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INTRODUCTION TO ASSET-
BACKED SECURITIES

1. A sequential-pay CMO has two tranches. Principal is paid to Tranche S until it is paid off, after which principal is paid to Tranche R. Compared to Tranche R, Tranche S has:
 - (A) less contraction risk and more extension risk.
 - (B) more contraction risk and less extension risk.
 - (C) more contraction risk and more extension risk.

2. An annualized measure of the prepayments experienced by a pool of mortgages is its:
 - (A) conditional prepayment rate.
 - (B) PSA prepayment benchmark.
 - (C) single monthly mortality rate.

3. Extension in an agency residential mortgage-backed security is most likely to result from:
 - (A) slower-than-expected prepayments.
 - (B) exhaustion of a support tranche.
 - (C) a decrease in interest rates.

4. The special purpose entity (SPE) in a securitization is:
 - (A) an entity independent of the seller.
 - (B) a subsidiary of the seller.
 - (C) a joint venture partner of the seller.

5. The type mortgage-backed security that is most likely to offer significant call protection is:
 - (A) a commercial mortgage-backed security.
 - (B) an agency residential mortgage-backed security.
 - (C) a non-agency residential mortgage-backed security.

6. An asset-backed security with a senior/subordinated structure is said to have:
 - (A) credit tranching.
 - (B) prepayment tranching.
 - (C) time tranching.

7. With respect to auto-loan backed ABS:
 - (A) all of them have some sort of credit enhancement.
 - (B) some of them have some sort of credit enhancement.
 - (C) the underlying loans are collateralized so no credit enhancement is necessary.

8. A collateralized debt obligation (CDO) in which the collateral is a pool of residential mortgage-backed securities is most accurately described as a:
 - (A) collateralized loan obligation (CLO).
 - (B) structured finance CDO.
 - (C) synthetic CDO.

9. Which of the following classes of asset-backed securities typically includes a lockout period?
 - (A) Auto loan ABS.
 - (B) Credit card ABS.
 - (C) Non-agency residential MBS.

10. A synthetic collateralized debt obligation (CDO) is backed by a pool of:
 - (A) credit default swaps
 - (B) leveraged bank loans.
 - (C) other CDOs.

11. Asset-backed securities (ABS) may have a higher credit rating than the seller's corporate bonds because:
 - (A) the seller's ABS are senior to its corporate bonds.
 - (B) they are issued by a special purpose entity.
 - (C) ABS are investment grade while corporate bonds may be speculative grade.

12. An agency RMBS pool with a prepayment speed of 50 PSA will have a weighted average life that is:
 - (A) equal to its weighted average maturity.
 - (B) less than its weighted average maturity.
 - (C) greater than its weighted average maturity.

13. When evaluating the loans backing a commercial mortgage-backed security based on credit ratios, which of the following most likely indicate better credit quality?
 - (A) Lower debt-service coverage ratios and higher loan-to-value ratios.
 - (B) Higher debt-service coverage ratios and higher loan-to-value ratios.
 - (C) Higher debt-service coverage ratios and lower loan-to-value ratios.

14. In contrast with most asset-backed securities (ABS), a collateralized debt obligation (CDO):
- (A) employs a collateral manager.
 - (B) has senior and subordinate tranches.
 - (C) is issued through a special purpose vehicle.
15. A renegotiable mortgage has a fixed interest rate that:
- (A) changes to a different fixed rate during its life.
 - (B) changes to a variable rate during its life.
 - (C) the borrower may change to a variable rate.
16. The pool of loans backing a commercial mortgage-backed security consists of:
- (A) both recourse and nonrecourse loans.
 - (B) nonrecourse loans only.
 - (C) recourse loans only.
17. One of the primary benefits of securitization is that it:
- (A) improves the collectability of the loans that are securitized.
 - (B) improves the legal claims of the security holders to the loans that are securitized.
 - (C) removes problem assets from the issuing firm's balance sheet.
18. The primary motivation for investing in the support tranche of a planned amortization class CMO, compared to investing in another tranche, is that the support tranche offers:
- (A) a higher interest rate.
 - (B) more protection against contraction risk.
 - (C) more protection against extension risk.
19. Total cash flows to investors in an ABS issue are:
- (A) equal to the total interest and principal payments from the underlying asset pool if only one class of ABS has been issued from the trust.
 - (B) equal to the total interest and principal payments from the underlying asset pool.
 - (C) less than the total interest and principal payments from the underlying asset pool.
20. Which of the following is least likely a benefit of securitization?
- (A) Increasing the liquidity of balance sheet assets.
 - (B) Reducing funding costs.
 - (C) Removing liabilities from the balance sheet.

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21. A mortgage is most attractive to a lender if the loan:
- (A) has a prepayment penalty.
 - (B) is convertible from fixed-rate to adjustable-rate.
 - (C) is non-recourse.
22. Strategic default by a mortgage borrower is most likely if the loan is:
- (A) non-amortizing.
 - (B) non-conforming.
 - (C) non-recourse.
23. Which of the following statements concerning the support tranche in a planned amortization class (PAC) CMO backed by agency RMBS is least accurate?
- (A) If prepayments are too low to maintain the scheduled PAC payments, the shortfall is provided by the support tranche.
 - (B) The purpose of a support tranche is to provide prepayment protection for one or more PAC tranches.
 - (C) The support tranches are exposed to high levels of credit risk.
24. Securitization least likely benefits the financial system by:
- (A) increasing liquidity for mortgages and other loans.
 - (B) increasing the amount banks are able to lend.
 - (C) removing liabilities from bank balance sheets.
25. In a commercial mortgage-backed security (CMBS), which of the following is an example of CMBS-level call protection?
- (A) Prepayment lockout.
 - (B) Residual tranche.
 - (C) Yield maintenance charges.
26. A mortgage-backed security has a pass-through rate of 4.3%. The average interest rate on its underlying pool of mortgages is 4.5%. The difference between these rates is most likely due to:
- (A) faster-than-expected prepayments.
 - (B) issuance and servicing costs.
 - (C) slower-than-expected prepayments.

