

## **Chapter 002**

### **Security Markets: Present and Future**

#### **True / False Questions**

1. Deregulation of financial institutions and mergers have created a more competitive environment for retail brokerage houses.

**TRUE**

2. NASDAQ is one of the three largest stock markets in the world.

**TRUE**

3. International competition from world markets has had very little affect on U.S. exchanges.

**FALSE**

4. When an investment bank sells securities on a best efforts basis, it assumes all risk of the offering.

**FALSE**

5. In the distribution of corporate bond issues, private placements to large insurance companies dominate the volume of public offerings.

**FALSE**

6. A shelf registration enables an investment banker to sell a small portion of an issue without forming a syndicate.

**TRUE**

7. The advent of the regional exchange in 1975 improved market efficiency and price competition between exchanges.

**FALSE**

8. The American Stock Exchange's main competitor in the options and futures markets is the New York Stock Exchange.

**FALSE**

9. During the last decade, an increasing number of new issues are being sold domestically and internationally.

**TRUE**

10. At the end of 2006, Citigroup (Smith Barney), J.P. Morgan and Deutsche Bank were three of the top ranked investment bankers in the underwriting of both global and domestic equity issues.

**TRUE**

11. Bringing private companies public for the first time is called an initial public offering.

**TRUE**

12. The Cincinnati Stock Exchange is the largest of the regional stock exchanges.

**FALSE**

13. NASDAQ ranks as the largest equity market in the world.

**FALSE**

14. Every security traded over-the-counter has its own set of dealers and its own distribution system.

**TRUE**

15. The rise of financial service firms through mergers and the consolidation of brokerage companies has given consumers access to better financial services.

**TRUE**

16. The Nasdaq stock market is a publicly traded corporation.

**TRUE**

17. A market is a way of exchanging assets.

**TRUE**

18. All markets must have a physical central trading location.

**FALSE**

19. One characteristic of efficient markets is that prices adjust rapidly to new information.

**TRUE**

20. Efficient markets need not be liquid as long as buyers and sellers can eventually get a fair price for the assets they trade.

**FALSE**

21. Primary markets are for new issues of securities.

**TRUE**

22. Secondary markets are for existing securities.

**TRUE**

23. The investment banker assumes a price risk under a best efforts agreement.

**FALSE**

24. When investment bankers underwrite a security, they usually guarantee purchase of the securities at a fixed price for the selling firm.

**TRUE**

25. The investment banker's major functions are performed as part of the operations of the secondary market.

**FALSE**

26. Super Dot refers to the New York Stock Exchange's designated order transfer system that allows NYSE member firms to electronically transmit all market and limit order directly to the specialist at the trading post.

**TRUE**

27. As a part of Super Dot, specialists are informed through (OARS) Opening Automated Report Service of market orders received before the opening bell.

**TRUE**

28. Specialists and over-the-counter dealers, sometimes called market makers, buy and sell for their own account.

**TRUE**

29. Secondary markets include only organized exchanges such as the NYSE and the regional exchanges.

**FALSE**

30. The U.S. treasury often uses investment bankers to sell new issues of government securities.

**FALSE**

31. Under the Securities Act of 1933, the SEC can certify that a stock is fairly priced.

**FALSE**

32. The composite tape is not allowed for dual listings on regional stock exchanges.

**FALSE**

33. A security traded on an exchange must meet listing requirements.

**TRUE**

34. Registered traders own their own seat and are not associated with a member firm on an exchange.

**TRUE**

35. A specialist is supposed to maintain an orderly market.

**TRUE**

36. Specialists are now able to keep their limit orders in the Electronic Book rather than the old manual "specialist's book."

**TRUE**

37. NASDAQ is directly related to the operations of the NYSE.

**FALSE**

38. Based on dollar volume of stocks and bonds, the OTC is the largest of all markets in the United States.

**TRUE**

39. According to insider trading rules of the SEC, securities analysts and financial writers may not trade on insider information, but these rules do not extend to relatives and friends.

**FALSE**

40. The Chicago Board Options Exchange is now operating 24 hours per day using a computerized trading system.

**FALSE**

41. The use of the NASDAQ Automated Quotation System has increased the number of equity trades on the American Stock Exchange.

**FALSE**

42. Program trading decreases market efficiency by exaggerating price discrepancies between the cash and futures markets.

**FALSE**

43. Shelf registration is more popular with new bond offerings than with new stock offerings.

**TRUE**

44. Underwriters are less concerned with the fees from their activities than simply the amount of dollars underwritten.

**FALSE**

45. The investment banker acts as a middleman in the process of raising new funds for corporations and governments.

**TRUE**

46. In the NASDAQ market, the difference between the bid and asked price is the spread representing the profit the dealer earns by making a market.

**TRUE**

47. The largest segment of the Over-the Counter Market in terms of dollar volume is the U.S. government securities markets.

**TRUE**

48. Program trading simply means that trades are executed on computer programs written by the SEC.

**FALSE**

49. Electronic communication networks (ECNs) automatically match buy and sell orders at specified prices and orders are not routed to the floor of an exchange before processing.

**TRUE**

50. The Gramm-Leach-Bliley Act repealed the Glass Steagall Act which restricted commercial banks from also being in the investment banking business.

**TRUE**

51. One of the main reasons institutional investors like ECNs is that they allow anonymity in trading.

**TRUE**

52. Decimalization has increased the profitability of market makers and specialists.

**FALSE**

53. Rule 80A goes into effect after the Dow Jones Industrial Average has gone up or down at least 50 points in one day.

**TRUE**

54. When Rule 80A is in effect the market stops trading for 30 minutes

**FALSE**

55. Circuit breakers implemented by the New York Stock Exchange in 1989, stopped trading in the market for 30 minutes when the DJIA went down by 250 points or more during the day and by 60 minutes if the DJIA went down by 400 points.

**TRUE**

56. The cost of compliance with Sarbanes Oxley has had little effect on the willingness of foreign companies to list their shares on U.S. stock exchanges.

**FALSE**

57. The biggest corporate financings in 2006 were mostly U.S. companies.

**FALSE**

58. Many large technology companies listed on NASDAQ could easily meet the NYSE listing standards.

**TRUE**

### **Multiple Choice Questions**



59. A means of exchanging assets, which may or may not include a specified location and in which the seller may or may not own the assets being sold is called,

- a. An organized exchange
- b. An options market
- C.** A market
- d. None of the above

60. Creating prices for securities and allowing for liquidity are functions of

- a. The primary market
- B.** The secondary market
- c. The third market
- d. The fourth market
- e. The real estate market

61. In the \_\_\_\_\_ market, existing assets are exchanged between investors, while in the \_\_\_\_\_ market, participants buy their assets directly from the source of the asset.

- a. Primary; secondary
- B.** Secondary; primary
- c. Tertiary; primary
- d. Primary; OTC
- e. Prime; sub prime

62. Which of the following best describes the function of an investment banker selling an issue on a "best efforts" basis?

- A.** Return unsold securities to the firm
- b. Create a market for the securities
- c. Guarantee a continuous liquid market
- d. Private placements to financial institutions
- e. More than one of the above.

63. The process of selling a new issue of securities so that the price is guaranteed to the selling firm is referred to as

- A. Underwriting
- b. Best efforts
- c. Direct by issuer
- d. Shelf registration
- e. All of the above involve a price guarantee

64. The least popular form of distributing corporate securities is:

- a. Underwriting
- b. Best efforts
- c. Firm commitment
- d. Syndicated offering
- E. Direct by issuer

65. Bringing private companies public for the first time is called

- a. A private placement
- B. An initial public offering (IPO)
- c. A secondary offering
- d. A founders sale
- e. A shelf registration

66. From the investment banker's point of view, the major reason syndicates are formed in the distribution of large issues is for the purpose of

- a. Improving the liquidity of the issue
- b. Improving geographic distribution
- C. Reducing the underwriter's risk
- d. Improving brand recognition
- e. All of the above.

67. A syndicate is formed to

- a. Share the risk between investment bankers
- b. Distribute securities to a wide group of investors
- c. To improve the liquidity/marketability of an offering
- D. All of the above

68. Which of the following is NOT a characteristic of an organized exchange?

- A. It functions as a primary market
- b. Securities are bought and sold in an auction market by brokers acting as agents for buyers and sellers in a central location
- c. It may be either national or regional
- d. It has a central location where all trading takes place
- e. It functions as a secondary market

69. The exchange with the largest dollar volume in major companies and which has the most restrictive listing requirements is

- A. The New York Stock Exchange
- b. The American Exchange
- c. The NASDAQ Stock Market
- d. The Securities Exchange

70. Dual trading creates the following benefit:

- A. It improves liquidity of a security
- b. It allows securities to be traded domestically and internationally
- c. It creates competition between the exchange and NASDAQ
- d. All of the above are benefits of dual trading

71. An employee of an investment house who executes orders on the floor of the exchange for customers of the firm is called a

- a. Floor broker
- b. Registered trader
- C. Commission broker
- d. Specialist
- e. Dealer

72. A person who is registered to trade on an exchange, who owns a seat but is not an employee of any member firm is a

- a. Commission broker
- b. Floor broker
- c. Registered trader
- d. Dealer
- E. B and C**

73. \_\_\_\_\_ has two major functions: to handle special orders, such as purchases with a price contingency; and to maintain continuous, liquid, orderly markets

- a. A registered trader
- B. A specialist**
- c. An odd-lot dealer
- d. Commission broker

74. The major exchange for warrants, options and commodity futures is the

- a. American Stock Exchange
- b. New York Stock Exchange
- c. NASDAQ
- D. None of the above**

75. The \_\_\_\_\_ is a futures market for common stock while the \_\_\_\_\_ is a futures market for commodities and financial instruments.

- A. Chicago Board Options Exchange; Chicago Board of Trade**
- b. Chicago Mercantile Exchange; Chicago Board Options Exchange
- c. Chicago Board of Trade; Chicago Board Options Exchange
- d. New York Stock Exchange; American Stock Exchange

76. Which of the following is true of over-the-counter markets?

- a. Trading takes place by telephone or electronic network
- b. It is regulated by the Securities and Exchange Commission and the National Association of Securities Dealers
- c. The total securities traded represent the largest dollar volume in the U.S
- D. All of the above are true**

77. ECNs provide several advantages to investors. Which of the following is not an advantage?

- a. They lower the cost of trading compared to organized exchanges with floor trading
- B.** They let everyone know who is making the trade and at what price
- c. They provide the ability to trade after hours when the exchanges are closed
- d. They provide more price transparency than organized exchanges.

78. According to the New York Stock Exchange, the largest holder of corporate equities in the United States is

- A.** Households
- b. Mutual funds
- c. Private pension plans
- d. Life insurance companies
- e. University endowment funds

79. Electronic communication systems

- a. Allow investors to communicate with others in investor chat rooms
- b. Allow markets to trade American Depository Receipts on-line in Europe and Asia
- C.** Automatically match buy and sell orders at specified prices
- d. Are operated by the investment bankers to stabilize new issue markets

80. Which of the following are exchange-traded funds on the American Stock Exchange?

- a. SPDRS
- b. DIAMONDS
- c. Fidelity Mutual Funds
- D.** A and B

81. Brokers who facilitate trading but provide little research advice are called

- A.** Discount brokers
- b. Retail brokers
- c. Wholesale brokers
- d. Financial service companies
- e. None of the above

82. The biggest dilemma in creating a national market system is

- a. The development of a composite tape reflecting trades on all exchanges for listed NYSE companies
- b. Competition between specialists and market makers
- C. A computerized system to handle limit orders from all markets
- d. None of the above

83. Full disclosure of all pertinent investment information in the sale of new securities is a provision of the

- A. Securities Act of 1933
- b. Securities Exchange Act of 1934
- c. Securities Acts Amendments of 1975
- d. Sarbanes Oxley Act of 2002
- e. More than one of the above

84. The Securities and Exchange Commission was created by the

- a. Securities Act of 1933
- B. Securities Exchange Act of 1934
- c. Investment Advisor Act of 1940
- d. None of the above.

85. Traditionally, the type of security sold by corporations to fund expansion was

- A. Debt
- b. Preferred stock
- c. Common stock
- d. Stock options
- e. A and b

86. Rule 80A was instituted by the New York Stock Exchange and permanently amended by the SEC. The rule attempts to

- A. Limit stock price volatility due to program trading
- b. Increase the liquidity of the market
- c. Help investment bankers issue new securities more effectively
- d. Limit short selling by specialists
- e. Increase the volatility of the market.

87. Program trading

- a. Means that when a given market indicator reaches a certain point, a large sale or purchase of securities may take place
- b. Has been argued that its effect on the market is to accelerate price movements
- c. Is likely to be voluntarily restricted by the securities exchanges and their member firms
- D.** All of the above

88. The Securities Investor Protection Corporation (SPIC) was established to

- a. Oversee the liquidation of brokerage firms and insure investor's accounts to a maximum value of \$500,000 in case of bankruptcy by the broker
- b. To protect investor from corporate insider trading and insure their accounts for \$500,0000 in case corporate fraud caused a company to go bankrupt
- C.** Cover the total market loss on an investor's brokerage account in case of bankruptcy of the broker
- d. Create an insurance pool for brokerage firms so that if one firm went bankrupt, all investor losses would be covered out of the insurance pool.

89. In order to be listed on an exchange, a firm must meet minimum standards pertaining to the following criteria:

- a. The number of common shares publicly held
- b. Net income of the firm
- c. The number of stockholders owning a minimum of 100 shares
- D.** All of the above are requirements.

90. In general, markets are efficient when

- a. Prices respond quickly to new information
- b. Each successive trade is made at a price close to the preceding price
- c. They can absorb large amounts of securities or assets without changing the price significantly
- D.** All of the above

91. Secondary markets provide everything except

- A. Illiquidity
- b. Efficiency
- c. Continuity
- d. Competition

92. A difference between the primary market and the secondary market is

- a. Liquidity
- b. That primary markets allow corporations, government units, and others to raise needed funds for the expansion of their capital base
- C. Price competition in the secondary markets between different risk-return classes enables the primary market to price new issues at higher prices to reflect existing risk-return relationships
- d. The secondary market is much more competitive than the primary market.

93. The investment banker is responsible for everything except

- a. Underwriting an issue of securities
- b. Being the leader and a part of the syndicate of large issues, providing that one is formed
- C. The distribution process of a security issue
- d. Selling an agreed-upon number of bonds and stocks.

94. A commission broker is one who

- a. Is registered to trade on the exchange but are not employees of a member firm
- b. Is not associated with a member firm
- C. Represents a retail brokerage firm and transacts business on the floor for customers of that firm
- d. Transacts orders for individuals buying or selling less than 100 shares.

95. The New York Stock Exchange measures the performance of specialists based on the following criteria:

- a. Price continuity
- b. Price continuity, quotation spreads
- c. Price continuity, quotation spreads, market depth
- D. Price continuity, quotation spreads, market depth, stabilization rate



96. Euronext and Eurex are electronic communication networks that trade:

- a. Futures contracts only in Europe
- B.** Futures contracts in Europe and the Chicago
- c. Equities in Europe and New York
- d. Equities and futures contracts only in Europe.

97. From 1965 to 2003 large block trades of common stock traded on the New York Stock Exchange increased from 3.1 percent to almost 50 percent. This indicates that

- a. Individual investors are getting out of the market entirely
- b. Individual investors are avoiding a long term buy-and-hold strategy in favor of market timing
- C.** The majority of trading is done by institutional investors
- d. Small investors panic at every market swing due to the crash of 1987.

98. The Gramm-Leach-Bliley Act was passed in 1999 by the U. S. Congress to allow

- A.** Financial institutions to offer full financial services such as insurance and investment banking as well as traditional commercial banking
- b. Financial institutions to be sued by stockholders for off-balance sheet accounting errors
- c. Savings and loans to compete with commercial banks in both the commercial banking arena and mortgage loans
- d. European banks to acquire U. S. financial institutions.

99. The first exchange to become a publicly traded company was the

- a. New York Stock Exchange
- b. Chicago Board of Trade
- c. Nasdaq Stock Market
- d. American Stock Exchange
- E.** Chicago Mercantile Exchange.

100. The accounting frauds and scandals that took place during the stock market boom of the late 1990s resulted in what significant act?

- A. Sarbanes Oxley Act
- b. Gramm-Leach Bliley Act
- c. Glass Steagall Act
- d. Honesty in Financial Reporting Act
- e. Securities Exchange Act.

101. The Sarbanes Oxley Act

- A. Has reduced the number of foreign companies willing to list their shares on U.S. exchanges
- b. Was enacted under the Securities Exchange Act of 1934
- c. Reduces the reporting requirements for publicly traded firms
- d. Has made it possible for small firms to list their shares in the public markets
- e. Was the loophole that enabled corporate executives to misrepresent their financial statements during the late 1990s and early 2000s.

102. The \_\_\_\_\_ the most restrictive listing requirements.

- a. Regional exchanges have
- b. ECNs have
- c. Nasdaq Stock market has
- D. New York Stock Exchange has
- e. American Stock Exchange has

103. Initial and annual listing fees are highest for \_\_\_\_\_ listed stocks.

- a. Chicago Mercantile Exchange
- b. ECN
- c. Nasdaq Stock market
- D. New York Stock Exchange
- e. American Stock Exchange

## Essay Questions

104. Match the best choice in Column II to the word or phrase in Column I.

Column II

- A. Maintain Orderly Market
- B. Exchange of Assets
- C. Dealer's Market
- D. Securities Act of 1933
- E. Computer Quotation
- F. Full financial services
- G. 10,000 Shares or more
- H. Method to pay for research
- I. Securities Amendments Act of 1975
- J. Securities Act of 1934
- K. Original Purchase Market
- L. Trade for Own Account
- M. Spread
- N. Government Securities
- O. Underwriting
- P. Insures Investor Accounts
- Q. Quick price response
- R. CBOE
- S. Anonymity of trades
- T. AMEX

Column I

1. Investment Banker
2. Efficient Market
3. Organized Exchange
4. Registered Trader
5. Specialists
6. Options Market
7. OTC
8. Ask Price minus the Bid Price
9. Largest dollar volume in OTC
10. Market
11. NASDAQ
12. ECNs
13. Gramm-Leach-Bliley Act
14. National Market System
15. Give-ups
16. Truth in Securities Act
17. Block Trade
18. Established SEC
19. SIPC
20. Primary Market

1-O; 2-Q; 3-T; 4-L; 5-A; 6-R; 7-C; 8-M; 9-N; 10-B; 11-E; 12-S; 13-F; 14-I; 15-H; 16-D; 17-G; 18-J; 19-P; 20-K