

## APPENDIX A: GLOSSARY

*Italicized terms within definitions are defined separately.*

**ABCP** *see asset-backed commercial paper.*

**ABS** *see asset-backed security.*

**ABX.HE** A series of *derivatives* indices constructed from the prices of 20 *credit default swaps* that each reference individual subprime *mortgage-backed securities*; akin to an index like the Dow Jones Industrial Average.

**adjustable-rate mortgage** A mortgage whose interest rate changes periodically over time.

**affordable housing goals** Goals originally set by the *Department of Housing and Urban Development* (now by the Federal Housing Finance Agency) for *Fannie Mae* and *Freddie Mac* to allocate a specified part of their mortgage business to serve low- and moderate-income borrowers.

**ARM** *see adjustable-rate mortgage.*

**ARS** *see auction rate securities.*

**asset-backed commercial paper** Short-term debt secured by assets.

**asset-backed security** Debt instrument secured by assets such as mortgages, credit card loans or auto loans.

**auction rate securities** Long-term bonds whose interest rate may be reset at regular short-term intervals by an auction process.

**bank holding company** Company that controls a bank.

**broker-dealer** A firm, often the subsidiary of an investment bank, that buys and sells securities for itself and others.

**capital** Assets minus liabilities; what a firm owns minus what it owes. Regulators often require financial firms to hold minimum levels of capital.

**Capital Purchase Program** *TARP* program providing financial assistance to 700-plus U.S. financial institutions through the purchase of senior preferred shares in the corporations on standardized terms.

**CDO** *see collateralized debt obligation.*

**CDO squared** CDO that holds other CDOs.

**CDS** *see credit default swap.*

**CFTC** *see Commodity Futures Trading Commission.*

**collateralized debt obligation** Type of security often composed of the riskier portions of *mortgage-backed securities*.

**commercial paper** Short-term unsecured corporate debt.

**Commercial Paper Funding Facility** Emergency program created by the *Federal Reserve* in 2008 to purchase three-month unsecured and *asset-backed commercial paper* from eligible companies.

**Commodity Futures Trading Commission** Independent federal agency that regulates trading in futures and options.

- Community Reinvestment Act** 1977 federal law encouraging *depository institutions* to make loans and provide services in the local communities in which they take deposits.
- Consolidated Supervised Entities program** A *Securities and Exchange Commission* program created in 2004 and terminated in 2008 that provided voluntary supervision for the five largest investment bank conglomerates.
- Counterparty** A party to a contract.
- CP** see *commercial paper*.
- CPP** see *Capital Purchase Program*.
- CRA** see *Community Reinvestment Act*.
- credit default swap** A type of *credit derivative* allowing a purchaser of the swap to transfer loan default risk to a seller of the swap. The seller agrees to pay the purchaser if a default event occurs. The purchaser does not need to own the loan covered by the swap.
- credit enhancement** Insurance or other protection that may be purchased for a loan or pool of loans to offset losses in the event of default.
- credit loss** Loss from delayed payments or defaults on loans.
- credit rating agency** Private company that evaluates the credit quality of securities and provides ratings on those securities; the largest are Fitch Ratings, Moody's Investors Service, and Standard & Poor's.
- credit risk** Risk to a lender that a borrower will fail to repay the loan.
- CSE** Consolidated Supervised Entity (see *Consolidated Supervised Entities program*).
- debt-to-income ratio** One measure of a borrower's ability to repay a loan, generally calculated by dividing the borrower's monthly debt payments by gross monthly income.
- delinquency rate** The number of loans for which borrowers fail to make timely loan payments divided by total loans.
- Department of Housing and Urban Development** Cabinet-level federal department responsible for housing policies and programs.
- Department of Justice** Cabinet-level federal department responsible for enforcement of laws and administration of justice, led by the attorney general.
- Department of Treasury** Treasury of the federal government; prints and mints all currency and coins, collects federal taxes, manages U.S. government debt instruments, supervises national banks and thrifts, and advises on domestic and international fiscal policy. Its mission includes protecting the integrity of the financial system.
- depository institution** Financial institution, such as a commercial bank, thrift (savings and loan), or credit union, that accepts deposits, including deposits insured by the *FDIC*.
- derivative** Financial contract whose price is determined (derived) from the value of an underlying asset, rate, index, or event.
- Fannie Mae** Nickname for the Federal National Mortgage Association (FNMA), a *government-sponsored enterprise* providing financing for the home mortgage market.
- FCIC** Financial Crisis Inquiry Commission.
- FDIC** see *Federal Deposit Insurance Corporation*.
- Federal Deposit Insurance Corporation** Independent federal agency charged primarily with insuring deposits at financial institutions, examining and supervising some of those institutions, and shutting down failing institutions.
- Federal Housing Administration** Part of the *Department of Housing and Urban Development* that provides insurance on mortgage loans made by FHA-approved lenders.
- Federal Housing Finance Agency** Independent federal regulator of *government-sponsored enterprises*; created by the *Housing and Economic Recovery Act* of 2008 as successor to the *Office of Federal Housing Enterprise Oversight* and the Federal Housing Finance Board.
- Federal Open Market Committee** Its members are the Board of Governors of the Federal Reserve

- System and certain of the presidents of the Federal Reserve Banks; oversees market conditions and implements monetary policy through such means as setting interest rates.
- Federal Reserve Bank of New York** One of 12 regional Federal Reserve Banks, with responsibility for regulating bank holding companies in New York State and nearby areas.
- Federal Reserve** U.S. central banking system created in 1913 in response to financial panics, consisting of the Federal Reserve Board in Washington, DC, and 12 Federal Reserve Banks around the country; its mission is to implement monetary policy through such means as setting interest rates, supervising and regulating banking institutions, maintaining the stability of the financial system, and providing financial services to depository institutions.
- FHA** see *Federal Housing Administration*.
- FHFA** see *Federal Housing Finance Agency*.
- FICO score** A measure of a borrower's creditworthiness based on the borrower's credit data; developed by the Fair Isaac Corporation.
- Financial Crimes Enforcement Network** Treasury office that collects and analyzes information about financial transactions to combat money laundering, terrorist financing, and other financial crimes.
- FinCEN** see *Financial Crimes Enforcement Network*.
- FOMC** see *Federal Open Market Committee*.
- foreclosure** Legal process whereby a mortgage lender gains ownership of the real property securing a defaulted mortgage.
- Freddie Mac** Nickname for the Federal Home Loan Mortgage Corporation (FHLMC), a *government-sponsored enterprise* providing financing for the home mortgage market.
- Ginnie Mae** Nickname for the Government National Mortgage Association (GNMA), a *government-sponsored enterprise*; guarantees pools of VA and FHA mortgages.
- Glass-Steagall Act** Banking Act of 1933 creating the *FDIC* to insure bank deposits; prohibited commercial banks from underwriting or dealing in most types of securities, barred banks from affiliating with securities firms, and introduced other banking reforms. In 1999, the *Gramm-Leach-Bliley Act* repealed the provisions of the Glass-Steagall Act that prohibited affiliations between banks and securities firms.
- government-sponsored enterprise** A private corporation, such as *Fannie Mae* and *Freddie Mac*, created by the federal government to pursue certain public policy goals designated in its charter.
- Gramm-Leach-Bliley Act** 1999 legislation that lifted certain remaining restrictions established by the *Glass-Steagall Act*.
- GSE** see *government-sponsored enterprise*.
- haircut** The difference between the value of an asset and the amount borrowed against it.
- hedge** In finance, a way to reduce exposure or risk by taking on a new financial contract.
- hedge fund** A privately offered investment vehicle exempted from most regulation and oversight; generally open only to high-net-worth investors.
- HOEPA** see *Home Ownership and Equity Protection Act*.
- Home Ownership and Equity Protection Act** 1994 federal law that gave the *Federal Reserve* new responsibility to address abusive and predatory mortgage lending practices.
- Housing and Economic Recovery Act** 2008 law including measures to reform and regulate the *GSEs*; created the *Federal Housing Finance Agency*.
- HUD** see *Department of Housing and Urban Development*.
- hybrid CDO** A *CDO* backed by collateral found in both cash *CDOs* and synthetic *CDOs*.
- illiquid assets** Assets that cannot be easily or quickly sold.
- interest-only loan** Loan that allows borrowers to pay interest without repaying principal until the end of the loan term.

- leverage** A measure of how much debt is used to purchase assets; for example, a leverage ratio of 5:1 means that \$5 of assets were purchased with \$4 of debt and \$1 of *capital*.
- LIBOR** London Interbank Offered Rate, an interest rate at which banks are willing to lend to each other in the London interbank market.
- liquidity** Holding cash and/or assets that can be quickly and easily converted to cash.
- liquidity put** A contract allowing one party to compel the other to buy an asset under certain circumstances. It ensures that there will be a buyer for otherwise illiquid assets.
- loan-to-value ratio** Ratio of the amount of a mortgage to the value of the house, typically expressed as a percentage. "Combined" loan-to-value includes all debt secured by the house, including second mortgages.
- LTV ratio** see *loan-to-value ratio*.
- mark-to-market** The process by which the reported amount of an asset is adjusted to reflect the market value.
- monoline** Insurance company, such as AMBAC and MBIA, whose single line of business is to guarantee financial products.
- mortgage servicer** Company that acts as an agent for mortgage holders, collecting and distributing payments from borrowers and handling defaults, modifications, settlements, and foreclosure proceedings.
- mortgage underwriting** Process of evaluating the credit characteristics of a mortgage and borrower.
- mortgage-backed security** Debt instrument secured by a pool of mortgages, whether residential or commercial.
- NAV** see *net asset value*.
- negative amortization loan** Loan that allows a borrower to make monthly payments that do not fully cover the interest payment, with the unpaid interest added to the principal of the loan.
- net asset value** Value of an asset minus any associated costs; for financial assets, typically changes each trading day.
- net charge-off rate** Ratio of loan losses to total loans.
- non-agency mortgage-backed securities** *Mortgage-backed securities* sponsored by private companies other than a *government-sponsored enterprise* (such as *Fannie Mae* or *Freddie Mac*); also known as *private-label mortgage-backed securities*.
- notional amount** A measure of the outstanding amount of over-the-counter *derivatives* contracts, based on the amount of the underlying referenced assets.
- novation** A process by which counterparties may transfer *derivatives* positions.
- OCC** see *Office of the Comptroller of the Currency*.
- Office of Federal Housing Enterprise Oversight** Created in 1992 to oversee financial soundness of *Fannie Mae* and *Freddie Mac*; its responsibilities were assumed in 2008 by its successor, the *Federal Housing Finance Agency*.
- Office of the Comptroller of the Currency** Independent bureau within *Department of Treasury* that charters, regulates, and supervises all national banks and certain branches and agencies of foreign banks in the United States.
- Office of Thrift Supervision** Independent bureau within *Treasury* that regulates all federally chartered and many state-chartered savings and loans/thrift institutions and their holding companies.
- OFHEO** see *Office of Federal Housing Enterprise Oversight*.
- originate-to-distribute** When lenders make loans with the intention of selling them to other financial institutions or investors, as opposed to holding the loans through maturity.
- originate-to-hold** When lenders make loans with the intention of holding them through maturity, as opposed to selling them to other financial institutions or investors.

**origination** Process of making a loan, including underwriting, closing, and providing the funds.

**OTS** see *Office of Thrift Supervision*.

**par** Face value of a bond.

**payment-option adjustable-rate mortgage** (also called payment *ARM* or option *ARM*) Mortgages that allow borrowers to pick the amount of payment each month, possibly low enough to increase the *principal* balance.

**PDCF** see *Primary Dealer Credit Facility*.

**PLS** see *private-label mortgage-backed securities*.

**pooling** Combining and packaging a group of loans to be held by a single entity.

**Primary Dealer Credit Facility** Program established by the *Federal Reserve* in March 2008 that allowed eligible companies to borrow cash overnight to finance their securities.

**principal** Amount borrowed.

**private mortgage insurance** Insurance on the payment of a mortgage provided by a private firm at additional cost to the borrower to protect the lender.

**private-label mortgage-backed securities** see *non-agency mortgage-backed securities*.

**repurchase agreement (repo)** A method of secured lending where the borrower sells securities to the lender as collateral and agrees to repurchase them at a higher price within a short period, often within one day.

**SEC** see *Securities and Exchange Commission*.

**section 13(3)** Section of the Federal Reserve Act under which the *Federal Reserve* may make secured loans to nondepository institutions, such as investment banks, under “unusual and exigent” circumstances.

**Securities and Exchange Commission** Independent federal agency responsible for protecting investors by enforcing federal securities laws, including regulating stock and security options exchanges and other electronic securities markets, the issuance and sale of securities, *broker-dealers*, other securities professionals, and investment companies.

**securitization** Process of pooling debt assets such as mortgages, car loans, and credit card debt into a separate legal entity that then issues a new financial instrument or security for sale to investors.

**shadow banking** Financial institutions and activities that in some respects parallel banking activities but are subject to less regulation than commercial banks. Institutions include mutual funds, investment banks, and hedge funds.

**short sale** The sale of a home for less than the amount owed on the mortgage.

**short selling** To sell a borrowed security in the expectation of a decline in value.

**SIV** see *structured investment vehicle*.

**special purpose vehicle** Entity created to fulfill a narrow or temporary objective; typically holds a portfolio of assets such as *mortgage-backed securities* or other debt obligations; often used because of regulatory and bankruptcy advantages.

**SPV** see *special purpose vehicle*.

**structured investment vehicle** Leveraged *special purpose vehicle*, funded through medium-term notes and *asset-backed commercial paper*, that invested in highly rated securities.

**synthetic CDO** A *CDO* that holds *credit default swaps* that reference assets (rather than holding cash assets), allowing investors to make bets for or against those referenced assets.

**systemic risk** In financial terms, that which poses a threat to the financial system.

**systemic risk exception** Clause in the Federal Deposit Insurance Corporation Improvement Act (FDICIA) under which the *FDIC* may commit its funds to rescue a financial institution.

**TAF** see *Term Auction Facility*.

**TALF** see *Term Asset-Backed Securities Loan Facility*.

**TARP** see *Troubled Asset Relief Program*.

- Term Asset-Backed Securities Loan Facility** *Federal Reserve* program, supported by *TARP* funds, to aid securitization of asset-based loans such as auto loans, student loans, and small business loans.
- Term Auction Facility** Program in which the *Federal Reserve* made funds available to all *depository institutions* at once through a regular auction.
- Term Securities Lending Facility** Emergency program in which the *Federal Reserve* made up to \$200 billion in Treasury securities available to banks or broker/dealers that traded directly with the Federal Reserve.
- tranche** From the French, meaning a slice; used to refer to the different types of mortgage-backed securities and CDO bonds that provide specified priorities and amounts of returns: “senior” tranches have the highest priority of returns and therefore the lowest risk/interest rate; mezzanine tranches have mid levels of risk/return; and “equity” (also known as “residual” or “first loss”) tranches typically receive any remaining cash flows.
- Troubled Asset Relief Program** Government program to address the financial crisis, signed into law in October 2008 to purchase or insure up to \$700 billion in assets and equity from financial and other institutions.
- TSLF** see *Term Securities Lending Facility*.
- undercapitalized** Condition in which a business does not have enough *capital* to meet its needs, or to meet its capital requirements if it is a regulated entity.
- Write-downs** Reducing the value of an asset as it is carried on a firm’s balance sheet because the market value has fallen.