GLOSSARY

Arbitrage	The simultaneous purchase and sale of a position in different markets or with different counterparties in order to earn a risk-free profit from pricing discrepancies. It can also involve taking offsetting positions in the same or similar risks in order to profit from an expected convergence of relative values.
Asset-backed security (ABS)	A security that is collateralized by loans, leases, receivables, or installment contracts on personal property, but not real estate and commercial or residential mortgages. When the securities are collateralized by mortgages, they are called commercial mortgage-backed securities (CMBSs) or residential mortgage-backed securities (RMBSs).
Asset/liability management (ALM)	The management of assets to ensure that liabilities are sufficiently covered by suitable assets when they fall due.
Assets under management (AUM)	The market value of assets that an investment company (i.e., pension fund, insurance company, mutual fund, hedge fund, etc.) manages for itself or on behalf of investors.
Back office	The office or unit within a financial institution that carries out support and administrative functions, such as trade settlement and accounting.
Bankruptcy remoteness	In the context of ABS and CDO issuance, the degree to which a special purpose vehicle (SPV) is protected from bankruptcy proceedings, which could potentially override the SPV's contractual loss prioritization mechanics.
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 were issued in the early 1990s.
CDO capital structure	In a full capital structure transaction, the tranches that are sold to investors cover all potential SPV losses. In partial structure transactions, only some of the potential losses are transferred to capital markets.
Carry trade	A leveraged transaction in which borrowed funds are used to take a position in which the expected return exceeds the cost of the borrowed funds. The "cost of carry" or "carry" is the difference between the yield on the security and the financing cost (e.g., in a "positive carry," the yield exceeds the financing cost).
Collateralized debt obligations (CDOs)	A structured debt security backed by the performance of a portfolio of securities, loans, or credit default swaps, and where securitized interests in the portfolio's performance are divided into tranches with differing repayment and interest earning streams. In the event of non-payment or default, the higher-risk "equity" tranche absorbs the first

	loss from anywhere in the portfolio, up to a limit. After the equity tranche has been exhausted, the next least-secured tranche then absorbs the additional principal loss, and so on. When the tranches are backed by securities or loans, the structure is called a "cash" CDO, and when backed by CDSs, it is a "synthetic" CDO.
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.
Correlation trading	Trading motivated by anticipated changes in the expected correlations of credit defaults and spread movements among specific credits and indices.
Counterparty risk	The potential loss on a transaction from a counterparty's failure to honor contractual obligations. Losses are usually measured in terms of contract replacement cost.
Credit derivatives and credit default swaps (CDSs)	A financial contract under which an agent buys or sells risk protection against the credit risk associated with a specific reference entity (or specific entities). For a periodic fee, the protection seller agrees to make a contingent payment to the buyer on the occurrence of a credit event (default in the case of a credit default swap (CDS)). Most CDS default settlements are "physical," whereby the protection seller buys a defaulted reference asset from the protection buyer at its face value. "Cash" settlement involves a net payment to the protection buyer equal to the difference between the reference asset face value and the price of the defaulted asset.
Credit-linked note (CLN)	A security backed by one or more credit derivative contracts.
Credit risk	The potential for losses on fixed-income investments and derivative contracts, caused by issue and counterparty defaults, and market value losses related to credit quality deterioration.
Credit spreads	The spread between 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). Sometimes simply referred to as "spread."
Derivatives	Financial contracts whose value derives from underlying securities prices, interest rates, foreign exchange rates, commodity prices, and market or other indices.
Dollarization	The widespread substitution of the U.S. dollar for the domestic currency in a country 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 JPMorgan Emerging Market Bond Index that tracks the total returns for traded external debt instruments in the emerging markets.

EMEA	Europe, Middle East, and Africa.
GBI-EM	JPMorgan Government Bond Index-Emerging Markets—a new index developed to track returns on local currency domestic government bonds in emerging markets.
Hedge funds	Investment funds that are typically organized as private partnerships and often resident offshore for tax reasons. Subject to few restrictions on their portfolios and transactions, they use a variety of investment techniques, including short positions, derivatives transactions, and leverage.
Hedging	Offsetting an existing exposure by taking an opposite position in the same or a similar risk, for example, by buying derivative contracts.
High-yield bonds	Bonds with noninvestment-grade credit ratings (below BBB–) (S&P and Fitch) or Baa3 (Moody's) that offer investors higher yields than bonds of financially sound companies. High-yield bonds are also known as "junk" bonds.
Interest rate swaps	An agreement between counterparties to exchange periodic interest payments based on different references on a predetermined notional amount. Typically, one party will make fixed-rate and receive variable-rate interest payments.
Investment-grade issues	Bonds or loans that are assigned a rating in the top four categories by commercial credit rating agencies. S&P and Fitch classify investment-grade obligations as BBB–, or higher, and Moody's as Baa3 or higher. Obligations rated below investment grade are labeled "high-yield" or "junk."
Large complex financial institution (LCFI)	A large financial institution that is involved in a diverse range of financial activities and/or in diverse geographical areas.
Leverage	The proportion of debt to equity. Leverage can be built up by direct borrowing (on-balance-sheet leverage, commonly measured by debt-to-equity ratios) or by using off-balance-sheet transactions. In the hedge fund context, leverage can be defined in terms of an economic risk to equity ratio, or a ratio of effectively invested funds to equity.
Leveraged loans	Bank loans that are rated below investment grade (BB+ and lower by S&P or Fitch, and Ba1 and lower by Moody's) to firms with a debt-to-EBITDA ratio of three times or greater, or that trade at wide spreads over LIBOR (e.g., more than 125 basis points). ("Earnings before interest, taxes, depreciation, and amortization" (EBITDA) is a balance sheet leverage measure, and LIBOR is the "London Interbank Offered Rate.")
Liquidity risk	The potential for losses associated with an inability to fund obligations as they come due ("funding liquidity") and the potential inability to sell or unwind positions ("market liquidity").

Mark-to-market	The valuation of a position or portfolio by reference to the most recent price of a financial instrument.
Market maker	A bank or broker-dealer that stands ready to buy or sell a particular financial instrument on a regular and continuous basis at reasonably tight bid-offer spreads, and that is recognized as such by market participants.
Mutual fund	An investment company that pools money from shareholders and invests it in a group of assets, in accordance with a stated set of objectives. Open-ended mutual funds sell and redeem shares at any time directly to shareholders. Closed-end funds generally sell a fixed number of shares, which trade on an exchange.
Notional value	The face value of the assets that underlie a derivatives contract.
Novation	The reassignment of a derivative contract to another counterparty.
Over-the-counter market (OTC)	A decentralized market in which market participants trade over a telephone, facsimile, or electronic network instead of on a public exchange or physical trading floor.
Portfolio swap	A credit derivative that references a portfolio of single-name CDSs. In a bespoke transaction, the portfolio is customized for a particular investor, and in an index trade, it is based around a standardized CDS index, such as one of the U.S.-based CDX or Europe-based iTraxx indexes.
Price discovery	The process of determination of market prices through the interaction of market supply and demand.
Primary market	The market in which a newly issued security is first offered/sold to investors.
Proprietary trading	In an investment bank, the group that trades, using the bank's own capital, typically for direct gains, rather than for fee or commission income from customers.
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.
Recovery rate	The post-default value of a bond or loan, usually expressed as a percentage of face value. The loss-given-default (LGD) rate is the loss amount, also usually expressed as a percentage of face value.
Regulatory arbitrage	A transaction by a regulated institution designed to profit from the difference between its own-calculated economic risk capital requirement, and that required by regulators.
Reinsurance	Insurance purchased by an underwriter (insurer) from another company (reinsurer) to cut down the amount of risk assumed by the underwriter under the original insurance contact.

Risk premium	The extra expected return on an asset that investors demand in exchange for accepting the risk associated with the asset.
Secondary markets	Markets in which securities are traded after they are initially offered/sold in the primary market.
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 (a "special purpose vehicle" (SPV) or "special purpose entity" (SPE)). With a "synthetic" securitization, the securities are created out of a portfolio of derivative instruments.
Short selling	Selling an asset that the seller does not own but is borrowed with a commitment to eventually repurchase, typically in order to profit from an expected decline in the asset's price.
Syndicated loans	Loans made jointly by a group of banks to one borrower. One or several lead banks take a larger percentage of the loan and partition (i.e., "syndicate") the balance to other banks.
Synthetic risk transfer	The transfer of risk using derivative instruments (e.g., credit derivatives).
True sale	In the context of securitization, the absolute transfer of ownership of an asset and all of the legal rights of ownership into a special purpose vehicle, so that it is insulated from the originator's bankruptcy.
Value-at-Risk (VaR)	An estimate of the loss, over a given horizon, that is statistically unlikely to be exceeded at a given probability level.
Yield curve	A chart that plots the yield to maturity at a specific point in time for debt securities with equal or similar credit risk but different maturity dates.