

# Index

- Accounting standards, 60  
 Accuracy measure, 318*n*14  
 Accuracy ratio, 329*n*6  
 Acharya, V., 56, 138, 139, 141, 142, 293, 309*n*6, 311*n*19  
 Adjustable rate mortgages (ARMs), 25  
 Advanced approaches, 289, 297  
 Advanced IRB (internal ratings-based) model, 282, 286, 288–289, 291–292, 294, 296.  
*See also* foundation vs. advanced IRB models  
 Advanced measurement approach (AMA), 276, 340*n*37  
 Advanced models, 276, 283  
 After-tax adjusted income, 231  
 Agent/arranger, 11  
 Agrawal, D., 312*n*34  
 Aguais, S. D., 113  
 AIG, 16–17, 246  
 Alexander, 321*n*22  
 Allen, L., 139, 307*n*5, 339–340*n*31, 340*n*41  
 Almeida, H., 332*n*2  
 Alt-A mortgages, 27, 50, 305*n*1  
 Altman, E. I., 118, 120, 125, 139, 140, 141, 280, 329*n*9, 338–339*n*20, 338*n*18  
 Altman Z-Score model, 118–119, 130  
 American Express, 49  
 Amihud, K., 112  
 Anderson, R., 89, 312*n*26  
 Arbitrage, 265  
 Argentina, 337*n*4, 338*n*19  
 Arora, N., 86, 313*n*36  
 Arrangers, 11, 303*n*3, 304*n*10  
 Arrow, K. K., 98  
 Artificial neural networks, 125–127  
 Asarnow, E., 340*n*32  
 Asia, 250, 271, 334*n*18  
 Asian banking crisis, 310*n*11  
 Assessment of the IRB models, 292–293  
 Asset-backed commercial paper (ABCP), 8, 9, 28, 34, 303*n*5, 336*n*40  
 Asset-backed securities (ABSs), 5, 6, 8, 20, 22, 26, 303*n*2, 303*n*5, 336*n*40  
 Asset-backed securitization, 15, 259  
 Asset correlation, 321*n*18  
 Asset drift, 313*n*37  
 Asset securitization, 25  
 Astebro, T., 318*n*3  
 Asymmetric counterparty credit risk, 314*n*3  
 Auction mechanism, 251–252  
 Auctions, 334*n*18, 334*n*19  
 Australia, 338*n*19  
 Autoregressive models of housing prices, 31  
 Average default rate, 317*n*39  
 Average estimated LGD, 319*n*4  
 Average yield spreads, 316*n*28  
 Ayuso, J., 340*n*41  
 Back-propagation neural network, 126  
 Back-testing, 328–329*n*1, 329*n*8  
 Bailout mechanisms, 307*n*4  
 Bailouts, 34, 49, 50, 54  
 Balance sheets, 17  
 Bangia, A., 139, 326*n*22  
 Bank capital quantity, 295  
 Bank capital requirements, 263  
 Bankers Trust, 228, 231  
 Bank for International Settlements (BIS), 15, 275, 304*n*14, 336*n*1  
 regulatory capital requirements, 230  
 risk based capital ratio, 319*n*1  
 Bank holding companies (BHCs), 49  
 Banking changes, 3–17  
 credit default swaps, 15–17  
 loan syndication, 11–14  
 proprietary investing, 14–15  
 securitization, 5–11  
 Banking models, 21  
 Banking problems, causes of, 268  
 Bank leverage, 295  
 Bank loans (CLOs), 6  
 Bank obligations, credit risk of, 274  
 Bank of America (BOA), 34, 37, 48, 55, 231, 234, 322*n*30, 329*n*2  
 Bank of England (BOE), 5, 32, 37, 47, 244, 306*n*15  
 Bank of Japan, 36  
 Bankruptcy, 32, 81–82, 309*n*2

- Bankruptcy prediction:
  - expert systems, 125
  - option-pricing approach to, 92
- Banks:
  - credit rating of, 280
  - financing and capital costs, 332*n*18
  - monitoring function, 282
  - off-balance-sheet activities of, 17
- Barclays, 251
- Barnhill, T. M., Jr., 322*n*25
- Barniv, R., 121
- Basel Capital Accord (Basel II). *See* Basel II
- Basel Committee, 135, 142, 268, 304*n*14, 338*n*19
- Basel Committee member states, 293
- Basel I, 253–254, 256, 264, 294, 295, 304*n*15, 335*n*23
  - capital requirements, 335*n*25
  - capital requirements for Argentine banks, 337*n*4
  - credit conversion factors, 338*n*14
  - methodology, 258
  - model of credit risk for swaps, 253–254
  - risk-based capital ratio rules, 253
  - risk weight (RW) under, 278
- Basel II, 257, 258, 259, 265, 267, 274, 280, 281, 287, 291, 292, 297
  - adoption of throughout the world, 293–296
  - capital accord, 18, 335*n*29
  - capital requirements, 337*n*6
  - IRB (internal ratings-based model), 288
  - IRB equations, 339*n*30
  - January 2009 proposals for changes in, 265–268
  - lower bound on PD, 335*n*24
  - risk weight (RW), 280
- Basel II Accord, 56, 62
- Basel II capital model, 142
- Basel II capital requirements, 288, 295
  - Tier 2 capital, 339*n*28
- Basel II capital requirements for asset-backed/ securities, 263–265
- Basel II capital requirements for CDS, 257–259
- Basel II IRB Advanced Model, 139
- Basel II models, 283, 339–340*n*31
- Basel II plan (2006), 275–296
  - assessment of the standardized model, 280–282
  - Basel II's standardized model, 278–280
  - foundation vs. advanced IRB models, 289–296
  - internal ratings-based models for credit risk, 282–283
  - three tiers of capital designations, 275–278
  - VAR in Basel II IRB capital models, 283–289
- Basel II proposals, 335*n*31, 339*n*21
- Basel II standardized model, 278–280
- Basic indicator approach to operational risk measurement, 340*n*38
- Basis points, 304*n*9
- Basis risk, 334*n*16
- Basket credit default swap, 333*n*6
- Baskets, 333*n*6
- Bear Stearns, 10, 32, 38, 48, 55
  - High-Grade Structured Credit Master Fund, 32
- Beaver, W. H., 19
- Belgium, 293, 304*n*14, 336*n*1
- Belkin, B., 315*n*11
- Bessembinder, H., 309*n*3
- Best efforts deals, 12
- Bharath, S. T., 92, 107, 108, 128, 309*n*6, 313*n*37
- Binomial tree model, 105, 315*n*14
- BIS (Bank for International Settlements). *See* Bank for International Settlements (BIS)
- BIS II survey, 299
- BISTRO (Broad Index Secured Trust Offering), 262
- Black, F., 89
- Black and Cox model, 91
- Black-Scholes-Merton Model (BSM), 68
- Black-Scholes options pricing model, 309–310*n*8
- Block Maxima Models, 325*n*19
- Bohn, J. R., 88, 113, 130, 309–310*n*8, 311*n*24, 312*n*26, 312*n*27, 313*n*38
- Bond seniority and loss given default (LGD), 329*n*9
- Bond spreads, 88, 312*n*27
  - vs. default probabilities, 90
  - determinants, 110–114
- Bond trading, 309*n*3
- Bongini, P., 305*n*19, 310*n*11
- Borowski, D. M., 125
- Box-Cox-GEV, 325*n*19
- Boyd, J., 307*n*1
- Brady bond prices, 329*n*7
- Brazil, 121
- Broad Index Secured Trust Offering (BISTRO), 336*n*39
- Brown, C. O., 56
- Brown, S., 308*n*17
- Brunnermeier, M., 34, 306*n*18
- BSM model, 89
  - for call options, 71

- Buffett, Warren, 243  
 Bufford, Samuel L., 40  
 Bursting of the credit bubble, 24–29  
  
 Calem, P. S., 139  
 Call options, 92, 328*n*51  
     BSM model for, 71  
     equity as, 92  
 Camara, A., 313–314*n*1  
 Campbell, J., 92, 107, 108, 315–316*n*21, 318*n*12  
 Canada, 293, 304*n*14, 336*n*1, 338*n*19  
 Capital adequacy, 276, 288–289  
 Capital Assistance Plan (CAP), 49  
 Capital at risk, 228, 234  
 Capital constraints, 329*n*1  
 Capital designations, tiers of, 275–278  
 Capital regulation, 274–302, 304*n*15, 337*n*5  
     2006 BASEL II plan, 275–296  
     about, 274  
     loan rating systems, 297–302  
     summary, 296–297  
 Capital requirement methodology, 258  
 Capital requirements, 60, 257, 274, 337*n*6  
     for counterparty credit risk, 335*n*23  
     from external credit ratings, 281  
     for market risk, 323*n*1  
     risk sensitivity of, 275  
 Capital requirements coefficient, 288  
 Capital risk, 233  
 Capital vs. debt, 331*n*8  
 Carey, M., 137, 297, 298, 299, 318*n*6, 338*n*12, 339*n*24  
 Carpenter, J., 311*n*19  
 Carty, L. V., 340*n*32  
 Caselli, S., 137, 138, 141  
 Cash settlement, 250  
     vs. physical settlement, 334*n*20  
 Catastrophic economywide default risk, 335*n*35, 336*n*37  
 Cathcart, L., 315*n*17  
 CDO squared, 260  
 CDS Indices, 249–250  
 CDS premiums, 272  
 CDS spreads, 91–92  
     pricing with counterparty credit risk exposure, 272–273  
     and rating agency rating systems, 269–271  
 Central Bank of Argentina, 318*n*8  
 Central banks/bankers, 25, 47. *See also* Federal Reserve (FED)  
 Centralized clearinghouse, 308*n*15  
 Chang, G., 317*n*32  
 Chatterjee, S., 142  
  
 Chava, S., 107, 108, 109  
 Chicago Board Options Exchange (CBOE) Volatility Index, 41  
 China, 307*n*5  
 Choelsky factorization process, 327*n*39  
 Circularity, 329–330*n*6  
 Citibank, 135, 324*n*14  
 Citicorp, 10  
 Classification gaming, 329*n*5  
 Clawbacks, 307*n*5  
 Clean break conditions, 263, 336*n*40  
 Club deals, 12  
 Coates, P. K., 121  
 Collateralization, 336*n*39  
 Collateralized debt obligations (CDOs), 5, 260, 303*n*2  
     pricing, 335*n*35  
 Collateralized insurance obligations (CIOs), 6  
 Collateralized loan obligations (CLOs), 5, 13, 262, 303*n*2  
 Collateralized mortgage obligations (CMOs), 5, 303*n*2  
 Collateralized transactions, 257  
 Collin-Dufresne and Goldstein model, 90, 91  
 Comdioco, 80–81  
 Commercial loans, 274  
 Commercial real estate (CRE) CDOs, 6  
 Commodity Futures Trading Commission (CFTC), 52, 53, 61  
 Compensation levels, 49  
 Concentration risk, 291, 323*n*1, 325*n*16, 340*n*33  
 Conduct of Business Regulatory Agency (CBRA), 54  
 Conference of State Bank Supervisors, 53  
 Confidence intervals, 285  
 Confidence level, 340*n*35  
 Conflicts of interest, 28, 63, 281, 339*n*22  
 Consumer credit debt, 27  
 Consumer Financial Protection Agency, 59, 61  
 Consumer protection, 58  
 Consumers and investors protection, 61–63  
 Contagion, 339*n*23  
 Contagion mechanism, 11  
 Contingent value rights (CVRs), 319*n*1  
 Continuous time capital asset pricing model (CAPM), 87  
 Corporate bonds (CDOs), 6  
 Corporate borrowers, credit spreads for, 316*n*27  
 Correlated default probabilities, 326*n*21  
 Correlation coefficients, 320*n*10  
 Correlation estimate, 320*n*9  
 Correlation history, 322*n*25

- Correlation risk, 319*n*2
- Correlations, 288, 291–292, 339*n*26
  - asset correlation, 321*n*18
  - default intensity, 322*n*31
  - default risk correlation, 287
  - formulaic correlation, 339*n*26
  - foundation vs. advanced IRB models, 291–292
  - parametric values for, 320*n*10
  - systematic risk correlation, 293
- Counter-cyclical capital requirement, 295, 296
- Counterparty credit risk, 246, 334*n*12
  - capital requirements for, 335*n*23
  - and credit exposure size, 328*n*47
  - on derivatives, 329*n*10
  - and trading losses, 329*n*17
- Counterparty default risk, 272
- Counterparty Risk Management Group, 329*n*10
- Countrywide Financial, 26, 34, 305*n*1
- Covariance, 237
- Covenant-lite loans, 27
- Cox, James M., 89
- Credit boom, 27
- Credit bubble, 24, 28
- Credit contagion, 246–247
- Credit conversion factors, 340*n*39
- Credit crisis, 11, 13
- Credit crisis phases:
  - bursting of the credit bubble, 24–29
  - Lehman failure, 33–37
  - liquidity risk, 33–37
  - mortgage market, 29–33
  - summary, 43–44
  - underwriting and political intervention risk, 33–37
- Credit cycle index (*Z*), 326*n*22
- Credit default swaps (CDSs), 5, 15–17, 107, 244–259, 303*n*2, 304*n*13
  - auction process, 138
  - Basel II capital requirements for CDS, 257–259
  - Basel I model of credit risk for swaps, 253–254
  - CDS Indices, 249–250
  - clearinghouse for, 61
  - example, 254
  - pure credit default swaps, 248–249
  - spreads, 313*n*36
  - swap settlement upon trigger of credit event, 250–252
  - total return swap, 247–248
- Credit derivatives, 243–273
  - about, 243–244
  - CDS spreads and rating agency rating systems, 269–271
  - credit default swaps, 244–259
  - credit securitizations, 259–268
  - financial firms use of credit derivatives, 269
  - pricing the CDS spread with counterparty credit risk exposure, 272–273
  - summary, 271
- Credit derivatives trading, 333*n*4
- Credit equivalent amounts, 253
- Credit events, 247–248, 323*n*9, 332*n*3
  - marketwide, 326*n*29
  - swap settlement upon trigger of, 250–252
- Credit exposure size and counterparty credit risk, 328*n*47
- Credit linked notes (CLNs), 260
- CreditMetrics, 73, 321*n*15, 321*n*21, 323*n*9, 329*n*4, 329*n*10, 329*n*12
- Credit mitigation, 259
- Credit rating agencies 18–20, 26, 27, 63, 303*n*8. *See also* conflicts of interest; Fitch (rating services); Moody's; Standard & Poor's (S&P)
- Credit rating default predictions, 77
- Credit rating models, 74
- Credit rating of banks, 280
- Credit ratings, 304*n*17
- Credit rating system, 61
- Credit risk, 4, 16, 17, 244, 311*n*24, 323*n*1, 331*n*10, 337*n*9
  - of bank obligations, 274
  - vs. market risk, 329*n*12
  - mispricing of, 337*n*4
  - of mortgage obligations, 274
  - of real estate market, 332*n*2
  - of sovereign obligations, 274
- Credit risk capital requirements, 276
- Credit risk exposure, 274
- Credit-risk-free rate (Treasury rate), 331*n*10
- Credit risk measurement models, 283
- Credit risk mitigation, 279
- Credit risk models, 117–134
  - about, 117
  - artificial neural networks, 125–127
  - credit scoring systems, 117–121
  - mortality rate systems, 121–124
  - summary, 131
- Credit risk premium, 232
- Credit risk volatility, 312*n*26
- Credit-scoring models, 117
- Credit scoring models, 317*n*2, 318*n*3
  - accuracy of, 318*n*5
- Credit scoring systems, 117–121
- Credit securitizations, 259–260
  - Basel II capital requirements for asset-backed/securities, 263–265

- January 2009 proposals for changes in
  - Basel II, 265–268
- Credit spread (CS), 32, 103, 105, 106, 143, 312*n*27, 312*n*31, 315*n*12, 315*n*16, 324*n*12
  - for corporate borrowers, 316*n*27
- Credit spread options, 334*n*13
- Credit substitution process, 259
- Creditworthiness, 102
- Crisis and regulatory failure:
  - about, 45
  - crisis intervention, 45–51
  - Obama/Geithner Plan (2008), 57–63
  - restructuring plans, 52–63
  - Senior Supervisors Group (SSG) Plan, 56–57
  - summary, 64
- Crisis intervention, 45–51
- Crisis intervention programs, 46
- Crosbie, P. J., 309–310*n*8, 311*n*24
- Crouchy, M., 235
- Cumulative mortality rates (CMRs), 121–123
- Current exposure, 253, 254, 256
- Curve measure, 109
- Customer approach, 331*n*7
- Cut-off EDF, 74
- Cutoff point, 318*n*3, 322*n*30
  
- Daisy chain of risk, 243
- Das, S., 107
- Deadweight costs, 296
- Debt:
  - vs. capital, 331*n*8
  - consumer credit debt, 27
  - internal ratings of, 298
  - quality of, 25
  - quantity of, 25
  - risky debt pricing, 102–105
  - sovereign, 338*n*18
  - subordinated debt (Tier 2 capital), 337*n*11, 338*n*12
- Debt seniority, 144
- Default, 329*n*14. *See also* credit default swaps (CDSs); distance to default (DD); expected default frequency (EDF); exposure at default (EAD); loss given default (LGD); probability of default (PD)
  - average default rate, 317*n*39
  - growth rate and default risk, 95
  - impending default, 146
  - mortgage defaults, 29
  - natural default rates, 314*n*7
  - official default date, 146
  - portfolio default, 322*n*31
  - post-default debt prices, 143, 145
  - predictive default probabilities, 74
  - pure default-free rate, 314*n*4
  - risk-neutral probabilities of, 98, 99–102, 315*n*13
  - Russian sovereign debt default, 13, 24, 37
  - time to default, 88
  - unexpected default rate, 234
- Default arrival rate, 323*n*32
- Default boundary, 89, 90, 312*n*31, 313*n*37, 329*n*13, 329*n*14
- Default data, 146
- Default hazard rate, 108
- Default histories, 329*n*3
- Default horizon, 323*n*3
- Default insolvency, 310*n*9
- Default intensity, 106–108, 115–116, 161–164
  - correlations, 322*n*31
  - model, 323*n*33
- Default modeling, 146
- Default option, 67–68, 69
- Default payments, 334*n*15
- Default point, 71
- Default predictions, 67
- Default probabilities. *See* probability of default (PD)
- Default protection, 86
- Default rates, 29, 314*n*7, 331*n*12
- Default risk, 315–316*n*21
  - and growth rate, 95
  - hazard functions of, 321*n*21
  - on loans, 25
- Default risk correlation, 287
- Defaults, 306*n*12
- Delegated monitors, 282
- Delinquencies, 29, 31, 51
- Delphi auction, 250–251
- Deposit insurance, 11
- Derivatives, 5
  - counterparty credit risk on, 329*n*10
  - pricing of, 314*n*2
- Dermine, J., 231
- DeSantes, R., 336*n*44
- De Stefano, M., 339*n*21
- Diebold, F. X., 139
- Dillon Read Capital Management (DRCM), 32
- Dinc, L. S., 56
- Direct equity investment, 48–49
- Discount rates, 324*n*12
- Discount window, 45
- Discrete reduced form model vs. multi-period nonstatic discriminant model, 318*n*11
- Discriminant model, 318*n*13
- Distance to default (DD), 73, 88, 93, 143, 310*n*13

- Distress risk anomaly, 315–316<sup>n21</sup>  
 Distress risk premium, 315–316<sup>n21</sup>  
 Distribution asymmetries, 325<sup>n17</sup>  
 Diversification, 235, 322<sup>n24</sup>  
 DM model, 320<sup>n13</sup>  
 Documentation agent, 303<sup>n7</sup>  
 Dominion Bond Rating Services, 19  
 Dow Jones CDX (DJ CDX) North American Grade Index, 249–250  
 Downgrade risk, 323<sup>n1</sup>, 325<sup>n16</sup>  
 Downgrading, 102  
 Driessen, J., 319<sup>n2</sup>  
 Duan, J. C., 88  
 Duffee, G. R., 112, 315<sup>n13</sup>  
 Duffie, D., 89, 107, 115, 116, 308<sup>n15</sup>, 314<sup>n4</sup>, 315<sup>n16</sup>, 316<sup>n27</sup>, 320<sup>n10</sup>, 322<sup>n31</sup>  
 Dvorak, B., 322<sup>n30</sup>, 331–332<sup>n14</sup>  
 Dwyer, D., 77, 309<sup>n4</sup>, 311<sup>n18</sup>, 312–313<sup>n35</sup>
- East Asian currency crisis, 24  
 Easy credit, 28  
 Easy money policy, 45  
 Ebnother, S., 339<sup>n24</sup>  
 Economic capital (EC), 229, 292, 331<sup>n9</sup>  
     and regulatory capital requirements, 337<sup>n7</sup>  
     term structure of, 329–330<sup>n5</sup>  
 Economic default date, 146  
 Economic value added (EVA), 238  
 EDF (expected default frequency). *See*  
     expected default frequency (EDF)  
 Edwards, A. K., 110, 112  
 Edwards, D., 340<sup>n32</sup>  
 Effective maturity, 338<sup>n17</sup>  
 Egan-Jones Ratings (EGR), 19–20  
 El-Jahel, L., 315<sup>n17</sup>  
 Elmer, P. J., 125  
 Emergency Economic Stabilization Act of 2008 (EESA), 40–49  
 Empirical EDF, 73, 88  
 Enron:  
     bankruptcy, 19, 81–82  
     credit default swaps, 311<sup>n22</sup>  
 Equity as call options, 92  
 Equity market, signals from, 89  
 Equity owners, payoff function of, 71  
 Equity prices, 20  
 Equity tranche, 261–262  
 Equity value, 309<sup>n7</sup>  
 Equivalent martingale measure, 99  
 Ericsson, J., 88, 91  
 Eurobonds, 281, 329<sup>n4</sup>  
 Europe, 271, 293, 334<sup>n18</sup>  
 European Central Bank, 36, 280  
 European Community (EC), 280  
 European Union, 249, 293, 338<sup>n19</sup>
- Evans, David, 271  
 Excess returns vs. gross returns, 320<sup>n12</sup>  
 Exchange-traded derivative security contracts, 253  
 Executive compensation, 49, 50, 60, 307<sup>n5</sup>  
 Exercise price, 72  
 Expected default frequency (EDF), 70. *See also* KMV EDF  
     accuracy measure of, 318<sup>n14</sup>  
     cut-off, 74  
     empirical, 73, 88  
     risk-neutral, 88, 312<sup>n26</sup>  
     theoretical, 73  
 Expected default frequency (EDF) scores, 72, 76, 77, 86  
 Expected losses (ELs), 105, 146–147, 231, 282, 284, 286, 311<sup>n20</sup>  
 Expected loss rate, 234  
 Expected probability of default (PD), 287  
 Expected return, 98  
 Expected tail loss, 293  
 Export credit agency (ECA), 279  
 Exposure at default (EAD), 258, 282, 288, 291, 297  
     for off-balance sheet items, 338<sup>n14</sup>  
     for on-balance sheet items, 338<sup>n14</sup>  
 External credit ratings, 63, 266, 281, 305<sup>n19</sup>, 310<sup>n11</sup>, 338<sup>n19</sup>  
 Extreme value theory (EVT), 325<sup>n16</sup>, 325<sup>n17</sup>, 325<sup>n18</sup>, 329<sup>n2</sup>
- Factor sensitivities, 327<sup>n35</sup>  
 Fair disclosure laws, 19  
 Fair Isaac, 317<sup>n1</sup>  
 Falkenheim, M., 337<sup>n4</sup>  
 Fan, H., 91  
 Fannie Mae (Federal National Mortgage Association), 26, 82  
 Fant, L. F., 121  
 Federal Deposit Insurance Corporation (FDIC), 46, 52, 53  
 Federal Deposit Insurance Corporation Act, 62  
 Federal financial service provider (FFSP), 54  
 Federal Insurance Guarantee Corporation (FIGC), 54  
 Federal Insurance Guarantee Fund (FIGF), 54  
 Federal insurance institution (FII), 54  
 Federal Reserve (FED), 15, 24, 25, 29, 36, 45–46, 52–54, 59, 306<sup>n16</sup>, 307<sup>n1</sup>, 307<sup>n3</sup>  
 Federal Reserve (FED) banks, 308<sup>n13</sup>  
 Federal Reserve Act of 1913, 307<sup>n3</sup>  
 Federal Reserve Bank of England, 253  
 Federal Savings and Loan Insurance Corporation (FSLIC), 308<sup>n8</sup>

- Federal Trade Commission (FTC), 61  
 Ferri, G., 338*n*19  
 Financial Accounting Standards (FAS) 157, 20  
 Financial Accounting Standards Board (FASB), 20, 336*n*43  
 Financial concentration, 308*n*13  
 Financial Consumer Coordinating Council, 61–62  
 Financial crises, 3  
   economic losses of, 307*n*1  
   losses, 322*n*30  
 Financial distress and liquidation, timing between, 319*n*5  
 Financial firms:  
   credit derivatives use, 269  
   regulation of, 59–60  
 Financial holding companies (FHCs), 59  
 Financial institutions (FIs), 54  
 Financial market regulation, 60–61  
 Financial meltdown background:  
   banking changes, 3–17  
   reengineering financial institutions and markets, 17–21  
   summary, 21–23  
 Financial regulators, 56  
 Financial Services Agency, 304*n*13  
 Financial services holding companies, 18  
 Financial Services Modernization Act, 52  
 Financial Services Oversight Council, 59, 62  
 Financial Stability Board, 62  
*Financial Stability Report* (Bank of England), 37  
 Fingar, C. C., 326*n*21, 326*n*29, 328*n*47, 329*n*10  
 Firm commitment (underwritten) deals, 12  
 Firm-specific risk, 335*n*35  
 First-to-default swaps, 335*n*6, 333*n*9  
 Fitch (rating services), 19, 269  
 Fitch Investor Service, 137  
 Fitch Investor Service Report, 324*n*14  
 Flight to quality, 32, 34, 306*n*12, 317*n*32  
 Floating rates, 29  
 Flood, M., 337*n*4  
 Ford, 250  
 Forecasting errors, 326*n*22  
 Foreclosure rate, 51  
 Foreclosures, 29  
 Formulaic correlation, 339*n*26  
 Foundation approach (FA), 275, 289, 291, 296, 297  
 Foundation model, 276, 283, 286  
 Foundation vs. advanced IRB models:  
   adoption of Basel II throughout the world, 293–296  
   assessment of the IRB models, 292–293  
   correlation, 291–292  
   exposure at default (EAD), 291  
   loss given default (LGD), 289, 291  
   maturity, 291  
   probability of default (PD), 291  
   summary, 292  
 France, 293, 304*n*14, 336*n*1  
 Fraser, Steve, 329*n*11  
 Freddie Mac (Federal Home Loan Mortgage Corporation), 26, 82  
 Froot, K. A., 236–237, 332*n*17  
 Frye, J., 141  
 Funded CDs, 335*n*34  
  
 Galai, D., 319*n*5  
 Garmaise, M. J., 332*n*2  
 Geithner, Timothy, 57  
 Generalized extreme value (GEV)  
   distribution, 325*n*12  
 General Motors, 244, 250  
 General Pareto distribution (GPD), 325*n*19  
 Geographic diversification, 31  
 Geographic diversification assumptions, 28  
 Germany, 293, 304*n*14, 336*n*1, 339*n*21  
 Geske, F., 310*n*10  
 Geske model, 90  
 Gilbert, R., 294  
 Glass-Steagall Act of 1933, 18  
 Goldman Sachs, 49  
 Goldstein, M., 111  
 Gordy, Michael, 137  
 Gorton, G., 31  
 Government sponsored enterprises (GSE's), 60, 86, 293  
 Graham-Leach-Bliley (GLB) Act, 18. *See also* Financial Services Modernization Act  
 Granularity, 292, 340*n*34  
 Griep, C., 339*n*21  
 Gross, J., 251  
 Growth rate and default risk, 95  
 Gunduz, Y., 334*n*15  
 Guntay, L., 141  
 Gupton, G. M., 340*n*32  
  
 Haircuts on collateral, 259  
 Harrison, J. M., 98  
 Hazard functions, 108, 321*n*21  
 Hazard rate, 115, 315*n*17  
 Hazards, 106  
 Hedge fund registration, 308*n*17  
 Hedge funds, 5, 10, 15, 34, 60, 62, 333*n*5  
 Heid, F., 295  
 Helwege, J., 138, 244, 251, 252  
 Herding behavior, 56, 296  
 Hildebrand, Philipp, 295  
 Hillegeist, S. A., 129

- Hilscher, J., 107, 108, 315–316 $n$ 21  
Hirtle, B., 247, 269  
Historical migration probabilities:  
    vs. risk-neutral probabilities, 326 $n$ 23,  
    326 $n$ 30  
    transition matrix using, 326 $n$ 30  
Historical one-year loss experience, 338 $n$ 18  
Ho, T. S., 235, 332 $n$ 18  
Homeowner equity lines of credit (HELCO),  
    340 $n$ 39  
Hotchkiss, E., 111, 118, 120, 309 $n$ 3  
Households, 141  
Housing price decline, 31  
Housing prices, 28, 29, 31  
Houweling, P., 140  
Hrycar, M., 318 $n$ 6  
HSBC, 251, 335 $n$ 22  
Hu, Z., 142, 143  
Huang, J. Z., 90, 91, 110, 312 $n$ 31, 316 $n$ 28  
Huang, M., 90, 110, 312 $n$ 31, 316 $n$ 28  
Huber-White standard errors, 130  
Hull, J., 271, 334 $n$ 12  
Human expert systems, 127  
Hurdle rate, 235, 237, 238, 331 $n$ 11, 332 $n$ 17  
  
Idiosyncratic risk, 335 $n$ 35, 339–340 $n$ 31  
IIF/USDA, 321 $n$ 15  
IKB (bank), 33–34  
Illiquidity credit risk, 236  
IMF (International Monetary Fund), 280  
Impending default, 146  
Implicit recourse, 263  
Implied ratings, 271  
Independent ratings agencies, 276  
Indexed CDs, 244  
Industry default risk, 335 $n$ 35  
Industry factors, 147  
Industry groups, 315 $n$ 20  
Inflation, 29  
Inside market midpoint, 251  
*Inside Mortgage Finance*, 40  
Instantaneous model, 145  
Institute of International Finance (IIF),  
    280–281  
Institutional investors, 19  
Insurance, 53  
Insurance companies, 60, 297, 309 $n$ 3  
    leverage at, 336 $n$ 44  
    and RAROC, 331 $n$ 8  
Insurance policy against systemic risks,  
    308 $n$ 9  
Intensity, 115  
Intensity process, 106, 114–116  
Interbank market, 32  
Interest rate risk, 4, 244  
Interest rates, 311 $n$ 19, 324 $n$ 11  
Interest rate swaps, 334 $n$ 10  
Internal capital markets, 329 $n$ 1  
Internal model approach. *See* standardized  
    model (SM)  
Internal model rules, 328–329 $n$ 1  
Internal ratings, 299–302  
    accuracy of, 318 $n$ 5  
    of banks, 299–302  
    of debt, 298  
    model, 299  
    models for credit risk, 282–283  
    systems, 301  
Internal ratings-based (IRB) foundation  
    model, 296, 297  
Internal ratings-based (IRB) models, 282,  
    283, 289, 292, 294, 339 $n$ 27  
Internal VAR, 328–329 $n$ 1  
International bank standards, 336–337 $n$ 2  
International Index Company (IIC) iTraxx,  
    249  
International Monetary Fund (IMF), 280  
International regulatory conditions, 62  
International Swaps and Derivatives  
    Association (ISDA), 304 $n$ 13, 333 $n$ 7  
International Swaps and Derivatives  
    Association (ISDA) Novation Protocol,  
    333 $n$ 5  
Interquartile range (IQR), 307 $n$ 25  
investor fear gauge, 41  
Italian loans, 137  
Italy, 293, 304 $n$ 14, 336 $n$ 1  
  
Jackson, P., 340 $n$ 35  
James, C., 235, 237, 332 $n$ 18  
Japan, 249, 293, 304 $n$ 14, 334 $n$ 18, 336 $n$ 1,  
    338 $n$ 19  
Jarrow, R. A., 106, 107, 108, 109, 316 $n$ 24,  
    320 $n$ 9, 321 $n$ 21  
Jenkins, Holman, Jr., 62  
Johnson, R., 20  
Jokivuolle, E., 140  
Jones, D., 337 $n$ 5  
Jorian, P., 246  
Jostova, G., 111, 309 $n$ 3  
J.P. Morgan, 48, 55, 121  
J.P. Morgan CreditMetrics model, 145  
Jumbo market, 26  
Jump process, 315 $n$ 17  
Junior mezzanine tranche, 261  
  
Kamakura, 316 $n$ 23, 321 $n$ 21  
Kamakura Public Firm Model, 108  
Kamakura Risk Manager, 98–116,  
    316 $n$ 23  
Kamakura's approach to LGD estimation,  
    146

## Index

373

- Kamakura's Risk Information System (KRIS), 108–110, 114  
 Kamakura troubled company index, 109  
 Kansas City Financial Stress Index (KFSI), 41  
 Karels, G. V., 121  
 Karlin, B., 329*n*9  
 Kashyap, A. K., 296, 308*n*9, 337*n*6  
 Kealhofer, S., 87, 305*n*19, 313*n*38  
 Kelling, J. G., 234, 329*n*2  
 Keswani, A., 329*n*7  
 Kim, J., 326*n*22  
 Kim, Y., 20  
 Kishore, V. M., 139  
 KMV, 89, 143–146, 282, 309*n*4, 310*n*9, 310*n*10, 310*n*13, 318*n*12, 322*n*30, 329*n*4  
 KMV CreditMark, 312*n*34  
 KMV database, 135  
 KMV EDF, 73, 76, 77, 80, 82, 92, 108, 311–312*n*25, 311*n*24, 312*n*26  
 KMV empirical EDF, 86–87, 311*n*17, 312*n*27  
 KMV LossCalc model, 143, 144, 145, 319*n*4  
 KMV model, 70, 311*n*18, 313*n*38  
 KMV Portfolio Manager, 312*n*27, 321*n*14, 321*n*15, 321*n*21, 321*n*23  
 KMV Private Firm Model, 96, 313*n*40  
 KMV RiskCalc, 95, 97, 308*n*1, 311*n*16, 313*n*40  
 Korabiev, I., 77  
 Korea, 142, 143, 338*n*15  
 Kreps, D., 98  
 Kupiec, P. H., 329*n*2  
 Kurtosis, 285  
 Kwak, S., 307*n*1  
  
 LaCour-Little, M., 139  
 Lando, D., 89, 106  
 Lead arranger, 11  
 Lead bank, 11  
 Left-hand side (LHS) variables, 69  
 Legacy loans, 49, 50  
 Legacy securities, 49  
 Lehman Brothers, 3, 38, 48  
     failure, 33–37  
     senior bonds auction, 251–252  
 Leland, H., 89, 90  
 Leland and Toft model, 90  
 Lender of last resort policies, 45  
 Less developed countries (LDCs), 282, 338*n*19  
 Leverage:  
     bank, 295  
     insurance companies, 336*n*44  
     Leveraged-buyouts (LBO's), 13  
     Leverage ratio, 295, 340*n*40  
     Leverage ratio capital requirements, 295  
     Leverage requirement, 294  
     Levy, A., 142, 143  
     Li, G., 307*n*5  
     LIBOR (London Inter-Bank Offered Rate), 13, 25, 36, 38, 112, 247–248, 260, 306*n*16, 317*n*31  
     Likelihood function, 312*n*28  
     Limited liability, 71  
     Linnell, I., 338–339*n*20  
     Liquidity, 112, 306*n*18  
     Liquidity crisis, 36  
     Liquidity facilities, 267–268  
     Liquidity premiums, 112, 314*n*3  
     Liquidity risk, 4, 33–37, 244  
     Liquidity run, 34  
     Liquidity squeeze, 34  
     Loan loss experience, 337*n*4  
     Loan loss rates, 329*n*16  
     Loan modification, 39, 50  
     Loan payoff function, 68  
     Loan Pricing Corporation (LPC), 13  
     Loan rating systems, 297–302  
         internal rating of banks, 299–302  
     Loan repayment incentive program, 70  
     Loan restructuring, 332–333*n*3  
     Loan risk, 9, 233  
     Loan risk components, 236–237  
     Loan risk premium, 232  
     Loans:  
         default risk on, 25  
         as put options, 92  
         syndication of, 5, 11–14, 22, 25  
     Loan-to-value (LTV) ratios, 294  
     Loan tradable risk component, 237  
     Loan transfer pricing, 331–332*n*14  
     Loan values, 104  
     Loeffler, G., 31, 306*n*11  
     London Inter-Bank Offered Rate (LIBOR).  
         See LIBOR (London Inter-Bank Offered Rate)  
     Longin, F., 325*n*17  
     Longstaff, F.A., 107, 112, 262, 311*n*19, 311*n*20, 312*n*31, 320*n*10, 335*n*35  
     Longstaff and Schwartz model, 90, 91  
     Longstaff-Schwartz structural model, 316*n*28  
     Long Term Capital Management (LTCM), 13, 24, 37  
     Long-term suggestions for supervisory framework, 53–54  
     Loss distribution, 234, 285  
         vs. undiversified portfolios, 321*n*17

- Loss given default (LGD), 31, 99, 107, 114, 135, 234, 282–283, 289, 291–292, 297, 315*n*15  
 academic models, 135–142  
 actual LGD, 289  
 and bond seniority, 329*n*9  
 cyclical nature, 139  
 loans to household, 138  
 measurement of, 138  
 vs. PD (probability of default), 141, 142–143  
 for small and medium enterprises, 137  
 systematic components of, 140  
 values, 340*n*32
- Loss given default (LGD) parameter, 135–147  
 about, 135  
 academic models of LGD, 135–142  
 Kamakura's approach to LGD estimation, 146  
 KMV's approach to LGD estimation, 143–146  
 LGD vs. PD, 142–143
- Loss intensity process, 105–108
- Luxembourg, 293, 304*n*14, 336*n*1
- Macauley duration, 232
- Maclachlan, I., 139, 312*n*27, 329–330*n*6, 331–332*n*14
- Macroeconomic conditions, 76, 90, 139, 141, 144, 147
- Madan, D. B., 107, 141
- Madoff, Bernie, 53
- Maenhout, P. J., 319*n*2
- Making Home Affordable program, 50
- Maltzan, J. von, 305*n*19
- Managed leverage ratio, 340*n*40
- Management shortcomings, 57
- Management tools, 62
- Mapping models, 308*n*1
- Marco, G., 125
- Marginal loans, 332*n*17
- Marginal mortality rates (MMR), 121–123
- Marginal risk contribution (MRC), 322*n*28
- Marginal tax rate, 231
- MarketAxess Holdings, 316*n*29
- Market fear, 41
- Market prices, 237
- Market risk, 325*n*16, 337*n*9  
 vs. credit risk, 329*n*12
- Market risk capital requirements, 276, 323*n*1
- Market value accounting, 20–21
- Markit's indexes, 249
- Mark-to-market accounting, 20
- Mark-to-market approach, 283
- Matrix prices, 309*n*3
- Maturity, 282, 291, 297, 338*n*17, 339*n*25
- Maturity adjustment factor, 288
- Maturity mismatch, 335*n*30
- Maximum likelihood approach, 88
- Maxwell, W. F., 309*n*3, 322*n*25
- McCarran-Ferguson Act, 53
- McKinsey and Co., 337*n*9
- McNeil, A. J., 329*n*2
- McQuown, J. A., 321*n*23
- Medium-term regulatory restructuring recommendations, 53–54
- Mella-Barral, P., 89, 310*n*9
- Mendelson, H., 112
- Merrill Lynch, 37, 48, 55
- Merton, R. C., 67
- Merton, R. C., 68, 326*n*24
- Merton model, 86, 88, 89, 309*n*6, 310*n*10, 311*n*19, 312*n*29, 313*n*37, 326*n*24
- Merton model options, 102
- Merton naive model, 313*n*37
- Merton options-theoretic model, 128, 130, 316*n*23
- Mester, L., 117–118, 317*n*1
- Mexico, 142–143, 338*n*15
- Mingo, J., 337*n*5
- Mispricing of credit risk, 337*n*4
- Mitchel, S., 112, 320*n*10
- Model time horizon, 312–313*n*35
- Modern portfolio theory (MPT), 228
- Modified modified restructuring, 271
- Modified restructuring, 269
- Money market mutual funds, 60
- Monitoring function of banks, 282
- Moody, J., 127
- Moody's, 19, 20, 32, 103, 109, 269, 271, 311–312*n*25, 317*n*39, 339*n*22. *See also specific entries under* KMV
- Moody's Analytics, 309*n*4
- Moody's credit rating, 77, 80, 86, 312*n*33
- Moody's Investor Service, 137, 324*n*14
- Moody's KMV. *See specific entries under* KMV
- Moody's ratings, 311*n*20
- Moral hazards, 17, 54, 62, 63, 281, 296
- Morgan Stanley, 49
- Morgenson, Gretchen, 39
- Morrison A. D., 336–337*n*2
- Mortality models, 121
- Mortality rate, 318*n*7
- Mortality rate systems, 121–124
- Mortality tables, 318*n*8
- Mortgage-backed security (MBS), 303*n*2
- Mortgage defaults, 29
- Mortgage foreclosures, 51
- Mortgage market, 29–33
- Mortgage obligations credit risk, 274

- Mortgage Origination Commission (MOC), 52  
 Moskowitz, T. J., 332n2  
 Mueller models, 93  
 Multiname CDSs, 333n6, 333n9  
 Multi-period nonstatic discriminant model  
   vs. discrete reduced form model, 318n11  
 Multivariate models, 118  
  
 Nabar, S., 20  
 Nakada, P., 231, 329–330n4, 331n8  
 Named credits, 269  
 National Association of Insurance  
   Commissioners (NAIC), 297, 309n3  
 National Association of Realtors, 31  
 National Association of Securities Dealer  
   (NASD), 111  
 National Bank Supervisor, 60  
 National Bureau of Economic Research  
   (NBER), 139, 326n22, 339n24  
 National Credit Union Administration, 53  
 Nationally Recognized Statistical Rating  
   Organization (NRSO), 19  
 Natural default rates, 314n7  
 Natural PD, 315n13  
 Neftci, S. N., 325n16  
 Neis, E., 112, 320n10  
 Net cash flows, 248  
 Net current exposure, 256–257  
 Net gross to current exposure ratio (NGR),  
   335n27  
 Netting rules, 256  
 Net to gross ratio, 256  
 New Century Financial, 32  
 New York Stock Exchange (NYSE), 316n29  
 Nickell, P., 329n4  
 Nomura Securities, 121  
 Nonstandard mortgages, 4  
 Nonstochastic interest rates vs. stochastic  
   interest rates, 326n24  
 Non-tradable illiquid credit risk, 237  
 Non-tradable risk components, 236–237  
 Non-traditional assets, 5  
 Normality assumption, 310n14  
 Northern Rock, 33, 306n15  
 Notation, 314n5, 324n10  
 Novation, 333n5  
  
 Obama, Barack, 50  
 Obama administration, 49  
 Obama/Geithner Plan (2008), 49, 52, 57–63,  
   271, 295–296  
 Objectives-based regulatory approach, 54  
 Off-balance sheet (OBS) vehicles/activities,  
   14, 17, 253, 256, 340n40  
 Off-balance sheet items, 338n14  
  
 Office of Federal Housing Enterprise  
   Oversight (OFHEO), 28  
 Office of Insurance Oversight (OIO), 53  
 Office of National Insurance (ONI), 53  
 Office of the Comptroller of the Currency  
   (OCC), 50, 52, 53, 297, 299  
 Office of Thrift Supervision (OTS), 50, 52, 53  
 Official default date, 146  
 OFHEO index, 306n11  
 Ohlson, J., 318n13  
 On-balance sheet items, 338n14  
 One-factor capital asset pricing model  
   (CAPM), 235  
 One-year time horizon, 339n24  
 Online corporate bond trading, 316n29  
 Open Market Committee, 36  
 Operational risk, 325n18, 337n9  
 Operational risk capital requirements, 276  
 Operational risk measurement, 340n38  
 Option prices, 313–314n1  
 Option-pricing model (OPM), 71, 92  
 Options-theoretical structural model, 140  
 Originate-and-distribute model, 21, 25, 31  
 Originating transactions, 13  
 O score model, 318n13  
 Overall risk, 337n9  
 Overnight index swap (OIS), 36, 112  
 Overnight index swap (OIS) rate, 306n16,  
   317n31  
 Over-the-counter (OTC) CDSs, 334n11  
 Over-the counter (OTC) contracts, 244  
 Over-the counter (OTC) derivatives, 60  
 Over-the counter (OTC) traded instruments,  
   253  
  
 Pan, J., 143, 320n10  
 Parlour, C., 314n3  
 Participants, 11  
 Paulson 2008 blueprint:  
   long-term suggestions for supervisory  
     framework, 53–54  
   medium-term regulatory restructuring  
     recommendations, 53–54  
   short-term crisis-related recommendations,  
     52–53  
   too big and too many to fail, 54–56  
 Payment-in-kind (PIK) provisions, 305n5  
 Payoff function of equity owners, 71  
 Peaks-over-threshold (POT) models, 325n19  
 Pederson, L. H., 316n27  
 Perez, D., 340n41  
 Perraudin, W., 89, 310n9  
 Peura, S., 140  
 Phelan, 321n22  
 Philippon, T., 307n4, 332n2  
 Physical delivery, 319n2

- Physical settlement, 250, 334*n*15, 334*n*17  
vs. cash settlement, 334*n*20
- Pillar 1 (minimum capital requirements), 268, 275
- Pillar 2 (supervisory oversight), 268, 275, 340*n*33
- Pillar 3 (market discipline), 268, 275
- Planitin, G., 314*n*3
- Pliska, S. R., 98
- Poddig, T., 125
- Point-in-time ratings, 269
- Poison process, 315*n*18, 317*n*34
- Poisson hazard process, 106
- Ponzi scheme, 53
- Popova, I., 313–314*n*1
- Portfolio default, 322*n*31
- Portfolio diversification, 256
- Portfolio risk, 319–320*n*4
- Portfolio risk equation, 322*n*29
- Post-default debt prices, 143, 145
- Potential current exposure, 257
- Potential exposure, 253, 254, 256, 328*n*48
- Powell, A., 337*n*4, 338*n*15, 338*n*18, 338*n*19
- Power, 109
- Power curve, 311*n*23
- Prakash, A. J., 121
- Predatory lending, 58
- Predictive default probabilities, 74
- President's Working Group (PWG), 52
- Price shock (capital charge), 332*n*18
- Price transparency, 111
- Pricing of derivatives, 314*n*2
- Primary market transactions, 13
- Private equity funds, 15
- Private firm model, 308*n*1, 316*n*25
- Probability distribution, 284
- Probability of default (PD),  
annual, 99–102  
vs. bond spreads, 20  
capital reserves and, 287  
correlation and, 291–292  
and correlations, 339–340*n*31  
determination of, 93  
exposure at default (EAD) and, 297  
for financial companies and building  
construction firms, 314*n*9  
foundation IRB approach, 282  
granularity of, 292  
historic-based loan ratings systems, 291  
vs. LGD (loss given default), 141  
loss given default (LGD), 114, 283  
lower bound on, 339*n*24  
and recovery rate (RR), 143  
risk-neutral EDF and KMV empirical EDF,  
87  
S&P ratings, 311*n*20, 312–313*n*35
- Probability of default (PD) estimation, 65–97
- Procyclicality, 295–296, 305*n*19, 340*n*41
- Proprietary investing, 14–15
- Proprietary reduced form model, 110
- Proprietary trading, 5
- Protection buyer, 245–248, 269, 333*n*9
- Protection seller, 245–248
- Prudential Financial Regulatory Agency (PFRA), 54
- Public firm model, 97, 108–109, 311*n*16
- Public-Private Investment Program (PIIP),  
48, 49–50
- Purchased funds, 10
- Pure credit default swaps, 248–249
- Pure default-free rate, 314*n*4
- Put options, 68, 92, 328*n*51
- Qu, S., 311*n*18, 312–313*n*35
- Qualifying capital, 277
- Quality of debt, 25
- Quality of investment-grade rated tranches of  
ABSs, 32
- Quantity of bank capital, 295
- Quantity of debt, 25
- Rajan, A., 262, 335*n*35
- Rajan, R. G., 296, 308*n*9
- Range of uncertainty, 307*n*25
- RAROC models, 228–239, 329–330*n*4,  
329*n*2  
about, 228–229  
and efficient portfolio allocations,  
331–332*n*14  
RAROC, ROA, AND RORAC, 229–230  
RAROC and EVA, 238  
RAROC denominator and correlations,  
235–238  
summary, 238–239
- Rating agencies, 18, 23, 81, 127, 329*n*3,  
339*n*22
- Ratings comparisons, 23
- Rating transition, 323*n*8
- Raveh, A., 121
- Raviv, A., 319*n*5
- Real estate investment trust (REIT), 6
- Receiver operating characteristic (ROC), 109
- Recovery of face value, 319*n*2
- Recovery rate (RR), 135, 140, 143, 324*n*14
- Reduced form hazard models, 128
- Reduced form models, 106, 146, 313–314*n*1,  
315*n*17  
about, 98–99  
bond spreads, determinants of, 110–114  
intensity process, 114–116  
Kamakura's Risk Information Services  
(KRIS), 108–110

- loss intensity process, 105–108
- risk-neutral probabilities of default, 99–102
- risky debt pricing model, 102–105
  - vs. structural approach, 320n9
  - vs. structural models, 316n22, 329n7
  - summary, 114
- Reengineering financial institutions and markets, 17–21
  - credit rating agencies, 18–20
  - market value accounting, 20–21
  - regulators, 18
- Reforms, 52, 56
- Regulation FD, 304n16
- Regulators, 18
- Regulatory arbitrage, 337n5
- Regulatory capital requirements, 276
  - and economic capital (EC), 337n7
- Regulatory ratings, 297
- Reinhart, C., 305n19
- Reintermediation, 37
- Reisen, H., 305n19
- Reneby, J., 88
- Replacement cost. *See* current exposure
- Repurchase agreements (repos), 303n6
- Reputational risk, 262, 263, 303n5
- Required return (hurdle rate), 332n17
- Resecuritization, 266
- Residential mortgage-backed securities (RMBSs), 5, 32, 34
- Resolution Trust Corporation (RTC), 50, 308n8
- Resti, A., 140, 141, 281
- Restructuring plans, 52–63
- Restructuring triggers, 269
- Return on assets (ROA), 230
- Return on equity (ROE), 229
  - vs. weighted-average cost of capital (WACC), 329n5
- Return on risk-adjusted capital (RORAC), 230. *See also* RAROC Models
- Returns, 326n28
- Rhine funding, 34
- Right-hand side (RHS) variables, 69
- Risk-adjusted discount rate, 98
- Risk-adjusted hurdle rate, 238
- Risk-adjusted return on capital (RAROC). *See also* RAROC models; return on assets (ROA); return on risk-adjusted capital (RORAC):
  - alternative forms, 230–234
  - alternative forms of, 230–234
  - alternative forms of RAROC, 230–234
  - denominator and correlations, 235–238
  - and EVA, 238
  - formula, 236
  - and insurance companies, 331n8
  - ROA, AND RORAC, 229–230
- Risk based capital ratio, 319n1
- RiskCalc, 95, 97, 311n16
- Risk components, 283
- Risk exposures, 4
- Risk-free rates, 317n32
- Risk management tools, 244
- Risk measurement shortcomings, 57
- Risk modeling, 56
- Risk-neutral default rates, 314n7
- Risk-neutral EDF, 88, 312n26
- Risk-neutral fashion, 98
- Risk-neutral pricing method vs. risk-adjusted matrix pricing, 321n15
- Risk-neutral probabilities of default, 98, 99–102, 315n13
- Risk-neutral probabilities vs. historical migration probabilities, 326n23, 326n30
- Risk-neutral valuation, 105
- Risk of natural casualties, 332n2
- Risk premium, 11, 232, 315n11
- Risk sensitivity, 280–281
- Risk spread required, 95
- Risk taking, 21
- Risk weight (RW), 254, 257–258, 264–266, 276, 278–281, 335n29, 338n16, 339n27
  - levels of, 337n9
  - of market risk, 336n43
  - for unrated securities, 336n42
- Risk-weighted assets (RWA), 288
- Risky bond yields, 113
- Risky debt pricing, 104
- Risky debt pricing model, 102–105
- Ronn, E., 71
- Rucker, F., 318n3
- Runs, 10–11
- Russian sovereign debt default, 13, 24, 37
- S&P. *See* Standard & Poor's (S&P)
- Sachsen LB, 34
- Saperia, N., 251
- Saunders, A., 110, 139, 280, 305n19, 338–339n20, 338n18, 339–340n31, 340n41
- Saurina, J., 340n41
- Saxony, Germany, 34
- Scenario analysis vs. nonstochastic interest rates, 326n23
- Schnabel, P., 307n4
- Scholes-type model, 328n48
- Schroder, Gerhard, 339n21
- Schuermann, T., 139
- Schultz, P., 110
- Schwartz, E. F., 107, 311n19, 312n31
- Secondary market prices, 320n6

- Second-lien mortgages, 27  
 Securities and Exchange Act of 1934, 19  
 Securities and Exchange Commission (SEC),  
   15, 52, 53, 61  
   Regulation FD, 304*n*16  
 Securitization, 4, 5–11, 22, 265, 303*n*4  
 Securitization framework, 264  
 Securitization instruments, 265  
 Securitized commercial loans (CLOs), 27  
 Self-dealing, 307*n*6  
 Sellers, M., 86  
 Senior mezzanine tranche, 261–262  
 Senior Supervisors Group (SSG) plan, 52,  
   56–57  
 Settlement auction, 251  
 Settlement methodology, 250  
 Shakespeare, C., 19  
 Sharpe ratio, 87, 228, 236, 238, 312*n*27,  
   321*n*23, 322*n*24  
 Shimko, D., 326*n*24  
 Short-horizon risk, 89  
 Short-term crisis-related recommendations,  
   52–53  
 Shumway, T., 92, 107, 108, 128, 318*n*11  
 “Significant judgment” treatment, 20  
 Simkins, B. J., 313–314*n*1  
 Simonato, J. G., 88  
 Single-factor capital asset pricing model  
   (CAPM), 291  
 Single-name CDSs, 333*n*6  
 Singleton, J. C., 127  
 Singleton, K. J., 107, 115, 116, 143, 314*n*4,  
   315*n*16, 316*n*27, 320*n*10, 322*n*23  
 Sironi, A., 140, 141, 281  
 Sirri, E., 111  
 Skewness, 285  
 Small and medium enterprises, 137, 141  
 Smith, B., 307*n*1  
 Soft credit event, 332–333*n*3, 335*n*28  
 Soliman, M. T., 19  
 Solnik, B., 325*n*17  
 Sovereign CDs, 319*n*2–3  
 Sovereign countries:  
   credit risk of obligations, 274  
   risk weight (RW) for, 279–280  
 Sovereign debt, 338*n*18  
 Spain, 293, 295, 340*n*41  
 Special-purpose entities (SPEs), 5  
 Special-purpose vehicles (SPVs), 5, 6, 10  
 Spread risk, 323*n*1, 325*n*16  
 Spreads, 10, 34, 230, 304*n*9  
 Srinivasan A., 110  
 Standard & Poor’s (S&P), 19, 20, 103, 232,  
   311–312*n*25  
   100 index options, 319*n*2  
   Case-Schiller Index, 306*n*11  
   convexity charge, 332*n*18  
   credit ratings, 312*n*33  
   rating, 80, 82, 311*n*20  
   Standardized (IRB) method, 336*n*41  
 Standardized model (SM), 169, 266,  
   275–276, 278–279, 281–282, 292,  
   294, 296, 338*n*15, 339*n*22  
   assessment of, 280–282  
 Standardized return, 327*n*31  
 Static credit scoring models vs. reduced form  
   hazard models, 128  
 Static debt structure, 92  
 Statistical methodology, 88  
 Statutory tax rate, 231  
 Stein, J. C., 236–237, 282, 296, 308*n*9,  
   332*n*17  
 Stein, R. M., 309*n*4, 311*n*23  
 Stochastic interest rates, 325*n*16  
 Stress-test multipliers, 325*n*16, 328–329*n*1  
 Stress tests/testing, 278, 329*n*2  
 Strike price, 71  
 Structural models, 90, 93, 98, 312*n*29,  
   312*n*34, 313*n*37, 313*n*38, 315*n*17,  
   316*n*24  
   vs. reduced form models, 316*n*22, 320*n*9,  
   329*n*7  
 Structured investment vehicles (SIVs), 5, 8, 9,  
   10, 28, 34, 37  
 Subordinated debt (Tier 2 capital), 337*n*11,  
   338*n*12  
 Subprime crisis, 21  
 Subprime market, 11, 25, 27  
 Subprime mortgage-backed securities  
   (MBSs), 26, 27, 29, 32  
 Subprime mortgages, 25, 50  
 Subscript notation, 314*n*5  
 Sundaresan, S. M., 89, 91, 312*n*26, 317*n*32  
 Super-senior mezzanine tranche, 262  
 Surkan, A. J., 127  
 Survival rates (SRs), 122  
 Swap settlement upon trigger of credit event,  
   250–252  
 Swap spreads, 245, 334*n*12  
 Swaptions, 334*n*13  
 Sweden, 293, 304*n*14, 336*n*1  
 Swidler, S., 309*n*7  
 Switzerland, 293, 304*n*14, 336*n*1  
 Syndicated bank loans, 13, 14  
 Syndication, 4, 11, 303*n*7  
 Syndication agent, 303*n*7  
 Synthetic CDOs, 244, 260, 262, 303*n*2,  
   333*n*9  
 Synthetic securitizations, 336*n*40  
 Systematic risk, 291, 292  
 Systematic risk coefficients, 321*n*21  
 Systematic risk correlation, 293

- Systematic risk factors, 321*n*21  
 Systematic risk premium, 87  
 Systemic risk bank surcharge, 56  
 Systemic risks, 55, 58, 293, 305*n*19  
     insurance policy against, 296, 308*n*9  
 Systemic risks exposure, 244  
 Systemwide insolvency risk, 293  
 Szilagyi, J., 107, 108, 315–316*n*21
- Tail ends, 325*n*16  
     negative vs. positive, 325*n*17  
 Tang, D. Y., 313*n*36  
 Tax penalty, 331*n*8  
 Teaser rates, 25, 27  
 Tech-bubble, 24  
 Tejima, N., 326*n*24  
 Term Auction Facility (TAF), 46  
 Term Securities Lending Facilities (TSLF), 48  
 Term structure of economic capital (EC), 329–330*n*5  
 The Netherlands, 293, 304*n*14, 336*n*1  
 Theoretical EDF, 73  
 Thrift charter, 53  
 Tier 1 capital, 274, 276, 278, 289, 295, 337*n*3, 338*n*12  
 Tier 2 capital, 274, 276, 278, 289, 337*n*3, 338*n*12, 339*n*28  
 Tier 3 capital, 276, 337*n*11  
 Time to default, 88  
 Timing between financial distress and liquidation, 319*n*5  
 Toft, K., 91  
 Too big to fail (TBTf), 11, 37, 38, 54, 55, 56, 62  
 Too big to fail (TBTf) and too-many-to fail (TMTF), 54–56  
 Too big to fail (TBTf) premiums, 63  
 Too-many-to fail (TMTF), 56  
 Total return swap, 247–248  
 Toxic bank loans, 49, 50  
 Toxic securities, 39  
 Tradable risk, 237  
 Tradable risk components, 236–237  
 Trade Reporting and Compliance Engine (TRACE), 60, 111, 112, 309*n*3, 317*n*30  
 Trading losses and counterparty credit risk, 329*n*17  
 Traditional banks, 3–5  
 Traffic light system, 328–329*n*1  
 Transaction costs, 110  
 Transition matrix, 323*n*6, 325*n*20, 326*n*23, 328*n*49  
     using historical migration probabilities, 326*n*30  
 Transition ratings, 314*n*6  
 Transparency, 112, 127
- Treacy, W., 299  
 Tree diagram, 314*n*6  
 Troubled Asset Relief Program (TARP), 38, 48  
 Troubled Company Index, 109, 316*n*26  
 Tufano, P., 107  
 Turkey, 142, 143  
 Turnbull, S. M., 106, 235, 329–330*n*5, 331*n*8, 331*n*9, 332*n*17  
 Two-factor model, 239  
 Tychon, P., 89  
 Type I errors, 86, 118, 127, 318*n*9  
 Type II errors, 86, 118, 126, 127, 318*n*9
- UBS, 32  
 Uhrig-Homburg, L., 89  
 Unal, H., 107, 141, 315*n*15  
 Underwriters/underwriting, 32, 33–37, 39, 40, 336*n*37  
 Undetected risk, 17  
 Undiversified portfolios vs. loss distribution, 321*n*17  
 Unexpected default rate, 234  
 Unexpected losses (ULs), 284, 286  
 Unhedgeable assets, 236  
 Unintended consequences, 274  
 United Kingdom, 293, 304*n*14, 308*n*7, 336*n*1  
 United States, 293, 294, 297, 299, 304*n*14, 336*n*1, 338*n*19  
 Unrated classification risk weight, 338–339*n*20  
 Unrated risk, 281  
 Unrated securities, risk weight (RW) for, 336*n*42  
 Unsystematic risk, 236, 292  
 Untraded assets, 236  
 U.S. bank holding companies, 299  
 U.S. bank regulators, 340*n*38  
 U.S. bank regulators/regulation, 293–295  
 U.S. commercial banks, 247  
 U.S. Department of Justice (DOJ), 61  
 USG Corporation, 81  
 U.S. prime rate, 13  
 U.S. Treasury, 46, 48, 49, 52  
 U.S. Treasury bills (TED) spread, 41  
 U.S. Treasury securities, 32, 34, 112, 232, 329*n*11  
 Utans, J., 127
- Valuation volatility (VVOL), 321*n*15  
 Value at risk (VAR):  
     capital requirement, 325*n*16  
     measures of risk, 292  
     models, 31, 283–289  
     multiplier, 328–329*n*1

- van Deventer, D. R., 320n9, 321n21, 326n24  
 VanHoose, D., 337n5  
 Vanini, P., 339n24  
 VAR. *See* value at risk (VAR)  
 Varetto, F., 125  
 Variance-reduction techniques, 327n40  
 Vassalou, M., 86, 92, 309–310n8  
 Venkataraman, K., 309n3  
 Venture funds, 15  
 Verma, A., 71  
 Vilkov, G., 319n2  
 Volatility:  
   annual MMRs with LGD, 318n6  
   Chicago Board Options Exchange (CBOE)  
     Volatility Index, 41  
   and conditional default probabilities, 219  
   credit risk volatility, 312n26  
   of credit spreads, 244  
   empirical, 88  
   implied, 69  
   market, 41, 43  
   market price, 244  
   of market value a firm's assets, 69–71, 72  
   of market value a firm's equity, 70  
   mitigation of, 295  
   stock price, 86  
   unobservable vs. observable, 71, 88  
   from untradable risk component, 237  
   valuation volatility (VVOL), 155, 321n15  
 Vorst, T., 140  
 Vulture capitalists, 39  
 Vulture funds, 140, 307n19  
 Wachovia, 55  
 Wakeman, Lee M., 235  
 Walk forward analysis, 145  
 Wallison, Peter, 62  
*Wall Street Journal*, 27, 28, 37  
 Walter, I., 110, 234  
 Walter, J., 329n2  
 Warehouse lenders, 303n3  
 Warehousing, 11  
 Washington Mutual (WaMu), 55  
 Weighted-average cost of capital (WACC),  
   229  
   vs. return on equity (ROE), 329n3  
 Weighted-average life (WAL), 339n25  
 Wells Fargo, 50–51, 55  
 White, Alan, 50, 272, 334n12  
 White, L., 336–337n2  
 Wiener, Z., 319n5  
 Wilcox, J. A., 309n7  
 Wilson, T., 321n17  
 World Trade Center attack, 24  
 Wrong way credit exposure, 328n47, 329n10  
 Xing, Y., 86, 92, 309–310n8  
 Yan, A., 142  
 Yan, H., 313n36  
 Yang, Z. P., 126  
 Yield curves, 100  
 Yield spread, 94, 232  
 Yogo, M., 306n18  
 Yorulmazer, T., 56  
 Zaik, E., 234, 329n2  
 Zhang, G., 246  
 Zhou, C., 89, 107  
 Zhu, H., 308n15  
 Z'' model, 318n4  
 Z score model, 118–119, 130, 318n14