Question 1 of 100

Which of the following are typically unsecured forms of debt whose repayments do not involve amortization of loan principal?

I. High-yield bonds
II. Leveraged loans
III. Mezzanine debt

- **A.** I only
- **B.** II only
- **C.** III only
- ✓ **D.** I and III only

EXPLANATION • Learning Objective 5.1.5 **ID:** L1-5.1.5-029

Both mezzanine debt and high-yield bonds are unsecured debt whose repayments involve no amortization of loan principal (only interest is paid until maturity; then a bullet payment is made).

Other response: leveraged loans are secured forms of debt whose debt repayments involve amortization of principal.

Question 2 of 100

According to Antczak, Lucas, and Fabozzi (2009), which of the following are ways in which covenants may control risk for lenders?

I. Performance and reporting requirements
II. Control of market risk
III. Preservation of collateral
IV. Use of excess cash flow

- ✓ **A.** I, III, and IV only
- **B.** I, II, III, and IV
- **C.** II and IV only
- **D.** I and III only

EXPLANATION • Learning Objective 5.1.2 **ID:** L1-5.1.2-017

Antczak et al provide five ways in which covenants may control risk for lenders.

1. Preservation of collateral - Lenders may require a maximum loan-to-value ratio of 50% for inventory; 60% for property, plant, & equipment; and 80% for receivables. Each asset should only be pledged as collateral to one lender.
2. Appropriation of excess cash flow - Lenders often require that most or all of the value of asset sales and new debt be paid to debt holders (not to equity holders).
3. Control of business risk - Lenders should limit the types and sizes of investments, mergers, and debt that companies can undertake due to the inherent conflict of interest between stockholders and bondholders (i.e., a distressed firm taking on risky projects may benefit stockholders as long call option holders, but is typically detrimental to bondholders).
4. Performance requirements - Negative covenants require borrowers to maintain strong financial ratios.
5. Reporting requirements - Affirmative covenants require borrowers to report their financial results and other material information to lenders.

Question 3 of 100

Which of the following best describes blanket subordination?

- **A.** Blanket subordination prevents any payment of principal or interest to the mezzanine investor until the senior debt has been fully repaid. ✔
- **B.** Blanket subordination prevents any payment of principal to the LBO investor until the senior debt has been fully repaid.
- **C.** Blanket subordination permits payment of principal to the LBO investor while the senior debt is outstanding.
- **D.** Blanket subordination permits payment of principal or interest to the mezzanine investor while the senior debt is outstanding.

EXPLANATION • Learning Objective 5.1.5 **ID:** L1-5.1.5-024

Blanket subordination is a provision of the inter-creditor agreement between the mezzanine investor and the senior creditors. It prevents payment of principal or interest to the mezzanine investor until the senior debt has been fully repaid.

Other response: Springing subordination permits payments to be made to mezzanine investor while senior debt is outstanding. However, if the issuer defaults on the senior debt, payments to mezzanine investors stop until the default has been resolved.

Question 4 of 100

Which of the following is true of project finance of an infrastructure project?

- **A.** The loans are paid back with cash flows from the project. ✔
- **B.** The loans provided are not secured.
- **C.** The loans are funded with an equal mix of equity and debt.
- **D.** The loans provided are typically recourse loans.

EXPLANATION • Learning Objective 5.1.6 **ID:** L1-5.1.6-018

Project finance is the long-term financing of projects by investors who provide loans (typically non-recourse loans) to finance a specific project, and are repaid with the cash flows generated by the project. The loans are secured by the assets of the project.

Question 5 of 100

Baltech Corp. has declared Chapter 11 bankruptcy and presented a reorganization plan to its creditors. Viktors Licis, a creditor of Baltech, plans to block the reorganization plan by establishing a blocking position. Which of the following would enable him to accomplish this?

- **A.** if he files an objection to the reorganization plan within 120 days after the bankruptcy filing
- **B.** if he files an objection to the reorganization plan within 60 days after the bankruptcy filing
- ✔ **C.** if he holds one-third of the dollar amount of any claimant class
- **D.** if he holds two-thirds of the dollar amount of any claimant class

EXPLANATION • Learning Objective 5.1.8 **ID:** L1-5.1.8-017

A blocking position constitutes one-third ownership of any class of claimants. The position forces the debtor company and the other parties to negotiate with the blocking creditor.

Question 6 of 100

Subordinated debt with warrants provide issuers which of the following advantages compared to other bonds?

- ✔ **A.** lower interest rates and less restrictive covenants
- **B.** less restrictive covenants and equity upside potential
- **C.** more credit enhancements and lower interest rates
- **D.** more restrictive covenants and shorter maturities

EXPLANATION • Learning Objective 5.1.6 **ID:** L1-5.1.6-016

Compared to other bonds, subordinated debt with warrants provide issuers the advantages of: 1) lower interest rates and 2) less restrictive covenants.

Question 7 of 100

Which of the following characterizes the business approach of different categories of venture lenders?

- **A.** Specialized venture banks charge the highest rates and convert warrants into large equity stakes.
- ✔ **B.** Venture debt funds seek high growth, shorter-term investments, and charge high interest rates.
- **C.** Venture debt funds are less expensive than banks since they have access to low cost capital.
- **D.** International financial institutions are the primary venture lenders and they pursue social objectives.

EXPLANATION • Learning Objective 5.1.7 **ID:** L1-5.1.7-003

Venture debt funds seek 2-5 year investments in high-growth companies and offer relatively expensive financing with rates driven by hurdle rates.

Other responses -

- Specialized banks typically charge lower rates than funds and do not typically exercise warrants into equity stakes.
- International financial institutions often target investments in view of pursuing specific social objectives and do not represent the majority of venture lending.

Question 8 of 100

The lender of an asset-backed security takes steps to ensure that another creditor cannot claim the security's collateral if the debtor becomes insolvent. Which of the following best describes this process?

- **A.** increasing the borrowing base
- **B.** including a traditional overadvance
- ✔ **C.** perfecting the security interest

EXPLANATION • Learning Objective 5.2.2 **ID:** L1-5.2.2-003

This is referred to as perfecting the security interest. It essentially ensures the secured party's priority to the collateral over other parties.

Other response: Traditional overadvance refers to additional borrowing that is amortized over several years. The overadvance provides a higher advance rate for an asset-backed loan, and may be structured as a component of the existing term loan or as a separate facility.

Question 9 of 100

Which of the following risk factors most likely affects commercial and insured residential MBSs to the same extent?

- ✔ **A.** geographic location
- **B.** path that the mortgage rate has followed to arrive at the current level
- **C.** borrowers' creditworthiness
- **D.** prevailing mortgage rate

EXPLANATION • Learning Objective 5.2.4 **ID:** L1-5.2.4-008

Location is a common risk factor for both types of MBSs that affects them both to a similar extent.

Other responses -

- The prevailing mortgage rate and the path of rates affect residential MBSs more, since they are subject to more prepayment risk than commercial MBSs.
- Borrowers' creditworthinesss affects commercial MBSs more than insured residential MBSs, since commercial MBSs are subject to more credit risk due to their non-standardized nature.

Question 10 of 100

A homeowner has a 30-year fixed-rate, constant payment, fully amortized mortgage. Which of the following best describes the interest and principal components of the monthly mortgage payments over the 30-year term?

- **A.** The change in interest and principal components depends on whether the mortgage has a balloon payment at maturity.
- **B.** The interest component increases and the principal component decreases.
- ✅ **C.** The interest component decreases and the principal component increases.

EXPLANATION • Learning Objective 5.2.5 **ID:** L1-5.2.5-011

For a fixed-rate, constant payment, fully amortized loan, the interest component decreases and the principal component increases as the loan matures.

Other response: A fully amortized loan does not have a balloon payment at maturity. Its principal at maturity is zero.

Question 11 of 100

30-year mortgage loans in a pool underlying a mortgage-backed security are 100% PSA. Which of the following most accurately describes these loans with respect to their conditional prepayment rates (CPRs)?

- ✅ **A.** The CPRs begin at 0.2% in the first month, increase by 0.2% each month over the next 30 months until they reach 6%, and then remain at 6% for the remaining 330 months.
- **B.** The CPRs begin at 0% in the first month, increase by 0.2% each month over the next 10 months until they reach 6%, and then remain at 6% for the remaining 350 months.
- **C.** The CPRs begin at 0% in the first month, increase by 0.1% each month over the next 10 months until they reach 5%, and then remain at 5% for the remaining 350 months.
- **D.** The CPRs begin at 0.2% in the first month, increase by 0.1% each month over the next 30 months until they reach 5%, and then remain at 5% for the remaining 330 months.

EXPLANATION • Learning Objective 5.2.4 **ID:** L1-5.2.4-003

The CPR begins at 0.2% in the first month, increases by 0.2% each month over the next 30 months until it reaches 6%, and then remains at the 6% rate for the remainder of the mortgage's life.

Question 12 of 100

Amy DeWitt has a recourse mortgage with Citixens Bank. If Amy defaults on this loan, which of the following best describes Citixens Bank's options?

- **A.** The bank can only seize and sell Amy's house.
- **B.** The bank can seize and sell Amy's house and can go after Amy's other physical assets to cover the amount owed.
- ✅ **C.** The bank can seize and sell Amy's house and can go after Amy's other assets to cover the amount owed.

EXPLANATION • Learning Objective 5.2.3 **ID:** L1-5.2.3-011

With recourse loans, borrowers are liable for repaying outstanding loan balances. Therefore, in the event of borrower default, lenders can take the collateral on the loan (e.g. the house, in this case) and can go after the borrower's other assets (e.g., garnish wages) to recoup the amount owed to them.
With non-recourse loans, lenders can only collect the loan collateral; lenders have no claim on borrowers' other assets.

Question 13 of 100

Which of the following is NOT true of an asset-backed security structure with three tranches: A, B, and C?

- ✔ **A.** Tranche A never suffers losses.
- **B.** Tranche C has a lower credit rating than tranche B.
- **C.** Tranche B has higher yield than tranche A.

EXPLANATION • Learning Objective 5.2.3 **ID:** L1-5.2.3-001

If losses due to a credit event are large enough, the most senior tranche (A) may suffer losses.

Question 14 of 100

Which of the following insurance-linked security payment triggers is based on actual losses?

- **A.** parametric trigger
- ✔ **B.** indemnity trigger
- **C.** industry loss trigger
- **D.** modeled trigger

EXPLANATION • Learning Objective 5.3.2 **ID:** L1-5.3.2-001

The insurance-linked security payment trigger based on actual losses is the indemnity trigger.

Question 15 of 100

Which of the following statements about the diversification benefits of cat bonds is most accurate?

- ✔ **A.** The diversification benefits of mortality cat bonds are lower than those of non-life cat bonds.
- **B.** The diversification benefits of mortality cat bonds are higher than those of non-life cat bonds.
- **C.** The diversification benefits of mortality cat bonds are about the same as those of non-life cat bonds.

EXPLANATION • Learning Objective 5.3.4 **ID:** L1-5.3.4-021

Mortality cat bonds have exposure to systematic risk (e.g., a pandemic that may have broad financial market consequences) that non-life cat bonds do not and, as a result, provide less diversification benefits.

Note: Life cat bonds are related to mortality and longevity risk; non-life cat bonds are related to natural disasters.

Question 16 of 100

Which of the following best represents the primary motivation for the creation of the Ethereum network by Vitalik Buterin?

- **A.** To introduce a blockchain architecture that does not use tokens.
- **B.** To overtake Bitcoin as the primary public blockchain network.
- ✓ **C.** To use blockchain technology for applications other than the transfer of money.
- **D.** To centralize the deployment of online applications.

EXPLANATION • Learning Objective 7.1.4 **ID:** L1-7.1.4-002

Vitalik Buterin created the Ethereum network after recognizing the potential of blockchain technology to accommodate diverse decentralized applications other than the transfer of money.

Other responses: Ethereum facilitates decentralized application deployment, and uses tokens (native and non-native).

Question 17 of 100

A company has gotten DeFi insurance against a category 5 hurricane in Florida. Which of the following best describes the form of insurance that the company has?

- ✓ **A.** parametric insurance
- **B.** yield farming insurance
- **C.** indemnity insurance

EXPLANATION • Learning Objective 7.1.6 **ID:** L1-7.1.6-005

Parametric insurance is insurance against a well-defined event with specific parameters (e.g., category 5 hurricane in Florida).

Question 18 of 100

Which of the following statements regarding the proof-of-stake (PoS) consensus mechanism is NOT correct?

- **A.** With PoS, a validator proposing a bad data block may lose its staked ether.
- **B.** In PoS, validators need to acquire tokens to create new blocks.
- **C.** In a PoS system, users with larger stakes are more likely to be selected as validators of new blocks.
- ✓ **D.** A PoS system is more energy-intensive than a proof-of-work (PoW) system.

EXPLANATION • Learning Objective 7.1.4 **ID:** L1-7.1.4-009

A PoS system is less energy-intensive than a PoW system. In a PoS system, validators who stake their tokens in a smart contract are selected at random to validate and produce new blocks on the blockchain. As a result, a PoS system does not involve the large amounts of computational power used by miners in a PoW consensus mechanism.

Other response: Validators in PoS needing to acquire tokens to be block producers contrasts with PoW miners that are not obligated to hold the blockchain's native token.

Question 19 of 100

Which of the following terms describes the process of blockchain users locking up digital tokens in a smart contract in a bid to be selected as validators of new data blocks?

- **A.** collateralization
- **B.** proof of funds
- **C.** buy-in
- ✓ **D.** staking

EXPLANATION • Learning Objective 7.1.4 **ID:** L1-7.1.4-011

In a proof-of-stake (PoS) blockchain consensus system, prospective validators of new data blocks lock up (or stake) digital tokens (e.g., ether) they own in a smart contract. Validators are chosen randomly among those who have staked, and users with larger stakes are more likely to be selected.

Question 20 of 100

Which of the following is among the benefits of decentralized systems relative to centralized systems?

- **A.** better scalability
- **B.** increased censorship
- **C.** lower power consumption
- ✓ **D.** no single point of failure

EXPLANATION • Learning Objective 7.1.1 **ID:** L1-7.1.1-011

An important benefit of decentralized systems is that they do not have a single point of failure, which can expose them to attacks from hackers and censorship from a central authority.

Other responses -

- Decentralized systems rely on consensus protocols that require large computing power and electricity consumption.
- Decentralized systems are less scalable than centralized systems.
- Increased censorship is not a benefit of decentralized systems; centralized systems are at a higher risk of censorship.

Question 21 of 100

Which of the following is NOT a feature that enhances the security of a decentralized network such as a blockchain?

- **A.** public and transparent nature
- **B.** digital signature
- **C.** private key
- **D.** small number of nodes

EXPLANATION • Learning Objective 7.1.1 **ID:** L1-7.1.1-006

Decentralized networks comprise peer-to-peer networks of nodes that share information. A system with more nodes is typically considered safer, as power is less concentrated in any individual node and the likelihood of a group of nodes acting together to compromise the integrity of the network is reduced.

Other responses -

- A private key protects individual users of a decentralized network.
- The public and transparent nature of decentralized networks disincentivizes nodes to work against the network, thus reducing its value to all users.
- A digital signature authenticates the identity of a participant in a network transaction, thus enhancing network security.

Question 22 of 100

Which of the following stablecoins may be uncollateralized?

- **A.** crypto-backed stablecoin
- **B.** central bank digital currencies
- **C.** fiat-backed stablecoin
- **D.** algorithmic stablecoin

EXPLANATION • Learning Objective 7.1.5 **ID:** L1-7.1.5-006

Algorithmic stablecoins use smart contracts to maintain their price stability, and may or may not have collateral backing.

Other response: Central bank digital currencies are fiat-backed stablecoins.

Question 23 of 100

Which of the following is the best definition of sustainability as given in the 1987 Brundtland report?

- **A.** Balances between the components of social and environmental concerns for present and future generations.
- **B.** Addresses necessary changes for how resources are currently developed and used.
- **C.** Meets the needs of the present without compromising the ability of future generations to meet their own needs.

EXPLANATION • C26-L1-1.1.2-001 **ID:** C26-L1-1.1.2-001

The 1987 Brundtland report defined sustainability as "meeting the needs of the present without compromising the ability of future generations to meet their own needs".

Question 24 of 100

Which of the following best describes the fundamental purpose of the investment industry?

- **A.** to provide wealth and risk management to end savers
- **B.** to contribute to society via increases in societal wealth and well-being
- **C.** to mobilize the sourcing and allocation of capital to where it is needed
- **D.** to produce opportunities, and rewards for investment organizations

EXPLANATION • C26-L1-1.1.1-001 **ID:** C26-L1-1.1.1-001

The investment industry's fundamental purpose is to contribute to society via increases in societal wealth and well-being.

Other responses -

- Mobilizing the sourcing and allocation of capital to where needed is the intrinsic purpose.
- Producing opportunities, etc. for investment professionals and organizations is the collateral purpose.
- Providing wealth and risk management to end savers is the core purpose.

Question 25 of 100

Other than prudence and care, fiduciary obligations include which of the following areas?

- **A.** diversification and impartiality
- **B.** independence and transparency
- **C.** client first and partnership
- **D.** loyalty and objectivity

