

## Question #1 of 16

Question ID: 460702

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.

### Explanation

The support tranches are exposed to high levels of prepayment risk, not credit risk.

## Question #2 of 16

Question ID: 460699

An annualized measure of the prepayments experienced by a pool of mortgages is its:

- ☒ A) conditional prepayment rate.
- ☐ B) single monthly mortality rate.
- ☐ C) PSA prepayment benchmark.

### Explanation

The conditional prepayment rate (CPR) is an annualized measure of a mortgage pool's prepayments. The single monthly mortality rate is the percentage by which prepayments have reduced the month-end principal balance. The PSA prepayment benchmark is a monthly series of CPRs to which a mortgage pool's CPR may be compared.

## Question #3 of 16

Question ID: 472425

An agency RMBS pool with a prepayment speed of 50 PSA will have a weighted average life that is:

- ☐ A) greater than its weighted average maturity.
- ☐ B) equal to its weighted average maturity.
- ☒ C) less than its weighted average maturity.

### Explanation

Weighted average life of a mortgage pool is less than its WAM if there are any prepayments. "50 PSA" means the prepayment speed is assumed to be 50% of the Public Securities Association prepayment benchmark.

## Question #4 of 16

Question ID: 460694

Total cash flows to investors in an ABS issue are:

- ✓ **A) less than the total interest and principal payments from the underlying asset pool.**
- X **B) 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.**
- X **C) equal to 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.

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**Question #5 of 16**

Question ID: 472426

Which of the following classes of asset-backed securities typically includes a lockout period?

- X **A) Auto loan ABS.**
- ✓ **B) Credit card ABS.**
- X **C) Non-agency residential MBS.**

Explanation

Credit card ABS typically have a lockout period during which principal payments by credit card borrowers are used to purchase additional credit card debt, rather than paid out to the ABS holders.

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**Question #6 of 16**

Question ID: 472427

Asset-backed securities with a waterfall structure *most likely* include:

- X **A) agency RMBS.**
- X **B) credit card ABS.**
- ✓ **C) auto loan ABS.**

Explanation

ABS with a waterfall structure (senior and subordinated tranches) are typically those with amortizing loans as collateral, such as auto loan ABS. ABS with non-amortizing loans as collateral, such as credit card ABS, typically use a revolving structure. Agency RMBS are pass-through securities.

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**Question #7 of 16**

Question ID: 460697

A mortgage is *most* attractive to a lender if the loan:

- ✓ **A) has a prepayment penalty.**
- X **B) is convertible from fixed-rate to adjustable-rate.**
- X **C) is non-recourse.**

### Explanation

Prepayment penalties are attractive to a lender because borrowers are most likely to prepay when interest rates have decreased (i.e., when the lender will earn a lower return by reinvesting prepaid principal). Recourse loans are more favorable to the lender than non-recourse loans because with a non-recourse loan the lender can only reclaim the collateral in the event of default, while recourse gives the lender a claim against the borrower's other assets. The conversion option in a convertible mortgage is held by the borrower and is therefore attractive to a borrower rather than a lender.

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## Question #8 of 16

Question ID: 460703

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.

### Explanation

Call protection in the context of a CMBS refers to protection against prepayment risk. Structuring a CMBS with a residual (equity or first-loss) tranche provides investors in the senior tranches with CMBS-level call protection. Prepayment lockout periods and yield maintenance charges are examples of loan-level call protection because they apply to the individual loans.

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## Question #9 of 16

Question ID: 472424

Securitization *least likely* benefits the financial system by:

- ☒ A) removing liabilities from bank balance sheets.
- ☐ B) increasing liquidity for mortgages and other loans.
- ☐ C) increasing the amount banks are able to lend.

### 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.

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## Question #10 of 16

Question ID: 460704

A collateralized debt obligation (CDO) in which the collateral is a pool of residential mortgage-backed securities is *most accurately* described as a:

- ☒ A) structured finance CDO.
- ☐ B) synthetic CDO.
- ☐ C) collateralized loan obligation (CLO).

### Explanation

In a structured finance CDO the collateral is a pool of mortgage-backed securities, asset-backed securities, or other CDOs. In a synthetic CDO the collateral is a pool of credit default swaps. In a CLO the collateral is a pool of leveraged bank loans.

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**Question #11 of 16**

Question ID: 460698

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) issuance and servicing costs.**
- X **B) slower-than-expected prepayments.**
- X **C) faster-than-expected prepayments.**

Explanation

Pass-through (i.e., coupon) rates on an MBS are less than the average interest rate on its underlying pool of mortgages because some of the cash flows from the mortgages are used to pay issuance costs and fees to the servicer of the mortgages.

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**Question #12 of 16**

Question ID: 460695

The special purpose vehicle in a securitization is:

- ✓ **A) an entity independent of the seller.**
- X **B) a joint venture partner of the seller.**
- X **C) a subsidiary of the seller.**

Explanation

The SPV 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.

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**Question #13 of 16**

Question ID: 472428

An investor wants to take advantage of the 5-year spot rate, currently at a level of 4.0%. Unfortunately, the investor just invested all of his funds in a 2-year bond with a yield of 3.2%. The investor contacts his broker, who tells him that in two years he can purchase a 3-year bond and end up with the same return currently offered on the 5-year bond. What 3-year forward rate beginning two years from now will allow the investor to earn a return equivalent to the 5-year spot rate?

- X **A) 5.6%.**
- ✓ **B) 4.5%.**
- X **C) 3.5%.**

Explanation

$(1.04^5 / 1.032^2)^{1/3} - 1 = 4.5\%$ .

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**Question #14 of 16**

Question ID: 460701

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.**
- X **B) more protection against contraction risk.**
- X **C) more protection against extension risk.**

Explanation

In a planned amortization class (PAC) CMO, the support tranches have more extension risk and more contraction risk than the PAC tranches. Because of these higher risks, the support tranches offer a higher interest rate than the PAC tranches.

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**Question #15 of 16**

Question ID: 460696

A mortgage that includes some repayment of principal in each payment, and has an outstanding principal balance at maturity, is *most accurately* described as a:

- ✓ **A) partially amortizing mortgage.**
- X **B) hybrid mortgage.**
- X **C) rollover mortgage.**

Explanation

A partially amortizing mortgage includes some amount of principal in each payment but still has an outstanding principal balance at maturity. A hybrid mortgage becomes an adjustable-rate mortgage after an initial fixed-rate period. A rollover mortgage changes from one fixed rate to another during its life.

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**Question #16 of 16**

Question ID: 460700

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:

- X **A) less contraction risk and more extension risk.**
- X **B) more contraction risk and more extension risk.**
- ✓ **C) more contraction risk and less extension risk.**

Explanation

In a sequential-pay CMO the short tranche, which receives principal payments and prepayments first, has more contraction risk, while the tranche that receives principal payments and prepayments last has more extension risk.