

GLOSSARY

Asset-backed commercial paper (ABCP)	Commercial paper collateralized by a pool of loans, leases, receivables, or structured credit products.
Asset-backed security (ABS)	A security that is collateralized by the cash flows from a pool of underlying assets, such as loans, leases, and receivables. Often, when the cash flows are collateralized by real estate, an ABS is called a mortgage-backed security.
Asset-backed securities index (ABX)	An index of credit default swaps referencing 20 bonds collateralized by subprime mortgages.
Basel II	An accord providing a comprehensive revision of the Basel capital adequacy standards issued by the Basel Committee on Banking Supervision. Pillar I of the accord covers the minimum capital adequacy standards for banks, Pillar II focuses on enhancing the supervisory review process, and Pillar III encourages market discipline through increased disclosure of banks' financial condition.
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.
Carry trade	A leveraged transaction in which borrowed funds are used to take a position in which the expected interest return exceeds the cost of the borrowed funds. The "cost of carry" or "carry" is the difference between the interest yield on the investment and the financing cost (e.g., in a "positive carry" the yield exceeds the financing cost).
Collateralized debt obligation (CDO)	A structured credit security backed by a pool of securities, loans, or credit default swaps, where securitized interests in the security are divided into tranches with differing repayment and interest earning streams. The pool can be either managed within preset parameters or static. If the CDO is backed by other structured credit securities, it is called a structured finance CDO, and if it is backed solely by other CDOs, it is called a CDO-squared.
Collateralized loan obligation (CLO)	A collateralized debt obligation backed by whole commercial loans, revolving credit facilities, or letters of credit.
Commercial paper	A private unsecured promissory note with a short maturity. It need not be registered with the U.S. Securities and Exchange Commission provided the maturity is within 270 days; typically, new issues refinance maturing ones.
Conduit	A legal entity whose assets consist of various types of loans, receivables, and structured credit products. A conduit's liabilities are short-term commercial paper and are supported by a liquidity facility with 100 percent coverage.

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 conversion factor (CCF)	The factor by which off-balance-sheet positions are converted to credit risk equivalents for risk-based capital purposes. The resulting amount is then weighted according to the appropriate Basel Accord risk weight.
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. The CLN issuance proceeds are usually invested in liquid and highly rated securities to cover the principal repayment at maturity plus any interim conditional payments associated with the underlying credit default swap.
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 be able to absorb potential losses from its positions (including loans) 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	JPMorgan’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.

GLOSSARY

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 attempt 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, in related 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 option 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 investments from clients or invests on its own behalf.
Interest rate swap	An agreement between counterparties to exchange periodic interest payments on some predetermined 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 when it obtains money from depositors or other lenders and onlends to borrowers.
Internal ratings based (IRB) approach	A methodology of the Basel Capital Accord that enables banks to use their internal models to generate estimates of risk parameters that are inputs into the calculation of their risk-based capital requirements.
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 obligations 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 (also assets to equity and assets to capital). 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 (i.e., more than 150 basis points).
LIBOR	The London interbank offered rate is an index of the interest rates at which banks offer to lend unsecured funds to other banks in the London wholesale money market.
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.
Maturity mismatch	The difference in cash flows at different maturities when projected payment inflows and outflows are placed into maturity brackets.
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 or loans on commercial properties.
Nonperforming loans	Loans that are in default or close to being in default (i.e., typically past due for 90 days or more).
Overnight index swap (OIS)	An interest rate swap whereby the compounded overnight rate in the specified currency is exchanged for some fixed interest rate over a specified term.
Primary market	The market in which a newly issued security is first offered for sale to investors.
Private equity	Shares in privately held companies that are not listed on a public stock exchange.
Private equity funds	Pools of capital invested by private equity partnerships, typically involving the purchase of majority stakes in companies and/or entire business units to restructure the capital, management, and organization.
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.

GLOSSARY

Regulatory arbitrage	Taking advantage of differences in regulatory treatment across countries or different financial sectors, as well as differences between the real (economic) risks and the regulatory risk, to reduce regulatory capital requirements.
Repurchase agreement (repo)	An agreement whereby the seller of securities agrees to buy them back at a specified time and price. The transaction is a means of borrowing cash collateralized by the securities “repo-ed” at an interest rate implied by the forward repurchase price.
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 higher 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]). In the case of “synthetic” securitizations, the securities are created from a portfolio of derivative instruments.
Sovereign wealth fund (SWF)	A special investment fund created/owned by a government to hold assets for long-term purposes; it is typically funded from reserves or other foreign currency sources, including commodity export revenues, and predominantly owns, or has significant ownership of, foreign currency claims on nonresidents.
Spread	See “credit spread” above. Other definitions include (1) the gap between the bid and ask price 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.
Standing facility	A facility whereby a central bank’s specified counterparties can borrow from (or lend to) the central bank in excess of amounts supplied (or withdrawn) through routine open market operations. Such a facility is usually charged at a penal rate and collateralized.
Structured credit product	An instrument that pools and tranches credit risk exposure, including mortgage-backed securities and collateralized debt obligations.
Structured investment vehicle (SIV)	A legal entity, whose assets consist of asset-backed securities and various types of loans and receivables. An SIV’s funding liabilities are usually tranching and include short- and medium-term debt; the solvency of the SIV is put at risk if the value of the assets of the SIV falls below the value of the maturing liabilities.

Subinvestment-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.
Swap	An agreement between counterparties to exchange periodic interest payments based on different references on a predetermined notional amount.
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	The relationship between the interest rates (or yields) and time to maturity for debt securities of equivalent credit risk.