GLOSSARY

ABX	An index of credit default swaps referencing 20 bonds collateralized by subprime mortgages.
Asset-backed commercial paper (ABCP)	Commercial paper collateralized by loans, leases, receivables or asset-backed securities.
Asset-backed security (ABS)	A security that is collateralized by the cash flows from a pool of underlying loans, leases, receivables, installment contracts on personal property, or on real estate. Often, when the security is collateralized by real estate, it is called a mortgage-backed security (MBS), although in principle an MBS is a type of ABS.
Assets under management (AUM)	Assets managed by an investment company on behalf of investors.
Call (put) option	A financial contract that gives the buyer the right, but not the obligation, to buy (sell) a financial instrument at a set price on or before a given date.
Capital-to-risk-weighted assets ratio	A measure that represents an institution's capacity to cope with credit risk. It is often calculated as a ratio of categories of capital to assets, which are weighted for riskiness.
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 investment and the financing cost (e.g., in a "positive carry" the yield exceeds the financing cost).
Cash securitization	The creation of securities from a pool of preexisting assets and receivables that are placed under the legal control of investors through a special intermediary created for this purpose. This compares with a "synthetic" securitization where the generic securities are created out of derivative instruments.
CAT (catastrophe) bonds	A type of insurance-linked security whereby investors bear risk if a specified catastrophic event occurs in return for an interest premium.
Collateralized debt obligation (CDO)	A structured credit security backed by a pool of securities, loans, or credit default swaps, and where securitized interests in the security are divided into tranches with differing repayment and interest earning streams.

Collateralized loan obligation (CLO)	A structured vehicle backed by whole commercial loans, revolving credit facilities, letters of credit, or other asset-backed securities.
Commercial paper	A private unsecured promissory note with short maturity. It need not be registered with the Securities and Exchange Commission provided the maturity is within 270 days, and it is typically rolled over such that new issues finance maturing ones.
Corporate governance	The governing relationships between all the stakeholders in a company—including the shareholders, directors, and management—as defined by the corporate charter, bylaws, formal policy, and rule of law.
Credit default swap (CDS)	A default-triggered credit derivative. 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 derivative	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).
Credit-linked note (CLN)	A security that is bundled with an embedded credit default swap and is intended to transfer a specific credit risk to investors. CLNs are usually backed by highly rated collateral.
Credit risk indicator	An indicator that measures the probability of multiple defaults among the firms in selected portfolios.
Credit spread	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).
Derivatives	Financial contracts whose value derives from underlying securities prices, interest rates, foreign exchange rates, commodity prices, and market or other indices.
EBITDA	Earnings before interest, taxes, depreciation, and amortization.
Economic risk capital (ERC)	An assessment of the amount of capital a financial institution requires to absorb losses from extremely unlikely events over long time horizons with a given degree of certainty. ERC calculations make provision not just for market risk, but also for credit and operational risks, and may also take account of liquidity, legal, and reputational risks.

EMBIG	JP Morgan's Emerging Market Bond Index Global, which tracks the total returns for traded external debt instruments in 34 emerging market economies with weights roughly proportional to the market supply of debt.
Emerging markets	Developing countries' financial markets that are less than fully developed, but are nonetheless broadly accessible to foreign investors.
Expected default frequency	An estimate of a firm's probability of default over a specific time horizon constructed using balance sheet and equity price data according to a Merton-type model.
Expected shortfall	The average expected portfolio loss, conditional on the loss exceeding the value-at-risk threshold.
Foreign direct investment (FDI)	The acquisition abroad (i.e., outside the home country) of physical assets, such as plant and equipment, or of a controlling stake in a company (usually greater than 10 percent of shareholdings).
Generalized method of moments (GMM)	A generalized statistical method—used primarily in econometrics—for obtaining estimates of parameters of statistical models; many common estimators in econometrics, such as ordinary least squares, are special cases of the GMM. The GMM estimator is robust in that it does not require information on the exact distribution of the disturbances.
Hedge funds	Investment pools, typically organized as private partnerships and often resident offshore for tax and regulatory purposes. These funds face few restrictions on their portfolios and transactions. Consequently, they are free to use a variety of investment techniques—including short positions, transactions in derivatives, and leverage—to raise returns and cushion risk.
Hedging	Offsetting an existing risk exposure by taking an opposite position in the same or a similar risk, for example, by buying derivatives contracts.
Home-equity loan/Home-equity line of credit (HEL/HELOC)	Loans or lines of credit drawn against the equity in a home, calculated as the current market value less the value of the first mortgage. When originating a HEL or HELOC, the lending institution generally secures a second lien on the home, i.e., a claim that is subordinate to the first mortgage (if it exists).
Implied volatility	The expected volatility of a security's price as implied by the price of options or swaptions (options to enter into swaps) traded on that security. Implied volatility is computed as the expected standard deviation that must be imputed to investors to satisfy risk neutral arbitrage conditions, and is calculated with the use of an options pricing model such as Black-Scholes. A rise in implied volatility suggests the market is willing to pay more to insure against the risk of higher volatility, and hence implied volatility is sometimes used as a measure of risk

	appetite (with higher risk appetite being associated with lower implied volatility). One of the most widely quoted measures of implied volatility is the VIX, an index of implied volatility on the S&P 500 index of U.S. stocks.
Institutional investor	A bank, insurance company, pension fund, mutual fund, hedge fund, brokerage, or other financial group that takes large investments from clients or invests on its own behalf.
Interest rate swap	An agreement between counterparties to exchange periodic interest payments on some predetermined dollar principal, which is called the notional principal amount. For example, one party will make fixed-rate and receive variable-rate interest payments.
Intermediation	The process of transferring funds from the ultimate source to the ultimate user. A financial institution, such as a bank, intermediates credit when it obtains money from depositors or other lenders and on-lends it to borrowers.
Investment-grade obligation	A bond or loan is considered investment grade if it is assigned a credit rating in the top four categories. S&P and Fitch classify investment-grade obligations as BBB- or higher, and Moody's classifies investment grade bonds as Baa3 or higher.
Large complex financial institution (LCFI)	A major financial institution frequently operating in multiple sectors and often with an international scope.
Leverage	The proportion of debt to equity. Leverage can be built up by borrowing (on-balance-sheet leverage, commonly measured by debt-to-equity ratios) or by using off-balance-sheet transactions.
Leveraged buyout (LBO)	Acquisition of a company using a significant level of borrowing (through bonds or loans) to meet the cost of acquisition. Usually, the assets of the company being acquired are used as collateral for the loans.
Leveraged loans	Bank loans that are rated below investment grade (BB+ and lower by S&P or Fitch, and Baa1 and lower by Moody's) to firms with a sizable debt-to-EBITDA ratio, or trade at wide spreads over LIBOR (e.g., more than 150 basis points).
LIBOR	London Interbank Offered Rate.
Liquidity-adjusted value-at-risk (L-VaR)	A value-at-risk calculation that makes an adjustment for the trading liquidity of the assets that constitute the assessed portfolio. This can either be limits on trading positions in the portfolio linked to the assets' underlying turnover or adjustments made to the VaR's volatility and correlation structures to take account of illiquidity risk in extreme circumstances.

Mark-to-market	The valuation of a position or portfolio by reference to the most recent price at which a financial instrument can be bought or sold in normal volumes. The mark-to-market value might equal the current market value—as opposed to historic accounting or book value—or the present value of expected future cash flows.
Mezzanine capital	Unsecured, high-yield, subordinated debt, or preferred stock that represents a claim on a company's assets that is senior only to that of a company's shareholders.
Mortgage-backed security (MBS)	A security that derives its cash flows from principal and interest payments on pooled mortgage loans. MBSs can be backed by residential mortgage loans (RMBS) or loans on commercial properties (CMBS).
Nonperforming loans	Loans that are in default or close to being in default (i.e., typically past due for 90 days or more).
Payment-in-kind toggle note	A note (or loan) feature that gives the borrower the option to defer the interest due on existing debt or to make payment using new debt, and in the process pay an effectively higher interest rate.
Primary market	The market in which a newly issued security is first offered/sold to investors.
Private equity	Shares in companies that are not listed on a public stock exchange.
Private equity funds	Pools of capital invested by private equity partnerships. Investments can include leveraged buyouts, as well as mezzanine and venture capital. In addition to the sponsoring private equity firm, other qualified investors can include pension funds, financial institutions, and wealthy individuals.
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.
Risk aversion	The degree to which an investor who, when faced with two investments with the same expected return but different risk, prefers the one with the lower risk. That is, it measures an investor's aversion to uncertain outcomes or payoffs.
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 preexisting 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.
Security arbitrage conduit	A conduit (a vehicle that issues ABCP only) that is formed specifically for the purpose of investing in assets using relatively cheap financing. The mix of assets can change over time.
Sovereign wealth fund (SWF)	A special investment fund created/owned by government to hold assets for long-term purposes; it is typically funded from reserves or other foreign currency sources and predominantly owns, or has significant ownership of, foreign currency claims on nonresidents.
Spread	See "credit spread" (the word credit is sometimes omitted). Other definitions include (1) the gap between bid and ask prices of a financial instrument; and (2) the difference between the price at which an underwriter buys an issue from the issuer and the price at which the underwriter sells it to the public.
Structured investment vehicle (SIV)	A legal entity, whose assets consist of asset-backed securities and various types of loans and receivables. An SIV's liabilities are usually tranched and include debt that matures in less than one year and must be rolled over.
Sub-investment-grade obligation	An obligation rated below investment-grade, sometimes referred to as "high-yield" or "junk."
Subprime mortgages	Mortgages to borrowers with impaired or limited credit histories, who typically have low credit scores.
Swaps	An agreement between counterparties to exchange periodic interest payments based on different references on a predetermined notional amount. For example, in an interest rate swap, one party will make fixed-rate and receive variable-rate interest payments.
Syndicated loans	Large loans made jointly by a group of banks to one borrower. Usually, one lead bank takes a small percentage of the loan and partitions (syndicates) the rest to other banks.
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 having equal credit risk but different maturity dates.