A

Banker's Glossary

A B C D E F G H I J K L M N O P Q R S T U V W X Y Z

ABO
See accumulated benefit obligation.

ABS
(1) Initials for asset-backed security. See asset-backed security.

(2) The name for a convention used to express the rate of prepayments for an asset-backed security. ABS expresses principal prepayments as a percentage of the original number of loans or contracts in the pool of securitized loans that created the security. ABS is always expressed as a monthly rate.

Absorption
A term used by real estate lenders and developers to describe the process of renting up newly built or renovated office space or apartments. The term "absorption period" is often used to describe the period of time necessary for absorption.

Abstract of title
A written report summarizing the history of title transactions and conditions of title that affect a given piece of land covering the period from the present back to a date in the past. A comprehensive, but cumbersome, and somewhat obsolete, method of verifying the ownership and encumbrances of a parcel, or parcels, of real estate.

Accelerated depreciation
A group of methods for achieving periodic reductions in the book value of fixed assets that make larger reductions in the early periods and progressively smaller reductions in later periods. The offsetting entry is the depreciation expense.

Acceleration
Making demand for payment in full for a debt that has not yet matured. Usually a remedy provided in a loan document for the lender to use in the event of default by the borrower.

Acceleration clause
A provision in a loan document stating that the entire amount of unpaid indebtedness owed to the lender may become immediately due and payable if the borrower defaults.

Acceptance
A time draft that has been accepted for payment. See banker's acceptance.

Accessions
Goods that are physically united with other goods in such a manner that the identity of the original goods is not lost. An example is a new motor in a piece of equipment.

Accommodation maker
Name used to refer to a co-maker who agrees to sign a note to induce the lender to make a loan, but who receives no direct benefit from the loan.

Account analysis
An analysis performed to determine the profitability of each demand account to the bank. The analysis may also be used to determine the profitability of a group of demand accounts with the same owner. Account analysis is normally performed by the bank, but can be done by anyone in the depositor's organization provided sufficient information is available. The analysis identifies the net earnings based on the average daily ledger balance less reserved requirements and float. The net earnings can then be compared with the various activity service charges based on the volume of transactions and the per item price of the services.

Account control agreement

An agreement perfecting a creditor's interest in a securities account while allowing the securities to remain registered in the name of the owner. An account control agreement is used to establish a security interest conforming to the requirements set forth in the UCC.

Account debtor
An individual or business that is obligated to pay on an account, chattel paper, contract right, or general intangible.

Account reconciliation services
A cash management service. One or more of a series of bank services designed to aid a deposit customer in the reconciliation of its bank account balance. A basic account reconciliation service may simply be a listing of paid checks in serial number order. More advanced account reconciliation services combine electronic data provided by the customer with the bank's records to reconcile completely the account and list all outstanding items. Many variations exist. Also called account recs, ARPs, or recons.

Accounts
A category of personal property defined by Article 9 of the UCC. Under the pre-2000 version of Article 9, an account is a right to receive payment for goods sold or leased, or for services rendered, where these rights are not evidenced by an instrument or by chattel paper. Under the revised Article 9, the definition of accounts is much broader. The revised definition covers a much wider variety of payment obligations, whether or not earned by performance, including license fees payable for the use of software, credit card receivables, and healthcare insurance receivables.

Accounts payable
A category of liabilities that represents funds due to creditors. Usually, accounts payable is due to trade creditors who have supplied goods or services without requiring immediate payment. Accounts payable is sometimes simply called payables. Accounts payable to trade creditors are sometimes called accounts payable trade, due to trade, or trade payables.

Accounts receivable
An asset account that reflects amounts due from private persons or organizations for goods and services furnished. For corporations, accounts receivable excludes funds due from departments, but may include funds due from affiliates. For governments and nonprofit organizations using fund accounting, it does not include funds due from other funds owned by the same entity. A category of personal property defined by Article 9 of the UCC. Accounts receivable is the right to receive payment for goods sold or leased or for services rendered where those rights are not evidenced by an instrument or by chattel paper.

Accounts receivable - trade
Also called trade receivables. Amounts due from the credit sales of goods or services that are not evidenced by promissory notes.

Accreting swap
An interest rate swap with an increasing notional amount.

Accretion
The process of making incremental, periodic increases in the book or carrying value of an asset. For example, when a bond is purchased at a price below 100, the difference between the purchase price and the par value, the discount, is accreted. Discounts are usually accreted in roughly equal amounts that completely eliminate the discount by the time that the bond has matured, or by the call date, if applicable.

Accretion bond
See Z tranche.

Accrual basis
See accrual convention.

Accrual bond
(1) Bonds that pay the investor an above-market coupon rate as long as a reference rate is between preset levels established at the time the security is issued. A type of structured note. Also called range bonds.

(2) A type of CMO security that does not pay holders periodic interest in cash. Instead, periodic interest for these bonds is accrued. It is added to the principal amount due to the holder at a later date. See Z tranche.

Accrual convention
Method used by investors for counting the number of days in each month and in the year. Also called accrual basis or day basis. The accrual convention is expressed in different ways. An accrual basis of 30/360 indicates that every month is treated as if it was 30 days long and a year is assumed to have 360 days. Accrual basis of actual/360 indicates that each month is treated using its actual number of days while a year is assumed to have 360 days. Day basis of actual/actual indicates that the true number of days for each month and year are used. The accrual convention is used in the calculation of the amount of interest payable on bonds, loans, deposits, and other financial instruments on the interest payment dates. This convention is also used for the purpose of calculating accrued interest due from a buyer to a seller of a security sold between interest payment dates.

Accrued interest
Interest that has been earned but not yet paid. For example, the interest earned by a bondholder between semiannual coupon payments or the

interest earned by a lender since the last monthly interest payment was collected from the borrower. Accrued interest for investment securities is calculated from the issue date or the last payment date up to but not including the settlement date. When a buyer purchases a bond, the buyer owes the seller the accrued interest in addition to the market price of the security purchased.

Accumulated benefit obligation (ABO)
The actuarial present value of the pension benefits earned to date. Measurement of the accumulated benefit obligation uses the historical compensation rates for pay-related benefit plans. The ABO must be disclosed in a footnote to the financial statements.

Accumulated depreciation
The total of the periodic reductions for depreciation in fixed assets. Also called allowance for depreciation.

Accumulator
See capital appreciation bond.

ACH
See automated clearinghouse.

Acid test ratio
Another name for the quick ratio.

Active tranche
A REMIC tranche that is currently paying principal payments to its owners.

Actual delay days
See delay days.

Adjustable-rate mortgage (ARM)
A loan for which the interest rate (coupon rate) is adjusted periodically to reflect changes in a previously selected index rate. ARMs may have caps and floors that limit the annual and/or the lifetime change in the coupon rate.

Adjusted duration
See option-adjusted duration.

Adjusted trading
A practice used to sell securities without recognizing any or all of the true loss from that sale. To hide the loss, the investor agrees to overpay for a newly purchased security in exchange for the broker/dealer's agreement to overpay for the security that the investor wants to sell. The broker/dealer incurs a loss by purchasing the investor's underwater bond at an above-market price. At the same time, the broker/dealer offsets that loss by selling the investor a new bond at an above-market price. Thus the transactions are completely neutral from the broker/dealer's perspective. However, from the investor's perspective, the transactions effectively defer the recognition of losses on the security sold by establishing an excessively high book value for the security purchased. These transactions are specifically prohibited for federally insured financial institutions. They may also be illegal. Sometimes called fee trading.

Administered rates
Interest rates that the bank or other payer is contractually permitted to change at any time and by any amount. For example, the rates paid on savings accounts. All interest rates can be categorized as either fixed, administered, or floating. Rates that may change at the payer's discretion are sometimes called variable rates, easily confused with floating rates, which change at contractually specified times by contractually specified amounts - a very different arrangement.

Administrative float
Float resulting from the time it takes to administratively process checks or other related paperwork. Total elapsed time for processing checks can range from less than a day to more than a week. Note that its basic elements are present whether the work is done by the owner of the funds or the work is done by a bank or other lockbox vendor. Sometimes referred to as payment processing float or internal float, but since some of the sources of the float delay are not necessarily internal, the term internal float is not a completely accurate synonym.

Administrative review
One of two types of real estate appraisal reviews. Administrative reviews focus primarily on the underwriting issues addressed in the appraisal. These reviews, usually performed by the loan officer, approach the appraisal from a loan underwriting point of view. Typical issues addressed in an administrative review include: How comparable are the comparable properties used in the appraisal? How reasonable are income and expense projections? Is the capitalization rate appropriate? See technical review.

ADR
See American depository receipt.

Advance formula
A provision sometimes used in lines of credit as a sublimit on the maximum amount that can be borrowed. Typically, an advance formula limits the amount that can be borrowed under a line of credit to the lesser of the amount of the line or some percent of accounts receivable collateral.

Advanced Measurement Approaches (AMA)
One of three methods for quantifying capital required for operational risk under proposed Basel II capital rules. Banks using the Advanced Measurement Approaches must hold capital for operational risk based on a risk quantity generated by the bank's internal measurement procedures. The most common internal methods are self-assessments. See also self-assessment, Standardized Approach, basic indicator approach and operations risk.

Advances
Funds received for goods or services prior to the delivery of the goods or services. Typically, the funds must be returned if the transaction is canceled or if the recipient of the advance fails to provide the goods or services. See progress payments.

Adverse opinion
An opinion letter accompanying audited financial statements in which the CPA reports that the financial statements do not fairly present the financial position or the results of operations in conformity with GAAP.

Affiliate
A business organization that shares some aspect of common ownership or control with another business organization.

Affinity card
A card that is offered jointly by two organizations. One is a credit card issuer and the other is a professional association, special interest group or other non-bank company. For example, Citibank and American Airlines sponsor the Citibank AAdvantage card.

Affirmative covenant
A provision in the lender's documents that requires the borrower to do something in the future. For example, a requirement for the borrower to provide annual audited financial statements to the bank during the term of the loan.

Affordable growth rate

The maximum rate at which a firm's sales can grow without straining the capacity of the firm's capital or other financial resources. This term is closely associated with a formula of the same name.

AFMLS
Asset Forfeiture and Money Laundering Section, U.S. Department of Justice.

AFS
See available-for-sale.

After-acquired property clause
A provision in a bank's documents, the purpose of which is to extend the bank's interest in the debtor's property to property not owned by the debtor at the time of the transaction but subsequently acquired by the debtor.

Agencies
Informal name used to refer to securities issued by agencies of the United States government and by U.S. government sponsored enterprises.

Agency fund
A fund normally used to account for assets held by a government as an agent for individuals, private organizations or other governments, and/or other funds. The agency fund also is used to report the assets and liabilities of Internal Revenue Code, Section 457, deferred compensation plans.

Aging
A report or schedule of all outstanding accounts payable or accounts receivable that lists all account debtors or creditors by name, shows the total amount due to each debtor, and shows how much of the amount due to each debtor is due within specific time periods.

AHP
An acronym for affordable housing program.

AICPA
See American Institute of Certified Public Accountants.
a.k.a.
Initials for "also known as". A designation used to denote an alternative name for a person, business or organization.

ALCO
See asset/liability management committee.

ALLL
An acronym for allowance for loan and lease losses.

Allonge
A paper attached to negotiable instruments for signatures when there isn't enough room on the instruments themselves for the signatures.

Allowance for depreciation
See accumulated depreciation.

Allowance for doubtful accounts
A reserve for accounts receivable that may not be collectable. The allowance is always shown as a reduction from gross receivables used to calculate net receivables. An example of a contra-asset account.

Allowances
Reductions to gross sales that occur when customers are given partial credit for sold goods that the buyer is not satisfied with. An accounting term usually used together with returns.

ALM
See asset/liability management.

ALT-A
A classification used to describe residential mortgage loans that are considered to be slightly less risky than "subprime" loans. The loan structure and/or the borrower's credit score are typically better than the very worst loans but are still high risk. Common in parts of the USA during the 2000-2007 boom.

Alternative minimum tax (AMT)

A federal income tax applied to individuals and corporations that take advantage of tax benefits in amounts that are large relative to their incomes. Investors subject to AMT lose the benefits of the tax exemption for interest paid on otherwise tax-exempt securities.

AMA
See Advanced Measurement Approaches.

Amendment
A revision to a document. A UCC financing statement can be amended by filing a designated amendment form, usually UCC-3.

American depository receipt (ADR)
Trust receipts equal to a specific number of shares of corporate stock issued in a foreign country. ADRs are sold and traded in the United States.

American Institute of Certified Public Accountants (AICPA)
The national association that represents certified public accountants in business and industry, public practice, government, and education.

American option or American-style option
An option that the holder can exercise any time prior to and including the expiration date. See European option, Bermuda option and Asian option.

Amortization
(1) The process of making regular, periodic decreases in the book or carrying value of an asset. For example, when a bond is purchased at a price above 100, the difference between the purchase price and the par value, the premium, is amortized. Premiums are usually amortized in roughly equal amounts that completely eliminate the premium by the time that the bond has matured or by the call date, if applicable.

(2) Liquidation of a loan or security by means of periodic reductions. The principal amount of loans is amortized by the periodic, usually monthly, payment of a fraction of the principal calculated to repay the entire amount of principal due by the date of the last scheduled periodic payment. Amortization methods differ based upon the type of loan. Mortgage loans and securities usually have level payments of principal and interest. For such amortizations, the interest consumes most of the early payments and, therefore, principal amortization increases as the loan ages. Many business loans use a level amortization with roughly equal principal reductions from each periodic payment.

Amortization period
For financial instruments, the time from the inception of a loan or investment instrument with scheduled principal repayments to the due date of

the final contractually obligated principal repayment. For fixed assets, the period from the acquisition of a fixed asset to the date of the last periodic reduction (made to reflect depreciation) of the book value of that asset. (Assets may be depreciated until the book value is zero, but sometimes are only depreciated until the book value is reduced to an assumed salvage value.)

Amortizing swap
An interest rate swap with a declining notional principal.

AMT
See alternative minimum tax.

Analytical solution
See closed form solution.

Analytical VAR
See correlation VAR.

Annual percentage rate (APR)
The total financing costs associated with a loan on an annualized basis, divided by the amount borrowed. As defined by Federal Reserve Regulation Z and the Truth-in-Lending Act, this is a precisely calculated measure of the cost of a loan. The Truth-in-Lending Act and Regulation Z have specific requirements covering both how to calculate and how to disclose APRs.

Annual percentage yield (APY)
A precisely calculated measure of yield paid on a bank deposit account.

Annuities
Contracts that guarantee income, often for an individual's lifetime, in exchange for a lump sum or periodic payment. Annuity contracts have a number of standard variants, including deferred, fixed, immediate, or variable.

Anticipated income doctrine of liquidity
An explanation of bank liquidity developed by Herbert Prochnow, in which the net cash flow of bank borrowers, rather than subsequent new borrowings, is seen as the true source of loan repayments. Accordingly, to the extent that loans are written with payment terms and maturities

that reflect the borrower's cash flow stream, the cash flow to the bank from loan principal payments is the source of bank liquidity. See commercial loan theory of liquidity and shiftability theory of liquidity.

Anticipatory hedge
A hedge of a yet-to-be-acquired asset or liability.

Appraisal
A statement or estimate of the market value of tangible personal property or real estate. Under the federal appraisal regulations for real estate pledged to secure loans, the term "appraisal" refers to a statement of market value that meets the five specific standards. See complete appraisal, evaluation, and limited appraisal.

Appraisal surplus
The difference between the historical cost and the appraised value of fixed assets.

APR
See annual percentage rate.

APY
See annual percentage yield.

Arbitrage
(1) In theory, arbitrage is the simultaneous purchase and sale of two identical commodities or instruments to take advantage of price variations in different markets. For example, the purchase of gold in London and the simultaneous sale of gold in New York.

(2) In practice, the term is used to refer to the simultaneous purchase and sale of any two contracts or commodities with largely offsetting risks. For example, the purchase of two-year Treasuries and the sale of futures contracts for an equivalent amount.

(3) In municipal finance, the specific practice of investing funds obtained at a tax-preferred low rate of interest in higher-yielding investments until the funds are needed for the purpose intended.

Arbitrage CDO
A CDO whose purpose is to allow a money manager to expand assets under management and equity investors to achieve non-recourse leverage

to CDO assets. There is no "arbitrage" in the classic sense of the word. Rather, equity holders hope to capture the difference between the after-default yield on the assets and the financing cost due debt tranches. See collateralized debt obligation (CDO).

Arbitrage free
A type of financial model that generates market scenarios excluding scenarios that provide arbitrage opportunities.

Arbitrageur
An individual or broker who engages in arbitrage.

ARM
See adjustable-rate mortgage.

ARP
See account reconciliation services

Arrears
Unpaid dividends or bond interest that a corporation owes its stockholders or bond holders after the payable or due date on which the dividends or interest should have been paid.

Article 2A
Portion of the UCC covering leases. See Uniform Commercial Code.

Article 8
Portion of the UCC covering collateral interests in both physical (certificated) and book-entry (uncertificated) securities. See Uniform Commercial Code.

Article 9
Portion of the UCC covering security interest in most personal property other than securities. See Uniform Commercial Code.

Article of agreement

Contractual arrangement used in some states under which a buyer purchases real estate from a seller over a period of time, usually by making periodic installment payments. Title is not conveyed to the buyer until the final payment is made. Also called land contract.

Asian option
An option whose payoff is based upon the average value of an underlying over a specified period of time. See underlying. Also see American option, European option and Bermuda option.

As-extracted collateral
Oil, gas, or other minerals that are subject to a security interest that is created by a debtor having an interest in the minerals either before or after extraction. A security interest can also include accounts arising out of the sale at the wellhead or minehead of oil, gas, or other minerals in which the debtor had an interest before extraction. A category of personal property collateral defined by the 2000 revisions to Article 9 of the UCC.

Ascending rate bonds
Securities with a coupon rate that increases in previously defined increments at scheduled intervals.

Asked or asking price
The trading price proposed by the prospective seller of securities. Also called the offer or offered price.

Asset-backed security (ABS)
A debt security collateralized by assets. Created from the securitization of any loans.
(1) The phrase may describe the broad category that includes named subcategories such as securitized residential mortgage loans (RMBS) and securitized commercial mortgage loans (CMBS).

(2) The phrase directly names, asset backed securities created from consumer installment or credit card loans.

(3) Securitized commercial (non-consumer) obligations not secured by real estate are typically called collateralized debt obligations or CDOs. CDOs are sometimes defined to be a subset of ABSs.

ABSs may be structured in a variety of ways including simple "pass through" structures and complex, "multi-tranche" structures. The value that ABSs provide to investors is comprised of the cash flows due to the ABS holders from the underlying loans. ABS issues are typically structured so that the bankruptcy or insolvency of an underlying borrower does not impact the cash flow received by the security owner. See special purpose vehicle and waterfall.

Asset sensitive
Describes an entity's position when an increase in interest rates will help the entity and a decrease in interest rates will hurt the entity. An entity is asset sensitive when the impact of the change in its assets is larger than the impact of the change in its liabilities after a change in prevailing interest rates. This occurs when either the timing or the amount of the rate changes for liabilities causes interest expense to change by more than the change in interest income. The impact of a change in prevailing interest rates may be measured in terms of the change in the value of assets and liabilities. In that case, an asset-sensitive entity's economic value of equity increases when prevailing rates rise or declines when prevailing rates fall. Alternatively, the impact of a change in prevailing rates may be measured in terms of the change in the interest income and expense for assets and liabilities. In that case, an asset-sensitive entity's earnings or net income increases when prevailing rates rise and declines when prevailing rates fall.

Asset/liability management committee (ALCO)
A committee, usually comprising senior managers, responsible for managing assets and liabilities to maximize income and safety over the long run. In a financial institution, the ALCO is usually responsible for asset and liability distribution, asset and liability pricing, balance sheet size, funding, spread management, and interest rate sensitivity management. Usually used somewhat redundantly, as in ALCO committee.

Asset/liability management (ALM)
Coordinated management of all of the financial risks inherent in the business conducted by a financial institution. The process of balancing the management of separate types of financial risk to achieve desired objectives while operating within predetermined, prudent risk limits. Accomplishing that task requires coordinated management of assets, liabilities, capital, and off-balance sheet positions. Therefore, in the broadest sense of the term, ALM is simply the harmonious management of cash, loans, investments, fixed assets, deposits, short-term borrowings, long-term borrowings, capital, and off-balance sheet commitments. However, in practice, the term is often used to refer to segments of that broader definition such as only interest rate risk management or only interest rate and liquidity risk management. See earnings at risk, market value at risk and market value of portfolio equity.

Assets repriced before liabilities
A measure of the gap between the quantity of assets repricing and the quantity of liabilities repricing within a given period of time. A simple measure of a financial institution's exposure to beneficial or adverse consequences from changes in prevailing interest rates.

Assignee
The party to whom an assignment is made.

Assignment

Transfer of any contractual agreement between two parties. One of the parties, the assignor, transfers its rights or obligations to another party, the assignee. If interests in assets of the assignor are assigned, the assignment transfers all or some of the rights of ownership to the assignee. If interests in obligations of the assignor are assigned, the assignor is totally or partially absolved from further performance. Lenders sometimes see leased property assigned from the original lessor to another party who then pledges them to the bank as collateral for a loan. For personal property collateral, a secured party may enter an assignment of its security interest into the public record by using a standard form called UCC-3.

Assignment of buyer's interest in land contract
A document used when a borrower is purchasing real estate over time under an article of agreement or land contract. The document assigns the lender all of the borrower's personal property, real property, and contractual rights under the land contract.

Assignment of lease and rentals
A document used in real estate loans when the mortgaged property is leased to third-party tenants. If the borrower defaults, the assignment of lease and rentals gives the lender the right to receive rents from the tenants and to transfer the leases to a subsequent purchaser of the property.

Assignment of seller's interest in land contract
A document used in real estate loans when the mortgaged property is subject to a land contract or article of agreement under which it is being sold over time to a third party. If the borrower defaults, the assignment of the land contract gives the lender the right to receive payments from the buyer and to transfer the land contract to another buyer.

Association of Financial Professionals
A national organization for finance professionals that provides educational, and certifications programs, research programs, standards development, and government relations activities.

Assumable
As applied to mortgage loans, assumable means that a borrower who sells his or her home may transfer the outstanding mortgage loan secured by that dwelling to the new buyers. The new buyers are said to assume the loan.

Assumed name
Name used by a proprietorship, partnership, or corporation to conduct business that is different from the legal name of the proprietorship, partnership or corporation. Sometimes an assumed name is prefaced by the initials "t/a" for "trading as" or "d.b.a." for "doing business as ".

Asymmetric behavior

Unbalanced behavior exhibited by financial instruments, the rates or values of which do not change in proportion to changes in market rates. For example, increases in the prime rate quickly reflect most or all of increases in prevailing interest rates, while decreases in the prime rate are slow to reflect decreases in prevailing interest rates.

ATM
See Automated Teller Machine.

At the money
The situation in which the current market price, the spot price, of an underlying instrument is equal to the strike or exercise price of an option to buy or sell that instrument.

Attachment
A procedure established by Article 9 of the UCC. Creditors must comply with this procedure in order to obtain a security interest in property owned by a debtor. Alternatively or in addition, the process may be used to give the creditor a security interest in property owned by a guarantor or by another third party. Often, attachment alone is not sufficient to establish the priority of the creditor's interest relative to the interests of other creditors. See financing statements and perfection.

Attorney's certificate of title
See title opinion.

Attrition analysis
Evaluation of the reduction in the amount of an asset or liability held. For example, an analysis of the reduction in savings account balances caused by withdrawals over time.

Audited statements
The most reliable type of financial statements. The audit is based on information submitted by the client, and the CPA does not verify all of the information. Limits on the scope of the audit and on the CPA's responsibility are described in the opinion letter that accompanies the audited statements. However, the value of an audited statement is that the independent CPA is responsible for testing and verifying any numbers that seem questionable or unusual as well as the most material financial information. For example, if a firm has a material amount of accounts receivable, the auditor will typically confirm at least a sample of those accounts. If a firm has a material amount of inventory, the auditor will typically perform a physical verification of that inventory.

Authenticated security agreement

A electronic security agreement between the debtor and the bank that is accepted by the borrower either by downloading the agreement into a personal database or by printing a copy. As an alternative to a security agreement physically signed by the debtor, the 2000 amendments to the UCC provide for an authenticated security agreement.

Authority

A government or public agency created to perform a single function or a restricted group of related activities. Usually, such units are financed from service charges, fees, and tolls, but in some instances they also have taxing powers. An authority may be completely independent of or partially dependent upon other governments for its financing or the exercise of certain powers.

Automated clearinghouse (ACH)

The ACH network is a nationwide electronic funds transfer system for participating depository financial institutions. The American Clearing House Association, Electronic Payments Network, Federal Reserve and Visa act as ACH Operators, central clearing facilities through which financial institutions transmit or receive ACH debits and credits. The ACH network serves 20,000 financial institutions, 3 million businesses, and 100 million individuals. The ACH Network is commonly used for direct deposit of payroll and government benefits such as Social Security, direct payment of consumer bills, business-to-business payments, federal tax payments, and, increasingly, e-commerce payments. In 2000 there were 6.9 billion ACH payments made worth more than $20 trillion.

Automated Teller Machine (ATM)

A computer terminal for user initiated banking transactions.

Automatic stay

An injunction that automatically becomes effective upon the filing of any bankruptcy proceeding. The stay precludes creditors from taking action against the debtor or the debtor's property. In Chapter 12 or 13 bankruptcy proceedings, the automatic stay also applies to co-obligors and guarantors.

Availability

The condition in which deposited funds are available for use by the depositor. The time lag between the date of a deposit and the date it is credited to the collected balance.

Availability schedule

A schedule that determines when each bank in the check-clearing process will receive credit and when the depositor of checks will be able to withdraw or invest the funds. The schedule sets a standard time period since each check cannot be individually traced through the check-clearing process. Every major bank publishes its availability schedule based on its location and on the location of the bank on which the check is drawn.

Available balance
The balance in an account that can be invested or withdrawn. Available balance refers to the bank ledger balances less checks in the process of collection. Also called collected balances, good funds, or usable funds.

Available-for-sale (AFS)
One of three defined categories established in FAS 115 for the classification of financial instruments held as assets on the books of an investor. Available-for-sale, or AFS, securities are securities that the investor is unable or unwilling to commit to hold to maturity. Designation of a security as AFS does not mean that the investor plans to sell it prior to maturity. FAS 115 requires investors to report unrealized gains or losses in AFS securities as changes in reported equity. See FAS 115, held-to-maturity, and trading.

Aval
A guaranty.

Average life
The time-weighed for a stream of principal cash flows. See weighted average life.

Average daily balance
The average daily balance is a method used to calculate finance charges. It is calculated by adding the outstanding balance on each day in the billing period, and dividing that total by the number of days in the billing period. The calculation includes new purchases and payments.

B

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BA
See banker's acceptance.

Back-end load
A form of sales charge imposed on investors by some mutual funds. These charges may be called back-end loads, deferred loads, deferred sales charges, contingent deferred sales charge (CDSC), or redemption fees. Regardless of the name, funds with deferred sales charges are simply one form of load funds. These funds offer investors the opportunity of paying a sales charge later rather than paying one at the time of purchase. The main advantage is that earnings from the investment in a deferred charge fund are paid on the full amount of the investor's principal. In contrast, earnings in a fund with an front-end load are only paid on the net amount of the investor's principal after the front-end charge is deducted. A second, potentially significant, advantage, is that deferred sales charges often decrease as the investor's holding period lengthens. See front-end load, load, and no-load.

Backlog
Unfilled orders for goods or services. Orders for goods or services that the company has not yet delivered or rendered to its customers.

Backtesting
Back-testing
In general, the process of comparing predictions from a forecasting model to observable data. A model may be run using historical inputs after which the mode's forecast is compared to the actual outcomes observed for the forecasted period. In practice, either final model outputs or intermediate calculations may be backtested. Backtesting is often inexact because of the impact of extraneous events on the observable data.

Bad delivery
A delivery of securities that does not fulfill the requirements for good delivery. See good delivery.

Bailment for hire

A safekeeping agreement between a safekeeping institution and its customer. A contract whereby a third-party bank or other financial institution, for a fee, agrees to exercise ordinary care in protecting the securities held in safekeeping for its customers.

Balance sheet matching
The (discredited) process of "assigning" groups or quantities of liabilities to groups or quantities of assets. Sometimes described as the identification of "mini-banks" within the bank.

Balloon loan
A loan for which the final payment, larger than all of the previous, regularly scheduled payments, is due in a lump sum before the loan is fully amortized. The final payment is called a balloon payment.

Balloon mortgage
A mortgage loan with a balloon payment. Typically, the balloon payment is due 10 or 15 years after the loan is made.

Balloon payment
A contractually required loan payment, almost always the final payment, that is larger than the other contractually required, periodic loan payments. Results from the fact that required, periodic loan payments are too small to fully amortize the loan balance by the maturity date.

BAN
See bond anticipation note.

Band
The PSA range within which certain performance measures such as yield and average life are set for a CMO tranche. This range is expressed in terms of PSA speeds. Differences between predicted speeds and the actual speeds subsequently experienced can cause bracket creep.

Band of investment
A method of determining a cap rate that blends the return or cash flow required by an equity investor with the return or interest rate required by the debt lender. Also called cash flow method.

Bank float

The time between the date a check is deposited in a bank and the date it is charged to the drawer. Also called bank collection float, check-clearing or transit float. Not the same as float.

Bank name risk or Bank name liquidity risk
See bank-specific liquidity risk.

Bank Secrecy Act of 1970 (BSA)
More formally known as The Financial Recordkeeping and Reporting of Currency and Foreign Transactions Act of 1970. Designed to aid the federal government in detecting illegal activity through tracking certain monetary transactions. Requires financial institutions, broker-dealers, casinos and money services businesses to file reports of suspicious transactions. Also establishes certain exemptions to the currency transaction reporting requirements. The corresponding BSA regulation is found at 31 C.F.R. Part 103. See also USA PATRIOT Act which substantially amended this statute in 2001.

Bank services contract
A contract with a bank outlining the responsibilities of the bank and the bank's customer.

Bank-specific liquidity risk
One of three main types of liquidity need environments. The risk that a bank might experience a funding crisis resulting when one or more events or problems applicable just to the bank cause funds providers to lose confidence in the bank. Also know as internal liquidity risk or bank name risk. See liquidity in the ordinary course of business and systemic liquidity risk.

Banker's acceptance (BA)
A short-term financial instrument that is the unconditional obligation of the accepting bank. Banker's acceptances, or BAs, arise from transactions involving the import, export, transit, or storage of goods, including domestic as well as international transit. For investors, it is very important to realize that the underlying transaction that gives rise to a BA is almost completely irrelevant to the credit quality or the liquidity of the instrument. The actual BA is created at a late stage in the underlying transaction when a bank accepts its obligation to pay the holder of the accepted draft. In other words, when the transaction becomes a BA it becomes an unconditional obligation of the accepting bank. From an investor's point of view, a BA is a bank obligation that has at least the same credit strength as any CD issued by the same bank. Typically, BAs are stronger than CDs because, in addition to the credit strength of the accepting bank, BAs are backed by the credit strength of a drawer; an endorsing bank, if one is involved in the transaction; and usually by the pledge of documents representing ownership of the trade goods and insurance on the goods. BAs do not, however, carry federal deposit insurance. BAs are considered safe, liquid, short-term money market investments. For bank holders of BAs, an additional issue is called eligibility. See eligible banker's acceptances.

Barbell
A maturity pattern within a portfolio in which maturities of the portfolio assets are concentrated in both the short and long ends of the maturity spectrum with substantially smaller holdings of assets with intermediate-term maturities.

Basel II
The common name for capital guidelines issued by the Bank for International Settlements (BIS) located in Basel, Switzerland. The Basel II capital guidelines replace previous, much simpler, BIS guidelines. The guidelines are developed by an international committee of banking regulators and implemented by rules issued by the national regulators.

Risks, under Basel II, are regulated in three general ways called "pillars". Pillar I calls for explicit capital allocations. Credit risk and operations risk fall under pillar I. Pillar II calls for supervisory review of capital adequacy. Interest rate risk and liquidity risk fall under pillar II. Pillar III calls for public disclosure. All risks fall under pillar III.

Basel III
Revised capital and liquidity risk rules published by the Bank for International Settlements. The rules include a quantitative requirement called liquidity coverage ratio (LCR) and a requirement called net stable funding ration (NSFR).

Basic indicator approach
One of three methods for quantifying capital required for operational risk under proposed Basel II capital rules. Banks using the basic indicator approach must hold capital for operational risk equal to the average over the previous three years of a fixed percentage of positive annual gross income. Based on the questionable assumptions that losses from operational risk are closely proportionate to gross income. See also Standardized Approach, Advanced Measurement Approaches and operations risk.

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Basis
(1) The difference between rates or prices of assets that are related but not identical. For example, the difference between the cash price and the futures price of a security. Sometimes called spread.

(2) The difference between the price of a futures contract and the price of the underlying.

(3) The number of days in a bond coupon period. See day basis.

Basis point
A unit of measurement for interest rates or yields that is expressed as a percentage. One-hundredth of one percent. One hundred basis points equal one percent.

Basis risk
The risk to a holder of financial instruments that a change in prevailing interest rates will not affect the prices of or yields on similar instruments in exactly equal amounts. For example, an increase in prevailing interest rates might raise 3-month U.S. Treasury yields by 100 basis points while 3-month certificate of deposit yields go up by only 85 basis points. One of the four primary components of interest rate risk. Sometimes called spread risk.

Basis swap
A type of interest rate swap in which the net cash flows that the parties agree to exchange are based upon the differences between two different interest rate indexes. Banks use basis swaps to hedge basis risk by locking in a net interest rate spread between a variable rate cost of funds tied to one index and a variable rate asset tied to a different index. See interest rate swap and swap.

Bearer
The holder of an instrument.

Bearer bonds or stocks
Securities owned by and payable to whomever holds the physical certificate. Securities without a registered owner.

Behavioral assumptions
Forecast assumptions about future deposit, loan or other balance changes where the change is the result of customer decisions to exercise options or to renew maturing instruments.

Benchmark
(1) A standard of comparison used for judging performance. For example, the return from a bond portfolio may be compared to the return from a

benchmark instrument or portfolio. In this context, a nearly risk-free benchmark or one that closely matches the risk in the bond portfolio may be selected.

(2) The process of comparing a forecast or simulation to a standard for the purpose of evaluating the accuracy of the forecast or simulation. For example, the forecasted change in net income projected by an ALM simulation model may be benchmarked by comparing that forecast to subsequent earnings. Also called benchmarking.

(3) See index.

Beneficial owner
The party that receives all of the benefits or rights of an owner of a security even though the legal ownership of the security is recorded in the name of a broker or a bank in street name.

Bermuda option
An option that allows the issuer of a security to call the security at discrete points in time after a certain date. Also known as a modified American option. See American option, European option and Asian option.

Beta
A Greek letter used by mathematicians to label the degree of sensitivity to changes in one variable to changes in another. The name for correlation of the changes.

Beta-adjusted gap
Gap reports modified to mollify the errors caused by basis risk. The essential concept of beta-adjusted gap is that all interest rates do not change by the same amounts, but that there is an identifiable relationship, a correlation, between changes in various interest rates. Some rates are more sensitive to change than other rates. In beta-adjusted gap analysis, the volumes of assets and liabilities subject to repricing are weighted to reflect the historical sensitivity of the yields or costs of those assets and liabilities relative to some benchmark yield or cost.

BEY
See bond equivalent yield.

Bid or bid price
The trading price acceptable to a prospective buyer of securities.

Big board
Informal name for the New York Stock Exchange.

Bilateral netting
A legally enforceable arrangement between two parties to two or more swaps that creates a single legal obligation covering all of the individual swap contracts. This means that the size of the risk that one party is exposed to for the default or insolvency of the counterparty is net of all of the positive and negative values of the contracts included in the bilateral netting arrangements. Parties that engage in numerous swap contracts may use bilateral netting agreements to be able to recognize only the net sum of their obligations rather than the gross total of the individual swap contracts. Bilateral netting is also used by a party that wishes to cancel a swap contract, in which case the party can enter into a new swap that is an equal but offsetting swap with the same counterparty. The two parties can then enter into a bilateral netting agreement under which the two equal but offsetting swap contracts net to zero.

Billing cycle
The number of days between statement dates.

Billing float
Float resulting from delays in billing or in the payor's response to those bills. For governments, can also occur if payor taxpayers drag their feet in filing self-assessed taxes. When due dates are fixed, an easy measure of billing float compares the date paid to the date due.

Billings in excess of cost
A liability created under a type of accrual accounting used when firms such as contractors bill their customers in accounting periods for costs that they incur in subsequent accounting periods.

Bills
See Treasury bills.

Binder
A preliminary, temporary insurance agreement that obligates the insurance company to pay the insured if the loss insured against occurs after the binder is issued but before the insurance policy is issued.

Black Scholes model

A model used to value options. This model was developed in 1973 by Fischer Black and Myron Scholes. While not the only sophisticated, mathematically derived model for valuing options, it was the first, and it remains the best known.

Blanket lien
An informal term meaning a lien on all of the debtor's current and subsequently acquired personal property assets.

Blue list
Informal name for a daily Standard & Poor's publication titled the Blue List of Current Municipal Offerings.

BMA
See Bond Market Association.

BOLI
Acronym for "bank-owned life insurance".

Bond
(1) A debt security. Sometimes used only in reference to long-term debt securities. Sometimes called a fixed-income security even though many bonds have floating interest rates.

(2) A guarantee provided by a surety or insurance company. For example, fidelity bond, indemnity bond, performance bond, or payment bond.

bond anticipation note (BAN)

A short-term note sold by a public entity that will be repaid from the proceeds of an anticipated bond issue.

Bond equivalent yield
An annual yield, expressed as a percentage, describing the return provided to bond holders. A bond equivalent yield is double the simple interest, semiannual yield. Since Treasury and agency notes and bonds, as well as most corporate and municipal bonds, pay interest semiannually, the bond equivalent yield is a way to compare yields available from discount securities such as Treasury bills and BAs with yields available from coupon securities. From that usage, this yield measure is also known as the coupon yield equivalent or the equivalent bond yield. For securities that pay daily, monthly, or quarterly interest, the bond equivalent yield understates the benefits obtained from the compounding of income.

Bond indenture

A document that sets forth the terms of a bond issue, the obligations of a bond issuer, and the rights of the bond holders. The bond indenture is a contract between the company that issued the bonds and the bond trustee acting on behalf of the bond holders. Bond indentures may include a variety of provisions and thus define and create the differences in term and risk.

Bond insurance
Credit support for a bond or a tranche in a multi-tranche debt security. The credit support is provided by an external, third party - usually an insurance company that specializes in financial guarantees.

Bond Market Association (BMA)
An industry trade organization for U.S. broker/dealers. Among other things, the BMA has developed standard documentation for repurchase agreement transactions and for describing prepayments received from MBSs. Formerly known as the Public Securities Association (PSA).

Bond swap
The simultaneous, or nearly simultaneous, purchase of one debt security with the proceeds from the sale of another debt security. The swap is done after the investor has conducted an analysis showing that the debt security being purchased has more desirable characteristics than the debt security being sold.

Bond value (for convertible securities)
See investment value (for convertible bonds).

Bonding
(1) Either the process of obtaining or the state of having a fidelity, indemnity, performance, payment, or similar bond. In commercial construction financing, bonding usually refers to a contractor's performance bond. For employees of financial institutions, bonding usually refers to fidelity bonds. See fidelity bond, payment bond and performance bond.

(2) Refinancing short-term debt with long-term debt is sometimes called bonding out.

Book entry
The nonphysical record of ownership, custody, and transfer of securities through electronic means. The system for settlement, delivery, and custody of uncertificated securities.

Book entry securities

Stocks, bonds, other securities, and some certificates of deposit that are purchased, sold, and held with only manual or computer accounting entries rather than transfers of physical certificates to evidence the transfer. Typically, instead of a physical certificate or instrument, buyers only receive receipts or confirmations as evidence of their ownership.

Book value
The value at which an asset is carried and reported on the owner's balance sheet. For debt securities, the current book value may be the purchase price plus accretion (in the case of securities purchased at a discount) or the purchase price minus amortization (in the case of securities purchased at a premium). Book value may differ, perhaps significantly, from market value.

Bootstrapping
For financial risk mangers, bootstrapping means (1) the procedure where coupon bonds are used to generate the set of zero-coupon bond prices, or (2) the use of historical returns to create an empirical probability distribution for returns. Bootstrapping is an iterative calculation technique, often used in the construction of specialized time series. For example, the calculation of forward rates from traditional yield curves uses an iterative process to extract the implied rate for each forward period. The term is used in other ways in other contexts.

Bow
An informal term used to describe the curvature in a yield curve.

Break-even point
(1) The price level at which income equals expense.

(2) The expense level at which expense equals income.

(3) The market price of a financial instrument that just equals the purchase price plus cost of carry for an investor owning that instrument.

(4) The price level of a call option that equals the sum of the exercise price plus the premium paid to acquire the option, or the price level of a put option that equals the exercise price minus the premium.

Break-even interest rate
The maximum interest rate that a firm or property can pay from available cash flow and still have enough cash flow to make all required principal and interest payments.

Break-even occupancy

The minimum occupancy level of a commercial real estate property that will generate enough cash flow to make all required principal and interest payments.

Break-even prepayment rate
The specific prepayment rate (speed) at which the yield of a mortgage security is equal to the yield available from another security to which it is being compared.

Break-even sales

The minimum sales level that a firm must achieve in order to generate enough cash flow to make all required principal and interest payments.

Break-even time (for convertible securities)
The amount of time before the higher yield on the convertible bond compared to an otherwise similar nonconvertible bond compensates the investor for the excess cost of the convertible over the common stock. Usually calculated by using current yields rather than the coupon and dividend rates.

Bridge loan
Bridge financing
A short-term loan to enable the borrower to purchase an asset where the loan is to be repaid from the proceeds of the sale of an asset being replaced by the asset just purchased. In consume loans bridge loans may be used to enable the cons8umer to buy a new house before selling her current house. Also commonly used investment banking for project finance, buyouts and other large transactions.

Broker
A party who brings buyers and sellers together. Brokers do not take ownership of the property being traded, but rather they are compensated by commissions. Brokers are not the same as dealers; however, the same individuals and firms who act as brokers in some transactions may act as dealers in other transactions.

Brokered deposits
Bank deposits solicited by a third-party broker. Usually but not always deposits for some amount slightly below $250,000 so that all interest as well as principal is covered by deposit insurance. Brokers are typically paid a fee by the depository bank.

BSA

See Bank Secrecy Act.

Buckets
In gap reports, the predefined time interval groups are often called buckets. The buckets can be defined to represent whatever time units a bank wants to see in its gap reports. The time intervals can be single months or years. Smaller buckets, such as one-month buckets, give more detail, which in turn can provide a more accurate measure of interest rate risk. On the other hand, smaller buckets can require a greater number of buckets to show the interest rate risk far enough into the future for prudent analysis. Often, one-month buckets are used for the first six or twelve months with larger time intervals used as buckets for later periods.

Builder's risk insurance
Insurance covering perils resulting in loss caused by the builder's operations on the borrower's property. Usually required by property owners and by construction lenders when a contractor is hired to make improvements in an existing building or to construct a new building.

Building code
Laws, usually but not always enacted by local government units, that set safety and fire protection standards. These codes affect the materials and methods used in the construction of buildings. For example, a code provision might require sprinkler systems in motel rooms.

Bulge
Informal term used by some lenders to describe a provision in a line of credit promissory note that allows for a temporary increase in the maximum amount that can be borrowed under the line of credit. A bulge is particularly suited to loans to firms with seasonal increases in sales.

Bullet loan
A name occasionally used to describe a promissory note used for transactions that do not require any principal to be repaid until the maturity of the note. Interest is usually due periodically prior to maturity. Most often used to describe loans with time periods of at least one year.

Bullet security
An instrument that repays the full principal at maturity.

Busted convertible
A convertible bond trading so far below its conversion value that it trades on investment value alone, meaning it has value only as a bond. It has essentially no equity value.

Busted PAC
Planned amortization class tranches in collateralized mortgage obligations for which the companion or support tranche has been completely retired by larger than expected prepayments from the underlying mortgage loans. Because the companion or support tranche is no longer outstanding and can therefore no longer absorb future prepayments, the maturity of the PAC tranche(s) may be shorter than expected. See stressed PAC.

Butterfly call spread
One of the more well known option trading strategies. A complex option trading strategy using puts and calls with different maturity dates and different strike prices. An option strategy designed to profit from stable or decreasing volatility.

Buydown
A lump sum payment made to a creditor by a borrower or a third party to reduce the amount of some or all of the borrower's periodic payments to repay the indebtedness.

Buy/Sellback
A form of secured, short-term investment in which a security is purchased with a simultaneous agreement to sell it back to the seller at a future date. The purchase and sales agreements are simultaneous but the settlement dates for the transactions are not. The purchase is a cash transaction while the return sale is a forward transaction since it occurs at a future date. A buy/sellback is very similar to a reverse repurchase agreement, except that in a buy/sellback the investor is compensated by the difference between the purchase price and sales price rather than by interest. Unlike a reverse repurchase agreement, a buy/sellback probably does not include a haircut or collateral margin. Furthermore, the buy/sellback may be treated differently in the event of the buyer's bankruptcy. Every transaction that is a buy/sellback from the buyer/lender's point of view is, by definition, a sell/buyback from the seller/borrower's point of view.

Buyer in the ordinary course of business
A purchaser who buys inventory from a seller who is in the business of selling that type of inventory.

C

Banker's Glossary

A B C D E F G H I J K L M N O P Q R S T U V W X Y Z

CAB
See capital appreciation bond.

Calendar spread
An option trading strategy that involves buying two calls or two puts on the same underlying, but with different maturity dates. If two call options are used, the spread may be referred to as a calendar call spread. Similarly, if two put options are used, the spread may be described as a calendar put spread. When the exercise price of the two options is the same, the calendar spread is described as a horizontal spread. When the exercise price of the two options is different, the calendar spread is described as a diagonal spread.

Call
An option that grants the holder the right to purchase an instrument in the future at a price established today. The call option gives the holder the right but not the obligation to purchase the underlying instrument.

Call date
The date on which a call option may be exercised. The date before the contractual maturity date on which a bond may be redeemed at the option of its issuer.

Call feature
See call option.

Call option
A contract, or a provision in a contract, that gives its holder the right to buy an underlying security, commodity, or currency before a certain date. The option to purchase is for a predetermined price called the strike price. When the call option is a provision in a contract defining a transaction such as a bond or a loan, it is sometimes called a call feature. Options are often used in hedging.

Call or calling
Making demand for payment in full of a loan, usually a loan that is in default, Often referred to as calling the loan.

Call price
The price at which a call option may be exercised. For example, the price that an issuer is required to pay in order to redeem a bond before its maturity.

Call protection
A feature of a bond issue that protects investors from risk of prepayment. In mortgage-backed bonds, call protection may take the form of prepayment penalties or lock-in periods. A lock-in period is a time period, starting from the issue date and ending at a specified subsequent date, during which an otherwise callable bond may not be called. This time period is specified in the bond's indenture agreement. The call protection period may be a few months or as long as 25 years. For convertible bonds, see hard call protection and soft call protection (for convertible bonds).

Call risk
The risk that declining interest rates will create an economic incentive for the owner of a call option to exercise that option. In MBSs, call risk is the risk that declining interest rates will accelerate prepayment of the underlying mortgage loans and thereby shorten the life of the investment.

Callable bond
A bond that the issuer has the right to redeem prior to maturity. Some callable bonds may be redeemed on a single call date while others have multiple call dates. Some callable bonds may be redeemed at par while others can only be redeemed at a premium.

Callable swap
A receive fixed/pay floating interest-rated swap with an embedded option that permits the holder to cancel the swap prior to its maturity.

CAMEL
An acronym for the institution composite rating system used by the federal regulators during a regulatory examination. The evaluation is based on Capital, Asset Quality, Management, Earnings and Liquidity.

Cap
An upper limit for a variable, such as the upper limit on the interest rate paid or received in a transaction. For example, an adjustable-rate

mortgage may have a cap of 10 percent. In this case, the rate can adjust however the loan terms provide, without exceeding 10 percent. Also called a ceiling. Cap is often used with its converse, a floor. A cap may be an embedded option, such as the cap on the rate for a floating rate loan, or a stand-alone option contract.

Cap rate
An interest rate used in the process of capitalization.

Capacity
A lending and credit analysis term that describes a borrower's or applicant's ability to meet debt service obligations. See debt service coverage.

Capital
(1) Usually refers to the total of the equity accounts in a firm. For a bank, the equity accounts are common and preferred stock, surplus, and undivided profits. For other corporations, equity accounts are common and preferred stock, surplus, and retained earnings. For bank capital, see tier 1 capital and tier 2 capital.

(2) Sometimes used as a synonym for common stock, as in capital stock.

Capital appreciation bond (CAB)
Securities that are issued at par, but which do not remit interest to the holder until maturity. The interest accrues at the coupon rate and is compounded at a stated rate. The issuer holds the accumulated, compounded interest until the maturity date of the bonds. At the maturity date, the bondholder receives all of the accumulated interest along with the par amount of the security. Reflecting their structure, CABs are sometimes called compound interest bonds or accumulators.

Capital expenditures
Expenditures resulting in the acquisition of or addition to fixed assets. Expenditures made for the purpose of acquiring capital assets.

Capital lease, capitalized lease
See lease.

Capital markets disruptions
A type of systemic liquidity risk. The risk of funding problems arising from problems in the secondary markets for financial instruments. For a

community bank, the main problem is that a capital market disruption arises from the fact that the bank is only able to sell investment assets at very unacceptable prices. See flight to quality and systemic liquidity risk.

Capital markets hedges
Hedging done with instruments traded in the capital markets, including but not limited to swaps, options, and futures. (These hedge instruments are derivatives.) The term "capital markets" is slightly broader than "exchange traded" since some instruments, such as interest rate swaps, are bought and sold outside of the exchanges in over the counter (OTC) markets that are still capital markets.

Capitalization
(1) The process of imputing a value to an income stream by dividing the annual net income before income taxes and depreciation by a rate of return expressed as a decimal. This process is used in real estate lending and appraisals.

(2) The total of, or the mix between, a corporation's shareholders' equity and its long-term debt.

(3) The process of reflecting a long-term, noncancelable lease on the lessee's balance sheet.

Capitalization ratio
A measure of a corporation's reliance on long-term debt. Similar to the debt-to-worth ratio but not the same. This ratio is calculated by dividing long-term debt by the sum of long-term debt plus equity.

Capitalized interest
Interest that a lender "receives" by adding the unpaid interest to the amount of the loan balance to be paid by the borrower.

Capitalized lease
Lease obligations that must be capitalized under GAAP; the unpaid future lease payments due under the terms of the lease must be shown as a liability on the firm's balance sheet. As a general rule, this requirement applies to most equipment and buildings leased by a business and used in the conduct of the business.

Caption
An option that grants the holder the right to purchase a cap.

CAR

See certificates of automobile receivables.

Cascading late charges
The practice of imposing late charges for previously unpaid late charges. Federal Regulation AA prohibits this practice for consumer loans.

Cash and due from banks
A banking expression used to describe the total sum of assets represented by cash, funds on deposit with the Federal Reserve bank, funds on deposit with correspondent banks, and items in transit to those banks

Cash equivalents
Defined by FASB as short-term, highly liquid investments that are both: (a) readily convertible to known amounts of cash, and (b) so near their maturity that they represent insignificant risk of changes in value because of changes in interest rates.

Cash flow
A finance and accounting term used to describe the net amount of cash generated by a firm's operations. In traditional and over-simplified usage, cash flow is defined as the sum of net income after tax plus all noncash expenses such as depreciation. More modern and sophisticated usage defines cash flow to include the net difference between all cash outflows and cash inflows.

Cash flow gap
The difference between cash inflows and cash outflows in a defined time period. Also called liquidity gap.

Cash flow hedge
A type of hedge defined by FAS 133. An entity may designate a derivative instrument as hedging the exposure to variability in expected future cash flows that is attributable to a particular risk. That exposure may be associated with a recognized asset or liability such as all or some of the future interest payments due for a variable-rate debt. Alternatively, that exposure may be associated with a forecasted transaction such as a planned purchase or sale. Certain requirements must be met to qualify for cash flow hedge accounting. Gains or losses from the effective portion of a derivative used for a qualifying cash flow hedge are reported in comprehensive income. In other words, the gains and losses are used to adjust equity but are not included in income or losses from operations. Gains or losses from the ineffective portion of hedges must be reflected in earnings. See comprehensive income, FAS 133, and hedge effectiveness.

Cash flow recapture clause

A loan agreement or bond indenture provision that requires the borrower to apply excess cash flow (or some percentage of excess cash flow) to reduce the outstanding debt balance.

Cash flow yield
The monthly internal rate of return of an investment based upon a projected stream of monthly principal and interest payments. The cash flow yield depends upon the prepayment assumption that is used to describe anticipated cash flows.

Cash forward agreement
A commitment to purchase or sell a security at a future date that is binding on both the buyer and the seller. Also known as a firm commitment.

Cash instrument
Financial instruments or commodities for which the value is dependent upon the term, coupon rate, or other characteristics of the instrument itself. Differs from derivative instruments, for which the value is partially dependent upon characteristics or prices of an underlying cash instrument. Cash instruments include U.S. Treasury, agency, and government sponsored enterprise securities; municipal securities and corporate securities; syndicated loans; securitized mortgages, car loans and credit card receivables, (but not collateralized mortgage obligations); and bank obligations such as negotiable certificates of deposit and banker's acceptances. Not the same as cash market or cash market instruments.

Cash letter
Items (primarily checks) along with a letter that specifies amounts and directions. Cash letters are sent to a bank for transmittal to other banks for the purpose of clearing checks drawn on other banks.

Cash management
One or a combination of various techniques for accelerating cash receipts, delaying cash disbursements, effectively utilizing banking services, managing or augmenting liquidity, increasing the amount of cash available for investment, and/or increasing returns from liquid investments.

Cash management bills
U.S. Treasury bills. Unlike more typical bills with 13-, 26- or 52-week maturities, cash management bills are issued with maturities selected to match expected tax receipts.

Cash market
(1) noun - A market for buying or selling financial instruments, commodities, or other property for cash settlement and immediate (as opposed to future) delivery. Also called spot market.

(2) adjective — A financial instrument or transaction for which the ownership of the financial instrument or commodity is transferred at, or very shortly after, the time of the transaction, as opposed to futures market transactions where ownership of the financial instrument or commodity is transferred, if it is transferred at all, at a later date. Also called spot or spot market transactions.

Cash settlement
The agreement of a buyer and seller to exchange the security and the payment on the same day as the trade. For money market instruments, cash settlement is the delivery of purchased securities against payment in fed funds on the same day that the trade is made. See settlement.

Cash surrender value (CSV)
The amount of cash that can be obtained by the policy owner upon cancellation of a whole life insurance policy. CSV may also be borrowed by the policy owner. Only certain kinds of life insurance policies have cash surrender values.

CATS
See Certificate of Accrual on Treasury Securities.

CBO
See collateralized bond obligation.

CBOT
See Chicago Board of Trade.

CDO
See collateralized debt obligation.

Ceiling
An upper limit for a variable. For example, an adjustable- rate mortgage may have a ceiling of 10 percent. In this case, the rate can be adjusted however the loan terms provide without exceeding 10 percent. Also called a cap.

CERCLA
See Comprehensive Environmental Response, Compensation, and Liability Act of 1980.

Certificate of acceptance
See delivery and acceptance certificate.

Certificate of Accrual on Treasury Securities (CATS)
A proprietary name for a zero coupon Treasury security created from a coupon-bearing Treasury security.

Certificate of automobile receivables (CAR)
A form of asset-backed security. Securitized installment loans secured by automobiles.

Certificate of deposit (CD)
A deposit of funds, in a bank or savings and loan association, for a specified term that earns interest at a specified rate or rate formula. CDs may be secured or unsecured. CDs may be for terms as short as one week or for terms of 10 years or longer. CDs may have fixed or floating rates. CDs may be issued in either non-negotiable or negotiable form and in either physical or book-entry form. CDs may be issued by domestic offices of U.S. banks, by foreign branches of U.S. banks, and by foreign banks at either domestic U.S. or foreign locations. See Eurodollar CDs, jumbo CDs, negotiable CDs and Yankee CDs.

Certificate of good standing
A written form prepared by a state office or officer attesting to the fact that a named corporation is in good standing in that state.

Certificate of insurance
A document that describes an insurance policy. It is issued for informational purposes only. It is not legal evidence of insurance and may even describe a policy that has not yet been issued. See binder.

Certificate of origin
A document that specifies the country of origin for goods traded internationally.

Certificate of participation (COP)
Undivided proportionate interests in the future lease payments made by the municipal lessees/issuers. Investors owning COPs own the right to receive a portion of the payments arising from the lease, but do not own debt of the lessee.

Certificate of survey
See survey.

Certificate of title
See title opinion.

Certificated
Legal term used (especially in UCC Article 8) as an adjective to describe stocks, bonds, other investments, and certificates of deposit held in physical form.

CFTC
See Commodity Futures Trading Commission.

Chain of title
Another name for abstract of title.

Change in factor amortization
See level factor amortization.

Character
A term used by lenders and credit analysts to describe an individual's integrity and management ability. The term also may be used to describe the integrity and management ability of individuals managing a corporation. As used by lenders, character does not mean the citizenship or moral rectitude of an individual.

Charge-backs
The reduction of unpaid invoices owed to a trade creditor due to a dispute, return, offset, or any reason other than an account debtor's inability to pay.

Chattel

An archaic term for personal property that was common in many states before the adoption of the UCC. The term is used almost exclusively by bankers and lawyers who were trained before the adoption of the code.

Chattel mortgage
An archaic term for a security agreement.

Chattel paper
A category of personal property defined by Article 9 of the UCC. Chattel paper is a document that includes both a monetary obligation and a security interest in goods or a lease. For example, installment sales contracts that include a retail purchaser's promise to pay and a security interest retained by the seller become chattel paper for a bank when the seller pledges them to another party. Such a document is often called dealer paper because automobile dealers engaged in indirect lending frequently sell or pledge their retail installment contracts to a financial institution.

Cheapest to deliver
The cash market instrument that is the least expensive instrument to acquire and deliver into an exchange-traded contract at maturity.

Check
A commercial demand deposit instrument signed by the maker and payable on the presentation to the bank on which it is drawn.

Check 21 Act
The Check Clearing for the 21st Century Act (Pub. L. No. 108-100 - signed by President Bush on October 28, 2003). The law facilitates check truncation by creating a new negotiable instrument called a substitute check, which permits banks to truncate original checks, to process check information electronically, and to deliver substitute checks to banks that want to continue receiving paper checks. A substitute check is the legal equivalent of the original check and includes all the information contained on the original check. The law does not require banks to accept checks in electronic form nor does it require banks to use the new authority granted by the Act to create substitute checks. Check 21 is designed to foster innovation in the payments system and to enhance its efficiency by reducing some of the legal impediments to check truncation.

Check truncation
A process whereby deposited checks are retained by the fist bank (payee's bank) with notification sent to the local bank (payor's bank) that the check has been deposited. Canceled checks are not returned to the maker. Sometimes called check safekeeping.

Check-clearing float

The time between the date a check is deposited in a bank and the date it is charged to the drawer. Also called bank float or transit float.

Chicago Board of Trade (CBOT)
A futures exchange.

Chicago Mercantile Exchange (CME)
A futures exchange.

CHIPS
See Clearing House Interbank Payment System.

chose in action
A personal right to receive or recover a debt or damages, but only through a lawsuit.

Churning
The process of unnecessary purchases and sales in customers' accounts for the purpose of generating commissions.

CIP
See customer identification program.

Class
See tranche.

Clean letter of credit
A letter of credit that can be drawn upon with a simple written request not supported by other documentation. Often used to identify or describe standby letters of credit. This type of letter of credit is often used to enhance the credit quality of securities.

Clean REMIC
See sequential-pay REMIC.

Clean up (v.), clean-up (adj.),or cleanup (n.)
(1) An informal phrase used by lenders to describe a provision in loan documents, usually the promissory notes used for lines of credit. The clean-up provision requires that the loan balance outstanding under the line of credit be reduced, usually to zero, for a period of time, usually one or two months, with some specified frequency, usually annually. Sometimes called an "out of debt" requirement. A clean-up requirement is particularly well suited to borrowers with significant seasonal fluctuations in sales.

(2) The unwinding of an asset-backed security when the remaining balance is very small is sometimes referred to as a clean-up call.

Clear
The collection of funds on which a check is drawn and the subsequent payment of these funds to the holder of the check.

Clearing account
An account used to accumulate total charges or credits so that they can be distributed later among the accounts to which they are allocable, or so that the net differences can be transferred to the proper account.

Clearing corporation
An agency connected with a financial exchange through which brokers and other parties to a securities trade settle trades conveniently, with minimum paperwork. Financial settlements are simplified by combining and netting transactions. Sometimes called a clearinghouse.

Clearing House Interbank Payment System (CHIPS)
A privately owned electronic system in New York City that is used to transfer funds between banks. Often used for funds moving into and out of the United States. See Fed wire and Society for Worldwide Interbank Financial Telecommunication (SWIFT).

CLO
See collateralized loan obligation.

Closed-end credit
Credit extensions in which the borrower receives the entire proceeds of the loan at or shortly after the loan is closed. In closed-end credit facilities, the amount borrowed cannot increase after it has been disbursed and partially repaid. Closed-end credit may require regular repayment of principal (see installment note and term note) or may only require the repayment of principal at maturity. See bullet loan, single-payment loan, and time note.

Closed form solution
A solution to a math problem that can be obtained from simple formulas. Risk modelers and investors can use closed form solutions such as Black-Scholes or Vasicek models to value options. Also known as analytical solution. See one-factor model.

CLTV ratio
See combined loan to value ratio.

CME
See Chicago Mercantile Exchange.

CMIR
Report of International Transportation of Currency or Monetary Instruments. Each person who physically transports, mails, or ships, or causes to be physically transported, mailed, shipped or received currency or other monetary instruments in an aggregate amount exceeding $10,000 on any one occasion from the United States to any place outside the United States, or into the United States from any place outside the United States must file form 4790 (CMIR).

CMO
See collateralized mortgage obligation.

CMT
See constant maturity Treasury.

COFI
See cost-of-funds index.

Cognovit note
A promissory note that includes language in which the debtor acknowledges liability and allows the creditor to obtain a judgment without suit. Not permitted in some states.

Coinsurance

A provision in an insurance policy that requires the insured to carry an amount of insurance equal to a certain specified percentage of the value of the insured property. The coinsurance provision, or clause, provides for full payment of losses up to the amount of the policy if the amount of insurance carried equals the specified coinsurance percentage. If the amount of insurance carried does not equal the specified coinsurance percentage, the losses are shared between the insurer and the insured even if the loss is below the amount of the policy.

Collar
(1) The combination of a cap option and a floor option.

(2) For CMOs, the collar is the range in which certain performance variables (e.g., yield, average life) are guaranteed to stay. This range is expressed in terms of PSA speeds. See band.

(3) An informal name for caps and floors.

Collateral
(1) Property that a debtor has pledged, mortgaged, or assigned to a creditor.

(2) Securities exchanges in a repo, reverse repo, buy/sellback, or sell/buyback.

Collateral receipt
See warehouse receipt.

Collateral trust bonds
A type of corporate bond that employs a trustee to hold collateral, other than equipment or real estate, for the bond holders. For example, a parent corporation may borrow funds through a bond issue and pledge the stock in one of its subsidiaries as collateral for the bondholders.

Collateralized bond obligation (CBO)
A multi-tranche security secured by a pool of corporate securities (generally noninvestment-grade corporate bonds) or sovereign debt. Similar to the more familiar CMO, except that in a CBO the tiers or tranches are created with differing levels of credit quality. The CBO structure creates at least one tier of investment-grade bonds, thus providing liquidity to a portfolio of junk bonds. CBOs are a type of CDO. See collateralized debt obligation (CDO), special purpose vehicle and waterfall.

Collateralized debt obligation (CDO)
(1) A multi-tranche security with credit risk exposure to corporations. A securitization of corporate obligations. CDOs can be securitizations or re-

securitizations of commercial loans, corporate bonds, other types of ABSs, residential MBSs, commercial MBSs, and emerging market debt. CDOs may even be backed by other CDOs. Securitizations of corporate bonds are a type of CDO called a collateralized bond obligation or CBO. A synthetic CDO uses credit default swaps rather than actual corporate obligations to create a pool of credit exposure. Similar to the more familiar CMO, except that in a CDO the tiers or tranches are created with differing levels of credit quality. A CBO divides the credit risk of a pool of high yield bonds into different classes that appeal to investors with different credit risk tolerances. The CDO structure creates at least one tier of investment-grade bonds. The contractual rules for the cash flow distributions in a CDO structure enable the senior tranches to receive high credit ratings by shifting risk to the equity tranche. See equity tranche, special purpose vehicle, and waterfall.

(2) The term "CDO" may be used to refer to the special purpose entity, SPV, that holds the securitized assets.

Collateralized loan obligation (CLO)
A multi-tranche security secured by a pool of corporate loans. Similar to the more familiar CMO, except that in a CBO the tiers or tranches are created with differing levels of credit quality. The CBO structure creates at least one tier of investment-grade bonds, thus providing liquidity to a portfolio of junk bonds.

Collateralized mortgage obligation (CMO)
A type of MBS created by dividing the rights to receive the principal and interest cash flows from an underlying pool of mortgages into separate classes or tiers. The tiers or classes are usually called tranches. In other words, it is a multiclass bond backed or collateralized by mortgage loans or mortgage pass-through securities. A given tranche is typically not redeemed until all bonds with earlier priority have been redeemed. By dividing the cash flows into one or more tranches with shorter terms, the risk resulting from the potential volatility from future changes in prevailing rates is shifted away from the shorter-term tranche or tranches and onto the longer-term tranches and the residual tranche.

Collected balances
Collected balances are bank ledger balances minus checks in the process of collection. Also called available balances, good funds, or usable funds.

Collection
Obtaining payment.

Collection float
The total time period between when a check is prepared by the remitter and when the check is presented to the remitter's bank. The float also includes the mail float, processing float, and transit float, and is considered the disbursement float for the organization that issues the check.

Collection guaranty

A guaranty in which the signer guarantees to pay the bank only if the bank cannot obtain repayment through other means.

Combined loan to value ratio (CLTV)
A measure of collateral coverage provided by a consumer borrower's residence. The borrower's total senior and subordinated loan balances divided by the appraised value of the borrower's residence.

Commercial letter of credit
An obligation issued by a bank on behalf of a bank customer to a third party. A commercial or trade letter of credit is a bank promise to pay the third party for the purchase of goods by the bank's customer. If the bank's obligation to pay is not immediate, the transaction can later give rise to a banker's acceptance. Also called trade letter of credit. See banker's acceptance and letter of credit.

Commercial loan theory of liquidity
An explanation of bank liquidity described by Adam Smith: short-term loans advanced to finance salable goods on the way from producer to consumer are the most liquid loans the bank can make. These are self-liquidating loans because the goods being financed will soon be sold. The loan finances a transaction and the transaction itself provides the borrower with the funds to repay the bank. Adam Smith described these loans as liquid because their purpose and their collateral were liquid. The goods move quickly from the producers through the distributors to the retail outlet and then are purchased by the ultimate cash-paying consumer. Also called the real bills doctrine.

Commercial paper
Unsecured, short-term promissory notes issued by corporations for specific amounts and with specific maturity dates. Firms with lower ratings or firms without well-known names usually back their commercial paper with guarantees or bank letters of credit. Commercial paper may be sold on a discount basis or may be interest bearing. Terms can be as short as 1 day and usually do not exceed 270 days.

Commercial tort claim
A claim rising as a result of a tort that (a) does not include damages arising out of a personal injury or death and (b) arises out of the normal course of business from either an individual or organization. A category of personal property collateral defined by the 2001 revisions to Article 9 of the UCC. See tort.

Commingled funds
Money pooled for a common purpose. Often funds pooled for investments. See local government investment pools.

Commingled goods

Goods that become part of a product or mass of goods. An example is the flour used to bake bread.

Commitment letter
A legally binding letter in which a lender documents the terms, prerequisites and conditions under which it agrees to provide financing to an applicant. Commitment letters may be used in almost any lending transaction but are most common in commercial real estate transactions.

Commodity Futures Trading Commission (CFTC)
The Federal agency that is responsible for regulating futures trading in the United States.

Common stock
A type of equity or capital representing shares of ownership in a corporation. May or may not receive distributions of corporate income in the form of dividends. Receives the lowest priority for repayment in the event of a corporate liquidation. As opposed to preferred stock, which has a slightly higher claim to corporate funds.

Community Reinvestment Act
A federal statute enacted to require banks and savings and loan associations to meet the credit needs of their communities, including low- and moderate-income neighborhoods.

Companion tranche
A specific tier or segment of REMIC security. A REMIC tranche that is structured to absorb a disproportionate amount of the volatility caused by variations in the prepayments of the underlying collateral. Companion tranches are created to be more volatile so that other tranches in the same REMIC, called PAC or TAC tranches, may have more stable cash flows. Hence the name companion. Also called support tranches.

Compensating balance
A method of paying the bank for providing services.

(1) In lending, compensating balances are minimum balances that the bank requires a borrower to maintain with the bank as partial compensation to the bank for the credit facility.

(2) The amount of deposit balances necessary to offset the cost of deposit, cash management, or other bank services. Each period, usually monthly, the actual bank service charges applicable for the services used by the depositor are used to determine the level of balances to be left with the bank. Adjustments are made to reduce the deposit total for reserve requirements and float. See account analysis.

Compilation statement
Financial statement put together for the client firm by a CPA that is entirely based upon data submitted to the CPA by the firm with no review, no testing, and no opinion expressed by the CPA.

Complete appraisal
A term used in the Uniform Standards of Professional Appraisal Practice (USPAP) requirements for real estate appraisals. Synonymous with an appraisal as defined by the Federal appraisal regulations for real estate pledged to secure loans. A complete appraisal is a statement of market value that meets the five specific standards. A complete appraisal is conducted in conformity with USPAP rules and without invoking the departure provision in those rules. See appraisal, evaluation, and limited appraisal.

Compliance risk
One of nine risks defined by the Office of the Comptroller of the Currency (OCC). The risk to earnings or capital arising from violations of or nonconformance with laws, rules, regulations, prescribed practices, or ethical standards. This risk is incorporated in the Federal Reserve definition of legal risk.

Compound interest
Interest computed by applying the simple rate of interest to calculate interest on principal plus interest on successive increments of interest earned in prior periods.

Compound interest bond
See capital appreciation bond.

Compound option
An option on an option. Examples are captions and floortions.

Comprehensive Environmental Response, Compensation, and Liability Act of 1980
Imposes liability on owners and operators for cleanup of environmental sites.

Comprehensive income
A term defined by FAS 130 as the change in equity of an entity during a reporting period that results from transactions and "other events and circumstances from nonowner sources." The "other events and circumstances from nonowner sources" are referred to as "other comprehensive

income." Accordingly, comprehensive income is the change in equity during a reporting period that results from the combination of net income and other comprehensive income. See FAS 130 and also see other comprehensive income.

Concentration account
A cash management tool. A single account established by an entity, usually in conjunction with one or more zero balance disbursement accounts. Sometimes the concentration account is referred to as a parent account while the associated zero balance accounts are called daughter or subsidiary accounts.

Concession
The underwriting spread. The difference between the price that an underwriter or underwriting syndicate pays to the issuer and the price that is received from investors who buy the issue. The concession is the income earned by the underwriter.

Conditions
A term used by lenders and credit analysts to describe the background or underlying economic and industry circumstances affecting a business.

Confidence interval
The degree of certainty that an event will fall outside of boundaries on a distribution. For a normal distribution, boundaries set at two standard deviations from the mean create approximately 95 percent confidence intervals. In other words, only 5 percent of the events will be smaller or larger than the boundary amounts. Often applied to VaR measures of risk.

Confirmation
The document used to state in writing the terms of a trade that were previously agreed to orally by the buyer and the seller.

Conformed copy
A copy of an original document on which the signature, seal, and other such authenticating features are typed or otherwise noted.

Conforming mortgage
A residential mortgage loan that meets all FNMA or FHLMC standards. Mortgages may conform to agency requirements regardless of whether they are sold or retained by the originator. Even though a conforming mortgage may not be sold to FNMA or FHLMC, its amount, repayment terms, and documentation meet the standards of those agencies, and the loan may be sold to them at any time during its life.

Consensual lien
A security interest given to a creditor by a debtor. A consensual lien is granted by the consent of the parties and is the basis for most secured transactions. See judicial lien and statutory lien for alternative types of liens.

Consideration
A legal term used to describe the benefit that a borrower, guarantor, or pledgor receives in exchange for agreeing to repay, guarantee, or pledge security to the bank. Usually, but not always, the consideration is the proceeds of the loan. In some states, a reasonable expectation of benefit can be sufficient. Consideration must involve benefit that is meaningful, which means that the value of the consideration, whether or not it is directly monetary, must be comparable to the benefit.

Consignment
(1) (adjective) — Goods or inventory that are held by a selling agent, wholesaler, or reseller until the goods are either sold or returned to the seller. The goods are owned by the consignor. The selling agent is merely a consignee.

(2) (verb) — The physical transfer of goods from a seller/consignor who retains title to the goods to a consignee who acts as a selling agent.

Note that not all consignments are "true" consignments. Also note that not all true consignments are covered by UCC Article 9.

Consignee
Selling agent, wholesaler or retailer holding goods owned by a consignor.

Consignor
Owner of goods (e.g. retains right and title to the goods) that are placed with a selling agent.

Consolidated statements
Consolidated financial statements show the combined assets, liabilities, net worth, income, expense, net income, and cash flows for a related group of companies. Unlike simpler combined statements, consolidated statements do not merely show the aggregate of the values for each line item for all of the firms in the group. Instead, consolidated statements also reflect the elimination of intercompany transactions. Consolidated statements disregard the distinction between separate legal entities and treat a parent firm and its subsidiaries as a single economic entity.

Consolidating statements

Consolidating financial statements are reports or worksheets that show the financial condition of each entity in a consolidated group of entities as well as the intercompany eliminations used in the preparation of consolidated reports.

Constant maturity Treasury (CMT)
An average of the yields from various Treasury securities that all have the same remaining time until maturity. For example, the one-year CMT is the average yield of various Treasury securities maturing in one year. CMT indexes are published by the Federal Reserve Board of Governors in statistical release H.15.

Constant percent prepayment (CPP)
An expression of mortgage loan prepayments in annual terms. The single monthly mortality rate (SMM) multiplied by 12. CPP annualizes SMM without reflecting the impact of compounding. See constant prepayment rate and single monthly mortality rate.

Constant prepayment rate (CPR)
A measure of the historical or expected prepayment of principal on a mortgage or an MBS that expresses the prepayment as a constant proportion of the outstanding principal. The CPR is an annualized expression of the SMM that reflects compounding and is therefore more accurate. See single monthly mortality rate.

Consumer goods
A category of goods defined by Article 9 of the UCC. Consumer goods are goods used primarily for personal, family, or household purposes. Typical examples are jewelry, furniture, automobiles, and appliances.

Consumer lease
A consumer lease is defined under Article 2A of the UCC. It is a lease between a lessor who regularly engages in the business of leasing or selling to a lessee who is an individual and who takes the lease for personal, family, or household purposes. To meet the definition of a consumer lease, the total payments to be made under the lease, excluding payments for options to renew or buy, may not exceed $25,000. Any prohibitions on a party's right to transfer its rights in a consumer lease must be in writing, conspicuous, and specific.

Consumer Leasing Act
A federal law that governs consumer leases. The act is implemented by Federal Reserve Regulation M. Compliance with the Consumer Leasing Act is largely, but not entirely, a matter of providing the consumer with required disclosures intended to enable the consumer to compare different leases.

Contagion
The process (verb) or risk (noun) were a crisis in one bank, country, market or currency spreads. Typically, regulators worry about contagion in two directions. Upward contagion arises when idiosyncratic problems at one financial institution spread to create systemic problems. Downward contagion arises when the systemic problems lead to severe problems at individual banks that are relatively more vulnerable.

Contingent deferred sales charge (CDSC)
See back-end load.

Contingent liability
A debt or obligation that becomes a liability only when something else happens. For example, a guarantor becomes liable for his guarantee only if the debt that is guaranteed does not get paid by the debtor.

Continuation
A form and process by which a secured party extends the priority of its security interest in the public record. The priority of liens created under Article 9 of the UCC is usually established by filing a financing statement. Under the provisions of Article 9, financing statements are only valid for five years. However, a financing statement can be renewed by filing a continuation statement, usually a UCC-3 form. Continuations must be filed no earlier than six months prior to the expiration of the financing statement and no later than the expiration date of the financing statement. Continuations last for five years and can be extended by filing another continuation.

Continuing guaranty
A guaranty in which the guarantor agrees to guarantee all future loans made to that borrower by the bank, not just the loan or loans made as part of the transaction in which the guaranty was obtained.

Continuous repo
A repo/reverse repo transaction that does not have a specified term. These transactions are like a series of overnight repos renewed daily. The repo rate, the amount of funds invested, and/or the amount of collateral is adjusted each day. Continuing repos are commonly used in conjunction with bank sweep accounts. Under a continuing repo agreement, the transaction is terminated whenever either party requests termination. Also called open repos.

Contra account
Accounts receivable due from debtors who also have accounts payable due to them from the borrower.

Contra asset
An asset account that normally has a credit balance. Examples are the allowance for doubtful accounts and accumulated depreciation.

Contra liability
A liability account that normally has a debit balance.

Contract right
A defined term under the 1962 version of the UCC that means a right to payment under a contract that has not yet been earned by performance and is not evidenced by an instrument or chattel paper. Under the 1972 version of the UCC, these rights are either accounts or general intangibles.

Contractual gap
A crude measure of a financial institution's exposure to adverse consequences resulting from changes in prevailing interest rates. The contractual gap is a gap mismatch measure calculated using the contractual maturity and repricing dates for all assets and liabilities. It is arguably the least accurate gap methodology.

Control stock
Control stock is stock held by a person who directly or indirectly controls the management of the issuing company. The right of the owner or a pledgee to sell control stock is limited by provisions in the Securities and Exchange Acts.

Controlled disbursement bank
A bank that can provide better management control over checks being presented. Generally, this bank is located outside the local area and receives only presentments from the Federal Reserve System and the local clearing-house.

Conventional mortgage
A mortgage loan based solely upon the value of the mortgaged real estate and the creditworthiness of the borrower. A mortgage loan without insurance or guarantees from a government agency.

Convergence
Describes an inevitable change in the relationship between cash and futures prices for instruments until delivery. Prior to delivery, the futures

price and the cash price differ by the cost of carry. As time passes, the cost of carry diminishes and the futures price will equal the cash price at the time of delivery. This is a necessary condition for the futures contract to effectively hedge the cash instrument.

Conversion premium
A convertible's conversion premium is the amount by which a convertible's market price exceeds its value in stock. The premium may be expressed as the dollar difference or as a percentage.

Conversion ratio
The specified number of shares of common stock that will be received for each convertible bond or share of convertible preferred stock at the time of conversion. This ratio is specified at issuance in the bond indenture agreement. This is often an uneven amount using partial shares.

Conversion value
For convertibles, the value in stock. Also called the parity value. The conversion value can be determined by multiplying the conversion ratio by the value of the stock at any point in time.

Convertible ARM
An ARM for which the borrower has the option to convert from a floating-rate loan to a fixed-rate loan. Convertible ARMs can typically be converted in the first through fifth years of the mortgage loan. Because borrowers can exercise their conversion option for a modest fee, conversion is more attractive to borrowers than the alternative of obtaining a nonconvertible ARM and then later refinancing with a fixed-rate loan when prevailing rates have fallen. Consequently, prepayment speeds for convertible ARMs are faster than prepayment speeds for nonconvertible ARMs.

Convertible bond
A bond that includes a provision allowing the holder to exchange the bond for a quantity of the issuer's common stock at some fixed exchange ratio. An otherwise normal corporate bond that has a fixed maturity date that pays coupon interest and repays principal at maturity. It is issued with an option to exchange the bond for a fixed number of shares of common stock at the option of the bondholder, thereby allowing the convertible bond to share in the growth potential of the underlying common stock. It is senior to stock within the corporate equity structure, although probably junior to other corporate debt. Convertible bonds are often callable.

Convertible debt spread
The difference between the coupon interest rate on the convertible and the coupon interest rate on the issuing company's nonconvertible bonds.

The amount by which the convertible's interest is lower depends on a number of factors, including the structure of the convertible itself. The debt spread typically ranges from two to five percentage points.

Convertible preferred stock
Preferred stock that can be converted into the common stock of the issuing company. Like nonconvertible preferred stock, the convertible preferred stock is a class of the corporation's capital stock; has a specified dividend rate that is usually declared quarterly and is cumulative (accumulates in arrears if the corporation does not make the payment); and has priority over common shares for dividend payments. Both convertible and nonconvertible preferred stock are considered to be perpetual, but in fact, both are callable. Call dates on convertible preferreds are specified in the prospectus at issuance.

Convexity
A measure of the sensitivity of duration to changes in yield levels. Convexity is a measure of the stability or instability of the measured duration over a range of yields. If convexity is low, that is, if the price/yield relationship is close to a straight line, duration is stable. If convexity is high, duration is unstable. The greater an instrument's convexity, the less accurate duration will be. See duration, effective duration, Macaulay duration and modified duration.

COP
See certificate of participation.

Core deposits or core funding
(1) A bank's deposits that are the most stable.

(2) A bank's deposits under $100,000 each.

(3) Deposits that have an indefinite maturity, such as checking accounts, NOW accounts, money market deposit accounts, and savings accounts. See retail deposits.

Corporate settlement
The agreement of a buyer and seller to exchange the security and the payment on the third business day after the trade date. See regular way settlement and settlement.

Correlation
The degree of relationship between two sets of data. A correlation near plus 1, called a positive correlation, indicates that changes in one set of

data are closely related to changes in the other set and that the data sets change in the same direction. A correlation near minus 1, called negative correlation, indicates that changes in one set of data are closely related to changes in the other set and that the data sets change in the opposite direction. A correlation near zero indicates little or no relationship between the changes in the two sets of data.

Correlation VAR

Correlation VAR is a measure of a financial instrument's, a portfolio of financial instruments,' or an entity's exposure to reductions in value resulting from changes in prevailing interest rates. Also called analytical VAR, correlation VAR is one of several different methods for calculating VAR. Analytical or correlation VAR compares the sensitivity of risk elements within a portfolio. The volatility of each component is then calculated using a standard matrix. This is the type of VAR calculated by popular models such as RiskMetrics. This is the least computationally insensitive of the three statistically based VAR measurements. However, this approach does not do a good job of reflecting option risk or of incorporating the risk of unlikely events. See empirical VAR, historical VAR and value at risk (VAR).

Correspondent bank

A bank that serves as a depository and provides banking services for another bank.

Cosigner, co-maker and co-obligor

Terms used to identify multiple parties who sign as borrowers for a loan.

COSO

(1) The Committee of Sponsoring Organizations of the Treadway Commission. Formed in 1985 by five U.S. professional organizations to sponsor the National Commission on Fraudulent Financial Reporting. This was an independent, private sector initiative. The committee developed recommendations used by financial auditors, the SEC and regulators.

(2) The name most commonly used to refer to guidelines for enterprise-wide risk management (ERM) called "Internal Control - Integrated Framework". These COSO guidelines now serve two purposes.

They are used by internal and external auditors to implement and evaluate a firm's financial controls. The 2002 Sarbanes-Oxley Act and similar legislation is a primary driver of this application.
Financial institutions are also using COSO guidelines for ERM in general but primarily for the identification and control of operations risk. The Basel II capital requirements and related rules issued by national banking regulators are a primary driver of this application.
See enterprise-wide risk management, operations risk and self-assessment.

Cost in excess of billing

An asset created under a type of accrual accounting used when firms such as contractors incur expenses in accounting periods that are repaid in subsequent accounting periods. This account is comprised of money spent by the contractor for things that will be billed to buyer at a future date.

Cost of carry
The cost of financing an asset. If the cost of carry is smaller than the interest received from the asset by the investor, the investor has a positive carry. Conversely, if the cost of carry is larger than the interest received from the asset by the investor, the investor has a negative carry.

Cost-of-funds index (COFI)
The weighted-average interest rate paid by savings institutions to obtain funds. There are national and regional cost-of-fund indexes. The most common is the 11th District Federal Home Loan Bank COFI. A specific COFI index may be used as a benchmark rate for a floating-rate security.

Cost of goods sold
Amount shown on a firm's income statement representing the direct expenses that the firm incurred for sales. Cost of goods sold is always a debit balance and is shown as either a deduction or a negative number.

Counter balancing capacity (CBC)
A term sometimes used to describe the quantity of funds that a financial institution can obtain to meet liquidity requirements. See forward cash exposure.

Counterparty
A term used to identify the "other" party in a two-party transaction. For example, the counterparty of a buyer is the seller to that buyer. The term counterparty is frequently used to identify the other party in repurchase agreement transactions and in interest rate swap transactions.

Counterparty risk
The risk that a counterparty will default (fail to perform) on its obligation under a contract. Counterparty risk is not limited to credit risk (the risk that the counterparty cannot fulfill its contractual obligations) but may also result from other problems associated with a counterparty unwilling to honor the contract.

Coupon leverage
The inclusion of a multiple in the formula for calculating the coupon rate on an inverse floating-rate CMO. For example, an inverse floater with a multiple may pay interest at the rate of 22 percent minus the product of 2 times the 1-month London Interbank Offered Rate (LIBOR). (Note that when the rate formula for a floater or inverse floater applies a multiple to a sum, the CMO tranche is called a super floater. See super floater.)

Coupon yield equivalent
See bond equivalent yield.

Coupon, coupon rate
(1) The rate of interest received by the holder of a security. Not necessarily the same as the yield realized by the holder. See rate.

(2) For pass-through securities, the holder's coupon rate is the gross coupon of the underlying loans less servicing fees and any agency guarantee fees.

Covariance
A measurement of the relationship between two variables. The arithmetic mean of the products of the deviations of corresponding values of two quantitative variables from their respective means.

Covariant
The condition of varying with something else in a way that satisfies a mathematical relationship. See covariance.

Covenants
Restrictions on the activities of a debtor written into bank loan agreements or bond indenture agreements. Also called indenture covenants or protective covenants. Contractual terms of the loan or indenture agreement that prohibit the debtor from taking actions that might hurt the interests of the lenders or bondholders. Designed to protect the interests of creditors — often (but not limited to) unsecured creditors. Four common examples of covenants are prohibitions against: issuing new debt, paying dividends if certain minimum financial standards are not maintained, merging with another company, and selling corporate assets.

Covered calls
A call option for which the owner of a security grants the buyer of the call option the right to purchase a security owned by the option seller. The opposite of naked calls. In theory, selling covered calls can be a hedging strategy. If investment prices fall, the investor's loss will be offset by the income from the covered call. (When prices fall, the call option is likely to expire unexercised because the call buyer can buy the security on the open market at a lower price.) On the other hand, if prices rise, the seller's gain is limited to the difference between the seller's book value and the option strike price (which in this case is probably less than the market price), but the seller also retains the proceeds of the option sale. For banks, regulatory restrictions as well as practical difficulties may restrict the suitability of covered calls as hedging tools.

Covered put

The sale of a put option while holding sufficient cash to buy the underlying.

CPLTD
Acronym for current portion of long-term debt.

CPP
See constant percent prepayment.

CPR
See constant prepayment rate.

CRA
See Community Reinvestment Act.

Cram down
An informal name for a settlement or terms that a debtor forces creditors to accept. For example, a debtor in Chapter 11 bankruptcy proceedings can, subject to some restrictions, have a plan to resolve the bankruptcy approved by the court even though a creditor or a class of creditors objects.

Credit default swaps
See credit swap.

Credit derivative
Contractual arrangements that allow one party to transfer credit risk of a reference asset, which it may or may not own, to one or more counterparties. The first party may be called the "protection buyer", the "beneficiary" or the "originator". The counterparty or counterparties may be called the "protection seller" or the "guarantor". Credit derivatives are contracts for transferring risk - just like foreign exchange, commodity and interest rate risk derivatives. The only difference is the type of risk transferred. See total return swaps, credit default swaps, credit linked note and credit options for definitions of specific types of credit derivative instruments. Also see reference asset.

Credit enhancement
A measure that alters the structure of a security in a way that reduces its credit risk. Credit enhancement may take the form of a letter of credit

issued to back securities. For mortgage-backed and asset-backed securities, credit enhancement may take the form of arrangements to over-collateralize the security.

Credit event

A term used in credit swap and some other credit related contracts. The specified credit event in each contract is defined by the parties to suit their particular needs. Typical specified credit events are bankruptcy, insolvency, credit rating downgrade or failure to make a required scheduled payment. Note that for a credit swap transaction, these events do not refer to occurrences or change impacting one of the contract counter parties. Instead they refer to events applicable to the underlying reference asset. The defined events must be well-defined and unambiguous.

Credit history

A record of how a person has borrowed and repaid debts.

Credit linked note

Credit linked security

A type of credit derivative instrument. Credit linked notes are a securitized form of credit derivatives. The protection buyer issues notes. If a specified credit event occurs, the investor who buys the notes has to suffer either a delay in repayment or has to forego interest. (The specified credit event is pre-defined can be any one of a number of alternatives.) Also known as credit linked security.

Credit memos

Accounting adjustments that reduce account receivable balances due from account debtors. Usually credit memos are generated to account for merchandise that is returned and when credit is given to customers for damaged goods. Credit memos are the accounting reflection of charge-backs.

Credit migration

Improvement or deterioration in an obligor's credit worthiness over time. Most often used to describe the improvement or deterioration in the credit worthiness as represented by a rating or credit grade.

Credit options

A type of credit derivative instrument. Options on a credit spread take the form of credit-spread put options. The put-buyer pays an upfront fee to the put-seller in exchange for a contingent payment in the event that the credit spread for an asset rises beyond a pre-agreed upon threshold. This is a put option where the underlying is the spread on a third party security. For example, if you were holding a bond issued by a third party and the bond's spread over the comparable Treasury rate were 200 basis points, you might purchase an option that pays off if the spread widens to 300 basis points. (Although that example uses the Treasury rate as a basis for comparison, it is becoming more common to use swap rates.) In other words, the widening of the credit spread to a defined size gives the protection buyer the right to demand a payment from the protection seller. Unlike a total return or default swap, the parties in a credit spread option do not have to agree upon any specific credit events. The fact that the market spread for the underlying rises compared to the reference index rate is, in effect, a proxy for a deterioration in the credit quality. Also known as credit spread options and credit spread put options.

Credit risk
The risk to earnings or capital from the potential that a borrower or counterparty will fail to perform on an obligation. Usually, but not always, the obligation in question is a requirement to make interest or principal payments. Sometimes called default risk, the failure to make required payments reduces the value of equity securities, debt securities, and loans. In the extreme, credit defaults eliminate all or almost all of the value in loans or securities. Adverse consequences from credit risk are not restricted to default, the ultimate manifestation of credit risk. In addition, asset owners can suffer from reductions in value resulting from either real or perceived declines in the obligor's financial strength.
Both the Office of the Comptroller of the Currency (OCC) and the Federal Reserve list credit risk as one of their defined risk types for risk-based examinations. Credit risk exposure is found in all activities in which success depends on the performance of a counterparty, issuer, or borrower. Credit risk arises any time a financial institution extends, commits, invests, or otherwise exposes its funds through actual or implied contractual agreements, whether reflected on or off the balance sheet.

Credit scoring system
A statistical system used to determine whether or not to grant credit by assigning numerical scores to various characteristics related to creditworthiness.

Credit spread options
See credit options.

Credit swap
A type of credit derivative instrument. Swap contracts in which one party makes payments only if a specified credit event occurs. In a credit default swap, the protection seller agrees, for an upfront or periodic fee, to compensate the protection buyer upon the happening of the specified credit event. Credit default swaps are similar to a traditional financial guarantees but more flexible. It is more flexible because a credit swap need not be limited to compensation upon an actual default. The specified credit event in each swap is defined by the parties to suit their particular needs. Variations of the basic structure outlined in this definition are also used. Also known as default swaps or credit default swaps. See credit derivative, credit event and reference asset.

Credit watch

A warning issued by a credit rating agency alerting investors that the current rating is under review and may be upgraded or downgraded.

Creditor
A party who is owed money by another party.

Creditworthiness
A creditor's measure of a consumer's past and future ability and willingness to repay debts.

Critical path
A sequence of those tasks (e.g., in payment processing) which must be completed before the next task can be started. Anything not on the critical path is something that can be done later without delaying an important step.

Cross collateralization
Extension of the creditor's interest in property of the debtor so that collateral for one debt also serves as collateral for one or more other debts.

Cross correlation
Statistical term for the degree of similiarity for two different sets of data.

Cross default
Provision in the loan documents in which the debtor agrees that default on one loan will also constitute default on other obligations to the creditor.

Cross hedge
A hedge transaction in which a cash market instrument is hedged by an option contract for a different underlying instrument. Sometimes called proxy hedge, surrogate hedge, or tandem hedge.

Cross stream guaranty
A phrase sometimes used to describe a guaranty of a loan to a borrowing entity when the borrowing entity is affiliated with the guarantor corporation through common ownership but is neither a parent nor a subsidiary corporation. For the purposes of this definition, the borrower and the guarantor do not necessarily have to meet the accounting definition of affiliates.

CSV
See cash surrender value.

Cubic spline
A mathematical technique used for yield curve smoothing. A cubic spline fits a different third degree polynomial to each interval between data points (0 to 1 years, 1 to 2 years, 2 to 3 years, etc.) Either yields or prices can be smoothed using cubic splines. This smoothing technique is the most common and works well for spot rates. See smoothing.

Cumulative gap
The net sum obtained by adding all of the interval gaps or mismatches between rate-sensitive assets and rate-sensitive liabilities beginning with the first bucket in the gap analysis and proceeding to a selected time. For example, the one-year cumulative gap is the sum of the gaps for all of the time intervals prior to and including the gap bucket ending one year from the date that the report was prepared. A crude and highly inexact measure of interest rate risk.

Currency transaction report (CTR)
Each financial institution (other than casinos, which instead must file a CTRC form) must file a CTR for each deposit, withdrawal, exchange of currency or other payment or transfer, by, through or to the financial institution which involves a transaction in currency of more than $10,000 unless a CTR Exemption form has been previously filed. See Bank Secrecy Act.

Current assets
The group of assets considered the most liquid. Usually comprised of cash, accounts receivable, inventory, and a few minor items. The subgrouping of assets into current and long-term categories is common for all financial statements except for firms in the financial industry.

Current coupon
The term used to refer to all fixed-income securities paying interest at the rate currently required by purchasers for securities of that maturity and quality. Current coupon securities trade at or very near par.

Current coupon yield curve
See yield curve.

Current face

The total amount of the current principal outstanding of the loans in an MBS pool. The current face is always equal to the product of the original face multiplied by the current factor. Analogous to the par value of a conventional debt security.

Current factor
See factor.

Current liabilities
The group of liabilities considered to be the shortest term. Usually comprises accounts payable, short-term bank debt, bank overdrafts, other short-term accounts or notes payable, current portion of long-term debt, and a few minor items. The subgrouping of liabilities into current and long-term categories is common for all financial statements except for firms in the financial industry.

Current ratio
The ratio obtained when total current assets are divided by total current liabilities. A commonly used but not always good proxy for a firm's liquidity.

Current yield
(1) For bonds, a measure of the simple interest annual yield for investments with coupon rates and with maturities of one year or more. To calculate the current yield, the annual coupon interest income is simply divided by the amount paid to acquire the investment. It is important to note that the current yield is only accurate for investments purchased at par. The current yield calculation includes just one income cash flow - the annual coupon interest income. It ignores the profit or loss resulting from discounts and premiums.

(2) For stocks, the annual dividend income divided by the price per share.

Cushion bonds
An informal name for callable bonds with long maturities that have coupon rates well above current market rates. Because these bonds have such high coupon rates, they trade at prices and yields calculated to the call date rather than to the maturity date. This makes the cushion bond's price less volatile. If prevailing rates remain the same, fall, or rise to any level not greater than the coupon rate, the bond will offer a competitive return. Even if rates do rise to exceed the coupon rate, the cushion bond offers a higher yield in exchange for its longer maturity since the premium paid at purchase can be amortized over a longer period.

CUSIP number
A nine-digit letter and number combination established by the Committee on Uniform Securities Identification Procedures (CUSIP) that is used to identify publicly traded securities. Each publicly traded security receives a unique CUSIP number when the security is issued.

Custodial agreement
A written contract establishing the responsibilities of a custodian who holds property. In finance, the custodian holds collateral for deposits with financial institutions, investment securities, or securities underlying repurchase agreements.

Custodial credit risk
The risk that a financial instrument owner will suffer a loss resulting from the default of a third party that holds the financial instrument. The third party might be a safekeeping agent or a secured creditor. The financial instruments are typically deposits or securities.

Customer identification program (CIP)
A proposed requirement under the Bank Secrecy Act that all financial institutions implement a written, risk-based customer identification program, maintain information used to verify identities and compare the names of new customers against government lists of known or suspected terrorists or terrorist organizations. The proposed rule would apply to all customers seeking to open new accounts.

Cyclical liquidity risk
A type of systemic liquidity risk. The risk of funding problems arising from national or regional macroeconomic corrections, such as recessions or credit crunches.

D

Dampening
The phenomenon or the result of a declining volatility trend.

Data mining
Obtaining information about customers or groups of customers from a data warehouse for marketing or other purposes.

Data warehouse
A computerized database composed of data extracted from the data processing and accounting systems used for various bank deposit, loan, and other customer products. Typically, data is extracted from the various product systems, balanced, scrubbed, and converted into a standardized, readily accessible format.

Dated billings
Receivables created by invoices that do not require the account party to pay until some date in the future. Sometimes called datings.

Day basis
See accrual convention.

Day count basis
See accrual convention.

Daylight overdraft
A negative position in a bank's Federal Reserve account that occurs at any time during the business day.

Days inventory
The level of inventory expressed as its equivalent in days of a portion of cost of goods sold for the year. Calculated by multiplying inventory by 365 and then dividing that product by cost of goods sold.

Days payables
The level of accounts payable expressed as its equivalent in days of a portion of cost of goods sold for the year. Calculated by multiplying accounts payable by 365 and then dividing that product by cost of goods sold.

Days receivables
The level of accounts receivable expressed as its equivalent in days of a portion of net sales for the year. Calculated by multiplying accounts receivable by 365 and then dividing that product by net sales.

DDA
See demand deposit.

Dealer
A firm or an individual who buys and sells for his own account. A dealer has ownership, even if only for an instant, between a purchase from one party and a sale to another party, and is thus compensated by the spread between the price paid and the price received. Not the same as a broker, although an individual or firm may act as either a broker or a dealer in separate transactions.

Dealer paper
Retail installment sales contracts, often for automobiles, that are sold or pledged to a third party, usually a financial institution. See chattel paper.

Debentures
Unsecured, long-term corporate bonds. Even though debenture holders are not protected by collateral, they still have a legal right to repayment. In the event of default, debenture holders are treated like other unsecured creditors. In addition, debenture holders may benefit from indenture restrictions.

Debt
Funds owed by a debtor to a creditor. Outstanding debt obligations are assets for creditors and liabilities for debtors. May or may not be covered by written agreements.

Debt coverage
See debt service coverage.

Debt security
Any financial instrument representing a creditor relationship between the issuer (the debtor) and the holder of the instrument (the creditor). This generally includes all U.S. Treasury securities, municipal securities, corporate bonds, convertible debt, commercial paper, and securitized debt instruments such as CMOs and REMICs. Debt securities are usually not defined to include option contracts, futures contracts, forward contracts, lease contracts, or nonsecuritized loans.

Debt service
A term used to refer to the amount of principal and interest payments required by a borrower's loans or securities issued. Also used as a verb to describe making such payments.

Debt service coverage ratio
A simple comparison of the cash available to make principal and interest payments to the bank or to bond holders with the amount of those required principal and interest payments. Debt service coverage is expressed as a ratio with the annual net income divided by the annual debt service requirement.

Debt service coverage (DSC)
The margin by which all of a borrower's or bond issuer's required principal payments (not just those for the loan under consideration or just those for loans to one bank) are exceeded by the sum of the firm's cash flow plus all of the principal repayments and interest expense deducted in the process of calculating that cash flow.

Debt sinking fund
See sinking fund.

Debt tranche
Tranches in a multi-class security that have seniority ranking, for repayment, ahead of equity trances. See collateralized debt obligation (CDO), equity tranche and waterfall.

Debt-to-worth ratio

The simplest way to measure leverage. Calculated by dividing total liabilities by total equity.

Debtor
(1) A party who owes money or other performance to another party. Under the UCC, debtor includes the seller of accounts or chattel paper.

(2) For the purposes of UCC provisions dealing with collateral, debtor also applies to the owner of collateral given as security for the debt of another.

Debtor in possession
In some bankruptcy proceedings, the debtor, rather than a trustee, may continue to operate the business. The debtor in possession is the same person or company that controlled the business prior to the bankruptcy, however, the debtor in possession is a different legal entity.

Decay analysis
Statistical analysis of the rate of attrition. Decay analysis is used to analyze historical volatility of core deposit volumes, specifically rates for withdrawals and account closures. Deposit decay rates should be calculated by tracking a representative sample of accounts over a period of time that covers at least one interest rate cycle. Such volatility studies have been used by banks for many years to determine effective maturity assumptions that are then employed in present value analysis to calculate core deposit values for deposit purchases, branch acquisitions, and bank acquisitions.

Declaration page
The page in an insurance policy that contains all, or almost all, of the policy information specific to that particular insurance policy. The declaration page typically includes the name of the insured, the identification of the insured property, the amount of the insurance coverage, the expiration date of the policy, and the name of any lender with an interest in the insured property.

Deed in lieu of foreclosure
A deed executed by the mortgagor that transfers ownership in real estate to a lien creditor. This instrument is used when the debtor is unable or unwilling to pay and wishes to avoid foreclosure.

Deed of trust
A three-party document conveying interest in property, almost always real estate, to a trustee. In many states, deeds of trust are used instead of mortgages. In those states, the trustee holds the deed in favor of the lender and then reconveys the title to the borrower when the loan is paid in full. Sometimes called a trust deed.

Deep discount
A large discount for a financial instrument. The condition that exists when a financial instrument is trading at a market price that is well below its par value. May also be used to refer to those securities selling at prices well below par.

Deep in the money
A phrase used to describe an option with a high intrinsic value resulting from the fact that the market value of the underlying instrument is well below (for a call option) or well above (for a put option) the strike price of the option.

Default
(1) noun — A condition in which a loan or investment is not performing as expected because of the debtor's failure to act or refrain from acting in ways contractually agreed upon. As in "the loan is in default" or "an event of default."

(2) verb — A debtor's failure to act or refrain from acting in ways contractually agreed upon in the loan documents. Most often, default is the debtor's failure to pay.

Default rate
An alternative higher rate of interest or a premium specified in a loan document to be added to the contractual rate of interest that can be charged by the lender if the borrower is in default.

Default risk
The risk arising from the chance that debtors will not make promised payments either on time or in full. Also called credit risk.

Defeasance
The legal release of a debtor from being the primary obligor under the debt, either by the courts or by the creditor. Also called legal defeasance. See in-substance defeasance.

Deferred charges
Costs capitalized as assets on a firm's balance sheet for expenses such as long-term expenses that will not be recovered in the normal working capital cycle of the business or expenditures that will be charged to future operations. Examples include costs of rearranging equipment in a factory and capitalized research costs.

Deferred load
See back-end load.

Deferred sales charge
See back-end load.

Deferred tax asset
An asset reflecting a likely reduction in future income taxes. Accounting for deferred tax assets is governed by FAS 109.

Deferred taxes
A liability account that reflects the accumulated difference between the amount of income tax that the firm shows each year as an expense on its financial statements and the amount of income tax, usually lower, that the firm pays to the government.

Defined benefit plan
A pension or other employee benefit plan that provides specified amounts of benefits to eligible participants. The specified amounts of benefits are usually determined based upon age, years of service, and/or levels of compensation.

Defined contribution plan
A pension or other employee benefit plan that provides a specified contribution amount for the benefit of eligible employees. The participants ultimately receive amounts that depend on both the accumulated contributions and the investment returns realized from investment of the accumulated contributions.

Delay days
Lag times. The amount of time before the owner of a MBS receives payments from the underlying mortgages. The time between when the underlying mortgagors make their payments to the servicers and when those payments are due to the MBS investors. Delay days may refer to either stated delay or actual delay days. Stated delay days is the number of days from the issuance of an MBS pool or from the beginning of the interest accrual period until the first payment remitted to the investors who own the right to receive the cash flow. For example, a GNMA MBS pool with a stated delay of 45 days would pay interest accrued in January to security holders on February 15. Actual delay days is the monthly lag, measured in days, between the date the payments are due from a mortgage loan borrower and the date that the pro rata share of those payments is remitted to the MBS investors who own the right to receive the cash flow. Thus, since the January payment is not due until February 1, GNMA holders who receive January's payment on February 15 have 14 actual delay days.

De-leveraged bonds
Bonds that pay interest to investors according to a formula based on a fraction of the increase or decrease in a specified index. De-leveraged bonds are a type of structured note.

Delivery and acceptance certificate
A document that evidences the fact that goods have been delivered to a purchaser or lessee and accepted by that purchaser or lessee.

Delivery float
The time between when a check is ready for disbursement and when the vendor or employee actually receives it. For vendors, this may be considered the same as mail float.

Delivery vs. payment (DVP)
The simultaneous exchange of securities and cash. The safest method of settling either the purchase or sale of a security. In a DVP settlement, the funds are wired from the buyer's account and the security is delivered from the seller's account in simultaneous, interdependent wires.

Delta
(1) The Greek letter used by mathematicians to refer to change or the quantity of change.

(2) The price sensitivity of an option. The change in an option's price divided by the change in the price of the underlying instrument. As an option becomes deeper in the money, its delta gets closer to 1.0. As an option get further out of the money, its delta gets closer to zero. However, the change is nonlinear - the delta changes faster when the option is close to being in the money. The rate of change in an option's delta is called the option's gamma.

Demand
Term used to describe a creditor's right to request payment in full of a debt.

Demand deposit
A deposit account that permits the depositor to withdraw funds on demand. Usually, but not always, a checking account. Sometimes called demand deposit account (DDA).

Demand note

A promissory note that calls for principal to be payable on demand. In recent years, courts have significantly restricted the circumstances under which a bank could make and enforce a demand for repayment under a demand note.

Dematerialized
A term used to describe a physical certificate representing ownership of a security (a stock certificate or a bond) that is held by a trustee. This is an arrangement through which a physical certificate is held so that all future transactions can be conducted as if the security were issued as a book-entry security. Ownership and liens are recorded in the records of the trustee rather than evidenced by physical possession of the certificate. Also called immobilized. Less often, dematerialized is used to refer to book-entry securities that have never been issued in physical form.

Denomination
The par value of a bond.

Department of Housing and Urban Development (HUD)
A department of the U.S. government that promotes private and public housing. FHA and GNMA are agencies within HUD.

Departure provision
A specific provision in the USPAP rules for real estate appraisals. The departure provision states that: "An appraiser may enter into an agreement to perform an assignment that calls for something less than, or different from, the work that would otherwise be required by the specific guidelines." An appraisal conducted under the departure provision is called a limited appraisal. See complete appraisal, limited appraisal, and Uniform Standards of Professional Appraisal Practice.

Deposit notes
A form of bank obligation that is similar to a deposit. Deposit notes are typically issued with terms from two to five years. Like CDs, deposit notes are issued for specified terms at either specified rates or specified rate formulas. Unlike CDs, deposit notes are sold in a predetermined amount for a predetermined time period. The deposit note terms are usually described in an offering circular similar to an offering of securities. For investors, the primary difference between bank CDs and bank deposit notes is the way in which interest is calculated. Like many government agency securities and corporate bonds, interest rates for deposit notes are typically calculated using accrual methods that assume a 360-day year comprised of months that all have 30 days. Deposit notes may be rated by a nationally recognized statistical rating organization (NRSRO).

Depository bank
A bank used as the point of deposit for cash receipts

Depository Trust Company (DTC)
An organization that holds physical certificates for stocks and bonds and issues receipts to owners. Securities held by DTC are immobilized so that they can be traded on a book-entry basis.

Depreciation
The amount by which a fixed asset's accounting or book value is periodically reduced to reflect the fact that the economic value of the asset is steadily reduced by a combination of wear and tear from use, age, and/or obsolescence. The offsetting entry is depreciation expense.

Derivatives
(1) Financial instruments whose value depends upon the values of underlying assets, interest rates, currency exchange rates, or indexes. Various authorities define derivative instruments in broad, inclusive terms or narrow, exclusive terms. It is a common misconception that all derivatives are high-risk, speculative instruments. Large financial institutions use derivatives for hedging. Options, futures, swaps, and swaptions are common derivatives used for hedging purposes. All CMOs are derivatives. There are many derivative instruments, and new ones are developed often. See underlying.

(2) In FAS 133, FASB defines derivatives narrowly. With some exceptions, FAS 133 defines a derivative instrument to be any financial instrument or other contract that has all three of the following characteristics:

A. The financial instrument or contract has both:

1. One or more underlyings.

2. One or more notional amounts or payment provisions or both.

B. The financial instrument or contract either does not require an initial investment or requires an initial net investment that is "smaller than the amount that would be required for other types of contracts that would be expected to have a similar response to changes in market factors."

C. The terms of the financial instrument or contract either

1. Require or permit net settlement.

2.Provide that the contract can be readily settled net by a means outside the contract.

3.Provide for delivery or an asset that puts the recipient in a position not substantially different from net settlement.

Mainly as a result of FASB's second requirement, financial instruments such as CMOs and structured notes that are commonly called derivatives are not derivatives as defined by FASB. See FAS 133.

Detail method financing
See dominion of funds.

Dilution
(1) The difference between gross sales and net sales. Dilution is caused by sales that are reversed as a result of returns and/or allowances.

(2) The reduction in an existing stockholder's position that results from the issuance of new shares.

Dilution rate
Dilution as a percentage of gross sales.

Dime
An informal name for 10 basis points.

Direct deposit
A system wherein amounts are transferred from a payor's checking account to the accounts of payees no matter where they bank. The transfers are made electronically and do not require a paper check or draft. The key consideration is that the transaction is accomplished without involving the payee.

Direct hedges
A form of capital markets or derivatives hedge in which the cash market instrument being hedged is hedged by an options or futures contract on the same underlying instrument. For example, a 91-day U.S. Treasury bill hedged with a Treasury bill future. Because traded futures and options contracts have underlying instruments tied to securities, retail banks do not have much opportunity to use direct hedges to manage the interest rate risk in their loans and deposit portfolios. The opposite of a direct hedge is a cross hedge.

Direct lease
A form of lease financing in which the bank acquires property from a supplier and then leases that property directly to an end user. The bank is the owner and the lessor and the end user is the lessee.

Direct verification
The audit procedure of mailing the account debtor a note requesting the account debtor to confirm the balance owed.

Directionally correct
An expression used to indicate that a measurement is accurate to the extent that it shows the quantity to be measured to be positive or negative even though the degree to which the quantity is positive or negative may be measured inaccurately.

Disbursement float
The total time period between when a check is prepared by the remitter and when the check is presented for payment. This float also includes the delivery float, processing float, and transit float. Disbursement float is the float period for the remitter. The collection float for the organization that will receive the check is the same duration as the disbursement float.

Disbursements
Cash payments.

Discharge
(1) The action of releasing a lien or the document in which the creditor relinquishes a lien. Also known as a satisfaction, a release, a reconveyance, or an extinguishment. However, release tends to be used in connection with both real and personal property, while the discharge, extinguishment, reconveyance, and satisfaction are more often used only in connection with real property. See partial release and release.

(2) Relief granted to a debtor by a bankruptcy court. Discharge relieves the debtor from all further responsibility for pre-petition debt covered by the discharge.

Disclaimer opinion
An opinion letter accompanying audited financial statements in which the CPA states that he or she cannot express an opinion because of limitations in either the scope of the audit and/or because of uncertainties about the future which either have an effect that cannot be estimated or which cannot be resolved.

Discount
The amount by which the price for a security is less than its par or face value. The discount or difference between such a reduced value purchase price and the redemption (par) value comprises all or part of the investor’s compensation for owning the security.

Discount rate
(1) The percentage rate applied to the redemption value of a security in order to calculate a reduced value for a purchaser. Some (or all in the case of zero coupon securities) of the investor’s return comes from the resulting price discount.

(2) The rate of return for short-term securities for which the investor's entire compensation comes from the discount amount.

(3) The rate of interest charged by the Federal Reserve Banks for advances.

(4) An interest rate applied to a single cash flow that will not be paid or received until a future time in order to calculate the present value of that future cash flow.

(5) An interest rate or a series of interest rates applied to every one of the future cash flows of interest and principal expected from a financial instrument in order to create a single value for that instrument. This single value is equivalent to the sum of the present values for each of the separate cash flows expected from the instrument. When prevailing market rates are used as the discount rate, this technique produces a fair market value that is used as a proxy for market value when the market value of a financial instrument is not readily available. See fair value.

Discount securities
(1) Securities that do not pay periodic interest. Investors earn the difference between the discount issue price and the full face value paid at maturity. Treasury bills, banker's acceptances, and zero coupon bonds are discount securities. Most commercial paper is also issued at a discount. See original issue discount.

(2) Any security that is trading at a price less than par or 100.

Discounted cash flow
A technique or process for valuing a financial instrument by applying a discount rate (or a series of discount rates) to calculate a present value of each future interest and principal cash flow expected from a financial instrument. The sum of the market values of the cash flows is considered to be the value of the instrument. For financial instruments with readily available, current trade prices, this value is called the fair value and is used in lieu of a trade- or transaction-based market value.

Disintermediation
(1) The investing of funds that would normally have been placed in a bank or other financial institution (financial intermediaries) directly into investment instruments issued by the ultimate users of the funds. Investors and borrowers transact business directly and thereby bypass banks or other financial intermediaries.

(2) The elimination of intermediaries between the first case provides of capital and the ultimate users of capital.

Dispersion
The distribution pattern of measurements. The standard deviation is the most common measure of dispersion.

Dividend received deduction (DRD)
Federal tax law allows a C corporation investing in the stock of other corporations to take a tax deduction for the dividend income received from other corporations. This tax treatment applies to dividends from preferred and convertible preferred stock in addition to common stock. The deduction is usually, but not always, 70 percent of the dividend amount received.

Dividends
(1) Part of a corporation's profits that are distributed to shareholders rather than kept by the corporation in retained earnings.

(2) The interest expense paid out by mutual financial institutions for deposits and by credit unions for shares.

Division
An unincorporated subunit of a corporation.

DK
Acronym for "Don't Know." A security is said to be "DK'd" when it is delivered to the purchaser or more typically the purchaser's correspondent but is rejected because the purchaser either doesn't know or doesn't agree with one or more of the aspects of the trade. For example, a trade may be DK'd because of an incorrect price, amount, or CUSIP number.

Documents
A category of personal property defined by Article 9 of the UCC. Documents are written evidence of title such as bills of lading, warehouse receipts, and dock receipts. To be a document of title, it must be issued by or addressed to a third party (called a bailee) and cover goods in the bailee's possession.

Doing business as (d.b.a.)
Designation, usually following a name, indicating that a name used by a business is not the legal name of the entity doing business but is an assumed name or trade name instead.

Dollar roll
A short-term funding technique used for mortgage pass-through securities. A seller of a roll agrees to sell a mortgage security at an agreed-upon price on a specified date and to buy back a similar security at a specified future date. The seller receives the use of the funds for the specified time period but does not receive the monthly cash flows from the mortgage security during the roll period. The buyer or counterparty agrees to buy the mortgage security at an agreed-upon price and to sell back a similar security at a specified future date. The buyer is the owner of the

security for that time period and as the owner is entitled to all of the cash flows during that period. Unlike a repo/reverse repo transaction, at the end of the transaction time period, the buyer is only required to resell a substantially similar security to the seller. See drop.

Dominion of funds
A form of receivable lending in which the bank requires that the borrower give the bank control over the borrower's accounts receivable collections. Dominion is a legal term meaning control. This form of lending is also called ledgering or the detail method financing. Do not confuse with factoring.

Double-barreled bonds
Municipal revenue bonds that are also supported by a second source of repayment. For example, payments of an airport bond issue may depend primarily upon income generated by the airport. Those funds may then be further backed by a limited guarantee from the county or city that owns the airport.

Double leverage
Leverage in bank holding companies that use borrowed funds to finance the holding company's equity investments in its subsidiaries.

Downstream funding
The practice of borrowing funds at the bank holding company level. The funds are then lent by the holding company to a subsidiary.

Downstream guaranty
A guaranty of a loan to a borrowing entity when the guarantor is a parent company or stockholder of the borrowing entity.

Downward sloping yield curve
A yield curve depicting a situation in which yields for shorter-term maturities are higher than those for longer-term maturities. Downward sloping yield curves are atypical.

Draft
A written order drawn by one party, called a drawer, that directs a second party (almost always a bank), called a drawee, to pay a sum of money to a third party, called the payee. For example, a check. Drafts are used with letters of credit. Drafts may be sight drafts, payable upon receipt, or time drafts, payable on some specified future date.

Dragnet clause
A provision in a mortgage or security agreement that attempts to extend the security interest granted to the creditor to cover not only the described debt but also all other present and future indebtedness of the debtor.

Drawee
The party to whom a check or draft is written. Also called payee.

Drawor
The party who writes a draft or check against funds he or she owns. Also called payor.

DRD
See dividend received deduction.

Dribble rule
An unofficial name for a provision in Securities and Exchange Commission Rule 144. The dribble rule is a limit on how much restricted or controlled stock can be sold within a period.

Driver rate
A market interest rate used in simulation modeling to affect interest rates for other instruments. For example, instead of forecasting future levels of rates to be paid on its 90 day CDs, a bank modeler may tie those rate changes to future changes in a market driver rate such as the 90 day T-Bill rate.

Drop
The difference between the prices in a dollar roll on the two settlement dates. The drop is expressed in 32nds. The drop is the price that the buyer of the dollar roll pays to the seller for the right to own the mortgage security and receive its cash flows during the term of the transaction.

Drop dead agreement
See forbearance agreement.

DSC

See debt service coverage.

DTC
See Depository Trust Company.

Dual index notes
Securities with coupon rates that are determined by the difference between two market indexes. These bonds often have a fixed coupon rate for a brief period followed by a longer period of variable rates. A type of structured note.

Due bill
An instrument evidencing the obligation of a seller to deliver sold securities to the buyer of those securities.

Due-on-sale clause
A provision in a mortgage permitting the lender to demand payment in full when the property is sold.

Duration
A sophisticated measure of the average timing of cash flows from an asset or a liability or from an asset portfolio or a liability portfolio. Essentially, duration is a more accurate measure of maturity because it reflects the timing of cash flows from periodic interest and/or principal payments in addition to the cash flows represented by the funds transferred at maturity. Duration is computed by summing the present values of all of the future cash flows after multiplying each by the time until receipt, and then dividing that product by the sum of the present value of the future cash flows without weighting them for the time of receipt. One way to view duration is as the balancing point for a series of cash flows. One author described it as that "sweet spot" or "balancing point" somewhere between the day a position is acquired and the day that it matures, where the return remains practically unchanged no matter what happens to interest rates. See convexity, effective duration, Macaulay duration and modified duration.

Duration drift
A phrase used to describe the slow but inexorable change in duration that occurs with the passage of time. Measurements of duration must be regularly recalculated because of duration drift.

Duration MVPE
The measured interest rate sensitivity of bank equity calculated with the use of duration methodology. The modified duration of equity. This

name is used to distinguish between MVPE rate sensitivity calculated using duration methodology and the more common VAR calculation using economic value simulation methodology.

Duration of equity
An application of duration analysis that measures the interest rate sensitivity of the bank as whole. Duration of equity views the bank's equity as if it were a bond. This "bond" has a stream of obligations for future cash inflows. Those are the cash flows from the bank's assets. It also has a stream of obligations for future cash outflows. Those are the cash flows from the bank's liabilities. When the present value weighted average for the asset cash flows is calculated and reduced by the total of the present value weighted cash flows from the liabilities, then the duration of the equity "bond" is determined. It is expressed by the formula: duration of equity = duration of assets minus (the duration of liabilities times (total liabilities divided by total assets)).

DVP
See delivery vs. payment.

Dwarfs
Fifteen-year FNMA MBS pools.

Dynamic gap
Gap analysis methodologies that include assumed volumes for renewals, rollovers, replacement business, growth, etc., to reflect the fact that banks do not close their doors and simply honor remaining outstanding obligations as of the date on which gap reports are prepared. Dynamic gap analysis attempts to reflect the reality that on an ongoing basis loan payments and maturities are replaced with new loans; deposit withdrawals are replaced by new deposits. The opposite of static gap analysis.

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Early amortization event
A type of credit enhancement used in asset backed securities. One or more triggers, defined in the asset backed security's documentation require the termination of revolving periods, controlled amortization periods and/or accumulation periods. Once triggered, the early amortization provision requires that the monthly principal payments be distributed to investors as they are received. The most common trigger is a measure of how the portfolio yield net of charge-offs exceeds the base rate of servicing plus the investor coupon rate. Also called a payout event.

Earnings at risk (EAR)
The quantity by which net income is projected to decline in the event of an adverse change in prevailing interest rates. One measure of an institution's exposure to adverse consequences from changes in prevailing interest rates. See value at risk (VAR) for an alternative measure.

Earnings credit rate
An interest rate applied to investable account balances to determine how much expense for bank services used by a depositor is offset by the deposits maintained by that depositor. The same calculation can work in the opposite way by applying the earnings credit rate to the actual service charges to determine how much deposit balance is needed to pay for the charges. The earnings credit rate is always expressed as an annual rate even though the calculations are usually done monthly. Also called earnings allowance rate.

Earnings retention rate
The percent of current period earnings retained by the firm as opposed to being paid out as dividends or partners' withdrawals. The after-tax net income minus dividends then divided by the after-tax net income. Not to be confused with retained earnings, a name for the quantity on the balance sheet that includes the accumulated total of earnings retained.

EBIT
Acronym for earnings before income taxes.

ECOA

See Equal Credit Opportunity Act. Pronounced ee

Econometric models
Systems of mathematical formulas that attempt to represent the interaction of various macroeconomics variables. Some economists use these models to predict the alterations that will result from changes in one or more economic conditions. These models are sometimes used to predict interest rates. Rate forecasts made by econometric models are seldom correct.

Economic Development Corporation (EDC)
A special type of corporation established by a community solely to act as a conduit. The EDC can, as a municipal entity, borrow funds or sell securities that are, in most cases, exempt from federal income tax. Consequently, the EDC can raise funds at lower interest rates than businesses. The lower-cost funds are used by the EDC to buy fixed assets that are then leased to the business. The lease rate reflects the EDC's low cost of capital. The EDC has no responsibility for the payment of interest and principal on the debt except to pass the business's rent payments through to the investors.

Economic value added (EVA®)
See shareholder value added (SVA). Since EVA is a registered mark, the phrase shareholder value added, or SVA, is often used instead.

Economic value of equity (EVE)
One measure of exposure to interest rate risk. The difference between the sum of the present values of all cash flows from assets and the sum of the present values of all cash flows from liabilities. This difference is a proxy or estimate used for capital when the sensitivity of capital to changes in prevailing interest rates is calculated. The rate risk exposure target focuses on the amount of change in the economic value of equity that might result from a change in prevailing interest rates. It is a long-term, economic target for measuring rate risk exposure. Previously known by the less-accurate name market value of portfolio equity or MVPE. Sometimes called net portfolio value (NPV).

EDC
See Economic Development Corporation.

Effective annual yield
A seldom-used expression to refer to the yield on an investment expressed on a compound interest basis.

Effective date
(1) The date on which funds will be transferred electronically from or to a customer's account.

(2) The date on which cash flows due under a swap contract begin to accrue.

Effective duration

(1) One of several methods of expressing duration. More accurate than Macaulay duration or modified duration. See convexity, duration, Macaulay duration, and modified duration

(2) A synonym for empirical duration. See empirical duration.

(3) A synonym for option-adjusted duration. See option-adjusted duration.

Effective hedge

See hedge effectiveness.

Effective interest amortization

A methodology for amortizing premiums or accreting discounts for MBSs that is required by FAS 91. Under this methodology, premiums are amortized and discounts are accreted into income over the average life of the securities. To accomplish this, a prepayment speed assumption (PPA) must be made when the MBS is purchased. An average life is then estimated from that prepayment assumption. Then an initial accretion or amortization schedule is determined to evenly spread the accretion or amortization into income over the estimated life of the MBS investment. If actual prepayments received during the life of the investment differ from the assumed speed, as they almost always will, the average life projection must be revised. When the average life projection is revised, a revised accretion or amortization schedule must be calculated for the entire period from the purchase date. In practice, many investors do not do this until the difference between the original speed assumption and a more accurate, current assumption, is material. An alternative system, level factor amortization, is often considered superior.

Effective margin

The effective margin is the average spread over the underlying index that the investor expects to earn over the life of a floating-rate security. For a floating-rate security selling at its par line, the effective margin is identical to the spread between the coupon rate and the underlying index. An advantage of using an effective margin measurement is that it applies equally well to floating-rate securities trading at discounts, at par, or at premiums. A security trading at a discount will have an effective margin greater than the difference between the coupon rate and the index.

Effective maturity

One description of the tenor of a CMO. The final date at which principal will be repaid based upon the prepayment speed assumption selected for the calculation.

Effective range
The spread between specified upper and lower limits for prepayments in a structured CMO such as a PAC.

Effective yield
A measure of the annual return from an investment. The Effective yield is calculated by dividing the coupon interest rate by the amount invested expressed as a percentage of the par value.

Efficient asset or efficient portfolio
An asset or portfolio of assets that earns the maximum possible return for its given level of risk. An asset or a portfolio of assets is considered to be efficient if no other asset or portfolio of assets offers a higher expected return with the same (or lower) risk or offers a lower risk with the same (or higher) expected return. This concept is part of a financial explanation sometimes called the Markowitz Portfolio Model or the Efficient Frontier Theory. The efficient portfolio is defined mathematically based upon the expected returns, the standard deviation of returns, and the covariance of returns for the portfolio.

EFT
See electronic funds transfer.

EITF
See Emerging Issues Task Force.

Electronic chattel paper
A document that includes both monetary obligation and a security agreement consisting of information stored in an electronic medium. A category of personal property collateral defined by the 2001 revisions to Article 9 of the UCC.

Electronic funds transfer (EFT)
An electronically based rather than paper-based system of transferring funds to and from accounts. Two main EFT remittance methods are wire transfers and automated clearing house (ACH).

Electronic Signatures in Global and National Commerce Act
A Federal statute that gives electronic signatures the same validity as handwritten signatures on paper documents. Actually, it is more accurate to say that under this law online contracts "may" have the same legal status as paper contracts. The e-sign law does not make electronic

contracts enforceable it merely provides that courts cannot deem an electronic contract to be unenforceable solely because they are in electronic form. Enacted in 2000. Better known as the "e-sign law".

Eligible accounts
Receivables that are acceptable to the lender for the purpose of making advances to the borrower under a line of credit with an advance formula. The criteria for determining the eligibility of accounts must be set forth in the loan documentation.

Eligible banker's acceptances
Banker's acceptances that meet Federal Reserve requirements and thus can serve as collateral for bank borrowings from the Federal Reserve. The accepting bank can sell eligible BAs without incurring reserve requirements. (When an accepting bank sells an ineligible BA, the sale is treated as a borrowing subject to reserve requirements.) See banker's acceptance.

Eliminations
See intercompany eliminations.

Embedded derivative instrument
Defined by FASB in FAS 133. An implicit or explicit term in a contract such as a bond, insurance policy, or lease, that meets the definition of a derivative even though the entire contract may not. Under FAS 133, the certain embedded derivatives must be separated from the host contract for purposes of reporting and accounting. See embedded option and FAS 133.

Embedded option
A provision in a financial contract or financial instrument, such as a loan or a security, that allows one party to change the timing or amount of one or more cash flows associated with that contract or instrument. An options feature of minor importance in bank products or debt instruments. Sometimes called a hidden option. They are "hidden" not because they are in any way secret but because they are not separate, detachable features that banks or customers can add or subtract to customize individual transactions. Instead, they are one of a number of features, terms, or contract rights that are embedded in the contract or financial instrument. Examples include prepayment options on loans, early withdrawal options on certificates of deposit, annual and lifetime rate caps on ARMs, and call options in bonds. Embedded options make both the projected return and the interest rate risk of a financial instrument difficult to evaluate because the probability that the option will be exercised must be evaluated, and may vary with movements in rates. See embedded derivative instrument, option and option risk.

Emerging Issues Task Force (EITF)

A unit of the Financial Accounting Foundation that addresses accounting issues not yet addressed by a published FASB Statement of Financial Accounting Standards.

Eminent domain
The power of a government to acquire private property for public purposes. It is used frequently to obtain real property that cannot be purchased from owners in a voluntary transaction. When the power of eminent domain is exercised, owners normally are compensated by the government in an amount determined by the courts.

Empirical duration
A measure of duration calculated by "backing into" the duration value using changes in observed market prices resulting from changes in prevailing rate.

Empirical VAR
A measure of a financial instrument's, a portfolio of financial instruments', or an entity's exposure to reductions in value resulting from changes in prevailing interest rates. Also known as simulation VAR, empirical VAR is one of several different methods for calculating VAR. Empirical or simulation VAR calculates VAR by modeling potential value changes for a defined time horizon over a large number of possible scenarios. The result of these hundreds or even thousands of simulations is a distribution of possible outcomes. VAR is then calculated from that distribution. This approach does the best job of capturing option risk. Unfortunately, it is the most computationally intensive of the three statistical techniques for calculating VAR. See correlation VAR, historical VAR and value at risk (VAR).

Employee Retirement Income Security Act of 1974 (ERISA)
Legislation mandating standards for vesting requirements and funding of pension plans.

End lender
See permanent lender.

End point analysis
A determination of the number and value of checks drawn on each transit routing number.

End user
A counterparty who intends to own the position. Contrast with a counterparty such as a dealer who intends to sell the position to an end user.

Endorsement
A written statement on a document, usually on the back of the document, in which the owner assigns his rights to an individual or entity named in the endorsement.

Endorser
Technically, an endorser is anyone who signs the back of a financial instrument. In lending, the term is used as functional equivalent of a guarantor. A loan endorser usually signs a guaranty agreement included on the promissory note form, often on the back.

Endowment
Funds or property that are donated with either a temporary or permanent restriction as to the use of principal.

Enterprise fund
(1) A fund established to account for government operations financed and operated in a manner similar to private business enterprises (e.g., water, gas, and electric utilities; airports; parking garages; or transit systems). In this case the governing body intends that costs (i.e., expenses, including depreciation) of providing goods or services to the general public on a continuing basis be refinanced or recovered primarily through user charges.

(2) A fund established because the governing body has decided that periodic determination of revenue earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

Enterprise-wide risk management (ERM)
An integrated approach to measuring and managing risks within a financial institution. ERM, as opposed to traditional separate, "silo" based, risk analysis, recognizes that risks are inter-related and often have common drivers. For example, the macroeconomic conditions related to high interest rates impact credit risk in addition to interest rate risk. Moves to ERM are partially driven by the Basel II capital guidelines and related rules issued by national banking regulators.

Equal Credit Opportunity Act (ECOA)
A Federal statute that makes it illegal for creditors to discriminate in any aspect of a credit transaction on the basis of sex, marital status, age, race, national origin, color, religion, receipt of public assistance, or the exercise of rights under the Consumer Protection Act. The Federal Reserve Board of Governors has adopted Regulation B to implement this statute.

Equipment

A category of goods defined by Article 9 of the UCC. Equipment is goods used primarily in the operation of a business. It includes professional equipment and farm equipment. Any personal property that is tangible and is not consumer goods, farm products, or inventory.

Equipment trust certificates
A common type of secured corporate bond. For these bonds, a collateral interest in equipment or machinery provides extra protection for bond holders. In most cases, the equipment that is pledged to secure the bonds is equipment or machinery that is purchased from the proceeds of the bond issue. Typically, a trustee will purchase the equipment, issue the bonds, and lease the equipment to the end user. The end user's lease payments to the trustee are passed to the bond holders in the form of interest and principal. When the bonds are retired, the end user acquires title to the equipment. Airlines, railroads, and shipping companies are the most common issuers.

Equitable subordination
A legal term used in bankruptcy to describe a process in which a bankruptcy judge decides that fairness can only be achieved by giving lower priority (subordinating) the claims of one or more creditors (usually a secured bank) to the claims of other (usually unsecured) creditors.

Equity method
An accounting method used to reflect an investor's interest in a company. This method is used when the investor owns 20 percent or more of the investee and has significant influence over the investee. Under the equity method, the investment is originally recorded on the books of the investor at its cost. Subsequently, the asset value of that investment on the investor's financial statements is increased or decreased by the investor's proportionate share of the increase or decrease in the investee's net worth.

Equity security
Any security representing an ownership interest in the issuing entity. This includes common, preferred, or other capital stock. It also includes mutual funds and contractual rights to acquire or dispose of ownership interests at fixed or determinable prices such as warrants, rights, call options, and put options. Does not include convertible debt.

Equity tranche
One name for the lowest quality (highest credit risk) tranche in a CDO structure. Sometimes called junior subordinated notes, preferred stock or income notes. The contractual rules for the cash flow distributions in a CDO structure enable the senior tranches to receive high credit ratings by shifting risk to the equity tranche. See collateralized debt obligation and waterfall.

Equity value at risk (EVAR)
A less-commonly used synonym for value at risk. The quantity by which the assumed market value, or portfolio value, of an institution's equity is

projected to decline in the event of an adverse change in prevailing interest rates. One measure of an institution's exposure to adverse consequences from changes in prevailing interest rates. See earnings at risk for an alternative measure.

Equivalent bond yield
See bond equivalent yield.

ERM
See enterprise-wide risk management.

Escrow accounts
Cash held in abeyance until an event occurs or does not occur. For example, funds paid monthly by a mortgagor to the mortgagee are held in escrow until they are due to the taxing authority.

E-sign law
See Electronic Signatures in Global and National Commerce Act.

Estoppel
A legal term describing the preclusion of a party from alleging in a legal action anything that is contrary to previous actions or admissions of that party. See estoppel letter or estoppel certificate.

Estoppel letter or estoppel certificate
A document used in commercial mortgage transactions where the lender is secured by property that is leased to tenants. Also known as tenant estoppel letters or tenant acceptance letters. Written admissions that are obtained by the lender prior to funding to create estoppel. In an estoppel letter, the tenants attest that they believe the lease to be valid and enforceable, that they are making lease payments as agreed, that the landlord is not in default of any lease provisions requiring landlord performance and that no rent has been prepaid. The estoppel letter gives the lender more rights and more flexibility for disposing of the property in the event that the borrower defaults. See estoppel.

Eurodollar CDs
One type of Eurodollar deposit. The certificates are more liquid than the time deposits and therefore trade at lower yields/higher prices.

Eurodollar deposits

Bank deposits denominated in U.S. dollars but held at locations outside of the U.S. Initially, the term only referred to dollar deposits in London; later it became applicable to dollar deposits anywhere in Europe or the Caribbean; now it often refers to dollar deposits at any offshore location. The deposits may be held by the foreign branches of U.S. banks or by non-U.S. banks. Eurodollar deposits may be Eurodollar certificates of deposit or simply Eurodollar time deposits.

European option
European-style option
An option that the holder can exercise only on the expiration date. See American option, Bermuda option and Asian option.

Evaluation
The act or process of estimating the market value of real estate when a transaction secured by real estate falls within one or more of the exemptions set forth to the requirements for obtaining a full appraisal. If a transaction falls under one of three exemptions, an evaluation is required. If the transaction is exempted under one or more exemptions not including one of the three that require an evaluation, an evaluation may still conducted if the lender considers it prudent. An evaluation may be conducted by independent bank personnel or by an appraiser. When an appraiser conducts such an estimate of value, it is called a limited appraisal and must meet requirements for limited appraisals. See limited appraisal and Uniform Standards of Professional Appraisal Practice (USPAP).

EVA®
See shareholder value added (SVA). Since EVA is a registered mark, the phrase shareholder value added, or SVA, is often used instead.

EVAR
See equity value at risk.

EVE
See economic value of equity.

Event of default
An event described in a promissory note, security agreement, or loan agreement that triggers rights of the lender to take remedies set forth in the documents. The most common event of default is the debtor’s failure to make required interest and/or principal payments to the bank when they are due. Often, the remedy permitted to the bank when an event of default occurs is the right to declare the debt to be due and payable in its entirety. Formal loan agreements frequently include numerous events of default.

Event risk
The risk of an unexpected, future decrease in credit quality that is a result of events such as a corporate acquisition or material changes in taxes, laws, or regulations.

Excess servicing
Excess spread
A term used in asset backed securities to describe the amount by which the yield from the loan collateral, net of charge-offs, exceeds the sum of the servicing fee and the interest paid to holders of the security.

Exchange traded
An expression used to refer to financial instruments that are purchased and sold in securities exchanges such as the Chicago Board of Trade. It excludes instruments that are actively traded in over-the-counter (OTC) capital markets.

Exchange-traded derivative contracts
Some derivatives are traded on organized exchanges. These derivatives usually have margin requirements. Common exchange-traded derivatives include futures and options. Other derivatives, such as swaps, are not exchange traded but are traded in over-the-counter (OTC) capital markets.

Exercise
The implementation or use of a contractual right, for example, a call option holder's purchase of the underlying security.

Exercise price
The price at which an option may be used. The price at which the owner of the option has the right to buy or sell whatever the option contract is for. Sometimes called the strike price.

Expectations hypothesis
The theory that the shape of yield curves is determined by investors' collective expectations of future interest rates. See implied forward rates. Also see liquidity preference for a modification of this interest rate theory.

Expected loss or expected risk
The portion or component of risk or loss that is predicted by statistical analysis.

Expenditures
Decreases in net financial resources. Expenditures include current operating expenses requiring the present or future use of net current assets, debt service, and capital outlays, intergovernmental grants, entitlements, and shared revenue.

Expenses
Outflows or other reductions of assets or increases in liabilities (or a combination of both) from delivering or producing goods, rendering services, or carrying out other activities that constitute the entity's ongoing major or central operations.

Expiration date
The final date on which an option may be used. See American option and European option.

Extension risk
The risk that rising interest rates may slow prepayment speeds and therefore cause an investment in a pass-through or CMO MBS to last longer than the investor anticipated. By taking longer to return the investor's principal, the extension of the MBS prevents the investor from taking advantage of higher rates available from other investments.

External liquidity risk
A term defined by the Federal Reserve. The risk that a bank will experience funding problems as a result of factors outside of its direct control. The Federal Reserve defines three types of external liquidity risk. These are geographic (such as the premiums required on deposits at many Texas banks in the late 1980s), systemic (such as the adverse effects upon several large banks caused by the near failure of Continental Illinois Bank in 1984), or instrument-specific (such as the collapse of the perpetual floating-rate note market in 1986.) See bank-specific liquidity risk and systemic liquidity risk.

Extinguishment
See discharge.

Extraordinary items
Accounting income, gains, expenses, or losses resulting from transactions or events that are both unusual in their nature and infrequent in their occurrence. The GAAP requirements for defining something as extraordinary are strict. The exact language, found in APB Opinion No. 30, paragraph 20, states in order for extraordinary items to be considered unusual… "the underlying event or transaction should possess a high degree of abnormality and be of a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity, taking

into account the environment in which the entity operates ....". Thus the same transactions or events can be extraordinary for one firm but ordinary for another firm. When extraordinary items are reported, they are shown on the income statement net of applicable income taxes.

F

Banker's Glossary

A B C D E F G H I J K L M N O P Q R S T U V W X Y Z

Face or face value
See current face and original face.

Facsimile
An exact copy of something, such as a signature.

Factor
(1) The percent of the original face of an MBS pool that remains outstanding at any given time is called the current factor. Principal payments, made by the borrowers, reduce the original face every month. Thus there is a new current factor each month. The current face is always equal to the product of the original face times the current factor.

(2) An individual or firm that purchases accounts receivable from firms in need of working capital. Usually, a specialized financial firm engaged exclusively or almost exclusively in factoring.

Factoring
Providing working capital to businesses by buying their receivables (usually at a discount) rather than lending against them. Factoring is not lending; it is an outright purchase of the receivable assets, usually on a nonrecourse basis.

Fail
The event of a securities purchase or sale transaction not settling as intended by the parties.

Fair and Accurate Transactions Act (FACT Act)
Consumer protection legislation enacted in 2003. The FACT Act, permanently established the Fair Credit Reporting Act's federal pre-emption to those areas typically governed by the Fair Credit Reporting Act. Other portions of FACT Act also amended the Fair Credit Reporting Act to provide consumers with a free annual credit report, new identification protections, medical privacy rights and restrictions and the ability to opt out of information sharing among affiliated companies for marketing and solicitation purposes. Section 112 provides a fraud alert system for

identity theft victims and consumers that are on active duty in the military. Section 212 requires lending institutions to provide home loan applicants with a copy of their credit score that was obtained from a consumer credit reporting agency. Section 311 imposes a requirement on lenders to provide additional disclosures when risk based pricing affects the rate provided to the borrower.

Fair Credit Reporting Act (FCRA)
Consumer protection legislation enacted in 1968 as part of the Consumer Credit Protection Act to ensure that the banking system in the United States would have a reliable credit reporting system. The stated purpose of the Fair Credit Reporting Act was to require that consumer reporting agencies adopt reasonable procedures to meet the needs of commerce for consumer credit, personnel, insurance, and other information that was fair and equitable to the consumer with respect to the confidentiality, accuracy, relevancy and proper utilization of such information. One of the most prominent requirements of the Act was to establish the permissible purposes of the information contained in a consumer report.

In 2003 Congress updated the Fair Credit Reporting Act when it passed the Fair and Accurate Transactions Act, FACT Act. FACT made significant changes and expansions to the Fair Credit Reporting Act. See Fair Credit Reporting Act.

Fair value
An accounting term defined by FASB. The amount at which an asset could be bought or sold in a current transaction between willing parties, that is, other than in a forced or liquidation sale. Quoted market prices in active markets are the best evidence of fair value and should be used as the basis for the measurement, if available. If a quoted market price is available, the fair value is the product of the number of trading units times that market price. If a quoted market price is not available, the estimate of fair value should be based on the best information available in the circumstances. The estimate of fair value should consider prices for similar assets and the results of valuation techniques to the extent available in the circumstances. Examples of valuation techniques include the present value of estimated expected future cash flows using a discount rate commensurate with the risks involved, option-pricing models, matrix pricing, option-adjusted spread models, and fundamental analysis. Valuation techniques for measuring assets should be consistent with the objective of measuring fair value. Those techniques should incorporate assumptions that market participants would use in their estimates of values, including assumptions about interest rates, default, prepayment, and volatility. (Note that the FASB definition in FAS 115 is replaced by the definition in FAS 133.

Fair value hedge
A type of hedge defined by FAS 133. An entity may designate a derivative instrument as hedging the exposure to changes in the fair value of an asset or a liability, or a portion of an asset or a liability. Certain requirements must be met to qualify for fair value hedge accounting. Changes in the fair market value of the derivative instrument in qualifying fair value hedges are recorded and reported in earnings. At the same time, gains or losses associated with the hedged risk are also recognized in current earnings. The carrying value (book value) of hedged asset/liability must be adjusted commensurately with resulting basis adjustment, producing a prospective yield adjustment thus offsetting the related derivative loss/gain in the same accounting period. See FAS 133.

Fannie Mae
An informal name for the Federal National Mortgage Association (FNMA) or for securities issued by it.

Farm products
A category of goods defined by Article 9 of the UCC. Farm products are crops, livestock, or supplies used or produced in farming operations. In addition, this category includes products of crops or livestock (such as milk and eggs or other things in the possession of a farmer) in their unprocessed state.

FAS 80
An accounting rule formerly applicable to futures contracts. See FAS 133.

FAS 87
Financial Accounting Standard No. 87. A rule promulgated by the AICPA that requires firms to report prepaid pension assets or accrued pension liabilities on their balance sheets. It also requires that financial statement footnotes disclose a "statement of funded status" and a "reconciliation of funded status" for those plans.

FAS 95
Financial Accounting Standard No. 95, Statement of Cash Flows. A rule promulgated by the AICPA that requires all audited financial statements to include a statement of cash flows in the audited reports. Under FAS 95 rules, firms may elect to prepare the required statement of cash flows using either the direct or the indirect method defined in the rule.

FAS 105
An accounting rule that previously required disclosures of information about financial derivatives. Superseded by FAS 133.

FAS 106
Financial Accounting Standard No. 106, Employers' Accounting for Post Retirement Benefits Other Than Pensions. A rule promulgated by the AICPA . that requires firms to accrue postretirement benefit costs during the periods of the active service of the covered employees.

FAS 107
Financial Accounting Standard No. 107, Disclosures About Fair Value of Financial Instruments. A rule promulgated by the AICPA that requires

mark- to-market value disclosure of financial instruments. These disclosures are made in footnotes to published financial statements. FAS 133 amended FAS 107 to include the disclosure provisions about concentrations of credit risk that were formerly in FAS 105.

FAS 109

Financial Accounting Standard No. 109, Accounting for Income Taxes. A rule promulgated by the AICPA that requires the recognition of unrealized income tax benefits as deferred tax assets on a firm's balance sheet. Also provides for the establishment of a valuation reserve to offset some or all of the deferred tax assets when the tax benefits are not likely to be realized.

FAS 115

Financial Accounting Standard No. 115, Accounting for Certain Investments in Debt and Equity Securities. A rule promulgated by the AICPA that requires different accounting treatment for unrealized gains and losses incurred for securities held in portfolios. Unrealized gains and losses from trading account securities must be reflected in reported earnings. Unrealized gains and losses from securities deemed available for sale must be netted to a single number that is shown as a component of shareholders' equity until realized. Gains and losses for securities deemed to be held to maturity are not reflected in either the income statements or balance sheets of the holders.

FAS 119

An accounting rule that used to govern disclosures of financial derivatives. Superseded by FAS 133.

FAS 130

Statement of Financial Accounting Standard No. 130, Reporting Comprehensive Income. A rule promulgated by the AICPA that creates new procedures for reporting certain changes in selected financial assets and liabilities. Under FAS 130, these changes are not reflected in the traditional income statement. See other comprehensive income.

FAS 133

Statement of Financial Accounting Standard No. 133, Accounting for Derivative Instruments and Hedging Activities. A rule promulgated by the AICPA that establishes accounting and reporting standards for derivative instruments. The scope of the rule includes some derivative features embedded in other contracts. The rule establishes specific accounting and reporting requirements for derivatives used for each of two kinds of hedging activities - fair value hedges and cash flow hedges. This rule supersedes FAS 80, FAS 105, and FAS 119. See cash flow hedge, comprehensive income, embedded option and fair value hedge.

FAS 138

Statement of Financial Accounting Standard No. 138, Accounting for Certain Derivative Instruments Certain Hedging Activities A rule promulgated by the Financial Accounting Standards Board (FASB) that makes major changes to FAS 133.

FAS 149
Statement of Financial Accounting Standard No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities A rule promulgated by the Financial Accounting Standards Board (FASB) that makes major changes to FAS 133.

FASB
See Financial Accounting Standards Board.

Fast pools or fast pay
An informal name for MBS pools that prepay rapidly.

Fat tail
Informal descriptive term used to describe the portions of a probability distribution that have a larger than normal number of values that are far from the mean. The formal name is kurtosis.

FBAR
Report of Foreign Bank and Financial Accounts. Each United States person who has a financial interest in, or signature authority over, any financial accounts including bank, securities or other types of financial accounts, in a foreign country must report that relationship by filing an FBAR if the aggregate value of these financial accounts exceeds $10,000 at any time during the calendar year. The deadline to file the FBAR with the Department of the Treasury for each calendar year is on or before June 30th of the following year. The term "United States person" means a citizen or resident of the United States, domestic partnership, domestic corporation, or a domestic estate or trust.

FDICA 305
See Federal Deposit Insurance Corporation Improvement Act 305.

Federal Deposit Insurance Corporation Improvement Act (FDICIA) 305
A section in the FDICIA that requires the FDIC, the Office of the Comptroller of Currency (OCC), Office of Thrift Supervision (OTS), and the Federal Reserve to add an interest rate risk component to bank and thrift capital requirements.

Fed float
The time lag between when the proceeds of a check are available to a bank according to the availability schedule and when the check is actually presented for payment (clears against the payer's bank). The fed float represents the difference between available and collected balances.

Fed funds
See federal funds.

Fed wire
An informal name for the Federal Reserve Communications System. This is the electronic communication network interconnecting Federal Reserve offices, the Federal Reserve Board, member banks, the U.S. Treasury, and other government agencies. The Fed wire is used for transferring member bank reserve account balances and government securities, as well as for transmitting information from the Federal Reserve System. See Clearing House Interbank Payment System (CHIPS) and Society for Worldwide Interbank Financial Telecommunication (SWIFT).

Federal Emergency Management Agency (FEMA)
See flood insurance.

Federal Financial Institutions Examination Council (FFIEC)
A body comprising representatives from all of the federal banking regulatory organizations (the Federal Reserve System, the FDIC, the OCC, the OTS, and the National Credit Union Administration). The FFIEC issues policy statements but has no power to mandate any actions. Its policy decisions must be approved by its member organizations.

Federal funds
Short-term investments/borrowings between banks, usually called fed funds. The investing/lending bank refers to the transaction as fed funds sold while the borrowing bank refers to the transaction as fed funds purchased. Despite its name, these transactions are not loans to or from the federal government. Nor do they include any guarantee or backing from the federal government. They are only called federal funds because the parties exchange the funds by transferring balances from the lender's account with its Federal Reserve District Bank to the borrower's account with its Federal Reserve District Bank. Fed funds investments are usually overnight loans. See term fed funds.

Federal funds rate
The rate for which overnight federal funds are traded.

Federal Home Loan Bank System (FHLB)
A U.S. government-sponsored enterprise. Twelve district banks and a Federal Housing Finance Board created by the U.S. government and owned by member financial institutions. The main purpose of the system is to provide loans to members for the accommodation of home lending.

Federal Home Loan Mortgage Corporation (FHLMC)
A U.S. government-sponsored enterprise. FHLMC is owned by member financial institutions and is not an agency of the U.S. government. It provides financial products and services in the mortgage market that enhance liquidity. Informally but widely known as Freddie Mac.

Federal Housing Administration (FHA)
An agency within the Department of Housing and Urban Development (HUD) that provides insurance for single-family and multifamily residential mortgages.

Federal National Mortgage Association (FNMA)
A U.S. government sponsored enterprise. FNMA is a private corporation created by the U.S. government to facilitate financing for housing. Informally but widely known as Fannie Mae.

Fee appraiser
An individual qualified under federal rules to perform real estate appraisals. Unlike a staff appraiser, a fee appraiser is not employed by the financial institution contemplating the extension of credit to be secured by the property to be appraised.

Fee trading
See adjusted trading.

FEMA
Federal Emergency Management Agency. See flood insurance.

FFIEC
See Federal Financial Institutions Examination Council.

FHA

See Federal Housing Administration.

FHA experience
A statistical publication of the FHA that shows the proportion of FHA-insured and VA mortgage loans that terminate each year. Mortgage loan mortality tables.

FHLB
See Federal Home Loan Bank System.

FHLB advances
Loans granted to member financial institutions by Federal Home Loan Banks. FHLB advances are structured to meet a wide variety of borrower needs. Common structures include bullet advances, puttable advances, and principal reducing credit advances.

FHLMC
See Federal Home Loan Mortgage Corporation.

Fictitious name
A name used by a proprietorship, partnership, or corporation to conduct business that is different from the legal name of the proprietorship, partnership, or corporation.

Fidelity bond or fidelity insurance
Insurance protecting an employer from losses resulting from the deliberate misappropriation of the firm's assets by one or more of its employees. Fidelity insurance is obtained by most financial institutions.

Field audits
Any on-site inspection of the bank's collateral may be referred to as a field audit. However the phrase is most often used to refer to on-site audits of a borrower's records related to sales, accounts receivable, accounts payable, customer records, and shipping documents. Field audits are often conducted by specially trained bank employees but may be done by internal bank auditors, external accounting firms hired by the bank, or firms specializing in this service. Written field audit reports contain significant information for secured lenders.

Field warehousing

A method of financing inventories in which the inventory is held in custody for the lender by an agent of the lender at the borrower’s place of business.

FIFO
See first in, first out.

Final distribution date
The latest possible date on which an MBS holder receives payment. Because mortgage loans tend to be repaid sooner than their contractual maturity dates, the actual final payment is likely to occur earlier than the final distribution date.

Final maturity
The maturity date of the single loan in a pool of mortgage loans that has the maturity date furthest in the future. Because mortgage loans tend to be repaid sooner than their contractual maturity dates, the actual final payment is likely to occur earlier than the final maturity date.

Finance lease
A term used in UCC Article 2A. A lease in which the lessor is not the supplier or manufacturer of the leased goods. In a finance lease, the lessor must not have any involvement in the selection of the leased goods and it must be serving only as a conduit for the lessee to obtain the goods. Finally, the lessor must acquire the goods or the right to possess the goods in connection with the lease.

Financial Accounting Standards Board (FASB)
An accounting industry organization; part of the Financial Accounting Foundation. FASB issues Statements of Financial Accounting Standards that define and govern GAAP for nongovernment entities in the United States. FASB also publishes Interpretations and Technical Bulletins that govern the application of their accounting standards.

Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA)
A federal law enacted in 1989. FIRREA primarily addresses the operation of savings and loan associations; however, it includes a number of important provisions affecting commercial banks. Arguably the most important FIRREA provisions affecting banks are those that address requirements for real estate appraisals.

Financial instrument
Cash, evidence of ownership in an entity (e.g., stock), a contract that creates a right or obligation to receive or deliver cash (e.g., notes and bonds), or a contract that creates a right or obligation to receive or deliver another financial instrument or commodity (e.g., options and futures).

Financial intermediary
A party such as a bank or other financial institution that accepts funds from a provider and places those funds with a user. The intermediary's investment from the user is usually for a longer term, usually has less liquidity, and usually has more credit risk than the intermediary's liability to the provider.

Financial statements
Collective name for historical financial reports of assets, liabilities, capital, income, and expense.

Financing statements
Forms, usually standard UCC-1 forms, that are required by Article 9 of the UCC to be recorded in a designated public location in order to perfect a creditor's lien in personal property collateral. The financing statement is used as a vehicle for a public recording that establishes lien priority — it does not normally constitute the actual agreement between the secured party and the debtor. For that reason, the financing statement by itself does not create a security interest and must therefore be supported by a separate security agreement or pledge agreement.

Firm commitment
An agreement with an unrelated party that is binding on both parties and that is usually legally enforceable. In FAS 133, FASB specifies that the following are both satisfied for a firm commitment: a) The agreement specifies all significant terms, including the quantity to be exchanged, the price at which the quantity will be exchanged, and the timing of the transaction. b) The agreement includes a disincentive for nonperformance that is sufficiently large to make performance probable.

FIRREA
See Financial Institutions Reform, Recovery, and Enforcement Act.

First in, first out
A method of accounting for business inventory permitted by GAAP.

Fixed-period ARM
MBSs that are fixed-rate instruments for an initial period and floating-rate securities thereafter. The initial, fixed-rate period may be 3, 5, 7, or 10 years. After the expiration of the fixed-rate period, a typical fixed-period ARM may adjust annually at a margin over the one-year Treasury index. Some fixed-period ARMs have rates tied to LIBOR.

Fixtures
Fixtures are items that become attached to real property. Examples are heating and air conditioning systems, wall-mounted shelving, and security alarm systems. Lenders must be extremely cautious about what constitutes a fixture. As a general rule, an item may be considered goods before it becomes attached to a building, but becomes a fixture after it is attached. Once affixed to real property, goods may be subject to laws governing real estate collateral rather than rules under Article 9 of the UCC.

Flat yield curve
See yield curve slope.

Flex repo
A term repo/reverse transaction that allows for the investor to sell some of the collateral securities back to the borrower before the final maturity date of the transaction. Flex repos are well suited to construction projects for which bond proceeds need to be invested until payment is due for each stage of construction. Usually, the timing of the loan payments is subject to considerable uncertainty. The flex repo investment has a draw-down schedule for reducing the size of the investment; however, the investor is not required to adhere to it rigidly. In return for the added flexibility, investors in flex repos almost always receive slightly lower rates of return than investors in repos with terms that are more traditional.

Flight to quality
The situation in which many investors sell or reduce purchases of less creditworthy investments and simultaneously buy or increase purchases of the most creditworthy investments. Flights to quality often occur suddenly after a major unexpected default or a major political event.

Float
The use of funds generated as a result of timing differences in the check-clearing system. For banks, float occurs because debits given by the Federal Reserve to a bank's reserve account for checks being cleared can be received prior to the time that the bank allows the customer who presented the check to use the funds. For depositors, float occurs because credits may be given for checks deposited or tendered for payment before the depositor's accounts are debited. See bank float, check-clearing float, collection float, delivery float, disbursement float, fed float and processing float.

Float analysis
An analysis of an organization's disbursements to determine the approximate number of days between issuance of a check and presentation of the check for payment at the organization's bank.

Floater
An informal name for a security with a variable coupon rate. Particularly used to refer to floating-rate CMO tranches.

Floating lien
The name for and the nature of a creditor's interest in a debtor's accounts receivable and inventory. In the natural operation of any business, the specific receivables and inventory owned at one point in time are replaced over time by new receivables and new inventory. Thus a creditor's security interest in accounts receivable and inventory floats from the specific accounts and inventory held today to that held next week, next month, and thereafter.

Floating-rate note (FRN)
A medium-term instrument with a coupon rate that floats up or down based upon changes to an index or reference rate. Often, FRNs are tied to LIBOR.

Flood hazard zone
A geographic area officially designated under Federal law as an area that might experience damage from flooding. Under the National Flood Insurance Reform Act of 1994, lenders taking an interest in real property are required to complete a standard flood hazard determination form developed by the Federal Emergency Management Agency (FEMA). Flood hazard forms must be retained in the lender's records. If the form indicates that the property is in a designated flood hazard zone, the lender is required to have flood insurance protection. Lenders may also have notice requirement obligations for collateral located in flood hazard zones.

Flood insurance
Insurance protection against damage caused by floods. For applicable parcels of real estate, lenders with a security interest in that real estate are required by law to either require that borrowers obtain flood insurance or to obtain flood insurance for their borrowers. See flood hazard zone.

Floor
A lower limit for a variable, such as the lower limit on an interest rate paid or received in a transaction. For example, an adjustable-rate loan may have a floor of 5 percent. In that example, the rate can adjust however loan terms provide, but it can never fall below 5 percent. The term "floor" is often used with its converse, a cap. A floor may be an embedded option, such as the floor on the rate for a floating-rate loan, or a stand-alone option contract.

Floor planning

A form of inventory financing involving loans or advances for specific items of inventory.

Floortion
An option that grants the holder the right to purchase a floor.

Flower bonds
U.S. Treasury bonds that can be applied at par toward the payment of U.S. inheritance taxes. The Treasury stopped issuing flower bonds in 1977. The last flower bond matured in 1998.

Flux
A measure of the sensitivity of CMO cash flows to changes in the prepayment rate of the underlying MBS collateral. Derived from flow uncertainty index. Developed by the National Association of Insurance Commissioners to create a standard measure of CMO volatility. A flux score is a composite of two elements that indicate the impact of six prepayment scenarios on a bond's present value and on the timing of its cash flows. That impact is expressed in terms of variation from a base case. Flux scores are calculated once each year in January. A flux score of 0 indicates no cash flow uncertainty. (Rather than a lack of interest rate risk, this score indicates that the amount and timing of the cash flows are known.) There is no upper limit for flux scores.

FNMA
See Federal National Mortgage Association.

Food Security Act of 1985
A Federal law that preempts state laws including the UCC as they apply to farm products. The law allows certain buyers to obtain clear title to farm products regardless of security interests that the seller previously granted to secured lenders.

Forbearance agreement
An agreement between a creditor and a debtor. A forbearance agreement is utilized when a debtor has defaulted or is likely to default. Under the terms of the forbearance agreement, the debtor is given more time to make loan payments, a reduction in the amount of loan payments due each month or both. Typically, the lender agrees not to exercise rights to foreclose or accelerate during the forbearance period. In return, the debtor agrees not to contest any actions taken by the creditor to collect the debt in the event that the debtor fails to comply with the payment schedule or other terms specified in the forbearance agreement. In some forbearance agreements, the debtor may grant the creditor a deed in lieu of foreclosure if the terms of the forbearance agreement are not met. Sometimes called a drop dead agreement.

Forced placed insurance
Insurance purchased by a creditor covering personal or real property owned by debtor. In some cases, forced placed flood insurance is required by law. In other cases, creditors are granted the right to force place insurance by provisions in loan agreements, security agreements, and/or mortgages. Forced placed insurance is almost exclusively purchased when the debtor refuses to obtain or renew required insurance coverage.

Forecasted transaction
An accounting term defined by FASB in FAS 133. A transaction that is expected to occur but for which there is no firm commitment. Because no transaction or event has yet occurred and because the transaction or event, when it occurs, will be at the current prevailing market price, a forecasted transaction does not give an entity any present rights to future benefits or a present obligation for future sacrifices.

Foreclosure
A remedy provided by state law for creditors secured by an interest in real property to obtain title to the property under certain conditions.

Foreign exchange risk
One of nine risks defined by the OCC. The risk to earnings or capital arising from adverse movement of foreign exchange rates. The Federal Reserve includes this risk in its definition of market risk.

Forward cash exposure (FCE)
A term sometimes used to describe the quantity of a financial institution's liquidity risk. See counter balancing capacity.

Forward delivery
The transfer of commodities or foreign exchange at a specified date subsequent to the date of the contract that provides for the transfer.

Forward market
The informal (nonexchange) trading of foreign exchange or commodities to be delivered at a future date. Contracts for forward delivery are not standardized. Instead, the delivery time and amount are negotiated by the parties.

Forward rate
The interest rate for a specified maturity of a fixed-income security for a future date. For example, the forward rate for six-month Treasury bills one month from today. See spot rate for contrast.

Forward rate agreement (FRA)
A customized agreement between two parties specifying the rate to be paid at some future date. Usually tied to LIBOR.

Forward roll
The sale of an investment position when the sale proceeds are used to acquire a new position that is very similar to the one that was sold.

Forward yield curve
See yield curve.

Forwards
Contracts for the sale/purchase of a specified quantity of a financial instrument, currency, or commodity at an agreed-upon price on a given future date. Unlike an option, a forward contract obligates both parties to consummate the transaction. Forwards are very similar to futures - the principal difference is that futures are almost always exchange traded while forwards are traded over the counter.

FRA
See forward rate agreement.

Fraudulent conveyance/
Fraudulent transfer
A transfer of an interest of the debtor made within one year prior to the filing of bankruptcy that is either made by the debtor with the intent to defraud its creditors or for which the debtor receives less than reasonable consideration. A fraudulent transfer may be set aside (reversed) by a bankruptcy judge.

Freddie Mac
An informal name for the Federal Home Loan Mortgage Corporation (FHLMC) or for securities issued by it.

Free cash flow
Cash flow from operations minus capital expenditures and dividends. Cash flow from operations is reduced by those adjustments to generate a measure of cash available to meet other corporate purposes. While the above definition is commonly used by equity investors, bank credit analysts create similar measures of free cash flow that may involve more or different adjustments to cash flow from operations.

FRN
See floating-rate note.

Front-end load
A form of sales charge imposed by some mutual funds. A front-end load is an initial charge that is deducted from each investment made in the fund. The amount of the charge is usually a percentage of the amount of the investment. See back-end load, load and no-load.

FTP
See funds transfer pricing.

Full faith and credit
A pledge of the general taxing power for the payment of debt obligations. Bonds carrying such pledges are referred to as general obligation bonds or full-faith-and-credit bonds.

Full payout
A phrase used to describe personal property leases that are structured such that the bank/lessor receives its total repayment from one customer/lessee and that the total repayment comes from the proceeds of rents, tax advantages, and the residual value assumption.

Fund
A fiscal and accounting entity with a self-balancing set of accounts in which cash and other financial resources, all related liabilities and residual equities, or balances, and charges therein, are recorded and segregated to carry on specific activities or attain certain objectives in accordance with special regulations, restrictions, or limitations.

Funded status
A term used to describe either the excess or shortfall of pension assets in relation to pension liabilities. When pension liabilities exceed the assets, the funded status is a shortfall. When a plan liquidation or termination is being analyzed, the funded status is calculated using the accumulated benefit obligation (ABO) as the liability value. When a plan's funded status is calculated to analyze the plan on a going concern basis, the projected benefit obligation (PBO) is used as the liability value.

Funding gap
See liquidity mismatch.

Funding liquidity risk or funding risk
The potential that an institution will be unable to meet its obligations as they come due because of an inability to liquidate a sufficient quantity of assets or to obtain a sufficient quantity of new liabilities.

Funds pool
Funding pool
See pool.

Funds transfer pricing (FTP)
An internal cost accounting system or methodology that transfers a cost of funds expense to profit centers that generate assets and a credit for funds to profit centers that provide funding. Most funds transfer pricing systems are matched maturity systems that attempt to reflect the term structure of interest rates in their transfer rates. Transfer rates may be allocated to pools of similar assets or liabilities, may be specifically allocated to individual assets or liabilities, or may employ a combination of those two approaches.

Fungibles
Property that is indistinguishable from other property of the same type. Fungibles are completely substitutable or interchangeable. Two examples of fungibles are pork bellies and dollar bills.

Future advance clauses
Provisions in mortgages or security agreements that attempt to extend the secured party's interest in the collateral to cover future extensions of credit made by that creditor to the debtor.

Futures
Contracts for the sale/purchase of a specified quantity of a financial instrument, currency, or commodity at an agreed-upon price on a given future date. First developed for agricultural commodities, actively traded futures are available for foreign currencies, stocks, stock indexes, U.S. Treasury debt, Eurodollar deposits, and other financial instruments. Futures are often used in hedging. Unlike an option, a futures contract obligates both parties to consummate the transaction. Futures are very similar to forwards - the principal difference is that futures are almost always exchange traded while forwards are traded over the counter.

G

Banker's Glossary

G & A expense
A shorthand expression used by many bankers to refer to general and administrative expenses. These are a subgrouping of a firm's operating expenses. In most banks, the term refers to all operating expenses excluding interest, depreciation, and amortization.

GAAP
See generally accepted accounting principles.

Gains trading
The practice of purchasing securities and then selling those that subsequently appreciate in value while retaining as investment portfolio assets those that cannot be sold at a profit. Accounting and banking regulators have repeatedly and strongly criticized this practice. Rules related to the transfer of securities from trading portfolios to available-for-sale (AFS) or held-to-maturity (HTM) portfolios are specifically designed to prohibit gains trading.

Gamma
The rate of change of an option's delta for a small change in the price of the option's underlying. See delta.

Gap
(1) As a measurement of exposure to interest rate risk, the amount of mismatch or imbalance between the quantity of an entity's assets and the quantity of its liabilities that reprice in a defined or selected time period. In a single time period, the net mismatch or imbalance may be called the interval gap. Over a series of consecutive time periods or buckets, the total net imbalance or mismatch may be called the cumulative gap. See rate-sensitive assets and rate-sensitive liabilities.

(2) One of the four components of interest rate risk. The component of interest rate risk arising from the mismatch defined above. Also called mismatch or repricing risk.

(3) As a measurement of liquidity risk, the amount of mismatch between the quantities of cash provided from decreases in liabilities and increases in assets and the quantities of cash used by increases in assets and decreases in liabilities in a defined or selected time period.

Gap analysis
A technique or process for quantifying exposure to adverse consequences from changes in interest rates. A comparison of the total quantity of a financial institution's rate-sensitive assets (RSAs) and rate-sensitive liabilities (RSLs) for each of a number of different future time periods or buckets. Gap analysis is used to evaluate the potential effect of rate shocks on income over these time periods. See gap, rate-sensitive assets and rate-sensitive liabilities.

Gapping
Mismatching assets and liabilities, usually by borrowing short and lending long.

GASB
See Government Accounting Standards Board.

General fund
In fund accounting, the fund used to account for all financial resources, except those required to be accounted for in another fund. Often used as and referred to as the operating fund.

General intangibles
A category of personal property defined by Article 9 of the UCC. General intangibles is a catch-all term for intangibles other than accounts such as copyrights, trademarks, patent rights, franchise rights, good will, tax refunds, relocation claims, operating rights, and legal claims.

General obligation (GO)
A municipal obligation that is supported by the full faith and credit — the full taxing authority — of the municipality (as opposed to support from only the revenues from specific user fees).

General partnership
A partnership in which every partner is fully liable to the full extent of his, her, or its net worth for all the obligations of the partnership.

Generally accepted accounting principles (GAAP)

Accounting treatments that fully conform to established rules from the American Institute of Certified Public Accountants (AICPA). For all nongovernment entities in the United States, GAAP is primarily determined by the Financial Accounting Standards Board (FASB). For state and local government entities in the United States, GAAP is primarily determined by the Government Accounting Standards Board (GASB). Both FASB and GASB function under the auspices of the Financial Accounting Foundation (FAF), an independent, nonprofit foundation.

Geographic liquidity risk
A type of systemic risk where deterioration in regional economic conditions triggers liquidity crisis. Usually, such a crisis is triggered by credit loss. See systemic liquidity risk.

Giants
FHLMC MBSs created when older pools that have been reduced to small outstanding balances (i.e., low current face) as a result of cumulative prepayments are combined to create new securities with larger remaining balances. Giants may be either fixed- or adjustable-rate securities.

Ginnie Mae
An informal name for the Government National Mortgage Association (GNMA) or for securities issued by it.

GLBA
See Gramm-Leach Bliley Act of 1999.

GNMA
See Government National Mortgage Association.

Gnome
Fifteen-year FHLMC MBS pool that is issued under the FHLMC fifteen-year Cash Program. See nongnome.

GO
See general obligation.

Good delivery
(1) Delivery of a security, from a seller to a buyer, that complies with all terms of the contract of sale.

(2) For a new, to-be-announced MBS, good delivery is delivery by the seller that conforms to rules published by the Bond Market Association (BMA).

Good faith estimate
A document that lenders are required by regulation to provide all applicants for covered real estate loans. This document discloses the anticipated expenses that the applicant(s) will have to pay if the covered transaction is approved and closed.

Goods
A category of personal property defined by Article 9 of the UCC. Sometimes called tangible goods. Further divided into consumer goods, equipment, farm products, and inventory.

Government Accounting Standards Board (GASB)
An accounting industry organization; part of the Financial Accounting Foundation. GASB issues Statements of Financial Accounting Standards that define and govern GAAP for state and local government entities in the United States.

Government National Mortgage Association (GNMA)
A government-owned corporation that is part of the U.S. Department of Housing and Urban Development. GNMA provides its guarantee, backed by the full faith and credit of the United States Government, to certain mortgage-related securities. Informally but widely known as Ginnie Mae.

Grace period
A time period, usually one or more months, during which the debtor may delay principal repayment without incurring a penalty.

GPM
See graduated payment mortgage.

Graduated payment mortgage (GPM)
A mortgage in which the monthly payment of principal and interest begins at a low amount and progressively increases to a predetermined higher amount. Thereafter, the amount of the monthly payment remains constant for the remaining life of the loan. The interest rate is fixed for the entire period.

Gramm-Leach Bliley Act of 1999 (GLBA)

Major banking legislation designed to significantly enhance the powers and authority of financial institutions by allowing the formation of new financial holding companies. Financial holding companies are authorized to engage in: underwriting and selling insurance and securities, conducting both commercial and merchant banking, investing in and developing real estate and other "complimentary activities." The statute also restricts the disclosure of nonpublic customer information by financial institutions and provides the major financial regulators with increased authority.

Grantor
A person, partnership or corporation that gives or conveys an interest in property. Often used to identify the creator of a trust.

Gross-bonded debt
The total amount of direct debt of an issuer, represented by outstanding bonds before deduction of any assets available and earmarked for their retirement.

Gross margin
See margin.

Gross profit
A subtotal on a firm's statement of income that is net sales minus cost of goods sold. Sometimes called gross profit on sales.

Gross sales
The total dollar value of all revenue derived by the firm from the principal operations of its business during the period covered by the income statement report.

Group sort
A service enabling a collecting bank to deposit checks drawn on a limited preselected group of payer institutions.

Guarantee
See guaranty.

Guaranteed bonds

A type of corporate bond for which a corporation other than the issuing corporation guarantees the repayment of a bond issue. Usually, the guarantee is provided by the parent firm of the issuing corporation.

Guaranty
An agreement by a person, partnership, or corporation (other than the borrower) to repay a bank loan if the borrower does not pay.

Guidance line of credit
A line of credit approved by the bank, but not disclosed to the borrower until some specific event, usually a request for funding from the borrower. Also called an unadvised line.

H

Banker's Glossary

A B C D E F G H I J K L M N O P Q R S T U V W X Y Z

Haircut
(1) A lender's informal expression for a collateral margin. The amount by which the value of collateral exceeds the loan it secures. Commonly used with repurchase and reverse repurchase agreements informally called repos and reverses.

(2) The dealer's commission for a transaction.

Handle
An informal name for the portion of a security's price that is comprised of the numbers to the left of the decimal point, colon, or dash. For example, if a bond's price is 103.25, its handle is 103. Sometimes brokers and dealers only quote the numbers to the right of the decimal point and assume that the handle is understood.

Hard call protection
For convertible bonds, one of two types of call protection. Hard call protection prohibits an issuer from calling an issue within a certain period of time. For convertible bonds, hard call protection is most often set at three years, but can range from two to five years.

Hazard insurance
Insurance covering losses incurred by an insured as a result of damage, destruction, or loss of property. Mainly, but not entirely, insurance against fire and lightning damage. Insurance other than life or liability insurance.

Health care insurance receivable
An interest in or claim under a policy of insurance which is a right to payment of a monetary obligation for health care goods or services. A category of personal property collateral defined by the 2001 revisions to Article 9 of the UCC.

Hedge
(1) Verb— To reduce risk or behavior that reduces risk from future price movements.

(2) Noun — A transaction undertaken to reduce risk by offsetting the risk in another transaction. The risk in one position is hedged by counterbalancing it with the risk in another transaction. The values of each position must change inversely and with a high degree of correlation. Hedges may be cash to cash in which a position in a cash instrument such as a loan or investment reduces or offsets the risk in another cash position such as a deposit. For example, a $1,000,000 investment in a U.S. Treasury bond maturing in 10 years and a $1,000,000 certificate of deposit are largely (but not completely) offsetting risks. Hedges may also be cash to futures or futures to futures.

Hedge accounting
Deferring recognition of unrealized gains and losses from a hedge instrument until the corresponding gains or losses from the hedged instrument(s) are recognized. See FAS 133 and FAS 149.

Hedge effectiveness
The extent to which a hedge transaction results in the offsetting changes in value or cash flow that the transaction was and is intended to provide. FAS 133 requires users to regularly assess the effectiveness of hedges. Furthermore, under FAS 133 only the portion of a transaction that is deemed effective may qualify for hedge accounting treatment. Under FAS 133, any part of fair value changes in a derivative that are not perfectly correlated with the fair value (or variable cash flow) changes of the hedged item must be reported in current earnings. FAS 133 does not delineate a specific methodology for assessing whether a hedge is expected to be highly effective or for measuring hedge ineffectiveness. Hedge effectiveness is a very broad concept, and FASB believes each company must define it relative to the intent of its hedging activities. The only requirement is that there be a reasonable basis for assessing hedge effectiveness. The focus on hedge effectiveness in FAS 133 contributes to a significant difference between previous practice and the new accounting standard. Whereas the earnings effect of minor hedge ineffectiveness was spread over the life of the hedge in the past, the FAS 133 rules result in anything other than perfect correlation being recorded in current earnings. Thus under FAS 133 there is the potential (and even likelihood) that hedges may have both an effective component and an ineffective component even for a highly effective hedge. The fact that some portion of a derivative is ineffective does not preclude a hedge from being deemed highly effective. See cash flow hedge, fair value hedge, and FAS 133.

Hedge ratio
The relationship between the size of a position needed in a hedge instrument and the size of the position being hedged. The hedge ratio is determined by the delta.

Held-to-maturity (HTM)
One of three defined categories established in FAS 115 for the classification of financial instruments held as assets on the books of an investor. HTM securities are those the investor intends to hold to maturity and is able to hold to maturity. Designation of a security as HTM allows the investor to report the security value at historical cost plus accretion or minus amortization. Unrealized gains or losses are not shown on the balance sheet, reflected in reported income, or reflected in reported net worth. FAS 115 imposes conditions that restrict an investor’s flexibility to remove securities from the HTM category. See available-for-sale, FAS 115, and trading.

Hidden option
An option feature in an instrument in which the option feature is only a minor feature of that product. Sometimes called an embedded option. They are hidden because they are not separate, detachable features that issuers or holders can add or subtract to customize individual transactions. Instead, they are one part of a number of features embedded in the product.

High-grade
A phrase used to describe investments with the highest quality ratings — usually AAA or AA.

High-yield securities
(1) A formal name for junk bonds.

(2) All bonds in the following credit categories as defined by NASD Rule 6200 Series as "Non-Investment Grade": BB, B, CCC, CC, C, C, and NA/NR.

Histogram
A table or bar chart displaying a probability distribution. All of the probabilities in the histogram total to 100 percent. The frequency of the data for each interval is represented by the height of the bar. The technique can be used to combine a group of individual rate forecasts to obtain a single probability weighted average of the various subjective predictions for interest rates.

Historical VAR
A measure of a financial instrument's, a portfolio of financial instruments', or an entity's exposure to reductions in value resulting from changes in prevailing interest rates. Historical VAR is one of several different methods for calculating VAR. Historical VAR calculates value at risk by comparing the actual volatility of components or risk elements within a portfolio to the historical sensitivity of those components. This provides a range or distribution of possible losses. A single value at risk can then be calculated for the selected confidence level. Historical VAR is generally preferred for its ability to capture risk from unlikely events. However, the measured amount of VAR is heavily influenced by the choice of time horizon and by the volatility that occurred during that historical time period. If future changes do not resemble the change in value that occurred during the selected time horizon, the forecasted VAR will not be a good indicator of the real risk. See correlation VAR, empirical VAR, and value at risk (VAR).

HMDA
See Home Mortgage Disclosure Act. Pronounced hum-da.

Hold
A process by which a bank restricts funds deposited by checks. Usually but not always used to restrict the proceeds of checks drawn on other banks until the funds have been transferred by the drawor's bank to an account that the depositor's bank maintains with the Federal Reserve.

Hold-harmless agreement
A contract under which the liability of one party for damages is assumed by another.

Home Mortgage Disclosure Act (HMDA)
A Federal statute that requires most lenders in metropolitan areas to collect data about their housing-related lending activity. Lenders must file annual reports with their Federal supervisory agencies and make disclosures available to the public regarding their origination of housing-related loans. The reports cover loan originations, applications that are declined or withdrawn, and loan purchases. The data is used to evaluate possible discrimination in loan approvals. The Federal Reserve Board of Governors has adopted Regulation C to implement this statute. The information collection requirements were expanded in 2004. See loan application register.

Home Ownership and Equity Protection Act (HOPEA)
A 1994 Federal statue enacted to address perceived abuses in high cost home mortgage lending. Final rules implementing this law where adopted by the Federal Reserve Board as amendments to Regulation Z, Truth-In-Lending in December 2001.

Horizon analysis
A less-common name for total return analysis. The term "horizon analysis" derives from the fact that total return analysis requires the user to select an ending date for the investment being analyzed. That ending date is sometimes called the investor's horizon.

Hot money
An informal term used to describe funds provided by the most price-sensitive and credit quality-sensitive sources. The bank liabilities that are likely to be lost most quickly in the event of a loss of confidence or competitiveness.

HUD
See Department of Housing and Urban Development.

Hybrid or hybrid security
A package or combination of financial instruments. Hybrid structures range from simple to highly complex. See structured notes.

Hypothecation
(1) An archaic term for pledging that did not involve either possession or title transfer.

(2) Any pledge of an asset as collateral for a debt. (An uncommon but correct usage.)

(3) The pledge of marketable securities or deposits to secure a loan — particularly the pledge of marketable securities or deposits owned by someone other than the borrower.

I

IAN
See index amortizing note.

IAS
See index amortizing swap.

IDA
See Industrial Development Authority.

IDB
See Industrial Development Authority bond.

IDC
Acronym for Industrial Development Corporation. See Industrial Development Authority.

Imbedded option
See embedded option.

Immobilized
A physical certificate representing ownership of a security (a stock certificate or bond) that is held by a trustee. An arrangement through which a physical certificate is held so that all future transactions can be conducted as if the security were book entry. Ownership and liens are recorded in the books of the trustee rather than evidenced by physical possession of the certificate. Also called dematerialized.

Immunization
Establishing and maintaining equal and offsetting exposures to interest rate risk. For example, holding equal amounts of assets and liabilities of the same duration.

Implied forward rates
Indicated future interest rates derived from the differences between current rates for different maturities of the same instrument. Yield curves include implied information about future interest rates. For example, suppose that a 2-year investment offers a return of 6 percent while an otherwise identical 1–year investment offers a return of 5 percent. In this case, an investor who bought the 1-year investment and realized a return of 5 percent for the first year would have to be able to reinvest his money at 7 percent in the second year in order to get an average 2-year return of 6 percent. If the investor gets less than 7 percent in the second year, he will not do as well as the investor who purchased the 2-year investment. This implies that the rate for 1-year investments that will be available one year in the future will be 7 percent.

Implied volatility
Volatility of a financial instrument that is imputed by subtracting all of the other factors thought to contribute to the price of an option. The amount remaining after those subtractions is attributed to volatility. Implied volatility is not the same as the actual volatility. See realized volatility, volatility and variance swap.

Implied waiver
A legal name for a situation in which a lender is deemed to have lost the right to enforce a provision in the loan documents as a result of the lender's failure to enforce the same provision when it was previously violated.

In the money
The situation in which an option has value because of the relationship between the option's strike price and the current market price for the underlying instrument, the spot price. A call option is in the money when the strike price is below the spot price. A put option is in the money when the strike price is above the spot price.

Income notes
See equity tranche.

Incumbency certificate
A list of the names of the individuals holding various corporate offices within a corporation.

Indemnification agreement
An agreement in which the borrower promises to protect the bank or reimburse the bank for any damages, claims, costs, penalties, or liabilities that may arise from some problem. For example, the bank may obtain an indemnification agreement to protect itself from costs, penalties, or liabilities arising from environmental contamination or from violations of environmental regulations.

Indenture covenants
See covenants.

Indeterminate maturity
An unspecified maturity date for a financial instrument. For example, the maturity date of a savings account.

Index
A benchmark upon which the payment rate or accrual rate for an adjustable-rate loan or investment is based. For example, a business loan may pay interest at the prime rate plus 1 percent. In that example, the prime rate is the index. For adjustable-rate residential mortgage loans, federal law requires that indexes must move independently (not controlled by the lender) and that indexes must be easily confirmed by borrowers. See margin and reset date.

Index amortizing note (IAN)
Securities which repay principal according to a predetermined amortization schedule that is linked to the level of a specific index or a specific prepayment rate. As market interest rates increase or prepayment rates decrease, the maturity of an IAN extends. An IAN is a type of structured note.

Index amortizing swap (IAS)
A type of amortizing interest rate swap in which the notional amount declines or amortizes based upon a specific index such as a mortgage prepayment speed.

Indirect costs
In cost accounting applications, the share of costs imputed, attributed or allocated to the cost center or product being measured.

Indirect leases
A form of lease financing in which the bank acquires or finances a lease transaction entered into by an end user and a third party. The third party

is the lessor and the end user is the lessee. The bank is the lender to the third party if it merely finances the transaction or the assignee of the third party if it purchases the lease.

Industrial Development Authority (IDA)
Special types of municipal authorities established to promote economic development in their communities. A community establishes an Industrial Development Authority to act as a conduit. The authority can, as a municipal entity, borrow funds or sell securities that are, in most cases, exempt from federal income tax. Consequently, the authority can raise funds at lower interest rates than businesses. The lower-cost funds are used by the authority to buy fixed assets that are then leased to the business. The lease rate reflects the authority's low cost of capital. See Industrial Development Authority bond.

Industrial Development Authority bond (IDB)
A special type of revenue bond issued by municipal authorities established to promote economic development in their communities. A community establishes an Industrial Development Authority to act as a conduit. A business that would otherwise have to borrow at taxable interest rates to finance the purchase or construction of a building may, under some defined circumstances, let the IDA own the building and pay rent to the authority with an option to purchase. The authority borrows at a lower, tax-exempt rate. The authority has no responsibility for the payment of interest and principal on the securities except to pass the business's rent payments through to the investors. The business's rent payments equal the interest and principal due for the lower rate, tax-exempt securities.

Industrial Revenue Authority bond (IRB)
See Industrial Development Authority bond.

Ineffective hedge
See hedge effectiveness.

Insecurity clause
A provision found in some promissory notes that attempts to give the lender the right to demand payment in full at any time the lender deems itself insecure. More often than not, such a clause is unenforceable except when other material defaults are also involved.

Insiders
A legal term used in bankruptcy to describe parties that have a special relationship to the bankrupt debtor. Creditors who are officers, directors, or stockholders are obvious examples of insiders. In some cases, the bank may be deemed to be an insider. The main consequence of being

deemed an insider is that insiders are subject to a one-year preference period while other creditors are only subject to a 90-day preference period. See preference.

Insolvency
The lack of adequate capital. The condition that exists when the amount of losses exceeds the amount of capital. See solvency and solvency risk.

Installment note
In consumer lending, name used to describe a promissory note that calls for mostly regular, periodic payments of principal and.

Instrument-specific liquidity risk
A type of systemic or capital markets liquidity risk. The risk that the failure of a market for a financial instrument, such as the commercial paper market, might trigger a bank funding crisis. See systemic liquidity risk.

Instruments
A category of personal property defined by Article 9 of the Uniform Commercial Code. Instruments are notes, checks, drafts, securities (such as stocks and bonds), and any other written evidence of rights to the payment of money that, in the ordinary course of business, is transferred by delivery with any necessary endorsements or assignments. See financial instrument

In-substance defeasance
An advanced refunding in which the debtor is not legally released from being the primary obligor on the refunded bonds, but the possibility of the debtor having to make additional payments is considered remote under criteria provided by FAS 76.

Insurance binder
See binder.

Intangible pension asset
An asset booked to offset the additional minimum pension obligation. This asset is created under the FAS 87 rules to offset the minimum liability for underfunded plans that FAS 87 required firms to recognize as a liability. Little or no justification can be made to support the classification of this debit as an asset; it is conceptually more accurate to consider it as a reduction to equity.

Intangibles

An informal term used by secured lenders to refer to the categories of personal property defined by Article 9 of the Uniform Commercial Code as accounts and general intangibles.

Intercompany accounts
Accounts receivable or payable from or to affiliated companies.

Intercompany eliminations
Accounting entries made on consolidating statements in the process of generating consolidated financial statements. Intercompany eliminations cancel the accounting effects of transactions between firms in the consolidated group so that the final consolidated numbers exclude all transactions between entities in the group.

Interest
(1) A monetary benefit paid by a borrower for the right to use a lender's or a depositor's funds. Usually, the interest is paid periodically over the life of the loan, deposit, or security. However, some interest-bearing instruments, such as savings accounts, do not have defined maturities. Under the terms of some instruments, interest is not paid periodically over the life of the instrument but instead is paid solely at the end of the loan/deposit/security term.

(2) A right to enjoy some benefits of ownership of property. For example, the rights that a debtor or a court grants to a secured party in the assets owned by the debtor. Or, for example, the rights that a lessee is granted in the lease of property owned by a lessor.

Interest-coverage ratio
A ratio that uses historical financial information. sometimes combined with projected financial information, to measure a firm's short-term credit strength. This ratio measures the firm's ability to make its required interest payments. In its simplest form, the ratio takes the firm's pretax net income plus interest expense and divides that sum by the interest expense. Interest-coverage ratios can be calculated with several variations. One variation involves using next year's projected interest expense in the denominator rather than the most recent year's actual interest expense. A second variation reduces net income by deducting nonrecurring income amounts. Other variations are in use. Sometimes called times interest earned.

Interest-only strip (I/O)
A form of stripped mortgage-backed security (MBS) that only passes interest payments received from the underlying mortgage loans to the security owners. May be a real estate mortgage investment conduit (REMIC) tranche.

Interest rate cap

See cap.

Interest rate floor
See floor.

Interest rate risk (IRR)
The potential that changes in market rates of interest will reduce earnings and/or capital. The risk that changes in prevailing interest rates will adversely affect assets, liabilities, capital, income, and/or expense at different times or in different amounts. The Federal Reserve calls this type of risk market risk and defines it as the risk to a financial institution's condition resulting from adverse movements in market rates or prices, such as interest rates, foreign exchange rates, or equity prices. Within that definition, the Federal Reserve clearly views interest rate risk as just one component of market risk. The Office of the Comptroller of the Currency (OCC) defines interest rate a bit more narrowly than the Federal Reserve since it defines price risk as a separate risk. The OCC defines price risk as the risk to earnings or capital arising from adverse changes in the value of portfolios of financial instruments. Since such adverse changes generally result from changes in prevailing interest rates, price risk is essentially the same as interest rate risk. Most rate risk managers use the term in the broadest sense as defined in the first sentence of this paragraph. Interest rate risk has four components. See basis risk, mismatch risk, option risk and yield curve risk. Closely related to price risk and market risk.

Interest rate swap
A financial instrument representing a transaction in which two parties agree to swap or exchange net cash flows, on agreed-upon dates, for an agreed-upon period of time, for interest on an agreed-upon principal amount. The agreed-upon principal amount, called the notional amount, is never exchanged. Only the net interest cash flows are remitted. In the simplest form of interest rate swap, one party agrees to swap fixed-rate loan payments with the floating-rate payments of the other party. Interest rate swaps are often used in hedging. See basis swap and swap.

Interim statements
Financial statements prepared for periods other than the firm's fiscal year-end.

Internal float
Elapsed time for processing checks. Also called administrative float or processing float.

Internal liquidity risk
A term defined by the Federal Reserve. Internal liquidity risk relates largely to funding problems arising from unfavorable changes in the perception of an institution in its various markets: local, regional, national, or international. See bank-specific liquidity risk, external liquidity risk and systemic liquidity risk.

Internal rate of return (IRR)
A measure of yield that relates the cash flow from each interest payment and the cash flow from the investment's redemption value at maturity to the purchase price of the investment. It is a present value calculation that reflects the time value of each of those cash flows. By calculating the present value of the cash flows, the IRR reflects the reinvestment income that the investor can earn from reinvesting those cash flows, at the same yield as the investment that generated them, during the life of the investment.

International Swaps and Derivatives Association, Inc. (ISDA)
A global trade association representing participants in the privately negotiated (i.e., nonexchange traded) derivatives industry. Most derivatives transactions use a standard set of three documents often called "the ISDA". See master agreement.

Interpolation
The mathematical process of obtaining an unknown number that has a value between two known numbers in a series of numbers. For example, if the yields or prices for 2-, 3-, and 5-year Treasury notes are known, a yield or price for 4-year Treasury notes can be extrapolated or interpolated. Interpolated values are not always correct, but they are usually close enough for most users.

Intrinsic value
That portion of an option's value that derives from the fact that the option is in the money. The difference between exercise price of the option and the price of the underlying. The other primary component of an option's price is its time value.

Inventory
A category of goods defined by Article 9 of the Uniform Commercial Code. Inventory is goods held for sale or lease. It includes raw materials, work-in-progress, finished goods, and materials used or consumed in a business.

Inverse floater
Bonds whose coupon rates increase as rates decline and decrease as rates rise. The coupon rate is based on a formula using an index and moves in the opposite direction of changes in that index. Some inverse floaters may be a type of structured note. Other inverse floaters, such as interest-only (I/O) and principal-only (P/O) strips are types of collateralized mortgage obligations (CMOs).

Inverted yield curve
See yield curve slope.

Investment grade
A term defined by the Office of Comptroller of the Currency (OCC) (12 CFR 1) and used in its investment regulation to define eligible investments. Investment grade means a security that is rated in one of the four highest rating categories by either:

(1) Two or more nationally recognized statistical rating organizations (NRSROs); or (2) One NRSRO if the security has only been rated by one NRSRO.

See NRSRO.

Investment premium (for convertible bonds)
The amount by which it's the convertible bond's market price exceeds its value as a bond only, expressed as a percentage. The calculation is done by subtracting the investment value from the market value and dividing the difference by the investment value.

Investment property
(1) Certificated or uncertificated security, entitlement, securities account, commodity contract, or commodity account. A category of personal property collateral defined by the 2001 revisions to Article 9 of the Uniform Commercial Code. See certificated and uncertificated.

(2) An informal term for real estate owned for investment rather than the owner's use.

Investment security
As defined by the Office of the Comptroller of the Currency (OCC) (12 CFR 1), a marketable debt obligation that is not predominantly speculative in nature. A security is not predominantly speculative in nature if it is rated investment grade. When a security is not rated, the security must be the credit equivalent of a security rated investment grade. See marketable and investment grade.

Investment value (for convertible bonds)
The value of a convertible bond calculated as a straight bond without giving any value to the conversion feature. Although this is done according to normal bond calculations, the rate used to discount the bond is that for similar, nonconvertible debt. The discount rate is likely to be two to five percentage points higher than the convertible's coupon rate. Also called the bond value.

IO or I/O
See interest-only strip.

IRB
See Industrial Development Authority bond.

IRR
See internal rate of return and interest rate risk.

ISDA
See International Swaps and Derivatives Association.

ISDA master agreement
a.k.a. the ISDA
An industry-standard agreement used between the counterparties to privately negotiated (i.e., nonexchange traded) derivatives transactions. The body of the master agreement" presents the most common legal and operating terms and conditions that could apply to derivatives transactions between parties to the agreement. These include basic representations, events of default and termination events, numerous contractual housekeeping items, and a list of key definitions. The provisions in the master agreement itself are non-negotiable so users customize the agreement in the "schedule", selecting from terms provided in the master agreement or adding new provisions. The schedule contains a number of optional provisions that counterparties can choose to select or add. A third and final part of the ISDA is a "Credit Support Annex" (CSA),that details the terms of certain credit support required in the Agreement.

Issue date
The date on which interest for a new security issue begins accruing. For mortgage-backed bonds, the issue date of the pool is not the same as the origination date of the underlying mortgages. A pool may be assembled from new loans or from older loans.

Issuer
A party or entity that sells a security representing a claim on its assets (an equity security) or its contractual obligation to pay the holder at a future date (a debt security).

J

Banker's Glossary

Joint and several
A legal expression used to indicate that two or more parties each are fully liable rather than together fully liable. For example, if two individuals execute joint and several guaranties, either one can be asked to repay the entire amount of the guaranteed debt.

Judgment
A sum due for payment or collection as a result of a court order.

Judgment clause
A provision in bank promissory notes or guaranties. In this clause, the borrowers or guarantors authorize the bank to create a judgment lien at any time after the documents have been executed. The bank only has to take the documents to a court. Many states prohibit judgment clauses.

Judgment lien
See judicial lien.

Judicial lien
An interest in property acquired from a judicial or court proceeding. A judicial lien is usually the result of a judgment that a winning party of a lawsuit receives in the form of a court order. See consensual lien and statutory lien for alternative types of liens.

Jumbo CDs
An informal name for certificates of deposit of $100,000 or larger. In order to include accrued interest within the $100,000 federal deposit insurance coverage, some banks issue $98,000 jumbo CDs.

Jump Z tranche
A Z tranche in a real estate mortgage investment conduit (REMIC) that is permitted to receive principal payments before prior tranches are retired.

Junior creditor
A creditor holding junior debt.

Junior debt
Obligations of an issuer for which repayment has contractually been given a priority that is lower than the repayment priority of other debts of the same obligor. This arrangement may arise from either a specific subordination agreement or a public issuance of subordinated debt instruments.

Junior subordinated notes
See equity tranche.

Junk bonds
An informal name for high-yield securities with quality ratings below investment grade (i.e., rated lower than Baa).

K

Kappa
A Greek letter used in the financial industry to represent the sensitivity of an option's price to changes in the price volatility of the underlying.

Key rate duration
A measure of duration that calculates effective or empirical duration by changing the market rate for one specific maturity point on the yield curve while holding all other variables constant. May be done as part of a series of calculations that separately and sequentially vary the yields for two or more maturity points on the yield curve. Sets of partial durations for multiple points on the same yield curve will sum to a value that is usually close to the overall effective duration. Also known as reshaping duration. Key rate duration is the most common type of partial duration and those terms are often used as synonyms. See effective duration, empirical duration and partial duration.

Kitchen sink bonds
(1) An informal name for some re-REMICs created when tranches of existing CMO REMICs are combined and used to collateralize new securities. A re-REMIC that combines highly volatile tranches is called a kitchen sink bond. Kitchen sink bonds are very high-risk securities.

(2) An old term from CDOs.

Knot points
The points on a yield curve for which there are observable prices for traded instruments. Rates for all maturity points between the knot points are "filled in" using any one of a variety of techniques for yield curve smoothing. See smoothing.

Kurtosis
See fat tail.

L

Banker's Glossary

L/C or LC
See letter of credit and line of credit.

Laddered maturities
A maturity pattern within a portfolio in which maturities of the assets in the portfolio are equally spaced. Over time, the shortening of the remaining lives of the assets provides a steady source of liquidity or cash flow.

Land contract
Contractual arrangement used in some states under which a buyer purchases real estate from a seller over a period of time, usually by making periodic installment payments. Title is not conveyed to the buyer until the final payment is made. Also called an article of agreement.

Land flip
A colloquial expression used by some lenders and real estate developers to describe an abuse intended to overstate the purchase price of real estate collateral. Typically a land flip involves a sale of real estate at an inflated price that is not an arm's length transaction. An example of this kind of abuse might be a property purchased by X for $50,000 and one year later sold to a partnership involving X for $100,000.

Landlord's waiver
A loan document used in a number of different situations. Most often used when inventory or equipment lenders are secured by collateral located in premises leased by the borrower. In those cases, the secured lender may request a landlord's waiver to establish the lender's right to enter the premises and to control or remove the collateral. May also be used to obtain a landlord's permission and waiver of rights when a lender takes a security interest in leasehold improvements made by a borrower/tenant.

LAR
See loan application register.

Last in, first out (LIFO)
One of the methods for accounting for business inventory permitted by generally accepted accounting principals (GAAP).

Late charges
Charges that are assessed for late payments of principal or interest on a loan. Late charges may be determined as a percentage applied to the unremitted payment or as a fixed dollar amount. Some states limit late charges. Federal Regulation AA prohibits a practice called cascading late charges for consumer loans.

LBO
See leveraged buyout.

Lease
A contract providing for the use of property in which one party (the owner, landlord, or lessor) allows another party (the tenant or lessee) to use the property in exchange for value given to the lessor. May cover either real or personal property. Long-term, noncancelable leases, called capital leases, must be carried on the lessee's balance sheet as liabilities under GAAP. When they are recorded on the lessee's balance sheet, they are said to be capitalized. Short-term, cancelable leases, sometimes called operating leases, do not have to be capitalized.

Leasehold improvements
Things such as walls, air conditioners, and shelves that are added to leased space.

Leasehold mortgages
Collateral interests in real property leased by the borrower. For example, a borrower may own a building located on leased land. In those cases, a lender will take a leasehold mortgage covering the borrower's interest in both the leased land and the building.

Lease purchase agreement
A lease that includes an option for the lessee to purchase the leased property at a time and under terms specified in the lease.

Ledgering
A type of secured, working capital lending. See dominion of funds.

Legal risk
The risk to earnings or capital arising from unenforceable contracts, lawsuits, adverse judgments, or nonconformance with laws, rules, and regulations. One of six risks defined by the Federal Reserve. The Office of the Comptroller of the Currency (OCC) uses a slightly narrower definition for what it calls compliance risk.

Lender's loss payable clause
A provision in a hazard insurance contract stipulating that in the event of a loss, proceeds will be paid to a secured party. Usually used when the insured property is personal property. This is the personal property version of the standard mortgagee clause. Unlike a more common loss payable clause, the lender's loss payable clause is actually a stronger, much broader type of insurance policy stipulation. Under the lender's loss payable clause, the secured party is protected against any act or neglect of the insured that may otherwise invalidate the policy for the owner. (Some states use a different form that also provides broader coverage than the simple loss payable clause.)

Lender liability
An informal term referring to various manifestations of actual or potential legal liability arising from the conduct of a financial institution lender. Generally, lender liability arises from allegations that a lender has violated a duty (whether implied or contractual) of good faith and fair dealing owed to the borrower or has assumed a degree of control over the borrower resulting in the creation of a fiduciary duty owed to the borrower or its other creditors or shareholders.

Letter of credit
An obligation issued by a bank on behalf of a bank customer to a third party. There are many different kinds of letters of credit. The two most common are commercial letters and standby letters. A commercial or trade letter of credit is a bank promise to pay the third party for the purchase of goods by the bank's customer. A standby letter of credit is a bank promise to pay the third party in the event of some defined failure by the bank's customer, usually, but not always, a failure to pay. Standby letters of credit are often used as credit enhancements for securities.

Letter of credit right
A right to payment or performance under a letter of credit whether or not the beneficiary has demanded or is at the time entitled to demand payment or performance. The term does not include the right of a beneficiary to demand payment or performance under a letter of credit. A category of personal property collateral defined by the 2000 revisions to Article 9 of the Uniform Commercial Code.

Letter stock
Stock that bears a restrictive legend on the certificate that limits the owner's ability to sell. All letter stock is restricted stock.

Level factor amortization
Perhaps the best method of accounting for MBS premiums and discounts is the change in factor or level factor amortization method. Under the change in factor method, the amount of monthly premium amortization or discount accretion is calculated to be proportionate to the amount of the monthly principal payments. The alternative amortization method is called the effective interest method.

Leverage
The amount of the owners' or stockholders' money relative to the money that lenders, suppliers and others have contributed to the firm. The ratio of owners' money to other peoples' money.

Leveraged buyout
Corporate acquisitions in which the acquiring company borrows most or all of the funds needed to finance the purchase. In a typical leveraged buyout, the buyer intends to repay the finance debt from funds gained from either the sale of assets owned by the acquired company or from profits earned by the acquired company. The high level of debt associated with almost all leveraged buyouts makes them relatively high-risk transactions. Thus, while some bank financing is often involved, some form of junior debt is needed. The junior debt in leveraged buyout may come from a lender willing to take a subordinate position. This type of financing is often called mezzanine financing. The funds needed for a leveraged buyout may also be raised by issuing junk bonds.

Leveraged leases
A form of lease financing in which the lessor/owner supplies only a portion of the cost of acquiring the leased property as equity. The remaining portion of the purchase price of the leased equipment is borrowed from long-term lenders.

LGIPs
See local government investment pools.

Liability insurance
Insurance that protects a party from various types of claims. Typically liability insurance protects the insured from losses resulting from property damage claims or from bodily injury claims. Construction lenders usually require contractors to obtain and carry liability insurance to protect against claims resulting from the contractor's operations.

Liability management
A term used to describe the general banking strategy of focusing on the management of the amount, maturity, and cost of core deposits and

purchased funds, with an emphasis on the latter. Under liability management, bankers make loans and loan commitments to meet market conditions without concern for funding. Liability managers increase or decrease the amount of funds obtained by the bank as necessary to provide whatever funding is needed at any given time.

Liability sensitive

Describes an entity's position when an increase in interest rates will hurt the entity and a decrease in interest rates will help the entity. An entity is liability sensitive when the impact of the change in its assets is smaller than the impact of the change in its liabilities after a change in prevailing interest rates. This occurs when either the timing or the amount of the rate changes for assets cause interest income to change by more than the change in interest expense. The impact of a change in prevailing interest rates may be measured in terms of the change in the value of assets and liabilities. In that case, a liability sensitive entity's economic value of equity decreases when prevailing rates rise or increase when prevailing rates fall. Alternatively, the impact of a change in prevailing rates may be measured in terms of the change in the interest income and expense for assets and liabilities. In that case, a liability sensitive entity's earnings or net income decreases when prevailing rates rise and increases when prevailing rates fall.

LIBID

See London Interbank Bid Rate.

LIBOR

See London Interbank Offered Rate.

Lien

An interest or encumbrance held by a creditor in a debtor's real or personal property for the satisfaction of a debt. The lien may arise as a result of a consensual contract between the debtor and the creditor such as a security agreement or a mortgage. Alternatively, liens may be established by courts or by statutes. See consensual lien, judicial lien and statutory lien.

Lien search

The process or the result of investigations into the outstanding liens in a pledgor's or potential pledgor's property. The lien search not only investigates the existence of all liens but also the relative priority of those liens. For personal property, a lien search may be obtained in most states by submitting a standard form, called a UCC-4, to the appropriate filing office. Secured lenders often conduct preclosing lien searches prior to loan closings and postclosing lien searches shortly after loan closings.

Life estate deed

A document used to convey title in real estate from one party to another but only upon the death of the grantor. A life estate allows the grantor the right to own or possess real estate until his or her death. Upon the life estate holder's death, the property is automatically conveyed to another person or persons who hold a remainder interest. The holder of a remainder interest is often called a remainderman because he or she gets the remaining interest in the property.

Lifetime cap
The upper limit for increases in the interest rate on a floating-rate or adjustable-rate instrument.

LIFO
See last in, first out.

LIFO reserve
The amount by which the book value of inventory is lower than it would be if first in, first out (FIFO) rather than LIFO accounting was applied to value the inventory. Only relevant to firms reporting inventory on a LIFO basis.

Limited appraisal
One of two types of appraisals defined by the Uniform Standards of Professional Appraisal Practice (USPAP). Under USPAP, a limited appraisal may be performed when the appraiser invokes a USPAP provision that it calls the departure provision. Limited appraisals may only deviate from the requirements set forth for complete appraisals in specifically identified areas. See appraisal, complete appraisal and evaluation.

Limited guaranty
A guaranty agreement that includes a statement that limits the guarantor's liability to the bank to a defined amount.

Limited liability company
Legal entity that is a special kind of corporation. A limited liability company offers shareholders the limitations on personal liability that are available to stockholders in C or S corporations. At the same time, limited liability companies are taxed very much like partnerships; that is, the income is allocated to the stockholders for tax purposes. Generally, limited liability companies offer owners the same advantages of the more familiar S corporations but have fewer restrictions.

Limited partnership
A partnership with at least one general partner and at least one, often more, limited partner(s). The general partner has unlimited liability for the debts of the partnership, but the limited partners are only liable to the extent of their investment in the partnership.

Linear yield curve smoothing
The simple process of "drawing" straight lines to connect the knot points. The simplest but least accurate technique for yield curve smoothing. See smoothing.

Line of credit
A type of credit facility. The specific meaning of the term varies from bank to bank. Since the various uses often cause confusion, two definitions are presented here. In this book, the second definition is used.

(1) A type of loan that permits a borrower to draw funds, up to a specified maximum, for a defined period of time. Sometimes called a nonrevolving line of credit.

(2) Any loan that permits the borrower to borrow funds up to a specified maximum, make repayments in any amount at any time, and obtain any number of readvances so long as the maximum is not exceeded. Sometimes called a revolving line of credit. The distinguishing feature of a line of credit is that it rebounds, which means that the amount borrowed can be paid down and reborrowed, or readvanced, as the borrower's needs change.

Liquidity
Both the capacity and the perceived capacity to meet all obligations whenever due and to take advantage of business opportunities important to the future of the enterprise. The capacity and the perceived ability to meet known near-term and projected long-term funding commitments while supporting selective business expansion.

Liquidity contingency risk
The risk that future events may require a materially larger amount of liquidity than the financial institution currently requires. One of the three primary components of liquidity risk along with mismatch liquidity risk and market liquidity risk. Also called prudential liquidity risk, funding risk or stand-by liquidity risk. Contingency risk arises from two closely related elements. See liquidity franchise risk and liquidity option risk.

Liquidity franchise risk
The risk arising from the implied obligation of a bank to continue making new loans or other new business related cash flows in order to preserve its business franchise even though it may be having funding difficulties. One of two types of liquidity contingency risk. Also called liquidity-implied option risk. See liquidity contingency risk and liquidity option risk.

Liquidity gap or liquidity gap risk
See liquidity mismatch.

Liquidity in the ordinary course of business
One of the three main types of liquidity-need environments. An institution's "going concern" need for liquidity. Funding required for the normal ebb and flow of cash in the course of conducting bank business. Includes seasonal funding fluctuations. See bank-specific liquidity risk and systemic liquidity risk.

Liquidity mismatch or liquidity mismatch risk
The expected amount of liquidity risk based on the mismatch between contractual amounts and dates for inflows and outflows. Also called funding gap, liquidity gap, or term liquidity risk. One of the three primary components of liquidity risk along with contingency risk and market liquidity risk.

Liquidity option risk
The risk that actual cash flows will occur on dates or in amounts different from the contractual maturity dates and amounts. Put option risk includes the rights of saving, checking, and money market depositors to withdraw funds. It also includes the right of certificate of deposit (CD) holders to make early withdrawals. Call option risk includes the rights of line of credit borrowers to draw down on their committed lines of credit. One of the two types of liquidity contingency risk. See liquidity contingency risk and liquidity franchise risk.

Liquidity preference
(1) A desire among some holders of financial instruments to keep some or all of their funds in liquid instruments, that is, instruments that either mature in a short period of time or that can be readily sold with small risk of loss.

(2) A theory that attempts to explain the shape of yield curves. Under the liquidity preference hypothesis, the shape of yield curves is determined by the collective expectations of investors (the expectations hypothesis and implied forward rates) but with an upward bias at least for short-term rates caused by investors' preferences for liquidity.

Liquidity premium
(1) The portion of a security's yield that is attributable to investors' desire to hold liquidity.

(2) The difference or spread paid for liquidity.

Liquidity reserves
The amount of unused capacity to meet unexpected reductions in funding or unexpected new funding requirements in the future. For much of the twentieth century, liquidity reserves were defined as primary reserves (cash and deposits due from banks) and secondary reserves (short-term, marketable investment securities). However, the term is used more broadly today.

Liquidity risk
(1) For a financial institution, the risk that not enough cash will be generated from either assets or liabilities to meet cash requirements. For a bank, cash requirements are primarily made up of deposit withdrawals or contractual loan fundings. One of six risks defined by the Federal Reserve and one of nine risks defined by the Office of the Comptroller of the Currency (OCC). The OCC defines liquidity risk as the risk to earnings and capital arising from a bank's inability to meet its obligations when they become due, without incurring unacceptable losses. The Federal Reserve uses a broad definition of liquidity risk as the potential that an institution (a) will be unable to meet its obligations as they come due because of an inability to liquidate assets or obtain adequate funding (referred to as "funding liquidity risk") or (b) cannot easily unwind or offset specific exposures without significantly lowering market prices because of inadequate market depth or market disruptions ("market liquidity risk").

(2) For a security, the risk that not enough interested buyers will be available to permit a sale at or near the currently prevailing market price.

Liquidity stock
See liquidity reserves.

Load
A sales charge paid by an investor in some mutual fund shares or annuities. The sales charge may be a front-end charge, a back-end charge, or a 12b-1 charge. Also, an expression used to describe a mutual fund that imposes sales charges on investors. The opposite of a no load mutual fund. See 12b-1 fee, back-end load and front-end load.

Loan application register (LAR)
A document required by the Home Mortgage Discolure Act (HMDA) to gather information indicative of possible discrimiantion. Lending instititutions are required to collect information on the sex, race and ethnicity of loan applicants. At the end of each calendar year, the lender must provide the loan application register to its primary regulator no later than March 1 of the following year. Once the information is analyzed and returned in the form of a disclosure statement, the lender must make the information available to the public at its home office and, if requested, at any branch location.

Loan participation
An arrangement in which two or more lenders share in a loan to one borrower.

Loan-to-value (LTV) ratio
The name used to refer to a credit analysis ratio that measures collateral coverage. To calculate the LTV ratio, the total amount of the borrower's

obligations to the bank is divided by the total calculated value for the collateral. For example, if the total collateral value is estimated to be $1,000,000 and the total amount of the borrower's obligations to the bank is $800,000, then the LTV ratio is 0.80 or 80percent.

LOC
See letter of credit and line of credit.

Local clearing house
An organization established by the banks in a local area to facilitate the presentment and exchange of checks between those banks.

Local government investment pools (LGIPs)
Commingled investment pools. The public sector equivalent of money market mutual funds. LGIPs are usually but not always created by states for the benefit of their local governments. Sometimes these pools are managed by the states.

Lockbox
(1) A cash management arrangement designed to reduce delays in depositing funds into the payee's bank accounts. A post office box that is established by a bank to receive checks for its cash management customers. Lockboxes are utilized to accelerate deposits to the bank by eliminating internal processing by the payee organization. The bank need not maintain a separate post office box for each lockbox customer. Instead, it can sort mail received in a common box.

(2) A secured lending control arrangement. Under this arrangement, the borrower's account debtors mail their payments into a post office box that is controlled by the bank. The funds are then applied by the bank to reduce a loan to the borrower that is secured by those accounts receivable. The bank need not maintain a separate post office box for each lockbox customer. Instead, it can sort mail received in a common box.

Lock-in period
See call protection.

Lockout
(1) A prohibition, usually, but not always, for a specified period of time. For example, a prohibition against prepayment of a loan.

(2) The period of time before a REMIC investor will begin receiving principal payments.

LOCOM

See lower of cost or market.

London Interbank Bid Rate (LIBID)
The rate that a bank is willing to pay to acquire funds in the international interbank market.

London Interbank Offered Rate (LIBOR)
The rate the highest quality banks pay for Eurodollar deposits. There is a different LIBOR for each deposit maturity. LIBOR is commonly used as an index that represents short-term rates.

Long
The position of an investor who owns, or commits to buy, a security in either the cash or futures markets. For example, the purchase of an interest rate future is a commitment to take delivery of securities at an agreed-on price on some future date. This is called a long futures position. Owning an investment security is a long cash position.

Long bond
The term used to describe the most recent 30-year bond issue. Once the Treasury sells a new 30-year bond issue, that issue remains the long bond until the Treasury sells a subsequent issue.

Long coupon
Sometimes bonds are issued with a bond date of greater than six months from the issue date. Coupons after the initial, long coupon are every six months. A long coupon reduces the effective yield-to-maturity by reducing the income that can be earned from reinvestment of the coupon.

Lookback
The interval of time, or lag, between the date when an index value is established and the date when the payment rate and/or accrual rate is changed.

Loss payee
A secured party to whom insurance proceeds are paid as stipulated in a loss payee clause of an insurance policy obtained by a debtor and covering property owned by a debtor and pledged to the secured party. Generally applies to personal property.

Lower of cost or market (LOCOM)

The accounting practice of reflecting the value of an asset at the lower of its historical cost or market value.

M

Banker's Glossary

A B C D E F G H I J K L M N O P Q R S T U V W X Y Z

Macaulay duration
The earliest form of duration measurement. Developed in 1938 by Professor Frederick Macaulay, this simple form of duration provides only an approximate measure of the true price volatility and interest rate sensitivity of an instrument. See convexity, duration, effective duration and modified duration.

Macro hedging
Hedging the net risk exposure of an entity's entire portfolio or balance sheet. As opposed to micro hedging a single instrument. In interest rate risk management, macro hedging involves hedging the net mismatch or the net duration for the entire entity.

Magnetic Ink Character Recognition (MICR)
A description comprising numbers and symbols printed in magnetic ink on documents for automated processing. For checks, this MICR line appears at the bottom of the check.

MAI
See Member Appraisal Institute.

Mail float
The time it takes a remittance to move from the remitter to the recipient through the mail. This period can range from one to several days. Also called remittance float; however, remittance float can also result from electronic rather than mail delivery.

Maker
See writer.

Making a market

The conduct of a dealer who buys or sells at his or her bid and offered prices to ensure that there is a secondary market for other buyers or sellers. See market maker.

Management letter
A document prepared by a firm's auditors in conjunction with its annual audit.

Management statements
Term used to describe financial reports prepared by the borrower with no assistance from independent, outside parties.

Mandatory convertible securities
Types of convertible bonds that have required conversion or redemption features. One type of mandatory convertible requires the holder to exchange the bonds for common stock at maturity. Often used by banks seeking to meet regulatory capital requirements without issuing common stock until a later date. Often called equity-linked securities. These securities provide investors with higher yields to compensate holders for the mandatory conversion structure. They also typically have caps on the amount of upside potential that the security can achieve. For moderate stock increases, they will outperform the common stock due to the yield advantage, but the cap on the upside means that they lag stock performance for high stock returns.

Margin, gross margin, net margin, security margin, variation margin
(1) An amount of cash or collateral that a buyer or borrower must provide in excess of value owed to that buyer or borrower by a seller, lender or depositor. Ensures performance by the buyer or borrower. Initial margin is posted at inception. Variation margin is the amount of any additional margin needed to correct deficiencies in the currently posted margin.

(2) The amount by which the coupon rate for a floating- or variable- rate financial instrument differs from the defined index for that coupon rate. For example, if a floating-rate note requires that the coupon rate be set at 250 basis points above 30-day LIBOR, the gross margin is 250 basis points. Can also be the amount added to, or subtracted from, the index in determining the instrument's fully indexed rate. Investors in adjustable rate mortgage-backed securities (MBSs) receive a coupon rate that is lower than the fully indexed rate because the cost of servicing, the servicing spread, is deducted. The gross spread minus the servicing spread is called the net margin or the security margin. See index and servicing.

(3) In a firm's profit and loss statement, margin is the difference between sales price and the cost of goods sold. It may be expressed as a dollar quantity or as a percentage of the cost of goods sold.

Margin loans
Loans acquired from brokers or financial institutions for the purpose of acquiring margin stock.

Margin stock
A term defined by the Federal Reserve Board of Governors in Regulations T and U. Any stock listed on a national securities exchange, any over-the-counter security approved by the SEC for trading in the national market system, or any security appearing on the Board's list of over-the-counter margin stock and most mutual funds. There are certain requirements a stock must meet before it can be margined. The most important of which is that the price must be greater than five dollars.

Marginal rate
Marginal return
The incremental rate or return realized by making just one change, adding a single additional unit, or deleting a single unit. For example, if one more new loan is added to an existing portfolio, and the yield on that loan is 10%, the marginal yield for the portfolio is 10%. Not the same as the average.

Mark to market
The process of restating the carrying value of an asset or liability to equal its current market value. Under FAS 115, financial instruments held in trading accounts must be marked to market by increasing income to reflect unrealized gains or by decreasing income to reflect unrealized losses. Financial instruments categorized as available-for-sale (AFS) under FAS 115 must also be marked to market but receive different accounting treatment.

Market depth
A term used to describe the characteristic of a secondary market for a financial instrument evidenced by more than a minimal amount of active daily trading. One of the requirements for readily marketable assets.

Market liquidity risk
The potential that an institution cannot easily unwind or offset specific exposures, such as investments held as liquidity reserves, without incurring a loss because of inadequate market depth or market disruptions. One of the three primary components of liquidity risk along with mismatch liquidity risk and liquidity contingency risk.

Market maker
An individual or entity that stands ready to buy or sell financial instruments at all times. Market makers quote both a bid and an offer price to the market. Market makers provide liquidity to markets. They profit from the spread between bid and offer prices as well as from changes in market prices. Market makers adjust their bid or offer prices depending upon positions that they hold and/or upon their outlook for changes in prices.

Market risk
One of six risks defined by the Federal Reserve. The risk of an increase or decrease in the market value/price of a financial instrument. Market values for debt instruments are affected by actual and anticipated changes in prevailing interest rates. Market values for all financial instruments, except direct obligations of the U.S. Treasury, are affected by either actual or perceived changes in credit quality. Market risk includes reinvestment risk - that is, the risk that all or part of the principal may be received when interest rates are lower than when the security was originally purchased. In that case, the principal must be reinvested at a lower rate than that originally received. Sometimes called market value risk. Also see interest rate risk and price risk.

Market thickness
See market depth.

Market value
The value of a financial instrument based upon the price at which a financial instrument is purchased or sold or the price at which it could presumably be purchased or sold. For an equity instrument, the product of the number of shares times the market price. For a debt instrument, the product of the par or current face times the market price.

Market value of portfolio equity (MVPE)
The difference between the sum of the present values of all cash flows from assets and the sum of the present values of all cash flows from liabilities. In other words, the market value of the institution's capital account. Defined by the Office of Thrift Supervision (OTS) to represent the difference between the market value of a financial institution's assets and liabilities plus or minus the value of any off-balancesheet positions. This is a proxy or estimate used for capital when the sensitivity of capital to changes in prevailing interest rates is calculated. As used by thrift institutions and the OTS, the term has been replaced by "net portfolio value" or NPV. As used by bankers and banking regulators, the term is slowly being replaced by "economic value of equity" or EVE. See net economic value and value at risk.

Market value simulation
The process of generating multiple forecasts for future interest rate scenarios and then discounting the estimated cash flows anticipated under those rate scenarios. The results of market value simulation are a range of forecasted market values of equity for both current and potential rate risk exposures. Comparisons of these forecasted MVPE values reveal the sensitivity of MVPE to changes in rates.

Marketable, marketability
An attribute that may or may not be associated with a security. A security is considered to be marketable if it is readily salable to buyers in an active secondary market. As defined by the Office of the Comptroller of the Currency (OCC) (12 CFR 1), marketable means that the security:

(1) Is registered under the Securities Act of 1933,15 USC 77a et seq.;

(2) Is a municipal revenue bond exempt from registration under the Securities Act of 1933, 15 USC 77c(a)(2);

(3) Is offered and sold pursuant to Securities and Exchange Commission Rule 144A,17 CFR 230.144, and rated investment grade or is the credit equivalent of investment grade; or

(4) Can be sold with reasonable promptness at a price that corresponds reasonably to its fair value.

Master agreement
(1) Securities A written contract covering all future transactions between the parties to repurchase/reverse repurchase agreements and establishing each party's rights in the transactions. A master agreement often will specify, among other things, the right of the buyer-lender to liquidate the underlying securities in the event of default by the seller-borrower.

(2) Derivatives. See ISDA master agreement.

Match fund or matching
An entity is said to match fund a loan or investment when it acquires a liability in equal amount for the same maturity. However it is not perfectly match funded unless all of the interest and principal cash flows and any prepayment options are also the same for the asset as they are for the liability.

Match maturity funds transfer pricing (MMFTP)
A funds transfer pricing system or methodology that assigns a cost of funds to assets and a credit for funds to liabilities that reflect the interest rate risk - especially the rate risk associated with the time remaining to maturity - in those assets or liabilities. See funds transfer pricing.

Matched trade
A trade that is mirrored by an equal and offsetting trade with a different counterparty. In a matched trade, the interest rate, market, and price risks are offset but not the credit risk. The trading entity incurs credit risk for the counterparties on each side of the trade.

Materialman's lien
A lien against real property created under state laws that give a person who supplies materials used to repair or improve real estate the right to place a lien against the property if that person is not paid.

Maturity band

The remaining time to maturity calculated as the time between the execution date of a trade and the maturity.

Maturity date
The date a financial instrument's contractual term expires. The date on which the principal or last principal payment on a debt is due and payable. For mortgage-related securities, see final distribution date and final maturity.

Maturity ladder
See laddered maturities.

Maturity transformation
The term economists use to describe the activity of a financial intermediary that accepts deposits or investments of one term (usually short) and places those funds with a debtor in another term (usually intermediate or long term).

Maximum forward rate smoothing
An alternative yield curve smoothing technique. The most accurate yield curve smoothing method for forward rates. The yield curve with the smoothest possible forward rate function, consistent with observable data, is closely related to but significantly different from the popular cubic spline approach to the smoothing of both yields and discount bond prices. The yield curve which produces the smoothest possible forward rates consistent with given zero coupon bond prices has a quartic forward rate function which spans each time interval between observable data points. This contrasts with the cubic polynomial that is used to fit either yields or discount bond prices in the cubic spline approach. This method produces the smoothest possible forward rate curve (with $f'=0$ at the longest maturity) that causes the interpolated yield curve to be totally consistent with the observable data. See smoothing.

MBS
See mortgage-backed security.

Mean reversion
The behavior of a variable in which the values for that variable move towards the long-run average value for that variable.

Mechanic's lien
A lien against real property created under state laws that give a person who makes repairs or improvements to real estate the right to place a lien against the property if that person is not paid.

Medium-term notes (MTNs)
Debt instruments with maturities ranging from 9 months to 30 years that are offered on a continuous basis. Offered on a continuous basis means that they are issued and sold as buyers request them rather than on a single issue date. MTNs have features similar to corporate bonds. Bank deposit notes are a form of MTNs.

Megapool
FNMA MBSs created when older pools that have been reduced to small outstanding balances (i.e., low current face) as a result of cumulative prepayments are combined to create new securities with larger remaining balances.

Member Appraisal Institute (MAI)
A designation earned by qualifying commercial real estate appraisers. It is awarded by the Appraisal Institute.

Meta data
Data about data. A term used in database management and data warehousing.

Metes and bounds
A name for a type of property description used to identify parcels of land for which the legal identification is expressed in surveying terms. "Metes" means measurements and "bounds" means boundaries. A metes and bounds description gives the length and direction of the boundaries of a property.

Mezzanine financing
Financing wherein the junior debt in a leveraged buyout comes from a lender willing to take a subordinate position. See leveraged buyout.

MICR
See magnetic ink character recognition.

Micro hedging
Hedging the interest rate risk exposure of a single asset or liability. See macro hedging, its converse.

Midget

Government National Mortgage Association (GNMA) issued pools of fixed-rate mortgages with original maturities of 15 years.

Minimum pension liability
A term used to describe a liability for underfunded pension obligations that FAS 87 required firms to recognize as an actual balance sheet liability. The minimum pension liability is the excess of accumulated vested and nonvested plan benefits over plan assets. FAS 130 establishes accounting requirements for adjustments to minimum pension liability.

Mismatch
Used in asset/liability management to describe the difference between rate-sensitive assets and rate-sensitive liabilities in rate gaps or between cash inflows and outflows in liquidity gaps. See gap.

Mismatch risk
(1) The risk that a financial institution will suffer either a decline in income or capital because future changes in prevailing interest rates impact assets more or less than they impact liabilities. The component of interest rate risk arising from differences in the timing of asset and liability repricing. Also called gap or repricing risk.

(2) The risk that a financial institution will suffer either a decline in income or capital because of future funding problems. The component of liquidity risk arising from differences in the timing of cash inflows and outflows. Also called liquidity gap or liquidity mismatch risk.

MMDA
See money market deposit account.

MMFTP
See match maturity funds transfer pricing.

Model risk
The risk that incorrect or sub-optimal interest rate risk management decisions will be made because of errors in the model used to measure risk exposure. Errors may arise from inaccurate data input into the model, from inaccurate assumptions used in the simulation, and/or from errors in model logic or programming.

Modified American option
See Bermuda option.

Modified duration
Macaulay duration adjusted for compounding. The figure for Macaulay duration is divided by the sum of one plus the rate divided by the number of compounding periods per year. A more accurate measure of the weighted average time remaining until receipt of a series of cash flows. In essence, modified duration is a measurement of price and interest rate sensitivity. (Economists refer to this as price elasticity.) Modified duration expresses the percentage change in the value of an instrument for each one percentage point change in prevailing interest rates. See convexity, duration, effective duration, Macaulay duration, negative duration and positive duration.

Modified gap
A term used to describe a variety of gap analysis methodologies that make modifications to contractual gap analysis in an effort to improve the accuracy of the gap analysis. See beta-adjusted gap and dynamic gap.

Money laundering
The conversion or transfer of property derived from a criminal offense for the purpose of concealing, or disguising, the illicit origin of the property, or of assissting any person who is involved in the commission of such an offense, to evade the legal consequences of the action; the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from a criminal offense.

Money market
The aggregation of buyers and sellers actively trading money market instruments.

Money market deposit account (MMDA)
A bank deposit account designed to pay a higher rate of interest to depositors than might otherwise be earned in checking or savings accounts. Money market deposit accounts do not have specified maturities. Their rates are administered by the bank although they are influenced by prevailing rates for money market instruments traded in capital markets. Some banks index the rates that they pay on MMDAs to rates paid for traded money market instruments such as U.S. Treasury bill rates. Federal regulations limit the number of transactions that can be made from these accounts.

Money market fund
A form of mutual fund that restricts investments to relatively safe, relatively short-term instruments. Typical money market funds may invest in short-term U.S. government obligations, commercial paper, and banker's acceptances. Average maturities of fund assets are typically 14 to 28 days. The income, less costs, is paid out every day so that the share value is always the same. However, shareholders are not protected against loss from the fund's investments.

Money market instrument
The broadest definition of a money market instrument is a short-term debt instrument that is purchased from a broker, dealer, or bank. Sometimes the term "money market" is used more restrictively by further defining short-term to mean an instrument with no more than 12 months remaining from the purchase date until the maturity date. (The remaining life of the instrument is the basis for the definition rather than the its original term.) Sometimes money market is used more restrictively to mean only those instruments that have active secondary markets. Definitions of money market instruments that only include instruments with active secondary markets exclude non-negotiable investments such as most bank certificates of deposit.

Money market mutual fund
See money market fund.

Money market rate
In asset/liability management, the phrase money market rate is used to distinguish a rate set in actively traded markets from a rate that is administratively set by banks or other financial institutions. Rates on short-term U.S. Treasury notes and the London Interbank Offered Rate (LIBOR) are the most common money market rates. However, any actively traded, short-term, high-quality instrument might be considered to be a money market instrument.

Monte Carlo method
A statistical technique that involves using a large number of repeated calculations. A methodical and formalized version of trial and error.

Monte Carlo simulation
A statistical technique that involves using a large number of repeated calculations. A methodical and formalized version of trial and error. Monte Carlo simulation uses historically known interest rate volatilities to scientifically generate the large number of interest rate paths needed to simulate the interest rate sensitivity of bank products with embedded options. Monte Carlo simulation is one of the best tools for dealing with many of the option-related problems in interest rate risk measurement.

Moral obligation bond
Revenue bonds issued by state agencies, government commissions, or other special purpose municipal entities that purport to have the added backing of a moral obligation of the city or state government. Since there is no legal obligation for the state or city to back the principal or interest due on these bonds, the moral obligation provides limited, if not dubious, support.

Mortgage
(1) noun — A legal instrument that creates a lien upon real estate for the purpose of securing a debt. The instrument is executed by a lender and a borrower or guarantor as collateral for the payment of a debt that creates a lien on real estate owned by the borrower or guarantor. The borrower or guarantor is called the mortgagor and the lender is called the mortgagee. In some states, a different legal instrument called a deed of trust fulfills a similar function even though it is not legally the same. See chattel mortgage.

(2) verb — The action of granting a lien to pledge real property as security for the repayment of a debt.

Mortgage bonds
A common type of secured corporate bond. The bond indenture for mortgage bonds, along with associated documents executed by the issuer, provides for the bondholders to have, through the trustee, an interest in real property collateral. For example, the bonds may be secured by a mortgage on real estate used by the company. This may be the case when the bond proceeds are used to finance the construction of a factory or plant. (Many pollution control and utility bonds are mortgage bonds.) It is important to understand that the mortgage is not the sole, or even the primary, backing for the repayment of these bonds. These debts are still financial obligations that the firm must repay even if the value of the collateral falls.

Mortgage constant
Percentages that are an expression of the total interest and principal payments that must be made each year to fully amortize a loan over a specified number of years using level payments.

Mortgage loan
A loan secured by a mortgage. In the mortgage-backed securities industry, loans secured through deeds of trust are also referred to as mortgage loans.

Mortgage note
A name used to describe a promissory note that is secured by an interest in real property. Mortgage notes generally, but not always, call for mostly regular, periodic payments of principal and interest.

Mortgage pass-through
The simplest and oldest type of MBS. A pass-through is a security that provides its owners with a pro rata claim to all of the cash flow generated from a pool of mortgage loans.

Mortgage REIT
See real estate investment trust.

Mortgage-backed security (MBS) or mortgage-backed bond
Securities composed of, or collateralized by, loans that are themselves collateralized by liens on real property. MBSs can be categorized into two major types. Pass-through pools are mortgage-backed bonds created by assembling a pool of similar mortgage loans into a single security. Investors in a pass-through pool receive a portion of every interest and principal payment (less serving charges) that is equivalent to the investor's pro rata ownership share in the pool. The other major type is collateralized mortgage obligations (CMOs), usually real estate mortgage investment conduits (REMICs). Investors in a CMO own the rights to receive cash flow from an underlying pool of mortgages in a predetermined order based on priority. CMO securities are secured by pass-through pools. Both types of MBSs may be backed by either liens on residential or commercial properties; however, residential mortgages are more common. Both types of MBSs may be issued by either government agencies or private issuers; however, those issued by government agencies are more common. See pass-through, collateralized mortgage obligation and real estate mortgage investment conduit.

Mortgagee
A secured party to whom insurance proceeds are paid as stipulated in a mortgagee payee clause of an insurance policy obtained by a debtor and covering property owned by a debtor and pledged to the secured party. Generally applies to real property.

Mortgagee clause
A provision in a hazard insurance contract stipulating that in the event of a loss, proceeds will be paid to a secured party. Usually used when the insured property is real property. Includes personal property that is insured as contents of the insured real property. The term mortgagee clause may be used to refer to all such insurance policy stipulations. However mortgagee clauses are technically not as broad as a similar insurance policy stipulation called a standard mortgagee clause. See standard mortgagee clause.

Mortgagee waiver
A document obtained by some secured lenders with a collateral interest in property covered or potentially covered by a mortgage granted to a different lender. For example, if Bank B is taking a security interest in large equipment that might be deemed to be fixtures covered by a mortgage held by Bank A, Bank B may request a mortgagee waiver from Bank A. May also be used when a tenant is granting its lender a security interest in property that might be deemed to be fixtures subject to a mortgage granted by the landlord to its lender.

MTNs
See medium-term notes.

Municipal derivatives
Synthetic securities created from municipal securities. Variable-rate, short-term securities are, for example, created from long-term, taxable municipals when remarketing agents add a series of put options, the backing of a letter of credit, and an agreement to pay interest at rates that vary weekly, monthly, quarterly, or semiannually.

MVPE
See market value of portfolio equity.

N

Banker's Glossary

A B C D E F G H I J K L M N O P Q R S T U V W X Y Z

NACM
Acronym for National Association of Credit Managers.

Naked
The position of an option holder who does not also own an offsetting position in the underlying. For example, an investor who sells a call option but who does not own the underlying instrument that can be called has a naked call option or a naked call position. Also called uncovered. The opposite of covered.

NALMA
Acronym for the National Asset and Liability Management Association.

National Association of Securities Dealers (NASD)
An association of broker/dealers. The association supervises and regulates the trading and the conduct of its member organizations and the licensed brokers who work for those member organizations. The NASD was created under the Securities and Exchange Act of 1934. Even though it is not a government organization, it works closely with state and federal securities regulators.

National Council on Government Accounting (NCGA)
Prior to 1984, this group and its predecessor organization were responsible for setting generally accepted accounting principals for state and local governments.

National Flood Insurance Reform Act
A Federal law that establishes requirements for flood insurance. Under the National Flood Insurance Reform Act of 1994, lenders taking an interest in real property are required to complete a standard flood hazard determination form developed by the Federal Emergency Management Agency (FEMA). Flood hazard forms must be retained in the lender's records. If the form indicates that the property is in a designated flood

hazard zone, the lender is required to have flood insurance protection. Lenders may also have notice requirement obligations for collateral located in flood hazard zones.

Natural hedges
Balance sheet hedge activity done by altering asset and/or liability repricing characteristics or volumes to reduce the entity's interest rate risk exposure without purchasing derivative hedge instruments such as interest rate swaps or futures. The opposite of natural hedging is capital markets or derivatives hedging. Note that some bankers use the term "natural hedges" more narrowly than others. As narrowly defined, a natural hedge is one in which the rate risk in one piece of customer business is offset by the rate risk in another piece of customer business. Thus a hedge involving the investment portfolio is not a natural hedge under the most narrow definition of the term.

NCGA
See National Council on Government Accounting.

Negative amortization
The increase in a loan balance resulting from a situation in which the payments due from the borrower are not sufficient to cover the full amount of the interest due. The amount of interest due that is not covered by the amount of the payment is added to the unpaid principal balance of the loan. Negative amortization typically occurs during periods of high interest rates for loans with floating interest rates but fixed monthly payments.

Negative convexity
A phrase use to describe a particular type of instability in the duration of an instrument. Negative convexity means that as yields rise, duration rises and as yields fall, duration falls. Graphically, this is seen as a price/yield curve for which the price at very low and very high yields is less than the price indicated by a straight, tangent line. For an instrument with negative convexity, duration understates the interest rate sensitivity. If convexity is low, that is, if the price/yield relationship is close to a straight line, duration is stable. If convexity is high, duration is unstable. The greater an instrument's convexity, the less accurate duration will be. Callable bonds, loans, and mortgage-backed bonds typically have negative convexity.

Negative correlation
See correlation.

Negative covenant
A provision in the lender's documents that prohibits the borrower from doing something in the future. For example, a provision prohibiting the borrower from acquiring additional debt during the term of the loan.

Negative duration
(1) The name for a particular relationship between changes in the price of a debt security and changes in prevailing interest rates. When a security has negative duration, its price decreases in response to a decrease in prevailing market rates. Very few securities have negative duration. Note that the term "duration," as used in this definition, refers to modified duration. See convexity, duration and positive duration.

(2) For a financial institution, a situation in which the total duration of its assets is shorter than the total duration of its liabilities. In such cases, the duration of equity is negative. In other words, an entity with short-term assets funded by long-term liabilities will have a negative duration of equity. A financial institution that has a negative duration of equity may also be described as having a positive gap or as being asset sensitive. The theoretical equity value, but not necessarily the stock price, of a financial institution with a negative duration of equity will decrease if rates decline and increase if rates rise. Note that the term "duration," as used in this definition, refers to modified duration. See convexity, effective duration, Macaulay duration and modified duration.

Negative gap
A term referring to a liability-sensitive condition. A mismatch in which interest-sensitive liabilities exceed interest-sensitive assets.

Negative pledge
A document or a provision in a document in which a borrower agrees not to give any creditor a security interest in identified property owned by the borrower.

Negative response verification
A form of auditing account balances in which the account debtor is only requested to respond if the balance owed is not the same as the amount shown on the confirmation letter. One of two forms of direct verification.

Negative sloping yield curve
See yield curve slope.

Negotiable
Salable.

Negotiable Order of Withdrawal (NOW)
The name of an interest-bearing checking account that banks are permitted by regulation to offer to certain customers.

Net asset value (NAV)
A mutual fund's share value. It is calculated by subtracting total liabilities from total assets to determine net worth or equity. The equity value is then divided by the number of outstanding shares. The NAV is calculated once each day at the close of business.

Net economic value
Term favored by the Federal Banking regulators in lieu of market value of portfolio equity. The difference between the sum of the present values of all cash flows from assets and the sum of the present values of all cash flows from liabilities. This is a proxy or estimated value used for capital when the sensitivity of capital to changes in prevailing interest rates is calculated. See market value of portfolio equity and value at risk (VAR).

Net interest margin
The amount of interest income minus interest expense, usually expressed as a percentage. The net interest margin percentage is calculated by dividing interest income less interest expense by average earning assets. If interest income includes tax-free income, that income should be "grossed up" to its taxable equivalent before calculating the percentage. (To gross up tax-free income to its taxable equivalent, divide the income by one minus the marginal income tax rate.) The net interest margin expressed as a percentage of earning assets is often confused with the net spread. The spread is the difference between the average rate earned on assets minus the average rate paid on liabilities. That spread would only equal the net interest margin percentage if the dollar amount of earning assets equaled the dollar amount of interest-bearing liabilities.

Net lease
Leases that require the lessee to pay expenses. For real estate leases, see triple net. For personal property leases, a net lease is a lease that requires the customer/lessee to pay for the insurance, maintenance, and all taxes, if any, levied on the equipment.

Net margin
See margin.

Net noninterest expense
Total noninterest expense minus total noninterest income. A measure used by financial institutions to monitor the extent to which fees and other sources of noninterest income offset noninterest expenses. For a financial institution, expenses other than interest expense are almost always much larger than income other than interest income. Also called net overhead. Often expressed as a percentage of average earning assets. See noninterest income and noninterest expense.

Net overhead

See net noninterest expense.

Net portfolio value
A term used by the Office of Thrift Supervision to refer to a proxy value for an institution's capital when the rate sensitivity of capital is measured. See market value of portfolio equity and net economic value.

Net sales
Term used to describe a firm's revenue after the amount of returns, allowances, and discounts is deducted from gross revenue from the firm's principal operations.

Net settlement
(1) For groups of financial transactions between the same counterparties, the settlement of a group of monetary transactions by delivery of only the net amount due.

(2) For derivatives, a type of arrangement between two counterparties to a financial transaction in which the parties exchange value without the delivery of the full value or an asset. FAS 133 defines net settlement to be the case in which neither party is required to deliver an asset that is associated with the underlying. This is the case in which a net amount of interest is exchanged between the parties based upon some notional amount that is not exchanged. See notional amount and underlying.

NEV
See net economic value.

Next-day settlement
The agreement of a buyer and seller to exchange the security and the payment on the first business day after the trade date. See settlement.

NIAT
Acronym for net income after income taxes.

NIBT
Acronym for net income before income taxes.

Nickel
An informal name for 5 basis points.

No-load
An expression used to describe a mutual fund that does not impose any sales charges on investors. The term "no-load" fund is sometimes used to describe a fund without either a front-end charge or a deferred sales charge but which may nevertheless have a 12b-1 charge. However, a true no-load fund is one without any sales charges at all - front-end, deferred or 12b-1. See 12b-1 fee, back-end load and front-end load.

No-lien contract
In real estate construction, this is a contract in which the subcontractors agree to give up their rights to file mechanic's or materialman's liens.

Nonappropriation clause
A provision in some municipal leases. The clause provides that the lease terminates without penalty to the lessee in the event that the municipal lessee fails to appropriate sufficient funds to make required lease payments during the ensuing annual or biannual budget period. Usually, this clause is only used in states where legal restrictions apply to the quantity of or to the approval process required for municipal debt. The nonappropriation clause is intended to avoid characterization of the lease as debt subject to such restrictions. This clause is almost always used in conjunction with a nonsubstitution clause.

Nonconsumer deposit account
A demand, time, savings, passbook, or similar deposit account maintained with a bank, credit union, or other financial institution that is used primarily for business purposes. A category of personal property collateral defined by the 2001 revisions to Article 9 of the Uniform Commercial Code.

Nondisturbance agreement
An agreement used in some commercial mortgage loans that are secured by interests in real estate leased to tenants. In a nondisturbance agreement, the lender promises the tenant that in the event of foreclosure, the lender will not cancel the tenant's lease. Often, lenders have to give nondisturbance agreements to tenants in order to induce the tenants to provide the lender with subordination and attornment agreements and/or tenant estoppel letters.

Non-gnome
Fifteen-year FHLMC MBS pools that are issued under the FHLMC 15 year-Guarantor Program. See gnome.

Noninterest expense
For a financial institution, operating expense from sources other than interest expense. The main components of noninterest expense are usually personnel, occupancy, equipment, and professional services.

Noninterest income
For a financial institution, operating income from sources other than interest income. The main components of noninterest income are fees such as deposit service charges, funds transfer fees, trust fees, brokerage fees, etc.

Non-notification
Receivable lending in which the borrower's account debtors are not notified of the bank's lien. (The bank may use non-notification lending but still have a provision in the loan document that allows the bank to switch to notification-based financing in the event of a default.) Under non-notification financing arrangements, payments may be sent directly to the bank by the account debtors.

Nonpossessory agricultural lien
An interest other than a security interest in farm products that secures payment or performance of an obligation for goods or services furnished in connection with a debtor's farming operation. Arises primarily through the furnishing of goods and services or leased property that are connected with a debtor's farming operation.

Nonsubstitution clause
A provision in some municipal leases. This lease provision stipulates that if the municipal lessee terminates the lease under a nonappropriation clause, the lessee will not use any other property performing a similar function to that performed by the property covered by the lease for the period of time covered by the lease. The nonsubstitution clause is intended to be a deterrent to termination of the lease contract under a nonappropriation clause.

Notice of adverse action
In many cases, lenders are required by law to provide applicants with timely notice of adverse action, such as denial of credit applications. This requirement applies to some loans covered by the Equal Credit Opportunity Act and to some loans covered by the Women's Business Ownership Act.

Notification

Receivable lending with the requirement that the borrower's account debtors must be notified of the bank's lien. The payments on the accounts are then usually sent directly to the lender by the account debtors. Sometimes called notification plan.

Notional amount
The principal amount or face value of a derivative. Defined by the Financial Accounting Standards Board (FASB) in FAS 133 as the number of currency units, shares, bushels, pounds or other units specified in a derivatives contract. The notional amount is used to calculate the payments that are exchanged by the counterparties in the transaction. Market participants refer to notional principal because, unlike bonds or other conventional credit instruments, these types of derivatives do not involve an exchange of principal. Rather, the parties state the principal amount only as a basis for calculating the sizes of the interest related payments that they exchange. In this application, principal is only a reference point or idea - hence the term. Also called the notional principal balance.

Notional principal
See notional amount.

Novation
(1) The substitution of an existing debt with a newer debt.

(2) An agreement to substitute an existing party to a contract with a new party. All of the original parties to the contract must agree to the substitution.

NOW
now account
See Negotiable Order of Withdrawal.

NRSRO
Acronym used by the Securities Exchange Commission (SEC) and by banking and securities regulators to refer to nationally recognized statistical rating organizations. The most well known NRSROs are Standard & Poor's and Moody's.

O

OAS
See option-adjusted spread.

Obligor
Any party with an obligation to discharge; usually used to refer to a borrower.

OCC
See Office of the Comptroller of the Currency.

Off-balance sheet
A term used to describe contingent liabilities, contingent assets, and commitments that are legally binding but are not assets or liabilities shown on the balance sheet under GAAP. Examples include loan commitments and letters of credit.

Off-the-run
A term used to describe all but the most recently issued treasury or agency securities in a particular maturity class. For example, at any given time, there may be a number of U.S. Treasury security issues with remaining lives of about two years. The most recently issued two year securities are described as on-the-run. All the rest are described as off-the-run. Off the run securities trade at wider spreads than similar securities that are actively quoted or traded. They may also trade at slightly lower prices(higher yields).

Offer or offered price
The trading price proposed by the prospective seller of securities. Also called the asked or asking price.

Office of the Comptroller of the Currency (OCC)
Part of the U.S. Treasury department. The OCC is the primary regulator for banks with national charters.

Office of Thrift Supervision (OTS)
The OTS regulates federally insured savings and loan institutions. One of the provisions of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) established the OTS to replace the Federal Home Loan Bank Board as the primary thrift regulator.

OID
See original-issue discount.

On-the-run
A term used to describe the most recently issued treasury or agency securities in a particular maturity class. For example, at any given time, there may be a number of U.S. Treasury security issues with remaining lives of about two years. The most recently issued two year securities are described as on-the-run. (All the rest are described as off-the-run.) On the run securities trade at narrower spreads than similar securities that are less actively traded. They may also trade at slightly higher prices(lower yields).

On-us items
Checks or drafts drawn on the same bank that is used by the payee/drawee to cash the check or deposit the proceeds. Checks or drafts payable to the drawor's bank itself, as opposed to checks drawn on other institutions.

One-factor model
A simple financial model where the future price of an instrument is the single variable or unknown. One-factor models, such as Black-Scholes or Vasicek, usually lead to closed form solutions. See closed form solution.

Open-end credit
Types of credit extensions that permit borrowers to add to the amount borrowed, usually in irregular amounts, at various times subsequent to the granting of the credit. Examples include credit card loans, personal lines of credit, and home equity lines of credit.

Open market activities
The purchase or sale of government securities conducted by the Federal Reserve Bank of New York acting upon instruction from the Federal Reserve Board of Governors. Used to decrease the money supply when bonds are sold and the purchase funds paid the Fed are taken out of circulation or increase the money supply when newly created cash is used to buy securities. The changes in the money supply impact short-term interest rates and through that mechanism are the primary monetary tool of the FRB.

Open repo
See continuous repo.

Operating expense ratio
A ratio used in real estate lending analysis. The ratio is the total operating expenses divided by the effective gross income.

Operating income
An income statement subtotal that is variously called operating income or operating profit. Gross profit minus operating expenses. A credit balance here, shown as a positive number, indicates that the firm makes money on its principal operations. . A debit balance, shown as a negative number, indicates that the firm loses money on its principal operations.

Operating lease
See lease.

Operational efficiency
A term used to describe the characteristic of a secondary market for a financial instrument evidenced by low transaction costs and smooth execution of trades. The spread between bid and offered prices, brokerage commissions, and taxes are the three main types of transaction costs. One of the requirements for readily marketable assets.

Operations risk
Operational risk
The risk to the bank that errors made in the course of conducting its business will result in losses. The Federal Reserve calls this operational risk and states in its definition that operational risk arises from the potential that inadequate information systems, operational problems, breaches in internal controls, fraud, or unforeseen catastrophes will result in unexpected losses. The Office of the Comptroller of the Currency calls this transaction risk and defines it as the risk to earnings or capital from problems with service or product delivery. Operations risk is covered under Basel II pillar I.

Opinion letter
Letter issued by a certified public accountant to accompany financial statements. The opinion letter has two parts. One describes the scope of the accountant's work in the preparation and testing, if any, related to the preparation of the financial reports covered by the letter. The other provides the accountant's opinion regarding the fairness, accuracy, and conformity with GAAP of the financial statements. Accountant's opinions

are categorized as unqualified, qualified, disclaimer, or adverse depending upon the nature of the comments in the letter. See adverse opinion, disclaimer opinion, qualified opinion and unqualified opinion.

Opportunity cost
The cost of pursuing one course of action measured in terms of the foregone return that could have been earned on an alternative course of action that was not undertaken.

Option
(1) A contract that gives its holder the right, but not the obligation, to buy or sell an underling security, commodity, or currency before a certain date. Options are often used in hedging. Put options give the holder the right to sell the underlying security, commodity, or currency at the strike price. Call options give the holder the right to buy the underlying security, commodity or currency at the strike price.

(2) A provision in a financial contract that gives one party to the contract one or more rights to change the maturity, the principal amount, the interest rate, or other contract term. In loans, the most common form of option risk arises from a borrower's right to prepay. In securities, the most common form of option risk arises from an issuer's right to call the security. See embedded option.

Option-adjusted duration
A duration measure that does allow for changes in cash flows as yields change A variation of effective or empirical duration. Option adjusted duration incorporates the expected duration-shortening effect of an issuer's embedded call provision. It is also called adjusted duration.

Option-adjusted spread (OAS)
(1) A measurement of the return provided to an investor from a financial instrument that is either an option or that includes an option. The option-adjusted spread calculations break up a security into separate cash flows. Each of those cash flows is discounted at a unique discount rate appropriate for its maturity. The discount rates are obtained from a benchmark yield curve. The benchmark yield curve is simply the currently available (spot) yields for risk-free investments of various maturities. Since U.S. Treasury obligations are not considered to have any credit risk, Treasury rates are used. OAS is not quoted as a yield. Instead, it is quoted as a difference, or spread, in basis points.

(2) A valuation technique for valuing financial instruments, portfolios of financial instruments, or financial institutions with options. This tool is one component used in the Office of Thrift Supervision net portfolio value model for modeling the interest rate risk in complex financial instruments. This methodology is also used by high-end commercial interest rate risk analysis models.

Option risk
The risk that a change in prevailing interest rates will lead to an adverse impact on earnings or capital caused by changes in the timing of cash flows from investments. Cash flows may be received earlier than expected as a result of the exercise of options or of embedded options in

financial contracts. One of the four primary components of interest rate risk. Option risk usually arises when a change in prevailing interest rates prompts the option holder to exercise the option. See option.

Option writer
The seller of a put or call option.

Original face or original face value
The total principal amount of all of the loans in an MBS pool as of the issue date.

Original-issue discount (OID)
The amount of the difference between the par or redemption price and the price of the security at the time of its original issue. Issuers can issue securities with OID as an alternative to making periodic interest payments as a means of compensating investors. Zero coupon notes, strips, discount notes, and banker's acceptances are examples of investment types with OID. For those instruments, the return provided to the investor comes in the form of a discount. OID should not be confused with the discounts that investors may pay for either coupon-bearing instruments or discount instruments resulting from a change in prevailing rates subsequent to the issuance of a security. OID is subject to different income tax treatment than discounts resulting from changes in market prices.

OTC
See over the counter.

Other comprehensive income (OCI)
A term defined by FAS 130. FAS 130 identifies three components of other comprehensive income

OTS
See Office of Thrift Supervision.

Out of the money
The situation where an option has only time value as opposed to intrinsic value because of the relationship between the option's strike price and the current market price for the underlying instrument, the spot price. A call option is out of the money when the strike price is above the spot price. A put option is out of the money when the strike price is below the spot price.

Over collateralization
A type of credit enhancement used in some asset backed securities and some private mortgage backed securities. The principal amount of the collateral pledged for a given security exceeds to the principal amount of the security.

Over the counter (OTC)
Purchases and sales of financial instruments that do not take place in organized exchanges such as the New York Stock Exchange or the Chicago Board of Trade are termed over the counter. The phrase may be used as a noun to describe capital markets other than organized exchanges. The phrase may also be used as an adjective to describe instruments not traded on an organized exchange, such as over-the-counter derivatives.

Over trading
See adjusted trading.

Ownership and encumbrance reports
See title search.

P

Banker's Glossary

A B C D E F G H I J K L M N O P Q R S T U V W X Y Z

P & I
Principal and interest as in the principal and interest required for periodic loan repayments.

PAC tranche
Planned amortization class tranche. A REMIC security created to receive selected cash flows from a pool of underlying mortgages securing the REMIC. PAC tranches use a structure similar to a sinking fund to establish a fixed principal payment schedule. Created together with a companion or support tranche.

PAC Z tranche or PAC Z bond
A CMO Z bond with some call and extension protection provided by collars. Like other Z bonds, a PAC Z bond earns interest that is accrued but not paid in cash for a defined time period. See Z tranche.

Pair-off
A security purchase transaction that is closed out or sold on or before the settlement or expiration date. In a pair-off, the investor commits to purchase a security. Then, prior to the predetermined settlement date, the investor offsets that purchase with a sale of the same security that is arranged to settle on or before the settlement date for the purchase. Instead of paying for the purchased security on the settlement date, the investor need only pay or receive the difference between the purchase and sale prices. Pair-offs are price speculations that are considered trading activities and may be criticized by bank examiners if not handled as trading activities.

Par
(1) The principal or maturity value of a non-amortizing, debt security.

(2) The current face of a mortgage-backed security. See par line.

(3) The price at which the face value of a debt security equals its selling price or 100.

(4) For stocks, the face or nominal amount of a share.

Par line
The parity price at which the yield of a mortgage-backed bond equals its net coupon rate. Because of the delay days, the par line is not 100 but instead is somewhat lower. Par line is not constant for different coupon rates at different delay days. However, it is not a function of prepayment speeds.

Par value
See par for all securities except MBSs. See par line for MBSs.

Par yield curve
See yield curve.

Parallel yield curve shift
A change in interest rates that affects all of the different maturities for an instrument by the same amount. For example, if there was a parallel shift in U. S. Treasury rates in the amount of a 25 basis point increase, every maturity from 30 days to 30 years would rise by 25 basis points. The new yield curve, or graphical depiction of the term structure of interest rates, would be 25 basis points above the old yield curve at all points.

Pari passu
A lending term meaning at an equal rate or pace.

Parity price
(1) For a mortgage-backed security, see par line.

(2) For a convertible security, see conversion value.

Parity value of a convertible bond
See conversion value.

Partial duration
A duration measure calculated by changing one variable while all other variable are held constant. The most common example Is key rate duration where all variables are held constant except the yield for a specific maturity point on the yield curve. Another application of partial duration is the calculation of option-adjusted duration by changing a variable such the OAS while holding all other variables constant.

Partial release
A document or a process in which a secured party gives up its collateral interest in a portion of the property of the debtor that is pledged to secure a loan. For example, if a real estate developer has pledged 10 lots as collateral for a loan, a partial release may be used for each lot as it is sold. For personal property collateral, a partial release may be entered into the public record by using a standard form called a UCC-3.

Participation
An agreement between lenders to share a commitment to extend funds (if any), the extension of funds, and the credit risk for one or more credit facilities to a borrower. Almost always evidenced by a written agreement.

Partnership
See general partnership and limited partnership.

Pass-through
The original type of MBS structure. In a pass-through, investors own a pro rata claim to the cash flows from the pool of underlying mortgages. Each investor's pro rata share of interest and principal is remitted to the investor, "passed through," by an agent.

Pass-through rate
The net amount of interest paid to investors owning mortgage-backed securities after all servicing and guarantee fees are deducted.

Path-dependent options
Options whose exercise is influenced by the historical trend in interest rates in addition to the current level of interest rates. The exercise of a path dependent option is influenced by whether or not it is in the money as well as by how many times that option has previously been that deep in the money. Loan prepayments are path dependent. For example, if interest rates fall to 8 percent, a borrower with an 11 percent loan is less likely to prepay his loan than another borrower if rates have fallen to 8 percent and returned to 11 percent several times since the first borrower obtained his loan but only fallen to 8 percent once since the second borrower obtained his loan.

Patriot Act
Short name for the "Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001" ("USA PATRIOT Act"). The Patriot Act was signed by President Bush on October 26, 2001.

This act contains a number of significant regulatory requirements for banks. Section 314(b) permits financial institutions, upon providing notice to the United States Department of the Treasury, to share information with one another in order to identify and report to the federal government activities that may involve money laundering or terrorist activity. Section 326 of the USA PATRIOT Act requires that financial institutions implement reasonable procedures to (1) verify the identity of any person opening an account; (2) maintain records of the information used to verify the person's identity; and (3) determine whether the person appears on any list of known or suspected terrorists or terrorist organizations. Additional provisions prohibit banks from having accounts with shell banks, address availability of bank records, and change and clarify suspicious activity report requirements.

Payable-through-draft (PTD)
A form of check that is written on an organization other than a bank but is payable through banks. Credit union "checks" are actually PTDs. PTDs are recognized as disbursements after they clear, not when they are written. A PTD functions the same as a warrant.

Payee processing float
Time between when a payment is received and when the funds are deposited. When employees hold their paychecks over a weekend and when vendors process receipts only once a week, the payor benefits from the extra time its investments earn interest. These beneficial payee processing delays are limited to payments by check. Electronic payments (wire transfers and ACH credits) produce no processing delay at all.

Paying agent
An entity responsible for paying bond principal and interest on behalf of the debtor.

Payment bond
A type of insurance purchased by a builder that protects both the bank and the owner by providing that the insurance company will be responsible for payments due to laborers and other parties who provided services for the building project.

Payment date
The date that dividends, interest, or principal and interest payments are due to be paid to the owner of record of a security.

Payment guaranty
A guaranty in which the signer is guarantying payment of the obligation upon the borrower's failure to pay without the bank having to first attempt to collect from the borrower or from any collateral.

Payment intangible
A general intangible under which a debtor's principal obligation is a monetary obligation from a third party. A category of personal property collateral defined by the 2000 revisions to Article 9 of the Uniform Commercial Code.

Payment processing float
See administrative float.

Payments systems disruptions
A type of systemic liquidity risk. The risk of funding problems arising from the failure to receive funds due to the bank. A payments system disruption need not result from an operational or computer failure. If one party fails to make a required funds transfer, that failure can trigger more defaults down the line. See systemic liquidity risk.

PBO
See projected benefit obligation.

Penciled in
An informal expression used to indicate that a potential buyer's offer to purchase a portion of a new issue is accepted subject to the potential seller winning the bid to become the underwriter.

Pension Benefit Guaranty Corporation (PBGC)
A U.S. Government agency that was created to insure guaranteed pension benefits. PBGC has statutory authority to claim up to 30% of the net assets of a firm that sponsors a pension plan when an underfunded plan is terminated. Such a PBGC claim is granted the same priority over the claims of other creditors as a tax lien.

Perfected security interest
A collateral interest in personal property collateral that has been properly documented. See security agreement and perfection.

Perfection
The name for a procedure established by Article 9 of the Uniform Commercial Code. Creditors must comply with this procedure in order to establish the priority of their security interest in personal property relative to the priority of security interests in the same property that may be held by other creditors. (It may be used when an interest in collateral is provided by the debtor or by a guarantor or other third party.) Perfection does not normally constitute the actual agreement between the secured party and the debtor. By itself, perfection does not create a security interest and must therefore be supported by a separate security agreement or pledge agreement. There are several different procedures that can be used to achieve perfection of a security interest in a debtor's personal property. The most common method is perfection by filing a financing statement. See financing statements and security agreement.

Performance bond
A type of insurance purchased by a builder that protects both the bank and the owner by providing that the insurance company will be responsible for completing construction if the contractor fails to do so.

Periodic cap
The maximum amount by which an adjustable-rate security's coupon rate can change in any given period of time. Also called reset cap. For most ARMs and floaters, the maximum periodic or reset change is defined as an amount of change in each consecutive 12-month period over the life of the security. Thus the term annual cap is also used to describe most periodic caps.

Permanent lender
A lender, which may be a financial institution, an insurance company, or a pension fund, that finances real estate projects after construction is completed. Also called end lender. See takeout commitments.

Permanent working capital
An informal phrase used to describe the amount of short-term liabilities needed to offset a continuous or nearly continuous working capital shortfall. Also used as a name for a borrower's need for year-round working capital financing. This type of financing is usually needed by rapidly growing and/or undercapitalized firms and is usually provided by asset-based lenders.

Personal property
Defined by law to be all property that is not real property. Further classified in Article 9 of the Uniform Commercial Code into various categories.

Personalty
Personal property.

Phase I audit
The most common form of environmental liability risk assessment. A phase I audit consists of a thorough review of the past and present ownership of the property as well as the past and present uses of the property. These reviews include examinations of public records regarding the property. Additional information is obtained from both a physical inspection of the property and from interviews with people who are familiar with the property. The goal of a phase I audit is to determine the presence or the likely presence of hazardous substances in the buildings, soil or ground water. Phase I audits are noninvasive and do not include the collection or analysis of samples. Accordingly, the findings of a phase I audit cannot be conclusive. The audit merely determines whether further investigations are needed.

Phase II audit
An environmental liability risk assessment. A phase II audit is usually conducted only when the phase I audit or other information about the property or about the activities conducted on the property indicate that there is a possibility of contamination. In the phase II audit, qualified individuals collect ground and water samples, test storage tanks, and/or collect building materials samples. Drilling may be conducted to obtain subsurface soil samples. Samples are then tested and analyzed.

Pillar I, pillar II, pillar III
See Basel II.

Pivot point
The point on a yield curve that separates the rising rates from the falling rates when yield curves flatten or steepen. Often near the five year point.

Plain vanilla
Simple; not complex. Sometimes used to differentiate pass-through MBS pools from CMO structures. More often used to mean sequential-pay REMICs, the simplest REMIC structure.

Planned amortization class (PAC) tranche
A REMIC security created to receive selected cash flows from a pool of underlying mortgages securing the REMIC. PAC tranches use a structure similar to a sinking fund to establish a fixed principal payment schedule. Created together with a companion or support tranche. PAC tranches are intended to have low call and low extension risk. Sometimes called controlled amortization bonds.

Platted land
Land that has been divided into lots described in a plat plan that is filed in the real estate records of a political entity.

Plus
An informal term for 1/64. Half of 1/32, the smallest increment commonly used to quote the price of an agency security. For example, a quoted price of 101 and 5/32 plus is equivalent to 101 and 11/64ths.

PO or P/O
See principal-only strip.

Point
See basis point.

Political subdivision
A county, city, town, or other municipal corporation, a public authority, and generally any publicly owned entity that is an instrumentality of a state or of a municipal corporation.

Pool
(1) For mortgage-backed securities, a pool is a group of mortgage loans backing an individual security issue.

(2) In funds transfer pricing systems, a pool is an aggregation of funds to provide average or moving average cost of funds for allocation to products or business units.

Pool factor
See factor.

Portfolio
A collection of financial assets belonging to a single owner. For example, the municipal bond portfolio. Risk in portfolios is reduced by diversification.

Positioning
The act of holding a financial instrument, one or more portfolios of financial instruments, or one's entire balance sheet in a way that exposes the holder to profits or losses from future changes in market prices. Positions may be taken with the intent to profit from expected future market changes (trading activities); may result from inventories of financial assets maintained for sale to customers (dealing activities); or may be the result of the net exposure from transactions (residual positions resulting from trading activities, dealing activities, or customer accommodations).

Banks take positions in one of two ways: (1) In their trading accounts, banks (mainly large banks) may take positions with one or more financial instruments in the expectation of profiting from future rate changes. (2) More typically, banks hold or take balance sheet positions. The cumulative interest rate risk exposure from customer deposits, loans, and other activities creates a net residual position that the bank may or may not hedge. Choosing not to hedge is positioning. Alternatively, banks may create a position or add to a residual position in the expectation of profiting from them.

Positive convexity
A particular type of instability in the duration of an instrument. Positive convexity means that as yields rise, duration declines. Graphically, this is seen as a price/yield curve for which the price at very low and very high yields exceeds the price indicated by a straight, tangent line. For an instrument with positive convexity, duration overstates the interest rate sensitivity. If convexity is low, that is, if the price/yield relationship is close to a straight line, duration is stable. If convexity is high, duration is unstable. The greater an instrument's convexity, the less accurate duration will be.

Positive correlation
See correlation.

Positive duration
(1) The name for a particular relationship between changes in the price of a debt security and changes in prevailing interest rates. When a security has positive duration, its price increases in response to a decrease in prevailing market rates. Almost all securities have positive duration. Note that the term "duration" as used in this definition refers to modified duration. See convexity, modified duration and negative duration.

(2) For a financial institution, a situation in which the total duration of its assets is longer than the total duration of its liabilities. In such cases, the duration of equity is positive. In other words, an entity with long-term assets funded by short-term liabilities will have a positive duration of equity. A financial institution that has a positive duration of equity may also be described as having a negative gap or as being liability sensitive. The theoretical equity value, but not necessarily the stock price, of a financial institution with a positive duration of equity will decrease if interest rates rise and increase if interest rates decline. Note that the term "duration" as used in this definition refers to modified duration. See convexity, modified duration and negative duration.

Positive gap
A term referring to an asset-sensitive condition. A mismatch in which interest-sensitive assets exceed interest-sensitive liabilities.

Positive response verification
A form of auditing account balances in which the account debtor is requested to respond to either confirm or dispute the balance. One of two forms of direct verification.

Positive sloping yield curve
See yield curve slope.

Postclosing lien search
An investigation of the appropriate public records, conducted shortly after the closing of a secured transaction, to verify that the creditor's security interest in the collateral was properly recorded and that it received the priority intended. See lien search.

Preauthorized check
A process by which the issuer of a check gives written permission to have the check written and charged against his or her account on a predetermined basis.

Prebid conference
A conference held with potential bank bidders to explain a request for proposal and answer questions.

Preclosing lien search
An investigation of the appropriate public records, conducted shortly before the closing of a secured transaction, to determine the likely priority that will be received for the creditor's security interest in the proposed collateral. See lien search.

Preference
preference period
A legal term used in bankruptcy to describe a transaction deemed to have occurred under circumstances favorable to the creditor that benefited from the transaction. This provision is intended to protect unsecured creditors. Under the U.S. Bankruptcy Code, the preference period for most creditors is 90 days prior the date of the debtor's petition filing. The exception is a one year preference period applicable to creditors deemed to be an "insider" with respect to the bankrupt debtor. Collateral interests obtained by a creditor during the preference period are undone by the bankruptcy. See insiders.

Preferential transfer
See preference.

Preferred stock
A type of equity or capital representing shares of ownership in a corporation. May or may not receive distributions of corporate income in the form of dividends. Has a higher priority claim to corporate earnings or assets than common stock but lower priority than corporate debt. A corporation may issue more than one class of preferred stock with differing priority status such as first or second preferred. Often preferred stock issues have a defined dividend payment rate as long as there are sufficient corporate earnings to distribute.

Premium
(1) The amount by which the price for a security is greater than its par amount.

(2) The amount that must be paid above the par amount for an issuer to call or refund an issue before its maturity.

(3) The amount paid to purchase an option.

(4 The cost of an insurance policy.

(5) In banking, the segment of an interest rate that is offered or paid by one issuer representing the difference between the rate offered or paid by that issuer and the rate that other issuers of the same type offer or pay for similar issues. For example, the extra or higher interest rate that a distressed bank must pay above rates offered by other banks in order to attract funds.

Premium payer
The party in an options collar contract required to pay the difference between the cap and floor.

Prepaids
Expenses that are capitalized as assets on a firm's financial statements because they will be charged against activities in the near future rather than past activities. Also called prepaid expenses, prepaid assets or prepaid items. For example, if insurance premiums for the next six months are paid today, the amount paid may be shown as a pre- paid asset. The asset in that example would then be reduced to zero over the following six months by recognizing one-sixth of the amount as an expense in each of next six months. Insurance, taxes, and subscriptions are common prepaid expenses.

Prepayment estimate
A reasonable and supportable forecast of loan prepayments. In the case of a mortgage-backed security, it is the forecast of principal amortization caused by loan prepayments. A single prepayment estimate is associated with each projected interest rate environment. Estimates are used to forecast expected lives. Investors typically examine data for a range of prepayment estimates applicable to a range of preselected rate changes.

Prepayment or prepayments
(1) noun — A term used to describe loan or bond principal payments that are made in excess of the scheduled principal payments and before maturity. Any amount paid to reduce the principal before the due date or in excess of the required principal amortization. Prepayments may be voluntary or involuntary. For example, most residential mortgage loan contracts permit the homeowner to voluntarily prepay his or her loan at any time. Involuntary prepayments are liquidations resulting from foreclosures, condemnations, or casualty.

2) verb — The action of making excess or early payments.

Prepayment penalty
A fee that must be paid to the lender if the borrower prepays a loan within a defined time period. Many consumer loans, especially residential mortgage loans, do not have prepayment penalties.

Prepayment rate
A representation that reflects the rate at which prepayments are received or forecasted to be received for a mortgage loan, a pool of mortgage loans, or an MBS. May be expressed as a PSA or CPR speed.

Prepayment risk
The risk that prepayments will speed or slow and therefore change the yield and/or life of the security.

Pre-refunding (pre-re)
The sale of bonds used to obtain funds that are then placed in escrow to back bonds previously issued. The first issue typically comprises bonds that were originally issued at high, fixed coupon rates and that could not be called when rates subsequently fell. Since they could not be called, the issuer's alternative method for reducing its interest cost for the debt is to issue new, lower cost debt and to use the proceeds of the new bonds to purchase Treasury securities. The interest received from the Treasury securities pays the interest due for the pre-refunded bonds until they can be called or until they mature. The original set of bonds is said to be pre-refunded by the second set of bonds. Those pre-refunded bonds have very little credit risk since the cash for their debt service comes from the Treasury securities and does not depend on the issuer. See refunding escrow deposits.

Presentment
A process by which a check is presented for payment at the drawee's bank.

Price
The amount paid for a security. The price of a security is usually expressed as a percentage of its par value. For mortgage-related securities, the price is usually expressed as a percentage of the current face value. A price greater than 100 percent is a premium price while a price less than 100 percent is a discount price. See current face, discount, par and premium.

Price risk
The risk that the market value of an asset or liability will change adversely. One of nine risks defined by the OCC. The OCC defines price risk as

the risk to earnings or capital arising from adverse changes in the value of portfolios of financial instruments. Since such adverse changes generally result from changes in prevailing interest rates, price risk is essentially the same as interest rate risk. The Federal Reserve includes this risk in its definition of market risk. See interest rate risk and market risk.

Primary market
The issuance (sale) of new securities. As distinguished from the secondary market.

Primary reserves
For a bank, assets considered to be the primary source of extra liquidity. Primary reserves are usually defined to be cash on hand, balances on deposit with the Federal Reserve Bank, and balances due from correspondent banks (e.g., cash and due from banks).

Principal
The remaining balance owed on a loan by a borrower or on a security by its issuer, exclusive of any accrued interest.

Principal component analysis (PCA)
A mathematical tool used to reduce the number of variables while retaining the original variability of the data The first principal component accounts for as much of the variability in the data as possible, and each succeeding component accounts for as much of the remaining variability as possible. In interest rate risk analysis, PCA is applied to define non-parallel yield curve sifts to model. The number of variables is equal to the number of points on the yield curve, the first principal component is the rate level, the second is the twist or rotation of the yield curve around a pivot point and the third is the change in curvature or "bow" in the yield curve.

Principal-only strip (P/O)
A form of stripped mortgage-backed security that only passes principal payments received from the underlying mortgage loans to the security owners. May be a REMIC tranche.

Prior service costs
Costs that arise from amendments to defined benefit pension plans that retroactively increase benefits. In rare cases, retroactive amendments that decrease benefits can create negative prior service costs. Under FAS 87 rules, these costs are not added to the minimum pension liability reported on the balance sheets for sponsors of underfunded defined benefit pension plans. Instead, the costs are amortized over the projected remaining service lives for the employees expected to receive benefits. The amortization increases the reported benefit expense of the sponsoring firm. The unamortized portion of this off-balance sheet liability is disclosed as "unrecognized prior service costs" in a footnote to the financial statements.

Private placement
Instead of being sold to the general public after completion of an SEC registration, some bonds are sold privately, without a registration, to one or a few investors. When a bond issue is underwritten in this way, it is called a private placement.

Private pool
private label
Mortgage-backed securities not issued by or guaranteed by a U.S government agency or U.S. government sponsored enterprise. The mortgage loans comprising private pools are generally loans that do not meet GNMA, FNMA, or FHLMC requirements. Private pools may be structured as fixed-rate pass-through securities, floating-rate pass-through securities, or CMOs. Also known as whole loan pools.

Pro formas or pro forma statements
Financial information, often just balance sheets, prepared by adjusting a recent financial report to show the effect of recent or planned changes. Projected financial statements.

Probability distribution
The mathematical function describing the probability of different events, as described by values for a variable. A symmetrical distribution (one where to values are evenly distributed around the mean) is called a bell curve, a normal distribution or Gaussian bell curve. Values that are far more widely spread from the mean are said to have ″fat tails″, an informal name for kurtosis. Credit risk and liquidity risk have distributions that are very asymmetrical a phenomena called ″skewness″.

Proceeds
Money or property received when collateral is sold, exchanged, or collected.

Processed goods
Goods that become part of a product or mass of goods. An example is the flour used to bake bread.

Processing float
The internal processing time that an organization takes to prepare a receipt for a deposit or an invoice for payment.

Products
Property that is created from other property.

Professional corporations
Entities sometimes used by doctors, lawyers, and other professionals. These entities can provide favorable tax treatment and administrative advantages and can therefore be advantageous to the professionals who use them. In most respects, other than taxes, they are indistinguishable from all other corporations.

Progress payments
Progress payments are payments made by the purchaser in stages as the seller acquires or builds the property to be sold. A written purchase agreement or contract establishes the seller's rights to claim payments before the property is delivered to the buyer. When the Federal government is making progress payments, the purchase contracts usually include standard clauses that affect secured lenders. These clauses provide that title to all materials, inventory, fixtures, and equipment that are chargeable to the government contract vests in the government.

Projected benefit obligation (PBO)
The actuarial present value of the pension benefits earned to date. In contrast to the ABO, measurement of the projected benefit obligation incorporates assumptions for future compensation rates for pay-related benefit plans. The PBO must be disclosed in a footnote to the financial statements.

Projections
Projected financial statements showing predicted income, cash flow, and/or balance sheets. Unlike pro forma statements, projections typically cover multiple time periods — sometimes as many as five future years.

Promissory note
A written contract between a borrower/debtor and a lender/creditor in which the borrower agrees to repay a loan granted by the lender. The contract specifies the amount of the loan and the terms of repayment.

Proprietary trading
Trading activity that is conducted purely for the anticipated profit of the trading entity. The term is used to distinguish such trades from trading that is conducted for customers, for market-making, or for hedging. Also
called strategic trading.

Proprietorship
Name used to identify a business that is not a separate legal entity but instead is operated by an individual.

Prospectus
A document that describes the details and financial support for a new bond or stock issue offering. A prospectus is required by the Securities and Exchange Commission.

Protection buyer
Protection seller
Parties in a credit derivatives transaction. See credit derivative, credit swap, credit options and credit linked note.

Prothonotary
The name used in some states, (e.g., Pennsylvania) for the public official responsible for receiving and maintaining public notices of liens such as financing statements. Usually a county official.

Provisional call protection
See soft call protection (for convertible bonds).

Prudential liquidity
Liquidity held for liquidity contingency risk or as a safety cushion. Also called standby liquidity.

PSA
See Bond Market Association and PSA model.

PSA model
One of two standard models for describing the rate at which prepayments have been, are, or are expected to be received for mortgages and mortgage-backed securities. The model assumes that borrowers are far less likely to refinance a new mortgage than they are to refinance an older mortgage. Thus the PSA model builds in an assumption of a 30-month phasein or ramp-up of prepayments. After a mortgage or a pool of mortgages is 30 months old, a speed of 100 percent PSA is equal to 6 percent CPR. Similarly, a speed of 200 percent PSA is equal to 12 percent CPR and 50 percent PSA is equal to 3 percent CPR. During the initial 30-month ramp-up, the PSA model assumes much slower speeds. For the first month, 100 percent PSA equals 0.20 percent CPR. In the second month, 100 percent PSA equals 0.40 percent CPR. This level rate of increase continues throughout the 30-month period. PSA is the standard prepayment model of the Bond Market Association, formerly the Public Securities Association. The letters PSA were once an acronym for the former organization name but now stand for ”prepayment speed assumptions.”

PTD
See payable-through-draft.

Public records
The records maintained by a filing authority that record the ownership and/or security interests held in property. Under Article 9 of the Uniform Commercial Code (UCC), creditors can perfect interests in a debtor's personal property by recording a lien in the public records. Some states require such UCC filings to be made in a central, state-wide location. Other states require UCC filings to be made in public records maintained locally in each county. Both ownership and liens in real property are usually recorded in public records maintained by each county.

Public Securities Association (PSA)
Former name for the Bond Market Association.

Public warehouse
A central warehouse that accepts, stores, and delivers goods for multiple businesses. Often, public warehouses are bonded. Importers often use bonded public warehouses located in or near points of entry to delay payment of duties. Food is often kept in public warehouses, including grain elevators. Public warehouses issue collateral receipts or warehouse receipts and can be used for controlling inventory pledged to secure loans. See warehouse receipt.

Purchase money interest
A security interest in a debtor's property that is created when the creditor's extension of credit to the debtor is used by the debtor to acquire the property that is used to secure the transaction.

Put
A contract that gives its holder the right to sell an underlying security, commodity, or currency on or before a certain date. The sale option is for a predetermined price called the strike price. Options are often used in hedging. See American option and European option.

Puttable advance
A loan granted to a member financial institution by a Federal Home Loan Bank. The put feature in a puttable advance enables the borrower to prepay the advance, in whole or in part, in the event that prevailing rates decline. Borrowers benefit when using this type of borrowing to fund loans or investments that prepay when prevailing interest rates fall.

Putable swap
A pay fixed/receive floating swap that grants the holder the option to cancel the swap before its maturity.

Q

Qualified opinion
Term used to describe the opinion letter accompanying audited financial statements in which the CPA reports the same information as in the unqualified opinion with one or more additions. The additional information describes either (1) one or more material aspects of the scope of the audit that may be deviations from necessary practice or (2) uncertainty about the future that either cannot be resolved or the effect of which cannot be estimated.

Quality spread
The difference in yield between a risk-free obligation, an obligation of the U. S. Treasury, and another obligation of similar maturity that has credit risk. This difference is expressed in basis points. The most common quality spread is the Treasury-Eurodollar spread (TED spread). Quality spreads are expressions of credit risk as yield differentials. See TED spread.

Quick ratio
A commonly used, but not always accurate, proxy for a firm's liquidity. The quick ratio is calculated by subtracting inventory from current assets and then dividing the result by current liabilities. Sometimes called the acid test ratio.

Quit claim deed
A document by which title to real estate is conveyed from one party, the grantor, to another party, the grantee. The distinguishing characteristic of a quit claim deed is that it transfers only such interest, title, or right that the grantor has at the time of conveyance to the grantee. A quit claim deed is common in divorce or other situations such as equitable interests, in which the grantor's interest is not clearly defined.

R

Banker's Glossary

Ramp

(1) A steady, noninstantaneous change in rates. Usually a projected change in rates with small, equal, incremental changes in each time period over a series of time periods until the full amount of the projected change is achieved.

(2) A term used in residential lending and in the analysis of mortgage backed securities to describe projections of monthly prepayment speeds which increase from a low initial rate over a series of time periods until the full amount of the expected, final prepayment speed is reached. See PSA model for an example.

RAN

See revenue anticipation note.

Range bonds

See accrual bond.

RAROC

See risk-adjusted return on capital.

Rate

The cost of debt service paid by a borrower or issuer to a lender or investor. The rate is expressed as an annual percentage of the amount borrowed. For some notes and bonds that pay interest semiannually, the semiannual interest due to the investor used to be evidenced by a coupon that could be detached and sent for collection. Thus the cost to the issuer for notes and bonds paying semiannual interest is often called the coupon rate. Lenders or investors may receive a yield that is higher or lower than the rate.

Rate covenant

A provision in the bond agreement or resolution that addresses the rate or method used to establish the fee(s) charged to users of the facility financed by the securities. Typically, a rate covenant promises that the fees will be adjusted when necessary to support the timely payment of interest and principal on the bonds.

Rate risk
The risk that the entity's earnings and/or its capital may be reduced by an adverse change in prevailing interest rates.

Rate sensitive
The exposure of either the bank's earnings or its market value to fluctuations caused by changes in prevailing interest rates.

Rate-sensitive assets (RSA)
The quantity of assets subject to repricing within a defined time period. Usually related to rate-sensitive liabilities in the ratio: RSA divided by RSL.

Rate-sensitive liabilities (RSL)
The quantity of liabilities subject to repricing within a defined time period. Usually related to rate-sensitive assets in the ratio: RSA divided by RSL.

Rate shock
An arbitrarily selected change in prevailing interest rates used to quantify either a change in profits or a change in capital associated with that size of a rate change.

Real bills doctrine
See commercial loan theory of liquidity.

Real estate
See real property.

Real estate investment trust (REIT)
A trust used to hold ownership of real property for investors. The trust structure is used to benefit from tax code provisions.

Real estate mortgage investment conduit (REMIC)
The name of a type of mortgage-backed pass-through security. REMICs can take many forms. REMICs are typically multiclass securities. Unlike

simple, non-REMIC CMOs, REMICs can separate mortgage pools into different risk classes as well as different maturity classes. Some of the most common forms of REMICs are sequential pay CMOs, planned amortization class (PAC) tranches, targeted amortization class (TAC) tranches, and companion tranches. REMICs may also have interest-only tranches, principal-only tranches, and residual tranches. Today almost all CMOs are issued in REMIC form to take advantage of provisions in the Tax Reform Act of 1986. However, even though REMICs are overwhelmingly dominant in the CMO market, the term "REMIC" is used far less often than the term "CMO." CMO is used to refer to all forms of MBSs other than simple pass-through MBS pools.

Real Estate Settlement Procedures Act (RESPA)
A Federal statute that requires lenders and persons who conduct real estate loan closings (settlements) to make certain disclosures. The law also prohibits certain practices such as kickbacks. The Department of Housing and Urban Development (HUD) has adopted Regulation X to implement this statute.

Real property
Informally used to refer to land or buildings. As defined by Federal banking regulations governing appraisals, real property is: an identified parcel or tract of land including improvements, easements, rights of way, undivided or future interests, and similar rights but excluding mineral rights, timber rights, or growing crops. Note that under state law in many states, growing crops, timber, and minerals that have not been separated from the land are also included in the definition of real property.

Realized volatility
Volatility calculated using the actual movements of prices in financial markets. See volatility and implied volatility.

Receivables
Name used by bankers to describe moneys owed to a business and yet to be received. Usually the amounts due from trade creditors who purchased goods or services on credit. Functionally equivalent to accounts or accounts receivable except that accounts is the only legally acceptable way to describe these assets for purposes of Article 9 of the Uniform Commercial Code.

Re-CMOs or re-REMICs
REMICs are created when tranches of existing CMO REMICs are combined and used to collateralize new securities. When this is done, the new securities are called re-REMICs, re-CMOs, or structured collateral. These may be more or less risky than the underlying tranches. See kitchen sink bonds.

Reconveyance

See discharge.

Record date
The date set to determine the owner entitled to the next dividend, interest, or principal payment. The payment is due to the owner who owned the security on the record date.

Recourse
The right to seek repayment of debt. Usually used to describe the right to seek repayment from an originator or prior endorser who sold or assigned debt to another party.

Red lining
Term used to describe the illegal practice of refusing to lend to borrowers located in a defined geographic area.

Redemption fee
See back-end load.

Reference asset
A term used in credit swap transactions to identify the underlying instrument. In the most simple structure, cash flow from the reference asset is paid by the asset owner called a protection buyer to a counter-party known as a protection seller. The reference asset is often a marketable, corporate bond rather than a corporate loan from the same obligor because the bonds provide price information than loans which are less homogenous and less marketable. See credit derivative and credit swap.

Reference rate
An interest rate used as an index rate. For example, if a loan pays interest at a rate of 50 basis points above the 6-month LIBOR, the reference rate is the 6-month LIBOR.

Refunding
The replacement of existing securities using funds obtained from the issuance of new securities.

Refunding bonds
Bonds issued to replace outstanding bond issues. Usually used to replace callable bonds when interest rates drop.

Refunding escrow deposits (REDs)
Financial instruments similar to pre-refunding bonds. Tax law changes in 1984 restricted tax exempt pre-refundings for certain types of municipal debt including airport and convention center related debt. To circumvent those restrictions, a forward transaction, rather than a second bond issue, is used to lock in a lower cost of funding. Under this arrangement, funds dedicated to repaying higher cost debt at the next call date are held in escrow. See pre-refunding (pre-re).

Register of Deeds
The name used in some states for the public official responsible for receiving and maintaining public notices of liens such as financing statements. Usually a county official.

Registered
A form of ownership of certificated bonds. The name of the owner is listed on the certificate and in the records of the issuer's agent.

Regular way settlement
Buyers and sellers can negotiate settlement periods; however, standard time periods are usually used. For U.S. Treasury and agency debt securities, the customary settlement time, called regular way settlement, is the next business day. For municipal and corporate debt securities, the customary settlement period, often called corporate settlement, is three days. See net settlement and settlement.

Regulation AA
Federal Reserve Regulation titled Unfair or Deceptive Acts or Practices. Provides for consumer complaints against banks and prohibits certain practices. See cascading late charges and late charges.

Regulation B
See Equal Credit Opportunity Act.

Regulation C
See Home Mortgage Disclosure Act.

Regulation CC
A Federal Reserve Board regulation governing the availability of funds and collection of checks. The regulation sets legal limits on the time banks can take before making deposited funds available for withdrawal.

Regulation M
See Consumer Leasing Act.

Regulation P
A Federal Reserve Board regulation covering privacy of consumer financial Information. Regulation P governs the treatment of nonpublic personal information about consumers by financial institutions. The regulation also requires financial institutions to provide notice to customers about privacy policies and practices and the right of a consumer to prevent a financial institution from disclosing nonpublic personal information about him or her to nonaffiliated third parties by "opting out" of that disclosure.

Regulation T
Federal Reserve Regulation entitled Credit by Brokers and Dealers. Provides limits on the amount of credit that can be extended for the purpose of purchasing or carrying certain stocks and a few bonds. See margin stock.

Regulation U
Federal Reserve Regulation entitled Credits by Banks For the Purpose of Purchasing or Carrying Margin Stock. Provides limits on the amount of credit that can be extended for the purpose of purchasing or carrying certain stocks and a few bonds. See margin stock.

Regulation X
See Real Estate Settlement and Procedures Act.

Regulation Z
See annual percentage rate, rescission and Truth-in-Lending Act.

REIT
See real estate investment trust.

Reinvestment risk
The risk of a decline in earnings or capital resulting from the fact the interest and/or principal cash flows received by investors during the time that an investment is held must be reinvested at a lower than expected rate as a result of a decline in prevailing interest rates.

Relative value
A phrase used to refer to whether or not a security's price is relatively cheap, relatively fair, or relatively rich (expensive) compared to prices for other securities.

Release
A document or a process in which a secured party gives up its collateral interest in the property of the debtor. Releases may be for all of the property of the debtor or may be partial. For example, if a real estate developer has pledged 10 lots as collateral for a loan, a partial release may be used for each lot as it is sold. For personal property collateral, a release may be entered into the public record by using a standard form called UCC-3.

Release price
The predetermined amount of loan reduction that will be required by the bank before the developer can obtain a partial release of the bank's lien that covers the portion of the collateral that is being sold.

REMIC
See real estate mortgage investment conduit.

Remittance float
Float due to the time a payment is in transit. This is often called mail float since its major component is the time it takes a remittance to move from the remitter to the recipient through the mail.

Remote disbursement
An arrangement by which an organization's checks are drawn against funds in a bank that is located in a distant area. A cash management practice designed to increase disbursement float.

Replicating portfolio(s)
A portfolio of instruments with known rates and maturities that tends to closely duplicate the changes in a portfolio of instruments with administered rates and/or indeterminate maturities. Sometimes referred to as the "Rod Jacobs" method for the probable developer of this approach.

Repo

An informal name for a repurchase agreement.

Repositioning repurchase agreement
A funding technique often used by dealers who encourage speculation through the use of gains trading, pair-off, when-issued, and extended settlement ploys. When an investor agrees to purchase a security with the intent of quickly selling it for a profit, price movements do not always favor these speculations. The repositioning repurchase agreement is service offered by dealers to enable buyers to hold onto such speculative positions until prices change and the position can be closed out at a profit. In a repositioning repurchase agreement, the buyer pays the dealer a small margin that approximates the actual loss in the security. The dealer then agrees to fund the purchase of the security by entering into a repurchase/reverse repurchase agreement with the buyer. (The transaction is a borrowing called a repurchase agreement for the buyer. It is a loan called a reverse repurchase agreement for the dealer.) These transactions are deemed to be inherently speculative.

Repossession
Taking physical possession of personal property collateral pledged to secure a defaulted loan.

Repricing
(1) A contractual provision applicable to specific loans, investments, or deposits that changes the interest rate paid or received. For example, a loan may have an interest rate tied to the prime rate that changes every time the prime rate changes, or an investment may have a rate tied to the one-month LIBOR. It is immaterial which index, if any, the rate is linked to or when the rate adjusts.

(2) As used in asset liability management (ALM), refers to the timing of cash flow from the principal of an asset that is received by the bank or the timing of payment of the principal of a liability by the bank. For example, in the case of a 5-year, fixed-rate investment, the principal is received at the end of 5 years, therefore, the asset reprices at the end of the fifth year. Note that the end of the fifth year could be tomorrow if the investment was issued 4 years and 364 days ago. In the case of a car loan, an amount equal to the monthly principal payments made to the bank reprices each month. In the case of a certificate of deposit, repricing occurs at maturity.

Repricing risk
See mismatch risk.

Repurchase agreement (RP)
A form of secured, short-term borrowing in which a security is sold with a simultaneous agreement to buy it back from the purchaser at a future date. The purchase and sales agreements are simultaneous but the transactions are not. The sale is a cash transaction while the return purchase is a forward transaction since it occurs at a future date. The seller/borrower pays interest to the buyer at a rate negotiated between the parties. Rates paid on repos are short-term money market interest rates and are completely unrelated to the coupon rate paid on the instrument being

purchased. Informally known as repos. Sometimes called a classic repo to distinguish between these transactions and sell/buybacks. Every transaction where a security is sold under an agreement to be repurchased is a repo from the seller/borrower's point of view and a reverse from the buyer/lender's point of view. Repos and reverses are often used to finance investment purchases, especially by traders.

Reputation risk
One of nine risks defined by the OCC and one of six risks defined by the Federal Reserve. The risk to earnings or capital arising from the possibility that negative publicity regarding the institution's business practices, whether true or not, will cause a decline in its customer base, costly litigation, or revenue reductions. The Federal Reserve and the OCC define reputation risk in almost exactly the same way.

Request for proposal (RFP)
A written notification prepared by an organization requesting offers to provide certain services (e.g., banking service) and to specify prices for these services. RFPs are generally quite detailed as to the types of services needed.

Rescission
Cancellation of a contract without penalty. Regulation Z provides circumstances under which a borrower may cancel loan transactions involving nonpurchase money liens on the borrower's principal place of residence. The regulation permits such rescissions during a three day period after the loan closing. Specific requirements apply to bank disclosures of the borrower's right to rescind.

Reserve account
A type of credit enhancement used in some asset backed securities. The reserve account may be created by an initial deposit from the seller and may be augmented over time by the application of funds from excess servicing income. Credit is enhanced because withdrawals from the reserve account are made to reimburse investors when excess servicing is insufficient to cover charge -offs. Until needed, funds in a reserve account are invested.

Reserve requirements
The percentages of different types of deposits that banks are required to hold on deposit at the Federal Reserve or as cash in their vaults. These requirements are determined by the Federal Reserve Board and function as a tool to control monetary policy.

Reset cap
The maximum amount by which an adjustable-rate security's coupon rate can change in any given period of time. Also called the periodic cap. For most ARMs and floaters, the maximum periodic or reset change is defined as an amount of change in each, consecutive 12-month period over the life of the security. Thus the term "annual" cap is also used to describe most periodic caps.

Reset date
The point in time when the coupon rate for a variable rate or floating rate financial instrument is re-established to reflect changes in a benchmark index. Reset dates are typically monthly, quarterly, semi-annually or annually. See index.

Residual
(1) For sequential-pay CMO structures, a residual tranche is the CMO tranche that receives the excess cash flow that remains after all of the payments due to the holders of other tranches and all of the administrative expenses have been met. When the residual is an accrual bond, it is often called a Z tranche or a Z bond.

(2) In REMIC CMO structures, one class of each issue must be designated as the residual for tax purposes. Some REMIC residuals do not meet the traditional definition of a residual as the last tranche to be retired.

Residual value
Term used to describe the market or sale value of leased equipment (net of removal or disposal costs) at the end of the lease term. In most cases, it is projected or estimated. Sometimes called salvage value. With some exceptions, national bank lessors are subject to a rule that limits the residual value assumption made at the time the lease is created to 25 percent of the equipment's cost. Bank holding company leasing subsidiaries are subject to a 20 percent limit on the residual assumption.

Reshaping duration
See key rate duration.

RESPA
See Real Estate Settlement Procedures Act.

Restricted appraisal reports
One of three types of real estate appraisal reports defined under Uniform Standards of Professional Appraisal Practice (USPAP) rules. A restricted appraisal report is the least detailed of the three report formats. Given a bank's need to meet both regulatory requirements and the needs of prudent loan underwriting, more detailed reports are almost always preferable.

Restricted cash
Cash held subject to limitations on how or when it may be used. For example, refundable customer deposits, cash in escrow accounts, and debt sinking funds.

Restricted stock
Restricted stock is stock purchased from the issuer or from a person in a controlled relationship to the issuer in a nonpublic or private transaction. The right to sell restricted stock is limited by provisions in the Securities and Exchange Act.

Retail deposits
(1) Deposits or deposit account balances in amounts of $100,000 or less.

(2) Deposits obtained from individuals and small businesses in the bank's local trade area(s).

Retainage
The portion of the payment due to a contractor or equipment builder that is withheld until final inspection and acceptance of the work. Also called a holdback.

Retained earnings
Earnings of a corporation from the current as well as prior years that have neither been distributed to the shareholders as dividends nor transferred to the surplus account. Corporate earnings accumulated over time. One of a corporation's equity or capital accounts.

Retentions
Portions of contracts that are not paid until all contract provisions are satisfied. Sometimes called holdbacks.

Return on assets (ROA)
A percentage calculated by dividing net income after tax by total assets. Annual income is usually used in the numerator; however, the annualized income for a month, quarter, or half year can be used. Period-end assets is often used in this calculation; however, average assets for the period is more accurate. This ratio is a measurement of how profitably assets are used in an enterprise. Firms in different industries usually have quite different returns on assets. This ratio is best used to compare firms in the same industry.

Return on capital
The return earned by an investor from a specific investment or group of investments measured in terms of a percentage return on the amount of capital invested. See return on equity.

Return on equity (ROE)

A measure of the return realized by the owners of an enterprise. Calculated by dividing an enterprise's annualized net income by its average capital for the period. Alternatively, it can be calculated by multiplying the enterprise's ROA by its leverage/equity multiplier. ROE indicates how effectively the enterprise is using its capital to produce income.

Returns
Reductions to gross sales that occur when customers are given credit for sold goods that are returned to the firm.

Revenue anticipation note (RAN)
A short-term note sold by a public entity that will be repaid from the proceeds of anticipated nontax income.

Revenue obligation
A bond or note for which the payments of principal and interest made to the investors by the issuer are payable exclusively from the earnings of the underlying project. For example, turnpike bonds repaid from tolls.

Reverse
An informal name for a reverse repurchase agreement.

Reverse repurchase agreement, reverse repo
A form of secured, short-term investment in which a security is purchased with a simultaneous agreement to sell it back to the seller at a future date. The purchase and sales agreements are simultaneous but the transactions are not. The purchase is a cash transaction while the return sale is a forward transaction since it occurs at a future date. Informally known as a reverse. The buyer/investor/lender earns interest paid at rate negotiated between the parties. Rates paid on reverse repos are short-term money market interest rates and are completely unrelated to the coupon rate paid on the instrument being purchased. Every transaction where a security is sold under an agreement to be repurchased is a repo from the seller/borrower's point of view and a reverse from the buyer/lender's point of view. Repos and reverses are often used to finance investment purchases, especially by traders.

Reverse TAC tranche
The opposite of a TAC tranche. Bonds created in scheduled-pay CMO structures. A reverse TAC tranche is structured to avoid prepayment volatility. Each TAC has a designated target speed. When prepayments fall below the targeted speed, excess cash flow is diverted to the reverse TAC tranche. Unlike a PAC, a TAC tranche is not protected from call risk if prepayments are faster than expected. For this reason, TACs can be viewed as half PACs. Reverse TACs offer investors protection (but not immunity) from extension risk but no protection from call risk. Sometimes called contraction bonds because of their call risk.

Review statements
Financial statements prepared by an independent CPA that have been subject to some examination but have not been audited. The CPA is required to consider the reasonableness of the information. If any number appears questionable, the CPA must make inquiries, apply analytical procedures or take other appropriate actions to provide the CPA with a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the statements in order for them to be in conformity with GAAP. Any departure from GAAP in reviewed statements should be noted in the transmittal letter and detailed in a footnote.

Revolving line of credit
A type of credit facility. A term that can be confusing, with different banks using the term to describe different types of credit facilities.

In some banks, "revolving line of credit" refers to a credit facility that permits the borrower to draw down and/or repay amounts up to a specified maximum at any time. Called a line of credit by other banks.

In other banks, the name "revolving line of credit" is used to distinguish between "regular lines of credit," (situations in which the bank is not legally committed to make advances) and "revolving lines," (situations in which the bank is legally committed to make advances.) This usage is outdated, wrong, and might expose the bank to legal liability.

Large banks, primarily, use the term to refer to a combination of a line of credit and a term loan. Typically it starts out as a line for a one-to-three year period, after which, on a previously determined date, the outstanding balance converts to an amortizing term loan.

Revolving period
A term used for asset backed securities to describe a period of time during which principal payments received from the underlying loan collateral are reinvested in new loan receivables thereby enabling the investor/ABS balance to remain constant. A revolving period may be prematurely terminated by an early amortization event.

RFP
See request for proposal.

Rho
A Greek letter used in the financial industry to represent the sensitivity of an option's price to changes in interest rates.

Riparian land
Land that has been created by natural or manmade filling in or by moving of water.

Risk
(1) Noun — The possibility of loss.

(2) Noun — The uncertainty of whether events, expected or otherwise, will have an adverse impact. In this context, the adverse impact is usually a quantity of return (income) or value at risk.

(3) Noun — the compound estimate of the probability of, and the severity of, an adverse event. The amount of risk is the product of the probability of the adverse consequence and the potential severity of that adverse consequence.

(4) Verb — to incur the possibility of loss, to create or accept the possibility of uncertain returns, or to create or accept volatility.

Risk-adjusted return on capital (RAROC)
An economic approach to measure unit and product profitability within a financial institution. Returns, adjusted to reflect normalized or expected losses, are divided by an amount of capital that is carefully quantified to reflect the risk or risks incurred to generate those returns. The total risk-adjusted capital for an entire financial institution reflects its calculated economic capital. Economic capital is the capital required to support the incurred risks. Economic capital will rarely, if ever, equal accounting or book-value capital. The risk-adjusted return on capital is usually compared to a standard or hurdle rate of return. When such comparisons are made, products or units with returns exceeding the hurdle rate are said to add value while products or units with returns below the hurdle rate are said to destroy value. RAROC is not always defined and applied exactly the same way by different financial institutions but must be defined and applied consistently throughout each financial institution that uses it. Often referred to by the acronym RAROC, pronounced "ray-rock."

Risk-adjusted return
Risk-adjusted rate of return
The profit, often but not always expressed as a percentage rate of return on allocated capital, after recognizing applicable costs for credit risk, interest rate risk, liquidity risk and/or other financial risks. In some measures, risk costs are treated as expenses. In other measures, they are reflected in the amount of capital allocated in the denominator of the return on capital ratio.

Risk-based capital
Rules for establishing minimum required levels of book capital for financial institutions. Capital is allocated to types of bank assets based upon weightings assigned to those assets. For example, U.S. Treasury obligations and some U.S. Agency obligations require no capital. Most other U.S. Agency obligations are given a 20 percent weighting for the purpose of calculating risk-based capital. Corporate obligations have a 100 percent weighting.

Risk-based pricing

The practice of charging different rates to different borrowers based on differences in their credit worthiness. Typically, all other loan terms remain the same. See Fair and Accurate Transactions Act (FACT Act) for limitations on the application of risk-based pricing to consumer loans.

Risk management
Controlling the probability, and/or the severity, of a potential adverse event so that the consequences of that event are within acceptable limits. Since all risks have, by definition, the potential to generate losses, and since capital is the ultimate protection against failure resulting from losses, the underlying basis of risk management is equivalent to managing solvency risk.

Risk measurement unit (RMU)
A defined quantity or unit of risk. Quantities of risk may be defined for the purposes of setting risk exposure limits or for the purposes of allocating capital to measure risk-adjusted returns on capital. RMUs are often defined in terms of the amount of change or volatility that is equal to one standard deviation of the volatility.

RMA
See Robert Morris Associates.

RMU
See risk measurement unit.

ROA
See return on assets.

Risk-adjusted rate of return
A national organization of bank commercial loan and credit officers.

Rod Jacobs method
A methodology for evaluating the rate sensitivity of indeterminate deposits. See replicating portfolio(s).

ROE
See return on equity.

Roll over
The paying off of existing debt, usually debt about to mature, through the issuance of new debt. Can also refer to the rolling over of an investment, such as a certificate of deposit at maturity, to another investment.

Rotation risk
See yield curve risk.

RP
See repurchase agreement.

RSA
See rate-sensitive assets.

RSL
See rate-sensitive liabilities.

Rule 144
See SEC Rule 144.

S

S corporation
Legal entity that is a special kind of Corporation. An S corporation offers shareholders the same limitations on personal liability that are available to corporate stockholders. At the same time, S corporations are taxed similarly to partnerships, that is, the income or loss incurred by the S corporation is allocated to the stockholders for tax purposes. S corporations are subject to limits on stockholders and may not be part of affiliated corporate groups.

Safekeeping
An arrangement under which a third party holds securities or other valuables under safe, controlled conditions. A safekeeping arrangement is evidenced by a safekeeping receipt.

Sallie Mae
See Student Loan Marketing Association.

SAR
See Suspicious Activity Report.

Satisfaction
See discharge.

Scenario
An outline of a hypothetical situation or chain of events. For example, a future recession.

Scenario analysis
(1) In investment analysis, the process of examining the anticipated performance of an investment under a variety of alternative potential interest rate environments.

(2) In bank asset/liability management, the process of modeling the anticipated effects of interest rate changes on the net income or capital of a financial institution. Scenario analysis incorporates assumptions for changes in the behavior of the institution's managers and its customers that are anticipated to be associated with the modeled changes in interest rates.

Screw clause (for convertible bonds)
An informal market term for a contractual clause or provision in the indenture agreement for a convertible bond. A screw clause provides that, upon conversion, the convertible bondholder may not receive accrued interest on the bond. Screw clauses may work in different ways. For example, the first call date may coincide with an interest payment date and the conversion rights may expire just before the interest payment date. In that example, an investor cannot take advantage of the bond's conversion feature without failing to hold the bond long enough to receive the semiannual interest payment. Another example is a mandatory convertible bond that requires conversion before the interest pay date.

Seasoned issue or seasoned security
A mortgage-backed security with underlying mortgages that are seasoned loans. Sometimes described as vintage securities especially in the case of CMOs.

Seasoned loans
Loans for which a year or more has passed since periodic payments began. GNMA requires that mortgages within a given pool be originated within two years of the issue date. FNMA and FHLMC pools may contain older mortgages called seasoned loans.

SEC
See Securities and Exchange Commission.

SEC Rule 144
A rule issued by the SEC that governs stock issued under special circumstances. See control stock, dribble rule and restricted stock.

SEC yield
A measure of return for investments in mutual bond funds. The SEC yield is calculated by dividing the net investment income per share for the 30 days ended on the date of the calculation by the net asset value per share on that date. The SEC has required fund managers to report uniform, annualized 30-day yields since 1988.

Secondary market

Markets for the purchase and sale of any previously issued financial instrument. The first sale of a financial instrument by the original issuer is said to be made on a primary market. All subsequent trades are said to be secondary market.

Secondary sources
Less reliable, slower to achieve cash sources. Part of the counter balancing capacity. Actions that reduce or delay outflows and actions that increase or hasten inflows. For example, a sales incentive program for one-year CDs can be thought of as a secondary source to increase expected future cash inflows.

Section 17(f)
See Securities and Exchange Act Section 17(f).

Secured party
A creditor that has been granted a collateral interest in property. The collateral interest is usually given to the creditor by the debtor but may be given by a guarantor or another third party.

Securities and Exchange Act Section 17(f)
A legal provision that requires investigations for possible lost or stolen securities. See Securities Information Center.

Securities and Exchange Commission (SEC)
The Federal agency with responsibility for regulating financial exchanges for cash instruments.

Securities Information Center (SIC)
A corporation that has been designated by the SEC to maintain and operate a national database of lost and stolen securities. Under Section 17(f) of the Securities and Exchange Act, banks, brokers, and dealers are required to use this database.

Securities Investors Protection Corporation (SIPC)
A private corporation providing insurance to brokerage firms to cover customer accounts up to $500,000 in securities (including $100,000 in cash).

Securities lending
The temporary transfer of securities from an investor's portfolio to a counterparty borrower. The counterparty may borrow to cover securities

transaction fails (securities sold but for some reason unavailable for delivery to the buyers), short sales, or other trading activities such as arbitrage. While corporate stocks used to be the most common securities lent, U.S. government and agency securities now comprise a major portion of this activity. Securities loans are usually secured by the pledge of U.S. government or agency bonds. Alternatively, cash or letters of credit may back some securities loans. The value of the collateral pledged exceeds the value of the securities lent by an agreed-upon collateral margin. When a securities loan is terminated, the securities are returned to the lender and the collateral is returned to the borrower. The two main risks in securities lending are counterparty risk (a form of credit risk) and reinvestment risk (a form of interest rate or market risk).

Securitization
The process and the result of pooling financial assets together and issuing liability and equity obligations backed by the resulting pool of assets to convert those assets into marketable securities. The underlying assets are usually, but always, non-marketable by themselves. Any type of financial asset can be securitized. Securitized mortgage obligations may be called mortgage backed securities or collateralized mortgage obligations. Securitized non-mortgage assets are typically called asset backed securities however the term collateralized debt obligation is increasingly used to refer to securitized corporate debts. A single loan or groups of similar loans may be securitized. Loans to be securitized must usually be underwritten with terms and documents that conform to wholesale market standards. For some securitizations, additional credit support, called credit enhancement, may be obtained through insurance, a letter of credit, over collateralization or other means. Many securitizations use multi-tranche structures that allocate the principal and interest cash flows from the underlying assets in patterns that create higher and lower risk securities. See collateralized debt obligation, collateralized mortgage obligation, mortgage-backed security, special purpose vehicle and waterfall.

Security agreement
An agreement between one or more debtors and one or more creditors in which the debtor grants the creditor an interest in the debtor’s personal property as collateral for the debt. (Alternatively or in addition, the collateral may be property owned by a guarantor or by another third party.) As used in Article 9 of the Uniform Commercial Code, it is an agreement that: is in writing; gives the names of the parties; is signed or authenticated by the debtor; describes the collateral; and includes language stating that the debtor is granting or giving the security interest in the collateral to the creditor. While the security agreement establishes the creditor’s interest in the collateral, it does not establish the priority of the creditor’s interest relative to the interests of other creditors. See financing statements and perfection.

Security interest
Term used to describe an interest in personal property (collateral) owned by a debtor.

Security margin
See margin.

Self-assessment
A risk evaluation approach. A subjective process of identifying risks, assessing the likelihood that they will occur and estimating the impact if they do occur. Although self assessment can be applied to any risk, it is primarily applied to operations risk - especially for the quantification of operations risk under Basel II guidelines. Self assessment is a major element in COSO.

See Basel II, COSO and operations risk.

Self-contained appraisal report
One of three types of real estate appraisal reports defined under Uniform Standards of Professional Appraisal Practice rules. A self-contained appraisal report is the most detailed of the three report formats.

Sell/buyback
See buy/sellback.

Senior creditor
A creditor holding senior debt.

Senior debt
Obligations of an issuer for which repayment has contractually been given a priority that is higher than the repayment priority of other debts of the same obligor. This arrangement may arise from either a specific subordination agreement or a public issuance of subordinated debt instruments.

Senior Residential Appraiser (SRA)
A designation earned by qualifying residential real estate appraisers. It is awarded by the Appraisal Institute.

Sensitivity test
Sensitivity analysis
A single variant test to see how dependent a forecast, projection or stress test outcome is upon a single, selected variable or assumption. For example, a bank AL manager might perform a sensitivity analysis by examining a range of rate risk forecasts where the only difference in the forecast generation is a range of possible values for savings account maturities. In that example, the AL manager would be able to see how sensitive the projected rate risk exposure is to changes in the savings maturity assumption.

Sequential-pay REMIC
The most basic, simplest REMIC structure. All investors owning a sequential-pay REMIC receive interest payments; however, the principal received from the underlying mortgages is directed to repay each tranche, one at a time, in a predetermined order.

Serial bond
A bond that provides for the amount of debt to be divided into a series of different staggered maturities. For example, instead of issuing$10 million of 15-year bonds, a municipality may issue $10 million with $1 million maturing each year from the year 6 to the year 15. By issuing debt in serial form, the municipal issuer can match its need to redeem maturing debts to its cash flow. This form also enables the issuer to save money since the shorter-term bonds carry a lower interest cost than longer-term debt.

Servicing
The collection of principal, interest, and sometimes property taxes from borrowers; accounting for the cash flows due and the cash flows received; and remitting the cash flows to the entitled recipients.

Servicing spread
A percentage of a loan's or security's principal amount that is paid to a third party as compensation for servicing. For example, in a mortgage pass-through security, the interest paid to the investors is typically one-half
percent less than the weighted average coupon rate paid by the underlying borrowers. In that example, the one-half percent difference is the servicing spread.

Set off
(1) In general, the legal right to reduce the amount owed by one party to another party by the sum that the second party also owes to the first party.

(2) The confiscation of a deposits held by a borrower to offset some or all of the amounts owed by the depositor the depository institution for defaulted loans. A common law right that is usually blocked or reversed by a bankruptcy court.

Settlement
(1) Noun — The standard number of days between the date that a purchase or sale is agreed upon (the trade date) and the date that the security and the payment actually change hands (the settlement date). See net settlement and regular way settlement.

(2) Verb — The process of exchanging a security delivered by a seller for the payment delivered by a buyer.

Settlement date
The agreed-upon date for transferring funds to complete a transaction. For example, the date of both the delivery of and the payment for a security.

Settlement risk
The possibility that operational problems might interrupt or delay the settlement of a purchase or sale of a financial instrument.

SFAS
See statement of financial accounting standards.

Shiftability theory of liquidity
An explanation of bank liquidity that holds that a bank's capacity to meet liquidity demands is related to the volume of its assets that can be readily shifted to another bank.

Shareholder value added (SVA)
A financial performance metric that attempts to measure the benefit created for a firm's capital holders. It is expressed in dollar terms for a period - not as a percentage return ratio. SVA is an adjusted value for after-tax earnings, for a period of time, minus the opportunity cost associated with the firm's capital. The net of those quantities is a measure of the surplus or additional value provided to the shareholders as a result of the firm's activities. The adjustments made to the reported amount of after-tax earnings are intended to remove distortions resulting from accrual accounting. For example, provisions for bad debts are usually added back to income and actual losses from bad debts are subtracted instead. Cash taxes are used instead of book taxes. One of the main attractions of this performance metric is that fact that, unlike measure of return on market value, it can be applied to segments within a firm. Accordingly, it is primarily used by managers to evaluate the performance of divisions or branches. Some users apply SVA down to the account manager or customer level.

The phrase "shareholder value added" is favored because the phrase "economic value added" is marked. See value based management.

Short
(1) noun — The position of an investor who sells, or commits to sell, a security in either the cash or futures markets. For example, the sale of an interest rate future is a commitment to deliver securities at some future date in exchange for an agreed-upon amount. This is called a short futures position.

(2) verb — The act of selling or committing to sell in the future.

Short sale
The sale of security that is not owned by the seller. The seller borrows the security, sells it, and then buys it at a later date to return it to the lender. The purpose of a short sale is to attempt to profit from the fall in the price of a security. Short sales are considered trading activities. For banks, when the security that is sold is "borrowed" from the seller's investment portfolio, the transaction is not considered a short sale; it must be treated as an outright sale of the underlying security.

SIC
See Securities Information Center.

Sight draft
A draft that is payable upon presentation to the drawee.

Simulation VAR
See empirical VAR.

Single-family loans
Loans secured by properties occupied by one to four families.

Single monthly mortality rate (SMM)
A measure of the amount of monthly principal reduction in excess of the scheduled monthly principal payment. The SMM is simply the amount of prepaid principal in a given month expressed as a percentage of the principal balance at the beginning of the month. It is not commonly quoted; however, an annualized SMM, called the constant prepayment rate or CPR, is commonly quoted.

Single-payment loan
Another name for a time or balloon loan. A closed-end loan that does not require periodic principal payments. Instead, the full amount is due at maturity.

Sinking fund
Cash set aside under restricted conditions as required by the terms of certain types of debt. See sinking fund bonds (sinkers).

Sinking fund bonds (sinkers)
Revenue bond issues that require the issuer to accumulate or set aside part of the annual revenue which is then used to redeem bonds before maturity, often well before regular call dates. The set-aside funds are called the sinking fund. The quantity of bonds subject to a sinking fund call is established in a sinking fund schedule. The specific bonds that are called each year are normally chosen for redemption by the drawing of random lots. Sinking fund calls are usually at or near par.

SIPC
See Securities Investors Protection Corporation.

Skew, skewness
Term used to describe an asymmetrical probability distribution.

Skip day settlement
A phrase used to describe the agreement of a buyer and seller to exchange the security and the payment two business days after the trade date. See settlement.

SLMA
See Student Loan Marketing Association.

Slow pools or slow-pay
An informal name for mortgage-backed security pools that repay slowly.

Small business-related security
A type of security defined in Section 3(a)(53) of the Securities Exchange Act of 1934. A security that represents ownership of one or more promissory notes or leases that are evidence of the obligation of a small business concern. It does not mean a security issued or guaranteed by the Small Business Administration.

Smoothing
Also called yield curve smoothing. The name for a set of alternative techniques for creating continuous yield curves by connecting the dots between observed. If, for example, we have observed rates for 1, 2, 3, 5 and 10 year maturities, smoothing is the technique used to infer rates for all

maturities between those known points. The known points are called "knot points". The simplest smoothing technique is "linear smoothing". The most commonly used technique is "cubic splines". For forward rates, the most accurate method is called "maximum forward rate smoothing".

SMBS
See stripped mortgage-backed securities.

SMM
See single monthly mortality rate.

Society for Worldwide Interbank Financial Telecommunication (SWIFT)
A privately owned electronic payments system used for funds transfers between member banks. See Clearing House Interbank Payment System (CHIPS) and Fed wire.

Soft call protection (for convertible bonds)
One of two types of call protection. Soft or provisional call protection prohibits an issuer from calling a bond issue until a certain threshold price level for the underlying stock has been reached. For example, the bond structure might specify that the bonds may be called when the closing price of the underlying stock is at least 120-150 percent of the conversion price for any 20 out of 30 consecutive trading days. Soft call provisions will be in effect for two to three years after hard call protection has expired. Soft call protection is a compromise between issuers and investors. It guarantees that the issuing company will not be able to call the bonds until the investors have achieved a certain level of profitability, but it also provides issuers with more flexibility than that available from hard call protection and allows the company to call the bonds once the bondholders have achieved a certain threshold level of returns.

Soft costs
Soft costs are legitimate expenses incurred by a borrower or developer for things not directly reflected in the construction value of the property.

Software
(1) A computer program, any informational content included in the program, and any supporting information provided in connection with a transaction relating to the computer program or informational content.

(2) A category of personal property collateral defined by the 2001 revisions to Article 9 of the Uniform Commercial Code.

Solvency

The condition of having sufficient funds to cover losses. In the short term, solvency is a manifestation of liquidity. Fundamentally, however, solvency is a function of capital adequacy. See insolvency.

Solvency risk
The risk of not being able to cover losses regardless of the source, type, or size of the losses. In a broad sense, solvency is often equated with liquidity risk since ready money is needed to cover losses. However, it is more accurate to say that the ultimate source of funds available to cover losses is capital. Therefore, solvency risk is the risk that the bank will default. Ultimately, it is the risk of bank failure.

Spec
An informal lender's term for real estate projects that are built in anticipation of finding tenants; the term "spec" is lender slang for speculative.

Special assessment bonds or notes
Municipal securities repaid from taxes that are imposed only on the individuals who are considered to directly benefit from public improvements made to a neighborhood or community within the municipality. The most common examples are school district bonds. These bonds are repaid from taxes, most often property taxes, imposed on residents served by the school district. Another example is securities issued to finance installation of a sewer system extended to a neighborhood.

special purpose entity (SPE)
special purpose vehicle (SPV)
A legal entity, sometimes a trust or a limited partnership, that is created solely for the purpose of holding assets.

(1) The SPV may be used to obtain "off balance sheet funding" by obtaining secured loans backed by its assets. GAAP accounting rules may permit the assets and liabilities of the SPV to be unconsolidated and therefore off the balance sheet of the entity that generated the assets.

(2) The SPV may issue securities backed by its assets. In a typical collateralized debt obligation, the underlying assets are owned by a special purpose vehicle. The SPV then issues different classes of securities with different risk characteristics. Note that the term "CDO" may be used to refer to the SPV or to the securities that are issued by the SPV.

Special tax bonds or notes
Municipal securities that are repaid solely from specific taxes. These taxes are typically excise taxes imposed upon purchases of items such as gasoline, tobacco products, or liquor. Only the revenue collected from that specific tax is available to pay interest and principal due for the securities.

Speed
The rate at which an MBS prepays. An MBS with little or no prepayments is said to have a slow speed. An MBS with significant prepayments is said to have a high speed or to be speeding. Since pools that prepay faster than anticipated can perform much worse than investors hoped, investors only half jokingly say that speed kills. See CPR, prepayment estimate and PSA for information about measures of speed.

Split-term amortization
An amortization schedule that has periodic payments inconsistent with the maturity date of the debt. For example, a 5/10 amortization schedule requires payments just large enough to fully amortize the debt in 10 years together with a final maturity date only 5 years in the future. Split-term amortization schedules result in balloon payments at maturity.

Spot delivery
The transfer of financial instruments or commodities upon purchase.

Spot market
Market for the purchase or sale of financial instruments, commodities, or other assets for cash settlement and immediate, as opposed to future, delivery. Also called the cash market.

Spot price
The price available in the spot market.

Spot rate
The rate available in the spot market as opposed to forward rates.

Spot yield curve
See yield curve.

Spread
(1) noun — The difference between two prices or two rates. Different users have many different and highly specific usages of this term. For example, traders use spread to mean the difference between bid and asked prices for a security. Underwriters use spread to mean the difference between the price realized by the issuer and the price paid by the investor. Bank analysts use spread to mean the difference between the average

rate paid on a bank's assets and the average rate paid on the bank's liabilities. (In connection with the use of the term spread by bank analysts, see net interest margin. In ALM, when spread is used as a noun it most often refers to the difference between two rates or yields.

(2) noun — Financial analysts, credit analysts, and lenders use the term spread to refer to a financial statement that has been converted to a standard format for purposes of analysis or comparison.

(3) verb — In ALM, most often means the disaggregation of a quantity. For example, the total amount of certificates of deposit on a bank's balance sheet may be spread into different time interval buckets on a gap report.

(4) verb — The process of reformatting financial statements for the purposes of analysis or comparison.

Spread lock
A contract that guarantees the ability to enter into an interest rate swap at a predetermined rate above some benchmark rate.

Spread-over Treasuries
The difference between the bond equivalent yield for any investment and the bond equivalent yield for a Treasury investment with the same maturity. Comparisons of the returns for most fixed-income investments are typically made using spread over Treasury values. Investments of the same type but different maturities as well as different types of investments can be readily compared in this manner. For example, one MBS may offer a bond equivalent yield that is 20 basis points above Treasury yields while another may offer a 40 basis point spread.

Spread risk
See basis risk.

Spreader clause
A provision in a mortgage or security agreement that attempts to extend the security interest granted to the creditor to cover not only the described debt but also all other present and future indebtedness of the debtor.

Spreads and spreading
Bankers almost always change the format of the borrower's financial statements to a standard format used by the bank in order to facilitate both analysis and comparisons. The process of restating the format is usually called spreading and the reformatted reports are often called spreads.

SRA
See Senior Residential Appraiser.

Staff appraiser
An individual qualified under Federal rules to perform real estate appraisals who is employed by and performs appraisals for the financial institution contemplating the extension of credit to be secured by the property to be appraised. The opposite of a fee appraiser.

Stage payments
Advances made under construction loans when the loan proceeds are disbursed only as specific construction tasks are completed. For example, a portion of the loan proceeds may be disbursed after the foundation is poured. Construction lenders often disperse funds in 4 or 5 stages; however, as many as 10 stages are common.

Standard deviation
A statistical measure of the extent to which measurements vary from their mean. A quantification of the dispersion for a set of data. For example, if the high temperature each day in one four-day period was 70 degrees, 71 degrees, 69 degrees, and 70 degrees, that four-day period has a mean (average) high temperature of 70 degrees. A second four-day period might have high temperatures of 70 degrees, 60 degrees, 80 degrees, and 70 degrees. That second period also has an average high temperature of 70 degrees. Even though both four-day periods had the same average high temperature, they were quite different. In the first period, the standard deviation is quite small. There is little dispersion. In the second period, the standard deviation is much larger.

Standard mortgagee clause
A provision in a hazard insurance contract stipulating that in the event of a loss, proceeds will be paid to a secured party. Usually used when the insured property is real property. Includes personal property that is insured as contents of the insured real property. Sometimes referred to as simply a mortgagee clause, the standard mortgagee clause is actually a much broader, stronger type of insurance policy stipulation. Under the standard mortgagee clause, the secured party is protected against any act or neglect of the insured that may otherwise invalidate the policy for the owner. For example, if an insured burns down his insured property, his arson may void his insurance coverage, but it does not invalidate the insurance protection provided to his secured lender. Sometimes called a New York mortgagee clause. See mortgagee clause.

Standardized Approach
One of three methods for quantifying capital required for operational risk under proposed Basel II capital rules. Banks using the Standardized Approach must hold capital for operational risk based the gross income for each of eight separate, defined lines of business. See also Advanced Measurement Approaches, basic indicator approach and operations risk.

Standby letter of credit
An obligation issued by a bank on behalf of a bank customer to a third party. A standby letter of credit is a bank promise to pay the third party in

the event of some defined failure by the bank's customer, usually, but not always, a failure to pay. Standby letters of credit are often used as credit enhancements for securities issued by bank customers.

Standby liquidity
Liquidity held for liquidity contingency risk. Also called prudential liquidity.

Stated delay
See delay days.

Statement of financial accounting standards (SFAS or FAS)
A ruling issued by the Financial Standards Accounting Board (FASB) covering a particular topic. Usually, these statements are referenced with the acronym FAS followed by the numeral for a specific statement. For example, FAS 119 covers disclosures required for holdings of derivatives. See FAS [numeral] for more information on specific accounting rulings.

Statement savings account
A savings account which does not provide the depositor with a passbook. Instead, the depositor receives a monthly or quarterly statement from the bank.

Static gap analysis
Gap analysis method that measures exposure to interest rate risk based solely upon the assets and liabilities held by the bank at the time that the analysis is performed. The opposite of dynamic gap analysis.

Static spread
(1) The difference between two values at a single point in time. For example, the difference between two yields.

(2) The calculated spread over the Treasury yield that the investor would realize from all of the cash flows produced by his investment if it is held to maturity. Those cash flows are each compared to the Treasury spot rate curve. Because the cash flows from a security are each compared to the Treasury yield curve, the static spread is a spread over the entire curve. Each of the cash flows from a bond is discounted to a present value using the spot Treasury rate with the same maturity as the cash flow. Those present values are then totaled. The static spread amount must be added to the discount rates obtained from the Treasury spot curve so that the sum of the discounted cash flows equals the bond's price.

Statutory lien

A lien created by either federal or state legislatures or through court rulings. For example, a lien that banks are given against a borrower's deposits. See consensual lien and judicial lien.

Steep yield curve
See yield curve slope.

Step-ups
A form of callable security for which the coupon rate increases if the security is not called.

Sticky
(1) A term used by economists to describe changes in dependent variables that tend to lag behind changes in the independent variables with which they are associated. For example, time lags are known to exist between changes in prevailing interest rates and changes in the rates offered on bank core deposit products. But they are sticky. Almost all banks are able to change the rates paid on their administered-rate deposit products after rates for money market instruments have already changed.

(2) An informal term used to describe the propensity of a deposit of indeterminate maturity to remain a stable source of funding.

Stochastic
A term used to describe outcomes based on uncertain relationships. The process of change in a variable resulting from change in a parameter. For example, option adjusted spread measures of yield and Monte Carlo models of interest rate risk are stochastic measures. A method of modeling changes that allows for a range of possible outcomes. Sometimes called probabilistic. The opposite of deterministic.

Stock power
A document assigning ownership of stock.

Straddle
An options trading strategy involving the purchase of an equal number of put and call options for the same underlying at the same strike price and with the same maturity. An options trade designed to profit from an increase in the volatility of the price for the underlying.

Straight-line depreciation
A method for achieving periodic reductions in the book value of fixed assets in which each periodic reduction is the same amount as every other reduction for the same asset.

Strangle
A trading strategy using options that is designed to profit from material increases in the volatility of the underlying. Similar to a straddle but using only put and call options with strike prices that are out of the money.

Strategic risk
One of nine risks defined by the Office of the Comptroller of the Currency. The risk to earnings or capital arising from a bank's adverse business decisions or improper implementation of those decisions.

Strategic trading
See proprietary trading.

Street
A colloquial expression used to describe Wall Street investors or the community of dealers. For example, the street consensus of prepayment speeds is the average forecast of prepayment speeds from major mortgage-backed securities dealers.

Street name
A name used by a broker or bank as the legal owner of a security actually owned by a client or customer. The true owner is called the beneficial owner. Street names are often assumed names or partnership names used by banks and brokers.

Stress test
A multivariate test of a specific scenario at a specific stress level. Not to be confused with single variant testing of variables in a projection or forecasted scenario. See sensitivity test.

Stress testing
Stress analysis
Stress scenario
Usually called stress testing but also known as stress analysis or stress scenario analysis. Modeling a series of unusual, hypothetical events or scenarios. Stress tests may model the impact of extreme market conditions, or they may model the change in the measured amount of value at risk (VAR) that occurs when simulation assumptions are pushed to extremes. For example, stress tests for correlation measures of VAR include simulations in which the correlations are assumed to change dramatically. See value at risk (VAR).

Stressed PAC
A planned amortization class (PAC) CMO tranche in a CMO experiencing rapid prepayments of underlying collateral. The PAC tranche is still performing within expected ranges, (i.e., it is not a busted PAC); however, the support tranches are under strain. A stressed PAC will become a busted PAC if the prepayments continue at or near their current speed. See busted PAC.

Strike price
See exercise price.

Stripped mortgage-backed securities (SMBSs)
Mortgage securities that separate principal and interest payments from the underlying mortgage-backed securities. SMBSs can take four forms: interest-only strips, called I/O strips; principal-only strips, called P/O strips; discount strips; and premium strips. I/O and P/O strips are the more common of the four. Today, REMIC CMOs are used far more frequently than SMBSs to create securities with the same cash flow characteristics.

Strips
Principal and interest cash flows due from any interest-bearing securities can be separated into different financial instruments. This is done by stripping each coupon payment from the underlying investment to create a separate security. For example, a 5-year note can be separated into 11 pieces: 10 semiannual coupon payments and the final principal payment. Each of these 11 pieces is a separate cash flow that can be purchased or sold just like a Treasury bill. The cash flows are sold at a discount. The amount of the discount and the time until the cash flow is paid determine the investor's return.

Structural liquidity
A term used to refer to the liquidity available to a financial institution from its current positions - principally its unpledged marketable assets and its holdings of term liabilities with long remaining lives.

Structured finance
A general term used to describe either the practice or the result of creating securities by repackaging cash flows from financial contracts. Examples include MBSs, CMOs, ABSs, and CDOs.

Structured notes
The broad, regulatory definition of this term is debt securities whose cash flow characteristics (coupon, redemption amount, or stated maturity) depend upon one or more indices and/or that have embedded forwards or options. For example, since the early 1990s, U.S. government agencies

have been issuing unsecured bonds and notes with coupons that are fixed for a predetermined time and then increase or step up to a higher amount if the securities are not called. Embedded forwards and options in the structure of notes allow underwriters to create an unlimited number of risk/reward profiles and to customize risk characteristics to fit an investor's desired risk exposure. By this broad definition, structured notes include all CMOs. However, the term also includes a variety of other securities that are not necessarily mortgage related. In fact, many structured notes are not mortgage backed and some definitions of this term explicitly exclude mortgage-backed securities. Sometimes called hybrid securities.

Student Loan Marketing Association (SLMA)
A U.S. government sponsored, privately owned corporation that provides liquidity for student loans and for the credit needs of students. Informally but widely known as Sallie Mae.

Subordinate debentures
A type of corporate bond for which the indenture covenants provide that some of the company's debt has a lower priority than other debts in the event of a liquidation. For example, some bonds may be subordinate to others. Subordinate bonds are usually unsecured. Unsecured subordinate bonds may be referred to as subordinate debentures.

Subordinate, subordinated, subordination
Debts or claims that have a lower status or priority than other debts or claims are subordinate. For example, creditor A may agree in a subordination agreement to have its claims on the cash flow or on the assets of a borrower lower in priority than (i.e., subordinate to) the claims to that cash flow or collateral by creditor B. In finance and accounting, the term also refers to debts that include provisions making them subordinate to other liabilities. For example, a bond issue may, by contractual agreement, be subordinate to all other bonds issued by a company.

Subordination and attornment agreements
Documents used in commercial mortgage transactions in which the mortgaged property is leased by the borrower to tenants. The agreement is executed by the tenants in favor of the lender. By executing the agreement, the tenant/lessee agrees to subordinate its lease to the mortgage that the borrower/lessor is granting to the lender. These agreements give the lender more rights and more flexibility for disposing of the property in the event that the borrower defaults.

Subsidiary
A separate corporation that is owned by another corporation.

Subsistence certificate

A written form prepared by a state office or officer attesting to the fact that a named corporation is in good standing in that state.

Suitability
A term used in the securities industry to describe the match between the risk characteristics of any investment and the investment needs, risks awareness and risk appetite of any buyer. Brokers and dealers have substantial legal and ethical responsibility to make sure that what they sell is suitable for each buyer.

Summary appraisal report
One of three types of real estate appraisal reports defined under Uniform Standards of Professional Appraisal Practice rules. A summary appraisal report provides the middle level of detail of the three report formats.

Super floater
Floating rate CMO tranches that have coupon rates that are determined by formulas such that the interest rate paid is a multiple of an underlying rate minus a stated spread. For example, a superfloater may pay interest at the rate of 3 times 1-month LIBOR minus 16 percent. In this example, if 1-month LIBOR is 5 percent, then the coupon rate for this super floater might be a negative 1 percent. However, to prevent the possibility of negative interest rates, super floaters often have floors. Super floaters are more desirable in high or rising rate environments.

Super PO
A principal-only security structured as a companion bond.

Superfund Act
See Comprehensive Environmental Response, Compensation, and Liability Act of 1980.

Super-generic description
A collateral description in a security agreement, financing statement, or other loan document that is very broad and does not specifically list individual items of collateral, for example, "All of the Borrower's Assets."

Support tranche
See companion tranche.

Supporting obligation

A letter of credit right or secondary obligation that supports the payment or performance of an account, chattel paper, document, general intangible, instrument, or investment property. A category of personal property collateral defined by the 2001 revisions to Article 9 of the Uniform Commercial Code.

Surety
Generally the same as guarantor; however, in some states there are important distinctions.

Survey
A precise physical determination of the location and boundaries of real property. Surveys are performed by qualified experts called surveyors. Survey findings are reflected in documents called surveys, survey reports, or certificates of survey. For unplatted land, the survey determines the location of the property with reference to known points. For all land, the survey shows the dimensions of the property, the location of improvements (such as buildings), and the dimensions of the improvements. Lenders use surveys to verify the legal description of property, to verify that the property discussed in appraisal reports is identical to the property owned by the borrower, and to verify that driveways, terraces, garden walls, and other structures do not cross property lines.

Survival horizon
(1) The forecasted time period, as revealed by a liquidity stress test, that the institution can continue to cover its liquidity needs (forward cash exposure) from sales of assets in its liquidity buffer.

(2) The forecasted time period, as revealed by a liquidity stress test, that the institution can continue to cover its liquidity needs (forward cash exposure) from its counter balancing capacity.

Suspicious Activity Report (SAR)
All financial institutions operating in the United States, including insured banks, savings associations, savings association service corporations, credit unions, bank holding companies, non-bank subsidiaries of bank holding companies, Edge and Agreement corporations, and U.S. branches and agencies of foreign banks are required to make this report following the discovery of: insider abuse involving any amount, violations aggregating $5,000 or more where a suspect can be identified, violations aggregating $25,000 or more regardless of a potential suspect, or transactions aggregating $5,000 or more that involve potential money laundering or violations of the Bank Secrecy Act. Casinos must file an SARC Form and Securities Brokers and Dealers are required to file an SAR-S Suspicious Activity Report. See also Bank Secrecy Act.

Sustainable growth rate
One term used to describe the maximum rate at which a firm’s sales can grow without straining the capacity of the firm’s financial condition. This term is closely associated with a formula of the same name.

SVA
See shareholder value added.

Swap
(1) The sale of one or more securities in order to purchase one or more different securities with the proceeds from the sale. Bond swaps are usually done to take advantage of changes in market conditions or more favorable investment characteristics. For example, swaps are often done to lengthen or shorten maturities when investors change their outlook for future rates.

(2) A financial instrument representing a transaction in which two parties agree to swap or exchange some obligation. Swaps began with currency swaps, but the idea quickly spread to interest rate exchanges. In an interest rate swap, one party agrees to swap fixed-rate loan payments with the floating-rate payments of the other party. Interest rate swaps are often used in hedging. See interest rate swap.

Swap curve
The yield curve of interest rate swap rates from 1 week to 30 years. See yield curve.

Swaption
An option to enter into a swap. A payer or put swaption is the option to enter into a pay fixed/receive floating swap. A receiver or call swaption is the option to enter into receive fixed/pay floating swap.

Sweep account
A deposit account, usually at a bank, that periodically removes a portion of the customer's funds into a higher yielding instrument. Bank sweep accounts are often sold as cash management tools. With a bank sweep account, idle funds are swept each night from a transaction account into a higher-yielding, overnight investment. Some banks offer sweep accounts that only remove excess balances weekly. Brokerage firms offer sweep accounts as well with weekly or monthly sweep frequencies.

SWIFT
See Society for Worldwide Interbank Financial Telecommunication.

Symmetric
Behavior exhibited by financial instruments whose rates or values move linearly with respect to changes in market rates.

Syndication
An arrangement in which two or more banks lend directly to the same borrower pursuant to one loan agreement. Each bank in the syndicate is a party to the loan agreement and may receive a note from the borrower evidencing the debt. Banks involved in syndicated transactions often sell some or all of their allotment in the credit facility.

Synthetic CDO
A CDO that uses credit default swaps rather than actual corporate obligations to create a pool of credit exposure. See collateralized debt obligation (CDO).

Synthetic hedges
A somewhat out-of-date term for capital markets hedges. Hedges that use derivatives.

Systemic liquidity risk
Liquidity risk arising from causes external to the entity. Systemic liquidity requirements can take a number of forms:

(1) Macro economic corrections. These may be recessions or credit crunches. They may be national or regional in scope.

(2) Capital markets disruptions. These types of liquidity crises are more common. An excellent recent example is the flight to quality that occurred in August and September of 1998 after the collapse of the Russian ruble and the rescue of a highly leveraged hedge fund.

(3) Payments systems disruptions. Banks are heavily dependent upon a few national and international data systems for transferring funds. A disruption in one of these systems can easily and quickly cascade into a major systemic problem.

T

Banker's Glossary

A B C D E F G H I J K L M N O P Q R S T U V W X Y Z

TAC tranche
See targeted amortization class tranche.

Takedown period
A time period during which a borrower is permitted to draw down (i.e., request and receive advances from) the proceeds of a loan.

Takeout commitments
Legally binding commitments made by end lenders to construction lenders. The end, or permanent, lender commits to providing financing to the property owner that will pay off the construction loan. End lenders may be banks, insurance companies, pension funds, or others. Also see permanent lender.

TAN
See tax anticipation notes.

Tangible equity or tangible net worth
Terms used to describe the amount of owners' or stockholders' equity after deduction of intangible assets. Total assets minus intangible assets minus total liabilities.

Targeted amortization class (TAC) tranche
Bonds created in scheduled-pay CMO structures. A TAC tranche is structured to avoid prepayment volatility. Each TAC has a designated target speed. When prepayments exceed the targeted speed, the excess cash flow is diverted to other tranches in the CMO. Unlike a planned amortization class (PAC) tranche, a TAC tranche is not protected from extension risk if prepayments are slower than expected. For this reason, TACs can be viewed as half PACs. TACs offer investors protection (but not immunity) from call risk but no protection from extension risk.

Tax and revenue anticipation notes (TRAN)
Short-term notes sold by a public entity that will be repaid from the proceeds of anticipated tax and/or fee collections.

Tax anticipation notes (TAN)
Short-term notes sold by a public entity that will be repaid from the proceeds of anticipated tax collections.

Taxable equivalent yield (TEY)
The yield that a tax-free investment would provide to an investor if the tax-free yield was "grossed up" by the amount of taxes not paid. This is the most common way of comparing yields on taxable and tax-free investments. Instead of reducing a taxable yield by the amount of applicable taxes to compare it with a tax-free yield, the tax-free yield is increased by a hypothetical amount of income tax.

TB-13
See Thrift Bulletin 13.

TBA
Acronym for to be announced. Most new MBS pass-through bonds can be purchased on a TBA basis.

Teaser
A teaser rate is a below-market interest rate offered to borrowers of adjustable-rate loans during the initial period of some adjustable-rate mortgages. A teaser period is the period of time during which the teaser rate applies.

Technical review
One of two types of real estate appraisal reviews. A technical review is a review performed by another appraiser. The primary purpose of the technical review is to determine whether or not the appraisal meets Uniform Standards of Professional Appraisal Practice requirements and whether the opinions and conclusions in the report are reasonable. Technical reviews ordinarily do not challenge the original appraiser's choice of comparables unless there is an obvious problem. See administrative review.

TED spread
The difference between U.S. Treasury bill yields and yields for Euro deposit contracts of the same maturity. The TED spread is used as a measure of investor confidence. When the spread is small, investors are not requiring a large amount of additional compensation for the additional risk of

Euro deposits. When the spread is large, investors are willing to give up yield to obtain the higher quality of U.S. Treasury bills. A sudden widening of the TED spread is indicative of a flight to quality. See quality spread.

Tenant acceptance letters or tenant estoppel letters
See estoppel letter.

10-K and 10-Q
Financial reports that must be filed by publicly traded corporations with the Securities and Exchange Commission (SEC). The quarterly reports are called 10Qs. The annual reports are called 10-Ks. Both must follow proscribed formats.

Term fed funds
Federal funds transactions made for tenors longer than one day. Typical term fed funds transactions range from a few days to a few months.

Term insurance
A form of life insurance that has no built-in savings feature and does not accumulate any cash surrender value.

Term note
(1) A name used to describe a promissory note used for any closed-end loan granted for a predetermined amount of time (e.g., short-term, medium-term or long-term).

(2) A name used in business or commercial lending to describe a promissory note that calls for mostly regular, periodic payments of principal and interest.

Term structure model
Also known as yield curve models. An assumption, or set of assumptions, used to describe future changes in interest rates over a range of maturities. The most simple term structure model is a parallel shift in rates, e.g. all rates rise by 1 percent. Implied forward rates may be the most common term structure model. More accurate models provide a systematic way to assume the random movement of the interest rates along the yield curve. These models constrain the range of movement of the rates, and the corresponding probabilities such that they are (i) internally consistent, that is, there is no riskless profitable arbitrage, and (ii) externally consistent, that is, the values of certain securities implied from the model agree with the market values. The following five term structure models are the most systemic and accurate: Vasicek, Extended Vasicek (Hull and White), Ho and Lee, Heath, Jarrow and Morton (constant volatility), and Heath, Jarrow and Morton (declining volatility).

Term structure of interest rates
The relationship between interest rates (or yields) for otherwise similar securities with different maturities. Yield curves are graphical depictions of the term structure of interest rates.

Termination
The action taken by a secured party to end or give up its interest in collateral. For personal property collateral, a termination may be entered into the public record by using a standard form called a UCC-3.

Termination date
The date on which cash flows due under a swap contract cease to accrue.

TEY
See taxable equivalent yield.

Theta
The Greek letter used in the financial industry to represent the amount by which the price of an option changes for each one-day decrease in the time remaining until its expiration.

Thrift Bulletin 13 (TB-13)
A rule published by the Office of Thrift Supervision (OTS) entitled Responsibilities of the Board of Directors and Management with Regard to Interest Rate Risk. This rule governs the measurement and management of interest rate risk at all insured savings and loan associations.

Tier 1 capital
A regulatory definition of bank capital. Tier 1 capital consists of common shareholders' equity, perpetual preferred shareholders' equity with noncumulative dividends, retained earnings, and minority interests in the equity accounts of consolidated subsidiaries.

Tier 2 capital
A regulatory definition of bank capital. Tier 2 capital consists of subordinated debt, intermediate-term preferred stock, cumulative and long-term preferred stock, and a portion of the bank's allowance for loan and lease losses.

TIGRS
A proprietary name for a zero coupon Treasury security created from a coupon-bearing Treasury security.

Time bands
See buckets.

Time deposit
A deposit with a specific maturity. Usually, but not always, a certificate of deposit.

Time draft
A draft that is payable on a future date.

Time note
A name used to describe a promissory note used for closed-end transactions that do not require any principal to be repaid until the maturity of the note. Interest may or may not be due periodically prior to maturity. Time notes are usually for periods of time no greater than one year.

Time value
The portion of an option's value imputed to the possibility that the price of the underlying will move in the option holder's favor during the time remaining before the option expires.

Times interest earned
See interest-coverage ratio.

TIPS
See Treasury inflation-protected securities.

Title insurance
An insurance policy that insures that the ownership of a parcel or parcels of real property and the lien priority of secured creditors with an interest in that property is as the title insurance policy states. The insured party protected by the title insurance policy may be the property owner, in which case the policy is called a owner's policy, or the lender, in which case the policy is called a lender's policy.

Title insurance commitment
A preliminary report prepared by a title insurance company and submitted to a potential secured party prior to a loan closing. The commitment shows the information and conditions that will appear on the final title insurance policy unless changes are made in the chain of title or in the outstanding liens prior to the issuance of the final policy.

Title opinion
A document prepared by an attorney that states ownership and a brief report of lien priority for a designated parcel of real property. The opinion is usually given in a letter written on the attorney's letterhead stationary. It includes the date and time of the record investigation. Also called attorney's certificate of title or certificate of title.

Title search
A report prepared by a title insurance company that indicates the ownership and outstanding liens for a designated parcel or parcels of real property. Even though a title search is prepared by a title insurance company, it does not offer any insurance protection. Also called ownership and encumbrance reports.

Toggle tranche
See jump Z tranche.

Tombstone
The informal name for a published notice listing the major participants in a syndicated loan or newly issued security.

Tort
A legal term for a wrongful act that results in an injury or damages to another person or entity that is not contractual in nature. See commercial tort claim.

Total return analysis
A methodology for calculating an investor's return from an investment. In total return analysis, the investor's returns from interest income paid on the invested principal plus interest income earned from the successive reinvestment of previously earned interest on that investment is combined with projected capital gains or losses. Total return differs from yield-to-maturity first because it can include gains or losses from sales prior to maturity and second because it permits the assumption of a reinvestment rate different from the yield earned on the underlying principal.

Total return swaps
A type of credit derivative instrument. Swap contracts in which the protection buyer sells the total return from a particular reference asset such as a corporate loan or bond. In exchange, the protection buyer receives a rate of interest such as LIBOR. Alternatively, the protection buyer may agree to receive the total return from a different reference asset. (In the first case, the protection buyer has reduced credit risk by taking a rate such as LIBOR and giving up the cash flow from a reference asset with credit risk. In the second case, the protection buyer is diversifying credit risk by exchanging the risk from one obligor for the risk for another obligor.) Note that in a total return swap, the support seller is guaranteeing not just against default by the reference obligor but also against the deterioration in the credit quality of the reference obligor even if there is no default. "Total return" includes interest payments and changes in the market value of the reference asset. As a result, the total return of a credit asset can be affected by various factors, some of which may be quite extraneous to the asset in question, such as interest rate movements, exchange rate fluctuations etc. Also known as a total rate of return swap or TROR swap.

Total risk-based capital
A regulatory definition of bank capital. The sum of tier 1 plus tier 2 capital.

TRACE
Trade Reporting and Compliance Engine. A public reporting service operated by NASD that provides real time price information for over-the-counter trades of eligible corporate bonds.

Trade credit
Credit granted by a supplier to a customer to finance the customer's purchase of goods or services from the supplier.

Trade date
The day on which a buyer and seller agree upon a transaction.

Trade letter of credit
An obligation issued by a bank on behalf of a bank customer to a third party. A commercial or trade letter of credit is a bank promise to pay the third party for the purchase of goods by the bank's customer. If the bank's obligation to pay is not immediate, the transaction can later give rise to a banker's acceptance. See letter of credit and banker's acceptance. Also called commercial letter of credit.

Trade name

Name used by a proprietorship, partnership, or corporation to conduct business that is different from the legal name of the proprietorship, partnership, or corporation.

Trade receivables
Also known as accounts receivable - trade. Amounts due from the sale of goods or service on credit that are not evidenced by promissory notes.

Trading
(1) The activity of buying and selling financial instruments or commodities for profit. Individuals or entities may engage in trading either strictly on their own behalf or for current or future transactions with customers. Trading profits may come from market price changes but may also come from the spreads between bid and asked prices or from customer markups. Trading is distinct from investing, although trading activities are not always easy to distinguish from investing activities. In trading, the profit goal is almost always short term. Unlike trading, investing is generally longer term and may even include the intent to hold the instrument to maturity. A common misconception is that trading activities are speculative while investing activities are not. Trading may indeed include highly speculative transactions. However, trading may also include relatively low-risk transactions such as matched trading or arbitrage. Like investing, trading may involve either cash or derivative instruments. Trading transactions may involve cash and/or futures positions.

(2) One of three defined categories established in FAS 115 for the classification of financial instruments held as assets on the books of an investor. Trading securities are those owned by investors engaged in trading activities including short-term speculation. Under FAS 115, trading assets must be reported at their market values. FAS 115 also includes provisions that restrict investors' ability to transfer assets from the trading category to available-for-sale (AFS) or held-to-maturity (HTM). Also see available-for-sale, FAS 115 and held-to-maturity.

Trading as (T/A)
Designation, usually following a name, indicating that a name used by a business is not the legal name of the entity doing business but is an assumed name or trade name instead.

TRAN
See tax and revenue anticipation notes. Also see tax anticipation notes and bond anticipation note.

Tranche
A segment or tier within a loan or security. Also known as a class. For example, collateralized mortgage obligations (CMOs) are securities for which the cash flows are segregated into tranches and sold separately. Each tranche is a separate security with its own maturity date and interest rate. CMOs may have over a hundred tranches or classes. Tranche is the French word for slice. Tranches are used to reallocate principal and interest cash flows so that some classes have lower risk while some have higher risk. See waterfall.

Transaction risk
One of nine risks defined by the Office of the Comptroller of the Currency. The risk to earnings or capital arising from problems with service or product delivery. The Federal Reserve and most banks refer to this risk as operations or operational risk.

Transit item
A check deposited and processed for collection that is drawn on another bank.

Transit routing number
A nine-digit number contained in the MICR line of each check. The routing number identifies the paying bank.

Transition asset
An off-balance sheet asset created under FAS 87 rules when pension plan assets exceed the projected benefit obligation (PBO) at the date that FAS 87 rules are implemented. The amount of the off-balance sheet asset is the amount of the excess. This asset is amortized - usually over the projected remaining service lives for employees expected to receive benefits. The amortization reduces the reported benefit expense of the sponsoring firm. The unamortized remaining balance of the transition asset is disclosed in a footnote to the financial statements as unrecognized initial net gain.

Transition obligation
An off-balance sheet liability created under FAS 87 rules when the PBO exceeds the amount of pension plan assets as of the date that FAS 87 rules are implemented. The amount of the off-balance sheet liability is the amount of the shortfall. This liability is amortized - usually over the projected remaining service lives for the employees expected to receive benefits. The amortization increases the reported benefit expense of the sponsoring firm. The unamortized remaining balance of the transition obligation is disclosed in a footnote to the financial statements as unrecognized initial net loss.

Treasuries
An informal name for securities issued by the United States Department of the Treasury.

Treasury bills
Short-term obligations issued by the U.S. Treasury. Bills are issued for maturities of one year or less. They do not pay interest but are issued on a discount basis instead.

Treasury bonds
Long-term obligations issued by the U.S. Treasury. Bonds are issued for initial maturities greater than ten years.

Treasury inflation-protected securities (TIPS)
Securities issued by the U.S. Treasury that provide inflation protection to investors. These securities have a fixed coupon rate and maturity date. However the interest payment is based on a principal amount that is adjusted semiannually to reflect changes in the Consumer Price Index (CPI).

Treasury notes
Medium-term obligations issued by the U.S. Treasury. Notes are issued for initial maturities from over one year to ten years.

Treasury stock
The name for shares of a corporation's stock that were issued and then subsequently repurchased by the corporation.

Triple net
An expression used to describe real estate leases that require utilities, insurance, and taxes to be paid by tenants.

Triple tax exempt
A phrase used to refer to municipal securities that are exempt from federal, state, and local income taxes.

True consignment
A transaction in which a person delivers goods to a merchant for the purpose of sale, and the merchant deals in goods of that type under a name other than that of the person delivering the goods.

True lease
A legal term for a transaction that is intended by the parties to be an actual lease of personal property rather than a conditional sale.

True yield
A seldom-used term meaning the simple interest yield for an investment maturing in one year or less. In calculating true yield, the actual number of days in the year (365) is divided by the actual number of days that the investment income is earned.

Truth-in-Lending Act
A Federal statute that governs a number of practices related to bank loans - especially, but not only, consumer loans. The Federal Reserve Board of Governors has adopted Regulation Z to implement this statute. The regulation has specific requirements giving some borrowers the right to rescind certain loans and very specific requirements about how banks must disclose rescission rights. The regulation also includes very detailed requirements for calculating and disclosing annual percentage rates for many loans. See annual percentage rate and rescission.

Turnover or turns
Terms used to describe the number of operating cycles in a defined period of time or the length of each specific operating cycle. Typical turnover cycles are: the rate at which accounts receivable converts to cash, the rate at which inventory converts to receivables or cash, the rate at which accounts payable are paid, and the number of times in a year inventory can be said to be sold and replaced. For example, if a firm's average inventory level is equivalent to one quarter of its annual sales, it can be said that inventory turns four times a year. (See days inventory, days payables and days receivables for definitions of other common measurements of turnover.) While turnover concepts are most often applied to elements of the working capital conversion cycle, there are other applications. For example, asset turnover is the ratio of net sales divided by total assets.

12b-1 fee
A type of fee charged to investors in some mutual funds. In theory, the fee is supposed to reimburse the sponsor for sales, distribution, or shareholder liaison expenses. In reality, however, it is another type of administrative or management fee. See load.

Twist risk
See yield curve risk.

Type I securities
A category of investment securities defined by the Office of the Comptroller of the Currency (OCC) (12 CFR 1). A Type I security is any one of the following:

(1) Obligations of the U.S. government.

(2) Obligations issued, insured or guaranteed by a department or an agency of the U.S. government if the obligation, insurance, or guarantee commits the full faith and credit of the United States for the repayment of the obligation.

(3) Obligations issued by a department or agency of the United States or an agency or political subdivision of a State of the United States that represent an interest in a loan or in a pool of loans made to third parties,if the full faith and credit of the United States has been validly pledged for the full and timely payment of interest on, and principal of, the loans in the event of nonpayment by the third party obligors.

(4) General obligations of a State of the United States or of any political subdivision.

(5) Obligations authorized under 12 USC 24 (Seventh) as permissible for a national bank to deal in, underwrite, purchase, and sell for the bank's own account, including qualified Canadian government obligations.

(6) Other securities that the OCC determines to be eligible as Type I securities under 12 USC 24 (seventh).

Type II securities
A category of investment securities defined by the Office of the Comptroller of the Currency (OCC) (12 CFR 1). A Type II security is any one of the following:

(1) Obligations issued by a State or a political subdivision or an agency of a state for housing, university, or dormitory purposes.

(2) Obligations of international and multilateral development banks and organizations listed in 12 USC 24 (Seventh).

(3) Other obligations listed in 12 USC 24 (Seventh) as permissible for a bank to deal in, underwrite, purchase, and sell for the bank's own account, subject to a limitation per obligor of 10 percent of the bank's capital and surplus.

(4) Other securities that the OCC determines to be eligible as Type II securities under 12 USC 24 (Seventh).

Type III securities
A category of investment securities defined by the Office of the Comptroller of the Currency (OCC) (12 CFR 1). All investment securities that do not qualify as Type I, II, IV, or V. For example, obligations of corporations and municipal revenue securities other than those defined as Type II.

Type IV securities
A category of investment securities defined by the Office of the Comptroller of the Currency (OCC) (12 CFR 1). This is a category added in the 1996 amendments. A Type IV security is any one of the following:

(1) A small business-related security as defined in section 3(a)(53)(A) of the Securities Exchange Act of 1934,15 USC 78c(a)(53)(A), that is rated investment grade or is that is the credit equivalent of investment grade and that is fully secured by interests in a pool of loans to numerous obligors.

(2) A commercial mortgage-related security that is offered or sold pursuant to section 4(5) of the Securities Act of 1933 that is rated investment grade or that is the credit equivalent of investment grade.

(3) A commercial mortgage-related security as described in section 3(a)(41) of the Securities Exchange Act of 1934, 15 USC 78c(a)(41), that is rated investment grade in one of the two highest investment grade rating categories, that represents ownership of a promissory note or certificate of

interest of participation that is directly secured by a first lien on one or more parcels of real estate upon which one or more commercial structures are located, and that is fully secured by interests in a pool of loans to numerous obligors.

(4) A residential mortgage-related security that is offered and sold pursuant to section 4(5) of the Securities Act of 1933, 15 USC 77d(5), that is rated investment grade or is the credit equivalent of investment grade.

(5) A residential mortgage-related security as described in section 3(a)(41) of the Securities Exchange Act of 1934,15 USC 78c(a)(41), that is rated investment grade in one of the two highest investment grade rating categories and that does not other wise qualify as a Type I security.

See investment grade.

Type V securities
A category of investment securities defined by the Office of the Comptroller of the Currency (OCC) (12 CFR 1). This is a category added in the 1996 amendments. A Type V security is a security that meets the following four requirements:

(1) Rated investment grade;

(2) Marketable;

(3) Not a Type IV security;

(4) Fully secured by interests in a pool of loans to numerous obligors and in which a national bank could invest directly.

U

UCC
See Uniform Commercial Code.

UCC - 1
See financing statements.

UCC - 3
See amendment, assignment, continuation, partial release, release and termination.

UCC - 4
See lien search.

Unadvised line
A line of credit that is approved by the bank but not disclosed to the borrower until some specific event, usually a request for funding from the borrower.

Uncertificated
Legal term used (especially in UCC Article 8) as an adjective to describe stocks, bonds, other investments, and certificates of deposit held in nonmaterial form as electronic computer entries. Ownership of these instruments is usually evidenced by a receipt or confirmation.

Uncovered
See naked.

Underlying or Underlier
An option or a future is a right or a commitment to buy or sell something at a future date. The underlying is the financial instrument that may or must be bought or sold in each option or futures contract. FAS 133, as amended by FAS 149, defines an underlying to be a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, or other variable (including the occurrence or nonoccurrence of a specified event such as a scheduled payment under a contract). An underlying may be a price or rate of an asset or liability but not the asset or liability itself.

Underwriter
The investment bank, commercial bank, or brokerage firm that works with an issuer to sell a new issue. Issuers may select underwriters by obtaining bids or on a negotiated basis. Potential underwriters may form groups called underwriting syndicates to bid collectively.

Underwriting
The name used to describe the process of analyzing and structuring a proposed loan. Good underwriting is the most important aspect of secured lending. Outside of banking, the term primarily refers to the purchase of risk.

Undivided profits
Bank term for retained earnings. Bank profits from current as well as prior years that have neither been distributed to shareholders as dividends nor transferred to surplus. Corporate earnings accumulated over time. One of a corporation's equity or capital accounts. See tier 1 capital and tier 2 capital.

Unexpected loss or unexpected risk
The portion or component of risk or loss that exceeds the predicted amount.

Unfunded pension losses
A contra equity account created under FAS 87 rules for cases in which the amount of the additional minimum pension liability exceeds the sum of unamortized prior service cost plus transition obligation. Sometimes called minimum pension liability adjustment or minimum pension liability in excess of unrecognized prior service costs.

Uniform Commercial Code (UCC)
A compilation of laws relating to commercial contracts involving personal property. The code does not address real property. In addition, a few

types of personal property are also excluded. While the UCC has been adopted by all 50 states, there are differences among the versions adopted in each state. Secured lenders tend to focus on UCC Article 2A covering leases, Article 8 covering securities, and Article 9 covering all other personal property collateral.

Universal life insurance
A form of life insurance that combines term insurance protection with a savings feature. The portion of the funds allocated to the savings feature is invested in a tax-deferred account that typically earns interest at rates comparable to prevailing money market interest rates. A universal insurance policy offers the policy holder the flexibility to change the amount of insurance coverage, the amount of the premium payment and/or the portion of the premium payment allocated to the savings feature.

Uniform Standards of Professional Appraisal Practice (USPAP)
Appraisal requirements published by the Appraisal Foundation. Prior to 1994, USPAP rules were included as an appendix to the Uniform Real Estate Appraisal Rule published by the four federal financial institution regulators. Since 1994, USPAP rules are referenced in the bank regulations but not provided in any form. Comments published with the 1994 amendments to the bank regulations indicate that readers are expected to assume that all references to USPAP in the regulations are references to the most current version of USPAP then available.

Unlimited guaranty
A guaranty agreement that does not include any provisions restricting the amount of debt guaranteed.

Unplatted land
Land that is not platted. Land for which the property description takes the form of a metes and bounds description rather than a lot identification. See metes and bounds and platted land

Unqualified opinion
Term used to describe an opinion letter accompanying audited financial statements in which the CPA states that the financial statements fairly present the financial position and the results of operations. The CPA will also state that the financial statements conform with GAAP for the present and the preceding reporting periods.

Unrecognized initial net gain
The current unamortized balance, as of the financial statement date, of the off-balance sheet asset for the initial transition asset in a defined benefit pension plan. FAS 87 requires that this amount be disclosed in a footnote to the financial statements. See transition asset.

Unrecognized initial net loss
The current unamortized balance, as of the financial statement date, of the off-balance sheet liability for the initial transition obligation in a defined benefit pension plan. FAS 87 requires that this amount be disclosed in a footnote to the financial statements. See transition obligation.

Unrecognized net gain or unrecognized net loss
An off-balance sheet asset or liability created under FAS 87 rules when plan assets in a defined benefit pension plan exceed or fall short of the projected benefit obligation (PBO). The gain or loss is usually caused by actual investment returns for plan assets that exceed or fall short of expected or assumed rates of return. Gains or losses may also result from changes in actuarial assumptions. These are off-balance sheet assets or liabilities because volatile returns on plan assets realized in subsequent periods can reduce or completely offset the unrealized gains or losses that previously existed. These gains or losses are from changes in the plan or the plan assets that occur subsequent to the adoption of FAS 87 rules and should not be confused with initial transition assets, unrecognized transition assets, initial transition obligations, or unrecognized transition obligations. The amount of any unrecognized gains or losses is disclosed in a footnote to the financial statements.

Unrecognized prior service costs
The current unamortized balance, as of the financial statement date, of the off-balance sheet liability for prior service costs in a defined benefit pension plan. FAS 87 requires that this amount be disclosed in a footnote to the financial statements. See prior service costs.

Upstream guaranty
A phrase sometimes used to describe a guaranty of a loan to a borrowing entity when the borrowing entity is a parent company or stockholder of the guarantor.

Upward sloping yield curve
A yield curve depicting a situation in which yields for shorter-term maturities are lower than yields for longer-term maturities. Upward sloping yield curves are common.

USA PATRIOT Act
An acronym for the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, ("USA PATRIOT Act"). The USA PATRIOT Act substantially amends the Bank Secrecy Act of 1970 (BSA). The statute contains strong measures to prevent, detect, and prosecute terrorism and international money laundering. The Act is far-reaching in scope, covering a broad range of financial activities and institutions. See Patriot Act.

USPAP
See Uniform Standards of Professional Appraisal Practice.

Usury laws
State and Federal laws establishing maximum allowable interest rates that may be charged on specified types of credit extensions to specified types of borrowers.

V

Value at risk (VAR)
The amount or percentage of value that is at risk of being lost from a change in prevailing interest rates (similarly defined for things other than interest rates as well). The sensitivity of the value of a single financial instrument, a portfolio of financial instruments, or an entire entity's balance sheet to changes in interest rates can be calculated. The resulting sensitivity is the amount of value at risk. See earnings at risk for an alternative measure of interest rate risk. VAR, sometimes called equity value at risk or EVAR, can be calculated by at least four different mathematical expresions. The simplest and least accurate measure of VAR is the difference between the calculated economic value of equity (EVE) under one projected rate scenario and the calculated EVE under a different projected rate scenario. See correlation VAR, empirical VAR and historical VAR for definitions of VAR calculated under more rigorous formulae.

Value based management (VBM)
A structured approach to measure the performance of a firm's unit managers or products in terms of the net benefit they provide to shareholders. Usually the application of shareholder value added (SVA) metrics. See shareholder value added.

Variable life insurance
A form of life insurance very similar to whole life insurance. In a variable life insurance policy, the cash value is invested in equity or debt securities. Policyholders can select and switch investment instruments. The policyholder bears the risk of the securities investment; the insurance company only guarantees a minimum death benefit amount.

Variable-rate mortgage
A less common name for an adjustable-rate mortgage (ARM).

Variance
Statistical term that quantifies the dispersion of data such as rates or prices around the mean. For example, highly volatile rates are rates that are sometimes high above the mean and sometimes way below the mean. Less volatile rates are dispersed closer to the mean and therefore have smaller variances. Similar to, but not the same as, the average amount by which data deviates from the mean for that data.

Variance swap
A swap agreement where one party agrees to receive implied volatility and pay realized while the counterparty agrees to receive realized volatility and pay implied.

Vector path
A series of prepayment speeds, in a sequence, that is chosen to reflect an assumed interest rate scenario. For example, if prevailing interest rates are near a cyclical low and still falling, a selected vector path might project a rate path that assumes steady or falling rates in the short run but rising rates for a year or more thereafter. A way of modeling future MBS performance with more complex assumptions than the customary single estimate of future prepayment speed.

Vega
The change in an option's price resulting from changes in the volatility of the price for the underlying.

Vested accumulated benefit obligation
The portion of the accumulated benefit obligation under a defined benefit plan to which the employees have a legal right even if their employment is terminated before retirement.

Vintage CMO
A collateralized mortgage obligation (CMO) backed by seasoned mortgage securities.

VIX
A measure of implied volatility published by the CBOE.

Volatility
The rate of change in a variable. More formally, a statistical term to quantify the dispersion of variables such as rates or prices around the mean. A measure of the variability of the price of an underlying financial instrument, rate, commodity, or currency. Volatility only measures the quantity of the change - not the direction. Volatility is not influenced by the direction of the change; it does not matter whether the price rises or falls. Volatility is often used as a proxy for riskiness. See realized volatility and implied volatility.

VRM
See variable-rate mortgage.

W

Banker's Glossary

A B C D E F G H I J K L M N O P Q R S T U V W X Y Z

WAC
See weighted-average coupon.

Waiver
The agreement of a lender to overlook a borrower's failure to meet one or more conditions attached to the granting of a credit — conditions that would, in the absence of a waiver, give the lender the right to declare the loan to be in default.

WAL
See average life.

WALA
See weighted-average loan age.

WAM
See weighted-average maturity.

Warehouse financing
A form of inventory financing in which goods are held in trust as collateral for the loan. Warehouse financing may involve the use of public warehouses in which the goods are held in locations owned by third parties. Alternatively, warehouse financing may involve the use of field warehouses in which the goods are located on the borrower's premises but are controlled by an independent third party.

Warehouse lines of credit
An informal name used by some bankers for lines of credit used to finance a borrower's temporary ownership of long-term assets such as mortgages.

Warehouse receipt
Written evidence of goods held in a warehouse operated by a third party. The goods may be in a public (i.e., general), private, or field warehouse. Also known as collateral receipts. The receipts may be negotiable or non-negotiable. Negotiable warehouse receipts are bearer instruments. A negotiable warehouse receipt can be sold to a buyer who then owns the inventory covered by the receipt.

Warrant
(1) An order drawn by a payor directing its treasurer to pay a specified amount to the person named or to the bearer. It may be payable upon demand, in which case it usually circulates in the same way as a bank check; or it may be payable only out of certain revenue when and if received, in which case it does not circulate as freely.

(2) A financial instrument that gives the holder the right, but not the obligation, to purchase a specified amount of an asset at a specified price during a specified period of time. A warrant may give its holder the right to buy shares of stock, bonds, currencies, or commodities. The major difference between warrants and options is that prices for warrants are usually published with lists of the prices for the underlying assets.

Warranty deed
A document that transfers title to real estate from a grantor to a grantee. The distinguishing characteristic of a warranty deed is that it guarantees the grantor's right to make such a conveyance and that the grantor's title is free of all liens and debts not specifically disclosed.

Waterfall
The contractual distribution of principal and interest cash flows in a multi-tranche security such as an ABS, CMO or CDO. The contractually specified allocation of cash to debt holders and other parties. The priority of payments to holders of different classes of securities created from a securitization.

Weighted-average coupon (WAC)
The average interest rate charged to mortgage loan borrowers in an MBS pool weighted by the size of each loan. Individual loans in an MBS pool will not usually have the same rates of interest. For example, FNMA pools may have mortgages with up to 250 basis points spread between the highest-rate and the lowest-rate loans in the pool. Investors must remember that the WAC may change over time as some loans in the pool repay faster than others. Since loan by loan information is not available, investors must rely on the original WAC throughout the life of the pool.

Weighted-average life (WAL)
See average life.

Weighted-average loan age (WALA)
The average number of months since the date of origination for each mortgage in a mortgage pass-through issued by Freddie Mac. The average is weighted by the size of the loans in the pool.

Weighted-average maturity (WAM)
The average of the time remaining until the contractual maturity date for the loans in an MBS pool weighted by the size of each loan. Expressed in months.

When-issued (WI)
New securities issues announced by the issuer but not yet sold or issued. Securities may be purchased or sold on a when-issued basis. Such trades are negotiated on a yield basis since price cannot be determined until the coupon rate is known. Price is usually calculated for delivery on the date of issue. Many U.S. Treasury securities are actively traded on a when-issued basis. Some corporate and municipal issues are also purchased on a when-issued basis. Purchasing or selling when-issued securities is a legitimate and acceptable practice that should not be confused with the related practice of when-issued trading. When-issued securities trading is the practice of agreeing to buy an about-to-be-issued security on or after the announcement of an offering and then selling the security before the date on which the securities are issued and must be paid for. Such transactions are regarded as trading activities by the banking regulators.

Whole life insurance
A form of life insurance that applies part of the premium payments to build an investment or savings value for the policy owner. The investment or savings value is called the cash surrender value of the policy.

Whole loan pools
Mortgage-backed securities not issued by or guaranteed by a U.S government agency or U.S. government sponsored enterprise. The mortgage loans comprising whole loan pools are generally loans that do not meet GNMA, FNMA, or FHLMC requirements. Whole loan pools may be structured as fixed-rate pass-through securities, floating-rate pass-through securities, or CMOs. Also known as private pools or private label pools.

Whole loans
A phrase used to describe mortgage loans when the owner of the debt also owns the servicing rights. In other words, mortgage loans that have not had the servicing separated.

Wholesale banking
Banking business conducted exclusively or almost exclusively with large corporations, governments, financial institutions, trusts, etc.

WI
When-issued.

Window
The period of time between the expected first principal payment and the last anticipated principal payment for a specific REMIC tranche.

Wire transfers
One of the two major methods of electronic funds transfer. Only the payer can originate the remittance. A wire transfer's information format is completely flexible, but this flexibility adds significantly to the bank's labor costs and results in much higher fees.

With recourse
A lending expression that means the loans or leases that have been acquired from an original lender or lessor are guaranteed by the originator.

Withdrawals
1) Any reduction in funds maintained in a deposit account or mutual fund.

2) Funds of a proprietorship or a partnership that are directly removed from the firm by the proprietor or partners. These are distributions distinct from salary, commission, bonus, or rent payments paid to proprietors or partners.

Without recourse
A lending expression that means loans or leases that have been acquired from an original lender with no guaranty from the originator.

Working capital
In accounting and finance, used to describe the amount, if any, by which a business's current assets exceed its current liabilities. Also used more loosely to describe the funds a firm has available to run its day-to-day business affairs.

Working capital conversion cycle

An accounting and financial phrase used to describe the dynamics of short-term cash flows that occur during the normal operations of a business. The working capital conversion cycle is the circular process of borrowing money first to purchase inventory, then to carry that inventory and finally to carry the resulting accounts receivable that are the proceeds of the inventory. When the receivables are paid, the firm can then use the proceeds to either repay the borrowing or to start the cycle all over again by purchasing new inventory.

Wraparound mortgage
A second mortgage that takes over the first. The first mortgage loan is not paid off. Instead, the borrower makes payments to the second mortgage lender for the debt service of both the first and second liens. The second lien holder then makes the payments to the first lien holder. This type of mortgage is used when the borrower is unwilling or unable to refinance the first mortgage. Prepayment of the first mortgage may be prohibited or may be subject to high penalties. Alternatively, the first mortgage may have a very attractive fixed rate of interest. The wraparound arrangement permits the borrower to leave the first mortgage intact while giving more control to the lender willing to make the second mortgage.

Writer
The party that sells an option contract. Also called the option grantor or maker.

Y

Banker's Glossary

A B C D E F G H I J K L M N O P Q R S T U V W X Y Z

Yankee bonds
Bonds denominated in U.S. dollars and issued in the United States by foreign issuers for U.S. investors.

Yankee CDs
Certificates of deposit denominated in U.S. dollars and issued in the United States by a U.S. branch of a foreign financial institution. See Eurodollar CDs.

Yield
The annual return on an investment expressed as a percentage on an annual basis. For interest-bearing securities, the yield is a function of the rate; the purchase price; the income that can be earned from the reinvestment of income received prior to maturity, call, or sale; and the time from purchase to maturity, call, or sale. Different formulas or methods are used to calculate yields. See total return analysis and yield-to-maturity.

Yield curve
A graph showing the relationship at a selected point in time between the available maturities of a security or similar securities with essentially identical credit risk and the yields that can be earned for each available maturity. A graphical depiction of the term structure of interest rates at any given point in time. Yield curves may be constructed for different instruments such asTreasury securities, AAA-rated municipal bonds, A-rated corporate bonds, etc. Even within the field of Treasury securities, yield curves are constructed from many different types of Treasury rates. When a yield curve is constructed by calculating the coupon rates necessary for the Treasury obligations of various maturities to be priced at par, it is called a par yield curve. When a yield curve is constructed using currently prevailing rates for instruments available for cash delivery, it is called the spot curve. When a yield curve is constructed using currently prevailing rates for instruments to be delivered at future dates, it is called the forward yield curve. When a yield curve is calculated using currently prevailing rates for interestbearing Treasuriy securities, it may be referred to as a coupon curve. When a yield curve is calculated using currently prevailing yields for zero coupon instruments, it is called the zero coupon curve.

Yield curve model

See term structure model.

Yield curve risk
The risk to a holder of financial instruments that a change in prevailing interest rates will not affect the prices or yields of the same instruments in exactly equal amounts for each available term. For example, an increase in prevailing interest rates might raise 3-month U.S. Treasury yields by 100 basis points while 6-month U.S. Treasury yields go up by only 85 basis points. (In this example, the change to the yield curve would be described as flattening. If, instead, the 6-month rate had risen by more than the 3-month rate, the change in the yield curve would be described as steepening.) The risk of a nonparallel shift in the yield curve. One of the four primary components of interest rate risk. Sometimes called yield curve twist risk, twist risk, or rotation risk.

Yield curve slope
Yield curves also describe the amount of difference between short-term and long-term rates. A yield curve that depicts the customary situation of long-term rates higher than short-term rates is called an upward sloping or positively sloped yield curve. A yield curve depicting the less common occurrence of short-term rates higher than long-term rates is called a downward sloping, negatively sloped, or inverted yield curve. When long-term rates are much higher than short-term rates, the yield curve is steep. When long-term rates are virtually the same as short-term rates, the yield curve is flat.

Yield curve smoothing.
See smoothing.

Yield curve twist
A phrase used to describe changes in prevailing interest rates that change the shape/slope of the yield curve. For example, a small increase in short-term rates and a large increase in lon- term rates that occur at the same time. A manifestation of yield curve risk.

Yield to call (YTC)
The annual percentage yield of a security calculated using the yield-to-maturity formula but with the assumption that the security is called on the first call date or on the first par call date.

Yield-to-maturity (YTM)
The annual percentage yield of a security calculated in a specific manner. The yield-to-maturity is the single discount rate that, when applied to all future interest and principal payments, produces a net present value equal to the purchase price of the security.

YTC
See yield to call.

YTM
See yield-to-maturity.

Z

Z bond
See Z tranche.

Z score
One of the oldest and most well-known insolvency prediction formulas. The Z score, developed by Dr. Robert Altman, is a financial model that uses historical financial data to calculate a score. The Z score successfully predicts bankruptcy with well over 90 percent accuracy using data from one year prior and is over 70 percent accurate using data from as many as five years prior to bankruptcy. Other financial models claim even higher accuracy levels.

Z tranche
A Z tranche is a CMO tranche. With the exception of jump Z tranches, owners of the Z tranche receive no cash flow from underlying mortgage collateral until the other tranches are retired. During the period when other tranches are still outstanding, the owners of the Z tranche receive credit for periodic interest. Those credits increase the face value of the tranche but are not paid to the owners. The Z bond may be, but does not have to be, the last tranche in a CMO structure that is retired. Sometimes called an accretion bond or an accrual bond.

ZBA
See zero-balance account.

Zero cost collar
The purchase of a floor (or cap) option with the proceeds realized from simultaneous sale of a cap (or floor) option. The levels of the floor and cap are selected so that the proceeds from the option sold exactly offset the cost of the option purchased resulting in a net transaction cost of zero. See cap, collar and floor.

Zero coupon bond
A type of debt security that does not pay periodic interest. Zero coupon securities are bought and sold at prices that are less than the par value

of the securities. The discount, or difference between the principal paid to purchase the security and the principal returned at maturity, constitutes the investor's return.

Zero coupon yield curve
See yield curve.

Zero-balance account (ZBA)
A cash management service offered by banks. A bank checking account that can accept deposits and/or make disbursements but that is always maintained at a zero balance. The zero balance is maintained by transferring just enough funds from or to a concentration account to offset each day's activity. The concentration account is sometimes called the parent account and the zero-balance account is sometimes called the daughter or subsidiary account.

Zeros
See zero coupon bond.

Zoning
A designation given to a particular geographic area by the local government to regulate the type of use and the density of development permitted for properties in that area. For example, areas may be zoned to allow only residential development.