

Reading 51: Fixed-Income Markets: Issuance, Trading, and Funding

Question #1 of 28

Question ID: 434404

Fixed income classifications by issuer *most likely* include:

- ☐ A) Floating-rate bonds.
- ☐ B) Money market securities.
- ☒ C) Financial sector bonds.

Explanation

Corporate bonds are frequently classified by issuer as financial or non-financial. Floating-rate bonds are a classification by coupon structure. Money market securities are a classification by original maturities.

References

Question From: Session 15 > Reading 51 > LOS a

Related Material:

- Key Concepts by LOS
-

Question #2 of 28

Question ID: 415480

Bonds issued by the International Monetary Fund (IMF) are *most accurately* described as:

- ☒ A) supranational bonds.
- ☐ B) quasi-government bonds.
- ☐ C) non-sovereign government bonds.

Explanation

Supranational bonds are issued by multilateral organizations such as the IMF. Quasi-government bonds are issued by agencies created by a national government. Non-sovereign government bonds are issued by state, provincial, and local governments or municipal entities.

References

Question From: Session 15 > Reading 51 > LOS f

Related Material:

- Key Concepts by LOS
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Question #3 of 28

Question ID: 415477

A bond is quoted at 96.25 bid and 96.75 ask. Based only on this information, this bond is *most likely*:

- ✓ **A)** relatively illiquid.
- X **B)** a corporate bond.
- X **C)** non-investment grade.

Explanation

The spread between the bid and ask prices is one-half percent of par, which most likely reflects an illiquid market for this bond. Bonds with liquid secondary markets typically have bid-ask spreads of approximately 10 to 12 basis points.

References

Question From: Session 15 > Reading 51 > LOS d

Related Material:

- Key Concepts by LOS
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Question #4 of 28

Question ID: 415470

Fixed income classifications by geography *most likely* include:

- X **A)** supranational bonds.
- X **B)** municipal bonds.
- ✓ **C)** emerging market bonds.

Explanation

Classifying fixed income securities as developed market or emerging market bonds is an example of classification by geography. Supranational bonds are a classification by type of issuer. Municipal bonds are a classification by type of issuer or by taxable status.

References

Question From: Session 15 > Reading 51 > LOS a

Related Material:

- Key Concepts by LOS
-

Question #5 of 28

Question ID: 415486

Compared to a term repurchase agreement, an overnight repurchase agreement is *most likely* to have a:

- X **A)** higher repo rate and repo margin.
- X **B)** lower repo rate and higher repo margin.
- ✓ **C)** lower repo rate and repo margin.

Explanation

Both the repo rate and the repo margin tend to be higher for longer repo terms. Therefore an overnight repo should have a lower repo rate and a lower repo margin than a term (i.e., longer than overnight) repo.

References

Question From: Session 15 > Reading 51 > LOS j

Related Material:

- Key Concepts by LOS
-

Question #6 of 28

Question ID: 496427

A quoted Libor interest rate is *least likely* to refer to a specific:

- X **A)** maturity.
- X **B)** currency.
- ✓ **C)** bank.

Explanation

Libor rates are averages calculated from a number of different banks' quotes on the interbank money market. Each Libor rate refers to a specific maturity (in a range from overnight to one year) and currency.

References

Question From: Session 15 > Reading 51 > LOS b

Related Material:

- Key Concepts by LOS
-

Question #7 of 28

Question ID: 765501

Which of the following coupon payment structures represents a leveraged inverse floater?

- X **A)** 10% - 0.75 times 180-day Libor.
- X **B)** 6% - 30-day Libor.
- ✓ **C)** 8% - 1.5 times 90-day Libor.

Explanation

A leveraged inverse floater has a coupon that increases or decreases by more than the change in its reference rate. A deleveraged inverse floater has a coupon that increases or decreases by less than the change in its reference rate.

References

Question From: Session 15 > Reading 51 > LOS h

Related Material:

- Key Concepts by LOS
-

Question #8 of 28

Question ID: 472420

Which of the following statements regarding repurchase agreements is *most accurate*?

- ☐ A) Lower credit rating of the underlying collateral results in a lower repo margin.
- ☐ B) Higher credit rating of the underlying collateral results in a higher repo rate.
- ☒ C) Greater demand for the underlying security results in a lower repo margin.

Explanation

Other things equal, the repo margin (percent difference between the market value of the collateral and the loan amount) is lower if the collateral is in greater demand. The repo margin and repo rate (the annualized percent difference between the sale price and repurchase price of the collateral) are inversely related to the credit quality of the collateral.

References

Question From: Session 15 > Reading 51 > LOS j

Related Material:

- Key Concepts by LOS
-

Question #9 of 28

Question ID: 415485

The interbank funds market is *most accurately* described as:

- ☐ A) trading of negotiable certificates of deposit.
- ☒ B) unsecured short-term loans from one bank to another.
- ☐ C) banks' borrowing of reserves from the central bank.

Explanation

The interbank funds market refers to short-term unsecured loans between banks. It does not refer to trading of negotiable certificates of deposit. Borrowing from the central bank is said to occur in the central bank funds market.

References

Question From: Session 15 > Reading 51 > LOS i

Related Material:

- Key Concepts by LOS
-

Question #10 of 28

Question ID: 765503

TBTF Bank issues credit-linked notes (CLNs) that have 5-year debentures of Ossien Company as their reference asset. If Ossien defaults on its debentures, the CLNs will be redeemed:

- ☐ A) immediately for their par value.
- ☒ B) for less than their par value.
- ☐ C) for their par value plus a premium.

Explanation

A credit-linked note (CLN) returns less than the full principal amount at redemption if a credit event on a reference asset has occurred. A CLN returns its full principal at redemption if a credit event on a reference asset has not occurred. In effect the CLN buyer takes on the credit risk of the reference asset.

References

Question From: Session 15 > Reading 51 > LOS h

Related Material:

- Key Concepts by LOS
-

Question #11 of 28

Question ID: 653094

Settlement for a government bond trade *most likely* occurs on the:

- ✓ **A)** next trading day after the trade.
- X **B)** third trading day after the trade.
- X **C)** second trading day after the trade.

Explanation

Government bond trades typically settle on the next trading day (T + 1) or have cash settlement (settle on the same day).

References

Question From: Session 15 > Reading 51 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #12 of 28

Question ID: 415474

Which of the following *least likely* represents a primary market offering? When bonds are sold:

- X **A)** in a private placement.
- X **B)** on a best-efforts basis.
- ✓ **C)** from a dealer's inventory.

Explanation

When bonds are sold from a dealer's inventory, the bonds have already been sold once and the transaction takes place on the secondary market. The other transactions in the responses take place in the primary market. When bonds are sold on a best-efforts basis, the investment banker does not take ownership of the securities and agrees to sell all she can. In a private placement, the bonds are sold privately to a small number of investors.

References

Question From: Session 15 > Reading 51 > LOS c

Related Material:

- Key Concepts by LOS

Question #13 of 28

Question ID: 415483

A structured security is a combination of:

- ✓ **A)** a medium-term note and a derivative.
- ✗ **B)** a corporate bond and a syndicated loan.
- ✗ **C)** commercial paper and a backup line of credit.

Explanation

Medium-term notes (MTNs) that are combined with derivatives to create features desired by an investor are known as structured securities.

References

Question From: Session 15 > Reading 51 > LOS g

Related Material:

- Key Concepts by LOS
-

Question #14 of 28

Question ID: 550543

Settlement for corporate bond trades generally happen on what basis?

- ✗ **A)** Cash settlement.
- ✓ **B)** Trade date + 3 days.
- ✗ **C)** Trade date + 1 day.

Explanation

Corporate bonds typically settle on the third trading day after the trade (T + 3). Some money market securities are settled on the trade date (cash settlement) and government bonds typically settle on the trading day following the trade date (T + 1).

References

Question From: Session 15 > Reading 51 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #15 of 28

Question ID: 415473

The reference rate for a floating-rate note should *least likely* match the note's:

- ✓ **A)** maturity.
- ✗ **B)** reset frequency.
- ✗ **C)** currency.

Explanation

An appropriate reference rate for a floating-rate note should match its currency and the frequency with which its coupon rate is reset, such as 90-day yen Libor for a yen-denominated note that resets quarterly.

References

Question From: Session 15 > Reading 51 > LOS b

Related Material:

- Key Concepts by LOS
-

Question #16 of 28

Question ID: 415482

If two banks fund a loan to a corporation, the loan is *most accurately* described as a:

- ✓ **A)** syndicated loan.
- X **B)** bilateral loan.
- X **C)** backup line of credit.

Explanation

Syndicated loans are funded by more than one bank. A bilateral loan involves only one bank ("bilateral" refers to the lender and the borrower). A backup line of credit is an agreement to provide funds if needed and may be used, for example, to provide credit enhancement for a commercial paper issue.

References

Question From: Session 15 > Reading 51 > LOS g

Related Material:

- Key Concepts by LOS
-

Question #17 of 28

Question ID: 496428

The interest rate on excess reserves borrowed by one bank from another bank is *most accurately* described as a(n):

- X **A)** interbank lending rate.
- X **B)** reserve swap rate.
- ✓ **C)** central bank funds rate.

Explanation

Required reserves are deposits with a country's central bank. Banks that deposit more than the required amount with the central bank are said to have excess reserves and may lend these to other banks. This lending is said to take place in the central bank funds market and the interest rates on such loans are known as central bank funds rates.

References

Question From: Session 15 > Reading 51 > LOS i

Related Material:

- Key Concepts by LOS
-

Question #18 of 28

Question ID: 415487

A repurchase agreement is described as a "reverse repo" if:

- ✓ **A)** a bond dealer is the lender.
- X **B)** the repurchase price is lower than the sale price.
- X **C)** collateral is delivered to the lender and returned to the borrower.

Explanation

Bond dealers frequently use repurchase agreements as sources of funding. When a bond dealer enters a repo as the lender instead of the borrower, the agreement is referred to as a reverse repo.

References

Question From: Session 15 > Reading 51 > LOS j

Related Material:

- Key Concepts by LOS
-

Question #19 of 28

Question ID: 598999

Settlement for corporate bond trades is *most likely* to happen on what basis?

- ✓ **A)** Trade date + 3 days.
- X **B)** Trade date + 1 day.
- X **C)** Cash settlement.

Explanation

Corporate bonds typically settle on the second or third trading day after the trade (T + 2 or T + 3), although in some markets their settlement can be as much as T + 7. Some money market securities are settled on the trade date (cash settlement) and government bonds typically settle on the trading day following the trade date (T + 1).

References

Question From: Session 15 > Reading 51 > LOS d

Related Material:

- Key Concepts by LOS
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Question #20 of 28

Question ID: 415472

The *most appropriate* reference rate for a one-year, U.S. dollar denominated, floating-rate note that resets monthly is:

- ✓ **A)** 30-day LIBOR.

- X **B)** 1-year LIBOR.
- X **C)** overnight LIBOR.

Explanation

The reference rate for floating-rate debt should match the frequency with which the coupon rate is reset.

References

Question From: Session 15 > Reading 51 > LOS b

Related Material:

- Key Concepts by LOS
-

Question #21 of 28

Question ID: 415481

On November 15, 20X1, Grinell Construction Company decided to issue bonds to help finance the acquisition of new construction equipment. They issued bonds totaling \$10,000,000 with a 6% coupon rate due June 15, 20X9. Grinell has agreed to pay the entire amount borrowed in one lump sum payment at the maturity date. Grinell is not required to make any principal payments prior to maturity. What type of bond structure has Grinell issued?

- X **A)** Amortizing maturity structure.
- X **B)** Serial maturity structure.
- ✓ **C)** Term maturity structure.

Explanation

These bonds have a term maturity structure because the issuer has agreed to pay the entire amount borrowed in one lump-sum payment at maturity.

References

Question From: Session 15 > Reading 51 > LOS g

Related Material:

- Key Concepts by LOS
-

Question #22 of 28

Question ID: 415471

Fixed income classifications by credit quality *most likely* include:

- ✓ **A)** investment grade bonds.
- X **B)** developed market bonds.
- X **C)** money market securities.

Explanation

Investment grade and non-investment grade are classifications by credit quality. Money market instruments are a classification by maturity. Developed market bonds are a classification by geography.

References

Question From: Session 15 > Reading 51 > LOS a

Related Material:

- Key Concepts by LOS
-

Question #23 of 28

Question ID: 415479

The principal value of a sovereign bond is \$1,000 at issuance and \$1,055 two years after issuance. This bond *most likely*:

- ☐ A) trades at a premium.
- ☐ B) has been upgraded.
- ☒ C) is indexed for inflation.

Explanation

Inflation-indexed bonds often have a capital-indexed structure in which the principal value is adjusted periodically by the inflation rate. Credit rating upgrades or downgrades do not affect the principal value of bonds. A bond is trading at a premium when its market price is greater than its principal value.

References

Question From: Session 15 > Reading 51 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #24 of 28

Question ID: 415484

Which of the following sources of short-term funding is available to banks but typically unavailable to other corporations?

- ☐ A) Syndicated loans.
- ☒ B) Central bank funds.
- ☐ C) Commercial paper.

Explanation

Sources of short-term funding for banks that are generally not available to other corporations include retail customer deposits, certificates of deposit, central bank funds, and interbank lending. Syndicated loans and commercial paper issuance are funding sources available to other corporations as well as banks.

References

Question From: Session 15 > Reading 51 > LOS i

Related Material:

- Key Concepts by LOS
-

Question #25 of 28

An indenture is *most likely* to specify a bond's:

- ✓ **A)** covenants.
- X **B)** underwriter.
- X **C)** credit rating.

Explanation

Covenants are provisions of a bond indenture. Credit ratings are assigned by independent rating agencies. The underwriter, if any, of a bond issue is not identified in the indenture but would be identified in the offering documents.

References

Question From: Session 15 > Reading 51 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #26 of 28

Question ID: 487761

Which type of issuer is *most likely* to issue bonds by auction?

- X **A)** Corporate.
- X **B)** Municipal.
- ✓ **C)** Sovereign.

Explanation

Many national governments use auctions to issue sovereign bonds. Corporate bonds are typically issued in an underwriting or private placement process while municipal bonds are typically issued in a negotiated or underwritten process.

References

Question From: Session 15 > Reading 51 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #27 of 28

Question ID: 415475

A purchase of a new bond issue by a single investor is *most accurately* described as a(n):

- X **A)** underwritten offering.
- ✓ **B)** private placement.
- X **C)** grey market transaction.

Explanation

In a private placement, an entire bond issue is sold to a single investor or a small group of investors, rather than being offered to the public.

References

Question From: Session 15 > Reading 51 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #28 of 28

Question ID: 765502

An investor pays \$100,000 for a security that consists of a zero-coupon bond that will pay \$90,000 in three months and \$11,000 worth of call options on an equity index that expire in three months. This security is *most accurately* described as a:

- ✓ **A)** capital protected instrument.
- X **B)** guarantee certificate.
- X **C)** participation instrument.

Explanation

The security described here is a capital-protected instrument, but it is not a guarantee certificate because the capital protection (promised payment at maturity) is less than the initial cost of the security. It is not a participation instrument because it does not promise payments that are based on the value of the reference instrument.

References

Question From: Session 15 > Reading 51 > LOS h

Related Material:

- Key Concepts by LOS