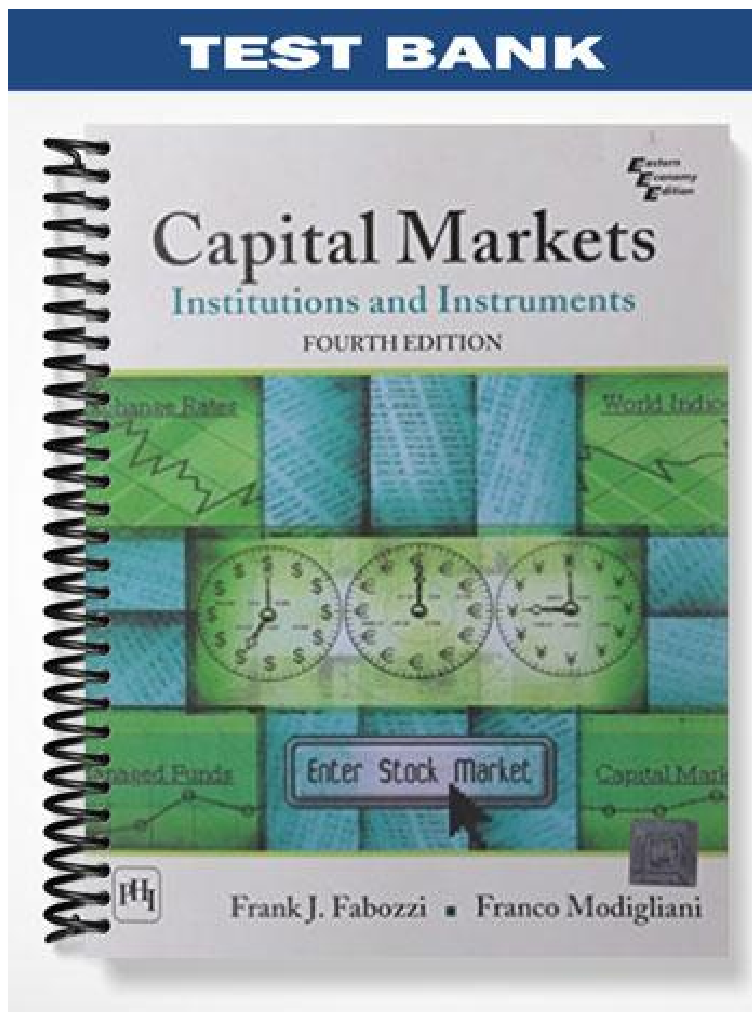
TEST BANK
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PHI
Frank J. Fabozzi
Franco Modigliani

TEST BANK
CAPITAL MARKETS: INSTITUTIONS AND INSTRUMENTS
FABOZZI/MODIGLIANI

Chapter 2

OVERVIEW OF MARKET PARTICIPANTS AND FINANCIAL INNOVATION

MULTIPLE CHOICE

1. Financial institutions provide which of the following services:
   a. Exchanging financial assets on behalf of customers.
   b. Providing investment advice.
   c. Managing portfolios
   d. Assisting in the creation of financial assets.
   * e. All of the above.

[E]

2. Treasury securities are debt obligations that are issued by:
   a. Municipal governments.
   b. Nonfinancial businesses.
   * c. Central governments.
   d. Financial enterprises.
   e. None of the above.

[E]

3. Depository institutions acquire the bulk of their funds by offering their liabilities to the public in the form of deposits. The depository institutions are:
   a. Commercial banks.
   b. Savings and loan associations.
   c. Savings banks.
   d. Credit unions.
   * e. All of the above.

[E]

4. Which of the following transactions is an example of direct investment?
   a. An investment company buys a portfolio of stocks and bonds.
   b. An individual makes a deposit at a commercial bank.
   c. Owning an equity claim against an investment company.
   * d. a and b only.
   e. All of the above.

[D]

5. Financial intermediaries transfer financial assets that are less desirable into other financial assets, which are more widely preferred by the public. This transformation involves which of the following economic functions?
   a. Providing maturity intermediation.
   b. Risk reduction via diversification.
   c. Reducing the costs of contracting and information processing.
   d. Providing a payments mechanism.
 * e. All of the above.

[E]

6. Maturity intermediation has implications for financial markets in that:
   a. Investors have more choices concerning the maturity of their investments.
   b. Borrowers have more choices for the length of their debt obligations.
   c. Investors will require that long-term borrowers pay a higher interest rate than on short-term borrowing.
   d. a and c only.
 * e. All of the above.

[M]

7. In contrast to individual investors, financial intermediaries will be willing to make longer term loans, and at a lower cost to borrowers, because:
 * a. They are counting on successive deposits providing the funds until maturity.
   b. Individual investors are more apt to make long-term loans.
   c. All risk is eliminated.
   d. None of the above.
   e. All of the above.

[D]

8. Investors who place their funds in an investment company, which in turn invests the funds received in the stock of a large number of companies benefit from:
   a. Diversification.
   b. Reduced risk.
   c. Lower cost.
 * d. All of the above.
   e. a and b only.

[D]

9. With a debit card,
   a. A bill is sent to the debit cardholder periodically requesting payment for transactions that have been made in the past.
   * b. Funds are immediately withdrawn from the purchaser's account at the time the transaction takes place.
   c. Funds are withdrawn periodically (usually once a month) for transactions made by the cardholder during the previous month.
   d. All of the above.
   e. None of the above.

[M]

10. Depository institutions seek to generate income by:
   a. The difference between the return that they earn on assets and the cost of their funds.
   b. Selling money for more than it costs to buy money.
   c. The bid-ask spread.
   * d. a and b only.
   f. None of the above.

[M]

11. A fixed-rate deposit represents what type of liability to a financial institution?
   * a. Type I liability.
   b. Type II liability.
   c. Type III liability.
   d. Type IV liability.
   e. None of the above.

[E]

12. Which of the following is true concerning a Type-II liability?
   a. Amount and timing of cash outlay are known.
   b. Amount and timing of cash outlay are unknown.
   * c. Amount of cash outlay is known while timing of cash outlay is unknown.
   d. Amount of cash outlay is unknown while timing of cash outlay is known.
   e. None of the above.

[M]

13. The advantage of liquidity which financial intermediaries offer savers means that savers may:
   a. Request the withdrawal of funds at any time.
   b. Redeem their shares at any time.
   c. Borrow against the cash value of their insurance policy.
   * d. All of the above.
   e. None of the above.

[M]

14. A perfectly competitive market is characterized by:
  a. Governmental regulation.
  b. Efficiency.
  c. Low-cost production.
* d. b and c only.
  e. All of the above.

[E]

15. "Market failure" is cited by economists as a reason for:
  a. Increased globalization.
* b. Regulation.
  c. Competition.
  d. Competitive markets.
  e. None of the above.

[E]

16. Government regulation of financial markets takes which of the following forms?
  a. Disclosure regulation.
  b. Financial activity regulation.
  c. Regulation of financial institutions.
  d. Regulation of foreign participants.
* e. All of the above.

[E]

17. When financial institutions' activities are restricted in the areas of lending, borrowing, and funding, the regulation is referred to as:
  a. Financial activity regulation.
  b. Disclosure regulation.
* c. Regulation of financial institutions.
  d. Regulation of foreign participants.
  e. None of the above.

[M]

18. Liquidity-generating innovations:
  a. Increase the liquidity of the market.
  b. Allow borrowers to draw upon new sources of funds.
  c. Allow market participants to circumvent capital constraints imposed by regulations.
  d. a and b only.
* e. All of the above.

[M]

19. One of the results of the financial innovations, which have occurred since the 1960, has been the introduction of market-broadening instruments, which increase the liquidity of markets and the availability of funds by:
    a. Attracting new investors.
    b. Offering new opportunities for borrowers.
    c. Reallocating financial risk to those less adverse to them.
  * d. a anb b only.
    e. All of the above.

[D]

20. The ultimate causes of financial innovations include:
    a. Increased volatility of interest rates, inflation, equity prices, and exchange rates.
    b. Advances in computer and telecommunication technologies.
    c. Financial intermediary competition.
    d. Changing global patterns of financial wealth.
  * e. All of the above.

[E]

TRUE/FALSE

1. When financial intermediaries acquire financial resources in the market, they create liabilities for themselves. They use those resources to create different and more widely preferred types of securities, which become their assets.
    a. True.
  * b. False.

[E]

2. The investments made by financial intermediaries in loans and/or securities are referred to as direct investment.
  * a. True.
    b. False.

[E]

3. As a result of the amount of funds managed by financial intermediaries, there are economies of scale in contracting and processing information about financial assets.
  * a. True.
    c. False.

[E]

4. The Securities Act of 193 and the Securities of Exchange Act of 1934 led to the creation of the Federal Reserve.
    a. True.
  * b. False.

[M]

5. Arbitraging instruments enable investors and borrowers to take advantage of differences in costs and returns between markets.
  * a. True.
  b. False.

[E]

ESSAY QUESTIONS

1. Explain how financial intermediaries provide at least one of four economic functions.

   Key Issues:
   a. Maturity intermediation.
   b. Risk reduction via diversification.
   c. Reducing the costs of contracting and information processing.
   d. Payments mechanism.

2. Discuss the primary reasons for financial innovation.

   Key Issues:
   a. Increased volatility of interest rates, inflation, equity prices, and exchange rates.
   b. Advances in computer and telecommunication technologies.
   c. Greater sophistication and educational training among professional market participants.
   d. Financial intermediary competition.
   e. Incentives to get around existing regulation and tax laws.
   f. Changing global patterns of financial wealth.

3. Describe the differences between direct and indirect investment and provide an example of each.

   Key Issues:
   a. Financial intermediaries obtain funds by issuing financial claims against themselves to market participants, then investing those funds.
   b. Financial intermediaries make investments in loans and/or securities.