

Glossary of Key Terms

American option. An option that can be exercised at any time up until the expiration date.

Call option. The right (but not the obligation) to buy a fixed amount of currency from the option writer (option seller) at a predetermined exchange rate and/or exercise price prior to the expiration date stipulated in the contract.

Central bank. The only institution that has the right to issue bank notes and that constitutes the monetary and credit policy authority of a currency zone. Apart from this, it supplies the economy with money and credit, regulates domestic and foreign payments transactions and maintains internal and external monetary stability.

Collar. An option contract that sets upper and lower exchange rate parameters that will be adhered to even if the market rate lies outside this range. Cross-rate exchange rate between two non-U.S. dollar currencies.

Currency basket. Various weightings of other currencies grouped together in relation to a basket currency, such as the ECU.

Devaluation. Reduction in the external value of a currency. This occurs with free exchange rates via the foreign exchange market, in that the price of the domestic currency drops against a specific unit of foreign currency. With fixed exchange rates, the parity of the domestic against the foreign currency is lowered administratively.

Discount. The amount the forward rate is reduced relative to the spot rate, i.e., the forward rate is lower than the spot rate.

EMU. Economic and Monetary Union of Europe. EMU's goal is to create a single European market for goods and services. As of January 1, 2008, the following countries were EMU members: Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal, Slovenia, and Spain.

Euro (EUR). A single currency introduced to replace the individual national currencies of EMU member countries. The national currencies are convertible into euros at an irrevocable fixed exchange rate. The euro replaced the ECU (European Currency Unit), a composite basket currency used as a unit of account, at a one-to-one rate on January 1, 1999.

Eurodollar. Name for U.S. dollar-denominated deposits and claims held outside the U.S.

European option. An option that can only be exercised on the expiration date, not during the option period as with an American option.

Exchange control. State control of all payment and asset transactions with foreign countries.

Exchange rate. Price of a foreign currency expressed in domestic currency, e.g., \$/CHF = 1.5 means that one U.S. dollar costs 1.5 Swiss francs.

Exercise price. Strike price of an option.

Expiration date. The last day on which an option can be exercised.

Foreign exchange. Worldwide system of contacts between non-bank foreign exchange dealers and foreign exchange traders (bank and non-bank) that are executed by telephone, telex or personal market computer; place or entity where foreign exchange rates are determined.

Foreign exchange trading. Buying and selling of foreign currency, holding currency positions, trading foreign exchange arbitrage, or foreign exchange speculation in the foreign exchange market.

Forward contract. A contractual obligation to buy or sell a foreign currency at an agreed upon rate for settlement in the future (more than two business days after the rate was agreed upon).

continued on reverse side



Option. The contractually agreed upon right to buy (call) or sell (put) a specific amount of currency at a predetermined price on (European option) or up to (American option) a future date.

- **In-the-money call option** When the market price is greater than the strike price.
- **In-the-money put option** When the market price is less than the strike price.
- **Out-of-the-money call option** When the market price is less than the strike price.
- **Out-of-the-money put option** When the market price is greater than the strike price.

Premium. Forward points corresponding to interest rate differentials that are added to the spot rate; price of an option that the option buyer pays to the option writer.

Put option. The right (but not the obligation) to sell a fixed amount of currency to the option writer (option seller) at a predetermined exchange rate and/or exercise price prior to the expiration date stipulated in the contract.

Spot contract. A contractual obligation to buy or sell foreign currency for settlement two business days after the trade was made.

Strike price. Price at which the option buyer can purchase (call option) or sell (put option) the underlying currency.

Swap transaction. Sale of one currency against another currency at a specific maturity and the simultaneous repurchase from the same counterparty at a different maturity.

Technical analysis. Analysis of past price and volume trends—often with the help of chart analysis—in a market in order to make forecasts about the future price developments of the commodity being traded. Often used in short-term exchange rate forecasts.

Value date. The date on which the spot or forward contract settles.

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