Security Financing

Meaning

A financial security is a document of a certain monetary value. Traditionally, it used to be a physical certificate but nowadays, it is more commonly electronic. It shows that one owns a part of a publicly-traded corporation or is owed a part of a debt issue. In the most common parlance, financial securities refer to stocks and bonds which are negotiable. Derivatives are also considered as a common type of financial security, with its growing popularity in recent years. In current usage, financial securities are no longer an evidence of ownership. Rather, they refer to the financial product themselves i.e. stock, bond, or other product of investment. They are also known as financial instruments or financial assets.

A security is a tradable financial asset. The term commonly refers to any form of financial instrument, but its legal definition varies by jurisdiction. In some jurisdictions the term specifically excludes financial instruments other than equities and fixed income instruments. In some jurisdictions it includes some instruments that are close to equities and fixed income, e.g., equity warrants. In some countries and languages the term “security” is commonly used in day-to-day parlance to mean any form of financial instrument, even though the underlying legal and regulatory regime may not have such a broad definition.

Securities may be represented by a certificate or, more typically, "non-certificated", that is in electronic (dematerialized) or "book entry" only form. Certificates may be bearer, meaning they entitle the holder to rights under the security merely by holding the security, or registered, meaning they entitle the holder to rights only if he or she appears on a security register maintained by the issuer or an intermediary. They include shares of corporate stock or mutual funds, bonds issued by corporations or governmental agencies, stock options or other options, limited partnership units, and various other formal investment instruments that are negotiable and fungible.

Types of Financial Securities

We can broadly categorize financial securities into three categories, equity securities, debt securities, and derivative securities. Let us understand them in more detail –

1) Equity Securities

An equity security is a share of interest in the capital of a company, firm or partnership. One can hold an equity interest in other forms of the organization too, other than the ones mentioned above. Holding an equity interest means contributing to the capital of the company. You can do this by buying shares of a company of your choice. A share of a company represents a monetary value. This monetary value is the amount of capital you contribute to the company.

2) Debt Securities

Debt securities are essentially loans made to a company. As the name suggests, these securities represent a debt owed by a company to lenders. There are different types of debt securities such as bonds, debentures, commercial paper, etc. These securities are different from each other in terms of maturity, collateral, and other characteristics. They are different from equity securities in the sense that debenture holders are creditors of the company. This is unlike equity shareholders, who are owners of the company.

Like equity shareholders, debenture holders too, have certain rights. They are entitled to interest for the amount lent and repayment of entire principal at the time of maturity. Note that company is liable to make such interest payments even if it is not making adequate profits or incurring losses. In case of winding up of the company, holders of debt securities have an edge over common stockholders. Before the proceeds of the company go to ordinary shareholders, debenture holders get their share. This makes debt securities safer than equity securities. However, their returns are also limited to fixed interest payments only. They do not get any share in the profits of the company.

3) Derivative Securities

Derivative securities are those securities whose value is derived from an underlying asset. These underlying assets can be bonds, stocks, commodities, currencies or other assets. These securities trade on exchanges like other financial securities and their value differ with a change in the value of an underlying asset. They themselves have no value of their own. One must note that ownership of a derivative does not mean ownership of an asset. Derivative securities are more sophisticated as compared to equity and debt securities. They work in a very different manner and therefore require sound financial knowledge to mitigate risk and earn good returns.

Derivative securities are also known as derivatives. Their most common use is containing risk. Such risks can be currency fluctuation risks, movements in index or commodities prices, adverse changes in rates of interest, weather, etc to name a few. There are several types of derivatives available in the market, in accordance with the needs of the customers. Broadly, derivatives can be classified as Futures, Forwards, Swaps, and Options.

Conclusion

From the point of view of investment, all financial securities have their own pros and cons. All types of financial securities provide a return commensurate with the risk. However, financial experts are of the opinion that a well-diversified portfolio is a key. Investing in different types of securities ensures that returns are stable.