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Exam : CSC1

**Title : Canadian Securities Course
Exam 1**

Version : DEMO

1. Why would a corporation choose to issue preferred shares rather than debt?

- A. Existing assets have excess financing capacity to justify the issue of preferred shares.
- B. The preferred dividend rate usually varies with the market interest rates
- C. Issuing preferred shares would reduce the amount of leverage.
- D. The costs for issuing preferred shares are usually lower than debt.

Answer: C

Explanation:

When a corporation issues preferred shares rather than debt, it avoids increasing its leverage (debt-to-equity ratio). Preferred shares are considered equity for financial reporting purposes and do not require the repayment of principal like debt instruments. Although they may have fixed dividend obligations, these are not legally binding in the way interest payments on debt are.

Issuing preferred shares allows the corporation to strengthen its balance sheet while potentially preserving its credit rating. Preferred shares do not directly affect leverage but provide capital without increasing debt.

References:

Volume 1, Chapter 8: Preferred Shares, section on "Why Companies Issue Preferred Shares" explains the advantages of using preferred shares instead of debt.

2. When a company issues a number of common shares, some of which are held by institutional investors, what are the institutional investors' shares known as?

- A. Market capitalization shares.
- B. Outstanding shares.
- C. Issued shares
- D. Public float shares.

Answer: D

Explanation:

The shares held by institutional investors, along with other shares available for trading by the public, are referred to as the public float shares. These are the issued shares of a company that are actively traded in the market, excluding restricted shares held by insiders or strategic investors.

Other options:

Issued shares: Includes all shares a company has issued, including restricted shares.

Outstanding shares: Includes all shares held by all shareholders, including restricted shares and shares not available for trading.

Market capitalization shares: Not a term used to describe shares; market capitalization is a measure of a company's total value based on its stock price and outstanding shares.

References:

Volume 1, Chapter 8: Equity Securities, section on "Public Float and Market Capitalization" explains the concept of public float shares.

3. What is the normal shape of a yield curve?

- A. Downward slope
- B. Inverted
- C. Upward slope
- D. Humped

Answer: C

Explanation:

The normal shape of a yield curve is an upward slope, indicating that longer-term bonds offer higher yields than shorter-term bonds. This reflects the additional risk and time value of money associated with longer maturities.

A. Downward slope: This could describe a yield curve during unusual circumstances, such as a period of market uncertainty or deflation.

B. Inverted: An inverted yield curve, where shorter-term yields exceed longer-term yields, is a rare occurrence and often signals economic recession.

D. Humped: A humped curve is rare and occurs when intermediate-term yields exceed both short-term and long-term yields.

4. A fixed-rate bond was originally priced at \$100 and paid \$5 per year in interest. Currently, the bond is trading at \$102.75.

What is the impact on the current yield of coupon of the bond as a result of the change in price?

A. The coupon is higher than 5%.

B. The current yield is higher than 5%.

C. The current yield is lower than 5%.

D. The coupon is lower than 5%.

Answer: C

Explanation:

The coupon rate of the bond remains fixed at 5%, as it is based on the bond's original par value of \$100. The current yield, however, decreases because the bond's price has increased to \$102.75.

Current yield is calculated as:

$$\text{Current Yield} = \frac{\text{Coupon Payment}}{\text{Current Price}}$$

Given:

Coupon Payment = \$5

Current Price = \$102.75

$$\text{Current Yield} = \frac{5}{102.75} \approx 4.87\%$$

A. The coupon is higher than 5%: The coupon remains fixed at 5%.

B. The current yield is higher than 5%: The current yield is lower than 5% due to the increased price.

D. The coupon is lower than 5%: The coupon does not change with the bond's price.

5. Which type of bond offers the investor a choice of interest payments in either of two currencies?

A. Eurobonds

B. Foreign pay bonds

C. Subordinated debentures

D. Floating-rate securities

Answer: B

Explanation:

A foreign pay bond is a type of bond that allows the investor to choose the currency in which to receive interest payments, usually between the currency of the issuer's country and a foreign currency. This

feature provides flexibility for investors who may want to manage currency risk or take advantage of fluctuations in exchange rates.

Review of Other Options:

A. Eurobonds:

Eurobonds are international bonds issued in a currency other than the currency of the country where they are issued. However, they do not provide the investor with a choice of interest payments in different currencies.

C. Subordinated Debentures:

These are unsecured bonds that rank below other debts in terms of repayment priority in case of liquidation.

They do not involve currency options for interest payments.

D. Floating-Rate Securities:

These bonds have variable interest rates that adjust periodically based on a benchmark interest rate, such as LIBOR or prime rate, but they do not allow investors to choose the currency of interest payments.

Why B is Correct:

Foreign pay bonds are explicitly designed to offer investors a choice of interest payments in two currencies, making them unique among fixed-income securities. This feature provides added flexibility for investors dealing with foreign exchange considerations.

References:

Canadian Securities Course (CSC), Volume 1, Chapter 6: Fixed-Income Securities – Features and Types.

Detailed explanation of foreign pay bonds and their distinguishing features.

Discussion of bond types and their characteristics, including Eurobonds and floating-rate securities, in Chapter 6.