From PLI's Course Handbook
Nuts and Bolts of Financial Products 2007: Understanding the Evolving World of Capital Market & Investment Management Products
#10870

14

SECURITIZATION GLOSSARY

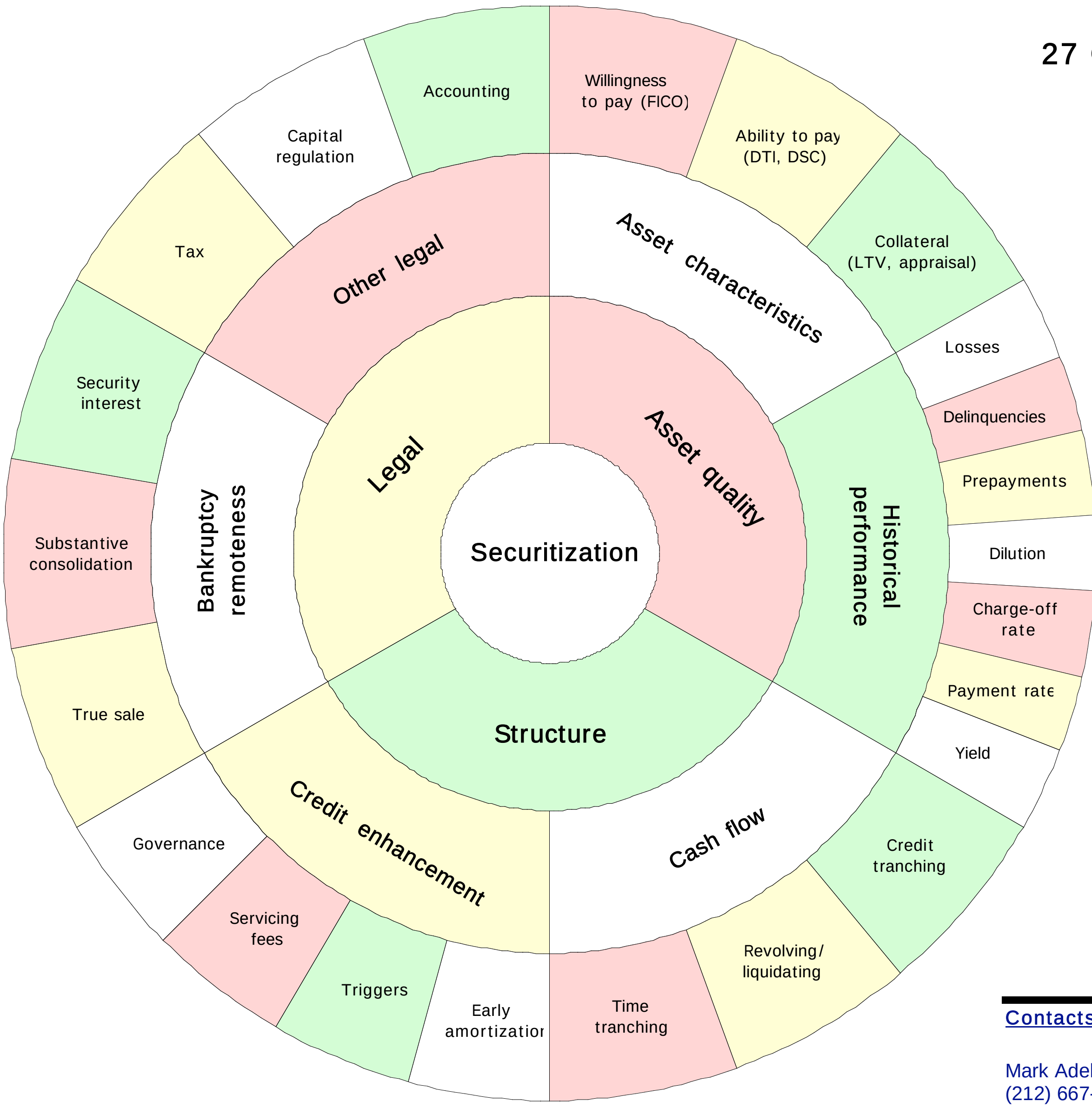
Submitted by:
Mark Adelson
Nomura Securities International, Inc.

Nomura Fixed Income Research

NOMURA

Securitization Glossary

27 October 2004



Contacts:

Mark Adelson
(212) 667-2337
madelson@us.nomura.com

Michiko Whetten
(212) 667-2338
mwhetten@us.nomura.com

Beth Hoyt
Analyst

Nomura Securities International, Inc.
Two World Financial Center
Building B
New York, NY 10281-1198
Fax: (212) 667-1046

accretion bond; Z bond – a CMO class on which interest accrues but is not paid currently. Instead, interest is added to principal each period. CMOs often include accrual bonds, which are generally designated as "Class Z."

agency MBS – mortgage-backed securities issued or guaranteed by Ginnie Mae, Fannie Mae, or Freddie Mac.

amortization – the periodic repayment or return of the principal of a bond or loan. Residential mortgage loans in the U.S. experience amortization each month. Regular corporate bonds and U.S. Treasury securities do not experience amortization before their maturity dates.

anchor tenant – a large retailer that attracts tenants to small stores in a shopping center.

appraisal – estimate by an expert of the value of specific property. It is a common practice for a mortgage lender to obtain an appraisal of the property that will serve as collateral for a mortgage loan.

asset-backed commercial paper; ABCP – short-term securities created using securitization techniques. A commercial bank may create and sponsor an ABCP program to make secured loans to its corporate customers. Typical collateral for such secured loans is trade receivables.

asset-backed security; ABS – securities backed by specific assets and the payments on which are tied to or derived from the cash flows produced by the underlying assets. Examples of typical collateral backing ABS include the following: auto loans, credit card receivables, home equity loans, manufactured housing loans, student loans, and equipment leases. In the U.S., the term ABS does *not* include securities backed by: (1) prime-quality first-lien mortgages, (2) commercial mortgage loans, or (3) pools of corporate bonds and loans. Outside the U.S., the term ABS may include deals backed by such collateral. ABS also includes securities backed by "esoteric assets" such as; healthcare receivables, tax liens, trade receivables, structured settlements, entertainment royalties, patent and trademark receivables, etc. ABS are distinguished from traditional secured debt because ABS use "bankruptcy remote structures" to provide superior isolation of the underlying assets.

assumable loan – mortgage loan that allows the borrower to transfer the debt to the buyer in a sale of the related property.

average loan balance – with respect to a pool of residential mortgage loans, the average balance of the loans composing the pool. Prepayments on pools with low average loan balances are less sensitive to changes in interest rates than prepayments on pools with high average loan balances.

back-up servicer – see "servicer."

balloon mortgage loan – a mortgage loan that provides for a final payment that is much larger than earlier payments. A balloon loan is distinguished from a "fully amortizing loan." In a fully amortizing loan, the final scheduled payment generally is the same size as each earlier payment. A common structure for a balloon loan is to have 119 monthly payments calculated as if the loan were to amortize over 30 years and to have the full remaining outstanding balance due in the 120th month.

bank capital regulation – regulations that require banks to maintain minimum levels of capital. Each modern nation establishes bank capital regulations in order to promote the safety and soundness of its banking system. Internationally, the Bank for International Settlements (BIS) promotes a framework for bank capital regulation that many nations accept. The BIS framework gauges a bank's capital requirement primarily against the riskiness of its assets.

bankruptcy remote structure; bankruptcy remoteness – techniques used for isolating assets or loans from the bankruptcy risk of the company financing or selling them. The use of bankruptcy remote structures distinguishes securitizations from traditional secured financings. For example, in the U.S., a loan originator (*e.g.* a consumer loan company) might finance its loans by transferring them to a special purpose entity (SPE) and causing the SPE to issue securities backed by the loans. The transfer of the loans to the SPE is designed to be a "true sale," which places the loans outside of the originator's bankruptcy estate in case it goes into bankruptcy. In addition, the SPE is established in such a way that its independence (separateness) from the originator would be respected by a bankruptcy court. The use of bankruptcy remote structures developed in response to features of the U.S. bankruptcy law, which sometimes may deny a secured lender the full benefit of his collateral.

B&C borrowers; subprime borrowers – consumer borrowers whose credit histories reflect significant delinquencies, defaults, or bankruptcies. B&C borrowers are distinguished from "prime-quality" borrowers. For example, some lenders classify B&C borrowers as those who have been delinquent by 30 days or more on a mortgage loan within the preceding year or who have been in bankruptcy within the preceding 5 years. Other lenders use slightly different classifications.

B class; subordinate class – in a securitization, the tranche or class that has the lowest credit priority in a deal. The holder of the B class is sometimes called "B-buyer."

benchmark – a standard to measure, monitor, price or evaluate a security, derivative, or portfolio. Bond yields are often described in terms of their level or "spread" over or under a specified benchmark. For fixed-rate bonds, swap rates and yields on U.S. Treasury securities are common benchmarks. For floating rate bonds, LIBOR is a common benchmark. The term benchmark sometimes refers to particular securities – such as those issued by the GSEs – against which other securities are compared.

bond equivalent yield; BEY – yield calculated on the basis of semiannual compounding, as in the case of corporate bond yields. Although MBS usually pay monthly, MBS yields and spreads normally are converted to a BEY basis for easier comparison with U.S. Treasury securities, agency debt, and corporate bonds.

bullet security; bullet payment – a type of debt security that repays its entire principal in a single payment. Before the maturity or prepayment of the security, only interest payments are made in accordance with the payment schedule (*e.g.*, corporates).

burnout – with respect to the prepayment rate of mortgage pools, the tendency to become less sensitive to changing interest rates after a period of low interest rates. A mortgage pool is said to be "burnt out" when its prepayment rate has become substantially insensitive to changing interest rates.

call protection – protection against prepayment risk. In commercial mortgage loans, examples of call protection include lockouts (temporary prohibitions against prepayment), defeasance (requirement to purchase securities that create an identical cash flow), prepayment fees (calculated as a predetermined percentage of outstanding balance), and yield maintenance penalties. In subprime residential mortgage loans, prepayment penalties are a form of call protection.

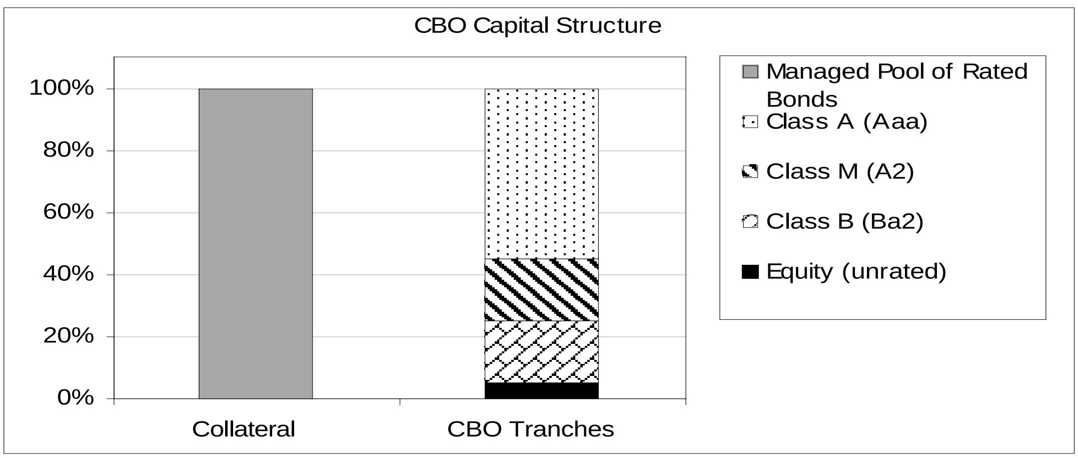
callable bond – a bond redeemable (prepayable), in whole or in part, by its issuer before its final maturity date. MBS are a special form of callable bonds because the borrowers on the individual underlying mortgage loans can prepay their loans. A mortgage loan borrower is long an option that allows him to prepay his loan. An investor who owns an MBS backed by the loan has a short position in the option.

charge-off – to recognize a loss on a receivable. The charge-off rate on a pool of receivables (*e.g.*, credit card receivables) is the annual rate at which losses are realized, expressed as a percentage of the balance of the pool.

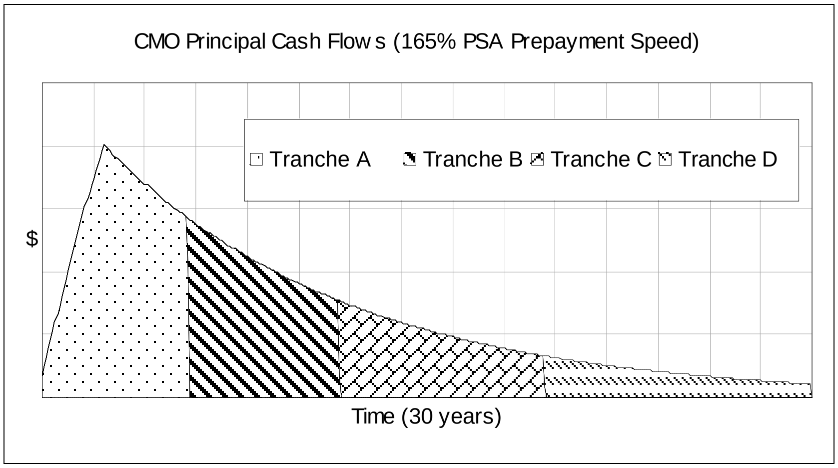
clean-up call – the right of a servicer to redeem an ABS or MBS after the balance of the underlying asset pool has declined below a predetermined level (*e.g.*, 10% of its original amount). A clean-up call permits a servicer to terminate its administrative obligations (such as processing monthly remittances to investors and sending out monthly reports) when the related servicing fee has been reduced to a level that might not fully cover the cost of administering the transaction.

collateral – (1) assets serving as security for a loan; (2) assets subject to a lien, charge or encumbrance; (3) assets backing or underlying a securitization. In the case of a loan secured by collateral, if the borrower fails to make required payments, the lender has the right to seize and sell the collateral to recover the defaulted amount.

collateralized bond obligation; CBO – in the U.S., a securitization structure/technique similar to a hedge fund. In a U.S. CBO, an actively managed pool of rated bonds serves as the collateral backing other debt securities. In contrast, most Japanese CBOs are backed by static pools of debt securities. The underlying bonds may include junk bonds, investment grade corporate bonds, or securitization instruments. A CBO generally issues multiple tranches of debt securities, each at its own level of seniority in the transaction's capital structure.



collateralized mortgage obligation; CMO; REMIC – a series of securities created by dividing the cash flows from a pool of mortgage loans among various serially maturing tranches of securities. A CMO allows for disproportionate allocations of prepayment and extension risk among the different tranches. Sometimes the underlying collateral of a CMO is raw mortgage loans and sometimes it is previously issued mortgage pass-through securities. A CMO's structure can include tranches designed with a wide variety of special attributes to meet investors' preferences. REMIC refers to the tax classification applicable to CMOs under U.S. tax law and is an acronym for "real estate mortgage investment conduit." See "planned amortization class."



collateralized debt obligation; CDO – refers to CBOs and CLOs collectively.

collateralized loan obligation; CLO – similar to a CBO except the underlying collateral is bank loans to corporations.

commercial mortgage-backed security; CMBS – security backed by commercial mortgage loans.

CMO – see "collateralized mortgage obligation."

companion bond; support bond – a type of CMO tranche that provides partial protection to other tranches against prepayment risk. See "planned amortization class."

conforming mortgage loan – a mortgage loan that satisfies the guidelines of Fannie Mae or Freddie Mac. In general, a conforming loan must be of prime quality and its principal amount must be below a threshold level established each year by the federal government. Prime-quality loans that exceed the threshold (but which otherwise satisfy the guidelines) are called "jumbo mortgage loans."

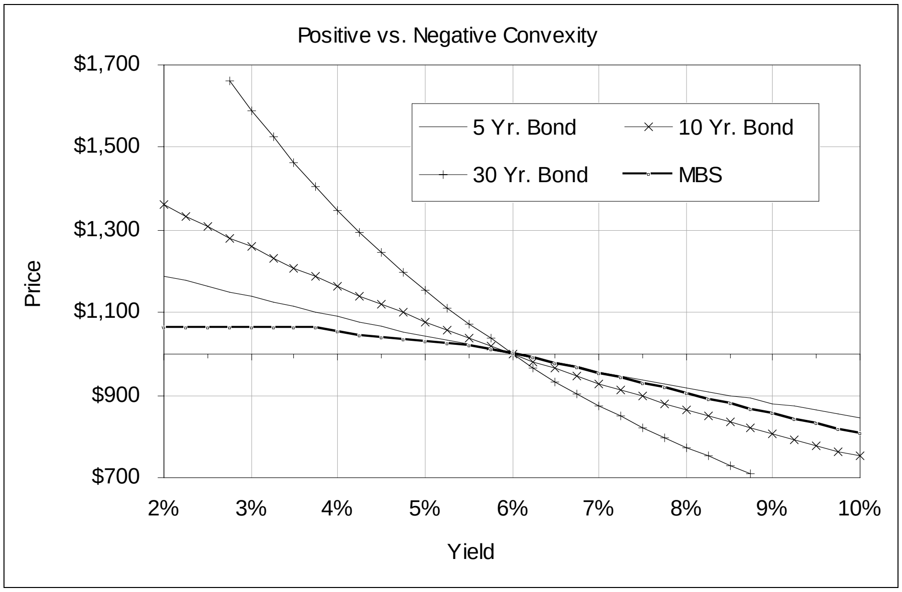
constant prepayment rate; conditional prepayment rate; CPR – a widely accepted model or framework for describing or measuring prepayments on pools of mortgage loans or other financial assets; 10% CPR refers to a constant annual rate of prepayment such that 10% of the balance of a pool of loans is prepaid during each year. 10% CPR corresponds to a monthly prepayment rate (*i.e.*, single monthly mortality or SMM) of approximately 0.8742%, calculated as follows:

$$0.8742\% \cong 100\% - \sqrt[12]{100\% - 10\%}$$

See "prepayment rate."

conventional loans – a residential mortgage loan that is not insured or guaranteed by the government or a governmental agency. Mortgage loans insured by the Federal Housing Administration (FHA) or guaranteed by the Veterans Administration (VA) are *not* conventional loans.

convexity – the second derivative of price with respect to yield; the change in a bond's duration for a percentage point change in its yield. Ordinary (*i.e.*, non-callable) bonds have positive convexity. That is, as yields rise their price falls at a *decreasing* rate and as yields fall their prices rises at an *increasing* rate. Callable bonds, including most MBS, display negative convexity. In general, negative convexity is an adverse trait and investors require extra compensation (in the form of incremental yield) to accept it. The following chart compares the relationship of price to yield for four securities, each of which has a price of par at a yield of 6%. Three of the bonds are regular bonds and the fourth is a mortgage-backed security. Convexity is visible as the degree and direction of curvature in the price-yield function for each bond. The duration of a bond at a given yield corresponds to the slope of the tangent line to its price-yield function at that yield.



corporates – corporate bonds

credit enhancement; credit support – techniques used to improve the credit quality of a bond so that it can obtain a high rating. Most securitizations use credit enhancement to allow their senior classes of bonds to obtain triple-A ratings. Common examples of credit enhancement include the following:

- subordination - the credit quality of a deal's senior class of bonds is improved by subordinating the junior classes (also called senior-subordinated structure; see glossary entry for that term).
- overcollateralization - the par amount of securities issued in a deal is less than the aggregate principal amount of underlying financial assets being securitized.
- excess spread – difference between the interest rate on securitized financial assets and the interest rate on the bonds backed by those assets (similar to net interest margin for a finance company), which can be applied to offset losses.
- reserve fund - within the structure of securitization, an account containing cash or high-quality securities from which withdrawals can be made to offset losses or shortfalls on securitized assets.
- guarantee - either the sponsor of a transaction or a third party, such as a bond insurer, can guarantee bonds.

credit rating – a formal evaluation of the credit quality of a bond, usually expressed with a symbol such as "AAA" or "Aaa." In the U.S., the most active rating agencies are Moody's and S&P. A third rating agency, Fitch, is active in rating securitizations and in selected other areas of the fixed-income markets.

current coupon – (1) with respect to agency MBS, the pass-through rate on securities that will be backed by the conforming mortgage loans currently being originated; (2) the pass-through rate on agency MBS having the highest price below par; (3) the pass-through rate on agency MBS being sold most actively by mortgage originators. Pass-through rates on an agency MBS are set in half percentage point increments (*e.g.*, 5%, 5½%, 6%, 6½%, 7%, 7½%, etc.). In general, at any time, the current coupon in the sense of (1) above is approximately 50 basis points below prevailing rates on conforming mortgage loans.

cusp coupon – (1) with respect to agency MBS, the next highest pass-through rate above the current coupon; (2) agency MBS having the pass-through rate corresponding to the interest rate on mortgage loans whose prepayments are the most sensitive to changes in interest rates. Agency MBS at the cusp coupon display the greatest degree of negative convexity.

debt service coverage ratio; DSCR – a measure of a property's ability to support payments on debt that it secures; with respect to a commercial mortgage loan, the ratio of monthly revenue on the mortgaged property to the scheduled monthly payment on the loan. A debt service coverage ratio near or below 1:1 indicates that a loan may be in distress.

debt-to-income ratio; DI ratio; DTI – a measure of a borrower's capacity to repay a loan; with respect to a residential mortgage loan, the ratio of the borrower's scheduled monthly mortgage payment to his monthly income (including one twelfth of other recurring annual income, such as bonuses). Traditional guidelines for conforming loans specify that a borrower's monthly mortgage payment should not be more than 28% of his gross monthly income and that all the borrower's total monthly debt service (including mortgage, auto loans, credit cards, student loans and all other debt) should not be more than 36% of his gross monthly income. The traditional guidelines for debt-to-income ratios became less important in mortgage loan underwriting following the widespread deployment of automated underwriting systems such as Desktop Underwriter (DU) from Fannie Mae and Loan Prospector (LP) from Freddie Mac.

defeasance – satisfaction of debt before its scheduled maturity by transferring U.S. Treasury securities that will produce a cash flow sufficient to make all remaining scheduled payments when due. In a typical scenario, an issuer of bonds may *defease* its obligation on the bonds by transferring appropriate U.S. Treasury securities to the trustee for the bonds.

delinquency – the condition of having failed to make one or more scheduled payments on a debt obligation. A borrower may be considered delinquent on its debt as soon as the due date for payment has passed, even though a grace period may apply. There are a number of different (and incompatible) methods that servicers of securitizations use for reporting delinquencies. For example, suppose (1) a securitized loan has payments due on the first of day of each month, (2) the servicer of the securitization reports on the condition of the loans as of the last day of each month, and (3) no payments are made on the loan from January 1 through April 1. Three reporting methods would treat the loan as follows:

	Jan 31	Feb 28	Mar 31
MBA method	30+	60+	90+
OTS method	under 30	30-89	30-89
modified OTS method	under 30	30-59	60-89

See *Contradictions in Terms: Variations in Terminology in the Mortgage Market*, Moody's Special Report (9 June 2000, Moody's doc. no. SF8707).

duration – (1) the negative of the first derivative of price with respect to yield; (2) the percentage change in a bond's price for a percentage point change in its yield. Nearly all bonds have positive duration (*i.e.*, as yields rise their price falls). Interest-only MBS can have negative duration. Calculating duration is straightforward for bonds with fully predetermined cash flows. Estimating duration of a callable bond, such as an MBS, requires making assumptions about the timing of future prepayments. See "convexity."

effective duration; option-adjusted duration – the duration of a mortgage-backed security estimated by using an option-adjusted spread (OAS) model. An OAS model can be used to estimate the duration of a security by holding its OAS constant and observing the change in the modeled price that result from incremental changes in interest rates. See "duration."

embedded option – an option included in the structure of a security. With respect to callable corporate bonds, an issuer's option to redeem the bonds before their scheduled maturity constitutes an embedded call option. An investor that owns such bonds has a *short* position in the call option. Conversely, the issuer is *long* the call option. MBS and real estate-related ABS usually contain embedded options. A homeowner's ability to prepay his mortgage loan constitutes a call option on the loan at par. An investor who owns MBS is short the call option. The embedded short call option is the reason that MBS and certain other callable bonds display the undesirable characteristic of negative convexity. See "convexity."

excess spread – the difference between the gross yield on a pool of securitized assets and the cost of financing those assets, including applicable servicing fees. Excess spread can be a source of credit enhancement for securitized assets, provided that it is available to absorb losses on the assets. For securitizations backed by liquidating pools of assets, (*e.g.*, home equity loans or subprime auto loans), excess spread usually is calculated as follows:

$$ES = Y - C - S$$

where:

ES is excess spread
Y is the gross yield on the securitized assets
C is the (weighted average) coupon of ABS backed by the assets
S is the servicing fee for servicing the assets

The preceding calculation produces a result in terms of a *rate* of excess spread generated by the underlying assets. The actual amount of excess spread generated in a given month might be (1) applied to cover losses incurred during that month, (2) converted into another form of credit enhancement (*i.e.*, overcollateralization or reserve fund), or (3) paid to the holder of the residual interest in the deal. Most securitizations of home equity loans apply excess spread first to cover current period losses, then to build-up overcollateralization to a predetermined level, and lastly for distributions to the residual interest.
In the case of credit card securitizations (and other securitizations backed by pools of revolving assets), excess spread is calculated somewhat differently:

$$ES = Y - C - S - L$$

where:

ES is excess spread
Y is the gross yield on the securitized assets
C is the (weighted average) coupon of ABS backed by the assets
S is the servicing fee for servicing the assets
L is the charge-off rate on the securitized assets

This calculation is different from the earlier one in that it subtracts the charge-off rate on the underlying assets. As long as the excess spread is positive, the deal is able to cover all of its costs, including losses on the assets. However, if excess spread becomes negative, this means that the deal is running at a deficit and that credit support in the form of subordination or overcollateralization is being used to cover losses. In a typical credit card securitization, negative excess spread – determined on a three-month rolling average basis – triggers early amortization of the deal.

expected maturity – the estimated date of final payment on a security, based on prepayment forecasts for the securitized assets. With respect to securitizations backed by credit card receivables or other revolving assets, expected maturity refers to the target date for full repayment of principal, even though the legal final maturity may be years later.

Fannie Mae; FNMA; Federal National Mortgage Association – a government sponsored enterprise (GSE) created to provide liquidity in the secondary market for conventional home mortgage loans. Fannie Mae's business is very similar to that of its principal competitor, Freddie Mac. Fannie Mae issues and guarantees both basic pass-through MBS and highly structured CMO/REMIC securities. Fannie Mae's guarantee is not backed by the federal government. Fannie Mae's basic business is converting pools of newly originated conventional mortgage loans into pass-through MBS. When a lender delivers a pool of qualifying mortgage loans to Fannie Mae, Fannie Mae creates a MBS and exchanges it for the mortgage loans. The lender can then sell the MBS to investors. The MBS carries Fannie Mae's corporate guarantee to protect investors from credit losses on the mortgage loans. However, investors bear the risk of prepayments on the mortgage loans. Fannie Mae sometimes also purchases mortgage loans to hold in its own portfolio. Fannie Mae is the largest investor in mortgage loans.

<u>GSE Historical Timeline</u>:

- Congress established Fannie Mae in 1938 to provide a secondary market in FHA-insured mortgages. Fannie Mae originally performed two functions: the "special assistance" function and the "secondary mortgage market" function.
- The special assistance function amounted to a form of subsidy, providing low interest rate mortgage loans through certain of the FHA programs. Fannie Mae purchased at par certain FHA-insured mortgage loans with artificially low interest rates and, if required, resold the mortgage loans at discount prices. The loss incurred by Fannie Mae through the special assistance function was borne by the U.S. Treasury.
- All the remaining operations of Fannie Mae were called the "secondary market function". The secondary mortgage market function was limited to FHA-insured mortgage loans. It was not a subsidy and was required to be completely self-supporting.
- In 1948, Fannie Mae purchased its first mortgage loan guaranteed by the Veterans Administration ("VA").
- In 1954, the Fannie Mae Charter Act converted Fannie Mae to a privately owned and financed corporation. Supervisory authority over Fannie Mae remained in the Housing and Home Finance Agency.
- In 1968, Congress created Ginnie Mae and transferred to it the special assistance function formerly performed by Fannie Mae. At that time, Fannie Mae ceased to be a government agency but remained subject to oversight by the Department of Housing and Urban Development ("HUD").
- In 1970, Ginnie Mae guaranteed the first publicly traded pass-through securities representing undivided interests in pools of FHA/VA mortgage loans. Also in 1970, Congress passed the Emergency Home Finance Act, which established Freddie Mac to provide a secondary mortgage market for conventional mortgage loans. Congress also authorized Fannie Mae to provide a secondary market for the same type of mortgage loans.
- In 1971, Freddie Mac introduced the first conventional mortgage pass-through certificate.
- From 1971 through 1977, virtually all MBS were either guaranteed by Ginnie Mae or issued directly by Freddie Mac. During that period the volume of outstanding MBS issued or guaranteed by the two agencies increased dramatically. Fannie Mae had not yet become actively involved in issuing MBS. Fannie Mae continued to purchase mortgage loans to hold in its portfolio and did not commence actively issuing MBS until later.
- In June 1983, Freddie Mac issued the first collateralized mortgage obligations ("CMOs").
- In July 1986, Fannie Mae issued the first stripped MBS providing for disproportionate allocation of principal and interest between two classes of certificates representing interests in a single mortgage pool.

FHA; Federal Housing Administration – a federal agency that insures residential mortgage loans to low- and moderate-income homeowners. FHA is an agency within HUD. FHA-insured mortgage loans can be included in pools backing Ginnie Mae MBS.

Freddie Mac; FHLMC; Federal Home Loan Mortgage Corp.– a government sponsored enterprise (GSE) created to provide liquidity in the secondary market for home mortgage loans. Freddie Mac's business is very similar to that of its principal competitor, Fannie Mae. Freddie Mac issues and guarantees both basic pass-through MBS and highly structured CMO/REMIC securities. Freddie Mac's guarantee is *not* backed by the federal government. See glossary entry for Fannie Mae for additional information.

financial statements – tables and accompanying textual explanation designed to disclose the economic condition and business prospects of an enterprise. Accountants prepare financial statements. Basic financial statements consist of the following:

- balance sheet: summarizes the assets, liabilities, and owners' equity of a company at a specific point in time
- income statement: summarizes the revenues and expenditures of a company during a given period (usually a year)
- statement of cash flows: summarizes the sources and uses of cash by a company during a given period (usually a year)

fixed-rate bond – a bond that pays a fixed (unchanging) rate of interest for the entire time that it is outstanding.

floater – a bond that pays a floating rate of interest. The floating rate of interest changes periodically, usually in tempo with the frequency of interest payments on the bond. For each interest payment, the actual rate of interest is determined by reference to an objective benchmark that is not under the control of the issuer. For example, many floaters use LIBOR as the benchmark for determining interest due. In most cases, interest is determined as a fixed spread above or below the benchmark.

foreclosure – a legal procedure in which mortgaged property that secures a defaulted loan is seized and sold to repay the loan.

Ginnie Mae; GNMA; Government National Mortgage Association – a federal agency under HUD that guarantees full and timely payments on MBS backed by pools of FHA-insured and VA-guaranteed mortgage loans. Strictly speaking, Ginnie Mae does not issue any securities but instead guarantees securities issued by banks, thrifts and mortgage bankers that participate in Ginnie Mae's programs. When an approved Ginnie Mae originator wants to issue a Ginnie Mae guaranteed security, it first applies to Ginnie Mae for a guarantee commitment. Then, after the originator has selected mortgage loans for inclusion in the mortgage pool, the issuer delivers the mortgage loan documents to an independent custodian. When the custodian certifies that all the required documents are in order, Ginnie Mae assigns a "pool number" to the mortgage pool and the originator issues mortgage pass-through certificates. Ginnie Mae's guarantee is backed by the full faith and credit of the United States. Prepayments on Ginnie Mae-guaranteed MBS tend to be slower than prepayments on MBS issued by Fannie Mae or Freddie Mac.

Ginnie Mae multi-family; Ginnie Mae project loan – a Ginnie Mae-guaranteed security backed by loans on multi-family housing projects such as apartment buildings. Ginnie Mae sponsors its multi-family program to expand available financing for apartment complexes and other multi-family housing. As with other Ginnie Mae-guaranteed products, the guarantee of full and timely payments of principal and interest on Ginnie Mae project loan securities is backed by the full faith and credit of the United States.

grantor trust – in the U.S., the tax classification of certain securitization SPEs that issue only pass-through certificates. As a general matter, a grantor trust must have no more than one class of ownership interests. However, senior and subordinate certificates are allowed, as are stripped certificates. In practice, this means that a grantor trust SPE cannot be used for issuing time-tranched securities such as CMOs. *See* James Peaslee and David Nirenberg, FEDERAL INCOME TAXATION OF SECURITIZATION TRANSACTIONS, at 19, 276-278 (3d ed., 2001)

healthcare receivables; medical receivables – receivables arise from medical services furnished by hospitals, doctors, clinics, and other healthcare service providers. In the U.S., a typical fact pattern that gives rise to healthcare receivables is as follows: After furnishing medical services to a consumer, the service provider submits a bill to the consumer's insurance company or to the government insurance program that covers the consumer's healthcare expenses. The insurance company or government program processes the bill and determines the amount that it will pay. In general, the amount billed by the provider is irrelevant to the payor. The payor determines the amount that it will pay based on predetermined schedules or formulas. In some cases, the service provider collects a portion of the total bill from the consumer

high LTV mortgage loan; 125% mortgage loan – a second mortgage loan where the loan amount, combined with the amount of the related first mortgage loan, substantially exceeds the value of the mortgaged property. High LTV mortgage loans are sometimes called "125% mortgage loans" because many lenders would allow the combined LTV to be as high as 125%. For example, suppose a consumer borrows $80,000 to buy a house for $100,000. The consumer might subsequently take a high LTV mortgage loan for an additional $45,000. The combined loan amount would be $125,000 and the combined LTV would be 125%

home equity loans; HELs – a major asset class backing ABS. Traditionally the term "home equity loan" referred to a second mortgage loan. More recently, in the context of ABS, the term refers broadly to virtually all loans secured by residential real estate *other than* prime-quality first mortgage loans, and manufactured housing loans. ABS professionals sometimes include all the following types of residential real estate loans within the HEL category:

- subprime mortgage loans (*i.e.*, first lien mortgage loans to subprime borrowers)
- second lien mortgage loans
- home equity lines of credit (*i.e.*, revolving lines of credit secured by the borrowers' homes)
- high LTV mortgage loans

HUD; Department of Housing and Urban Development – a department of the U.S. government that sponsors programs to promote home ownership among low- to middle-income Americans. FHA and Ginnie Mae are agencies within HUD.

implicit guarantee – refers to the widely held view that the U.S. government would voluntarily support Fannie Mae's and Freddie Mac's guarantee obligations on their MBS if either became financially unable to do so. In contrast to its relationship with Ginnie Mae, the U.S. government has no legal obligation to support Fannie Mae or Freddie Mac. However, many securitization professionals hold the view that both Fannie Mae and Freddie Mac are "too big to fail" and, therefore, that the U.S. government would rescue either of them from imminent failure.

interest-only security; IO – a security that receives some or all of the interest component of payments on underlying debt obligations, but none of the principal component of such payments. Issuers of MBS sometimes create IOs – and their corresponding principal-only (PO) securities – by separating interest and principal from an underlying pool of mortgage loans and allocating each to different classes of securities. Often, an IO backed by residential mortgage loans has the unusual characteristic of negative duration. Thus, an IO can serve as a tool for hedging interest rate risk in a fixed income investment portfolio.

interest rate process – in the context of an option-adjusted spread (OAS) model, the mechanical or mathematical scheme for simulating changes in interest rates over time. A typical OAS model treats interest rate movements as a random walk with mean reversion. In such a model, a key parameter is the volatility of interest rates, which is often described in terms of the standard deviation of interest rates (measured daily) over the course of one year.

interest rate sensitivity – the sensitivity of a security's price to changes in interest rates. See "duration."

inverse floater – a security where the rate of interest changes in the opposite direction of changes on an underlying benchmark. For example, if an inverse floater uses LIBOR as its benchmark, increases in LIBOR will *reduce* the rate of interest on the security. In many cases, an inverse floater is created by subtracting the benchmark from a fixed rate (*e.g.*, the inverse floater pays interest at a rate of 10%-LIBOR). Inverse floaters appear most frequently in CMOs.

jumbo loan – a conventional loan that is too large to be purchased by Fannie Mae or Freddie Mac. Most of the time, the term jumbo loan refers to a loan that meets all applicable requirements of the Fannie Mae/Freddie Mac programs, except for size. In particular, the term jumbo loan rarely is used to refer to a subprime mortgage loan. MBS backed by jumbo loans usually use subordination as their primary means of credit enhancement. See glossary entries for "Fannie Mae" and "B&C borrowers."

legal final maturity – in reference to a bond, the date before which the bond must be retired in order not to be in default. In the case of residential MBS, the legal final maturity is determined on the assumption that none of the underlying mortgage loans are prepaid. In the case of credit card ABS and certain other deals backed by revolving pools of assets, legal final maturity is determined on the assumption that poor asset performance causes the trust to enter early amortization at the latest possible time.

A security's legal final maturity can occur no earlier than its expected maturity. See "expected maturity."

loan-to-value ratio; LTV – a measure of the collateral coverage for a mortgage loan. In the case of a residential purchase-money mortgage loan, the loan-to-value ratio is calculated as the ratio of (1) the amount of the loan to (2) the lesser of purchase price or the appraised value of the subject property. In the case of a residential refinancing loan, the loan-to-value ratio is calculated as the ratio of the loan amount to the appraised value of the subject property. A lower LTV reflects higher levels of collateral coverage – and presumably lower risk – for a loan.

lockout – a form of protection against the risk that a borrower will prepay a mortgage loan. A lockout is a prohibition against prepayments. A lockout may be either temporary (i.e., it expires after a specified period) or permanent (i.e., lasting for the entire term of a loan). Lockouts are a feature of some commercial mortgage loans but seldom appear in residential mortgage loans.

manufactured home; manufactured housing – a low-cost, factory build home, which is shipped to its installation site on a truck. A manufactured home generally is a single-floor structure installed on a concrete slab. Sometimes, two manufactured housing units are installed side-by-side to create a so-called "double wide" home. Manufactured homes are often recognizable by their simple architectural form (rectangular shape) and single-story design. Manufactured homes are most common in the southern U.S., where their modest insulation is sufficient to handle the climate. Regular homes differ from manufactured homes in that the former are larger, more elaborate, more expensive, built on site, and often contain higher-quality materials. Manufactured homes are popular with two particular segments of the population: Low- and moderate-income homebuyers find manufactured homes attractive because of their low cost. Senior citizens like them because their single-story design (without a basement) means that there are no stairs in the home. Until the mid-1970s, manufactured homes were called "mobile homes" and "trailers." Owners of manufactured homes felt those terms were denigrating and disparaging and, consequently, those terms fell out of use. The term "manufactured home" generally does not include so-called "modular homes," which are more elaborate and expensive, and which usually are considered simply a type of site-built home.

master servicer – see "servicer."

master trust – a type of SPE that issues multiple series of securities (at different times), all of which are backed by a common pool of collateral. Master trust SPEs are most often seen in the context of credit card securitizations.

monoline insurer; bond insurer – an insurance company engaged solely in the business of insuring bonds. Securitization issuers sometimes use bond insurance as a form of credit enhancement for ABS. Most of the major bond insurers carry triple-A ratings from Moody's and Standard & Poor's. Some of the leading bond insurers are: Ambac, FGIC, Financial Security Assurance, and MBIA Insurance Corp.

mortgage backed security; MBS – securities backed by specific mortgage loans and the payments on which are tied to or derived from the cash flows produced by the underlying mortgage loans. The term "MBS" sometimes refers specifically to mortgage pass-through certificates issued or guaranteed by Ginnie Mae, Fannie Mae, or Freddie Mac. In other contexts, the term is used more broadly to include CMOs/REMICs as well as MBS issued by private sector entities (*i.e.*, private label MBS).

municipal bond – a debt security issued by a state or local government. Interest paid on a municipal bond is exempt from federal taxes and may be exempt from state and local taxes in the issuing municipality.

negative amortization – a situation where the principal balance of a mortgage loan increases over time because the monthly payment is insufficient to cover fully the interest accrued during a month. Negative amortization can occur in an adjustable-rate mortgage loan if the interest rate can rise more rapidly than the monthly payment amount. This can happen if adjustments to monthly payments are subject to limitations but adjustments to the interest rate are unrestricted.

negative convexity – see "convexity."

NIM – (1) net interest margin; (2) a securitization backed by the residual interest(s) from one or more home equity loan or manufactured housing loan securitizations. NIM securitizations often represent leveraged exposure to the credit risk and prepayment risk of the related HEL or MH transactions.

non-performing mortgage loan - a residential mortgage loan that is in default and on which the borrower has ceased making payments. In essence, a non-performing loan represents the right to the eventual proceeds of the foreclosure on or other disposition of the underlying mortgaged property. Sometimes a servicer can resolve a non-performing loan with techniques other than foreclosure. Examples include taking a deed in lieu of foreclosure or helping the borrower to sell the property. In any such case, the servicer's objective is the same: to maximize the recovery on the loan as quickly as possible. In choosing the best strategy, a servicer must be able to accurately assess both the value of the underlying property and the time required for the whole foreclosure/liquidation process.

notional balance – with respect to an interest-only (IO) security or other interest rate derivative contract, the amount used for calculating payments on the security from time to time. In the case of IO MBS, the notional balance might be the aggregate balance of all loans in the underlying mortgage pool or it might be the aggregate balance of a specified portion of the loans (*e.g.*, those with interest rates above a certain level).

option adjusted spread; OAS – a class of quantitative methods for assessing the relative value of securities that contain embedded options. OAS analysis is often applied to residential MBS because of their embedded short option positions (*i.e.*, the borrowers' options to prepay their loans). OAS models attempt to estimate the value of securities by projecting future cash flows under a variety of interest rate scenarios. A typical OAS model uses an "interest rate process" to generate multiple hypothetical paths of future interest rates. For each such path, the OAS model uses a "prepayment model" to estimate the level of mortgage loan prepayments in each future month. The prepayment model produces a hypothetical cash flow corresponding to each scenario.

The OAS model calculates the fixed spread over benchmark interest rates at which the discounted value of the modeled cash flows equals the actual market price of the security.

originator – a lender who originally supplies funds to make a loan. In the residential mortgage sector originators sometimes sell their loans to other companies ("conduits" or "aggregators") that pool them in securitizations.

over-collateralization – a form of credit enhancement where the principal balance of securitized assets exceeds the balance of securities issued. For example, if $20 of securities are backed by $30 of assets, there is $10 of overcollateralization protecting the $20 of securities. The level of overcollateralization is described as a percentage of the amount of securities. If $20 of securities is backed by $30 of assets, there is 50% over-collateralization. After all the securities are retired, the overcollateralization assets belong to the holder of the residual interest in the deal. Overcollateralization is similar to subordination. Subordination refers to credit enhancement in the form of subordinated securities. For example, if $20 of senior securities and $10 of subordinate securities are backed by $30 of assets, the $20 of senior securities have $10 of protection just as they did in the prior example. However, the level of subordination is described as a percentage of the amount of assets. Thus, in the latter example, the $20 of senior securities have protection of 33⅓% subordination (*i.e.*, $10 divided by $30).

owner trust – a type of SPE that can issue pay-through securities (*i.e.*, securities that feature time tranching). Owner trusts have been replaced by REMICs in the context of mortgage securitizations. However, owner trusts still are used in securitizations of non-mortgage assets, such as auto loans.

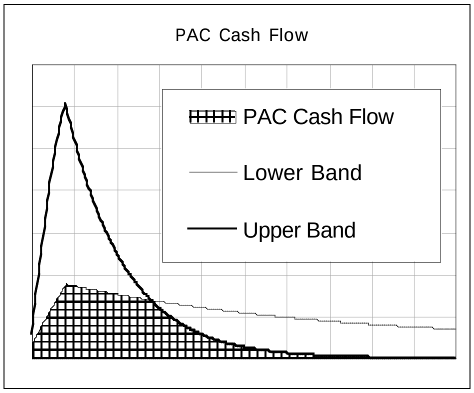
pass-through – a security that provides for the distribution of collections or proceeds from specific underlying assets to investors. The collections or proceeds are said to be "passed through" to the investors. Basic MBS (*i.e.*, not CMOs) generally are described as pass-throughs because monthly distributions to investors exactly reflect collections on the underlying mortgage pool, less the servicing fee. Pass-through securities represent ownership interests in the underlying assets. Pass-through securities typically are issued by "grantor trust" SPEs. Pass-through structures can provide for the creation of distinct senior and subordinate interests for the disproportionate allocation of credit risk. However, pass-through structures cannot accommodate time tranching in the manner of CMOs. Securities that involve elaborate allocations of cash-flows among multiple classes or tranches generally are not pass-throughs. See "collateralized mortgage obligation" and "tranche."

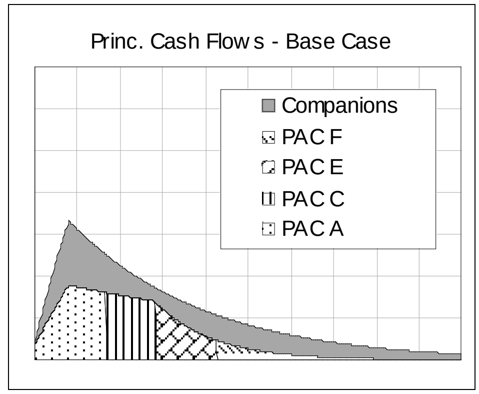
pay-through – a form of debt security that allows for the creation of multiple classes or tranches that mature at different times. The ability to create such a structure is the main advantage of pay-through securities over pass-through securities. As with pass-through securities, cash flow from a pool of underlying assets is the sole or primary source of payment on an issue of pay-through securities. CMOs are common examples of pay-through securities.

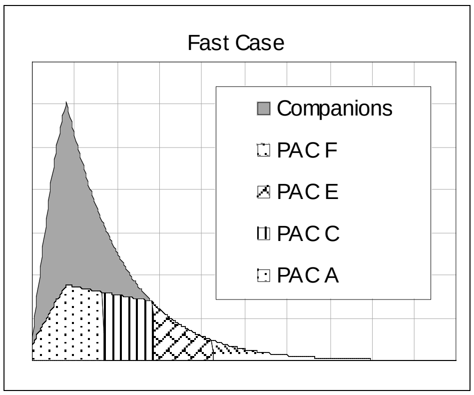
path dependency – describes the sensitivity of mortgage loan prepayments to both the current level of interest rates and previous levels. For example, suppose that current interest rates on new mortgage loans are 5%. More borrowers are likely to refinance their mortgage loans if rates have been substantially higher than 5% for the past few years than if rates have recently been lower than 5%. The level of refinancing activity (prepayments) is dependant on the "path" of interest rates over time.

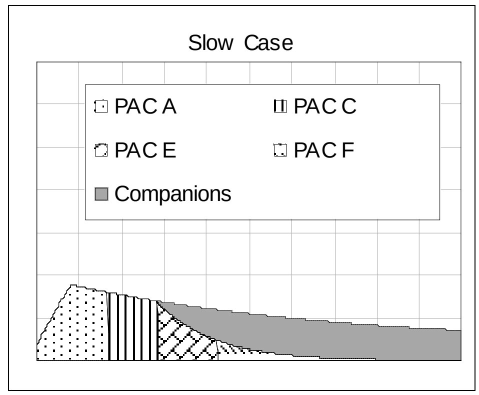
paydown – see "amortization."

planned amortization class; PAC – a type of CMO class that is partially protected from prepayment risk. A PAC class is designed with an amortization schedule that can be maintained provided that actual prepayments on the underlying mortgage loans do not experience severe fluctuations. In quantitative terms, a PAC's amortization schedule can be maintained provided that actual prepayments on the underlying loans occur at a constant rate no greater than a specified maximum speed (*i.e.*, the "upper band") and no slower than a specified minimum speed (*i.e.*, the "lower band"). Protection for a PAC comes from one or more corresponding "companion classes" which absorb fluctuations in mortgage loan cash flows to stabilize the cash flow to the PAC. If rapid prepayments cause the companion classes to be retired while the PAC remains outstanding, the protection for the PAC will have been exhausted and the PAC will be "naked." If subsequent cash flow fluctuations make a PAC diverge from its amortization schedule, the PAC will be "busted."



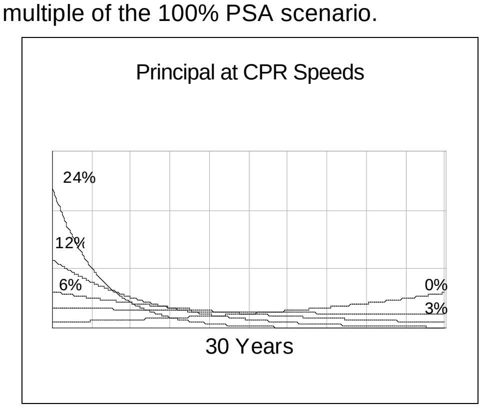


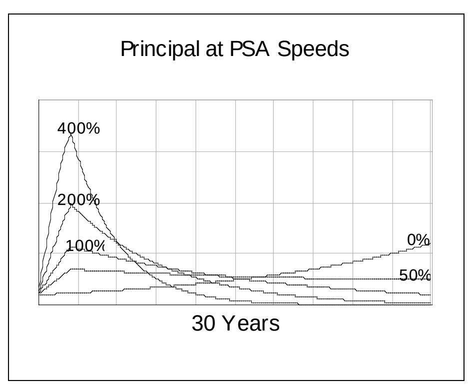




prepayment – payment of principal on a loan before its due date. Prepayments can occur on virtually any type of loan, but are most significant with respect to residential mortgage loans. Prepayments happen for many reasons but the two most important are refinancing and housing turnover. A refinancing prepayment occurs when a homeowner pays off his mortgage loan with the proceeds of a new loan. Often, the homeowner's motivation for getting a new loan is that he can get a lower interest rate on his new loan than he had on his old loan. Sometimes the homeowner's reason for refinancing is to borrow more money. For example, if the outstanding balance of a homeowner's loan is $100,000 and the value of his home is $200,000, the homeowner might pay off the old loan to take out a new loan in the amount of $150,000. Such a loan is called a "cash out" refinancing because the homeowner takes cash out of his home. A housing turnover prepayment happens when a homeowner sells his home. Most conventional mortgage loans include a "due on sale" clause, which requires the borrower to repay the entire amount of the loan upon the sale of the related home. A partial prepayment of a loan is called a "curtailment."

prepayment rate; prepayment speed – describes the pace at which the mortgage loans underlying an MBS are prepaid by their borrowers. For purposes of measuring and describing the pace of prepayments, MBS professionals use two standardized models. The first, called "constant prepayment rate" or CPR expresses the pace of prepayments in terms of a constant annual rate of prepayment that would produce a measured change in outstanding principal over the interval of measurement. The second, called PSA (named for the Public Securities Association, the predecessor to the Bond Market Association), is based on the CPR model. The base case of the PSA model (*i.e.*, 100% PSA) is defined as follows: prepayments are 0.2% CPR in the first month following origination of a pool of mortgage loans and increase by 0.2% CPR per month until they reach a steady-state rate of 6% CPR in the 30th month. Multiples of the base case, such as 200% PSA, refer to situations where prepayments in each month are at a level corresponding to the multiple of the 100% PSA scenario.





prepayment risk – the risk that borrowers prepay their mortgage loans. Residential MBS have the undesirable feature of negative convexity primarily because of prepayment risk. Mortgage loan prepayments tend to increase when interest rates fall and homeowners have the opportunity to refinance their loans at lower interest rates. In turn, the prepayments return a substantial portion of invested principal to the MBS investors. Investors who receive a return principal may be forced to reinvest at lower yields.

primary servicer – see "servicer."

principal balance – the outstanding amount of a loan or bond; the amount that must be paid (together with interest and any applicable prepayment penalties) to repay a debt.

principal-only security; PO – a security that receives some or all of the principal component of payments on underlying debt obligations, but none of the interest component of such payments. Issuers of MBS sometimes create POs (and their corresponding interest-only securities) by allocating interest and principal from an underlying pool of mortgage loans to different classes of securities.

private label – refers to residential MBS issued by private companies rather than by the GSEs.

PSA; Public Securities Association – the Public Securities Association was the former name of the Bond Market Association. The organization is a trade group that represents bond dealers. In the early days of the MBS market, the organization promoted a simple model for describing and measuring prepayments on pools of mortgage loans. That model is often called the PSA model. See "prepayment rate."

rating agency – see "credit rating."

real estate; real property – land, buildings, and immovable fixtures. In many legal systems, real estate is treated differently than other property. The special treatment of real estate under many legal systems has its roots in the longstanding practice of taxing ownership of real estate. The tradition of taxing real estate is very old: in ancient and medieval times such taxes sometimes included requiring a landowner to raise an army to fight in the king's wars. Virtually all governments maintain records of land ownership to facilitate the administration of their real estate tax systems. Those file systems have been adapted to facilitate real estate financing by allowing mortgage lenders to protect their rights in mortgaged property by recording their claims in the public files.

receivables – money owed to repay a loan or as payment for merchandise or services. In its broadest sense, the term receivables can include virtually all payment obligations. More narrowly, the term "trade receivables" refers to payments expected to be received in the near future (generally within 90 days) relating to merchandise sold or services rendered.

refinancing – substituting a loan with more-favorable terms for one with less-favorable terms. A borrower may refinance his loan when interest rates fall and he can obtain a new loan at a lower interest rate. In a typical refinancing, the proceeds of the new loan are applied to repay the older loan.

REMIC – See "collateralized mortgage obligation."

reperforming mortgage loan - a residential mortgage loan that is contractually delinquent but on which the borrower consistently makes monthly payments. The loan may be characterized by "rolling delinquencies." In such a case, the loan becomes delinquent and the borrower subsequently resumes making monthly payments but is unable to pay overdue amounts. The overdue amounts continue to "roll" forward as an ongoing delinquency. Although such a loan may have regained payment stability, it remains contractually delinquent. Reperforming loans pose greater credit risk than "clean" prime-quality mortgage loans, but they pose less prepayment risk. Borrowers on reperforming loans have few, if any, refinancing opportunities because of their delinquencies.

residual interest; retained interest – the most subordinated claim (equity) in a pool of securitized assets; generally retained by the seller of the assets (*i.e.*, the sponsor of the securitization). In some product areas, issuers customarily sell or transfer residual interests to investors.

- If securitized assets produce excess spread, the residual interest generally embodies the seller's right to receive the excess spread (e.g., ABS backed by home equity loans).
- If a securitization uses overcollateralization as a form of credit enhancement, the residual interest also includes the seller's right to the overcollateralization after all other claims are satisfied (e.g., ABS backed by home equity loans).
- If a deal is structured without overcollateralization and the seller retains the most subordinate classes of securities, those securities generally are not considered part of a residual interest. In that case, the subordinate securities are distinct from the residual interest even though they are retained by the seller.
- In the case of CMOs/REMICs, residual interests can carry significant tax liabilities under U.S. tax laws. In fact, the tax liabilities associated with such residual interests can greatly exceed any cash flow to which the holder of the residual would be entitled.
- In ABS backed by credit card receivables, the residual interest is the seller's right to receive excess spread from the underlying portfolio. Apart from the residual interest, the seller also usually retains an un-subordinated interest in the underlying assets to absorb month-to-month fluctuations in the size of the receivable pool and to absorb dilution on receivables. Dilution occurs when receivables become un-collectible for reasons other than credit defaults by the payor. For example, a consumer may use his credit card to purchase merchandise and then return the merchandise before paying the credit card bill. In such a case, the decline in the balance of the receivable pool would be absorbed by the seller's interest.

revolving assets; revolving pools – refers to asset pool comprised primarily of short-term receivables, where new receivables are continually added to replace receivables that have been paid off. Securitizations of credit card receivables use revolving pools of receivables. In a typical credit card securitization, the underlying asset pool includes all receivables arising from time to time under designated accounts. For any given account, old receivables are paid off as the cardholder makes payments each month, but new receivables are created as the cardholder continues using his credit card.

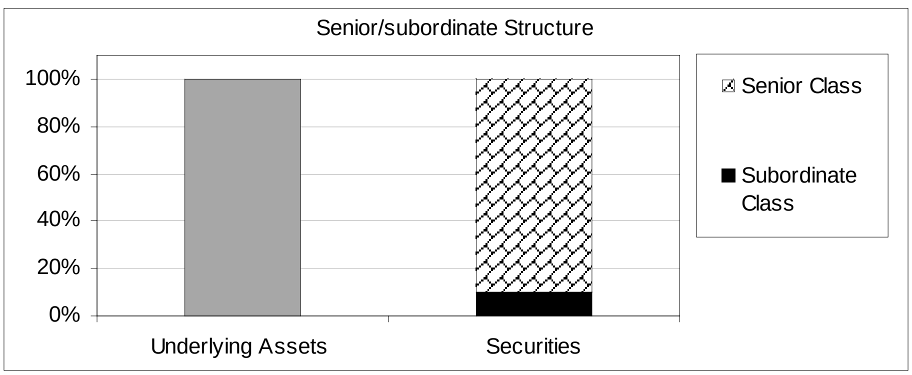
seasoning – refers to changes in the character of loans or accounts (in the case of revolving receivables) as they age. For example, the default risk on residential mortgage loans is correlated with seasoning: all other things being equal, such loans are most likely to default between four and seven years following their origination. Likewise, the prepayment risk associated with mortgage loans changes with their degree of seasoning. Highly seasoned loans (*i.e.*, very old loans) are viewed as posing less prepayment risk than loans with moderate seasoning. The PSA prepayment model reflects the view that prepayments increase during the first two and a half years following the origination of a pool of loans.

secured debt; secured loan – debt supported by collateral that the lender can seize and sell if the borrower fails to repay the debt. Secured debt is generally viewed as safer than unsecured debt, which lacks the benefit of collateral. In making a secured loan, a lender generally considers (1) whether the borrower historically has paid his debts on time, (2) the borrower's financial capacity to repay the debt, and (3) the value of the assets serving as collateral for the debt. If the value of collateral equals or exceeds the amount of the secured obligation, the debt is said to be "fully secured."

securitization – a modern financing tool. Securitization is a close cousin to traditional secured debt. In a securitization, a company raises money by issuing securities that are backed by specific assets. In most cases, the underlying assets are loans, such as mortgage loans or auto loans. The cash flow from the underlying assets usually is the source of funds for the borrower/issuer to make payments on the securities. Securitization products generally are viewed as including the following: asset-backed securities, residential mortgage-backed securities, commercial mortgage-backed securities, collateralized debt obligations, and asset-backed commercial paper.

- Compared to traditional secured debt, securitizations are intended to provide a lender/investor with greater protection against the corporate credit risk of the originator of the assets. In principle, a securitization lender/investor is a kind of "super-secured creditor," with rights that surpass those of a traditional secured lender. Securitization employs the notion that the subject assets have been "sold" by the originator and, therefore, will not become entangled in bankruptcy proceedings if the originator files for protection under the bankruptcy code.
- Accomplishing a "sale" of the securitized assets often requires the use of an SPE. A typical securitization is structured as a two-step transaction. In the first step, the originator transfers the subject assets to an SPE in a transfer designed to constitute a "true sale." In the second step, the SPE issues securities backed by the assets. The SPE uses the proceeds from selling the securities to pay the originator for the assets. In addition, part of the "consideration" that the originator receives for transferring the assets to the SPE is its ownership of the SPE.
- In some securitizations, the originator does not receive the equity in the SPE. Instead, the originator may retain the subordinate or equity position in the securitized assets through other means, such as variable fee structure.

senior-subordinate structure – a deal structure that uses subordination as credit enhancement. A subordinate class or classes absorb losses and must be wiped out before any losses are allocated to the senior classes. For example, if $100 of assets supports a $90 senior certificate and a $10 subordinate certificate, the senior certificates would be insulated against the impact of losses on the assets so long as losses remain less than $10.



sequential pay – describes a deal structure in which principal distributions to various tranches are made sequentially, such that a given tranche receives no distributions of principal until each tranche scheduled to be paid earlier has been fully retired. See the chart under "collateralized mortgage obligation" for an example of a sequential pay structure.

servicer – an entity that collects payments on securitized assets and that administers securitization transactions. Administrative duties including processing remittances to investors and transmitting periodic reports to investors, rating agencies, and other interested parties. Often the originator of securitized assets acts as the servicer.

- primary servicer: a company that actually performs routine servicing functions, especially processing collections. In some cases, a primary servicer refers seriously delinquent loans to a special servicer. When assets from multiple originators back a single securitization, each originator might be the primary servicer of the assets that it originated. In such a case, the sponsor of the deal (a conduit or aggregator) generally would be the master servicer, and each originator would function as a sub-servicer.
- master servicer: a company responsible for making sure that the servicing function is carried out, but which may not actually perform the function itself. A securitization backed by assets from multiple originators often has a master servicer. The master servicer subcontracts the collection functions to other companies. A master servicer generally does not outsource administrative functions such as processing remittances and preparing investor reports.
- sub-servicer: an company that collects payments on securitized assets on behalf of a master servicer.
- backup servicer: an entity designated in advance to take over the servicing of securitized assets in case the primary servicer fails to perform its servicing duties.
- special servicer: a servicer designated specifically to handle collections and foreclosures on delinquent and problematic loans. In transactions that use a special servicer, there is also a primary servicer, that handles servicing of loans that are current or only mildly delinquent.

shadow anchor – similar to an anchor tenant for a shopping mall, except that the shadow anchor is located on an adjacent property.

special purpose corporation; SPC – a special purpose entity in a form of a corporation.

special purpose entity (vehicle); SPE (SPV) – a legal entity formed for a limited purpose; in securitization, it serves to hold the legal rights to the assets transferred from the originator. In the U.S., SPEs facilitate securitization by enabling the use of bankruptcy remote structures. See "bankruptcy remote structure."

special servicer – See "servicer."

structured finance; structured products – usually synonymous with "securitization;" sometimes used in a broader sense to include project finance (*i.e.*, financing of roads, airports, and other major public projects that will generate tolls or user fees to repay bonds) and certain types of non-ABS equipment financing such as equipment trust certificates (ETCs).

structured settlement receivable – a series of payments over time, typically resulting from settlement of personal injury claims. In the U.S., personal injury claimants who have been awarded structured settlements sometimes sell their structured settlement receivables for lump sum cash payments. The companies that purchase structured settlement receivables may then package the receivables into ABS.

sub-servicer – see "servicer."

subordinate class – tranche in a senior/subordinate structure that has the lowest priority in credit risk, thereby protecting the senior class(es) from credit losses on the underlying securitized assets.

tax lien – a lien against a parcel of real estate for the non-payment of real estate taxes. Some U.S. cities, including New York, Washington, and Philadelphia, have securitized their tax lien receivables. In some cases, a private-sector company purchases tax liens from across the country and then executes a securitization backed by a widely diversified pool. Tax lien securitizations present a wide variety of issues because the priority and enforceability of the underlying tax liens is controlled by idiosyncratic local laws. For example, liens relating to earlier tax years have higher priority in some locales (*e.g.*, New York) while the opposite is true in others (*e.g.*, Washington). See *Tax Liens Revisited*, Standard & Poor's Special Report (18 Oct. 1996, S&P doc. no. 217454).

tranche – from French, meaning slice; in the context of a securitization, refers to one class of securities issued in a transaction that created multiple classes issued simultaneously. In a deal that uses the senior/subordinate structure, the senior and subordinate classes are the tranches of the deal. Such a deal is described as using "credit tranching." A CMO can include dozens of tranches. Sequential pay structures in CMOs are an example of "time tranching."

Treasuries – negotiable debt obligations of the U.S. government.

true sale – a transfer of assets from one entity to another that places the assets beyond the reach of the first entity's creditors, even if the first entity becomes the subject of a bankruptcy or similar proceeding. In a typical securitization, the originator of the underlying assets transfers the assets to a SPE in a transaction designed to be a true sale. An example of a transfer that is not a true sale is a pledge of collateral to secure a debt. In securitizations, achieving a true sale is an important aspect of bankruptcy remoteness.

VA; Veterans Administration – administers benefits for veterans of the U.S. military. One important benefit for veterans is the right to obtain a mortgage loan guaranteed by the VA. VA-guaranteed loans can be included in pools backing Ginnie Mae MBS.

weighted-average coupon; WAC – the weighted-average interest rate of loans backing a securitization. In calculating the WAC of an asset pool, the interest rate of each loan is weighted by its balance. In the case of mortgage loans, the higher the WAC, the higher the prepayment risk on the pool.

weighted-average life; WAL – (1) used instead of maturity for pricing amortizing securities; (2) with respect to a security, the weighted-average time to the return of principal on a security. In calculating a security's WAL, each payment date is expressed as the interval (in years) between the time of calculation and the payment date. Each interval is weighted by the amount of principal that will be distributed on the corresponding payment date.

weighted-average maturity; WAM – the weighted-average maturity date of loans backing a securitization. In calculating the WAM of an asset pool, a loan's maturity (expressed in years from the time of calculation) is weighted by the loan's balance.

whole loans – (1) mortgage loans that have not been packaged into MBS; (2) used to describe a CMO/REMIC backed by non-conforming mortgage loans, as opposed to one backed by agency MBS.

yield maintenance – a type of prepayment penalty on a mortgage loan. Yield maintenance provisions are found in some commercial mortgage loans, but their use is declining as other types of penalties (*e.g.*, defeasance) have become more popular. In loans with a yield maintenance provision, the amount of the penalty is calculated at the time of a prepayment according to a formula specified in the loan documents. Although different loans use different formulas, all are designed to approximately restore the lender's yield on his investment in the loan as if no prepayment were being made. In general, the calculation is based on the degree to which interest rates have fallen since the loan was originated.

— END –

Recent Nomura Fixed Income Research

Fixed Income General Topics

- U.S. Fixed Income Research Mid-Year Review: Tale of Two Cities (July 2002)
- Accounting vs. Reality: Can We Handle the Truth? (16 April 2002)
- Thirty Years Later Securitization Is Still Good for America (15 March 2002)
- 2002 Fixed Income and Structured Products Outlook (24 January 2002)
- How the Events of 9/11 Affect Thinking about Risk (3 January 2002, updated 28 February 2002)
- Risk-Based Capital Update (19 December 2001)
- Regulatory Update: FDIC Approves New Risk-Based Capital Standards for Securitized Products (9 November 2001)
- Securitization Update: After the Attack (26 September 2001)
- New FFIEC Risk Based Capital Standards Likely to be Adopted Soon: May Buoy ABS, CMBS, Non-Agency MBS Markets by Year End (17 July 2001)

MBS

- Relative Value Analysis of Passthroughs backed by FHA/VA Reperforming Mortgages (27 June 2002)
- Terrorism Insurance Update (published in Nomura CMBS Weekly Report, 7 June 2002)
- GNMA Multifamily Quarterly (2 May 2002)
- Value in Interest-Only Tranches Backed by GNMA Multifamily Pools (12 April 2002)
- Jumbo MBS Credit Support Continues to Reach New Lows (27 March 2002)
- Jumbo MBS Credit Enhancement: More of the Same, or Less? (5 December 2001)
- Relative Value Analysis of FNW 01-W3 Senior Passthrough (22 October 2001)
- Jumbo MBS: Where's the Credit Enhancement? (12 July 2001)
- On the Prepayment Behavior of GHLC MBS (25 June 2001)
- Freddie Mac's Change in Payment Cycle to Cause One-Month Prepayment Spike in June (9 May 2001)
- Alt-A MBS Face Changing Times (30 April 2001)

CMBS

- Aging Deals: Changes in CMBS Deal Diversity and Loan Concentration Over Time and Other Age Related Issues (8 Oct 2002)
- The Hotel Sector – The Cycle Begins Again (January 2002)
- Final FASB Guidance on SFAS 140 Implementation (6 July 2001)
- New Guidance from FASB Addresses Commercial Mortgage Industry's Concerns (29 June 2001)
- FASB to Act on SFAS 140 Limitations on Commercial Mortgage Servicers at Its Upcoming Meeting (published in Nomura CMBS Weekly Update, 25 June 2001)
- SFAS 140 Update – FASB Meets (published in Nomura CMBS Weekly Update, 21 May 2001)

ABS

- Healthcare ABS Primer (18 October 2002)
- Report from Paradise Island: Coverage of Selected Sessions of ABS East 2002 (7 October 2002)
- ABS Credit Migrations (9 January 2002, updated 5 March 2002)
- Report from Arizona: Coverage of Selected Sessions of the February 2002 Securitization Conferences (27 February 2002)
- The LTV Bankruptcy Case and Its Threat to Securitization – Is it Over or Just Beginning? (7 March 2001)
- Downgrades of Heilig-Meyers Credit Card Deals Reveal New Extent of ABS Ratings Volatility (1 March 2001)

NEW YORK	TOKYO	LONDON

NEW YORK
Nomura Securities International
2 World Financial Center, Building B
New York, NY 10281
(212) 667-9300

TOKYO
Nomura Securities Company
2-2-2, Otemachi, Chiyoda-Ku
Tokyo, Japan 100-8130
81 3 3211 1811

LONDON
Nomura International PLC
Nomura House
1 St Martin's-le-grand
London EC1A 4NP
44 207 521 2000

Nomura Fixed Income Research

New York

David P. Jacob	(212) 667 2255	Head of Fixed Income Research and Structuring
David Resler	(212) 667 2415	Head of U.S. Economic Research
Mark Adelson	(212) 667 2337	Securitization/ABS Research
Arthur Q. Frank	(212) 667 1477	MBS Research
Louis (Trey) Ott	(212) 667 9521	Corporate Bond Research
Joshua Phillips	(212) 667 2042	CMBS Research
Carol Stone	(212) 667 2418	Deputy Chief Economist
Lisle Leonard	(212) 667 9076	Analyst
James Manzi	(212) 667 2231	Analyst
Javier Villanueva	(212) 667 9170	Analyst
Kumiko Kimura	(212) 667 9088	Translator
Michiko Whetten	(212) 667 2338	Translator

Tokyo

Nobuyuki Tsutsumi	81 3 3211 1811	ABS Research

London

John Higgins	44 207 521 2534	Head of Macro Economic Research- London
Duncan Sankey	44 207 521 2984	Head of London Credit Research