

# Penn State Financial Literacy Center

## Glossary of Basic Financial Terms

**Annual percentage rate (APR)** – the interest rate charged, expressed as a percent per year, for the use of credit

**Assets** – possessions that have economic value (some of which may provide an economic and/or financial return)

**ATM** – automated teller machine; an ATM allows bank customers to deposit and withdraw money without the direct assistance of a bank employee.

**Bank** – a company chartered by state or federal government to offer numerous financial services, such as checking and savings accounts, loans and safe-deposit boxes; the Federal Deposit Insurance Corporation (FDIC) insures accounts in federally chartered banks and most state-chartered banks.

**Bond** – a certificate of indebtedness issued by a government or a company, promising to repay borrowed funds to the lender at a fixed rate of interest and at predetermined intervals

**Borrower** – an individual, business or government that has received and used something belonging to somebody else, with the intention of returning or repaying it - often with interest in the case of borrowed Money

**Budget** – a plan to manage income, spending and saving

**Capital gains** – a profit realized from the sale of property, stocks or other investments

**Cash** – money in the form of paper currency or coins

**Cashier's check** – a form of check bought for a specific amount and paid to a person or firm named on the check. People pay a fee for a cashier's check. A cashier's check cannot bounce because full payment is needed prior to a cashier's check being issued.

**Certificate of deposit (CD)** – a certificate issued by a bank to a person depositing money in an account for a specified period of time. A penalty is charged for early withdrawal from most CD accounts.

**Check** – a written order to a financial institution directing the financial institution to pay a stated amount of money, as instructed, from the customer's Account

**Checking account** – a financial account into which people deposit money and from which they withdraw money by writing checks or using debit or ATM cards

**Compound interest** – a situation in which interest is earned on previously earned interest in such a way that earnings accumulate more rapidly over time

**Credit** – borrowing to buy something with the promise to make payment at a later time

**Credit card** – a small, specially coded plastic card issued by a bank, business, etc., authorizing the cardholder to purchase goods and services on credit. Credit cards allow users to borrow funds (that must be repaid) that the user does not currently have.

**Credit report** – a written record collected by a credit agency that tracks a borrower's credit payments, whether or not these

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payments are made on a timely basis, and how long the borrower has had various credit accounts.

**Credit union** – not-for-profit cooperatives of members with some type of common bond (e.g., employer) that provide a wide array of financial services, often at a lower cost than commercial banks

**Debit card** – a small, specially coded plastic card issued by a bank; allows the cardholder to transfer funds electronically and immediately from his or her checking account, as if the cardholder were writing a check to pay for a purchase. A debit card is different from a credit card in that debit card users are limited to accessing only the available balances in their deposit accounts. Credit cards allow users to borrow funds that must be repaid.

**Diversify** – to invest in a variety of financial assets, such as stocks, bonds, money market accounts, etc., in order to reduce the overall risk of financial investment

**Dividend** – a payment of apportion of a company's net profits which is periodically made to stockholders

**Expenses** – payments for goods and services

**FICO score** – a mathematical model that assesses a person's reliability in repaying borrowed funds

**Finance charges** – the interest paid on unpaid credit balances

**Financial institutions** – intermediaries that help channel funds from savers to borrowers

**Financial literacy** – basic financial knowledge, including an understanding of banks and the banking system, financial markets, credit and credit cards, and tax laws, as well as the ability to apply this knowledge in making decisions on how to spend, earn, or save money today to build wealth for tomorrow

**Fixed expenses** – expenses that are the same every month

**Grace period** – the amount of time one has to pay a line of credit before there is a finance charge

**Human capital** – the knowledge, skills, abilities and talents that people acquire through experience, training and education that help workers produce goods and services and help determine their income-producing capacity

**Income** – earnings that result from providing resources in the market place

**Inflation risk** – the chance that the rate of inflation will exceed the rate of return on an investment; also, the risk that future earnings will have reduced purchasing power because of an increase in average prices

**Installment plan** – a closed-end loan for a specific product such as furniture or appliances

**Interest** – the price associated with using someone else's money. Banks pay savers interest to encourage them to make deposits. Banks charge interest to borrowers, who pay this interest as a cost of using someone else's money. In general, banks earn profits when the interest payments made on loans are

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larger than the interest used to attract savers to make deposits.

**Lender** – one who lends; may be an individual, a business or a government

**Liabilities** – things that are owed; financial obligations that must be paid. Debt is a common household liability.

**Liquidity** – the ease with which a financial asset can be turned into cash.

**Liquidity risk** – the chance that an investor will find it difficult to turn an investment into cash (by trying to sell a house, for example, in a real estate market that is slow)

**Long-term goal** – a goal that a person or organization plans to achieve more than five years in the future

**Medium-term goal** – a goal that a person or organization plans to achieve in one to five years

**Minimum payment** – the smallest amount a person is required to pay in a given month on an open-ended credit account

**Money market account** – an interest-bearing account that offers limited check-writing privileges. Deposits may be added at any time; some money market accounts limit the withdrawals depositors may make without paying a penalty. Money market accounts are low-risk investments that serve as a cross between saving and checking accounts. Money market accounts offered within the banking system are known as money market deposit accounts. Money market accounts offered by mutual funds are known as money market mutual funds.

**Money order** – a form of payment that a person can buy for a specific amount and sign over to the person or firm named on the money order. People must pay a fee to obtain a money order. A money order cannot bounce because full payment is needed before the money order is issued.

**Mutual fund** – a pool of funds used by a financial services company to purchase a variety of stocks, bonds or money market instruments. A mutual fund provides diversification and is professionally managed by investment professionals.

**Net income** – the amount of income left after taxes have been paid

**Net worth** – a person's assets, or what a person owns, minus a person's liabilities, or what a person owes

**Open-ended credit** – a form of credit that allows a person to borrow funds to make purchases for which there is no predetermined repayment period

**Opportunity cost** – the highest-valued alternative that is given up when a choice is made not regularly

**Productive resources** – factors used to produce a good or service (natural resources or land, human resources, human capital and capital goods)

**Problem-solving model** – also known as the PACED model; the five steps of decision-making: identify the problem, list the alternatives, list the criteria upon which the decision will be based, evaluate the alternatives using the criteria, make a decision

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**Rate of return** – earnings from a financial investment, stated as a percentage of the amount invested; usually calculated on an annual basis

**Return** – earnings from an investment, usually expressed as an annual percentage rate

**Revolving credit** – an open-ended account with a limit to how much can be borrowed but no time limit for repayment

**Risk** – the chance of experiencing a financial loss

**Rule of 72** – offers a simple way to determine how long it will take for a principal value to double in size. Divide the annual expected interest rate into 72 to know the approximate number of years it will take for the principal to double.

**Saving** – income not spent on current consumption or taxes

**Savings account** – an interest-bearing deposit account at a banking establishment that is not typically used for transactions and has no maturity date

**Scarcity** – the condition that arises whenever limited resources are insufficient to provide for peoples' basically unlimited wants

**Short-term goal** – a goal that a person or organization plans to achieve in less than one year

**Smart card** – a plastic card, usually about the size of a credit card, which has been embedded with a microchip that manages

and processes information. Because of the chip, the card can handle multiple applications such as personal identification, banking, and use in pay phones. The cards make it easy to carry data. They provide high data security and offer great convenience to users.

**Spending** – using income for current consumption

**Stocks** – shares of ownership in a corporation

**Taxes** – required payments to government

**Trade-off** – that which is given up to get something

**Traveler's check** – a form of check that can be used to obtain cash; the buyer of the traveler's check pays a specific dollar amount to acquire these checks, which are issued in standardized packets by a traveler's check issuer. The checks are written to a person or firm and signed by the person writing the check. Often these come with protection against loss or theft. Traveler's check issuers usually charge a fee when they sell these instruments.

**Variable expenses** – expenses that may change from week to week or from month to month