1) Financial markets have the basic function of

A) assuring that governments need never resort to printing money.

B) getting people with funds to lend together with people who want to borrow funds.

C) assuring that the swings in the business cycle are less pronounced.

D) both A and B of the above.

E) both B and C of the above.

2) Financial markets improve economic welfare because

A) they allow funds to move from those without productive investment opportunities to those who have such opportunities.

B) they allow consumers to time their purchase better.

C) they weed out inefficient firms.

D) they do each of the above.

E) they do A and B of the above.

3) Well–functioning financial markets

A) promote political instability.

B) cause inflation.

C) eliminate the need for indirect finance.

D) cause financial crises.

E) produce an efficient allocation of capital.

4) A breakdown of financial markets can result in

A) stable prices.

B) rapid economic growth.

C) political instability.

D) an efficient allocation of capital.

E) financial stability.

5) 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) 5%. B) 12.5%. C) 0.5%. D) 10%. E) 25%.

6) Which of the following can be described as involving direct finance?

A) An insurance company buys shares of common stock in the over–the–counter markets.

B) People buy shares in a mutual fund.

C) A corporation buys a short–term security issued by another corporation.

D) A corporation takes out a loan from a bank.

E) None of the above.

7) Which of the following can be described as involving direct finance?

A) A pension fund manager buys a short–term corporate security in the secondary market.

B) People buy shares in a mutual fund.

C) A corporation issues new shares of stock.

D) An insurance company buys shares of common stock in the over–the–counter markets.

8) Which of the following can be described as involving direct finance?

A) A corporation issues new shares of stock.

B) A corporation buys a short–term security issued by another corporation.

C) A pension fund manager buys commercial paper in the secondary market.

D) Both A and B of the above.

E) Both B and C of the above.

9) Which of the following can be described as involving direct finance?

A) A corporation buys a short–term security paper issued by another corporation.

B) A pension fund manager buys commercial paper in the primary market.

C) A corporation issues new shares of stock through an investment bank.

D) All of the above.

E) Both B and C of the above.

10) Which of the following can be described as involving direct finance?

A) An insurance company buys shares of common stock in the primary markets.

B) People buy shares in a mutual fund.

C) A corporation takes out loans from a bank.

D) A corporation buys a short–term corporate security in a secondary market.

11) Which of the following can be described as involving direct finance?

A) An insurance company buys shares of common stock in the over–the–counter markets.

B) A pension fund manager buys a short–term corporate security in the secondary market.

C) People buy shares in a mutual fund.

D) A corporation's stock is traded in an over–the–counter market.

E) None of the above.

12) Which of the following can be described as involving indirect finance?

A) You make a deposit at a bank.

B) A corporation buys a share of common stock issued by another corporation.

C) You buy a U.S. Treasury bill from the U.S. Treasury.

D) You make a loan to your neighbor.

13) Which of the following can be described as involving indirect 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) Both A and B of the above.

E) Both B and C of the above.

14) Which of the following can be described as involving indirect finance?

A) A corporation buys a short–term security issued by another corporation.

B) A corporation issues new shares of stock.

C) A pension fund manager buys a short–term corporate security in the secondary market.

D) Both A and B of the above.

15) Which of the following can be described as involving indirect finance?

A) A pension fund manager buys a short–term corporate security the primary market.

B) A corporation buys a short–term security issued by another corporation.

C) A bank buys a U.S. Treasury bill from one of its depositors.

D) Both B and C of the above.

16) Which of the following can be described as involving indirect finance?

A) People buy shares in a mutual fund.

B) A pension fund manager buys a short-term corporate security in the secondary market.

C) A corporation's stock is issued in an over-the-counter market.

D) All of the above.

E) Only A and B of the above.

17) Which of the following can be described as involving indirect finance?

A) A corporation's stock is traded in an over-the-counter market.

B) A pension fund manager buys a short-term security from the issuing corporation.

C) A corporation buys a short-term security issued by another corporation.

D) Both A and B of the above.

18) Which of the following can be described as involving indirect finance?

A) A corporation issues new shares of stock.

B) A bank buys a U.S. Treasury bill from one of its depositors.

C) A corporation buys a short-term security issued by another corporation.

D) All of the above.

E) Both B and C of the above.

19) Which of the following can be described as involving indirect finance?

A) You buy a U.S. Treasury bill from the U.S. Treasury.

B) A corporation buys a short-term security issued by another corporation.

C) You make a loan to your neighbor.

D) You buy a U.S. Treasury bill from the bank.

20) Which of the following are securities?

A) A share of Texaco common stock

B) A Treasury bill

C) A corporate bond

D) Each of the above

E) Only A and B of the above

21) Which of the following statements about the characteristics of debt and equity is untrue?

A) They both involve a claim on the issuer's income.

B) They can both be long-term financial instruments.

C) They can both be short-term financial instruments.

D) They both enable a corporation to raise funds.

E) None of the above.

22) Which of the following statements about the characteristics of debt and equity are true?

A) They both enable a corporation to raise funds.

B) They both involve a claim on the issuer's income.

C) They can both be long-term financial instruments.

D) All of the above.

E) Only A and B of the above.

23) Which of the following statements about the characteristics of debt and equity are true?

A) They can both be short-term financial instruments.

B) They can both be long-term financial instruments.

C) Debt is a claim on the issuer's assets, but equity is a claim on the issuer's income.

D) Both A and B of the above.

E) Both A and C of the above.

24) Which of the following statements about financial markets and securities are 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 long term if its maturity is ten years or longer.

C) The maturity of a debt instrument is the number of years (term) to that instrument's expiration date.

D) All of the above are true.

E) Both B and C are correct.

25) Which of the following statements about financial markets and securities are 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 long 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.

E) Both C and D are correct.

26) Which of the following statements about financial markets and securities are true?

A) Equities often make periodic payments called dividends and are considered to be long–term securities because they have no maturity date.

B) A bond is a debt security that promises to make payments for a specified period of time.

C) A debt instrument is short term if its maturity is less than ten years.

D) All of the above are true.

E) Only A and B of the above are true.

27) Which of the following statements about financial markets and securities are true?

A) A debt instrument is long term if its maturity is more than one year.

B) Equities often make periodic payments called dividends and are considered to be long–term securities because they have no maturity date.

C) A debt instrument is short term if its maturity is between one and ten years.

D) Only A and B of the above are true.

E) Only B and C of the above are true.

28) Forty or so dealers establish a "market" in these securities by standing ready to buy and sell them.

A) Surplus stocks

B) U.S. government bonds

C) Secondary stocks

D) Common stocks

29) Which of the following are primary markets?

A) The options markets

B) The U.S. government bond market

C) The over–the–counter stock market

D) The New York Stock Exchange

E) None of the above

30) Which of the following are secondary markets?

A) The over–the–counter stock market

B) The options markets

C) The New York Stock Exchange

D) The U.S. government bond market

E) All of the above

31) Secondary markets make financial instruments more

A) solid.

B) fluid.

C) risky.

D) vapid.

E) liquid.

32) The higher a security's price in the secondary market

A) secondary market prices have no effect on the funds a firm can raise.

B) the less funds a firm can raise by selling securities in the secondary market.

C) the more funds a firm can raise by selling securities in the primary market.

D) the less funds a firm can raise by selling securities in the primary market.

E) the more funds a firm can raise by selling securities in the secondary market.

33) An important financial institution that assists in the initial sale of securities in the primary market is the

A) investment bank. B) stock exchange. C) commercial bank. D) brokerage house.

34) A corporation acquires new funds only when its securities are sold

A) in the secondary market by a commercial bank.

B) in the secondary market by a stock exchange broker.

C) in the secondary market by an investment bank.

D) in the primary market by an investment bank.

35) Which of the following assets is traded only in an over-the-counter market?

A) commodities

B) treasury bonds

C) stocks

D) all of the above

E) none of the above

36) Which of the following markets is sometimes organized as an over-the-counter market?

A) The federal funds market

B) The bond market

C) The foreign exchange market

D) The stock market

E) Each of the above

37) Which of the following statements about financial markets and securities are 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) Because of their short terms to maturity, the prices of money market instruments tend not to fluctuate wildly.

D) Only A and B of the above are true.

E) Only A and C of the above are true.

38) 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) country bonds. D) equity bonds.

39) Financial intermediaries lower costs by spreading them over a large number of customers, thereby taking advantage of

A) asymmetric information.

B) diversification.

C) economies of scale.

D) transactions costs.

E) risk sharing.

40) An example of economies of scale in the provision of financial services is

A) spreading the cost of borrowed funds over many customers.

B) investing in a diversified collection of assets.

C) spreading the cost of writing a standardized contract over many borrowers.

D) providing depositors with a variety of savings certificates.

E) all of the above.

41) The process where financial intermediaries create and sell low–risk assets and use the proceeds to purchase riskier assets is known as

A) risk neutrality.

B) risk selling.

C) risk aversion.

D) risk sharing.

E) risk shedding.

42) Risk sharing is also known as

A) liability transformation.

B) asset discounting.

C) asset transformation.

D) asset selection.

E) liability discounting.

43) The concept of diversification is captured by the statement

A) don't look a gift horse in the mouth.

B) make hay while the sun shines.

C) don't put all your eggs in one basket.

D) the only thing we have to fear is fear itself.

E) it never rains, but it pours.

44) The process of asset transformation refers to the conversion of

A) safer assets into risky liabilities.

B) safer assets into risky assets.

C) risky assets into risky liabilities.

D) risky assets into safer assets.

E) safer assets into safer liabilities.

45) The presence of transaction costs in financial markets explains, in part, why

A) equity and bond financing play such an important role in financial markets.

B) corporations get more funds through equity financing than they get from financial intermediaries.

C) direct financing is more important than indirect financing as a source of funds.

D) financial intermediaries and indirect finance play such an important role in financial markets.

46) Financial intermediaries

A) are involved in the process of indirect finance.

B) exist because there are substantial information and transactions costs in the economy.

C) improve the lot of the small saver.

D) do each of the above.

E) do only A and B of the above.

47) Financial intermediaries promote economic efficiency and thereby increase people's wealth

A) to the extent that they help solve the problems due to asymmetric information.

B) by reducing the transactions cost of linking together borrowers and lenders.

C) by reducing the exposure of investors to risk.

D) because of all of the above.

E) because of only A and B of the above.

48) 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 __________, and it creates the __________ problem.

A) adverse selection; moral hazard

B) adverse selection; risk sharing

C) asymmetric information; risk sharing

D) moral hazard; adverse selection

E) asymmetric information; adverse selection

49) A potential borrower usually has better information about the potential returns and risk of the investment projects he plans to undertake than does the lender. This inequality of information is called

A) asymmetric information.

B) adverse selection.

C) moral hazard.

D) reverse causation.

50) 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) costly state verification.

B) moral hazard.

C) free–riding.

D) adverse selection.

51) The presence of _____ in financial markets leads to adverse selection and moral hazard problems that interfere with the efficient functioning of financial markets.

A) free–riding

B) asymmetric information

C) noncollateralized risk

D) costly state verification

52) Adverse selection is a problem associated with equity and debt contracts arising from

A) the lender's inability to legally require sufficient collateral to cover a 100% loss if the borrower defaults.

B) the lender's relative lack of information about the borrower's potential returns and risks of his investment activities.

C) the borrower's lack of incentive to seek a loan for highly risky investments.

D) none of the above.

53) The concept of adverse selection helps to explain

A) which firms are more likely to obtain funds from banks and other financial intermediaries, rather than from the securities markets.

B) why indirect finance is more important than direct finance as a source of business finance.

C) why direct finance is more important than indirect finance as a source of business finance.

D) only A and B of the above.

E) only A and C of the above.

54) That only large, well–established corporations have access to securities markets

A) explains why indirect finance is such an important source of external funds for businesses.

B) can be explained by the problem of adverse selection.

C) can be explained by government regulations that prohibit small firms from acquiring funds in securities markets.

D) can be explained by all of the above.

E) can be explained by only A and B of the above.

55) In financial markets, lenders typically have inferior information about potential returns and risks associated with any investment project. This difference in information is called

A) comparative informational disadvantage.

B) variant information.

C) asymmetric information.

D) caveat venditor.

56) A professional baseball player may be contractually restricted from skiing. The team owner includes this clause in the player's contract to protect against

A) fraud.

B) moral hazard.

C) adverse selection.

D) risk sharing.

E) regulatory circumvention.

57) An example of the problem of ______ is when a corporation that uses the funds raised from selling new shares of stock to pay for Caribbean cruises for all of its employees and their families.

A) adverse selection

B) credit risk

C) moral hazard

D) risk sharing

E) prudential supervision

58) A buyer of a used car faces the __________ problem that most of her choices are lemons.

A) adverse selection

B) bureaucratic behavior

C) free rider

D) moral hazard

E) diversification

59) In the early 1980s, a particular bank in Oklahoma developed a reputation of readily providing loans to borrowers for the purpose of exploring for oil deposits. Many of these loans were never repaid, because this bank failed to address the

A) free–rider problem.

B) risk–sharing problem.

C) moral hazard problem.

D) regulatory avoidance problem.

E) adverse selection problem.

60) Which of the following is the primary source of external funds used by American businesses to finance their activities?

A) Other loans

B) Bonds and commercial paper

C) Stock

D) Bank loans

61) Although the dominance of _____ over _____ is clear in all countries, the relative importance of bond versus stock markets differs widely.

A) financial intermediaries; government agencies

B) financial intermediaries; securities markets

C) government agencies; securities markets

D) government agencies; financial intermediaries

62) 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) financial intermediaries.

C) equities markets.

D) bond markets.

63) Which of the following financial intermediaries is not a depository institution?

A) A commercial bank

B) A credit union

C) A savings and loan association

D) A finance company

E) None of the above

64) Which of the following is a contractual savings institution?

A) A savings and loan association
B) A mutual fund
C) A credit union
D) A life insurance company

65) Contractual savings institutions include

A) mutual savings banks.
B) commercial banks.
C) money market mutual funds.
D) life insurance companies.
E) all of the above.

66) Which of the following financial intermediaries are not depository institutions?

A) Finance companies
B) Pension funds
C) Savings and loan associations
D) Only A and B of the above
E) Only B and C of the above

67) Which of the following are not contractual savings institutions?

A) A pension fund
B) A life insurance company
C) A mutual fund
D) Only A and B of the above

68) Which of the following are investment intermediaries?

A) State and local government retirement funds
B) Pension funds
C) Life insurance companies
D) Mutual funds

69) Which of the following financial intermediaries are depository institutions?

A) A savings and loan association
B) A commercial bank
C) A money market mutual fund
D) All of the above
E) Only A and B of the above

70) Which of the following is a depository institution?

A) A credit union
B) A pension fund
C) A mutual fund
D) A life insurance company

71) Which of the following are depository institutions?

A) Mutual savings banks

B) Credit unions

C) Mutual funds

D) All of the above

E) Only A and B of the above

72) Which of the following is a depository institution?

A) A pension fund

B) A finance company

C) The stock exchange

D) A mutual savings bank

E) A life insurance company

73) Which of the following is not a contractual savings institution?

A) A savings and loan association

B) A fire and casualty insurance company

C) A pension fund

D) A life insurance company

74) Which of the following are not investment intermediaries?

A) A life insurance company

B) A pension fund

C) A mutual fund

D) Only A and B of the above

75) Which of the following are investment intermediaries?

A) Finance companies

B) Mutual funds

C) Pension funds

D) All of the above

E) Only A and B of the above

76) The primary assets of a mutual savings bank are

A) bonds.

B) commercial loans.

C) stocks.

D) mortgages.

E) deposits.

77) The primary liabilities of a credit union are

A) mortgages.

B) bonds.

C) commercial loans.

D) stocks.

E) deposits.

78) The primary assets of a pension fund are

A) mortgages.
B) money market instruments.
C) corporate bonds and stock.
D) consumer and business loans.

79) The primary assets of a savings and loan association are

A) mortgages.
B) money market instruments.
C) consumer and business loans.
D) corporate bonds and stock.

80) The primary assets of credit unions are

A) mortgages.
B) municipal bonds.
C) consumer loans.
D) business loans.

81) The primary assets of a finance company are

A) municipal bonds.
B) mortgages.
C) consumer and business loans.
D) corporate stocks and bonds.

82) The primary assets of commercial banks include

A) mortgages.

B) U.S. government securities.

C) consumer and business loans.

D) all of the above.

E) only A and B of the above.

83) The primary assets of fire and casualty insurance companies include

A) municipal bonds.

B) corporate stocks and bonds.

C) consumer and business loans.

D) all of the above.

E) only A and B of the above.

84) The primary source of funds of fire and casualty insurance companies include

A) savings deposits.
B) commercial paper, stocks, and bonds.
C) premiums from policies.
D) all of the above.

85) The primary liabilities of a commercial bank are

A) commercial paper.
B) mortgages.
C) bonds.
D) deposits.

86) The primary liabilities of depository institutions are

A) stocks.
B) premiums from policies.
C) deposits.
D) shares.
E) bonds.

87) The primary assets of money market mutual funds are

A) municipal bonds.
B) deposits.
C) stocks.
D) money market instruments.
E) bonds.

88) Money market mutual fund shares function like

A) checking accounts that pay interest.
B) currency.
C) municipal bonds.
D) bonds.
E) stocks.

89) An important feature of money market mutual fund shares is

A) deposit insurance.
B) the ability to write checks against shareholdings.
C) claims on shares of corporate stock.
D) the ability to borrow against shareholdings.
E) all of the above.

90) Thrift institutions include

A) savings and loan associations, mutual savings banks, and credit unions.

B) banks, mutual funds, and insurance companies.

C) life insurance companies, fire and casualty companies, and pension funds.

D) pension funds, mutual funds, and banks.

E) finance companies, mutual funds, and money market funds.

91) Which of the following is not a goal of financial regulation?

A) Ensuring that investors never suffer losses

B) Reducing adverse selection

C) Ensuring the soundness of the financial system

D) Reducing moral hazard

92) The Federal Deposit Insurance Corporation (FDIC) regulates

A) savings and loan associations.

B) mutual savings banks.

C) credit unions.

D) all of the above.

E) only A and B of the above.

93) Savings and loan associations are regulated by the

A) Department of Justice.

B) Office of Thrift Supervision.

C) Federal Reserve System.

D) Securities and Exchange Commission.

E) Office of the Comptroller of the Currency.

94) Which of the following regulates at least some commercial banks?

A) The Federal Deposit Insurance Corporation (FDIC)

B) The Federal Reserve System

C) The Office of the Comptroller of the Currency

D) Each of the above

E) Only A and B of the above

95) Which of the following examines the books of depository institutions?

A) The Office of the Comptroller of the Currency

B) State banking and insurance commissions

C) The Federal Reserve System

D) The National Credit Union Administration

E) Each of the above

96) Which of the following do not provide charters?

A) The Office of the Comptroller of the Currency

B) State banking and insurance commissions

C) The Federal Reserve System

D) The National Credit Union Administration

97) Regulations that protect against financial panics include

A) restrictions on assets and activities.

B) disclosure.

C) deposit insurance.

D) restrictions on entry.

E) all of the above.

98) An important restriction on bank activities that was repealed in 1999 was

A) the prohibition of the payment of interest on checking deposits.

B) minimum down payments on loans to purchase securities.

C) prohibition on ownership of municipal bonds.

D) restrictions on credit terms.

E) separation of commercial banking from the securities industries.

99) A goal of the Securities and Exchange Commission is to reduce problems arising from

A) banking panics.

B) asymmetric information.

C) competition.

D) risk.

E) all of the above.

100) Asymmetric information is a universal problem. This would suggest that

A) financial regulations in industrial countries are an unqualified failure.

B) financial regulations differ significantly around the world.

C) financial regulations are unnecessary.

D) financial regulations in industrialized nations are similar.

E) financial regulation exists only in the United States.

101) The purpose of the disclosure requirements of the Securities and Exchange Commission is to

A) protect investors against financial losses.

B) increase the information available to investors.

C) prevent bank panics.

D) improve monetary control.

E) all of the above.

102) The primary purpose of deposit insurance is to

A) improve the flow of information to investors.

B) protect bank shareholders against losses.

C) protect bank employees from unemployment.

D) prevent banking panics.

E) all of the above.

Answer Key
Testname: CH2

1) B
2) E
3) E
4) C
5) A
6) C
7) C
8) D
9) A
10) A
11) E
12) A
13) E
14) C
15) C
16) E
17) A
18) B
19) D
20) D
21) C
22) D
23) B
24) E
25) E
26) E
27) B
28) B
29) E
30) E
31) E
32) C
33) A
34) D
35) B
36) E
37) E
38) A
39) C
40) C
41) D
42) C
43) C
44) B
45) D
46) D
47) D
48) E
49) A
50) D

51) B
52) B
53) D
54) E
55) C
56) B
57) C
58) A
59) E
60) D
61) B
62) B
63) D
64) D
65) D
66) D
67) C
68) D
69) E
70) A
71) E
72) D
73) A
74) D
75) E
76) D
77) E
78) C
79) A
80) C
81) C
82) D
83) E
84) C
85) D
86) C
87) D
88) A
89) B
90) A
91) A
92) E
93) B
94) D
95) E
96) C
97) E
98) E
99) B
100) D

101) B
102) D