Financial Markets and Institutions 14th edition Madura Test Bank

SKU: 9780357988299-TEST-BANK

Chapter_01_Role_of_Financial_Markets_and_Institutions

True / False

1. If financial markets are efficient, this implies that all securities should earn the same return.
   a. True
   b. False

ANSWER: False

2. Securities represent a claim on the issuer.
   a. True
   b. False

ANSWER: True

3. Debt securities represent debt (borrowed funds) incurred by the issuer.
   a. True
   b. False

ANSWER: True

4. When security prices fully reflect all available information, the markets for these securities are said to be efficient.
   a. True
   b. False

ANSWER: True

5. If markets are perfect, securities buyers and sellers do NOT have full access to information and CANNOT always break down securities to the precise size they desire.
   a. True
   b. False

ANSWER: False

6. A broker executes securities transactions between two parties and charges a commission for the transaction.
   a. True
   b. False

ANSWER: True

7. The adoption of the euro by 20 European countries has increased business between those countries and created a more competitive environment in Europe.
   a. True
   b. False

ANSWER: True

8. In recent years, financial institutions have consolidated to capitalize on economies of scale and on economies of scope.
   a. True
   b. False

ANSWER: True

9. Securities represent a claim on the provider of funds.

a. True

b. False

ANSWER: False

10. Debt securities include commercial paper, Treasury bonds, and corporate bonds.

a. True

b. False

ANSWER: True

11. Common types of capital market securities include Treasury bills and commercial paper.

a. True

b. False

ANSWER: False

12. Common types of money market securities include negotiable certificates of deposit and Treasury bills.

a. True

b. False

ANSWER: True

13. Money market securities are commonly issued to finance the purchase of assets such as buildings, equipment, or machinery.

a. True

b. False

ANSWER: False

14. The total asset value of savings institutions is larger than that of commercial banks.

a. True

b. False

ANSWER: False

15. An asymmetric information problem arises when one party to a transaction has information that is not available to the other party, as when a corporation fails to tell investors the full extent of its losses.

a. True

b. False

ANSWER: True

16. Systemic risk is the risk that a large decline in one stock's price could cause investors to sell their stock in other companies.

a. True

b. False

ANSWER: False

17. The Sarbanes-Oxley Act requires firms to provide complete and accurate financial information and imposes penalties on key executives of the firm if financial fraud is detected.

a. True

b. False

ANSWER: True

18. Capital market securities are commonly issued in order to finance the purchase of assets such as buildings, equipment, or machinery.

a. True

b. False

ANSWER: True

19. Commercial banks in aggregate have more assets than credit unions.

a. True

b. False

ANSWER: True

20. The credit crisis in the 2008–2009 period was caused by weak economies in Asia.

a. True

b. False

ANSWER: False

21. Financial markets that facilitate the flow of short-term funds (with maturities of less than one year) are known as capital markets, while those that facilitate the flow of long-term funds are known as money markets.

a. True

b. False

ANSWER: False

22. Bonds commonly have maturities of one to three years.

a. True

b. False

ANSWER: False

23. As markets are efficient, institutional and individual investors should ignore the various investment instruments available.

a. True

b. False

ANSWER: False

24. Speculating with derivative contracts on an underlying asset typically results in both higher risk and higher returns than speculating in the underlying asset itself.

a. True

b. False

ANSWER: True

25. When security prices fully reflect all available information, the markets for these securities are said to be perfect.

a. True

b. False

ANSWER: False

26. Securities that are not as safe and liquid as other securities are never considered for investment by anyone.
   a. True
   b. False

ANSWER: False

27. By requiring full disclosure of information, securities laws prevent investors from making poor investment decisions.
   a. True
   b. False

ANSWER: False

28. When a depository institution offers a loan, it is acting as a creditor.
   a. True
   b. False

ANSWER: True

29. Savings institutions are a type of nondepository institution.
   a. True
   b. False

ANSWER: False

30. Most mutual funds raise funds by issuing securities and then lend the funds to individuals and small businesses.
   a. True
   b. False

ANSWER: False

31. Institutional investors provide financial support to companies and also exercise some degree of corporate control over them.
   a. True
   b. False

ANSWER: True

32. Valuing stocks is easier than valuing debt securities because stocks promise to provide investors with specific payments at regular intervals.
   a. True
   b. False

ANSWER: False

33. Most funds that insurance companies receive from premiums are invested in short-run money market securities.
   a. True
   b. False

ANSWER: False

Multiple Choice

34. Financial market participants who provide funds are called
   a. deficit units.
   b. surplus units.
   c. primary units.
   d. secondary units.

ANSWER: b

35. Which of the following is NOT an issuer of bonds?
   a. Households
   b. Corporations
   c. The U.S. Treasury
   d. Government agencies

ANSWER: a

36. Behavioral finance
   a. applies concepts from sociology and anthropology to the behavior of market participants.
   b. studies the behavior of financial markets in response to changes in Federal Reserve policy.
   c. applies psychology to financial decision making.
   d. explains why markets are efficient.

ANSWER: c

37. Financial markets that facilitate the flow of short-term funds are known as
   a. money markets.
   b. capital markets.
   c. primary markets.
   d. secondary markets.

ANSWER: a

38. Funds are provided to the initial issuer of securities in the
   a. secondary market.
   b. primary market.
   c. deficit market.
   d. surplus market.

ANSWER: b

39. Which of the following is a capital market instrument?
   a. Six-month certificate of deposit
   b. Three-month Treasury bill
   c. Ten-year bond
   d. Agreement for a bank to loan funds directly to a company for nine months

ANSWER: c

40. Which of the following is a money market security?
   a. Treasury note

b. Municipal bond
c. Mortgage
d. Commercial paper

ANSWER: d

41. The creditors in the federal funds market are
a. households.
b. depository institutions.
c. firms.
d. government agencies.

ANSWER: b

42. Investors in equity securities may earn a return from
a. coupon payments and the return of principal at the maturity date.
b. coupon payments and a capital gain when they sell the securities.
c. quarterly dividends (if paid) and a capital gain when they sell the securities.
d. quarterly dividends (if paid) and the return of principal at the maturity date.

ANSWER: c

43. Money market securities generally have
a. relatively low liquidity, low expected return, and a high degree of credit risk.
b. relatively high liquidity, high expected return, and a high degree of credit risk.
c. relatively low liquidity, high expected return, and a low degree of credit risk.
d. relatively high liquidity, low expected return, and a low degree of credit risk.

ANSWER: d

44. If security prices fully reflect all available information, the markets for these securities are
a. efficient.
b. primary.
c. overvalued.
d. undervalued.

ANSWER: a

45. When investors can use available information ignored by the market to earn abnormally high returns, markets are said to be
a. perfect.
b. active.
c. inefficient.
d. in equilibrium.

ANSWER: c

46. Which of the following is true of the Securities Act of 1933?
a. It required complete disclosure of relevant financial information for publicly offered securities in the primary market.

b. It declared trading strategies to manipulate the prices of public secondary securities illegal.

c. It imposed heavy penalties for insider trading.

d. It required complete disclosure of relevant financial information for securities traded in the secondary market.

ANSWER: a

47. The Securities and Exchange Commission (SEC) was established by the

a. Federal Reserve Act.

b. McFadden Act.

c. Securities Exchange Act of 1934.

d. Glass-Steagall Act.

e. None of these are correct.

ANSWER: c

48. Stock issued by a corporation is an example of a(n)

a. debt security.

b. money market security.

c. equity security.

d. debt security and a money market security.

ANSWER: c

49. All information about any securities for sale in primary and secondary markets would be continuously and freely available to investors if financial markets were considered

a. efficient.

b. inefficient.

c. perfect.

d. imperfect.

ANSWER: c

50. Which of the following is NOT a typical function of securities firms?

a. Providing brokerage services

b. Providing underwriting services

c. Accepting deposits that are insured by the federal government and using the funds to provide loans to corporations

d. Offering advice on mergers and other corporate restructurings

ANSWER: c

51. Without the participation of financial intermediaries in financial market transactions,

a. information and transaction costs would be lower.

b. transaction costs would be higher but information costs would be unchanged.

c. information costs would be higher but transaction costs would be unchanged.

d. information and transaction costs would be higher.

ANSWER: d

52. Which of the following is most likely to be described as a depository institution?

a. Finance company
b. Securities firm
c. Credit union
d. Pension fund

ANSWER: c

53. In aggregate, which of the following is the most dominant depository institution, with more total assets than other depository institutions?

a. Commercial banks
b. Savings banks
c. Credit unions
d. Savings and loan association

ANSWER: a

54. Which of the following is a nondepository financial institution?

a. Savings bank
b. Commercial bank
c. Savings and loan association
d. Mutual fund

ANSWER: d

55. Which of the following distinguishes credit unions from commercial banks and savings institutions?

a. Credit unions are nonprofit
b. Credit unions accept deposits but do not make loans.
c. Credit unions make loans but do not accept deposits.
d. Savings institutions restrict their business to members who share a common bond.

ANSWER: a

56. When a securities firm acts as a broker, it

a. guarantees the issuer a specific price for newly issued securities.
b. makes a market in specific securities by adjusting its own inventory.
c. executes securities transactions between two parties.
d. purchases securities for its own account.

ANSWER: c

57. When a securities firm makes a market in specific securities by maintaining an inventory of those securities, it is acting as a(n)

a. adviser.
b. dealer.
c. broker.
d. fiduciary.

ANSWER: b

58. Which institution obtains funds by issuing securities and then lending the funds to individuals and small businesses?

a. Finance company
b. Securities firm
c. Mutual fund
d. Insurance company

ANSWER: a

59. Which institution concentrates predominantly on mortgage loans?
a. Finance company
b. Commercial bank
c. Savings institution
d. Credit union

ANSWER: c

60. Which of the following securities has a maturity of one year or less and generally has relatively high liquidity?
a. Money market
b. Mutual fund
c. Capital market
d. Bond

ANSWER: a

61. Which of the following are NOT major investors in stocks?
a. Commercial banks
b. Insurance companies
c. Mutual funds
d. Pension funds

ANSWER: a

62. Which of the following financial intermediaries commonly invest in stocks and bonds?
a. Pension funds
b. Insurance companies
c. Mutual funds
d. Pension funds, insurance companies, and mutual funds.

ANSWER: d

63. A five-year security was purchased two years ago by an investor who plans to resell it. The investor will sell the security in the
a. secondary market.
b. primary market.
c. deficit market.
d. surplus market.

ANSWER: a

64. Financial markets facilitating the flow of short-term debt securities with maturities of one year or less are known as
a. secondary markets.

b. capital markets.

c. primary markets.

d. money markets.

ANSWER: d

65. Which of the following transactions would NOT be considered a secondary market transaction?

a. An individual investor purchases some existing shares of stock in Apple through her broker.

b. An institutional investor sells some Disney stock through its broker.

c. A firm that was privately held engages in an offering of stock to the public.

d. An investor sells some securities and purchases other securities.

ANSWER: c

66. If investors speculate in the underlying asset rather than in derivative contracts on the underlying asset, they will likely achieve what returns and be exposed to how much risk, respectively?

a. Lower; lower

b. Lower; higher

c. Higher; lower

d. Higher; higher

ANSWER: a

67. Which of the following maintains a larger amount of assets in aggregate than the other types of nondepository institutions?

a. Finance companies

b. Mutual funds

c. Life insurance companies

d. Securities firms

ANSWER: b

68. Participants who receive more money than they spend are referred to as

a. deficit units.

b. surplus units.

c. borrowing units.

d. government units.

ANSWER: b

69. Equity securities have which of the following features?

a. They have a maturity.

b. They pay interest on a periodic basis.

c. They represent ownership in the issuer.

d. They repay the principal amount at maturity.

ANSWER: c

70. Which of the following involves decisions such as how much funding to obtain and what types of securities to issue when financing operations?

a. Corporate finance
b. Investment management
c. Financial markets
d. Ethical decision making

ANSWER: a

71. Which type of relationship exists between the risk of a security and the expected return from investing in the security?
a. Positive
b. Negative
c. Indeterminable
d. Inverse

ANSWER: a

72. Which of the following is classified as a depository institution?
a. Credit unions
b. Pension funds
c. Finance company
d. Securities firms

ANSWER: a

73. The main reason depository institutions experienced financial problems during the credit crisis was their investment in
a. subprime mortgages.
b. money market securities.
c. stocks.
d. Treasury bonds.

ANSWER: a

74. Which of the following is NOT a reason depository financial institutions are popular?
a. They offer deposit accounts that can accommodate the amount and liquidity characteristics desired by most surplus units.
b. They repackage funds received from deposits to provide loans of the size and maturity desired by deficit units.
c. They accept the risk on loans that they provide.
d. They use their information resources to act as brokers, executing securities transactions between two parties.
e. They have more expertise than individual surplus units in evaluating the creditworthiness of deficit units.

ANSWER: d

75. Which of the following is NOT considered a money market security?
a. Treasury bills
b. Mortgage-backed security
c. Negotiable certificates of deposit
d. Commercial paper

ANSWER: b

76. Which of the following are NOT considered capital market securities?

a. Derivative securities
b. Treasury bonds
c. Corporate bonds
d. Equity securities

ANSWER: a

77. Which of the following are long-term debt obligations issued by corporations and government agencies to support their operations?
a. Common stocks
b. Derivative securities
c. Bonds
d. Mortgage-backed securities

ANSWER: c

78. Which of the following is an example of an asymmetric information problem?
a. A corporation releases toxic wastes into a river.
b. A corporation relocates to Ireland to take advantage of lower corporate tax rates.
c. A stock analyst rates a stock higher than it deserves because the securities firm she works for wants to obtain business from the corporation that issued the stock.
d. A corporation manipulates its financial information to avoid disclosing a large loss from its operations in China.

ANSWER: d

79. If a security's price decreases when sold by investors, what is the perception of those securities in the market?
a. They are undervalued.
b. They are overvalued.
c. They are fairly priced.
d. The market is operating efficiently.

ANSWER: b

80. Which of the following are NOT considered depository financial institutions?
a. Finance companies
b. Commercial banks
c. Savings institutions
d. Credit unions

ANSWER: a

81. The main source of funds for which of the following is proceeds from selling securities to households and businesses, while their main use of funds is providing loans to households and businesses?
a. Savings institutions
b. Commercial banks
c. Mutual funds
d. Finance companies

ANSWER: d

82. Which of the following statements about markets and investors is NOT true?
   a. Financial markets attract funds from investors and channel the funds to corporations.
   b. Money markets enable corporations to borrow funds on a short-term basis so that they can support their existing operations.
   c. Financial institutions serve solely as intermediaries with the financial markets and never serve as investors.
   d. Investors seek to invest their funds in the stock of firms that are presently undervalued and have much potential to improve.

ANSWER: c

83. Which of the following facilitates the exchange of currencies?
   a. Money market
   b. Foreign exchange market
   c. New York Stock Exchange
   d. Federal funds market

ANSWER: b

84. Which of the following applies psychology to financial decisions and offers an explanation for why markets are not always efficient?
   a. Psychological marketing
   b. Behavioral finance
   c. Inefficient markets theory
   d. Financial psychology

ANSWER: b

85. International integration of securities markets
   a. allows governments and corporations to have easier access to funding from creditors and investors in other countries.
   b. does not allow investors and creditors to benefit from investment opportunities in other countries.
   c. prevents one country's financial problems from adversely affecting other countries.
   d. causes governments and corporations to have less access to funding from creditors in other countries.

ANSWER: a

86. The foreign exchange market facilitates the exchange of
   a. information between investors in different countries.
   b. debt securities.
   c. equity securities.
   d. currencies.

ANSWER: d

87. If a depository institution is experiencing more deposits than it needs to make loans or invest in securities, it can lend its excess funds to another depository institution through the
   a. Federal Reserve's trading desk.
   b. options market.
   c. federal funds market.
   d. federal exchange market.

ANSWER: c

88. The risk that financial problems could spread among financial institutions and across financial markets, causing a collapse of the financial system, is known as

a. systemic risk.

b. leverage risk.

c. financial meltdown risk.

d. credit risk.

ANSWER: a

89. What is the primary reason that systemic risk exists?

a. There is no government regulation of financial markets.

b. Financial institutions invest in similar securities and therefore are similarly exposed to large declines in prices of those securities.

c. Financial institutions borrow using long-term debt securities but lend their funds for short-term periods.

d. Financial institutions invest heavily in Treasury securities and therefore are exposed to the possibility that the government will default on its debts.

ANSWER: b

90. Which of the following best describes systemic risk?

a. The risk that a few financial institutions will have financial problems

b. The risk that financial problems will spread across financial markets

c. The risk that all financial institutions will fail

d. The risk that the economy will experience high inflation

ANSWER: b

91. Mortgage defaults in 2008 contributed to the credit crisis and impacted financial institutions in all of the following ways EXCEPT that

a. mortgage defaults caused construction companies to lay off employees.

b. financial institutions invested heavily in mortgage-backed securities.

c. the price of mortgage-backed securities declined substantially.

d. the price of equities securities remained fairly stable.

ANSWER: d

92. Financial technology, or fintech, refers to

a. regulations imposed on financial institutions.

b. innovative technological products in the financial sector.

c. cryptocurrencies such as Bitcoin.

d. algorithms used for high-frequency trading.

ANSWER: b

93. Which of these is a way in which fintech provides accessible and efficient alternatives compared to traditional financial services?

a. Be reducing regulations for financial services

b. By providing automated investment platforms and advisory services

c. By allowing taxpayers to file at the click of a button
d. By offering retinal scanning for options transactions

ANSWER: b

94. Which of these was a key contributor to systemic risk during the 2008 financial crisis?
a. Many financial institutions invested heavily in mortgage-backed securities.
b. Financial institutions relied on long-term debt financing.
c. The prices of mortgages and mortgage-backed securities increased substantially.
d. Financial institutions relied on too many low-risk investments.

ANSWER: a

95. Which of the following is an example of a fintech innovation in banking?
a. Increased lending
b. Direct deposits
c. Automated clearinghouse payments
d. Predatory payday loan agencies

ANSWER: c

96. Fintech can benefit financial institutions in all but which of the following ways?
a. By providing innovative products to attract customers
b. By automating processes to reduce costs
c. By providing opportunities to charge higher interest rates
d. By facilitating regulatory compliance

ANSWER: c

97. Which of these is a potential risk associated with the growth of fintech?
a. Decreased competition from fintech companies
b. Security and privacy concerns with digital platforms
c. Too much opportunity for foreign investment
d. Regulation over new fintech products and red tape

ANSWER: b

98. Which type of financial institution is most vulnerable to systemic risk?
a. Commercial banks
b. Insurance companies
c. Investment banks
d. Credit unions

ANSWER: a

99. Which financial market innovation allows investors to trade securities using a mobile app?
a. Online trading platforms
b. Payment processing networks
c. Cryptocurrency exchanges
d. Robinhood

ANSWER: d

100. Regulatory technology (regtech) can benefit financial institutions in all but which of the following ways?
   a. By increasing efficiency in compliance processes
   b. By reducing the number of regulations
   c. By reducing costs associated with regulations
   d. By providing data analytics on transactions

ANSWER: b

101. Which of the following poses a challenge for the adoption of fintech globally?
   a. Similar regulatory environments across countries
   b. Consumer access to digital financial services
   c. Clear policymaking on emerging technologies
   d. Limited possibility of yielding cost savings

ANSWER: b