LM04 · FIXED INCOME · CFA LEVEL I

Fixed-Income Markets for Corporate Issuers

Short-term funding for non-financial corps and banks; repos; investment grade vs high yield corporate debt.

Learning Outcomes

LOS a Describe short-term funding alternatives available to corporate issuers (non-financial and financial)

LOS b Describe repurchase agreements (repos) and their uses and risks

LOS c Describe long-term corporate debt: investment grade vs. high yield

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LOS A · SHORT-TERM FUNDING — NON-FINANCIAL CORP

Short-Term Funding — Non-Financial Corporates

1. **Uncommitted lines of credit** — **least reliable** form of bank borrowing. The bank can refuse to honor the request to use the line.
2. **Committed lines of credit** — more reliable; the bank makes a **formal commitment** in exchange for a fee.
3. **Revolving credit agreements** — **most reliable**; formal multi-year agreements, often larger amounts.
4. **Secured loans** — lender requires the company to provide **collateral**.
5. **Commercial paper (CP)** — short-term, **unsecured** instrument typically issued by large, well-rated companies. Maturities range from a few days to **270 days**. Many issuers **roll over** CP regularly.

Exam Tip: Order of reliability (least → most): uncommitted < committed < revolving. CP is unsecured and has ≤ 270-day maturity in the U.S.

LOS A · SHORT-TERM FUNDING — BANKS

Short-Term Funding — Financial Institutions (Banks)

- **Retail deposits** — primary source of bank funds. Three types: **demand deposits, savings accounts, money market accounts**.
- **Central bank funds** — reserves kept with the central bank; inter-bank trading of these reserves is the **central bank funds market**.
- **Interbank funds** — banks lend to and borrow from each other; **unsecured**; terms from overnight to one year.
- **Certificates of deposit (CDs)** — savings instrument with fixed maturity and rate. Two forms: **negotiable** and **non-negotiable**.
- **Commercial paper** — banks also issue unsecured CP. Some banks issue a secured form known as **asset-backed commercial paper (ABCP)**.

LOS B · REPURCHASE AGREEMENTS

Repurchase Agreements (Repos)

A **repo** is a sale and repurchase agreement: the seller sells a security with a commitment to buy the **same security back** from the purchaser at an agreed-upon price at a future date. Economically, it is **borrowing funds against collateral**.

Key terms

Repo rate	The implicit interest rate of the repo
Repo margin (haircut)	Difference between the value of the collateral and the amount borrowed
Term	Overnight (most common) to term repos of weeks or months

Three market uses of repos

1. **Finance the ownership** of a security (buy and fund via repo).
2. **Earn short-term income** by lending funds on a secured basis.
3. **Borrow a security** in order to sell it short (reverse repo side).

Risks of repos

- **Default (counterparty) risk** — the other party fails to honor the repurchase.
- **Collateral risk** — drop in collateral value below the loan.
- **Margining risk** — disputes or inability to meet margin calls.
- **Legal risk** — enforceability of repo agreement across jurisdictions.
- **Netting and settlement risk**.

CHECKPOINT 1

Quiz 1: Short-Term Funding & Repos

Answer all questions to test your understanding. Your score updates on the final step.

Q1. Which of the following short-term funding sources is *most reliable* for a non-financial corporation?

Q2. Commercial paper is *best* described as:

Q3. In a repurchase agreement, the **repo margin (haircut)** is *best* described as:

Q4. An investor who wants to **short-sell** a bond will *most likely* use the repo market to:

Q5. Asset-backed commercial paper (ABCP) is *best* described as:

LOS C · LONG-TERM CORPORATE DEBT

Long-Term Corporate Debt

Investment grade

Strong ability to meet obligations from operating cash flows. A **significant proportion of YTM** is attributed to the **government benchmark yield**; credit spread is relatively small. Investors accept **fewer or no restrictive covenants**.

High yield (non-investment grade)

Higher expected likelihood of financial distress. A **greater proportion of YTM** is attributable to the **issuer-specific spread** over the benchmark. More equity-like in risk/return profile. Investors typically impose **more restrictions and covenants**.

Decomposition of corporate YTM

$$\text{Corporate YTM} = \text{Government benchmark yield} + \text{Issuer credit spread}$$

For IG issuers the benchmark component dominates; for HY issuers the spread component dominates.

LOS C · DEBT TRANCHES AND MATURITIES

Long-Term Debt Structures

Seniority in corporate capital structure

1. Senior secured (bank loans / secured bonds)
2. Senior unsecured
3. Subordinated / junior
4. Preferred equity
5. Common equity

Maturity spectrum

- **Short-term** — CP, bank loans (< 1 yr).
- **Medium-term notes (MTN)** — offered continuously at negotiated terms; 1–10+ years.
- **Long-term bonds / debentures** — 10 yr+, typically public issues.

Maturity structures by issue

- **Term maturity** — all principal at one maturity date.
- **Serial maturity** — portions of principal mature on staggered dates.

CHECKPOINT 2

Quiz 2: Long-Term Debt

Answer all questions to test your understanding. Your score updates on the final step.

Q6. Relative to an investment-grade issuer, a high-yield issuer's YTM *most likely*:

Q7. Medium-term notes (MTNs) are *best* described as:

Q8. A serial-maturity bond *most accurately*:

Q9. A bond issued by a highly rated corporate issuer with a low credit spread will *most likely* be:

Q10. Which of the following sits at the *top* of a corporate capital structure in terms of seniority?

INTEGRATION · NON-FINANCIAL VS. FINANCIAL

How Corporate Markets Work Together

Non-financial corporations and banks use different but overlapping toolkits:

NEED	NON-FINANCIAL CORP	BANK
Overnight / very short-term	Committed LOC, CP	Central bank funds, interbank loans
Up to 1 year	Revolver, CP (rolled)	CDs (negotiable), ABCP
1–10 years	MTN, syndicated loans	Senior unsecured bonds
Long-term	Corporate bonds / debentures	Covered bonds, subordinated debt

CHECKPOINT 3 · SYNTHESIS

Quiz 3: Synthesis

Answer all questions to test your understanding. Your score updates on the final step.

Q11. Which of the following banks' short-term funding sources is *unsecured*?

Q12. A manufacturer rolls its 30-day CP every month. The primary risk of this strategy is:

Q13. An investor uses a **reverse repo** to *most likely*:

Q14. The primary difference between a **committed** and an **uncommitted** line of credit is:

Q15. A high-yield corporate bond is *most likely* to include:

MODULE COMPLETE

Your Scorecard

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LM04 Key Takeaways — Exam-Ready Cheat Sheet

Short-term corporate funding

Reliability: uncommitted < committed < revolving. Plus secured loans and commercial paper (unsecured, ≤270d U.S.). Banks also use deposits, central bank funds, interbank lending (unsecured), CDs, and ABCP.

Repos

Economic substance: borrowing against collateral. Repo rate = implicit interest; haircut = over-collateralization cushion. Uses: finance ownership; earn secured income; borrow security to short. Risks: default, collateral, margining, legal, settlement.

Long-term corporate debt

IG: benchmark component of YTM dominates; fewer covenants. HY: issuer-specific spread dominates; more covenants. Seniority: senior secured > senior unsecured > subordinated > preferred > common.

Exam trigger: CP = unsecured, ≤270d. ABCP = secured. Revolver = most reliable. Repo haircut protects the lender. HY = wider spread + more covenants.

Step 1 of 11