

7.18 Asset-Backed Security (ABS) Instrument and Market Features

Question 1

Which of the following is the last level of internal credit-loss protection for bondholders of an auto loan asset-backed security (ABS)?

- A. Overcollateralization
- B. Excess spread account
- C. Sequential pay structure

Question 2

Due to adverse losses on a credit card receivable asset-backed security (ABS), the early amortization period was triggered. Which of the following *best* describes the impact on investors?

- A. Principal repayment begins
- B. All cash flows to investors stop
- C. Only finance charges and fees are paid to investors

Question 3

If a collateralized debt obligation provision is triggered, requiring the return of principal to the senior tranche, the *most likely* cause for the trigger is the failure:

- A. of prespecified risk tests.
- B. to return principal to the equity tranche investors.
- C. to earn a return higher than the costs of issuing the bonds.

Question 4

An arbitrage collateralized debt obligation (CDO) holding a portfolio of fixed coupon bonds is funded in part by a floating rate senior tranche. The interest rate mismatch of fixed rate collateral versus a floating rate tranche is:

- A. the CDO sponsor's risk-free profit.
- B. an excess spread used to fund a cash reserve.
- C. hedged with a fixed-for-floating interest rate swap.

Question 5

During the lockout period for asset-backed securities (ABS) secured by credit card receivables, payments made by cardholders on the credit card debt balances are *most likely* used to:

- A. establish a reserve fund to cover future defaults by cardholders.
- B. purchase additional credit card receivables to replace collateral that was paid off.
- C. reimburse the ABS issuer for any principal and/or interest it advanced to investors.

Question 6

In a falling interest rate environment, an auto loan asset-backed security (ABS) *most likely* exposes an investor to:

- A. balloon risk.
- B. extension risk.
- C. contraction risk.

Question 7

Credit card receivable asset-backed securities (ABS) are not subject to contraction risk since the underlying pool of loans is *most likely*:

- A. amortizing.
- B. non-amortizing.
- C. partially amortizing.

Question 8

If covered bondholders do not receive payments as scheduled and the bond has a soft-bullet redemption regime, the bond default is *most likely*:

- A. delayed, and final maturity is extended.
- B. triggered, and bond payments are accelerated.
- C. delayed, and the bond converts to a pass-through structure.

Question 9

A mortgage-backed securities (MBS) issuer is concerned that interest rates will soon fall, so it structures tranches with various maturities to mitigate prepayment risk. This *most likely* describes:

- A. time tranching.
- B. credit tranching.
- C. floating-rate tranching.

Question 10

In securitizations that create residential mortgage-backed securities (RMBS), credit tranching *most likely* refers to multiple classes of bonds that offer unequal:

- A. default risk.
- B. extension risk.
- C. contraction risk.

Question 11

Which of the following instruments is *least likely* to have loans as its collateral?

- A. Credit card asset-backed security
- B. Nonagency residential mortgage-backed security
- C. Sequential-pay collateralized mortgage obligation

Question 12

A key distinction regarding collateral of a covered bond compared to other types of asset-backed securities is:

- A. only covered bonds are overcollateralized.
- B. a covered bond's collateral remains on the issuer's balance sheet.
- C. the issuer of a covered bond does not substitute for defaulted collateral.

Question 13

For asset securitization, credit tranching is *most likely* used:

- A. as a waterfall structure.
- B. for mitigation of prepayment risk.
- C. as a method of overcollateralization.