

## **Retail Securities Exam**

**CIRO RSE**

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### QUESTION NO: 1

An investor is evaluating how high inflation impacts securities prices and market movements. Which of the following outcomes is most consistent with the effects of high inflation on the economy and investor expectations?

- A. Stock prices rise significantly, because companies can increase prices without losing customers
- B. The purchasing power of money declines, reducing consumer spending and potentially lowering corporate earnings
- C. Bond prices increase sharply, because investors favor fixed-income securities during inflationary periods
- D. Productivity surges, leading to higher employment and economic growth despite inflationary pressures

**ANSWER: B**

#### Explanation:

The purchasing power of money declines, reducing consumer spending and potentially lowering corporate earnings. Inflation is a sustained rise in the general price level, so each dollar purchases fewer goods and services over time. When wages and other household income do not keep pace with price increases, real disposable income is reduced. Households may then curtail discretionary purchases or substitute less expensive goods and services. This weaker real consumer demand can affect businesses' sales volumes and revenues.

Corporate earnings may also come under pressure because inflation often raises input, labour, financing, and distribution costs. A company's ability to preserve profits depends on whether it can pass those higher costs to customers without materially reducing demand. Consequently, the effect differs among issuers and industries, but reduced purchasing power and potential pressure on consumer spending and earnings are broadly consistent implications of high inflation.

This relationship matters to securities valuation because investors assess expected revenues, margins, and future cash flows when forming expectations about equity prices and market performance. The Bank of Canada explains that inflation reduces money's purchasing power and that monetary policy seeks to keep inflation low, stable, and predictable. Statistics Canada provides the Consumer Price Index measures used to track changes in consumer prices. See [Bank of Canada: What is monetary policy?](#) and [Statistics Canada: Consumer price indexes](#).

### QUESTION NO: 2

An investor, with a low risk tolerance and a short-term investment objective, approaches a Registered Representative (RR) for investment options. Which best fulfills suitability requirements linking this know-your-client (KYC) information to a recommendation?

- A. Suggest an equity growth fund based on market trends and diversification potential
- B. Recommend a balanced mutual fund to fulfill income needs and risk capacity
- C. Advise an exchange-traded fund (ETF) after noting investment knowledge and growth interest
- D. Propose a bond mutual fund to meet the time horizon and liquidity preference

**ANSWER: D**

#### Explanation:

"Propose a bond mutual fund to meet the time horizon and liquidity preference" is the best available recommendation because it connects the proposed investment to the client's key KYC facts: a low tolerance for risk and a short-term objective. A broadly diversified, conservatively managed bond mutual fund can generally offer lower expected volatility than an equity-oriented fund while allowing the investor to redeem units at net asset value on a regular basis. This makes it a potentially appropriate starting point for a client who should not be exposed to substantial equity-market fluctuations over a limited period.

Suitability is not established merely by selecting a fund labelled “bond.” The RR must complete the KYC assessment and determine that the particular fund is suitable in the context of the client’s overall account. Important considerations include the fund’s interest-rate sensitivity or duration, credit quality, liquidity and redemption features, fees, distribution policy, and the possibility of capital loss. For a very short investment horizon, a short-duration, high-quality bond fund may be more consistent with the client profile than a fund holding long-term or lower-rated bonds. CIRO’s client-focused reforms require registrants to collect KYC information and make suitability determinations that put the client’s interest first. See [CIRO’s Know Your Client information](#) and [CIRO Investment Dealer Rules](#).

### QUESTION NO: 3

What primary advantage do participating preferred shares provide over straight preferred shares in terms of potential returns?

- A. They provide voting rights in corporate decisions, allowing shareholders more influence over management
- B. They offer more predictable dividend payments than common shares, reducing income uncertainty
- C. They have the highest claim on assets in case of liquidation, ensuring stronger financial protection
- D. They provide additional dividends beyond their stated rate when the corporation distributes profits to common shareholders, increasing potential returns

**ANSWER: D**

#### Explanation:

They provide additional dividends beyond their stated rate when the corporation distributes profits to common shareholders, increasing potential returns. Participating preferred shares retain the usual preferred-share entitlement to a specified dividend, but also include a participation feature. Once the conditions specified in the share terms have been met—commonly after common shareholders receive a stated amount—holders may share in additional corporate distributions. This creates the potential for income above the fixed preferred dividend when the issuer performs well and has sufficient profits available for distribution.

This is the key return-related distinction from straight preferred shares. A straight preferred share generally provides its stated dividend entitlement but does not participate further in distributions made to common shareholders. The participation provision therefore gives the investor some opportunity to benefit from stronger corporate earnings and larger dividends, while preserving the priority characteristics associated with preferred shares. The exact participation formula, trigger, and limits are set out in the share provisions, so an investor should review the prospectus or other offering documents to understand how additional dividends are calculated. See the [U.S. SEC Investor Bulletin on preferred stock](#) and [Britannica’s overview of preferred stock](#).

### QUESTION NO: 4

A client inherited shares from a parent and refuses to sell them even though the holding creates excessive concentration and no longer fits the client’s objectives. The client states that the shares are more valuable because they are now “part of the family.” Which behavioural bias is most directly demonstrated?

- A. Endowment effect
- B. Gambler’s fallacy
- C. Hindsight bias
- D. Representativeness bias

**ANSWER: A**

#### Explanation:

**Endowment effect** is correct because the client assigns extra value to the inherited shares as a result of possessing them and their personal connection to the family. This valuation is not based primarily on the shares' expected return, risk characteristics, diversification benefits, or suitability within the client's current objectives. Instead, ownership and sentimental attachment cause the shares to be perceived as more valuable than they would be if the client did not own them. In behavioural finance, the endowment effect describes the tendency to demand more to give up an owned asset than one would be willing to pay to acquire the same asset. This effect can be especially strong for inherited property because family history and identity add emotional significance. For a registered representative, recognizing this bias supports a constructive suitability discussion: explain the consequences of the concentrated position, review diversification and issuer-specific risk, consider the client's tax circumstances, and explore whether retaining a smaller sentimental holding could be consistent with the client's wishes and overall plan. The client's informed decision should be respected and documented. CISO's conduct framework requires registrants to address suitability and put clients' interests first; see [CISO's suitability overview](#). For a behavioural-finance description of ownership increasing perceived value, see [BehavioralEconomics.com's endowment-effect reference](#).

#### QUESTION NO: 5

An investor buys one put option on 100 shares with a strike price of \$50 and pays a premium of \$3 per share. At expiration, the underlying shares are trading at \$42. Ignoring commissions, what is the investor's profit per share?

- A. Loss of \$3 per share
- B. Profit of \$3 per share
- C. Profit of \$5 per share
- D. Profit of \$8 per share

#### ANSWER: C

##### Explanation:

The investor's profit is **\$5 per share**. A put option gives its holder the right to sell the underlying shares at the strike price. At expiration, the put has intrinsic value of \$8 per share because the investor can sell at \$50 when the shares trade at \$42.

The \$3 premium paid to purchase the option must be deducted from the \$8 intrinsic value. The net profit is therefore  $\$8 - \$3 = \$5$  per share. For one standard contract covering 100 shares, this would equal a total profit of \$500 before commissions.

#### QUESTION NO: 6

A bond has a face value of \$1,000, an annual coupon rate of 5.5% and a current market price of \$925. What is the bond's current yield?

- A. 5.50%
- B. 5.95%
- C. 6.49%
- D. 9.25%

#### ANSWER: B

##### Explanation:

The correct current yield is **5.95%**. Current yield expresses a bond's annual interest income as a percentage of the price an investor pays for the bond in the market. First, calculate the annual coupon payment using the face value and stated coupon rate:  $\$1,000 \times 5.5\% = \$55$  per year. Next, divide that annual coupon payment by the current market price:  $\$55 \div \$925 = 0.059459\dots$ , which rounds to 5.95%.

This calculation is useful because the coupon rate alone does not show the income return available to an investor buying the bond today. Although the bond pays a fixed annual coupon of \$55, an investor can acquire it for \$925 rather than its \$1,000

par value. Consequently, the \$55 of annual coupon income represents a higher percentage return on the amount invested than the stated 5.5% coupon rate. Current yield focuses only on annual coupon income relative to market price; it does not incorporate the bond's remaining term, the time value of money, or any gain or loss resulting from redemption at maturity. Those factors are considered in yield-to-maturity calculations. See the [U.S. SEC Investor.gov bond overview](#) and [FINRA's bonds resource](#).

#### QUESTION NO: 7

A Canadian investor holds investments in a non-registered account. Which type of income may generally qualify for the Canadian dividend gross-up and dividend tax credit mechanism?

- A. Interest from a corporate bond
- B. Dividends from an eligible Canadian corporation
- C. Dividends from a foreign corporation
- D. Capital returned to the investor as original principal

#### ANSWER: B

##### Explanation:

Dividends from an eligible Canadian corporation may generally qualify for the Canadian dividend gross-up and dividend tax credit when received in a non-registered account. This system integrates corporate and personal income tax: the corporation first pays tax on its income, then distributes after-tax earnings as dividends. The shareholder reports a grossed-up dividend amount, which approximates the corporation's pre-tax income, and may claim the corresponding dividend tax credit to recognize corporate tax paid before the distribution. The precise gross-up and credit rates are set under tax legislation and can change, but the fundamental treatment applies to taxable dividends paid by qualifying taxable Canadian corporations. A corporation normally designates a dividend as eligible when it was paid from income subject to the general corporate tax rate. The investor should receive a tax slip, generally a T5, identifying the taxable dividend and related credit information for personal tax reporting. This preferential treatment is relevant only to taxable, non-registered accounts; registered-plan taxation follows the rules of the particular plan rather than the personal dividend tax-credit mechanism. See the CRA's guidance on [taxable Canadian dividends](#) and the [federal dividend tax credit](#).

#### QUESTION NO: 8

What is the main driver of the intraday price of an exchange-traded fund (ETF)?

- A. Fund manager's portfolio rebalancing
- B. Supply-demand changes on the exchange
- C. Liquidity from institutional investors
- D. Daily valuation of assets under management

#### ANSWER: B

##### Explanation:

Supply-demand changes on the exchange is correct because an ETF's intraday market price is formed continuously in the secondary market through orders submitted by buyers and sellers. The best available bids and offers, and the transactions that occur when those orders match, establish the price at which an investor can buy or sell ETF units at a particular moment. Thus, changing buying and selling interest is the immediate mechanism behind movements in an ETF's quoted and traded price during the day.

The value of the ETF's underlying holdings remains an important reference point. Market makers and authorized dealers can generally create or redeem ETF units, and this creation/redemption process supports arbitrage when a meaningful difference emerges between the ETF's trading price and the value of its portfolio. That mechanism tends to keep the market price

reasonably aligned with net asset value over time, but it does not replace exchange trading as the direct source of the intraday execution price. ETF investors should therefore distinguish the market price, which is determined by tradable bids and offers, from NAV, which is a calculated portfolio value. See the [SEC's ETF investor bulletin](#) and the [Ontario Securities Commission's ETF resource](#).

#### QUESTION NO: 9

A company wants to raise capital but prefers to delay equity dilution while still attracting investors interested in potential ownership. Which type of bond is most suitable?

- A. Convertible bonds
- B. Extendable bonds
- C. Callable bonds
- D. Sinking fund bonds

#### ANSWER: A

##### Explanation:

Convertible bonds are most suitable because they initially allow the issuer to obtain financing as debt, rather than issuing common shares immediately. This means the company can raise capital without creating immediate dilution for existing shareholders. A convertible bond also gives its holder the contractual right to exchange the bond for a specified number of the issuer's common shares, usually at a predetermined conversion price or conversion ratio and subject to the bond's terms.

This embedded conversion right is particularly attractive to investors who want the relative income and principal-repayment features of a bond while retaining an opportunity to participate in appreciation of the issuer's equity. If the company's share price rises sufficiently, conversion may become valuable and the investor can elect to become an equity holder. Dilution occurs only if and when bonds are converted and new shares are issued. The conversion feature may also reduce the issuer's borrowing cost, since investors can accept a lower coupon in exchange for the potential equity upside.

This structure directly meets the stated objective: it defers potential equity dilution while providing a clear future path to ownership. CIRO registrants should understand the characteristics and investor implications of debt securities, including securities with equity-linked features. See CIRO's [investing basics](#) and the Ontario Securities Commission's [bond investment overview](#).

#### QUESTION NO: 10

A portfolio earns 11%. The risk-free rate is 3%, the market return is 8%, and the portfolio beta is 1.2. What is the portfolio's Jensen alpha?

- A. 2%
- B. 0%
- C. 2%
- D. 5%

#### ANSWER: C

##### Explanation:

The correct answer is **2%**. Jensen alpha measures the return a portfolio actually earned above or below the return required by the Capital Asset Pricing Model (CAPM), given its beta. First, calculate the CAPM-required return: risk-free rate + beta × (market return – risk-free rate). Here, that is  $3\% + 1.2 \times (8\% - 3\%)$ , or  $3\% + 1.2 \times 5\% = 9\%$ . The portfolio's actual return was 11%, so its Jensen alpha is actual return minus the CAPM-required return:  $11\% - 9\% = 2\%$ .

This positive result means the portfolio outperformed the return implied by its systematic market risk exposure by two percentage points for the measurement period. In performance evaluation, Jensen alpha is useful because it adjusts the benchmark return for beta rather than simply comparing the portfolio with the market return. It should be interpreted in the context of the evaluation period, the suitability of the market benchmark, and the reliability of the beta estimate. The CAPM framework underlying this calculation is summarized in the [CFA Institute's portfolio management overview](#); CRO identifies the Retail Securities Exam among its [exam preparation resources](#).

#### QUESTION NO: 11

What is the expected return of a portfolio of investments if the risk-free rate is 5%, beta is 2.0, portfolio variance is 15% and market rate of return is 10%?

- A. 12%
- B. 10%
- C. 15%
- D. 20%

#### ANSWER: C

##### Explanation:

The correct expected return is **15%**, calculated with the capital asset pricing model (CAPM). CAPM estimates the return required for bearing systematic market risk using the formula:  $\text{expected return} = \text{risk-free rate} + \text{beta} \times (\text{expected market return} - \text{risk-free rate})$ . Here, the market risk premium is 5%: the 10% market return less the 5% risk-free rate. Applying the portfolio beta of 2.0 gives a required risk premium of 10% ( $2.0 \times 5\%$ ). Adding that premium to the 5% risk-free rate produces an expected return of 15%.

Beta measures the sensitivity of the portfolio's returns to movements in the overall market. A beta of 2.0 indicates that the portfolio has twice the systematic risk exposure of the market, so CAPM assigns it twice the market risk premium. Portfolio variance is not an input to the CAPM expected-return calculation; it describes total variability of returns, while CAPM compensates investors specifically for non-diversifiable, systematic risk as represented by beta. This is a model-derived expected or required return, not a promise of realized performance. See the [U.S. SEC Investor.gov discussion of investment risk](#) and [CFA Institute material on portfolio risk and return](#).

#### QUESTION NO: 12

A Registered Representative (RR) meets with an investor seeking a low-risk option for retirement savings. The Representative considers recommending a bond fund. Which step best ensures compliance with know-your-product (KYP) regarding the bond fund's suitability?

- A. Comparing the fund's diversification with similar products in the market
- B. Reviewing the fund's historical returns to confirm steady performance
- C. Assessing the fund's exposure to interest rate fluctuations and credit risks
- D. Evaluating the fund's marketing materials for clarity on investment objectives

#### ANSWER: C

##### Explanation:

Assessing the fund's exposure to interest rate fluctuations and credit risks is the appropriate KYP step because it establishes whether the representative understands the bond fund's material risk characteristics before considering it for the client. A bond fund is not inherently low risk merely because it invests in fixed-income securities. Its value can decline when market interest rates rise, particularly where the portfolio has greater duration or sensitivity to rate changes. The

fundâ€™s credit exposure is equally important: holdings with weaker credit quality may carry a greater possibility of downgrades, widening credit spreads, reduced liquidity, or default-related losses.

Understanding these features permits the representative to identify the productâ€™s actual risk profile and to determine whether it can reasonably fit an investor who has a retirement objective and a stated preference for low risk. KYP is therefore a substantive analysis of the productâ€™s structure, risks, features, and costs—not simply a review of performance or promotional information. This analysis also supports the subsequent suitability determination, which must connect the productâ€™s characteristics to the clientâ€™s circumstances and objectives. CIROâ€™s client-focused reforms framework addresses KYP and suitability obligations, while National Instrument 31-103 sets the Canadian registrant conduct framework: [CIRO Client-Focused Reforms](#) and [CSA National Instrument 31-103](#).

#### QUESTION NO: 13

A client is considering selling a significant portion of their holding in an S & P/TSX 60 Index exchange-traded fund (ETF) in order to invest in a successful company's stock. What is the most significant risk created by this action?

- A. Loss through the reversion to mean of the stock
- B. Exposure to a single, potentially more volatile asset
- C. Reduction in potential returns against the market
- D. The risk of being unable to claim for any capital losses

#### ANSWER: B

##### Explanation:

**Exposure to a single, potentially more volatile asset** is correct because selling a substantial portion of a broad-market ETF to buy one company's shares replaces diversified market exposure with concentrated, company-specific exposure. An S&P/TSX 60 Index ETF holds securities representing many large Canadian issuers and sectors, so performance is not dependent on the circumstances of a single business. A direct investment in one stock is instead highly affected by that company's earnings, management decisions, competitive position, industry conditions, financing needs, litigation, and other issuer-specific events. Even a company that has performed well historically can experience a sharp price decline or underperform the broader market. The client would therefore face greater volatility and a larger potential impact on their portfolio if adverse news affects that one issuer. Diversification does not eliminate market risk, but it can reduce the effect that poor performance by any one investment has on the overall portfolio. This is the central portfolio risk introduced by moving a significant amount from an index ETF to one stock. CIRO's investor education materials discuss diversification and investment risk at [CIRO Investing Basics](#). The Canadian Securities Administrators also describe diversification as a risk-management principle at [GetSmarterAboutMoney: Diversification](#).

#### QUESTION NO: 14

An Investment Dealer executes a client's trade at a worse price than what was available on another exchange, despite having access to the better option. Which CIRO rule has been violated?

- A. Best execution
- B. Front running
- C. Wash trading
- D. Insider trading

#### ANSWER: A

##### Explanation:

**Best execution** is the applicable CIRO requirement because an Investment Dealer must make reasonable efforts to achieve the most advantageous execution terms reasonably available for a client order. For an exchange-traded security, price is a



central execution factor. Where the dealer had access to a better-priced displayed order on another marketplace and nevertheless executed the client's order at an inferior price, the dealer failed to take the reasonable steps required to obtain the best available result for that client.

CIRO's best-execution framework requires dealers to establish, maintain, and apply policies and procedures designed to achieve best execution, considering relevant factors such as price, speed, certainty of execution, and overall cost. In the facts given, the available superior price is directly material and should have been considered in routing or executing the order. The obligation is not merely to execute a trade somewhere; it is to use reasonable diligence so the client receives the most advantageous execution reasonably obtainable in the circumstances. This requirement supports fair, efficient Canadian capital markets and protects clients from avoidable execution-quality losses. See CIRO Rule 3109, [Best Execution of Client Orders](#), and CIRO's [Investment Dealer and Partially Consolidated Rules](#).

## QUESTION NO: 15

A Registered Representative (RR) is comparing two companies and correctly calculates their interest coverage ratio as below:

Company A: 1.3

Company B: 1.9

Both the companies have the same interest expense during the period. Which of the following is correct with respect to the two companies?

- A. Net Profit Margin % of Company B is higher than Net Profit Margin % of Company A
- B. Earnings before Interest and Tax (EBIT) of Company B is higher than the EBIT of Company A
- C. Total Assets of Company B are higher than Total Assets of Company A
- D. Total Debt of Company B is higher than Total Debt of Company A

## ANSWER: B

### Explanation:

"Earnings before Interest and Tax (EBIT) of Company B is higher than the EBIT of Company A" is correct because the interest coverage ratio measures a company's ability to meet its interest obligations from operating earnings. It is generally calculated as EBIT divided by interest expense. Therefore, EBIT can be expressed as the interest coverage ratio multiplied by interest expense.

Since the two companies have the same interest expense, the comparison depends directly on their respective ratios. Company B has an interest coverage ratio of 1.9, while Company A has a ratio of 1.3. For each dollar of interest expense, Company B produces \$1.90 of EBIT and Company A produces \$1.30 of EBIT. Applying the same interest-expense amount to both ratios necessarily produces a greater EBIT figure for Company B.

For example, if each company incurred \$1 million in interest expense, Company B's EBIT would be \$1.9 million and Company A's EBIT would be \$1.3 million. This reflects stronger earnings available to service interest costs for Company B. Interest coverage is consequently a useful risk-analysis measure when assessing a company's debt-servicing capacity. See [Investopedia's interest coverage ratio overview](#) and [Corporate Finance Institute's interest coverage ratio guide](#).