Chapter 1
Role of Financial Markets and Institutions

1. Financial markets that facilitate the flow of long-term funds with maturities of more than one year are known as ____________.
   a. money markets
   b. capital markets
   c. primary markets
   d. secondary markets

2. Financial markets facilitating the issuance of new securities are known as ____________.
   a. money markets
   b. capital markets
   c. primary markets
   d. secondary markets

3. ____________ are not considered capital market securities.
   a. bonds
   b. mortgages
   c. retail CDs
   d. stocks

4. ____________ are financial contracts whose values are obtained from the values of underlying assets.
   a. Bonds
   b. Mortgages
   c. Stocks
   d. Derivatives

5. A bank's ________ quote is slightly higher than its ________ quote.
   a. ask; bid
   b. bid; ask
   c. ask; transaction
   d. transaction; bid

6. In a(n) ________ market, all information about any securities for sale is continuously and freely available to investors.
   a. inefficient
   b. efficient
   c. perfect
   d. imperfect

7. ____________ are depository financial institutions.
   a. Savings banks
   b. Finance companies
   c. Mutual funds
   d. Securities firms
8. In aggregate, ____________ are the most dominant depository institution.
   a. credit unions
   b. savings banks
   c. savings and loan associations
   d. commercial banks

9. ________ sell shares to surplus units and use the funds received to purchase a portfolio of securities. They are the dominant nondepository financial institution when measured in total assets.
   a. Securities firms
   b. Mutual funds
   c. Finance companies
   d. Pension funds

10. The main source of funds for ________________ is deposits from households, businesses, and government agencies, while their main use of funds is the purchase of government and corporate securities and mortgages and other loans to households.
    a. savings institutions
    b. commercial banks
    c. mutual funds
    d. finance companies

11. The federal government commonly acts as a surplus unit.
    a. True
    b. False

12. An investor who holds bonds has partial ownership in a corporation.
    a. True
    b. False

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

14. To prevent overreactions to rumors, so-called circuit breakers are now used to permanently halt the trading of some securities or contracts.
    a. True
    b. False

15. Securities firms can act both as brokers and as dealers.
    a. True
    b. False
Chapter 2
Determination of Interest Rates

1. According to the _____________________, market interest rates are determined by factors that control the supply of and demand for loanable funds.
   a. Fisher effect
   b. real interest rate
   c. loanable funds theory
   d. none of the above

2. From a business point of view, the opportunity cost of investing in short-term assets is ________ when interest rates are ________.
   a. higher; lower
   b. lower; higher
   c. higher; higher
   d. none of the above

3. ________ demand for funds is said to be interest-inelastic, or insensitive to interest rates.
   a. Household
   b. Business
   c. Federal government
   d. Foreign

4. The __________ interest rates are, the __________ will be the required return to implement a project, everything else being equal.
   a. higher; higher
   b. lower; higher
   c. higher; lower
   d. Answers b and c are correct.

5. If the aggregate __________ for loanable funds __________ without a corresponding increase in aggregate ________, there will be a shortage of loanable funds.
   a. supply; increases; demand
   b. demand; increases; supply
   c. demand; decreases; supply
   d. none of the above

6. At any interest rate _______ the equilibrium interest rate, there is a ________ of loanable funds.
   a. above; shortage
   b. below; surplus
   c. above; surplus
   d. none of the above

7. The expected impact of an increased expansion by businesses is an ________ shift in the demand schedule and __________ in the supply schedule.
   a. outward; inward
   b. inward; outward
   c. outward; outward
   d. outward; no obvious change
8. If inflation is expected to increase, this would result in an ________ shift in the supply curve of loanable funds and an ________ shift in the demand schedule for loanable funds.
   a. inward; outward
   b. outward; inward
   c. outward; outward
   d. inward; inward

9. If the nominal interest rate is 7%, and the expected inflation rate is 2%, what is the real interest rate according to the Fisher effect?
   a. 9%
   b. 5%
   c. 2%
   d. 7%

10. When the Fed ________ the money supply, there is ________ pressure on interest rates.
    a. increases; downward
    b. increases; upward
    c. decreases; downward
    d. none of the above

11. A ________ federal government deficit ________ the quantity of loanable funds demanded at any prevailing interest rate.
    a. higher; increases
    b. higher; decreases
    c. lower; increases
    d. none of the above

12. The quantity of loanable funds supplied is normally expected to be more elastic, meaning more sensitive to interest rates, than the quantity of loanable funds demanded.
   a. True
   b. False

13. The Fed controls the amount of reserves held by depository institutions and can influence the amount of savings that can be converted into loanable funds.
   a. True
   b. False

14. The equilibrium interest rates is the rate that equates the aggregate demand for funds with the aggregate supply of loanable funds.
    a. True
    b. False

15. If the nominal interest rate was equal to the expected inflation rate, the real interest rate would be zero.
    a. True
    b. False

16. If the federal government is willing to supply as many funds as desired by the market, this impact is known as the crowding-out effect.
    a. True
    b. False
Chapter 3
Structure of Interest Rates

1. Which of the following statements is true with respect to debt securities?
   a. Some types of debt securities always offer a higher yield than others.
   b. Debt securities offer very similar yield even if they exhibit different characteristics that influence the offered yield.
   c. In general, securities with favorable characteristics will offer higher yields to entice investors.
   d. All of the above are true with respect to debt securities.

2. Which of the following is not a characteristic affecting the yields on debt securities?
   a. default risk
   b. dividend yield
   c. tax status
   d. term to maturity

3. Some investors will __________ for a _______ degree of liquidity.
   a. accept a lower return; low
   b. require a higher return; high
   c. accept a lower return; high
   d. Answers b and c are correct.

4. Consider a taxable security that offers a before-tax yield of 13 percent. If the tax rate of an investor is 30 percent, the after-tax yield on the security will be ________ percent.
   a. 13.0
   b. 16.9
   c. 30.0
   d. 9.1

5. An investor is aware of a tax-free security that offers a yield of 5 percent. The investor is in the 20 percent tax bracket. What is the equivalent before-tax yield necessary to match the after-tax yield of the tax-exempt security?
   a. 5.0 percent
   b. 6.3 percent
   c. 20.0 percent
   d. 4.0 percent

6. The d curve indicates that Treasury securities with ____________ maturities offer higher annualized yields.
   a. upward sloping; shorter
   b. upward sloping; longer
   c. downward sloping; longer
   d. flat; longer

7. A(n) ______________ allows the issuer of bonds to buy the bonds back before maturity at a specified price.
   a. call feature
   b. convertibility clause
   c. debenture
   d. The bond rating helps investors to assess the creditworthiness of the security issuer.
8. Which of the following money market securities has the highest yield?
   a. commercial paper
   b. Treasury bills
   c. eurodollar deposits
   d. none of the above

9. The theory used to explain the term structure of interest rates which states that the preference for more liquid short-term securities placed upward pressure on the slope of the yield curve is the
   a. pure expectations theory.
   b. liquidity premium theory.
   c. segmented markets theory.
   d. preferred habitat theory.

10. According to the pure expectations theory, if interest rates are expected to increase, there is ________ pressure on the yield of short-term funds, and the yield curve should be __________ sloping.
    a. upward; upward
    b. upward; downward
    c. downward; upward
    d. downward; downward

11. The annualized yield on a three-year security is 11 percent; the annualized two-year interest rate is 10 percent, while the one-year interest rate is 8 percent. The one-year ahead forward rate is ________ percent.
    a. 1.9
    b. 14.1
    c. 12.0
    d. none of the above

12. Assume the one-year forward rate is 12.0 percent. The annualized yield on a three-year security is 11 percent; the annualized two-year interest rate is 10 percent, while the one-year interest rate is 8 percent. Based on this information, the two-year ahead forward rate is ________ percent.
    a. 1.9
    b. 13.1
    c. 10.0
    d. none of the above

13. The ________________ theory suggests that investors and borrowers normally concentrate on a particular natural maturity market.
    a. pure expectations
    b. liquidity premium
    c. segmented markets
    d. preferred habitat

14. Credit risk is particularly relevant for short-term securities.
    a. True
    b. False

15. Investors will require a higher yield on securities that contain the convertibility feature, other things being equal.
    a. True
    b. False
16. If liquidity influences the yield curve, the forward rate overestimates the market’s expectation of the future interest rate.
   a. True
   b. False

17. Some analysts believe that flat or inverted yield curves indicate a recession in the near future.
   a. True
   b. False

Chapter 4
Functions of the Fed

1. Which of the following is true with respect to the Federal Reserve Act of 1913?
   a. It established reserve requirements for nonmember commercial banks.
   b. It specified fourteen districts across the United States as well as a city in each district where a Federal Reserve district bank was to be established.
   c. Each district focused on its particular district, without much concern for other districts.
   d. All of the above are true.

2. The Fed earns most of its income
   a. by collecting taxes.
   b. in the form of interest on its holdings of U.S. government securities.
   c. from providing services to financial institutions.
   d. none of the above

3. The _____________ is made up of seven individual members, who are appointed by the president of the United States and confirmed by the Senate.
   a. Board of Governors
   b. Federal Open Market Committee
   c. Consumer Advisory Council
   d. Thrift Institutions Advisory Council

4. Which of the following is not true with respect to Fed member banks?
   a. Commercial banks can elect to become member banks if they meet specific requirements.
   b. All national banks are required to be members of the Fed.
   c. Banks chartered by their respective states are required to be members of the Fed.
   d. About 35 percent of all banks are members of the Fed.

5. The Federal Open Market Committee
   a. regulates commercial banks.
   b. controls the money supply.
   c. oversees the operations of the district banks.
   d. establishes regulations in consumer finance.
6. Which of the following is not a tool used by the Board of Governors in conducting monetary policy?
   a. reserve requirements
   b. discount rate
   c. money supply
   d. Treasury bill rate

7. The advisory committee offering views on consumer issues is the
   a. Consumer Advisory Council
   b. Thrift Institutions Advisory Council
   c. Federal Advisory Council
   d. none of the above

8. If the Trading Desk _________ government securities, the money supply would be ___________.
   a. purchases; tightened
   b. purchases; loosened
   c. sells; loosened
   d. Answers a and c are correct.

9. To decrease money supply growth, the Fed could ________________.
   a. sell government securities in the secondary market
   b. decrease the discount rate
   c. reduce the reserve requirement ratio
   d. none of the above

10. Which of the following is the broadest measure of money?
    a. M1
    b. M2
    c. M3
    d. M4

11. The Depository Institutions Deregulation and Monetary Control Act (DIDMCA) ________________.
    a. mandates that all depository institutions be subject to the same reserve requirements imposed by the Fed
    b. requires all depository institutions to report their deposit levels promptly to the Fed
    c. allows all depository institutions that offer transaction accounts to have access to the discount window
    d. all of the above

12. Before DIDMCA, member banks of the Federal reserve were subject to its reserve requirements, and nonmember banks were subject to the reserve requirements of their respective states.
    a. True
    b. False

13. Because of the euro, any participating country is allowed to solve local economic problems with its own unique monetary policy.
    a. True
    b. False
14. The federal funds rate is the interest rate charged on Fed district loans to depository institutions.
   a. True
   b. False

15. If the Fed desires to increase the aggregate level of bank funds for only a few days, the Trading Desk may trade repurchase agreements rather than government securities.
   a. True
   b. False

Chapter 5
Monetary Theory and Policy

1. A sale of Treasury securities by the Fed leads to a(n) ___________ in interest rates and a(n) ___________ in the level of business investment.
   a. increase; decrease
   b. decrease; decrease
   c. increase; increase
   d. decrease; increase

2. To correct a weak economy, the Fed would use open market operations to __________ the money supply, which would __________ interest rates and encourage more borrowing and spending.
   a. decrease; reduce
   b. increase; reduce
   c. decrease; increase
   d. increase; increase

3. Under pure Keynesian theory, the Fed could slow economic growth by _______ Treasury securities, which would _______ pressure on interest rates.
   a. buying; upward
   b. buying; downward
   c. selling; upward
   d. selling; downward

4. The modern quantity theory of money revised the original quantity theory by
   a. relaxing the stable-velocity of money assumption.
   b. relaxing the stable-price assumption.
   c. relaxing the stable-quantity assumption.
   d. none of the above.

5. The monetary theory suggesting how the Fed can affect the interaction between the demand for money and the supply of money to influence interest rates is the
   a. quantity theory.
   b. modern quantity theory of money.
   c. pure Keynesian theory.
   d. theory of rational expectations.
6. The monetary theory that advocates a natural rate of unemployment is the
   a. quantity theory.
   b. modern quantity theory of money.
   c. pure Keynesian theory.
   d. theory of rational expectations.

7. Which of the following is a goal the Fed is trying to achieve consistently?
   a. low inflation
   b. high interest rates
   c. slow GDP growth
   d. high unemployment

8. The Phillips curve illustrates the tradeoff between
   a. interest rates and inflation.
   b. GDP growth and inflation.
   c. nominal interest rates and real interest rates
   d. unemployment and inflation.

9. The ________________ is not an indicator of inflation.
   a. national income
   b. producer price index
   c. consumer price index
   d. wage rates

10. The ________________ is the lag between the time a problem arises and
    the time it is recognized.
    a. implementation lag
    b. recognition lag
    c. impact lag
    d. none of the above

11. Which of the following markets is not influenced by monetary policy?
    a. money market
    b. bond market
    c. stock market
    d. All of the above are influenced by monetary policy.

12. The portion of high inflation due to excessive spending that is pulling up prices is
    referred to as supply-pull inflation.
    a. True
    b. False

13. A credit crunch may partially offset the desired effects of a stimulative monetary
    policy and magnify the effects of a restrictive monetary policy.
    a. True
    b. False

14. If the Fed loosens the money supply to offset a reduced demand for loanable
    funds by the federal government, this action is known as monetizing the debt.
    a. True
    b. False
15. A weak dollar can stimulate U.S. exports, discourage U.S. imports, and therefore stimulate the U.S. economy.
   a. True
   b. False

Chapter 6
Money Markets

1. Which of the following is not a money market security?
   a. Treasury bill
   b. commercial paper
   c. bond
   d. repurchase agreement

2. Treasury bills
   a. offer coupon payments.
   b. are sold at a discount from par value.
   c. have a yield equal to the coupon rate.
   d. are not sold in the secondary market.

3. An investor purchases a six-month (182-day) T-bill with a $10,000 par value for $9,850. If the investor holds the Treasury bill to maturity, his annualized yield is _____ percent.
   a. 1.52
   b. 1.50
   c. 3.05
   d. 3.01

4. An investor purchases a six-month (182-day) T-bill with a $10,000 par value for $9,850. If the investor holds the Treasury bill to maturity, the Treasury bill discount yield is ______ percent.
   a. 3.05
   b. 2.97
   c. 3.01
   d. none of the above

5. An investor purchases a six-month (182-day) T-bill with a $10,000 par value for $9,850. If the investor had sold the T-bill after 100 days for $9,940, her annualized yield would be ______ percent.
   a. 3.34
   b. 3.29
   c. 1.83
   d. 1.80

6. At a given point in time, the yield on commercial paper is __________ the yield on a T-bill with the same maturity.
   a. slightly lower than
   b. slightly higher than
   c. about equal to
   d. none of the above
7. An investor purchases 270-day commercial paper with a par value of $2,000,000 for a price of $1,960,000. The yield is ______ percent.
   a. 2.76
   b. 2.67
   c. 2.72
   d. none of the above

8. Which of the following financial institutions does not frequently participate in repurchase agreements?
   a. banks
   b. savings and loan associations
   c. money market funds
   d. All of the above frequently participate in repos. d

9. __________ are the most active participants in the federal funds market.
   a. Savings banks
   b. Investment banks
   c. Large corporations
   d. Commercial banks

10. If short-term interest rates decline, the required rate of return on money market securities will ________, and the values of money market securities will ________.
    a. increase; decline
    b. decline; increase
    c. decline; decline
    d. increase; increase d

11. Which of the following securities probably has the lowest degree of default risk?
    a. Treasury bill
    b. negotiable certificate of deposit
    c. banker's acceptance
    d. all of the above have the same degree of default risk

12. __________ have the highest degree of interest rate risk.
    a. Fixed-rate eurodollar CDs
    b. Eurodollar floating-rate CDs (FRCDs)
    c. Floating-rate eurodollar loans
    d. All of the above are affected equally by an increase in interest rates.

13. The yield of a newly issued Treasury bill that is held to maturity will always be lower than the Treasury bill discount.
    a. True
    b. False a

14. Commercial paper is a short-term debt instrument issued only by well-known, credit-worthy firms and is typically unsecured.
    a. True b. False

15. When firms sell their commercial paper at a lower price than projected, their cost of raising funds will be higher than they initially anticipated.
    a. True b. False

16. There is an active secondary market for repos.
    a. True b. False
17. During periods of heightened uncertainty about the economy, investors tend to shift from risky money market securities to Treasury securities.
   a. True
   b. False

Chapter 7
Bond Markets

1. Which of the following statements is correct?
   a. Federal agency bonds are issued by the Treasury.
   b. Municipal bonds are issued by the federal government.
   c. Corporate bonds are issued by corporations.
   d. All of the above are correct.

2. Investors in Treasury notes and bonds receive ______ interest payments from the Treasury.
   a. quarterly
   b. semiannual
   c. annual
   d. none of the above

3. __________ bids are often used at auctions because many bidders want to purchase more Treasury bonds than the maximum that can be purchased otherwise.
   a. Competitive
   b. Noncompetitive
   c. Average
   d. none of the above

4. (Financial calculator required.) An investor can purchase a bond with ten years remaining until maturity, a par value of $1,000, and a 7 percent annual coupon rate for $1,050. The yield to maturity is _____ percent.
   a. 6.31
   b. 7.00
   c. 3.16
   d. none of the above

5. The bid price for a bond with a $100,000 par value is quoted as 110:11. Thus, the bid price for the bond is __________.
   a. $110,688
   b. $110,344
   c. $111,375
   d. none of the above

6. Stripped securities:
   a. were originally created by securities firms in the early 1980s.
   b. are issued by the Treasury.
   c. have to be held until maturity.
   d. all of the above
7. Which of the following is not an issuer of federal agency bonds?
   a. Government National Mortgage Association (Ginnie Mae)
   b. Federal Home Loan Mortgage Association (Freddie Mac)
   c. Federal National Mortgage Association (Fannie Mae)
   d. All of the above are issuers of federal agency bonds.

8. Payments on __________ bonds are supported by the municipal government's ability to tax.
   a. general obligation
   b. revenue
   c. treasury
   d. corporate

9. The requirement that a firm retire a certain amount of the bond issue each year is the _____________.
   a. indenture
   b. call provision
   c. sinking-fund provision
   d. convertibility clause

10. A __________ is secured by personal property.
    a. first mortgage bond
    b. chattel mortgage bond
    c. debenture
    d. subordinated debenture

11. The popularity of junk bonds in the 1990s declined because of:
    a. allegations of insider trading against some participants in the junk bond market.
    b. financial problems in the thrift industry.
    c. increased regulation.
    d. all of the above.

12. Callable bonds are _______ likely to be called when interest rates _________.
    a. less; decline
    b. more; decline
    c. more; increase
    d. none of the above

13. Registered bonds require the owner to clip coupons attached to the bonds and send them to the issuer to receive coupon payments.
    a. True
    b. False

14. Treasury bonds are registered over-the-counter, but the secondary market trading occurs at the New York Stock Exchange.
    a. True
    b. False

15. Common purchasers of corporate bonds include many financial and some nonfinancial institutions, as well as individuals.
    a. True
    b. False

16. Investors in zero-coupon bonds are taxed annually on the amount of interest earned, even though much or all of the interest will not be received until maturity.
    a. True
    b. False
Chapter 8
Bond Valuation and Risk

1. (Financial calculator required.) An investor would like to purchase a bond that has a par value of $1,000 and pays $60 at the end of each year in coupon payments. The bond has seven years remaining until it matures. If the prevailing annualized yield on other bonds with similar characteristics is 5 percent, how much should the investor be willing to pay for the bond?
   a. $1,000.00
   b. $1,057.86
   c. $944.18
   d. none of the above

2. Jerry Garcia purchased a $1,000 par value bond with a 9 percent annual coupon rate and an original maturity of 20 years. The bond was issued four years ago, and the yield to maturity is 11 percent. What is the price Mr. Garcia should be willing to pay for this bond?
   a. $1,166.25
   b. $1,000
   c. $852.42
   d. $840.73

3. If a bond pays interest semiannually, which of the following adjustments needs to be made to correctly compute the price of the bond?
   a. The number of years should be split in half.
   b. The annualized coupon should be doubled.
   c. The annual yield to maturity should be divided by 2.
   d. The par value should be split in half.

4. A private investor is considering the purchase of a $1,000 par value bond paying interest semiannually. The bond has an annualized coupon rate of 8 percent, and bonds with similar characteristics pay interest rates of 6 percent. The bond has 15 years remaining to maturity. A fair price for the bond is $_________.
   a. 1,000.00
   b. 1,196.00
   c. 1,194.24
   d. 827.08

5. If a bond sells above its par value, it is called a __________ bond.
   a. discount
   b. premium
   c. callable
   d. convertible

6. If the coupon rate of a bond is _______ the yield to maturity, the price of the bond should be _________ the par value.
   a. below; above
   b. above; below
   c. above; above
   d. above; the same as
7. A _________ than expected level of inflation will put _________ pressure on the value of bonds.
   a. higher; downward  
   b. higher; upward  
   c. lower; downward  
   d. none of the above

8. A zero-coupon bond sells for $1,000. Assume that the required rate of return changes from 6 percent to 5 percent. As a result, the price of the zero bond increases to $1,070. What is the bond price elasticity for this bond?
   a. -7.00  
   b. -0.42  
   c. 0.42  
   d. 7.00

9. A bond has a par value of $1,000 and pays $100 in interest every year. The bond has three years remaining to maturity, and the yield to maturity is 8 percent. What is the duration of this bond?
   a. 2.74 years  
   b. 1.23 years  
   c. 2.64 years  
   d. none of the above

10. Refer to question 9. The modified duration of this bond is _________ years.
    a. 2.40  
    b. 1.14  
    c. 2.54  
    d. none of the above

11. Three bonds comprise a portfolio that is valued at $500,000. The investment in the first bond is $100,000, the investment in the second bond is $200,000, and the investment in the third bond is $200,000. The first bond has a duration of 1.8 years, the second bond has a duration of 1.7 years, and the third bond has a duration of 2.0 years. What is the duration of the portfolio of bonds?
    a. 1.84 years  
    b. 1.50 years  
    c. 1.69 years  
    d. none of the above

12. In the ____________ strategy, funds are evenly allocated to bonds in each of several different maturity classes.
    a. matching  
    b. laddered  
    c. barbell  
    d. interest rate

13. Strong economic growth tends to place downward pressure on interest rates.
    a. True  
    b. False

    a. True  
    b. False
15. From the perspective of the investing institution, the most attractive foreign bonds offer a high coupon rate and are denominated in a currency that strengthens over the investment horizon.
   a. True
   b. False

Chapter 9
Mortgage Markets
1. Which of the following is not typically included in a mortgage contract?
   a. whether the mortgage is federally insured
   b. the amount of the loan
   c. whether the interest rate is fixed or adjustable
   d. the tenure of the bank manager drawing up the contract

2. The ________ is a guarantor of federally insured mortgages.
   a. Federal Housing Administration (FHA)
   b. Federal Reserve System
   c. U.S. Treasury
   d. Internal Revenue Service

3. Most of the monthly mortgage payment reflects ________ during the later years of a mortgage.
   a. principal reduction
   b. interest payments
   c. dividend payments
   d. cannot answer without more information

4. With a ________ mortgage, initially interest payments are made for a three- to five-year period. At the end of this period, the borrower must pay the full amount of the principal.
   a. shared-appreciation
   b. balloon-payment
   c. graduated-payment
   d. growing-equity

5. A __________ mortgage offers initially low payments; the payments continue to increase throughout the life of the loan.
   a. balloon-payment
   b. shared-appreciation
   c. graduated-payment
   d. growing-equity

6. Savings institutions and commercial banks are most active in the __________ mortgage market.
   a. one- to four-family
   b. multi-family
   c. commercial
   d. farm

7. Which of the following institutions hold the largest percentage of mortgages?
   a. savings institutions
   b. commercial banks
   c. life insurance companies
   d. credit unions
8. A relatively _______ level of money supply growth tends to place _______ pressure on the risk-free interest rate.
   a. high; upward
   b. low; downward
   c. high; downward
   d. none of the above

9. Mortgage prices are affected by all of the following, except:
   a. expectations of inflation.
   b. economic growth.
   c. the budget deficit.
   d. Mortgage prices are affected by all of the above.

10. ____________ risk is the risk that a borrower may prepay the mortgage in response to a decline in interest rates.
    a. Prepayment
    b. Interest rate
    c. Credit
    d. none of the above

11. ____________ are mortgage pass-through securities that are similar to Ginnie Mae mortgage-backed securities, except that they are backed by conventional rather than FHA or VA mortgages.
    a. Fannie Mae mortgage-backed securities
    b. Participation certificates (PCs)
    c. Publicly issued pass-through securities (PIPs)
    d. Collateralized mortgage obligations (CMOs)

12. Publicly issued pass-through securities are issued by ____________.
    a. Ginnie Mae
    b. private insurance companies
    c. Fannie Mae
    d. Freddie Mac

13. For the lending institution, interest rate risk is higher for fixed-rate mortgages than for adjustable-rate mortgages.
    a. True
    b. False

14. A second mortgage must be used independently of the first mortgage.
    a. True
    b. False

15. Securitization refers to the pooling and repackaging of loans into securities.
    a. True
    b. False

16. The price of a mortgage increases as a result of a strong economic growth.
    a. True
    b. False
Chapter 10
Stock Offerings and Investor Monitoring

1. Stocks are issued by corporations that need ______________.
   a. short-term funds
   b. long-term funds
   c. debt with a fixed interest rate
   d. none of the above

2. A firm has two million shares outstanding. The total value of the firm is $500 million. The price per share of stock is $______.
   a. 25.00
   b. 40.00
   c. 250.00
   d. none of the above

3. Preferred stock:
   a. allows for the same voting rights as common stock.
   b. represents debt.
   c. does normally not allow its owners to participate in the profits of the firm beyond the stated fixed annual dividend.
   d. is generally a more desirable source of capital for a firm than bonds.

4. Before a firm goes public:
   a. it develops a prospectus and files it with the Securities and Exchange Commission (SEC).
   b. it ultimately sends the prospectus to investors who may want to invest in the initial public offering (IPO).
   c. it attempts to gauge the price that will be paid for its shares.
   d. all of the above

5. The transaction cost to the issuing firm associated with an IPO is usually _____ percent of the funds raised.
   a. 1
   b. 3
   c. 7
   d. 12

6. Flipping:
   a. refers to the purchase of a stock at the offer price and subsequent sale of the stock shortly afterward.
   b. refers to the short sale of a stock at the offer price and subsequent purchase of the stock shortly afterward.
   c. may place excessive upward pressure on the stock's price.
   d. is illegal.

7. There is evidence that IPOs of firms perform _______ immediately after issuance and _______ over a period of a year or longer, on average.
   a. well; well
   b. poorly; poorly
   c. well; poorly
   d. poorly; well

8. The ______________ is a telecommunications network.
   a. American Stock Exchange
   b. New York Stock Exchange
c. Pacific Stock Exchange
d. NASDAQ

9. The _________ lists stocks that have a price below $1 per share (penny stocks).
a. NASDAQ National Market
b. OTC Bulletin Board
c. New York Stock Exchange
d. none of the above

10. _______ stocks are listed on the New York Stock Exchange, and these stocks have a ______ aggregate market value than the stocks listed on the NASDAQ.
   a. Fewer; lower
   b. More; higher
   c. Fewer; higher
   d. More; lower

11. A company pays an annual dividend of $2 per share. The stock's prevailing price is $54. The dividend yield is ________ percent.
   a. 2.00
   b. 2.70
   c. 3.70
   d. none of the above

12. The ______________ is a price-weighted average of stock prices of 30 large U.S. firms.
   a. Dow Jones Industrial Average
   b. Standard and Poor's 500
   c. Russell 3000
   d. Wilshire 5000

13. __________ represent a barrier to corporate control.
   a. Proxy contests
   b. Antitakeover amendments
   c. Shareholder lawsuits
d. Stock repurchases

14. ______________ are special rights awarded to shareholders or specific managers upon specified events.
   a. Antitakeover amendments
   b. Poison pills
   c. Golden parachutes
d. none of the above

15. If an IPO stock is quickly sold by investors in the secondary market, there will be downward pressure on the stock’s price.
   a. True
   b. False

16. A secondary stock offering is a new stock offering by a specific firm whose stock is not yet publicly traded.
   a. True
   b. False

17. With shelf registration, a corporation can fulfill SEC requirements up to two years before issuing new securities.
   a. True
   b. False
Chapter 11
Stock Valuation and Risk

1. Higher risk will lead to a(n) ________ in the required rate of return and to a(n) ________ in the price of stock.
   a. increase; increase
   b. decrease; decrease
   c. increase; decrease
d. decrease; increase

2. A company anticipates earnings per share of $0.20. The mean ratio of share price to expected earnings of competitors in the oil and gas industry is 15. What is the expected stock price according to the price-earnings method?
   a. $3.00
   b. $30.00
   c. $75.00
d. none of the above

3. Diaz Inc. has consistently paid a dividend of $2.50 per year in the past and expects to continue to pay this dividend indefinitely. Investors require a return of 11 percent on Diaz Inc. stock. According to the dividend discount model, the per-share price of Diaz Inc. should be $__________.
   a. 2.50
   b. 22.73
   c. 27.50
d. This cannot be determined without additional information.

4. XYZ Corp. just paid a dividend of $3.02. Next year, XYZ plans to pay a dividend of $4.05 per share, which XYZ intends to increase by 2.5 percent every year subsequently. The required rate of return is 14 percent. A fair per share price of XYZ Corp. stock is $__________.
   a. 36.10
   b. 35.22
   c. 26.92
d. 28.93

5. A company currently has earnings of $7 per share. It is expected that the company's earnings will grow by 3 percent per year over the next three years. If the mean PE ratio of all other firms in the same industry as the company is 10, what is the expected stock price in three years?
   a. $7.65
   b. $76.49
   c. $7.00
d. none of the above
6. A company currently has earnings of $7 per share. It is expected that the company's earnings will grow by 3 percent per year over the next three years. The mean PE ratio of all other firms in the same industry as the company is 10. If the company's required rate of return is 9 percent, and if the firm expects to pay no dividends over the next three years, what is the estimated stock price of the company today?
   a. $0.00
   b. $70.17
   c. $59.06
   d. none of the above

7. Which of the following is not used directly to determine the required rate of return on a stock?
   a. capital asset pricing model
   b. arbitrage pricing model
   c. dividend discount model
   d. All of the above are directly used to determine the required rate of return on a stock.

8. The ___________ assumes that several market- and economic-related factors should be considered to accurately determine the price of a stock.
   a. capital asset pricing model
   b. arbitrage pricing model
   c. dividend discount model
   d. price-earnings method

9. A firm has a beta of 2.0. T-bills are currently offering 2 percent, and the return on the S&P 500 index is estimated to be 9 percent. What is the required rate of return according to the capital asset pricing model?
   a. 9.0%
   b. 11.0%
   c. 16.0%
   d. 20.0%

10. Foreign investors tend to purchase U.S. stock when the dollar is _______ relative to their home currency.
    a. strong
    b. weak
    c. stable
    d. none of the above

11. Which of the following is an economic factor that affects stock prices?
    a. interest rates
    b. noise trading
    c. investor sentiment
    d. January effect

12. In general, unexpected favorable information about the economy tends to cause a(n) ___________ revision of a firm's expected cash flows and therefore places ________ pressure on the firm's value.
    a. unfavorable; upward
    b. favorable; upward
    c. unfavorable; downward
    d. favorable; downward
13. Assume the following information for X stock.
• Average return for X stock = 10%
• Average risk-free rate = 4%
• Standard deviation for X stock = 18%
• Beta of X stock = 1.2
Based on this information, X stock has a Sharpe index of _______.
   a. 0.22
   b. 0.33
   c. 0.56
   d. none of the above

14. Assume the following information for Y stock.
• Average return for Y stock = 13%
• Average risk-free rate = 4%
• Standard deviation for Y stock = 20%
• Beta of Y stock = 2.2
Based on this information, Y stock has a Treynor index of _______.
   a. 0.45
   b. 0.06
   c. 0.04
   d. none of the above

15. _______________ efficiency suggests that security prices reflect all market-related information, such as historical price movements and volume of securities trades, as well as all publicly available information.
   a. Weak form
   b. Semi-strong form
   c. Strong form
   d. Answers b and c are correct.  

Chapter 12
Market Microstructure and Strategies

1. ________ only execute the transactions desired by customers without offering advice.
   a. Full-service brokers
   b. Discount brokers
   c. Floor brokers
   d. Specialists

2. ____________ are situated on the floor of stocks exchange and receive requests from brokerage firms to fulfill orders and execute those orders.
   a. Specialists
   b. Floor brokers
   c. Market-makers
   d. Discount brokers
3. The initial deposit in a margin account to satisfy the maintenance margin is the ________.
   a. initial margin
   b. actual margin
   c. margin requirement
   d. none of the above

4. A _______ order to buy or sell a stock means to execute the transaction at the best possible price.
   a. limit
   b. stop-loss
   c. stop-buy
   d. market

5. The _______ the short interest ratio, the _______ the level of short sales.
   a. higher; higher
   b. higher; lower
   c. lower; higher
   d. none of the above

6. An investor just purchased a stock with a price of $24, paying $12 and borrowing the remainder on margin. The brokerage firm charges an interest rate of 8 percent on the loan. The stock pays no dividends. If the investor sells the stock after one year for $30, what is his return?
   a. 25.00%
   b. 42.00%
   c. 50.00%
   d. none of the above

7. An investor just purchased a stock with a price of $24. The stock pays no dividends. If the investor sells the stock after one year for $30 and had not used any borrowed funds to purchase the stock, his return would be:
   a. 25.00%
   b. 42.00%
   c. 50.00%
   d. none of the above

8. An investor who purchases a stock hopes that the stock will _______ in value, and a short seller hopes that the stock will _______ in value.
   a. increase; increase
   b. decrease; decrease
   c. increase; decrease
   d. decrease; increase

9. Exchange-traded funds:
   a. are funds designed to mimic particular stock indexes.
   b. are traded on a stock exchange.
   c. resemble some index mutual funds in several ways.
   d. all of the above

10. _______ represent the NASDAQ 100 index.
    a. Diamonds
    b. Spiders
    c. Cubes
    d. WEBS
11. __________ is the simultaneous buying and selling of a portfolio of different 
stocks that are in the S&P 500 index and have an aggregate value of more than $1 
million.
   a. Short selling
   b. Margin trading
   c. Program trading
   d. none of the above

12. When collars are imposed, program trading that reflects a buy order is allowed 
only when the last movement in the stock's price was:
   a. zero.
   b. an uptick.
   c. a downtick.
   d. program trading is always allowed when collars are imposed.

13. The SEC's Division of Market Regulation:
   a. reviews the registration statement files when a firm goes public.
   b. requires the orderly disclosure of securities trades by various organizations 
      that facilitate the trading of securities.
   c. assesses possible violations of the SEC's regulations and can take action 
      against offenders.
   d. none of the above

14. True or False? A direct access broker is a broker that facilitates trades for his or 
her customers.
   a. True.
   b. False.

15. True or False? Circuit breakers are restrictions on trading when stock prices or a 
stock index reaches a specified threshold level.
   a. True.
   b. False.
Chapter 13
Financial Futures Markets

1. The Commodity Futures Trading Commission (CFTC):
   a. established and enforces rules for the trading of financial futures contracts.
   b. provide an organized marketplace where futures contracts can be traded.
   c. clear, settle, and guarantee all transactions that occur on any exchange.
   d. approves futures contracts before they can be listed by futures exchanges.

2. _______ execute orders for their customers.
   a. Commission brokers
   b. Floor traders
   c. Locals
   d. none of the above

3. _______ take positions to reduce their exposure to future movements in interest rates or stock prices.
   a. Speculators
   b. Hedgers
   c. Day traders
   d. Position traders

4. If there are more traders with ______ offers than ______ offers for a particular contract, the futures price will ______ until this imbalance is removed.
   a. sell; buy; rise
   b. buy; sell; fall
   c. buy; sell; rise
   d. none of the above

5. An unexpected increase in the consumer price index tends to create expectations of higher interest rates and places ______ pressure on bond prices and ______ pressure on Treasury bond futures prices.
   a. downward; upward
   b. downward; downward
   c. upward; upward
   d. upward; downward

6. An increase in the government deficit would result in a(n) ______ in interest rates and a(n) ______ in Treasury bond futures prices.
   a. increase; decrease
   b. decrease; increase
   c. increase; increase
   d. decrease; decrease

7. In July, Jerry McGuire expects that interest rates will increase over the next month. Thus, Bolder calls a broker and sells a Treasury bill futures contract for 101.00. Assume that the price of T-bills as of the September settlement date is 99.00. What is the nominal profit or loss (in dollars) from Jerry’s speculative strategy?
   a. $20,000 gain
   b. $20,000 loss
   c. $2,000 gain
   d. $2,000 loss
8. Refer to question 7. Assume instead that interest rates had decreased from July to September, and that the price of T-bills as of the September settlement date is 102.00. Jerry's gain or loss would be _________.
   a. a $10,000 gain
   b. a $10,000 loss
   c. a $1,000 gain
   d. a $1,000 loss

9. Two months ago, a private investor purchased a futures contract on Treasury bonds at a price of 101-08. The investor just closed out the position by selling Treasury bond futures. Currently, these futures contracts trade at 102-17. The investor's nominal profit is $_________. (Hint: The par value of the futures contract is $100,000.)
   a. 1,090.00 profit
   b. 1,090.00 loss
   c. 1,528.75 profit
   d. 1,528.75 loss

10. An insurance company is concerned that interest rates will decline over the next two months. However, the insurance company would like to invest $5 million in Treasury bonds in two months. To hedge against the potential decrease in interest rates, the company should _______ Treasury bond futures contracts.
    a. sell 50
    b. buy 50
    c. sell 500
    d. buy 500

11. In cross-hedging, when the futures contract is highly correlated with the portfolio being hedged, the value of the futures contract changes by:
    a. a higher percentage than the portfolio's market value.
    b. a lower percentage than the portfolio's market value.
    c. the same percentage as the portfolio's market value.
    d. either a higher percentage, a lower percentage, or the same percentage as the portfolio's market value.

12. John Doe would like to purchase S&P 500 index futures contracts. The S&P 500 is currently at a level of 1,200. What is the value of the S&P 500 index futures contract?
    a. $1,200
    b. $120,000
    c. $240,000
    d. $300,000

13. A private investor would like to invest in the stock market via S&P 500 futures contracts. The investor purchases futures when the S&P 500 index is at 1,150. At the settlement date, the S&P 500 index is at 1,210. The investor's profit or loss is $______.
    a. 15,000 profit
    b. 15,000 loss
    c. 6,000 profit
    d. 6,000 loss
14. __________ risk refers to fluctuations in the value of the instrument as a result of market conditions.
   a. Market
   b. Liquidity
   c. Credit
   d. Basis

15. Many of the popular financial futures contracts are on debt securities.
   a. True.
   b. False.

   a. True.
   b. False.

17. Program trading is commonly used in conjunction with the trading of stock index futures contracts in a strategy known as index arbitrage.
   a. True.
   b. False.

Chapter 14
Options Markets

1. A __________ option is said to be in the money when the market price of the underlying security _______ the exercise price.
   a. call; is less than
   b. call; exceeds
   c. put; exceeds
   d. none of the above

2. The _________ was the first over-the-counter options exchange.
   a. Pacific Stock Exchange
   b. Philadelphia Stock Exchange
   c. International Securities Exchange
   d. Chicago Board Options Exchange

3. Options trading is regulated by the:
   a. Options Clearing Corporation (OCC).
   b. Federal Reserve.
   d. U.S. Treasury.
4. The ______ the existing market price of the underlying financial instrument relative to the exercise price, the ______ the call option premium.
   a. higher; higher
   b. lower; higher
   c. higher; lower
   d. none of the above

5. An investor expects a stock to increase in value from its current price of $23 per share. The investor purchases a call option on the stock that has an exercise price of $27 per share. The option premium is $3 per share. On the expiration date, the stock trades for $29. If the investor exercises the option and immediately sells the purchased shares, his net gain per share is:
   a. -$1.
   b. $1.
   c. -$3, since the investor would not exercise the option.
   d. $2.

6. An investor expects a stock to increase in value from its current price of $23 per share. The investor purchases a call option on the stock that has an exercise price of $27 per share. The option premium is $3 per share. Now assume that the price of the stock is $26 on the expiration date. If the investor likes to minimize his loss, his gain or loss on the transaction is:
   a. $0.
   b. $3.
   c. -$3.
   d. none of the above.

7. A call option has an exercise price of $48 and a premium of $2 per share. What is the break-even price of the underlying stock on the expiration date?
   a. $50
   b. $48
   c. $46
   d. none of the above

8. An investor buys a put option with an exercise price of $77 and a $2 option premium. The current price of the underlying stock is $74. On the expiration date, the underlying stock trades for $72. If the investor does not own the stock prior to the expiration date, his profit or loss per share is $______.
   a. -2
   b. 1
   c. 3
   d. none of the above

9. An investor buys a put option with an exercise price of $74 and a $2 option premium. The current price of the underlying stock is $77. On the expiration date, the underlying stock trades for $72. Assume that the price of the underlying stock on the expiration date is $78. Based on this information, the investor's profit or loss per share is $______.
   a. -3
   b. -2
   c. 1
10. An investor buys a put option with an exercise price of $74 and a $2 option premium. The current price of the underlying stock is $77. On the expiration date, the underlying stock trades for $72. The investor's breakeven point of the underlying stock at expiration is $______ per share.
   a. 75
   b. 77
   c. 79
   d. none of the above

11. The _______ the existing market price of the underlying financial instrument relative to the exercise price, the ______ the put option premium.
   a. higher; lower
   b. higher; higher
   c. lower; lower
   d. none of the above

12. An investor expects interest rates to decline and purchases a call option on Treasury bond futures with an exercise price of 92-16 and a call option premium of 2-00. Interest rates decline, and the value of Treasury bond futures on the expiration date is 94-20. Based on this information, the investor's net gain or loss is:
   a. $2,062.50 gain.
   b. $2,062.50 loss.
   c. $62.50 gain.
   d. $62.50 loss.

13. The exercise price is the price at which the owner of a call option can sell a specified financial instrument.
   a. True.
   b. False.

14. Market-makers can execute stock option transactions for customers, but they also trade stock options for their own account.
   a. True.
   b. False.

15. The purchase of a call option when the investor owns the underlying stock is known as a covered call.
   a. True.
   b. False.

16. Speculators purchase call options on currencies that they expect to weaken against the dollar.
   a. True.
   b. False.
Chapter 16
Foreign Exchange Derivative Markets

1. ____________ typically do not use foreign exchange markets to hedge a portion of their exposure.
   a. Commercial banks
   b. International mutual funds
   c. Insurance companies
   d. Pension funds

2. The _________ rate indicates the rate at which a currency can be exchanged in the future.
   a. spot exchange
   b. forward
   c. cross-exchange
   d. none of the above

3. The Smithsonian Agreement allowed for _________.
   a. devaluation of the British pound
   b. appreciation of the U.S. dollar
   c. devaluation of the U.S. dollar
   d. none of the above

4. You observe that the Canadian dollar has a quoted exchange rate of $.65. At the same time, the British pound has a quoted exchange rate of $1.63. What is the value of the Canadian dollar (C$) in British pounds (£)?
   a. C$0.40
   b. £0.40
   c. C$2.51
   d. £2.51

5. Which of the following countries does not participate in the euro?
   a. Germany
   b. France
   c. Italy
   d. All of the above participate in the euro.

6. If British inflation ________ relative to U.S. inflation, the British pound would ________ relative to the dollar.
   a. increases; depreciate
   b. increases; appreciate
   c. decreases; depreciate
   d. Both b and c are correct

7. When countries experience substantial net outflows of funds, they commonly use indirect intervention by ________ interest rates to discourage excessive outflows of funds and therefore limit any ________ pressure on the value of their currency.
   a. raising; upward
   b. lowering; downward
   c. raising; downward
   d. lowering; upward
8. Using indirect intervention, the Fed could attempt to ________ interest rates by reducing the money supply to place _______ pressure on the dollar's value.
   a. increase; upward  
   b. increase; downward  
   c. decrease; upward  
   d. decrease; downward

9. Time-series models that examine moving averages, and thus allow forecasters to develop some rule, are most useful in which type of forecasting?
   a. technical  
   b. fundamental  
   c. market-based  
   d. none of the above

10. Which of the following method(s) is (are) not used for forecasting exchange rate volatility?
    a. the volatility of historical exchange rate movements as a forecast for the future  
    b. time series of volatility patterns in previous periods  
    c. deriving the exchange rate's implied standard deviation  
    d. All of these are methods for forecasting exchange rate volatility.

11. To speculate on an anticipated depreciation of a foreign currency, an investor would take a _______ position in dollars and a ______ position in the foreign currency.
    a. short; short  
    b. long; long  
    c. short; long  
    d. long; short

12. Currency __________ are standardized contracts that specify an amount of a particular currency to be exchanged on a specified date and at a specified exchange rate.
    a. forward contracts  
    b. futures contracts  
    c. swaps  
    d. options contracts

13. A system with no boundaries in which exchange rates are market determined but are still subject to government intervention is called a dirty float.
    a. True.  
    b. False.

14. Central bank intervention may not always succeed in reversing exchange rate movements.
    a. True.  
    b. False.

15. The forward market is a visible location.
    a. True.  
    b. False.
Chapter 17
Commercial Bank Operations

1. Which of the following is not a source of funds for commercial banks?
   a. transaction deposits
   b. bonds issued by the bank
   c. investment in securities
   d. eurodollar borrowings

2. ______ deposits are deposits that cannot be withdrawn until a specified maturity date.
   a. Transaction
   b. Savings
   c. Money market
   d. Time

3. ________ is not a time deposit.
   a. Negotiable order of withdrawal (NOW) account
   b. Certificate of deposit (CD)
   c. Bull-market CD
   d. Callable CD

4. The ______ the demand by banks to borrow federal funds relative to a small supply of excess funds available at other banks, the ______ the federal funds rate.
   a. higher; higher
   b. lower; higher
   c. higher; lower
   d. none of the above

5. __________ represent the sale of securities by one party to another with an agreement to repurchase the securities at a specified date and price.
   a. Federal funds borrowed
   b. Eurodollar borrowing
   c. Repurchase agreements
   d. none of the above

6. A bank's reported earnings per share are ________ when additional shares of stock are issued, unless earnings increase by a ________ proportion than the increase in outstanding shares.
   a. reduced; smaller
   b. reduced; greater
   c. increased; smaller
   d. increased; greater

7. A ________ loan is a self-liquidating loan designed to support ongoing business operations.
   a. term
   b. bullet
   c. working capital
   d. direct lease
8. The interest rate charged by banks on loans to their most creditworthy customers is known as the ______ rate.
   a. federal funds
   b. prime
   c. discount
   d. none of the above

9. Which of the following types of securities do banks not invest in?
   a. treasury securities
   b. federal agency securities
   c. investment-grade securities
   d. Banks invest in all of the above.

10. All types of loans make up between ______ of bank assets.
    a. 20 and 30 percent
    b. 30 and 40 percent
    c. 40 and 50 percent
    d. 50 and 70 percent

11. _______ are an obligation by a bank to provide a specified loan amount to a particular firm upon the firm's request.
    a. Consumer loans
    b. Standby letters of credit
    c. Loan commitments
    d. Forward contracts

12. Banks commonly borrow in the federal funds market rather than through the discount window, even though the federal funds rate is typically higher than the discount rate.
    a. True.
    b. False.

13. Highly leveraged transactions (HLTs) are typically used to support initial public offerings (IPOs).
    a. True.
    b. False.

14. In an interest rate swap, two parties agree to periodically exchange interest payments on a specified notional amount of principal.
    a. True.
    b. False.
Chapter 18
Bank Regulation

1. Which of the following is not true with respect to a bank's regulatory structure?
   a. The U.S. regulatory structure is referred to as a dual banking system.
   b. A charter from either a state or the federal government is required to open a commercial bank.
   c. State banks may decide whether they wish to be members of the Federal Reserve system.
   d. All of the above are true.

2. The ________ allowed for the phaseout of deposit rate ceilings.
   a. Deregulation Act of 1980 (DIDMCA)
   b. Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA)
   c. Garn-St Germain Act
   d. none of the above

3. The ________ permitted depository institutions to acquire failing institutions across geographic boundaries.
   a. Deregulation Act of 1980 (DIDMCA)
   b. Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA)
   c. Garn-St Germain Act
   d. none of the above

4. As a result of the Basel Accord, ________ banks are subject to _______ stringent capital requirements.
   a. riskier; more
   b. less risky; less
   c. riskier; less
   d. answers a and b are correct

5. Highly leveraged transactions are commonly defined as loan transactions in which the borrower's liabilities are valued at more than ______ percent of total assets.
   a. 50
   b. 65
   c. 75
   d. 90

6. The __________ separated banking and securities activities.
   a. Garn-St Germain
   b. Deregulation Act of 1980
   c. Financial Institutions Reform, Recovery, and Enforcement Act
   d. Glass-Steagall Act

7. The __________ eliminated most restrictions on interstate bank mergers and allowed commercial banks to open branches nationwide.
   a. Financial Services Modernization Act
   b. Reigle-Neal Act
   c. McFadden Act
   d. none of the above
8. Return on assets (ROA) is often used to evaluate a bank's:
   a. capital adequacy.
   b. asset quality.
   c. earnings.
   d. liquidity.

9. Which of the following is the best CAMELS rating?
   a. 1
   b. 3
   c. 4
   d. 4

10. The _____________ was intended to penalize banks that engage in high-risk activities and also to reduce the regulatory costs of closing troubled banks.
    a. Financial Services Modernization Act
    b. McFadden Act
    c. Federal Deposit Insurance Corporation Improvement Act (FDICIA)
    d. Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA)

11. According to the Federal Deposit Insurance Corporation Improvement Act, deposit insurance premiums were to be based on:
    a. a fixed rate.
    b. the risk of the banks.
    c. the banks' ROA.
    d. none of the above.

12. The banking industry has become more competitive due to deregulation in recent years.
    a. True.
    b. False.

13. In general, a bank defines the value-at-risk as the estimated potential loss from its trading businesses that could result from adverse movements in its financial statements.
    a. True.
    b. False.

14. Before the Financial Services Modernization Act, banks were not allowed to offer discount brokerage services.
    a. True.
    b. False.

15. A bank that obtains a state charter is referred to as a national bank.
    a. True.
    b. False.
Chapter 19
Bank Management

1. Best Bank's total assets are $7 million. Furthermore, the bank has interest expenses of $4 million and interest revenues of $7 million. Based on this information, Best Bank's net interest margin is ______ percent.
   a. 43
   b. -43
   c. 47
   d. 27

2. ________ is the difference between rate-sensitive assets and rate-sensitive liabilities.
   a. The gap ratio
   b. The gap
   c. The duration gap
   d. none of the above

3. A bank has $5 million in rate-sensitive assets and $4 million in rate-sensitive liabilities. The bank's gap is:
   a. -$1 million.
   b. $1 million.
   c. 0.8.
   d. 1.25.

4. A bank has $5 million in rate-sensitive assets and $4 million in rate-sensitive liabilities. The bank's gap ratio is:
   a. -$1 million.
   b. $1 million.
   c. 0.8.
   d. 1.25.

5. Banks with a _______ gap are typically concerned about a potential _______ in interest rates.
   a. negative; decrease
   b. positive; decrease
   c. positive; increase
   d. Answer a and c are correct.

6. A __________ duration gap implies that a bank will be negatively affected by _______ interest rates.
   a. positive; rising
   b. negative; declining
   c. positive; declining
   d. Answers a and b are correct.

7. A bank has assets of $500 million and liabilities of $400 million. The average duration of the bank's assets is three years, and the average duration of the bank's liabilities is five years. The bank's duration gap is _______ years.
   a. -3.25
   b. 3.25
   c. -1
   d. 1
8. In regression analysis, if the bank's interest rate coefficient is __________, the bank should consider hedging its interest rate risk if it expects interest rates to __________.
   a. negative; decrease
   b. positive; increase
   c. negative; increase
   d. none of the above

9. A common method to reduce interest rate risk is a(n) __________, which is an agreement to receive payments when the interest rate of a particular security or index rises above a specified level during a specified time period.
   a. interest rate cap
   b. floating-rate loan
   c. interest rate futures contract
   d. interest rate swap

10. A bank whose liabilities are ______ rate sensitive than its assets would probably want to enter an interest rate swap to receive ______ payments.
    a. more; variable
    b. more; fixed
    c. less; variable
    d. answers b and c are correct

11. A bank has total assets of $240 million and shareholders' equity of $170 million. The bank has $4.2 million in profit after taxes. The bank's return on equity is ______ percent.
    a. 1.8
    b. 2.5
    c. 6.0
    d. none of the above

12. Which of the following is not a method of measuring the credit risk of a bank?
    a. determining the collateral of a loan
    b. determining the loan rate
    c. using the value-at-risk method
    d. all of the above are methods of measuring the credit risk of a bank

13. The underlying goal behind the managerial policies of a bank is to maximize the wealth of the bank's shareholders.
    a. True.
    b. False.

14. If a bank wants to minimize credit risk, it should dispose of its Treasury securities holdings.
    a. True.
    b. False.

15. Banks can reduce credit risk by eliminating loans that are causing excessive risk to their loan portfolios and sell them in the secondary market.
    a. True.
    b. False.

16. Bank growth can be achieved more quickly with acquisitions than by establishing new branches.
    a. True.
    b. False.
Chapter 20
Bank Performance

1. A(n) _______ in interest rates most likely results in a(n) _______ in a commercial bank’s cash flows.
   a. increase; increase
   b. decrease; decrease
   c. decrease; increase
   d. answers a and b are correct

2. Which of the following is not a factor that affects the risk premium on banks?
   a. regulatory constraints
   b. technological innovations
   c. the level of competition
   d. All of the above are factors that can affect the risk premium on banks.

3. Changes in a bank’s risk premium are ________ related to economic growth and ________ related to management abilities.
   a. positively; negatively
   b. negatively; positively
   c. positively; positively
   d. negatively; negatively

4. ________ is interest income generated from all assets.
   a. Gross interest income
   b. Gross interest expenses
   c. Noninterest income
   d. Securities gains and losses

5. Which of the following income statement items is least likely to be affected by a bank’s composition of assets?
   a. gross interest income
   b. gross interest expenses
   c. noninterest expenses
   d. loan losses

6. The ______ the capital ratio, the ________ the leverage measure in the return on equity computation.
   a. higher; higher
   b. higher; lower
   c. lower; higher
   d. Answers b and c are correct.

7. Banks whose stock returns are ________ vulnerable to market conditions have relatively ______ betas.
   a. very; low
   b. less; high
   c. less; low
   d. Answers a and b are correct.
8. Capital structure decisions by a bank would ______ ROA and ______ ROE.
   a. affect; not affect
   b. affect; affect
   c. not affect; affect
   d. not affect; not affect

9. Which of the following is not a characteristic identified by the Comptroller of the Currency for failing banks?
   a. Many banks did not have a loan policy.
   b. Many banks did not use an adequate system for identifying problem loans.
   c. Many banks did not adequately monitor key bank officers or departments.
   d. All of the above are characteristics of failing banks.

10. Which of the following is the factor affecting the value of a bank over which management has the most control?
    a. economic growth
    b. interest rate movements
    c. regulations
    d. management abilities

11. In the past, the net interest margin was typically highest for:
    a. small banks.
    b. medium banks.
    c. large banks.
    d. money center banks.

12. When the risk-free rate increases, the required rate of return decreases.
    a. True.
    b. False.

13. Valuations of commercial banks increased following the attack on the United States on September 11, 2001.
    a. True.
    b. False.

14. The loan loss provision is a reserve account established by the bank in anticipation of loan losses in the future.
    a. True.
    b. False.

15. The underlying goal behind the managerial policies of a bank is to maximize the wealth of the bank's shareholders.
    a. True.
    b. False.
Chapter 21
International Banking

1. The U.S. bank presence is larger in _______ than in any other foreign country.
   a. Germany
   b. the United Kingdom
   c. Russia
   d. China

2. Edge Act corporations:
   a. have existed since 1950.
   b. have been established in foreign countries to specialize in foreign financial transactions.
   c. can accept deposits and provide loans, as long as these functions are specifically related to international transactions.
   d. all of the above

3. The Single European Act of 1987:
   a. allowed capital to flow freely throughout the participating countries.
   b. imposed similar regulations across domestic and foreign banks doing business in the United States.
   c. required foreign banks to identify one state as their home state.
   d. all of the above

4. As a result of a 1988 agreement, retained earnings or funds obtained from issuing stock would be classified as:
   a. Tier 1 capital.
   b. Tier 2 capital.
   c. Tier 3 capital.
   d. none of the above

5. As a result of ____________, several U.S. banks have expanded their business in Mexico to help finance the establishment of subsidiaries by U.S.-based corporations.
   a. the Single European Act
   b. the North American Free Trade Agreement (NAFTA)
   c. the International Banking Act of 1978
   d. none of the above

6. Banks can facilitate the trend toward privatization by:
   a. providing direct loans to businesses.
   b. acting as underwriters on bonds or stocks issued by firms in Eastern Europe.
   c. providing letters of credit.
   d. all of the above

7. _______ risk is not a risk faced by multinational banks.
   a. Credit
   b. Exchange rate
   c. Settlement
   d. All of the above are risks faced by multinational banks.
8. A bank has short-term dollar deposits and uses the funds to make long-term dollar loans. A(n) _______ in interest rates will _______ the spread on the bank's dollar loans versus deposits.
   a. decrease; reduce
   b. increase; reduce
   c. increase; increase
   d. none of the above

9. Some banks react to their large LDC debt exposure by _______ their loan loss reserves, thereby causing a(n) _______ in reported earnings.
   a. reducing; decrease
   b. reducing; increase
   c. increasing; decrease
   d. increasing; increase

10. Which of the following is not true with respect to the international debt crisis?
    a. Debt problems of less-developed countries (LDCs) were adversely affected by a strengthening dollar during the early 1980s.
    b. A strengthening dollar meant that less of the LDC's currency was needed to make payments.
    c. Many of the loans provided to LDCs were denominated in U.S. dollars.
    d. Interest rates were at their peak in the early 1980s.

11. Which of the following is not true with respect to the Asian crisis?
    a. Commercial developers borrowed heavily without having to provide that their projections were feasible.
    b. Lenders were willing to lend large sums of money based on a developer's previous success.
    c. The amount of defaulted loans to Thailand's banks was estimated at over $30 billion.
    d. All of the above are true.

12. ______ is not a debt management variable used to assess country risk.
    a. Changes in the consumer price index
    b. Debt service
    c. Ratio of total debt to GDP
    d. Short-term debt divided by total debt

13. Based on a survey of Institutional Investor magazine, ________ countries have relatively ______ country risk ratings.
    a. industrialized; high
    b. less-developed; high
    c. less-developed; low
    d. Answers a and c are correct.

14. The reason many commercial banks are establishing branches around the world is to diversify among various economies so that their performance is less dependent on economic conditions of any single country.
    a. True.
    b. False.

15. U.S. banks have had much more freedom than European banks in offering investment banking services such as underwriting corporate securities.
    a. True.
    b. False.
16. The use of the euro reduces exposure to exchange rate risk.
   a. True.
   b. False.

17. In a debt-equity swap, a bank swaps its debt in exchange for some assets owned by the borrower.
   a. True.
   b. False.

Chapter 22
Thrift Operations

1. Since 1986, the number of savings institutions has:
   a. increased.
   b. declined.
   c. remained stable.
   d. none of the above

2. About ______ percent of savings institutions have less than $1 billion in assets.
   a. 40
   b. 50
   c. 70
   d. 90

3. Most savings institutions are:
   a. stock owned.
   b. mutual.
   c. debt owned.
   d. none of the above.

4. __________ is (are) the largest source of funds for SIs.
   a. Deposits
   b. Borrowed funds
   c. Capital
   d. Mortgages

5. In 1981, SIs were allowed to offer negotiable order of withdrawal (NOW) accounts as a result of:
   a. the Monetary Control Act.
   b. the Garn-St Germain Act.
   c. the Glass-Steagall Act.
   d. none of the above.

6. Which of the following is not a use of funds for SIs?
   a. mortgage-backed securities
   b. consumer loans
   c. commercial loans
   d. All of the above are uses of funds for SIs.
7. About _______ percent of mortgages originated by SIs are for commercial properties.
   a. 10
   b. 20
   c. 30
   d. 50

8. SIs are regulated:
   a. at the state level.
   b. at the federal level.
   c. at both the state and federal level.
   d. none of the above

9. New deposits at a savings institution are not sufficient to cover withdrawal requests. This is an example of:
   a. credit risk.
   b. liquidity risk.
   c. interest rate risk.
   d. none of the above.

10. Adjustable-rate mortgages ________ the adverse impact of ________ interest rates.
    a. reduce; declining
    b. increase; increasing
    c. reduce; increasing
    d. Answers a and b are correct.

11. A substantial __________ in inflation and a substantial __________ in the budget deficit typically result in lower valuations of SIs.
    a. increase; reduction
    b. reduction; increase
    c. reduction; reduction
    d. increase; increase

12. In the late 1980s, interest rates increased. Thus, those SIs that had provided ________ mortgages were adversely affected, and their net interest margin ________.
    a. adjustable-rate; declined
    b. adjustable-rate; increased
    c. fixed-rate; increased
    d. fixed-rate; declined

13. Savings institutions include savings banks and savings and loan associations.
    a. True.
    b. False.

14. It is relatively easy for another firm to take control of a mutual institution.
    a. True.
    b. False.

15. Because savings banks are not as heavily concentrated in mortgage loans and mortgage-backed securities, they hold a greater percentage of securities than S&Ls.
    a. True.
    b. False.
Chapter 23
Consumer Finance Operations

1. ______________ concentrate on providing direct loans to customers.
   a. Consumer finance companies
   b. Commercial finance companies
   c. Sales finance companies
   d. none of the above

2. When a company's assets are ________ interest-rate sensitive than its liabilities
   and when interest rates are expected to ________, bonds can provide long-term
   financing at a rate that is completely insulated from risky market rates.
   a. more; increase
   b. less; increase
   c. less; decrease
   d. none of the above

3. Finance companies can build their capital base by:
   a. issuing bonds.
   b. issuing stock.
   c. issuing commercial paper.
   d. none of the above.

4. Which of the following is not a use of finance company funds?
   a. consumer loans
   b. business loans
   c. real estate loans
   d. deposits

5. __________ dominate a finance company's asset portfolio.
   a. Real estate loans
   b. Business and consumer loans
   c. Leasing
   d. none of the above

6. A finance company is a subsidiary of a bank holding company. Thus, it is:
   a. federally regulated.
   b. regulated by the state.
   c. regulated by the U.S. Treasury.
   d. none of the above.

7. Finance companies are subject to:
   a. a loan ceiling.
   b. a ceiling interest rate.
   c. a maximum length on the loan maturity.
   d. all of the above.

8. __________ risk of finance companies is less than that of other financial institutions.
   a. Liquidity
   b. Interest rate
   c. Credit
   d. none of the above
9. Captive finance subsidiaries (CFSs):
   a. allow a corporation to clearly separate its manufacturing and retailing activities from its financing activities.
   b. have no reserve requirements and no legal prohibitions on how they obtain funds or use funds.
   c. have diversified their financing activities to include more than just the parent company product installment plans.
   d. all of the above

10. The expected cash flows of a finance company are _______ related to economic growth and _______ related to changes in the risk-free rate.
    a. positively; positively
    b. negatively; negatively
    c. positively; negatively
    d. negatively; positively

11. The risk-free rate is __________ related to inflation, economic growth, and the budget deficit level, and __________ related to money supply growth.
    a. positively; negatively
    b. negatively; positively
    c. positively; positively
    d. negatively; negatively

12. Only the most well-known finance companies have traditionally been able to issue commercial paper to attract funds.
    a. True.
    b. False.

13. Finance companies rarely act as factors for accounts receivable.
    a. True.
    b. False.

14. The primary purpose of a captive finance subsidiary (CFS) is to finance sales of a parent company's products and services.
    a. True.
    b. False.

15. U.S.-based finance companies penetrate foreign countries to enter new markets and to reduce their exposure to U.S. economic conditions.
    a. True.
    b. False.
Chapter 24
Mutual Fund Operations

1. A mutual fund's board of directors is responsible for:
   a. monitoring management.
   b. establishing procedures.
   c. generally ensuring that the fund is properly serving its shareholders.
   d. all of the above

2. A mutual fund prospectus contains the:
   a. maximum amount of investment allowed.
   b. return on the fund over the last 10 years.
   c. exposure of the fund to various types of risk.
   d. The prospectus contains all of the above.

3. A mutual fund has 30 million shares issued to investors. It currently has a market value of $700 million. The fund's net asset value (NAV) is $_________ per share.
   a. 23.33
   b. 42.86
   c. 2.33
   d. none of the above

4. Which of the following is not a mutual fund classification?
   a. equity funds
   b. bond funds
   c. money market funds
   d. All of the above are mutual fund classifications.

5. ________ funds are the most dominant form of mutual fund.
   a. Bond
   b. Stock
   c. Money market
   d. Hybrid

6. ________ funds are willing to repurchase the shares they sell from investors at any time.
   a. Load
   b. No-load
   c. Open-end
   d. Closed-end

7. When a closed-end fund's market price per share is _______ than the NAV per share, the fund is priced at a _______
   a. more; discount
   b. less; premium
   c. less; discount
   d. Answers a and b are correct.

8. ________ funds are composed of stocks that have potential for very high growth but may also be unproven.
   a. Growth
   b. Capital appreciation
   c. Growth and income
   d. Global
9. ________ funds focus on a group of companies sharing a particular characteristic.
   a. Growth
   b. Index
   c. Specialty
   d. Growth and income

10. A(n) ________ fund invests in a portfolio of different mutual funds.
    a. multifund
    b. income
    c. tax-free
    d. Internet

11. ___________ is(are) clearly the dominant asset maintained by mutual funds.
    a. Preferred stock
    b. Common stock
    c. Corporate bonds
    d. Treasury bonds

12. Most studies that assess mutual fund performance find that mutual funds:
    a. outperform the market.
    b. perform the same as the market.
    c. underperform the market.
    d. none of the above.

13. From an investor's viewpoint, money market funds have a _____ level of credit risk and a ______ level of interest rate risk.
    a. high; high
    b. low; low
    c. low; high
    d. high; low

14. Investors share the gains or losses generated by a mutual fund.
    a. True.
    b. False.

15. The net asset value (NAV) computation ignores dividends.
    a. True.
    b. False.

16. A mutual fund's performance is usually closely related to market conditions.
    a. True.
    b. False.

17. Equity REITs invest in mortgage and construction loans.
    a. True.
    b. False.
Chapter 25
Securities Operations

1. Investment banking firms (IBFs):
   a. originate common stock.
   b. underwrite stock issues.
   c. advise firms through the origination stage.
   d. IBFs do all of the above.

2. The __________ discloses relevant financial data about a firm and provisions applicable to the security.
   a. registration statement
   b. prospectus
   c. best-efforts agreement
   d. none of the above

3. Flotation costs as a percentage of the value of securities issued are _____ for ______ issues.
   a. lower; larger
   b. lower; smaller
   c. higher; larger
   d. none of the above

4. When arbitrage firms accumulate shares of targets with the expectation that the target would be willing to buy their shares back at a premium, this tactic is known as:
   a. asset stripping.
   b. a leveraged buyout.
   c. greenmail.
   d. a bridge loan.

5. Requests by customers to purchase or sell securities at the market price existing when the order reaches the exchange floor are called _______ orders.
   a. market
   b. limit
   c. stop-loss
   d. none of the above

6. The __________ regulates the issuance of securities and specifies disclosure rules for the issuers.
   a. National Association of Securities Dealers (NASD)
   b. Securities and Exchange Commission (SEC)
   c. Federal Reserve Board
   d. New York Stock Exchange

7. Securities firms are subject to _______ risk.
   a. market
   b. interest rate
   c. credit
   d. all of the above
8. The market value of bonds held as investments by securities firms _______ as interest rates _______.
   a. increases; decline
   b. increases; increase
   c. decreases; increase
   d. Answers a and c are correct.

9. Some __________ were organized by securities firms.
   a. commercial banks
   b. insurance companies
   c. mutual funds
   d. pension funds

10. IBFs do not participate in the _______ market.
    a. money
    b. bond
    c. mortgage
    d. IBFs participate in all of the above.

11. Leveraged buyouts are typically financed using:
    a. common stock.
    b. money market securities.
    c. junk bonds.
    d. preferred stock.

12. The private placement of bonds avoids the underwriting fee.
    a. True.
    b. False.

13. A common form of arbitrage is asset stripping.
    a. True.
    b. False.

14. Investors can speculate on expectations of an increase in securities prices by short selling.
    a. True.
    b. False.

15. An advantage of a private placement is that the demand is stronger than for a publicly placed issue.
    a. True.
    b. False.

4. While the primary market provides _______ for spenders, the secondary market provides _______ for investors.
   a. funds; liquidity
   b. a place for investing; liquidity
   c. funds; low risk
   d. securities; funds