

Reading 49**FIXED-INCOME INSTRUMENT
FEATURES**

1. (C) **6% 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.

(Module 49.1, LOS 49.a)

2. (A) **A zero coupon bond may sell at a premium to par when interest rates decline.**

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 if it has a positive yield.

(Module 49.1, LOS 49.a)

3. (A) **£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.

(Module 49.1, LOS 49.a)

4. (B) **negative covenants.**

Explanation

Negative covenants are prohibitive in nature, such as restrictions on asset sales and additional borrowings.

Affirmative or positive covenants are actions a borrower is required to take and are often administrative in nature, for example to comply with relevant laws and regulations or to insure and maintain assets.

(Module 49.1, LOS 49.b)

5. (A) **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.

(Module 49.1, LOS 49.b)

6. (A) 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.

(Module 49.1, LOS 49.a)

7. (B) Indenture.

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.

(Module 49.1, LOS 49.b)

8. (C) identity of the lender.

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.

(Module 49.1, LOS 49.b)

9. (B) 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.

(Module 49.1, LOS 49.b)

10. (A) price is greater than its par value.

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.

(Module 49.1, LOS 49.a)

11. (B) No additional debt.

Explanation

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

(Module 49.1, LOS 49.b)

