2. Definitions of Common Terms

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Chapter 2

Definitions of Common Terms

ABS: See "Asset-Backed Security."

Accretion Bond: See "Accrual Tranche."

Accrual Tranche: Also known as "accrual bond." Often the last tranche in a CMO, the accrual receives no cash payments for an extended period of time until the previous tranches are retired. While the other tranches are outstanding, the accrual tranche receives credit for periodic interest payments that increase its face value but are not paid out. When the other tranches are retired, the accrual tranche begins to receive cash payments that include both principal and continuing interest.

Accrued Interest: Interest deemed to be earned on a security but not yet paid to the investor. For trades that settle with accrued interest, the accrued interest represents the coupon earned by the seller of the security. The buyer of the security must reimburse the seller for this amount.

Active Tranche: An ABS tranche that is currently making principal payments to investors.

Actual Delay: The length of time from the end of an interest-accrual period to the actual payment of interest due.

Adjustable-Rate Mortgage (ARM): A mortgage loan on which interest rates are adjusted at regular intervals according to predetermined criteria. An ARM's interest rate is tied to an objective, published interest-rate index.

Agent: Any person or entity possessing authority to act on behalf of another.

Allocation: The process of assigning mortgage-backed security pools to fulfill a TBA transaction by the seller which constitutes good delivery to the buyer.

American Option: An option that may be exercised at any time before the expiration date.

Amortization: Liquidation of a debt through installment payments.

Asset-Backed Security (ABS): A security that is collateralized by any type of financial asset, such as a loan or lease, secured or unsecured receivables, mortgages or installment sales contracts. Although the term "Asset-Backed Security" generally includes any security supported by any type of financial asset, note that it is sometimes used to distinguish non-mortgage-backed securities (such as an auto loan or credit card ABS) from those collateralized by residential or commercial mortgages (which are generally referred to as "mortgage-backed securities").

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Assignee: The entity to which an assignment is made, and which thereby becomes entitled to performances by an obligor.

Assignment: The transfer of rights, duties and/or obligations from one party (the assignor) to another (the assignee).

Assignor: The entity originally entitled to receive performance from an obligor, and which assigns such entitlements to a third party (i.e., to an assignee).

Assumption Agreement: A contract whereby a buyer acquires title to property and undertakes the obligations of an existing mortgage.

Average Life: On a mortgage-backed or asset-backed security, the expected average time to receipt of each dollar of principal, weighted by the amount of each principal prepayment, based on a particular prepayment assumption.

Balloon Loan: A mortgage in which the remaining balance becomes fully due and payable at a predetermined time.

Balloon Payment: The final payment on a balloon loan.

Basis Point: One-one hundredth (1/100 or .01) of one percent. Yield differences among bonds are generally stated in basis points.

Beneficial Owner: The party entitled to principal and/or interest payments for a security, even if the security's nominal ownership is in the name of another party.

Beneficiary Date: The last day of an interest-accrual period. On the beneficiary date, the beneficial owner is entitled to the upcoming principal and interest (P&I) payment.

Bid: The price at which a buyer is willing to purchase a security.

Blackout Period: The period from the first day of accrual until the day the factor/coupon is available. Trades settling in this period should be calculated with the last available factor/coupon and subsequently canceled and corrected when the current factor/coupon is published.

Bond Equivalent Yield: An adjustment to a security's yield that reflects its greater present value. In the case of mortgage-backed securities, bond equivalent yield is often used because these securities pay monthly or quarterly interest, as opposed to semiannual interest payments on most other types of bonds.

Book-Entry: A method of recording and transferring ownership of securities electronically, thereby eliminating the need for physical movement of certificates.

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Broker: An entity that engages in securities transactions for the account of others. There are two types of brokers: (a) a give-up broker, who reveals the identity of the buyer and seller to each other, and (b) a clearing broker, who does not reveal the identity of the buyer and seller to each other. Brokers usually earn commissions for the services they provide.

Broker-Dealer: An entity engaged in buying and selling securities both for its own account and for the account of others.

Broker or Dealer Loan: A loan to a broker-dealer from a bank to finance the securities position of the broker-dealer and its customers. Broker-dealer loans may be terminated ("called") on 24-hour notice and, therefore, are also known as broker call loans.

Builder Buy-Down Loan: A mortgage loan on newly developed property that the builder subsidizes during the early years of the development. The builder uses cash to buy-down the mortgage rate to a level lower than the prevailing rate for some period of time. Typically, a builder buys-down 3% of interest in the first year, 2% in the second year and 1% in the third year.

Bullet Bond: An interest-paying bond that returns all principal on the final maturity date.

Buydown: The payment of additional points to a mortgage lender in return for a lower interest rate on the loan.

Buy-In: A method of closing out transactions in which a fail to deliver has occurred. The party that is failing to receive purchases the undelivered securities in the open market for the account and at the expense of the party that is failing to deliver.

Calculated Loan Age (CAGE): An estimate determined by the average original maturity of the loans in a pool, minus the original Weighted Average Maturity of the loans (at the time of the pool formation), plus the time elapsed since pool formation. The Federal Agencies do not use CAGE calculations at this time.

Call Option: The right, but not the obligation, to purchase a security at a predetermined price on or before a specified future date.

Call Risk: The risk that declining interest rates may accelerate underlying loan prepayment speeds, causing an investor's principal to be returned sooner than expected. As a consequence, investors may have to reinvest their principal at a lower rate of interest.

Cap: The upper limit for the interest rate on an adjustable-rate loan or security.

Carry: The interest cost of financing securities positions, calculated by subtracting the financing costs from the interest earned on securities.

Ceiling: Also known as a lifetime cap, the limit beyond which the interest rate on an adjustable mortgage rate may never be raised.

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Claim (P&I): A request by the beneficial owner of a security (as of the record date) for payment of monies owed for principal and interest. For registered securities, when the security is registered in a name other than that of the beneficial owner, the beneficial owner claims the principal and interest from the registered holder whose name appears on the books of the paying agent as of the record date.

Clean REMIC: See "Sequential Pay Security."

Clean-up Call: The process of calling a bond when the outstanding balance in a transaction is a small percentage of the original deal (usually 5-15%).

Clear: To consummate a trade by delivering securities in proper form to the buyer and funds in proper form to the seller. Trades that are not cleared on the settlement date are said to fail.

Clearing Agent: An entity that clears transactions for other entities.

Clearinghouse Funds: Funds represented by checks or drafts that pass between banks through the Federal Reserve System. Clearinghouse funds are next-day available funds.

CMT (Constant Maturity Treasury): A series of indices of various maturities (one, three, five, seven or ten years) published by the Federal Reserve Board and based on the average yields of a range of Treasury securities adjusted to a constant maturity corresponding to that of the relevant index.

COFI (Cost of Funds Index): A bank index reflecting the weighted-average interest rate paid by savings institutions on their sources of funds. There are national and regional COFI indices; the most prevalent is the 11th District COFI.

Collateral: Securities or property pledged by a borrower to secure payment of a loan or the performance of some other obligation. If the borrower fails to repay the loan or perform the obligation, the lender may take ownership of or otherwise realize the value of the collateral. Collateral for CMOs consists primarily of mortgage pass-through securities or mortgage loans, although it may also encompass letters of credit, insurance policies or other credit enhancements.

Collateralized Mortgage Obligation (CMO): A multiclass issue backed by a pool of mortgage pass-through securities or mortgage loans. Also see "REMIC."

Companion Tranche: A CMO tranche that absorbs a higher or lower proportion of prepayments in order to stabilize the principal payment schedule for a related PAC or TAC tranche in the same offering. Also known as a support tranche.

Confirmation: A transaction advice — in electronic or physical form — used by securities dealers and banks to express the basic terms of an agreement to buy or sell a security.

Conventional Mortgage Loan: A mortgage loan issued by a bank or thrift institution that is based solely on real estate as security and is not insured or guaranteed by a government agency or instrumentality.

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Conventional Pass-Through Securities: Pass-through mortgage-backed securities whose payments of principal and/or interest are not insured or guaranteed by a government agency or instrumentality.

Coupon Rate: The stated annual percentage rate of interest, whether fixed or variable, paid on a fixed-income instrument.

CPR (Constant Repayment Rate): The percentage of outstanding mortgage loan principal that prepays in one year, based on the annualization of the Single Monthly Mortality (SMM), which reflects the outstanding mortgage loan principal that prepays in one month.

Current Face: The current remaining principal balance outstanding on a security. Current face is computed by multiplying the original face value of the security by the current principal balance factor.

CUSIP Number: A unique nine-digit identification number permanently assigned by the Committee on Uniform Securities Identification Procedures to each publicly traded security at the time of issuance. If the security is in physical form, the CUSIP number is printed on its face.

Customer: Generally, an individual or other entity that (i) is not a registered broker or dealer, (ii) is not principally engaged in the business of buying or selling securities for its own account, or for the account of others, and (iii) acts as a buyer of securities for its own account, rather than as a seller. Each party to a trade should establish whether its counterparty will be considered to have customer status.

Dealer: Generally, an individual or other entity that is principally engaged in the business of buying and selling securities for its own account. Each party to a trade should establish whether its counterparty will be considered to have dealer status.

Delay: See “Actual Delay” and “Stated Delay.”

Delayed-Delivery Contract: A contract for the purchase or sale of a mortgage-backed security to be delivered at an agreed-upon future date. May also be known as a “TBA” (“To Be Announced”), because as of the trade date the seller has not yet identified certain terms of the contract, such as the pool number and number of pools, to the buyer.

Delivery Date: The date upon which the actual payment of funds and the delivery of securities occurs. The standard delivery date for a TBA transaction is on the business day 48 hours after the seller gives the buyer pool information, provided that such pool information is given before the requisite cutoff time and provided further that delivery cannot be made before the settlement date.

Delivery Versus Payment (DVP): A transaction in which the buyer’s payment for securities is due at the time of delivery by the seller of the securities. Payments can be made by bank wire, check or direct credit to an account.

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Depository: An institution that accepts securities for deposit and that facilitates book-entry delivery and transfer between and among its members.

The Depository Trust Company (DTC): A participant-owned securities depository that accepts deposits of eligible securities for custody, executes book-entry deliveries and records book-entry pledges of securities in its custody and provides for withdrawals of securities from its custody. DTC's depository services extend to many CMOs, ABSs and conventional pass-through securities. DTC is a limited-purpose trust company chartered by the State of New York, a member of the Federal Reserve system and registered with the Securities and Exchange Commission as a clearing agency.

DK: See "Don't Know."

Don't Know: Also known as "DK" or "bounce." A term used by a buyer when the buyer or its receiving agent does not recognize or acknowledge the confirmation or the securities that the seller has delivered.

Draft Delivery: The delivery of securities to a location outside of New York City (usually) to be paid for upon receipt at their intended destination.

Due Bill: (1) A document delivered by the seller of a security to a buyer evidencing that any principal and interest received by the seller past the record date for that security will be paid to the buyer by the seller. (2) A document delivered by a seller to a buyer in lieu of securities which evidences the seller's obligation to deliver securities to the buyer at a later date.

Due Bill Check: A post-dated check that is issued by the seller to the buyer and that becomes payable to the buyer on a specified date (the next payable date) in the amount of principal and interest due to the buyer. Prior to the specified payable date, the due bill check serves as a due bill.

Electronic Pool Notification (EPN): A real-time centralized computer network offered by the MBS Clearing Corporation (MBSCC) for buyers and sellers of mortgage-backed securities to exchange pool information electronically, eliminating the need to communicate via telephone or facsimile.

Endorsement: A signature or equivalent indication on an instrument by which all right, title and interest in such instrument are assigned and transferred by a registered owner or its authorized agent.

European Option: An option that may be exercised only on the expiration date.

Exercise: The act of calling or putting the option, which results in the receipt or delivery of the underlying security.

Exercise Date: The date upon which an option may be exercised.

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Expiration Date: The last day upon which an option may be exercised.

Extension Risk: The risk that rising interest rates may slow anticipated prepayment speeds, causing investors to find their principal committed longer than expected. As a consequence, they may miss the opportunity to reinvest principal at the then higher market rates of interest .

Factor: A decimal value reflecting the proportion of the outstanding principal balance of a security, which changes over time in relation to its original principal value, which is expressed as a factor of 1.0.

Fail: A trade is said to fail if on the settlement date the seller fails to deliver securities in good delivery form to the buyer. The purchaser who has not received the securities is said to have a "fail to receive." The seller who has not delivered the securities is said to have a "fail to deliver."

Fannie Mae: See "Federal National Mortgage Association."

Fannie Mae Dwarf: A Fannie Mae mortgage pool backed by fixed-rate mortgages with 15-year terms. Fannie Mae Dwarf is a dealer term and is not used by Fannie Mae.

FASIT (Financial Asset Securitization Investment Trust): A special-purpose tax vehicle for a wide range of financial asset securitizations, similar to the tax vehicle employed by REMICs for multiclass mortgage securitizations.

Fast-Pay Bond: Tranches in a CMO/REMIC with relatively short average lives that are likely to pay down quickly in a declining interest-rate environment.

Fed Book-Entry: An electronic registration, transfer and settlement system for securities on the Federal Reserve system.

Federal Funds: Also known as "Fed funds." Funds deposited by commercial banks at Federal Reserve Banks, including funds in excess of bank reserve requirements. Member banks may lend federal funds to each other on an overnight basis. Member banks may also transfer funds between each other or on behalf of customers on a same-day basis by debiting and crediting their balances at the Federal Reserve Bank. Federal funds are immediately available funds.

Federal Home Loan Bank System: Established in 1932, the system is made up of 12 regional Federal Home Loan Banks and supplies credit reserves for savings and loan institutions, cooperative banks and other mortgage lenders.

Federal Home Loan Mortgage Corporation: Also known as "Freddie Mac" or "FHLMC." Freddie Mac is a federally chartered, publicly owned corporation. It was created by Congress to enhance the secondary mortgage market. It is authorized to purchase and sell conventional, FHA-insured and VA-guaranteed loans. Freddie Mac guarantees the timely payment of interest and payment of principal on the majority of its pass-through mortgage-backed securities.

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Federal Housing Administration (FHA): The FHA is a corporate instrumentality of the U.S. Government created in 1934 under the National Housing Act to insure lenders against loss on residential mortgages.

Federal National Mortgage Association: Also known as "Fannie Mae" or "FNMA." Fannie Mae is a federally chartered, publicly owned corporation that was created by Congress to enhance the secondary mortgage market. It is authorized to purchase and sell conventional, FHA-insured and VA-guaranteed loans. Fannie Mae guarantees the timely payment of principal and interest on its pass-through mortgage-backed securities.

Federal Reserve System (the "Fed"): A system established by the Federal Reserve Act of 1913 to regulate the U.S. monetary and banking system. The Fed is comprised of the Board of Governors and the Federal Reserve Board, which is the central decision-making authority. The system also includes 12 district Federal Reserve Banks, their 24 branches and all national and state banks that are part of the system. The Fed's functions include regulating the national money supply and operating the Fedwire Network.

Fedwire® Network: A computer system linking member banks to the Federal Reserve System and used for making interbank payments of Fed funds and for transferring in book-entry form U.S. Treasury securities and certain federal agency securities, as well as Ginnie Mae, Fannie Mae and Freddie Mac mortgage-backed securities.

Fedwire Network Message: An electronic message issued by the Fed that evidences the transfer of securities over the Fedwire Network. The Fed also issues funds Fedwire Network messages that evidence the transfer of funds over the Fedwire Network.

Federal Housing Finance Agency ("FHFA"): The FHFA is the regulator of Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System.

Fee: (1) Commitment fee: a payment to investors or prospective investors, which may or may not be refundable, for the purpose of obtaining a commitment to purchase securities. (2) Standby fee: a nonrefundable amount received or paid for the sale or purchase of a standby commitment. (3) Up-front fee: a commitment fee paid in advance of the settlement date to an investor as part of a future purchase.

Flat: (1) A trade that settles with no accrued interest. (2) An offsetting position in securities.

Floating-Rate Security: A security that pays an adjustable rate of interest tied to a representative interest rate index such as the London Interbank Offered Rate (LIBOR), the Constant Maturity Treasury (CMT) or the Cost of Funds Index (COFI).

Floor: The lower limit for the interest rate on an adjustable-rate loan or security.

Foreclosure: Legal procedure for enforcing payment of a debt by seizing and selling the mortgaged property.

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48-Hour Rule: The requirement that all pool information, as specified in these *Uniform Practices,* in a TBA transaction be communicated by the seller to the buyer before the requisite cutoff time on the business day 48 hours prior to the agreed settlement date.

Forward Trade: A transaction in which the settlement is scheduled to occur on a specified date in the future at a price agreed upon on the trade date.

Freddie Mac: See "Federal Home Loan Mortgage Corporation."

Ginnie Mae : See "Government National Mortgage Association."

Ginnie Mae I: Ginnie Mae I securities are single-issuer pools. On payable date, the 15th of the month, the Federal Reserve Banks as registered holder receive principal and interest payments, which they in turn allocate to their members.

Ginnie Mae II: Ginnie Mae II securities are collateralized by multiple-issuer pools or custom pools that contain loans from a single issuer. Unlike Ginnie Mae I securities, interest rates may vary within one percentage point. On payable date, the 20th of the month, the Federal Reserve Banks, as registered holder of Ginnie Mae II securities, receive principal and interest payments from a central paying agent on all Ginnie Mae II securities, which they in turn allocate to their members.

Ginnie Mae Midget: A Ginnie Mae pass-through security backed by fixed-rate mortgages with 15-year terms. Ginnie Mae Midget is a dealer term and is not used by Ginnie Mae.

Ginnie Mae Platinum: A reconstituted Ginnie Mae security backed by multiple Ginnie Mae single-class mortgage securities combined into a single larger mortgage security.

Good Delivery: A term indicating that a transaction has met all relevant guidelines for clearance, delivery and settlement, such as cutoff times for notification, allocation and endorsement, as set forth in these *Uniform Practices*.

Good Funds: Funds that are immediately available to the receiver of the funds (i.e., Fed funds).

Gold PC Exchange: With the advent of UMBS, Freddie Mac will provide for the ability of holders of Gold PC securities to exchange them for UMBS.

Government National Mortgage Association: Also known as "Ginnie Mae" or "GNMA." Ginnie Mae is a wholly owned government corporation within the Department of Housing and Urban Development. Ginnie Mae was created to support a secondary market in government-insured and -guaranteed mortgages. Ginnie Mae guarantees the timely payment of principal and interest on its securities. These payments are guaranteed by the full faith and credit of the U.S. Government. Ginnie Mae securities are backed by pools of FHA-insured and VA- and RHS-guaranteed mortgages.

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Graduated Payment Mortgage (GPM): A mortgage that features negative amortization in which early payments are insufficient to pay the interest due on the outstanding principal. As a result, the unpaid interest is added to the principal, thereby increasing the borrower's balance owed. The payments must graduate or increase over time until they can completely amortize the loan's remaining principal balance by its maturity. The number, frequency and rate of increases are specified in the original contract.

Haircut: The margin or difference between the actual market value of a security and the value assessed by the lending side of a transaction.

Handle: The whole-dollar price of a security. For example, if a security is quoted at 101-10/32, 101 is the handle.

Hedge: A commitment or investment made with the intention of minimizing the impact of adverse movements in interest rates or securities prices and offsetting potential losses.

ID: See "Trade Suite."

Interest: Compensation paid or to be paid for the use of money, generally expressed as an annual percentage rate.

Interest Accrual Period: The period of time in which a bond accrues interest, usually on a 30/360 basis unless otherwise stated.

Interest Rate: The face coupon rate of a security.

Interest Shortfall: A deficiency in collections on loans underlying a security, such that the amount of interest actually paid on a class of securities is less than the amount scheduled to be paid. This is caused primarily when mortgagors fully or partially prepay principal, or upon foreclosures or other liquidations of defaulted mortgage loans that result in a prepayment. Interest on the amount prepaid generally accrues only to the date of prepayment.

Interim Accounting Period: The period between the record date and the corresponding beneficiary date. Since paying agents distribute principal and interest based on the record-date position, trades settling during the interim accounting period are not reflected in the trustee's record-date position. It therefore is necessary to track the position to the beneficiary date, since that is the date representing entitlement to the payment.

Inverse Floater: A security that pays an adjustable rate of interest and that moves in the opposite direction from movements in a representative interest rate index, such as the London Interbank Offered Rate (LIBOR), the Constant Maturity Treasury (CMT) or the Cost of Funds Index (COFI).

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IO (Interest-Only) Security: A security that pays investors only interest and not principal. IO securities are generally priced at a deep discount to the "notional" amount of principal used to calculate the amount of interest due.

Issue Date: The date on which a security is deemed to be issued or originated.

Issuer: An entity that issues and is responsible for the ultimate payments on securities.

Jumbo Pools: Ginnie Mae II pass-through mortgage securities collateralized by pools that are generally larger and contain mortgages that are often more geographically diverse than single-issuer pools. Mortgage loans in jumbo pools may vary in terms of the interest rate within one percentage point.

Jump Z-Tranche: A Z-tranche that may start receiving principal payments before prior tranches are retired if market forces create a "triggering" event, such as a drop in Treasury yields to a defined level or a prepayment experience that differs from assumptions by a specific margin. "Sticky" jump Z-tranches maintain their changed payment priority until they are retired. "Non-sticky" jump Z-tranches maintain their priority only temporarily for as long as the triggering event is present. Although jump Z-tranches are no longer issued, some still trade in the secondary market.

LIBOR (London Interbank Offered Rate): The interest rate banks charge each other for short-term Eurodollar loans ranging from overnight to five years in maturity.

Life Rate Cap: A consumer protection option (or cap) in an ARM that limits the amount that the interest rate and monthly payment can increase. The Life Rate Cap sets the maximum interest rate that can be charged for the life of the loan.

Loan-to-Value (LTV): A measure used to describe the loan amount as a percent of the home's market value. It is calculated by dividing the loan amount by the market value of the home. Its purpose is to ensure that if the borrower defaults on the loan, the property can be sold for enough to satisfy the loan.

Lockout: The period of time before an investor will begin receiving principal payments.

Market Price: The current price of a security in the market.

Market Value: The product of the current face of a security and its market price.

Mark-to-Market: The process whereby the book value or collateral value of a security is adjusted to reflect its current market value.

Maturity Date: The date on which the principal amount of the security is due and payable to the registered owner of the security.

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MBS Clearing Corporation (MBSCC): A registered clearing agency with the Securities and Exchange Commission that provides various clearing services to its participants for Ginnie Mae, Fannie Mae and Freddie Mac securities, as well as EPN services that allow mortgage-backed securities buyers and sellers to exchange allocated pool information electronically.

Mortgage: A legal instrument that creates a lien upon real estate securing the payment of a specific debt.

Mortgage-Backed Bond: A general obligation of the issuer, secured by mortgage collateral, where the issuer retains ownership of the mortgages. The bond is secured by the market value of the underlying mortgages. Since the value of the mortgages will decrease over time as a result of principal amortization and prepayments, the market value of the collateral must exceed the value of the bonds issued. Unlike pass-through securities, the cash flow on a mortgage-backed bond is not directly related to the cash flow of the underlying mortgage collateral. Interest on the bond is paid semiannually at a predetermined rate, and principal is paid at maturity.

Mortgage-Backed Securities (MBS): The term mortgage-backed securities is a generic term that, for purposes of these *Uniform Practices,* refers to securities backed by mortgages, pass-through securities, mortgage-backed bonds, mortgage pay-through securities and CMOs. The term also includes all commitments or arrangements to purchase or sell such securities, including stand-by contracts, but, for purposes of these *Uniform Practices,* does not include repurchase agreements, reverse repurchase agreements, transactions for future delivery or options on mortgage-backed securities executed on a contract market or an exchange.

Mortgage Banker: An entity that originates mortgage loans, sells them to other investors and services the loans.

Mortgage Loan: A loan secured by a mortgage.

Mortgage Pass-Through Security: A security representing a direct interest in a pool of mortgage loans. The pass-through issuer or servicer collects the payments on the loans in the pool and "passes through" the principal and interest to the security holders on a pro rata basis. Mortgage pass-through securities are also known as mortgage-backed securities (MBS), participation certificates (PCs), and Uniform Mortgage Backed Securities (UMBS).

Mortgage Pay-Through Bonds: These bonds combine features of pass-through securities and mortgage-backed bonds. A pay-through bond, like a mortgage-backed bond, is a debt obligation of the issuer, secured by mortgage collateral that is owned by the issuer. However, like a pass-through security, the cash flow on a pay-through bond is related to the cash flow on the mortgage collateral. Therefore, the cash flow generated by the mortgage collateral must be sufficient to cover principal and interest payments on the bonds. Prepayments on the mortgage collateral will be passed on to the bondholders, thereby causing fluctuations in the principal payment on the bonds.

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Negative Amortization: A situation in which the current payments on a graduated-payment mortgage or on an adjustable-rate mortgage are insufficient to pay the interest due on the outstanding principal. The unpaid interest is added to the principal, thereby increasing the borrower's balance owed.

Negative Convexity: A characteristic of callable or prepayable securities that causes investors to have their principal returned sooner than expected in a declining interest-rate environment or later than expected in a rising interest-rate environment. In the former scenario, investors may have to reinvest their funds at lower rates ("call risk"); in the latter, they may miss an opportunity to earn higher rates ("extension risk").

Nominee Name: An entity in whose name securities are registered. Nominee names are usually used to facilitate transactions, but the beneficial owner retains the rights to the security.

Nonconforming Loan: A loan that does not meet the size limits mandated by Congress for loans that Fannie Mae and Freddie Mac can buy. Also called a jumbo loan.

NRSRO (Nationally Recognized Statistical Rating Organization): An organization designated through an SEC no-action process to provide credit ratings information and opinions to the financial community. The major NRSROs include: Duff & Phelps Credit Rating Co., Inc.; Fitch IBCA; Moody's Investors Service Inc.; and Standard & Poor's Corporation.

Odd-Lot: A quantity of securities that is less than the accepted unit of trading.

Offer: The price at which a seller is willing to sell a security.

Offering Materials Guidelines: Guidelines adopted by Government Sponsored Enterprises (GSEs), which include among others Fannie Mae and Freddie Mac, that require dealers that sell GSE securities to deliver offering materials to investors within a specified distribution period, similar to prospectus delivery requirements under federal law for nonexempt securities.

Option: The right, but not the obligation, to purchase or sell a security at a predetermined price, on or before a future specified date.

Original Face: The face value or original principal amount of a security on its issue date.

PAC (Planned Amortization Class) Tranche: A CMO tranche that uses a mechanism similar to a sinking fund to determine a fixed-principal payment schedule that will apply over a range of prepayment assumptions. The effect of the prepayment variability that is removed from a PAC bond is transferred to a companion tranche.

Pair Off: A process by which two parties offset a position in securities by buying an issue previously sold or selling an issue previously bought.

Par: 100% of the face value of a debt security.

Payable Date: The scheduled date on which P&I distributions are to be made.

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Paying Agent: An entity responsible for making the payment of interest and principal to bondholders on behalf of the bond's issuer.

Payment Date: Also known as the payable date. The date that actual principal and interest payments are scheduled to be made to the registered holder of a security.

Payment Delay: The number of days between when interest starts accruing on a loan and when funds are remitted to holders of MBS backed by those loans.

P&I (Principal and Interest): The term used to refer to regularly scheduled payments or prepayments of principal and of interest on mortgage securities.

P&I Check: A check representing payment of principal and interest owed and received.

P&I Claim Letter: A request by the beneficial owner for payment of principal and interest paid to the registered holder.

Periodic Rate Cap: The amount that an ARM's interest rate can change from one adjustment interval to the next. For example, if the ARM's periodic rate cap is 2 percent, the interest rate cannot go up or down more than 2 percent from one year to the next, even if the index goes up or down more than 2 percent.

Plain Vanilla CMO: See "Sequential Pay Security."

PO (Principal-Only) Security: A security that pays investors principal only and not interest. PO securities are generally priced at a deep discount from their face value.

Pool: A collection of mortgage loans or other collateral assembled by an originator or master servicer as the collateral for a security. In the case of Fannie Mae, Freddie Mac or Ginnie Mae mortgage pass-through securities, pools are identified by a number assigned by the issuing agency.

Premium: A nonrefundable fee paid to the seller of an option by the buyer of the option in consideration for entering into the option agreement.

Prepayment: The unscheduled partial or complete payment of the principal amount outstanding on a mortgage loan or other debt obligation before it is due.

Price: The dollar amount to be paid for a security, which may also be stated as a percentage of its face value or par in the case of debt securities.

Principal: The face amount of a bond, exclusive of accrued interest, if any, and payable at maturity. With mortgage securities, principal refers to the amount outstanding on the mortgage loans.

Principal Transaction: A securities transaction in which one or both of the parties act as principals dealing for their own account.

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Private Label: The term used to describe a mortgage security whose issuer is an entity other than a U.S. Government agency or U.S. Government-sponsored enterprise. Such issuers may be subsidiaries of investment banks, financial institutions or other private entities.

Put Option: The right, but not the obligation, to sell a security at a predetermined price on or before a specified future date.

Ratings: Designations used by NRSROs to give relative indications of credit quality.

Reclamation: A claim for the right to return or the right to demand the return of a security that has been previously accepted as a result of bad delivery or other irregularities in the settlement process.

Record Date: The date for determining the registered owner who will receive the next scheduled payment of principal and/or interest on a security.

Registered Owner: The name in which a security is registered as stated on the certificate itself or on the books of the paying agent. All principal and interest payments are made to the registered owner as of the record date.

REMIC (Real Estate Mortgage Investment Conduit): A federal income tax designation available to certain mortgage securities trusts. Most CMOs are today issued in REMIC form to create certain tax advantages for the issuer. The terms REMIC and CMO are now used interchangeably.

Repurchase Agreement (Repo): An agreement of one party to sell securities at a specified price to a second party, and a simultaneous agreement of the first party to repurchase the securities at a specified price on demand or at a specified later date.

Residual: The equity interest in a structured product. The residual is the cash flow remaining on each payment date after all payments on other tranches have been made. The primary source of income to the residual is cash generated by the collateral that is greater than the principal and interest payments due on the other tranches.

Reverse Repurchase Agreement (Reverse Repo): An agreement of one party to purchase securities at a specified price from a second party, and a simultaneous agreement by the first party to resell the securities at a specified price to the second party on demand or at a specified later date.

Rural Housing Service (RHS): A government agency established under the Farmers Home Administration Act of 1946 to provide financing to farmers and other qualified rural borrowers who are unable to obtain loans elsewhere. Formerly known as FmHA, RHS originates, participates in and insures loans for rural housing and other purposes.

Safekeeping: The storage and protection of customers' securities provided as a service by a bank or institution acting as agent for the customer.

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Secondary Market: The market for previously issued securities.

Secondary Mortgage Market Enhancement Act of 1984 (SMMEA): Adopted by Congress in 1984, SMMEA was designed to ease and expand the role of private-sector investment entities such as mortgage bankers, investment bankers and pension funds in the secondary mortgage market by, among other things, preempting state investment and securities registration laws.

Sequential Pay Security: A security in which all tranches receive regular interest payments, but principal payments are directed initially only to the first tranche until it is completely retired. Once the first tranche is retired, the principal payments are applied to the second tranche until it is fully retired, and so on.

Serialized Mortgage-Backed Security: See "Collateralized Mortgage Obligation."

Servicer: An entity that is responsible for the collection and pooling of principal, interest and escrow payments on loans and loan pools, as well as performing certain operational and administrative procedures such as accounting, bookkeeping, insurance, tax records, loan-payment follow-up, delinquency loan follow-up and loan analysis. The servicer receives a servicing fee for providing these loan-maintenance functions.

Servicing Fee: The amount retained by the mortgage servicer from monthly interest payments made on a mortgage loan.

Settlement Balance Order (SBO): The net position of a firm as a result of netting its transactions with other participants in the Clearing Division of the MBS Clearing Corporation. The end position represents the actual receive/delivery obligations of each participant per coupon (class).

Settlement Class: A classification for mortgage-backed securities based on product type for purposes of establishing The Securities Industry and Financial Markets Association settlement dates.

Settlement Date: The date agreed upon by the parties to a transaction for the payment of funds and the delivery of securities.

Sinking Fund: Money set aside on a regular basis, sometimes from current earnings, for the specific purpose of redeeming debt.

Slow-Pay Bond: See "Collateralized Mortgage Obligation."

SMM (Single Monthly Mortality): The percentage of outstanding mortgage loan principal that prepays in one month.

Specified Transaction: A contract for the purchase or sale of securities, the settlement of which is conditional upon specific terms mutually agreed to by both parties at the time of the trade, and which is thus distinguished from a TBA transaction. Note that where the original faces and pool

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numbers are specified at the time of the trade for a forward transaction, the variance and the 48-hour notification rule do not apply.

Standard Prepayment Model of The Securities Industry and Financial Markets Association: A model based on historical mortgage prepayment rates that is used to express prepayment rates on mortgage securities. The Association's model is based on the Constant Prepayment Rate (CPR), which annualizes the Single Monthly Mortality (SMM), or the amount of outstanding principal that is prepaid in a month. Projected and historical prepayment rates are often expressed as "percentage of PSA" (Prepayment Speed Assumptions). A prepayment rate of 100% PSA implies annualized prepayment rates of 0.2% CPR in the first month, 0.4% CPR in the second month, 0.6% CPR in the third month and 0.2% increases in every month thereafter until the thirtieth month, when the rate reaches 6%. From the thirtieth month until the mortgage loan reaches maturity, 100% PSA equals 6% CPR.

Standby Commitment: An arrangement whereby a buyer is paid a negotiated, nonrefundable fee by a seller which entitles the seller to sell to the buyer, at the seller's option, securities on a specified date and at a specified price.

Stated Delay: Time elapsed from the first day of the month of purchase to the first payment date of principal and interest.

Street Name: A registered security that has been endorsed "in blank" or in favor of a broker or dealer is said to be in street name.

Strike Price: The price at which the underlying security will be purchased or sold for upon exercise.

Stripped Mortgage-Backed Security: A security that is created by redistributing the cash flows from the underlying mortgages or mortgage-backed securities to create two or more new securities, each with a specified percentage of the underlying security's principal payments, interest payments or combinations of the two. Securities may be partially stripped, i.e., each investor class receives some interest and some principal. For example, the cash flow on an 8 percent pass-through security might be redistributed to create one security with a 10 percent coupon and another security with a 6 percent coupon. Some securities are completely stripped, thereby creating interest-only and principal-only securities, in which all of the interest is distributed to one security and all of the principal to the other.

Superfloater: A floating-rate CMO tranche whose rate is based on a formulaic relationship to a representative interest-rate index.

Super: Supers are backed by pooled multiple single-class MBS and/or UMBS with similar characteristics and/or other pooled Supers with similar characteristics. Supers are issued in transactions in which a lender or investment banker exchanges pooled single-class MBS and/ or other pooled Supers for newly issued Super certificates. Note that Freddie Mac Supers may contain UMBS issued and guaranteed by Fannie Mae, and Fannie Mae Supers may contain UMBS issued and guaranteed by Freddie Mac.

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Super PO: A principal-only security structured as a companion bond.

Support Tranche: See "Companion Tranche."

TAC Tranche: Targeted amortization class tranche. A TAC tranche uses a mechanism similar to a sinking fund to determine a fixed principal payment schedule based on an assumed prepayment rate. The effect of prepayment variability that is removed from the TAC tranche is transferred to a companion tranche.

TBA: A To-Be-Announced Trade. See "Delayed-Delivery Contract."

Toggle Tranche: See "Jump Z-Tranche."

Trade Date: The date on which parties enter into an agreement for the purchase or sale of securities.

Trade Suite: Refers to a series of services in DTC's electronic trade confirmation arena including what was previously known as ID.

Tranche: A specific class or designation of bonds that shares the same payment and maturity characteristics. "Tranche" is the French word for "slice."

Transfer Agent: A party appointed to maintain records of securities owners, to cancel and issue certificates and to address issues arising from lost, destroyed or stolen certificates.

Trustee: A financial institution with trust powers which acts in a fiduciary capacity for the benefit of the bondholders in enforcing the terms of the bond contract.

Uniform Mortgage-Backed Security: A form of a mortgage passthrough security issued by either Fannie Mae or Freddie Mac that shares common 55-day payment delays, disclosure, and other aspects of the product.

VA (U.S. Department of Veterans Affairs): A U.S. government agency that guarantees home loan mortgages issued by lending institutions to qualified veterans of the U.S. armed forces or to their surviving spouses.

Variance: The permitted maximum over- or under-allocation of securities that can be delivered to satisfy an outstanding commitment.

Weighted Average Coupon (WAC): The weighted average interest rate of the underlying mortgage loans or pools that serve as collateral for a security, weighted by the size of the principal loan balances.

Weighted Average Loan Age (WALA): The weighted average number of months since the date of the loan origination of the mortgages in a mortgage pass-through security pool weighted by the size of the principal loan balances.

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Weighted Average Maturity (WAM): The weighted average number of months to the final payment of each loan backing a mortgage security, weighted by the size of the principal loan balances. Also known as weighted average remaining maturity (WARM) and weighted average remaining term (WART).

Whole Loan: An unsecuritized loan.

Window: In a CMO bond, the period of time between the expected first payment of principal and the expected last payment of principal.

Yield: The annual percentage rate of return earned on a security, as computed in accordance with standard industry practices. Yield is a function of a security's purchase price and interest rate.

Z-Tranche: See "Accrual Bond."

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