

UNIVERSITY OF COLOMBO, SRI LANKA
FACULTY OF MANAGEMENT & FINANCE

Bachelor of Business Administration in Finance (Level II- Semester VII)
Examination, July, 2017

FIN - 2206 Fixed Income Securities

Two (02) Hours

Instructions to Candidates:

- Answer all Questions
- Use of calculators is permitted

1.

- i. "In investment management, the most important decision is to allocate funds among different types of asset classes." Explain each of asset classes available for an investment manager.

(10 Marks)
- ii. "One of the most important features of a bond is the nature of its issuer." Compare and contrast the nature of bond issuers in United States of America (USA) and Sri Lanka (SL).

(06 Marks)
- iii. "Often, the words 'maturity' and 'term to maturity' are used interchangeably to refer the number of years remaining in the life of a bond." Distinguish between maturity and term to maturity.

(04 Marks)
- iv. Briefly explain the optional acceleration feature in sinking fund provisions.

(05 Marks)

(Total 25 Marks)

2.

- i. Explain at least three factors which are hindering the development of the corporate bond market in Sri Lanka.

(06 Marks)

ii. "Call feature benefits the issuer and places the investor at a disadvantage."

a. Briefly explain what the call option is.

(03 Marks)

b. Explain how the investor is being compensated for granting the call privilege to the issuer.

(03 Marks)

iii. "Nonrefundable bonds cannot be called for any reason during the deferment period." Do you agree with this statement? Justify your answer.

(05 Marks)

iv. "Investors are provided some protection against reinvestment rate risk through make-whole call provision. However firms often find instances where it is profitable to refund an issue." Do you agree with this statement? Illustrate your answer. (Hint: Use a hypothetical example and justify your answer using calculations.)

(08 Marks)

(Total 25 Marks)

3.

i. For each of the following issues, indicate whether the price of the issue should be par value, above par value, or below par value:

Issue	Coupon Rate (as percentage)	Yield required by the market (as a percentage)
1	5.5	7.05
2	0	5.5
3	5.875	5.00
4	4.75	4.75
5	4.5	4.00

(03 Marks)

ii.

a. What is the difference between positive and negative covenants?

(04 Marks)

b. What is the purpose of analyzing the covenants in assessing the credit risk of an issuer?

(07 Marks)

iii. "Portfolios have different exposures as to how the yield curve shifts and this risk exposure is called the yield curve risk."

Explain the above statement.

(05 Marks)

iv. "Volatility risk with respect to a puttable bond would arise if there is an increase in the expected yield volatility."

Do you agree with this statement? Explain your answer.

(06 Marks)

(Total 25 Marks)

4.

i.

a. Differentiate between Multiple (Competitive) and Uniform- price auctions with the help of an example.

(05 Marks)

b. In a primary auction, why does the government attempt to maximize the bid price?

(05 Marks)

ii.

a. Explain what are the issues with respect to the debt management in Sri Lanka?

(04 Marks)

b. As you think, what is the long-term impact of these issues on the economy?

(02 Marks)

iii. The design of the primary dealer system of a country as a developmental objective should aim at a mix of obligations, privileges, and supporting arrangements that help the authorities to achieve their objectives. What have been the measures taken by the Central Bank of Sri Lanka over the time in order to strengthen the role of the primary dealer system of the country with the major objective of market development.

(05 Marks)

iv. What could be the rationale behind introducing following debt instruments:

a. Reverse (Inverse) Floaters

(07 Marks)

(02 Marks)

b. Catastrophe Bonds

(07 Marks)

(02 Marks)

(Total 25 Marks)
