GLOSSARY

Annuity	A contract that provides an income for a specified period of time, such as a number of years or for life.
Asset/liability management	The management of assets to ensure that liabilities are sufficiently covered by suitable assets at all times.
Balance sheet mismatch	A balance sheet is a financial statement showing a company's assets, liabilities, and equity on a given date. Typically, a mismatch in a balance sheet implies that the maturities of the liabilities differ (are typically shorter) from those of the assets and/or that some liabilities are denominated in a foreign currency while the assets are not.
Banking soundness	The financial health of a single bank or of a country's banking system.
Benchmark issues	High-quality debt securities, typically bonds. Investors use their yield for comparison purposes and to price other bond issues.
Brady Bonds	Bonds issued by emerging market countries as part of a restructuring of defaulted commercial bank loans. These bonds are named after former U.S. Treasury Secretary Nicholas Brady and the first bonds were issued in March of 1990.
Capital account liberalization	Removal of statutory restrictions on cross-border private capital flows, an important part of financial liberalization. In particular, the relaxation of controls or prohibitions on transactions in the capital and financial accounts of the balance of payments, including the removal of foreign exchange convertibility restrictions.
Carry trade	A leveraged transaction in which borrowed funds are used to buy a security whose yield is expected to exceed the cost of the borrowed funds.
Cash securitization	The creation of securities from a pool of pre-existing assets and receivables that are placed under the legal control of investors through a special intermediary created for this purpose. This compares with a "synthetic" securitization where the generic securities are created out of derivative instruments.
Collective action clause	A clause in bond contracts that includes provisions allowing a qualified majority of lenders to amend key financial terms of the debt contract and bind a minority to accept these new terms.
Contagion	The transmission or spillover of financial shocks or crises across countries and/or across asset classes, characterized by an apparent increase in the comovement of asset prices.

Note: Insurance terms are adapted from the International Association of Insurance Supervisors (IAIS) *Glossary of Terms,* September 2003.

Convergence fund	A fund that invests in Eastern European countries' debt securities on the assumption that interest rates in these countries will converge to those in the European Union.
Convexity	A measure of the relationship between bond prices and bond yields. The more positive a bond's convexity, the less sensitive is the price of the bond to interest rate changes, other things being equal. Negative convexity implies the bond's price is more sensitive to interest rate changes, other things being equal.
Corporate governance	The governing relationships between all the stakeholders in a company—including the shareholders, directors, and management—as defined by the corporate charter, bylaws, formal policy, and rule of law.
Credit default swap	A financial contract under which an agent buys protection against credit risk for a periodic fee in return for a payment by the protection seller contingent on the occurrence of a credit/default event.
Credit insurance	A form of guarantee to manufacturers and wholesalers against loss resulting from default on the part of debtors.
Credit risk	The risk that a counterparty to the insurer is unable or unwilling to meet its obligations causing a financial loss to the insurer.
Credit spreads	The spread between sovereign benchmark securities and other debt securities that are comparable in all respects except for credit quality (e.g., the difference between yields on U.S. Treasuries and those on single A-rated corporate bonds of a certain term to maturity).
Defined benefit pensions	A retirement pension plan where the benefits that retirees receive are determined by such factors as salary history and the duration of employment. The company is typically responsible for the investment risk and portfolio management.
Defined contribution pensions	A retirement pension plan where the benefits that retirees receive are determined by the returns on the plan's investments.
Derivatives	Financial contracts whose value derives from underlying securities prices, interest rates, foreign exchange rates, market indexes, or commodity prices.
Dollarization	The widespread domestic use of another country's currency (typically the U.S. dollar) to perform the standard functions of money—that of a unit of account, medium of exchange, and store of value.
Double gearing	Situations where multiple companies use shared capital to protect against risk occurring in separate entities. For example, an insurance company may purchase shares in a bank as a reciprocal arrangement for loans. In these cases, both institutions are leveraging their exposure to risk.
Dynamic hedging	A dynamic-hedging scheme involves the periodic re-balancing of a portfolio of hedging instruments (the buying or selling of securities) in order to maintain a specific hedging level.

Eligible capital	On- or off-balance sheet element that, in accordance with domestic regulations, is suitable to cover the required solvency margin (i.e., eligible for inclusion in the calculation of available solvency or regulatory capital). As a general rule, these elements are either assets free of all foreseeable liabilities, or, if they represent liabilities, the latter should be subordinated to any other liabilities, i.e., in the event of a bankruptcy, they are to be paid only after the claims of all other creditors have been satisfied.
EMBI	The acronym for the J.P. Morgan *Emerging Market Bond Index* that tracks the total returns for traded external debt instruments in the emerging markets.
Emerging markets	Developing countries' financial markets that are less than fully developed, but are nonetheless broadly accessible to foreign investors.
Financial guarantee insurance	A form of coverage in which the insurer guarantees the payment of interest and/or principal of the insured in connection with debt instruments issued by the insured.
Foreign direct investment	The acquisition abroad (i.e., outside the home country) of physical assets, such as plant and equipment, or of a controlling stake (usually greater than 10 percent of shareholdings).
Forward price-earnings ratio	The multiple of future expected earnings at which a stock sells. It is calculated by dividing the current stock price (adjusted for stock splits) by the estimated earnings per share for a future period (typically the next 12 months).
Hedge funds	Investment pools, typically organized as private partnerships and often resident offshore for tax and regulatory purposes. These funds face few restrictions on their portfolios and transactions. Consequently, they are free to use a variety of investment techniques—including short positions, transactions in derivatives, and leverage—to raise returns and cushion risk.
Hedging	Offsetting an existing risk exposure by taking an opposite position in the same or a similar risk, for example, by buying derivatives contracts.
In-force business	In the life insurance industry, the expression refers to the stock of existing policies that have been previously written and have not yet matured or been cancelled.
Interest rate swaps	An agreement between counterparties to exchange periodic interest payments on some predetermined dollar principal, which is called the notional principal amount. For example, one party will make fixed-rate and receive variable-rate interest payments.
Intermediation	The process of transferring funds from the ultimate source to the ultimate user. A financial institution, such as a bank, intermediates credit when it obtains money from depositors and relends it to borrowers.

Investment-grade issues (Sub-investment-grade issues)	A bond that is assigned a rating in the top four categories by commercial credit rating agencies. S&P classifies investment-grade bonds as BBB or higher, and Moody's classifies investment grade bonds as Baa or higher. (Sub-investment-grade bond issues are rated bonds that are below investment-grade.)
Leverage	The proportion of debt to equity. Leverage can be built up by borrowing (on-balance-sheet leverage, commonly measured by debt-to-equity ratios) or by using off-balance-sheet transactions.
Mark-to-market	The valuation of a position or portfolio by reference to the most recent price at which a financial instrument can be bought or sold in normal volumes. The mark-to-market value might equal the current market value—as opposed to historic accounting or book value—or the present value of expected future cash flows.
Mutual insurance company	A nonprofit insurance carrier, without capital stock, that is owned by the policyholders.
Nonperforming loans	Loans that are in default or close to being in default (i.e., typically past due for 90 days or more).
Offshore instruments	Securities issued outside of national boundaries.
(Pair-wise) correlations	A statistical measure of the degree to which the movements of two variables (for example, asset returns) are related.
Pension funding gaps	The difference between the discounted value of accumulating future pension obligations and the present value of investment assets.
Policy reserves	The amounts that a life insurance company allocates specifically for the fulfillment of its policy obligations: reserves are so calculated that, together with future premiums and interest earnings, they will enable the company to pay all future claims.
Primary market	The market where a newly issued security is first offered/sold to the public.
Put (call) option	A financial contract that gives the buyer the right, but not the obligation, to sell (buy) a financial instrument at a set price on or before a given date.
Reinsurance	Insurance placed by an underwriter in another company to cut down the amount of the risk assumed under the original insurance.
Reserve	Amounts of an insurance company's funds that are set aside to meet unforeseeable liabilities (i.e., an obligation that has not yet materialized) or statutory requirements. These amounts stem either from shareholders' capital or, in the case of mutual companies, members' contributions and accumulated surplus.
Retrenchment from risk	A reduction in the purchases or holdings of risky securities.

Risk aversion	The degree to which an investor who, when faced with two investments with the same expected return but different risk, prefers the one with the lower risk. That is, it measures an investor's aversion to uncertain outcomes or payoffs.
Secondary markets	Markets in which securities are traded after they are initially offered/sold in the primary market.
Separate account	Funds held by a life insurer that are segregated from the other assets of the insured and invested for pension plans and other designated policies.
Solvency	Narrowly defined as the ability of an insurer to meet its obligations (liabilities) at any time. In order to set a practicable definition, it is necessary to clarify the type of claims covered by the assets, e.g., already written business (run-off basis, break-up basis), or would future new business (going-concern basis) also to be considered. In addition, questions regarding the volume and the nature of an insurance company's business, the appropriate time horizon to be adopted, and setting an acceptable probability of becoming insolvent are taken into consideration in assessing a company's solvency.
Solvency requirements	The statutory requirements or rules on the required solvency margin and eligible capital elements, including the performance of the solvency test, to prove compliance with these requirements.
Spread	See "credit spreads" above (the word credit is sometimes omitted). Other definitions include: (1) the gap between bid and ask prices of a financial instrument; (2) the difference between the price at which an underwriter buys an issue from the issuer and the price at which the underwriter sells it to the public.
Subordinated debt	Loans or other liabilities that rank after claims of all other creditors and to be paid, in the event of liquidation or bankruptcy, only after all other debts have been met.
Swaptions	Options on interest rate swaps.
Syndicated loans	Large loans made jointly by a group of banks to one borrower. Usually, one lead bank takes a small percentage of the loan and partitions (syndicates) the rest to other banks.
Tail events	The occurrence of large or extreme security price movements, that, in terms of their probability of occurring, lie within the tail region of the distribution of possible price movements.
Technical provision	Amount set aside to meet liabilities arising out of insurance contracts, including claims provision (whether reported or not), provision for unearned premiums, provision for unexpired risks, life assurance provision and other liabilities related to life insurance contracts (e.g., premium deposits, savings accumulated over the term of with-profit policies).

Underwriting	The process by which an insurance company determines whether or not and on what basis it will accept an application for insurance.
Unit-linked investment	An insurance policy where a portion of the premium is used to purchase insurance protection, and the balance is invested in an authorized unit trust. The return on the policy is linked to the performance of the unit trust and the risk associated with the investment is borne by the policyholder.
Variable annuity	An annuity contract under which the amount of each periodic payment fluctuates according to the investment performance of the insurer.
With-profits policies	The insurance company guarantees to pay an agreed amount at a specific time in the future, and may increase this guaranteed amount through bonus payments. In effect, the policyholders are participating in the profits of the life insurance company.
Yield curve	A chart that plots the yield to maturity at a specific point in time for debt securities having equal credit risk but different maturity dates.