QBank Quiz December 1, 2017

Test ID: 59459484

Question #1 of 240

Question ID: 605008

A newly-issued municipal bond pays interest on March 1 and September 1. If the bond has a dated date of August 1, 2011, the bondholder's first interest payment (payable on March 1, 2012) would include interest for a period of:

- ✓ **A)** 7 months.
- ✗ **B)** 6 months.
- ✗ **C)** 1 month.
- ✗ **D)** 4 months.

Explanation

From the dated date of August 1, 2011, to the first payment date of March 1, 2012, is 7 months.

Reference: 2.7.1 in the License Exam Manual

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Question ID: 604819

A call premium is *best* described as the amount the:

- ✗ **A)** common stock is above the conversion price.
- ✗ **B)** bondholder receives at maturity.
- ✗ **C)** investor pays above par value.
- ✓ **D)** issuer pays above par to redeem the bonds early.

Explanation

When bonds are called at a premium, the issuer redeems them before maturity at a price exceeding par. The call premium is the difference between the call price and par.

Reference: 2.1.7.1.3 in the License Exam Manual

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Question ID: 604883

In which of the following will a change in interest rates cause the greatest price fluctuation?

- ✗ **A)** Series EE bond.
- ✗ **B)** 7% AA rated 1-year municipal note.
- ✗ **C)** 7% AAA rated corporate bond with 8 years until maturity.
- ✓ **D)** 7% 30-year U.S. Treasury bond.

Explanation

Price fluctuations are the greatest in bonds with the longest terms to maturity. The more risky the instrument, the more price volatility. Long-term bonds have greater risk than short-term bonds.

Reference: 2.2.7.6 in the License Exam Manual

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Question ID: 604820

A bond would be considered speculative below which of the following Standard & Poor's (S&P) ratings?

- ✓ **A)** BBB.
- ✗ **B)** BB.
- ✗ **C)** B.
- ✗ **D)** A.

Explanation

A rating of BBB is the lowest investment-grade rating assigned by Standard & Poor's. Any rating beneath this is considered speculative.

Reference: 2.1.6.1.1 in the License Exam Manual

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Question ID: 786002

One of your customers buys a new issue municipal revenue bond on March 19. The trade settles on March 21, and the bond pays interest on February 1 and August 1. If the dated date of the bond is March 1, how many days of accrued interest are due?

✗ **A)** 19
✗ **B)** 24
✗ **C)** 55
✓ **D)** 20

Explanation

Interest started accruing from the dated date of the bond (March 1). Interest accrues up to, but not including, settlement. Therefore, 20 days of accrued interest are due. The customer's first interest payment, the following August, will represent interest that has accrued from the dated date.

Reference: 2.7.1 in the License Exam Manual

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Question ID: 604886

An inverted yield curve is the result of:

✗ **A)** investors buying short-term bonds and selling long-term bonds.
✗ **B)** investors moving from equities to debt instruments.
✗ **C)** investors moving from debt instruments to equity instruments.
✓ **D)** investors buying long-term bonds and selling short-term bonds.

Explanation

When investors believe that interest rates may decline soon, they seek to lock in the current rate of return by buying long-term bonds. Increased demand increases the price and causes the yields on long-term debt instruments to fall. In addition, selling short-term bonds depresses prices, causing yields to rise. As a result, the yield curve takes on a negative slope. Short-term yields are then higher than long-term yields, which is the definition of an inverted curve.

Reference: 2.2.7.5 in the License Exam Manual

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Question ID: 604974

If an investor watches the latest T-bill auction fall to 4.71% from 4.82%, the *best* interpretation is that:

✓ **A)** investors who purchased bills at this auction paid more for them than purchasers last week.
✗ **B)** the federal funds rate and other short-term interest rate indicators are probably rising.
✗ **C)** investors who purchased T-bills 12 weeks ago paid less than subsequent purchasers.
✗ **D)** the decline in yields indicates the Federal Reserve Board has raised the discount rate.

Explanation

The rates on the T-bills fell, so prices rose and the investor paid more for the bills this week than last week. The decline in yields indicates there was good demand for the securities because the price rose, driving the yields down. The question does not indicate the price of T-bills 12 weeks ago; it is unclear if the investor paid less for the T-bills then. The federal funds rate and other short-term interest rates would decline, not rise, in line with those of T-bills.

Reference: 2.6.1.1.2 in the License Exam Manual

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Question ID: 604872

Which of the following statements regarding the economics of fixed-income securities are TRUE?

I. Short-term interest rates are more volatile than long-term rates.
II. Long-term interest rates are more volatile than short-term rates.
III. Short-term bond prices react more than long-term bond prices given a change in interest rates.
IV. Long-term bond prices react more than short-term bond prices given a change in interest rates.

- ✗ **A)** II and IV.
- ✗ **B)** II and III.
- ✓ **C)** I and IV.
- ✗ **D)** I and III.

Explanation

There are two separate issues in this question: the volatility of rates and volatility of bond prices. Short-term rates are more volatile than long-term rates and move more quickly than long-term rates. Often the most volatile interest rate is the federal funds rate, which is an overnight rate of interest. Given a change in rates, long-term bond prices move more than short-term bond prices because of the compounding effect over a much longer period.

Reference: 2.2.7.6 in the License Exam Manual

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Question ID: 604900

If LMN, Inc. has filed for bankruptcy, in what order would interested parties be paid?

1. Holders of secured debt.
2. Holders of subordinated debentures.
3. General creditors.
4. Preferred stockholders.

- ✗ **A)** 4, 1, 2, 3.
- ✗ **B)** 3, 1, 2, 4.
- ✓ **C)** 1, 3, 2, 4.
- ✗ **D)** 1, 2, 3, 4.

Explanation

The liquidation order is as follows: the IRS (and other government agencies), secured debt holders, unsecured debt holders and general creditors, holders of subordinated debt, preferred stockholders, and common stockholders.

Reference: 2.3.2.3 in the License Exam Manual

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Question ID: 604917

Reggie owns a convertible bond that converts into 20 shares of common stock. The current market value of the bond was 118-½ at the close on Friday, April 1. A 30-day call is announced prior to the opening on Monday, April 4, at a price of 102. The stock is trading at $57.75. What should Reggie do?

- ✗ **A)** Sell the bond
- ✗ **B)** Hold the bond to maturity
- ✓ **C)** Convert the bond into the stock
- ✗ **D)** Redeem the bond at the call price

Explanation

Reggie will not be allowed to hold the bond to maturity because it is being called. The real question is whether he should sell the bond, allow it to be called, or convert it to the underlying stock. Now that the call has been announced, the market value of the bond will fall to meet the call price. This occurs as a result of declining demand. (Who wants to buy a bond that is about to be called at a lower price?) Thus, redeeming the bond at the call price and selling the bond would both yield the same results: $1,000 × 102% = $1,020. If he converts the bond, he will get the following results: 20 shares × $57.75 = $1,155. Therefore, it makes the best sense to convert the bond.

Reference: 2.5.2.5 in the License Exam Manual

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Question ID: 604942

An investor interested in monthly interest income should invest in:

- ✗ **A)** Treasury bonds.
- ✓ **B)** GNMAs.
- ✗ **C)** corporate bonds.
- ✗ **D)** utility company stock .

Explanation

GNMAs pay monthly interest and principal, treasury bonds pay semiannual interest, utility stocks pay quarterly dividends, and corporate bonds pay semiannual interest.

Reference: 2.6.2.3.1 in the License Exam Manual

Question #12 of 240

Question ID: 604910

Bond trust indentures are required for:

- ✗ **A)** Treasury securities.
- ✗ **B)** municipal general obligation bonds.
- ✓ **C)** corporate debt securities.
- ✗ **D)** municipal revenue bonds.

Explanation

Municipal and government bonds are exempt from the trust indenture requirement of the Trust Indenture Act of 1939. Revenue bonds are frequently issued with a trust indenture, but no legal requirement to do so exists. The Trust Indenture Act of 1939 requires that corporate bond issues of $50 million or more sold interstate must be issued with a trust indenture.

Reference: 2.4 in the License Exam Manual

Question #13 of 240

Question ID: 604834

Defeasement can be *best* described as a:

- ✗ **A)** refinancing.
- ✗ **B)** refundment.
- ✓ **C)** prerefunding.
- ✗ **D)** matched sale.

Explanation

Pre-refunding involves issuing one bond to call an outstanding bond at a future date. When this is done, the money raised is held in escrow to redeem the outstanding bonds at a future call date. What was originally pledged to back the bonds is now replaced by the escrowed funds. The issuer no longer has to show these bonds as an obligation on its debt statement. This is known as defeasement. The escrowed funds are invested in U.S. government securities.

Reference: 2.1.7.3 in the License Exam Manual

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Question ID: 604833

If a bond has a call provision, this will tend to:

- ✗ **A)** place a floor on how low the price will decline.
- ✗ **B)** make the bond more attractive to investors because most bonds are called at a premium.
- ✓ **C)** make the bond less attractive to investors because a call would terminate the interest payments.
- ✗ **D)** have no effect on the price.

Explanation

Callability is unattractive to the investor. It is attractive to the issuer because, with a call, the bonds are bought back at par or a small premium, and interest payments end.

Reference: 2.1.7.1.6 in the License Exam Manual

Question #15 of 240

Question ID: 604966

All of the following statements regarding Treasury bills are correct EXCEPT

- ✗ **A)** Treasury bills are a direct obligation of the U.S. government
- ✗ **B)** Treasury bills trade at a discount to par
- ✗ **C)** 4, 13 and 26 week maturities are typical with the maximum sometimes changing
- ✓ **D)** most Treasury bill issues are callable

Explanation

Treasury bills trade at a discount to par and are 4, 13, or 26 weeks in original maturity (maximum maturities are subject to change). They are a direct obligation of the U.S. government and are noncallable.

Reference: 2.6.1.1 in the License Exam Manual

Question #16 of 240

Question ID: 604950

The function of the Federal National Mortgage Association (FNMA) is to:

- ✓ **A)** purchase FHA-insured, VA-guaranteed, and conventional mortgages.
- ✗ **B)** guarantee the timely payment of interest and principal on FHA and VA mortgages.
- ✗ **C)** provide financing for government-assisted housing.
- ✗ **D)** issue conventional mortgages.

Explanation

The FNMA buys FHA, VA, and conventional mortgages and uses them to back the issuance of debt securities. FNMA currently issues debentures, mortgage-backed securities, and certificates.

Reference: 2.6.2.6 in the License Exam Manual

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Question ID: 604801

Which of the following statements regarding puttable bonds is TRUE?

- ✗ **A)** The bondholder can expect to receive a premium over par if he chooses to put the bonds.
- ✗ **B)** The put feature is likely to be exercised when interest rates are falling.
- ✓ **C)** Their yields are usually lower than those of nonputtable bonds.
- ✗ **D)** The issuer may require that the put feature be exercised if interest rates drop significantly.

Explanation

A put feature is advantageous to the bondholder, and therefore carries with it a lower yield. Exercise of the put feature is at the discretion of the bondholder, not the issuer, and will most likely be used if interest rates are rising.

Reference: 2.1.7.5 in the License Exam Manual

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Question ID: 605014

On February 13, your customer buys an 8% Treasury bond maturing in 2009 for settlement on February 14. If the bonds pay interest on January 1 and July 1, how many days of accrued interest are added to the buyer's price?

- ✗ **A)** 14.
- ✓ **B)** 44.
- ✗ **C)** 43.

- ✗ **D)** 45.

Explanation

Accrued interest for government bonds is figured on an actual-days-elapsed basis. The number of days begins with the previous coupon date and continues up to, but not including, the settlement date. The bonds pay interest on January 1. There are 31 days of accrued interest for January. The bonds settle February 14. There are 13 days of accrued interest for February. Do not count the settlement date (31 + 13 = 44 days).

Reference: 2.7.2.1.2 in the License Exam Manual

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Question ID: 604996

Which of the following is NOT considered a short-term investment vehicle?

- ✓ **A)** Treasury bonds.
- ✗ **B)** Commercial paper.
- ✗ **C)** Repurchase agreements.
- ✗ **D)** Negotiable CDs.

Explanation

Treasury bonds are long-term investment vehicles having maturities of ten years or more.

Reference: 2.6.1.3 in the License Exam Manual

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Question ID: 604829

A corporation plans to make a public tender for 50% of its outstanding subordinated debentures. The price of the tender will be set by the:

- ✗ **A)** trustee.
- ✗ **B)** transfer agent.
- ✗ **C)** paying agent.
- ✓ **D)** issuer.

Explanation

In a tender offer, the issuer is offering to buy back all or a portion of the issue at a stated price. The price of the tender is set by the issuer although the issuer may engage an underwriter to help it set the price.

Reference: 2.1.7.4 in the License Exam Manual

Question #21 of 240

Question ID: 605000

Treasury bills (T-bills) are auctioned by the U.S. Treasury

- ✓ **A)** weekly
- ✗ **B)** bi-monthly
- ✗ **C)** only when the U.S. Treasury Department deems it necessary
- ✗ **D)** monthly

Explanation

Treasury bills (T-bills) are auctioned by the U.S. Treasury weekly.

Reference: 2.6.1.1.1 in the License Exam Manual

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Question ID: 604919

A bond convertible at $50 is selling at 105% of parity, while the common stock has a current market value of $45. What is the market value of the bond?

✓ **A)** $945.
✗ **B)** $900.
✗ **C)** $1,000.
✗ **D)** $1045.

Explanation

Each $1,000 bond would allow conversion into 20 shares of stock ($1,000 divided by $50). Parity is 20 × $45 (CMV) or $900; 105% of parity is $945.

Reference: 2.5.2.5 in the License Exam Manual

Question #23 of 240

Question ID: 604805

A 7% bond is selling to yield 4-½%. The next time interest is paid, an investor who owns $10,000 face amount of the bonds will receive:

✗ **A)** $700.
✗ **B)** $450.
✗ **C)** $225.
✓ **D)** $350.

Explanation

The bond is a 7% bond. The total amount paid each year on 10 bonds is $700. The amount paid for a 6 month's interest is $350.

Reference: 2.1.2 in the License Exam Manual

Question #24 of 240

Question ID: 604864

Currently, a company issues 5% Aaa/AAA debentures at par. Two years ago, the corporation issued 4% AAA-rated debentures at par. Which of the following statements regarding the outstanding 4% issue are TRUE?

I. The dollar price per bond will be higher than par.
II. The dollar price per bond will be lower than par.
III. The current yield on the issue will be higher than the coupon.
IV. The current yield on the issue will be lower than the coupon.

✓ **A)** II and III.
✗ **B)** II and IV.
✗ **C)** I and IV.
✗ **D)** I and III.

Explanation

Interest rates in general have risen since the issuance of the 4% bonds, so the bond's price will be discounted to produce a higher current yield on the bonds. Remember that as interest rates go up, the price of outstanding debt securities goes down.

Reference: 2.2.7.6 in the License Exam Manual

Question #25 of 240

Question ID: 604918

KLM Company has 10 million convertible bonds outstanding that are convertible at $25. The bonds contain an anti-dilution feature. If KLM declares a 10% stock dividend, the new conversion price will be:

✗ **A)** $22.50.
✓ **B)** $22.73.
✗ **C)** $50.00.
✗ **D)** $45.45.

Explanation

Before the stock dividend, an investor would have received 40 shares of stock for each $1,000 bond ($1,000 / $25). A 10% stock dividend would now give an investor 44 shares on conversion (40 shares + 10% = 4 shares more). $1,000 / 44 shares = $22.73 per share for the new conversion price.

Reference: 2.5.2.4 in the License Exam Manual

Question #26 of 240

Question ID: 604997

Which of the following agencies approves private lending institutions to issue bonds that are backed by the full faith and credit of the US government?

- ✓ **A)** GNMA.
- ✗ **B)** FNMA.
- ✗ **C)** FHLMC.
- ✗ **D)** FGIC.

Explanation

GNMA stands for Government National Mortgage Association. GNMA bonds are issued by private lending institutions approved by GNMA and are backed by the full faith and credit of the US government. They are considered to be default risk-free.

Reference: 2.6.2.3 in the License Exam Manual

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Question ID: 786003

Ten municipal bonds were purchased with 9% nominal yield for settlement on February 1, 2005. The maturity date of the bonds is July 1, 2020. What is the number of days of accrued interest on the 10-bond trade?

- ✗ **A)** 31
- ✗ **B)** 37
- ✓ **C)** 30
- ✗ **D)** 29

Explanation

The maturity month and day will always match one of the two semiannual coupon dates. Since maturity is July 1, the bond pays interest on January 1 and July 1 of each year. With settlement on February 1, the bond accrued interest from January 1 up to but not including settlement (30 days).

Reference: 2.7.1 in the License Exam Manual

Question #28 of 240

Question ID: 604979

A quote of 6.20 bid 6.18 offered would *most* likely be a quote on a:

- ✗ **A)** T-bond.
- ✓ **B)** T-bill.
- ✗ **C)** GO bond.
- ✗ **D)** Ginnie Mae bond.

Explanation

Discounted instruments (such as T-bills) are quoted on a discount yield basis. Even though the number representing the bid is higher than the ask, it would be lower when converted into dollars. The greater the yield, the lower the price.

Reference: 2.6.1.1.2 in the License Exam Manual

Question #29 of 240

Question ID: 604963

Which of the following is NOT true regarding Treasury Receipts?

- ✗ **A)** Treasury securities held in trust collateralize the Receipts.

✗ **B)** They pay interest at maturity.

✓ **C)** Interest income is taxed at maturity.

✗ **D)** They are not backed by the faith and credit of the U.S. government.

Explanation

Unlike Treasury STRIPS, which are issued directly by the U.S. government, Treasury Receipts are indirect obligations of the government. Treasury Receipts are issued by investment bankers who buy Treasury securities, place them in trust at a bank, and sell separate receipts against the principal and interest payments. Like most zeroes, interest must be accreted and taxed annually even though it is not received until maturity.

Reference: 2.6.1.4 in the License Exam Manual

Question #30 of 240

Question ID: 604792

In comparing long-term and short-term bonds, all of the following are characteristics of long-term bonds EXCEPT that they:

✗ **A)** usually have higher yields.

✗ **B)** will fluctuate in price more in response to interest rate changes.

✓ **C)** usually provide greater liquidity.

✗ **D)** are more likely to be callable.

Explanation

Long-term bonds are not as liquid as short-term obligations.

Reference: 2.1.6.4 in the License Exam Manual

Question #31 of 240

Question ID: 604899

Which of the following regarding corporate debentures are TRUE?

I. They are certificates of indebtedness.
II. They give the bondholder ownership in the corporation.
III. They are unsecured bonds issued to finance capital expenditures or to raise working capital.
IV. They are the most senior security a corporation can issue.

✗ **A)** II and IV.

✓ **B)** I and III.

✗ **C)** III and IV.

✗ **D)** I and II.

Explanation

Debentures are debt securities that represent unsecured loans of the issuer. They are senior to common and preferred stock in claims against an issuer. They are issued to finance capital expenditures or raise working capital.

Reference: 2.3.2.1 in the License Exam Manual

Question #32 of 240

Question ID: 604930

ABC Company issues a 10% bond due in 10 years. The bond is convertible into ABC common stock at a conversion price of $25 per share. The ABC bond is quoted at 90. Parity of the common stock is:

✗ **A)** $36.00.

✗ **B)** $100.00.

✗ **C)** $25.00.

✓ **D)** $22.50.

Explanation

The bond is quoted at 90, so it is selling for $900. The parity price of the common stock is $22.50, calculated as follows: the bondholder could convert the bond into 40 shares of stock ($1,000 face amount / $25 per share = 40 shares). Because the bond has a current price of $900, divide $900 by 40 to get the underlying parity price (90% × $25 = $22.50).

Reference: 2.5.2.5 in the License Exam Manual

Question #33 of 240

Question ID: 605005

All of the following trade flat EXCEPT:

- ✓ **A)** negotiable CDs.
- ✗ **B)** commercial paper.
- ✗ **C)** T-bills.
- ✗ **D)** bankers' acceptances.

Explanation

While most money-market securities are zeroes and trade flat, negotiable CDs do trade with accrued interest.

Reference: 2.7 in the License Exam Manual

Question #34 of 240

Question ID: 604869

What would likely happen to the market value of existing bonds during an inflationary period coupled with rising interest rates?

- ✓ **A)** The price of the bonds would decrease.
- ✗ **B)** The price of the bonds would stay the same.
- ✗ **C)** The nominal yield of the bonds would increase.
- ✗ **D)** The price of the bonds would increase.

Explanation

Bond prices fall when interest rates rise because bond prices have an inverse relationship with interest rates.

Reference: 2.2.7.6 in the License Exam Manual

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Question ID: 604894

An investor seeking a high level of income combined with a moderate level of risk would purchase:

- ✗ **A)** income bonds.
- ✓ **B)** mortgage bonds.
- ✗ **C)** junk bonds.
- ✗ **D)** convertible bonds.

Explanation

Bonds provide a semiannual stream of fixed income. Because convertible bonds normally have a lower coupon rate than nonconvertible bonds-and income bonds only pay interest if the company declares a payment-the best choice is the mortgage bond, which is secured by real estate.

Reference: 2.3.1.1 in the License Exam Manual

Question #36 of 240

Question ID: 604798

All of the following statements regarding a 6% municipal bond that is puttable at par are true EXCEPT the:

- ✗ **A)** owner will receive $1,000 from the issuer when the put option is exercised.
- ✗ **B)** bond may be put to the issuer at the owner's discretion.
- ✗ **C)** owner would likely put the bond to the issuer when interest rates are rising.
- ✓ **D)** bond is likely to trade at a discount in the secondary market when it is puttable.

Explanation

Once a bond becomes puttable, the holder has the right to put the bond to the issuer at par. As a result, the bond would not trade below par in the secondary market. This effectively insulates the holder from interest rate risk-the risk that rising rates will force prices down.

Reference: 2.1.7.5 in the License Exam Manual

Question #37 of 240

Question ID: 604882

A corporate bond with a nominal yield of 6% is currently trading at a yield to maturity (YTM) of 5.8%. It would be accurate to state that this bond is trading at

- ✗ **A)** parity.
- ✓ **B)** a premium.
- ✗ **C)** a discount.
- ✗ **D)** par.

Explanation

If YTM is less than the nominal or coupon yield, the bond is trading at a premium.

Reference: 2.2.7.3 in the License Exam Manual

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Question ID: 604821

The terminology "guaranteed full faith and credit" is *most* applicable to:

- ✗ **A)** interest only on a U.S. government issued bond.
- ✗ **B)** interest and principal on a municipal revenue bond.
- ✗ **C)** interest and principal on a corporate bond.
- ✓ **D)** interest and principal on a U.S. government issued bond.

Explanation

Of the choices given, the terminology would be most applicable to both interest and principal on a U.S. government bond. Remember that the U.S. government's guarantee is backed by their authority to tax and print money. While corporate bonds can be backed by the issuer's full faith and credit, the guarantee is only as good as the corporation's ability to pay. Municipal revenue bonds are backed by the expected revenue generated from the project being financed.

Reference: 2.1.1 in the License Exam Manual

Question #39 of 240

Question ID: 604863

A customer buys an 8% bond on an 8.20 basis. If the bond is callable in 5 years at par and matures in 10 years, which of the following statements is TRUE?

- ✗ **A)** Nominal yield is higher than YTC.
- ✓ **B)** YTC is higher than YTM.
- ✗ **C)** YTC is lower than YTM.
- ✗ **D)** Nominal yield is higher than YTM.

Explanation

A bond with a YTM (basis) greater than its coupon is trading at a discount. When a bond is trading at a discount, the YTC is greater than the YTM. Nominal yield is lower than both YTM and YTC.

Reference: 2.2.7.3 in the License Exam Manual

Question #40 of 240

Question ID: 785999

A municipal A & O bond is issued on October 1, 2010 with a 10-year stated maturity. If a trade in this bond settles on April 1, 2017, how many days' worth of accrued interest will be added to the price of the bond?

✓ **A)** Zero
✗ **B)** 1
✗ **C)** 180
✗ **D)** 90

Explanation

Interest on a municipal bond begins to accrue on the previous payment date and ends the day before settlement date. Always assume a bond pays interest on the 1st of the month unless told differently. In this case, interest is payable on April and Oct. 1st each year. Whenever a bond trade settles on a payment date, it trades flat (without accrued interest).

Reference: 2.7.2 in the License Exam Manual

Question #41 of 240

Question ID: 604799

Seventy-five basis points are equal to which of the following?
I. .75%.
II. 7.5%.
III. $7.50.
IV. $75.00.

✗ **A)** II and III.
✓ **B)** I and III.
✗ **C)** II and IV.
✗ **D)** I and IV.

Explanation

There are 100 basis points in each point. One point represents 1% of a bond's value therefore one basis point represents .01% and 75 basis points would represent .75%. Because each point is worth $10, 75 basis points represents $7.50.

Reference: 2.1.5.1 in the License Exam Manual

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Question ID: 604837

Mr. Donald, an analyst, is comparing two discounted 8% AA bonds. Both have 20 years to maturity. One of the bonds is callable in 4 years and the other is callable in 9 years. If interest rates fall, which will have the greatest increase in price?

✓ **A)** The bond with the 9-year call.
✗ **B)** Both will decrease the same.
✗ **C)** The bond with the 4-year call.
✗ **D)** Both will increase the same.

Explanation

All bond prices move inversely in response to changes in interest rates (i.e., rates go down and prices go up), but they do not all respond to the same degree. The rule is that, all else being equal, a bond with a long maturity will have a greater change in price than a shorter maturity bond, given the same change in interest rates.

Reference: 2.2.7.6 in the License Exam Manual

Question #43 of 240

Question ID: 604924

XYZ Corporation has outstanding a 7% convertible bond currently trading at 102. The bond, which has a conversion price of $50, was issued with an antidilution covenant. If XYZ declares a 10% stock dividend, the new conversion price, as of the ex-date, will be:

✗ **A)** $55.00.
✓ **B)** $45.45.
✗ **C)** $45.00.
✗ **D)** $55.55.

Explanation

To compute a new conversion price, divide the current conversion price by 100% plus the percent increase in shares. $50 / 110% = $45.45.

Reference: 2.5.2.4.1 in the License Exam Manual

Question #44 of 240

Question ID: 604857

Current yield on an 8-1/4% Treasury bond at 104.24 is:

- ✗ **A)** 7.75%.
- ✓ **B)** 7.88%.
- ✗ **C)** 7.91%.
- ✗ **D)** 8.08%.

Explanation

Current yield on a bond is computed by dividing the annual interest by the market price. Here, the annual interest is $82.50 and the market price of the bond is $1,047.50. Therefore, $82.50 / $1,047.50 = 7.88%. A quote of 104.24 for a T-bond represents a price of $1,047.50 computed as a percentage of par in 32nds of one bond point as follows; 104.24 is 104% of par = $1,040 and 24/32nds of one bond point ($10) = $7.50. $1040 + $7.50 = $1047.50.

Reference: 2.2.7.2 in the License Exam Manual

Question #45 of 240

Question ID: 604789

An investor sells 10 5% bonds at a profit and buys another 10 bonds with a 5-1/4% coupon rate. The investor's yearly return will increase by:

- ✗ **A)** $2.00 per bond.
- ✓ **B)** $2.50 per bond.
- ✗ **C)** $1.00 per bond.
- ✗ **D)** $1.50 per bond.

Explanation

The first bonds are 5% and pay $50 per year per bond. The new bonds are 5-1/4% and pay $52.50 per year per bond, for a difference of $2.50 per bond.

Reference: 2.1.5 in the License Exam Manual

Question #46 of 240

Question ID: 604795

All of the following statements regarding bonds with both a convertible and callable feature are correct EXCEPT:

- ✗ **A)** after the call redemption date, interest payments will cease.
- ✗ **B)** the coupon rate on a convertible bond would be less than the rate for comparable nonconvertible debt.
- ✗ **C)** dilution of company stock will occur on conversion of the bonds.
- ✓ **D)** if called, the owners have the option of retaining the bonds and will continue to receive interest.

Explanation

After bonds are called, the issuer no longer pays interest. Conversion of convertible bonds causes more shares outstanding, resulting in a reduced proportionate ownership interest (dilution) for current shareholders. The coupon rate paid on convertible bonds is lower than the coupon for nonconvertible bonds. There is a trade-off in the amount of interest for the ability to convert the bonds into common stock.

Reference: 2.1.7.1.6 in the License Exam Manual

Question #47 of 240

Question ID: 604854

A callable municipal bond maturing in 30 years is purchased at 102. The bond is callable at par in 15 years. If the bond is called at the first call date, the effective yield earned on the bond is:

- ✗ **A)** higher than the yield to maturity.
- ✓ **B)** lower than the yield to maturity.
- ✗ **C)** the same as the yield to maturity.
- ✗ **D)** not determinable.

Explanation

If the bond is trading at a premium and it is called before maturity, the loss of the premium is compressed into a shorter period of time. This reduces the effective yield on the bond. If the bond is called, the effective yield is the yield to call.

Reference: 2.2.7.4 in the License Exam Manual

Question #48 of 240

Question ID: 604937

A customer purchases an ABC 6-½% convertible preferred stock at $80. The conversion price is $20. If the common stock is trading 2 points below parity, the price of ABC common is:

- ✗ **A)** $16.
- ✗ **B)** $18.
- ✓ **C)** $14.
- ✗ **D)** $12.

Explanation

The conversion ratio is computed by dividing par value by the conversion price ($100 par / $20 = 5). Parity price of the common stock is computed by dividing the market price of the convertible by the conversion ratio ($80 / 5 = $16). $16 − 2 = $14.

Reference: 2.5.2.5 in the License Exam Manual

Question #49 of 240

Question ID: 604842

A bond has a 7% coupon and an offering price of 102. Which of the following yields could be the yield to maturity for this bond?

- ✗ **A)** 0.0709.
- ✓ **B)** 0.0655.
- ✗ **C)** 0.0702.
- ✗ **D)** 0.0707.

Explanation

For a bond trading at a premium, the ranking of yields from lowest to highest is: YTC, YTM, current yield, and nominal yield. Therefore, the YTM for this bond must be less than the nominal yield.

Reference: 2.2.7.3 in the License Exam Manual

Question #50 of 240

Question ID: 604840

A condition in which long-term debt instruments have higher yields than short-term debt instruments is also called a:

- ✗ **A)** negative yield curve.
- ✓ **B)** positive yield curve.
- ✗ **C)** flat yield curve.
- ✗ **D)** inverted curve.

Explanation

A chart showing a curve with long-term debt instruments having higher yields than short-term debt instruments is often referred to as a positive yield curve.

Reference: 2.2.7.5 in the License Exam Manual

Question #51 of 240

Question ID: 604844

Six percent XYZ debentures are trading for $1,200. Other similarly rated bonds are being offered at 4.5%. What is the current yield on the 6% XYZ debentures?

- ✓ **A)** 5%.
- ✗ **B)** 6%.
- ✗ **C)** 1.5%.
- ✗ **D)** 7.5%.

Explanation

Current yield is defined as the annual income (or coupon rate) from a bond divided by the bond's current market price. Accordingly, $60 / $1,200 = .05 × 100 = 5%. The current yield will be lower than the coupon rate when the bond is trading at a premium.

Reference: 2.2.7.2 in the License Exam Manual

Question #52 of 240

Question ID: 604808

If a bond has a basis price of 7%, which of the following would *most* likely be refunded?

- ✗ **A)** Coupon 7-½%, maturing in 2033, callable in 2013 at 103.
- ✗ **B)** Coupon 6-½%, maturing in 2033, callable in 2013 at 103.
- ✓ **C)** Coupon 7-½%, maturing in 2033, callable in 2013 at 100.
- ✗ **D)** Coupon 6-½%, maturing in 2033, callable in 2013 at 100.

Explanation

An issuer is most likely to refund the issue that will cost it the most money over the life of the issue. Always use the following order in making this choice: (1) highest coupon, (2) lowest call premium, (3) earliest call date, and (4) longest maturity.

Reference: 2.1.7.2 in the License Exam Manual

Question #53 of 240

Question ID: 604813

If a customer buys bonds that have already been called, the trade confirmation must disclose all of the following EXCEPT:

- ✗ **A)** the redemption price.
- ✗ **B)** the yield to call.
- ✓ **C)** the yield to original maturity.
- ✗ **D)** the redemption date.

Explanation

Once a bond has been called, the yield to original maturity is no longer a factor and need not be on the confirmation.

Reference: 2.1.7.1.2 in the License Exam Manual

Question #54 of 240

Question ID: 604807

A newly issued bond cannot be called for the first five years after it is issued. This call protection feature would be most valuable to bondholders if during this five-year period, interest rates are generally:

- ✗ **A)** rising.
- ✗ **B)** stable.
- ✗ **C)** fluctuating.
- ✓ **D)** falling.

Explanation

Issuers generally call bonds when interest rates are falling so they can reduce their interest cost (the same concept as a homeowner refinancing a mortgage). During a call protection period, bonds cannot be called, so the investor will continue to receive the coupon rate of interest. This protects the bondholder from losing a relatively high rate of fixed income until the call protection period ends.

Reference: 2.1.7.1.5 in the License Exam Manual

Question #55 of 240

Question ID: 604880

The current yield on a bond with a coupon rate of 7.5% currently selling at 105-½ is approximately:

- ✗ **A)** 8%.
- ✗ **B)** 6.5%.
- ✗ **C)** 7.5%.
- ✓ **D)** 7.1%.

Explanation

A bond with a coupon rate of 7.5% pays $75 of interest annually. Current yield equals annual interest amount divided by bond market price, or $75 / $1,055 = 7.109%, or approximately 7.1%.

Reference: 2.2.7.2 in the License Exam Manual

Question #56 of 240

Question ID: 604938

All of the following debt instruments pay interest semiannually EXCEPT:

- ✓ **A)** Ginnie Mae pass-through certificates.
- ✗ **B)** municipal General Obligation bonds.
- ✗ **C)** industrial development bonds.
- ✗ **D)** municipal revenue bonds.

Explanation

Ginnie Maes pay interest on a monthly basis, not semiannually.

Reference: 2.6.2.3.1. in the License Exam Manual

Question #57 of 240

Question ID: 604812

One of your clients owns 2 different 6% corporate bonds maturing in 15 years. The first bond is callable in 5 years, while the second has 10 years of call protection. If interest rates begin to fall, which bond is likely to show a greater change in price?

- ✗ **A)** Both will decrease by the same amount.
- ✓ **B)** Bond with the 10-year call.
- ✗ **C)** Bond with the 5-year call.
- ✗ **D)** Both will increase by the same amount.

Explanation

As interest rates fall, the investor benefits from having the highest interest rate for as long as possible. The price change will not be the same for both bonds. The greater the call protection, the more likely a bond will appreciate if rates fall.

Reference: 2.1.7.1.5 in the License Exam Manual

Question #58 of 240

Question ID: 605022

All of the following trade with accrued interest EXCEPT:

- ✓ **A)** zero-coupon bonds.

✗ **B)** Treasury bonds.

✗ **C)** convertible bonds.

✗ **D)** jumbo certificates of deposit.

Explanation

Zero-coupon bonds are issued at a deep discount from face value instead of providing semiannual interest payments. T-bonds, convertible bonds, and CDs all make periodic interest payments; thus the seller receives any accrued interest from the buyer.

Reference: 2.7.2.1.2 in the License Exam Manual

Question #59 of 240

Question ID: 604856

A respected analyst reports that last week's T-bill rate at 6% is lower than the rate for the preceding week and lower than the average for the past month. Which of the following is TRUE?

✗ **A)** The general level of interest rates is increasing.

✗ **B)** Prices are descending.

✓ **C)** Investors are paying more for T-bills.

✗ **D)** Investors are paying less for T-bills.

Explanation

When the rate is lower, the price has gone up; this means investors are paying more as interest rates are going down.

Reference: 2.2.7.6 in the License Exam Manual

Question #60 of 240

Question ID: 604990

Which of the following are a direct obligation of the U.S. government?

✗ **A)** Government bond mutual funds.

✓ **B)** Ginnie Maes.

✗ **C)** Fannie Maes.

✗ **D)** Treasury receipts.

Explanation

Direct debt is backed in full by the U.S. government. The Government National Mortgage Association is owned by the U.S. government; thus, Ginnie Maes are fully backed. Treasury receipts are zero-coupons based on U.S. government debt instruments but are created and issued by broker/dealers and, as such, are not direct obligations of the U.S. government.

Reference: 2.6.2.3 in the License Exam Manual

Question #61 of 240

Question ID: 605019

If an investor were to purchase a bond in the secondary market, which of the following would factor in calculating the total dollar amount paid for the bond?

I. Settlement date.
II. Dated date.
III. Coupon.
IV. Scale.

✗ **A)** II and IV.

✗ **B)** II and III.

✓ **C)** I and III.

✗ **D)** I and IV.

Explanation

Accrued interest is part of a bond transaction's total dollar amount. To calculate the accrued interest, you must know the settlement date.

Reference: 2.7 in the License Exam Manual

Question #62 of 240

Question ID: 604991

A customer buys a 6% Treasury bond, maturing in 10 years, at a price of 91.07. The yield to maturity is:

- ✗ **A)** same as current yield.
- ✗ **B)** less than nominal yield.
- ✗ **C)** less than current yield.
- ✓ **D)** greater than nominal yield.

Explanation

A bond whose price is below par or at a discount has a higher yield to maturity than current yield, which in turn is higher than the nominal yield.

Reference: 2.6.1.3.2 in the License Exam Manual

Question #63 of 240

Question ID: 604831

A corporation with a single outstanding bond issue chooses to refund this debt. This means that the corporation:

- ✗ **A)** established a sinking fund for use in making regular open market purchases of the bonds.
- ✗ **B)** issues stock to replace the bonds.
- ✗ **C)** buys back the bonds, at par, from the bondholders, using corporate profits.
- ✓ **D)** replaces one debt with another.

Explanation

Refunding is synonymous with refinancing. When we refinance, we take out a new debt and use the proceeds of that debt to pay off the old one.

Reference: 2.1.7.2 in the License Exam Manual

Question #64 of 240

Question ID: 604957

Which of the following statements regarding U.S. government agency obligations are TRUE?

I. They are direct obligations of the U.S. government.
II. They generally have higher yields than direct U.S. obligations.
III. The Federal National Mortgage Association (FNMA) is a publicly traded corporation.
IV. Securities issued by the Government National Mortgage Association (GNMA) trade on the NYSE floor.

- ✓ **A)** II and III.
- ✗ **B)** I and III.
- ✗ **C)** II and IV.
- ✗ **D)** I and II.

Explanation

U.S. government agency debt is an obligation of the issuing agency. This obligation causes agency debt to trade at slightly higher yields that reflect this greater risk. FNMA securities and GNMA pass-through certificates trade OTC. GNMA is the only agency whose securities are direct U.S. government obligations.

Reference: 2.6.2 in the License Exam Manual

Question #65 of 240

Question ID: 721397

The term "trading flat" means:

- ✗ **A)** the price of the bond has remained level.

- ✗ **B)** the bond is sold without markup or commission.
- ✗ **C)** the bond is in default.
- ✓ **D)** there is no accrued interest.

Explanation

When a bond trades flat, the buyer does not owe accrued interest to the seller. Trading flat means there is no accrued interest due. While it is true that a bond in default trades flat, one cannot say that the term trading flat means the bond is necessarily in default.

Reference: 2.7.2.1.2 in the License Exam Manual

Question #66 of 240

Question ID: 604933

A customer owns a 7-½% ABC convertible bond currently trading at 115. The conversion price is $40. What is the parity price of the common?

- ✓ **A)** $46.
- ✗ **B)** $28.75.
- ✗ **C)** $44.
- ✗ **D)** $34.

Explanation

To compute the parity price of common stock, divide the market price of the convertible bond by the conversion ratio. $1,150 / 25 (the number of common shares that the bond is convertible into) = $46 (115% × $40 = $46).

Reference: 2.5.2.5 in the License Exam Manual

Question #67 of 240

Question ID: 604936

An investor purchases a PQR convertible bond at 98 on June 18, 1994. The bond is convertible at $25, and on June 19, 1995, when the common stock is trading at $26 per share, the investor converts his bond into the stock. For tax purposes, these transactions will result in:

- ✗ **A)** a $40 capital loss.
- ✓ **B)** neither gain nor loss.
- ✗ **C)** a $40 capital gain.
- ✗ **D)** a $60 capital gain.

Explanation

The process of converting a convertible bond into common stock is not a taxable event. When the stock is sold, the taxable event occurs.

Reference: 2.5.2.3 in the License Exam Manual

Question #68 of 240

Question ID: 604889

The following is taken from the S&P Bond Guide:

FLB Zr 12 87 87-½.

What is the coupon rate on this bond?

- ✗ **A)** 0.12.
- ✗ **B)** 87.
- ✓ **C)** No coupon.
- ✗ **D)** 87.5.

Explanation

FLB is the issuer, Zr means zero-coupon, 12 indicates the year of maturity (2012), 87 is the bid price ($870), and 87-½ is the asked price ($875).

Reference: 2.3.5 in the License Exam Manual

Question #69 of 240

Question ID: 604861

A customer buys a 5% bond at par. The bond is callable in 5 years at par and matures in 10 years. Which of the following statements is TRUE?

- ✗ **A)** YTC is lower than YTM.
- ✓ **B)** YTC is the same as YTM.
- ✗ **C)** Nominal yield is higher than either YTM or YTC.
- ✗ **D)** YTC is higher than YTM.

Explanation

If a bond is trading at par, the nominal yield (coupon rate) = current yield = yield to maturity = yield to call. YTC is higher than YTM if the bond is trading at a discount to par. YTC is lower than YTM if the bond is trading at a premium over par. Nominal yield is higher than either YTM or YTC if the bond is trading at a premium over par.

Reference: 2.2.7.3 in the License Exam Manual

Question #70 of 240

Question ID: 604875

A customer purchases a 4% corporate bond yielding 5%. A year before the bond matures, new corporate bonds are issued at 3%, and the customer sells the 4% bond. Which of the following statements regarding the bond are TRUE?

I. The customer bought it at a discount.
II. The customer bought it at a premium.
III. The customer sold it at a premium.
IV. The customer sold it at a discount.

- ✓ **A)** I and III.
- ✗ **B)** II and III.
- ✗ **C)** II and IV.
- ✗ **D)** I and IV.

Explanation

A 4% bond yielding 5% has a YTM of 5%. If a bond's yield to maturity is higher than its coupon (or nominal yield), the bond is selling at a discount to par. If interest rates decline, new bonds will be issued with lower coupons, and outstanding bonds with higher coupons will trade at a premium.

Reference: 2.2.7.6 in the License Exam Manual

Question #71 of 240

Question ID: 604876

A bond offered at par has a coupon rate:

- ✗ **A)** less than its yield to maturity.
- ✗ **B)** greater than its yield to maturity.
- ✗ **C)** less than its current yield.
- ✓ **D)** equal to its current yield.

Explanation

When a bond is selling at par, its coupon or nominal rate, current yield, and yield to maturity are all the same.

Reference: 2.2.7.2 in the License Exam Manual

Question #72 of 240

Question ID: 604985

U.S. Treasury bills are issued for all of the following maturities EXCEPT:

✓ **A)** 8 weeks.
✗ **B)** 4 weeks.
✗ **C)** 13 weeks.
✗ **D)** 26 weeks.

Explanation

U.S. Treasury bills are issued with 4, 13, and 26-week maturities. There have been 52-week T- bills in the past, but there are no 8-week T-bills.

Reference: 2.6.1.1.1 in the License Exam Manual

Question #73 of 240

Question ID: 604925

A convertible corporate bond has been issued with an antidilution covenant. If the issuer declares a 5% stock dividend, which of the following are TRUE as of the ex-date?
I. Conversion ratio increases.
II. Conversion ratio decreases.
III. Conversion price increases.
IV. Conversion price decreases.

✗ **A)** II and IV.
✗ **B)** II and III.
✗ **C)** I and III.
✓ **D)** I and IV.

Explanation

The bond will be convertible into 5% more shares, so the conversion price will decrease in proportion. If the conversion price is lowered, the conversion ratio must increase.

Reference: 2.5.2.6 in the License Exam Manual

Question #74 of 240

Question ID: 604826

A corporate issuer has issued a new bond and escrowed the proceeds to be used to call in an existing bond issue as soon as the first call date for the existing bond is reached. Known as pre-refunding, the concept would be most closely associated with

✗ **A)** secondary offering
✗ **B)** amortization
✗ **C)** disintermediation
✓ **D)** defeasance

Explanation

When an issue is pre-refunded (advance refunded) with all of the funds needed to call it in as soon as the first call date is reached, the issue is known to be defeased. Because all of the capital needed to call in the existing bond has been escrowed and is available, the issue can now be removed from the issuer's debt statement.

Reference: 2.1.7.3 in the License Exam Manual

Question #75 of 240

Question ID: 604970

All of the following are characteristics of Treasury receipts EXCEPT:

✗ **A)** they are zero-coupon bonds.
✓ **B)** accumulated interest is not subject to federal taxation.
✗ **C)** the certificates may represent either the principal or the interest portion of the securities that were deposited with a trustee.
✗ **D)** they are stripped bonds.

Explanation

Treasury receipts are zero-coupon instruments, which are purchased at a discount and mature at face value. Although interest is not paid annually on receipts, investors receive a 1099 Original Issue Discount (OID) that reports the amount of interest imputed for that year. This interest must be reported to the IRS as taxable income.

Reference: 2.6.1.4 in the License Exam Manual

Question #76 of 240

Question ID: 803402

An investor purchases 5 Mt. Vernon Port Authority J & J bonds in a regular way transaction on Wednesday, October 18. How many days of accrued interest are added to the bond's price?

- ✗ **A)** 108
- ✗ **B)** 110
- ✗ **C)** 114
- ✓ **D)** 109

Explanation

Interest accrues on municipal bonds on a 360-day-year basis, with all months having 30 days. Therefore, July, August, and September each have 30 days of accrued interest and October has 19 days of accrued interest; this totals 109 days. Settlement date is Friday, October 20.

Reference: 2.7.2.1.1 in the License Exam Manual

Question #77 of 240

Question ID: 604897

Rank the following in order of payment at liquidation, from first to last.

I. Employee wages.
II. Preferred stock.
III. Subordinated debentures.
IV. Accrued taxes.

- ✗ **A)** III, IV, II, I.
- ✗ **B)** IV, III, I, II.
- ✗ **C)** III, IV, I, II.
- ✓ **D)** I, IV, III, II.

Explanation

When a corporation is liquidated, employee wages are paid first, followed by taxes, secured debt, debentures and general creditors, unsecured debt, subordinated debt, preferred stock, and common stock.

Reference: 2.3.2.3 in the License Exam Manual

Question #78 of 240

Question ID: 604832

Which of the following types of bonds would be characterized by decreasing interest costs to the issuer?

- ✗ **A)** Limited tax bonds.
- ✓ **B)** Serial bonds.
- ✗ **C)** Term bonds.
- ✗ **D)** Revenue bonds.

Explanation

Periodically, serial bonds pay off part of the principal through serial maturities. This eliminates the interest costs on the matured bonds.

Reference: 2.1.3.2 in the License Exam Manual

Question #79 of 240

Question ID: 604858

In a period of loose money, corporate bond prices:

- ✗ **A)** fluctuate.
- ✗ **B)** decrease.
- ✓ **C)** increase.
- ✗ **D)** stay the same.

Explanation

In a period of loose money, interest rates fall. When interest rates fall, bond prices rise.

Reference: 2.2.7.6 in the License Exam Manual

Question #80 of 240

Question ID: 604998

Treasury Inflation Protection Securities (TIPS) offer which of the following benefits to an investor?

I. Semiannual adjustments to principal based on the CPI.
II. A Guarantee of profit upon sale.
III. The interest payments will keep pace with inflation.
IV. TIPS provide investors with an income they can't outlive.

- ✗ **A)** II and III
- ✓ **B)** I and III
- ✗ **C)** III and IV
- ✗ **D)** I and II

Explanation

Treasury Inflation Protection Securities (TIPS), are issued by the government and designed to offer investors inflation protection by adjusting the principal of the TIPS semiannually based on the Consumer Price Index (CPI). In times of inflation the interest payments increase and they decrease during times of deflation. No security guarantees a profit upon sale and only an annuity can guarantee an income for life.

Reference: 2.6.1.5 in the License Exam Manual

Question #81 of 240

Question ID: 604939

Securities issued by private lending institutions approved by which of the following are directly backed by the federal government?

- ✗ **A)** Federal National Mortgage Association (FNMA).
- ✗ **B)** Federal Intermediate Credit Bank (FICB).
- ✗ **C)** Federal Home Loan Mortgage Corporation (FHLMC).
- ✓ **D)** Government National Mortgage Association (GNMA).

Explanation

The GNMA is a government agency backed by the full faith and credit of the federal government. The FNMA and FHLMC are government-sponsored corporations owned by public stockholders. FICB bonds are backed by the banks, not the U.S. government.

Reference: 2.6.2.3 in the License Exam Manual

Question #82 of 240

Question ID: 604852

During periods when the yield curve is normal, as market interest rates change, which is TRUE?

- ✗ **A)** There is no relationship between the relative price movements of short-term and long-term bonds.
- ✗ **B)** Short-term bond prices move more sharply.
- ✓ **C)** Long-term bond prices move more sharply.
- ✗ **D)** Both short-term and long-term bond prices move equally.

Explanation

Long-term bond prices are more volatile than similar short-term prices, in large part due to the added risk of owning a longer-term debt security.

Reference: 2.2.7.5 in the License Exam Manual

Question #83 of 240

Question ID: 604983

Which of the following choices lists Treasury bills, Treasury bonds, and Treasury notes in ascending order of maturity?

- ✗ **A)** Bonds, notes, bills.
- ✗ **B)** Notes, bills, bonds.
- ✗ **C)** Bills, bonds, notes.
- ✓ **D)** Bills, notes, bonds.

Explanation

Treasury bills have a maturity of less than 1 year, Treasury notes mature in 1 to 10 years, and Treasury bonds mature in 10 years or more.

Reference: 2.6.1 in the License Exam Manual

Question #84 of 240

Question ID: 604855

The current yield of a callable bond selling at a premium is calculated:

- ✗ **A)** to its maturity date.
- ✗ **B)** as a percentage of its par value.
- ✓ **C)** as a percentage of its market value.
- ✗ **D)** as a percentage of its call price.

Explanation

Current yield for any security is always computed on the basis of the current market value.

Reference: 2.2.7.2 in the License Exam Manual

Question #85 of 240

Question ID: 605013

Which of the following statements regarding a bond trading flat is NOT true?

- ✓ **A)** It may be traded with accrued interest.
- ✗ **B)** It may be an income bond.
- ✗ **C)** It may be a bond in default.
- ✗ **D)** It may have interest in arrears.

Explanation

A municipal or corporate bond trading flat is trading without accrued interest. The bond may be an income bond, which normally pays no interest, or it may be a bond currently paying no interest because it is in default.

Reference: 2.7.2.1.2 in the License Exam Manual

Question #86 of 240

Question ID: 604892

If ABC Corporation reports a loss for the year, it is obligated to pay interest on all of the following EXCEPT:

- ✗ **A)** nonconvertible bonds.
- ✓ **B)** adjustment bonds.
- ✗ **C)** convertible bonds.

✗ **D)** variable rate bonds.

Explanation

Even if a corporation reports a loss, the corporation is obligated to pay interest on all of its outstanding debt except for income (adjustment) bonds. Income, or adjustment bonds, require interest to be paid only if declared by the board of directors.

Reference: 2.3.4 in the License Exam Manual

Question #87 of 240

Question ID: 604878

Which of the statements below *best* describes why a normal yield curve is positively sloped?

✗ **A)** Stocks generally have lower yields than bonds, although their total returns may be higher.

✓ **B)** Investors demand higher interest when lending their money for longer periods.

✗ **C)** Short-term bonds generally fluctuate in price more than long-term bonds.

✗ **D)** Investors logically demand higher returns from government securities than they do from corporate securities.

Explanation

When the yield curve is positively sloped (and thus normal), long-term bonds carry higher interest rates than short-term bonds of the same quality.

Reference: 2.2.7.5 in the License Exam Manual

Question #88 of 240

Question ID: 604980

Which of the following statements are TRUE regarding Sallie Mae debentures?

I. Interest is generally paid monthly.
II. Interest is generally paid semiannually.
III. Interest is exempt from state and local taxation.
IV. Interest is not exempt from state and local taxation.

✗ **A)** I and III.

✗ **B)** I and IV.

✓ **C)** II and III.

✗ **D)** II and IV.

Explanation

As a general rule, debentures pay interest every six months. Further, interest on nonmortgage-backed government securities is taxable at the federal level and exempt from state and local taxation.

Reference: 2.6.2.7 in the License Exam Manual

Question #89 of 240

Question ID: 604952

Which of the following usually does NOT pay interest semiannually?

✓ **A)** GNMA.

✗ **B)** Treasury notes.

✗ **C)** Treasury bonds.

✗ **D)** Public utility bonds.

Explanation

GNMA pass-through certificates pay principal and the interest monthly. All other choices usually pay interest semiannually.

Reference: 2.6.2.3.1 in the License Exam Manual

Question #90 of 240

Question ID: 604969

Which of the following is a debt instrument that pays no periodic interest?

- ✗ **A)** GNMA.
- ✗ **B)** Treasury bond.
- ✗ **C)** Treasury note.
- ✓ **D)** STRIPS.

Explanation

STRIPS are Treasury bonds with the coupons removed. STRIPS do not make regular interest payments. Instead, they are sold at a deep discount and mature at par value.

Reference: 2.6.1.4.1 in the License Exam Manual

Question #91 of 240

Question ID: 604835

Your customer is interested in long-term corporate bonds. Which of the following interest-rate environments makes a call protection feature most valuable to your customer?

- ✓ **A)** Declining interest rates
- ✗ **B)** Stable interest rates
- ✗ **C)** Volatile interest rates
- ✗ **D)** Rising interest rates

Explanation

A call protection feature is an advantage to bondholders in periods of declining interest rates. When interest rates are falling, issuers are more likely to call in bonds previously issued at higher interest rates. For bondholders this creates reinvestment risk for them when the bonds are called as they are unlikely to be able to reinvest at the rate they had been earning. Call protection gives the bond holder a specified length of time during which the bond cannot be called.

Reference: 2.1.7.1.5 in the License Exam Manual

Question #92 of 240

Question ID: 604988

Which of the following statements regarding Treasury bills are TRUE?

I. They are sold in minimum denominations of $10,000.
II. They mature in 4, 13, or 26 weeks from issuance.
III. Their interest is exempt from taxation at the state level.
IV. They are callable by the U.S. Treasury at any time before maturity.

- ✗ **A)** II and IV.
- ✗ **B)** I and III.
- ✗ **C)** I and II.
- ✓ **D)** II and III.

Explanation

Treasury bills are sold in minimum denominations of $100 and are not callable before maturity. They mature in 4, 13, or 26 weeks from issuance and are sold at a discount. Interest on Treasury bills is taxable at the federal level only.

Reference: 2.6.1.1 in the License Exam Manual

Question #93 of 240

Question ID: 604984

Interest on direct debt issued by the U.S. government is taxable at:

- ✓ **A)** the federal level and exempt at the state level.
- ✗ **B)** the state level only.
- ✗ **C)** the federal and state level.

✗ **D)** different levels in different states.

Explanation

Interest on direct debt (T-bills, T-notes, T-bonds, and STRIPS) is taxable by the federal government but not by state or local governments.

Reference: 2.6 in the License Exam Manual

Question #94 of 240

Question ID: 604803

Twenty-five basis points on a par bond with 1 year to maturity are equal to:

I. $.25 per $1,000.
II. $2.50 per $1,000.
III. 0.25%.
IV. 2.5%.

✗ **A)** I and IV.
✗ **B)** II and IV.
✓ **C)** II and III.
✗ **D)** I and III.

Explanation

If 1 basis point equals .01%, 25 basis points equal .25%. .25% of $10 (which is the value of one full point for a bond) = $2.50.

Reference: 2.1.5.1 in the License Exam Manual

Question #95 of 240

Question ID: 721396

Debt instruments put up for auction by the U.S. treasury that offer intermediate maturities *best* describes:

✓ **A)** Treasury notes.
✗ **B)** Anticipation notes.
✗ **C)** Treasury bills.
✗ **D)** Treasury bonds.

Explanation

T-notes are the intermediate maturity (two to ten years). T-bills are short term (less than one year), Anticipation notes are short term revenue notes, and T-bonds are long term (ten years or more).

Reference: 2.6.1.2.1 in the License Exam Manual

Question #96 of 240

Question ID: 721389

Which of the following appreciates *most* during a period of falling interest rates?

✗ **A)** 7.4% coupon, 3-1/3 year maturity.
✗ **B)** 7% coupon, 2-7/8 year maturity.
✗ **C)** 7.2% coupon, 3 year maturity.
✓ **D)** 7.6% coupon, 3-1/2 year maturity.

Explanation

Although all bonds would appreciate in value as a result of falling interest rates, bonds with longer maturities experience a greater appreciation than do shorter maturities. While lower coupon bonds tend to be more price sensitive the overriding factor will first be length of time to maturity.

Reference: 2.2.7.6 in the License Exam Manual

Question #97 of 240

Question ID: 604953

Which of the following is NOT part of the Federal Farm Credit System?

- ✗ **A)** The Federal Bank for Cooperatives.
- ✗ **B)** The FICB.
- ✗ **C)** The Federal Land Banks.
- ✓ **D)** The Federal Home Loan Banks.

Explanation

The Federal Farm Credit Bank system is for farms, not homes.

Reference: 2.6.2.5 in the License Exam Manual

Question #98 of 240

Question ID: 604907

Bondholders may not take action against the corporation if it fails to make interest payments for:

- ✗ **A)** convertible bonds.
- ✓ **B)** income bonds.
- ✗ **C)** subordinated debentures.
- ✗ **D)** debentures.

Explanation

Income bonds pay interest only if earnings are sufficient and declared by the board of directors. This is not true of any of the other fixed-income securities listed (debentures, subordinated debentures, or convertible bonds).

Reference: 2.3.4 in the License Exam Manual

Question #99 of 240

Question ID: 604800

A city waterworks publishes a tombstone offering a $20 million new issue of bonds priced at 100.65%. The bonds are priced above par because the:

- ✗ **A)** amount exceeding par includes accrued interest.
- ✗ **B)** amount exceeding par represents the underwriter's spread.
- ✓ **C)** price reflects the fact that the coupon rate for the bonds at issuance is more than the rates of similar newly issued bonds available in the market.
- ✗ **D)** municipality has applied the standard municipal bond servicing charge to the issue price.

Explanation

If a bond issue is priced above par, it is usually because the coupon rate at which the bonds were issued is more than the prevailing rate for other newly issued bonds.

Reference: 2.1.5.1 in the License Exam Manual

Question #100 of 240

Question ID: 604895

Libby sees a tombstone advertisement for a new issue of Southwest Barge subordinated convertible debentures. The bonds will carry an 11-1/4% coupon, are convertible into common stock at $10.50, and are being issued to the public at 100. The proceeds of the issue will be used specifically for purchasing new Southwest barges. Libby's concerns about the issue could include:

- ✓ **A)** the issue may be junior-in-lien to another security issue.
- ✗ **B)** the new barges might sink, and the collateral would be gone.
- ✗ **C)** the company might demand that she accept common stock for her bond.
- ✗ **D)** she should not be concerned as the bonds will be first in liquidation.

Explanation

The word "subordinated" is the key to the question. A subordinated bond has other debt holders ahead of it in the event of liquidation. The barges do not serve as collateral as the bonds are identified as debentures, and having to convert to common stock is not a threat since she is the one that will, if she desires, exercise the conversion privilege.

Reference: 2.3.2.2 in the License Exam Manual

Question #101 of 240

Question ID: 604909

If a customer sells a zero-coupon bond before maturity, gain or loss will be the difference between sales proceeds and:

- ✗ **A)** original cost.
- ✗ **B)** par value.
- ✓ **C)** accreted value.
- ✗ **D)** discounted value.

Explanation

Zero-coupon bonds must be accreted for tax purposes. Each year, the annual accretion is taxable to the holder. In addition, the customer may adjust the cost basis of the zero upward by the amount of the annual accretion.

Reference: 2.3.5.2 in the License Exam Manual

Question #102 of 240

Question ID: 785997

A customer purchases a municipal bond in the secondary market and settles the trade in cash on August 1. If the next interest payment is September 1, which of the following statements regarding interest on this bond are TRUE?

I. The bond pays interest on March 1 and September 1 each year.
II. The seller must pay accrued interest no later than settlement day.
III. Accrued interest on this bond is computed using actual days elapsed.
IV. On September 1, the buyer will receive from the issuer interest for the period March 1 through August 31.

- ✓ **A)** I and IV
- ✗ **B)** I and III
- ✗ **C)** II and IV
- ✗ **D)** II and III

Explanation

Municipal bond accrued interest is calculated using a 30-day month and a 360-day year, with interest paid every 6 months. On settlement day, August 1, the buyer will pay the seller accrued interest from March 1 through July 31. Then on September 1, the next interest payment date, the buyer will receive 6 months' interest directly from the issuer.

Reference: 2.7.2 in the License Exam Manual

Question #103 of 240

Question ID: 604841

All of the following bonds have 5 years to go to maturity. Which would have the greatest price change in response to a change in interest rates?

- ✗ **A)** 7-½%, A rated, price 102.
- ✗ **B)** 7-½%, AA rated, price 108.
- ✗ **C)** 7-½%, BBB rated, price 95.
- ✓ **D)** 7-½%, B rated, price 88.

Explanation

Factors increasing a bond's response to an interest rate change include: time to go to maturity, distance from par, and lower rating. The bond with a lowest ratings (B) and farthest from par (88) would have the greatest price change.

Reference: 2.2.7.6 in the License Exam Manual

Question #104 of 240

Question ID: 604827

Which of the following would be considered funded debt?

- ✗ **A)** U.S. Treasury bonds maturing in 20 years.
- ✗ **B)** Municipal revenue bonds maturing in 10 years.
- ✓ **C)** Corporate debt maturing in 10 years.
- ✗ **D)** Commercial paper maturing in 270 days.

Explanation

Funded debt is simply another name for medium- to long-term corporate debt. If a corporate bond has 5 or more years to maturity, it is said to be funded debt of the issuer.

Reference: 2.1.1 in the License Exam Manual

Question #105 of 240

Question ID: 604959

Which of the following is NOT part of the Federal Farm Credit System (FFCS)?

- ✗ **A)** Federal Land Bank.
- ✗ **B)** Bank For Cooperatives.
- ✓ **C)** Federal Home Loan Bank.
- ✗ **D)** Federal Intermediate Credit Bank.

Explanation

The Federal Land Bank, Bank for Cooperatives, and Federal Intermediate Credit Bank are all parts of the FFCS. The Federal Home Loan Bank is not part of the FFCS.

Reference: 2.6.2.5 in the License Exam Manual

Question #106 of 240

Question ID: 604896

Which of the following corporate bonds is backed by other securities?

- ✓ **A)** Collateral trust bond.
- ✗ **B)** Equipment trust certificate.
- ✗ **C)** Mortgage bond.
- ✗ **D)** Debenture.

Explanation

Collateral trust bonds are backed by a portfolio of other securities; mortgage bonds are backed by real estate. Equipment trust certificates are backed by equipment. Debentures are backed only by the company's promise to pay.

Reference: 2.3.1.2 in the License Exam Manual

Question #107 of 240

Question ID: 604823

The following items are all correct statements regarding liquidity EXCEPT:

- ✓ **A)** it is the inability to find willing buyers for an asset.
- ✗ **B)** the most liquid of assets is cash.
- ✗ **C)** liquid assets include CDs and Treasury bills.
- ✗ **D)** a liquid asset can easily be converted to cash.

Explanation

Liquidity and marketability are often used synonymously. Liquidity is the ability to turn an asset into cash whereas marketability is the ability to easily find buyers for an asset. If an asset is easily marketable this would imply that it is also liquid.

Reference: 2.1.6.4 in the License Exam Manual

Question #108 of 240

Question ID: 785995

For both U.S. Treasury notes and Ginnie Maes

- ✗ **A)** interest is computed on an actual-day basis
- ✗ **B)** settlement is next business day
- ✓ **C)** quotes are as a percentage of par, in 32nds
- ✗ **D)** interest income is taxed at the federal level only

Explanation

Interest from U.S. T-notes is taxed at the federal level only, while interest on Ginnie Maes is taxed at all levels. GNMA bonds are treated like corporate bonds in many ways. T-notes settle next day; Ginnie Maes normally settle T+2. Interest on T-notes is computed on an actual day basis; Ginnie Mae interest is computed on a 30 day month/360 day year basis. Both Ginnie Maes and T-notes are quoted in 32nds.

Reference: 2.6.2.3.1 in the License Exam Manual

Question #109 of 240

Question ID: 604865

Which of the following expressions describes the current yield of a bond?

- ✗ **A)** Annual interest payment divided by par value.
- ✓ **B)** Annual interest payment divided by current market price.
- ✗ **C)** Yield to maturity divided by current market price.
- ✗ **D)** Yield to maturity divided by par value.

Explanation

The current yield on a bond is calculated by dividing the annual interest payment by the current market price of the bond.

Reference: 2.2.7.2 in the License Exam Manual

Question #110 of 240

Question ID: 785998

A new municipal bond issue had a dated date of January 1, 2015. The first coupon was due on August 1, 2015. The customer bought for settlement on September 1, 2015. How many months of accrued interest must he pay at settlement?

- ✗ **A)** 6 months
- ✓ **B)** 1 month
- ✗ **C)** 7 months
- ✗ **D)** 8 months

Explanation

The customer only owes interest from the August 1, 2015 coupon payment date up to but not including the September 1 settlement date (1 month).

Reference: 2.7.2.1 in the License Exam Manual

Question #111 of 240

Question ID: 604949

All of the following statements regarding Government National Mortgage Association (GNMA) pass-through securities are true EXCEPT

- ✓ **A)** GNMAs are considered to be the riskiest of the agency issues
- ✗ **B)** investors own an undivided interest in a pool of mortgages
- ✗ **C)** the minimum investment increment is $1,000
- ✗ **D)** investors receive a monthly check representing both interest and a return of principal

Explanation

GNMA securities, which are backed by the full faith and credit of the US government, are considered to be the safest of the agency issues.

Reference: 2.6.2.3.1. in the License Exam Manual

Question #112 of 240

Question ID: 604885

If all of the following bonds mature on September 1, 2020, which would have the highest price?

- ✗ **A)** 5-¾% coupon at 5.85
- ✓ **B)** 6-1/4% coupon at 6.10
- ✗ **C)** 5-½% coupon at 5.50
- ✗ **D)** 6-¾% coupon at 6.80

Explanation

A bond that is trading at a premium has a yield to maturity that is lower than its coupon rate. Of the choices given, only the 6-1/4% coupon with a 6.10 yield to maturity is trading at a premium. The other bonds shown are either trading at a discount (their yield to maturity is higher than the coupon rate) or at par (their yield to maturity is equal to the coupon rate).

Reference: 2.2.7.3 in the License Exam Manual

Question #113 of 240

Question ID: 604862

A 10-year bond, callable in 5 years at par, is sold at a discount. Rank the following yields from lowest to highest.

I. Nominal yield.
II. Current yield.
III. Yield to call.
IV. Yield to maturity.

- ✓ **A)** I, II, IV, III.
- ✗ **B)** II, I, IV, III.
- ✗ **C)** IV, II, III, I.
- ✗ **D)** I, II, III, IV.

Explanation

The lowest of all yields for a discount bond is the nominal yield (coupon rate), which is a fixed percentage of par. The highest possible return to the owner of a bond purchased at a discount would occur if the bond were called before maturity, because less time must elapse for the investor to receive the discount.

Reference: 2.2.7.3 in the License Exam Manual

Question #114 of 240

Question ID: 604902

You have a client who is about to retire and wants to rearrange his portfolio in order to have predictable income. Which of the following would NOT be a good investment vehicle?

- ✗ **A)** AA rated debenture.
- ✗ **B)** AA rated IDB.
- ✓ **C)** Income bonds.
- ✗ **D)** U.S. Treasury note.

Explanation

Income bonds, also known as adjustment bonds, are issued when a company is reorganizing and coming out of bankruptcy. Income bonds pay interest only if the company has enough income to meet the interest payment. As a result, these bonds normally trade flat, without accrued interest. Therefore, they are not suitable for customers seeking income.

Reference: 2.3.4 in the License Exam Manual

Question #115 of 240

Question ID: 604867

Three 3% bonds are listed in the newspaper. One bond will mature in one year, another bond will mature in ten years, and the third bond will mature in 20 years. If interest rates are going up, which bond will have the greatest decrease in value?

- ✗ **A)** The bond with the 10-year maturity.
- ✓ **B)** The bond with the 20-year maturity.
- ✗ **C)** They will all have the same decrease in value.
- ✗ **D)** The bond with the 1-year maturity.

Explanation

Long-term bonds have the greatest interest rate risk. A bond with only 1 year to maturity will trade very close to par.

Reference: 2.2.7.6 in the License Exam Manual

Question #116 of 240

Question ID: 604866

A 5% bond is trading at a premium. Which of the following would be the bond's highest yield?

- ✗ **A)** Current yield.
- ✗ **B)** Yield to maturity.
- ✓ **C)** Coupon yield.
- ✗ **D)** Dividend yield.

Explanation

If a bond is trading at a premium, its coupon rate will represent the highest of its yields. Bonds do not have a dividend yield.

Reference: 2.2.7.1 in the License Exam Manual

Question #117 of 240

Question ID: 604941

All of the following statements regarding government and agency securities are true EXCEPT:

- ✗ **A)** interest paid is always subject to federal income tax.
- ✗ **B)** they are authorized by Congress.
- ✓ **C)** they are always directly backed by the federal government.
- ✗ **D)** they are considered safer than corporate debt securities.

Explanation

Only GNMAs are directly backed by the federal government. FNMAs and FHLMCs are only indirectly backed but are still considered less risky than corporate debt. All are subject to federal taxation, and all were authorized by Congress.

Reference: 2.6.2 in the License Exam Manual

Question #118 of 240

Question ID: 604981

The accreted interest income from Treasury STRIPS is:

- ✓ **A)** taxed at the federal level.
- ✗ **B)** tax free.
- ✗ **C)** taxed at all levels.
- ✗ **D)** taxed at the state and local levels.

Explanation

Treasury STRIPS are government-issued zero-coupon bonds. The discount must be accreted each year (phantom income) and is taxed at the federal level only.

Reference: 2.6 in the License Exam Manual

Question #119 of 240

Question ID: 785996

A customer buys a new issue municipal bond with a dated date of January 1 for settlement on January 31. If the first interest payment date is March 1, how many days of accrued interest will the customer pay to the syndicate?

✓ **A)** 30
✗ **B)** 60
✗ **C)** 31
✗ **D)** Zero

Explanation

In this new issue, interest begins to accrue as of the dated date, so the customer (buyer) must pay the syndicate interest from the dated date up to, but not including, the settlement date. The number of days from January 1 up to, but not including, January 31 equals 30.

Reference: 2.7.1 in the License Exam Manual

Question #120 of 240

Question ID: 604790

A customer has 10 municipal bonds which each increased in yield by 1 basis point. For the 10 bond position this increase is equal to:

✗ **A)** $10.00.
✗ **B)** $0.50.
✗ **C)** $5.00.
✓ **D)** $1.00.

Explanation

In terms of bonds, a basis point is an increment of yield equal to $.10 per $1,000 face value. This equals .01% or 1/100%. A movement of 1 basis point is a movement of $.10 per bond × 10 bonds = $1.

Reference: 2.1.5.1 in the License Exam Manual

Question #121 of 240

Question ID: 604797

All of the following statements regarding municipal bond put options are true EXCEPT that the put option:

✗ **A)** protects the holder from a loss of principal when bond prices fall.
✓ **B)** is generally exercisable immediately after the bond has been issued.
✗ **C)** ensures that the holder will never receive less than par for the bond.
✗ **D)** protects the holder from depreciation because of rising interest rates.

Explanation

Put options are exercisable only after the put protection period has passed; this protects the issuer. Once puttable, the put feature isolates the bondholders from market risk-the risk that rising rates will force prices down.

Reference: 2.1.7.5 in the License Exam Manual

Question #122 of 240

Question ID: 604901

Which of the following securities is considered the *most* junior?

✗ **A)** Prior lien preferred stock.
✗ **B)** Debenture.
✗ **C)** Mortgage bond.
✓ **D)** Common stock.

Explanation

In the event of a company's bankruptcy, common stock owners have the lowest priority in claims against corporate earnings and assets. This identifies common stock as the most junior security.

Reference: 2.3.2.3 in the License Exam Manual

Question #123 of 240

Question ID: 604787

A customer bought a bond that yields 6-½% with a 5% coupon. If the bond matures at this point, the customer will receive:

- ✗ **A)** $1,050.
- ✓ **B)** $1,025.
- ✗ **C)** $1,000 plus a call premium.
- ✗ **D)** $1,065.

Explanation

Upon redemption of a bond, whatever current interest rates may be, the investor receives par ($1,000) plus the final semiannual interest payment ($25 in this case), for a total of $1,025.

Reference: 2.1.2 in the License Exam Manual

Question #124 of 240

Question ID: 721388

If interest rates increase, the interest payable on outstanding corporate bonds will:

- ✗ **A)** decrease.
- ✗ **B)** increase.
- ✓ **C)** remain unchanged.
- ✗ **D)** change according to the inverse payout theory.

Explanation

The interest payable is the nominal yield, which is stated on the face of the bond. It is the percentage of face value the bond will pay each year regardless of the prevailing interest rates in the market. It is the market price of bonds, not the interest payable, which responds inversely to changes in interest rates.

Reference: 2.2.7.6 in the License Exam Manual

Question #125 of 240

Question ID: 604847

An investor might expect to receive the greatest gain on an investment in a corporate bond by purchasing:

- ✗ **A)** short-term bonds when interest rates are low.
- ✓ **B)** long-term bonds when interest rates are high.
- ✗ **C)** short-term bonds when interest rates are high.
- ✗ **D)** long-term bonds when interest rates are low.

Explanation

If an investor purchases bonds when market interest rates are high, a drop in interest rates will lead to a corresponding increase in bond value. Long-term debt instruments will fluctuate to a greater degree than those with short-term interest rates. Thus, long-term debt offers the greater chance at gain.

Reference: 2.2.7.6 in the License Exam Manual

Question #126 of 240

Question ID: 604794

Which of the following *best* describes book entry?

- ✗ **A)** The transfer of ownership is entered only on the books of the buyer.
- ✓ **B)** The transfer of ownership is entered on the books of the issuer or the issuer's transfer agent.

- ✗ **C)** The transfer of ownership is entered on the books of the SRO.
- ✗ **D)** The transfer of ownership is entered on the books of the clearing agency.

Explanation

For book-entry ownership, transfers of ownership are accounting functions in the records of the issuer or the issuer's transfer agent.

Reference: 2.1.4.4 in the License Exam Manual

Question #127 of 240

Question ID: 604824

Expressed as a percentage of par, one basis point equals:

- ✗ **A)** 1/10 of 1%
- ✗ **B)** 1/1000 of 1%
- ✗ **C)** 10%
- ✓ **D)** 1/100 of 1%

Explanation

One basis point equals 1/100 of 1% of par. 1% of par ($1,000) equals $10, therefore one basis point equals 1/100 of $10 or $.10 (ten cents).

Reference: 2.1.5.1 in the License Exam Manual

Question #128 of 240

Question ID: 604828

When a corporation issues a long-term bond, one of the factors influencing the bond's interest rate is the credit rating of the issuer. Another factor is the:

- ✗ **A)** tax status of the bond.
- ✓ **B)** cost of money in the marketplace.
- ✗ **C)** par value of the bond.
- ✗ **D)** call loan rate.

Explanation

Money is a commodity, and its cost is determined by supply and demand. When the cost of money is higher, borrowers incur a higher interest rate. The call loan rate impacts broker/dealers, not issuers of bonds. The par value of the bond has nothing to do with the cost of borrowing and, with almost no exception, all corporate bonds pay taxable interest so that is not a variable factor.

Reference: 2.1.6.2 in the License Exam Manual

Question #129 of 240

Question ID: 604891

Which of the following debt instruments is unsecured?

- ✗ **A)** Junior lien mortgage bonds.
- ✗ **B)** Equipment trust certificates.
- ✗ **C)** Collateral trust certificates.
- ✓ **D)** Aaa/AAA rated debentures.

Explanation

Corporate debentures are unsecured bonds backed by the credit of the issuing corporation; they are not secured by underlying collateral. Mortgage bonds are secured with real estate serving as collateral. Collateral trust bonds are secured by securities that a corporation owns in other companies or bonds. Equipment trust certificates are secured by transportation equipment owned by the corporation.

Reference: 2.3.2.1 in the License Exam Manual

Question #130 of 240

Question ID: 604893

Equipment trust certificates are commonly issued by:

- ✓ **A)** transportation companies.
- ✗ **B)** political subdivisions.
- ✗ **C)** the U.S. government.
- ✗ **D)** utilities.

Explanation

Equipment trust certificates are corporate bonds commonly issued by transportation companies, such as railroads and airlines. These bonds are backed by equipment (e.g., aircraft) the issuer uses in their business.

Reference: 2.3.1.3 in the License Exam Manual

Question #131 of 240

Question ID: 604968

Which of the following is TRUE regarding GNMA?

- ✓ **A)** Private lending institutions approved by GNMA originate eligible loans and sell the mortgage-backed securities to investors.
- ✗ **B)** Lending institutions apply to GNMA for funds to lend to residential home buyers.
- ✗ **C)** GNMA approves residential mortgages for home buyers.
- ✗ **D)** GNMA originates loans to home buyers and sells the mortgage backed securities to private lending institutions.

Explanation

GNMA is a government-owned corporation who approves private lending institutions such as banks and mortgage companies to originate eligible loans, pool them into securities and sell the GNMA mortgage-backed securities to investors. GNMA does not originate loans nor does it issue or sell securities.

Reference: 2.6.2.3 in the License Exam Manual

Question #132 of 240

Question ID: 604994

Primary Dealers in U.S. government securities are selected by:

- ✗ **A)** Financial Industry Regulatory Authority (FINRA).
- ✗ **B)** Securities Investors Protection Corporation (SIPC).
- ✓ **C)** Federal Reserve Board (FRB).
- ✗ **D)** Securities and Exchange Commission (SEC).

Explanation

The Federal Reserve Board (FRB) chooses banks and broker/dealers to act as Primary Dealers in U.S. government securities.

Reference: 2.6.3 in the License Exam Manual

Question #133 of 240

Question ID: 604884

An investor purchases a corporate bond at par to yield 5.5% to maturity. If he sells the bond at a price equivalent to a 5% yield to maturity two years later, the investor incurs:

- ✗ **A)** no taxable result at this time.
- ✓ **B)** a capital gain.
- ✗ **C)** tax-free income.
- ✗ **D)** a capital loss.

Explanation

Yields fall as bond prices rise. Because the bond is trading at a higher price than when it was purchased, its yield to maturity has dropped from 5.5% to 5%. The consequence of the sale is a capital gain, because the investor sold the bond that was purchased for par at a premium.

Reference: 2.2.7.6 in the License Exam Manual

Question #134 of 240

Question ID: 605001

Ginnie Mae pass-throughs will pay back both principal and interest

- ✗ **A)** annually
- ✗ **B)** quarterly
- ✗ **C)** semiannually
- ✓ **D)** monthly

Explanation

Ginnie Mae (GNMA) securities are called pass-through certificates because the monthly home mortgage payments, which consist of both principal and interest, pass through to the GNMA investor monthly.

Reference: 2.6.2.3.1 in the License Exam Manual

Question #135 of 240

Question ID: 604904

Which of the following is a characteristic shared by debentures and income bonds?

- ✓ **A)** Both must pay principal as it comes due.
- ✗ **B)** Both must pay interest semiannually.
- ✗ **C)** Both are secured by assets of the corporation.
- ✗ **D)** Both are a type of mortgage bond.

Explanation

All bonds must pay principal when due. Income bonds, however, are not required to pay interest when due unless the earnings of the issuer are deemed to be sufficient by the board.

Reference: 2.3.4 in the License Exam Manual

Question #136 of 240

Question ID: 604971

If an investor keeps $100,000 invested in U.S. Treasury bills at all times during a 10-year period, he is subject to which of the following?

I. Stable principal.
II. Unstable principal.
III. Stable interest.
IV. Unstable interest.

- ✓ **A)** I and IV.
- ✗ **B)** II and IV.
- ✗ **C)** I and III.
- ✗ **D)** II and III.

Explanation

Treasury bills are purchased at a discount and mature at face value. This feature provides principal stability to investors who own them. The discount on bills is determined by current market interest rates and fluctuates accordingly.

Reference: 2.6.1.1 in the License Exam Manual

Question #137 of 240

Question ID: 786000

The dated date on a municipal bond issue is the

- ✗ **A)** date on which the bonds are delivered to the buyer
- ✗ **B)** settlement date

✓ **C)** date on which the bonds begin accruing interest

✗ **D)** trade date

Explanation

The dated date is the date on which newly issued bonds begin to accrue interest.

Reference: 2.7.1 in the License Exam Manual

Question #138 of 240

Question ID: 604888

In a scenario of falling interest rates and a positive yield curve, assuming all to be of equal face value which of the following bonds will appreciate the most?

✗ **A)** 20-year bond selling at a premium

✗ **B)** 1-year bond selling at a premium

✗ **C)** 1-year bond selling at a discount

✓ **D)** 20-year bond selling at a discount

Explanation

In general, prices of long-term bonds are more volatile than prices of short-term bonds. Therefore, the 20-year bonds will appreciate more than the 1-year bonds when interest rates fall. Also, prices of bonds with low coupon rates tend to be more volatile than prices of bonds with high coupon rates. A bond sells at a discount when its coupon is lower than prevailing interest rates. Because of its lower coupon, the 20-year discount bond tends to appreciate more than the 20-year premium bond.

Reference: 2.2.7.5 in the License Exam Manual

Question #139 of 240

Question ID: 605003

The date on which interest will begin accruing on a new municipal issue is the:

✓ **A)** dated date.

✗ **B)** filing date.

✗ **C)** closing date.

✗ **D)** delivery date.

Explanation

New issues of municipal bonds begin accruing interest as of the dated date.

Reference: 2.7.1 in the License Exam Manual

Question #140 of 240

Question ID: 604932

All of the following statements regarding convertible bonds are true EXCEPT:

✗ **A)** the issuer pays a lower interest rate.

✗ **B)** holders have a fixed interest rate.

✓ **C)** holders receive a higher interest rate.

✗ **D)** holders may share in the growth of the common stock.

Explanation

Because of the possibility of participating in the growth of the common stock through an increase in the market price of the common, the convertible can be issued with a lower interest rate.

Reference: 2.5.2.1 in the License Exam Manual

Question #141 of 240

Question ID: 604818

An investor anticipating a fall in interest rates would likely purchase:

- ✓ **A)** noncallable bonds.
- ✗ **B)** noncallable and callable bonds.
- ✗ **C)** none of these.
- ✗ **D)** callable bonds.

Explanation

If rates fall, bonds are likely to be called.

Reference: 2.1.7.1.2 in the License Exam Manual

Question #142 of 240

Question ID: 604989

Which of the following statements regarding Treasury receipts are TRUE?
I. Interest is paid annually.
II. Interest is paid at maturity.
III. Interest is taxed annually.
IV. Interest is taxed at maturity.

- ✗ **A)** I and IV.
- ✓ **B)** II and III.
- ✗ **C)** II and IV.
- ✗ **D)** I and III.

Explanation

Treasury receipts are zero-coupon bonds issued by broker/dealers. Zero coupon bonds pay all of their interest at maturity. They are issued at a discount and redeemed at par, and the difference represents the interest earned. For zeroes with a maturity of more than one year, the interest (or discount) must be accreted each year-and is taxable that year as income. This is termed imputed interest.

Reference: 2.6.1.4 in the License Exam Manual

Question #143 of 240

Question ID: 604940

Freddie Mac does which of the following?
I. Issues pass-through securities.
II. Purchases student loans.
III. Purchases conventional residential mortgages from financial institutions.
IV. Issues securities backed directly by the full faith and credit of the U.S. government.

- ✓ **A)** I and III.
- ✗ **B)** II and IV.
- ✗ **C)** II and III.
- ✗ **D)** I and IV.

Explanation

Freddie Mac is a publicly owned and traded U.S. government agency that issues pass-through securities based on a pool of conventional residential mortgages purchased from financial institutions. Ginnie Mae is the only U.S. agency that issues securities backed by the full faith and credit of the U.S. government.

Reference: 2.6.2.5 in the License Exam Manual

Question #144 of 240

Question ID: 604976

Treasury STRIPS and Treasury receipts are quoted based on

- ✗ **A)** 0.125 (1/8 of a point in dollars)

- ✗ **B)** 0.03125 (1/32 of a point in dollars)
- ✗ **C)** amortization of premiums
- ✓ **D)** yield to maturity

Explanation

Noninterest-bearing securities, like zeroes, are quoted based on their yield to maturity. They are sold at a discount and mature at par.

Reference: 2.6.1.4 in the License Exam Manual

Question #145 of 240

Question ID: 604810

A single bond has been issued with successive maturity dates set from 1985 through 2015. What type of bond is this?

- ✓ **A)** Serial.
- ✗ **B)** Term.
- ✗ **C)** Series.
- ✗ **D)** Balloon.

Explanation

Serial bonds are all issued at one time and mature in successive years. Term bonds all have the same maturity date.

Reference: 2.1.3.2 in the License Exam Manual

Question #146 of 240

Question ID: 604786

A corporation is likely to call eligible debt when interest rates are:

- ✗ **A)** volatile.
- ✗ **B)** rising.
- ✗ **C)** stable.
- ✓ **D)** declining.

Explanation

A corporation generally calls in its debt when interest rates are declining, in order to replace old, higher interest-rate debt with new, lower interest-rate issues.

Reference: 2.1.7.1.4 in the License Exam Manual

Question #147 of 240

Question ID: 604982

Which of the following statements is TRUE regarding auctions of U.S. Treasury securities?

- ✗ **A)** Competitive bids are always filled.
- ✗ **B)** Both competitive and noncompetitive bids are always filled.
- ✓ **C)** Noncompetitive bids are always filled.
- ✗ **D)** Neither competitive nor noncompetitive bids are always filled.

Explanation

Noncompetitive bids are made by entities other than primary dealers. The total dollar amount of these bids is set aside (to be filled) and the amount remaining is auctioned to primary dealers (competitive bids) with the highest bid (lowest yield) filled first.

Reference: 2.6.3 in the License Exam Manual

Question #148 of 240

Question ID: 604908

Which one of the following *best* describes a debenture?

- ✗ **A)** An investment in the debt of another corporate party.
- ✓ **B)** Unsecured corporate debt.
- ✗ **C)** A long-term corporate debt obligation with a claim against securities rather than against physical assets.
- ✗ **D)** A corporate debt obligation that allows the holder to purchase shares of the company's common stock at specified dates before maturity.

Explanation

A debenture is unsecured corporate debt.

Reference: 2.3.2.1 in the License Exam Manual

Question #149 of 240

Question ID: 604848

Which of the following bonds would appreciate the *most* if the interest rates fell?

- ✓ **A)** 30-year discount.
- ✗ **B)** 15-year discount.
- ✗ **C)** 30-year premium.
- ✗ **D)** 15-year premium.

Explanation

The general rule of thumb is that bonds with long-term maturities will have greater fluctuations in price than will short-term maturities, given the same move in interest rates. Furthermore, discounted bonds respond more favorably to falling rates than do premium bonds. Thus, the 30-year discounted bond will move farther than the others.

Reference: 2.2.7.6 in the License Exam Manual

Question #150 of 240

Question ID: 604874

The *best* time for an investor seeking returns to purchase long-term, fixed-interest-rate bonds is when:

- ✓ **A)** long-term interest rates are high and beginning to decline.
- ✗ **B)** long-term interest rates are low and beginning to rise.
- ✗ **C)** short-term interest rates are low and beginning to rise.
- ✗ **D)** short-term interest rates are high and beginning to decline.

Explanation

The best time to buy long-term bonds is when interest rates have peaked. In addition to providing a high initial return, as interest rates fall, the bonds will rise in value.

Reference: 2.2.7.6 in the License Exam Manual

Question #151 of 240

Question ID: 604911

All of the following securities are exempt from the Trust Indenture Act of 1939 EXCEPT:

- ✓ **A)** debentures.
- ✗ **B)** preferred stock.
- ✗ **C)** Treasury bonds.
- ✗ **D)** municipal bonds.

Explanation

The Trust Indenture Act regulates new corporate debt issues, including debentures.

Reference: 2.4 in the License Exam Manual

Question #152 of 240

Question ID: 604836

If you are advised that the yield curve is currently inverted, this means that:

- ✓ **A)** long-term rates are lower than short-term rates.
- ✗ **B)** long-term and short-term rates move inversely.
- ✗ **C)** short-term rates are lower than long-term rates.
- ✗ **D)** long-term rates are significantly higher than short-term rates.

Explanation

An inverted yield curve is negatively sloped, which means that long-term yields are lower than short-term yields. When short-term rates are lower than long-term rates, the yield curve is positively sloped or normal.

Reference: 2.2.7.5 in the License Exam Manual

Question #153 of 240

Question ID: 604943

Which of the following statements regarding Treasury bills (T-bills) are TRUE?

I. The government auctions T-bills at a discount.
II. The difference between the cost of a T-bill and its value at maturity is treated as a capital gain.
III. T-bills have longer maturities than T-notes.
IV. The minimum denomination of a T-bill is $100 face amount.

- ✓ **A)** I and IV.
- ✗ **B)** II and III.
- ✗ **C)** II and IV.
- ✗ **D)** I and III.

Explanation

T-bills are sold at a discount and can be purchased in minimum denominations of $100. The difference between the purchase price and the maturity value is taxed as interest income, not as a capital gain. Treasury bills are short-term investments maturing in 1 year or less. T-notes have maturities of 2 to 10 years. T-bonds have maturities of longer than 10 years.

Reference: 2.6.1.1 in the License Exam Manual

Question #154 of 240

Question ID: 721395

The longest initial maturity for U.S. T-bills is:

- ✗ **A)** 13 weeks.
- ✓ **B)** 26 weeks.
- ✗ **C)** 2 years.
- ✗ **D)** 39 weeks.

Explanation

Maximum initial maturity for T-bills is subject to change. Though T-bills have been issued in 1 year (52 weeks) maturities, historically the longest initial maturity of T-bills has been 6 months (26 weeks); the shortest initial maturity is 4 weeks.

Reference: 2.6.1.1.1 in the License Exam Manual

Question #155 of 240

Question ID: 604978

A primary dealer has its bid on Treasury bills filled at the weekly auction. Settlement between the dealer and the Treasury will be:

- ✗ **A)** same day.
- ✓ **B)** Thursday of that week.
- ✗ **C)** regular way.

- ✗ **D)** next business day.

Explanation

Settlement for the weekly Treasury bill auction normally occurs on the Thursday of the same week as the auction.

Reference: 2.6.3 in the License Exam Manual

Question #156 of 240

Question ID: 604946

Which of the following securities is an original issue discount obligation?

- ✗ **A)** FNMA bonds.
- ✗ **B)** GNMA certificates.
- ✗ **C)** Corporate bonds.
- ✓ **D)** 13-week U.S. Treasury bills.

Explanation

U.S. Treasury bills are always originally issued at a discount and mature at par, with the investor making the appreciation between the original discounted amount and the par value at maturity. This appreciation is treated as interest, however, as opposed to a capital gain.

Reference: 2.6.1.1 in the License Exam Manual

Question #157 of 240

Question ID: 605017

Each of the following securities trade "and interest" EXCEPT:

- ✗ **A)** treasury bonds.
- ✗ **B)** negotiable CDs.
- ✗ **C)** municipal revenue bonds.
- ✓ **D)** zero-coupon bonds.

Explanation

Trading "and interest" means trading with accrued interest. Debt instruments that pay interest periodically (e.g., municipal bonds or Treasury bonds) trade with accrued interest.

Reference: 2.7.2.1.2 in the License Exam Manual

Question #158 of 240

Question ID: 604947

U.S. government securities that are deposited with a trustee against which certificates are sold representing principal payments only on the securities are:

I. clipped bonds.
II. stripped bonds.
III. subject to annual taxation on the per year accreted amount.
IV. subject to taxation at maturity.

- ✓ **A)** II and III.
- ✗ **B)** II and IV.
- ✗ **C)** I and IV.
- ✗ **D)** I and III.

Explanation

U.S. government securities that are deposited with a trustee and against which certificates are sold representing principal payments only on the securities are referred to as Treasury STRIPS. These are zero-coupon bonds issued by the U.S. government and are subject to annual taxation on the per-year accreted amount.

Reference: 2.6.1.4.1 in the License Exam Manual

Question #159 of 240

Question ID: 721390

Corporate bonds that are guaranteed are:

- ✗ **A)** insured by Assured Guaranty Corp. (AGC).
- ✗ **B)** guaranteed as to payment of principal and interest by the U.S. government.
- ✓ **C)** guaranteed as to payment of principal and interest by another corporation.
- ✗ **D)** required to maintain a self-liquidating sinking or surplus fund.

Explanation

A guaranteed corporate bond is one guaranteed by another corporation that typically has a higher credit rating than the issuing corporation, and is in a control relationship with it.

Reference: 2.3.3 in the License Exam Manual

Question #160 of 240

Question ID: 604961

Which of the following statements are TRUE of Ginnie Maes?

I. They are quoted in 1/8ths.
II. They are quoted in 1/32nds.
III. They are traded with an accrued interest computed on an actual day basis.
IV. They are traded with an accrued interest computed on a 30/360 basis.

- ✗ **A)** I and III.
- ✗ **B)** II and III.
- ✗ **C)** I and IV.
- ✓ **D)** II and IV.

Explanation

Like governments, Ginnie Maes are quoted in 32nds, but, like corporates, Ginnie Maes compute accrued interest on a 30/360 day basis.

Reference: 2.6.2.3.1 in the License Exam Manual

Question #161 of 240

Question ID: 604964

Your customer wishes to lock in a long-term yield with minimal risk and is not interested in regular income. Which of the following securities should you recommend?

- ✗ **A)** Treasury Bill.
- ✓ **B)** Treasury STRIPS.
- ✗ **C)** Treasury Bond.
- ✗ **D)** Corporate A-rated zero coupon bond.

Explanation

The Treasury STRIPS is long-term, no-interim income, and has a locked-in yield since it is purchased at a discount from par. The T-bill is short term, the T-bond provides semiannual interest, and the corporate zero is riskier than the STRIPS.

Reference: 2.6.1.4.1 in the License Exam Manual

Question #162 of 240

Question ID: 604992

Which of the following statements regarding auctions of U.S. Treasury bonds are TRUE?

I. Bids are submitted on a percentage of par basis.
II. Bids are submitted on a yield basis.
III. Competitive bids are always filled.
IV. Noncompetitive bids are always filled.

- ✗ **A)** I and III.

✓ **B)** II and IV.
✗ **C)** I and IV.
✗ **D)** II and III.

Explanation

When U.S. Treasury bonds are sold at auction, the competitive bids filled are the most favorable bids (lowest yield) submitted by the primary dealers. These bids are submitted on a yield basis and the winning bids establish the "stop out price". Noncompetitive bids, which are made by nonprimary dealers, are guaranteed to be filled at the stop out price.

Reference: 2.6.3 in the License Exam Manual

Question #163 of 240

Question ID: 604931

Which of the following statements regarding convertible bonds is NOT true?

✓ **A)** Coupon rates are usually higher than nonconvertible bond rates of the same issuer.
✗ **B)** Convertible bondholders are creditors of the corporation.
✗ **C)** If there is no advantage to converting the bonds into common stock, they would sell at a price based on their market value without the convertible feature.
✗ **D)** Coupon rates are usually lower than nonconvertible bond rates of the same issuer.

Explanation

Coupon rates are not higher; they are lower because of the value of the conversion feature. The bondholders are creditors. If the stock price falls, the conversion feature will not influence the bond's price.

Reference: 2.5.2.1 in the License Exam Manual

Question #164 of 240

Question ID: 604804

A corporate bond is quoted at 102-5/8. A customer buying 10 bonds would pay:

✗ **A)** $10,285.00.
✗ **B)** $10,258.00.
✗ **C)** $10,025.80.
✓ **D)** $10,262.50.

Explanation

Par ($1,000) × 102% = $1,020. 5/8 of one bond point ($10) = .625 × $10 = $6.25. Therefore, the quote reading 102-5/8 = $1,026.25 per bond ($1,020 + $6.25). Because we are told the customer is buying 10 bonds, we multiply $1,026.25 × 10 bonds which equals the amount the customer will need to pay in order to make the entire purchase; $10,262.50.

Reference: 2.1.5.1 in the License Exam Manual

Question #165 of 240

Question ID: 604972

An investor purchases $10,000 worth of Treasury bills on November 27 and holds them until they mature on March 30 of the following year. For purposes of taxation, the interest from those Treasury bills is treated as:

✓ **A)** ordinary income subject to federal income tax.
✗ **B)** a short-term gain.
✗ **C)** partially ordinary income and partially capital gain.
✗ **D)** tax-free income.

Explanation

Interest on Treasury bills, notes, and bonds is taxable as ordinary income at the federal level. It is exempt from state and local taxation.

Reference: 2.6 in the License Exam Manual

Question #166 of 240

Question ID: 604860

If a fund has a fixed portfolio of municipal bonds with long maturities, how will substantial changes in general interest rates affect the fund's portfolio?

- ✗ **A)** Both the income and the current value will remain unchanged.
- ✗ **B)** Both the income and the current value will fluctuate significantly.
- ✗ **C)** The current value will not change, but the investment income will fluctuate significantly.
- ✓ **D)** The current value will fluctuate significantly, but the investment income will remain relatively unchanged.

Explanation

For a fund with a fixed portfolio of long-term municipal bonds, the market value of the portfolio will fluctuate with changing interest rates, but the income will remain unchanged.

Reference: 2.2.7.6 in the License Exam Manual

Question #167 of 240

Question ID: 604822

All of the following have been recognized by the SEC under the Credit Rating Agency Reform Act as being registered with the commission to rate debt instruments. Which of the following historically has specialized in ratings for the insurance sector?

- ✗ **A)** Moody's.
- ✗ **B)** Standard & Poor's.
- ✗ **C)** Fitch Ratings.
- ✓ **D)** A.M. Best.

Explanation

A.M. Best historically has specialized exclusively on the insurance marketplace. They issue financial strength ratings measuring insurance companies' ability to pay claims and rate financial instruments issued by insurance companies, such as bonds and notes. They can issue debt and financial strength ratings for other sectors as well, under the Credit Rating Agency Reform Act.

Reference: 2.1.6.1 in the License Exam Manual

Question #168 of 240

Question ID: 604945

T-bills are quoted:

- ✗ **A)** in 16ths.
- ✗ **B)** as a percentage of par.
- ✗ **C)** in 32nds.
- ✓ **D)** on an annualized discount yield basis.

Explanation

T-bills do not bear interest. T-bills trade and are quoted on an annualized discount yield basis.

Reference: 2.6.1.1.2 in the License Exam Manual

Question #169 of 240

Question ID: 604951

All of the following issue securities under the Federal Farm Credit System EXCEPT:

- ✗ **A)** Federal Intermediate Credit Bank.
- ✗ **B)** Bank for Cooperatives.
- ✓ **C)** Federal Home Loan Mortgage Corporation.
- ✗ **D)** Federal Land Bank.

Explanation

The Federal Home Loan Mortgage Corporation issues securities backed by residential mortgages. The Farm Credit System is made up of Federal Intermediate Credit Banks, Cooperative Banks, and Federal Land Banks.

Reference: 2.6.2.4 in the License Exam Manual

Question #170 of 240

Question ID: 605016

Accrued interest for U.S. government bonds is computed on the basis of:

- ✓ **A)** actual days elapsed.
- ✗ **B)** SEC accrued interest guidelines.
- ✗ **C)** 31-day months.
- ✗ **D)** 30-day months.

Explanation

Accrued interest for U.S. government bonds is calculated on the basis of actual days elapsed.

Reference: 2.7.2.1.2 in the License Exam Manual

Question #171 of 240

Question ID: 604922

A DMF convertible bond (convertible into 25 shares) has increased 20% above par in market value. Which of the following would you expect the price of the DMF's common stock to be?

- ✗ **A)** $40.00.
- ✗ **B)** $42.00.
- ✓ **C)** $48.00.
- ✗ **D)** $32.00.

Explanation

$1,000 (par) + 20% = $1,200 / 25 shares = $48. Alternatively, ordinarily it is the 20% increase in the value of the common stock that has caused the bond to increase 20% in value. $1,000 / 25 shares = $40 + 20% = $48.

Reference: 2.5.2.4 in the License Exam Manual

Question #172 of 240

Question ID: 604887

Two $1,000 par bonds are issued with coupons of 5.2% and 5.4%, respectively. The 20-basis-point difference is:

- ✗ **A)** $10.00.
- ✗ **B)** $20.00.
- ✗ **C)** $100.00.
- ✓ **D)** $2.00.

Explanation

One basis point is .01%. The difference between 5.20% and 5.40% is .20%, which is equal to 20 basis points. The bond with a 5.2% coupon rate pays interest of $52. The bond with a 5.4% coupon rate pays interest of $54. The difference is $2.

Reference: 2.2.7.1 in the License Exam Manual

Question #173 of 240

Question ID: 604825

Crossover refunding, which is a type of advance refunding, is best described by which of the following statements?

- ✗ **A)** The revenue stream is halted completely from the project until the new bonds are issued.
- ✗ **B)** Revenues can never cross over to fund a new issue.

- ✗ **C)** The new issue will not be funded by the revenue stream from the project that funded the initial bond offering.
- ✓ **D)** The revenue stream originally pledged to secure the refunded issue continues to pay debt service on those bonds until they mature or are called.

Explanation

Crossover refunding is a method of advance refunding in which the revenue stream originally pledged to secure the refunded bonds continues to be used to pay debt service on those bonds until they mature or are called in by the issuer.

Reference: 2.1.7.3.1 in the License Exam Manual

Question #174 of 240

Question ID: 604912

An investor purchases an ABC Corporation convertible bond at 98 on June 18, 1997. The bond is convertible at $25 and the investor converts his bond into the stock on June 19, 1998, when the common stock is trading at $26 per share. For tax purposes, these transactions will result in:

- ✗ **A)** a $60 capital gain.
- ✓ **B)** neither gain nor loss.
- ✗ **C)** a $40 capital loss.
- ✗ **D)** a $40 capital gain.

Explanation

Converting a bond into shares of common stock does not result in tax consequences. For a taxable gain or loss to exist, the shares received as a result of the conversion must be sold.

Reference: 2.5.2 in the License Exam Manual

Question #175 of 240

Question ID: 604944

All of the following are true of stripped Treasury bonds EXCEPT

- ✗ **A)** they are backed by the U.S. government
- ✗ **B)** interest is received at maturity
- ✗ **C)** they are a form of zero-coupon bond
- ✓ **D)** interest is not taxed

Explanation

Stripped U.S. Treasury bonds sell at a deep discount and mature at par like zero-coupon bonds. The gain the investor receives is treated as interest, which is taxed as ordinary income. They are fully backed by the U.S. government.

Reference: 2.6.1.4.1 in the License Exam Manual

Question #176 of 240

Question ID: 604927

A 7% convertible debenture is selling at 101, and it is convertible into the common stock of the same corporation at $25. The common stock is currently trading at $23. What must the market price of the debenture be to be at parity with the common?

- ✗ **A)** $910.00.
- ✗ **B)** $929.00.
- ✓ **C)** $920.00.
- ✗ **D)** $850.00.

Explanation

To determine the parity price of the bond, first find the number of shares the debenture is convertible into (conversion ratio) by dividing par value by the conversion price ($1,000 / $25 = 40 shares). Next, multiply the current price of the common by the conversion ratio. The result is the parity price of the bond (40 shares × $23 = $920).

Reference: 2.5.2.5 in the License Exam Manual

Question #177 of 240

Question ID: 604926

A customer purchased 10 9% convertible debentures at 98. The bonds are callable at 101. The conversion ratio is 40. The bonds are called while the common is trading at $24 and the debenture is trading at 98. Which of the following options would be *most* beneficial to the customer?

✓ **A)** Tender the bonds to the corporation.
✗ **B)** Convert the bonds and sell the common stock.
✗ **C)** Sell the bonds.
✗ **D)** Wait for a better offer from the corporation.

Explanation

The option most beneficial to the investor is tendering the bond to the corporation for $10,100. If the bond were sold on the market, the investor would receive $9,800. If the bond were converted into common, the investor would receive 400 common shares that could be sold for their current price of $24 for a total of $9,600.

Reference: 2.5.2.4 in the License Exam Manual

Question #178 of 240

Question ID: 604955

Which of the following are issued by the Federal Intermediate Credit Banks (FICB)?

I. Discount notes.
II. Debentures.
III. Mortgage-backed securities.
IV. Equity securities.

✓ **A)** I and II.
✗ **B)** II and III.
✗ **C)** I and III.
✗ **D)** II and IV.

Explanation

FICB (Federal Intermediate Credit Banks) is one of the associations in the Federal Farm Credit Bank system that issues notes and bonds. Since the bonds are not backed by the government or by any specific assets, they are considered debentures backed only by the faith and credit of the bank issuer or issuers.

Reference: 2.6.2.4 in the License Exam Manual

Question #179 of 240

Question ID: 604817

All of the following will affect the marketability of a block of corporate bonds EXCEPT:

✗ **A)** maturity.
✓ **B)** bond denominations.
✗ **C)** rating.
✗ **D)** block size.

Explanation

Block size is a key factor. Maturity is also important-shorter maturities tend to be more marketable than longer maturities. Also, the higher the rating, the more marketable the block. Bond denominations are not relevant.

Reference: 2.1.4.5 in the License Exam Manual

Question #180 of 240

Question ID: 604839

A customer purchased a callable XYZ Corporation 5% debenture to yield 4.5%. The price paid for the bond would *most* likely be:

✗ **A)** 99½.

- ✓ **B)** 100½.
- ✗ **C)** 97½.
- ✗ **D)** 95.

Explanation

In this example the stated coupon is greater than the yield or yield to maturity. This relationship exists when a bond is trading at a premium to par.

Reference: 2.2.7.6 in the License Exam Manual

Question #181 of 240

Question ID: 604993

Which of the following securities is sold at auction?

- ✗ **A)** Ginnie Maes.
- ✗ **B)** Freddie Macs.
- ✗ **C)** Corporate bonds.
- ✓ **D)** T-bills.

Explanation

T-bills, T-notes, and T-bonds are sold through auction. These auctions award securities to the most competitive bids. Agency securities are sold through selling groups appointed by the agency.

Reference: 2.6.3 in the License Exam Manual

Question #182 of 240

Question ID: 604877

If the yield curve is currently inverted:

- ✗ **A)** long-term and short-term rates move inversely.
- ✓ **B)** long-term rates are lower than short-term rates.
- ✗ **C)** long-term rates are higher than short-term rates.
- ✗ **D)** it signifies a time of easy credit.

Explanation

A normal yield curve reflects short-term rates below long-term rates. An inverted or negative yield curve reflects the opposite. This usually occurs during a period of tight money.

Reference: 2.2.7.5 in the License Exam Manual

Question #183 of 240

Question ID: 604987

A customer purchases five 6-1/4% U.S. Treasury notes at 98.24. How much will the customer receive on each interest payment date?

- ✗ **A)** $625.00.
- ✓ **B)** $156.25.
- ✗ **C)** $312.50.
- ✗ **D)** $468.75.

Explanation

While minimum purchase denominations can be less, always use par value ($1,000) for these calculations. A 6-1/4% bond pays $62.50 annually (6-1/4% × $1,000 = $62.50). Therefore, a customer purchasing 5 bonds receives $312.50 each year. As Treasury notes pay semiannually, each interest payment equals $156.25.

Reference: 2.6.1.2 in the License Exam Manual

Question #184 of 240

Question ID: 604898

Which of the following statements regarding a bond quoted as QRS Zr 12 is TRUE?

- ✗ **A)** The interest payable is tax free.
- ✗ **B)** The bond pays $120 interest annually.
- ✓ **C)** The bond pays no interest until maturity.
- ✗ **D)** The bond pays $12 interest annually.

Explanation

QRS Zr 12 represents a zero-coupon bond issued by the QRS Company maturing in 2012. Zero-coupon bonds are bought at a discount and mature at face value. If a bond is held to maturity, the difference between the purchase price and the maturity price is considered interest, though it is taxed on a yearly basis.

Reference: 2.3.5 in the License Exam Manual

Question #185 of 240

Question ID: 604879

Which of the following statements regarding a $1,000 corporate 8.50% bond offered at 110 is TRUE?

- ✗ **A)** The bond's current yield is lower than its yield to maturity.
- ✗ **B)** The bond is a discount bond.
- ✓ **C)** The bond's current yield is calculated by dividing its annual interest by its market price.
- ✗ **D)** To determine the bond's current yield, its stated rate must be compared against other fixed-rate investments in the client's portfolio.

Explanation

A bond's current yield is calculated by dividing its annual interest by its current (market) price. The current yield will be higher than its yield to maturity which will include the premium return. The determination of a bond's yield is unrelated to other bonds. In addition, this is a premium bond, not a discount bond.

Reference: 2.2.7.2 in the License Exam Manual

Question #186 of 240

Question ID: 604785

Two conservative customers in their 50s are interested in preserving principal and high-current income from their investments. In which order, from first to last, are the following bonds ranked in meeting your customer's needs?

I. A1 Fort Worth Gas 9¼s of '25.
II. AA+ San Antonio Transit 9¼s of '25.
III. Aaa Texas Telecom 9¼s of '25.
IV. AA- Dallas Electric 9¼ of '25.

- ✗ **A)** III, IV, II, I.
- ✗ **B)** I, II, III, IV.
- ✗ **C)** IV, III, I, II.
- ✓ **D)** III, II, IV, I.

Explanation

Because the maturity and coupon rates are all the same, we can rank the bonds by rating. Based on the ratings given, the highest-quality bond is the Texas Telecom, rated Aaa, followed in order by the bonds rated AA+, AA-, and A1.

Reference: 2.1.6.1 in the License Exam Manual

Question #187 of 240

Question ID: 604868

Assume that a corporation issues a 5% Aaa/AAA rated debenture at par. Two years later, similarly rated debt issues are being offered in the primary market at 5.5%. Which of the following statements regarding the outstanding 5% debenture are TRUE?

I. The current yield on the debenture will be higher than 5%.
II. The current yield on the debenture will be lower than 5%.
III. The dollar price per bond will be higher than par.

IV. The dollar price per bond will be lower than par.

- ✗ **A)** II and III.
- ✗ **B)** I and III.
- ✗ **C)** II and IV.
- ✓ **D)** I and IV.

Explanation

Because interest rates have risen after the issue of the 5% debenture, the bond's price will be discounted to result in a higher current yield (computed as annual income divided by current market price). Accordingly, the discounting of the issue will make the 5% debenture competitive with new issues offered with a 5.5% coupon.

Reference: 2.2.7.6 in the License Exam Manual

Question #188 of 240

Question ID: 604948

Which of the following regarding T-bills are TRUE?
I. T-bills trade at a discount to par.
II. T-bills have maturities of 1 to 10 years.
III. Most T-bill issues are callable.
IV. T-bills are a direct obligation of the U.S. government.

- ✓ **A)** I and IV.
- ✗ **B)** II and IV.
- ✗ **C)** I and III.
- ✗ **D)** II and III.

Explanation

T-bills trade at a discount to par, are 6 months or less to maturity, and are a direct obligation of the U.S. government. T-bills are also noncallable.

Reference: 2.6.1.1 in the License Exam Manual

Question #189 of 240

Question ID: 604921

If an investor is faced with converting a bond into 20 shares of common stock with a CMV of $57.75 or allowing the bond to be called at 102, the investor is experiencing:

- ✗ **A)** an arbitrage.
- ✗ **B)** a refunding call.
- ✗ **C)** a hedge.
- ✓ **D)** a forced conversion.

Explanation

If the value of the stock to be received on conversion exceeds the call price, this is essentially forcing the bondholder to convert.

Reference: 2.5.2.7 in the License Exam Manual

Question #190 of 240

Question ID: 604791

If interest rates are falling, issuers will likely call which of the following bonds?
I. Bonds with low coupons.
II. Bonds with high coupons.
III. Bonds trading at a discount.
IV. Bonds trading at a premium.

- ✗ **A)** II and III.
- ✓ **B)** II and IV.

- ✗ **C)** I and III.
- ✗ **D)** I and IV.

Explanation

An issuer will call higher coupon bonds first because the interest payments on them are more costly to the issuer than those for lower coupon bonds. Bonds with higher coupons are the ones trading at a premium (above par) as they are more desirable to investors and demand for them pushes their prices up.

Reference: 2.1.7.1.4 in the License Exam Manual

Question #191 of 240

Question ID: 604843

The coupon on a bond can be described as its:

- ✗ **A)** yield to call.
- ✗ **B)** current yield.
- ✓ **C)** nominal yield.
- ✗ **D)** basis.

Explanation

The coupon on a bond is also known as the "nominal yield" and indicates the annual interest paid. For example, a 4% bond pays $40 of interest per year.

Reference: 2.2.7.1 in the License Exam Manual

Question #192 of 240

Question ID: 604956

All of the following statements are true regarding the federal Farm Credit System securities EXCEPT:

- ✗ **A)** the proceeds are used to make loans to farmers.
- ✓ **B)** they are direct obligations of the U.S. government.
- ✗ **C)** they issue short-term notes and long-term bonds.
- ✗ **D)** interest is tax exempt at the state and local levels.

Explanation

With the exception of Ginnie Mae, all agency securities are indirect obligations of the U.S. government.

Reference: 2.6.2.4 in the License Exam Manual

Question #193 of 240

Question ID: 604958

All of the following statements regarding the Federal National Mortgage Association (FNMA) are true EXCEPT

- ✗ **A)** FNMA pass-through certificates are not guaranteed by the U.S. government
- ✗ **B)** interest on FNMA certificates is taxable at all levels
- ✗ **C)** FNMA is a publicly held corporation
- ✓ **D)** FNMA is owned by the U.S. government

Explanation

FNMA is a publicly held corporation. The interest income on all mortgage-backed securities is fully taxable. Though a government agency, FNMA pass through certificates are not guaranteed by the US government. The only U.S. agency whose securities are considered direct obligations of the U.S. government is the Government National Mortgage Association (GNMA).

Reference: 2.6.2.6 in the License Exam Manual

Question #194 of 240

Question ID: 604928

A 7% convertible debenture is selling at 101. It is convertible into the common stock of the same corporation at $25. The common stock is currently trading at $23. If the stock were trading at parity with the debenture, the price of the stock would be:

- ✗ **A)** $43.91.
- ✗ **B)** $25.00.
- ✗ **C)** $40.00.
- ✓ **D)** $25.25.

Explanation

To determine the parity price of the common, first find the number of shares the debenture is convertible into (conversion ratio) by dividing par value by the conversion price ($1,000 / $25 = 40 shares). Next, divide the current price of the bond by the conversion ratio. The result is the parity price of the common stock. (1010 / 40 = $25.25).

Reference: 2.5.2.5 in the License Exam Manual

Question #195 of 240

Question ID: 604845

What happens to outstanding fixed-income securities when market interest rates drop?

- ✗ **A)** Coupon rates increase.
- ✗ **B)** Short-term fixed-income securities are affected most.
- ✓ **C)** Prices increase.
- ✗ **D)** Yields increase.

Explanation

When interest rates drop, the price of outstanding bonds rises to adjust to the lower yields on bonds of comparable quality.

Reference: 2.2.7.6 in the License Exam Manual

Question #196 of 240

Question ID: 604851

When investor confidence in the economy is increasing, a technical analyst would anticipate that:

I. yields on AAA-rated bonds will be higher than those on BBB-rated bonds.
II. yields on BBB-rated bonds will be higher than those on AAA-rated bonds.
III. the spread between yields on AAA-rated and BBB-rated bonds will increase.
IV. the spread between yields on AAA-rated and BBB-rated bonds will decrease.

- ✗ **A)** I and III.
- ✗ **B)** I and IV.
- ✓ **C)** II and IV.
- ✗ **D)** II and III.

Explanation

When investor confidence in the economy is increasing, yield spreads between the safest bonds and more speculative bonds decrease because investors are willing to take on greater risk. Yields on less safe bonds remain higher than those of AAA bonds. When investor confidence is declining the yield spreads will increase.

Reference: 2.2.7.5 in the License Exam Manual

Question #197 of 240

Question ID: 604965

Income from all of the following securities is fully taxable at the federal, state, and local levels EXCEPT:

- ✗ **A)** Ginnie Maes.
- ✓ **B)** Treasury bonds.
- ✗ **C)** corporate bonds.
- ✗ **D)** reinvested mutual fund dividends.

Explanation

Interest on Treasury bonds is not taxed at the state level or local level.

Reference: 2.6 in the License Exam Manual

Question #198 of 240

Question ID: 604870

If an investor is anticipating that the yield spread between U.S. government and BBB-rated corporate bonds will widen, the investor is expecting the U.S. economy to:

- ✓ **A)** enter a recession over the coming months.
- ✗ **B)** expand over the coming months.
- ✗ **C)** remain flat over the coming months.
- ✗ **D)** experience volatility over the coming months.

Explanation

If investors anticipate a recession, they tend to flee to quality. In this case, they would likely sell lower quality corporate bonds (forcing prices down and yields up) and use the proceeds to buy higher quality U.S. government bonds (forcing prices up and yields down). Thus, the yield spread would widen between corporate and government bonds. Yields on corporate bonds are higher than yields on U.S. government bonds to begin with. If yields on corporate bonds go up and yields on government bonds decline, the spread will widen.

Reference: 2.2.7.5 in the License Exam Manual

Question #199 of 240

Question ID: 604881

An 8% corporate bond is offered on a 8.25 basis. Which of the following statements are TRUE?

I. Nominal yield is higher than YTM.
II. Current yield is higher than nominal yield.
III. Nominal yield is lower than YTM.
IV. Current yield is lower than nominal yield.

- ✗ **A)** II and IV.
- ✓ **B)** II and III.
- ✗ **C)** I and III.
- ✗ **D)** I and IV.

Explanation

A bond offered on an 8.25 basis is the same as at a YTM of 8.25%. Because the yield quoted is higher than the 8% coupon, the bond is trading at discount to par. For discount bonds, the nominal yield is lower than both the current yield and the yield to maturity.

Reference: 2.2.7.1 in the License Exam Manual

Question #200 of 240

Question ID: 604853

Which of the following statements regarding callable municipal bonds is TRUE?

- ✗ **A)** As interest rates rise, callable bonds trading at a premium will generally rise in value.
- ✗ **B)** Noncallable bonds usually yield more than callable bonds.
- ✗ **C)** Bonds are typically called when interest rates are rising.
- ✓ **D)** Bond call premiums generally compensate the bondholder for interest payments lost if the bond is called.

Explanation

As callable bonds represent more risk to the investor, they generally trade at higher yields than comparable noncallable bonds. Bonds are called when rates are falling or have fallen, allowing the issuer to replace the called issue with one with a lower coupon. As rates rise, bond prices fall. The call premium on a callable bond, which represents the difference between the call price and par, compensates bondholders for lost interest if the bond is called.

Reference: 2.2.7.4 in the License Exam Manual

Question #201 of 240

Question ID: 604815

Which of the following would make a corporate bond more subject to liquidity risk?

I. Short-term maturity.
II. Long-term maturity.
III. High credit rating.
IV. Low credit rating.

- ✗ **A)** II and III.
- ✓ **B)** II and IV.
- ✗ **C)** I and IV.
- ✗ **D)** I and III.

Explanation

The most marketable bonds have shorter maturities and higher credit ratings.

Reference: 2.1.3 in the License Exam Manual

Question #202 of 240

Question ID: 604906

From first to last, in what order would claimants receive payment in the event of bankruptcy?

I. Holders of secured debt.
II. Holders of subordinated debentures.
III. General creditors.
IV. Preferred stockholders.

- ✗ **A)** I, II, III, IV.
- ✗ **B)** III, I, II, IV.
- ✗ **C)** IV, I, II, III.
- ✓ **D)** I, III, II, IV.

Explanation

The liquidation order is as follows: wages, taxes, secured debt holders, unsecured debt holders (including general creditors), holders of subordinated bonds, preferred stockholders, and common stockholders.

Reference: 2.3.2.3 in the License Exam Manual

Question #203 of 240

Question ID: 604960

All of the following issue mortgage-backed securities EXCEPT:

- ✗ **A)** Freddie Mac.
- ✗ **B)** Fannie Mae.
- ✓ **C)** Sallie Mae.
- ✗ **D)** Ginnie Mae.

Explanation

Sallie Mae is the name for the Student Loan Marketing Association, which does not issue mortgage-backed securities. Ginnie Mae, Fannie Mae, and Freddie Mac do issue mortgage-backed securities.

Reference: 2.6.2.7 in the License Exam Manual

Question #204 of 240

Question ID: 604920

A convertible bond callable at 101 is trading at 105. The bond is a 4% bond convertible at $25. The common stock is trading at $27. If an investor bought the bond and converted, his profit would be:

- ✗ **A)** $20.
- ✓ **B)** $30.
- ✗ **C)** $40.
- ✗ **D)** $75.

Explanation

First, calculate the number of shares each bond will convert to: $1,000 (par) / $25 per share = 40 shares per bond. With market value at 105, each bond costs $1,050. What is the stock parity price? $1,050 / 40 shares = $26.25 per share stock parity price. CMV of the stock minus stock parity price equals profit (or loss). $27.00 − $26.25 = $.75 per share × 40 shares = $30.

Reference: 2.5.2.5 in the License Exam Manual

Question #205 of 240

Question ID: 605012

A May and November Treasury bond is traded the regular way on Wednesday, June 8th. The number of days of accrued interest is:

- ✗ **A)** 45.
- ✗ **B)** 38.
- ✓ **C)** 39.
- ✗ **D)** 44.

Explanation

Accrued interest on government bonds is based on actual days in a year. Settlement occurs on the next business day. This bond pays interest in May and November, with the most recent payment on May 1st. Interest has accrued on this bond for 31 days in May and 8 days in June, for a total of 39 days. Settlement date is Thursday, June 9th.

Reference: 2.7.2.1.2 in the License Exam Manual

Question #206 of 240

Question ID: 604905

Which of the following statements regarding corporate zero-coupon bonds are TRUE?

I. Interest is paid semiannually.
II. The discount is in lieu of periodic interest payments.
III. The discount must be accreted and is taxed annually.
IV. The discount must be accreted annually with taxation deferred until maturity.

- ✓ **A)** II and III.
- ✗ **B)** I and III.
- ✗ **C)** II and IV.
- ✗ **D)** I and IV.

Explanation

The investor in a corporate zero-coupon bond receives the return in the form of growth of the principal amount over the bond's life. The bond is purchased at a deep discount and redeemed at par at maturity. That discount from par represents the interest that will be earned at maturity date. However, the discount is accreted annually and the investor pays taxes yearly on the imputed interest.

Reference: 2.3.5.1 in the License Exam Manual

Question #207 of 240

Question ID: 604788

A debenture maturing in 2019 is bid at 77-7/8 and asked at 78-3/4. Which of the following is TRUE of the spread?

- ✗ **A)** The spread represents 3/4 per bond equivalent to $75.
- ✗ **B)** The spread represents 3/4 per bond equivalent to $0.75.

✓ **C)** The spread represents 7/8 per bond equivalent to $8.75.

✗ **D)** The spread represents 7/8 per bond equivalent to $87.50.

Explanation

The spread between the bid and ask price is 7/8. 7/8 of one bond point ($10) = $8.75.

Reference: 2.1.5 in the License Exam Manual

Question #208 of 240

Question ID: 604838

A customer buys a long-term, 10% Treasury bond with a current yield of 12% and holds the bond until 1 year before maturity. She sells the bond when the short-term T-bill rate is 8%. Which of the following statements are CORRECT?

I. The bond was purchased at a premium.
II. The bond was purchased at a discount.
III. The bond was sold at a premium.
IV. The bond was sold at a discount.

✓ **A)** II and III.

✗ **B)** I and III.

✗ **C)** II and IV.

✗ **D)** I and IV.

Explanation

When the yield is higher than the coupon, it means the bond was purchased at a discount. Since the question tells us the T-bills are now yielding 8% and she has a bond maturing within a year with a 10% coupon, she would be able to sell that bond at a premium.

Reference: 2.2.7.6 in the License Exam Manual

Question #209 of 240

Question ID: 604916

DMF Company has $50 million of convertible bonds (convertible at $50) outstanding. The current market value of DMF's stock is $42. The bond indenture contains a nondilution feature. If DMF declares a 10% stock dividend, the new conversion price will be:

✗ **A)** higher than $50.

✗ **B)** the stock's current market price.

✓ **C)** lower than $50.

✗ **D)** $50.

Explanation

With an antidilution feature, the issuer will increase the number of shares available upon conversion if the company declares a stock split or stock dividend. This means the bondholder must be able to convert it to more shares, which requires a lower conversion price.

Reference: 2.5.2.5 in the License Exam Manual

Question #210 of 240

Question ID: 604954

Which of the following statements regarding GNMA securities are TRUE?

I. Interest is subject to federal income tax.
II. Interest is exempt from federal income tax.
III. They are backed by farm mortgages.
IV. They are backed by residential mortgages.

✓ **A)** I and IV.

✗ **B)** I and III.

✗ **C)** II and III.

✗ **D)** II and IV.

Explanation

Government National Mortgage Association (GNMA) securities are subject to both state and federal income tax and are backed by residential mortgages.

Reference: 2.6.2.3.2 in the License Exam Manual

Question #211 of 240

Question ID: 604999

A married couple with a two-year-old child wants a suitable investment to help meet the financial obligations for the child's college education. Which of the following choices are the most suitable alternatives?

I. A CMO tranche scheduled to mature in 5 years
II. A STRIP scheduled to mature in 15 years
III. Treasury receipts
IV. A money-market fund

✗ **A)** I and III
✗ **B)** II and IV
✓ **C)** II and III
✗ **D)** I and IV

Explanation

STRIPs and treasury receipts are forms of zero-coupon bonds. STRIPs are backed in full by the US government and treasury receipts by the financial institutions that issue them. Purchased at a discount and maturing at face value in the future, they are suitable investments for those wishing to save for anticipated expenses such as college tuition sometime in the future. A CMO maturing in five years doesn't align with the time horizon for this child's college education and carry other unsuitable risks. A money market fund would hardly meet the growth requirement needed to meet college tuition needs.

Reference: 2.6.1.4.1 in the License Exam Manual

Question #212 of 240

Question ID: 721387

The funds used for the retirement of a bond may be deposited into a:

✗ **A)** collateral trust fund.
✓ **B)** sinking fund.
✗ **C)** level debt service account.
✗ **D)** priority capitalization account.

Explanation

A sinking or surplus fund is used as an escrow account to set funds aside for retiring a revenue bond.

Reference: 2.1.7.1.1 in the License Exam Manual

Question #213 of 240

Question ID: 605002

Relative to a corporate bond, what begins on the dated date?

✓ **A)** Accrual of interest.
✗ **B)** The date of all mathematical computations.
✗ **C)** Settlement and delivery.
✗ **D)** The computation of principal payment.

Explanation

Interest begins accruing on the dated date on new bond issues.

Reference: 2.7.1 in the License Exam Manual

Question #214 of 240

Question ID: 604935

PDQ Corporation has a 6-1/4% convertible preferred stock (conversion ratio of 4) outstanding. The stock has an antidilution covenant. If PDQ declares a 10% stock dividend, the antidilution covenant will adjust:

- ✗ **A)** the par to $110.
- ✓ **B)** the conversion price to $22.72.
- ✗ **C)** the par to $90.
- ✗ **D)** the conversion price to $27.50.

Explanation

The stock is convertible at $25 ($100 par / 4 shares). To determine the new conversion price, $100 / 4.4 shares = $22.72, or divide $25 by 110%.

Reference: 2.5.2.6 in the License Exam Manual

Question #215 of 240

Question ID: 604934

A convertible bond has a conversion price of $40 per share. If the market value of the bond rises to a 12½ point premium over par, which of the following are TRUE?

I. Conversion ratio is 25:1.
II. Conversion ratio is 28:1.
III. Parity price of the common stock is $42.
IV. Parity price of the common stock is $45.

- ✗ **A)** II and III.
- ✓ **B)** I and IV.
- ✗ **C)** II and IV.
- ✗ **D)** I and III.

Explanation

The conversion ratio is computed by dividing par value by the conversion price ($1,000 par / $40 = 25). Parity price of the common stock is computed by dividing the market price of the convertible bond by the conversion ratio ($1,125 / 25 = $45). Or, 112½% × $40 = $45.

Reference: 2.5.2.5 in the License Exam Manual

Question #216 of 240

Question ID: 604816

All of the following statements regarding discount bonds are correct EXCEPT:

- ✗ **A)** their discounted price can indicate that the issuer's credit rating has fallen.
- ✗ **B)** their discounted price can indicate that interest rates have risen.
- ✓ **C)** they are more likely to be called than comparable premium bonds.
- ✗ **D)** at maturity they will be valued at par.

Explanation

Bonds trading at a premium have higher coupons than current interest rates and therefore are more likely to be called. Bonds trading at a discount have coupons that are lower than current interest rates and therefore less likely to be called. If rates rise, prices fall. If a bond's rating falls, it will be less attractive to investors and its price will fall as well. All bonds move toward par value as they get closer to maturity.

Reference: 2.1.5.1 in the License Exam Manual

Question #217 of 240

Question ID: 604967

A customer purchased a 5% U.S. government bond yielding 6%. A year before the bond matures, new U.S. government bonds are being issued at 4%, and the customer sells the 5% bond. The customer probably did which of the following?

I. Bought it at a discount.

II. Bought it at a premium.
III. Sold it at a discount.
IV. Sold it at a premium.

- ✗ **A)** I and III.
- ✗ **B)** II and III.
- ✓ **C)** I and IV.
- ✗ **D)** II and IV.

Explanation

The customer purchased the 5% bond when it was yielding 6% (at a discount). The customer sold the bond when other bonds of like kind, quality, and maturity were yielding 4%. The bond is now at a premium. Therefore, the customer realized a capital gain.

Reference: 2.6.1.3.2 in the License Exam Manual

Question #218 of 240

Question ID: 604802

Consider a municipal bond issue that has been defeased. Which of the following statements is NOT true?

- ✗ **A)** The issue is now backed by U.S. government securities.
- ✗ **B)** The marketability of the issue increases.
- ✗ **C)** The issue is no longer considered part of the issuer's outstanding debt.
- ✓ **D)** The rating on the issue decreases.

Explanation

Once a municipal issue has been defeased (pre-refunded), its rating increases as it is now backed by U.S. government securities held in escrow. As the rating of a bond increases, so does its marketability. Once defeased, the issue is no longer considered part of the issuer's outstanding debt (although it will remain outstanding with interest paid until called).

Reference: 2.1.7.3 in the License Exam Manual

Question #219 of 240

Question ID: 604830

Which of the following rate commercial paper issued by corporations?
I. Moody's
II. Standard & Poor's
III. MSRB
IV. SEC

- ✓ **A)** I and II.
- ✗ **B)** I and III.
- ✗ **C)** II and III.
- ✗ **D)** II and IV.

Explanation

Moody's, Standard & Poor's and Fitch's as well are all recognized as rating companies that would rate commercial paper issued by corporations. The Securities Exchange Commission (SEC) is a federal government regulatory body.

Reference: 2.1.6.1 in the License Exam Manual

Question #220 of 240

Question ID: 604811

The price of which of the following will fluctuate *most* with a change in interest rates?

- ✗ **A)** Money-market instruments.
- ✓ **B)** Long-term bonds.
- ✗ **C)** Short-term bonds.

✗ **D)** Common stock.

Explanation

Long-term debt prices fluctuate more than short-term debt prices as interest rates rise and fall.

Reference: 2.1.3 in the License Exam Manual

Question #221 of 240

Question ID: 604871

The result of declining inflation on outstanding bonds would be:

✗ **A)** lower prices and higher yields.

✗ **B)** lower prices and lower yields.

✓ **C)** higher prices and lower yields.

✗ **D)** higher prices and higher yields.

Explanation

Declining inflation means declining interest rates. If interest rates decline, bond prices rise.

Reference: 2.2.7.6 in the License Exam Manual

Question #222 of 240

Question ID: 605004

A J & J Treasury bond with a 5% coupon due July 1, 2007, is purchased in a cash transaction on February 24. What is the number of days of accrued interest?

✗ **A)** 63.

✗ **B)** 55.

✗ **C)** 53.

✓ **D)** 54.

Explanation

A bond begins accruing interest on the prior interest payment date (January 1) and accrues up to, but not including, the settlement date (February 24). Because accrued interest on government bonds is computed actual days, actual year, 31 days for January plus 23 days for February, it equals 54 days.

Reference: 2.7.2.1.2 in the License Exam Manual

Question #223 of 240

Question ID: 604890

Rank the following from first to last in order of payment at liquidation of a corporation.

I. General creditors.
II. Preferred stock.
III. Subordinated debentures.
IV. Accrued taxes.

✗ **A)** III, IV, I, II.

✗ **B)** IV, III, I, II.

✓ **C)** IV, I, III, II.

✗ **D)** III, IV, II, I.

Explanation

The complete order of liquidation is as follows: wages, taxes, secured debt, debentures and general creditors, subordinated debentures, preferred stock, common stock.

Reference: 2.3.2.3 in the License Exam Manual

Question #224 of 240

Question ID: 604850

If general interest rates increase, the interest income of an open-end bond fund will:

- ✗ **A)** It cannot be determined from the information given.
- ✗ **B)** decrease.
- ✗ **C)** remain unchanged.
- ✓ **D)** increase.

Explanation

Most mutual funds do not have 100% of their assets in securities and they continually receive new money from investors. Any increase in the general interest rate would allow the fund to purchase new, higher-yielding, lower-cost instruments, which would increase the fund's income.

Reference: 2.2.7.6 in the License Exam Manual

Question #225 of 240

Question ID: 604806

An investor purchasing long-term AAA rated bonds should be concerned *most* with:

- ✗ **A)** reinvestment risk.
- ✗ **B)** marketability risk.
- ✗ **C)** no risk.
- ✓ **D)** inflation risk.

Explanation

The major risk assumed by any investor in long-term high-quality bonds is inflation or purchasing power risk. AAA rated debt securities are likely to earn a lower rate of return, which over a longer period of time might not keep up with the rate of inflation.

Reference: 2.1.3 in the License Exam Manual

Question #226 of 240

Question ID: 604915

A convertible corporate bond with a conversion price of $20 is trading at 115. The parity price of the common stock is:

- ✗ **A)** $26.00.
- ✗ **B)** $20.00.
- ✓ **C)** $23.00.
- ✗ **D)** $17.00.

Explanation

A conversion price of $20 means the conversion ratio is 50 (i.e., each bond can be converted into 50 shares of common stock). $1,150/50 = $23 parity price.

Reference: 2.5.2.5 in the License Exam Manual

Question #227 of 240

Question ID: 604923

ABC Corporation has outstanding a 7-¾% convertible debenture currently trading at 102. The bond is convertible into common stock at $40. ABC stock is trading $45 per share. Which of the following statements is TRUE?

- ✗ **A)** To profit in this situation, the investor should buy the stock and short the bonds.
- ✗ **B)** An arbitrage opportunity does not exist in this situation.
- ✗ **C)** The bond is at parity with the stock.
- ✓ **D)** To profit in this situation, the investor should buy the bonds and short the stock.

Explanation

With a conversion price of $40, the bond is convertible into 25 shares of ABC common stock ($1,000 / $40 = 25 shares). As the common stock is currently trading at $45 per share, the value of the stock as converted would be $1,125 (25 shares × $45 = $1,125), which is greater than the current price of the bond ($1,020). Therefore, the bond and the stock are not at parity. An investor could profit in this situation by shorting the stock and buying an equivalent number of bonds. A bond could be purchased for $1,020 and immediately converted into stock worth $1,125, a risk-free profit opportunity.

Reference: 2.5.2.5 in the License Exam Manual

Question #228 of 240

Question ID: 604973

A customer purchases ten 8% Treasury notes at 101-16. What is the dollar amount of this purchase?

- ✗ **A)** $10,812.
- ✗ **B)** $10,116.
- ✓ **C)** $10,150.
- ✗ **D)** $10,015.

Explanation

Though the denomination of the T-notes purchased is not given, always assume par ($1,000) unless told differently in the question. Remember that government notes and bonds are quoted in 32nds. Therefore, a quote of 101-16 means 101 plus 16/32. 101 plus 1/2 = $1,015; $1,015 × 10 bonds = $10,150.

Reference: 2.6.1.2.2 in the License Exam Manual

Question #229 of 240

Question ID: 604814

Corporate bonds are considered safer than common stock issued by the same company because:

- ✓ **A)** bonds place the issuer under an obligation but stock does not.
- ✗ **B)** if there is a shortage of cash, dividends are paid before interest.
- ✗ **C)** the par value of bonds is generally higher than that of stock.
- ✗ **D)** bonds and similar fixed-rate securities are guaranteed by SIPC.

Explanation

A bond represents a legal obligation to repay principal and interest by the company. Common stock carries no such obligation.

Reference: 2.1 in the License Exam Manual

Question #230 of 240

Question ID: 722111

A legal contract known as an indenture between a bond issuer and a trustee appointed to represent the bondholders is required for

- ✗ **A)** corporate bond issues of $25 million or more sold interstate
- ✗ **B)** municipal bond issues of $100 million or more sold within one municipality
- ✓ **C)** corporate bond issues of $50 million or more sold interstate
- ✗ **D)** government bond issues of any size sold to domestic (U.S.) investors

Explanation

The Trust Indenture Act of 1939 requires corporate bond issues of $50 million or more sold interstate to be issued under a trust indenture, a legal contract between the bond issuer and a trustee representing bondholders.

Reference: 2.4 in the License Exam Manual

Question #231 of 240

Question ID: 604873

Market interest rates have been rising, which means that the price of bonds traded in the secondary market has:

- ✗ **A)** not changed because bond prices are not affected by interest rates.
- ✗ **B)** increased.

- ✗ **C)** not changed because only new bond prices are impacted by changes in interest rates not the price of bonds already trading in the secondary market.
- ✓ **D)** decreased.

Explanation

When interest rates rise, bond prices fall.

Reference: 2.2.7.6 in the License Exam Manual

Question #232 of 240

Question ID: 605015

The computation for accrued interest on corporate and municipal debt obligations is based on a(n):

- ✗ **A)** actual-day month and a 360-day year.
- ✗ **B)** actual-day month and an actual-day year.
- ✗ **C)** 30-day month and an actual-day year.
- ✓ **D)** 30-day month and a 360-day year.

Explanation

Accrued interest on corporate and municipal bonds is computed on a 30-day month and a 360-day year.

Reference: 2.7.2 in the License Exam Manual

Question #233 of 240

Question ID: 604796

If a customer believes that interest rates have peaked and wants to buy long-term, fixed-income securities providing semiannual interest payments, you would recommend:

- ✓ **A)** noncallable bonds.
- ✗ **B)** puttable bonds.
- ✗ **C)** Treasury STRIPS.
- ✗ **D)** premium bonds with low call premiums.

Explanation

The purchase of noncallable bonds provides the investor with a constant flow of semiannual interest income until maturity. Treasury STRIPS do not make regular interest payments.

Reference: 2.1.7.1.2 in the License Exam Manual

Question #234 of 240

Question ID: 604793

A Notice of Defeasance informs bondholders that:

- ✗ **A)** the purpose of the issue has been defeated and the bonds are called.
- ✓ **B)** the funds for the principal and the interest are in escrow.
- ✗ **C)** the interest and the principal will not be paid.
- ✗ **D)** the facility has been condemned and the bonds have been called.

Explanation

A defeased issue is one in which the issuer placed U.S. government securities in the bank as collateral for the old issue.

Reference: 2.1.7.3 in the License Exam Manual

Question #235 of 240

Question ID: 604929

ABC Corporation has an outstanding 8% convertible bond that is callable at 102. Currently, the bond is trading at 101. The conversion price is $40, and the common stock is currently trading at $39.50. ABC announces a call at 102. To realize the greatest profit, a bondholder should:

- ✓ **A)** tender the bonds.
- ✗ **B)** sell the bonds at the current market price.
- ✗ **C)** continue to hold the bonds.
- ✗ **D)** convert the bonds into common and sell the converted shares.

Explanation

The investor would realize the greatest sales proceeds by tendering the bond to the corporation for 102. Selling the bond at its current market value of 101 is not an attractive option. Converting the bond to common stock would result in 25 shares ($1,000 par converted at $40 = 25 shares) sold at $39.50 per share (39.50 × 25 = $987.50).

Reference: 2.5.2.5 in the License Exam Manual

Question #236 of 240

Question ID: 604977

A Treasury bond is quoted in "The Wall Street Journal" as follows:

Bid 100:15
Asked 100:17
Bid Chg. -1
Yield 7.9

From this information, you know that the nominal yield is:

- ✗ **A)** less than 7.9%.
- ✓ **B)** greater than 7.9%.
- ✗ **C)** 7.89%.
- ✗ **D)** 7.9%.

Explanation

The "Bid" and "Asked" prices show that the Treasury bond is being quoted at a premium (above par), with a yield to maturity of 7.9%. When bonds are trading at a premium, the nominal yield (coupon rate) is greater than the yield to maturity.

Reference: 2.6.1.3.2 in the License Exam Manual

Question #237 of 240

Question ID: 604846

The price of which of the following will fluctuate *most* with fluctuating interest rates?

- ✗ **A)** Short-term bonds.
- ✗ **B)** Money market instruments.
- ✗ **C)** Common stock.
- ✓ **D)** Long-term bonds.

Explanation

Long-term debt prices will fluctuate more than short-term debt prices as interest rates rise and fall. When buying a debt instrument, one is really buying the interest payments and final principal payment. Money has a time value: the longer it takes to receive the money, the less it is worth today.

Reference: 2.2.7.6 in the License Exam Manual

Question #238 of 240

Question ID: 604914

An investor interested in acquiring a convertible bond as part of his investment portfolio would:

- ✗ **A)** seek to minimize changes in the bond price during periods of steady interest rates.
- ✗ **B)** want the assurance of a guaranteed dividend on the underlying common stock.

- ✗ **C)** be interested in tax advantages available to convertible debt securities.
- ✓ **D)** want the safety of a fixed-income investment along with potential capital appreciation.

Explanation

An investor who wants the safety of a fixed-income investment with the potential for capital gains would be most interested in purchasing a convertible bond. However, because convertible bonds can be exchanged for common stock, their market price tends to be more volatile during times of steady interest rates than other fixed-income securities.

Reference: 2.5.2.3 in the License Exam Manual

Question #239 of 240

Question ID: 604975

Treasury bills are:

- ✗ **A)** callable.
- ✓ **B)** issued in book entry form.
- ✗ **C)** issued at par.
- ✗ **D)** issued in bearer form.

Explanation

All Treasury securities are issued in book entry form. Treasury bills are always issued at a discount and are never callable.

Reference: 2.6.1.1 in the License Exam Manual

Question #240 of 240

Question ID: 604913

The market price of a convertible bond depends on all of the following EXCEPT:

- ✓ **A)** the conversion prices of bonds from similar companies.
- ✗ **B)** current interest rates.
- ✗ **C)** the value of the underlying stock into which the bond can be converted.
- ✗ **D)** the rating of the bond.

Explanation

A convertible bonds current market price will be impacted by the value of the underlying stock into which the bond can be converted, current interest rates and the rating of the bond. Conversion prices are not set in competition, therefore the conversion prices of similar bonds would be of no concern regarding price.

Reference: 2.5.2.3 in the License Exam Manual