

**WALL STREET WITHOUT WALLS**  
**FEDERAL RESERVE BANK OF DALLAS**

**GLOSSARY OF TERMS**

**Accrued interest:** Interest earned on a bond from the last date interest was paid by the issuer to the present.

**Agency theory:** The analysis of principal-agent relationships, in which one person, an agent, acts on behalf of another person, a principal.

**Agent:** A party appointed to act on behalf of a principal entity or person. Someone who acts on behalf of another.

**Asset-Backed Securities:** Asset-backed securities represent securitized interests in a pool of assets. Issues have been backed by credit card receivables, auto loans and other forms of consumer installment loans. Investors receive monthly payments of principal and interest. All principal and interest payments flow directly to investors. Securities backed by revolving credit lines, such as credit cards, may delay distributing principal during a lockout period. During that period, principal cash flows are reinvested in additional receivables. Once the lockout period is over, principal flows to the investors. The rate at which asset-backed securities pay down principal, as well as their ultimate maturity date, is uncertain. This is because principal cash flows depend upon the rate at which individual consumers decide to prepay their indebtedness.

**Bonds:** Bonds, otherwise known as fixed-interest securities, are basically IOUs issued by governments, financial institutions and companies. Generally, the issuer undertakes to pay investors a fixed rate of interest for a fixed number of years (e.g. 7% for 5 years). The fact that the interest rate is fixed makes bonds attractive because their return is so predictable. Bonds are traded in open markets, in the same way as shares.

**Capitalize:** When an organization takes risk—be it the risk of a new venture or perhaps the risk of proprietary trading—the institution will set aside capital to support the risk. In the case of a new venture, the capital might be used to purchase plant and equipment. In the case of proprietary trading, it would be set aside to assure regulators, investors and counterparties that the institution could survive adverse performance. With this process, the organization is said to capitalize the risk.

**Collateral Community Funds:** A type of foundation formed by broad-based community support from multiple sources: trusts, endowments, individual contributions, private foundations, or corporate grants. A community foundation generally makes grants only within a specified geographic area, governed by a board representing the community it serves. Some community foundations offer donor-advised funds to contributors.

**Corporate Bond:** Companies issue bonds to raise money and pay interest on the bonds. Usually bonds expire on a fixed date, when the company repays you. You can buy and sell bonds easily (like shares). Bond prices tend to change when interest rates change and are usually not as risky as shares because a company will pay off all its debts (including bonds) before the shareholders get anything.

**Community Reinvestment Act:** The Community Reinvestment Act is intended to encourage depository institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods. It was enacted by the Congress in 1977 (12 U.S.C. 2901) and is implemented by Regulation BB (12 CFR 228). The regulation was revised in May 1995. The CRA requires that each depository institution's record of helping to meet the credit needs of its entire community be evaluated periodically. That record is taken into account when considering an institution's application for deposit facilities. Neither the CRA, nor its implementing regulation gives specific criteria for rating the performance of depository institutions. Rather, the law indicates that the evaluation process should accommodate an institution's individual circumstances. CRA examinations are conducted by the federal agencies that are responsible for supervising depository institutions. CRA information on other depository institutions is available from the [Federal Deposit Insurance Corporation](#) (FDIC), the [Office of the Comptroller of the Currency](#) (OCC), and the [Office of Thrift Supervision](#) (OTS). Interagency information about the CRA is available from the [Federal Financial Institutions Examination Council](#) (FFIEC).

**Coupon:** The Coupon states the rate and on what date interest will be paid on a bond, usually semi-annually.

**Credit Enhancement:** Credit enhancement is a provision that is added to a deal in order to protect parties to the deal from a possible default by another of the parties. A third party may guarantee the performance of one or more parties to the deal. Alternatively, a letter of credit may be obtained from a bank. A drawback of credit enhancements is that they can add to the cost of a deal. For example, when an institution posts collateral, it incurs the cost of financing that collateral.

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**Debt service:** The total amount of money required to meet the annual principal and interest payments when due. Coverage for revenue bonds, a ratio of how many times the net project revenues exceed the total annual debt service due in the same period.

**Default:** The failure of an issuer to promptly pay principal and/or interest when due.

**Discounted rate:** An arrangement providing a set reduction, or 'discount' off our standard variable rate for a specified period of time. At the end of the specified period your mortgage rate will change to the standard variable rate in force at the time. Sometimes redemption penalties are associated with this type of deal.

**Fund:** Fund is a general term for any investment vehicle which pools together the money of many small individual investors and invests it in certain markets and securities according to a defined set of investment aims and objectives. Covers such investments as unit trusts, investment trusts and pension plans.

**Fundamentals:** Usually refers to the underlying economic factors affecting a particular market, country or sector and will include such aspects as industrial output, wages and raw materials costs, currency strength or weaknesses, trade balance and so on.

**Fungibility:** The substitutability of listed options, which is dependent upon their common expiration dates and strike prices. The congruence of expiration dates and strike prices lets investors close positions by offsetting transactions through the options clearing corporation.

**High-Yield Bond:** High-yield bonds (often called junk bonds) are corporate bonds with significant credit risk. High-yield bonds trade with yields-to-maturity exceeding those of otherwise comparable instruments.

**Individual Taxpayer Identification Number (ITIN):** ITIN is tax processing number issued by the Internal Revenue Service. It is a nine-digit number that always begins with the number 9 and has a 7 or 8 in the fourth digit, example 9XX-7X-XXXX. IRS issues ITINs to individuals who are required to have a U.S. taxpayer identification number but who do not have, and are not eligible to obtain a Social Security Number (SSN) from the Social Security Administration (SSA). ITINs are issued regardless of immigration status because both resident and nonresident aliens may have U.S. tax return and payment responsibilities under the Internal Revenue Code.

**Insurance:** An agreement under which individuals, businesses, and other organizations, in exchange for payment of a sum of money (a premium), are guaranteed indemnity for losses resulting from certain events or conditions specified in a contract (policy).

**Interest:** The monthly effective rate paid on borrowed money (a loan). Expressed as a % of sum borrowed.

**Market Capitalization:** The value of a company as measured by the total stock market price of its issued and outstanding shares. This is calculated by multiplying the number of shares by the current market price of a share. It is also widely used as a definition of company size - hence, big corporations are usually referred to as large cap stocks (See also Small Caps).

**Maturity:** The date upon which the issuer repays the principal.

**Maximum Credit Exposure:** Maximum credit exposure (also called worst-case credit exposure) is a statistical risk measure which quantifies the potential credit exposure of a party to a specific counterparty at a specified time in the future, based on existing contracts with that counterparty. Maximum credit exposure is calculated at a specified confidence level C for some time T in the future.

**Nonprofit:** (Also Not for profit and sometimes Charitable). A term describing the Inland Revenue (in Britain) and the Internal Revenue Service (in the US) designations of an organization whose income is not used for the benefit or private gain of stockholders, directors, or any other persons with an interest in the company. A nonprofit organization's income must be used solely to support its operations and stated public purpose.

**Pooled Investment Fund:** A vehicle for bringing together the investments of many people or organizations and using the combined funds to obtain economies of scale and investment management skills not available to individuals. Examples include unit trusts, investment trusts, etc.

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**Program Related Investments (PRI):** While most foundations make grants to support their programmatic interests, some funders have developed an alternative financing approach known as program-related investing (PRIs) to supply capital to the nonprofit sector. PRIs are charitable investments used to support community revitalization, low-income housing, micro-enterprise development, historic preservation, human services, and more. Source of Information is provided in Program-Related Investments: A Guide to Funders and Trends. Offering current perspectives of PRI providers and recipients; a directory of leading PRI providers; examples include more than 550 PRIs.

**Private Placement:** Private Placements are securities or privately placed debt negotiated directly between the company (issuer) and the lender. If the issue is too large to be absorbed by one institution, the company generally employs an investment banker to draw up the prospectus and identify the possible buyers. It costs less to arrange a private placement than to make a public issue. The private placement can be custom tailored for firms with special problems or opportunities. Renegotiating a private placement after some extreme event is much easier with a private placement than with a public issue. Private placements usually face the most detailed investigation or due diligence and may require specialized loan arrangements. Private placements account for approximately ½ of the US bond placements a/o/1990.

**Project Finance:** Debt that is largely a claim against cash flows from a particular project rather than against the firm as a whole.

**Ratings:** Credit categories that denote the various degrees of quality for a bond. The major rating agencies establish their own criteria for each credit rating. The rating agencies are Standard & Poors, Moodys, Fifth ICBA, Duff & Phelps. There are other specialized rating groups as well.

**Risk:** Risk is the degree of uncertainty of the return on an asset. Often defined as the standard deviation of the return on total investment.

**Risk Premium:** Expected additional return for making a risky investment rather than a safe one. The tendency for potential risk to vary directly with potential return, so that the more risk involved, the greater the potential return, and vice versa.

**Securitization:** Securitization is a process whereby assets are pooled and security interests in the pool are sold—typically to institutional investors. Assets created in this manner include mortgage-backed securities backed by residential mortgages, and asset-backed securities backed by credit card receivables or consumer installment loans. In a typical arrangement, the assets are transferred to a trust and security interests are sold to investors. In this way, the investors incur the prepayment risk of the underlying assets. Most deals entail some sort of credit enhancement. This may include over-collateralization, a third party guarantee, or other enhancements. For this reason, the securities tend to have excellent credit ratings. The originator of the underlying assets may continue to process the assets—communicating with borrowers and collecting their payments. They subtract a fee for doing so.

**Socially Motivated Capital:** SMC seeks to develop philanthropy and volunteerism to achieve positive social change in distressed or low wealth communities. Using either the capital markets, market rate debt instruments or the venture capital approach as a model, socially motivated capital commits time, money and expertise to create partnerships with not-for-profit organizations.

**Subordinated Debt (junior debt):** Debt over which senior debt takes priority. In the event of bankruptcy, subordinated debt holders receive payment only after senior debt is paid off in full.

**Tranche:** In the bond market Tranche has two meanings 1) One of a series of two or more issues with the same coupon rate and maturity date, but with different dated dates. The tranches become fungible at a future date, usually the first coupon date. 2) A bond that shares documentation with another issue, but has different terms. Tranches from the same offering usually have different risk, reward, and/or maturity characteristics.

**Underwriter:** A technician trained in evaluating risks and determining rates and coverage for them. The term derives from the practice at Lloyd's of each person willing to accept a portion of the risk writing his name under the description of the risk.

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**Underwriting:** Where an insurance company takes into account known facts like a portfolios defaults, delinquencies, cost of capital, in order to assess the likelihood of investors making a claim on the policy. Insurance premiums are calculated after taking these factors into consideration.

**Yield:** The amount of income an investment delivers after deduction of charges (but not tax) expressed as a percentage of the amount invested. Usually expressed as an annual figure - e.g. "the fund's estimated gross yield is 5.9% p.a."

**Return Yield:** Three different measures of a bond's potential rate of return are used: **Current yield:** This is the most simple - and crude - measure. It is simply the bond's annual coupon divided by the bond's current market price. If a bond is trading above or below par, current yield can give a misleading sense of a bond's potential rate of return.

**Yield to maturity:** This is the rate of return which the bond will realize, based upon its current market price, if it is not called, and makes all of its principal and interest payments as scheduled. **Yield to call:** This is the rate of return which the bond will realize, based upon its current market price, if it is called on the next call date, but otherwise makes all its principal and interest payments as scheduled. Typically, the term yield will be used by itself to signify yield to maturity. For non-callable instruments, this is an unambiguous measure of potential rate of return.