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Glossary of Financial Terms

United States: Financial Crisis Inquiry Commission (FCIC)

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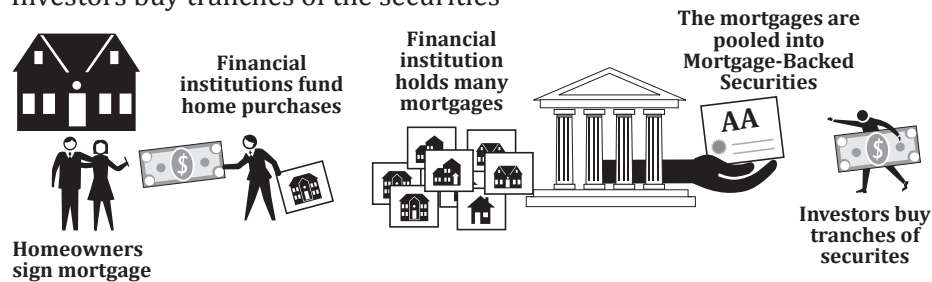
GLOSSARY OF FINANCIAL TERMS

Structured Product

For our purposes, a bond backed by a pool of assets, such as mortgages.

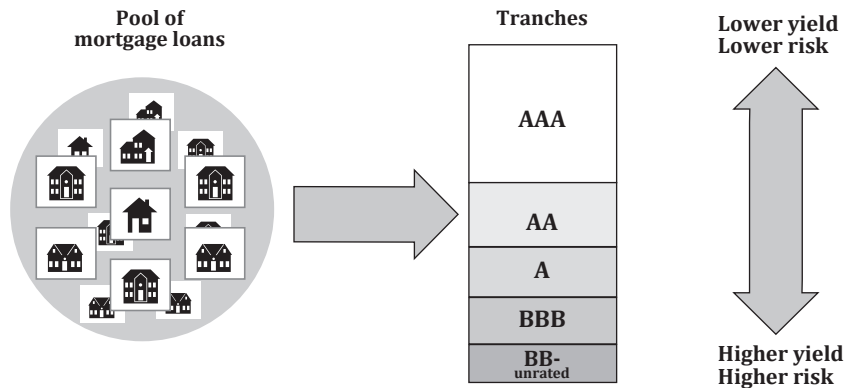
Mortgage-Backed Securities

The mortgages are pooled into Mortgage-Backed Securities. Investors buy tranches of the securities



Tranche

The word tranche is French for slice, section, series, or portion. A tranche is a portion of a structured product created such that each portion has the same cash flow characteristics. A structured product is divided into multiple tranches that have different risk characteristics.



CDO

A structured product which gives the bond holders the right to receive the cash flows from a pool of other securities – often including mortgage backed securities. A CDO is divided into multiple tranches that have different risk characteristics.

CDO² (or CDO squared)

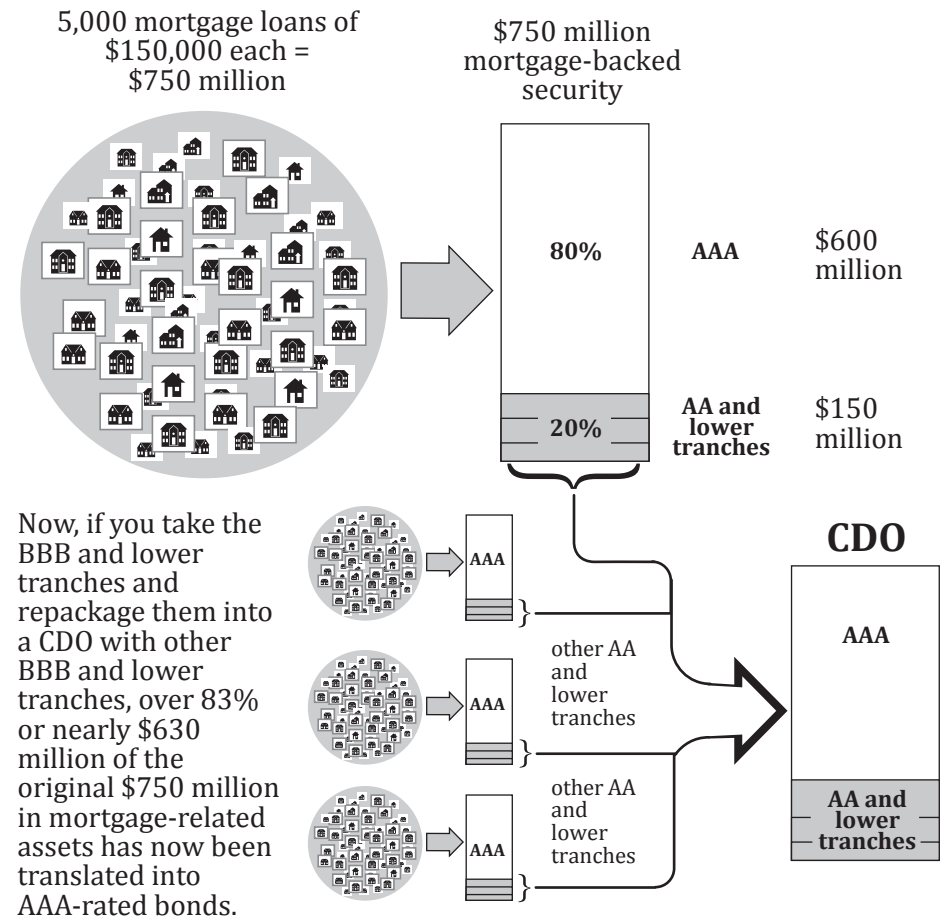
A structured product which gives the bond holders the right to receive the cash flows from a pool of tranches of different CDOs.

AAA rating

The highest available rating from a credit rating agency, representing the lowest credit risk of any class of debt securities. For example, the AAA tranches of a mortgage-backed security, a CDO, or a CDO squared are the highest rated, lowest risk tranches.

By the numbers

Take a hypothetical \$750 million mortgage-backed security backed by 5,000 subprime mortgages of \$150,000 each. Typically, about 80% or \$600 million of these subprime mortgage-backed securities are rated AAA.



Now, if you take the BBB and lower tranches and repackage them into a CDO with other BBB and lower tranches, over 83% or nearly \$630 million of the original \$750 million in mortgage-related assets has now been translated into AAA-rated bonds.

Now, if you take the AA and A tranches of the CDO and repackage them into a CDO squared with other AA and A tranches, over 84% or nearly \$635 million of the original \$750 million in mortgage-rated assets has now been translated into AAA-rated bonds.