

Glossary of Terms
Federal Reserve Bank of St. Louis
September 2009

Adjustable-rate mortgage (ARMs)—A mortgage loan with an interest rate that changes, usually in response to changes in the LIBOR, the Treasury Bill rate or the prime rate. The interest rate adjusts primarily to bring the rate on the mortgage in line with market rates. The borrower is usually protected by a maximum interest rate (called a ceiling) which may reset annually. ARMs usually start with a lower interest rate than the rate for fixed-rate mortgages to compensate the borrower for the risk of future interest rate changes.

Broker—A broker is someone who works as a conduit between a lender and a borrower

Cash-out refinancing—The process of taking out a new *mortgage* amount that exceeds the balance on the current mortgage in order to refinance the original mortgage and receive additional cash for other uses.

Collateralized debt obligation—A debt *security* backed by a pool of commercial loans.

Collateralized mortgage obligation – A debt security backed by a pool of mortgage loans or some combination of residential mortgage loans and agency securities. A transaction in which collateralized mortgage obligations are issued usually involves multiple classes of securities having varying maturities and coupons.

Consumer Confidence Survey™--This survey reflects prevailing business conditions and likely developments for the months ahead. This monthly report details consumer attitudes and buying intentions, with data available by age, income and region.

Consumer Price Index (CPI)—A measure of the prices paid by urban consumers for a market basket of consumer goods and services.

Credit—The granting of money or something else of value in exchange for a promise of future repayment.

Credit cards—Cards that represent an agreement between a lender—the institution issuing the card—and the cardholder. Credit cards may be used repeatedly to buy products or services or to borrow money on credit. Credit cards are issued by banks, savings and loans, retail stores and other businesses.

Credit history—A person's payment activity over a period of time.

Credit markets—Financial markets in which investors trade securities based on their appetite for risk.

Credit rating agencies—A credit rating agency is a company that estimates the credit worthiness of the borrowers underlying debt obligations and then assigns a rating.

Credit report—A loan and bill payment history kept by a credit bureau and used by financial institutions and other potential creditors to determine the likelihood a future debt will be repaid.

Glossary of Terms
Federal Reserve Bank of St. Louis
September 2009

Credit score—A number that predicts the likelihood that a borrower will be able to repay a loan as agreed. Credit-reporting agencies are businesses that collect information about consumers' loan and bill payment histories. Credit agencies keep these records and, upon request, provide information to creditors in the form of a credit report. When a creditor requests a borrower's credit report, a credit score is generated based on the information in the credit report. Factors that can damage a credit score include late payments, absence of credit references, too much outstanding credit and unfavorable credit card use.

Credit standards—The guidelines used to determine if a potential borrower is creditworthy. Credit standards are often created after careful analysis of past borrowers and market conditions, and are designed to limit the risk of a borrower not making payments.

Debt—An amount owed to a person or organization for funds borrowed. Examples of debt include loan notes, mortgages or other forms stating repayment terms and, when applicable, interest requirements. These different forms all imply intent to repay an amount owed by a specific date which is set forth in the repayment terms.

Deflation—A generally downward movement of prices for goods and services in an economy.

Depression—A very severe recession; a period of severely declining economic activity spread across the economy (not limited to particular sectors or regions) normally visible in a decline in real GDP, real income, employment, industrial production, wholesale-retail credit and the loss of overall confidence in the economy.

Discount Window Lending—Lending by the Federal Reserve to financial institutions which includes primary credit, secondary credit, seasonal credit and emergency credit.

Down payment—The part of the purchase price paid in cash up front, reducing the amount of the loan or mortgage.

Economic stability—A broad economic goal that encompasses both price stability—the absence of inflation and deflation—and employment stability.

Economic stabilization—Implementing policies to avoid economic and financial crises. Economic stability means avoiding large swings in economic activity, high inflation and excessive volatility in exchange rates and financial markets.

Fannie Mae—Federal National Mortgage Association—The largest buyer of home mortgages from a wide range of mortgage originators, including banks and thrifts. Fannie Mae securitizes and guarantees most of these loans as mortgage-backed securities. It sells the securities to investors or retains them for its own portfolio. Fannie Mae issues debt to fund its own portfolio holdings and holds a small amount of equity capital. Congress established Fannie Mae in 1938 to create a secondary market for government-backed mortgages. Fannie Mae has operated since 1968 as a government sponsored enterprise (GSE). Since September 2008, Fannie Mae has operated under a government conservatorship.

Glossary of Terms
Federal Reserve Bank of St. Louis
September 2009

Federal Funds Rate—The interest rate that U.S. banks charge one another for loans. This is the rate targeted by the Federal Open Market Committee (FOMC) when it undertakes monetary policy open market operations.

Federal Reserve Act—Federal legislation, enacted 1913, that established the Federal Reserve System.

Federal Reserve System—The central bank of the United States, created by the Federal Reserve Act. The Federal Reserve System is made up of a seven-member Board of Governors in Washington D.C., twelve regional Federal Reserve Banks and Branches of the Federal Reserve Banks.

Federal Open Market Committee (FOMC)—A major component of the Federal Reserve System. The FOMC is a twelve-voting-member committee made up of the seven members of the Board of Governors, the president of the Federal Reserve Bank of New York and presidents of four other Federal Reserve Banks, who serve on a rotating basis. The FOMC oversees open market operations, which is the main tool used by the Federal Reserve to influence overall monetary and credit conditions.

Financial institutions—Institutions that use their funds chiefly to purchase financial assets, such as loans or securities (as opposed to tangible assets such as real estate). Financial institutions can be separated into two major groups according to the nature of the principal claims they issue: (1) depository institutions, such as commercial banks, savings and loan associations, savings banks and credit unions, which obtain funds largely by accepting deposits from the public and (2) non-depositories, such as life insurance and property-casualty insurance companies and pension funds, whose claims are the policies they sell or their promise to provide income after retirement.

Financial stability – The absence of financial crises.

Fiscal policy—Spending and taxing policies used by the federal government to influence the economy.

Fixed-rate mortgage—A mortgage for which the interest rate does not change during the entire term of the loan.

Fractional reserve banking system—A banking system in which the amount of reserves that banks hold is less than the value of their customers' deposits.

Freddie Mac—Federal Home Loan Mortgage Corporation—Established in 1970 and operated as a GSE, it is the second largest player in the secondary mortgage market after Fannie Mae. Freddie Mac securitizes and guarantees most of these loans as mortgage-backed securities. It sells the securities to investors or retains them for its own portfolio. Freddie Mac issues debt to fund its own portfolio holdings and holds a small amount of equity capital. Since September 2008, Freddie Mac has operated under a government conservatorship.

Government securities—Securities issued by the U. S. Treasury or federal agencies. (See U. S. Treasury securities.)

Glossary of Terms
Federal Reserve Bank of St. Louis
September 2009

Gross Domestic Product (GDP)—The market value of all final goods and services produced within an economy during a year.

Income—Earnings received as interest, rent, profit and wages or salaries.

Inflation—A generally upward movement of the prices of goods and services in the economy.

Interest rate—The percentage of the amount loaned that is charged for a loan. Also, the percentage of interest paid on a savings account.

International capital—Flows of financial instruments into and out of the United States

LIBOR--London Inter-Bank Offer Rate—The interest rate that banks charge each other for loans. This rate is applicable to the short-term international interbank market and is the primary benchmark for interest rates around the world.

Liquidity—The ability of an asset to be converted into cash quickly and without any price discount.

Monetary policy—Central bank actions involving the use of interest rate or money supply tools to achieve such goals as maximum employment, stable prices and moderate long-term interest rates.

Money supply (stock)—The quantity of money available in an economy. The basic money supply in the United States consists of currency, coins and checking accounts (i.e., demand deposits).

Mortgage—A loan to a borrower usually for the purchase of real estate such as a house or a similar property.

Mortgage broker—An individual or company that brings borrowers and lenders together for the purpose of loan origination. However, the mortgage broker does not originate or service the mortgage. A broker might also negotiate with the lender to try to find the best possible financing deal for the borrower. The broker receives a fee for completing the transaction.

Mortgage-backed security—A bond that is created by pooling multiple mortgages.

No-doc/low-doc mortgage—A category of loans that give borrowers the ability to state a limited amount of information on their mortgage application. Limited income, employment or asset information may be required depending on the specific type of low documentation loan; however, in some cases the borrower may not need to document the information at all.

Glossary of Terms
Federal Reserve Bank of St. Louis
September 2009

Originate to distribute model—The traditional mortgage model involved a financial institution originating a loan to the borrower and retaining the credit (default) risk. Over time, traditional model gave way to the "originate to distribute" model, in which financial institutions essentially sell the mortgages and distribute credit risk to investors through mortgage-backed securities.

Prime rate—The *interest rate* that commercial banks charge their best customers—that is—their most creditworthy borrowers, such as large corporations.

Private-label security—In the housing finance business, a mortgage-backed security or other bond created and sold by a company other than a government sponsored enterprise. The security frequently is collateralized by loans that are ineligible for purchase by the GSE.

Recession—In general usage, the word recession connotes a marked slippage in economic activity. The often cited identification of a recession is two consecutive quarters of a negative GDP growth. According to the National Bureau of Economic Research which determines the actual peaks and troughs of a business cycle, a recession is a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production and wholesale-retail sales. A recession begins just after the economy reaches a peak of activity and ends as the economy reaches its trough.

Securities—Paper certificates (definitive securities) or electronic records (book-entry securities) evidencing ownership of equity (stocks) or debt obligations (bonds). A security can be created when many individual assets are pooled together and sold to investors in the financial markets. The income from the assets that make up the security produce a return on investment (ROI) for the investor.

Structured financial products—A structured financial product is a broad term used to describe a sector of finance that was created to help transfer risk using complex legal and corporate entities. This risk transfer as applied to securitization of various financial assets (e.g. mortgages, credit card receivables, auto loans, etc.) has helped to open up new sources of financing to consumers. However, it arguably contributed to the degradation in underwriting standards for these financial assets, which helped give rise to both the credit bubble of the mid-2000s and the financial crisis of 2007-2009.

Structured investment vehicle—A financing mechanism where short-term debt is used to finance a range of asset-backed securities as well as corporate bonds. In theory, investors in the structured investment vehicle earn money from the "spread" between the two (the amount of income from the securities over the cost to fund the investment).

Subprime mortgage—A home loan to a borrower who has not established a good record of repaying debts (a borrower who has a poor credit history).

Troubled Asset Relief Program (TARP)—A plan proposed by Secretary of the Treasury Paulson to remove illiquid assets that are weighing down financial institutions and threatening economic stability. The TARP has now been approved by Congress and signed into law by the president.

Glossary of Terms
Federal Reserve Bank of St. Louis
September 2009

Unemployment—The number of people 16 years of age and older who are without jobs and actively seeking work.

Unemployment rate—The percentage of the labor force that is willing and able to work, does not currently have a job and is actively looking for employment.

U. S. Treasury Security—Obligations of the U. S. government issued by the U.S. Department of the Treasury as a means of borrowing money to meet government expenditures not covered by tax revenues. All marketable Treasury securities have a minimum purchase amount of \$1,000 and are issued in \$1,000 increments. There are three types of marketable Treasury securities: bills, notes, and bonds.

- Treasury bill (T-bill)—A short-term U.S. Treasury security having a maturity of up to one year. T-bills are sold at a discount. Investors purchase a bill at a price lower than the face value (for example, the investor might buy a \$10,000 bill for \$9,700); the return is the difference between the price paid and the amount received when the bill is sold or when it matures (if held to maturity, the return on the T-bill in the example would be \$300).
- Treasury note—An intermediate-term security issued with a maturity of two, five and ten years. Notes pay interest semiannually, and the principal is payable at maturity.
- Treasury bond—Long-term security having a maturity of longer than ten years. Bonds pay interest semiannually, and the principal is payable at maturity.