GLOSSARY

401(k)	U.S. tax-deferred retirement plan that allows workers to contribute a percentage of their pre-tax salary for investment in stocks, bonds, or other securities. The employer may match all or part of employees' contributions.
Accrued benefit	Amount of accumulated pension benefits of a pension plan member.
Accumulated benefit obligation (ABO)	Present value of pension benefits promised by a company to its employees, at a particular date and based on current salaries.
Actuarial gain/loss	An actuarial gain (loss) appears when actual experience is more (less) favorable than the actuary's estimate.
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 (ALM)	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.
Beneficiary	Individual who is entitled to a pension benefit (including the pension plan member and dependants).
Book reserve scheme (also known as *Direktzusage*)	In Germany, accounting system whereby the actuarial value of future pension benefits appears as a liability, but is not offset by any specific provision on the sponsor company's balance sheet.
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.
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.
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 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 plan	Pension plan in which benefits are determined by such factors as salary history and duration of employment. The sponsor company is responsible for the investment risk and portfolio management.
Defined contribution plan	Pension plan in which benefits are determined by returns on the plan's investments. Beneficiaries bear the investment risk.
Dependency ratio	Ratio of pensioners to those of working age in a given population.
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.
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.
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).

Funded pension plan	Pension plan that has accumulated dedicated assets to pay for the pension benefits.
Funding gap	The difference between the discounted value of accumulating future pension obligations and the present value of investment assets.
Funding ratio	Ratio of the amount of assets accumulated by a defined benefit pension plan to the sum of promised benefits.
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.
Hybrid pension plan	Retirement plan that has characteristics typical of both defined benefit and defined contribution plans.
Individual Retirement Account (IRA)	In the United States, tax-deferred retirement plan permitting all individuals to set aside a fraction of their wages (additional contributions are possible on a nondeductible basis).
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 (Subinvestment-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. (Subinvestment-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.
Lump sum payment	Withdrawal of accumulated benefits all at once, as opposed to in regular installments.
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.
Nonperforming loans	Loans that are in default or close to being in default (i.e., typically past due for 90 days or more).
Occupational pension scheme	Pension plan set up and managed by a sponsor company for the benefit of its employees.
Offshore instruments	Securities issued outside of national boundaries.
Overfunded plan	Defined benefit pension plan in which assets accumulated are greater than the sum of promised benefits.
Pillar I	National pension systems are typically represented as a "multi-pillar" structure with the sources of retirement income derived from a mixture of government, employment, and individual savings. Pillar I refers to state-based retirement income, often a combination of universal entitlement and an earnings-related component. See Chapter III of the September 2004 GFSR for further details. (Note: Another classification scheme used in pension studies, particularly for emerging markets, was first developed at the World Bank. It describes Pillar 1 as "non-contributory state pensions," Pillar 2 as "mandatory contributory," and Pillar 3 as "voluntary contributory".)
Pillar II	Occupational pension funds, increasingly funded, organized at the workplace (e.g., defined benefit, defined contribution, and hybrid schemes).
Pillar III	Private saving plans and products for individuals, often tax advantaged.
Pair-wise correlations	A statistical measure of the degree to which the movements of two variables (e.g., asset returns) are related.
Pay-as-you-go basis (PAYG)	Arrangement under which benefits are paid out of revenue over each period, and no funding is made for future liabilities.
Pension benefit	Benefit paid to a participant (beneficiary) in a pension plan.
Pension contribution	Payment made to a pension plan by the sponsor company or by plan participants.
Primary market	The market where a newly issued security is first offered/sold to the public.
Private pension plan	Pension plan where a private entity receives pension contributions and administers the payment of pension benefits.
Projected benefit obligation (PBO)	Present value of pension benefits promised by a company to its employees at a particular date, and including assumption about future salary increases (i.e., assuming that the plan will not terminate in the foreseeable future).

Public pension plan	Pension plan where the general government administers the payment of pension benefits (e.g., Social Security and similar schemes).
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.
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.
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.
Sponsor company	Company that designs, negotiates, and normally helps to administer an occupational plan for its employees and members.
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.
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.
Trustee	Private entity (person or organization) with a duty to receive, manage and disburse the assets of a plan.
Underfunded plan	Defined benefit pension plan in which assets accumulated are smaller than the sum of promised benefits.

Unfunded benefit liability	Amount of promised pension benefits that exceeds a plan's assets.
Vesting	Right of an employee, on termination of employment, to obtain part or all of his accrued benefits.
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 policy holders 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.