CRS Terminology

Credit Risk Sharing (CRS) is a form of securitisation also known by its technical term of 'synthetic' or 'on-balance-sheet securitisation'. A large part of the perceived complexity of synthetic securitisations stems from the jargon used in the industry. Here we strive to demystify some of this jargon.

Securitisation	Securitisation is a technique to allow investors to participate in a portfolio of loans by pooling these loans and then creating securities for one or more different 'tranches' (levels of risk) to suit the purpose of the bank and the preferences of different investors.
Synthetic Securitisation	The term 'synthetic' comes from the fact that, unlike in a true sale or 'traditional' securitisation, the securitised loans being securitised are not sold by the bank but are referenced. Within CRS, this means they remain on the bank's balance sheet (see "on-balance sheet securitisation" below). Synthetic securitisations are often used for hedging the credit risk on loans that cannot easily be sold. Examples are revolving credit facilities, SME lending and trade finance, as these credit facilities often require a large amount of operational handling that a bank is uniquely set up for and which cannot easily be taken over by a non-bank.
On-Balance-Sheet Securitisation	The term 'on-balance sheet securitisation' is included to indicate that the securitised loans remain on the bank's balance sheet. This way, the bank reduces the credit risk on the securitised loans and remains in charge of managing the loans and the lending relationship with its clients. The technique of synthetic securitisation can also be used to buy credit protection for assets that the buyer does not actually own; these transactions are called 'arbitrage' securitisations. Arbitrage securitisations are not a hedge for the assets of the protection buyer and the benefits for the investor that come from the fact that the bank retains ownership of the securitised loans are not applicable to arbitrage securitisations. For this reason, we do not invest in arbitrage securitisations, but only in on-balance sheet securitisations.
True Sale Securitisation	Refers to the fact that the loans are sold by the bank to a securitisation vehicle in a legal true sale that effectively ring-fences the assets away from the bank.
Tranches	Slices of a securitised portfolio which have different rankings in terms of when the investors in the tranches will be affected by losses, and therefore different risk profiles. A first loss tranche investor will be affected by the first 'losses, until that tranche is depleted; any additional losses will then be absorbed by the investors in the second loss tranche and so on.

First loss or Equity Tranche	The 'first loss' or 'equity' tranche, as the name implies, covers the first losses to occur in the loan portfolio. It therefore carries the highest risk, but it will also generate a commensurately higher premium. The 'senior' tranche on the other hand only covers losses after the first loss tranche and any other 'mezzanine' tranches have been exhausted. The senior tranche is therefore the least risky and also has the lowest premium.
Mezzanine Tranche	An alternative name for the second loss tranche.
Reference Portfolio	The portfolio of loans that is being referenced in a credit risk sharing transaction or synthetic securitisation. Any valid claims for losses in this portfolio will be compensated by the investor, up to a pre-agreed maximum amount.
Special Purpose Vehicle (SPV)	Also sometimes referred to as SSPE (Securitisation Special Purpose Entity) legal entity specifically set up for the securitisation transaction. In a true sale securitisation, the SPV purchases the loans from the bank and issues securities backed by the payments on the loans. In a synthetic securitisation, the SPV does not purchase the loans, but enters into a CDS or Financial Guarantee with the bank and it issues credit linked notes to investors who agree to reimburse losses suffered by the bank on the agreed (a referenced) portfolio of loans. In a true sale securitisation, an SPV is required as there must be an entity that legally owns and ring-fences the loans. In a synthetic securitisation or CRS transaction, and SPV is optional.
Credit Default Swap (CDS)	A contract between two parties in which one party agrees to cover credit losses incurred by the other party. In this contract the protection buyer pays a fixed rate of interest (the 'CDS premium') in exchange for a 'floating' payment from the protection seller. Such a 'floating payment' would be the loss amount claimed by the protection buyer, following a credit event on a loan in the portfolio.
Financial Guarantee	A contract in which one or more investors agree with a bank to reimburse losses suffered by a bank on a portfolio of loans as the result of credit events, such as failure to pay and bankruptcy.
Credit Event	When a borrower cannot repay its obligations. Usually this is separated in three categories: 'Failure to Pay', 'Bankruptcy' and 'Restructuring'.
Credit Protection	Protection for credit risk, which is the basis for credit risk sharing.
Protection Buyer	The party that wants to receive credit protection on loans they hold, typically a bank.

Protection Seller	The party that offers the credit protection (the investor(s)).
Premium	The premium is the payment that a bank pays investors to compensate them for taking a portion of the credit risk of the loans in a synthetic securitisation. The premium is calculated on the invested amount, which equals the maximum amount of losses on the securitised loans the investors commit to reimburse.
Significant Risk Transfer (SRT)	For a bank to claim capital relief (see below) for a securitisation of on-balance-sheet assets, the supervisor wants to see that a significant portion of the credit risk has been genuinely transferred to a third party. For this purpose, the bank needs to provide information and data so that the supervisor can make this assessment. CRS transactions are also often referred to as "SRT transactions" as a bank typically issues in order to achieve capital relief. We like to use our own version of SRT, being "Sharing Risk Together".
Capital Relief	A reduction in the amount of capital that a bank (or other financial institution) is required to hold against the loans it made. Capital relief is usually provided by the regulators in a form of compliance with certain regulatory requirement, such as achieving the SRT (see above), and it allows banks to make more loans and investments. There are a number of ways that capital relief can be achieved. One of them is securitisation.
Retention	The share of the loan portfolio the bank remains exposed to, and which is not sold to or hedged by the investors. Retention is an important element of getting 'alignment of interest' between the bank and investor. For more details about risk retention see here.

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