

Chapter 2: The Nature and Variety of Financial Intermediation

1. Broadly classified, a financial intermediary performs
 - a. a brokerage function
 - b. a qualitative asset transformation function
 - c. as a monetary policy stabilizer
 - d. a securities underwriting function
 - e. both a and b

Ans. e.

2. Which of the following statements is (are) true about the brokerage function?
 - a. bringing together transactors of financial claims with complementary needs
 - b. the broker has special information and can reuse that information
 - c. the cost of using a brokerage service to an individual is the same as that which he must spend without the help of a broker
 - d. the brokerage function usually results in a mismatch of assets and liabilities
 - e. both a and b

Ans. e.

3. Special information possessed by a broker
 - a. can be used across different users
 - b. can be used over time across the same borrower
 - c. depreciates over time through consumption
 - d. both a and b
 - e. all of the above

Ans. d.

4. Qualitative Asset Transformation involves
 - a. a mismatch of assets and liabilities
 - b. transforming a liquid asset into an illiquid one
 - c. originating a loan
 - d. screening a borrower
 - e. all of the above

Ans. a.

5. An investment banker who underwrites securities through a “firm commitment” contract performs
- a. a brokerage function
 - b. a qualitative asset transformation function
 - c. both a and b
 - d. a funding function
 - e. a loan-originating function

Ans. b.

6. With a “best-efforts” contract, an investment banker performs
- a. a brokerage function
 - b. a qualitative asset transformation function
 - c. both a and b
 - d. a monitoring function
 - e. as a firm’s guarantor

Ans. a.

7. Which of the following statements is (are) false about the qualitative asset transformation function?
- a. a financial intermediary monitors the borrower’s compliance with loan covenants
 - b. a financial intermediary creates liquidity through asset transformation
 - c. a financial intermediary buys and sell securities
 - d. a financial intermediary originates a loan
 - e. a financial intermediary fluids a loan

Ans. c.

8. Commercial banks
- a. serve as a monetary policy stabilizer
 - b. serve as a provider and servicer of demand deposits
 - c. usually have a high leverage ratio
 - d. specialize mostly on residential mortgages
 - e. a, b, and c are all correct

Ans. e.

9. The federally-chartered banks are not regulated by
- a. The Federal Reserve System
 - b. The Office of the Comptroller of the Currency
 - c. The Federal Deposit Insurance Corporation
 - d. The Federal Home Loan Bank Board
 - e. All of the above regulate banks

Ans. d.

10. Which of the following statements is (are) not true?
- a. Commercial banks are all shareholder-owned
 - b. The ownership of thrifts is often mutual
 - c. Credit Unions are shareholder-owned
 - d. Credit Unions typically have specialized asset portfolios
 - e. Thrifts cannot conduct an underwriting business

Ans. c.

11. Which of the following services is not currently offered by commercial banks?
- a. risk shifting services such as swaps
 - b. working capital loan
 - c. residential and commercial mortgages
 - d. automobile loans
 - e. management expertise

Ans. e.

12. Which federal agency regulates insured state banks that choose not to join the Federal Reserve System?
- a. Office of Thrifts Supervision
 - b. The U.S. Treasury
 - c. The Resolution Trust Corporation
 - d. The Federal Deposit Insurance Corporation
 - e. The Office of The Comptroller of the Currency

Ans. d.

13. Which of the following statements is (are) not true about thrifts?
- a. Thrifts have kept their capital ratios lower than banks following the thrift failures in the 1980s
 - b. thrifts' assets are mostly home mortgages
 - c. thrifts are regulated by the Office of Thrifts Supervision
 - d. FDIC provides a deposit insurance for thrifts
 - e. thrifts' ownership is usually mutual

Ans. a.

14. Which of the following statements is (are) true?
- a. mutual savings banks are cooperatively owned
 - b. like thrifts, mutual savings banks mostly invest in mortgage loans
 - c. mutual savings banks were regulated by the FDIC
 - d. both a and b
 - e. a, b, and c are all correct

Ans. e.

15. Thrifts specialize in mortgage lending because
- a. of tax incentives provided by Congress
 - b. they have the management expertise to specialize in mortgage lending
 - c. they are mandated under the FIRREA of 1989 to invest in mortgages
 - d. both a and b
 - e. a, b, and c are all correct

Ans. d.

16. In terms of funding, thrifts are different from commercial banks in that
- a. thrifts rely on savings deposits as a source of funds
 - b. rely on commercial loans as a source of funds
 - c. rely on checking deposits as a source of funds
 - d. rely on short-term money market securities as a source of funds
 - e. rely on commercial banks as a source of funds

Ans. a.

17. Which of the following statements is (are) not true?
- a. The formation of a credit union requires a common bond
 - b. Federally chartered credit unions are regulated by the National Credit Union Administration
 - c. Credit unions, due to their small size, cannot match the extent of services offered by a commercial bank
 - d. To use the services of a credit union, one must be a member
 - e. Credit unions have better ability to control credit risks due to their homogeneous borrower base

Ans. c.

18. Typically, venture capitalists provide _____ financing for _____ companies.
- a. Debt, start-up
 - b. Equity, start-up
 - c. Debt, prominent
 - d. Equity, established
 - e. Both debt and equity, start-up

Ans. e.

19. Which of the following feature(s) characterize a typical venture capital contract?
- a. an earnout arrangement
 - b. no de novo financing
 - c. buyout option
 - d. performance requirement
 - e. all of the above

Ans. e.

20. No “de novo” financing means
- a. that the entrepreneur can walk away after obtaining the financing to arrange a better deal with another financier
 - b. that the entrepreneur is not allowed to continue to be in control of the company after the financing is obtained
 - c. that the entrepreneur must satisfy a certain capital contribution requirement in order to obtain the financing
 - d. that the entrepreneur cannot walk away after obtaining the financing to negotiate a better deal with another financier
 - e. that the entrepreneur cannot be in control of the company until the financing is paid off

Ans. d.

21. With the “buyout” option, the entrepreneur can
- a. buy out the venture capitalist in order to maintain control
 - b. buy out the venture capitalist through a financing arrangement with a more sophisticated financier
 - c. be bought out at a fixed amount by the venture capitalist and is relieved of control
 - d. be bought out by outside investors that the venture capitalist has a financing arrangement with
 - e. buy out the venture capitalist and then sell the company to the general public

Ans. c.

22. Which of the following statements is (are) true about the “**earnout**” arrangement?
- a. If the entrepreneur remains in control, the venture capitalist receives an equity payoff while the entrepreneur receives a flat payment

- b. If the entrepreneur remains in control, the venture capitalist receives a flat payment while the entrepreneur receives an equity payoff
- c. If the entrepreneur remains in control, both the venture capitalist and the entrepreneur receive a flat payment and outside investors receive an equity payoff
- d. If the entrepreneur remains in control, both the venture capitalist and the entrepreneur receive an equity payoff
- e. The entrepreneur is relieved of control and is given a flat payment while the equity payoff goes to the venture capitalist

Ans. d.

23. The performance requirement specifies that
- a. the entrepreneur will be relieved of control by the venture capitalist if certain performance standard is not met
 - b. the entrepreneur may be relieved of control by the venture capitalist if certain performance standard is not met
 - c. the entrepreneur can be relieved of control by the venture capitalist at any time during the contract
 - d. the entrepreneur will be given an equity payoff provided that a certain performance standard is met
 - e. after a certain performance standard is met, the company can be sold to the general public

Ans. b.

24. The reasons why the start-up companies obtain financing from a venture capitalist rather than a bank are
- a. the venture capitalist knows more about the firm's business than does a bank
 - b. the venture capitalist has cheaper financing sources than a bank
 - c. the venture capitalist has developed a considerable management skills in dealing with numerous ventures
 - d. the bank is prohibited by regulation to lend to start-up ventures
 - e. both b and d

Ans. c.

25. Which of the following functions is not usually performed by a finance company?
- a. a funding function
 - b. a screening function
 - c. a liquidity creation function
 - d. a loan originating function
 - e. a claim transformation function

Ans. c.

26. Typical sources of financing for finance companies are

- a. demand deposits
- b. secured loans from banks
- c. unsecured loans from banks
- d. commercial paper
- e. all of the above

Ans. d.

27. The major assets of finance companies are

- a. cash to be lent out
- b. loan receivables
- c. commercial paper
- d. certificates of deposit
- e. marketable securities

Ans. b.

28. The difference between a commercial bank and a finance company is that a commercial is _____, while a finance company is _____; and a bank lends on _____ basis, while a finance company lends on _____ basis.

- a. unregulated, unregulated, secured, unsecured
- b. regulated, largely unregulated, secured, secured
- c. regulated, regulated, unsecured, secured
- d. unregulated, regulated, unsecured, secured
- e. regulated, largely unregulated, both secured and unsecured, secured

Ans. e.

29. Which of the following statements is (are) false about insurance companies?

- a. Insurance companies are organized as mutuals
- b. Insurance companies have the same liabilities structure as commercial banks
- c. Insurance companies hold mostly the same kinds of assets as commercial banks
- d. Insurance companies perform a certification function
- e. all of the above are false

Ans. b.

30. Commercial banks and insurance companies are different in that

- a. the duration of the insurance companies' liabilities is much shorter than that of the commercial banks
- b. the duration of the insurance companies' liabilities is the same as that of the commercial banks
- c. the duration of the insurance companies' liabilities is much longer than that of the commercial banks
- d. commercial banks do not perform a certification function but insurance companies do

- e. both c and d

Ans. d.

31. Which of the following functions is the key intermediary service performed by a pension fund?
- a. liquidity creation
 - b. guaranteeing
 - c. claim transformation
 - d. funding
 - e. both b and c

Ans. e.

32. The primary difference between open-end and closed-end mutual funds is
- a. a closed-end fund does not stand ready to purchase its own shares when one of its owners sell them while an open-end fund does
 - b. both a closed-end and open-end funds stand ready to purchase their own shares when one of their owners sell them
 - c. a closed-end fund is typically traded on an organized exchange while an open-end fund is not
 - d. both a and c
 - e. both b and c

Ans. d.

33. Which of the following services is not performed by a closed-end mutual fund?
- a. transaction
 - b. risk diversification
 - c. maturity transformation
 - d. sharing the costs of investment management
 - e. all of the above

Ans. c.

34. The tremendous growth in the mutual funds industry can be attributed to
- a. an attempt to circumvent Regulation Q
 - b. futile effort to beat the stock market
 - c. an attempt to diversify internationally
 - d. all of the above
 - e. none of the above

Ans. c.

35. Which of the following is not the key functions performed by an investment bank?
- a. screening

- b. origination
- c. transaction services
- d. guaranteeing
- e. liquidity creation

Ans. e.

36. Which of the following was not the objective of the Glass-Steagall Act?
- a. discourage speculation in the financial markets
 - b. restore confidence in the banking system
 - c. promote a safe and sound investment banking environment
 - d. prevention of conflicts of interest and self-dealing
 - e. all of the above

Ans. c.

37. Which of the following services is not offered by an investment bank?
- a. bringing new issues to the market
 - b. making commercial loans
 - c. trading and brokerage
 - d. arranging a syndicate selling group
 - e. financial advice

Ans. b.

38. The key function provided by pawnbrokers are
- a. origination
 - b. funding
 - c. market completeness
 - d. screening
 - e. a, b, and c are correct

Ans. e.

39. Loan sharks perform the following key function, except
- a. screening
 - b. originating
 - c. funding
 - d. monitoring
 - e. claim transformation

Ans. a.

40. The following intermediaries perform a qualitative asset transformation function, except
- a. Commercial banks
 - b. Finance companies
 - c. Insurance companies
 - d. Investment banks
 - e. Thrifts

Ans. d.

41. Credit rating agencies provide:
- a. ratings on television shows that feature credit transactions
 - b. provide brokerage services as information processors of the credit risk embedded in debt securities
 - c. opinions that tell investors which securities they should invest in
 - d. provide a blend of qualitative asset transformation and brokerage services
 - e. specialize mostly in rating mortgage-backed securities (MBS)

Ans. b.

42. Hedge funds are:
- a. the same as mutual funds
 - b. like passive index funds
 - c. actively managed funds that pursue non-traditional investment strategies
 - d. funds that take only long positions in traded securities for hedging purposes

Ans. c.