Chapter 2: The Nature and Variety of Financial Intermediation

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

Ans. e.

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

Ans. e.

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

Ans. d.

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

Ans. a.

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

Ans. b.

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

Ans. a.

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

Ans. c.

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

Ans. e.

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

Ans. d.

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

Ans. c.

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

Ans. e.

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

Ans. d.

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

Ans. a.

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

Ans. e.

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

Ans. d.

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

Ans. a.

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

Ans. c.

18. Typically, venture capitalists provide__________financing for__________companies.
    a. Debt, start-up
    b. Equity, start-up
    c. Debt, prominent
    d. Equity, established
    e. Both debt and equity, start-up

Ans. e.

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

Ans. e.

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

Ans. d.

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

Ans. c.

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

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

Ans. d.

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

Ans. b.

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

Ans. c.

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

Ans. c.

26. Typical sources of financing for finance companies are

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

Ans. d.

27. The major assets of finance companies are
a. cash to be lent out
b. loan receivables
c. commercial paper
d. certificates of deposit
e. marketable securities

Ans. b.

28. The difference between a commercial bank and a finance company is that a commercial is________________________, while a finance company is__________; and a bank lends on___________basis, while a finance company lends on____________basis.
a. unregulated, unregulated, secured, unsecured
b. regulated, largely unregulated, secured, secured
c. regulated, regulated, unsecured, secured
d. unregulated, regulated, unsecured, secured
e. regulated, largely unregulated, both secured and unsecured, secured

Ans. e.

29. Which of the following statements is (are) false about insurance companies?
a. Insurance companies are organized as mutuals
b. Insurance companies have the same liabilities structure as commercial banks
c. Insurance companies hold mostly the same kinds of assets as commercial banks
d. Insurance companies perform a certification function
e. all of the above are false

Ans. b.

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

e. both c and d

Ans. d.

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

Ans. e.

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

Ans. d.

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

Ans. c.

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

Ans. c.

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

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

Ans. e.

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

Ans. c.

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

Ans. b.

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

Ans. e.

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

Ans. a.

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

Ans. d.

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

Ans. b.

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

Ans. c.