Test Bank for Economics of Money Banking and Financial Markets 12th Mishkin

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***Economics of Money, Banking, and Financial Markets, 12e* (Mishkin)**
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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
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5) A breakdown of financial markets can result in
A) financial stability.
B) rapid economic growth.
C) political instability.
D) stable prices.
Answer: C
Ques Status: Previous Edition
AACSB: Reflective Thinking

6) The principal lender-savers are
A) governments.
B) businesses.
C) households.
D) foreigners.
Answer: C
Ques Status: Previous Edition
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 $2,500 from a friend.
C) You buy shares of common stock in the secondary market.
D) You buy shares in a mutual fund.
Answer: B
Ques Status: Previous Edition
AACSB: Analytical Thinking

8) Assume that you borrow $2,000 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
Ques Status: Previous Edition
AACSB: Analytical Thinking

9) You can borrow $5,000 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
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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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
AACSB: Reflective Thinking

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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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
AACSB: Reflective Thinking

17) Well functioning financial markets benefit _____ by allowing them to time their purchases more efficiently.
A) consumers
B) lenders
C) creditors
D) cashiers
Answer: A
Ques Status: New
AACSB: Reflective Thinking

18) 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.
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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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
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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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
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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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
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AACSB: Application of Knowledge

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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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
AACSB: Reflective Thinking

18) Secondary markets make financial instruments more
A) solid.
B) vapid.
C) liquid.
D) risky.
Answer: C
Ques Status: Previous Edition
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
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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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
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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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
AACSB: Analytical Thinking

26) Equity instruments are traded in the _____ market.
A) money
B) bond
C) capital
D) commodities
Answer: C
Ques Status: Previous Edition
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
Ques Status: Previous Edition
AACSB: Reflective Thinking

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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.
Ques Status: Previous Edition
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.
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
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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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
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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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
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AACSB: Analytical Thinking

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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
Ques Status: Previous Edition
AACSB: Analytical Thinking

14) Bonds issued by state and local governments are called _____ bonds.
A) corporate
B) Treasury
C) municipal
D) commercial
Answer: C
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
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AACSB: Analytical Thinking

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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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
AACSB: Application of Knowledge

22) _____ bonds allow the holder to change them into a specific number of shares of stock at any time up to the maturity date.
A) Convertible
B) Treasury
C) Municipal
D) Commercial
Answer: A
Ques Status: New
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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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
AACSB: Application of Knowledge

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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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
AACSB: Application of Knowledge

7) If Toyota (headquarters in Japan) sells a $1,000 bond in the United States, the bond is a
A) foreign bond.
B) Eurobond.
C) Tokyo bond.
D) currency bond.
Answer: A
Ques Status: Revised
AACSB: Application of Knowledge

8) If Volkswagen, a German company, sells a euro-denominated bond in London, the bond is a
A) Eurobond.
B) foreign bond.
C) currency bond.
D) Duetsche bond.
Answer: A
Ques Status: New
AACSB: Reflective Thinking

9) 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.
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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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
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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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
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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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
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
Ques Status: Previous Edition
AACSB: Application of Knowledge

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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
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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
Ques Status: Previous Edition
AACSB: Ethical Understanding and Reasoning Abilities

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
Ques Status: Previous Edition
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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
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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
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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
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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
Ques Status: Previous Edition
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22) Financial intermediaries are better equipped than individuals to screen out bad credit risks from good ones, thus reducing losses due to
A) adverse selection.
B) moral hazard.
C) free-riding.
D) economies of scope.
Answer: A
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23) Financial intermediaries have developed expertise in monitoring the parties they lend to, thus reducing losses due to
A) moral hazard.
B) adverse selection.
C) free-riding.
D) economies of scope.
Answer: A
Ques Status: New
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24) 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.
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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
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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
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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
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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
Ques Status: Previous Edition
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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
Ques Status: Previous Edition
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6) The primary assets of credit unions are
A) municipal bonds.
B) business loans.
C) consumer loans.
D) mortgages.
Answer: C
Ques Status: Previous Edition
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7) The primary liabilities of a commercial bank are
A) bonds.
B) mortgages.
C) deposits.
D) commercial paper.
Answer: C
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8) The primary liabilities of depository institutions are
A) premiums from policies.
B) shares.
C) deposits.
D) bonds.
Answer: C
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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
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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
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11) Contractual savings institutions include
A) mutual savings banks.
B) money market mutual funds.
C) commercial banks.
D) life insurance companies.
Answer: D
Ques Status: Previous Edition
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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
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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
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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
Ques Status: Previous Edition
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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
Ques Status: Previous Edition
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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
Ques Status: Previous Edition
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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
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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
Ques Status: Previous Edition
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19) Money market mutual fund shares function like
A) checking accounts that pay interest.
B) bonds.
C) stocks.
D) currency.
Answer: A
Ques Status: Previous Edition
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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
Ques Status: Previous Edition
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21) The primary assets of money market mutual funds are
A) stocks.
B) bonds.
C) money market instruments.
D) deposits.
Answer: C
Ques Status: Previous Edition
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22) An investment bank helps _____ issue securities.
A) a corporation
B) the United States government
C) the SEC
D) foreign governments
Answer: A
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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
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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
Ques Status: Previous Edition
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25) Hedge funds require large minimum investments ranging from _____ to _____ or more.
A) $100,000; $1 million
B) $1,000; $10,000
C) $100; $1,000
D) $$10,000; $25,000
Answer: A
Ques Status: Previous Edition
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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
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27) Life insurance companies and fire and casualty insurance companies are both examples of contractual savings institutions. Because fire and casualty insurance companies have a greater possibility of loss of funds if disasters occur, they tend to hold more _____ assets than life insurance companies.
A) liquid
B) real
C) long-term
D) consumer loans
Answer: A
Ques Status: New
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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
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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
Ques Status: Previous Edition
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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
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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
Ques Status: Previous Edition
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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
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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
Ques Status: Previous Edition
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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
Ques Status: Previous Edition
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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
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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
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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
Ques Status: Previous Edition
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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
Ques Status: Previous Edition
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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
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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
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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.
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