QBank Quiz December 1, 2017

Test ID: 59459567

Question #1 of 128

Question ID: 605035

Planned amortization class (PAC) CMOs were designed to provide which of the following benefits compared to plain vanilla tranches?

- ✗ **A)** Eliminate prepayment risk for tranche holders.
- ✗ **B)** Match the prepayment risk of plain vanilla tranches.
- ✗ **C)** Increase prepayments to tranche holders.
- ✓ **D)** Reduce prepayment risk for tranche holders.

Explanation

PACs reduce but cannot eliminate prepayment risk for tranche holders. The companion tranches will have higher prepayment risk than the PAC, as they were designed to absorb the bulk of the prepayment risk.

Reference: 2.8.1.3 in the License Exam Manual

Question #2 of 128

Question ID: 605111

Which of the following is a money market instrument?

- ✗ **A)** Preferred stock.
- ✗ **B)** Long-term debt.
- ✓ **C)** Short-term debt.
- ✗ **D)** Common stock.

Explanation

A money market instrument is short-term debt with 1 year or less to maturity.

Reference: 2.10.1.1 in the License Exam Manual

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Question ID: 605073

If interest rates are dropping, an investor with a maturing bond will be *most* concerned with:

- ✗ **A)** a negative yield curve.
- ✗ **B)** a positive yield curve.
- ✗ **C)** the quality declining with the yield.
- ✓ **D)** the difficulty in finding another investment with a like yield.

Explanation

When interest rates decrease, investors with maturing bonds will have to accept lesser yields to replace their investments. This is often referred to as a form of reinvestment risk.

Reference: 2.10.3.5 in the License Exam Manual

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Question ID: 605090

If a U.S. corporation wishes to issue eurodollar bonds, which of the following statements are TRUE?

I. The corporation will be subject to currency risk.
II. The corporation will not be subject to currency risk.
III. The issue must be filed with the SEC.
IV. The issue need not be filed with the SEC.

- ✗ **A)** I and III.

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

Explanation

Because eurodollar bonds are denominated in U.S. dollars, a U.S. corporate issuer will not be subject to foreign exchange risk, regardless of the country of issuance. In addition, because the bonds are issued outside the U.S., the issue is not registered with the SEC.

Reference: 2.10.4.2 in the License Exam Manual

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Question ID: 605097

The effective Fed funds rate is:

- ✗ **A)** the lowest rate charged by any bank.
- ✗ **B)** the highest rate charged by any bank.
- ✓ **C)** the daily average rate charged by banks.
- ✗ **D)** the rate charged by the largest bank.

Explanation

Each week, banks have to report their daily Fed funds rate. The published rate is the average of all reporting banks over the course of the week.

Reference: 2.10.3.1 in the License Exam Manual

Question #6 of 128

Question ID: 721399

All of the following can be associated with asset-backed securities EXCEPT

- ✗ **A)** pooling individual assets into larger financial securities to be sold to investors
- ✗ **B)** expected cash flow from credit card debt, leases, auto loans, and mortgages
- ✓ **C)** minimal risk
- ✗ **D)** the securitization of assets

Explanation

The value of asset-backed securities is backed by the expected cash flow from a pool of assets such as mortgages, other types of loans, credit card debt, and leases. Pooling individual smaller and sometimes less liquid assets into larger securities allows them to be sold easier to investors. This process is known as securitization. However, the cash flow from these assets is not guaranteed in any way, and therefore, these securities cannot be characterized as carrying minimal risk.

Reference: 2.8 in the License Exam Manual

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Question ID: 605058

A client of your broker/dealer is interested in collateralized mortgage obligations (CMOs). While determining suitability for the client all of the following should be discussed EXCEPT

- ✗ **A)** the relationship between mortgage loans and mortgage securities
- ✓ **B)** how currency exchange rates may affect the value of the securities
- ✗ **C)** how changing interest rates may affect the prepayment rates
- ✗ **D)** the tax consequences of CMOs

Explanation

Currency exchange rates are not applicable to the risks associated with CMOs. However, when determining suitability, a discussion of all of the characteristics and risks of CMOs, should occur. This would include how changing interest rates may affect prepayment rates and therefore the average life of the security, tax considerations (CMOs are taxable at all levels), and the relationship between actual mortgage loans and mortgage-backed securities.

Reference: 2.8.2 in the License Exam Manual

Question #8 of 128

Question ID: 605098

All of the following are true of negotiable commercial paper EXCEPT:

- ✗ **A)** it has a maximum 270-day maturity.
- ✗ **B)** it is discounted on a 360-day year.
- ✗ **C)** it is considered a money market instrument.
- ✓ **D)** it trades with accrued interest.

Explanation

The only money market instruments that trade with accrued interest are CDs.

Reference: 2.10.2.4 in the License Exam Manual

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Question ID: 605054

Characteristics of Inverse Floater CMOs include:

I. low volatility.
II. high volatility.
III. decreasing principal payments as interest rates rise.
IV. increasing principal payments as interest rates rise.

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

Explanation

Inverse floater CMO tranche types are considered to be highly volatile and suitable only for sophisticated investors willing to assume high levels of risk. As interest rates rise, principal payments to the investor may decrease. The reduction in repayment of principal extends the maturity date which is known as extension risk.

Reference: 2.8.1.6 in the License Exam Manual

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Question ID: 605092

If the value of the U.S. dollar increases against other currencies, which of the following are TRUE?

I. U.S. exports are more competitive in foreign countries.
II. U.S. exports are less competitive in foreign countries.
III. Foreign imports into the U.S. are more competitive in U.S. markets.
IV. Foreign imports into the U.S. are less competitive in U.S. markets.

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

Explanation

If the value of the U.S. dollar increases against other currencies, then U.S. exports cost more for foreign markets to purchase. This also makes foreign imports less expensive for U.S. consumers.

Reference: 2.10.4.4 in the License Exam Manual

Question #11 of 128

Question ID: 605105

A repurchase agreement is usually initiated by which of the following?

I. U.S. Treasury.
II. Federal Home Loan Bank.
III. Commercial bank.
IV. Federal Reserve Board.

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

Explanation

Repurchase agreements are typically initiated by commercial banks or the Federal Reserve Board. They enable banks to meet reserve requirements through the sale of securities (often overnight) with an agreement to buy them back at an agreed-on price.

Reference: 2.10.2.1 in the License Exam Manual

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Question ID: 605084

All of the following statements regarding a Eurodollar deposit are true EXCEPT:

✗ **A)** the deposit is dollar-denominated but is held in a foreign bank.
✗ **B)** it pays a higher interest rate than a domestic certificate of deposit.
✓ **C)** the interest rate is set by the Federal Reserve Board.
✗ **D)** it carries higher risk than a domestic certificate of deposit.

Explanation

The Federal Reserve Board has no authority to set interest rates on eurodollar deposits, which are dollar- denominated deposits held in banks outside the United States.

Reference: 2.10.4.1 in the License Exam Manual

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Question ID: 605089

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

✓ **A)** they are registered with the SEC.
✗ **B)** they are issued in bearer form.
✗ **C)** they are not subject to withholding taxes.
✗ **D)** interest is paid once a year.

Explanation

Eurodollar bonds are issued in bearer form, pay interest once a year, and are not subject to withholding taxes. They are issued outside the United States and are therefore not subject to SEC registration.

Reference: 2.10.4.2 in the License Exam Manual

Question #14 of 128

Question ID: 605145

Which of the following characteristics are associated with bond laddering?

I. Purchasing fewer bonds, each having larger face values
II. Purchasing more bonds, each having smaller face values
III. Purchasing bonds with maturity dates spread over periods of time
IV. Purchasing bonds all maturing on the same date

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

✗ **C)** I and III
✗ **D)** I and IV

Explanation

Bond laddering is a strategy for fixed income portfolios involving the purchase of more bonds with smaller face values having maturities spread over greater periods of time. The strategy is used to decrease the overall risk of a bond portfolio by spreading risk over longer sections of the interest rate curve. This is considered a form of diversification.

Reference: 2.13.1 in the License Exam Manual

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Question ID: 605068

The interest on Series EE bonds is received by the holder of the bond:

✗ **A)** quarterly.
✓ **B)** upon redemption.
✗ **C)** annually.
✗ **D)** monthly.

Explanation

Series EE bonds are designed for individual investors, sold at face value, and redeemed at an amount that includes the interest income which is calculated and accrues every six months.

Reference: 2.9.1 in the License Exam Manual

Question #16 of 128

Question ID: 605037

Which of the following risk factors would be *least* important to disclose in recommending CMO securities to public customers?

✗ **A)** Prepayment risk.
✓ **B)** Credit risk.
✗ **C)** Extended payment risk.
✗ **D)** Interest rate risk.

Explanation

The majority of CMOs offered to the public are backed by mortgages held by government-sponsored corporations: Fannie Mae, Ginnie Mae, Freddie Mac, etc. Credit risk would be a minimal consideration. The other risks are inherent to mortgage-backed securities.

Reference: 2.8.2 in the License Exam Manual

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Question ID: 605067

Which of the following statements regarding Series EE bonds is NOT true?

✗ **A)** They are issued at 100% of face value.
✗ **B)** They are an accrual-type security.
✓ **C)** They earn tax-free interest.
✗ **D)** They are no longer exchangeable for Series HH bonds.

Explanation

The interest earned on U.S. government securities is generally taxable at the federal level only. Series EE bonds are issued at 100% of face value. The interest earned is added to the purchase price (an accrual-type security) to establish a redemption value. The interest earned is not taxable until sale or redemption. Also, Series EE bonds can no longer be exchanged for Series HH bonds.

Reference: 2.9.1 in the License Exam Manual

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Question ID: 721398

Which of the following accounts would a CMO Z-tranche be best suited for?

- ✓ **A)** a professionally managed hedge fund specializing in real estate portfolio securities
- ✗ **B)** a custodial account set up under the uniform transfer to minors act (UTMA)
- ✗ **C)** a joint account with a nonworking spouse
- ✗ **D)** an IRA account for a middle aged client

Explanation

A zero tranche (Z-Tranche) CMO is considered to be among the most volatile CMO tranches because they receive no payments until all preceding tranches of the CMO are retired. Generally CMO tranches are not suitable for smaller or unsophisticated investors which is why customers are required to sign a suitability statement before purchasing any CMO tranche. Of the answer choices given the best suited account would be the one that is professionally managed and already specializing in real estate investments.

Reference: 2.8.1.5 in the License Exam Manual

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Question ID: 605086

All of the following may issue U.S. dollar-denominated Eurobonds EXCEPT

- ✗ **A)** Greater Health, Ltd., a British company based in London
- ✗ **B)** the Kenosha, Wisconsin Municipal Harbor Authority in the U.S.
- ✗ **C)** ABC Corporation, an American company with offices in Japan
- ✓ **D)** the U.S. Treasury on behalf of the U.S. government

Explanation

Eurobonds are issued in foreign countries and backed by U.S. dollars on deposit in those countries' banks. They can be issued by nearly any issuer: foreign corporations, foreign governments, U.S. municipalities, and U.S. corporations with offices in foreign countries. They are not issued by the U.S. government.

Reference: 2.10.4.2 in the License Exam Manual

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Question ID: 605131

Which of the following statements *best* describes banker's acceptances?

- ✗ **A)** They are unsecured promissory notes with long term maturities issued by financially strong corporations.
- ✗ **B)** They are used to satisfy short-term cash needs of broker/dealers.
- ✗ **C)** They are an asset that provides a competitive rate of return, broad diversification, and liquidity.
- ✓ **D)** They are used primarily to finance imports and exports.

Explanation

Banker's acceptances are used primarily to finance imports and exports. They are short-term time drafts with a specified payment date drawn on a bank—essentially lines of credit.

Reference: 2.10.2.3 in the License Exam Manual

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Question ID: 605138

The Trade Reporting and Compliance Engine (TRACE):

I. requires that both sides of a transaction report the trade.
II. requires only the sell side of a transaction report the trade.
III. is a reporting system for corporate bonds trading in the OTC market.
IV. is an execution system for corporate bonds trading on exchanges.

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

Explanation

The Trade Reporting and Compliance Engine (TRACE) is the FINRA approved trade reporting system for corporate bonds trading in the OTC secondary market. It is not an execution system. Both sides of a TRACE eligible transaction are required to report a trade when it occurs.

Reference: 2.11.1.1 in the License Exam Manual

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Question ID: 605036

A CMO makes an interest-only payment to an investor. This payment will be:

- ✗ **A)** taxed as a capital gain if the underlying mortgage is prepaid.
- ✓ **B)** taxed as ordinary income.
- ✗ **C)** tax free.
- ✗ **D)** treated partly as ordinary income and partly as a tax-free return of principal.

Explanation

Interest-only payments made by CMOs are taxed as ordinary income.

Reference: 2.8.2.2 in the License Exam Manual

Question #23 of 128

Question ID: 605078

The effective federal funds rate is the:

- ✗ **A)** daily average of all commercial banks.
- ✗ **B)** weekly average of all commercial banks.
- ✓ **C)** daily average of Federal Reserve System member banks.
- ✗ **D)** weekly average of Federal Reserve System member banks.

Explanation

The effective federal funds rate is the daily average of money center banks, all of which are Federal Reserve System members. This rate is the rate charged bank to bank for overnight loans.

Reference: 2.10.3.1 in the License Exam Manual

Question #24 of 128

Question ID: 605103

Which of the following is NOT a money market instrument?

- ✓ **A)** Newly issued Treasury notes.
- ✗ **B)** Treasury bills.
- ✗ **C)** Banker's acceptances.
- ✗ **D)** Commercial paper.

Explanation

Commercial paper, Treasury bills, and banker's acceptances are debt instruments with maturities of 1 year or less and are therefore money market instruments. A newly issued Treasury note would have a maturity of 2 to 10 years and therefore would not be a money market instrument.

Reference: 2.10.1.1 in the License Exam Manual

Question #25 of 128

Question ID: 605033

All of the following concerning CMOs are true EXCEPT:

- ✓ **A)** CMOs are issued by government agencies.

✗ **B)** CMOs are not backed by the federal government.

✗ **C)** most CMOs are backed by government agency pass-through securities held in a trust account.

✗ **D)** CMOs can be purchased and sold OTC.

Explanation

CMOs are created by broker/dealers, who buy pass-through securities from government agencies and government-sponsored corporations, place the certificates in trust, and issue participation interests in the trusts that are tied to specific maturity periods (tranches).

Reference: 2.8.2.5 in the License Exam Manual

Question #26 of 128

Question ID: 605075

When a higher interest rate is predicted for the future, a municipality will issue:

✓ **A)** a long-term bond.

✗ **B)** none of these.

✗ **C)** an intermediate bond.

✗ **D)** a short-term bond.

Explanation

When interest rates are predicted to rise, a municipality will issue a long-term bond, because it can take advantage of the current lower rate.

Reference: 2.10.3 in the License Exam Manual

Question #27 of 128

Question ID: 605132

Your customer is interested in purchasing a brokered CD and asks how they trade in the event he would want to sell it before it matures. Which of the following statements best describes how brokered CDs trade?

✗ **A)** Brokered CDs always trade at a discount to par value.

✓ **B)** Brokered CDs trade at a market driven price that typically moves inversely to the movement of interest rates.

✗ **C)** Brokered CDs trade at the original issue price until they mature, with no price fluctuation.

✗ **D)** Brokered CDs always trade at a premium to par value.

Explanation

A brokered CD trades at market driven prices. Similar to how a debt instrument typically trades, their price will fluctuate inversely to the movement in interest rates. This is one of the risks associated with selling a brokered CD before it matures. Rising interest rates along with limited liquidity may result in a significant loss of principal.

Reference: 2.10.2.5.3 in the License Exam Manual

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Question ID: 605118

A repurchase agreement is an agreement between two parties to conduct a transaction and then reverse the transaction at an agreed-upon price in the future. The duration of the agreement and the rate charged, which represents the difference between the two transactions prices, can *best* be described as:

I. long term.
II. short term.
III. lower than bank loan rates.
IV. higher than bank loan rates.

✓ **A)** II and III.

✗ **B)** I and IV.

✗ **C)** II and IV.

✗ **D)** I and III.

Explanation

Repurchase agreements are used by financial institutions to raise cash for short periods of time, typically overnight. Because these agreements are of such short duration, their rate (also known as the repo rate) is generally going to be lower than bank loan rates at that time.

Reference: 2.10.2.1 in the License Exam Manual

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Question ID: 605053

Yield quotes on CMOs are based on the:

- ✗ **A)** underlying mortgages' average life.
- ✓ **B)** tranche's expected life.
- ✗ **C)** underlying mortgages' interest rate.
- ✗ **D)** underlying mortgages' maturity.

Explanation

Yield quotes on CMOs are based on the tranche's expected life, not the average life of the mortgages in the pool backing all of the tranches.

Reference: 2.8 in the License Exam Manual

Question #30 of 128

Question ID: 605066

A customer calls you and expresses interest in purchasing nonmarketable U.S. government debt. His primary concern is purchasing power risk. You should advise the customer to consider purchasing

- ✗ **A)** any of these
- ✗ **B)** Series EE bonds
- ✗ **C)** Series HH bonds
- ✓ **D)** Series I bonds

Explanation

Series I bonds have been designed for investors seeking to protect the purchasing power of their investment. The interest rate on these bonds has two components: a fixed rate and an inflation rate tied to the Consumer Price Index. The inflation component is recalculated every six months. Series I bonds are an accrual-type security, meaning the interest is added to the bond's face value each month and is paid when the bond is sold or redeemed. If the customer were interested in buying marketable U.S. government debt, the customer would purchase Treasury Inflation Protection Securities (TIPS).

Reference: 2.9.2 in the License Exam Manual

Question #31 of 128

Question ID: 605039

If interest rates fall, which of the following statements regarding CMOs are TRUE?
I. Prepayment risk will increase.
II. Prepayment risk will decrease.
III. Prices of each tranche will rise.
IV. Prices of each tranche will fall.

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

Explanation

Prepayment risk is the risk that the underlying mortgages will be paid off sooner than expected. If rates fall, mortgage holders will refinance, paying off the existing high rate mortgages with lower rate mortgages. Thus, a tranche with an expected average life of 5-½ years may be extinguished in 2 years because of an acceleration in prepayments. As rates fall, prices of the underlying mortgages will rise.

Reference: 2.8.2 in the License Exam Manual

Question #32 of 128

Question ID: 605042

Which of the following debt securities does NOT have a fixed maturity date?

- ✗ **A)** General obligation bond.
- ✗ **B)** Subordinated debenture.
- ✗ **C)** Treasury STRIPS.
- ✓ **D)** Collateralized mortgage obligation.

Explanation

Collateralized mortgage obligations (CMOs) are mortgage-backed securities. Because mortgages are often paid off ahead of the scheduled maturity, the exact maturity date of a CMO is uncertain.

Reference: 2.8 in the License Exam Manual

Question #33 of 128

Question ID: 605112

Which of the following statements regarding negotiable CDs are TRUE?

I. The issuing bank guarantees them.
II. They are callable.
III. Minimum denominations are $1,000.
IV. They can be traded in the secondary market.

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

Explanation

Negotiable CDs are issued primarily by banks and backed by the issuing bank. The minimum denomination is $100,000. These are sometimes referred to as jumbo CDs.

Reference: 2.10.2.5.2 in the License Exam Manual

Question #34 of 128

Question ID: 605031

A customer interested in a collateralized mortgage obligation (CMO) might look to which of the following for historical data or projections regarding mortgage prepayments?

- ✗ **A)** DEA.
- ✓ **B)** PSA.
- ✗ **C)** FINRA.
- ✗ **D)** Daily Bond Buyer.

Explanation

The Public Securities Association (PSA) uses historical data and projections of mortgage prepayments to estimate yield and maturity of different CMO tranches.

Reference: 2.8 in the License Exam Manual

Question #35 of 128

Question ID: 605130

Debt normally issued by big corporations with reliable credit ratings who seek to finance short-term needs *best* describes:

- ✗ **A)** T-bills.
- ✗ **B)** step-up CDs.
- ✓ **C)** commercial paper.
- ✗ **D)** revenue anticipation notes.

Explanation

Also known as promissory notes this is the definition of commercial paper. They are short-term corporate issued instruments sold at a discount and maturing at par.

Reference: 2.10.2.4 in the License Exam Manual

Question #36 of 128

Question ID: 605030

A planned amortization class (PAC) CMO offers:

- ✗ **A)** protection from extension risk only.
- ✗ **B)** protection from prepayment risk only.
- ✗ **C)** less protection than a targeted amortization class.
- ✓ **D)** protection from both prepayment and extension risk.

Explanation

A PAC offers protection from both prepayment and extension risk. This protection is greater than that offered by a targeted amortization class (TAC) CMO, which protects against prepayment risk only.

Reference: 2.8.1.3 in the License Exam Manual

Question #37 of 128

Question ID: 605070

Which of the following is nonnegotiable?

- ✗ **A)** Ginnie Mae bonds.
- ✗ **B)** Treasury bills.
- ✗ **C)** Treasury notes.
- ✓ **D)** Series EE bonds.

Explanation

Series EE bonds, usually known as savings bonds, are sold at face value to the purchaser and are nonnegotiable. Since EE bonds must be redeemed by the original purchaser, ownership cannot be transferred, which makes them a nonmarketable security. Series EE bonds may not be used as collateral for a loan.

Reference: 2.9.1 in the License Exam Manual

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Question ID: 721403

When reviewing a money market fund portfolio, one would NOT expect to find

- ✗ **A)** T-bonds with less than 1 year to maturity
- ✓ **B)** common stock
- ✗ **C)** T-bills
- ✗ **D)** negotiable CDs

Explanation

Money market instruments are short-term high-quality debt securities. This includes treasuries with less than 1 year to maturity and negotiable CDs. Because common stock is equity, it is not found in money market funds.

Reference: 2.10.1.1 in the License Exam Manual

Question #39 of 128

Question ID: 721400

Which of the following is a characteristic associated with I bonds?

- ✗ **A)** Issued by municipalities.
- ✗ **B)** Generally considered highly speculative and suitable for sophisticated investors only.

✗ **C)** Pay interest payments monthly to the holder.
✓ **D)** A variable, semiannually adjusted inflation rate, based on changes in the CPI.

Explanation

I bonds are nonmarketable U.S. government securities which have a variable semiannually adjusted inflation rate that is based on the Consumer Price Index (CPI). They were designed for investors wishing to protect the purchasing power of their investment. They are sold at face value and they grow in value with the addition of the inflation-adjusted interest.

Reference: 2.9.2 in the License Exam Manual

Question #40 of 128

Question ID: 605124

Which of the following are characteristics of commercial paper?

I. It represents a loan by the holder to the issuer.
II. It is a certificate of ownership in the corporation.
III. It is commonly issued to raise working capital for a corporation.
IV. It is junior in preference to convertible preferred stock.

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

Explanation

Commercial paper instruments are debt securities; they represent loans to the issuing corporation by the holder. They are commonly issued to raise working capital and, as debt obligation, are senior in preference to preferred stock in claims against an issuer.

Reference: 2.10.2.4 in the License Exam Manual

Question #41 of 128

Question ID: 605120

Which of the following is the *most* sensitive/volatile short-term interest rate?

✗ **A)** Broker call loan rate.
✗ **B)** Prime rate.
✗ **C)** Discount rate.
✓ **D)** Federal funds rate.

Explanation

The federal funds rate is considered to be the most volatile of all short-term interest rates.

Reference: 2.10.3.1 in the License Exam Manual

Question #42 of 128

Question ID: 605102

Which of the following are characteristics of commercial paper?

I. Registered with the SEC
II. Short-term debt instrument.
III. Issued by commercial banks.
IV. Unsecured debt.

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

Explanation

Commercial paper represents the unsecured debt obligations of corporations needing short-term financing. Because commercial paper is issued with maturities of less than 270 days, it is exempt from SEC registration under the Act of 1933.

Reference: 2.10.2.4 in the License Exam Manual

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Question ID: 605133

Your customer, a US corporate manufacturer, is selling goods overseas and is, therefore, exposed to currency risk. You advise that in order to lessen the risk exposure, aside from utilizing listed currency options, the corporation might also

- ✗ **A)** trade the foreign currencies on the NYSE
- ✗ **B)** trade the foreign currencies on regional US exchanges
- ✓ **C)** trade the foreign currencies in the interbank spot market
- ✗ **D)** restrict its overseas sales to a minimum

Explanation

Aside from trading listed foreign currency options on US exchanges to lesson risk, trades of the foreign currency can be accommodated in the interbank spot market. Spot trades that settle in 1 or 2 business days and forward delivery contracts can both be done there. Currencies do not trade on US exchanges.

Reference: 2.10.4.3 in the License Exam Manual

Question #44 of 128

Question ID: 605063

A collateralized mortgage obligation (CMO) issued by a financial institution or a home builder would be known as

- ✗ **A)** a planned amortization (PAC) CMO
- ✓ **B)** a private label issued CMO
- ✗ **C)** an agency issued CMO
- ✗ **D)** a targeted amortization (TAC) CMO

Explanation

Private label CMOs are issued by private entities such as financial institutions, investment banks or even home builders. They may or may not include government agency securities in their portfolios and therefore carry and additional element of risk. Both PACs and TACs are CMO tranche types and either can be a part of either an agency or private label CMO issue.

Reference: 2.8.2.5.1 in the License Exam Manual

Question #45 of 128

Question ID: 605064

Private label CMOs

I. never use government issued securities as collateral
II. can use government issued securities as collateral
III. are considered as safe as agency issued CMOs
IV. can carry greater risk than agency issued CMOs

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

Explanation

Private label CMOs can be issued by investment banks, other financial institutions, and even home builders. They may or may not use government-issued securities as collateral. In either case, they are considered to carry greater risk than agency issued CMOs as they can only be backed by their issuer and carry no implied backing or guarantee from the government or government agency even when agency issued securities are used as collateral.

Reference: 2.8.2.5.1 in the License Exam Manual

Question #46 of 128

Question ID: 721402

For Eurodollar bonds, all of the following are accurate statements EXCEPT

- ✗ **A)** they are issued outside of the United States
- ✓ **B)** non-U.S. investors would not be subject to currency risk
- ✗ **C)** U.S. investors are not exposed to currency risk
- ✗ **D)** interest and principal payments are made in U.S. dollars

Explanation

Eurodollar bonds are issued outside the United States, but principal and interest are paid in U.S. dollars. Therefore, a U.S. investor bears no currency risk, although a foreign issuer or investor does.

Reference: 2.10.4.2 in the License Exam Manual

Question #47 of 128

Question ID: 605060

A customer expresses the need to invest a fixed dollar sum now that will return a fixed dollar sum in 10 years. He mentions several investments. Of those listed which would not be a suitable recommendation for his objective?

- ✗ **A)** A zero-coupon bond maturing in 10 years
- ✓ **B)** Collateralized mortgage obligations (CMOs)
- ✗ **C)** Treasury Inflation Protection Securities (TIPS)
- ✗ **D)** A high-yield corporate bond maturing in 10 years

Explanation

Due to the interest rate sensitivity of mortgage-backed securities and the possibility of high prepayment risk (receiving the invested funds back earlier than anticipated) CMOs would not be suitable. TIPs, designed to protect against inflation, and the high yield corporate bond if held to maturity, could each meet the objective. Zero coupon bonds are specifically designed to meet the objective of investing a fixed sum now and realizing a fixed sum later and in this regard would be the most suitable of those listed.

Reference: 2.8.2.5 in the License Exam Manual

Question #48 of 128

Question ID: 765459

All of the following are TRACE eligible and require reporting EXCEPT

- ✗ **A)** asset backed securities (ABS)
- ✗ **B)** collateralized mortgage securities (CMOs)
- ✓ **C)** new issue primary market securities
- ✗ **D)** corporate bonds

Explanation

The Trade Reporting and Compliance Engine (TRACE) is the FINRA approved trade reporting system for corporate bonds, asset backed securities, collateralized mortgage obligations and Treasury securities trading in the OTC secondary market. Money market securities and new issues (primary market) among others are specifically excluded from the TRACE reporting requirements.

Reference: 2.11.1.1 in the License Exam Manual

Question #49 of 128

Question ID: 765460

Which of the following are excluded from the Trade Reporting and Compliance Engine (TRACE) reporting requirements?

- ✓ **A)** Money market securities
- ✗ **B)** Collateralized mortgage obligations (CMOs)

- ✗ **C)** Government agency bonds
- ✗ **D)** Asset Backed Securities (ABSs)

Explanation

The Trade Reporting and Compliance Engine (TRACE) is the FINRA approved trade reporting system for corporate, government agency and Treasury securities trading in the OTC secondary market. While most corporate debt securities, asset backed securities (ABS), and collateralized mortgage obligations (CMOs) are TRACE-eligible, there are exclusions such as, debt of foreign governments, money market instruments, and debt securities that are not Depository Trust-eligible.

Reference: 2.11.1.1 in the License Exam Manual

Question #50 of 128

Question ID: 605047

All of the following are used to back collateralized mortgage obligations EXCEPT:

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

Explanation

Sallie Mae is the Student Loan Marketing Association, which purchases student loans and packages them for the secondary market. The FNMA, GNMA, and FHLMC sell mortgage-backed securities.

Reference: 2.8 in the License Exam Manual

Question #51 of 128

Question ID: 605024

The term "tranche" is associated with which of the following investments?

- ✓ **A)** CMO.
- ✗ **B)** SLMA.
- ✗ **C)** GNMA.
- ✗ **D)** FNMA.

Explanation

Collateralized mortgage obligations are a type of mortgage-backed security. A CMO issue is divided into several tranches, or slices, which set priorities for payments of principal and interest.

Reference: 2.8 in the License Exam Manual

Question #52 of 128

Question ID: 605104

Which of the following does NOT issue commercial paper?

- ✗ **A)** Finance company.
- ✗ **B)** Broker/dealer.
- ✓ **C)** Commercial bank.
- ✗ **D)** Corporation.

Explanation

Commercial banks do not issue commercial paper. The commercial paper market was developed to circumvent banks so that corporations could lend to, and borrow from, each other more economically. Commercial paper is unsecured, short-term corporate debt.

Reference: 2.10.2.4 in the License Exam Manual

Question #53 of 128

Question ID: 605108

Which of the following securities trades with accrued interest?

- ✗ **A)** Treasury bill
- ✓ **B)** Negotiable certificate of deposit
- ✗ **C)** Banker's acceptance
- ✗ **D)** Commercial paper

Explanation

Negotiable CDs are traded with interest. Bankers' acceptances, commercial paper, and T-bills are issued at a discount and traded without accrued interest (flat).

Reference: 2.10.2.5.2 in the License Exam Manual

Question #54 of 128

Question ID: 605077

Which of the following money rates are set by banks in competition with one another for borrowers?

I. Federal Funds Rate.
II. Discount Rate.
III. Broker Call Loan Rate.
IV. Prime Rate.

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

Explanation

The Federal Funds Rate is charged by banks to one another. The Discount Rate is set by the Federal Reserve Board. The remaining two rates are charged by banks competing for borrowers.

Reference: 2.10.3.2 in the License Exam Manual

Question #55 of 128

Question ID: 605122

All of the following are characteristics of certificates of deposit EXCEPT:

- ✗ **A)** A CD may be payable to the bearer or registered in the name of the investor.
- ✗ **B)** A CD is often issued by a bank.
- ✓ **C)** The Federal Deposit Insurance Corporation (FDIC) provides insurance for CDs to $500,000.
- ✗ **D)** A CD can be negotiable or nonnegotiable.

Explanation

The FDIC provides insurance for CDs up to $250,000. All of the other characteristics are applicable to CDs.

Reference: 2.10.2.5 in the License Exam Manual

Question #56 of 128

Question ID: 605061

A home builder has issued a collateralized mortgage obligation (CMO) using government agency mortgage pass-through securities, mortgage loans and letters of credit as collateral. This would be known as what type of CMO?

- ✗ **A)** inverse floater
- ✓ **B)** private-label
- ✗ **C)** agency-issued
- ✗ **D)** agency-backed

Explanation

When private institutions such as finance agencies, investment banks or home builders issue CMOs they are known as “private-label” CMOs. They are the sole obligation of their issuer and often have as collateral non-agency issued securities such as letters of credit and mortgage loans or pools of mortgage loans.

Reference: 2.8.2.5.1 in the License Exam Manual

Question #57 of 128

Question ID: 605045

Which of the following statements regarding CMOs is TRUE?

✓ **A)** CMO returns are affected by interest rate changes.
✗ **B)** CMOs are considered high yield bonds.
✗ **C)** CMOs may not trade at a premium.
✗ **D)** CMO earnings are tax exempt.

Explanation

CMOs, like other mortgage-backed securities, respond to changes in interest rates. When interest rates decline, certain CMO tranches are subject to prepayment risk. CMOs are corporate instruments, and their interest is taxable at all levels.

Reference: 2.8 in the License Exam Manual

Question #58 of 128

Question ID: 605043

The interest on which of the following instruments is subject to taxation at the federal, state, and local levels?

✓ **A)** Collateralized mortgage obligations.
✗ **B)** Public Housing Authority bonds.
✗ **C)** Treasury notes.
✗ **D)** Revenue bonds.

Explanation

The interest on corporate debt securities is subject to taxation at the federal, state, and local levels, and collateralized mortgage obligation (CMOs) are issued by corporations. Interest on Treasury instruments is taxable at the federal level only. Interest on municipal instruments is exempt from taxation at the federal level and possibly the state level if the holder is a resident of the state of issue. Public Housing Authority bonds and revenue bonds are types of municipal issues, which are tax free at the federal level.

Reference: 2.8.2.2 in the License Exam Manual

Question #59 of 128

Question ID: 605046

Which of the following should a registered representative disclose when discussing CMOs with a customer?

✓ **A)** Rate of return may vary because of early repayment.
✗ **B)** The federal government guarantees return of principal.
✗ **C)** All CMOs have similar risk.
✗ **D)** CMOs offer the same tax advantages as Treasury securities.

Explanation

CMOs are corporate mortgage-backed bonds that separate mortgage pools into different maturity classes called tranches. Like other mortgage-backed securities, CMOs subject investors to the risk of early repayment when interest rates fall; registered representatives should disclose this risk to CMO customers. CMO interest is taxed at all levels, and there is no government backing on CMOs. Different CMO tranches have differing levels of investment risk.

Reference: 2.8.2.5 in the License Exam Manual

Question #60 of 128

Question ID: 605025

All of the following statements regarding CMOs are true EXCEPT:

- ✓ **A)** interest is paid semiannually.
- ✗ **B)** principal repayments are applied to earlier tranches first.
- ✗ **C)** CMOs are a derivative security.
- ✗ **D)** interest payments are distributed pro rata when received.

Explanation

CMO holders are paid interest monthly. As payments are received from the underlying mortgages, interest is paid pro rata to all tranches, but principal repayments are paid to the first tranche until it is retired. Subsequent principal repayments are then applied to the second tranche until it is retired, and so on. CMOs are a derivative security because the value of each tranche is derived from the timing of principal repayments to that tranche.

Reference: 2.8 in the License Exam Manual

Question #61 of 128

Question ID: 605057

Two registered representatives (RRs) are discussing a collateralized debt obligation (CDO) backed by cash flow from credit card payments. All of their statements during the discussion are true EXCEPT

- ✗ **A)** a customer would have to choose a tranche that has the right risk characteristics for him, in terms of suitability
- ✓ **B)** CDOs always represent pools of assets that individually are very liquid, and that is why the CDOs themselves are very liquid
- ✗ **C)** CDOs are securitized products where pooling or repackaging of individual loans has occurred
- ✗ **D)** CDOs are not considered suitable for all customers

Explanation

In most cases, the assets comprising the CDO portfolio are small and individually not very liquid. Generally, individual investors would not have an opportunity to purchase these assets separately. Repackaging the assets, however, facilitates them being sold to individual investors in the secondary markets.

Reference: 2.8.3 in the License Exam Manual

Question #62 of 128

Question ID: 605028

All of the following are derivative securities EXCEPT:

- ✓ **A)** general obligation bonds.
- ✗ **B)** warrants to purchase publicly traded common stock.
- ✗ **C)** equity options.
- ✗ **D)** collateralized mortgage obligations.

Explanation

A derivative security is one whose value is dependent on (derived from) the value of another security. The value of an equity option is derived from the value of the underlying stock as is the value of a warrant. The value of a CMO is derived from the values of the underlying mortgages.

Reference: 2.8 in the License Exam Manual

Question #63 of 128

Question ID: 605127

In a repurchase agreement between a broker/dealer and a large institutional customer, the broker/dealer:

- ✗ **A)** sells securities to the customer who, with prior agreement, resells the securities to an unrelated third party.
- ✗ **B)** buys securities from the customer with an agreement to sell them back.
- ✗ **C)** buys securities from the customer who, with prior agreement, repurchases the securities from an unrelated third party.
- ✓ **D)** sells securities to the customer with an agreement to buy them back.

Explanation

The dealer agrees to buy back the securities at a specified date at a higher price than they were sold for. The difference represents interest to the party who bought the securities (the lender).

Reference: 2.10.2.1 in the License Exam Manual

Question #64 of 128

Question ID: 605081

Which of the following statements describes the discount rate?

- ✓ **A)** Charge on loans to member banks by the New York Federal Reserve Bank.
- ✗ **B)** Charge on loans to brokers on stock exchange collateral.
- ✗ **C)** Rate charged on reserves traded among commercial banks for overnight use in amounts of $1 million or more.
- ✗ **D)** Base rate on corporate loans at large U.S. money center commercial banks.

Explanation

The discount rate is the charge on loans to member banks by the New York Federal Reserve Bank. The prime rate is the base rate on corporate loans at large U.S. money center commercial banks. The federal funds rate is the rate charged on reserves traded among commercial banks for overnight use in amounts of $1 million or more. The call rate, or broker call loan rate, is the charge on loans to brokers for margin loans.

Reference: 2.10.3.3 in the License Exam Manual

Question #65 of 128

Question ID: 765458

Of the following system characteristics which can be associated with TRACE (Trade Reporting and Compliance Engine)?

I. Both sides of the transaction must report.
II. Only the buyer is required to report.
III. Money market securities are excluded from the reporting system.
IV. It is an execution and trade reporting system.

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

Explanation

TRACE requires that both sides of the transaction report corporate bond trades that occur in the OTC secondary market. Money Market securities are one of the specific exclusions from the trade reporting system. Trace is not an execution system.

Reference: 2.11.1.1 in the License Exam Manual

Question #66 of 128

Question ID: 605085

The floating exchange rate for a nation's currency:

- ✗ **A)** is set by the nation's central bank.
- ✓ **B)** fluctuates based on the values of other currencies.
- ✗ **C)** is tied to the current market price of gold.
- ✗ **D)** fluctuates based on the London Interbank Offered Rate.

Explanation

Most of the world's currencies go up and down in value in relation to one another.

Reference: 2.10.4.4 in the License Exam Manual

Question #67 of 128

Question ID: 605026

If interest rates are rising, which statements are TRUE regarding CMOs?

I. Prepayment risk increases.
II. Prepayment risk decreases.
III. Extended maturity risk increases.
IV. Extended maturity risk decreases.

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

Explanation

If rates are rising, homeowners are less likely to refinance. Therefore, prepayment risk will decrease. Similarly, if prepayments are declining, the estimated life of the underlying mortgages should increase.

Reference: 2.8.2 in the License Exam Manual

Question #68 of 128

Question ID: 605134

Brokered CDs, like other CDs issued by a bank directly to customers, carry FDIC insurance up to

- ✓ **A)** $250,000
- ✗ **B)** $500,000
- ✗ **C)** $100,000
- ✗ **D)** $25,000

Explanation

Brokered CDs, like other CDs issued by banks directly to customers, are FDIC insured up to $250,000.

Reference: 2.10.2.5.3 in the License Exam Manual

Question #69 of 128

Question ID: 605123

A money market mutual fund would be *least* likely to invest in which of the following assets?

- ✗ **A)** Repurchase agreements.
- ✗ **B)** U.S. Treasury bills.
- ✓ **C)** U.S. Treasury notes.
- ✗ **D)** Bank certificates of deposit.

Explanation

A money market mutual fund typically invests in money market instruments, or those with a maturity date not exceeding 397 days. Treasury notes have maturity dates of 2-10 years.

Reference: 2.10.1.1 in the License Exam Manual

Question #70 of 128

Question ID: 605083

Which of the following is TRUE concerning the payment of the repo rate?

- ✗ **A)** The issuer of the securities pays the buyer.
- ✗ **B)** The issuer of the securities pays the seller.
- ✓ **C)** The original seller pays the original buyer.
- ✗ **D)** The original buyer pays the original seller.

Explanation

The original seller is buying back at a guaranteed higher price from the original buyer. In a repurchase agreement, securities are sold and then bought back or repurchased.

Reference: 2.10.2.1 in the License Exam Manual

Question #71 of 128

Question ID: 721405

A customer is interested in diversifying a portfolio by using an investment technique known as bond laddering. Regarding suitability, which of the following are applicable and should be brought to the investor's attention?

I. Liquidations needed to be made before maturity may expose one to interest rate risk.
II. The strategy cannot be used to reduce investment risk.
III. This strategy is best suited for someone with an income objective.
IV. This strategy is best suited for someone with a growth objective.

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

Explanation

Bond laddering reduces both interest rate risk and reinvestment risk because it spreads investments made in smaller bond denominations over time. This lends itself to smaller bonds maturing with proceeds needing to be reinvested at set intervals. It is most suitable for those seeking protection of principal and income from the bond's interest payments. However, if unexpected liquidations need to be made, the ill-timed liquidations could expose the portfolio to heightened interest rate risk if rates happen to be high at the time. This would deflate the prices of the bonds being liquidated.

Reference: 2.13.1 in the License Exam Manual

Question #72 of 128

Question ID: 605113

A valid reason for investing in Eurobonds is that they:

- ✗ **A)** can provide an exchange rate hedge against fluctuations in the U.S. dollar.
- ✗ **B)** are less expensive than comparable U.S. bonds.
- ✗ **C)** are traded in an unregulated market free from government intervention.
- ✓ **D)** can provide diversification to a portfolio.

Explanation

Eurobonds may add diversification to a sophisticated investor's portfolio.

Reference: 2.10.4.2 in the License Exam Manual

Question #73 of 128

Question ID: 605141

Exchange-traded notes (ETNs)

I. are unsecured debt securities
II. are unsecured equity securities
III. are issued by financial institutions such as banks
IV. have no credit risk associated with them

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

Explanation

Exchange-traded notes (ETNs) are unsecured debt securities issued by financial institutions such as banks. Their prices can be impacted by changes in the credit rating of the issuer.

Reference: 2.12.1 in the License Exam Manual

Question #74 of 128

Question ID: 605038

All of the following are true regarding interest received from a CMO investment EXCEPT

- ✓ **A)** it is non-taxable at the local level
- ✗ **B)** it is taxable at the federal level
- ✗ **C)** it is taxable at the state level
- ✗ **D)** it is fully taxable at all levels

Explanation

Interest received from CMOs is fully taxable at the federal, state, and local levels.

Reference: 2.8.2.2 in the License Exam Manual

Question #75 of 128

Question ID: 605110

All of the following might be found in a money market fund's portfolio EXCEPT:

- ✓ **A)** common stock.
- ✗ **B)** negotiable CDs.
- ✗ **C)** banker's acceptances.
- ✗ **D)** T-bills.

Explanation

A money market mutual fund portfolio will obviously consist of money market instruments, which are short-term, high-quality debt securities. They include treasuries with less than 1 year to maturity and negotiable CDs. Because common stock is equity, it is not found in money market funds.

Reference: 2.10 in the License Exam Manual

Question #76 of 128

Question ID: 605106

All of the following are money market instruments EXCEPT:

- ✗ **A)** reverse repurchase agreements.
- ✓ **B)** options.
- ✗ **C)** commercial paper.
- ✗ **D)** bankers' acceptances.

Explanation

Money market instruments are short-term (one year or less to maturity) liquid debt instruments. Reverse repurchase agreements, repurchase agreements, commercial paper, CDs, and bankers' acceptances are examples. Options are not money market instruments.

Reference: 2.10.1.1 in the License Exam Manual

Question #77 of 128

Question ID: 605040

Which of the following statements are TRUE of CMO investors?

I. They have interest rate risk.
II. They do not have interest rate risk.
III. They have little or no risk exposure.
IV. They can be exposed to extension and prepayment risk.

- ✗ **A)** II and III.

✗ **B)** I and III.

✗ **C)** II and IV.

✓ **D)** I and IV.

Explanation

Collateralized Mortgage Obligations are backed by mortgages. All mortgage-backed securities are subject to interest rate risk. If rates rise, extended maturity risk exists, which means the actual life of the underlying mortgage will be longer than the expected life. If rates fall, prepayment risk exists, which means mortgage holders will likely refinance their existing mortgages. As a result, the actual life of the underlying mortgages will be shorter than the expected life.

Reference: 2.8.2.5 in the License Exam Manual

Question #78 of 128

Question ID: 605062

Which of the following statements regarding private label CMOs is TRUE?

✗ **A)** If they include government agency securities such as GNMAs in their portfolio, the CMO carries the guarantee of that agency.

✗ **B)** They can only be issued if they contain government agency securities.

✗ **C)** They can only be issued by government agencies.

✓ **D)** They carry no guarantee other than that of the good faith and credit of their issuer.

Explanation

Private label CMOs are issued by private entities such as financial institutions, investment banks or even home builders. They may or may not include government agency securities in their portfolios and never carry any implied guarantee other than that of the good faith and credit of their issuer.

Reference: 2.8.2.5.1 in the License Exam Manual

Question #79 of 128

Question ID: 605114

Repurchase agreements, utilized by financial institutions to raise short term financing, include

I. a clause stipulating no interest rate risk exists
II. a clause stipulating no credit risk exists
III. a repurchase price
IV. a maturity date that may be fixed or left open

✓ **A)** III and IV

✗ **B)** I and IV

✗ **C)** I and III

✗ **D)** II and IV

Explanation

Financial institutions utilize repurchase agreements to raise short-term financing. The Federal Reserve Board can also utilize repurchase agreements to affect the money supply by selling and repurchasing them in the open market. Repo agreements contain an agreed upon repurchase price and a maturity date which may or may not be fixed (left open at the buyer's discretion). Interest rate risk is the major risk concern with repos but credit risk can exist as well, although it is negated when the contra party is the FRB.

Reference: 2.10.2.1 in the License Exam Manual

Question #80 of 128

Question ID: 605034

Which of the following are ordinarily TRUE concerning prepayment of CMOs?

I. If interest rates fall, prepayments increase.
II. If interest rates rise, prepayments increase.
III. If interest rates fall, prepayments decrease.
IV. If interest rates rise, prepayments decrease.

✗ **A)** III and IV.

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

Explanation

When interest rates fall, homeowners often refinance their homes to take advantage of lower interest rates, resulting in the existing mortgages being paid off early. Also, homeowners tend to sell their homes to upgrade to larger homes when mortgage interest rates (and monthly payments) are low. When interest rates rise, homeowners do not usually refinance, and housing turnover is reduced.

Reference: 2.8.2 in the License Exam Manual

Question #81 of 128

Question ID: 605049

Which of the following statements regarding CMOs is TRUE?

- ✗ **A)** Yield is locked in.
- ✓ **B)** They can be purchased for as little as $1,000.
- ✗ **C)** There is no extended maturity risk.
- ✗ **D)** There is no prepayment risk.

Explanation

CMOs can be purchased for as little as $1,000 but mainly trade in minimum amounts of $25,000. Both prepayment risk and extended maturity risk apply to these mortgage-backed securities. The only security where yield is locked in is a zero coupon bond.

Reference: 2.8.2.4 in the License Exam Manual

Question #82 of 128

Question ID: 605146

Bond laddering is intended to

- ✓ **A)** add diversification and decrease reinvestment risk in fixed income portfolios
- ✗ **B)** increase diversification in equity portfolios
- ✗ **C)** maximize return through selective timing when purchasing bonds
- ✗ **D)** lessen both diversification and liquidity in fixed income portfolios to target higher yields

Explanation

Bond laddering is intended to increase diversification, maintain steady cash flow, and decrease reinvestment risk by spreading maturities of smaller face value bonds over greater periods of time.

Reference: 2.13.1 in the License Exam Manual

Question #83 of 128

Question ID: 605048

All of the following may be included in an advertisement for a CMO issue EXCEPT a:

- ✗ **A)** disclosure of the CMO's coupon rate and final maturity date.
- ✗ **B)** generic description of the CMO tranche.
- ✗ **C)** disclosure that payment assumptions may or may not be met.
- ✓ **D)** statement that the CMO is guaranteed by the U.S. government.

Explanation

The U.S. government does not issue or back CMOs. It is also misleading to state or imply that a CMO's anticipated yield or average life is guaranteed. CMOs must include the coupon rate and the final maturity date, a generic description of the CMO tranche, and disclosure that payment assumptions may or may not be met.

Reference: 2.8.2.5 in the License Exam Manual

Question #84 of 128

Question ID: 605116

Money market instruments guaranteed by a bank that are used to provide capital for exporters to foreign countries are called:

- ✗ **A)** eurodollars.
- ✓ **B)** banker's acceptances.
- ✗ **C)** foreign bills.
- ✗ **D)** ADRs.

Explanation

BAs provide short-term financing for importers and exporters.

Reference: 2.10.2.3 in the License Exam Manual

Question #85 of 128

Question ID: 605115

All of the following are true of negotiable, jumbo certificates of deposit EXCEPT:

- ✗ **A)** they are readily marketable.
- ✗ **B)** they are usually issued in denominations of $100,000 to $1 million.
- ✓ **C)** they are fully insured in any denomination by the FDIC.
- ✗ **D)** they usually have maturities of less than 1 year.

Explanation

The FDIC insures only up to $250,000.

Reference: 2.10.2.5.2 in the License Exam Manual

Question #86 of 128

Question ID: 605072

Interest paid on I bonds is:

- ✓ **A)** Exempt from state and local taxation.
- ✗ **B)** Exempt at all levels.
- ✗ **C)** Taxable at all levels.
- ✗ **D)** Exempt at the federal level only.

Explanation

Interest paid on I bonds is exempt from state and local taxes but is taxable at the federal level. Although, federal income taxes can be deferred for up to 30 years or until the bonds are redeemed, whichever comes first.

Reference: 2.9.2 in the License Exam Manual

Question #87 of 128

Question ID: 605041

Which of the following disclosures regarding a CMO is accurate?

- ✗ **A)** All tranches have the same degree of risk and the same risk characteristics.
- ✗ **B)** Repayment of principal is guaranteed.
- ✗ **C)** CMOs are unique in that they are suitable for small or unsophisticated investors to invest in mortgage backed securities.
- ✓ **D)** Rate of return may vary as a result of early prepayment.

Explanation

Prepayment risk is one of the major risks associated with CMOs and must be disclosed to prospective investors. Tranches are structured to have different degrees and characteristics of risk such as prepayment and extension risk and therefore they may not be suitable for smaller or unsophisticated investors. There is no guarantee of principal repayment.

Reference: 2.8.2.5 in the License Exam Manual

Question #88 of 128

Question ID: 605082

The prime rate is the:

- ✗ **A)** charge on loans to depositary institutions by the Federal Reserve Bank of New York.
- ✗ **B)** rate on reserves traded among commercial banks for overnight use in amounts of $1 million or more.
- ✓ **C)** rate on loans offered by large U.S. money center commercial banks to their most creditworthy corporate customers.
- ✗ **D)** charge on loans to brokers for margin investors.

Explanation

The prime rate is the rate on corporate loans at large U.S. money center commercial banks. The federal funds rate is the rate for excess reserves traded among commercial banks for overnight use in amounts of $1 million or more. The discount rate is the charge on loans to member institutions by the New York FRB. The broker call loan rate is the charge on loans to brokers for margin investors.

Reference: 2.10.3.2 in the License Exam Manual

Question #89 of 128

Question ID: 605107

A U.S. government bond dealer sells bonds to another dealer with an agreement to buy back the securities within a specified period of time. This is a:

- ✗ **A)** commercial paper.
- ✗ **B)** reverse repurchase agreement.
- ✗ **C)** banker's acceptance.
- ✓ **D)** repurchase agreement.

Explanation

Repurchase agreements are used to borrow (or loan) money through the sale of securities (usually U.S. government securities) with an agreement to buy them back at stated time for an agreed-on price. They are widely used as both a money market vehicle and an instrument of the Federal Reserve Board's monetary policy.

Reference: 2.10.2.1 in the License Exam Manual

Question #90 of 128

Question ID: 605080

What does LIBOR stand for?

- ✗ **A)** Limited Industrial Bond Ordinance Regulation.
- ✓ **B)** London Interbank Offered Rate.
- ✗ **C)** Legal Interest Bond Opinion Rule.
- ✗ **D)** Letter of Intent Backdate Order Rule.

Explanation

LIBOR is the acronym for the London Interbank Offered Rate and is the average of interbank offered rates for dollar deposits in the London market. It is a market-driven rate of interest.

Reference: 2.10.4.1 in the License Exam Manual

Question #91 of 128

Question ID: 605121

Which of the following statements are TRUE regarding brokered CDs?

I. If customers choose to sell the CD before maturity, there may be a loss of principal.
II. If customers choose to sell the CD before maturity, all transactions are made at par.
III. Brokered CDs may be called before maturity.
IV. Brokered CDs are noncallable.

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

Explanation

If interest rates have risen since purchase, a secondary market sale will likely result in loss of principal. Similarly, if rates have fallen since purchase, a CD is likely to be called, forcing investors to reinvest at a lower rate.

Reference: 2.10.2.5.3 in the License Exam Manual

Question #92 of 128

Question ID: 605099

Because money market instruments are designed to meet the short-term cash needs of issuing institutions, which of the following is NOT a money market instrument?

- ✓ **A)** Newly issued Treasury notes issued to meet a specific government funding requirement.
- ✗ **B)** Federal Farm Credit Bank note maturing in one year or less.
- ✗ **C)** Municipal Construction Loan Note.
- ✗ **D)** Commercial paper issued by the finance corporation of a major automobile manufacturer.

Explanation

A newly issued Treasury note would have a maturity of 2 to 10 years and would not be considered a money market instrument. A Federal Farm Credit Bank note maturing in one year or less is a money market instrument, as is commercial paper issued by the finance corporation of a major automobile manufacturer with a maturity of less than one year. Municipal construction loans issued to provide short-term financing for a construction project are money market securities.

Reference: 2.10.1.1 in the License Exam Manual

Question #93 of 128

Question ID: 605029

All of the following statements regarding PAC CMOs are true EXCEPT:

- ✗ **A)** PACs have a more certain maturity date than comparable TACs.
- ✓ **B)** PACs have higher yields than comparable TACs.
- ✗ **C)** PACs have companion tranches.
- ✗ **D)** PACs have a lower than average prepayment risk.

Explanation

PACs have two companion tranches; one to absorb prepayments and one to buffer against extension risk. Because there is less risk and a more certain maturity date, PACs tend to have lower yields than comparable TACs.

Reference: 2.8.1.3 in the License Exam Manual

Question #94 of 128

Question ID: 605074

The overnight repo interest rate is usually lower than bank rates and just below or comparable to the:

- ✗ **A)** prime rate.
- ✗ **B)** discount rate.
- ✗ **C)** T-bill rate.
- ✓ **D)** Fed funds rate.

Explanation

From a duration standpoint, usually overnight, the repo rate is closest to the Fed funds rate, which is also overnight.

Reference: 2.10.2.1 in the License Exam Manual

Question #95 of 128

Question ID: 605027

When making recommendations to a customer, with which of the following investments may CMOs be compared?

- ✓ **A)** Other CMOs only.
- ✗ **B)** Ginnie Maes for comparative risk.
- ✗ **C)** Bank CDs for comparative yields.
- ✗ **D)** Real Estate Investment Trusts for trading characteristics.

Explanation

Because of their unusual characteristics, CMOs may not be compared to any other type of investment instrument.

Reference: 2.8.2 in the License Exam Manual

Question #96 of 128

Question ID: 605100

The minimum face amount of a negotiable CD is:

- ✗ **A)** $25,000.
- ✓ **B)** $100,000.
- ✗ **C)** $50,000.
- ✗ **D)** $10,000.

Explanation

Negotiable CDs are issued in the minimum face amount of $100,000. These are called jumbo CDs and are traded in blocks of $1 million.

Reference: 2.10.2.5.2 in the License Exam Manual

Question #97 of 128

Question ID: 605059

In a rising interest-rate environment which of the following risks associated with mortgage-backed securities such as a collateralized mortgage obligation (CMO) is of least consequence to a potential investor?

- ✓ **A)** Prepayment risk
- ✗ **B)** Interest rate risk
- ✗ **C)** Extension risk
- ✗ **D)** Credit risk

Explanation

Prepayment risk is the risk that mortgage holders will refinance or repay their mortgages early as a result of falling interest rates. Therefore in a rising interest rate environment it would be less of a concern for a CMO investor. Extension risk is the risk that mortgage payments will be missed or slower than anticipated in a faltering economic environment. Credit and interest rate risks are always of concern with CMOs.

Reference: 2.8.2.5 in the License Exam Manual

Question #98 of 128

Question ID: 605050

Which of the following mortgage-backed securities would provide investors with the *most* predictable maturity date?

- ✗ **A)** Ginnie Maes.
- ✗ **B)** TACs.
- ✗ **C)** Fannie Maes.
- ✓ **D)** PACs.

Explanation

PACs are planned amortization class CMOs and have established maturity dates. Prepayment risk is transferred to the PAC companion, or support, class bonds.

Reference: 2.8.1.3 in the License Exam Manual

Question #99 of 128

Question ID: 605119

All of the following would be found in the money market EXCEPT:

- ✓ **A)** preferred stock.
- ✗ **B)** repurchase agreements.
- ✗ **C)** Treasury bills.
- ✗ **D)** commercial paper.

Explanation

The money market consists of short-term, high-quality debt instruments. This would not include preferred stock, which is an equity instrument.

Reference: 2.10.1.1 in the License Exam Manual

Question #100 of 128

Question ID: 605117

Transactions in all of the following are affected in the money market, as opposed to the capital market, EXCEPT

- ✓ **A)** municipal revenue bonds
- ✗ **B)** U.S. Treasury bills
- ✗ **C)** commercial paper
- ✗ **D)** federal funds

Explanation

The money market is the marketplace for short-term (less than one year) debt obligations. The capital market is where long-term capital is raised. Municipal bonds, being long term, are a part of the capital market.

Reference: 2.10.1.1 in the License Exam Manual

Question #101 of 128

Question ID: 605096

The interbank market is:

- ✓ **A)** affected by international events.
- ✗ **B)** an agency of the World Bank.
- ✗ **C)** regulated.
- ✗ **D)** insulated from changes in individual countries' economies.

Explanation

The interbank market is the unregulated, decentralized market for currencies among banks and central banking authorities. Currency exchange rates are affected by economic and political events taking place in individual countries and on a global scale.

Reference: 2.10.4.3 in the License Exam Manual

Question #102 of 128

Question ID: 605095

Which of the following statements regarding the international currency spot market is TRUE?

- ✗ **A)** Regular way settlement is three business days following execution of the trade.
- ✓ **B)** Currencies traded in the spot market settle in one or two business days.
- ✗ **C)** It is centrally located.
- ✗ **D)** It is regulated by the central banks of the participating countries.

Explanation

In the interbank spot market currency trades generally settle in one or two business days. The interbank market is not subject to the regulations of individual countries, nor does it have a central location.

Reference: 2.10.4.3 in the License Exam Manual

Question #103 of 128

Question ID: 605032

Collateralized mortgage obligation (CMO) tranche A has been created to have the most predictable near term principal pay off. A tranche set up in this way will have:

I. the highest reinvestment risk.
II. the least reinvestment risk.
III. a higher yield.
IV. a lower yield.

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

Explanation

A CMO created to have the most predictable near term principal pay off will have lower reinvestment risk and lower yield than other CMOs.

Reference: 2.8.1.3 in the License Exam Manual

Question #104 of 128

Question ID: 605094

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

- ✗ **A)** interest and principal are paid in U.S. dollars.
- ✗ **B)** they are issued outside of the United States.
- ✓ **C)** non-U.S. investors are not subject to currency risk.
- ✗ **D)** U.S. investors are not subject to currency risk.

Explanation

Eurodollar bonds are issued outside the U.S., but principal and interest are paid in U.S. dollars. Therefore, a U.S. investor bears no currency risk, although a foreign issuer or investor does.

Reference: 2.10.4.2 in the License Exam Manual

Question #105 of 128

Question ID: 605069

A characteristic not associated with a Series EE bond is:

- ✗ **A)** security of principal.
- ✗ **B)** a fixed rate of return.
- ✓ **C)** marketability.
- ✗ **D)** a fixed maturity date.

Explanation

Marketability refers to the ability of the owner to sell (market) the Series EE bond to anyone who may desire to purchase it. Savings bonds are not marketable. They can be redeemed only by the government. They are not allowed to be transferred from one owner to another; hence, they are nonmarketable.

Reference: 2.9.1 in the License Exam Manual

Question #106 of 128

Question ID: 605093

If the U.S. dollar has been falling against foreign currencies, then which of the following are TRUE?

I. U.S. imports are likely to rise.
II. U.S. exports are likely to rise.
III. Foreign currencies buy fewer U.S. dollars.
IV. Foreign currencies buy more U.S. dollars.

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

Explanation

When the dollar declines in relation to foreign currencies, foreign money will buy more American currency. As a result, U.S. goods and services sold in foreign markets become less costly and exports should rise.

Reference: 2.10.4.4 in the License Exam Manual

Question #107 of 128

Question ID: 605135

Your customer has listed income and safety of principal as his primary investment objectives. Which of the following might be the least suitable recommendation?

- ✗ **A)** US government issued T-bonds
- ✓ **B)** Sovereign debt securities
- ✗ **C)** GNMA securities
- ✗ **D)** Preferred shares

Explanation

The least suitable of the answer choices given would be sovereign debt securities due to the unique and varied risks with which they are associated. Amongst those risks would be the instability of the issuing government, unfavorable changes in currency exchange rates, or inaccurate estimates of the payback from the projects the bonds finance. All of these risks can adversely impact the investment.

Reference: 2.10.4.6 in the License Exam Manual

Question #108 of 128

Question ID: 605079

The federal funds rate is the rate:

- ✗ **A)** that major commercial banks charge broker/dealers for margin account loans.
- ✓ **B)** that banks charge each other for overnight loans and is subject to daily change.
- ✗ **C)** that major commercial banks charge their best corporate customers.
- ✗ **D)** that the Federal Reserve charges a member bank.

Explanation

The federal funds rate is what banks charge each other for overnight loans. The discount rate is the rate charged by the Federal Reserve to a member bank. The prime rate is the rate that commercial banks charge their best corporate customers. The broker call loan rate is what major banks charge broker/dealers for margin account loans.

Reference: 2.10.3.1 in the License Exam Manual

Question #109 of 128

Question ID: 605144

An investor wants to purchase fixed-income securities (bonds) as a safe haven because he is uncomfortable with risk associated with stock volatility currently in the market. Before making a suitable recommendation, a registered representative should advise that

I. bonds are interest rate sensitive in all environments
II. bond prices are always stable when equities are volatile
III. bond prices can rise sharply when interest rates rise

IV. bond prices may fall as interest rates begin to rise

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

Explanation

Bonds are interest rate sensitive in all environments. Their prices have an inverse relationship to interest rate movements. Therefore, if interest rates begin to rise, bond prices will fall, exposing investors who sought them out as a safe haven to risk they might not have been aware of.

Reference: 2.13 in the License Exam Manual

Question #110 of 128

Question ID: 605126

All of the following statements regarding commercial paper are correct EXCEPT:

- ✗ **A)** it is quoted on a discount yield basis.
- ✗ **B)** interest is received at maturity.
- ✗ **C)** it is unsecured.
- ✓ **D)** it is quoted as a percentage of par.

Explanation

Commercial paper is short-term, unsecured corporate debt. It is issued and traded at a discount of face value and does not pay periodic interest. Like all zeroes, it is quoted on a discounted yield basis.

Reference: 2.10.2.4 in the License Exam Manual

Question #111 of 128

Question ID: 605125

Which of the following investments is the *most* liquid?

- ✓ **A)** Money market funds.
- ✗ **B)** Foreign stock funds.
- ✗ **C)** Common stock.
- ✗ **D)** Variable annuities.

Explanation

Money market funds are the most liquid investment.

Reference: 2.10.1.1 in the License Exam Manual

Question #112 of 128

Question ID: 605076

Which of the following interest rates is NOT market driven?

- ✗ **A)** Prime rate.
- ✗ **B)** Broker call loan rate.
- ✓ **C)** Discount rate.
- ✗ **D)** Federal funds rate.

Explanation

The discount rate is set by vote of the Federal Reserve Board. The remaining interest rates are directly or indirectly set by their markets.

Reference: 2.10.3.3 in the License Exam Manual

Question #113 of 128

Question ID: 605056

When assets are pooled into financial instruments such as Collateralized Mortgage Obligations (CMOs) to better facilitate selling them to the general public, the process is known as:

- ✗ **A)** structuring.
- ✗ **B)** best efforts.
- ✗ **C)** diversification.
- ✓ **D)** securitization.

Explanation

Asset backed securities represent a pool of assets that were combined into a financial instrument such as a CMO for the purpose of better facilitating sales to the general investing public. The process of pooling assets into a single financial instrument for this purpose is known as securitization.

Reference: 2.8 in the License Exam Manual

Question #114 of 128

Question ID: 605142

All of the following are characteristics of exchange-traded notes (ETNs) EXCEPT

- ✗ **A)** they can be bought or sold during normal trading hours on an exchange
- ✗ **B)** they are issued by financial institutions such as banks
- ✗ **C)** their value can be impacted by changes in the credit rating of the issuer
- ✓ **D)** each note is secured by a single specified asset

Explanation

Exchange-traded notes (ETNs) are unsecured debt securities generally issued by financial institutions such as banks. Prices can be impacted by changes in the issuer's credit rating, even though the value of the underlying securities has not changed. Like exchange-traded funds (ETFs) or other exchange-traded products, they can be bought or sold during normal exchange trading hours.

Reference: 2.12.1 in the License Exam Manual

Question #115 of 128

Question ID: 605052

Which of the following risks would impact CMO investors the least?

- ✗ **A)** Rate risk.
- ✓ **B)** Liquidity risk
- ✗ **C)** Extended maturity risk.
- ✗ **D)** Prepayment risk.

Explanation

CMO investors are always subject to rate risk, which includes maturity and prepayment risk. Because CMOs trade OTC they are fairly liquid allowing investors to purchase or sell them easily at fair market value.

Reference: 2.8.2.5 in the License Exam Manual

Question #116 of 128

Question ID: 605088

One of your clients tells you that he has been receiving interest payments in U.S. dollars from a bank domiciled in Hong Kong. The appropriate term to describe the client's banking deposit is:

- ✗ **A)** money laundering.
- ✗ **B)** Asia dollars.
- ✓ **C)** eurodollars.
- ✗ **D)** Hong Kong dollars.

Explanation

Originally, dollar-denominated deposits not subject to U.S. banking regulations were held almost exclusively in Europe-hence, the name "eurodollars". These deposits, which can be held anywhere outside the United States, are still referred to as eurodollars.

Reference: 2.10.4.1 in the License Exam Manual

Question #117 of 128

Question ID: 605128

A Certificate of Deposit that has a fixed interest rate for a period of time that later adjusts is known as a:

- ✗ **A)** Insured CD.
- ✗ **B)** Callable CD.
- ✗ **C)** Stop Loss CD.
- ✓ **D)** Step-Up or Step-Down CD.

Explanation

Step-Up or Down CDs have a fixed interest rate for a period of time, typically one year, and then have a higher or lower rate in later years.

Reference: 2.10.2.5.4 in the License Exam Manual

Question #118 of 128

Question ID: 605136

Which of the following is the FINRA approved trade reporting system for corporate bonds trading in the OTC secondary market?

- ✗ **A)** SDBK
- ✗ **B)** SIPC
- ✓ **C)** TRACE
- ✗ **D)** Nasdaq

Explanation

TRACE (Trade Reporting and Compliance Engine) is the FINRA approved trade reporting system for corporate bonds trading in the OTC secondary market. TRACE purpose is to add market transparency by disseminating trade details immediately to the investing public.

Reference: 2.11.1.1 in the License Exam Manual

Question #119 of 128

Question ID: 605091

Which of the following is NOT true of the Interbank market?

- ✓ **A)** It is based in London.
- ✗ **B)** It is susceptible to central bank intervention.
- ✗ **C)** It deals in currencies.
- ✗ **D)** It is unregulated.

Explanation

The interbank market deals primarily in currencies and is unregulated. It is an over-the-counter market whose participants are major currency dealers, such as banks. Central banks, such as the Federal Reserve, use the market to try to influence exchange rates.

Reference: 2.10.4.3 in the License Exam Manual

Question #120 of 128

Question ID: 605065

Which of the following statements is TRUE regarding Series EE savings bonds as a cash or cash-equivalent investment vehicle?

- ✗ **A)** Default risk is a necessary consideration for any purchaser of such bonds.

✗ **B)** The accrued interest on the bonds is always exempt from federal income taxes.

✗ **C)** The bonds are sold in a minimum denomination of $1,000.

✓ **D)** The bonds are purchased at face value and earn a fixed rate of return.

Explanation

Series EE savings bonds are purchased at face amount and earn a fixed rate of return.. They may be purchased in denominations as low as $25. Accrued interest on these bonds is exempt from state and local income taxes, but not federal taxes. Default risk would generally not be a concern regarding securities issued by the US Treasury Department.

Reference: 2.9.1 in the License Exam Manual

Question #121 of 128

Question ID: 605129

Which of the following CDs, all maturing in ten years, would be *most* suitable for an investor wanting long-term consistent income without incurring much risk?

✓ **A)** CD with no call feature.

✗ **B)** CD with call feature.

✗ **C)** Brokered CD.

✗ **D)** Step-Down CD.

Explanation

A noncallable CD would best meet the needs of this investor. Step-Down CDs have lower yields in later years. Callable CDs might limit the length of time the investor will hold the CD and brokered CDs issued by Broker/dealers carry additional risk because FDIC insurance does not apply.

Reference: 2.10.2.5 in the License Exam Manual

Question #122 of 128

Question ID: 721401

Which of the following interest rates is set by the Federal Reserve Bank (FRB)?

✗ **A)** Prime rate

✗ **B)** Federal funds rate

✗ **C)** Call rate

✓ **D)** Discount rate

Explanation

The discount rate is the interest rate charged on loans from the Federal Reserve Bank to its depository institutions (federal member banks).

Reference: 2.10.3.5 in the License Exam Manual

Question #123 of 128

Question ID: 605101

Which of the following are characteristics of negotiable (sometimes referred to as jumbo) CDs?

I. Issued in amounts of $100,000 to $1 million.
II. Always FDIC insured to face value.
III. Always mature in 1 to 2 years.
IV. Trade in the secondary market.

✓ **A)** I and IV.

✗ **B)** II and IV.

✗ **C)** I and III.

✗ **D)** II and III.

Explanation

Negotiable jumbo CDs are issued for $100,000 to $1 million and trade in the secondary market. Most jumbo CDs are issued with maturities of less than a year. The FDIC insures up to $250,000 per account.

Reference: 2.10.2.5.2 in the License Exam Manual

Question #124 of 128

Question ID: 605109

Which of the following are money market securities?

I. Commercial paper.
II. Treasury bonds.
III. ADRs.
IV. Negotiable certificates of deposit.

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

Explanation

Commercial paper and negotiable certificates of deposit are short-term debt securities and are considered money market securities.

Reference: 2.10.1.1 in the License Exam Manual

Question #125 of 128

Question ID: 605087

If the federal funds rate falls to an all-time low, all of the following statements are true EXCEPT that:

- ✗ **A)** the money supply will increase.
- ✓ **B)** the prime rate will rise.
- ✗ **C)** banks will have no difficulty borrowing short-term monies.
- ✗ **D)** the Fed is trying to expand credit.

Explanation

The federal funds market involves short-term loans (sometimes overnight) to one member bank from another that has excess reserves. If the funds rate is falling, short-term interest rates are low, and banks will have no difficulty borrowing required reserves, therefore the money supply will expand. These conditions could be the result of the Fed's deliberate actions to expand credit. The prime rate, which is the rate that commercial banks charge their best customers, will also undoubtedly fall.

Reference: 2.10.3.5 in the License Exam Manual

Question #126 of 128

Question ID: 605140

Which of the following is TRUE of principal protected notes?

- ✓ **A)** They are unsecured debt obligations backed by the full faith and credit of their issuer.
- ✗ **B)** The investor is always guaranteed that the note is 100% principal protected and, therefore, they cannot, in any circumstance, lose their initial investment.
- ✗ **C)** They are comprised of 2 bonds linked together and sold as one.
- ✗ **D)** They are considered to be equity securities.

Explanation

A principal protected note (PPN) is a fixed-income security that promises a minimum return equal to the investor's initial investment if held to maturity. It is considered to be a structured product and is comprised of a bond and an option component. PPNs are unsecured debt obligations backed only by the full faith and credit of their issuer

Reference: 2.12.1.1 in the License Exam Manual

Question #127 of 128

Question ID: 605143

Which of the following investor profiles would a principal protected equity-linked exchange-traded note best be suited for?

- ✗ **A)** An investor seeking current interest income
- ✓ **B)** An investor wishing to be able to get into and out of the investment easily
- ✗ **C)** An investor wanting to avoid credit risk
- ✗ **D)** An investor wanting a fixed return at maturity

Explanation

Because equity-linked exchange-traded notes are traded on an exchange, they can be easily invested in and divested of, like other exchange traded products. However, equity-linked exchange traded notes are unsecured debt instruments where credit risk associated with the issuer will be a suitability factor for anyone wishing to avoid such risk. They do not offer current interest payments or a fixed return at maturity as other debt instruments do, but instead have a final payment based on the return of single stock or a basket of stocks like an index.

Reference: 2.12.1.1 in the License Exam Manual

Question #128 of 128

Question ID: 605051

Which of the following is TRUE of taxation of CMO interest?

- ✓ **A)** Subject to federal, state, and local taxes.
- ✗ **B)** Exempt from all taxation.
- ✗ **C)** Taxed only on the state level.
- ✗ **D)** Taxed only on the federal level.

Explanation

Interest earned on all mortgage-backed securities is fully taxable.

Reference: 2.8.2.2 in the License Exam Manual