

Introduction to Securitisation Terminology

Sources: ECB, The Journal of Structured Finance, Duke Journal of Comparative and International Law, FT Lexicon, Investopedia.

Structured finance

Any financing transaction that utilises special-purpose vehicles (e.g. project finance, securitisation, complex leasing transactions, or structured risk transfer mechanisms). The common theme to all types of structured finance transactions is that the transaction is structured to modify or redistribute the risk of the collateral among different classes of investors through the use of a structure.

Security

A financial instrument that represents an ownership position in a publicly traded corporation (stock), a creditor relationship with governmental body or corporation (bond), or rights to ownership as represented by an option.

Credit risk

The risk of loss of the principal (i.e. the original sum invested or le), or loss of a financial reward stemming from a borrower's failure to repay a loan or otherwise meet a contractual obligation.

Derivative

A contract where the payment obligations of the parties are derived from another set of assets or liabilities, which need not reflect any real assets or liabilities but is a notional amount.

Credit derivative

A derivative where one party's obligation to pay is conditioned on the occurrence of a credit event (usually a default) on another, sometimes notional, contract.

Credit Default Swap (CDS)

A credit derivative under which one of the parties pays a fee periodically to the other, in exchange for which it obtains a guarantee that it will be compensated by the other party if a bond goes into default.

Par value

The nominal value shown on the side of a security or other type of financial instrument. The par value of a bond is the value at which it will be redeemed.

Secured debt or Asset Backed Security (ABS)

Debt supported by particular assets of the borrower (e.g. mortgages secured by houses, car purchase loans secured by the vehicle). A borrower in financial difficulty must sell these assets to repay the lender.

'Synthetic' securitisation

Transaction involving no transfer of legal title, but only the sale of the credit risk associated with the assets through the use of credit derivatives such as credit default swaps. The underlying assets remain on the balance sheet of the originator.

'True sale' securitisation

Transaction involving the effective legal transfer of the assets to the issuer of the securities (SSPE); as a result, the SSPE becomes entitled to the cash flows that are generated by the assets (including those resulting from a subsequent sale of the assets). The underlying assets are removed from the originator's balance sheet.

