CHAPTER 40

FIXED-INCOME MARKETS ISSUANCE TRADING AND FUNDING

1. (A) **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.

   (Study Session 13, Module 40.2, LOS 40.j)

   Related Material

   SchweserNotes - Book 4

2. (C) **unsecured short-term loans from one bank to another.**

   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.

   (Study Session 13, Module 40.2, LOS 40.i)

   Related Material

   SchweserNotes - Book 4

3. (C) **A medium-term note (MTN) is a corporate bond with an original maturity of 2 to 10 years.**

   Explanation

   The name "medium-term note" does not imply anything about the original maturity of the security.

   For Further Reference:

   (Study Session 13, Module 40.2, LOS 40.g)n 13, Module 39.1, LOS 39.d)

   Related Material

   SchweserNotes - Book 4

4. (B) **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.

   (Study Session 13, Module 40.2, LOS 40.g)

   Related Material

   SchweserNotes - Book 4

5. (C) **have less liquidity than long-term bonds of the same issuer.**

Explanation

As they are most often custom debt instruments, medium-term notes typically have less liquidity than a regular bond issue from the same issuer. Medium-term notes can have any maturity and are sold through agents.

For Further Reference:

(Study Session 13, Module 40.2, LOS 40.g)

CFA® Program Curriculum, Volume 4, page 489

Related Material

SchweserNotes - Book 4

6. (A) **private placement.**

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.

(Study Session 13, Module 40.1, LOS 40.c)

Related Material

SchweserNotes - Book 4

7. (B) **maturity.**

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.

(Study Session 13, Module 40.1, LOS 40.b)

Related Material

SchweserNotes - Book 4

8. (A) **next 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).

(Study Session 13, Module 40.1, LOS 40.d)

Related Material

SchweserNotes - Book 4

9. (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).

(Study Session 13, Module 40.1, LOS 40.d)

Related Material

SchweserNotes - Book 4

10. (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.

(Study Session 13, Module 40.2, LOS 40.h)

Related Material

SchweserNotes - Book 4

11. (A) for less than their par value.

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.

(Study Session 13, Module 40.2, LOS 40.h)

Related Material

SchweserNotes - Book 4

12. (A) 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.

(Study Session 13, Module 40.1, LOS 40.a)

Related Material

SchweserNotes - Book 4

13. (A) 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.

(Study Session 13, Module 40.2, LOS 40.j)

Related Material

SchweserNotes - Book 4

14. (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). 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).

(Study Session 13, Module 40.1, LOS 40.d)

Related Material

SchweserNotes - Book 4

15. (C) supranational bonds.

Explanation

Supranational bonds are issued by multilateral organizations such as the IMF.

Quasi-government bonds are issued by agencies established or sponsored by national government.

Non-sovereign government bonds are issued by state, provincial, and local government or municipal entities..

(Study Session 13, Module 40.1, LOS 40.f)

Related Material

SchweserNotes - Book 4

16. (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.

(Study Session 13, Module 40.1, LOS 40.d)

Related Material

SchweserNotes - Book 4

17. (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.

(Study Session 13, Module 40.1, LOS 40.c)

Related Material

SchweserNotes - Book 4

18. (A) 30-day LIBOR.

Explanation

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

(Study Session 13, Module 40.1, LOS 40.b)

Related Material

SchweserNotes - Book 44

19. (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.

(Study Session 13, Module 40.2, LOS 40.j)

Related Material

SchweserNotes - Book 4

20. (A) 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.

(Study Session 13, Module 40.2, LOS 40.g)

Related Material

SchweserNotes - Book 4

21 (A) capital protected 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.

(Study Session 13, Module 40.2, LOS 40.h)

Related Material

SchweserNotes - Book 4

22. (A) 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.

(Study Session 13, Module 40.2, LOS 40.i)

Related Material

SchweserNotes - Book 4

23. (C) its liquidity, but not its credit quality.

Explanation

Bond dealers' bid-ask spreads depend primarily on the liquidity of an issue. Spreads are narrower for highly liquid issues and wider for less liquid issues. Credit quality and liquidity are both reflected in yield spreads.

For Further Reference:

(Study Session 13, Module 40.1, LOS 40.d)

CFA® Program Curriculum, Volume 4, page 480

Related Material

SchweserNotes - Book 4

24. (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.

(Study Session 13, Module 40.2, LOS 40.g)

Related Material

SchweserNotes - Book 4

25. (A) 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.

(Study Session 13, Module 40.1, LOS 40.c)

Related Material

SchweserNotes - Book 4

26. (B) 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.

(Study Session 13, Module 40.1, LOS 40.e)

Related Material

SchweserNotes - Book 4

27. (A) 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.

(Study Session 13, Module 40.1, LOS 40.b)

Related Material

SchweserNotes - Book 4

28. (A) 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.

(Study Session 13, Module 40.1, LOS 40.a)

Related Material

SchweserNotes - Book 4