**Practice Quiz**

**Chapter 1: An Overview of Financial Markets and Institutions**

1. If the financial system is working properly,

a. interest rates are always low

b. risk is always low

c. all necessary projects are funded

d. only projects with high risk-adjusted returns are funded

e. household wealth increases

Ans: d

Difficulty: Easy

Response: See page 5

Ref: The Financial System: Preview of the Financial System

2. Which of the following is *not* one of the main groups of economic units?

a. households

b. depository institutions

c. business firms

d. governments

e. foreign investors

Ans: b

Difficulty: Easy

Response: See page 6

Ref: The Financial System: Budget Position (Table 1)

3. The principal SSUs in the economy are

a. households

b. financial institutions

c. business firms

d. governments

e. foreign investors

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Ans: a

Difficulty: Easy

Response: See page 6

Ref: The Financial System: Budget Position

4. “Direct financing” means that

a. no financial institutions are involved

b. SSUs borrow directly from DSUs

c. no financial markets are involved

d. DSUs borrow directly from SSUs

e. investment banks lend directly to other financial institutions

Ans: d

Difficulty: Medium

Response: See pages 7-8

Ref: Financial Markets and Direct Financing

5. For investment banks, a major consequence of the 2008 crisis was that they were

a. all forced out of business

b. prohibited from participating in mortgage markets

c. forced to acquire failed depository institutions

d. prohibited from offering trading or brokerage services

e. brought under Federal Reserve oversight

Ans: e

Difficulty: Medium

Response: See pages 9

Ref: Financial Markets and Direct Financing: Investment Banking Today

6. A DSU obtains the most direct and predictable financial benefit by

a. trading financial claims in a secondary market

b. issuing financial claims in a primary market

c. acquiring financial assets in a primary market

d. trading financial assets in a secondary market

e. trading financial assets in a primary market

Ans: b

Difficulty: Hard

Response: See page 12

Ref: Types of Financial Markets: Primary and Secondary Markets

7. Public and private markets differ significantly in all the following except

a. regulation

b. marketability of securities

c. types of costs incurred by participants

d. pricing mechanism

e. ultimate purpose

Ans: e

Difficulty: Hard

Response: See page 13

Ref: Types of Financial Markets: Public and Private Markets

8. Money and capital markets differ significantly in all the following except

a. importance of financial institutions

b. types of financial claims

c. motives of participants

d. importance to the economy

e. ultimate purpose

Ans: d

Difficulty: Hard

Response: See pages 14-17

Ref: Money Markets; Capital Markets

9. An important difference between indirect finance and direct finance is that

a. indirect finance requires a financial intermediary

b. direct finance requires a financial intermediary

c. direct finance “re-packages” securities

d. one is much riskier than the other

e. the DSU takes different risks

Ans: a

Difficulty: Medium

Response: See pages 17-18

Ref: Financial Intermediaries and Indirect Financing

10. To understand why financial intermediaries exist, we need to understand the role of

a. adverse selection and moral hazard

b. supply and demand

c. transactions costs and information costs

d. debt and equity

e. risk and return

Ans: c

Difficulty: Easy

Response: See pages 18-19

Ref: Financial Intermediaries: Economics of Financial Intermediation

11. Asymmetric information problems occur in two forms:

a. information costs and bargaining costs

b. adverse selection and moral hazard

c. systematic risk and unsystematic risk

d. monetary costs and opportunity costs

e. market failure and transaction failure

Ans: b

Difficulty: Easy

Response: See pages 20-21

Ref: Economic of Intermediation: Asymmetric Information

12. The five basic intermediation services do *not* include

a. Liquidity

b. Maturity flexibility

c. Currency transformation

d. Indemnification

e. Denomination Divisibility

Ans: d

Difficulty: Easy

Response: See pages 21-22

Ref: Types of Intermediation Services

13. Which of the following is least like all the others?

a. Commercial bank

b. Finance company

c. Savings & loan association

d. Credit union

e. Mutual savings bank

Ans: b

Difficulty: Medium

Response: See pages 23-25; 27

Ref: Types of Financial Intermediaries: Deposit-Type Institutions; Other Types of Financial Institutions

14. A financial institution which fails even though it is profitable has probably mismanaged

a. credit risk

b. interest rate risk

c. liquidity risk

d. foreign exchange risk

e. political risk

Ans: c

Difficulty: Easy

Response: See pages 28-29

Ref: Risks Financial Institutions Manage

15. The two fundamental reasons for heavily regulating the financial system are

a. protecting consumers and stabilizing the financial system

b. stabilizing inflation and stabilizing interest rates

c. promoting exports and protecting consumers

d. strengthening the currency and stabilizing price levels

e. promoting liquidity and eliminating risk

Ans: a

Difficulty: Easy

Response: See page 29

Ref: Regulation of the Financial System