

New Chapter 17 questions

MATCHING

Complete the following using the terms listed.

- a. bonds
 - b. commercial banks
 - c. NASDAQ
 - d. credit unions
 - e. financial system

 - f. call provision
 - g. fourth market
 - h. financial institutions
 - i. securities

 - j. New York Stock Exchange
 - k. ATM's
 - l. limit order
 - m. debentures
 - n. market order
 - o. common stock
1. The process by which money flows from savers to users is called the ____.
 2. ____ represent obligations on the part of issuers to provide purchasers with expected or stated returns on the funds invested or loaned.
 3. By selling ____, a firm obtains long-term debt capital.
 4. ____ are backed only by the financial reputation of the issuing corporation.
 5. A ____ allows the issuer to redeem the bond before its maturity at a specified price.
 6. The basic form of corporate ownership is ____.
 7. The ____ is sometimes referred to as the Big Board—is the most famous and one of the oldest stock markets in the world, having been founded in 1792.
 8. All trading on the ____ takes place through its intranet, rather than on a trading floor.
 9. The ____ is the direct trading of exchange-listed stocks off the floor of the exchange, in the case of NYSE-listed stocks, or outside the network, in the case of NASDAQ-listed stocks.
 10. The most common type of order is called a _____. It instructs the broker to obtain the best possible price—the highest price when selling and the lowest price when buying.
 11. A ____ sets a price ceiling when buying or a price floor when selling.
 12. _____ serve as an intermediary between savers and borrowers, collecting funds from savers and then lending the funds to individuals, businesses, and governments.
 13. ____ are the largest and probably most important financial institution in the United States and in most other countries as well.

14. ____ allow customers to make banking transactions at any time by inserting an electronic card into the machine and entering a personal identification number.
15. ____ are cooperative financial institutions that are owned by their depositors, all of whom are members.

1.	ANS: E NAT: AACSB Analytic	DIF: 2	REF: Understanding the Financial System MSC: KN	
2.	ANS: I MSC: KN	DIF: 2	REF: Types of Securities	NAT: AACSB Analytic
3.	ANS: A MSC: KN	DIF: 2	REF: Types of Securities	NAT: AACSB Analytic
4.	ANS: M MSC: KN	DIF: 2	REF: Types of Securities	NAT: AACSB Analytic
5.	ANS: F MSC: KN	DIF: 2	REF: Types of Securities	NAT: AACSB Analytic
6.	ANS: O Analytic	DIF: 2 MSC: KN	REF: Financial Institutions	NAT: AACSB
7.	ANS: J MSC: KN	DIF: 2	REF: Financial Markets	NAT: AACSB Analytic
8.	ANS: C NAT: AACSB Analytic	DIF: 2	REF: Understanding Stock Markets MSC: KN	
9.	ANS: G NAT: AACSB Analytic	DIF: 2	REF: Understanding Stock Markets MSC: KN	
10.	ANS: N NAT: AACSB Analytic	DIF: 2	REF: Understanding Stock Markets MSC: KN	
11.	ANS: L NAT: AACSB Analytic	DIF: 2	REF: Understanding Stock Markets MSC: KN	
12.	ANS: H MSC: KN	DIF: 2	REF: Financial Markets	NAT: AACSB Analytic
13.	ANS: B Analytic	DIF: 2 MSC: KN	REF: Financial Institutions	NAT: AACSB
14.	ANS: K Analytic	DIF: 2 MSC: KN	REF: Financial Institutions	NAT: AACSB
15.	ANS: D Analytic	DIF: 2 MSC: KN	REF: Financial Institutions	NAT: AACSB

ESSAY

1. Describe how the financial system operates.

ANS:

The financial system is the process by which funds are transferred between savers and borrowers. In any economy there are units who have surplus funds (savers), and there are units in need of additional funds (borrowers or users). Savings are provided by households, businesses, and government. At the same time, borrowers also consist of households, businesses, and government. However, households save more than they borrow, while businesses and governments tend to be net borrowers. Funds can be transferred between savers and borrowers in two different ways: through the financial markets or through financial institutions.

DIF: 3

REF: Understanding the Financial System

2. Explain how saving changes as one ages.

ANS:

People often transition from net borrowers to net savers as they get older. When you graduate from college and begin a career, you likely have little in the way of savings. In fact, you may be deeply in debt. In the early years of your career, you may spend more than you make as you acquire major assets, such as a home. So in these early years your *net worth*—the difference between what you own and what you owe—is very low and may even be negative. However, as your career progresses and your income rises, you will begin to build a financial nest egg to fund retirement and other needs. Your net worth will also increase. It will continue to increase until you retire and begin drawing on your retirement savings.

DIF: 2

REF: Understanding the Financial System

NAT: AACSB Knowledge

MSC: AP

3. Explain the different types of bonds.

ANS:

Government bonds are bonds sold by the U.S. Department of the Treasury. Because government bonds are backed by the full faith and credit of the U.S. government, they are considered the least risky of all bonds.

Municipal bonds are bonds issued by state or local governments. Two types of municipal bonds exist: revenue and general obligation.

Corporate bonds are a diverse group and often vary based on the collateral—the property pledged by the borrower—that backs the bond.

Mortgage pass-through securities are backed by a pool of mortgage loans purchased from lenders, such as savings banks.

DIF: 2

REF: Types of Securities

NAT: AACSB Knowledge

MSC: AP

4. Explain the main features of common stock.

ANS:

Common stock is the basic form of corporate ownership. Purchasers of common stock are the true owners of a corporation. Holders of common stock vote on major company decisions, such as purchasing another company or electing a board of directors.

Common stockholders benefit from company success, and they risk the loss of their investments if the company fails.

DIF: 2

REF: Types of Securities

NAT: AACSB Knowledge

MSC: AP

5. Explain the difference between primary and secondary markets.

ANS:

In the **primary market**, firms and governments issue securities and sell them initially to the public. When a company needs capital to purchase inventory, expand a plant, make major investments, acquire another firm, or pursue other business goals, it may sell a bond or stock issue to the investing public.

The **secondary market** is a collection of financial markets in which previously issued securities are traded among investors. The corporations or governments that originally issued the securities being traded are not directly involved in the secondary market. They neither make any payments when securities are sold nor receive any of the proceeds when securities are purchased.

DIF: 2
MSC: AP

REF: Financial Markets

NAT: AACSB Knowledge

6. Explain how the fourth market has begun to open up to smaller, individual investors.

ANS:

The fourth market has opened up to smaller investors through *electronic communications networks* (ECNs). In ECNs, buyers and sellers meet in a virtual stock market and trade directly with one another. No specialist or market maker is involved.

DIF: 2
MSC: AP

REF: Financial Markets

NAT: AACSB Knowledge

7. What is the difference between a depository financial institution and a nondepository institution? Give an example of each.

ANS:

A depository institution accepts deposits, such as checking accounts, that are payable on demand to a specific individual or organization. Nondepository institutions acquire capital by raising investment capital and reinvesting earned income rather than through deposits. A commercial bank is an example of a depository institution; a life insurance company is an example of a nondepository institution.

DIF: 1
MSC: AP

REF: Financial Institutions

NAT: AACSB Reflective Thinking

8. Explain how banks operate.

ANS:

Banks raise funds by offering a variety of checking and savings deposits to customers. The banks then pool these deposits and lend most of them out in the form of consumer and business loans.

DIF: 1
MSC: AP

REF: Financial Institutions

NAT: AACSB Reflective Thinking

9. Explain what a mutual fund is and give an example of one.

ANS:

Mutual funds are financial intermediaries that raise money from investors by selling shares. They then use the money by investing in securities that are consistent with the mutual fund's objectives. For example, a stock mutual fund invests mainly in shares of common stocks.

DIF: 1
MSC: AP

REF: Financial Institutions

NAT: AACSB Reflective Thinking

10. What is the Federal Reserve's most important function? How does this function affect the nation's rate of inflation and employment?

ANS:

The Fed's most important function is controlling the supply of money and credit, known as monetary policy. The Fed's job is to make sure the money supply grows at an appropriate rate, allowing the economy to expand while inflation remains in check. If the money supply grows too quickly, inflationary pressures can build. If the money supply doesn't grow fast enough, the economy will slow and unemployment will increase.

DIF: 3
MSC: AP

REF: The Role of the Federal Reserve

NAT: AACSB Reflective Thinking

11. Explain the Federal Reserve's four major policy tools.

ANS:

The Fed's major policy tools are reserve requirements, the discount rate, open market operations, and term auction facility loans. If the Fed raises the reserve requirements, banks will have less money to lend, interest rates will rise, and economic growth will slow. Lowering the reserve requirement will have the opposite effect. The discount rate is the rate the Fed charges member banks for short-term loans. If the Fed wants to increase the money supply growth rate, it could lower the discount rate. The decrease will make it less expensive for banks to borrow funds. Banks in turn will lower the interest rate they charge borrowers. Open market operations consist of the Fed buying or selling U.S. government securities. If the Fed buys government securities, banks will have more money to lend and interest rates will fall. If the Fed sells government securities, banks will have less money to lend and interest rates will rise. Term auction facility loans are designed to provide liquidity to the financial markets by boosting bank reserves. Banks compete for short-term lending at favorable rates, secured by securities such as mortgage loans.

DIF: 3
NAT: AACSB Analytic

REF: The Role of the Federal Reserve
MSC: KN

12. Explain the government regulation of the financial markets and the role of the SEC.

ANS:

Regulation of U.S. financial markets is primarily a function of the federal government, although states also regulate them. Federal regulation grew out of various trading abuses during the 1920s. To restore confidence and stability in the financial markets after the 1929 stock market crash, Congress passed a series of landmark legislative acts that have formed the basis of federal securities regulation ever since. The U.S. Securities and Exchange Commission (SEC), created in 1934, is the principal federal regulatory overseer of the securities markets. The SEC's mission is to administer securities laws and protect investors in public securities transactions. The SEC has broad enforcement power. It can pursue civil actions against individuals and corporations.

DIF: 3

REF: Regulation of the Financial System

13. Describe the global financial environment.

ANS:

Major U.S. banks have extensive international operations. They accept deposits from, and make loans to, customers throughout the world. Foreign banks also operate throughout the world, including in the United States. Virtually all nations have a central bank, similar to the Federal Reserve, and these central banks play roles much like the Fed. Central bankers from various nations often act together, such as adjusting interest rates and buying or selling currencies, to improve global economic conditions.

DIF: 2

REF: The Financial System: A Global Perspective

NAT: AACSB Reflective Thinking

MSC: AP

MULTIPLE CHOICE

1. In the U.S. financial system, which of the following is a net saver?
- The government
 - Business
 - Households
 - Financial institutions

ANS: C

DIF: 1

REF: Understanding the Financial System

NAT: AACSB Analytic

MSC: KN

2. Zachary buys a bond issued by the city of Atlanta. This is an example of funds being transferred from a saver to a user _____.
- through the financial markets
 - through a financial institution
 - directly
 - through the government

ANS: A

DIF: 2

REF: Understanding the Financial System

NAT: AACSB Reflective Thinking

MSC: AP

3. One of the most important variables that determines how much a person saves is ____.
- the person's age
 - the person's gender
 - the person's race
 - what country they are from

ANS: A

DIF: 2

REF: Understanding the Financial System

NAT: AACSB Analytic

MSC: KN

4. The difference between what you own and what you owe is called ____.
- gross worth
 - net worth
 - net value
 - debt factor

ANS: B

DIF: 2

REF: Understanding the Financial System

NAT: AACSB Analytic

MSC: KN

5. Funds can be transferred between savers and users in two ways: ____.

- a. individually and groups
- b. in person and electronically
- c. free and not free
- d. directly and indirectly

ANS: D DIF: 1

REF: Understanding the Financial System

NAT: AACSB Analytic

MSC: KN

6. Indirect transfer of funds occurs through: ____.

- a. financial institutions
- b. financial markets
- c. personal checks
- d. both a and b

ANS: D DIF: 2

REF: Understanding the Financial System

NAT: AACSB Analytic

MSC: KN

7. Securities are also called ____.

- a. cash
- b. savings accounts
- c. financial instruments
- d. financial institutions

ANS: C DIF: 2

REF: Types of Securities NAT: AACSB Knowledge

MSC: AP

8. All of the following are types of securities except ____.

- a. money market instruments
- b. cash
- c. bonds
- d. stock

ANS: B DIF: 2

REF: Types of Securities NAT: AACSB Knowledge

MSC: AP

9. ____ are short-term debt securities issued by governments, financial institutions, and corporations.

- a. Money market instruments
- b. Bonds
- c. Checks
- d. Stock

ANS: A DIF: 2

REF: Types of Securities NAT: AACSB Knowledge

MSC: AP

10. Alex buys a money market instrument. It will mature in ____.

- a. ten years

- b. two years
- c. one year
- d. six months

ANS: C DIF: 2 REF: Types of Securities NAT: AACSB Reflective Thinking
MSC: AP

11. ____ are short-term securities issued by the U.S. Treasury and backed by the full faith and credit of the U.S. government. .
- a. Bonds
 - b. CD
 - c. Commercial paper
 - d. Treasury bills

ANS: D DIF: 2 REF: Types of Securities NAT: AACSB Knowledge
MSC: AP

12. Treasury bills have a minimum denomination of ____.
- a. \$100,000
 - b. \$1,000
 - c. 10,000
 - d. 100

ANS: B DIF: 3 REF: Types of Securities NAT: AACSB Knowledge
MSC: AP

13. _____ is a form of short-term financing sold by corporations, such as Salton Brands, that mature from 1 to 270 days after the date of issue.
- a. Commercial paper
 - b. CD
 - c. Treasury bills
 - d. Bonds

ANS: A DIF: 1 REF: Types of Securities NAT: AACSB Analytic
MSC: KN

14. A _____ is a time deposit at a financial institution, such as a commercial bank, savings bank, or credit union.
- a. Commercial paper
 - b. CD
 - c. Treasury bills
 - d. Bonds

ANS: B DIF: 1 REF: Types of Securities NAT: AACSB Analytic
MSC: KN

15. _____ are creditors of a corporation or government body

- a. Commercial paper holders
- b. CD holders
- c. Treasury bills holders
- d. Bondholders

ANS: D DIF: 1 REF: Types of Securities NAT: AACSB Analytic
MSC: KN

16. The US Department of Treasury sells what type of bonds?

- a. Government bonds
- b. Corporate bonds
- c. Treasury bills bonds
- d. Municipal bonds

ANS: A DIF: 1 REF: Types of Securities NAT: AACSB Analytic
MSC: KN

17. Two types of municipal bonds exist. What are they?

- a. Government bond and mortgage pass-through security bond
- b. Corporate bond and General Obligation bond
- c. Revenue bond and General Obligation Bond
- d. Revenue bond and Government Bond

ANS: C DIF: 3 REF: Types of Securities NAT: AACSB Knowledge
MSC: AP

18. Corporate bonds are a diverse group and often vary based on the ____ that backs it.

- a. collateral
- b. value
- c. market
- d. company

ANS: A DIF: 2 REF: Types of Securities NAT: AACSB Knowledge
MSC: AP

19. Tom just bought a bond from United Pet Group. This bond is only backed by the financial reputation of the company. What type of bond did Tom buy?

- a. unsecured bond
- b. debenture
- c. both a and b
- d. neither a nor b

ANS: C
Thinking

DIF: 3
MSC: AP

REF: Types of Securities NAT: AACSB Reflective

20. These securities are backed by a pool of mortgage loans purchased from lenders, such as savings banks.

- a. mortgage bond
- b. mortgage pass-through security
- c. both a and b
- d. corporate bond

ANS: B
MSC: KN

DIF: 2

REF: Types of Securities NAT: AACSB Analytic

21. Mortgage pass-through securities consist of pools of ____, loans made to borrowers with poor credit ratings.

- a. low value mortgages
- b. prime mortgages
- c. subprime mortgages
- d. corporate mortgages

ANS: C
MSC: KN

DIF: 2

REF: Types of Securities NAT: AACSB Analytic

22. Two factors determine the price of a bond: ____ and ____.

- a. market and risk
- b. risk and interest rate
- c. interest rate and discount rate
- d. price of other bonds and the company selling the bond

ANS: B
MSC: KN

DIF: 2

REF: Types of Securities NAT: AACSB Analytic

23. Bonds with ratings of BBB and above are classified as ____.

- a. investment-grade bonds
- b. speculative bond
- c. junk bonds
- d. corporate bonds

ANS: A
MSC: KN

DIF: 1

REF: Types of Securities NAT: AACSB Analytic

24. Other things being equal, the higher the interest rate, the _____ the price of a bond.

- a. same
- b. cannot be determined
- c. higher
- d. lower

ANS: C
MSC: KN

DIF: 1

REF: Types of Securities NAT: AACSB Analytic

25. What provision allows the issuer to redeem the bond before its maturity at a specified price?

- a. bond provision
- b. not such provision exists
- c. redeem provision
- d. call provision

ANS: D
MSC: KN

DIF: 1

REF: Types of Securities NAT: AACSB Analytic

26. The basic form of corporate ownership is _____.

- a. preferred stock
- b. common stock
- c. convertible securities
- d. standard stock

ANS: B
MSC: AP

DIF: 2

REF: Types of Securities NAT: AACSB Knowledge

27. An owner of which form of stock would receive dividend payments first?

- a. preferred stock
- b. common stock
- c. convertible securities
- d. standard stock

ANS: A
MSC: AP

DIF: 2

REF: Types of Securities NAT: AACSB Knowledge

28. What feature gives the bondholder or preferred stockholder the right to exchange the bond or preferred stock for a fixed number of shares of common stock?
- a. preferred stock
 - b. common stock
 - c. convertible securities
 - d. standard stock

ANS: C
MSC: AP

DIF: 2

REF: Types of Securities NAT: AACSB Knowledge

29. Securities are issued and traded in the_____.
- a. financial market
 - b. securities market
 - c. government market
 - d. super market

ANS: A
MSC: AP

DIF: 2

REF: Types of Securities NAT: AACSB Knowledge

30. When a company needs capital to purchase inventory, expand a plant, make major investments, acquire another firm, or pursue other business goals, it may sell a bond or stock issue to the investing public. This is done which market?
- a. primary market
 - b. secondary market
 - c. government market
 - d. super market

ANS: A
MSC: KN

DIF: 2

REF: Financial Markets NAT: AACSB Analytic

31. The _____ is a collection of financial markets in which previously issued securities are traded among investors.
- a. primary market
 - b. secondary market
 - c. government market
 - d. super market

ANS: B
MSC: KN

DIF: 2

REF: Financial Markets

NAT: AACSB Analytic

32. The two largest stock markets in the world are the ____ and the ____.
- a. New York Stock Exchange; SP 500
 - b. Tokyo Stock Exchange; New York Stock Exchange;
 - c. New York Stock Exchange; Nasdaq stock market
 - d. Tokyo Stock Exchange; London Stock Exchange

ANS: C
MSC: KN

DIF: 2

REF: Financial Markets

NAT: AACSB Analytic

33. Daily trading on the AMEX market is ____ shares.
- a. over 2 billion
 - b. less than 100 million
 - c. about 1 billion
 - d. over 10 billion

ANS: B
MSC: KN

DIF: 2

REF: Financial Markets

NAT: AACSB Analytic

34. The _____ is perhaps the most international of all stock markets.
- a. New York Stock Exchange
 - b. Tokyo Stock Exchange
 - c. Nasdaq stock market
 - d. London Stock Exchange

ANS: D
MSC: AP

DIF: 3

REF: Financial Markets

NAT: AACSB Knowledge

35. In ____ buyers and sellers meet in a virtual stock market and trade directly with one another.
- a. electronic communications networks
 - b. the Tokyo Stock Exchange
 - c. the Nasdaq stock market
 - d. online communications networks

ANS: A
MSC: AP

DIF: 3

REF: Financial Markets

NAT: AACSB Knowledge

36. The most common type of order is called a _____. It instructs the broker to obtain the best possible price—the highest price when selling and the lowest price when buying.
- a. fast order
 - b. stock order
 - c. limit order
 - d. market order

ANS: D
MSC: AP

DIF: 1

REF: Financial Markets

NAT: AACSB Knowledge

37. Which of the following is a depository financial institution?
- a. Credit union
 - b. Life insurance company
 - c. Pension fund
 - d. Mutual fund

ANS: A
NAT: AACSB Analytic

DIF: 1

REF: Financial Institutions

MSC: KN

38. Which of the following is a nondepository financial institution?
- a. Commercial bank
 - b. Savings bank
 - c. Life insurance company
 - d. Credit union

ANS: C
NAT: AACSB Analytic

DIF: 1

REF: Financial Institutions

MSC: KN

39. All of the following statements are correct EXCEPT _____.
- a. The number of commercial banks is declining each year
 - b. Commercial banks are prohibited from selling securities or insurance
 - c. Commercial banks are the most important financial institution
 - d. Banks offer the widest range of services of any financial institution

ANS: B
NAT: AACSB Analytic

DIF: 2

REF: Financial Institutions

MSC: KN

40. Commercial banks obtain most of their funds from _____.
- a. the government
 - b. the sale of securities
 - c. stockholders
 - d. depositors

ANS: D
NAT: AACSB Analytic

DIF: 1

REF: Financial Institutions

MSC: KN

41. Sean made a purchase at his local Wal-Mart. Instead of writing a check, Sean used a card issued by his bank with a Visa logo on the front. He entered his PIN and the purchase was automatically deducted from his checking account. Sean used his _____ card.
- a. debit
 - b. credit
 - c. ATM
 - d. point-of-sale

ANS: A DIF: 1 REF: Financial Institutions

NAT: AACSB Reflective Thinking MSC: AP

42. With the prominence of online banking, more than _____ of U.S. households currently do some or all of their banking via the Internet.
- a. two-thirds
 - b. one-half
 - c. one-third
 - d. one-fifth

ANS: C DIF: 3 REF: Financial Institutions

NAT: AACSB Analytic MSC: KN

43. Deposit insurance shifts most of the financial risk of bank failures from depositors to _____.
- a. the federal government
 - b. the bank's stockholders
 - c. borrowers
 - d. the bank's creditors

ANS: A DIF: 2 REF: Financial Institutions

NAT: AACSB Analytic MSC: KN

44. Which of the following financial institutions is organized as a not-for-profit cooperative?
- a. Commercial bank
 - b. Savings bank
 - c. Life insurance company
 - d. Credit union

ANS: D DIF: 1 REF: Financial Institutions

NAT: AACSB Analytic MSC: KN

45. Which of the following financial institutions would typically invest the largest portions of its funds in home mortgage loans?
- a. Commercial bank
 - b. Credit union
 - c. Savings bank
 - d. Life insurance company

ANS: C DIF: 2 REF: Financial Institutions

NAT: AACSB Analytic MSC: KN

46. Savings banks were originally established to make _____ loans.
- a. business
 - b. home mortgage
 - c. agricultural
 - d. automobile

ANS: B DIF: 2 REF: Financial Institutions

NAT: AACSB Analytic

MSC: KN

47. Nina's financial institution has an office next to where she works. Everyone who uses the financial institution's services either works for Nina's employer or is related to someone who does. Nina's financial institution is a _____.
- a. credit union
 - b. savings bank
 - c. commercial bank
 - d. state chartered bank

ANS: A

DIF: 2

REF: Financial Institutions

NAT: AACSB Reflective Thinking

MSC: AP

48. The process used by an insurance company to determine whom to insure and how much to charge is called _____.
- a. a premium
 - b. a insuring agreement
 - c. underwriting
 - d. indemnity

ANS: C

DIF: 2

REF: Financial Institutions

NAT: AACSB Analytic

MSC: KN

49. Which of the following financial institutions would invest the greatest percentage of its assets in common stocks and other long-term investments?
- a. Commercial bank
 - b. Property and liability insurance company
 - c. Credit union
 - d. Pension fund

ANS: D

DIF: 2

REF: Financial Institutions

NAT: AACSB Analytic

MSC: KN

50. What type of financial institution raises money from investors by selling shares?
- a. Mutual fund
 - b. Property and liability insurance company
 - c. Credit union
 - d. Pension fund

ANS: A

DIF: 2

REF: Financial Institutions

NAT: AACSB Analytic

MSC: KN

51. There are _____ Federal Reserve districts.
- a. 5
 - b. 8
 - c. 12
 - d. 15

ANS: C

DIF: 2

REF: The Role of the Federal Reserve

NAT: AACSB Analytic

MSC: KN

52. All of the following statements concerning the Fed are correct EXCEPT _____.
- a. the Fed is the nation's central bank
 - b. the Fed acts as the banker's bank
 - c. virtually all large commercial banks are Fed members

d. credit unions and savings banks must belong to the Fed

ANS: D DIF: 2 REF: The Role of the Federal Reserve
NAT: AACSB Analytic MSC: KN

53. All of the following are included in M1 EXCEPT _____.

- a. money market mutual funds
- b. total value of coins
- c. checking accounts
- d. currency in circulation

ANS: A DIF: 1 REF: The Role of the Federal Reserve
NAT: AACSB Analytic MSC: KN

54. M2 includes _____ M1.

- a. all of
- b. none of
- c. some of

ANS: A DIF: 2 REF: The Role of the Federal Reserve
NAT: AACSB Analytic MSC: KN

55. Which of the following is not one of the four major policy tools The Fed has for controlling the growth in the supply of money and credit?

- a. reserve requirements
- b. open market operations
- c. Term Auction Facility loans
- d. check clearing

ANS: D DIF: 3 REF: The Role of the Federal Reserve
NAT: AACSB Analytic MSC: KN

56. The rate the Fed charges member banks for short-term loans is called the _____.

- a. federal funds rate
- b. margin rate
- c. discount rate
- d. reserve requirement

ANS: C DIF: 1 REF: The Role of the Federal Reserve
NAT: AACSB Analytic MSC: KN

57. Which of the following interest rates does the Federal Reserve actually set?

- a. Discount rate
- b. Federal funds rate
- c. Government bond rate
- d. Commercial paper rate

ANS: A DIF: 2 REF: The Role of the Federal Reserve
NAT: AACSB Analytic MSC: KN

58. If the Fed reduced reserve requirements, _____.

- a. banks would have less money to lend businesses and consumers
- b. interest rates would fall

- c. inflation would decline
- d. economic growth would decline

ANS: B

DIF: 2

REF: The Role of the Federal Reserve

NAT: AACSB Reflective Thinking

MSC: AP

59. Which of the following actions would have the effect of increasing the supply of money and credit and lowering interest rates?
- a. The Fed buying government securities
 - b. The Fed raising the margin requirement
 - c. The Fed raising the reserve requirement
 - d. The Fed raising the discount rate

ANS: A

DIF: 2

REF: The Role of the Federal Reserve

NAT: AACSB Reflective Thinking

MSC: AP

60. When the Fed sells government securities, banks have _____ money to lend and economic growth _____.
- a. less; will slow
 - b. less; will accelerate
 - c. more; will slow
 - d. more; will accelerate

ANS: A

DIF: 2

REF: The Role of the Federal Reserve

NAT: AACSB Analytic

MSC: KN

61. Which of the following policy tools does the Fed use most frequently?
- a. Changes to the discount rate
 - b. Changes to the reserve requirement
 - c. Changes to margin requirements
 - d. Open market operations

ANS: D

DIF: 2

REF: The Role of the Federal Reserve

NAT: AACSB Analytic

MSC: KN

62. The chairman of the Federal Reserve Board can accelerate economic activity by lowering interest rates. What primary method does the Federal Reserve use to accomplish this?
- a. Open market operations
 - b. Increasing the discount rate
 - c. Increasing reserve requirements
 - d. Selling margin requirements

ANS: A

DIF: 2

REF: The Role of the Federal Reserve

NAT: AACSB Reflective Thinking

MSC: AP

63. This new monetary policy tool makes extra funds available to banks at low interest rates.
- a. Open market operations
 - b. Term Auction Facility
 - c. discount rate
 - d. reserve requirement

ANS: B

DIF: 2

REF: The Role of the Federal Reserve

NAT: AACSB Reflective Thinking

MSC: AP

64. Which of the following agencies regulates both state and federally chartered commercial banks?

- a. The Federal Reserve
- b. Federal Comptroller
- c. FDIC
- d. State banking agencies

ANS: C DIF: 2
 NAT: AACSB Analytic

REF: Regulation of the Financial System
 MSC: KN

65. The SEC requires virtually all new public issues of corporate securities to be registered. As part of the registration process for a new security issue, the issuer must prepare a ____.

- a. essay
- b. application
- c. prospectus
- d. financial report

ANS: C DIF: 1
 NAT: AACSB Analytic

REF: Regulation of the Financial System
 MSC: KN

66. ____ is defined as the use of material nonpublic information about a company to make investment profits.

- a. Insider Trading
- b. Outsider Trading
- c. Cheating
- d. Poor Regulation

ANS: A DIF: 1
 NAT: AACSB Analytic

REF: Regulation of the Financial System
 MSC: KN

67. Financial markets are regulated by ____.

- a. the SEC
- b. professional associations
- c. the major financial markets.
- d. all of the above

ANS: D DIF: 1
 NAT: AACSB Analytic

REF: Regulation of the Financial System
 MSC: KN

68. All market participants must keep detailed records of every aspect of every trade. What is this called?

- a. paper trail
- b. trade record
- c. audit trail
- d. none of the above

ANS: C DIF: 2
 NAT: AACSB Analytic

REF: Regulation of the Financial System
 MSC: KN

69. Out of the 30 largest banks in the world, _____ are U.S. banks.

- a. less than five

- b. between five and ten
- c. between ten and fifteen
- d. more than fifteen

ANS: A DIF: 2
NAT: AACSB Analytic

REF: The Financial System: A Global Perspective
MSC: KN

70. If the Fed pushes interest rates lower, policymakers at other nations' central banks will most likely?
- a. increase their rates
 - b. follow suit, and drop their rates as well
 - c. do nothing; the Fed's actions have no influence on other countries central banks
 - d. keep their rates the same because a drop in US rates will help their economy

ANS: B DIF: 2
NAT: AACSB Reflective Thinking

REF: The Financial System: A Global Perspective
MSC: AP

TRUE/FALSE

1. The financial system describes the process by which funds flow from savers to users.

ANS: T DIF: 1
NAT: AACSB Analytic

REF: Understanding the Financial System
MSC: KN

2. Businesses are net savers, while households are net users of funds.

ANS: F DIF: 1
NAT: AACSB Analytic

REF: Understanding the Financial System
MSC: KN

3. The vast majority of funds flow through direct transfers.

ANS: F DIF: 1
NAT: AACSB Analytic

REF: Understanding the Financial System
MSC: KN

4. Securities represent obligations on the part of issuers—businesses and governments—to provide purchasers with expected or stated returns on the funds invested or loaned.

ANS: T DIF: 1
NAT: AACSB Analytic

REF: Types of Securities
MSC: KN

5. Money market instruments are generally high-risk securities and are purchased by investors when they are in need of a quick resell.

ANS: F DIF: 1
NAT: AACSB Knowledge

REF: Types of Securities
MSC: AP

6. Treasury bills have a minimum denomination of \$1,000.

ANS: T DIF: 1
NAT: AACSB Knowledge

REF: Types of Securities
MSC: AP

7. Commercial paper is securities sold by corporations, such as General Electric, that mature from 1 to 270 months from the date of issue

ANS: F DIF: 2 REF: Types of Securities
NAT: AACSB Knowledge MSC: AP

8. Commercial paper is generally considered a very low-risk security

ANS: T DIF: 2 REF: Types of Securities
NAT: AACSB Knowledge MSC: AP

9. CDs with denominations of \$1,000,000 or less per depositor are federally insured.

ANS: F DIF: 2 REF: Types of Securities
NAT: AACSB Knowledge MSC: AP

10. Bonds are issued in various denominations—face values—usually between \$100 and \$2,500.

ANS: F DIF: 2 REF: Types of Securities
NAT: AACSB Knowledge MSC: AP

11. Bondholders are creditors, therefore they have a claim on the firm's assets that must be satisfied before any claims of stockholders in the event of the firm's bankruptcy, reorganization, or liquidation.

ANS: T DIF: 2 REF: Types of Securities
NAT: AACSB Knowledge MSC: AP

12. Jeff wants to purchase a low risk bond. Therefore, he should buy a government bond.

ANS: T DIF: 2 REF: Types of Securities
NAT: AACSB Reflective thinking MSC: AP

13. The treasury sells bonds that mature in 2, 5, 10, and 30 years from the date of issue.

ANS: T DIF: 2 REF: Types of Securities
NAT: AACSB Knowledge MSC: AP

14. Municipal bonds are bonds issued by the federal government.

ANS: F DIF: 2 REF: Types of Securities
NAT: AACSB Knowledge MSC: AP

15. A town is considering putting in a toll road that will produce revenue for the town. To provide funding, the town plans to sell *revenue bonds*.

ANS: T DIF: 2 REF: Types of Securities

NAT: AACSB Knowledge

MSC: AP

16. Municipal bonds are exempt of interest payments from federal income tax.

ANS: T

DIF: 2

REF: Types of Securities

NAT: AACSB Knowledge

MSC: AP

17. *Secured bonds* are backed by a specific pledge of company assets.

ANS: T

DIF: 2

REF: Types of Securities

NAT: AACSB Knowledge

MSC: AP

18. Mortgage pass-through securities are relatively safe, even when loans are made to borrowers with poor credit ratings.

ANS: F

DIF: 2

REF: Types of Securities

NAT: AACSB Analytic

MSC: KN

19. The *credit crisis* came about because of subprime mortgages.

ANS: T

DIF: 2

REF: Types of Securities

NAT: AACSB Analytic

MSC: KN

20. Bonds vary considerably in terms of risk. One tool used by bond investors to assess the risk of a bond is its so-called *risk rating*.

ANS: F

DIF: 2

REF: Types of Securities

NAT: AACSB Knowledge

MSC: AP

21. Bonds with the highest level of risk are rated AAA.

ANS: F

DIF: 2

REF: Types of Securities

NAT: AACSB Knowledge

MSC: AP

22. Bonds with ratings of BB and below are classified as speculative, or so-called junk, bonds.

ANS: T

DIF: 2

REF: Types of Securities

NAT: AACSB Knowledge

MSC: AP

23. Junk bonds pay about 70 percent more in interest than do investment-grade corporate bonds.

ANS: F

DIF: 2

REF: Types of Securities

NAT: AACSB Knowledge

MSC: AP

24. The price of a bond is affected by its interest rate.

ANS: T DIF: 2 REF: Types of Securities
NAT: AACSB Knowledge MSC: AP

25. The market interest rate does not have any affect on bond prices.

ANS: F DIF: 2 REF: Types of Securities
NAT: AACSB Knowledge MSC: AP

26. As market interest rates rise, bond prices fall.

ANS: T DIF: 2 REF: Types of Securities
NAT: AACSB Knowledge MSC: AP

27. Issuers tend to call bonds when market interest rates are declining.

ANS: T DIF: 2 REF: Types of Securities
NAT: AACSB Knowledge MSC: AP

28. Purchasers of preferred stock are the true owners of a corporation.

ANS: F DIF: 2 REF: Types of Securities
NAT: AACSB Knowledge MSC: AP

29. Owners of common stock expect returns on their investment in the form of cash dividend payments, expected price appreciation, or both.

ANS: T DIF: 2 REF: Types of Securities
NAT: AACSB Analytic MSC: KN

30. The market value of a stock is the price at which the stock is currently selling.

ANS: T DIF: 2 REF: Types of Securities
NAT: AACSB Analytic MSC: KN

31. In the long run stock prices tend to follow a company's revenues

ANS: F DIF: 2 REF: Types of Securities
NAT: AACSB Analytic MSC: KN

32. Preferred stockholders receive fixed dividends.

ANS: T DIF: 2 REF: Types of Securities
NAT: AACSB Analytic MSC: KN

33. Convertible bonds pay lower interest rates than those lacking conversion features

ANS: T DIF: 2 REF: Types of Securities
NAT: AACSB Analytic MSC: KN

34. In the secondary market, firms and governments issue securities and sell them initially to the public.

ANS: F DIF: 2 REF: Financial Markets
NAT: AACSB Analytic MSC: KN

35. When a company offers stock for sale to the general public for the first time, it is called an initial public offering.

ANS: T DIF: 2 REF: Financial Markets
NAT: AACSB Analytic MSC: KN

36. Securities are sold to the investing public in two ways: in open auctions and through investment bankers.

ANS: T DIF: 2 REF: Financial Markets
NAT: AACSB Analytic MSC: KN

37. Sales of most corporate and municipal securities are made via auctions.

ANS: F DIF: 2 REF: Financial Markets
NAT: AACSB Knowledge MSC: AP

38. The New York Stock Exchange (NYSE) is a secondary market.

ANS: T DIF: 2 REF: Financial Markets
NAT: AACSB Knowledge MSC: AP

39. Any firm can be listed on the New York Stock Exchange.

ANS: F DIF: 1 REF: Financial Markets
NAT: AACSB Knowledge MSC: AP

40. The Nasdaq is a computerized communications network that links member investment firms and it is the world's largest intranet.

ANS: T DIF: 1 REF: Financial Markets
NAT: AACSB Knowledge MSC: AP

41. Virtually all developed countries and many developing countries have stock exchanges.

ANS: T DIF: 1 REF: Financial Markets
NAT: AACSB Knowledge MSC: AP

42. Most investors are members of the NYSE, or other stock markets, and therefore they do not need to use the services of a brokerage firm to buy or sell stocks.

ANS: F DIF: 1 REF: Financial Markets
NAT: AACSB Reflective thinking MSC: AP

43. Nondepository institutions include life insurance companies, such as Northwestern Mutual; pension funds, such as the Florida state employee pension fund; and mutual funds.

ANS: T DIF: 1 REF: Financial Markets
NAT: AACSB Reflective thinking MSC: AP

44. The number of banks has declined dramatically in recent years because larger banks are buying smaller banks.

ANS: T DIF: 2 REF: Financial Institutions
NAT: AACSB Analytic MSC: KN

45. Banking fees and other “non-interest income” constitute approximately one-third of total bank revenue.

ANS: T DIF: 2 REF: Financial Institutions
NAT: AACSB Analytic MSC: KN

46. Deposit insurance means that, in the event the bank fails, depositors are paid in full by the FDIC, up to \$250,000.

ANS: T DIF: 2 REF: Financial Institutions
NAT: AACSB Analytic MSC: KN

47. Savings banks have greatly expanded their business lending activities in recent years while cutting back on their home mortgage lending activity.

ANS: F DIF: 2 REF: Financial Institutions
NAT: AACSB Analytic MSC: KN

48. In order to join a credit union, you have to share something in common with other credit union members.

ANS: T DIF: 1 REF: Financial Institutions
NAT: AACSB Analytic MSC: KN

49. Credit union deposits are insured by private insurance companies.

ANS: F DIF: 2 REF: Financial Institutions
NAT: AACSB Analytic MSC: KN

50. Underwriting is the process used by insurance companies to determine whom to insure and what to charge.

NAT: AACSB Analytic

MSC: KN

61. The discount rate is the rate banks charge one another for short-term loans.

ANS: F

DIF: 1

REF: The Role of the Federal Reserve

NAT: AACSB Analytic

MSC: KN

62. When the Fed buys government securities, it adds to the supply of money and credit, which causes a reduction in interest rates.

ANS: T

DIF: 2

REF: The Role of the Federal Reserve

NAT: AACSB Analytic

MSC: KN

63. Regulation of U.S. financial markets is primarily a function of the federal government; States do not regulate banks in any way.

ANS: F

DIF: 2

REF: Regulation of the Financial System

NAT: AACSB Analytic

MSC: KN

64. The SEC requires reports anytime an investor accumulates more than 5 percent of a company's outstanding stock

ANS: T

DIF: 2

REF: Regulation of the Financial System

NAT: AACSB Analytic

MSC: KN

65. The National Association of Securities Dealers (NASD) purpose is to ensure that brokers perform their basic functions honestly and fairly, under constant supervision.

ANS: T

DIF: 2

REF: Regulation of the Financial System

NAT: AACSB Analytic

MSC: KN

66. U.S. banks make few foreign investments due to regulatory restrictions.

ANS: F

DIF: 1

REF: The Financial System: A Global Perspective

NAT: AACSB Analytic

MSC: KN

67. Most nations do not have a central bank similar to the U.S. Federal Reserve.

ANS: F

DIF: 2

REF: The Financial System: A Global Perspective

NAT: AACSB Analytic

MSC: KN

68. Banks in other nations often respond to changes in the U.S. financial system by making similar changes in their own systems.

ANS: T

DIF: 2

REF: The Financial System: A Global Perspective

NAT: AACSB Analytic

MSC: KN