Question #1 of 10

Question ID: 1574185

The interest rate on excess reserves borrowed by one bank from another bank is *most accurately* described as a(n):

A) central bank funds rate.

B) interbank lending rate.

C) reserve swap rate.

Explanation

Required reserves are deposits with a country's central bank. Banks that deposit more than the required amount with the central bank are said to have excess reserves and may lend these to other banks. This lending is said to take place in the central bank funds market and the interest rates on such loans are known as central bank funds rates.

(Module 52.1, LOS 52.a)

Question #2 of 10

Question ID: 1576042

Which of the following debt covenants is *most likely* to be found with a high-yield debt issuance?

A) A minimum dividend payment of $5 per share to common stockholders.

B) A debt-to-equity ratio that cannot go below 40%.

C) A cap of $20 million on total debt outstanding.

Explanation

Debt covenants are put in place to protect debt investors. A cap on the total amount of debt a company can have outstanding will protect current debt investors from the company borrowing more money and putting current obligation interest and principal payments at risk. The debt-to-equity ratio debt covenant will likely be a maximum (not a minimum) threshold. Dividend payments are likely to be maximum amounts not to be exceeded, rather than minimum amounts.

(Module 52.1, LOS 52.c)

Question #3 of 10

Question ID: 1576043

Redding Company (Redding) has struggled financially over the last several years but is hoping to turn things around under new leadership. Redding's credit rating is below investment grade, and it is looking to issue new debt to provide some much-needed capital. Redding's *best* course of option is to:

A) take out leveraged loans with prepayment options. ✓

B) issue low-yield bonds with a 20-year maturity. ✗

C) issue putable debt. ✗

Explanation

A company with a low credit rating will have to issue high-yield debt until the company is able to turn things around financially and can borrow at lower rates. Given the situation Redding is in, its best courses of action are either to issue callable debt (where the issuer has the right to call in the debt issuance before maturity) or take out leveraged loans with prepayment options. Shorter-maturity instruments are better, as the company may be able to borrow at lower rates later when its situation improves.

(Module 52.1, LOS 52.c)

Question #4 of 10

Question ID: 1576041

The credit spread is 5% of the yield on Bond A, 10% of the yield on Bond B, and 30% of the yield on Bond C. Bond C is *most likely*:

A) an investment-grade bond. ✗

B) a government bond. ✗

C) a high-yield bond. ✓

Explanation

For high-yield bonds, credit spreads are likely to be a larger proportion of yield than they are for investment-grade bonds and government bonds.

(Module 52.1, LOS 52.c)

Question #5 of 10

Question ID: 1576040

Reduced rollover risk resulting from standardization is a benefit available to which type of corporate bond issuer?

A) Short term.

B) Investment grade.

C) High yield.

Explanation

Investment-grade issues are standardized (similar across different issues) and typically issued across multiple maturities, which reduces rollover risk (the risk that maturing debt will have to be replaced with new debt at higher interest rates). High-yield debt is not standardized and often matures earlier than investment-grade debt. Short-term debt will carry more rollover risk.

(Module 52.1, LOS 52.c)

Question #6 of 10

Question ID: 1574188

Compared to a term repurchase agreement, an overnight repurchase agreement is *most likely* to have a:

A) higher repo rate and repo margin.

B) lower repo rate and higher repo margin.

C) lower repo rate and repo margin.

Explanation

Both the repo rate and the repo margin tend to be higher for longer repo terms. Therefore an overnight repo should have a lower repo rate and a lower repo margin than a term (i.e., longer than overnight) repo.

(Module 52.1, LOS 52.b)

Question #7 of 10

Question ID: 1576039

Assuming a normal yield curve environment, higher yields must be offered by corporate issuers on bonds that mature in 20 years compared with those that mature in 10 years, if the 20-year bonds are considered:

A) investment grade only.

B) high yield only.

C) investment grade or high yield.

Explanation

In a normal yield curve environment where bond yields are higher for longer-dated bond maturities, both investment-grade and high-yield corporate issuers need to offer higher yields on bonds with longer maturities.

(Module 52.1, LOS 52.c)

Question #8 of 10

Question ID: 1574184

The interbank funds market is *most accurately* described as:

A) banks' borrowing of reserves from the central bank.

B) trading of negotiable certificates of deposit.

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

Explanation

The interbank funds market refers to short-term unsecured loans between banks. It does not refer to trading of negotiable certificates of deposit. Borrowing from the central bank is said to occur in the central bank funds market.

(Module 52.1, LOS 52.a)

Question #9 of 10

Question ID: 1574186

Which of the following statements regarding repurchase agreements is *most accurate*?

A) Greater demand for the underlying security results in a lower repo margin.

B) Higher credit rating of the underlying collateral results in a higher repo rate.

C) Lower credit rating of the underlying collateral results in a lower repo margin.

Explanation

Other things equal, the repo margin (percent difference between the market value of the collateral and the loan amount) is lower if the collateral is in greater demand. The repo margin and repo rate (the annualized percent difference between the sale price and repurchase price of the collateral) are inversely related to the credit quality of the collateral.

(Module 52.1, LOS 52.b)

Question #10 of 10

Question ID: 1574187

A repurchase agreement is described as a "reverse repo" if:

A) a bond dealer is the lender.

B) collateral is delivered to the lender and returned to the borrower.

C) the repurchase price is lower than the sale price.

Explanation

Bond dealers frequently use repurchase agreements as sources of funding. When a bond dealer enters a repo as the lender instead of the borrower, the agreement is referred to as a reverse repo.

(Module 52.1, LOS 52.b)