Say what?

The economic meltdown has financial wizards, investors and consumers scrambling for their dictionaries.

BY MICHAEL L. DIAMOND • BUSINESS WRITER • NOVEMBER 16, 2008

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Workers move among the trading posts on the floor of the New York Stock Exchange. The recent financial crisis has brought much of their lingo into everyday conversation. (STAFF PHOTO: MICHAEL SYPNIEWSKI)
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Global financial crisis got you down? Do you watch CNBC with a blank stare? Do you still wonder why your home isn't worth what it used to be and why your loan application was denied?

Take heart. You're not alone.

"It's not something they teach you in school," said Judy Wittek, 51, of Brick, when presented with a list of business terms that have invaded the country's vocabulary. "Maybe they should incorporate that into a class."

The economy's meltdown has lifted the curtain on a financial system whose concepts are so complicated that even executives who practiced them didn't seem to understand what they were doing.

It has forced investors and consumers to keep a financial dictionary nearby as they wade through obscure terminology. But experts say the eat-your-vegetables moment is long overdue, primarily since workers with retirement and college savings plans are increasingly in charge of their own investments.

The trick, they say, is to ask questions until you understand.

"One of the most critical things, not just for finance, but about anything in general, is it's really important to be able to identify what you don't know," said Campbell Harvey, an international business professor at Duke University in Durham, N.C. "That's my No. 1 theme. You need to know what you don't know."

Here, with the help of several sources who patiently explained these terms to a reporter, is a closer look at terms that are suddenly part of the American lexicon:

Subprime loan: A loan offered to a borrower who has a shaky credit history. The loan has a higher interest rate because it carries more risk. They are widely credited with causing the housing bubble.

Derivative: A financial instrument whose value is based on another security, such as a stock or bond. For example, a mortgage-backed security is a type of derivative whose value is determined by the value of mortgages. Investors typically get income from the mortgage payments. It's a good investment when homeowners pay their mortgages. It's a big problem when they don't.

Collateralized debt obligation: Another product offered to investors. It's a pool of securities that have collateral. One example: The aforementioned mortgage-backed securities, whose collateral is real estate.

Credit default swap: A type of insurance offered to investors on a debt obligation, such as a bond. Investors pay a low premium on strong companies because the companies are more likely to meet their debt

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payments. They pay a bigger premium on shaky companies that are more likely to default. If the company defaults, investors collect. These contracts have value by themselves and can be traded to an investor who doesn't own the bond. What happens when a once-solid company defaults? Pray the insurer has enough money to pay it off.

Credit crisis: An environment where lending activity is severely restricted. The economy needs credit to expand. Credit is hard to come by. Hence, a crisis. It's also been referred to as a credit crunch and other, unprintable, terms.

LIBOR: Short for the London Interbank Offered Rate. The interest rate a consortium of London banks charge each other for short-term loans of three or six months. It sets a benchmark for adjustable rate loans. A higher LIBOR makes loans more expensive and means credit is in tight supply. Often confused with Napoleon Dynamite's favorite animal, a liger — a half-lion, half-tiger.

Commercial paper: A financial instrument sold to money-market accounts. Corporations tap into commercial paper to fund short-term operating costs, like payroll or inventory. It is less expensive than a line of credit from a bank. And they pay it back, plus interest, within nine months. It is viewed as a safe investment, unless skittish investors hold onto their money. Then companies scramble to pay their workers.

Break the buck: Money-market funds that are invested in corporate debt need to keep a net asset value of $1 a share, so investors' money is safe. If a corporation defaults on its debt on a massive scale, money market's assets may fall below $1 a share. That means investors take a loss — at least if they withdraw their money immediately. That's a bad sign, given that money markets are designed to be safe.

Hedge fund: An investment fund for wealthy individuals or institutions that hedges its bets to offset stock market risk. Some of its investments have been mentioned above — derivatives and credit default swaps to name a couple. They also can sell a stock short, meaning an investor borrows stock and agrees to buy the stock at a lower price. If the stock falls, they make a profit. If it rises, they take a loss. They fall outside federal regulatory guidelines, and they have higher fees than regular asset managers.

Naked short selling: A highly controversial practice and not because hedge-fund managers don't wear clothes. Investors bet on a stock to fall — without first borrowing the stock. Some believe the practice makes the stock market easily manipulated. The federal government says only that it is against "abusive" naked short selling.

Nationalize: The act of the federal government taking control of a private-sector company. Popular in socialist countries. Technically, the United States nationalized Fannie Mae and Freddie Mac, two mortgage companies, during the recent crisis. And it nationalized banks by pumping billions of dollars into them in exchange for an ownership stake. But the federal government has rejected the term when discussing companies in line to receive loans from the $750 billion bailout package.

Moral hazard: The idea that a company may behave recklessly if they know they are protected, like a child who isn't punished for behaving like a brat. For example, Fannie Mae and Freddie Mac might have purchased risky loans because they knew the government would step in to save them if something went wrong.

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