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Answers are located at the end of each chapter.

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.
   - ◎ true
   - ◎ false

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

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

4) The NYSE is an example of a secondary market.
   - ◎ true
   - ◎ false

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

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

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

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.
   - ◎ true
   - ◎ false

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

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

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

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

13) Financial intermediation provides direct transfer of funds to the users.
   - ◎ true
   - ◎ false

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

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

16) Financial markets are distinguished among three major dimensions: domestic, national, and global.
- ◎ true
- ◎ false

17) Most U.S. markets as said to be over-the-counter markets because stock certificates are traded a physical counter in a central location.
- ◎ true
- ◎ false

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

18) What factors are encouraging financial institutions to offer overlapping financial services such as banking, investment banking, and brokerage?

1. Regulatory changes allowing institutions to offer more services
2. Technological improvements reducing the cost of providing financial services
3. Increasing competition from full-service global financial institutions
4. Reduction in the need to manage risk at financial institutions

A) I
1only
B) II and III only
C) I
1, II, and III only
D) I
1, II, and IV only
E) I
1, II, III, and IV

19) 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):

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

20) 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):

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

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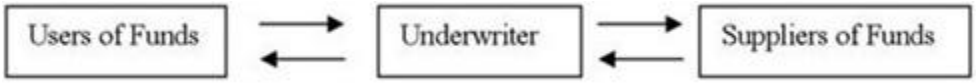
21) A corporation seeking to sell new equity securities to the public for the first time in order to raise cash for capital investment would most likely:

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.

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

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

23) The diagram below is a diagram of the:



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

24) _____and _____allow a financial intermediary to offer safe liquid liabilities such as deposits while investing the depositors' money in riskier illiquid assets.

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

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25) Depository institutions include:

A) banks only.
B) thrifts only.
C) finance companies only.
D) banks and thrifts.
E) thrifts and finance companies.

26) Match the intermediary with the characteristic that best describes its function.

1. Provide protection from adverse events
2. Pool funds of small savers and invest in either money or capital markets
3. Provide consumer loans and real estate loans funded by deposits
4. Accumulate and transfer wealth from work period to retirement period
5. Underwrite and trade securities and provide brokerage services

1. Thrifts
2. Insurers
3. Pension funds
4. Securities firms and investment banks
5. Mutual funds

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

27) Secondary markets help support primary markets because secondary markets:

1. offer primary market purchasers liquidity for their holdings.
2. update the price or value of the primary market claims.
3. reduce the cost of trading the primary market claims.

A) I
1only
B) II only
C) I
1and II only
D) II and III only
E) I
1, II, and III

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28) 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:
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.

29) 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. Money likely to be needed within six months
2. Money to be set aside for college in 10 years
3. Money to provide supplemental retirement income
4. 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
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

30) As of 2021, which one of the following derivatives instruments had the greatest amount of notional principal outstanding?
A) futures
B) swaps
C) options
D) bonds
E) forwards

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

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

32) The Securities Exchange Commission (SEC) does not:

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.

33) The most diversified type of depository institutions is:

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

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

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.

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

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.

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

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.

37) Money markets trade securities that:

1. mature in one year or less.
2. have little chance of loss of principal.
3. must be guaranteed by the federal government.

A) I
1only
B) II only
C) I
1and II only
D) I
1and III only
E) I
1, II, and III

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38) Which of the following are not capital market instruments?
A) 10-year corporate bonds
B) 30-year mortgages
C) 20-year Treasury bonds
D) 15-year U.S. government agency bonds
E) Treasury bills

39) Commercial paper is a:
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.

40) A negotiable CD is a:
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.

41) Financial intermediaries' ability to reduce the average cost of collecting information because of their efficient operations allows them to take advantage of:
A) asset transformation.
B) economies of scale.
C) economies of scope.
D) transformational trading.
E) standardization.

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42) Institutions that use technology to deliver financial solutions in a manner that competes with traditional financial methods are called:
A) credit unions.
B) savings associations.
C) fintech firms.
D) finance companies.
E) mutual funds.

43) Which of the following is a Fintech service that provides a system to support the exchange of value between two parties unknown to each other in a swift and effective way, without the use of financial intermediaries?
A) Blockchain
B) Wires
C) Money orders
D) Pay check cash advances
E) Zelle

44) Monitoring costs, liquidity costs, and price risk increase the attractiveness of holding cash and decrease financial market activity. Which of the following is a solution for investors to channel funds to users of the funds?
A) fintech
B) direct transfers
C) indirect transfers
D) thrifts
E) insurance companies

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

45) Discuss how secondary markets benefit issuers and investors.

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

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

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

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

50) 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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51) 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?

52) 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?

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

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

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55) 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.

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Answer Key

Test name: Chapter 01

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) FALSE
17) FALSE
18) C
19) A
20) A
21) A
22) E
23) B
24) D
25) D
26) C
27) E
28) D
29) D
30) B
31) A
32) A
33) C
34) E
35) D
36) C
37) C

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38) E
39) E
40) D
41) B
42) C
43) A
44) C
45) Short Answer
46) Short Answer
47) Short Answer
48) Short Answer
49) Short Answer
50) Short Answer
51) Short Answer
52) Short Answer
53) Short Answer
54) Short Answer
55) Short Answer

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