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, or 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 or home equity loans.
Auction rate security	Long-term debt or preferred stock for which the coupon or dividend is regularly reset via Dutch auction.
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 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. U.S. issues need not be registered with the 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 usually consist of short-term commercial paper and are supported by a liquidity facility with 100 percent coverage.
Convertible arbitrage strategy	A strategy entailing a long position on a convertible security and a short position on the underlying stock into which it converts.
Covered bond	A debt obligation on which the investor has recourse first to a pool of assets that secures the bond. Unlike asset-backed securities, covered bonds remain on the issuer's consolidated balance sheet and thus provide creditors with a second level of protection through recourse to other assets of the borrower.
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 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 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).
Derivative	A financial contract whose value derives from underlying securities prices, interest rates, foreign exchange rates, commodity prices, or market and other indices.
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 (EMs)	Developing countries' financial markets that are less than fully developed, but are nonetheless broadly accessible to foreign investors.
Government-sponsored enterprise (GSE)	A financial institution that provides credit to specific groups or areas of the economy, such as farmers or housing. Most GSEs maintain legal and/or financial ties to the government.
Fixed-effects panel data model	An econometric panel data technique that accounts for possible time-invariant unobserved characteristics in the underlying data.

GARCH model	The Generalized Autoregressive Conditional Heteroskedasticity (GARCH) framework allows for the modeling of the volatility—second moments—of the variables of interest. In the Dynamic Conditional Correlation (DCC) GARCH model, correlations are time-varying.
Hedge fund	Investment pool, typically organized as a private partnership 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 risk.
Hedging	Offsetting an existing risk exposure by taking an opposite position in the same or 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 an 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).
Hybrid security	A broad group of securities that combine the elements of both debt and equity. They pay a fixed or floating rate coupon or dividend until a certain date, at which point the holder has a number of options including converting the securities into the underlying share. Therefore, unlike equity, the holder has a predetermined cash flow, and, unlike a fixed-income security, the holder has the option to gain when the issuer's equity price rises. It is typically subordinate to other debt obligations in the capital structure of the firm.
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 by investors to satisfy risk neutral arbitrage conditions, and is calculated with the use of an options pricing model such as Black-Scholes.
Impulse response function	An econometric technique typically used for vector autoregressions that traces the impact to the variable in question over time from a shock to another variable.
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.

Term	Definition
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.
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)	The 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 loan	A bank loan that is 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 (earnings before interest, taxes, depreciation, and amortization) ratio, or trade at wide spreads over LIBOR (e.g., 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.
Loss given default (LGD)	The fraction of a loan or security's nominal value that would not be recovered following default.
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.
Mark-to-model	Pricing of a position or portfolio based on a set of assumptions and financial models.
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.
Originate-to-distribute model	A business model of financial intermediation, under which financial institutions originate loans such as mortgages, repackage them into securitized products, and then sell them to investors.

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.
Pfandbriefe	The German word (literally "letter of pledge") for covered bonds. They are mainly used to refinance mortgages or public projects, and issued only by specially authorized banks.
Prime brokerage	A bundled package of services provided by banks or investment banks to hedge funds, including global custody, securities lending, margin financing, portfolio reporting and accounting, and other operational support.
Private equity	Shares in privately held companies that are not listed on a public stock exchange.
Private equity fund	A pool of capital invested by a private equity partnership, typically involving the purchase of majority stakes in companies and/or entire business units to restructure their capital, management, and organization.
Probability of default (PD)	The likelihood that a loan or security will not be repaid and will fall into default.
Regulatory arbitrage	The process of 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.
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]). 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.
Stock market wealth effect	The impact from changes in stock values on macroeconomic variables, for instance, consumption or investment.
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 tranched 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.
Subprime mortgage	A mortgage 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 reference financial instruments on a predetermined notional amount.
Tender option bond	A debt obligation that grants the debt holder the right to require the issuer, or a third-party agent of the issuer, to purchase the debt, typically at par value.
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.
Variable rate demand obligation	A floating rate, long-term debt instrument on which the coupon is reset periodically, typically daily or weekly, and where the investor has the option to sell the instrument back to the issuer or issuer's agent.
Vector autoregression (VAR)	An econometric time series technique that models the dynamic interaction among the variables of interest.
Yield curve	The relation between the interest rates (or yields) and time to maturity for debt securities of equivalent credit risk.