

Question #1 of 69

Question ID: 415441

An analyst observes a 5-year, 10% coupon bond with semiannual payments. The face value is £1,000. How much is each coupon payment?

- X **A)** £25.
- X **B)** £100.
- ✓ **C)** £50.

Explanation

The coupon rate is the percentage of par value paid annually. With semiannual coupons, half of the annual coupon rate is paid every six months. For a 5-year, 10% coupon bond with semiannual payments and a face value of £1,000, each coupon payment is half of 10% times £1,000, or £50.

References

Question From: Session 15 > Reading 51 > LOS a

Related Material:

- Key Concepts by LOS
-

Question #2 of 69

Question ID: 415447

Which of the following is *least likely* an example of external credit enhancement?

- X **A)** Surety bond.
- X **B)** Bank guarantee.
- ✓ **C)** Excess spread.

Explanation

Excess spread is an internal credit enhancement. External credit enhancements include bank guarantees, letters of credit, and surety bonds.

References

Question From: Session 15 > Reading 51 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #3 of 69

Question ID: 415443

A bond's indenture *least likely* specifies the:

- ☐ A) source of funds for repayment.
- ☒ B) identity of the lender.
- ☐ C) covenants that apply to the issuer.

Explanation

The identity of the lender (i.e., the bondholder) is not specified in a bond's indenture because a bond may be traded during its life. An indenture or trust deed is a legal contract that specifies a bond issuer's obligations and restrictions. The indenture may include covenants that require the issuer to take or refrain from taking certain actions and may specify the source of funds for repayment, such as a project to be funded or the taxing power of a government.

References

Question From: Session 15 > Reading 51 > LOS b

Related Material:

- Key Concepts by LOS
-

Question #4 of 69

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

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 52 > LOS i

Related Material:

- Key Concepts by LOS
-

Question #5 of 69

Question ID: 460676

Which of the following securities is *least likely* classified as a eurobond? A bond that is denominated in:

- ✓ **A)** euros and issued in Germany.
- X **B)** U.S. dollars and issued in Japan.
- X **C)** euros and issued in the United States.

Explanation

Bonds denominated in the currency of the country or region where they are issued are domestic bonds. Eurobonds are denominated in a currency other than those of the countries in which they are sold.

References

Question From: Session 15 > Reading 51 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #6 of 69

Question ID: 415446

A covenant that requires the issuer not to let the insurance coverage lapse on assets pledged as collateral is an example of a(n):

- X **A)** negative covenant.
- X **B)** inhibiting covenant.
- ✓ **C)** affirmative covenant.

Explanation

Covenants are classified as negative or affirmative. Affirmative covenants specify administrative actions a bond issuer is required to take, such as maintaining insurance coverage on assets pledged as collateral. Negative covenants are restrictions on a bond issuer's actions, such as preventing an issuer from selling any assets that have been pledged as collateral or pledging them again as collateral for additional debt.

References

Question From: Session 15 > Reading 51 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #7 of 69

Question ID: 485805

Which of the following statements about floating-rate notes is *most accurate*?

- ✓ **A)** Floating-rate notes have built-in floors, while inverse floating-rate notes have built-in caps.

- X **B)** Inverse floating-rate notes are attractive to investors who expect interest rates to rise, while floating-rate notes are attractive to investors who expect interest rates to fall.
- X **C)** The coupon payment on a floating-rate note at each reset date is typically based on LIBOR as of that date.

Explanation

The lowest possible reference rate is zero. If this occurs, the coupon on a floating-rate note cannot go lower than its quoted margin. Hence, the quoted margin is a floor coupon for a floating-rate note. The coupon on an inverse floater is determined by a formula such as "15% - 1.5 × reference rate." If the reference rate goes to zero, the coupon on this inverse floater can go no higher than 15%.

References

Question From: Session 15 > Reading 51 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #8 of 69

Question ID: 415484

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

- X **A)** Syndicated loans.
- ✓ **B)** Central bank funds.
- X **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 52 > LOS h

Related Material:

- Key Concepts by LOS
-

Question #9 of 69

Question ID: 415444

Features specified in a bond indenture *least likely* include the bond's:

- X **A)** coupon rate and maturity date.
- X **B)** par value and currency.

✓ **C)** issuer and rating.

Explanation

Bond ratings are assigned by third-party credit rating agencies and may change during the life of a bond. Features that are specified in the indenture for a fixed income security include its issuer, maturity date, par value, coupon rate and frequency, and currency.

References

Question From: Session 15 > Reading 51 > LOS b

Related Material:

- Key Concepts by LOS
-

Question #10 of 69

Question ID: 415475

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

- ✓ **A)** private placement.
- X **B)** underwritten offering.
- 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 52 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #11 of 69

Question ID: 415437

Which of the following statements about zero-coupon bonds is *least* accurate?

- ✓ **A)** A zero coupon bond may sell at a premium to par when interest rates decline.
- X **B)** All interest is earned at maturity.
- X **C)** The lower the price, the greater the return for a given maturity.

Explanation

Zero coupon bonds always sell below their par value, or at a discount prior to maturity. The amount of the discount may change

as interest rates change, but a zero coupon bond will always be priced less than par.

References

Question From: Session 15 > Reading 51 > LOS a

Related Material:

- Key Concepts by LOS
-

Question #12 of 69

Question ID: 415448

In most countries including the United States, debenture is defined as:

- X **A)** a bond secured by specific assets.
- X **B)** a short-term debt instrument.
- ✓ **C)** an unsecured bond.

Explanation

In most countries a debenture is defined as unsecured debt.

References

Question From: Session 15 > Reading 51 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #13 of 69

Question ID: 415438

A bond is trading at a premium if its:

- X **A)** redemption value is greater than its face value.
- ✓ **B)** price is greater than its par value.
- X **C)** yield is greater than its coupon rate.

Explanation

If a bond's price is greater than its par value, the bond is trading at a premium. If a bond's yield is greater than its coupon rate, its price is less than par value and the bond is trading at a discount. Face value and redemption value both refer to par value.

References

Question From: Session 15 > Reading 51 > LOS a

Related Material:

- Key Concepts by LOS

Question #14 of 69

Question ID: 415483

A structured security is a combination of:

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

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 52 > LOS g

Related Material:

- Key Concepts by LOS
-

Question #15 of 69

Question ID: 415473

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

- ☐ A) currency.
- ☒ B) maturity.
- ☐ C) reset frequency.

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 52 > LOS b

Related Material:

- Key Concepts by LOS
-

Question #16 of 69

Question ID: 460678

A bond initially does not make periodic payments but instead accrues them over a pre-determined period and then pays a lump sum at the end of that period. The bond subsequently makes regular periodic payments until maturity. Such a bond is *best*

described as a:

- ☐ A) zero-coupon bond.
- ☒ B) deferred-coupon bond.
- ☐ C) step-up note.

Explanation

Deferred-coupon bonds carry coupons, but the initial coupon payments are deferred for some period. The coupon payments accrue, at a compound rate, over the deferral period and are paid as a lump sum at the end of that period. After the initial deferment period has passed, these bonds pay regular coupon interest for the rest of the life of the issue (i.e., until the maturity date). Zero coupon bonds do not pay periodic interest. A step-up note has a coupon rate that increases on one or more specified dates during the note's life.

References

Question From: Session 15 > Reading 51 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #17 of 69

Question ID: 434404

Fixed income classifications by issuer *most likely* include:

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

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 52 > LOS a

Related Material:

- Key Concepts by LOS
-

Question #18 of 69

Question ID: 434401

Which of the following is *least likely* a form of internal credit enhancement for a bond issue?

- ☐ A) Structuring the asset pool such that it has an excess spread.

- ✓ **B)** Covering the bond issue via a surety bond.
- X **C)** Including a tranche system to identify priority of claims.

Explanation

A surety bond is issued by a third party and hence is an external form of credit enhancement.

References

Question From: Session 15 > Reading 51 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #19 of 69

Question ID: 415460

Which of the following statements about U.S. Treasury Inflation Protection Securities (TIPS) is *most* accurate?

- X **A)** The inflation-adjusted principal value cannot be less than par.
- X **B)** Adjustments to principal values are made annually.
- ✓ **C)** The coupon rate is fixed for the life of the issue.

Explanation

The coupon rate is set at a fixed rate determined via auction. This is called the real rate. The principal that serves as the basis of the coupon payment and the maturity value is adjusted semiannually. Because of the possibility of deflation, the adjusted principal value may be less than par (however, at maturity the Treasury redeems the bonds at the greater of the inflation-adjusted principal and the initial par value).

References

Question From: Session 15 > Reading 51 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #20 of 69

Question ID: 415439

Every six months a bond pays coupon interest equal to 3% of its par value. This bond is a:

- ✓ **A)** 6% semiannual coupon bond.
- X **B)** 6% annual coupon bond.
- X **C)** 3% semiannual coupon bond.

Explanation

The coupon rate on a bond is the percentage of its par value that it pays in interest each year. The coupon frequency states how

often the bond will pay interest. A 6% semiannual coupon bond pays interest twice per year with each coupon equaling half of 6%, or 3%, of par value.

References

Question From: Session 15 > Reading 51 > LOS a

Related Material:

- Key Concepts by LOS
-

Question #21 of 69

Question ID: 415487

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

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

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 52 > LOS i

Related Material:

- Key Concepts by LOS
-

Question #22 of 69

Question ID: 655192

A company desiring to issue a fixed-income security has placed \$10 million worth of loan receivables in a special purpose entity (SPE) that is independent of the issuer. The credit rating agencies suggest the company secure a third-party guarantee in order to have the security rated AAA. After completing the transfer of assets to the SPE and obtaining a letter of credit from a national bank, the company issues the AAA rated security. The securities are *most likely*:

- X **A)** commercial paper.
- ✓ **B)** asset backed securities.
- X **C)** global bonds.

Explanation

Special purpose entities relate to asset-backed securities.

References

Question From: Session 15 > Reading 51 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #23 of 69

Question ID: 550543

Settlement for corporate bond trades generally happen on what basis?

- ☐ A) Trade date + 1 day.
- ☐ B) Cash settlement.
- ☒ C) Trade date + 3 days.

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 52 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #24 of 69

Question ID: 598999

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

- ☐ A) Cash settlement.
- ☐ B) Trade date + 1 day.
- ☒ C) Trade date + 3 days.

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 52 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #25 of 69

Question ID: 415468

Which of the following embedded options in a fixed income security can be exercised by the issuer?

- ☐ A) Conversion option.
- ☐ B) Put option.
- ☒ C) Call option.

Explanation

Securities with embedded call options may be called by the issuer. An embedded put option gives the bondholder the right to sell (put) the security back to the issuer. A conversion option gives the bondholder the right to exchange the security for the issuer's common stock.

References

Question From: Session 15 > Reading 51 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #26 of 69

Question ID: 441029

An investor holds \$100,000 (par value) worth of TIPS currently trading at par. The coupon rate of 4% is paid semiannually, and the annual inflation rate is 2.5%. What coupon payment will the investor receive at the end of the first six months?

- ☒ A) \$2,025.
- ☐ B) \$2,050.
- ☐ C) \$2,000.

Explanation

This coupon payment is computed as follows:

$$\text{coupon payment} = (\$100,000 \times 1.0125) \left(\frac{0.04}{2} \right) = \$2,025$$

References

Question From: Session 15 > Reading 51 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #27 of 69

Question ID: 415458

A bond has a par value of \$5,000 and a coupon rate of 8.5% payable semi-annually. The bond is currently trading at 112.16. What is the dollar amount of the semi-annual coupon payment?

- X **A)** \$238.33.
- X **B)** \$425.00.
- ✓ **C)** \$212.50.

Explanation

The dollar amount of the coupon payment is computed as follows:

$$\text{Coupon in \$} = \$5,000 \times 0.085 / 2 = \$212.50$$

References

Question From: Session 15 > Reading 51 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #28 of 69

Question ID: 415465

Which of the following statements about the call feature of a bond is *most* accurate? An embedded call option:

- X **A)** describes the maturity date of the bond.
- X **B)** stipulates whether and under what circumstances the bondholders can request an earlier repayment of the principal amount prior to maturity.
- ✓ **C)** stipulates whether and under what circumstances the issuer can redeem the bond prior to maturity.

Explanation

Call provisions give the issuer the right (but not the obligation) to retire all or a part of an issue prior to maturity. If the bonds are "called," the bondholder has no choice but to turn in his bonds. Call features give the issuer the opportunity to get rid of expensive (high coupon) bonds and replace them with lower coupon issues in the event that market interest rates decline during the life of the issue.

Call provisions do not pertain to maturity. A put provision gives the *bondholders* certain rights regarding early payment of principal.

References

Question From: Session 15 > Reading 51 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #29 of 69

Question ID: 415445

Which of the following bond covenants is considered *negative*?

- ✓ **A)** No additional debt.
- X **B)** Payment of taxes.
- X **C)** Maintenance of collateral.

Explanation

Negative covenants set forth limitations and restrictions, whereas affirmative covenants primarily set forth administrative activities that the borrower promises to do.

References

Question From: Session 15 > Reading 51 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #30 of 69

Question ID: 434400

Which of the following statements regarding Eurobonds is *least accurate*? Eurobonds are:

- X **A)** issued in a currency other than the issuer's domestic currency.
- ✓ **B)** typically registered rather than bearer bonds.
- X **C)** issued simultaneously to investors in many countries.

Explanation

Eurobonds are typically bearer bonds rather than registered because they are issued outside the jurisdiction of any single country.

References

Question From: Session 15 > Reading 51 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #31 of 69

Question ID: 460681

Three bonds are identical in credit quality and all other respects except the following:

- Bond X: Noncallable, accelerated sinking fund.
- Bond Y: Callable, accelerated sinking fund.
- Bond Z: Noncallable, no sinking fund.

The correct order for these three bonds, from highest yield to lowest yield, is:

- ✓ **A)** Bond Y; Bond X; Bond Z.
- X **B)** Bond X; Bond Z; Bond Y.
- X **C)** Bond Y; Bond Z; Bond X.

Explanation

Bond Z has no provisions for early retirement (which are unfavorable for the bondholder, other things equal), so it should yield the lowest. Bond X is noncallable, but allows the issuer to redeem principal through an accelerated sinking fund. Bond Y has an accelerated sinking fund and is callable, giving the issuer the most flexibility, and therefore requiring the highest yield.

References

Question From: Session 15 > Reading 51 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #32 of 69

Question ID: 653094

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

- ✓ **A)** next trading day after the trade.
- X **B)** second trading day after the trade.
- X **C)** third 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 52 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #33 of 69

Question ID: 415452

To reduce the cost of long-term borrowing, a corporation with a below average credit rating could:

- ✓ **A)** issue securitized bonds.
- X **B)** issue commercial paper.
- X **C)** decrease credit enhancement.

Explanation

Commercial paper is only issued by corporations with top credit ratings. Decreasing credit enhancements increase the cost of borrowing.

References

Question From: Session 15 > Reading 51 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #34 of 69

Question ID: 415462

The coupon rate of a fixed income security is stated as 90-day LIBOR plus 125 basis points. This security is *most accurately* described as a(n):

- ✓ **A)** floating-rate note.
- X **B)** reference-rate note.
- X **C)** variable-rate note.

Explanation

A floating-rate note has a coupon rate based on a market-determined reference rate such as 90-day LIBOR. Typically the coupon rate will be stated as a margin above the reference rate. A variable-rate note has a margin above the reference rate that is not fixed over the life of the note. An index-linked bond has a coupon payment or principal amount that adjusts based on the value of a published index such as an equity market, commodity, or inflation index.

References

Question From: Session 15 > Reading 51 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #35 of 69

Question ID: 415472

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

- X **A)** overnight LIBOR.
- X **B)** 1-year LIBOR.
- ✓ **C)** 30-day 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 52 > LOS b

Related Material:

- Key Concepts by LOS
-

Question #36 of 69

Question ID: 415457

Consider a floating rate issue that has a coupon rate that is reset on January 1 of each year. The coupon rate is defined as one-year London Interbank Offered Rate (LIBOR) + 125 basis points and the coupons are paid semi-annually. If the one-year LIBOR is 6.5% on January 1, which of the following is the semi-annual coupon payment received by the holder of the issue in that year?

- ☐ A) 7.750%.
- ☒ B) 3.875%.
- ☐ C) 3.250%.

Explanation

This value is computed as follows:

Semi-annual coupon = (LIBOR + 125 basis points) / 2 = 3.875%

References

Question From: Session 15 > Reading 51 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #37 of 69

Question ID: 460680

Which of the following embedded bond options tends to benefit the borrower?

- ☐ A) Conversion option.
- ☐ B) Put option.
- ☒ C) Interest rate cap.

Explanation

The interest rate cap benefits the borrower who issues a floating rate bond. The cap places a restriction on how high the coupon rate can become during a rising interest rate environment. Therefore, the floating rate borrower is protected against ever-rising interest rates.

References

Question From: Session 15 > Reading 51 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #38 of 69

Question ID: 415455

Which of the following statements with regard to floating rate notes that have caps and floors is *most* accurate?

- X **A)** A floor is a disadvantage to both the issuer and the bondholder while a cap is an advantage to both the issuer and the bondholder.
- ✓ **B)** A cap is a disadvantage to the bondholder while a floor is a disadvantage to the issuer.
- X **C)** A cap is an advantage to the bondholder while a floor is an advantage to the issuer.

Explanation

A cap limits the upside potential of the coupon rate paid on the floating rate bond and is therefore a disadvantage to the bondholder. A floor limits the downside potential of the coupon rate and is therefore a disadvantage to the bond issuer.

References

Question From: Session 15 > Reading 51 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #39 of 69

Question ID: 415440

Which of the following fixed income securities is classified as a money market security?

- X **A)** Security issued 18 months ago that will mature in six months.
- X **B)** Security issued six months ago that will mature in one year.
- ✓ **C)** Newly issued security that will mature in one year.

Explanation

Money market securities have original maturities of one year or less. Fixed income securities originally issued with maturities longer than one year are classified as capital market securities.

References

Question From: Session 15 > Reading 51 > LOS a

Related Material:

- Key Concepts by LOS
-

Question #40 of 69

Question ID: 460679

PRC International just completed a \$234 million floating rate convertible bond offering. As stated in the indenture, the interest rate on the bond is the lesser of 90-day LIBOR or 10%. The indenture also requires PRC to retire \$5.6 million per year with the option to retire as much as \$10 million. Which of the following embedded options is *most likely* to benefit the investor? The:

- ✓ **A)** conversion option on the convertible bonds.
- X **B)** 10% cap on the floating interest rate.
- X **C)** accelerated sinking fund provision for principal repayment.

Explanation

The conversion privilege is an option granted to the bondholder. The cap benefits the issuer. The accelerated sinking fund might reduce the investor's default risk, but the conversion option is the most likely benefit to the investor.

References

Question From: Session 15 > Reading 51 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #41 of 69

Question ID: 415469

The indenture of a callable bond states that the bond may be called on the first business day of any month after the first call date. The call option embedded in this bond is a(n):

- ✓ **A)** Bermuda style call option.
- X **B)** American style call option.
- X **C)** European style call option.

Explanation

A bond with a Bermuda style embedded call option may be called on prespecified dates after the first call date. A European style embedded call option specifies a single date on which a bond may be called. With an American style embedded call option, a bond may be called any time after its first call date.

References

Question From: Session 15 > Reading 51 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #42 of 69

Question ID: 415480

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

- X **A)** non-sovereign government bonds.
- X **B)** quasi-government bonds.
- ✓ **C)** supranational 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 52 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #43 of 69

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)** reserve swap rate.
- X **B)** interbank lending 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 52 > LOS h

Related Material:

- Key Concepts by LOS
-

Question #44 of 69

Question ID: 415454

Securitized bonds are *most likely* to be issued by:

- X **A)** banking institutions.
- ✓ **B)** special purpose entities.
- X **C)** supranational entities.

Explanation

The issuer of a securitized bond is typically a special purpose entity (SPE), also known as a special purpose vehicle (SPV) or special purpose company (SPC). An SPE is formed specifically to purchase and administer assets that will provide the cash flows to pay interest and principal on bonds the entity issues. These bonds are called securitized bonds.

References

Question From: Session 15 > Reading 51 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #45 of 69

Question ID: 415450

Which of the following is *least likely* an example of external credit enhancements?

- ☐ A) Letters of credit.
- ☐ B) Bank guarantees.
- ☒ C) Excess spread.

Explanation

Excess spread is an example of internal, not external credit enhancement.

References

Question From: Session 15 > Reading 51 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #46 of 69

Question ID: 415471

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

- ☒ A) investment grade bonds.
- ☐ B) money market securities.
- ☐ C) developed market bonds.

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 52 > LOS a

Related Material:

- Key Concepts by LOS
-

Question #47 of 69

Question ID: 415485

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

- X **A)** trading of negotiable certificates of deposit.
- ✓ **B)** unsecured short-term loans from one bank to another.
- X **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 52 > LOS h

Related Material:

- Key Concepts by LOS
-

Question #48 of 69

Question ID: 415474

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

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

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 52 > LOS c

Related Material:

- Key Concepts by LOS

Question #49 of 69

Question ID: 415482

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

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

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 52 > LOS g

Related Material:

- Key Concepts by LOS
-

Question #50 of 69

Question ID: 487761

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

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

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 52 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #51 of 69

Question ID: 415461

A bond whose periodic payments are all equal is said to have a(n):

- X **A)** balloon structure.
- X **B)** bullet structure.
- ✓ **C)** amortizing structure.

Explanation

Only a fully amortizing structure features payments that are all equal. A bullet structure pays a series of equal coupons but the final coupon is paid at the same time as the bond's principal. A final payment that includes a lump sum in addition to the last interest payment is referred to as a balloon payment.

References

Question From: Session 15 > Reading 51 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #52 of 69

Question ID: 415456

Allcans, an aluminum producer, needs to issue some debt to finance expansion plans, but wants to hedge its bond interest payments against fluctuations in aluminum prices. Jerrod Price, the company's investment banker, suggests a commodity index floater. This type of bond is *least likely* to provide which of the following advantages?

- X **A)** The bond's coupon rate is linked to the price of aluminum.
- ✓ **B)** Allows Allcans to set coupon payments based on business results.
- X **C)** Payment structure helps protect Allcan's credit rating.

Explanation

The coupon rate is set in the bond agreement (indenture) and cannot be changed unilaterally. Non-interest rate indexed floaters are indexed to a commodity price such as oil or aluminum. Business results could be impacted by numerous factors other than aluminum prices.

Both of the other choices are true. By linking the coupon payments directly to the price of aluminum (meaning that when aluminum prices increase, the coupon rate increases and vice versa), the non-interest index floater allows Allcans to protect its credit rating during adverse circumstances.

References

Question From: Session 15 > Reading 51 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #53 of 69

Question ID: 415463

Consider \$1,000,000 par value, 10-year, 6.5% coupon bonds issued on January 1, 20X5. The market rate for similar bonds is currently 5.7%. A sinking fund provision requires the company to redeem \$100,000 of the principal each year. Bonds called under the terms of the sinking fund provision will be redeemed at par. A bondholder would:

- ☐ **A)** prefer to have her bonds called under the sinking fund provision.
- ☐ **B)** be indifferent between having her bonds called under the sinking fund provision or not called.
- ☒ **C)** prefer not to have her bonds called under the sinking fund provision.

Explanation

With the market rate currently below the coupon rate, the bonds will be trading at a premium to par value. Thus, a bondholder would prefer not to have her bonds called under the sinking fund provision.

References

Question From: Session 15 > Reading 51 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #54 of 69

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

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 52 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #55 of 69

Question ID: 415466

As compared to an equivalent noncallable bond, a callable bond's yield should be:

- ☐ **A)** lower.

X **B)** the same.

✓ **C)** higher.

Explanation

A callable bond favors the issuer. Hence, the value of the bond is discounted by the value of the option, which means the yield will be higher.

References

Question From: Session 15 > Reading 51 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #56 of 69

Question ID: 434399

Restrictions on asset sales and borrowings most accurately describe:

X **A)** neutral covenants.

X **B)** affirmative covenants.

✓ **C)** negative covenants.

Explanation

Negative covenants are restrictions on a borrower's actions. Affirmative covenants are actions a borrower is required to take. There is no category known as neutral covenants.

References

Question From: Session 15 > Reading 51 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #57 of 69

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*:

X **A)** non-investment grade.

X **B)** a corporate bond.

✓ **C)** relatively illiquid.

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 52 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #58 of 69

Question ID: 415442

Which of the following contains the overall rights of the bondholders?

- X **A)** Covenant.
- ✓ **B)** Indenture.
- X **C)** Rights offering.

Explanation

An indenture specifies the rights of bondholders and the obligations of the issuer. Covenants are specific provisions within the indenture. A rights offering is typically associated with an equity security.

References

Question From: Session 15 > Reading 51 > LOS b

Related Material:

- Key Concepts by LOS
-

Question #59 of 69

Question ID: 415486

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

- X **A)** lower repo rate and higher repo margin.
- ✓ **B)** lower repo rate and repo margin.
- X **C)** higher 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 52 > LOS i

Related Material:

- Key Concepts by LOS
-

Question #60 of 69

Question ID: 415459

Which of the following statements regarding a sinking fund provision is *most* accurate?

- ✓ **A)** It requires that the issuer retire a portion of the principal through a series of principal payments over the life of the bond.
- X **B)** It requires that the issuer set aside money based on a predefined schedule to accumulate the cash to retire the bonds at maturity.
- X **C)** It permits the issuer to retire more than the stipulated amount if they choose.

Explanation

A sinking fund actually retires the bonds based on a schedule. This can be accomplished through either payment of cash or through the delivery of securities. An accelerated sinking fund provision allows the company to retire more than is stipulated in the indenture, but not all sinking fund provisions allow this.

References

Question From: Session 15 > Reading 51 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #61 of 69

Question ID: 415451

Which of the following is a general problem associated with external credit enhancements? External credit enhancements:

- X **A)** are very long-term agreements and are therefore relatively expensive.
- ✓ **B)** are subject to the credit risk of the third-party guarantor.
- X **C)** are only available on a short-term basis.

Explanation

If the guarantor is downgraded, the issue itself could be subject to downgrade even if the structure is performing as expected.

References

Question From: Session 15 > Reading 51 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #62 of 69

Question ID: 627889

Which of the following entities play a critical role in the ability to create a securitized bond with a higher credit rating than the corporation?

- ✓ **A)** Special purpose entities.
- X **B)** Rating agencies.
- X **C)** Investment banks.

Explanation

Special purpose entities (SPEs), buy the assets from the corporation. The SPE separates the assets used as collateral from the corporation that is seeking financing. This shields the assets from other creditors.

References

Question From: Session 15 > Reading 51 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #63 of 69

Question ID: 496427

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

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

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 52 > LOS b

Related Material:

- Key Concepts by LOS
-

Question #64 of 69

Question ID: 460682

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

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

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 52 > LOS c

Related Material:

- Key Concepts by LOS
-

Question #65 of 69

Question ID: 415453

Which of the following issues is *most accurately* described as a eurobond?

- X **A)** South Korean firm's euro-denominated bonds sold to investors in the European Union.
- ✓ **B)** Brazilian firm's U.S. dollar-denominated bonds sold to investors in Canada.
- X **C)** European Union firm's Japanese yen-denominated bonds sold to investors in Japan.

Explanation

Eurobonds are denominated in a currency other than that of the countries in which they are issued. The name "eurobond" does not imply that a bond is sold in Europe or by a European issuer, or denominated in the euro currency. A U.S. dollar-denominated bond sold to investors outside the United States is called a "eurodollar bond."

References

Question From: Session 15 > Reading 51 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #66 of 69

Question ID: 415470

Fixed income classifications by geography *most likely* include:

- X **A)** municipal bonds.
- X **B)** supranational 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 52 > LOS a

Related Material:

- Key Concepts by LOS
-

Question #67 of 69

Question ID: 415467

As compared to an equivalent nonputtable bond, a puttable bond's yield should be:

- X **A)** higher.
- ✓ **B)** lower.
- X **C)** the same.

Explanation

A puttable bond favors the buyer (investor). Hence, a premium will be paid for the option, which means the yield will be lower.

References

Question From: Session 15 > Reading 51 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #68 of 69

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?

- ✓ **A)** Term maturity structure.
- X **B)** Amortizing maturity structure.
- X **C)** Serial 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 52 > LOS g

Related Material:

- Key Concepts by LOS
-

Question #69 of 69

Question ID: 434403

Treasury Inflation Protected Securities, which provide investors with protection against inflation by adjusting the par value and keeping the coupon rate fixed, are *best* described as:

- X **A)** interest-indexed bonds.
- ✓ **B)** capital-indexed bonds.
- X **C)** indexed-annuity bonds.

Explanation

Indexed bonds that adjust the principal value while keeping the coupon rate fixed are best described as capital-indexed bonds. Interest-indexed bonds adjust the coupon rate. Indexed-annuity bonds are fully amortizing with the payments adjusted.

References

Question From: Session 15 > Reading 51 > LOS e

Related Material:

- Key Concepts by LOS