Appendix II

Glossary of Selected Terms

Agreement in principle—The stage of the restructuring or new money package process when the advisory committee banks seek the approval of other creditor banks of a draft agreement negotiated with the restructuring country.

Bank advisory committees—Also called coordinating committees, a limited number of banks designated by the authorities of a country to act on behalf of and as a liaison group with all bank creditors. Once an agreement is reached with the advisory committee, it is then submitted for approval to all participating banks. Typically, membership of advisory committees is determined on the basis of banks' exposure and to secure a regional balance. The bank with the largest exposure usually heads the committee, while member banks often act as regional coordinators.

Broker—(1) A person paid a fee or commission for acting as an agent in making contracts, sales, or purchases; (2) when used as "floor broker," it means a person who actually executes someone else's trading orders on the trading floor of an exchange; and (3) when referring to an account executive, it means the person who deals with customers and their orders in commission house offices.

Cash settlement—The settlement provision on some option and futures contracts that does not require delivery of the underlying instrument. For options, the difference between the settlement price on the underlying instrument and the option's exercise price is paid to the option holder at the time the option is exercised. For futures contracts, the exchange establishes a settlement price on the final day of trading and all remaining open positions are marked to market at that price.

Clearing firm—A firm that clears broker-dealers' process transactions and maintains custody of funds and securities on behalf of other broker-dealers. In addition to holding funds and securities, clearing firms are contractually responsible for the settlement of the securities transactions of the other broker-dealers and the maintenance of certain records relating to those transactions.

Commodity Futures Trading Commission (CFTC)—The federal agency that oversees stock index futures trading in the United States.

Concerted bank lending—Refers to proportional increases in bank exposure, coordinated by a bank advisory committee. There has generally been a close linkage between disbursements of concerted bank lending to a country and performance under a Fund-supported adjustment program.

Consolidation period—The period in which amortization payments to be rescheduled or refinanced under the terms of a restructuring agreement have fallen or will fall due.

Counterparty—The other party to a contract. For exchange-trade futures and options contracts, the counterparty is usually the exchange itself (an exception is LIFFE, where the broker plays this role). For OTC instruments, the counterparty is generally a financial intermediary such as a major money-center bank, an investment or merchant bank, or a securities company.

Counterparty risk—The risk that the other party to a contract will not fulfill the terms of the contract. This risk is avoided through the clearing house system for exchange-traded instruments; however, it is a relevant source of risk for OTC instruments, such as forward agreements, interest-rate caps, floors and collars, and interest rate or currency swaps.

Covenant—An agreement by a borrower that is legally binding upon the borrower over the life of an issue or loan to perform certain acts, such as the timely provision of financial statements, or to refrain from certain acts, such as incurring further indebtedness beyond an agreed level.

Credit risk—Risk associated with the possibility that the other party to a financial contract will be unwilling or unable to fulfill the terms of the contract. Credit risk is distinguished from the risks associated with changes in prices, interest rates, or exchange rates (see also *Counterparty risk*).

Critical mass—A minimum amount of bank commitments to a new money package giving reasonable assurance to Fund management that the financing assumptions of an adjustment program are realistic and that the program can be submitted to the Executive Board of the Fund for approval.

Current maturities—Principal and interest payments falling due within the consolidation period.

Debt conversion—The exchange of one form of claim on a debtor for another form of claim. A debt conversion may involve the exchange of an existing debt instrument for a stake in an enterprise (debt-for-equity swap), for a new debt instrument denominated in local or foreign currency (debt exchange), for designated export proceeds (debt-for-export swap), or for claims on other types of real or financial resources. The terms of the two claims will usually differ substantially. For example, the face value of the new claim may reflect a discount from the face value of the old claim. A debt buy-back, which involves extinguishing an existing debt instrument through a cash transaction, may also be considered as a form of debt conversion.

Debt refinancing—Either a rollover of maturing debt obligations or the conversion of existing or future debt service payments into a new medium-term loan.

Debt rescheduling—Formal deferment of debt service payments with new maturities applying to the deferred amounts.

Designated Order Turnaround (DOT) system—A system developed by the New York Stock Exchange (NYSE) to facilitate routing of orders from NYSE members' offices to the specialist in the particular stock on the floor of the NYSE.

Eurocommercial paper—A short-term unsecured note issued by a nonbank in the Euromarkets.

Exit bond—A bond issued by a debtor country to a creditor bank in place of a bank credit that allows the creditor bank to be exempted from future requests for new money and restructuring.

FEDWIRE—The Federal Reserve System wire transfer facility that provides a system for transferring funds and U.S. Government securities between all 12 Federal Reserve banks, their 24 branches, the Federal Reserve Board office in Washington, U.S. Treasury offices in Washington and Chicago, and the Washington office of the Commodity Credit Corporation.

Futures contract—An exchange-traded contract generally calling for delivery of a specified amount of a particular grade of commodity or financial instrument at a fixed date in the future. Contracts are highly standardized and traders need only agree on the price and number of contracts traded. Traders' positions are maintained at the exchange's clearing house, which becomes a counterparty to each trader once the trade has been cleared at the end of each day's trading session. Members holding positions at the clearing house must post margin, which is marked to market daily. Most trades are unwound before delivery. The interposition of the clearing house facilitates the unwinding since a trader need not find his original counterparty, but may arrange an offsetting position with any trader on the exchange.

London interbank offered rate (LIBOR)—The rate at which banks in London place Eurocurrencies with each other. It is frequently used in international loans as a reference rate.

Long position—(1) In the futures market, the position of a trader on the buying side of an open futures contract; (2) in the options market, the position of a trader who has purchased an option regardless of whether it is a put or a call. A participant with a long call-option position can profit from a rise in the price of the underlying instrument while a trader with a long put option can profit from a fall in the price of the underlying instrument.

Major Market Index (MMI)—The MMI is a futures contract that is based on a price-weighted index comprised of 20 highly capitalized U.S. stocks traded on the New York Stock Exchange. MMI is also the symbol for the futures contract on the MMI traded on the CBT.

Margin (futures)—Funds or collateral posted as a good-faith performance guarantee. Futures and options exchanges often require traders to post initial margin when they enter into new contracts. Margin accounts are debited or credited to reflect changes in the current market prices on the positions held. Members must replenish the margin account if margin falls below a minimum. In a similar fashion, customers must post margin on positions held for them at the exchange clearing house by member firms.

Margin (securities and options)—Broker-dealers extend credit to customers to purchase securities or options in margin accounts. Margin is the equity in the margin account. Generally, equity refers to the net market value of the securities positions increased by any funds in the account or reduced by the amount extended to the customer. When the customer purchases securities in a margin account, the margin provides additional collateral for the extension of credit by the broker-dealer. If the customer sells securities short or writes uncovered options, the margin protects the broker-dealer against losses related to customer default owing to adverse price movements in those positions. Broker-dealers are often required to obtain certain minimum amounts of margin from their customers.

Marking to market—The process of recalculating the exposure in a trading position in securities, option contracts, or futures contracts. In exchange-traded contracts, the exchange clearing house marks members' positions to market each day using closing market prices. Members must maintain a certain minimum level of margin at the exchange clearing house and must post additional margin if the marking-to-market process reduces margin below the minimum.

Market maker—The term market maker generally means any dealer who attempts to provide market liquidity (i.e., the ability to convert a security into cash at a price near the last transactions' price in the absence of new information). This may involve the market maker acting either as a broker (matching buyers to sellers) or being willing to buy and sell securities for his own account.

Maturity period—The grace period plus the repayment period.

Menu approach—The initiation of a broader range—the "menu"—of financing modalities into the debt-restructuring process.

Moratorium—An official declaration or decree by a government postponing all or certain types of maturing debt for a given period.

Multiyear Restructuring Agreement (MYRA)—Restructuring agreement where the consolidation period covers more than two years beyond the date of the signing of the agreement. These agreements aim principally at eliminating a hump in scheduled amortization that may prevent a return to normal market access. In the context of MYRAs, banks have sought special monitoring procedures to seek to ensure that adequate financial policies would be followed once the restructuring country no longer is using Fund resources.

NASDAQ—The National Association of Securities Dealers (NASD) Automated Quotations system, owned and operated by the NASD, is a computerized communications facility that provides broker-dealers with price quotations for securities that are traded over the counter.

Negative pledge clause—A covenant in a loan agreement which commits a borrower or its guarantor not to create a lien on any present or future property or revenues (by, for example, pledging collateral or preferential rights) as security for any new debt without offering to share that security with existing creditors on an equal basis, that is, pari passu. Such a clause can effectively prevent a borrower from negotiating separately with a creditor unless existing creditors covered by the clause waive their rights. In some cases, such a waiver may only require the consent of a majority of existing creditors.

New money/concerted money—Equiproportional increase in exposure of a group of banks arranged through a bank advisory committee responsible for negotiating a new loan package for countries that have lost spontaneous access to external financial resources.

Note issuance facility—A medium-term arrangement enabling borrowers to issue short-term paper, typically of three or six months' maturity, in their own names. A group of underwriting banks may guarantee the availability of funds to the borrower by purchasing any unsold notes at each rollover date, or by providing a stand-by credit.

On-lending—Redesignation of credits originally granted to a government or central bank for general balance of payments purposes as loans to parastatals or private sector borrowers.

Options—The contractual right, but not the obligation, to buy or sell a specified amount of a given financial instrument at a fixed price before or at a designated future date. A *call option* confers on the holder the right to buy the financial instrument. A *put option* involves the right to sell the financial instrument.

Over-the-counter (OTC) market—Trading in financial instruments transacted off organized exchanges. Generally the parties must negotiate all details of the transactions, or agree to certain simplifying market conventions. In most cases, OTC market transactions are negotiated over the telephone. OTC trading includes transactions among market makers and between market makers and their customers. Firms mutually determine their trading partners on a bilateral basis.

Portfolio insurance—Portfolio insurance is a hedging strategy designed to control market risk for a broad-based portfolio by selling and buying stock index derivative products to protect against market loss at the cost of some limitations on the opportunities for appreciation. Typically, portfolio insurance seeks to assure a minimum value for a portfolio over a specified time period. To achieve this, stock index futures are sold when the value of the portfolio decreases a certain percentage and are repurchased when the portfolio regains this loss.

Price limits—The maximum price movement from the previous day's settlement price permitted for a contract in one trading session.

Program trading—Program trading is the trading of a whole portfolio or basket of stocks. Computers are used extensively in this process to optimize the composition of the stocks and to assist in the execution of trades.

Redenomination clause—A clause in which a debt restructuring agreement allows banks to redenominate their loans in their home currency. The agreement normally specifies the amount, timing, and currency eligibility of such redenomination, as well as the applicable reference interest rates.

SEAQ—The Stock Exchange Automated Quotation System is the electronic communications facility of London's International Stock Exchange (ISE). SEAQ collects the quotes of competing U.K. market makers and disseminates them over the ISE's TOPIC System. (The TOPIC System is the ISE's computer terminal network that provides on-line information service to users in the United Kingdom.)

SEAQ International—The Stock Exchange Automated Quotation International is the electronic communications facility of the ISE covering international equities.

Securitization—The process in which banks' assets become more marketable through, for example, the substitution of floating rate notes for syndicated lending; the introduction of transferability into international credits; the packaging of existing assets for resale.

Settlement risk—The possibility that operational difficulties interrupt delivery of funds even when the counterparty is able to perform.

Sharing clause—A covenant in a loan or restructuring agreement that commits creditors party to the agreement to share on a proportional basis any payments received. In the case of a syndicated bank loan, for example, a bank receiving interest payments or principal repayments would have to share the proceeds with the other banks that participated in the syndicated loan on a pro rata basis. Since such a clause can generally be triggered by any creditor party to the original agreement, a waiver of the clause may require their unanimous consent.

Short position—(1) In the futures market, the position of a trader on the selling side of an open futures contract; and (2) in the options market, the position of a trader who has sold or written an option regardless of whether it is a put or a call. The writer's maximum potential profit is the premium received.

SOES—The Small Order Execution System is used by the NASD for the automatic execution of customer agency trades. The system also automatically reports trades to NASDAQ.

Specialist—An exchange member whose chief obligation is to maintain fair and orderly markets in his assigned securities or specialty stocks. In fulfilling this obligation in the United States, the specialist functions as both a broker and a dealer. As a broker, the specialist acts on behalf of other floor brokers who entrust to him stop or limit orders that cannot immediately be executed because the execution prices specified on the orders have not been reached. These orders are recorded in the specialist's "book" and are executed when the market reaches the appropriate price levels. As a dealer, the specialist facilitates orderly price movements between successive trades by buying stock for his own account when sellers outnumber buyers and selling stock from the account when buyers outnumber sellers. In Japan, the specialist acts only as a broker.

Standard & Poor's 500 Index—An index representing the value of 500 widely held common stocks on the New York Stock Exchange.

Standstill—An agreement between bank creditors and a government on a temporary deferment of amortization payments on long-term debt and on a freezing or rollover of short-term debt. Its principal objectives are to prevent a deterioration of the payments situation during the restructuring negotiation period and to preclude an uneven reduction in debt to some banks.

Stock index arbitrage—Index arbitrage is the simultaneous purchase (or sale) of stocks that comprise or closely track a stock index and the sale (or purchase) of either futures or options on that particular index. Index arbitrageurs take advantage of spreads that periodically develop between equities, futures, and options markets by buying in the lowest-priced market and selling in the highest-priced market.