

**Reading 65****FIXED – INCOME  
SECURITIZATION**

1. (C) less than the total interest and principal payments from the underlying asset pool.

**Explanation**

Cash flows from the underlying asset pool are used to pay fees to the servicer as well as payments to the ABS investors. Thus payments to investors are less than the total cash flows from the pool of assets.

(Module 65.1, LOS 65.b)

2. (C) removing liabilities from bank balance sheets.

**Explanation**

By enabling banks to raise cash by selling their existing loans and mortgages (which are balance sheet assets for banks), securitization increases the amount banks are able to lend.

(Module 65.1, LOS 65.a)

3. (B) improves the legal claims of the security holders to the loans that are securitized.

**Explanation**

Securitization reduces the cost of funding the assets. One way that is accomplished is through the transfer of the underlying financial assets to a special purpose entity so that securities holders have clear legal claim to them, something they may not have if they were to invest only in the securities of the securitizer, such as a bank. Securitization does not have improved collectability as a primary benefit. Problem loans are not good candidates for securitization because institutional investors require a minimum credit quality and even well performing loans can require internal or external credit enhancement for the securitized assets.

(Module 65.1, LOS 65.a)

4. (A) **Removing liabilities from the balance sheet.**

**Explanation**

Financial assets are securitized, not liabilities.

**(Module 65.1, LOS 65.a)**

5. (B) **an entity independent of the seller.**

**Explanation**

The SPE in a securitization must be a legal entity independent of the seller so that the seller's creditors do not have a claim against the securitized assets.

**(Module 65.1, LOS 65.b)**

6. (C) **they are issued by a special purpose entity.**

**Explanation**

The SPE in a securitization is bankruptcy-remote from the seller, which means the seller's creditors do not have a claim against the pool of assets underlying an ABS. As a result, the ABS may have a higher credit rating than the seller's corporate bonds.

**(Module 65.1, LOS 65.b)**

