



**“What Directors Need to Know About Hedging”**  
**Members-Only Breakfast**  
**October 9, 2008**

**Important Terms:**

<b>Hedge:</b> transaction to reduce risk
<b>Speculate:</b> transaction to increase risk, with hope of expected return
<b>Arbitrage:</b> transaction to lock in (hopefully) a riskless profit
<b>Interest rate risk:</b> exposure to changes in interest rates, such as floating vs. fixed
<b>FX risk:</b> exposure to changes in foreign currency rates
<b>Commodity risk:</b> exposure to changes in other financial variables
<b>Forward/future:</b> obligation to buy or sell at a future time and price
<b>Option:</b> right to buy or sell at a future time and price
<b>Call:</b> right to buy
<b>Put:</b> right to sell
<b>Swap:</b> private two-way contract to exchange cash over time
<b>Derivatives:</b> catch-all term for forwards, options, swaps, and related instruments
<b>Delta hedging:</b> buying and selling based on price changes to maintain hedges
<b>VAR:</b> "value-at-risk," a normal distribution-based estimate of maximum daily loss
<b>FAS 133:</b> accounting for derivatives
<b>Basis risk:</b> mismatch between instruments or indices
<b>Credit risk:</b> risk of default, failure of counterparty
<b>Liquidity risk:</b> risk of a difficulty or inability to sell