The Passionate Shepherd
Wrestling with a vigorous beast ...

I. Fill in the blanks and explain the scheme below.

An asset-backed security (ABS) is a securitized interest in a

[1. _____] of assets.

ABSs are backed by non-mortgage assets. Due to diversification of the [2. _____] assets, as well as credit enhancements, the risk tends to be modest.

ABSs are appealing to issuers because the structure allows them to get assets off their balance sheets, freeing up

[3. _____] for further receivables. Also, ABSs make it possible for issuers whose unsecured debt is below investment grade to sell investment grade—even AAA-

[4. _____]—debt. To create an ABS, a corporation creates a [5. _____] to which it sells the assets. While is is common to speak of the corporation as the issuer of the ABS, legally, it is the trust hat is the issuer. It sells [6. _____] to investors. To protect investors from possible bankruptcy of the corporation, there are three legal safeguards. Transfer of assets from the corporation is a non-recourse, true sale.

- Investors receive a [7. _____] interest in the assets' cash flows.

- A non-consolidation legal opinion is obtained certifying that assets of the trust or special purpose vehicle cannot be consolidated with the corporation's assets in the event of bankruptcy.

These same safeguards allow the corporation to remove the assets from its balance sheet. The corporation generally continues to service the assets—collecting interest and [8. _____] payments, pursuing delinquencies, etc. It is paid out of asset cash flows for providing these ongoing services.

For investors, ABSs are an alternative to highly-rated corporate [9. _____]. They generally offer similar or superior liquidity. Because the underlying assets are diversified, they are less subject to credit surprises.

ABSs can be structured into different classes or [10. _____]. There may be senior or subordinated classes, which have different credit ratings. They may be structured with different average maturities. Choice of structure depends upon investor demand as well as the nature of the underlying assets.