LM18 · FIXED INCOME · CFA LEVEL I

Asset-Backed Security (ABS) Instrument and Market Features

Key ABS structures: credit card receivables, auto loans, solar ABS, CDOs, and CLOs. Internal credit enhancement features.

Learning Outcomes

LOS a Describe the features of ABS backed by credit card receivables, auto loans, and other assets

LOS b Describe collateralized debt obligations (CDOs / CLOs)

Exam Tip: Credit card ABS have a **lockout / revolving** phase and then an amortization phase. Auto-loan ABS tend to amortize. CLOs have a **collateral manager**. Know covered bond vs ABS (dual recourse).

LOS A · CREDIT CARD RECEIVABLE-BACKED SECURITIES

Credit Card Receivable-Backed ABS

Credit card receivables are **non-amortizing** loans — borrowers can choose when to repay principal. Cash flows on a pool of credit card receivables consist of:

- **Finance charges & fees**
- **Principal repayments**

Structure

- **Lockout / revolving period:** only interest is paid to investors; principal on receivables is reinvested in new receivables.
- **Amortization period:** after lockout, principal on receivables is passed to investors.

> Credit card pools support a wide variety of tranches and typically include soft credit enhancement via excess spread and overcollateralization.

LOS A · OTHER ABS TYPES

Auto-Loan ABS

Auto-loan ABS are backed by **amortizing** auto loans. Cash flows include scheduled principal + interest + prepayments. Structures typically include senior / subordinated tranches plus overcollateralization.

Solar ABS

Solar ABS are backed by loans to homeowners who finance solar installations — attractive to ESG-focused investors. Solar ABS often include:

- Overcollateralization
- Excess spread
- Subordination
- **Pre-funding period** during which the trust invests in additional solar-related loans after ABS issuance.

> Other common ABS classes include student loans, receivables, equipment leases, franchise-fee streams, and future-flow deals.

CHECKPOINT 1

Quiz 1: ABS Types

Answer all questions to test your understanding. Your score updates on the final step.

Q1. During the **lockout period** of a credit card ABS, principal on receivables is:

Q2. Auto-loan ABS are backed by:

Q3. Solar ABS typically include a pre-funding period during which:

Q4. Credit card ABS are *most* exposed to:

Q5. A major difference between credit card ABS and mortgage ABS is:

LOS A · INTERNAL CREDIT ENHANCEMENTS

Internal Credit Enhancements (Recap)

These come from within the structure (no external party guarantee):

- **Overcollateralization** — collateral value > ABS face value.
- **Excess spread** — collateral yield > weighted-average ABS coupon; surplus builds up to absorb losses.
- **Subordination / credit tranching** — junior tranches absorb losses first; senior tranches benefit from the cushion.

LOS B · CDOS, CBOS, CLOS

Collateralized Debt Obligations

CDOs are structured securities backed by a pool of debt obligations. Subtypes:

- **CBOs** — collateralized bond obligations; backed by corporate and EM debt.
- **CLOs** — collateralized loan obligations; backed by **leveraged bank loans**. Most CDOs today are CLOs.

Key differentiator

CDOs have a **collateral manager** who actively buys and sells securities in the pool to generate cash for scheduled payments. This differs from static ABS.

CLO structure

- **Senior notes** — highest rated, lowest yield.
- **Mezzanine notes** — middle-ranked.
- **Subordinated / equity tranche** — residual claim; highest expected return, first loss.

The equity / subordinated tranche must offer an **attractive return**, net of payments to senior debt tranches, to make the CLO feasible.

CHECKPOINT 2

Quiz 2: CDOs / CLOs

Answer all questions to test your understanding. Your score updates on the final step.

Q6. A CLO is *best* described as:

Q7. The defining feature of a CDO compared with a regular ABS is the:

Q8. In a CLO, the **equity tranche**:

Q9. A synthetic CLO gains exposure to loan pools via:

Q10. To protect CLO investors, CLOs commonly include:

LOS A · COVERED BONDS REVISITED

Covered Bonds vs ABS (Recap)

Covered bonds are primarily issued by European, Asian, and Australian banks. They resemble ABS but differ in key ways:

- No SPE; collateral is **segregated** but stays on the issuer's balance sheet.
- Bondholders have **dual recourse** — to the collateral and to the issuer's other unpledged assets.
- Unlike a static ABS pool, a covered bond requires the issuer to **replace or augment** nonperforming or prepaid loans.

Default provisions

- **Hard-bullet:** missed payment → default; acceleration of payments.
- **Soft-bullet:** maturity can be extended by up to a year on a missed payment.
- **Conditional pass-through:** converts to a pass-through bond on maturity if payments remain due.

CHECKPOINT 3 · SYNTHESIS

Quiz 3: Synthesis

Answer all questions to test your understanding. Your score updates on the final step.

Q11. A soft-bullet covered bond’s maturity:

Q12. Covered bondholders have **dual recourse**, meaning:

Q13. Credit-card ABS differ from auto-loan ABS in that credit-card ABS:

Q14. A CLO equity tranche is most attractive to investors seeking:

Q15. Collateral manager activity in a CDO can **reduce** credit risk by:

MODULE COMPLETE

Your Scorecard

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LM18 Key Takeaways — Exam-Ready Cheat Sheet

ABS types

Credit card (non-amortizing, lockout + amortization phases) · **Auto loan** (amortizing) · **Solar** (pre-funding period) · **Student loan** · **Equipment lease** · **Future-flow**.

Internal credit enhancement

Overcollateralization · excess spread · subordination / credit tranching.

CDOs / CLOs

Active collateral manager. CLOs (leveraged loans) dominate post-GFC. Cash-flow / market-value / synthetic variants. Standard tests: coverage, OC, diversification, CCC limits.

Covered bonds

No SPE; dual recourse; dynamic pool. Hard-bullet / soft-bullet / conditional pass-through.

Step 1 of 10