Chapter 10 Test Bank-financial institution management

Financial Institutions Management (Western Sydney University)

Chapter 10 - Test Bank

Multiple Choice Questions

1. In relation to long-term financing, a fully drawn advance is a:

   A. a bank loan advanced for a precise period for an unspecified purpose.
   B. A term loan where the full amount is provided at the start of the loan, usually for a specified purpose.
   C. A term loan where the borrower has the option of putting its operating account in deficit up to an agreed limit.
   D. A term loan where the bank does not pay out the loan until after a specified period.

2. If a company wishes to finance a printing press with a five-year life, it would be advisable to finance it with a/an:

   A. overdraft.
   B. bank bill.
   C. commercial paper.
   D. fully drawn advance.

3. If a company wished to structure its financing so it repaid funds borrowed only when a project begins to have positive cash flows, it would choose a/an:

   A. fully drawn advance.
   B. term loan.
   C. interest-only loan.
   D. deferred payment loan.

4. Long-term debt can be categorised as financing with an initial maturity:

   A. over 180 days and less than a year.
   B. between 1 and 3 years.
   C. over 1 year.
   D. between 3 and 12 years.

5. In relation to long-term financing, an amortised loan involves:

   A. periodic payments principal and interest repaid at maturity.
   B. periodic interest and principal repayments when positive cash flows begin.
   C. periodic interest payments and principal repaid at maturity.
   D. periodic equal repayments of interest and principal throughout the term.

6. Which of the following statements best describes a fully amortised term loan?

   A. A fully amortised term loan is an interest-only loan with principal repayable at maturity.
   B. A fully amortised term loan has periodic repayments, including interest and principal reduction.
   C. Interest repayments on a fully amortised term loan are fixed for the period of the loan.
   D. A fully amortised term loan is a 'low-start' loan whose repayments are increased over the term.

7. Term loans where each periodic loan payment consists of interest payments and then the principal is repaid in full at maturity are:

   A. fully drawn advances.
   B. amortised loans.
   C. interest-only loans.
   D. credit foncier loans.

8. The fees that represent bank costs in considering loan applications and document preparation are called:

   A. commitment fees.
   B. establishment fees.
   C. line fees.
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9. The fees charged by banks onto the total amount of the loan facility and are normally payable in advance are:

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   B. establishment fees.
   C. line fees.
   D. service fees.

10. Compared with an amortised loan, a deferred repayment loan involves:

    A. periodic interest and principal repayments.
    B. periodic interest and principal repayments when positive cash flows begin.
    C. periodic interest payments and principal repaid at maturity.
    D. periodic principal payments and interest repaid at maturity.

11. The main longer-term finance provided by financial intermediaries is/are:

    A. certificates of deposit.
    B. commercial paper.
    C. corporate bonds.
    D. term loans.

12. ________ granted by banks generally have maturities of three to 15 years and are often made to finance capital expenditure such as building construction and the purchase of real estate.

A. Debentures
B. Mortgage bonds
C. Term loans
D. Capital leases

13. A term loan is:

A. a bill issued to finance a specific trade transaction.
B. a bill issued to raise funds for general purposes.
C. a flexible funding arrangement for companies.
D. when funds are borrowed for a set period.

14. Banks usually charge a/an _______ for any portion of a term loan that has not been drawn down.

A. establishment fee
B. service fee
C. commitment fee
D. term fee

15. A bank charge on any part of a loan that has not been fully drawn down by a company is called a/an:

A. establishment fee.
B. commitment fee.
C. line fee.
D. service fee.

16. All of the following affect interest rates charged on term loans except:

A. default risk.
B. the maturity.
C. the repayment schedule.
D. refinancing risk.

17. Which of the following rates serves as a reference interest rate in Australia?

A. BBSW
B. LIBOR
C. USCP
D. SIBOR

18. If the interest rates on shorter term-to-maturity deposits are higher than those of longer term deposits, it is likely that the costs for the longer term financing for a company are:

A. higher.
B. lower.
C. the same.
D. not related.

19. One of the advantages of a prime rate set by a financial institution is that it is less likely to be affected by:

A. changes in the bank bill swap rate.
B. short-term market illiquidity.
C. short-term credit fluctuations.
D. all of the given answers.

20. A company can borrow from a bank at a margin to the bank's base rate. According to the text, all of the following factors affect this margin except:

A. the credit risk of the company.
B. the term of the loan.
C. the term structure of interest rates.
D. the loan repayment schedule.

21. Compared with a company with a strong financial rating, a company with a weaker rating is likely to be charged:

A. LIBOR.
B. LIBOR plus 10 basis points.
C. LIBOR plus 25 basis points.
D. LIBOR plus 50 basis points.

22. When a lender includes conditions in a loan agreement to protect its loan, these are known as:

A. loan agreements.
B. loan covenants.
C. loan terms.
D. loan actions.

23. When a loan agreement contains actions for a borrowing company to comply with, such as supplying financial statements, these are called:

A. accounting ratios.
B. negative covenants.
C. positive covenants.
D. loan options.

24. Which of the following is NOT usually an example of restrictive debt covenants?

A. Limitations on additional borrowing
B. Constraints on disposal of non-current assets
C. Minimum levels of cash flow
D. Supplying the creditors with annual, audited financial statements

25. Which of the following is NOT an example of negative debt covenants?

A. Specifying what activities the business can enter into
B. Restrictions on amalgamation with other companies
C. Supplying creditors with annual audited reports
D. Limiting annual dividend payments to shareholders

26. Which of the following is NOT an example of a positive debt covenant?

A. The company has to maintain a minimum level of working capital.
B. The company is restricted from doing mergers and acquisitions.
C. The company has to supply periodic cash flow statements to the lender.
D. The company has to supply annual audited statements to the lender.

27. The purpose of debt covenants that require the firm to rank any subsequent borrowing below the original loan is to:

A. limit the amount of fixed-interest payments.
B. make sure that any cash restraints do not affect current obligations.
C. protect the lender in their claim over pledged assets in the event of failure.
D. protect the shareholders' claims over assets.

28. The purpose of debt covenants that ban borrowers from entering into certain types of leases is to:

A. limit the amount of fixed-interest payments.
B. prevent the firm from supplying too many cars to employees.
C. protect the lender in their claim over pledged assets in the event of failure.
D. protect the shareholders' claims over assets.

29. A breach of any specified loan covenant by the borrower generally gives the lender the right to do all of the following, except:

A. increase the interest rate.
B. demand immediate repayment of the loan.
C. alter the term of the agreement, such as by reducing the maturity date.
D. insist the company hand over its assets.

30. A key difference between a positive covenant and a negative covenant is, for a:

A. positive covenant, a company must comply with restrictions on its financial structure.
B. negative covenant, a company must maintain a minimum level of working capital.
C. negative covenant, a company must provide annual audited financial statements.
D. positive covenant, a company must maintain a minimum debt to gross cash flow ratio.

31. Which of the following is a positive loan covenant?

A. A minimum working capital ratio
B. A maximum gearing ratio
C. A maximum level of unsecured debt
D. All of the given answers

32. A ________ is provided to a business by a financial institution and has a maturity of more than one year.

A. debenture
B. mortgage bond
C. term loan
D. zero-coupon bond

33. The type of loan where a company pays periodic interest payments over its term and the principal at maturity to a lender is called:

A. amortised.
B. a debit foncier.
C. deferred payment.
D. interest-only.

34. All of the following financial institutions arrange mortgage finance for companies except:

A. commercial banks.
B. insurance companies.
C. building societies.
D. investment banks.

35. The lender who registers a mortgage as a security for a loan is the:

A. mortgagor.
B. mortgagee.
C. mortgager.
D. mortgage.

36. The borrower who issues a mortgage with real property as collateral to the bank is the:

A. mortgagor.
B. mortgagee.
C. mortgager.
D. mortgage.

37. A company borrows $75 000 from a bank, to be amortised over five years at 8.5% per annum. The annual instalment is:

A. $12 657.43
B. $16 275.00
C. $19 032.43
D. none of the given answers

38. A company borrows $125 000 from a bank at 7.2% per annum to be amortised over six years. The monthly instalment is:

A. $1861.11
B. $2143.15
C. $7274.21
D. $26 386.61

39. In Australia which of the following long-term debt markets are the largest?

A. The corporate bond market
B. The mortgage market
C. The unsecured note market
D. The leasing market

40. When illiquid assets are transformed into new asset-backed securities, the process is called:

A. conversion.
B. liquidisation.
C. securitisation.
D. transformation.

41. Many years ago, banks:

A. could make mortgage loans to households but not to businesses.
B. could make loans to businesses but not make mortgage loans.
C. held most loans on their books until they were paid off.
D. repackaged and sold most loans to investors.

42. The value of a bond is the present value of the:

A. dividends and coupon payments.
B. dividends and maturity value.
C. maturity value.
D. coupon payments and maturity value.

43. The coupon interest of a bond is calculated based on its _______, and is paid periodically.

A. market value
B. book value
C. face value
D. surrender value

44. Which of the following types of bond generally has the lowest interest rate?

A. Treasury bonds
B. Corporate BAA bonds
C. Semi-government bonds
D. Corporate ABB bonds

45. Corporations and governments use long-term debt financing called:

A. retained earnings.
B. bonds.
C. shares.
D. preferred stock.

46. Bonds are:

A. a type of equity financing.
B. a short-term financial arrangement with periodic interest payments.
C. a debt instrument issued at discount with interest and principal repaid at maturity.
D. long-term debt instruments.

47. Compared with unsecured notes, a debenture can offer:

A. a fixed charge over the issuer's already pledged assets.
B. a floating charge over the issuer's unpledged assets.
C. less chance of sale before maturity, as they are not usually traded.
D. provisions for interest rate changes.

48. An unsecured note differs from a debenture in that it has:

A. as security only unpledged assets.
B. as security a floating charge over assets.
C. as security a fixed charge over assets.
D. no supporting security.

49. A debt security supported or secured by mortgage assets held by a bank is a/an:

A. debenture.
B. income bond.
C. mortgage bond.
D. fixed-charge debenture.

50. All of the following are examples of long-term debt instruments except:

A. term loans.
B. debentures.
C. promissory notes.
D. bonds.

51. In relation to an issue of bonds, the method where the bond offer is made only to institutions that deal regularly in securities is called:

A. public issue.
B. family issue.
C. private placement.
D. institutional issue.

52. A debenture is a/an:

A. unsecured bond that only best-name corporate borrowers can issue.
B. legal document stating the restrictive covenants on the loan.
C. bond secured by a charge over the assets of the issuer.
D. corporate bond with a credit enhancement.

53. A company issues a long-term debt security with specified interest payments and fixed charges over unpledged assets. What type of security has been issued?

A. Subordinated debt
B. Unsecured notes
C. Commercial mortgage
D. Debenture

54. When a company defaults on interest payments for a debenture, the floating charge is said to ______ a fixed charge.

A. transform into
B. crystallise into
C. originate as
D. adjust to

55. In the event of failure for a company that has issued a bond, the highest claims on the company's assets generally comes from:

A. floating-charge debenture holders.
B. fixed-charge debenture holders.
C. unsecured note holders.
D. the shareholders.

56. A holder of ________ has generally no charge over the issuing company's unpledged assets.

A. a debenture
B. a subordinated debenture
C. a floating charge debenture
D. an unsecured note

57. Many securities contain an option that is included as part of a bond or preferred share, which allows the holder to convert the security into a predetermined number of shares. This feature is called a:

A. conversion feature.
B. put option.
C. repurchase agreement.
D. warrant.

58. Which type of financial claim is not satisfied until those of the creditors holding certain senior debts have been fully satisfied?

A. Mortgage bonds
B. Unsecured notes
C. Subordinated debentures
D. Deferred interest debentures

59. If a bond investor pays $1030 for an annual coupon bond with a face value of $1000, it follows that:

A. the coupon rate is higher than the current market yield.
B. the current market yield and coupon rate are equal.
C. the current market yield is higher than the coupon rate.
D. not enough information is given to compare the coupon rate and current market yield.

60. Which one of the following statements about bonds is correct?

A. Most bonds pay interest annually.
B. The yield on a bond for a bond investor is generally a fixed rate.
C. Bond prices vary inversely with interest rates.
D. Bond coupon rates vary with interest rates.

61. The _______ value of a bond is also called its par value. Bonds with a current price greater than their par value sell at _______, while bonds with a current price less than their par value sell at _______.

A. premium; face value; a discount
B. discount; a premium; face value
C. face; a premium; a discount
D. premium; a reduction; a discount

62. What happens to the coupon rate of a $100 face value bond that pays $7 coupon annually, if market interest rates change from 8 to 9%? The coupon rate:

A. increases to 8%.
B. increases to 9%.
C. remains at 7%.
D. increases to nearly 9%.

63. The market price of previously issued bonds is often different from face value because:

A. the coupon rate has altered.
B. the maturity date has altered.
C. the market rate of interest has altered.
D. previously issued bonds sell at a discount to new bonds.

64. The price of a bond with a fixed coupon has a/an _______ relationship with the market interest rates.

A. constant
B. linear
C. varying
D. inverse

65. When the coupon rate of a bond is above the current market interest rates, a bond will sell at:

A. discount.
B. its original value.
C. premium.
D. face value.

66. When the coupon rate of a bond is below the current market interest rates, a bond will sell at:

A. discount.
B. its original value.
C. premium.
D. face value.

67. When the coupon rate of a bond is equal to the current market interest rates, a bond will sell at:

A. discount.
B. its original value.
C. premium.
D. book value.

68. A company has two outstanding bonds with the same features, apart from the maturity date. Bond A matures in five years, while bond B matures in 10 years. If the market interest rate changes by 5%:

A. bond A will have the greater change in price.
B. bond B will have the greater change in price.
C. the price of the bonds will not alter.
D. the price of the bonds will change by the same amount.

69. A company has two outstanding bonds with the same features, apart from their coupon. Bond A has a coupon of 5%, while bond B has a coupon of 8%. If the market interest rate changes by 10%:

A. bond A will have the greater change in price.
B. bond B will have the greater change in price.
C. the price of the bonds will not alter.
D. the price of the bonds will change by the same amount.

70. Which of the following statements is correct?

A. Short-term debt instruments are more volatile in price than long-term instruments.
B. Coupon rates are generally fixed when the bond is issued.
C. Bond prices and market interest rates move together.
D. The higher the coupon of a bond, the lower its price.

71. A $1000 face value bond, with coupon rate of 8% paid annually, has five years to maturity. If bonds of similar risk are currently earning 6%, what is the current price of the bond?

A. $920.15
B. $1000
C. $1084.25
D. None of the given answers

72. A $1000 face value bond, with coupon rate of 9% paid annually, has six years to maturity. If bonds of similar risk are currently earning 11%, what is the current price of the bond?

A. $915.39
B. $1000
C. $1089.72
D. None of the given answers

73. All of the following features of a bond are fixed except the:

A. coupon rate.
B. face value.
C. price.
D. interest payments.

74. A $1000 face value bond, with a 7.5% coupon rate paid semi-annually and maturing in five years, is currently yielding 6.4% in the market. What is the current price of the bond?

A. $1000
B. $1045.84
C. $1046.44
D. $1079.45

75. When the market interest rates decline after a bond is issued, the:

A. face value of the bond decreases.
B. market value of the bond increases.
C. market value of the bond decreases.
D. bond price is at a discount.

76. When market interest rates increase after a bond is issued, the:

A. face value of the bond increases.
B. market value of the bond increases.
C. market value of the bond decreases.
D. bond price is at a premium.

77. If a bond's price is at a premium to face value, it has a:

A. yield below its coupon rate of interest.
B. yield equal to its coupon rate of interest.
C. yield above its coupon rate.
D. decreased risk premium.

78. If a bond's price is at a discount to face value, it has a:

A. yield below its coupon rate of interest.
B. yield equal to its coupon rate of interest.
C. yield above its coupon rate.
D. decreased risk premium.

79. A bond's price will be _______ when the coupon rate is higher than current market interest rates; _______ when the coupon rate is equal to the current market interest rates; and _______ when the coupon rate is less than the current market interest rates.

A. at a premium; equal to the face value; at a discount
B. at a premium; at a discount; equal to the face value
C. at a discount; at a premium; equal to the face value
D. equal to the face value; at a discount; at a premium

80. What is the current price of a debenture with a $500 000 face value, a coupon rate of 9.5% paid semi-annually, six years remaining to maturity and market interest rates increased to 14%?

A. $320 149.12
B. $401 613.48
C. $410 644.78
D. $688 638.80

81. Which of the following statements about 'net' finance leases is incorrect?

A. The lessor will be responsible for the periodic maintenance of the asset.
B. At the end of the lease period, the company will be required to make a residual payment.
C. Upon payment of the residual amount, ownership of the asset transfers to the company.
D. The lessor's role is one of financing, while the lessee makes regular rental payments.

82. A/An _______ lease is a short-term arrangement where the lessee agrees to make periodic payments to the lessor for the right to use the asset. This arrangement usually contains only minor or no penalties for cancellation of the lease.

A. financial
B. operating lease
C. direct
D. leveraged

83. The type of lease where the costs of ownership and operation are borne by the lessee, who agrees to make a residual payment at the end of the lease period, is a/an:

A. direct lease.
B. financial lease.
C. operating lease.
D. leveraged lease.

84. When a finance company purchases assets with its own funds and leases them to a lessee for a negotiated long-term period this is called a/an:

A. direct lease.
B. sale and lease-back.
C. operating lease.
D. leveraged lease.

85. For what type of lease does the lessee borrow a large part of the funds, typically in a multi-million dollar arrangement, often with a lease manager, while one or more financial institutions provide the remainder?

A. An equity lease
B. A leveraged lease
C. A sale and leveraged lease
D. A financial lease

86. A direct finance lease is best described as a/an:

A. operating lease.
B. sale and leaseback arrangement.
C. full-service lease.
D. leveraged lease.

87. Compared with missing an interest payment on debt, the penalties for missing a financial lease payment are:

A. less severe.
B. the same.
C. more severe.
D. not related.

88. Which of the following is NOT an advantage of leasing from the lessee's viewpoint?

A. 100% financing
B. The company's capital is not involved
C. Flexible repayment scheduling
D. With a net lease, costs of ownership remain with the lessee

89. Which of the following is NOT an advantage of leasing from the lessor's perspective (compared with offering a straight loan)?

A. Leasing has a relatively low default risk.
B. Administration costs may be lower for a lease than for a straight loan.
C. The return to the lessor may be higher than for a straight loan.
D. The lessor may use the funds for other investment opportunities.

90. For what type of lease does the lessee provide a significant part of the funds to purchase the asset, often losing the advantage of leveraged leasing, while a financial institution provides the remainder?

A. A capital lease
B. An equity lease
C. A sale and leveraged lease
D. A financial lease

True / False Questions

91. A term loan is referred to as a fully drawn advance when the borrower obtains the full amount at the start of the loan.

True False

92. A term loan with interest and principal repayments that are amortised over the term are sometimes called credit foncier loans.

True False

93. A long-term loan will generally attract a higher rate of interest than a short-term loan.

True False

94. Banks often calculate a prime rate lending as they can adjust it more quickly than other reference money market rates.

True False

95. Apart from an interest charge on funds advanced to a borrower, a bank will charge a service fee for considering the loan application and loan preparation.

True False

96. A positive loan covenant can state that a company must maintain a minimum level of working capital.

True False

97. The inclusion of covenants in a term loan is designed to protect the borrower from taking on too much debt.

True False

98. Under mortgage financing, the mortgagor is the lender of the mortgage funds.

True False

99. A bond is a long-term debt instrument issued directly into the capital markets.

True False

100. The terms subordinated debt and unsecured note are interchanged as they are both corporate bonds that have identical features.

True False

Short Answer Questions

101. Discuss major features of a term loan.

102. Define and discuss a reference interest rate in relation to lending.

103. Discuss the features of mortgage agreements for commercial loans.

104. Identify the main debt securities of the Australian bond market.

105. Discuss the use of a prospectus in relation to the issue of debt securities.

Chapter 10 - Test Bank Key

Multiple Choice Questions

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B. A term loan where the full amount is provided at the start of the loan, usually for a specified purpose.
C. A term loan where the borrower has the option of putting its operating account in deficit up to an agreed limit.
D. A term loan where the bank does not pay out the loan until after a specified period.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

2. If a company wishes to finance a printing press with a five-year life, it would be advisable to finance it with a/an:

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A. over 180 days and less than a year.
B. between 1 and 3 years.
C. over 1 year.
D. between 3 and 12 years.

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6. Which of the following statements best describes a fully amortised term loan?

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B. A fully amortised term loan has periodic repayments, including interest and principal reduction.
C. Interest repayments on a fully amortised term loan are fixed for the period of the loan.
D. A fully amortised term loan is a ‘low-start' loan whose repayments are increased over the term.

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8. The fees that represent bank costs in considering loan applications and document preparation are called:

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B. establishment fees.
C. line fees.
D. service fees.

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A. commitment fees.
B. establishment fees.
C. line fees.
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10. Compared with an amortised loan, a deferred repayment loan involves:

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B. periodic interest and principal repayments when positive cash flows begin.
C. periodic interest payments and principal repaid at maturity.
D. periodic principal payments and interest repaid at maturity.

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11. The main longer-term finance provided by financial intermediaries is/are:

A. certificates of deposit.
B. commercial paper.
C. corporate bonds.
D. term loans.

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B. a bill issued to raise funds for general purposes.
C. a flexible funding arrangement for companies.
D. when funds are borrowed for a set period.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

14. Banks usually charge a/an _______ for any portion of a term loan that has not been drawn down.

A. establishment fee
B. service fee
C. commitment fee
D. term fee

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

15. A bank charge on any part of a loan that has not been fully drawn down by a company is called a/an:

A. establishment fee.
B. commitment fee.
C. line fee.
D. service fee.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

16. All of the following affect interest rates charged on term loans except:

A. default risk.
B. the maturity.
C. the repayment schedule.
D. refinancing risk.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

17. Which of the following rates serves as a reference interest rate in Australia?

A. BBSW
B. LIBOR
C. USCP
D. SIBOR

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

18. If the interest rates on shorter term-to-maturity deposits are higher than those of longer term deposits, it is likely that the costs for the longer term financing for a company are:

A. higher.
B. lower.
C. the same.
D. not related.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

19. One of the advantages of a prime rate set by a financial institution is that it is less likely to be affected by:

A. changes in the bank bill swap rate.
B. short-term market illiquidity.
C. short-term credit fluctuations.
D. all of the given answers.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

20. A company can borrow from a bank at a margin to the bank's base rate. According to the text, all of the following factors affect this margin except:

A. the credit risk of the company.
B. the term of the loan.
C. the term structure of interest rates.
D. the loan repayment schedule.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

21. Compared with a company with a strong financial rating, a company with a weaker rating is likely to be charged:

A. LIBOR.
B. LIBOR plus 10 basis points.
C. LIBOR plus 25 basis points.
D. LIBOR plus 50 basis points.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

22. When a lender includes conditions in a loan agreement to protect its loan, these are known as:

A. loan agreements.
B. loan covenants.
C. loan terms.
D. loan actions.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

23. When a loan agreement contains actions for a borrowing company to comply with, such as supplying financial statements, these are called:

A. accounting ratios.
B. negative covenants.
C. positive covenants.
D. loan options.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

24. Which of the following is NOT usually an example of restrictive debt covenants?

A. Limitations on additional borrowing
B. Constraints on disposal of non-current assets
C. Minimum levels of cash flow
D. Supplying the creditors with annual, audited financial statements

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

25. Which of the following is NOT an example of negative debt covenants?

A. Specifying what activities the business can enter into
B. Restrictions on amalgamation with other companies
C. Supplying creditors with annual audited reports
D. Limiting annual dividend payments to shareholders

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

26. Which of the following is NOT an example of a positive debt covenant?

A. The company has to maintain a minimum level of working capital.
B. The company is restricted from doing mergers and acquisitions.
C. The company has to supply periodic cash flow statements to the lender.
D. The company has to supply annual audited statements to the lender.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

27. The purpose of debt covenants that require the firm to rank any subsequent borrowing below the original loan is to:

A. limit the amount of fixed-interest payments.
B. make sure that any cash restraints do not affect current obligations.
C. protect the lender in their claim over pledged assets in the event of failure.
D. protect the shareholders' claims over assets.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

28. The purpose of debt covenants that ban borrowers from entering into certain types of leases is to:

A. limit the amount of fixed-interest payments.
B. prevent the firm from supplying too many cars to employees.
C. protect the lender in their claim over pledged assets in the event of failure.
D. protect the shareholders' claims over assets.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

29. A breach of any specified loan covenant by the borrower generally gives the lender the right to do all of the following, except:

A. increase the interest rate.
B. demand immediate repayment of the loan.
C. alter the term of the agreement, such as by reducing the maturity date.
D. insist the company hand over its assets.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

30. A key difference between a positive covenant and a negative covenant is, for a:

A. positive covenant, a company must comply with restrictions on its financial structure.
B. negative covenant, a company must maintain a minimum level of working capital.
C. negative covenant, a company must provide annual audited financial statements.
D. positive covenant, a company must maintain a minimum debt to gross cash flow ratio.

Difficulty: Hard
Est time: <1 minute
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

31. Which of the following is a positive loan covenant?

A. A minimum working capital ratio
B. A maximum gearing ratio
C. A maximum level of unsecured debt
D. All of the given answers

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

32. A ________ is provided to a business by a financial institution and has a maturity of more than one year.

A. debenture
B. mortgage bond
C. term loan
D. zero-coupon bond

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

33. The type of loan where a company pays periodic interest payments over its term and the principal at maturity to a lender is called:

A. amortised.
B. a debit foncier.
C. deferred payment.
D. interest-only.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

34. All of the following financial institutions arrange mortgage finance for companies except:

A. commercial banks.
B. insurance companies.
C. building societies.
D. investment banks.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-02 Describe the nature, purpose and operation of mortgage finance and the mortgage market, and calculate an instalment on a mortgage loan.
Section: 10.2 Mortgage finance

35. The lender who registers a mortgage as a security for a loan is the:

A. mortgagor.
B. mortgagee.
C. mortgager.
D. mortgage.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-02 Describe the nature, purpose and operation of mortgage finance and the mortgage market, and calculate an instalment on a mortgage loan.
Section: 10.2 Mortgage finance

36. The borrower who issues a mortgage with real property as collateral to the bank is the:

A. mortgagor.
B. mortgagee.
C. mortgager.
D. mortgage.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-02 Describe the nature, purpose and operation of mortgage finance and the mortgage market, and calculate an instalment on a mortgage loan.
Section: 10.2 Mortgage finance

37. A company borrows $75 000 from a bank, to be amortised over five years at 8.5% per annum. The annual instalment is:

A. $12 657.43
B. $16 275.00
C. $19 032.43
D. none of the given answers

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-02 Describe the nature, purpose and operation of mortgage finance and the mortgage market, and calculate an instalment on a mortgage loan.
Section: 10.2 Mortgage finance

38. A company borrows $125 000 from a bank at 7.2% per annum to be amortised over six years. The monthly instalment is:

A. $1861.11
B. $2143.15
C. $7274.21
D. $26 386.61

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-02 Describe the nature, purpose and operation of mortgage finance and the mortgage market, and calculate an instalment on a mortgage loan.
Section: 10.2 Mortgage finance

39. In Australia which of the following long-term debt markets are the largest?

A. The corporate bond market
B. The mortgage market
C. The unsecured note market
D. The leasing market

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-02 Describe the nature, purpose and operation of mortgage finance and the mortgage market, and calculate an instalment on a mortgage loan.
Section: 10.2 Mortgage finance

40. When illiquid assets are transformed into new asset-backed securities, the process is called:

A. conversion.
B. liquidisation.
C. securitisation.
D. transformation.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-02 Describe the nature, purpose and operation of mortgage finance and the mortgage market, and calculate an instalment on a mortgage loan.
Section: 10.2 Mortgage finance

41. Many years ago, banks:

A. could make mortgage loans to households but not to businesses.
B. could make loans to businesses but not make mortgage loans.
C. held most loans on their books until they were paid off.
D. repackaged and sold most loans to investors.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-02 Describe the nature, purpose and operation of mortgage finance and the mortgage market, and calculate an instalment on a mortgage loan.
Section: 10.2 Mortgage finance

42. The value of a bond is the present value of the:

A. dividends and coupon payments.
B. dividends and maturity value.
C. maturity value.
D. coupon payments and maturity value.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-03 Discuss the bond market, in particular the structure and issue of debentures, unsecured notes and subordinated debt.
Section: 10.3 The bond market: debentures, unsecured notes and subordinated debt

43. The coupon interest of a bond is calculated based on its _______, and is paid periodically.

A. market value
B. book value
C. face value
D. surrender value

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-03 Discuss the bond market, in particular the structure and issue of debentures, unsecured notes and subordinated debt.
Section: 10.3 The bond market: debentures, unsecured notes and subordinated debt

44. Which of the following types of bond generally has the lowest interest rate?

A. Treasury bonds
B. Corporate BAA bonds
C. Semi-government bonds
D. Corporate ABB bonds

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-03 Discuss the bond market, in particular the structure and issue of debentures, unsecured notes and subordinated debt.
Section: 10.3 The bond market: debentures, unsecured notes and subordinated debt

45. Corporations and governments use long-term debt financing called:

A. retained earnings.
B. bonds.
C. shares.
D. preferred stock.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-03 Discuss the bond market, in particular the structure and issue of debentures, unsecured notes and subordinated debt.
Section: 10.3 The bond market: debentures, unsecured notes and subordinated debt

46. Bonds are:

A. a type of equity financing.
B. a short-term financial arrangement with periodic interest payments.
C. a debt instrument issued at discount with interest and principal repaid at maturity.
D. long-term debt instruments.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-03 Discuss the bond market, in particular the structure and issue of debentures, unsecured notes and subordinated debt.
Section: 10.3 The bond market: debentures, unsecured notes and subordinated debt

47. Compared with unsecured notes, a debenture can offer:

A. a fixed charge over the issuer's already pledged assets.
B. a floating charge over the issuer's unpledged assets.
C. less chance of sale before maturity, as they are not usually traded.
D. provisions for interest rate changes.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-03 Discuss the bond market, in particular the structure and issue of debentures, unsecured notes and subordinated debt.
Section: 10.3 The bond market: debentures, unsecured notes and subordinated debt

48. An unsecured note differs from a debenture in that it has:

A. as security only unpledged assets.
B. as security a floating charge over assets.
C. as security a fixed charge over assets.
D. no supporting security.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-03 Discuss the bond market, in particular the structure and issue of debentures, unsecured notes and subordinated debt.
Section: 10.3 The bond market: debentures, unsecured notes and subordinated debt

49. A debt security supported or secured by mortgage assets held by a bank is a/an:

A. debenture.
B. income bond.
C. mortgage bond.
D. fixed-charge debenture.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-03 Discuss the bond market, in particular the structure and issue of debentures, unsecured notes and subordinated debt.
Section: 10.3 The bond market: debentures, unsecured notes and subordinated debt

50. All of the following are examples of long-term debt instruments except:

A. term loans.
B. debentures.
C. promissory notes.
D. bonds.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-03 Discuss the bond market, in particular the structure and issue of debentures, unsecured notes and subordinated debt.
Section: 10.3 The bond market: debentures, unsecured notes and subordinated debt

51. In relation to an issue of bonds, the method where the bond offer is made only to institutions that deal regularly in securities is called:

A. public issue.
B. family issue.
C. private placement.
D. institutional issue.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-03 Discuss the bond market, in particular the structure and issue of debentures, unsecured notes and subordinated debt.
Section: 10.3 The bond market: debentures, unsecured notes and subordinated debt

52. A debenture is a/an:

A. unsecured bond that only best-name corporate borrowers can issue.
B. legal document stating the restrictive covenants on the loan.
C. bond secured by a charge over the assets of the issuer.
D. corporate bond with a credit enhancement.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-03 Discuss the bond market, in particular the structure and issue of debentures, unsecured notes and subordinated debt.
Section: 10.3 The bond market: debentures, unsecured notes and subordinated debt

53. A company issues a long-term debt security with specified interest payments and fixed charges over unpledged assets. What type of security has been issued?

A. Subordinated debt
B. Unsecured notes
C. Commercial mortgage
D. Debenture

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-03 Discuss the bond market, in particular the structure and issue of debentures, unsecured notes and subordinated debt.
Section: 10.3 The bond market: debentures, unsecured notes and subordinated debt

54. When a company defaults on interest payments for a debenture, the floating charge is said to ______ a fixed charge.

A. transform into
B. crystallise into
C. originate as
D. adjust to

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-03 Discuss the bond market, in particular the structure and issue of debentures, unsecured notes and subordinated debt.
Section: 10.3 The bond market: debentures, unsecured notes and subordinated debt

55. In the event of failure for a company that has issued a bond, the highest claims on the company's assets generally comes from:

A. floating-charge debenture holders.
B. fixed-charge debenture holders.
C. unsecured note holders.
D. the shareholders.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-03 Discuss the bond market, in particular the structure and issue of debentures, unsecured notes and subordinated debt.
Section: 10.3 The bond market: debentures, unsecured notes and subordinated debt

56. A holder of ________ has generally no charge over the issuing company's unpledged assets.

A. a debenture
B. a subordinated debenture
C. a floating charge debenture
D. an unsecured note

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-03 Discuss the bond market, in particular the structure and issue of debentures, unsecured notes and subordinated debt.
Section: 10.3 The bond market: debentures, unsecured notes and subordinated debt

57. Many securities contain an option that is included as part of a bond or preferred share, which allows the holder to convert the security into a predetermined number of shares. This feature is called a:

A. conversion feature.
B. put option.
C. repurchase agreement.
D. warrant.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-03 Discuss the bond market, in particular the structure and issue of debentures, unsecured notes and subordinated debt.
Section: 10.3 The bond market: debentures, unsecured notes and subordinated debt

58. Which type of financial claim is not satisfied until those of the creditors holding certain senior debts have been fully satisfied?

A. Mortgage bonds
B. Unsecured notes
C. Subordinated debentures
D. Deferred interest debentures

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-03 Discuss the bond market, in particular the structure and issue of debentures, unsecured notes and subordinated debt.
Section: 10.3 The bond market: debentures, unsecured notes and subordinated debt

59. If a bond investor pays $1030 for an annual coupon bond with a face value of $1000, it follows that:

A. the coupon rate is higher than the current market yield.
B. the current market yield and coupon rate are equal.
C. the current market yield is higher than the coupon rate.
D. not enough information is given to compare the coupon rate and current market yield.

Difficulty: Hard
Est time: <1 minute
Learning Objective: 10-04 Calculate the price of a fixed-interest bond.
Section: 10.4 Calculations: fixed-interest securities

60. Which one of the following statements about bonds is correct?

A. Most bonds pay interest annually.
B. The yield on a bond for a bond investor is generally a fixed rate.
C. Bond prices vary inversely with interest rates.
D. Bond coupon rates vary with interest rates.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-04 Calculate the price of a fixed-interest bond.
Section: 10.4 Calculations: fixed-interest securities

61. The _______ value of a bond is also called its par value. Bonds with a current price greater than their par value sell at _______, while bonds with a current price less than their par value sell at _______.

A. premium; face value; a discount
B. discount; a premium; face value
C. face; a premium; a discount
D. premium; a reduction; a discount

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-04 Calculate the price of a fixed-interest bond.
Section: 10.4 Calculations: fixed-interest securities

62. What happens to the coupon rate of a $100 face value bond that pays $7 coupon annually, if market interest rates change from 8 to 9%? The coupon rate:

A. increases to 8%.
B. increases to 9%.
C. remains at 7%.
D. increases to nearly 9%.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-04 Calculate the price of a fixed-interest bond.
Section: 10.4 Calculations: fixed-interest securities

63. The market price of previously issued bonds is often different from face value because:

A. the coupon rate has altered.
B. the maturity date has altered.
C. the market rate of interest has altered.
D. previously issued bonds sell at a discount to new bonds.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-04 Calculate the price of a fixed-interest bond.
Section: 10.4 Calculations: fixed-interest securities

64. The price of a bond with a fixed coupon has a/an _______ relationship with the market interest rates.

A. constant
B. linear
C. varying
D. inverse

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-04 Calculate the price of a fixed-interest bond.
Section: 10.4 Calculations: fixed-interest securities

65. When the coupon rate of a bond is above the current market interest rates, a bond will sell at:

A. discount.
B. its original value.
C. premium.
D. face value.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-04 Calculate the price of a fixed-interest bond.
Section: 10.4 Calculations: fixed-interest securities

66. When the coupon rate of a bond is below the current market interest rates, a bond will sell at:

A. discount.
B. its original value.
C. premium.
D. face value.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-04 Calculate the price of a fixed-interest bond.
Section: 10.4 Calculations: fixed-interest securities

67. When the coupon rate of a bond is equal to the current market interest rates, a bond will sell at:

A. discount.
B. its original value.
C. premium.
D. book value.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-04 Calculate the price of a fixed-interest bond.
Section: 10.4 Calculations: fixed-interest securities

68. A company has two outstanding bonds with the same features, apart from the maturity date. Bond A matures in five years, while bond B matures in 10 years. If the market interest rate changes by 5%:

A. bond A will have the greater change in price.
B. bond B will have the greater change in price.
C. the price of the bonds will not alter.
D. the price of the bonds will change by the same amount.

Difficulty: Hard
Est time: <1 minute
Learning Objective: 10-04 Calculate the price of a fixed-interest bond.
Section: 10.4 Calculations: fixed-interest securities

69. A company has two outstanding bonds with the same features, apart from their coupon. Bond A has a coupon of 5%, while bond B has a coupon of 8%. If the market interest rate changes by 10%:

A. bond A will have the greater change in price.
B. bond B will have the greater change in price.
C. the price of the bonds will not alter.
D. the price of the bonds will change by the same amount.

Difficulty: Hard
Est time: <1 minute
Learning Objective: 10-04 Calculate the price of a fixed-interest bond.
Section: 10.4 Calculations: fixed-interest securities

70. Which of the following statements is correct?

A. Short-term debt instruments are more volatile in price than long-term instruments.
B. Coupon rates are generally fixed when the bond is issued.
C. Bond prices and market interest rates move together.
D. The higher the coupon of a bond, the lower its price.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-04 Calculate the price of a fixed-interest bond.
Section: 10.4 Calculations: fixed-interest securities

71. A $1000 face value bond, with coupon rate of 8% paid annually, has five years to maturity. If bonds of similar risk are currently earning 6%, what is the current price of the bond?

A. $920.15
B. $1000
C. $1084.25
D. None of the given answers

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-04 Calculate the price of a fixed-interest bond.
Section: 10.4 Calculations: fixed-interest securities

72. A $1000 face value bond, with coupon rate of 9% paid annually, has six years to maturity. If bonds of similar risk are currently earning 11%, what is the current price of the bond?

A. $915.39
B. $1000
C. $1089.72
D. None of the given answers

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-04 Calculate the price of a fixed-interest bond.
Section: 10.4 Calculations: fixed-interest securities

73. All of the following features of a bond are fixed except the:

A. coupon rate.
B. face value.
C. price.
D. interest payments.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-04 Calculate the price of a fixed-interest bond.
Section: 10.4 Calculations: fixed-interest securities

74. A $1000 face value bond, with a 7.5% coupon rate paid semi-annually and maturing in five years, is currently yielding 6.4% in the market. What is the current price of the bond?

A. $1000
B. $1045.84
C. $1046.44
D. $1079.45

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-04 Calculate the price of a fixed-interest bond.
Section: 10.4 Calculations: fixed-interest securities

75. When the market interest rates decline after a bond is issued, the:

A. face value of the bond decreases.
B. market value of the bond increases.
C. market value of the bond decreases.
D. bond price is at a discount.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-04 Calculate the price of a fixed-interest bond.
Section: 10.4 Calculations: fixed-interest securities

76. When market interest rates increase after a bond is issued, the:

A. face value of the bond increases.
B. market value of the bond increases.
C. market value of the bond decreases.
D. bond price is at a premium.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-04 Calculate the price of a fixed-interest bond.
Section: 10.4 Calculations: fixed-interest securities

77. If a bond's price is at a premium to face value, it has a:

A. yield below its coupon rate of interest.
B. yield equal to its coupon rate of interest.
C. yield above its coupon rate.
D. decreased risk premium.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-04 Calculate the price of a fixed-interest bond.
Section: 10.4 Calculations: fixed-interest securities

78. If a bond's price is at a discount to face value, it has a:

A. yield below its coupon rate of interest.
B. yield equal to its coupon rate of interest.
C. yield above its coupon rate.
D. decreased risk premium.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-04 Calculate the price of a fixed-interest bond.
Section: 10.4 Calculations: fixed-interest securities

79. A bond's price will be _______ when the coupon rate is higher than current market interest rates; _______ when the coupon rate is equal to the current market interest rates; and _______ when the coupon rate is less than the current market interest rates.

A. at a premium; equal to the face value; at a discount
B. at a premium; at a discount; equal to the face value
C. at a discount; at a premium; equal to the face value
D. equal to the face value; at a discount; at a premium

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-04 Calculate the price of a fixed-interest bond.
Section: 10.4 Calculations: fixed-interest securities

80. What is the current price of a debenture with a $500 000 face value, a coupon rate of 9.5% paid semi-annually, six years remaining to maturity and market interest rates increased to 14%?

A. $320 149.12
B. $401 613.48
C. $410 644.78
D. $688 638.80

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-04 Calculate the price of a fixed-interest bond.
Section: 10.4 Calculations: fixed-interest securities

81. Which of the following statements about ‘net' finance leases is incorrect?

A. The lessor will be responsible for the periodic maintenance of the asset.
B. At the end of the lease period, the company will be required to make a residual payment.
C. Upon payment of the residual amount, ownership of the asset transfers to the company.
D. The lessor's role is one of financing, while the lessee makes regular rental payments.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-05 Explain lease financing, including types of lease arrangements and lease structures.
Section: 10.5 Leasing

82. A/An _______ lease is a short-term arrangement where the lessee agrees to make periodic payments to the lessor for the right to use the asset. This arrangement usually contains only minor or no penalties for cancellation of the lease.

A. financial
B. operating lease
C. direct
D. leveraged

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-05 Explain lease financing, including types of lease arrangements and lease structures.
Section: 10.5 Leasing

83. The type of lease where the costs of ownership and operation are borne by the lessee, who agrees to make a residual payment at the end of the lease period, is a/an:

A. direct lease.
B. financial lease.
C. operating lease.
D. leveraged lease.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-05 Explain lease financing, including types of lease arrangements and lease structures.
Section: 10.5 Leasing

84. When a finance company purchases assets with its own funds and leases them to a lessee for a negotiated long-term period this is called a/an:

A. direct lease.
B. sale and lease-back.
C. operating lease.
D. leveraged lease.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-05 Explain lease financing, including types of lease arrangements and lease structures.
Section: 10.5 Leasing

85. For what type of lease does the lessee borrow a large part of the funds, typically in a multi-million dollar arrangement, often with a lease manager, while one or more financial institutions provide the remainder?

A. An equity lease
B. A leveraged lease
C. A sale and leveraged lease
D. A financial lease

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-05 Explain lease financing, including types of lease arrangements and lease structures.
Section: 10.5 Leasing

86. A direct finance lease is best described as a/an:

A. operating lease.
B. sale and leaseback arrangement.
C. full-service lease.
D. leveraged lease.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-05 Explain lease financing, including types of lease arrangements and lease structures.
Section: 10.5 Leasing

87. Compared with missing an interest payment on debt, the penalties for missing a financial lease payment are:

A. less severe.
B. the same.
C. more severe.
D. not related.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-05 Explain lease financing, including types of lease arrangements and lease structures.
Section: 10.5 Leasing

88. Which of the following is NOT an advantage of leasing from the lessee's viewpoint?

A. 100% financing
B. The company's capital is not involved
C. Flexible repayment scheduling
D. With a net lease, costs of ownership remain with the lessee

Difficulty: Hard
Est time: <1 minute
Learning Objective: 10-05 Explain lease financing, including types of lease arrangements and lease structures.
Section: 10.5 Leasing

89. Which of the following is NOT an advantage of leasing from the lessor's perspective (compared with offering a straight loan)?

A. Leasing has a relatively low default risk.
B. Administration costs may be lower for a lease than for a straight loan.
C. The return to the lessor may be higher than for a straight loan.
D. The lessor may use the funds for other investment opportunities.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-05 Explain lease financing, including types of lease arrangements and lease structures.
Section: 10.5 Leasing

90. For what type of lease does the lessee provide a significant part of the funds to purchase the asset, often losing the advantage of leveraged leasing, while a financial institution provides the remainder?

A. A capital lease
B. An equity lease
C. A sale and leveraged lease
D. A financial lease

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-05 Explain lease financing, including types of lease arrangements and lease structures.
Section: 10.5 Leasing

True / False Questions

91. A term loan is referred to as a fully drawn advance when the borrower obtains the full amount at the start of the loan.

TRUE

The full amount of the loan is provided to the borrower at the start of the loan.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

92. A term loan with interest and principal repayments that are amortised over the term are sometimes called credit foncier loans.

TRUE

This is a term loan that involves regular equal payments that include an interest payment part and a principal reduction part.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

93. A long-term loan will generally attract a higher rate of interest than a short-term loan.

TRUE

Generally a borrower will have to pay higher interest for a longer term loan than a short-term loan owing to the lenders wanting compensation for liquidity and interest rate risk.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

94. Banks often calculate a prime rate lending as they can adjust it more quickly than other reference money market rates.

FALSE

The prime rate of a bank reflects its borrowing costs but in practice a prime rate tends to be less volatile than market interest rates.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

95. Apart from an interest charge on funds advanced to a borrower, a bank will charge a service fee for considering the loan application and loan preparation.

FALSE

Apart from an establishment fee, a bank will charge a service fee for ongoing loan account administration costs, not for considering the loan application—that is the establishment fee.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

96. A positive loan covenant can state that a company must maintain a minimum level of working capital.

TRUE

Loan covenants are rules in the actual loan contract about how much borrowing a borrower may do and a positive covenant specifies acts to be taken by the borrower.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-02 Describe the nature, purpose and operation of mortgage finance and the mortgage market, and calculate an instalment on a mortgage loan.
Section: 10.2 Mortgage finance

97. The inclusion of covenants in a term loan is designed to protect the borrower from taking on too much debt.

FALSE

Covenants in loan contracts are designed to protect the lender's financial risk exposure by imposing rules on the borrower.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-02 Describe the nature, purpose and operation of mortgage finance and the mortgage market, and calculate an instalment on a mortgage loan.
Section: 10.2 Mortgage finance

98. Under mortgage financing, the mortgagor is the lender of the mortgage funds.

FALSE

The mortgagor is the borrower who issues a mortgage contract to the lender of funds with the land and property as collateral.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-02 Describe the nature, purpose and operation of mortgage finance and the mortgage market, and calculate an instalment on a mortgage loan.
Section: 10.2 Mortgage finance

99. A bond is a long-term debt instrument issued directly into the capital markets.

TRUE

It is the long-term financial instrument when a borrower issues a financial security directly into the debt markets. A bond promises to pay its holder regular coupon payments and principal is repaid at maturity.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 10-03 Discuss the bond market, in particular the structure and issue of debentures, unsecured notes and subordinated debt.
Section: 10.3 The bond market: debentures, unsecured notes and subordinated debt

100. The terms subordinated debt and unsecured note are interchanged as they are both corporate bonds that have identical features.

FALSE

Subordinated debt refers to different debt issues with different ranking in respect to payment claims in the case of default by the company. An unsecured note is a corporate bond with no security or collateral attached.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 10-03 Discuss the bond market, in particular the structure and issue of debentures, unsecured notes and subordinated debt.
Section: 10.3 The bond market: debentures, unsecured notes and subordinated debt

Short Answer Questions

101. Discuss major features of a term loan.

A term loan is the main type of intermediated finance provided by financial institutions. It is a loan advanced for a specific period for a variety of purposes such as purchase of real estate, construction of premises or for buying plant and equipment. It is generally granted for a period from between three and 15 years and the lender generally requires some form of security to be attached to the loan that may be structured as an amortised loan or an interest-only loan.

Est time: 1-3 minutes
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

102. Define and discuss a reference interest rate in relation to lending.

A loan agreement will generally specify a reference interest rate that will apply for the loan and any subsequent reset of the loan, such as the BBSW rate, which is an adjusted average of the bank bill rate in the Australian money market. Published benchmarks are used as benchmarks for pricing loans. Banks also calculate their own reference benchmark called a prime rate.

Est time: 1-3 minutes
Learning Objective: 10-01 Explain term loans and fully drawn advances, including their structure, loan covenants and the calculation of a loan instalment.
Section: 10.1 Term loans or fully drawn advances

103. Discuss the features of mortgage agreements for commercial loans.

Companies may obtain debt finance by providing security to the lender by way of a mortgage over land and in some cases leasehold land. Commercial mortgage finance tends to be provided on shorter terms to maturity than retail mortgage loans. In Australia commercial property mortgages typically range up to 10 years and are available with a choice of variable interest rate or fixed interest rate.

Est time: 1-3 minutes
Learning Objective: 10-02 Describe the nature, purpose and operation of mortgage finance and the mortgage market, and calculate an instalment on a mortgage loan.
Section: 10.2 Mortgage finance

104. Identify the main debt securities of the Australian bond market.

The main debt securities are bonds issued by the Australian government, bonds issued by state government borrowing authorities known as semis, bonds issued by financial institutions such as National Bank of Australia, bonds issue by Australian corporations, asset-backed securities and Kangaroo bonds, which are Australian dollar bonds issued by non-residents.

Est time: 1-3 minutes
Learning Objective: 10-03 Discuss the bond market, in particular the structure and issue of debentures, unsecured notes and subordinated debt.
Section: 10.3 The bond market: debentures, unsecured notes and subordinated debt

105. Discuss the use of a prospectus in relation to the issue of debt securities.

In most countries where a corporate bond market exists, legislation will require any invitation to the public to deposit money with or lend to a corporation to be accompanied by a prospectus. A prospectus is a formal written offer to sell securities and will generally contain specified details about the business such as financial statements, and specialist accounting, taxation and legal reports. It is intended to protect the investor but does create certain disadvantages for the borrower such as being time consuming to prepare.

Est time: 1-3 minutes
Learning Objective: 10-03 Discuss the bond market, in particular the structure and issue of debentures, unsecured notes and subordinated debt.
Section: 10.3 The bond market: debentures, unsecured notes and subordinated debt

Chapter 10 - Test Bank Summary

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