Glossary

2a-7 Funds
Rule 2a-7 of the Investment Company Act of 1940 lays out requirements specific to money market funds. It defines accounting practices that permit a fund to report a stable net asset value of $1 per share and sets investment rules (see *Money Market Fund*).

Absorption Ratio (AR)
A summary measure of the degree of co-movement in asset prices, from Kritzman and others (2011) (see References for Chapter 3).

Agent-Based Models (ABM)
A simulation model that tracks the actions of agents with specified rules of behavior as they interact over time.

Arbitrage
A combination of purchases and sales of the same asset that yields a profit from the differences in prices across markets with little or no risk.

Asset-Backed Commercial Paper (ABCP)
Short-term debt that has a fixed maturity of up to 270 days and is backed by some financial asset, such as trade receivables, consumer debt receivables, auto and equipment loans or leases, or asset-backed securities.

Asset-Backed Security (ABS)
A debt instrument that is backed by specific financial assets that generate the cash flow used to service the debt instrument.

Bank for International Settlements (BIS)
An international financial organization that serves central banks in their pursuit of monetary and financial stability, helping to foster international cooperation in those areas and acting as a bank for central banks.

Bank Holding Company (BHC)
Any company that has direct or indirect control of one or more banks and is regulated and supervised by the Federal Reserve in accordance with the Bank Holding Company Act of 1956. BHCs may also own nonbanking subsidiaries such as broker-dealers and asset managers.

Basel Committee on Banking Supervision (BCBS)
An international committee of bank supervisors that develops and issues international standards on bank capital adequacy. In 1988 the BCBS introduced a capital measurement system commonly known as the Basel Capital Accord or Basel I. In 2004 the BCBS issued a revised framework that is commonly referred to as Basel II. Following the financial crisis, the BCBS developed new global standards for the banking system that are collectively referred to as Basel III.

Broker-Dealer
An entity that is engaged in the business of buying and selling securities for itself and others.

Call Report
A report of a bank's condition and income that all federally insured depository institutions in the U.S. must file on a quarterly basis.

Central Clearing
A settlement system in which securities or derivatives of a specific type are cleared by one entity, a clearing house or central counterparty, which guarantees the trades. It is an alternative to bilateral or over-the-counter trading (see *Over-the-Counter*).

Central Counterparty (CCP)
An entity that is interposed between the initial participants to a bilateral transaction and becomes the buyer to every seller and the seller

to every buyer of a specified set of contracts or financial instruments.

Clearing Bank
A commercial bank that facilitates payment and settlement of financial transactions, such as check clearing or facilitating trades between the sellers and buyers of securities or other financial instruments or contracts.

Collateral
Any asset pledged by a borrower to guarantee payment of a debt.

Collateralized Debt Obligation (CDO)
A type of structured asset-backed security that has tranches with distinct interest rates, payment flows, and risk levels.

Commercial Paper (CP)
Short-term (maturity of up to 270 days), unsecured corporate debt.

Comprehensive Capital Analysis and Review (CCAR)
A regular cross-institution study, most recently completed in March 2012, conducted by the Federal Reserve and other supervisors of the capital plans and capital planning processes of the 19 largest U.S. bank holding companies.

Conditional Value at Risk (CoVaR)
A measure of the value at risk to the financial system conditional on distress at a single financial institution, from Adrian and Brunnermeier (2010) (see References for Chapter 3).

Contingent Liability
A liability that is only incurred depending on the outcome of a future event.

Countercyclical
Movement of a financial or macroeconomic variable in the opposite direction of the business cycle. A variable is *procyclical* if it tends to increase when the economy is growing and decrease when it is shrinking.

Credit Cycle
The rise in credit creation during the expansion phase of the business cycle, often accompanied by a relaxation of underwriting and other credit standards, and the subsequent decline in the availability of credit during economic contractions.

Credit Default Swap (CDS)
A derivative contract in which one party (the protection seller) agrees to make a payment to another party (the protection buyer) in the event of default of a third party (the reference entity), in exchange for fixed payments from the protection buyer to the protection seller (see *Swap*).

Credit Risk Transfer
A financial transaction, typically through credit default swaps, that changes who bears the risk of default or changes in the creditworthiness of a counterparty or debtor.

Credit Value Adjustment (CVA)
An adjustment made to the value of an OTC derivative transaction to reflect the risk that the counterparty to the transaction could default.

Crowded Trade
A trade in which the market participants have large and similar positions, creating the risk that there will be insufficient liquidity should market participants seek to unwind their positions simultaneously.

Cyclical Risk
Any financial or economic risk that is closely tied to the business cycle.

Debt Value Adjustment (DVA)
An adjustment made to the value of a firm's liabilities as a result of a change in the firm's own creditworthiness.

Derivative
A financial contract, such as a swap, option, or futures contract, that derives its value from the price of some other security, commodity, or other asset.

Discount Window

The Federal Reserve facility for extending credit directly to eligible financial institutions.

Distressed Asset Sale

Refer to *Fire Sale*.

Duration Risk

The sensitivity of the prices of bonds and other fixed-income securities to changes in the level of interest rates.

European Union

An economic and political confederation of 27 nations.

Euro Area

An economic region that is comprised of all of the European Union countries that use the euro as their national currency.

Exchange-Traded Fund (ETF)

An investment fund whose shares are traded on an exchange. ETFs offer continuous pricing, unlike mutual funds which offer only end-of-day pricing. ETFs are often designed to track an index or a portfolio of assets.

Federal Financial Institutions Examination Council (FFIEC)

An interagency body that prescribes uniform principles, standards, and report forms for the federal examination of financial institutions. The FFIEC makes recommendations to promote uniformity in the supervision of financial institutions. Members include the Federal Reserve, the FDIC, the NCUA, the OCC, the CFPB, and a representative of state financial supervisors.

Federal Funds Rate

The interest rate at which depository institutions trade balances held in their reserve accounts at the Federal Reserve, usually overnight. The Federal Open Market Committee establishes the target rate for trading in the federal funds market and the Federal Reserve Bank of New York implements it.

Financial Accounting Standards Board (FASB)

A not-for-profit organization responsible for developing and updating the GAAP that governs American accounting.

Financial Contagion

The process by which losses at one institution spread to other institutions through the financial system.

Financial Intermediation

Any financial service in which a third party (the intermediary) matches lenders and investors with entrepreneurs and other borrowers in need of capital. Often investors and borrowers do not have precisely matching needs, and the intermediary's capital is put at risk to transform the credit risk and maturity of the liabilities to meet the needs of investors.

Financial Stability

The condition in which the financial system is sufficiently functioning to provide its basic tasks for the economy even under stress.

Financial Stability Board (FSB)

An international coordinating body that monitors developments in the international financial system on behalf of the G20 nations. The FSB was established by the G20 in 2009 at the London summit. The FSB is the successor to the earlier Financial Stability Forum.

Fire Sale

The disorderly liquidation of assets to meet margin requirements or other urgent cash needs. Such a sudden sell-off drives down prices, potentially below their intrinsic value, when the quantities to be sold are large relative to the typical volume of transactions.

Fixed Net Asset Value (Fixed NAV)

Net asset value is the value of a mutual fund's or ETF's assets divided by the number of its shares. The NAV is set daily, usually at the close of the market. Under Rule 2a-7, money market funds are allowed to round their NAV, maintaining an effective fixed NAV of $1 per share, unless the value of the fund's assets fall below $0.995 per share.

Form N-MFP

A monthly disclosure of holdings by money market funds. SEC Rule 30b1-7 establishes the technical and legal details of N-MFP filings.

Form PF (Form Private Funds)

A reporting form to the CFTC and SEC that provides information on the activities and holdings of hedge fund managers, private equity fund managers, and related entities. Depending on fund size, reporting is annual or quarterly.

Funding Liquidity

The availability of credit to finance the purchase of financial assets.

Futures

A standardized, exchange-traded contract to buy or sell an underlying asset at a specified date and price.

General Collateral Finance (GCF)

An interdealer market in which the Fixed Income Clearing Corporation plays the role of intraday central counterparty. Trades are netted at the end of each day and settled at the tri-party clearing banks (see *Tri-Party Repo*).

Generally Accepted Accounting Principles (GAAP)

The accounting and financial reporting standards set by FASB for publicly-traded companies in the United States.

Government-Sponsored Enterprise (GSE)

A privately owned financial institution that has a federal charter authorized by law and a mission to promote the flow of credit to the housing market, student loan, or other specific sectors.

Gross Domestic Product (GDP)

The broadest measure of aggregate economic activity, measuring the total value of all final goods and services produced within a country's borders during a specific period.

Haircut

The discount at which an asset can be pledged as collateral. For example, a million dollar bond with a 5 percent haircut would collateralize a $950,000 loan.

Interest Rate Swap

A swap in which the parties swap interest rate cash flows, typically between a fixed rate and a floating rate (see *Swap*).

International Monetary Fund (IMF)

An international organization created at the end of World War II to stabilize exchange rates and support international payment systems. The IMF provides credit to developing nations and those in economic distress, typically conditional on economic and financial reforms.

International Organization for Standardization (ISO)

The world's largest developer of voluntary international standards in products, services, and good practices.

International Swaps and Derivatives Association (ISDA)

A trade association of over-the-counter derivatives participants. The ISDA Master Agreements standardized derivative terms to simplify netting and reduce legal risks.

Legal Entity Identifier (LEI)

A uniform system that identifies parties to financial transactions.

Leverage

The use of borrowed money to finance investments or conduct financial activities.

Liquidity

See *Market Liquidity* and *Funding Liquidity*.

Liquidity Coverage Ratio (LCR)

A Basel III standard to ensure that a bank maintains adequate unencumbered, high-quality liquid assets to meet its anticipated liquidity needs for a 30-day horizon under a liquidity stress scenario specified by supervisors.

Loan Origination

The point in the loan process in which the borrower applies for a loan and the lender approves or declines the loan.

Loan-to-Value (LTV) Ratio

The ratio of the amount of a loan to the value of an asset, typically expressed as a percentage. This is a key metric when considering the financing of a mortgage.

London Interbank Offered Rate (LIBOR)

The interest rate at which banks can borrow unsecured funds from other banks in London wholesale money markets, as measured by daily surveys of the British Bankers' Association. The published rate is a trimmed average of the rates obtained in the survey. Many contracts are tied to the level of LIBOR, making it an important benchmark.

Long Term Capital Management

A highly leveraged fixed-income arbitrage hedge fund that failed in 1998 during the Asian and Russian financial crises.

Macroprudential Supervision

Supervision aimed at promoting the stability of the financial system as a whole (see *Microprudential Supervision*).

Margin Requirement

Rules governing the necessary collateral for a derivative, loan, or related security required to cover, in whole or in part, the credit risk one party poses to another.

Market Depth

The ability of a market to absorb excess demand to buy or sell a security without affecting the price quoted for subsequent trades. A market with a lot of depth will have low price impact from trading.

Market Liquidity

The ability of a market to absorb large and frequent transactions with limited price impact and low transaction costs.

Maturity Transformation

The funding of long-term assets with short-term liabilities. This creates a balance-sheet mismatch that can pose risks when short-term funding markets are constrained.

Metadata

Data that provide information about the structure, format, or organization of other data.

Microprudential Supervision

Supervision of the activities of a firm to ensure soundness and honest dealings (see *Macroprudential Supervision*).

Money Market Fund (MMF)

A fund that typically invests in government securities, certificates of deposit, commercial paper, or other highly liquid and low-risk securities. Some MMFs are governed by Rule 2a-7.

Option

A financial contract granting the holder the right but not the obligation to engage in a future transaction on an underlying security or real asset. The most prominent examples are an equity call option, which provides the right but not the obligation to buy a block of shares at a fixed price for a fixed period, and an equity put option, which similarly grants the right to sell a block of shares.

Overnight Indexed Swap (OIS)

An interest rate swap that serves as a measure of investor expectations of an average effective overnight rate over the term of the swap (see *Interest Rate Swap*).

Over-the-Counter (OTC)

A method of trading that does not involve an organized exchange. In over-the-counter markets, participants trade directly with each other, typically through voice or computer communication.

Prime Broker
Brokerage that provides a range of services to hedge funds, including securities lending, financing, trade execution, and cash management.

Procyclical
See *Countercyclical*.

Regulatory Arbitrage
The practice of taking advantage of differences between regulatory regimes to avoid their costs or constraints.

Rehypothecation
The reuse by a broker of collateral posted by a client, typically a hedge fund, for the broker's use for securities lending or as collateral for its own borrowing.

Repo Run
A situation in which repo investors lose confidence in the market—due to concerns about counterparties, collateral, or both—and respond by pulling back their funding or demanding larger haircuts.

Repurchase Agreement (Repo)
A transaction in which one party sells a security to another party, while agreeing to repurchase it from the counterparty at some date in the future at an agreed price, often done on an overnight basis as a form of liquidity for banks. The net effect is essentially a collateralized loan.

Risk Management
The business and regulatory process of identifying and measuring risks and then responding to them. Categories of risk include operations, credit, market, control, liquidity, model, and regulatory.

Risk Premium
The difference between the expected return of an asset and that of a risk-free asset. It is the investor's premium for bearing the risks of holding that asset.

Risk Transformation
A form of financial intermediation in which an intermediary raises funds from risk-averse investors and then uses those funds to provide capital to borrowers for risky ventures. Risk is retained by the intermediary and its capital serves as a buffer against losses for its investors.

Securities Industry and Financial Markets Association (SIFMA)
A securities industry trade group representing securities firms, banks, and asset management companies.

Securities Lending/Borrowing
The temporary transfer of securities from one party to another for a specified fee and term, in exchange for collateral in the form of cash or securities.

Securitization
A financial transaction in which assets such as mortgage loans are pooled and securities representing interests in the pool are issued.

Shadow Banking System
Credit intermediation by unregulated or lightly regulated financial institutions in combination with the creation of money-like liabilities, involving leverage and maturity transformation, in opaque markets.

Short-Term Wholesale Funding
Funding instruments that are typically issued to institutional investors to raise large amounts of funding for short periods. Examples include large checkable and time deposits, commercial paper, and repurchase agreements.

Sovereign Debt Crisis
A financial crisis created by the potential or actual default of government debt.

Stress Test
A modeling exercise where asset prices are shocked a pre-specified amount, sometimes

along with other financial and economic variables, in order to observe the effect on financial institutions or markets.

Structural Risk

Aspects of the design of the financial system that make it vulnerable to a shock. Structural risks could include excessive leverage or liquidity, crowded trades, large credit concentrations, poor governance, overreliance on one or a small number of essential service providers, or data and analytical gaps.

Structured Investment Vehicle (SIV)

A specific type of off-balance-sheet entity, popular before the financial crisis of 2007–2009, that issued short- and medium-term securities and invested the funds in a mix of assets, including asset-backed securities. SIVs sought to profit from the credit spread between long-term and short-term financial products.

Supervisory Capital Assessment Program (SCAP)

A stress test, conducted in 2009, designed to estimate the capital needs of U.S. bank holding companies with assets exceeding $100 billion under an adverse macroeconomic scenario; it was administered by the Federal Reserve, OCC, and FDIC.

Swap

An exchange of cash flows agreed by two parties with defined terms and over a fixed period.

Swap Execution Facility

A term defined in the Dodd-Frank Act as a trading platform which market participants use to execute and trade swaps by accepting bids and offers made by other participants.

SWIFT Messages

Payment and account reconciliation messages transmitted over the SWIFT (Society for Worldwide Interbank Financial Telecommunication) network, a secure platform designed to promote standards for international communication and fund transfers.

Systemic Expected Shortfall (SES)

The propensity for a financial firm to be undercapitalized when the system as a whole is undercapitalized, from Acharya and others (2010) (see References for Chapter 3).

Tail Risk

The risk of an extreme drop in the value of an asset. These risks are particularly difficult to model because they require estimating rare events with limited precedence.

Term Premium

The excess yield an investor must receive in order to purchase a longer maturity bond over a shorter maturity bond of the same issuer.

Tier 1 Capital Ratio and Tier 1 Common Capital Ratios

Two measures of banking capital adequacy defined in the Basel accords in which capital is compared to total risk-weighted assets. Tier 1 capital includes common stock, preferred stock, and retained earnings. Tier 1 common capital is more narrowly defined and excludes preferred stock.

Too Big To Fail

The assumption among market participants that some financial institutions are so large and interconnected that the government would rescue them in a crisis due to the perceived threats that their failure could pose to financial stability.

Tri-Party Repo

A repurchase agreement in which a third party agent, such as a clearing bank, acts as an intermediary to facilitate the exchange of cash and collateral between the two counterparties. In addition to providing operational services to participants, the tri-party agents in the U.S. tri-party repo market extend large amounts of intraday credit to facilitate the daily settlement of tri-party repos.

Underwriting Standards

Terms, conditions, and criteria used to determine the extension of credit in the form of a loan or bond.

Value at Risk (VaR)

An important tool for market risk management that measures the risk of loss of a portfolio. The VaR projects the maximum expected loss for a given time horizon and probability. For example, the VaR over 10 days and with 99 percent certainty measures the most one would expect to lose over a 10-day period, 99 percent of the time.

Variable Rate Demand Note (VRDN)

A type of security that allows a municipality to borrow over the long run while paying short-term interest rates.

XBRL (eXtensible Business Reporting Language)

A global reporting standard that enables the free and open exchange of business and financial information. The language is XML-based and uses XML syntax.

XML (eXtensible Markup Language)

A markup language that defines a set of rules for encoding documents or data structures that are both human-readable and machine-readable.