c01; Chapter 1: An Introduction to Finance

Multiple Choice

1. The difference between a financial intermediary and a market intermediary is best described as:
   A. one deals with the financing decision making within a business entity, the other deals with financial markets and securities.
   B. one involves the issuing of new securities, the other permits investors to buy and sell existing securities.
   C. one transforms the nature of securities in a market; the other does not change the nature of the transaction.

Answer	C
Difficulty	Easy
Learning outcome	LO 1.1
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	A financial intermediary transforms the nature of the securities they issue and invest in, whereas a market intermediary simply makes the markets work better.

2. The environment in which households provide funds to businesses and government is best described as a:
   A. financial system.
   B. market intermediary.
   C. financial intermediary.

Answer	A
Difficulty	Easy
Learning outcome	LO 1.1
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	A financial system is an environment in which households provide funds to businesses and government.

3. Which of the following would not be an example of intermediation?
   A. Matt borrows money from friends to start a food truck business.

B. Andrea takes out a mortgage loan from SunTrust Mortgage.
C. Angela borrows money from a credit union to purchase a new car.
D. A retired person withdraws money from their savings account to take a Caribbean cruise.

Answer	D
Difficulty	Easy
Learning outcome	LO 1.1
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	Intermediation is the transfer of funds from lenders to borrowers

4. Investment and financing decisions, which may be short-term or long-term decisions are best described as:
A. financial decision making.
B. economic decision making.
C. accounting decision making.

Answer	A
Difficulty	Easy
Learning outcome	LO 1.1
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	Financial decision making encompasses investment and financing decisions, which may be short-term or long-term decisions.

5. Mutual funds, pension funds, investment dealers and insurance companies are best described as examples of:
A. corporate finance.
B. market intermediaries.
C. financial intermediaries.

Answer	C
Difficulty	Easy
Learning outcome	LO 1.1
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	A financial intermediary transforms the nature of the securities they issue and invest in, whereas a market intermediary simply makes the markets work better.

6. Which of the following is not a type of financial instrument?
   A. Bond
   B. Collateral
   C. Equity security
   D. Debt instrument

Answer	B
Difficulty	Easy
Learning outcome	LO 1.2
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	A financial instrument is a legal agreement that represents an ownership interest, a debt obligation, or other claim on assets or income.

7. Farmers and Merchants Bank lends money to Ruth to purchase a car from Steven Toyota. Ruth is going to insure the car with Allstate Insurance. Which party is best described as the creditor?
   A. Ruth
   B. Steven Toyota
   C. Allstate Insurance
   D. Farmers and Merchants Bank

Answer	D
Difficulty	Easy
Learning outcome	LO 1.2
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	creditor - a party lending funds through a loan arrangement

8. Which of the following would not be described as a debenture?
   A. An unsecured loan
   B. A loan secured by collateral
   C. A loan secured by the "full faith and credit" of the issuer

Answer	B
Difficulty	Easy
Learning outcome	LO 1.2
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	A debenture is an unsecured debt obligation.

9. What is the primary difference between a bond and a note?
   A. One is short-term, one is long-term
   B. One is a debt security, one is an equity security
   C. One is issued in the primary market, one is issued in the secondary market

Answer	B
Difficulty	Easy
Learning outcome	LO 1.2
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	A note is similar to a bond, but with a maturity in the range of one to ten years.

10. What is wrong with the following statement? General Electric will be issuing $100 million in forty year notes at the end of September?
    A. This should be called a bond
    B. This should be called a stock
    C. Nothing is wrong with this statement

Answer	A
Difficulty	Easy
Learning outcome	LO 1.2
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	A bond is debt instrument that takes the form of a security, generally with a maturity of more than ten years.

11. The City of Harrisonburg issues revenue bonds to improve the city's water and sewer systems. These bonds would be best described as being backed by:
    A. nothing.
    B. the full faith and credit of the issuer.
    C. a specific revenue stream of the issuing entity.
    D. property taxes that are assessed by the local government.

Answer	C
Difficulty	Easy
Learning outcome	LO 1.2

Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	A revenue bond is a debt obligation backed by a specific revenue stream.

12. U.S. Treasury bonds, which are backed by the full faith and credit of the U.S. government, are best described as:
    A. revenue bonds.
    B. equity securities.
    C. assessment bonds.
    D. general obligation bonds.

Answer	D
Difficulty	Easy
Learning outcome	LO 1.2
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	A general obligation bond is a debt security backed by the general credit of the issuer.

13. School bonds backed by property taxes that are assessed by Rockingham County would best be described as:
    A. revenue bonds.
    B. equity securities.
    C. assessment bonds.
    D. general obligation bonds.

Answer	C
Difficulty	Easy
Learning outcome	LO 1.2
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	An assessment bond is a security backed by the property taxes of a government entity.

14. The type of stock that entitles the owner to stated dividend payments that must be made before any dividends are paid to other classes of shareholders would best be described as:
    A. common stock.
    B. preferred stock.
    C. corporate bonds.

D. municipal bonds.

Answer	B
Difficulty	Easy
Learning outcome	LO 1.2
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	Preferred stock is an equity security that usually entitles the owner to fixed dividend payments that must be made before any dividends are paid to common shareholders.

15. Which of the following is considered a capital market security?
    A. T-bills
    B. Equity securities
    C. Commercial paper
    D. Bankers' acceptances

Answer	B
Difficulty	Easy
Learning outcome	LO 1.2
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	A capital market security - is a security with a maturity greater than one year and includes notes, bonds, and debentures, as well as equity securities, which represent ownership in a company and generally have no maturity date.

16. Which of the following is *not* considered a money market security?
    A. T-bills
    B. 30-year bond
    C. Commercial paper
    D. Bankers' acceptances

Answer	B
Difficulty	Easy
Learning outcome	LO 1.2
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	A money market security is a short-term (i.e., maturity of less than one year) security.

17. Which of the following is considered a money market security?
    A. Treasury bill
    B. 30-year bond
    C. Common stock

Answer	A
Difficulty	Easy
Learning outcome	LO 1.2
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	A money market security is a short-term (i.e., maturity of less than one year) security.

18. Which of the following is best described as a capital market security?
    A. Treasury bill
    B. Common stock
    C. Commercial paper

Answer	B
Difficulty	Easy
Learning outcome	LO 1.2
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	A capital market security is a long-term security.

19. "There are more offerings of IPOs during periods of strong economic activity and fewer offerings of IPOs during economic downturns." "IPO" in the above statement best refers to:
    A. first sale of equity interest to the public.
    B. property that is pledged to secure a loan.
    C. trading environment that allows investors to buy and sell existing securities.
    D. instrument that takes the form of a security, generally with a maturity between one and ten years.

Answer	A
Difficulty	Moderate
Learning outcome	LO 1.2
Bloom's taxonomy	Remember
AACSB	Analytical skills

Feedback	An initial public offering (IPO is the first sale of equity interests to the public.

20. Morgan Stanley was the investment banking firm that took Facebook from being a closely held company to issuing stock to the public for the first time. Which of the following terms most closely describes this?
    A. money market security.
    B. issuing commercial paper.
    C. initial public offering (IPO).
    D. debt security backed by the general credit of the issuer.

Answer	C
Difficulty	Moderate
Learning outcome	LO 1.2
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	An initial public offering (IPO) is a **first** sale of equity interests to the public.

21. Trading of securities directly between investors without the involvement of brokers or dealers is best described as:
    A. Third market
    B. Fourth market
    C. Primary market
    D. Secondary market

Answer	B
Difficulty	Moderate
Learning outcome	LO 1.2
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	The fourth market involves the trading of securities directly between investors without the involvement of brokers or dealers.

22. The world's largest equity market in terms of the value of the stocks listed with the exchange is the:
    A. NASDAQ OMX.
    B. NYSE Euronext (US).
    C. Federal Reserve System.
    D. Tokyo Stock Exchange Group.

Answer	B

Difficulty	Moderate
Learning outcome	LO 1.2
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	The NYSE Euronext market in the U.S. is the world's largest equity market in terms of the value of the stocks listed with the exchange, $11,233 billion as of November 2011.

23. Establish margin requirements, require disclosures regarding consumer lending, assess reserve requirements of member banks and non-depository institutions, these are things the following institution has been given the power to do:
    A. NYSE Euronext (US).
    B. Federal Insurance Office (FIO).
    C. Federal Reserve System (the Fed).
    D. Securities and Exchange Commission (SEC).

Answer	C
Difficulty	Moderate
Learning outcome	LO 1.2
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	The Federal Reserve System (the Fed) is the central bank of the U.S., consisting of the Board of Governors and twelve district banks.

24. Which of the following organizations is charged with ensuring that financial markets are fair, orderly, and efficient, encouraging capital flows from investors to businesses, protecting investors, and oversight of self-regulatory organizations?
    A. NYSE Euronext (US)
    B. Federal Reserve System (the Fed)
    C. Securities and Exchange Commission (SEC)
    D. Financial Industry Regulatory Authority (FINRA)

Answer	C
Difficulty	Moderate
Learning outcome	LO 1.2
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	The Securities and Exchange Commission (SEC) U.S. is the agency responsible for ensuring that financial markets are fair, orderly, and efficient.

25. Which of the following would best be described as a self-regulatory organization (SRO)?
    A. NASDAQ OMX
    B. Federal Reserve Board
    C. Securities and Exchange Commission (SEC)
    D. Financial Industry Regulatory Authority (FINRA)

Answer	D
Difficulty	Moderate
Learning outcome	LO 1.2
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	Financial Industry Regulatory Authority (FINRA) is a **self**-regulatory organization that monitors and regulates brokerage firms, brokers, and market intermediaries.

26. Which of the following transactions does not take place in the primary market? An investor:
    A. buying a newly issued municipal bond.
    B. buying shares of an initial public offering.
    C. selling one hundred shares of stock through a stock broker.
    D. buying a U.S. Treasury bill through the government auction.

Answer	C
Difficulty	Moderate
Learning outcome	LO 1.2
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	Key: does not take place in the primary market, means secondary market – trading environment that permits investors to buy and sell existing securities.

27. Which of the following transactions takes place in the secondary market? An investor buying:
    A. 500 shares of an IPO.
    B. a newly issued municipal bond.
    C. 500 shares of stock in his online brokerage account.
    D. a U.S. Treasury bill through the government auction.

Answer	C
Difficulty	Moderate
Learning outcome	LO 1.2
Bloom's taxonomy	Describe

AACSB	Analytical skills
Feedback	Secondary market is the trading environment that permits investors to buy and sell existing securities.

28. Which of the following is *not* a power granted to the Board of Governors of the Federal Reserve System?
    A. Regulate competition among banks.
    B. Establish margin requirements for securities.
    C. Evaluate the reserve requirements of member banks.
    D. Buy equity securities to maintain equilibrium in the stock market.

Answer	D
Difficulty	Moderate
Learning outcome	LO 1.1
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	The Fed regulates banking institutions, but not markets.

29. Which of the following companies has the highest market capitalization?

	Company name	Shares Outstanding	Market price per share
A.	Company ABC	10,000,000	$2
B.	Company DEF	15,000,000	$10
C.	Company GHI	12,000,000	$20
D.	Company JKL	7,500,000	$40

Answer	D
Difficulty	Moderate
Learning outcome	LO 1.2
Bloom's taxonomy	Apply
AACSB	Analytical skills
Feedback	A company's market capitalization is the product of the market price of a share and the number of shares outstanding. Market Capitalization of D = 7,500,000 X $40 = $300,000,000.

30. Company A had its first day as a publicly traded company on October 20, 2011. The stock closed at a price of $17 per share, with 8,000,000 shares trading on this first day. There are 32,000,000 shares of common stock outstanding after this offering. What type of transaction took place on October 20, 2011 and what is the company's market capitalization at the end of the day?
    A. Primary market, $136,000,000

B. Primary market, $544,000,000
C. Secondary market, $136,000,000
D. Secondary market, $544,000,000

Answer	B
Difficulty	Moderate
Learning outcome	LO 1.2
Bloom's taxonomy	Apply
AACSB	Analytical skills
Feedback	• The primary market is the market that involves the issue of new securities by the borrower in return for cash from investors (or lenders). • A company's market capitalization is the product of the market price of a share and the number of shares outstanding. • Market Capitalization = 32,000,000 X $17 = $544,000,000.

31. Which market is particularly important for "block trades", which are extremely large transactions involving at least 10,000,000 shares or $100,000?
    A. Third market
    B. Fourth market
    C. Primary market
    D. Secondary market

Answer	A
Difficulty	Moderate
Learning outcome	LO 1.2
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	The third market refers to the trading of securities that are listed on organized exchanges in the OTC market. Historically, this market has been particularly important for "block trades," which are extremely large transactions involving at least 10,000 shares or $100,000.

32. Which of the following did not result in large scale mergers across the financial industry?
    A. Sarbanes- Oxley Act
    B. Gramm-Leach-Bliley Act
    C. Financial crisis of 2007 -2008

Answer	A
Difficulty	Moderate
Learning outcome	LO 1.2

Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	Sarbanes-Oxley Act of 2002 increases disclosure requirements of publicly traded companies, creates oversight boards for independent public accountants, requires specific corporate governance provisions, and holds the chief executive officer and the chief financial officer accountable for a public company's disclosures.

33. Classify each of the following transactions, sequentially, as occurring in either the primary market or the secondary market:
    1. Rosetta Stone goes public with an offering of 6,250,000 in April of 2009
    2. Health Care REIT, Inc., which is already publicly traded, issues 13,800,000 additional shares of stock as a public offering in August 0f 2012
    3. Laurie's Thursday night investment club buys 500 shares of Kohl's from their stockbroker following the recommendation of one of their members.
    4. A student sells 50 shares of McDonald's stock online to fund her summer travel plans.

    A. 1. Primary market, 2. Primary market, 3. Primary market, 4. Primary market
    B. 1. Primary market, 2. Primary market, 3. Secondary market, 4. Secondary market.
    C. 1. Secondary market, 2. Secondary market, 3. Primary market, 4. Primary market.
    D. 1. Secondary market, 2. Secondary market, 3. Secondary market, 4. Secondary market.

Answer	B
Difficulty	Moderate
Learning outcome	LO 1.2
Bloom's taxonomy	Analyze
AACSB	Analytical skills
Feedback	primary market **–** market that involves the issue of new securities by the borrower in return for cash from investors (or lenders). secondary market **–** trading (or market) environment that permits investors to buy and sell existing securities

34. The common stock of the social networking company, Facebook, began trading May 18, 2012 on NASDAQ. This start of trading on a securities market is best described as:

    A. a close out.
    B. a security filing.
    C. an initial public offer.
    D. a secondary market offer.

Answer	C
Difficulty	Moderate

Learning outcome	LO 1.2
Bloom's taxonomy	Analyze
AACSB	Analytical skills
Feedback	Facebook began trading under the ticker symbol FB in its initial public offering on May 18, 2012.

35. Classify each of the following , sequentially, as either a money market security or a capital market security:
    1. 20-year Rockingham County School Bonds
    2. 90-day Treasury Bill
    3. 9-month certificate of deposit
    4. Wal-Mart stock

    A. 1. Money market security, 2. Money market security, 3. Money market security, 4. Money market security
    B. 1. Capital market security, 2. Capital market security, 3. Capital market security, 4. Capital market security
    C. 1. Capital market security, 2. Money market security, 3. Capital market security, 4. Capital market security
    D. 1. Capital market security, 2. Money market security, 3. Money market security, 4. Capital market security

Answer	D
Difficulty	Moderate
Learning outcome	LO 1.2
Bloom's taxonomy	Analyze
AACSB	Analytical skills
Feedback	The primary market is the market that involves the issue of new securities by the borrower in return for cash from investors (or lenders). secondary market **–** trading (or market) environment that permits investors to buy and sell existing securities

36. You observe that the Express Company has total shareholders' equity on its balance sheet of $5 billion, total debt on its balance sheet of $3 billion, and its common stock has a price per share of $20. If Express has 1 billion shares outstanding, its market value is closest to:
    A. $5 billion
    B. $8 billion
    C. $20 billion
    D. $23 billion

Answer	C

Difficulty	Difficult
Learning outcome	LO 1.2
Bloom's taxonomy	Apply
AACSB	Analytical skills
Feedback	Market Capitalization = stock price × number of shares outstanding $20 × 1 billion = $20 billion.

37. August 16, 2012 Health Care REIT, Inc. (HCN) stock closed at $60.17 on trading volume of 1,660,000. That same day HCN completes a public offering of 13,800,000 shares which it sells for a price of $58.75 each. What most closely represents the increase in market capitalization HCN experienced from the new stock offering?
    A. $97,525,000
    B. $99,882,200.
    C. $810,750,000
    D. $830,346,000

Answer	D
Difficulty	Difficult
Learning outcome	LO 1.2
Bloom's taxonomy	Apply
AACSB	Analytical skills
Feedback	Market Capitalization = stock price × number of shares outstanding In this case the increase in market capitalization would be $60.17(stock price) × 13,800,000 (the increase in the number of shares) = $830,346,000.

38. Which of the following is *not* an example of a financial derivative?
    A. Options
    B. Mortgages
    C. Interest-rate swaps

Answer	B
Difficulty	Easy
Learning outcome	LO 1.3
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	A financial derivative is an investment whose value is based on some other investment.

39. Which of the following did not contribute to the 2007 – 2008 financial crisis?

A. Housing bubble
B. Lax lending standards
C. Globalization of financial investments and instruments
D. Mortgage loans made with moderate loan-to-value ratios
E. Push for government sponsored entities (GSEs) to purchase lower quality loans

Answer	D
Difficulty	Moderate
Learning outcome	LO 1.3
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	All except mortgage loans made with moderate loan-to-value ratios contributed to the crisis. Loans with low loan-to-value ratios contributed to the crisis.

40. The majority of home purchases in the U.S. are secured with a mortgage. A mortgage is:
A. an unsecured loan.
B. an equity investment in the property.
C. a debt obligation secured by a specific property.

Answer	C
Difficulty	Easy
Learning outcome	LO 1.3
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	mortgage - debt obligation secured by specific property

41. Which of the following is *not* characteristic of systemic risk?
A. Affects the larger economy
B. Cannot be diversified away
C. Arose from the mortgage housing crisis
D. Affects a specific sector of the economy

Answer	D
Difficulty	Easy
Learning outcome	LO 1.3
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	systemic risk- uncertainty that affects the larger economy

42. Lack of available loans for businesses is best described as:
    A. stress test.
    B. systemic risk.
    C. subprime mortgages.
    D. credit crunch or credit squeeze.

Answer	D
Difficulty	Easy
Learning outcome	LO 1.3
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	credit crunch or credit squeeze **-** lack of available loans for businesses

43. Which of the following is a government program designed to assist financial institutions in response to the financial crisis of 2007-2008?
    A. Glass-Steagall Act
    B. Troubled Asset Relief Program (TARP)
    C. Government- sponsored entities (GSEs)
    D. Financial Industry Regulatory Authority (FINRA)

Answer	B
Difficulty	Easy
Learning outcome	LO 1.3
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	The Troubled Asset Relief Program (TARP) is a U.S. government program to infuse capital in the financial system by purchasing assets and equity from troubled financial institutions.

44. The debt obligation secured by a person's primary home is best described as a:
    A. stock.
    B. mortgage.
    C. debenture.
    D. margin loan.

Answer	B
Difficulty	Easy
Learning outcome	LO 1.3
Bloom's taxonomy	Analyze

AACSB	Analytical skills
Feedback	A mortgage is a loan secured by a home.

45. Uncertainty that affects the larger economy is best described as:
    A. volatility risk.
    B. systemic risk.
    C. systematic risk.

Answer	B
Difficulty	Moderate
Learning outcome	LO 1.3
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	Systemic risk is the risk that affects the larger economy, such as the financial problems of AIG leading up to and during the financial crisis.

46. The primary responsibility of the Federal Open Market Committee is:
    A. U.S. monetary policy.
    B. regulate banks and insurance companies.
    C. to bring the U.S. out of a recession in a timely manner.

Answer	A
Difficulty	Moderate
Learning outcome	LO 1.3
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	The primary responsibility of the FOMC is to direct the monetary policy of the U.S.

47. The predominant regulator of insurance companies in the U.S.
    A. are the States.
    B. is the Federal government.
    C. is the Securities and Exchange Commission.

Answer	A
Difficulty	Moderate
Learning outcome	LO 1.3
Bloom's taxonomy	Remember
AACSB	Analytical skills

Feedback	There is now a federal oversight committee for insurance (the Federal Insurance Oversight committee), but this is primarily advisory. The primary regulator for insurance remains the States.

48. Which of the following U.S. securities laws created the Financial Stability Oversight Council, created criteria and standards for systemically important financial companies, provided for orderly liquidation of insolvent financial companies, and regulated derivatives and hedge funds?
    A. Securities Act of 1933
    B. Sarbanes-Oxley Act of 2002
    C. Investment Company Act of 1940
    D. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

Answer	D
Difficulty	Moderate
Learning outcome	LO 1.3
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 is a wide-reaching act. Among other things, the act:

- Creates the Financial Stability Oversight Council, which provides a formal system of coordination among key regulators.
- Creates criteria and standards for systemically important financial companies.
- Provides for the orderly liquidation of financial companies that are insolvent.
- Regulates derivatives, including swaps.
- Regulates hedge funds, which previously operated without any required disclosures.

49. Suppose homeowners own a home that has an appraised value of $200,000. The homeowners have a mortgage loan outstanding on the home of $180,000. The loan to value ratio is closest to:
    A. 0.9.
    B. 1.0.
    C. 1.05

Answer	A
Difficulty	Moderate
Learning outcome	LO 1.3
Bloom's taxonomy	Analyze
AACSB	Analytical skills

Feedback	The loan to value ratio is \$180,000 ÷ \$200,000 = 0.95

50. Suppose homeowners own a home that has an appraised value of \$250,000. The homeowners have a mortgage loan outstanding on the home of \$260,000. Which of the following statements is incorrect regarding the mortgage loan?
    A. This loan is underwater.
    B. The loan to value ratio is 0.9615
    C. The homeowners owe more than what the home is worth.

Answer	B
Difficulty	Moderate
Learning outcome	LO 1.3
Bloom's taxonomy	Analyze
AACSB	Analytical skills
Feedback	The loan to value ratio is \$260,000 ÷ \$250,000 = 1.04

51. Financial managers learned many lessons following the financial crisis of 2007 – 2008. These lessons include all of the following except:
    A. financial risk management is important.
    B. executive compensation should be tied to some measure of risk, not just earnings
    C. reliance on bank financing for short-term needs is recommended during a credit crunch.
    D. companies that rely on securitizing their assets should be prepared for the associated risks.

Answer	C
Difficulty	Moderate
Learning outcome	LO 1.3
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	Reliance on bank financing for short-term needs is problematic during a credit crunch

True-False

52. The three primary areas of finance are business finance, corporate finance, and investments.
    A. True
    B. False

Answer	B
Difficulty	Easy
Learning outcome	LO 5.1
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	The three areas of finance are business finance, also referred to as corporate finance or financial management, investments, and financial institutions.

53. The primary area of finance that deals with financing decision making within a business entity would best be described as investments.
    A. True
    B. False

Answer	B
Difficulty	Easy
Learning outcome	LO 1.1
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	Business finance, also referred to as corporate finance and financial management, deals with the financing decision making within a business entity.

54. Mortgage brokers, real estate brokers, stock brokers, and insurance brokers are all examples of market intermediaries.
    A. True
    B. False

Answer	A
Difficulty	Easy
Learning outcome	LO 1.1
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	Typically, we refer to market intermediary as a broker.

55. Mortgage brokers, real estate brokers, stock brokers, and insurance brokers are all examples of financial intermediaries.
    A. True
    B. False

Answer	B
Difficulty	Easy
Learning outcome	LO 1.1
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	These would be examples of market intermediaries, not financial intermediaries.

56. A broker is a type of market intermediary.
    A. True
    B. False

Answer	A
Difficulty	Easy
Learning outcome	LO 1.1
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	Typically, we refer to market intermediary as a broker.

57. The primary area of finance that deals with financing decision making within a business entity would best be described as investments.
    A. True
    B. False

Answer	B
Difficulty	Easy
Learning outcome	LO 1.1
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	Business finance, also referred to as corporate finance and financial management, deals with the financing decision making within a business entity.

58. Bank loans, commercial paper, banker's acceptance, and U.S. Treasury bills are all examples of short-term equity securities.
    A. True
    B. False

Answer	B
Difficulty	Easy
Learning outcome	LO 1.2
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	These are all examples of short-term debt instruments.

59. Mortgage loans, municipal bonds, and corporate bonds all represent equity interests.
    A. True
    B. False

Answer	B
Difficulty	Easy
Learning outcome	LO 1.2
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	These all represent long-term debt obligations.

60. An equity security represents a debt obligation.
    A. True
    B. False

Answer	B
Difficulty	Easy
Learning outcome	LO 1.2
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	An equity instrument **(**or equity security) represents the ownership stake in a company.

61. Common stock, preferred stock, and mortgage loans are all examples of equity instruments.
    A. True
    B. False

Answer	B
Difficulty	Easy
Learning outcome	LO 1.2
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	Mortgage loans would be an example of a debt obligation not an equity

instrument.

62. Secondary markets are the key to the wealth creation process because they enable money to be transferred to those who can make the best use of it in terms of developing new real assets like houses and factories.
    A. True
    B. False

Answer	B
Difficulty	Moderate
Learning outcome	LO 1.2
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	Primary markets are the key to wealth creation.

63. Without well-functioning secondary markets, governments and companies would be unable to raise financing because investors could not sell securities when necessary.
    A. True
    B. False

Answer	A
Difficulty	Easy
Learning outcome	LO 1.1
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	Well-functioning secondary markets are critical to the functioning of the primary markets because investors will not invest in companies or buy government securities if they cannot sell the investments when necessary.

64. Mortgage loans, municipal bonds, and corporate bonds all represent equity interests.
    A. True
    B. False

Answer	B
Difficulty	Easy
Learning outcome	LO 1.2
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	These all represent debt securities.

65. Secondary market trading in equity securities is many times the size of the primary market, whereas for debt securities it is the opposite.
    A. True
    B. False

Answer	A
Difficulty	Moderate
Learning outcome	LO 1.2
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	Debt securities, which are normally paid back and result in constant refinancing activity. Common shares are generally issued once and then stay outstanding indefinitely.

66. Exchange market or auction market is a secondary market that does not have a physical location and consists of a network of dealers who trade directly with one another.
    A. True
    B. False

Answer	B
Difficulty	Easy
Learning outcome	LO 1.2
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	The exchange market or auction market is a secondary market that involves a bidding process that takes place in a specific location.

67. Dealer market or over-the-counter (OTC) market is a secondary market that does not have a physical location and consists of a network of dealers who trade directly with one another.
    A. True
    B. False

Answer	A
Difficulty	Easy
Learning outcome	LO 1.2
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	A dealer market or over-the-counter (OTC) market is a secondary market that

does not have a physical location and consists of a network of dealers who trade directly with one another.

68. The twelve-member committee that affects the monetary policy of the U.S. is the Federal Open Market Committee (FOMC).
    A. True
    B. False

Answer	A
Difficulty	Easy
Learning outcome	LO 1.2
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	Federal Open Market Committee (FOMC) is a twelve-member committee that affects the monetary policy of the U.S .

69. The federal agency responsible for monitoring and advising regulators about insurance companies' risk and solvency is called the Federal Reserve System.
    A. True
    B. False

Answer	B
Difficulty	Easy
Learning outcome	LO 1.2
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	Federal Insurance Office (FIO) is the federal agency responsible for monitoring and advising regulators about insurance companies' risk and solvency.

70. There is substantial investment in the U.S. by non-U.S. investors, and there is also substantial investment outside the U.S. by U.S. investors.
    A. True
    B. False

Answer	A
Difficulty	Easy
Learning outcome	LO 1.3
Bloom's taxonomy	Remember
AACSB	Analytical skills

Feedback	There is substantial investment in the U.S. by non-U.S. investors, and there is also substantial investment outside the U.S. by U.S. investors. This is an example of globalization of the financial system.

71. The 2007 – 2008 financial crisis is an example of the globalization of the financial system.
    A. True
    B. False

Answer	A
Difficulty	Easy
Learning outcome	LO 1.3
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	The financial system is global, with parties crossing borders to raise and invest funds. No better example of the globalization of the financial system is available than the 2007–2008 financial crisis, where linkages among the markets were evident as the U.S. economy faltered, along with economies around the world.

72. The process of converting loans into securities is best referred to as packaging.
    A. True
    B. False

Answer	B
Difficulty	Easy
Learning outcome	LO 1.3
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	Securitization is the pooling of loans and subsequent creation and selling securities that have rights to specific cash flows from this pool.

73. The process of converting loans into securities is best referred to as securitization.
    A. True
    B. False

Answer	A
Difficulty	Easy
Learning outcome	LO 1.3
Bloom's taxonomy	Remember

AACSB	Analytical skills
Feedback	Securitization is the pooling of loans and subsequent creation and selling securities that have rights to specific cash flows from this pool.

74. Mortgage backed securities carry claims on the cash flows of a pool of mortgages.
    A. True
    B. False

Answer	A
Difficulty	Easy
Learning outcome	LO 1.3
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	Mortgage-backed securities are claims on the cash flows of a pool of mortgages.

75. A bond is a form of an equity security.
    A. True
    B. False

Answer	B
Difficulty	Moderate
Learning outcome	LO 1.3
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	A bond is a form of debt security.

76. Term Asset-Backed Securities Loan Facility (TALF) is one of the U.S. Government programs put into place in response to the financial crisis of 2007 – 2008. TALF is designed to infuse capital in the financial system by purchasing assets and equity from troubled financial institutions.
    A. True
    B. False

Answer	B
Difficulty	Moderate
Learning outcome	LO 1.3
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	This would be TARP. TALF is U.S. government program to inject capital in the

	financial system by lending funds to investors of specific high-quality asset-backed securities.

77. Stress tests were one of the tools Federal regulators used to evaluate bank holding companies' solvency following the financial crisis of 2007-2008.
    A. True
    B. False

Answer	A
Difficulty	Easy
Learning outcome	LO 1.3
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	A stress test is a scenario-based evaluation of a company's solvency, where the scenario is the worst-case scenario.

78. Deregulation in the 1990s resulted in fewer bank failures following the financial crisis of 2007 – 2008, as compared to previous economic downturns, but the size of losses per institution was larger during the 2007-2008 crisis.
    A. True
    B. False

Answer	A
Difficulty	Moderate
Learning outcome	LO 1.3
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	The number of banks failing during this recent financial crisis is far fewer than in prior economic downturns. Consolidation of the industry due to deregulation in the 1990s has resulted in larger failures in terms of losses though the average size of the loss per institution has increased significantly.

79. The U.S. economy faltering along with economies around the world during the 2007 – 2008 financial crisis is an example of the insulation of the U.S. economy to the globalization of the financial system.
    A. True
    B. False

Answer	B
Difficulty	Easy

Learning outcome	LO 1.3
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	The financial system is global, with parties crossing borders to raise and invest funds. No better example of the globalization of the financial system is available than the 2007–2008 financial crisis, where linkages among the markets were evident as the U.S. economy faltered, along with economies around the world.

Short Answer

80. What is finance?

Answer	Finance is the study of how and under what terms funds are allocated between those with excess funds and those who need funds
Difficulty	Easy
Learning outcome	LO 1.1
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	Finance is the study of how and under what terms funds are allocated between those with excess funds and those who need funds.

81. List three different types of securities.

Answer	Debt obligations, equity interests, and hybrid securities
Difficulty	Easy
Learning outcome	LO 1.2
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	Securities include debt obligations, equity interests, and hybrid securities.

82. What distinguishes between money market securities and capital market securities?

Answer	Their maturity. Money market securities have a maturity of less than a year. Capital market securities have a maturity of more than a year.
Difficulty	Easy
Learning outcome	LO 1.2

Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	money market security - short-term debt instrument, capital market security - debt security with a maturity of greater than one year.

83. Why is a well-functioning secondary market critical to the functioning of the primary markets?

Answer	Governments and companies would be unable to raise financing if investors could not sell securities when necessary.
Difficulty	Moderate
Learning outcome	LO 1.2
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	A secondary market provides trading (or market) environments that permit investors to buy and sell existing securities. This service is critical to the functioning of the primary markets because governments and companies would not be able to raise financing if investors were unable to sell their investments when necessary.

84. Consider the following information for a company:

Common shares outstanding	25,000,000
Book value per share of common stock	$5.00
Market value per share of common stock	$30.00
Total Assets	$350,000,000

What is this company's market capitalization?

Answer	$750,000,000
Difficulty	Moderate
Learning outcome	LO 1.2
Bloom's taxonomy	Apply
AACSB	Analytical skills
Feedback	A company's market capitalization is the product of the market price of a share and the number of shares outstanding. Market Capitalization =25,000,000 X $30 = $750,000,000.

85. When checking stocks online, you notice that Pfizer has a market capitalization of $215,250,360,000. What does this mean?

Answer	That Pfizer's market price times the number of shares outstanding is $215,250,360,000. It is the total market value of the company.
Difficulty	Moderate
Learning outcome	LO 1.2
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	A company's market capitalization is the product of the market price of a share and the number of shares outstanding. It is the total market value of the company

86. Provide two examples of equity securities.

Answer	Common stock, preferred stock
Difficulty	Easy
Learning outcome	LO 1.2
Bloom's taxonomy	Remember
	Analytical skills
Feedback	Other examples of equity securities may be given, but common stock and preferred stock will be the most common.

87. What type of mortgages contributed to the 2007 – 2008 financial crisis?

Answer	Sub-prime mortgages, or mortgages with a high loan-to-value ratio, or pools of mortgages, such as mortgage backed securities
Difficulty	Moderate
Learning outcome	LO1 .3
Bloom's taxonomy	Remember
AACSB	Analytical skills
Feedback	Sub-prime mortgages, or mortgages with a high loan-to-value ratio, or pools of mortgages, such as mortgage backed securities (Any of these would be acceptable answers).

88. What is meant by systemic risk?

Answer	Systemic risk is uncertainty that affects the larger economy.
Difficulty	Moderate
Learning outcome	LO1 .3
Bloom's taxonomy	Describe

AACSB	Analytical skills
Feedback	An issue with the subprime crisis was that many financial institutions were too big to fail, and any failure would have a significant, negative effect on the economy as a whole.

89. Suppose a family owns a home that is worth $300,000, but the mortgage on this house is $320,000. What is the loan-to-value ratio regarding this mortgage?

Answer	Loan to value = $320,000 ÷ $300,000 = 1.0667
Difficulty	Moderate
Learning outcome	LO1 .3
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	Loan to value = loan outstanding ÷ value of the home

90. Explain the importance of the global financial markets to U.S. investors.

Answer

- Global financial markets represent important sources of funds for borrowers and provide investors with significant alternatives.
- U.S. debt and equity markets represent only a small proportion of the total global marketplace. Therefore, it makes sense for U.S. investors to borrow and invest abroad, which has become easier to do in today's global business environment as investment barriers are relaxed.
- There is substantial investment in the U.S. by non-U.S. investors, and there is also substantial investment outside the U.S. by U.S. investors.
- The world's money markets and bond markets are very global in nature.
- Securities exchanges around the world have been consolidating.
- The globalization of the equity markets means that linkages between the markets are getting tighter.

Difficulty	Difficult
Learning outcome	LO 1.3
Bloom's taxonomy	Describe
AACSB	Analytical skills
Feedback	Any of the above ideas would be acceptable. Student does not need to have all of the above to illustrate an understanding of the importance of global financial markets to U.S. investors.

