334
	10.5.2 Lease structures	336
	Case study: The Kangaroo bonds and blockchain bond-i's	337
	<i>Master before you move on</i>	338
	<i>Extended learning: Securitisation</i>	341
	<i>Questions</i>	344
	<i>Key terms</i>	346

CHAPTER 11 INTERNATIONAL DEBT MARKETS 347

11.1	The euromarkets	349
11.2	Eurocurrency market	351
	11.2.1 Short-term bank advances	352
	11.2.2 Eurocurrency standby facilities	352
	11.2.3 Medium- to long-term eurocurrency bank loans	353
11.3	Euronote market	354
	11.3.1 Euronote issuance facility	354

11.3.2 Eurocommercial paper	356
11.3.3 Calculating the price of an NIF and an ECP	356
11.4 Eurobond market	357
11.4.1 Euro medium-term notes	357
11.4.2 Eurobonds	358
11.4.3 Issue and trading of eurobonds	359
11.4.4 Types of eurobonds	361
11.4.5 Calculating the price of fixed-interest euromarket securities	362
11.5 Markets in the USA	364
11.5.1 Commercial paper	364
11.5.2 US foreign bonds (Yankee bonds)	365
11.5.3 American depository receipts	366
11.6 Credit rating agencies	367
Case study: Supervision of rating agencies	371
<i>Master before you move on</i>	372
<i>Extended learning A: Novation, subparticipation and transferable loan certificates</i>	375
<i>Extended learning B: Convertible bonds and warrants</i>	376
<i>Extended learning C: US medium-term notes</i>	377
<i>Extended learning D: Standard & Poor's credit rating definitions</i>	379
<i>Questions</i>	381
<i>Key terms</i>	383

PART 4**GOVERNMENT DEBT, MONETARY POLICY, THE PAYMENTS SYSTEM AND INTEREST RATES****385****CHAPTER 12****GOVERNMENT DEBT, MONETARY POLICY AND THE PAYMENTS SYSTEM****388**

12.1 The Commonwealth Government borrowing requirement	390
12.1.1 The borrowing requirement: full financial year	390
12.1.2 The borrowing requirement: within the financial year	391
12.2 Commonwealth Government securities	392
12.2.1 Treasury bonds	392
12.2.2 Treasury notes	396
12.3 State government securities	399
12.4 Monetary policy	400
12.4.1 Open market operations	403
12.4.2 Impacts on financial system liquidity	404
12.5 The payments system	406
12.5.1 Exchange settlement accounts	407
12.5.2 Real-time gross settlement	408
12.5.3 Repurchase agreements (repos)	409
Case study: The new payments platform (NPP) in Australia and the risk of fraud	410
<i>Master before you move on</i>	411

<i>Extended learning: Fixed-coupon Treasury bonds: price calculation using the Australian Office of Financial Management (AOFM) formula</i>	413
<i>Questions</i>	414
<i>Key terms</i>	416

CHAPTER 13 AN INTRODUCTION TO INTEREST RATE DETERMINATION AND FORECASTING 417

13.1 The macroeconomic context of interest rate determination	419
13.2 The loanable funds approach to interest rate determination	423
13.2.1 The demand for loanable funds	425
13.2.2 The supply of loanable funds	426
13.2.3 Equilibrium in the loanable funds market	427
13.2.4 Loanable funds—an expected increase in the level of economic activity	428
13.2.5 Inflationary expectations in the loanable funds approach	429
13.3 The term structure of interest rates	431
13.3.1 The expectations theory	433
13.3.2 The segmented markets theory	435
13.3.3 The expectations approach versus the segmented markets approach	437
13.3.4 The liquidity premium theory	438
13.4 The risk structure of interest rates	441
Case study: The Reserve Bank’s balancing act	443
<i>Master before you move on</i>	445
<i>Extended learning: The yield curve and expectations theory calculations</i>	447
<i>Questions</i>	450
<i>Key terms</i>	452

CHAPTER 14 INTEREST RATE RISK MEASUREMENT 453

14.1 Interest rate risk	455
14.2 Exposure management systems	456
14.2.1 Forecasting	457
14.2.2 Strategies and techniques	457
14.2.3 Management reporting	458
14.3 Assets re-priced before liabilities principle	459
14.4 Pricing financial securities	460
14.4.1 Discount security pricing	460
14.4.2 Fixed-interest security pricing	461
14.5 Re-pricing gap analysis	462
14.6 Duration	464
14.7 Convexity	470
14.8 Interest rate risk management techniques	473
14.8.1 Internal techniques	474
14.8.2 External techniques	475

Case study: APRA and bear as risk management regimes in Australia	476
<i>Master before you move on</i>	477
<i>Questions</i>	480
<i>Key terms</i>	482

PART 5 **THE FOREIGN EXCHANGE MARKET** **483**

CHAPTER 15	FOREIGN EXCHANGE: THE STRUCTURE AND OPERATION OF THE FX MARKET	485
15.1	Exchange rate regimes	487
15.2	Foreign exchange market participants	488
	15.2.1 Foreign exchange dealers and brokers	489
	15.2.2 Central banks	489
	15.2.3 Firms conducting international trade transactions	489
	15.2.4 Investors and borrowers in the international money markets and capital markets	490
	15.2.5 Speculative transactions	490
	15.2.6 Arbitrage transactions	491
15.3	The operation of the FX market	492
15.4	Spot and forward transactions	493
15.5	Spot market quotations	494
	15.5.1 Asking for a quotation	494
	15.5.2 Two-way quotations	495
	15.5.3 Transposing spot quotations	497
	15.5.4 Calculating cross-rates	497
15.6	Forward market quotations	500
	15.6.1 Forward points and forward exchange contracts	500
	15.6.2 Some real-world complications	502
15.7	Economic and Monetary Union of the EU and the FX markets	505
	Case study: Fixed exchange rates and currency misalignments	506
	<i>Master before you move on</i>	507
	<i>Questions</i>	510
	<i>Key terms</i>	511
CHAPTER 16	FOREIGN EXCHANGE: FACTORS THAT INFLUENCE THE EXCHANGE RATE	513
16.1	The FX markets and an equilibrium exchange rate	515
	16.1.1 Demand for a currency	515
	16.1.2 Supply of a currency	515
	16.1.3 Equilibrium exchange rate	517
16.2	Factors that influence exchange rate movements	518
	16.2.1 Relative inflation rates	518
	16.2.2 Relative national income growth rates	520

16.2.3	Relative interest rates	521
16.2.4	Exchange rate expectations	524
16.2.5	Central bank or government intervention	525
16.3	Measuring exchange rate sensitivity to changes in economic variables	528
	Case study: Terrorist attacks and FX movements	530
	<i>Master before you move on</i>	531
	<i>Extended learning: Purchasing power parity</i>	533
	<i>Questions</i>	536
	<i>Key terms</i>	537

CHAPTER 17	FOREIGN EXCHANGE: RISK IDENTIFICATION AND MANAGEMENT	538
17.1	Foreign exchange risk policy formulation	540
17.1.1	Foreign exchange objectives	541
17.1.2	Management structure	541
17.1.3	Authorisations	542
17.1.4	Exposure reporting systems	543
17.1.5	Communications	543
17.1.6	Performance evaluation	543
17.1.7	Audit and review procedures	544
17.2	Measuring transaction exposure	545
17.2.1	Net cash flows	546
17.2.2	Transaction exposures: currency variability	548
17.2.3	Transaction exposures: currency correlations	549
17.3	Risk management: market-based hedging techniques	551
17.3.1	Forward exchange contracts	551
17.3.2	Money-market hedge to cover FX risk	553
17.4	Risk management: internal hedging techniques	555
17.4.1	Invoicing in the home currency	555
17.4.2	Creating a natural hedge	555
17.4.3	Currency diversification	556
17.4.4	Leading and lagging FX transactions	556
17.4.5	Mark-ups	557
17.4.6	Counter-trade and currency offsets	557
	Case study: FX risk management: Do companies hedge or speculate?	558
	<i>Master before you move on</i>	559
	<i>Questions</i>	561
	<i>Key terms</i>	562

PART 6

DERIVATIVE MARKETS AND RISK MANAGEMENT

563

CHAPTER 18	AN INTRODUCTION TO RISK MANAGEMENT AND DERIVATIVES	565
	18.1 Understanding risk	567
	18.1.1 Operational risks	567
	18.1.2 Financial risks	568
	18.2 The risk management process	570
	18.2.1 Identify operational and financial risk exposures	570
	18.2.2 Analyse the impact of the risk exposures	571
	18.2.3 Assess the attitude of the organisation to each identified risk exposure	571
	18.2.4 Select appropriate risk management strategies and products	572
	18.2.5 Establish related risk and product controls	572
	18.2.6 Implement the risk management strategy	572
	18.2.7 Monitor, report, review and audit	573
	18.3 Futures contracts	574
	18.4 Forward contracts	576
	18.4.1 Forward rate agreements	576
	18.4.2 Forward foreign exchange contracts	578
	18.5 Option contracts	579
	18.5.1 Call option profit and loss payoff profiles	580
	18.5.2 Put option profit and loss payoff profiles	581
	18.6 Swap contracts	582
	18.6.1 Interest rate swaps	583
	18.6.2 Cross-currency swaps	584
	Case study: Regulatory reforms and the ‘clearing’ of derivatives	586
	<i>Master before you move on</i>	588
	<i>Questions</i>	590
	<i>Key terms</i>	593
CHAPTER 19	FUTURES CONTRACTS AND FORWARD RATE AGREEMENTS	594
	19.1 Hedging using futures contracts	596
	19.2 Main features of a futures transaction	597
	19.2.1 Orders and agreement to trade	598
	19.2.2 Margin requirements	599
	19.2.3 Closing out of a contract	600
	19.2.4 Contract delivery	600
	19.3 Futures market instruments	601

19.4	Futures market participants	603
	19.4.1 Hedgers	603
	19.4.2 Speculators	603
	19.4.3 Traders	604
	19.4.4 Arbitrageurs	604
19.5	Hedging: risk management using futures	605
	19.5.1 Hedging the cost of funds (borrowing hedge)	605
	19.5.2 Hedging the yield on funds (investment hedge)	607
	19.5.3 Hedging a foreign currency transaction	608
	19.5.4 Hedging the value of a share portfolio	609
	19.5.5 Hedging against volatility	610
19.6	Risks in using futures contracts for hedging	612
	19.6.1 Standard contract size	612
	19.6.2 Margin payments	613
	19.6.3 Basis risk	614
	19.6.4 Cross-commodity hedging	614
19.7	Forward rate agreements	615
	19.7.1 Using an FRA for a borrowing hedge	617
	Case study: SPI futures market acts as a market-maker facilitating price discovery in the S&P/ASX 200 Index	619
	<i>Master before you move on</i>	620
	<i>Questions</i>	623
	<i>Key terms</i>	625

CHAPTER 20

	OPTIONS	626
20.1	The nature of options	628
20.2	Option profit and loss payoff profiles	629
	20.2.1 Call option profit and loss payoff profiles	629
	20.2.2 Put option profit and loss payoff profiles	632
	20.2.3 Covered and naked options	634
20.3	The organisation of the market	636
	20.3.1 International options markets	636
	20.3.2 The Australian options markets	637
20.4	Factors affecting an option contract premium	641
	20.4.1 Intrinsic value	641
	20.4.2 Time value	642
	20.4.3 Price volatility	642
	20.4.4 Interest rate levels	644
	20.4.5 Cap, floor and collar: an options cost-minimisation strategy	644
20.5	Option risk management strategies	645
	20.5.1 Single-option strategies	645
	20.5.2 Combined-options strategies	648

	Case study: The Black–Scholes option pricing model: The equation that can end the world?	657
	<i>Master before you move on</i>	659
	<i>Questions</i>	661
	<i>Key terms</i>	662
CHAPTER 21	INTEREST RATE SWAPS, CROSS-CURRENCY SWAPS AND CREDIT DEFAULT SWAPS	663
	21.1 Interest rate swaps	666
	21.2 Rationale for the existence of interest rate swaps	670
	21.2.1 Lowering the net cost of funds (comparative advantage)	670
	21.2.2 Gaining access to otherwise inaccessible debt markets	671
	21.2.3 Hedging interest rate risk exposures	671
	21.2.4 Lock in profit margins on business transactions	672
	21.3 Cross-currency swaps	673
	21.4 Rationale for the existence of currency swaps	676
	21.5 Credit default swaps	678
	21.6 Credit and settlements risk associated with swaps	681
	Case study: Naked credit default swaps: Two perspectives	683
	<i>Master before you move on</i>	684
	<i>Questions</i>	687
	<i>Key terms</i>	690
	Glossary	691
	Index	712