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Economics of Money, Banking & Financial Markets, 4e **(Bus. Schl. Ed.)**
Chapter 2 An Overview of the Financial System

2.1 Function of Financial Markets

1) Every financial market has the following
characteristic. A) It determines the level of interest rates.
B) It allows common stock to be
traded. C) It allows loans to be made.
D) It channels funds from lenders-savers to borrowers-
spenders. Answer: D
AACSB: Reflective thinking

2) Financial markets have the basic function of
A) getting people with funds to lend together with people who want to borrow funds.
B) assuring that the swings in the business cycle are less pronounced.
C) assuring that governments need never resort to printing money.
D) providing a risk-free repository of spending power.
Answer: A
AACSB: Reflective thinking

3) Financial markets improve economic welfare
because A) they channel funds from investors to savers.
B) they allow consumers to time their purchase
better. C) they weed out inefficient firms.
D) they eliminate the need for indirect
finance. Answer: B
AACSB: Reflective thinking

4) Well-functioning financial markets
A) cause inflation.
B) eliminate the need for indirect finance.
C) cause financial crises.
D) allow the economy to operate more
efficiently. Answer: D

AACSB: Reflective thinking

5) A breakdown of financial markets can result in
A) financial stability.
B) rapid economic growth.
C) political instability.
D) stable prices.
Answer: C
AACSB: Reflective thinking

6) The principal lender-savers are
A) governments.
B) businesses.
C) households.
D) foreigners.
Answer: C
AACSB: Application of knowledge

7) Which of the following can be described as direct
finance? A) You take out a mortgage from your local bank.
B) You borrow $2500 from a friend.
C) You buy shares of common stock in the secondary market.
D) You buy shares in a mutual fund.
Answer: B
AACSB: Analytical thinking

8) Assume that you borrow $2000 at 10% annual interest to finance a new business project. For this loan to be profitable, the minimum amount this project must generate in annual earnings is
A) $400.
B) $201.
C) $200.
D) $199.
Answer: B
AACSB: Analytical thinking

9) You can borrow $5000 to finance a new business venture. This new venture will generate annual earnings of $251. The maximum interest rate that you would pay on the borrowed funds and still increase your income is
A) 25%.
B) 12.5%.
C) 10%.
D) 5%.
Answer: D
AACSB: Analytical thinking

10) Which of the following can be described as involving direct finance?
A) A corporation issues new shares of stock.
B) People buy shares in a mutual fund.
C) A pension fund manager buys a short-term corporate security in the secondary market.
D) An insurance company buys shares of common stock in the over-the-counter
markets. Answer: A
AACSB: Analytical thinking

11) Which of the following can be described as involving direct finance? A) A corporation takes out loans from a bank.
B) People buy shares in a mutual fund.
C) A corporation buys a short-term corporate security in a secondary market.
D) People buy shares of common stock in the primary markets.
Answer: D
AACSB: Analytical thinking

12) Which of the following can be described as involving indirect finance? A) You make a loan to your neighbor.
B) A corporation buys a share of common stock issued by another corporation in the primary market.
C) You buy a U.S. Treasury bill from the U.S. Treasury at TreasuryDirect.gov. D) You make a deposit at a bank.
Answer: D
AACSB: Analytical thinking

13) Which of the following can be described as involving indirect finance?
A) You make a loan to your neighbor.
B) You buy shares in a mutual fund.
C) You buy a U.S. Treasury bill from the U.S. Treasury at Treasury Direct.gov.
D) You purchase shares in an initial public offering by a corporation in the primary market. Answer: B
AACSB: Analytical thinking

14) Securities are__________for the person who buys them, but are__________for the individual or firm that issues them.
A) assets; liabilities
B) liabilities; assets
C) negotiable; nonnegotiable
D) nonnegotiable; negotiable
Answer: A
AACSB: Reflective thinking

15) With__________finance, borrowers obtain funds from lenders by selling them securities in the financial markets.
A) active
B) determined
C) indirect D) direct Answer: D
AACSB: Application of knowledge

16) With direct finance, funds are channeled through the financial market from the _________ directly to the_________.
A) savers, spenders
B) spenders, investors
C) borrowers, savers
D) investors, savers
Answer: A
AACSB: Reflective thinking

17) Distinguish between direct finance and indirect finance. Which of these is the most important source of funds for corporations in the United States?
Answer: With direct finance, funds flow directly from the lender/saver to the borrower. With indirect finance, funds flow from the lender/saver to a financial intermediary who then channels the funds to the borrower/investor. Financial intermediaries (indirect finance) are the major source of funds for corporations in the U.S.
AACSB: Reflective thinking

2.2 Structure of Financial Markets

1) Which of the following statements about the characteristics of debt and equity is FALSE?
A) They can both be long-term financial instruments.
B) They can both be short-term financial instruments.
C) They both involve a claim on the issuer's income.
D) They both enable a corporation to raise funds.
Answer: B
AACSB: Reflective thinking

2) Which of the following statements about the characteristics of debt and equities is TRUE?
A) They can both be long-term financial instruments.
B) Bond holders are residual claimants.
C) The income from bonds is typically more variable than that from
equities. D) Bonds pay dividends.
Answer: A
AACSB: Reflective thinking

3) Which of the following statements about financial markets and securities is TRUE?
A) A bond is a long-term security that promises to make periodic payments called dividends to the firm's residual claimants.
B) A debt instrument is intermediate term if its maturity is less than one year.
C) A debt instrument is intermediate term if its maturity is ten years or longer.
D) The maturity of a debt instrument is the number of years (term) to that instrument's expiration date.
Answer: D
AACSB: Reflective thinking

4) Which of the following is an example of an intermediate-term debt? A) a fifteen-year mortgage
B) a sixty-month car loan
C) a six-month loan from a finance company
D) a thirty-year U.S. Treasury bond Answer:
B
AACSB: Analytical thinking

5) If the maturity of a debt instrument is less than one year, the debt is called A) short-term.
B) intermediate-term.
C) long-term.
D) prima-term.
Answer: A
AACSB: Application of knowledge

6) Long-term debt has a maturity that is
A) between one and ten years.
B) less than a year.
C) between five and ten years.
D) ten years or longer. Answer: D
AACSB: Application of knowledge

7) When I purchase_________, I own a portion of a firm and have the right to vote on issues important to the firm and to elect its directors.
A) bonds
B) bills C) notes D) stock
Answer: D
AACSB: Application of knowledge

8) Equity holders are a corporation's_________. That means the corporation must pay all of its debt holders before it pays its equity holders.
A) debtors
B) brokers
C) residual claimants
D) underwriters
Answer: C
AACSB: Reflective thinking

9) Which of the following benefits directly from any increase in the corporation's profitability? A) a bond holder
B) a commercial paper
holder C) a shareholder
D) a T-bill holder
Answer: C
AACSB: Reflective thinking

10) A financial market in which previously issued securities can be resold is called a _________ market.
A) primary
B) secondary
C) tertiary
D) used securities
Answer: B
AACSB: Application of knowledge

11) An important financial institution that assists in the initial sale of securities in the primary market is the
A) investment bank.
B) commercial bank.
C) stock exchange.
D) brokerage house.
Answer: A
AACSB: Application of knowledge

12) When an investment bank_________securities, it guarantees a price for a corporation's securities and then sells them to the public.
A) underwrites
B) undertakes
C) overwrites
D) overtakes
Answer: A
AACSB: Application of knowledge

13) Which of the following is NOT a secondary market?
A) foreign exchange market
B) futures market
C) options market
D) IPO market
Answer: D
AACSB: Reflective thinking

14) _________work in the secondary markets matching buyers with sellers of securities. A) Dealers
B) Underwriters
C) Brokers
D) Claimants
Answer: C
AACSB: Application of knowledge

15) A corporation acquires new funds only when its securities are sold in the
A) primary market by an investment bank.
B) primary market by a stock exchange broker.
C) secondary market by a securities dealer.
D) secondary market by a commercial bank.
Answer: A
AACSB: Reflective thinking

16) A corporation acquires new funds only when its securities are sold in the A) secondary market by an investment bank.
B) primary market by an investment bank.
C) secondary market by a stock exchange broker. D) secondary market by a commercial bank. Answer: B
AACSB: Reflective thinking

17) An important function of secondary markets is to
A) make it easier to sell financial instruments to raise funds.
B) raise funds for corporations through the sale of securities.
C) make it easier for governments to raise taxes.
D) create a market for newly constructed houses.
Answer: A
AACSB: Reflective thinking

18) Secondary markets make financial instruments more A) solid.
B) vapid.
C) liquid.
D) risky.
Answer: C
AACSB: Reflective thinking

19) A liquid asset is
A) an asset that can easily and quickly be sold to raise cash.
B) a share of an ocean resort.
C) difficult to resell.
D) always sold in an over-the-counter market.
Answer: A
AACSB: Reflective thinking

20) The higher a security's price in the secondary market the__________funds a firm can raise by selling securities in the__________market.
A) more; primary
B) more; secondary
C) less; primary D)
less; secondary
Answer: A
AACSB: Reflective thinking

21) When secondary market buyers and sellers of securities meet in one central location to conduct trades the market is called a(n)
A) exchange.
B) over-the-counter market.
C) common market.
D) barter market.
Answer: A
AACSB: Application of knowledge

22) In a(n)__________market, dealers in different locations buy and sell securities to anyone who comes to them and is willing to accept their prices.
A) exchange
B) over-the-counter
C) common
D) barter
Answer: B
AACSB: Application of knowledge

23) Forty or so dealers establish a "market" in these securities by standing ready to buy and sell them.
A) secondary stocks
B) surplus stocks
C) U.S. government
bonds D) common stocks
Answer: C
AACSB: Application of knowledge

24) Which of the following statements about financial markets and securities is TRUE?
A) Many common stocks are traded over-the-counter, although the largest corporations usually have their shares traded at organized stock exchanges such as the New York Stock Exchange.
B) As a corporation gets a share of the broker's commission, a corporation acquires new funds whenever its securities are sold.
C) Capital market securities are usually more widely traded than shorter-term securities and so tend to be more liquid.
D) Prices of capital market securities are usually more stable than prices of money market securities, and so are often used to hold temporary surplus funds of corporations. Answer:
A
AACSB: Reflective thinking

25) A financial market in which only short-term debt instruments are traded is called the ________

market. A) bond
B) money
C) capital
D) stock
Answer: B
AACSB: Analytical thinking

26) Equity instruments are traded in the __________ market.
A) money
B) bond
C) capital
D) commodities
Answer: C
AACSB: Analytical thinking

27) Because these securities are more liquid and generally have smaller price fluctuations, corporations and banks use the __________ securities to earn interest on temporary surplus funds. A) money market
B) capital market
C) bond market
D) stock market
Answer: A
AACSB: Reflective thinking

28) Corporations receive funds when their stock is sold in the primary market. Why do corporations pay attention to what is happening to their stock in the secondary market? Answer: The existence of the secondary market makes their stock more liquid and the price in the secondary market sets the price that the corporation would receive if they choose to sell more stock in the primary market.
AACSB: Reflective thinking

29) Describe the two methods of organizing a secondary market.
Answer: A secondary market can be organized as an exchange where buyers and sellers meet in one central location to conduct trades. An example of an exchange is the New York Stock Exchange. A secondary market can also be organized as an over-the-counter market. In this type of market, dealers in different locations buy and sell securities to anyone who comes to them and is willing to accept their prices. An example of an over-the-counter market is the federal funds market.
AACSB: Reflective thinking

2.3 Financial Market Instruments

1) Prices of money market instruments undergo the least price fluctuations because of
A) the short terms to maturity for the securities.
B) the heavy regulations in the industry.
C) the price ceiling imposed by government
regulators. D) the lack of competition in the market.
Answer: A
AACSB: Reflective thinking

2) U.S. Treasury bills pay no interest but are sold at a_________. That is, you will pay a lower purchase price than the amount you receive at maturity.
A) premium
B) collateral
C) default
D) discount
Answer: D
AACSB: Analytical thinking

3) U.S. Treasury bills are considered the safest of all money market instruments because there is a low probability of
A) defeat. B)
default. C)
desertion.
D) demarcation.
Answer: B
AACSB: Analytical thinking

4) A debt instrument sold by a bank to its depositors that pays annual interest of a given amount and at maturity pays back the original purchase price is called
A) commercial paper.
B) a certificate of deposit.
C) a municipal bond.
D) federal funds.
Answer: B
AACSB: Analytical thinking

5) A short-term debt instrument issued by well-known corporations is called
A) commercial paper.
B) corporate bonds.
C) municipal bonds.
D) commercial
mortgages. Answer: A
AACSB: Analytical thinking

6) _________are short-term loans in which Treasury bills serve as collateral.
A) Repurchase agreements
B) Negotiable certificates of deposit
C) Federal funds
D) U.S. government agency
securities Answer: A
AACSB: Analytical thinking

7) Collateral is__________the lender receives if the borrower does not pay back the loan.
A) a liability
B) an asset C)
a present D)
an offering
Answer: B
AACSB: Analytical thinking

8) Federal funds are
A) funds raised by the federal government in the bond market.
B) loans made by the Federal Reserve System to banks.
C) loans made by banks to the Federal Reserve System.
D) loans made by banks to each other.
Answer: D
AACSB: Analytical thinking

9) An important source of short-term funds for commercial banks are__________which can be resold on the secondary market.
A) negotiable CDs B)
commercial paper
C) mortgage-backed securities
D) municipal bonds Answer:
A
AACSB: Application of knowledge

10) Which of the following are short-term financial
instruments? A) a repurchase agreement
B) a share of Walt Disney Corporation stock C)
a Treasury note with a maturity of four years
D) a residential mortgage
Answer: A
AACSB: Analytical thinking

11) Which of the following instruments are traded in a money market?
A) state and local government bonds
B) U.S. Treasury bills
C) corporate bonds
D) U.S. government agency
securities Answer: B
AACSB: Analytical thinking

12) Which of the following instruments are traded in a money market?
A) bank commercial loans
B) commercial paper
C) state and local government bonds
D) residential mortgages
Answer: B
AACSB: Analytical thinking

13) Which of the following instruments is NOT traded in a money market?
A) residential mortgages
B) U.S. Treasury Bills
C) negotiable bank certificates of
deposit D) commercial paper
Answer: A
AACSB: Analytical thinking

14) Bonds issued by state and local governments are called _________
bonds. A) corporate
B) Treasury C)
municipal D)
commercial
Answer: C
AACSB: Application of knowledge

15) Equity and debt instruments with maturities greater than one year are called _________ market instruments.
A) capital
B) money C)
federal D)
benchmark
Answer: A
AACSB: Application of knowledge

16) Which of the following is a long-term financial instrument?
A) a negotiable certificate of deposit
B) a repurchase agreement
C) a U.S. Treasury bond
D) a U.S. Treasury bill
Answer: C
AACSB: Analytical thinking

17) Which of the following instruments are traded in a capital market? A) U.S. Government agency securities
B) negotiable bank CDs
C) repurchase agreements
D) U.S. Treasury bills
Answer: A
AACSB: Analytical thinking

18) Which of the following instruments are traded in a capital market? A) corporate bonds
B) U.S. Treasury bills C)
negotiable bank CDs D)
repurchase agreements
Answer: A
AACSB: Analytical thinking

19) Which of the following are NOT traded in a capital market?
A) U.S. government agency securities
B) state and local government bonds
C) repurchase agreements
D) corporate bonds
Answer: C
AACSB: Analytical thinking

20) The most liquid securities traded in the capital market
are A) corporate bonds.
B) municipal bonds.
C) U.S. Treasury bonds.
D) mortgage-backed
securities. Answer: C
AACSB: Reflective thinking

21) Mortgage-backed securities are similar to__________but the interest and principal payments are backed by the individual mortgages within the security.
A) bonds
B) stock
C) repurchase agreements
D) negotiable CDs
Answer: A
AACSB: Application of knowledge

2.4 Internationalization of Financial Markets

1) Equity of U.S. companies can be purchased
by A) U.S. citizens only.
B) foreign citizens only.
C) U.S. citizens and foreign
citizens. D) U.S. mutual funds only.
Answer: C
AACSB: Diverse and multicultural work environments

2) One reason for the extraordinary growth of foreign financial markets
is A) decreased trade.
B) increases in the pool of savings in foreign countries.
C) the recent introduction of the foreign bond.
D) slower technological innovation in foreign markets.
Answer: B
AACSB: Diverse and multicultural work environments

3) Bonds that are sold in a foreign country and are denominated in the country's currency in which they are sold are known as
A) foreign bonds.
B) Eurobonds. C)
equity bonds. D)
country bonds.
Answer: A
AACSB: Application of knowledge

4) Bonds that are sold in a foreign country and are denominated in a currency other than that of the country in which it is sold are known as
A) foreign bonds.
B) Eurobonds. C)
equity bonds. D)
country bonds.
Answer: B
AACSB: Application of knowledge

5) If Microsoft sells a bond in London and it is denominated in dollars, the bond is a
A) Eurobond.
B) foreign bond.
C) British bond.
D) currency
bond. Answer: A
AACSB: Reflective thinking

6) U.S. dollar deposits in foreign banks outside the U.S. or in foreign branches of U.S. banks are called
A) Atlantic dollars.
B) Eurodollars.
C) foreign dollars.
D) outside dollars.
Answer: B
AACSB: Application of knowledge

7) If Toyota sells a $1000 bond in the United States, the bond is a
A) foreign bond.
B) Eurobond.
C) Tokyo bond.
D) currency
bond. Answer: A
AACSB: Application of knowledge

8) Distinguish between a foreign bond and a Eurobond.
Answer: A foreign bond is sold in a foreign country and priced in that country's currency. A Eurobond is sold in a foreign country and priced in a currency that is not that country's currency. AACSB: Reflective thinking

2.5 Function of Financial Intermediaries: Indirect Finance

1) The process of indirect finance using financial intermediaries is called
A) direct lending.
B) financial intermediation.
C) resource allocation.
D) financial liquidation.
Answer: B
AACSB: Reflective thinking

2) In the United States, loans from__________are far__________important for corporate finance than are securities markets.
A) government agencies; more
B) government agencies; less C)
financial intermediaries; more
D) financial intermediaries; less
Answer: C
AACSB: Reflective thinking

3) The time and money spent in carrying out financial transactions are called
A) economies of scale.
B) financial intermediation.
C) liquidity services.
D) transaction
costs. Answer: D
AACSB: Application of knowledge

4) Economies of scale enable financial institutions
to A) reduce transactions costs.
B) avoid the asymmetric information problem.
C) avoid adverse selection problems.
D) reduce moral hazard.
Answer: A
AACSB: Reflective thinking

5) An example of economies of scale in the provision of financial services
is A) investing in a diversified collection of assets.
B) providing depositors with a variety of savings certificates.
C) hiring more support staff so that customers don't have to wait so long for
assistance. D) spreading the cost of writing a standardized contract over many
borrowers. Answer: D
AACSB: Reflective thinking

6) Financial intermediaries provide customers with liquidity services. Liquidity services A) make it easier for customers to conduct transactions.
B) allow customers to have a cup of coffee while waiting in the lobby.
C) are a result of the asymmetric information problem.
D) are another term for asset transformation. Answer: A
AACSB: Reflective thinking

7) The process where financial intermediaries create and sell low-risk assets and use the proceeds to purchase riskier assets is known as
A) risk sharing.
B) risk aversion.
C) risk neutrality.
D) risk selling.
Answer: A
AACSB: Analytical thinking

8) The process of asset transformation refers to the conversion of
A) safer assets into risky assets.
B) safer assets into safer liabilities.
C) risky assets into safer assets.
D) risky assets into risky liabilities.
Answer: C
AACSB: Analytical thinking

9) Reducing risk through the purchase of assets whose returns do not always move together is A) diversification.
B) intermediation.
C) intervention. D) discounting.
Answer: A
AACSB: Analytical thinking

10) The concept of diversification is captured by the statement
A) don't look a gift horse in the mouth.
B) don't put all your eggs in one basket.
C) it never rains, but it pours.
D) make hay while the sun shines.
Answer: B
AACSB: Reflective thinking

11) Risk sharing is profitable for financial institutions due to
A) low transactions costs.
B) asymmetric information.
C) adverse selection.
D) moral hazard.
Answer: A
AACSB: Reflective thinking

12) Typically, borrowers have superior information relative to lenders about the potential returns and risks associated with an investment project. The difference in information is called
A) moral selection.
B) risk sharing.
C) asymmetric information.
D) adverse hazard. Answer:
C
AACSB: Analytical thinking

13) If bad credit risks are the ones who most actively seek loans and, therefore, receive them from financial intermediaries, then financial intermediaries face the problem of
A) moral hazard.
B) adverse selection.
C) free-riding.
D) costly state verification.
Answer: B
AACSB: Reflective thinking

14) The problem created by asymmetric information before the transaction occurs is called ________, while the problem created after the transaction occurs is called ________. A) adverse selection; moral hazard
B) moral hazard; adverse selection
C) costly state verification; free-riding
D) free-riding; costly state verification Answer: A
AACSB: Application of knowledge

15) Adverse selection is a problem associated with equity and debt contracts arising from
A) the lender's relative lack of information about the borrower's potential returns and risks of his investment activities.
B) the lender's inability to legally require sufficient collateral to cover a 100% loss if the borrower defaults.
C) the borrower's lack of incentive to seek a loan for highly risky investments.
D) the borrower's lack of good options for obtaining funds.
Answer: A
AACSB: Reflective thinking

16) An example of the problem of__________is when a corporation uses the funds raised from selling bonds to fund corporate expansion to pay for Caribbean cruises for all of its employees and their families.
A) adverse selection
B) moral hazard C)
risk sharing
D) credit risk
Answer: B
AACSB: Ethical understanding and reasoning

17) Banks can lower the cost of information production by applying one information resource to many different services. This process is called
A) economies of scale.
B) asset transformation.
C) economies of scope.
D) asymmetric
information. Answer: C
AACSB: Application of knowledge

18) Conflicts of interest are a type of__________problem that can happen when an institution provides multiple services.
A) adverse selection
B) free-riding
C) discounting
D) moral hazard
Answer: D
AACSB: Ethical understanding and reasoning

19) Studies of the major developed countries show that when businesses go looking for funds to finance their activities they usually obtain these funds from
A) government agencies.
B) equities markets.
C) financial intermediaries.
D) bond markets.
Answer: C
AACSB: Application of knowledge

20) The countries that have made the least use of securities markets are__________and _________; in these two countries finance from financial intermediaries has been almost ten times greater than that from securities markets.
A) Germany; Japan
B) Germany; Great Britain
C) Great Britain; Canada
D) Canada; Japan Answer:
A
AACSB: Application of knowledge

21) Although the dominance of_________over_________is clear in all countries, the relative importance of bond versus stock markets differs widely.
A) financial intermediaries; securities markets
B) financial intermediaries; government agencies C) government agencies; financial intermediaries D) government agencies; securities markets Answer: A
AACSB: Reflective thinking

22) Because there is an imbalance of information in a lending situation, we must deal with the problems of adverse selection and moral hazard. Define these terms and explain how financial intermediaries can reduce these problems.
Answer: Adverse selection is the asymmetric information problem that exists before the transaction occurs. For lenders, it is the difficulty in judging a good credit risk from a bad credit risk. Moral hazard is the asymmetric information problem that exists after the transaction occurs. For lenders, it is the difficulty in making sure the borrower uses the funds appropriately. Financial intermediaries can reduce adverse selection through intensive screening and can reduce moral hazard by monitoring the borrower.
AACSB: Reflective thinking

2.6 Types of Financial Intermediaries

1) Financial institutions that accept deposits and make loans are called _________ institutions. A) investment
B) contractual savings C) depository
D) underwriting
Answer: C
AACSB: Application of knowledge

2) Thrift institutions include
A) banks, mutual funds, and insurance companies.
B) savings and loan associations, mutual savings banks, and credit unions.
C) finance companies, mutual funds, and money market funds.
D) pension funds, mutual funds, and banks.
Answer: B
AACSB: Analytical thinking

3) Which of the following is a depository institution? A) a life insurance company
B) a credit union
C) a pension fund
D) a mutual fund
Answer: B
AACSB: Analytical thinking

4) Which of the following is a depository
institution? A) a life insurance company
B) a mutual savings bank
C) a pension fund
D) a finance
company Answer: B
AACSB: Analytical thinking

5) Which of the following financial intermediaries is NOT a depository institution?
A) a savings and loan association
B) a commercial bank
C) a credit union
D) a finance
company Answer: D
AACSB: Analytical thinking

6) The primary assets of credit unions are
A) municipal bonds.
B) business loans.
C) consumer loans.
D) mortgages.
Answer: C
AACSB: Analytical thinking

7) The primary liabilities of a commercial bank
are A) bonds.
B) mortgages.
C) deposits.
D) commercial paper.
Answer: C
AACSB: Analytical thinking

8) The primary liabilities of depository institutions are
A) premiums from policies.
B) shares.
C) deposits.
D) bonds.
Answer: C
AACSB: Analytical thinking

9) _________institutions are financial intermediaries that acquire funds at periodic intervals on a contractual basis.
A) Investment
B) Contractual savings
C) Thrift
D) Depository
Answer: B
AACSB: Application of knowledge

10) Which of the following is a contractual savings institution?
A) a life insurance company
B) a credit union
C) a savings and loan association
D) a mutual fund
Answer: A
AACSB: Analytical thinking

11) Contractual savings institutions include
A) mutual savings banks.
B) money market mutual funds.
C) commercial banks.
D) life insurance companies.
Answer: D
AACSB: Analytical thinking

12) Which of the following are NOT contractual savings institutions?
A) life insurance companies
B) credit unions
C) pension funds
D) state and local government retirement
funds Answer: B
AACSB: Analytical thinking

13) Which of the following is NOT a contractual savings
institution? A) a life insurance company
B) a pension fund
C) a savings and loan association
D) a fire and casualty insurance
company Answer: C
AACSB: Analytical thinking

14) The primary assets of a pension fund are
A) money market instruments.
B) corporate bonds and stock.
C) consumer and business loans.
D) mortgages.
Answer: B
AACSB: Analytical thinking

15) Which of the following are investment intermediaries? A) life insurance companies
B) mutual funds
C) pension funds
D) state and local government retirement funds Answer: B
AACSB: Analytical thinking

16) An investment intermediary that lends funds to consumers is A) a finance company.
B) an investment bank.
C) a finance fund.
D) a consumer company. Answer: A
AACSB: Application of knowledge

17) The primary assets of a finance company are
A) municipal bonds.
B) corporate stocks and bonds.
C) consumer and business loans.
D) mortgages.
Answer: C
AACSB: Analytical thinking

18) _________are financial intermediaries that acquire funds by selling shares to many individuals and using the proceeds to purchase diversified portfolios of stocks and bonds.
A) Mutual funds
B) Investment banks
C) Finance companies D) Credit unions Answer: A
AACSB: Analytical thinking

19) Money market mutual fund shares function like
A) checking accounts that pay interest.
B) bonds. C)
stocks. D)
currency.
Answer: A
AACSB: Reflective thinking

20) An important feature of money market mutual fund shares is
A) deposit insurance.
B) the ability to write checks against shareholdings.
C) the ability to borrow against shareholdings.
D) claims on shares of corporate
stock. Answer: B
AACSB: Reflective thinking

21) The primary assets of money market mutual funds are
A) stocks.
B) bonds.
C) money market instruments.
D) deposits.
Answer: C
AACSB: Analytical thinking

22) An investment bank helps__________issue
securities. A) a corporation
B) the United States
government C) the SEC
D) foreign governments
Answer: A
AACSB: Analytical thinking

23) An investment bank purchases securities from a corporation at a predetermined price and then resells them in the market. This process is called
A) underwriting.
B) underhanded.
C) understanding.
D) undertaking.
Answer: A
AACSB: Analytical thinking

24) A mutual fund that is organized as a limited partnership with high minimum investments is called a
A) hedge fund.
B) investment bank.
C) mutual savings bank.
D) money market mutual fund.
Answer: A
AACSB: Application of knowledge

25) Hedge funds require large minimum investments ranging from_________to_________or more.
A) $100,000; $1 million
B) $1000; $10,000
C) $100; $1000
D) $$10,000; $25,000
Answer: A
AACSB: Application of knowledge

26) The limited memberships and high dollar minimums for hedge funds means that these funds are
A) subject to weaker regulation than other mutual funds.
B) more stringently regulated for fear of collapse.
C) limited in the types of assets they can purchase. D) under the control of the U.S. Treasury. Answer: A
AACSB: Application of knowledge

2.7 Regulation of the Financial System

1) Which of the following is NOT a goal of financial regulation?
A) ensuring the soundness of the financial system
B) reducing moral hazard
C) reducing adverse selection
D) ensuring that investors never suffer losses Answer: D
AACSB: Analytical thinking

2) Increasing the amount of information available to investors helps to reduce the problems of _________and_________in the financial markets. A) adverse selection; moral hazard
B) adverse selection; risk sharing
C) moral hazard; transactions costs
D) adverse selection; economies of scale Answer: A
AACSB: Reflective thinking

3) A goal of the Securities and Exchange Commission is to reduce problems arising from
A) competition.
B) banking
panics. C) risk.
D) asymmetric
information. Answer: D
AACSB: Reflective thinking

4) The purpose of the disclosure requirements of the Securities and Exchange Commission is
to A) increase the information available to investors.
B) prevent bank panics.
C) improve monetary control.
D) protect investors against financial losses.
Answer: A
AACSB: Reflective thinking

5) Government regulations to reduce the possibility of financial panic include all of the following EXCEPT
A) transactions costs.
B) restrictions on assets and activities.
C) disclosure.
D) deposit insurance.
Answer: A
AACSB: Reflective thinking

6) Which of the following do NOT provide charters?
A) the Office of the Comptroller of the Currency
B) the Federal Reserve System
C) the National Credit Union Administration
D) state banking and insurance
commissions Answer: B
AACSB: Analytical thinking

7) A restriction on bank activities that was repealed in 1999 was
A) the prohibition of the payment of interest on checking
deposits. B) restrictions on credit terms.
C) minimum down payments on loans to purchase securities.
D) separation of commercial banking from the securities
industries. Answer: D
AACSB: Reflective thinking

8) In order to reduce risk and increase the safety of financial institutions, commercial banks and other depository institutions are prohibited from
A) owning municipal bonds.
B) making real estate loans.
C) making personal loans.
D) owning common stock.
Answer: D
AACSB: Reflective thinking

9) The primary purpose of deposit insurance is to
A) improve the flow of information to investors.
B) prevent banking panics.
C) protect bank shareholders against losses.
D) protect bank employees from unemployment.
Answer: B
AACSB: Reflective thinking

10) The agency that was created to protect depositors after the banking failures of 1930-1933 is the
A) Federal Reserve System.
B) Federal Deposit Insurance Corporation.
C) Treasury Department.
D) Office of the Comptroller of the Currency.
Answer: B
AACSB: Analytical thinking

11) The agency that restricts insider trading is the
A) Federal Reserve System.
B) Securities and Exchange Commission.
C) Office of the Comptroller of the Currency.
D) Federal Deposit Insurance
Corporation. Answer: B
AACSB: Analytical thinking

12) The regulatory agency that sets reserve requirements for all banks
is A) the Federal Reserve System.
B) the Federal Deposit Insurance Corporation.
C) the Office of Thrift Supervision.
D) the Securities and Exchange Commission.
Answer: A
AACSB: Analytical thinking

13) Asymmetric information is a universal problem. This would suggest that financial regulations
A) in industrial countries are an unqualified failure. B) differ significantly around the world.
C) in industrialized nations are similar. D) are unnecessary.
Answer: C
AACSB: Application of knowledge

14) How do regulators help to ensure the soundness of financial intermediaries? Answer: Regulators restrict who can set up a financial intermediary, conduct regular examinations, restrict assets, and provide insurance to help ensure the soundness of financial intermediaries.
AACSB: Reflective thinking