

Glossary of Financial Terms

Asset managers: A financial professional that is responsible for managing a pool of funds or assets on behalf of a client. An asset manager may be responsible for determining how funds are invested, subject to the instructions of its client, or for managing specific assets that have already been purchased. The underlying assets may include equity, debt securities, money market instruments, currency, real estate or any other form of investment asset. Examples of asset managers include financial professionals that manage pension fund assets.

Auction: A system where potential buyers place competitive bids on assets and services. In auctions, the goal is to drive prices upward.

Reverse auction In this auction, the goal is to drive purchases prices downward, so the role of the buyer and seller are reversed. Reverse auctions are used to fill both large and small value contracts for public and private commercial organizations.

Dutch auction In this auction the price of the offering is set after taking in all bids and choosing the buyer who gave the highest price.

Auction rate securities A form of debt issued by groups¹ such interested in borrowing for the long-term, but doing so at short-term interest rates. Banks will hold Dutch auctions² in what amounts to a resetting of the interest rates as the securities are passed on to the new security holders (or reset for existing holders if they want to keep the debt).

Collateralized debt obligations (CDOs) A huge package of loans sold in assorted segments (known as tranches) with varying interest rates and levels of risk. CDOs appeared less risky than they truly were, because they helped hide liabilities. Specifically, subprime mortgages (which are risky) were not classified as such because companies that wrote the insurance policies on these mortgages assumed that default levels would be miniscule. CDOs need only a slight deterioration in the value of underlying assets for losses to escalate rapidly.

Corporate governance A set of processes, customs, policies, laws and institutions affecting the way a corporation is directed, administered or controlled. Corporate governance also includes the relationships among the stakeholders involved and the goals for which the corporation is governed. The principal stakeholders are the shareholders, management and the board of directors. Other stakeholders include employees, suppliers, customers, banks and other lenders, regulators, the environment and the community at large. "Corporate governance advocates" are generally said to seek *greater* shareholder say in corporate affairs (including the selection of board members and limits on executive compensation).

Credit default swap An insurance-like "derivatives" contract in which one party pays another party a fee to protect it from a third-party's default. For example, a large bank (A) that holds many bonds of company (B) may buy a credit default swap from bank/hedge fund (C) to insure it in case company B defaults on the bonds. True insurance contracts are regulated to make sure, for example, that sufficient cash reserved exist to pay the CDS if company B defaults. CDS are traded in an over-the-counter market where counterparties to a swap enter into a bilateral contract (usually based on a legal framework

¹ Such as municipalities, student-loan organizations, and others

² Every 7, 28, or 35 days, depending on the product

provided by the International Swap and Derivative Association (ISDA)). Counterparties put up collateral to ensure they can pay at the contract's termination.

Debt vs. equity (debt-for-equity swaps) An agreement whereby a company offers its creditors equity in the company in exchange for cancelling all or some of the company's debt.

Fair market value The price at which a buyer and a seller willingly engage in a trade. During the current credit situation, fair market value has been more difficult to estimate, since many assets (CDOs, for example) have not traded regularly – making prices more “opaque.”

Imposed value The value of a commodity mandated by a non-market authority, such as a government

Book value The net value of an asset (the cost of an asset minus its decrease in value)

Forbearance A postponement of loan payments, granted by a lender or creditor, for a temporary period of time. This is done to give the borrower time to make up for overdue payments.

Foreclosure A situation in which a homeowner is unable to make principal and/or interest payments on his or her mortgage, so the lender seizes and sells the property as stipulated in the terms of the mortgage contract.

Delinquent Mortgage A mortgage on which the borrower has failed to make payments as required in the loan documents. If the borrower fails to resume payments within a certain time period, the lender may begin foreclosure proceedings.

Deed in Lieu of a Foreclosure An alternative to foreclosure in which a borrower deeds the property back to the lender in exchange for the release of all obligations under the mortgage. Both sides must enter into these agreements voluntarily and in good faith. Both parties can benefit by saving the time and money that would have been spent on foreclosure proceedings.

Glass-Steagall Act of 1933 A finance law whose key provisions included:

1. Establishing the Federal Deposit Insurance Corporation (FDIC) to provide depositors with insurance (up to \$100,000 per depositor per bank)
2. Prohibiting banks from affiliating with securities underwriters. The act distinguished between commercial banks and brokerage firms.

Gramm-Leach-Bliley Act of 1999 A 1999 statute that repealed parts of the Glass-Steagall and other laws, permitting commercial banks to engage in broad new activities including securities underwriting and sales as well as insurance. It allowed banks, securities firms, and insurance companies to affiliate in "financial holding companies" regulated by the Federal Reserve. In practice, no major investment bank chose to submit to Federal Reserve regulation and become a "financial holding company."

Hope for Homeowners Program of 2008 A new Federal Housing Administration program created by Congress this summer to get distressed borrowers into FHA-insured mortgages. To participate, banks and other mortgage holders must realize losses on existing higher-priced mortgages, which will then be refinanced by new lower-cost loans from FHA-approved lenders and guaranteed by the FHA.

Liquidity An asset's ability to be easily converted (through an act of buying or selling) without causing a significant movement in the price and with a minimum loss of value. The more colloquial term refers to the ease with which an asset can be converted to money.

Illiquid assets Assets that cannot easily be sold or exchanged for cash without a substantial loss in value because of a lack of ready buyers. This makes illiquid assets riskier in volatile times. Examples include houses, cars, antiques.

Mark-to-market The adjustment of an account to reflect gains and losses at the end of a trading period. This requires a company to value its assets to reflect the assets' current market value as opposed to its book value.

Money market (money market funds) Collective funds (pooled by many participants) that are invested in low-risk securities — such as U.S. Treasury bonds.

Mortgage backed securities Financial commodities whose cash flows are backed by a mortgage or set of mortgages. For example, if a person has a mortgage, a bank can bundle this mortgage with many others, and sell the bundle of mortgages to investors. The investors, who now own this bundle, make a profit from the interest of the mortgages. The original bank can use its profit to lend again. The value of this security doesn't just rest on the creditworthiness of one borrower, but on the collective creditworthiness of a group of borrowers. This is supposed to spread risk, but if the majority of the loans in this bundle of mortgages is bad, it can implode.

Preferred shares (preferred share status) A special type of stock that regularly pays the investor a set amount of money out of the company's profits. The investor gets a preferential claim to the profits ahead of common shareholders, but the investor does not get voting rights in the company.

Principal Write-down A reduction the book value of an asset because it is overvalued compared to the market value.

Sarbanes-Oxley Act of 2002 A law passed in reaction to accounting scandals in recent history. The law was established to protect investors from the possibility of fraudulent accounting activities for public companies.

Security A financial instrument that represents an interest in an underlying company, asset, or pool of assets, or specified rights to payment. Securities are generally classified as either "debt" or "equity." Debt securities generally represent a right to payment. Equity securities generally represent an interest in the success of a company and or in the return on an asset or pool of assets. Securities can take many forms and may be privately placed or registered with the SEC and issued to the public. Examples of securities include a note, stock, preferred share, bond, debenture, option, right, warrant.

Securitization (securitized loan pools) The process through which an issuer creates a financial instrument. The issuer does this by combining & re-packaging financial assets.

Servicers (servicing of loans) Banks or firms that control the administrative aspects of a loan from the time the money is dispersed until the loan is paid off.

Structured Investment Vehicles (SIVs) Conduits that uses short term debt to invest in long term debt. (The difference between SIVs and CDOs is essentially in the type of debt they issue. The SIVs are structures backed by pools of assets and have shorter term debt than CDOs.

Warrants A derivative security that gives the holder the right to purchase securities (usually equity) from the issuer at a specific price within a certain time frame.