

25/01 560 FINANCIAL MARKETS

Course Overview

M1: Credit Risk and Financing

FM Forum M1

FINANCIAL MODELING OVERVIEW

✓ Screencast

LESSON 1: SAVING & BORROWING

✓ Accessing Spreadsheets

✓ Lesson Notes

LESSON 2: COUNTERPARTIES AND CREDIT RISK

✓ Required Readings

✓ Lesson Notes

LESSON 3: BUYING AND SELLING SHORT

✓ Lesson Notes

LESSON 4: SURVEYING THE FINANCIAL INDUSTRY

✓ Required Readings

✓ Lesson Notes

MODULE 1 SUMMARY

✓ Credit Risk and Financing Screencast

ASSESSMENTS

FM Practice Quiz M1

FM Graded Quiz M1

M2: Return and Volatility

M3: Correlation

Home > My Courses > Financial Markets > M1: Credit Risk and Financing > FM Practice Quiz M1

## FM Practice Quiz M1

Question 1

What is the bid-ask spread?

- ☐ The difference between the highest and lowest price of a security
- ☐ The difference between the current price and the face value of a bond
- ☒ The difference between the price at which someone is willing to buy (bid) and the price at which someone is willing to sell (ask)
- ☐ The difference between the opening and closing price of a security



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QUESTIONS



Question 2

Suppose an investor buys a bond with a face value of \$1,000, a coupon rate of 5%, and a maturity of 3 years. Assuming annual coupon payments, how much will the investor receive in coupon payments each year?

- ☐ \$100
- ☐ \$200
- ☒ \$50
- ☐ \$150

Question 3

What is the relationship between the slope of the yield curve and the level of risk associated with investments?

- ☐ A flat yield curve indicates that short-term investments are riskier than long-term investments
- ☐ The slope of the yield curve has no relationship with investment risk
- ☒ A negative slope indicates that short-term investments are riskier than long-term investments
- ☐ A positive slope indicates that short-term investments are riskier than long-term investments

Question 4

If a bond issuer's credit rating declines, what is the most likely outcome for the bond's price?

- ☐ The bond's price will remain unchanged
- ☒ The bond's price will decrease
- ☐ The bond's price will increase
- ☐ The bond will be immediately defaulted

Question 5

What are the two main components of the cost of financing a short position?

- ☐ The bid-ask spread and the transaction fees
- ☐ The transaction fees and the income cost
- ☒ The financing cost (interest rate for borrowing the security) and the income cost (payments the borrowed security generates)
- ☐ The bid-ask spread and the financing cost

Question 6

What is the main purpose of collateral in a loan?

- ☒ To serve as a backup for the credit risk of the borrower

- ☐ To increase the interest rate on the loan
- ☐ To ensure that the lender makes a profit on the loan
- ☐ To allow the borrower to borrow more money

Question 7

An investment of 10,000 *grows to* 15,000 in 5 years. What is the annual compound interest rate?

- ☐ 10.00%
- ☐ 9.00%
- ☒ 8.45%
- ☐ 7.50%

Question 8

Which of the following is an example of concentration risk?

- ☐ A bank adjusts its interest rates based on changes in the market
- ☐ A bank conducts thorough background checks on all loan applicants
- ☐ A bank diversifies its investments across multiple industries and asset classes
- ☒ A bank's portfolio is heavily invested in a single sector or asset class

Question 9

If a bond is trading at a price below its face value, what does this imply about the relationship between the bond's coupon rate and the current market interest rate?

- ☐ There is no relationship between the bond's coupon rate and the current market interest rate
- ☐ The bond's coupon rate is equal to the current market interest rate
- ☐ The bond's coupon rate is higher than the current market interest rate
- ☒ The bond's coupon rate is lower than the current market interest rate

Question 10

Which type of financial institution would likely be the best choice for someone looking to purchase insurance?

- ☐ Depository institution
- ☒ Contractual institution
- ☐ Investment institution
- ☐ None of the above

Question 11

Which of the following best describes the relationship between risk and return in investments?

- ☐ Lower risk generally leads to higher potential returns
- ☒ Higher risk generally leads to higher potential returns
- ☐ Risk and return are not related in investments
- ☐ Higher risk generally leads to lower potential returns

Question 12

What is the primary purpose of central banks?

- ☐ To maximize profits for their shareholders
- ☒ To maintain stability and transparency for countries' economies
- ☐ To compete with commercial banks for customers

- ☐ To invest in high-risk financial products

Question 13

Given a bond with a face value of \$1,000, a current market price of \$950, an annual coupon rate of 4%, and 4 years to maturity, what is the implied yield to maturity (YTM)?

- ☐ 4.32%
- ☐ 4.50%
- ☐ 3.75%
- ☒ 5.42%

Question 14

What is the main difference between an overdue payment and a default?

- ☐ There is no difference between an overdue payment and a default.
- ☐ An overdue payment involves interest while a default involves principal.
- ☒ An overdue payment is a late payment while a default is a failure to make any payment at all.
- ☐ An overdue payment is a failure to make any payment while a default is just a late payment.

Question 15

What is the primary principle behind the concept of time value of money?

- ☐ The value of money remains constant over time.
- ☒ The value of \$1 today is worth more than the value of \$1 in the future.
- ☐ The value of money increases at a constant rate over time.
- ☐ The value of money today is worth less than the value of the same amount of money in the future.

Question 16

Analyze the potential consequences of a lack of distinction between commercial and investment banking, as seen in the subprime mortgage crisis.

- ☒ It can lead to excessive risk-taking and financial instability
- ☐ It promotes healthy competition and innovation in the banking sector
- ☐ It ensures better protection for consumer deposits and investments
- ☐ It has no significant impact on the overall stability of the financial system

Question 17

What is the main difference between the buy-side and sell-side in the financial industry?

- ☐ The buy-side and sell-side are essentially the same
- ☐ The buy-side is always profitable while the sell-side is not
- ☐ The buy-side only buys securities and the sell-side only sells securities
- ☒ The buy-side invests on behalf of clients while the sell-side makes markets

Question 18

Which of the following is NOT a type of risk in finance?

- ☐ Equity risk
- ☐ Economic risk

- ☐ Model risk
- ☒ National security risk

Question 19

Evaluate the following statement: "The Fisher effect suggests that investors demand higher nominal interest rates to compensate for expected inflation."

- ☐ The Fisher effect is unrelated to the statement
- ☐ The statement is partially true
- ☐ The statement is false
- ☒ The statement is true

Question 20

What was the main purpose of the Glass-Steagall Act of 1933?

- ☐ To allow banks to open multiple branches across state lines
- ☒ To separate commercial banking from investment banking
- ☐ To increase competition between commercial and investment banks
- ☐ To encourage banks to invest in high-risk financial products the Glass-Steagall Act of 1933

SUBMIT

