PROFESSIONAL ENGLISH by M. Belogash

UNIT 7
MEASURING BANK PERFORMANCE

7.1 Starting up

Inevitably, different stakeholders in a bank view performance from different angles. For example, depositors are interested in a bank's long-term ability to look after their savings; their interests are safeguarded by supervisory authorities. Debt holders, on the other hand, look at how a bank is able to repay its obligations; a concern taken up by rating agencies. Equity holders, for their part, focus on profit generation, i.e. on ensuring a future return on their current holdings of stocks. This focus is reflected in the valuation approaches of banks' analysts, who try to identify the fundamental value of the firm. Managers, too, seek profit generation, but are subject to principal-agent considerations and need to take employee requests into consideration. The view of bank consultancies might also encompass the internal struggle of managers.

Discuss the following points:

1. When asked about performance measures of banks, which of the following metrics would you consider to measure *profitability*?
- Revenue and cost changes
- Efficiency indicators (e.g. ROE, ROA)
- Asset quality indicators
- Liquidity indicators
- Capital adequacy indicators
- Other

2. Which groups of stakeholders in a bank seek information about each of the major characteristics of a bank's performance - efficiency, liquidity and solvency?

7.2 Look through the following vocabulary notes which will help you understand the text and discuss the topic.

a stakeholder	заинтересованная сторона
a debt holder	кредитор, держатель долгового инструмента
an equity holder	акционер
performance	деятельность, эффективность, рабочие характеристики
to supervise	контролировать, осуществлять надзор
supervisory	контролирующий
supervisory authorities	надзирающие органы
to repay obligations/debts/loans	погашать обязательства/долги/ссуды
repayment	погашение
a rating agency	рейтинговое агентство
a return on	прибыль/ доход от
a holding of stocks	пакет акций/владение акциями
a principal	директор, принципал, доверитель, основная сумма
an agent	посредник, агент
a consultancy	консалтинговая компания
revenue (Br. E.)	прибыль, доход
income (Am. E.)	прибыль, доход
cost	стоимость, затрата, издержка
efficiency	эффективность, рентабельность
liquidity	ликвидность
solvency	платежеспособность
capital adequacy	достаточность/адекватность капитала
income statement (Am.E.)	отчет о прибылях и убытках
profit and loss account (Be.E.)	отчет о прибылях и убытках
net profit (Br. E.)	чистая прибыль/доход
net income (Am. E.)	чистая прибыль/доход
operating income	операционный доход
interest income	процентный доход, доход от процентов

noninterest income	непроцентный доход
service charges	сбор за обслуживание
operating expenses	операционные затраты/расходы
interest expenses	процентные расходы/расходы по процентам
noninterest expenses	непроцентные расходы
salaries	зарплата служащих
employee benefit	соцпакет, допвыплаты служащим
premises	территория с прилегающими постройками
a provision for loan losses/ bad debt	резерв на потери по ссудам
gains	доходы, прирост
extraordinary	незапланированный, непредвиденный
income tax	подоходный налог, налог на прибыль
ongoing operations	текущие операции
off-balance-sheet	забалансовый
to incur expenses/debts/costs	понести издержки, производить расходы
a bank teller	кассир банка
a bank officer	сотрудник банка
to anticipate	предвидеть
anticipation	предвидение, прогноз
to add	добавлять
to subtract	вычитать
to divide	делить
to multiply	умножать
retained earnings	нераспределенная прибыль
return on assets (ROA)	показатель доходности активов, рентабельность активов
return on equity (ROE)	рентабельности собственного капитала, доход на акционерный капитал

net interest margin (NIM)	процентная чистая маржа
a measure	мера, критерий оценки
to measure	измерять
a spread	разница, маржа

7.3 Reading

Bank's Income Statement

To understand how well a bank is doing, we need to start by looking at a bank's income statement, the description of the sources of income and expenses that affect the bank's profitability.

The end-of-year 2006 income statement for all federally insured commercial banks appears in Table 1.

Table 1 Income Statement for All Federally Insured Commercial Banks, 2006.

	Amount ($ billions)	**Share of Operating Income or Expenses (%)**
Operating Income		
Interest income	548.0	71.6
interest on loans	411.6	53.8
interest on securities	79.0	10.3
other interest	57.4	7.5
Noninterest income	217.4	28.4
service charges on deposit accounts	35.7	4.7
other noninterest income	181.7	23.7
Total operating income	**765.4**	**100.0**
Operating Expenses		
Interest expenses	263.1	45.5
interest on deposits	173.1	29.9
interest on fed funds and repos	34.5	6.0
other	55.5	9.6
Noninterest expenses	290.2	50.1
salaries and employee benefits	133.3	23.0
premises and equipment	35.9	6.2

other	121.0	20.9
Provisions for loan losses	25.5	4.4
Total operating expense	**578.8**	**100.0**
Net Operating Income	**186.6**	
Gains (losses) on securities	(1.3)	
Extraordinary items, net	2.6	
Income taxes	- 59.5	
Net Income	**128.4**	

Operating Income Operating income is the income that comes from a bank's ongoing operations. Most of a bank's operating income is generated by interest on its assets, particularly loans. As we see in Table 1, in 2006 interest income represented 71.6% of commercial banks' operating income. Interest income fluctuates with the level of interest rates, and so its percentage of operating income is highest when interest rates are at peak levels. That is exactly what happened in 1981, when interest rates rose above 15% and interest income rose to 93% of total bank operating income.

Noninterest income is generated partly by service charges on deposit accounts, but the bulk of it comes from the off-balance-sheet activities, which generate fees or trading profits for the bank. The importance of these off-balance-sheet activities to bank profits has been growing in recent years. Whereas in 1980 other noninterest income from off-balance-sheet activities represented only 5% of operating income, it reached 23.7% in 2006.

Operating Expenses Operating expenses are the expenses incurred in conducting the bank's ongoing operations. An important component of a bank's operating expenses is the interest payments that it must make on its liabilities, particularly on its deposits. Just as interest income varies with the level of interest rates, so do interest expenses. Interest expenses as a percentage of total operating expenses reached a peak of 74% in 1981, when interest rates were at their highest, and fell to 45.5% in 2006 as interest rates moved lower. Noninterest expenses include the costs of running a banking business: salaries for tellers and officers, rent on bank buildings, purchases of equipment such as desks and vaults, and servicing costs of equipment such as computers.

The final item listed under operating expenses is provisions for loan losses. When a bank has a bad debt or anticipates that a loan might become a bad debt in the future, it can write up the loss as a current expense in its income statement under the "provision for loan losses" heading. Provisions for loan losses are directly related to loan loss reserves. When a bank wants to increase its loan loss reserves account by, say, $1 million, it does this by adding $1 million to its provisions for loan losses. Loan loss reserves rise when this is done because by increasing expenses when losses have not yet occurred, earnings are being set aside to deal with the losses in the future.

Provisions for loan losses have been a major element in fluctuating bank profits in recent years. The 1980s brought the third-world debt crisis; a sharp decline in energy prices in 1986, which caused substantial losses on loans to energy producers; and a collapse in the real estate market. As a result, provisions for loan losses were particularly high in the late 1980s, reaching a peak of 13% of operating expenses in 1987. Since then, losses on loans have begun to subside, and in 2006, provisions for loan losses dropped to only 4.4% of operating expenses.

Income Subtracting the $578.8 billion in operating expenses from the $765.4 billion of operating income in 2006 yields net operating income of $186.6 billion. Net operating income is closely watched by bank managers, bank shareholders, and bank regulators because it indicates how well the bank is doing on an ongoing basis.

Two items, gains (or losses) on securities sold by banks ($1.3 billion) and net extraordinary items, which are events or transactions that are both unusual and infrequent (insignificant), are added to the $186.6 billion net operating income figure to get the $187.9 billion figure for net income before taxes. Net income before taxes is more commonly referred to as profits before taxes. Subtracting the $59.5 billion of income taxes then results in $128.4 billion of net income. Net income, more commonly referred to as profits after taxes, is the figure that tells us most directly how well the bank is doing because it is the amount that the bank has available to keep as retained earnings or to pay out to stockholders as dividends.

7.4 Comprehension

7.4.1 Answer the questions using the active vocabulary.

1. What does a bank’s income statement describe?
2. How do federally insured commercial banks differ from those commercial banks which are not federally insured? Use the information from the Glossary.
3. What is operating income?
4. What is the major source of a bank’s operating income?
5. How does interest income fluctuate?
6. What is noninterest income?
7. What is the major source of a bank’s noninterest income?
8. What do you know about off-balance-sheet activities of a bank? (See Glossary)
9. How can you define the term ‘operating expenses’?
10. What does the amount of interest expenses depend on?
11. What do noninterest expenses include?
12. Why is it important for a bank to make provisions for loan losses?
13. When do loss reserves rise?
14. How are banks’ profits related to loan losses provisions?
15. How did a sharp decline in energy prices in 1986 affect provisions for loan losses?
16. What is net operating income? Is it the same as net income?
17. Why is net operating income closely watched by bank managers, bank shareholders, and bank regulators?
18. What is the difference between net operating income and net income before tax?
19. What are the uses of net income?
20. Does the Income Statement for All Federally Insured Commercial Banks for the year 2006 show gains or losses on securities?

7.4.2 Mark these statements T(true) or F(false) according to the information in the Text and Glossary. If they are false say why.

1. A bank’s income statement describes its sources of income and uses of income.
2. A bank’s income statement summarizes its revenues and expenses quarterly and annually for its fiscal year.
3. Operating income of a bank includes interest income, noninterest income, and extraordinary items.
4. The total of interest income is made up of interest on loans, securities and deposits.
5. Other noninterest income includes nominal fees for various services, such as requesting a deposit slip or counter check or notarizing a document.
6. Service charges on deposit accounts are account-related charges to customers which include non-sufficient funds fees, overdraft charges, late fees, over-the-limit fees, wire transfer fees, monthly service charges, account research fees and more.
7. Operating expenses include interest expenses, noninterest expenses, and losses on securities.
8. The excess of interest on loans over interest on deposits is the major element of a bank’s profit.
9. The fed funds and repos are banks’ short-term borrowings which are usually made to raise short-term capital.
10. Loan loss provisions would be a bank's equivalent of a manufacturing company's allowance for returns on goods sold.
11. Gains on securities are deducted from net operating income.
12. Losses on securities are deducted from net operating income.
13. Net operating income is closely watched by bank managers, bank shareholders, and bank regulators because it indicates how well the bank is doing at the end of the fiscal year.
14. Loan loss provision is also known as a "valuation allowance" or "valuation reserve".

15. Net income is found on a company's income statement and is an important measure of how profitable the company is over a period of time.
16. Retained earnings are distributed as dividends among shareholders.
17. According to the Income Statement of All Federally Insured Commercial Banks, 2006, the total of losses on securities was $1.3 billion.

7.5 Language practice

7.5.1 Match the English terms in the left-hand column with the definition in the right-hand column.

1	Rating agency	A	It refers both to a business's ability to meet its payment obligations, in terms of possessing sufficient liquid assets, and to such assets themselves.
2	Return on equity (ROE)	B	Income
3	Stakeholder	C	A measure of the difference between the interest income generated by banks or and the amount of interest paid out to their lenders, relative to the amount of their (interest-earning) assets.
4	Liquidity	D	The amounts reported by a company or individual as expenses for borrowed money.
5	Solvency	E	A measure of a firm's efficiency at generating profits from every unit of shareholders' equity
6	Efficiency	F	The portion of net income which is retained by the corporation rather than distributed to its owners as dividends.
7	Capital adequacy	G	A company's total earnings (or profit).
8	Net interest margin	H	A company that assigns credit ratings for issuers of debt obligations or

			servicers of the underlying debt.
9	Revenue	I	A loan where full repayment is questionable and uncertain.
10	Return on assets (ROA)	J	A tax levied on the income of individuals or businesses (corporations or other legal entities).
11	Net operating income	K	The use of resources so as to maximize the production of goods and services.
12	Noninterest expense	L	A person, group, organization, or system which affects or can be affected by an organization's actions.
13	Net income	M	A measure of capital which shows whether it can absorb losses without a bank being required to cease trading, or in the event of a winding-up.
14	Income tax	N	The degree to which the current assets of an individual or entity exceed the current liabilities of that individual or entity.
15	Interest expenses	O	Fixed operating costs that a financial institution must incur.
16	Doubtful loan	P	This number tells you how many dollars of earnings they derive from each dollar of assets they control.
17	Retained earnings	Q	A company's operating income after operating expenses are deducted, but before income taxes and interest are deducted.

7.5.2 Complete the following text using the suitable words or phrases from the box.

A	flow of funds	E	receiving interest
B	paying interest	F	rate they receive
C	rate they pay	G	take deposits
D	taking on the risks	H	generate profits

Banks ____(1)____ from savers, ____(2)____ on some of these accounts. They pass these funds on to borrowers, ____(3)____ on the loans. Their profits are derived from the spread between the ____(4)____ for funds and the ____(5)____ from borrowers. This ability to pool deposits from many sources that can be lent to many different borrowers creates the ____(6)____ inherent in the banking system. By managing this flow of funds, banks ____(7)____, acting as the intermediary of interest paid and interest received and ____(8)____ of offering credit.

7.5.3 Complete the texts. Replace the Russian words and phrases by the English equivalents.

Text 1

Measures of Bank Performance: Return on Assets (ROA)

Although ***чистая прибыль*** gives us an idea of how well a bank is doing, it suffers from one ***большой недостаток***: it does not adjust for the ***размер банка***, thus making it hard ***сравнить*** how well one bank is doing relative to another. A ***основной критерий оценки*** of bank ***прибыльности*** that corrects for the size of the bank is the ***показатель доходности активов*** (ROA), which divides the ***чистую прибыль банка*** by the ***сумму его активов***. ROA is a useful measure of how well a ***управляющий банка*** is doing on the job because it indicates ***насколько хорошо*** a bank's assets are being used ***чтобы генерировать прибыль***. At the beginning of 2006, the ***активы*** of all federally insured ***коммерческих банков*** amounted to $9,040 billion, so using the $114.2 billion net income figure ***из таблицы 1*** gives us a ***рентабельность активов*** of:

ROA=NET INCOME:ASSETS =114.2:9,040=0.0126=1.26%

Text 2

Measures of Bank Performance: Return on Equity (ROE)

Although ROA provides ***полезную информацию о прибыльности банка***, we have already seen that it is not what the

владельцы банка (equity holders) care about most. They are more concerned about ***как много*** the bank is earning on their ***вложение в собственный капитал***, an amount that is measured by the ***показателем рентабельности собственного капитала*** (ROE), the ***чистая прибыль*** per dollar of equity capital. At the beginning of 2006, ***собственный капитал*** for all federally ***застрахованных*** commercial banks was $912.7 billion, so the ROE was therefore:

ROE=NET INCOME:CAPITAL=114.2:912.7=0.1251=12.51%

Text 3

Measures of Bank Performance: Net Interest Margin (NIM)

Another commonly watched ***критерий оценки деятельности банка*** is called the ***процентная чистая маржа*** (NIM), the ***разница между*** interest income and ***процентными расходами*** as a percentage of ***общей суммы активов***:

NIM=(INTEREST INCOME - INTEREST EXPENSES):ASSETS

If a ***управляющий банка*** has done a good job of ***управление активами и пассивами*** so that the bank earns substantial ***доход от активов*** and has ***низкие затраты по своим обязательствам***, profits will be high. The ***маржа*** between the ***процентом заработанным*** on the bank's assets and the ***процентными затратами*** on its liabilities is exactly what the ***процентная чистая маржа*** measures. If the bank is able to ***мобилизовать средства*** with liabilities that have low interest costs and is able to ***приобрести активы*** with ***высоким процентным доходом***, the net interest margin ***будет высокой***, and the bank is likely to be ***высокоприбыльным***. If the ***стоимость процентов*** of its liabilities rises relative to the ***процента заработанного*** on its assets, the ***процентная чистая маржа*** will fall, and ***прибыльность банка*** will suffer.

7.5.4 Text for discussion.

a. Look up the dictionary for the meaning and pronunciation of the following words and word-combinations and use them to discuss the problems outlined in the text.

A trend; a sharp decline; poor bank performance; bank profitability; fairly stable; interest-rate movements; risky loans; to turn sour; to return to health.

b. Briefly scan the text and outline the list of major points.

c. Read the text more carefully and comment on the following items:

- the relationship between different measures of bank performance;
- the reasons for the weak performance of commercial banks and the fall in ROA and ROE in the late 1980s;
- the general trends in bank performance and state of bank health before the crisis.

Trends in Bank Performance Measures

Table 2 provides measures of return on assets (ROA), return on equity (ROE), and the net interest margin (NIM) for all federally insured commercial banks from 1980 to 2005.

Table 2. Measures of Bank Performance, 1980 - 2007.

Year	ROA (%)	ROE (%)	NIM (%)
1980	0.77	13.38	3.33
1989	0.50	7.92	3.58
1990	0.49	7.81	3.50
1991	0.53	8.25	3.60
1992	0.94	13.86	3.89
1993	1.23	16.30	3.97
2005	1.30	12.73	3.50
2006	1.28	12.31	3.31
2007	1.21	11.44	3.32

In the 1980s, both the ROA and ROE measures of bank performance move closely together and indicate that from the early to the late 1980s, there was a sharp decline in bank profitability. The rightmost column, net interest margin, indicates that the spread between interest income and interest expenses remained fairly stable throughout the 1980s and even improved in the late 1980s and early 1990s, which should have helped bank profits. The NIM measure thus tells us that the poor bank performance in the late 1980s was not the result of interest-rate movements.

The explanation of the weak performance of commercial banks in the late 1980s is that they had made many risky loans in the early 1980s that turned sour. The resulting huge increase in loan loss provisions in that period directly decreased net income and hence caused the fall in ROA and ROE.

Beginning in 1992, bank performance improved substantially. The return on equity rose to nearly 14% in 1992 and remained above 12% in the 1993–2005 period. Similarly, the return on assets rose from the 0.5% level in the 1990–1991 period to around the 1.2% level in 1993–2005. The performance measures in Table 2 suggest that the banking industry had returned to health by the year 2007.

7.6 Render the passage in English using the English equivalents of the italicized phrases given in Russian. Express the main idea of the passage in one sentence or entitle it.

Традиционные критерии оценки деятельности банка *сходны с теми* **(are similar to those)**, которые используются в других *отраслях* **(industries)**: показатель доходности активов и показатель рентабельности собственного капитала. *В дополнение к этому* **(in addition)**, *учитывая* **(given)** важность *посреднической функции* **(intermediation function)** для банков, *показатель* **(the measure of)** процентной чистой маржи также обычно *отслеживается* **(monitored by)** управляющими банка.

Показатель доходности активов – это чистая прибыль за год, поделенная *на общую сумму* **(by the total of)** активов. По казатель рентабельности собственного капитала – это самый популярный критерий оценки деятельности, так как он *непосредственно* **(directly)** *оценивает* **(assesses)** финансовый доход от капиталовложений акционеров; он *легко доступен* **(easily available)** аналитикам из финансовых отчетов, публикуемых банками; *он позволяет делать сравнения* **(it allows for comparison)** между различными банками.

Professional English
Unit 7 Reading Self – Control Test
Bank’s Income Statement

1. What is the main idea of the text?

(A) The description of the sources of a bank’s income.
(B) The description of expenses that affect the bank’s profitability.
(C) The reasons for generating profits or losses.
(D) The results of a bank’s performance at the end of an accounting period.

2. What is most likely the audience the text is addressed to?

(A) bankers
(B) finance students
(C) a bank’s shareholders
(D) bank employees

3. It can be derived from the text that income statement

(A) provides no information the stock investors need to become familiar with.
(B) shows the financial position of a bank on the last date of a fiscal year.
(C) provides the final net figure, as well as various others, which is of major interest to the investment community.
(D) shows the sources of income and uses of income.

4. It can be inferred from the text that operating income can be defined as

(A) the total of interest on loans, interest on securities and gains on securities.

(B) the total of interest income and noninterest income.

(C) the total of interest on loans, interest on securities and extraordinary items.

(D) taxable income.

5. Judging by what you have derived from the text, which do you think of the following defines the term ‘provisions for loan losses’?

(A) customer defaults

(B) the sale under a contract of all or part of the cash stream from a specific loan

(C) amounts set aside by banks to allow for any loss in the value of the loans they have offered

(D) the amount reported by a bank as an expense for loaned money

6. Judging by what you have derived from the text, how do you think ‘net operating income’ can be described?

(A) A measure of the difference between the interest income generated by banks or other financial institutions and the amount of interest paid out to their lenders.

(B) A bank’s operating income after operating expenses are deducted, but before income taxes are deducted.

(C) A company's total earnings (or profit).

(D) Money earned by lending out customers' deposits in the form of mortgages, small business loans, lines of credit, personal loans, student loans, etc.

7. It can be derived from the text that

(A) retained earnings are not distributed as dividends among shareholders.

(B) gains on securities are deducted from net operating income.

(C) income tax is an interest expense.

(D) losses on securities are added to net operating income.

8. It can be derived from the text that

(A) Operating expenses include interest expenses, noninterest expenses, and losses on securities.

(B) The total of interest income is made up of interet on loans, securities and deposits.

(C) the excess of interest on deposits over interest on loans is the major element of a bank's profit.

(D) The excess of interest on loans over interest on deposits is the major element of a bank's profit.

9. Which of the following statements would the author most probably disagree with?

(A) Other interest income includes nominal fees for various services, such as requesting a deposit slip or counter check or notarizing a document.

(B) A bank's net operating income equals operating income minus operating expenses.

(C) Adding gains (losses) on securities and net extraordinary items to net operating income and then subtracting taxes yields net income.

(D) Net income is profits after taxes.

10. What is most likely the subject of the extract which is missing from this text?

(A) Trading activities of a bank.

(B) Standard measures of bank performance.

(C) Generation of fee income.

(D) Off-balance-sheet activities of a bank.

Unit 7 Glossary

BAD DEBT: a debt that is not collectible and therefore worthless to the creditor. This occurs after all attempts are made to collect on the debt. Bad debt is usually a product of the debtor going into bankruptcy or where the additional cost of pursuing the debt is more than the amount the creditor could collect. This debt, once considered to be bad, will be written off by the company as an expense.

BANK FEES: many banks charge nominal fees for various services, such as requesting a deposit slip or counter check or notarizing a document. Bank fees generally constitute a major portion of revenue for the bank, particularly for regional and local branches. .

BASEL ACCORD: a set of agreements set by the Basel Committee on Bank Supervision (BCBS), which provides recommendations on banking regulations in regards to capital risk, market risk and operational risk. The purpose of the accords is to ensure that financial institutions have enough capital on account to meet obligations and absorb unexpected losses. The first Basel Accord, known as Basel I, was issued in 1988 and focuses on the capital adequacy of financial institutions. The capital adequacy risk, (the risk that a financial institution will be hurt by an unexpected loss), categorizes the assets of financial institution into five risk categories (0%, 10%, 20%, 50%, 100%). Banks that operate internationally are required to have a risk weight of 8% or less. The second Basel Accord, known as Basel II, is to be fully implemented by 2015. It focuses on three main areas, including minimum capital requirements, supervisory review and market discipline, which are known as the three pillars. The focus of this accord is to strengthen international banking requirements as well as to supervise and enforce these requirements.

CAPITAL ADEQUACY RATIO: a measure of a bank's capital. It is expressed as a percentage of a bank's risk weighted credit exposures.

$$CAR = \frac{\text{Tier One Capital} + \text{Tier Two Capital}}{\text{Risk Weighted Assets}}$$

This ratio is used to protect depositors and promote the stability and efficiency of financial systems around the world. Two types of capital are measured: tier one capital, which can absorb losses without a bank being required to cease trading, and tier two capital, which can absorb losses in the event of a winding-up and so provides a lesser degree of protection to depositors.

DOUBTFUL LOAN: a loan where full repayment is questionable and uncertain. Degree of repayment of loans in question range from a complete loss to uncertain loss unless corrective actions are taken. Doubtful loans are usually non-performing loans on which interest is overdue and full collection of principal is uncertain. A loan classified as doubtful has all the characteristics of a substandard loan and credit weakness making full collection questionable and improbable. Fifty per cent of loans classified as doubtful are deducted from adjusted bank capital in computing regulatory capital adequacy.

EMPLOYEE BENEFITS: are various non-wage compensations provided to employees in addition to their normal wages or salaries. In most countries, most kinds of employee benefits are taxable to at least some degree. Some of these benefits are: housing (employer-provided or employer-paid), group insurance (health, dental, life etc.) and other benefits. The purpose of the benefits is to increase the economic security of employees.

EXTRAORDINARY ITEMS: gains or losses included in a company's financial statements, which are infrequent and unusual in nature. These are usually explained further in the "notes to the financial statements." These are the result of unforeseen and atypical events. They are usually accounted for separately so they don't skew the company's regular earnings.

FEDERAL DEPOSIT INSURANCE: a law for commercial banks since 1933 as part of the Glass-Steagall Act, and for Savings and Loans (S&Ls) since 1934. The Federal Deposit Insurance Corporation (FDIC) and the Federal Savings and Loan Insurance Corporation (FSLIC) were both established in 1934. As initially conceived in the legislation, coverage was to be on a sliding scale, insuring 100 percent of the first $5,000 of deposits and progressively lower percentages of larger amounts. But this plan was never adopted, and 100 percent insurance was provided for only the first $2,500 per account. This was quickly increased to $5,000 in mid-1934 and, in a number of steps, to $100,000 per account in 1980. The insurance coverage was funded by a flat annual premium on banks, initially set at 0.5 percent of insured deposits. That was lowered shortly thereafter to 1/12 of 1 percent or less of total domestic deposits before being increased again in the late eighties to pay for the large losses then occurring.

FEE INCOME: revenue taken in by financial institutions from account-related charges to customers. Charges that generate fee income include non-sufficient funds fees, overdraft charges, late fees, over-the-limit fees, wire transfer fees, monthly service charges, account research fees and more. Credit unions, banks and credit card companies are types of financial institutions that earn fee income. Financial institutions earn a significant portion of their income from fees, also called non-interest income.

FED FUNDS: funds that banks borrow from the Federal Reserve for longer than a day, but generally less than 90 days. As a general rule, banks borrow term Fed funds when they need a temporary influx of cash, but still wish to benefit from a low interest rate. Because they are held for longer than the customary 24 hours, term Fed funds sometimes have higher interest rates than those held for shorter periods of time, though that rate is still much lower than an individual borrower could receive.

INCOME STATEMENT: is one of the three financial statements - the other two are the balance sheet and cash flow statement - with which stock investors need to become familiar. In the context of corporate financial reporting, the income statement summarizes a company's revenues (sales) and expenses quarterly and annually for its fiscal year. The final net figure, as well as various others in this statement, are of major interest to the investment community. Income statements come with various monikers. The most commonly used are "statement of income," "statement of earnings," "statement of operations" and "statement of operating results." Many professionals still use the term "P&L," which stands for profit and loss statement, but this term is seldom found in print these days. In addition, the terms "profits," "earnings" and "income" all mean the same thing and are used interchangeably.

INTEREST EXPENSE: the amount reported by a company or individual as an expense for borrowed money. In the U.K. it is called "interest payable". Interest is calculated as a percentage of the amount of debt for each period of time.

INTEREST INCOME: is money earned by lending out customers' deposits in the form of mortgages, small business loans, lines of credit, personal loans, student loans and by allowing customers to carry a credit card balance makes up another significant portion of financial institutions' income.

LIQUIDITY: is a measure of the ability of a debtor to pay his current debts as and when they fall due. It is usually expressed as a ratio or a percentage of current liabilities.

LOAN LOSS PROVISION: an expense set aside as an allowance for bad loans (customer defaults, or terms of a loan have to be renegotiated, etc). Also know as a "valuation allowance" or "valuation reserve". This would be a bank's equivalent of a manufacturing company's allowance for returns on goods sold.

LOAN – LOSS RESERVES: or loan-loss provisions, are amounts set aside by banks to allow for any loss in the value of the loans they have offered.

LOAN SALE: the sale under a contract (also called a secondary loan participation) of all or part of the cash stream from a specific loan, thereby removing the loan from the bank's balance sheet.

NET INCOME: a company's total earnings (or profit). Net income is calculated by taking revenues and adjusting for the cost of doing business, depreciation, interest, taxes and other expenses. This number is found on a company's income statement and is an important measure of how profitable the company is over a period of time.

NET INTEREST MARGIN (NIM): a measure of the difference between the interest income generated by banks or other financial institutions and the amount of interest paid out to their lenders (for example, deposits), relative to the amount of their (interest-earning) assets. It is similar to the gross margin of non-financial companies. It is usually expressed as a percentage of what the financial institution earns on loans in a time period and other assets minus the interest paid on borrowed funds divided by the average amount of the assets on which it earned income in that time period.

NET OPERATING INCOME (NOI): a company's operating income after operating expenses are deducted, but before income taxes and interest are deducted. If this is a positive value, it is referred to as net operating income, while a negative value is called a net operating loss (NOL). NOI is often viewed as a good measure of company performance. Some believe this figure is less susceptible than other figures to manipulation by management.

NET OPERATING LOSS (NOL): a period in which a company's allowable tax deductions are greater than its taxable income, resulting in a negative taxable income. This generally occurs when a company has incurred more expenses than revenues during the period. The net operating loss for the company can generally be used to recover past tax payments or reduce future tax payments. The reasoning behind this is that because corporations are required to pay taxes when they earn money, they also deserve some form of tax relief when they lose money.

NONINTEREST EXPENSE: fixed operating costs that a financial institution must incur, such as anticipated bad debt provisions. Noninterest expenses can include employee salaries and benefits, equipment and property leases, taxes, loan loss provisions and professional service fees. Companies will offset noninterest expenses by generating revenue through noninterest income. Employee compensation (salaries and benefits) typically comprise the largest portion of an institution's noninterest expenses. Usually these expenses relate to activities that are not associated with targeting customers to deposit funds in the bank.

NONINEREST INCOME: bank and creditor income derived primarily from fees. Examples of non-interest income include deposit and transaction fees, insufficient funds (NSF) fees, annual fees, monthly account service charges, inactivity fees, check and deposit slip fees, etc. Institutions charge fees that provide non-interest income as a way of generating revenue and ensuring liquidity in the event of increased default rates. Non-interest income makes up a significant portion of most banks' and credit card companies' revenue. In 2008 alone, credit card issuers took in over $19 billion in penalty-fee income alone – this includes late fees and over-the-limit fees, among others. The passage of the Credit Card Accountability, Responsibility and Disclosure (CARD) Act of 2009 included sweeping restrictions on credit card companies' ability to generate non-interest income.

NONOPERATING INCOME: the portion of an organization's income that is derived from activities not related to its core operations. Non-operating income would include such items as dividend income, profits (and losses) from investments, gains (or losses) incurred due to foreign exchange, asset write-downs and other non-operating revenues and expenses.

OFF-BALANCE-SHEET ACTIVITIES: bank activities that involve trading financial instruments and the generation of income from fees and loan sales, all of which affect bank profits but are not visible on bank balance sheets.

OPERATING EXPENSES: ongoing costs for running a product, business, or system. Operating expenses include: accounting expenses, license fees, maintenance and repairs, advertising, office expenses, supplies, attorney fees and legal fees, insurance, property management, property taxes, travel and vehicle expenses.

OPERATING INCOME: the amount of profit realized from a business's operations after taking out operating expenses - such as cost of goods sold or wages - and depreciation. These operating expenses are costs which are incurred from operating activities and include things such as office supplies and heat and power. Operating Income is typically a synonym for earnings before interest and taxes (EBIT) and is also commonly referred to as "operating profit" or "recurring profit".

PREMISES: land and buildings together considered as a property.

REPURCHASE AGREEMENT (REPO): a form of short-term borrowing for dealers in government securities. The dealer sells the government securities to investors, usually on an overnight basis, and buys them back the following day. For the party selling the security (and agreeing to repurchase it in the future) it is a repo; for the party on the other end of the transaction, (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement. Repos are classified as a money-market instrument. They are usually used to raise short-term capital.

RETAINED EARNINGS: the term refers to the portion of net income which is retained by the corporation rather than distributed to its owners as dividends. Similarly, if the corporation takes a loss, then that loss is retained and called variously retained losses.

RETURN ON ASSETS (ROA): a percentage which shows how profitable a company's assets are in generating revenue. This number tells you what the company can do with what it has, i.e. how many dollars of earnings they derive from each dollar of assets they control. It's a useful number for comparing competing companies in the same industry.

RETURN ON EQUITY (ROE): measures the rate of return on the ownership interest (shareholders' equity) of the common stock owners. It measures a firm's efficiency at generating profits from every unit of shareholders' equity (also known as net assets or assets minus liabilities).

ROE shows how well a company uses investment funds to generate earnings growth. ROEs between 15% and 20% are considered desirable.

SERVICE CHARGE: a type of fee charged to cover services related to the primary product or service being purchased. For example, a fee for using the ATM of a competing bank.

SOLVENCY: in finance or business, is the degree to which the current assets of an individual or entity exceed the current liabilities of that individual or entity. Solvency can also be described as the ability of a corporation to meet its long-term fixed expenses and to accomplish long-term expansion and growth.

TIER 1 CAPITAL: a term used to describe the capital adequacy of a bank. Tier I capital is core capital, this includes equity capital and disclosed reserves. Equity capital includes instruments that can't be redeemed at the option of the holder.

TIER 2 CAPITAL: a term used to describe the capital adequacy of a bank. Tier II capital is secondary bank capital that includes items such as undisclosed reserves, general loss reserves, subordinated term debt, and more.