Manual for SOA Exam FM/CAS Exam 2.

Chapter 5. Bonds.

Section 5.1. Securities.

Extract from:
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Securities

When a corporation or a public institution needs to raise money, it arranges contracts with investors. These contracts are called **financial assets** or **securities**. From the investor's view point, securities are investment instruments, endorsed by a corporation, government, or other organization. The borrower offers either debt or ownership (equity). In the case of debt, the borrower agrees to make a series of payments to the investor. In the case of **equity securities**, the borrower gives a part of the ownership of the corporation to the investor.

Stock

For a corporation, claims to its ownership are determined by shares of **stock**. The proportion of a company which an investor owns is the fraction of its shares owned over the total number of shares outstanding.

There are several types of stocks. Some stocks provide voting rights to the holder. Some stocks entitle the holder to receive payments, such as dividends and/or capital appreciation. Different types of stocks have different order of preference to the company's assets in the case of liquidation (the company is forced to sells its assets, pay outstanding debts, and distribute the remainder to shareholders).

Common stock entitles the holder to payments of dividends and capital appreciation. Common stock gives voting rights.

A **preferred stock** is a stock which provides a fixed dividend that does not fluctuate. Preferred stock shareholders do not enjoy voting rights.

Bonds

A way for a government or corporation to raise money is to issue **bonds**. A bond is a certificate issued from a borrower to a lender agreeing to make payment(s) in a loan. The price of a bond P is the amount that the lender pays (loans) to the government or corporation for the bond. Types of available bonds are: U.S. government securities, municipal bonds, corporate bonds, mortgage and asset–backed securities, federal agency securities and foreign government bonds.

