

Chapter 01 Testbank

1. The exchange of goods and services is made more efficient by:
 - A. barter.
 - B. money.
 - C. governments.
 - D. some combination of government transfer and barter.

2. The term 'medium of exchange' for money refers to its use as:
 - A. coinage.
 - B. currency.
 - C. something that is widely accepted as payment for goods and services.
 - D. any standard of value that prices can be expressed in.

3. The role of money as a store of value refers to:
 - A. the value of money falling only when the money supply falls.
 - B. the value of money falling only when the money supply increases.
 - C. the fact that money allows worth to be stored readily.
 - D. the fact that money never loses its value compared with other assets.

4. Money increases economic growth by assisting transfers from:
 - A. consumers to investors.
 - B. savers to borrowers.
 - C. businesses to consumers.
 - D. borrowers to investors.

5. Financial markets have developed to facilitate the exchange of money between savers and borrowers. Which of the following is NOT a function of money?
 - A. A store of value
 - B. A medium of exchange for settling economic transactions
 - C. A claim to future cash flows
 - D. Short-term protection against inflation

6. Buyers of financial claims lend their excess funds because they:
 - A. expect to borrow extra funds in the future.
 - B. want surplus funds in the future.
 - C. want to invest in the future.
 - D. want to increase their costs relative to their incomes.

7. Sellers of financial claims promise to pay back borrowed funds:
- A. by borrowing extra funds in the future.
 - B. based on their expectation of having surplus funds in the future.
 - C. by selling other assets.
 - D. by reducing their costs relative to their incomes.
8. A savings-surplus unit is an entity:
- A. that needs to borrow funds from a surplus unit.
 - B. which has an income that exceeds its spending.
 - C. whose spending exceeds its income.
 - D. called a company.
9. The process of facilitating the flow of funds between borrowers and lenders performed by the financial system:
- A. is hindered by the problem of 'double coincidence of wants'.
 - B. greatly reduces the probability of inflation.
 - C. increases the rate of economic growth of a country.
 - D. occurs only through financial intermediaries.
10. Both real and financial assets have four principal attributes that are significant factors in the investment decision process. These are:
- i. liquidity
 - ii. capital gain
 - iii. risk
 - iv. return or yield
 - v. time pattern of future cash flows
 - vi. price and cash flow volatility
- A. i, ii, iii, iv
 - B. i, iii, iv, v
 - C. i, iii, iv, vi
 - D. ii, iii, iv, v
11. Which of the following is NOT associated with characteristics of shares?
- A. Part ownership of a company
 - B. Capital gains
 - C. A fixed interest payment
 - D. Dividends
12. A financial institution that obtains most of its funds from deposits is a/an:
- A. investment bank.
 - B. unit trust.

- C. commercial bank.
- D. general insurer.

13. Institutions that specialise in off-balance-sheet advisory services are called:

- A. depository financial institutions.
- B. contractual institutions.
- C. finance companies.
- D. investment banks.

14. A financial intermediary that receives premium payments which are used to purchase assets to cover future possible payments is a:

- A. building society.
- B. credit union.
- C. savings bank.
- D. life insurance office.

15. Financial institutions whose liabilities specify that, in return for the payment of periodic funds to the institution, the institution will make payments in the future (if and when a specified event occurs) are:

- A. money market corporations.
- B. unit trusts.
- C. contractual savings institutions.
- D. depository financial institutions.

16. Financial institutions that raise the majority of their funds by selling securities in the money markets are:

- A. commercial banks.
- B. building societies.
- C. finance companies.
- D. life insurance offices.

17. Financial institutions that are formed under a trust deed and attract funds by inviting the public to buy units are:

- A. finance companies
- B. building societies.
- C. unit trusts.
- D. life insurance offices.

18. Which of the following is NOT a term associated with shares?

- A. Residual
- B. Ownership

- C. Voting rights
- D. Contractual claim

19. Which of the following is NOT a characteristic commonly associated with preference shares?

- A. A specified, fixed return
- B. No voting rights
- C. Higher ranking than bond holders on claims on assets
- D. No entitlement to take possession of assets if the borrower defaults on payment

20. Long-term debt financing instruments used by companies are called:

- A. bills.
- B. debentures.
- C. shares.
- D. equities.

21. When a borrower issues a debt instrument with collateral specified in its contract this debt instrument is called:

- A. unsecured.
- B. secured.
- C. defined.
- D. negotiable.

22. Debt instruments that can be easily sold and transferred in the financial markets are called:

- A. negotiable.
- B. secured.
- C. unsecured.
- D. discounted.

23. Which of the following is NOT a feature of a debt instrument?

- A. A contractual claim against the borrower
- B. Periodic interest payments
- C. Higher claim on assets of borrower than equity holders
- D. Their prices do not fluctuate as much as shares

24. A fundamental difference between a futures contract and an options contract is that:

- A. futures contracts are traded on organised exchanges, such as the ASX.
- B. options contracts are mainly traded over-the-counter (OTC).
- C. futures contracts are derivative instruments whereas options contracts are not.
- D. both A and B are correct.

25. Which of the following is NOT a feature of forward contracts?

- A. Forward contracts are not standardised.
- B. Forward contracts do not trade on organised exchanges.
- C. The contract price may be settled at the end of the contract.
- D. Forward contracts are closed out by trading an opposite contract.

26. Which of the following is NOT a feature of option contracts?

- A. The buyer does not have an obligation to proceed with the contract.
- B. The writer of the contract receives a fee.
- C. The price of the designated asset is determined at the beginning of the contract.
- D. The right to buy is called a put option.

27. Which of the following is NOT a feature of swaps?

- A. There is a contractual arrangement to exchange cash flows
- B. Interest rate swaps exchange principal at the beginning and the end
- C. A fixed rate obligation may be exchanged for a variable rate obligation
- D. A swap can involve interest payments and currencies

28. A key reason for the existence of a wide range of financial instruments and markets is: (a) the matching principle; (b) people in modern economies like to trade; and:

- A. that holders of shares generally want to exchange them for bonds and other financial instruments.
- B. the high expenditure for many individuals and businesses.
- C. that the lack of money in an economy makes trade in financial assets necessary.
- D. the refusal of most modern governments to print money on demand.

29. Financial markets:

- A. facilitate the exchange of financial assets.
- B. provide information about prices of financial assets.
- C. provide a channel for funds to flow between the providers and users of funds.
- D. all of the given choices.

30. The most important function of a financial market is to:

- A. provide information about shares.
- B. provide a market for shares.
- C. facilitate the flow of funds between lenders and borrowers.
- D. provide employment for brokers and agents.

31. Secondary financial markets

- A. are where companies issue new debt and equity capital.
- B. provide liquidity to primary markets financial markets.

- C. transmit funds indirectly between lenders and borrowers.
- D. usually provide investors with lower liquidity than primary markets.

32. A primary financial market is one that:

- A. offers financial assets with the highest expected return.
- B. offers the greatest number of financial assets.
- C. involves the sale of financial assets for the first time.
- D. offers financial assets with the highest historical return.

33. A secondary financial market is one that:

- A. offers financial assets with the highest expected return.
- B. offers the greatest number of financial assets.
- C. involves the sale of existing financial assets.
- D. offers financial assets with the highest historical return.

34. Purchasing shares on the Australian Securities Exchange is an example of:

- A. a primary market transaction.
- B. companies raising finance from another financial intermediary.
- C. companies raising new finance.
- D. a secondary market transaction.

35. When a security is sold in the financial markets for the first time:

- A. funds flow from the saver to the issuer.
- B. funds flow from the borrower to the saver.
- C. it represents a secondary transaction to the underwriter.
- D. it is an asset for the borrower.

36. Which of the following is NOT an example of primary market transactions?

- A. A company issue of shares to raise funds for an investment project
- B. A government issue of bonds
- C. A mortgage bond
- D. A mortgage loan to buy a house

37. A 'primary market' is a market:

- A. only for equity issues by major or 'primary' companies.
- B. where borrowers sell new financial instruments to buyers.
- C. where savers sell new financial claims to borrowers.
- D. where government securities are bought and sold.

38. Buying bonds in the capital markets is an example of:

- A. a secondary market transaction.
- B. a primary market transaction.
- C. companies raising new funds.
- D. companies raising funds from a secondary source.

39. The market where existing securities are sold is the:

- A. economic market.
- B. primary market.
- C. secondary market.
- D. financial market.

40. When a large company issues a financial instrument into the financial markets:

- A. funds flow indirectly from saver to borrower.
- B. the cost of funds is generally higher owing to the risk involved.
- C. it buys a financial claim.
- D. it sells a financial claim.

41. Secondary markets:

- A. allow borrowers to raise long-term funds.
- B. facilitate capital-raising in the primary market.
- C. do not raise new funds but offer liquidity.
- D. all of the given answers.

42. The flow of funds through financial markets increases the volume of savings and investment by:

- A. maintaining low interest rates.
- B. storing large quantities of cash.
- C. providing savers with a variety of ways to lend to borrowers.
- D. offering lower interest rates than could be obtained directly from borrowers.

43. Which of the following statements is NOT a feature of financial markets?

- A. Financial markets generally provide borrowers with lower cost funds than through a financial intermediary.
- B. Funds are channelled directly from savers to borrowers.
- C. Contractual agreements are issued between savers and borrowers.
- D. Financial markets generally deal only with the purchase and sale of government securities.

44. Which of the following is NOT true? A well-functioning financial market:

- A. has a steadily increasing liquidity for most assets.
- B. offers increased ease of restructuring portfolios of assets.
- C. has a quick assimilation of information into asset prices.

D. has a selection of financial assets with similar timings of cash flow.

45. Financial markets:

- A. act as intermediaries between borrowers and savers.
- B. directly issue claims on savers to borrowers.
- C. involve the buying and selling of existing financial securities only.
- D. involve both primary and secondary transactions.

46. Direct financing allows a borrower to:

- A. easily assess a lender's level of default risk.
- B. match amounts and maturity of investments with borrowers.
- C. lower search and transaction costs.
- D. diversify their funding sources.

47. Which of the following is NOT a possible disadvantage of direct financing?

- A. Matching amounts of funds to be borrowed with those to be lent
- B. Assessment of the risk of the borrower
- C. Cost of preparing legal contracts, taxation and accounting advice
- D. Cost of the financial intermediary involved

48. An issue of debentures is an example of:

- A. a secondary market transaction.
- B. fundraising through financial intermediaries.
- C. a direct form of funding.
- D. an indirect form of funding.

49. An example of an indirect form of funding is a/an:

- A. issue of debentures.
- B. issue of unsecured notes.
- C. term loan.
- D. issue of shares.

50. Which of the following is NOT a major advantage of direct finance?

- A. Direct finance reduces financial institution' fees.
- B. Direct finance allows borrowers to diversify sources of funds.
- C. Direct finance allows greater flexibility in funding types.
- D. Direct finance reduces search and transactions costs.

51. Financial intermediaries:

- A. act as a third party by holding a portfolio of assets and issuing claims based on them to savers.

- B. issue claims on future cash flows of individual borrowers directly to lenders.
- C. transmit funds directly between lenders and borrowers.
- D. usually provide lenders with lower returns than other financial institutions.

52. The flow of funds between lenders and borrowers is channelled:

- A. indirectly through financial markets.
- B. directly through financial intermediaries.
- C. indirectly through financial intermediaries.
- D. mainly through government agencies.

53. 'Intermediaries, by managing the deposits they receive, are able to make long-term loans while satisfying savers' preferences for liquid claims.' This statement is referring to which important attribute of financial intermediation?

- A. Asset transformation
- B. Maturity transformation
- C. Credit risk transformation
- D. Denomination transformation

54. The main role of financial intermediaries is to:

- A. borrow funds from surplus units and lend them to borrowers.
- B. provide advice to consumers on their finances.
- C. provide funds for the government to cover budget deficits.
- D. help ensure there are enough funds in circulation in a country.

55. Financial intermediaries pool the funds of:

- A. many small savers and make loans to a few large borrowers.
- B. a few savers and make loans to many borrowers.
- C. many small savers and make loans to many borrowers.
- D. a few large savers and make loans to a few large borrowers.

56. The transaction costs associated with acquiring and disposing of a financial asset can often be quite high. A financial intermediary may have the capacity to lower transaction fees by:

- A. issuing further securities directly into the capital markets.
- B. holding none of their financial assets in a liquid form.
- C. spreading fixed costs across a large number of transactions.
- D. making loans of a shorter-term nature.

57. Financial intermediaries can engage in credit risk transformation because they:

- A. obtain cost advantages owing to their size and business volumes transacted.
- B. can quickly convert financial assets into cash, close to the current market price.
- C. develop expertise in lending and diversifying loans.

D. can pool savers' short-term deposits and make long-term loans.

58. When a financial intermediary collects together deposits and lends them out as loans to companies, it is engaging in:

- A. liability management.
- B. liquidity management.
- C. credit transformation.
- D. asset transformation.

59. 'Liquidity' in financial terms is:

- A. a feature of money only.
- B. the ease with which an asset can be sold at the published market price.
- C. the best measure of risk of a financial asset.
- D. to lower the rate of return for an asset.

60. When an individual has immediate access to their funds from an account with a financial intermediary, the intermediary is engaging in:

- A. asset transformation.
- B. liability management.
- C. liquidity management.
- D. credit transformation.

61. When a financial intermediary can repeatedly use standardised documents, it is engaging in:

- A. liability management.
- B. liquidity management.
- C. credit transformation.
- D. economies of scale.

62. According to the textbook, all of the following are financial intermediaries except a/an:

- A. bank.
- B. insurance company.
- C. superannuation fund.
- D. share broking firm.

63. An example of a financial intermediary is:

- A. a stockbroker.
- B. the Australian Securities Exchange.
- C. the Australian Securities Commission.
- D. an insurance company.

64. The main participants in the financial system are individuals, corporations and governments. Individuals are generally _____ of funds and corporations are net _____ of funds.

- A. borrowers; suppliers
- B. users; providers
- C. suppliers; users
- D. demanders; providers

65. Which of the following borrowers would pay the lowest interest rate on debts of equal maturity?

- A. The National Bank of Australia
- B. Telstra
- C. The City of Sydney
- D. The Commonwealth Government

66. Generally, in the long term, a government:

- A. is a net borrower of funds.
- B. is a net supplier of funds.
- C. borrows funds directly from households.
- D. borrows funds directly from the financial market.

67. The _____ is created by a financial connection between providers and users of short-term funds.

- A. share market
- B. capital market
- C. money market
- D. financial market

68. Which of the following is NOT usually a short-term discount security?

- A. Negotiable certificates of deposit
- B. Commercial paper
- C. Bank bills
- D. Unsecured notes

69. Which of the following is NOT a feature of the money market?

- A. It is a mainly wholesale market.
- B. It deals with short-term financial claims.
- C. It is important in financing the working-capital needs of businesses and governments.
- D. It only operates as a market in which new security issues are created and marketed.

70. The market that involves the buying and selling of short-term securities is the:

- A. securities market.

- B. money market.
- C. share market.
- D. capital market.

71. A large company with a temporary surplus of funds is most likely to buy:

- A. bank bills.
- B. convertible notes.
- C. debentures.
- D. shares.

72. A company that issues promissory notes into the short-term debt markets is conducting a transaction in the:

- A. commercial paper market.
- B. inter-bank market.
- C. bills market.
- D. official short-term money market.

73. A company with a high credit rating can issue _____ directly into the money markets.

- A. CDs
- B. Commercial paper
- C. unsecured notes
- D. debentures

74. The market that generally involves the buying and selling of discount securities is the:

- A. securities market.
- B. money market.
- C. share market.
- D. capital market.

75. A source of short-term liquidity funding for banks is the issue of:

- A. bank bills.
- B. debentures.
- C. certificates of deposit.
- D. commercial paper.

76. The market that includes individuals, companies and governments in the buying and selling of long-term debt and equity securities is the:

- A. currency market.
- B. debt market.
- C. capital market.
- D. financial market.

77. When a company issues a long-term debt instrument with no security attached it is selling _____ to investors.

- A. shares
- B. debentures
- C. unsecured notes
- D. term loans

78. From the viewpoint of a corporation, which source of long-term funding does not have to be repaid?

- A. Equity
- B. Commercial paper
- C. Corporate bonds
- D. Bank bills

79. The term 'liquidity' refers to:

- A. the length of time required to sell an asset.
- B. the price discount received from buying an asset.
- C. the price discount received from selling an asset.
- D. access to cash and other sources of funds to meet day-to-day expenses.

80. The major financial assets traded in the capital market are:

- A. bank bills and commercial paper.
- B. Treasury notes and certificates of deposits.
- C. bonds and convertible securities.
- D. shares and bonds.

81. Compared with Treasury bonds, Treasury notes generally:

- A. have a longer maturity.
- B. pay interest annually.
- C. are issued in the capital markets.
- D. are discount securities.

82. If you purchase an Australian government bond, that bond is:

- A. an asset to you but a liability for the Australian government.
- B. an asset to you as well as an asset for the Australian government.
- C. a liability to you but an asset for the Australian government.
- D. a liability to you as well as a liability for the Australian government.

83. When government borrowing reduces the amount of funds available for lending to businesses, this is called:

- A. credit rationing.
- B. crowding out.
- C. capital rationing.
- D. government quotas.

84. All of the following are key financial services provided by the financial system except:

- A. liquidity.
- B. risk transfer.
- C. profitability.
- D. information.

85. Which of the following would be most likely to use financial markets to borrow?

- A. A household with a small amount saved
- B. A small business wanting to borrow to buy some machinery
- C. A government authority wanting to borrow to finance highway construction
- D. A company with a poor credit rating

86. Generally, financial instruments are divided into three broad categories of equity, debt and derivatives. Which of the following are usually issued by a company to raise new funds?

- i. Unsecured notes
 - ii. Ordinary shares
 - iii. Debentures
 - iv. Bills of exchange
 - v. Futures contracts
 - vi. Preference shares
- A. ii, iii, iv, v
 - B. ii, iv, v, vi
 - C. i, ii, iii, iv
 - D. i, ii, iv, v

87. The movement of funds between the four sectors of a domestic economy and the rest of the world is called:

- A. flow of funds.
- B. sector analysis.
- C. sectorial flows.
- D. cross-sector flows.

88. As a broad generalisation, in the sectorial flow of funds households are typically:

- A. a deficit sector.
- B. a surplus sector.
- C. fluctuates between a deficit sector and a neutral sector.
- D. borrowers.

89. The flow of funds between the sectors of a nation-state:

- A. varies from year to year.
- B. depends on the business cycle.
- C. depends on the levels of economic activity.
- D. relates to all of the given answers.

90. Assume that depositors want to be able to withdraw their money at almost any time and assume that businesses like to borrow funds for two years or more. As a consequence, banks will naturally _____ the matching principle. With the matching principle the amount of short-term assets approximately should equal the amount of _____.

- A. meet; short-term liabilities
- B. meet; long-term assets
- C. not meet; short-term liabilities
- D. not meet; long-term assets

91. From the viewpoint of a corporation primary markets _____ and secondary markets _____.

- A. transfer claims; transfer claims
- B. transfer claims; raise funds
- C. raise funds; raise funds
- D. raise funds; transfer claims

92. A financial market would be judged as value-creating (or efficient) when:

- A. it transfers funds from those with good investment ideas to those with poor investment ideas.
- B. it transfers funds from those with poor investment ideas to those with good investment ideas.
- C. it creates more opportunities for most investors to make money.
- D. banks are liquid.

93. Which factor appeared to be fundamental to the Asian financial crisis?

- A. Easy bank credit
- B. Anti-inflationary monetary policy
- C. Weak economic performance for most of the 1990s
- D. Undervalued Asian currencies

94. Securitisation occurs when:

- A. an investor buys securities.
- B. a company buys up assets of a certain type and sells claims against these assets.
- C. a liquid asset is transformed into an illiquid asset.
- D. a bank takes deposits and funds new loans.

95. Direct finance has this characteristic:

- A. asset transformation
- B. contractual relationship between the ultimate supplier of funds and the user of funds
- C. maturity transformation
- D. liquidity transformation

96. Money market securities are _____, whilst capital market securities are _____.

- A. both debt and equity; only debt
- B. only debt; only equity
- C. only equity; both debt and equity
- D. only debt; both debt and equity

97. In terms of asset size the three largest financial institutions in declining order are:

- A. commercial banks, Reserve Bank, general insurance offices.
- B. commercial banks, superannuation funds, public unit trusts.
- C. Reserve Bank, commercial banks, building societies.
- D. commercial banks, life insurance offices, superannuation funds.

98. The matching principle involves funding short-term assets with long-term liabilities/owners equity and funding long-term assets with short-term liabilities.

True False

99. Four main attributes of an asset are return, risk, volatility and time-pattern of cash flows.

True False

100. Deficit entities purchase financial instruments that offer the lowest interest rate.

True False

101. Individuals may be categorised as risk averse, risk neutral or risk takers. Risk averse individuals will accept a lower rate of return so as to reduce their risk exposure.

True False

102. A well-functioning financial system enables participants to readily change the composition of their financial assets portfolio.

True False

103. Monetary policy relates to actions of a central bank to control the amount of money for transactions in an economy.

True False

104. The government organisation responsible for the conduct of monetary policy is the prudential supervisor of a country's banks.

True False

105. The return or yield on an ordinary share is calculated using only the dividend paid to the shareholder.

True False

106. In recent years, depository financial institutions have obtained a large proportion of their funds from the financial markets directly.

True False

107. A financial call/put option gives the holder the right and obligation to buy/sell the underlying asset in the future.

True False

108. Margin trading is the sale of a financial product that the seller does not own and who intends to buy back at a lower price later.

True False

109. Explain the advantages of financial intermediation.

110. What is monetary policy and who is responsible for its implementation?

111. Explain what a debt security is. What are some common types of debt securities?

112. Identify and explain briefly the types of derivatives in a financial system.

113. The capital markets provide the opportunity for large corporations to manage their long-term cash flows. Discuss this statement using the example of a surplus entity and a deficit entity.

114. The fundamental cause of a crisis is established in the boom period. Describe how a financial crisis starts in the boom. You can illustrate this with either the Asian financial crisis or the sub-prime mortgage crisis.

115. Explain why restrictions on capital movements are not consistent with globalisation.

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- C. governments.
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Ans: B

AACSB: Communication
Bloom's: Knowledge
Difficulty: Easy
Est time: <1 minute
Section: Introduction
Topic: Introduction

Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

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- D. Short-term protection against inflation

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Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

Section: Introduction
Topic: Introduction

8. A savings-surplus unit is an entity:

A. that needs to borrow funds from a surplus unit.

B. which has an income that exceeds its spending.

C. whose spending exceeds its income.

D. called a company.

Ans: B

AACSB: Communication
Bloom's: Knowledge
Difficulty: Easy
Est time: <1 minute

Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

Section: Introduction
Topic: Introduction

9. The process of facilitating the flow of funds between borrowers and lenders performed by the financial system:

A. is hindered by the problem of 'double coincidence of wants'.

B. greatly reduces the probability of inflation.

C. increases the rate of economic growth of a country.

D. occurs only through financial intermediaries.

Ans: C

AACSB: Communication
Bloom's: Knowledge
Difficulty: Medium
Est time: <1 minute

Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

Section: Introduction
Topic: Introduction

10. Both real and financial assets have four principal attributes that are significant factors in the investment decision process. These are:

i. liquidity

ii. capital gain

iii. risk

iv. return or yield

v. time pattern of future cash flows

vi. price and cash flow volatility

- A. i, ii, iii, iv
- B. i, iii, iv, v
- C. i, iii, iv, vi
- D. ii, iii, iv, v

Ans: B

AACSB: Reflective thinking
Bloom's: Evaluation
Difficulty: Medium
Est time: <1 minute

Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

Section: 1.02 The financial system and financial institutions
Topic: The financial system and financial institutions

11. Which of the following is NOT associated with characteristics of shares?

- A. Part ownership of a company
- B. Capital gains
- C. A fixed interest payment
- D. Dividends

Ans: C

AACSB: Diverse and multicultural
Bloom's: Evaluation
Difficulty: Easy
Est time: <1 minute

Learning Objective: 1.03 Define the main classes of financial instruments that are issued into the financial system, that is, equity, debt, hybrids and derivatives.

Section: 1.02 The financial system and financial institutions
Topic: The financial system and financial institutions

12. A financial institution that obtains most of its funds from deposits is a/an:

- A. investment bank.
- B. unit trust.
- C. commercial bank.
- D. general insurer.

Ans: C

AACSB: Reflective thinking
Bloom's: Analysis
Difficulty: Easy
Est time: <1 minute

Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

Section: 1.02 The financial system and financial institutions
Topic: The financial system and financial institutions

13. Institutions that specialise in off-balance-sheet advisory services are called:

- A. depository financial institutions.
- B. contractual institutions.
- C. finance companies.
- D. investment banks.

Ans: D

AACSB: Communication

Bloom's: Comprehension

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

Section: 1.02 The financial system and financial institutions

Topic: The financial system and financial institutions

14. A financial intermediary that receives premium payments which are used to purchase assets to cover future possible payments is a:

- A. building society.
- B. credit union.
- C. savings bank.
- D. life insurance office.

Ans: D

AACSB: Reflective thinking

Bloom's: Evaluation

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

Section: 1.02 The financial system and financial institutions

Topic: The financial system and financial institutions

15. Financial institutions whose liabilities specify that, in return for the payment of periodic funds to the institution, the institution will make payments in the future (if and when a specified event occurs) are:

- A. money market corporations.
- B. unit trusts.
- C. contractual savings institutions.
- D. depository financial institutions.

Ans: C

AACSB: Communication

Bloom's: Knowledge

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

Section: 1.02 The financial system and financial institutions

Topic: The financial system and financial institutions

16. Financial institutions that raise the majority of their funds by selling securities in the money markets are:

- A. commercial banks.
- B. building societies.
- C. finance companies.
- D. life insurance offices.

Ans: C

AACSB: Communication

Bloom's: Knowledge

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

Section: 1.02 The financial system and financial institutions

Topic: The financial system and financial institutions

17. Financial institutions that are formed under a trust deed and attract funds by inviting the public to buy units are:

- A. finance companies
- B. building societies.
- C. unit trusts.
- D. life insurance offices.

Ans: C

AACSB: Reflective thinking

Bloom's: Synthesis

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

Section: 1.02 The financial system and financial institutions

Topic: The financial system and financial institutions

18. Which of the following is NOT a term associated with shares?

- A. Residual
- B. Ownership
- C. Voting rights
- D. Contractual claim

Ans: D

AACSB: Communication

Bloom's: Comprehension

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.03 Define the main classes of financial instruments that are issued into the financial system, that is, equity, debt, hybrids and derivatives.

Section: 1.03 Financial instruments

Topic: Financial instruments

19. Which of the following is NOT a characteristic commonly associated with preference shares?

- A. A specified, fixed return
- B. No voting rights
- C. Higher ranking than bond holders on claims on assets
- D. No entitlement to take possession of assets if the borrower defaults on payment

Ans: C

AACSB: Communication

Bloom's: Comprehension

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.03 Define the main classes of financial instruments that are issued into the financial system, that is, equity, debt, hybrids and derivatives.

Section: 1.03 Financial instruments

Topic: Financial instruments

20. Long-term debt financing instruments used by companies are called:

- A. bills.
- B. debentures.
- C. shares.
- D. equities.

Ans: B

AACSB: Communication

Bloom's: Comprehension

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.03 Define the main classes of financial instruments that are issued into the financial system, that is, equity, debt, hybrids and derivatives.

Section: 1.03 Financial instruments

Topic: Financial instruments

21. When a borrower issues a debt instrument with collateral specified in its contract this debt instrument is called:

- A. unsecured.
- B. secured.
- C. defined.
- D. negotiable.

Ans: B

AACSB: Communication

Bloom's: Comprehension

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.03 Define the main classes of financial instruments that are issued into the financial system, that is, equity, debt, hybrids and derivatives.

Section: 1.03 Financial instruments

Topic: Financial instruments

22. Debt instruments that can be easily sold and transferred in the financial markets are called:

- A. negotiable.
- B. secured.
- C. unsecured.
- D. discounted.

Ans: A

AACSB: Reflective thinking
Bloom's: Synthesis
Difficulty: Easy
Est time: <1 minute

Learning Objective: 1.03 Define the main classes of financial instruments that are issued into the financial system, that is, equity, debt, hybrids and derivatives.

Section: 1.03 Financial instruments
Topic: Financial instruments

23. Which of the following is NOT a feature of a debt instrument?

- A. A contractual claim against the borrower
- B. Periodic interest payments
- C. Higher claim on assets of borrower than equity holders
- D. Their prices do not fluctuate as much as shares

Ans: D

AACSB: Reflective thinking
Bloom's: Synthesis
Difficulty: Medium
Est time: <1 minute

Learning Objective: 1.03 Define the main classes of financial instruments that are issued into the financial system, that is, equity, debt, hybrids and derivatives.

Section: 1.03 Financial instruments
Topic: Financial instruments

24. A fundamental difference between a futures contract and an options contract is that:

- A. futures contracts are traded on organised exchanges, such as the ASX.
- B. options contracts are mainly traded over-the-counter (OTC).
- C. futures contracts are derivative instruments whereas options contracts are not.
- D. both A and B are correct.

Ans: D

AACSB: Reflective thinking
Bloom's: Synthesis
Difficulty: Easy
Est time: <1 minute

Learning Objective: 1.03 Define the main classes of financial instruments that are issued into the financial system, that is, equity, debt, hybrids and derivatives.

Section: 1.03 Financial instruments
Topic: Financial instruments

25. Which of the following is NOT a feature of forward contracts?

- A. Forward contracts are not standardised.
- B. Forward contracts do not trade on organised exchanges.
- C. The contract price may be settled at the end of the contract.
- D. Forward contracts are closed out by trading an opposite contract.

Ans: D

AACSB: Reflective thinking

Bloom's: Synthesis

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.03 Define the main classes of financial instruments that are issued into the financial system, that is, equity, debt, hybrids and derivatives.

Section: 1.03 Financial instruments

Topic: Financial instruments

26. Which of the following is NOT a feature of option contracts?

- A. The buyer does not have an obligation to proceed with the contract.
- B. The writer of the contract receives a fee.
- C. The price of the designated asset is determined at the beginning of the contract.
- D. The right to buy is called a put option.

Ans: D

AACSB: Reflective thinking

Bloom's: Synthesis

Difficulty: Medium

Est time: <1 minute

Learning Objective: 1.03 Define the main classes of financial instruments that are issued into the financial system, that is, equity, debt, hybrids and derivatives.

Section: 1.03 Financial instruments

Topic: Financial instruments

27. Which of the following is NOT a feature of swaps?

- A. There is a contractual arrangement to exchange cash flows
- B. Interest rate swaps exchange principal at the beginning and the end
- C. A fixed rate obligation may be exchanged for a variable rate obligation
- D. A swap can involve interest payments and currencies

Ans: B

AACSB: Reflective thinking

Bloom's: Synthesis

Difficulty: Medium

Est time: <1 minute

Learning Objective: 1.03 Define the main classes of financial instruments that are issued into the financial system, that is, equity, debt, hybrids and derivatives.

Section: 1.03 Financial instruments

Topic: Financial instruments

28. A key reason for the existence of a wide range of financial instruments and markets is: (a) the matching principle; (b) people in modern economies like to trade; and:

- A. that holders of shares generally want to exchange them for bonds and other financial instruments.
- B. the high expenditure for many individuals and businesses.
- C. that the lack of money in an economy makes trade in financial assets necessary.
- D. the refusal of most modern governments to print money on demand.

Ans: A

AACSB: Reflective thinking
Bloom's: Synthesis
Difficulty: Medium
Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets
Topic: Financial markets

29. Financial markets:

- A. facilitate the exchange of financial assets.
- B. provide information about prices of financial assets.
- C. provide a channel for funds to flow between the providers and users of funds.
- D. all of the given choices.

Ans: D

AACSB: Reflective thinking
Bloom's: Knowledge
Difficulty: Easy
Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets
Topic: Financial markets

30. The most important function of a financial market is to:

- A. provide information about shares.
- B. provide a market for shares.
- C. facilitate the flow of funds between lenders and borrowers.
- D. provide employment for brokers and agents.

Ans: C

AACSB: Reflective thinking
Bloom's: Knowledge
Difficulty: Easy
Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets
Topic: Financial markets

31. Secondary financial markets

- A. are where companies issue new debt and equity capital.
- B. provide liquidity to primary markets financial markets.
- C. transmit funds indirectly between lenders and borrowers.
- D. usually provide investors with lower liquidity than primary markets.

Ans: B

*AACSB: Reflective thinking**Bloom's: Knowledge**Difficulty: Hard**Est time: <1 minute**Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.**Section: 1.04 Financial markets**Topic: Financial markets*

32. A primary financial market is one that:

- A. offers financial assets with the highest expected return.
- B. offers the greatest number of financial assets.
- C. involves the sale of financial assets for the first time.
- D. offers financial assets with the highest historical return.

Ans: C

*AACSB: Reflective thinking**Bloom's: Knowledge**Difficulty: Easy**Est time: <1 minute**Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.**Section: 1.04 Financial markets**Topic: Financial markets*

33. A secondary financial market is one that:

- A. offers financial assets with the highest expected return.
- B. offers the greatest number of financial assets.
- C. involves the sale of existing financial assets.
- D. offers financial assets with the highest historical return.

Ans: C

*AACSB: Reflective thinking**Bloom's: Knowledge**Difficulty: Easy**Est time: <1 minute**Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.**Section: 1.04 Financial markets**Topic: Financial markets*

34. Purchasing shares on the Australian Securities Exchange is an example of:

- A. a primary market transaction.
- B. companies raising finance from another financial intermediary.
- C. companies raising new finance.
- D. a secondary market transaction.

Ans: D

*AACSB: Reflective thinking**Bloom's: Knowledge**Difficulty: Easy**Est time: <1 minute**Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.**Section: 1.04 Financial markets**Topic: Financial markets*

35. When a security is sold in the financial markets for the first time:

- A. funds flow from the saver to the issuer.
- B. funds flow from the borrower to the saver.
- C. it represents a secondary transaction to the underwriter.
- D. it is an asset for the borrower.

Ans: A

*AACSB: Reflective thinking**Bloom's: Knowledge**Difficulty: Medium**Est time: <1 minute**Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.**Section: 1.04 Financial markets**Topic: Financial markets*

36. Which of the following is NOT an example of primary market transactions?

- A. A company issue of shares to raise funds for an investment project
- B. A government issue of bonds
- C. A mortgage bond
- D. A mortgage loan to buy a house

Ans: C

*AACSB: Reflective thinking**Bloom's: Knowledge**Difficulty: Medium**Est time: <1 minute**Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.**Section: 1.04 Financial markets**Topic: Financial markets*

37. A 'primary market' is a market:

- A. only for equity issues by major or 'primary' companies.
- B. where borrowers sell new financial instruments to buyers.
- C. where savers sell new financial claims to borrowers.
- D. where government securities are bought and sold.

Ans: B

AACSB: Reflective thinking
Bloom's: Synthesis
Difficulty: Medium
Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets
Topic: Financial markets

38. Buying bonds in the capital markets is an example of:

- A. a secondary market transaction.
- B. a primary market transaction.
- C. companies raising new funds.
- D. companies raising funds from a secondary source.

Ans: A

AACSB: Communication
Bloom's: Knowledge
Difficulty: Easy
Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets
Topic: Financial markets

39. The market where existing securities are sold is the:

- A. economic market.
- B. primary market.
- C. secondary market.
- D. financial market.

Ans: C

AACSB: Communication
Bloom's: Knowledge
Difficulty: Easy
Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets
Topic: Financial markets

40. When a large company issues a financial instrument into the financial markets:

- A. funds flow indirectly from saver to borrower.
- B. the cost of funds is generally higher owing to the risk involved.
- C. it buys a financial claim.
- D. it sells a financial claim.

Ans: D

AACSB: Communication

Bloom's: Comprehension

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

41. Secondary markets:

- A. allow borrowers to raise long-term funds.
- B. facilitate capital-raising in the primary market.
- C. do not raise new funds but offer liquidity.
- D. all of the given answers.

Ans: D

AACSB: Communication

Bloom's: Comprehension

Difficulty: Medium

Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

42. The flow of funds through financial markets increases the volume of savings and investment by:

- A. maintaining low interest rates.
- B. storing large quantities of cash.
- C. providing savers with a variety of ways to lend to borrowers.
- D. offering lower interest rates than could be obtained directly from borrowers.

Ans: C

AACSB: Communication

Bloom's: Knowledge

Difficulty: Medium

Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

43. Which of the following statements is NOT a feature of financial markets?

- A. Financial markets generally provide borrowers with lower cost funds than through a financial intermediary.
- B. Funds are channelled directly from savers to borrowers.
- C. Contractual agreements are issued between savers and borrowers.
- D. Financial markets generally deal only with the purchase and sale of government securities.

Ans: D

AACSB: Communication

Bloom's: Synthesis

Difficulty: Medium

Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

44. Which of the following is NOT true? A well-functioning financial market:

- A. has a steadily increasing liquidity for most assets.
- B. offers increased ease of restructuring portfolios of assets.
- C. has a quick assimilation of information into asset prices.
- D. has a selection of financial assets with similar timings of cash flow.

Ans: D

AACSB: Communication

Bloom's: Comprehension

Difficulty: Hard

Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

45. Financial markets:

- A. act as intermediaries between borrowers and savers.
- B. directly issue claims on savers to borrowers.
- C. involve the buying and selling of existing financial securities only.
- D. involve both primary and secondary transactions.

Ans: D

AACSB: Communication

Bloom's: Synthesis

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

46. Direct financing allows a borrower to:

- A. easily assess a lender's level of default risk.
- B. match amounts and maturity of investments with borrowers.
- C. lower search and transaction costs.
- D. diversify their funding sources.

Ans: D

AACSB: Communication

Bloom's: Synthesis

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

47. Which of the following is NOT a possible disadvantage of direct financing?

- A. Matching amounts of funds to be borrowed with those to be lent
- B. Assessment of the risk of the borrower
- C. Cost of preparing legal contracts, taxation and accounting advice
- D. Cost of the financial intermediary involved

Ans: D

AACSB: Communication

Bloom's: Synthesis

Difficulty: Medium

Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

48. An issue of debentures is an example of:

- A. a secondary market transaction.
- B. fundraising through financial intermediaries.
- C. a direct form of funding.
- D. an indirect form of funding.

Ans: C

AACSB: Reflective thinking

Bloom's: Synthesis

Difficulty: Medium

Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

49. An example of an indirect form of funding is a/an:

- A. issue of debentures.
- B. issue of unsecured notes.
- C. term loan.
- D. issue of shares.

Ans: C

AACSB: Communication

Bloom's: Synthesis

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

50. Which of the following is NOT a major advantage of direct finance?

- A. Direct finance reduces financial institution' fees.
- B. Direct finance allows borrowers to diversify sources of funds.
- C. Direct finance allows greater flexibility in funding types.
- D. Direct finance reduces search and transactions costs.

Ans: D

AACSB: Reflective thinking

Bloom's: Synthesis

Difficulty: Medium

Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

51. Financial intermediaries:

- A. act as a third party by holding a portfolio of assets and issuing claims based on them to savers.
- B. issue claims on future cash flows of individual borrowers directly to lenders.
- C. transmit funds directly between lenders and borrowers.
- D. usually provide lenders with lower returns than other financial institutions.

Ans: A

AACSB: Reflective thinking

Bloom's: Synthesis

Difficulty: Hard

Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

52. The flow of funds between lenders and borrowers is channelled:

- A. indirectly through financial markets.
- B. directly through financial intermediaries.
- C. indirectly through financial intermediaries.
- D. mainly through government agencies.

Ans: C

*AACSB: Reflective thinking**Bloom's: Knowledge**Difficulty: Easy**Est time: <1 minute**Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.**Section: 1.04 Financial markets**Topic: Financial markets*

53. 'Intermediaries, by managing the deposits they receive, are able to make long-term loans while satisfying savers' preferences for liquid claims.' This statement is referring to which important attribute of financial intermediation?

- A. Asset transformation
- B. Maturity transformation
- C. Credit risk transformation
- D. Denomination transformation

Ans: B

*AACSB: Reflective thinking**Bloom's: Synthesis**Difficulty: Medium**Est time: <1 minute**Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.**Section: 1.04 Financial markets**Topic: Financial markets*

54. The main role of financial intermediaries is to:

- A. borrow funds from surplus units and lend them to borrowers.
- B. provide advice to consumers on their finances.
- C. provide funds for the government to cover budget deficits.
- D. help ensure there are enough funds in circulation in a country.

Ans: A

*AACSB: Reflective thinking**Bloom's: Synthesis**Difficulty: Easy**Est time: <1 minute**Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.**Section: 1.04 Financial markets**Topic: Financial markets*

55. Financial intermediaries pool the funds of:

- A. many small savers and make loans to a few large borrowers.
- B. a few savers and make loans to many borrowers.
- C. many small savers and make loans to many borrowers.
- D. a few large savers and make loans to a few large borrowers.

Ans: C

*AACSB: Reflective thinking**Bloom's: Evaluation**Difficulty: Medium**Est time: <1 minute**Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.**Section: 1.04 Financial markets**Topic: Financial markets*

56. The transaction costs associated with acquiring and disposing of a financial asset can often be quite high. A financial intermediary may have the capacity to lower transaction fees by:

- A. issuing further securities directly into the capital markets.
- B. holding none of their financial assets in a liquid form.
- C. spreading fixed costs across a large number of transactions.
- D. making loans of a shorter-term nature.

Ans: C

*AACSB: Reflective thinking**Bloom's: Synthesis**Difficulty: Easy**Est time: <1 minute**Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.**Section: 1.04 Financial markets**Topic: Financial markets*

57. Financial intermediaries can engage in credit risk transformation because they:

- A. obtain cost advantages owing to their size and business volumes transacted.
- B. can quickly convert financial assets into cash, close to the current market price.
- C. develop expertise in lending and diversifying loans.
- D. can pool savers' short-term deposits and make long-term loans.

Ans: C

*AACSB: Reflective thinking**Bloom's: Synthesis**Difficulty: Hard**Est time: <1 minute**Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.**Section: 1.04 Financial markets**Topic: Financial markets*

58. When a financial intermediary collects together deposits and lends them out as loans to companies, it is engaging in:

- A. liability management.
- B. liquidity management.
- C. credit transformation.
- D. asset transformation.

Ans: D

AACSB: Reflective thinking

Bloom's: Knowledge

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

59. 'Liquidity' in financial terms is:

- A. a feature of money only.
- B. the ease with which an asset can be sold at the published market price.
- C. the best measure of risk of a financial asset.
- D. to lower the rate of return for an asset.

Ans: B

AACSB: Communication

Bloom's: Application

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

60. When an individual has immediate access to their funds from an account with a financial intermediary, the intermediary is engaging in:

- A. asset transformation.
- B. liability management.
- C. liquidity management.
- D. credit transformation.

Ans: C

AACSB: Communication

Bloom's: Knowledge

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

61. When a financial intermediary can repeatedly use standardised documents, it is engaging in:

- A. liability management.
- B. liquidity management.
- C. credit transformation.
- D. economies of scale.

Ans: D

AACSB: Communication

Bloom's: Comprehension

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

62. According to the textbook, all of the following are financial intermediaries except a/an:

- A. bank.
- B. insurance company.
- C. superannuation fund.
- D. share broking firm.

Ans: D

AACSB: Communication

Bloom's: Comprehension

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

63. An example of a financial intermediary is:

- A. a stockbroker.
- B. the Australian Securities Exchange.
- C. the Australian Securities Commission.
- D. an insurance company.

Ans: D

AACSB: Communication

Bloom's: Comprehension

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

64. The main participants in the financial system are individuals, corporations and governments. Individuals are generally _____ of funds and corporations are net _____ of funds.

- A. borrowers; suppliers
- B. users; providers
- C. suppliers; users
- D. demanders; providers

Ans: C

AACSB: Communication

Bloom's: Comprehension

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

Section: 1.05 Flow of funds, market relationships and stability

Topic: Flow of funds, market relationships and stability

65. Which of the following borrowers would pay the lowest interest rate on debts of equal maturity?

- A. The National Bank of Australia
- B. Telstra
- C. The City of Sydney
- D. The Commonwealth Government

Ans: D

AACSB: Communication

Bloom's: Knowledge

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

Section: 1.02 The financial system and financial institutions

Topic: The financial system and financial institutions

66. Generally, in the long term, a government:

- A. is a net borrower of funds.
- B. is a net supplier of funds.
- C. borrows funds directly from households.
- D. borrows funds directly from the financial market.

Ans: A

AACSB: Communication

Bloom's: Knowledge

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

Section: 1.05 Flow of funds, market relationships and stability

Topic: Flow of funds, market relationships and stability

67. The _____ is created by a financial connection between providers and users of short-term funds.

- A. share market
- B. capital market
- C. money market
- D. financial market

Ans: C

AACSB: Communication

Bloom's: Knowledge

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

68. Which of the following is NOT usually a short-term discount security?

- A. Negotiable certificates of deposit
- B. Commercial paper
- C. Bank bills
- D. Unsecured notes

Ans: D

AACSB: Communication

Bloom's: Comprehension

Difficulty: Medium

Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

69. Which of the following is NOT a feature of the money market?

- A. It is a mainly wholesale market.
- B. It deals with short-term financial claims.
- C. It is important in financing the working-capital needs of businesses and governments.
- D. It only operates as a market in which new security issues are created and marketed.

Ans: D

AACSB: Communication

Bloom's: Knowledge

Difficulty: Medium

Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

70. The market that involves the buying and selling of short-term securities is the:

- A. securities market.
- B. money market.
- C. share market.
- D. capital market.

Ans: B

AACSB: Communication

Bloom's: Knowledge

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

71. A large company with a temporary surplus of funds is most likely to buy:

- A. bank bills.
- B. convertible notes.
- C. debentures.
- D. shares.

Ans: A

AACSB: Communication

Bloom's: Knowledge

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

72. A company that issues promissory notes into the short-term debt markets is conducting a transaction in the:

- A. commercial paper market.
- B. inter-bank market.
- C. bills market.
- D. official short-term money market.

Ans: A

AACSB: Communication

Bloom's: Knowledge

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

73. A company with a high credit rating can issue _____ directly into the money markets.

- A. CDs
- B. Commercial paper
- C. unsecured notes
- D. debentures

Ans: C

AACSB: Reflective thinking
Bloom's: Synthesis
Difficulty: Medium
Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets
Topic: Financial markets

74. The market that generally involves the buying and selling of discount securities is the:

- A. securities market.
- B. money market.
- C. share market.
- D. capital market.

Ans: B

AACSB: Reflective thinking
Bloom's: Synthesis
Difficulty: Easy
Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets
Topic: Financial markets

75. A source of short-term liquidity funding for banks is the issue of:

- A. bank bills.
- B. debentures.
- C. certificates of deposit.
- D. commercial paper.

Ans: C

AACSB: Reflective thinking
Bloom's: Knowledge
Difficulty: Medium
Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets
Topic: Financial markets

76. The market that includes individuals, companies and governments in the buying and selling of long-term debt and equity securities is the:

- A. currency market.
- B. debt market.
- C. capital market.
- D. financial market.

Ans: C

*AACSB: Reflective thinking**Bloom's: Knowledge**Difficulty: Easy**Est time: <1 minute**Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.**Section: 1.04 Financial markets**Topic: Financial markets*

77. When a company issues a long-term debt instrument with no security attached it is selling _____ to investors.

- A. shares
- B. debentures
- C. unsecured notes
- D. term loans

Ans: C

*AACSB: Reflective thinking**Bloom's: Synthesis**Difficulty: Easy**Est time: <1 minute**Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.**Section: 1.04 Financial markets**Topic: Financial markets*

78. From the viewpoint of a corporation, which source of long-term funding does not have to be repaid?

- A. Equity
- B. Commercial paper
- C. Corporate bonds
- D. Bank bills

Ans: A

*AACSB: Reflective thinking**Bloom's: Synthesis**Difficulty: Medium**Est time: <1 minute**Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.**Section: 1.04 Financial markets**Topic: Financial markets*

79. The term 'liquidity' refers to:

- A. the length of time required to sell an asset.
- B. the price discount received from buying an asset.
- C. the price discount received from selling an asset.
- D. access to cash and other sources of funds to meet day-to-day expenses.

Ans: D

AACSB: Communication
Bloom's: Knowledge
Difficulty: Easy
Est time: <1 minute

Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

Section: 1.02 The financial system and financial institutions

Topic: The financial system and financial institutions

80. The major financial assets traded in the capital market are:

- A. bank bills and commercial paper.
- B. Treasury notes and certificates of deposits.
- C. bonds and convertible securities.
- D. shares and bonds.

Ans: D

AACSB: Reflective thinking
Bloom's: Synthesis
Difficulty: Easy
Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

81. Compared with Treasury bonds, Treasury notes generally:

- A. have a longer maturity.
- B. pay interest annually.
- C. are issued in the capital markets.
- D. are discount securities.

Ans: D

AACSB: Communication
Bloom's: Knowledge
Difficulty: Medium
Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

82. If you purchase an Australian government bond, that bond is:

- A. an asset to you but a liability for the Australian government.
- B. an asset to you as well as an asset for the Australian government.
- C. a liability to you but an asset for the Australian government.
- D. a liability to you as well as a liability for the Australian government.

Ans: A

AACSB: Communication

Bloom's: Knowledge

Difficulty: Hard

Est time: <1 minute

Learning Objective: 1.03 Define the main classes of financial instruments that are issued into the financial system, that is, equity, debt, hybrids and derivatives.

Section: 1.04 Financial markets

Topic: Financial markets

83. When government borrowing reduces the amount of funds available for lending to businesses, this is called:

- A. credit rationing.
- B. crowding out.
- C. capital rationing.
- D. government quotas.

Ans: B

AACSB: Communication

Bloom's: Knowledge

Difficulty: Medium

Est time: <1 minute

Learning Objective: 1.06 Analyse the flow of funds through the financial system and the economy, and briefly discuss the importance of 'stability' in relation to the flow of funds.

Section: 1.04 Financial markets

Topic: Financial markets

84. All of the following are key financial services provided by the financial system except:

- A. liquidity.
- B. risk transfer.
- C. profitability.
- D. information.

Ans: C

AACSB: Communication

Bloom's: Knowledge

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

Section: 1.02 The financial system and financial institutions

Topic: The financial system and financial institutions

85. Which of the following would be most likely to use financial markets to borrow?

- A. A household with a small amount saved
- B. A small business wanting to borrow to buy some machinery
- C. A government authority wanting to borrow to finance highway construction
- D. A company with a poor credit rating

Ans: C

AACSB: Communication

Bloom's: Comprehension

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

86. Generally, financial instruments are divided into three broad categories of equity, debt and derivatives. Which of the following are usually issued by a company to raise new funds?

- i. Unsecured notes
- ii. Ordinary shares
- iii. Debentures
- iv. Bills of exchange
- v. Futures contracts
- vi. Preference shares

- A. ii, iii, iv, v
- B. ii, iv, v, vi
- C. i, ii, iii, iv
- D. i, ii, iv, v

Ans: C

AACSB: Communication

Bloom's: Comprehension

Difficulty: Medium

Est time: <1 minute

Learning Objective: 1.03 Define the main classes of financial instruments that are issued into the financial system, that is, equity, debt, hybrids and derivatives.

Section: 1.04 Financial markets

Topic: Financial markets

87. The movement of funds between the four sectors of a domestic economy and the rest of the world is called:

- A. flow of funds.
- B. sector analysis.
- C. sectorial flows.
- D. cross-sector flows.

Ans: A

AACSB: Communication

Bloom's: Comprehension

Difficulty: Medium

Est time: <1 minute

Learning Objective: 1.06 Analyse the flow of funds through the financial system and the economy, and briefly discuss the importance of 'stability' in relation to the flow of funds.

Section: 1.05 Flow of funds, market relationships and stability

Topic: Flow of funds, market relationships and stability

88. As a broad generalisation, in the sectorial flow of funds households are typically:

- A. a deficit sector.
- B. a surplus sector.

- C. fluctuates between a deficit sector and a neutral sector.
D. borrowers.

Ans: B

AACSB: Communication
Bloom's: Knowledge
Difficulty: Medium
Est time: <1 minute

Learning Objective: 1.06 Analyse the flow of funds through the financial system and the economy, and briefly discuss the importance of 'stability' in relation to the flow of funds.
Section: 1.05 Flow of funds, market relationships and stability
Topic: Flow of funds, market relationships and stability

89. The flow of funds between the sectors of a nation-state:
A. varies from year to year.
B. depends on the business cycle.
C. depends on the levels of economic activity.
D. relates to all of the given answers.

Ans: D

AACSB: Communication
Bloom's: Knowledge
Difficulty: Easy
Est time: <1 minute

Learning Objective: 1.06 Analyse the flow of funds through the financial system and the economy, and briefly discuss the importance of 'stability' in relation to the flow of funds.
Section: 1.05 Flow of funds, market relationships and stability
Topic: Flow of funds, market relationships and stability

90. Assume that depositors want to be able to withdraw their money at almost any time and assume that businesses like to borrow funds for two years or more. As a consequence, banks will naturally _____ the matching principle. With the matching principle the amount of short-term assets approximately should equal the amount of _____.
A. meet; short-term liabilities
B. meet; long-term assets
C. not meet; short-term liabilities
D. not meet; long-term assets

Ans: C

AACSB: Communication
Bloom's: Comprehension
Difficulty: Medium
Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.
Section: 1.04 Financial markets
Topic: Financial markets

91. From the viewpoint of a corporation primary markets _____ and secondary markets _____.
A. transfer claims; transfer claims
B. transfer claims; raise funds
C. raise funds; raise funds
D. raise funds; transfer claims

Ans: D

AACSB: Communication
Bloom's: Knowledge
Difficulty: Easy
Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets
Topic: Financial markets

92. A financial market would be judged as value-creating (or efficient) when:

- A. it transfers funds from those with good investment ideas to those with poor investment ideas.
- B. it transfers funds from those with poor investment ideas to those with good investment ideas.
- C. it creates more opportunities for most investors to make money.
- D. banks are liquid.

Ans: B

AACSB: Communication
Bloom's: Comprehension
Difficulty: Medium
Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets
Topic: Financial markets

93. Which factor appeared to be fundamental to the Asian financial crisis?

- A. Easy bank credit
- B. Anti-inflationary monetary policy
- C. Weak economic performance for most of the 1990s
- D. Undervalued Asian currencies

Ans: A

AACSB: Communication
Bloom's: Knowledge
Difficulty: Medium
Est time: <1 minute

Learning Objective: 1.08 Appreciate the effects, consequences and relevance of the Asian financial crisis.

Section: 1.01 Theory and facts in finance
Topic: Financial crises and the real economy

94. Securitisation occurs when:

- A. an investor buys securities.
- B. a company buys up assets of a certain type and sells claims against these assets.
- C. a liquid asset is transformed into an illiquid asset.
- D. a bank takes deposits and funds new loans.

Ans: B

AACSB: Communication
Bloom's: Knowledge
Difficulty: Easy
Est time: <1 minute

Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

Section: 1.02 The financial system and financial institutions

Topic: The financial system and financial institutions

95. Direct finance has this characteristic:

- A. asset transformation
- B. contractual relationship between the ultimate supplier of funds and the user of funds
- C. maturity transformation
- D. liquidity transformation

Ans: B

AACSB: Communication
Bloom's: Knowledge
Difficulty: Medium
Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

96. Money market securities are _____, whilst capital market securities are _____.

- A. both debt and equity; only debt
- B. only debt; only equity
- C. only equity; both debt and equity
- D. only debt; both debt and equity

Ans: D

AACSB: Communication
Bloom's: Knowledge
Difficulty: Medium
Est time: <1 minute

Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

Section: 1.04 Financial markets

Topic: Financial markets

97. In terms of asset size the three largest financial institutions in declining order are:

- A. commercial banks, Reserve Bank, general insurance offices.
- B. commercial banks, superannuation funds, public unit trusts.
- C. Reserve Bank, commercial banks, building societies.
- D. commercial banks, life insurance offices, superannuation funds.

Ans: B

AACSB: Communication
Bloom's: Comprehension
Difficulty: Medium
Est time: <1 minute

Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

Section: 1.02 The financial system and financial institutions

Topic: The financial system and financial institutions

98. The matching principle involves funding short-term assets with long-term liabilities/owners equity and funding long-term assets with short-term liabilities.

Ans: False

Feedback: Short-term assets are funded using short-term liabilities and long-term assets are funded using long-term liabilities and owners equity.

AACSB: Communication
Bloom's: Comprehension
Difficulty: Easy
Est time: <1 minute

Learning Objective: 1.03 Define the main classes of financial instruments that are issued into the financial system, that is, equity, debt, hybrids and derivatives.

Section: 1.04 Financial markets

Topic: Financial markets

99. Four main attributes of an asset are return, risk, volatility and time-pattern of cash flows.

Ans: False

Feedback: The attributes are return, risk, *liquidity* and time-pattern.

AACSB: Communication
Bloom's: Comprehension
Difficulty: Easy
Est time: <1 minute

Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

Section: 1.02 The financial system and financial institutions

Topic: The financial system and financial institutions

100. Deficit entities purchase financial instruments that offer the lowest interest rate.

Ans: False

Feedback: Deficit entities sell financial instruments.

AACSB: Communication
Bloom's: Comprehension
Difficulty: Easy
Est time: <1 minute

Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

Section: 1.02 The financial system and financial institutions

Topic: The financial system and financial institutions

101. Individuals may be categorised as risk averse, risk neutral or risk takers. Risk averse individuals will accept a lower rate of return so as to reduce their risk exposure.

Ans: True

Feedback: An investor who prefers an investment with less risk to another with more risk, provided they offer the same expected return, is risk averse.

AACSB: Communication
Bloom's: Comprehension
Difficulty: Easy
Est time: <1 minute

Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

Section: 1.02 The financial system and financial institutions
Topic: The financial system and financial institutions

102. A well-functioning financial system enables participants to readily change the composition of their financial assets portfolio.

Ans: True

Feedback: With liquid markets and financial intermediaries, investors are able to change their portfolios.

AACSB: Communication
Bloom's: Comprehension
Difficulty: Easy
Est time: <1 minute

Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

Section: Introduction
Topic: Introduction

103. Monetary policy relates to actions of a central bank to control the amount of money for transactions in an economy.

Ans: False

Feedback: From the early days of banking it was recognised that there needed to be control over the money supply. A country's central bank was usually assigned this task.

AACSB: Communication
Bloom's: Knowledge
Difficulty: Easy
Est time: <1 minute

Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

Section: 1.02 The financial system and financial institutions
Topic: The financial system and financial institutions

104. The government organisation responsible for the conduct of monetary policy is the prudential supervisor of a country's banks.

Ans: False

Feedback: Generally, the task of monetary policy is assigned to a central bank.

AACSB: Communication
Bloom's: Knowledge
Difficulty: Easy
Est time: <1 minute

Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

Section: 1.02 The financial system and financial institutions
Topic: The financial system and financial institutions

105. The return or yield on an ordinary share is calculated using only the dividend paid to the shareholder.

Ans: False

Feedback: The return or yield calculation also includes any capital gain/loss from holding the asset.

AACSB: Communication

Bloom's: Comprehension

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.03 Define the main classes of financial instruments that are issued into the financial system, that is, equity, debt, hybrids and derivatives.

Section: 1.02 The financial system and financial institutions

Topic: The financial system and financial institutions

106. In recent years, depository financial institutions have obtained a large proportion of their funds from the financial markets directly.

Ans: False

Feedback: For the major financial intermediaries (the banks) the bulk of their funds are still obtained from deposits.

AACSB: Reflective thinking

Bloom's: Evaluation

Difficulty: Easy

Est time: <1 minute

Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

Section: 1.02 The financial system and financial institutions

Topic: The financial system and financial institutions

107. A financial call/put option gives the holder the right and obligation to buy/sell the underlying asset in the future.

Ans: False

Feedback: A call/put option gives the holder the right but not the obligation to buy/sell the underlying asset in the future.

AACSB: Communication

Bloom's: Knowledge

Difficulty: Medium

Est time: <1 minute

Learning Objective: 1.03 Define the main classes of financial instruments that are issued into the financial system, that is, equity, debt, hybrids and derivatives.

Section: 1.03 Financial instruments

Topic: Financial instruments

108. Margin trading is the sale of a financial product that the seller does not own and who intends to buy back at a lower price later.

Ans: False

Feedback: Short selling is the sale of a financial product that the seller does not own.

AACSB: Reflective thinking

Bloom's: Comprehension

Difficulty: Medium

Est time: <1 minute

Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

Section: Introduction

Topic: Introduction

109. Explain the advantages of financial intermediation.

Ans:

In carrying out the role of offering instruments with varying financial attributes (risk, return, liquidity, timing of cash flows), intermediaries perform a range of functions that are important to both savers and borrowers.

These are:

- asset transformation
- maturity transformation
- credit risk diversification and transformation
- liquidity transformation
- economies of scale.

AACSB: Communication

Bloom's: Knowledge

Difficulty: Easy

Est time: 2-3 minutes

Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

Section: 1.04 Financial markets

Topic: Financial markets

110. What is monetary policy and who is responsible for its implementation?

Ans: Monetary policy is the use of interest rates to control inflation, usually in a specified range, and to promote economic growth. A central bank is usually responsible for carrying out monetary policy.

AACSB: Communication

Bloom's: Knowledge

Difficulty: Medium

Est time: 1-3 minutes

Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

Section: Introduction

Topic: Introduction

111. Explain what a debt security is. What are some common types of debt securities?

Ans: A debt security represents a contractual claim against the issuer of the instrument who has borrowed the funds. The borrower agrees to abide by the terms of the contract such as meeting covenants. A major part of the contract is the terms of payment to the lender. Corporations issue debt securities such as debentures, term loans, commercial bills, promissory notes and unsecured notes.

AACSB: Reflective thinking

Bloom's: Synthesis

Difficulty: Medium

Est time: 1-3 minutes

Learning Objective: 1.03 Define the main classes of financial instruments that are issued into the financial system, that is, equity, debt, hybrids and derivatives.

Section: 1.04 Financial markets

Topic: Financial markets

112. Identify and explain briefly the types of derivatives in a financial system.

Ans: There are four basic types of derivative contracts.

1. A futures contract is a contract to buy (or sell) a specified amount of a commodity or financial instrument at a price determined today for delivery or payment at a future specified date.
2. A forward contract has features similar to a futures contract but is generally more flexible as it is negotiated with a bank or investment bank.
3. An option gives the buyer the right but not the obligation to buy (or sell) a certain asset before or at a specified date at a predetermined price.
4. A swap contract is an arrangement to exchange specified future cash flows. With an interest rate swap, there is an exchange of future cash flows, such as one based on a floating interest rate and the other on a fixed interest rate on a notional principal.

AACSB: Reflective thinking

Bloom's: Synthesis

Difficulty: Hard

Est time: 1-3 minutes

Learning Objective: 1.03 Define the main classes of financial instruments that are issued into the financial system, that is, equity, debt, hybrids and derivatives.

Section: 1.03 Financial instruments

Topic: Financial instruments

113. The capital markets provide the opportunity for large corporations to manage their long-term cash flows. Discuss this statement using the example of a surplus entity and a deficit entity.

Ans: The debt part of capital markets consists of a range of instruments. Large creditworthy companies seeking funds can issue long-term securities such as bonds or unsecured notes directly into capital markets. Organisations such as superannuation funds or insurance companies with funds to invest can buy these instruments for part of their portfolio.

AACSB: Reflective thinking

Bloom's: Comprehension

Difficulty: Easy

Est time: 1-3 minutes

Learning Objective: 1.05 Distinguish between various financial market structures, including wholesale markets and retail markets, and money markets and capital markets.

Section: 1.04 Financial markets

Topic: Financial markets

114. The fundamental cause of a crisis is established in the boom period. Describe how a financial crisis starts in the boom. You can illustrate this with either the Asian financial crisis or the sub-prime mortgage crisis.

Ans: For example, the seeds for the sub-prime crisis were planted in the 1990s with government promotion and pressure to extend home ownership to people who would not qualify for traditional mortgages (not detailed in textbook). Financial institutions followed by creating and

promoting sub-prime mortgages. The creation of sub-prime mortgages helped engineer a housing boom, particularly after the dot-com crisis had passed. Federal Reserve policy pushed interest rates low for an extended period. Low interest rate policy had an outsized impact on long-dated assets such as real estate construction. So the lethal combination of sub-prime mortgages and low interest rates fuelled the boom, which inevitably led to the bust. Prices for homes rose at a high rate until they became increasingly unaffordable. Once the perception of rising house prices ended and indeed reversed, many homeowners found that they were underwater, that is the debt owed was greater than the value of the house. This led to massive defaults, many of which were opportunistic (debtor with ability to pay).

AACSB: Reflective thinking

Bloom's: Comprehension

Difficulty: Hard

Est time: 1-3 minutes

Learning Objective: 1.01 Understand the basic frameworks that underlie the facts that characterise financial institutions, financial instruments and financial markets.

Section: 1.02 The financial system and financial institutions

Topic: The financial system and financial institutions

115. Explain why restrictions on capital movements are not consistent with globalisation.

Ans: Capital movements facilitate the purchase of assets in other countries, which helps to integrate or globalise business. One final product can be assembled from subparts produced in many disparate locations and countries. Capital movements allow for decision making to seek out the best modes of production and markets into which products can be sold. With capital restrictions production and trade will be more country-based, which foregoes the gains from trade.

AACSB: Reflective thinking

Bloom's: Comprehension

Difficulty: Hard

Est time: <1 minute

Learning Objective: 1.01 Understand the basic frameworks that underlie the facts that characterise financial institutions, financial instruments and financial markets.

Section: 1.02 The financial system and financial institutions

Topic: The financial system and financial institutions

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Bloom's: Synthesis

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Difficulty: Easy

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Difficulty: Hard

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Difficulty: Medium

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Est time: 1-3 minutes

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Est time: 2-3 minutes

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Est time: <1 minute

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Learning Objective: 1.01 Understand the basic frameworks that underlie the facts that characterise financial institutions, financial instruments and financial markets.

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Learning Objective: 1.02 Explain the functions of a modern financial system and categorise the main types of financial institutions, including depository financial institutions, investment banks, contractual savings institutions, finance companies and unit trusts.

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Learning Objective: 1.03 Define the main classes of financial instruments that are issued into the financial system, that is, equity, debt, hybrids and derivatives.

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Learning Objective: 1.04 Discuss the nature of the flow of funds between savers and borrowers, including primary markets, secondary markets, direct finance and intermediated finance.

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Learning Objective: 1.05 Distinguish between various financial market structures, including wholesale markets and retail markets, and money markets and capital markets.

1

Learning Objective: 1.06 Analyse the flow of funds through the financial system and the economy, and briefly discuss the importance of 'stability' in relation to the flow of funds.

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Learning Objective: 1.08 Appreciate the effects, consequences and relevance of the Asian financial crisis.

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Topic: Financial crises and the real economy

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Topic: Flow of funds, market relationships and stability

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