Financial Markets and Institutions 8th edition Saunders Test Bank

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Financial Markets and Institutions 8th Edition by Saunders CH01

ANSWERS ARE LOCATED IN THE SECOND PART OF THIS DOCUMENT

TRUE/FALSE - Write 'T' if the statement is true and 'F' if the statement is false.

1) Primary markets are markets in which users of funds raise cash by selling securities to funds suppliers.

1) _____

◎ true
◎ false

Question Details
AACSB : Reflective Thinking
Bloom's : Remember
Difficulty : 1 Easy
Topic : Overview of Financial Markets
Learning Goal : 01-01 Differentiate between primary and secondary markets.
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

2) Secondary markets are markets used by corporations to raise cash by issuing securities for a short time period.

2) _____

◎ true
◎ false

Question Details
AACSB : Reflective Thinking
Bloom's : Remember
Difficulty : 1 Easy
Topic : Overview of Financial Markets
Learning Goal : 01-01 Differentiate between primary and secondary markets.
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

3) Corporate security issuers are always directly involved in funds transfers in the secondary market.

3) _____

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◎ true
◎ false

Question Details
AACSB : Reflective Thinking
Bloom's : Remember
Difficulty : 1 Easy
Topic : Overview of Financial Markets
Learning Goal : 01-01 Differentiate between primary and secondary markets.
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

4) The NYSE is an example of a secondary market.

4) _____

◎ true
◎ false

Question Details
AACSB : Reflective Thinking
Topic : Overview of Financial Markets
Bloom's : Understand
Learning Goal : 01-01 Differentiate between primary and secondary markets.
Difficulty : 2 Medium
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

5) Central governments sometimes indirectly intervene in foreign exchange markets by affecting foreign exchange rates through raising or lowering interest rates.

5) _____

◎ true
◎ false

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Question Details
AACSB : Reflective Thinking
Bloom's : Remember
Difficulty : 1 Easy
Topic : Overview of Financial Markets
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible
Learning Goal : 01-03 Understand what foreign exchange markets are.

6) Money markets are the markets for securities with an original maturity of one year or less.

6) _____

- ◎ true
- ◎ false

Question Details
AACSB : Reflective Thinking
Bloom's : Remember
Difficulty : 1 Easy
Topic : Overview of Financial Markets
Learning Goal : 01-02 Differentiate between money and capital markets.
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

7) Financial intermediaries rather than financial systems are the most common agents to channel funds from the suppliers to the users of funds.

7) _____

- ◎ true
- ◎ false

Question Details
AACSB : Reflective Thinking
Bloom's : Remember
Difficulty : 1 Easy
Learning Goal : 01-06 Know the services financial institutions perform.
Topic : Overview of Financial Institutions
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

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8) There are three types of major financial markets today: primary, secondary, and derivatives markets. The NYSE and NASDAQ are both examples of derivatives markets.

8) _____

◎ true
◎ false

Question Details
AACSB : Reflective Thinking
Topic : Overview of Financial Markets
Bloom's : Understand
Learning Goal : 01-01 Differentiate between primary and secondary markets.
Learning Goal : 01-04 Understand what derivative security markets are.
Difficulty : 2 Medium
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

9) Asset transformation by financial intermediaries involves increasing the risk attributes of securities such as mortgages, bonds, and stocks.

9) _____

◎ true
◎ false

Question Details
AACSB : Reflective Thinking
Bloom's : Remember
Difficulty : 1 Easy
Learning Goal : 01-06 Know the services financial institutions perform.
Topic : Overview of Financial Institutions
Learning Goal : 01-07 Know the risks financial institutions face.
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

10) One of the factors responsible for globalization of financial markets and institutions is deregulation.

10) _____

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◎ true
◎ false

Question Details
AACSB : Reflective Thinking
Bloom's : Remember
Difficulty : 1 Easy
Learning Goal : 01-09 Recognize that financial markets are becoming increasingly global.
Topic : Globalization of Financial Markets and Institutions
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

11) The average cost incurred by financial institutions to collect information is larger than that of individuals.

11) _____

◎ true
◎ false

Question Details
AACSB : Reflective Thinking
Bloom's : Remember
Difficulty : 1 Easy
Learning Goal : 01-06 Know the services financial institutions perform.
Topic : Overview of Financial Institutions
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

12) The Vol-cker Rule prohibits U.S. depository institutions from engaging in proprietary trading.

12) _____

◎ true
◎ false

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Question Details
AACSB : Reflective Thinking
Bloom's : Remember
Difficulty : 1 Easy
Topic : Overview of Financial Markets
Learning Goal : 01-04 Understand what derivative security markets are.
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

13) Financial intermediation provides direct transfer of funds to the users.

13) _____

- ◎ true
- ◎ false

Question Details
AACSB : Reflective Thinking
Bloom's : Understand
Topic : Overview of Financial Institutions
Learning Goal : 01-05 Distinguish between the different types of financial institutions.
Difficulty : 2 Medium
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

14) In the United States, the SEC provides deposit insurance for $250,000 per person per bank.

14) _____

- ◎ true
- ◎ false

Question Details
AACSB : Reflective Thinking
Bloom's : Remember
Difficulty : 1 Easy
Topic : Overview of Financial Institutions
Learning Goal : 01-08 Appreciate why financial institutions are regulated.
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

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15) An Enterprise Risk Management (ERM) system is responsible for managing the totality of a firm's risk exposures.

15) _____

◎ true
◎ false

Question Details
AACSB : Reflective Thinking
Bloom's : Remember
Difficulty : 1 Easy
Topic : Overview of Financial Institutions
Learning Goal : 01-08 Appreciate why financial institutions are regulated.
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

MULTIPLE CHOICE - Choose the one alternative that best completes the statement or answers the question.

16) What factors are encouraging financial institutions to offer overlapping financial services such as banking, investment banking, brokerage, etc.? 1.I. Regulatory changes allowing institutions to offer more services
2.II. Technological improvements reducing the cost of providing financial services
3.III. Increasing competition from full-service global financial institutions
4.IV. Reduction in the need to manage risk at financial institutions

16) _____

A) I only
B) II and III only
C) I, II, and III only
D) I, II, and IV only
E) I, II, III, and IV

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Question Details
AACSB : Reflective Thinking
Bloom's : Understand
Topic : Overview of Financial Institutions
Learning Goal : 01-08 Appreciate why financial institutions are regulated.
Difficulty : 2 Medium
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

17) IBM creates and sells additional stock to the investment banker Morgan Stanley. Morgan Stanley then resells the issue to the U.S. public through its mutual funds.

This transaction is an example of a(n):

17) _____

A) primary market transaction.
B) asset transformation by Morgan Stanley.
C) money market transaction.
D) foreign exchange transaction.
E) forward transaction.

Question Details
AACSB : Reflective Thinking
Topic : Overview of Financial Markets
Bloom's : Understand
Learning Goal : 01-01 Differentiate between primary and secondary markets.
Difficulty : 2 Medium
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

18) IBM creates and sells additional stock to the investment banker Morgan Stanley. Morgan Stanley then resells the issue to the U.S. public through its mutual funds.

Morgan Stanley is acting as a(n)

18) _____

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A) asset transformer.
B) asset broker.
C) government regulator.
D) foreign service representative.
E) derivatives trader.

Question Details
AACSB : Reflective Thinking
Bloom's : Understand
Learning Goal : 01-06 Know the services financial institutions perform.
Topic : Overview of Financial Institutions
Difficulty : 2 Medium
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

19) A corporation seeking to sell new equity securities to the public for the first time in order to raise cash for capital investment would most likely:

19) _____

A) conduct an IPO with the assistance of an investment banker.
B) engage in a secondary market sale of equity.
C) conduct a private placement to a large number of potential buyers.
D) place an ad in the *Wall Street Journal* soliciting retail suppliers of funds.
E) issue bonds with the assistance of a dealer.

Question Details
AACSB : Reflective Thinking
Topic : Overview of Financial Markets
Bloom's : Understand
Learning Goal : 01-01 Differentiate between primary and secondary markets.
Learning Goal : 01-02 Differentiate between money and capital markets.
Difficulty : 2 Medium
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

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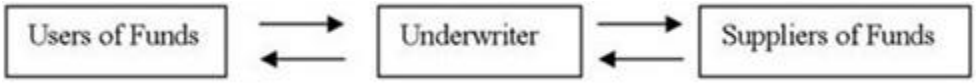
20) The largest capital market security outstanding in 2019 measured by market value was:

20) _____

A) securitized mortgages.
B) corporate bonds.
C) municipal bonds.
D) Treasury bonds.
E) corporate stocks.

Question Details
AACSB : Reflective Thinking
Bloom's : Remember
Difficulty : 1 Easy
Topic : Overview of Financial Markets
Learning Goal : 01-02 Differentiate between money and capital markets.
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

21) The diagram below is a diagram of the:



21) _____

A) secondary markets.
B) primary markets.
C) money markets.
D) derivatives markets.
E) commodities markets.

Question Details
AACSB : Reflective Thinking
Bloom's : Remember
Difficulty : 1 Easy
Topic : Overview of Financial Markets
Learning Goal : 01-01 Differentiate between primary and secondary markets.
Accessibility : Keyboard Navigation

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22) _____ and _____ allow a financial intermediary to offer safe liquid liabilities such as deposits while investing the depositors' money in riskier illiquid assets.

22) _____

A) Diversification; high equity returns
B) Price risk; collateral
C) Free riders; regulations
D) Monitoring; diversification
E) Primary markets; foreign exchange markets

Question Details
AACSB : Reflective Thinking
Bloom's : Understand
Learning Goal : 01-06 Know the services financial institutions perform.
Topic : Overview of Financial Institutions
Learning Goal : 01-07 Know the risks financial institutions face.
Difficulty : 2 Medium
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

23) Depository institutions include:

23) _____

A) banks only.
B) thrifts only.
C) finance companies only.
D) banks and thrifts.
E) All of these choices are correct.

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Question Details
AACSB : Reflective Thinking
Bloom's : Understand
Topic : Overview of Financial Institutions
Learning Goal : 01-05 Distinguish between the different types of financial institutions.
Difficulty : 2 Medium
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

24) Match the intermediary with the characteristic that best describes its function. 1.I. Provide protection from adverse events
2.II. Pool funds of small savers and invest in either money or capital markets
3.III. Provide consumer loans and real estate loans funded by deposits
4.IV. Accumulate and transfer wealth from work period to retirement period
5.V. Underwrite and trade securities and provide brokerage services
1.Thrifts
2.Insurers
3.Pension funds
4.Securities firms and investment banks
5.Mutual funds

24) _____

A) 1, 3, 2, 5, 4
B) 4, 2, 3, 5, 1
C) 2, 5, 1, 3, 4
D) 2, 4, 5, 3, 1
E) 5, 1, 3, 2, 4

Question Details
AACSB : Reflective Thinking
Bloom's : Understand
Learning Goal : 01-06 Know the services financial institutions perform.
Topic : Overview of Financial Institutions
Learning Goal : 01-05 Distinguish between the different types of financial institutions.
Difficulty : 2 Medium
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

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25) Secondary markets help support primary markets because secondary markets: 1.I. offer primary market purchasers liquidity for their holdings.

2.II. update the price or value of the primary market claims.

3.III. reduce the cost of trading the primary market claims.

25) _____

A) I only
B) II only
C) I and II only
D) II and III only
E) I, II, and III

Question Details
AACSB : Reflective Thinking
Topic : Overview of Financial Markets
Bloom's : Understand
Learning Goal : 01-01 Differentiate between primary and secondary markets.
Difficulty : 2 Medium
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

26) Financial intermediaries (FIs) can offer savers a safer, more liquid investment than a capital market security, even though the intermediary invests in risky illiquid instruments because:

26) _____

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A) FIs can diversify away some of their risk.
B) FIs closely monitor the riskiness of their assets.
C) the federal government requires them to do so.
D) FIs can diversify away some of their risk and closely monitor the riskiness of their assets.
E) FIs can diversify away some of their risk and the federal government requires them to do so.

Question Details
AACSB : Reflective Thinking
Topic : Overview of Financial Markets
Bloom's : Understand
Learning Goal : 01-02 Differentiate between money and capital markets.
Learning Goal : 01-06 Know the services financial institutions perform.
Topic : Overview of Financial Institutions
Difficulty : 2 Medium
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

27) Households are increasingly likely to both directly purchase securities (perhaps via a broker) and also place some money with a bank or thrift to meet different needs. Match the given investor's desire with the appropriate intermediary or direct security.

1.I. Money likely to be needed within six months
2.II. Money to be set aside for college in 10 years
3.III. Money to provide supplemental retirement income
4.IV. Money to be used to provide for children in the event of death

1.Depository institutions
2.Insurer
3.Pension fund
4.Stocks or bonds

27) _____

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A) 2, 3, 4, 1
B) 1, 4, 2, 3
C) 3, 2, 1, 4
D) 1, 4, 3, 2
E) 4, 2, 1, 3

Question Details
AACSB : Reflective Thinking
Topic : Overview of Financial Markets
Bloom's : Understand
Learning Goal : 01-01 Differentiate between primary and secondary markets.
Learning Goal : 01-02 Differentiate between money and capital markets.
Learning Goal : 01-06 Know the services financial institutions perform.
Topic : Overview of Financial Institutions
Learning Goal : 01-05 Distinguish between the different types of financial institutions.
Difficulty : 2 Medium
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

28) As of 2019, which one of the following derivatives instruments had the greatest amount of notional principal outstanding?

28) _____

A) Futures
B) Swaps
C) Options
D) Bonds
E) Forwards

Question Details
AACSB : Reflective Thinking
Bloom's : Remember
Difficulty : 1 Easy
Topic : Overview of Financial Markets
Learning Goal : 01-04 Understand what derivative security markets are.
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

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29) Which of the following is/are money market instrument(s)?

29) _____

A) Negotiable CDs
B) Common stock
C) T-bonds
D) 4-year maturity corporate bond
E) Negotiable CDs, common stock, and T-bonds

Question Details
AACSB : Reflective Thinking
Bloom's : Remember
Difficulty : 1 Easy
Topic : Overview of Financial Markets
Learning Goal : 01-02 Differentiate between money and capital markets.
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

30) The Securities Exchange Commission (SEC) does <u>not:</u>

30) _____

A) decide whether a public issue is fairly priced.
B) decide whether a firm making a public issue has provided enough information for investors to decide whether the issue is fairly priced.
C) require exchanges to monitor trading to prevent insider trading.
D) attempt to reduce excessive price fluctuations.
E) monitor the major securities exchanges.

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Question Details
AACSB : Reflective Thinking
Bloom's : Understand
Topic : Overview of Financial Institutions
Learning Goal : 01-08 Appreciate why financial institutions are regulated.
Difficulty : 2 Medium
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

31) The most diversified type of depository institutions is:

31) _____

A) credit unions.
B) savings associations.
C) commercial banks.
D) finance companies.
E) mutual funds.

Question Details
AACSB : Reflective Thinking
Bloom's : Understand
Learning Goal : 01-06 Know the services financial institutions perform.
Topic : Overview of Financial Institutions
Learning Goal : 01-05 Distinguish between the different types of financial institutions.
Difficulty : 2 Medium
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

32) Insolvency risk at a financial intermediary (FI) is the risk:

32) _____

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A) that promised cash flows from loans and securities held by FIs may not be paid in full.

B) incurred by an FI when the maturities of its assets and liabilities do not match.

C) that a sudden surge in liability withdrawals may require an FI to liquidate assets quickly at fire sale prices.

D) incurred by an FI when its investments in technology do not result in cost savings or revenue growth.

E) that an FI may not have enough capital to offset a sudden decline in the value of its assets.

Question Details
AACSB : Reflective Thinking
Bloom's : Understand
Topic : Overview of Financial Institutions
Learning Goal : 01-07 Know the risks financial institutions face.
Difficulty : 2 Medium
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

33) Depository institutions (DIs) play an important role in the transmission of monetary policy from the Federal Reserve to the rest of the economy because:

33) _____

A) loans to corporations are part of the money supply.
B) bank and thrift loans are tightly regulated.
C) U.S. DIs compete with foreign financial institutions.
D) DI deposits are a major portion of the money supply.
E) thrifts provide a large amount of credit to finance residential real estate.

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Question Details
AACSB : Reflective Thinking
Bloom's : Understand
Learning Goal : 01-06 Know the services financial institutions perform.
Topic : Overview of Financial Institutions
Difficulty : 2 Medium
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

34) Liquidity risk at a financial intermediary (FI) is the risk:

34) _____

A) that promised cash flows from loans and securities held by FIs may not be paid in full.
B) incurred by an FI when the maturities of its assets and liabilities do not match.
C) that a sudden surge in liability withdrawals may require an FI to liquidate assets quickly at fire sale prices.
D) incurred by an FI when its investments in technology do not result in cost savings or revenue growth.
E) that an FI may not have enough capital to offset a sudden decline in the value of its assets.

Question Details
AACSB : Reflective Thinking
Bloom's : Understand
Learning Goal : 01-06 Know the services financial institutions perform.
Topic : Overview of Financial Institutions
Difficulty : 2 Medium
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

35) Money markets trade securities that: 1.I. mature in one year or less.
2.II. have little chance of loss of principal.
3.III. must be guaranteed by the federal government.

35) _____

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A) I only
B) II only
C) I and II only
D) I and III only
E) I, II, and III

Question Details
AACSB : Reflective Thinking
Bloom's : Remember
Difficulty : 1 Easy
Topic : Overview of Financial Markets
Learning Goal : 01-02 Differentiate between money and capital markets.
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

36) Which of the following are capital market instruments?

36) _____

A) 10-year corporate bonds
B) 30-year mortgages
C) 20-year Treasury bonds
D) 15-year U.S. government agency bonds
E) All of these choices are correct.

Question Details
AACSB : Reflective Thinking
Bloom's : Remember
Difficulty : 1 Easy
Topic : Overview of Financial Markets
Learning Goal : 01-02 Differentiate between money and capital markets.
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

37) Commercial paper is a:

37) _____

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A) time draft payable to a seller of goods, with payment guaranteed by a bank.
B) loan to an individual or business to purchase a home, land, or other real property.
C) short-term fund transferred between financial institutions usually for no more than one day.
D) marketable bank-issued time deposit that specifies the interest rate earned and a fixed maturity date.
E) short-term unsecured promissory note issued by a company to raise funds for a short time period.

Question Details
AACSB : Reflective Thinking
Bloom's : Remember
Difficulty : 1 Easy
Topic : Overview of Financial Markets
Learning Goal : 01-02 Differentiate between money and capital markets.
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

38) A negotiable CD is a:

38) _____

A) time draft payable to a seller of goods, with payment guaranteed by a bank.
B) loan to an individual or business to purchase a home, land, or other real property.
C) short-term fund transferred between financial institutions usually for no more than one day.
D) marketable bank-issued time deposit that specifies the interest rate earned and a fixed maturity date.
E) short-term unsecured promissory note issued by a company to raise funds for a short time period.

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Question Details
AACSB : Reflective Thinking
Bloom's : Remember
Difficulty : 1 Easy
Topic : Overview of Financial Markets
Learning Goal : 01-02 Differentiate between money and capital markets.
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

39) Financial intermediaries' ability to reduce the average cost of collecting information because of their efficient operations allows them to take advantage of:

39) _____

A) asset transformation.
B) economies of scale.
C) economies of scope.
D) transformational trading.
E) standardization.

Question Details
AACSB : Reflective Thinking
Topic : Overview of Financial Markets
Bloom's : Understand
Learning Goal : 01-02 Differentiate between money and capital markets.
Difficulty : 2 Medium
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

SHORT ANSWER. Write the word or phrase that best completes each statement or answers the question.

40) Discuss how secondary markets benefit issuers and investors.

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Question Details
AACSB : Reflective Thinking
Topic : Overview of Financial Markets
Bloom's : Understand
Learning Goal : 01-01 Differentiate between primary and secondary markets.
Difficulty : 2 Medium
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

41) How can brokers and dealers make money? Which activity is riskier? Why?

Question Details
Topic : Overview of Financial Markets
Learning Goal : 01-01 Differentiate between primary and secondary markets.
AACSB : Analytical Thinking
Bloom's : Analyze
Difficulty : 3 Hard
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

42) What does an asset transformer do? Why is asset transformation a risky activity?

Question Details
AACSB : Reflective Thinking
Bloom's : Understand
Learning Goal : 01-06 Know the services financial institutions perform.
Topic : Overview of Financial Institutions
Difficulty : 2 Medium
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

43) How can using indirect finance rather than direct finance reduce agency costsfor users of funds that is associated with monitoring funds?

Financial Markets and Institutions 8th edition Saunders Test Bank

Question Details
Topic : Overview of Financial Institutions
Learning Goal : 01-05 Distinguish between the different types of financial institutions.
AACSB : Analytical Thinking
Difficulty : 3 Hard
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible
Bloom's : Apply

44) What have been the major factors contributing to growth in the foreign financial markets?

Question Details
AACSB : Reflective Thinking
Bloom's : Understand
Learning Goal : 01-09 Recognize that financial markets are becoming increasingly global.
Topic : Globalization of Financial Markets and Institutions
Difficulty : 2 Medium
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

45) You are a corporate treasurer seeking to raise funds for your firm. What are some advantages of raising funds via a financial intermediary (FI) rather than by selling securities to the public?

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Question Details
Topic : Overview of Financial Markets
Learning Goal : 01-01 Differentiate between primary and secondary markets.
Learning Goal : 01-06 Know the services financial institutions perform.
Topic : Overview of Financial Institutions
AACSB : Analytical Thinking
Difficulty : 3 Hard
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible
Bloom's : Apply

46) How can a depository intermediary (DI) afford to purchase long-term risky direct claims from users of funds and finance these purchases with safe, liquid, short-term, low-denomination deposits? What can go wrong in this process?

Question Details
Learning Goal : 01-06 Know the services financial institutions perform.
Topic : Overview of Financial Institutions
AACSB : Analytical Thinking
Bloom's : Analyze
Difficulty : 3 Hard
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

47) Discuss the benefits to funds suppliers of using a financial intermediary asset transformer in place of directly purchasing claims such as stocks or bonds. What is the major disadvantage?

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Question Details
AACSB : Reflective Thinking
Topic : Overview of Financial Markets
Bloom's : Understand
Learning Goal : 01-01 Differentiate between primary and secondary markets.
Learning Goal : 01-06 Know the services financial institutions perform.
Topic : Overview of Financial Institutions
Difficulty : 2 Medium
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

48) Discuss the major macro benefits of financial intermediaries. What role does the government have in the credit allocation process?

Question Details
Topic : Overview of Financial Institutions
Learning Goal : 01-07 Know the risks financial institutions face.
Learning Goal : 01-09 Recognize that financial markets are becoming increasingly global.
Topic : Globalization of Financial Markets and Institutions
Learning Goal : 01-08 Appreciate why financial institutions are regulated.
AACSB : Analytical Thinking
Bloom's : Evaluate
Difficulty : 3 Hard
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

49) What determines the price of financial instruments? Which are riskier, capital market instruments or money market instruments? Why?

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Financial Markets and Institutions 8th Edition by Saunders CH01

Question Details
Learning Goal : 01-06 Know the services financial institutions perform.
Topic : Overview of Financial Institutions
Learning Goal : 01-05 Distinguish between the different types of financial institutions.
AACSB : Analytical Thinking
Bloom's : Analyze
Difficulty : 3 Hard
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

50) Explain how the credit crunch originating in the mortgage markets hurt financial intermediaries' attempts to use diversification and monitoring to limit the riskiness of their loans and investments while offering more liquid claims to savers.

Question Details
Topic : Overview of Financial Markets
Learning Goal : 01-02 Differentiate between money and capital markets.
Topic : Overview of Financial Institutions
Learning Goal : 01-08 Appreciate why financial institutions are regulated.
AACSB : Analytical Thinking
Bloom's : Analyze
Difficulty : 3 Hard
Accessibility : Keyboard Navigation
Accessibility : Screen Reader Compatible

Financial Markets and Institutions 8th edition Saunders Test Bank

Financial Markets and Institutions 8th Edition by Saunders CH01
Answer Key

Test name: CH01

1) TRUE
2) FALSE
3) FALSE
4) TRUE
5) TRUE
6) TRUE
7) TRUE
8) FALSE
9) FALSE
10) TRUE
11) FALSE
12) TRUE
13) FALSE
14) FALSE
15) TRUE
16) C
17) A
18) A
19) A
20) E
21) B
22) D
23) D
24) C
25) E

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26) D
27) D
28) B
29) A
30) A
31) C
32) E
33) D
34) C
35) C
36) E
37) E
38) D
39) B
40) The secondary markets provide liquidity to investors after their initial purchase of the security. This liquidity encourages them to purchase the security at the initial offer. The current market price also reflects current prospects for the firm and the competitiveness of the issue relative to similar securities. Corporate treasurers follow their stock's price closely because the stock price reflects how well their firm and the market are performing. The current security price also provides information about the cost of obtaining any additional funds.

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41) An asset broker assists buyers and sellers of securities by providing a mechanism for buyers or sellers to process their orders. If the broker assists one party in finding another party, the broker charges a small fee called a commission. An asset dealer buys the security for his or her own account at the bid price and then sells the security at a higher ask price. The dealer profits by earning the bid-ask spread or the difference between the buy and sell prices. The dealer's function is riskier because the dealer must maintain an inventory of the asset and honor quotes to buy and sell. If the security is risky, the value of the inventory can fluctuate with market prices. The broker takes less risk because he or she does not own the security.

42) An asset transformer buys one security from a customer and makes or creates a separate claim in order to raise funds. For example, a bank accepts deposits and uses them to make loans. This is normally a risky activity because the asset acquired will be riskier than the security (or deposit) used to raise funds because the intermediary hopes to profit on the spread between the rate earned on the asset claim and the rate paid on the liability claim. In order for this spread to be positive, generally speaking, the asset must be riskier than the liability.

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43) A large FI has a greater incentive to monitor the behavior of users of funds in indirect financing. The FI supposedly hires and trains experts who know how to collect information about a fund's user and evaluate whether the fund's user is acting appropriately. In direct finance, a fund user sells claims to the public at large. In this case, there is little incentive for an individual claim holder to monitor and attempt to enforce good behavior on the part of the fund's user. The benefit of monitoring and enforcement is shared among all claim holders, but the cost would be borne by the sole individual. This is termed the "free-rider" problem. If there is improved monitoring of borrower behavior, the problem of agency costs is likely to be reduced.

44) 1.The amount of savings available for investment in foreign countries has increased.

2.International investors have looked to the United States and other markets for better investment opportunities.

3.The Internet has helped provide additional information on foreign markets and overseas investment opportunities.

4.Specialized intermediaries such as country-specific mutual funds have been developed to facilitate overseas investments.

5.The euro has had a notable impact on the global financial system by being an important currency for international transactions.

6.Deregulation of foreign markets has allowed many new investors to participate in international investing.

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45) Advantages include: ● Speed: Funds can normally be raised more quickly through FIs.

● Registration process/cost: The registration process can be quite costly and time-consuming in terms of workers' hours, audit fees, and fees to investment bankers. Raising funds via an FI can be less expensive, particularly for smaller capital needs or when funds are needed for only a short time period. (Maturities of 270 days or less do not require registration, nor do private placements.)

● Flexible terms: Nonstandard terms can be negotiated with FIs but are difficult to sell to the public. For example, if a borrower can only begin paying interest after two years, he or she would have a difficult time selling bonds to the public.

● Ability to change terms: There is a greater ability to renegotiate terms if necessary. Terms of public issue generally cannot be changed outside of court.

● Privacy: Less information is made public.

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46) DIs can afford to do so because the rate they must pay to attract funds is lower than the rate they can charge on their riskier assets. A lot can go wrong, however, including: ● If the money lent is not repaid, the DI may not be able to repay its depositors on demand (credit and liquidity risk). Diversification of the credit risk is a key way DIs limit credit risk.

● The difference between the rate earned on assets and the rate paid on liabilities is called the Net Interest Margin (NIM). The NIM can turn negative if interest rates rise or if the rates on long-term securities fall below the interest rate risk on short-term securities (after adjusting for risk).

● Because the assets and liabilities are different claims, it is possible for the value of the assets to drop resulting in an insolvent institution (insolvency risk). Because the assets are primarily financial, their value can be quite volatile. As a result, risk management is crucial at today's financial institution.

● DIs attract many savers with a small amount of funds. DIs then invest the bulk of these savings in investments that cannot be immediately liquidated. If the savers lose confidence in the DI, they will seek to withdraw their money, which can precipitate a liquidity crisis and cause insolvency.

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47) Potential benefits to funds suppliers are as follows: ● Professional risk managers to assess risk of borrower's claim and help decide the correct price to pay.

● Risk reduction via:

● insurance.

● additional diversification.

● more frequent monitoring.

● additional cushion of FI equity.

● improved liquidity of funds supplier’s claim on FI.

● Denomination intermediation.

● Maturity intermediation.

● The major disadvantage is that you may forego potentially higher returns if you do not purchase the riskier direct claims.

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48) ● Money supply transmission: Depository institutions affect the level of money supply growth in the economy. The money supply is increased when the Fed increases money available to banks, but the extent of money supply growth is affected by banks' decisions to lend the increased supply of funds. If the banks do not lend the increased money, the given increase in funds by the Fed will result in only a small change in the total money supply in the economy.

● Credit Allocation: FIs price risk and allocate capital to users who they believe can generate a high enough rate of return to compensate the lender for the risk the lender bears in loaning the money. FIs also monitor the borrower's condition after the loan is made. A well-functioning economy must have sound mechanisms for allocating capital. In capitalist countries, FIs and markets allocate capital to its highest valued uses, thereby maximizing economic growth. The role of government is to ensure disclosure of risks and fair practices of all involved. In communist and some socialist countries, governments allocate capital according to a current political agenda and strong, lasting economic growth is rarely, if ever, seen in these countries. As the text indicates, the government can also channel credit to socially deserving areas such as housing, farms, and small business development.

● Intergenerational wealth transfers and risk shifting: Pension funds and insurance firms allow investors to transfer wealth through time, while avoiding taxation, and/or allow investors the ability to choose which risks in their life they will bear and which they will insure.

● Payment services: The ability to store and quickly move large sums of money (or many small sums) at low cost with little risk encourages greater investment by market participants and, thus, lowers the overall cost of funds in our economy.

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49) The price of any financial instrument is the present value of future cash flows discounted at an appropriate rate. A small change in interest rates causes a large change in present value of distant cash flows. Hence, the prices of long-term capital market instruments are more sensitive to changes in interest rates than prices of short-term instruments. In addition, distant cash flows for stocks are not known with certainty. Changing economic prospects can cause very large changes in current stock values. Money market instruments have predictable cash flows and mature in one year or less, so they are much less risky.

50) Financial intermediaries' (FIs) attempts to diversify away from specific risk failed when large portions of the debt markets "seized up" and stopped functioning. At that point, many security prices declined all at once, regardless of historical correlations among security prices. This is a failure of diversification to reduce risk. FIs exploit diversification principles and economies of scale to allow the FI to invest large amounts of money. They also must closely monitor the riskiness of their loans and securities, and many FIs are also regulated by the government to ensure they manage the riskiness of their assets. Some would argue that FIs failed to monitor the riskiness of many of their mortgage investments as well, leading to large numbers of poor investments.

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