
DICTIONARY
OF
BANKING
TERMS

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— THOMAS P. FITCH

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INTRODUCTION

by Ben Weberman

Banking industry changes have been roaring along in the decade of the 1980s without slowing in the '90s. Integration of business, along with diversification and technological advance, has been the hallmark of progress. Soon it will be difficult to differentiate a commercial bank from a savings institution or a securities firm. Concurrently, financial institutions have entered an era of product innovation unprecedented in history.

Banks can no longer be characterized as institutions that take deposits and make loans. In today's market, credits are arranged in a variety of ways to provide the basic seasonal capital or capital asset needs. As an example, banks are arranging senior debt, intermediate (or intermezzo) financing, and even subordinated credits. Mergers, leveraged buyouts, and takeovers can all be arranged through the banking system.

Meanwhile, computer-generated information is being used to set terms for interest rate swaps and currency swaps. Borrowers and lenders can more easily move between floating rate and fixed rate, between dollars or pounds or any other combination of exchanges. Balance sheet assets, once fixed and illiquid, are now securitized so participations can be sold to other institutions or to the public.

Lest it be forgotten, the sprawling, trillion-dollar mortgage market is the ancestor of securitization, and is well represented in the list of definitions. First there was pooling of residential mortgages for resale to investors. Then pools of mortgage loans were separated into tranches, with each tranche possessing different payment characteristics, through the medium of Collateralized Mortgage Obligations (CMOs).

CMOs and other derivative mortgage-backed securities (such as Interest Only and Principal Only securities) can trace their history to the creation of U.S. Treasury stripped bond issues. The first such securities were arranged by securities firms that bought large blocks of bonds and had a bank trustee separate all semiannual interest payments from the principal, or corpus.

Even as banks are leaping into new fields, they are also merging into larger institutions. Regional banking companies are crossing state lines to join with other institutions of similar size, creating super-regional banks. The competition between these super-regionals and money center banks is on an equal footing.

An entirely new range of banking organizations has arisen from efforts to support and retain the thrift industry. Many savings and loan associations are being merged out of existence, acquired by healthy savings institutions or by commercial banks. The Federal Savings and Loan Insurance Corporation (FSLIC) has had its existence terminated by Congress, but new supervisory organizations have arisen to regulate and indemnify the thrift industry.

The securities industry is experiencing the thrust of banks into its deepest confines through the securities subsidiaries of bank holding companies. Underwriting of corporate debt securities, formerly barred by the Banking Act of 1933—widely known as the Glass-Steagall Act—is no longer forbidden to commercial banks.

Deposit insurance is mostly responsible for these changes in banking. Prior to the Banking Act of 1933, which initiated federal insurance of bank deposits, banks were using their own assets to bail out failing corporate financings through purchase of securities for their own account. They thus established conditions for loss of confidence in the banking system. The backing of deposit insurance has prevented public loss of large sums even though institutions have failed, thus maintaining public confidence in banks and savings institutions.

While commercial bankers and investment bankers may debate the merits of whether loans or investments hold the greater risk, banking regulators, including the Federal Reserve Board, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation, are aligning with thrift regulators to create a wholly new set of capital rules. Banking institutions are being asked to post reserves whose size is determined by the risk of various categories of bank assets. Higher levels of capital are required for higher risk assets.

In sum, the banking system has been made over and the transition is not yet complete. A new industry has emerged. While most participants and observers are familiar with the terminology of what they have been doing, they have encountered new and strange worlds in other parts of their daily business lives.

This book is designed to provide a key source of information about all activities in banking, traditional as well as ones newly created. It will be of considerable value and benefit to the long time professional as well as the novice. Those interested in investment banking as well as commercial banking will find the book a necessity.

HOW TO USE THIS BOOK EFFECTIVELY

Alphabetization: All entries are alphabetized by letter rather than word, so that multiple-word terms are treated as single words. For example, **asset management account** follows **asset-liability committee (ALCO)**, **Dun & Bradstreet** follows **due-on-sale clause**, **goodwill** follows **good money**, and **selling group** follows **seller-servicer** and precedes **sell short**.

Many terms commonly used in banking have distinctly different meanings depending on the context in which they are used. Readers must determine the context relevant to their purpose. When a term has several entries, subentries are presented in alphabetical sequence. In some entries the various meanings are presented as simple numerical headings. Numbers in entry titles are alphabetized as if they were spelled out—for example **x.9** follows **x-mark**.

Abbreviations and Acronyms: A separate list of abbreviations and acronyms follows the Dictionary. It contains a shortened version of terms defined in the book, plus related business terms.

Cross-References: To add to your understanding of a term, related, or contrasting terms are sometimes cross-referenced. The cross-referenced terms will appear in SMALL CAPITALS either in the body of the entry (or subentry) or at the end of the definition. These terms will be printed in SMALL CAPITALS only the first time they appear in the entry. When a term is fully defined by another term, a reference rather than an entry is provided; for example, **community bank** see INDEPENDENT BANK.

Italics: Italic type is used to indicate that another term has a meaning identical or very closely related to that of the entry. Italic type is also used to highlight words or phrases that have a special meaning to the trade. Italics are also used for the titles of publications.

Parentheses: Parentheses are used in entry titles for two reasons. The first is to indicate that a word or phrase has a meaning so closely related to the term defined that only one entry is necessary; for example **capital gain (or loss)**. The second is to indicate that an abbreviation is used with about the same frequency as the term itself. For example: **certificate of deposit (CD)**, or **Federal Deposit Insurance Corporation (FDIC)**.

Examples, Illustrations, and Tables: The examples in the Dictionary are designed to help readers gain understanding and to help them relate abstract concepts to the real world of banking. Line drawings are presented in some entries in addition to text to clarify concepts best understood visually. Tables supplement definitions where essential detail is more effectively condensed and expressed in tabular form; for example, an AMORTIZATION SCHEDULE shows how a loan is paid down through regular payments of principal and interest.

Special Definitions: Some entries are given expanded treatment to enhance their reference value. Examples are **Depository Institutions Deregulation & Monetary Control Act of 1980** and **Financial Institutions Reform, Recovery & Enforcement Act of 1989**. Organizations and associations that play a role in the industry are included in the Dictionary along with a brief statement of their mission.

A

AAA highest rated corporate or municipal bond, with full payment of principal and interest expected at maturity. Bonds rated AAA, AA, A, and BBB by Standard & Poor's, and Bbb or better by Moody's Investors Service, are considered investment grade bonds, eligible for purchase by banks and savings institutions as INVESTMENT SECURITIES. See also BOND RATING.

abandonment voluntary surrender of property, or a right to property, without attempting to reclaim it or name a successor. In most states, ownership of abandoned property reverts to the party holding a prior interest, or to the state if no owner is found. In bankruptcy law, abandonment is a means for returning collateral to secured creditors, provided the bankruptcy trustee agrees. See also DORMANT ACCOUNT; ESCHEAT.

ABA transit number Numerical Transit System of two-part coding assigned to banks and savings institutions by the AMERICAN BANKERS ASSOCIATION. The first part shows the city, state, or territory where a bank is located; the second part (separated by a hyphen) identifies the bank itself. The ABA number is the numerator of a fraction appearing in the upper right corner of a check; the denominator is the bank's CHECK ROUTING SYMBOL, identifying the FEDERAL RESERVE BANK clearing checks drawn on that bank and funds availability. Every depository financial institution in the United States has a unique transit number, assigned from a list of ABA numbers maintained by Rand McNally & Co. of Chicago. See also BANK IDENTIFICATION NUMBER; MAGNETIC INK CHARACTER RECOGNITION.

ability to pay capacity to meet future obligations from earnings or income.

1. **Banking.** A borrower's capacity to make principal and interest payments from disposable income. When making loans, lenders look closely at a credit applicant's current salary and expected future earnings, and at an organization's CASH FLOW

from conversion of assets into cash. See also BALANCE SHEET RATIOS; FIVE C's OF CREDIT; QUALIFYING RATIO.

2. **Securities, municipal bonds.** The issuer's capacity to generate sufficient income from taxes or other sources, based on property taxes, bond rating, and so on.
3. **Finance.** The ability to meet DEBT SERVICE payments on bonds and other long-term obligations.

above par price of a stock or bond above its face value. Most bonds have a par value of \$1,000 or \$5,000. Bond prices are expressed in terms of a 100 scale (100 = par or face value). A \$1,000 bond priced at 105 is 105% of \$1,000 or \$1,050. The value above par is the PREMIUM value. The par value for stocks is vastly different than for bonds. Most stocks have no par value at all, or have a nominal value (for example, 10 cents per share) that has no relation to market or book value, unless the issuer is near failure. See also AT PAR; PAR VALUE.

absolute priority rule see BANKRUPTCY.

absolute title clean title, free of liens or attachments, replacing all previous titles. Accepted as the sole document of title, it is defensible against claims by third parties.

abstraction of bank funds wrongful taking of bank funds from a teller's cash drawer, escrow account, or trust account for unauthorized use, in violation of a bank's responsibility as a FIDUCIARY. Also called DEFALCATION or EMBEZZLEMENT.

accelerated cost recovery schedule (ACRS)
see ACCELERATED DEPRECIATION.

accelerated depreciation accounting method of reducing the book value of an asset at a higher rate than comparable methods in the early years of ownership. It is based on the theory that an asset's value is highest during its early years, when it is new and has greater earnings potential than in subsequent years. Since 1981, the most common form of accelerated depreciation is the accelerated cost recovery system (ACRS), which later was modified by the TAX REFORM ACT OF 1986. The Internal Revenue Service must approve accelerated methods of depreciation, which are arithmetically more complicated than

straight line asset depreciation allocating an equal portion of the asset value to each year. Accelerated depreciation also has the undesirable effect of reducing income in the early years, although offsetting advantages include the deferral of taxes until later years. Under ACRS, depreciation is more a method of allocating costs over multiple accounting periods than an attempt to match costs with income. Previous methods of accelerated depreciation included the declining balance method and the sum-of-the-years digits method.

acceleration clause clause in a bond mortgage, bond, or promissory note stating that the unpaid balance is due and payable if specified conditions of default, defined in a loan COVENANT or bond INDENTURE, should occur. Acceleration, at the option of the lender, calls for immediate payment of the remaining balance, plus interest due, if the borrower fails to make timely payments, maintain insurance on mortgaged property, pay property taxes, and so on.

acceptance promise to pay created when the drawee of a TIME DRAFT stamps or writes the word "accepted" above his signature and a designated payment date. Once accepted, the draft is the equivalent of a promissory note; the drawee becomes the ACCEPTOR, and is obligated to pay the amount shown at maturity. Acceptances are NEGOTIABLE INSTRUMENTS, which means they can be sold to another holder before maturity.

1. **Banking.** A time draft accepted by a bank, known as a BANKER'S ACCEPTANCE. It is used primarily in financing international trade, for example, an overseas manufacturer selling goods to an importer, although a domestic acceptance is not uncommon. See also DOCUMENTARY CREDIT; THIRD COUNTRY ACCEPTANCE.
2. **Finance.** Trade acceptance issued by a finance company affiliated with a manufacturer, for example, General Motors Acceptance Corp. or by an importer acting as agent for a manufacturer. It is often backed by a bank LETTER OF CREDIT.

acceptor person or party, normally the DRAWEE, who accepts a bill of exchange or TIME DRAFT, and becomes responsible for payment at maturity to the party named in the draft.

access

1. right to use banking services. Specifically, the right to make deposits to, or withdrawals from, a checking or savings account, verify an account balance, use a safe deposit box, or make electronic transfers using a bank card or other ACCESS DEVICE.
2. bank card organization in Great Britain formed in 1972, a member of MASTERCARD INTERNATIONAL and Eurocard.

access device bank card or personal security code giving consumers the means to make deposits, withdraw funds, transfer funds, or pay bills electronically. As defined by Federal Reserve Board Regulation E, an access device is any DEBIT CARD, PERSONAL IDENTIFICATION NUMBER, telephone transfer code, or telephone bill payment code used by a consumer to initiate an electronic transfer of funds. Financial institutions may issue an access device only at the consumer's request.

accommodation endorser person who endorses a PROMISSORY NOTE as a favor to the borrower, without compensation or benefit. An endorser or cosigner's signature enables the borrower to qualify for credit, or to obtain credit at more favorable terms. The endorser is a GUARANTOR or surety, and remains secondarily liable in event of default. Accommodation endorsements are widely used in banking. A parent company may endorse the bank loan of a subsidiary; banks sometimes endorse the ACCEPTANCE of other banks to make these instruments more readily marketable in the SECONDARY MARKET. See also CO-MAKER.

accommodation paper PROMISSORY NOTE or NEGOTIABLE INSTRUMENT signed by a third party, who acts as accommodation maker, endorser, or party. Banks, before advancing funds to corporations of uncertain credit strength or to closely held corporations, often require corporate officers to personally guarantee repayment of bank loans by endorsing the note evidencing the loan. See also ACCOMMODATION ENDORSER.

account contractual relationship between two parties involving an exchange of funds at a later date, as between buyer and seller, or an agreement by one party to hold funds in trust for the

other. It also is the continuously updated record of transactions, yielding the current balance, or AVAILABLE BALANCE. For example, a charge account, checking account, or trust account.

1. **Accounting.** A bookkeeping entry in a ledger. Examples are accounts receivable, accrued interest, allowance for bad debt.
2. **Banking.** (1) A record evidencing funds on deposit under a particular name or ACCOUNT NUMBER, including a checking account, also called a DEMAND DEPOSIT account, which pays no interest but allows the account holder to withdraw funds by writing checks; a NEGOTIABLE ORDER OF WITHDRAWAL (NOW) account, a check-like account that pays interest; a PASS-BOOK account, a savings account with no specified maturity; and a TIME DEPOSIT account, which pays interest on funds deposited for specified periods (7 days up to seven years or more), and is subject to an EARLY WITHDRAWAL PENALTY if funds are taken out before the maturity date. The MONETARY CONTROL ACT of 1980 phased out deposit interest ceilings by March 1986, allowing banks and thrifts to pay competitive rates on savings accounts, sharply reduced penalties for early withdrawal, but maintained the prohibition on paying interest on checking accounts. See also ALL SAVERS CERTIFICATE; AUTOMATIC TRANSFER SERVICE (ATS); DRAFT; MONEY MARKET DEPOSIT ACCOUNT; ORDER; PAYABLE THROUGH DRAFT; SAVINGS ACCOUNT; SMALL SAVER CERTIFICATE; STATEMENT SAVINGS ACCOUNT; SUPER NOW ACCOUNT; TRUST ACCOUNT; (2) A transaction record of an OPEN-END CREDIT plan, such as a CREDIT CARD or home equity credit line, or a commercial open account relationship, as in ACCOUNTS RECEIVABLE FINANCING or ASSET-BASED LENDING. In commercial finance the term account generally refers to the indebtedness, not the borrower or account holder.
3. **Securities.** A contractual arrangement under which securities, mutual fund shares, futures and options, and so on are bought and sold; a brokerage account.

accountabilities deposits, stock certificates and other items held in trust by one party for another. A bank's TRUST DEPARTMENT or other fiduciary is required by law in many states to give a periodic accounting of the assets, or liabilities, comprising a TRUST.

account activity deposits, withdrawals, earnings credits for deposit balances, and service charges on a bank account during a particular time period. These are summarized in an ACCOUNT STATEMENT, which banks are required by banking regulation to issue every month, to give customers an opportunity to correct posting errors. A recent trend in banking is the COMBINED STATEMENT, listing activity on several related accounts, for example, checking, statement savings, money market savings account, and so on. See also ACCOUNT ANALYSIS.

account analysis monthly statement evaluating the adequacy of COMPENSATING BALANCES or fees paid by a corporate account for banking services, taking into account a company's AVERAGE DAILY BALANCE, AVERAGE DAILY FLOAT, EARNINGS CREDIT note on collected balances, and other factors. When servicing costs exceed the bank's compensation from fees or balances, the extra cost is passed on to the customer as service charges or higher balance requirements. An analytical tool mostly used in pricing corporate CASH MANAGEMENT services, account analysis is also used by banks to evaluate profitability of CORRESPONDENT banking services, such as check clearing, performed for other financial institutions.

accountant's opinion statement describing results of an examination of a firm's books and records, following accepted auditing standards. Most banks, except for the smallest commercial banks, have their records and accounts audited annually by a certified public accountant. The opinion may be qualified or unqualified, depending on the scope of the examination and the accountant's confidence in the information reviewed. A qualified opinion, although not necessarily negative, indicates information that the accountant was not able to directly confirm, normally because of limitations in the scope of the audit. See also GENERALLY ACCEPTED ACCOUNTING PRINCIPLES; REGULATORY ACCOUNTING PRINCIPLES.

account balance see BALANCE.

account history

1. bank's summary of a deposit account's activity, including interest earned, during a particular period.

2. internal summary of transaction activity by a credit card or other OPEN-END CREDIT account, including late payments, overlimit activity, average daily balance, and so on. See also ACCOUNT STATEMENT; CREDIT FILE.

account hold

1. CHECK HOLD, or the number of days that a bank legally can hold uncollected balances before giving customers use of those funds. The EXPEDITED FUNDS AVAILABILITY ACT of 1987 accelerates the AVAILABILITY SCHEDULE requiring banks to make the first \$100 available for withdrawal at the opening of business the day after the funds are deposited, remaining funds on the third day after a deposit if drawn on a local bank and within six days if drawn on nonlocal banks, starting in 1990. See also LOCAL CHECK; REGULATION CC.
2. notation limiting an account owner's access to funds in the account, as when a time savings account is used as collateral for a loan.

account inquiry request for a copy of an individual's ACCOUNT HISTORY, usually in connection with a credit approval or renewal of an existing line of credit. See also CREDIT REPORT.

account in trust account managed by one party for use by another, who is named the BENEFICIARY. A parent or guardian opening a child's savings account under the UNIFORM GIFTS TO MINORS ACT approves any withdrawals until the child reaches legal age.

account number numeric code identifying the holder of an account. Account numbers are generally issued sequentially by the date an account is opened, have a standardized number of characters, and may contain coded information for internal security purposes. Bank credit cards, for example, have 16 digit account numbers, as required by MasterCard and Visa. See also CHECK DIGIT.

account reconciliation bookkeeping service offered by banks, usually for a fee, to assist customers in balancing their checkbooks. Some banks provide, as a cash management service to corporate customers, an electronic reconciliation service that automatically balances a checking account, lists checks paid and

deposits posted, and summarizes all account activity for an accounting period. This service reduces the company's clerical costs, and also functions as an outside AUDIT control over funds collection and disbursement.

accounts receivable financing form of ASSET-BASED LENDING in which businesses obtain short-term financing by selling their trade receivables or pledging receivables as collateral for a loan. Direct sale of accounts receivable is a nonrecourse type of financing called FACTORING. An accounts receivable loan from a bank is a DISCOUNT: the borrower draws against a line of credit that is less than the full dollar value of his trade credits. Accounts receivable financing is a rather flexible way of obtaining credit, since the borrower's financing costs are directly related to his business cycle, but is often priced at spreads above the bank PRIME RATE and is relatively expensive compared to other forms of credit. See also BORROWING BASE; INVENTORY FINANCING; SECURITY INTEREST.

accounts receivable turnover ratio of total credit sales to average accounts receivable during an accounting period, a measure of an organization's ability to convert inventory into cash, and thus, financial efficiency. Close attention should be paid to credit terms, billing procedures, and company and industry trends. See also BALANCE SHEET RATIOS; RATIO ANALYSIS.

account statement any summary of transaction activity occurring during an accounting period, usually monthly, but sometimes quarterly, or at other intervals.

1. **Banking.** A listing of deposits, withdrawals, checks paid, interest earned, and service charges against an account—called a bank statement. It is issued monthly, as required by Federal Reserve regulations, to give customers an opportunity to review their financial records and correct any errors. Many financial institutions issue consolidated bank statements to save postage expense, and also to give customers a single statement showing all of their account relationships with a bank. See also CONSOLIDATED FINANCIAL STATEMENT; PERIODIC STATEMENT.
2. **Securities.** A record of transactions showing status of an account maintained at a broker-dealer firm, net market value of securities owned, cash and securities positions, and so on

Brokerage statements are issued monthly or quarterly, depending on the level of activity in the account.

accounts uncollectible loans in DEFAULT that have been charged off, or are likely to be charged off, as losses. Lenders are required to report the condition of loans with principal and interest in arrears in quarterly CALL REPORTS to bank regulatory agencies. See also ADVERSELY CLASSIFIED ASSETS; LOAN LOSS RESERVES.

accretion of discount accounting process for adjusting the book value of a bond purchased at a discount (the ORIGINAL ISSUE DISCOUNT) to the PAR VALUE at maturity. Accretion is, in effect, a noncash payment of interest, reflecting interest earned while a bond is owned. Accretion is calculated through the "straight line" method, which increases the bond price at a fixed rate per year (a bond purchased at 90, repayable at par in five years, accretes at 2 points per year); and the scientific or constant interest method, which accelerates the accretion as the bond redemption date approaches. Contrast with AMORTIZATION.

accrual basis basis of accounting in which revenues and expenses are recognized in the period in which they arise, regardless of when the cash for the revenue or the expenditure actually occurs. Matching revenues and expenses in the appropriate periods, it is considered superior to any other basis of accounting. The CASH BASIS form of accounting, on the other hand, is more susceptible to manipulation. Accrual accounting is the only basis of accounting approved under GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, and is used by public companies and most privately owned companies.

accrual bond long-term, deferred interest COLLATERIZED MORTGAGE OBLIGATION (CMO) bond that pays no interest until all prior bonds in a CMO bond offering have been retired. Also called a Z-Bond. An accrual bond is similar to a ZERO-COUPON BOND, except that it has an explicit coupon rate and pays both principal and coupon interest. These bonds, backed by residential mortgages, have maturities of 20-25 years, and are most often purchased by investors desiring protection from call risk caused by early prepayments of underlying mortgages, or who

seek the price leverage afforded by these deep-discount bonds. See also STRIP; STRIPPED MORTGAGE BACKED SECURITIES.

accrued interest interest earned but not paid on a bond, certificate of deposit, or time deposit. Fixed income security after the most recent interest payment. When securities are sold, the buyer pays, in addition to the purchase price, any interest earned by the seller up to, though not including, the settlement date. Accrued interest is calculated, ordinarily using the 360-day year, by multiplying the coupon rate times the bond par value and the number of days elapsed since the last interest payment. (Interest = rate \times par value \times number of days/360). Accrued interest on bank owned securities is carried as an asset account on the balance sheet. See also UNEARNED DISCOUNT; UNEARNED INTEREST.

acid test ratio see BALANCE SHEET RATIOS.

acknowledgment admission of the truth of a statement or validity of a document. See also ATTEST.

1. **Banking.** A notification by a paying bank that an item presented for payment has been paid, or that it cannot be honored. See also WIRE FATE ITEM.
2. **Securities.** A verification, by an authorized official, that a customer's signature is genuine, required when transferring accounts to another broker or fiduciary.

acquirer

1. in bank cards, a bank that purchases merchant sales drafts. Also called the MERCHANT BANK. Merchants receive credit for the dollar value of credit card receipts, less a processing fee (the MERCHANT DISCOUNT RATE).
2. in AUTOMATED TELLER MACHINE networks, the financial institution that dispenses the cash, collecting a transaction fee from the card issuing bank.
3. bank gaining control over another financial institution, either through an exchange of stock, payment in cash, or a combination.

acquisition purchase of an asset, such as real estate, chattels, securities, and so on, with title and rights of ownership passing to the new owner.