EC 370 **Name:** ____________________

Chapter 2 - Practice

1. Well-functioning financial markets
   - A. cause inflation.
   - B. eliminate the need for indirect finance.
   - C. cause financial crises.
   - D. allow the economy to operate more efficiently.
2. Which of the following can be described as direct finance?
   - A. You take out a mortgage from your local bank.
   - B. You borrow $2,500 from a friend.
   - C. You buy shares of common stock in the secondary market.
   - D. You buy shares in a mutual fund.
3. Which of the following can be described as involving direct finance?
   - A. A corporation takes out loans from a bank.
   - B. People buy shares in a mutual fund.
   - C. A corporation buys a short-term corporate security in a secondary market.
   - D. People buy shares of common stock in the primary markets.
4. Which of the following can be described as involving indirect finance?
   - A. You make a loan to your neighbor.
   - B. A corporation buys a share of common stock issued by another corporation in the primary market.
   - C. You buy a U.S. Treasury bill from the U.S. Treasury at TreasuryDirect.gov.
   - D. You make a deposit at a bank.
5. Securities are _____ for the person who buys them, but are _____ for the individual or firm that issues them.
   - A. assets; liabilities
   - B. liabilities; assets
   - C. negotiable; nonnegotiable
   - D. nonnegotiable; negotiable
6. With direct finance, funds are channeled through the financial market from the _____ directly to the _____.
   - A. savers; spenders

B. spenders; investors

C. borrowers; savers

D. investors; savers

7. Which of the following statements about the characteristics of debt and equity is FALSE?

   A. They can both be long-term financial instruments

   B. They can both be short-term financial instruments.

   C. They both involve a claim on the issuer's income.

   D. They both enable a corporation to raise funds.

8. Which of the following statements about the characteristics of debt and equities is TRUE?

   A. They can both be long-term financial instruments.

   B. Bond holders are residual claimants.

   C. The income from bonds is typically more variable than that from equities.

   D. Bonds pay dividends.

9. Which of the following is an example of an intermediate-term debt?

   A. a fifteen-year mortgage

   B. a sixty-month car loan

   C. a six-month loan from a finance company

   D. a thirty-year U.S. Treasury bond

10. Which of the following benefits directly from any increase in the corporation's profitability?

    A. a corporate bond holder

    B. a T-bond holder

    C. a stock shareholder

    D. a T-bill holder

11. Equity holders are a corporation's _____.

    A. debtors

    B. brokers

    C. residual claimants

    D. underwriters

12. A corporation acquires new funds only when its securities are sold in the

    A. secondary market by an investment bank

B. primary market by an investment bank.
C. secondary market by a stock exchange broker
D. secondary market by a commercial bank.

13. 20) The higher a security's price in the secondary market the _____ funds a firm can raise by selling securities in the _____ market.
    A. more; primary
    B. more; secondary
    C. less; primary
    D. less; secondary

14. Which of the following statements about financial markets and securities is TRUE?
    A. Many common stocks are traded over-the-counter, although the largest corporations usually have their shares traded at organized stock exchanges such as the New York Stock Exchange.
    B. As a corporation gets a share of the broker's commission, a corporation acquires new funds
    C. Capital market securities are usually more widely traded than shorter-term securities and so tend to be more liquid.
    D. Prices of capital market securities are usually more stable than prices of money market securities, and so are often used to hold temporary surplus funds of corporations.

15. Prices of money market instruments undergo the least price fluctuations because of
    A. the short terms to maturity for the securities.
    B. the heavy regulations in the industry
    C. the price ceiling imposed by government regulators.
    D. the lack of competition in the market.

16. Collateral is _____ the lender receives if the borrower does not pay back the loan.
    A. a liability
    B. an asset
    C. a present
    D. an offering

17. Federal funds are
    A. funds raised by the federal government in the bond market.
    B. loans made by the Federal Reserve System to banks.
    C. loans made by banks to the Federal Reserve System.

D. loans made by banks to each other.

18. Which of the following instruments are traded in a money market?

    A. state and local government bonds

    B. U.S. Treasury bills

    C. corporate bonds

    D. U.S Treasury notes

19. The primary liabilities of a commercial bank are

    A. municipal bonds.

    B. mortgages.

    C. deposits.

    D. T-bills.

20. Which of the following are investment intermediaries?

    A. life insurance companies

    B. mutual funds

    C. pension funds

    D. state and local government retirement funds

21. An investment bank purchases securities from a corporation at a predetermined price and then resells them in the market. This process is called

    A. underwriting

    B. underhanded.

    C. understanding.

    D. undertaking

22. Life insurance companies and fire and casualty insurance companies are both examples of contractual savings institutions. Because fire and casualty insurance companies have a greater possibility of loss of funds if disasters occur, they tend to hold more _____ assets than life insurance companies.

    A. liquid

    B. long-term

    C. risky

    D. consumer loans

23. The purpose of the disclosure requirements of the Securities and Exchange Commission is to

    A. increase the information available to investors.

B. prevent bank panics.

C. improve the control of monetary policy

D. protect investors against financial losses.

24. In order to reduce risk and increase the safety of financial institutions, commercial banks are prohibited from

    A. owning municipal bonds.

    B. making real estate loans.

    C. making personal loans.

    D. owning common stock.

25. The primary purpose of deposit insurance is to

    A. improve the flow of information to investors.

    B. prevent banking panics.

    C. protect bank shareholders against losses.

    D. protect bank employees from unemployment.

26. The regulatory agency that sets reserve requirements for all banks is

    A. the Federal Reserve System.

    B. the Federal Deposit Insurance Corporation

    C. the Office of Thrift Supervision.

    D. the Securities and Exchange Commission.