**Money and Banking**

**Homework 3**

**Financial Intermediation**

Following are 40 multiple choice questions, each worth 2.5 points. Indicate the answer you think is correct.

**Chapter 11: Financial Intermediaries**

1) Adverse selection is a problem

A) unique to direct finance.

B) unique to indirect finance.

C) arising before a transaction is consummated.

D) arising after a transaction is consummated.

2) Asymmetric information occurs when

A) buyers and sellers are not equally informed about the true quality of what they are buying and selling.

B) banks face an adverse selection problem with their borrowers.

C) borrowers covertly engage in activities that increase the probability of poor performance.

D) All of the above.

3) Lenders must be concerned that borrowers may do risky unauthorized things with the funds they are lent. This is the \_\_\_\_\_\_\_\_\_\_ problem.

A) moral hazard

B) non-divisibility

C) adverse selection

D) None of the above.

4) Moral hazard is a problem

A) peculiar to direct finance.

B) peculiar to mutual funds.

C) arising before a transaction is consummated.

D) arising after a transaction is consummated.

5) A major reason for the existence of financial intermediaries is

A) transactions costs that would be incurred without their existence.

B) the fees charged by dealers and brokers in direct finance are so high.

C) the problem of symmetric information.

D) to assist borrowers in buying securities in financial markets.

6) Financial intermediaries are specialists in the production of

A) market failure.

B) information.

C) traded assets.

D) commercial paper.

7) Most bank loans are \_\_\_\_\_\_\_\_\_\_ maturity by the bank because of the \_\_\_\_\_\_\_\_\_\_ in monitoring how the borrower maintains his obligations.

A) held to; ease

B) held to; difficulty

C) sold before; ease

D) sold before; difficulty

8) Nontraded securities are part of

A) direct, but not indirect finance.

B) indirect, but not direct finance.

C) direct and indirect finance.

D) neither direct nor indirect finance.

9) One type of financial intermediary now falling in relative importance is

A) money market mutual funds.

B) pension funds.

C) thrift institutions.

D) mutual funds.

10 One type of financial intermediary now rising in relative importance is

A) pension funds.

B) banks.

C) savings-and-loan associations (S&Ls).

D) life insurance companies.

11) The advent of money market mutual funds is \_\_\_\_\_\_\_\_\_\_ the trend of "institutionalization," in which a \_\_\_\_\_\_\_\_\_\_ percentage of financial assets are directly owned by individuals.

A) part of; growing

B) part of; shrinking

C) not a part of; growing

D) not a part of; shrinking

12) A rise in deposit rates, all else constant, \_\_\_\_\_\_\_\_\_\_ a bank's \_\_\_\_\_\_\_\_\_\_ risk.

A) lowers; credit

B) lowers; interest rate

C) raises; credit

D) raises; interest rate

13) When a financial intermediary purchases a nontraded claim of either a business or an individual, its main concern is with

A) interest rate risk.

B) credit risk.

C) reinvestment rate risk.

D) None of the above.

**Chapter 12: Depository Institutions**

1) Which of the following is not a thrift?

A) a savings-and-loan

B) a commercial bank

C) a credit union

D) a mutual savings bank

2) Which type of thrift institution was relatively unaffected by the traumas of deregulation in the 1980s?

A) credit unions

B) savings-and-loans

C) mutual savings banks

D) IBFs

3) Depository institutions are the most important source of credit to

A) mutual funds.

B) large businesses.

C) small businesses.

D) state governments.

4) The largest type of depository institution in the United States is

A) savings-and-loans.

B) commercial banks.

C) credit unions.

D) mutual funds.

5) The assets of a bank are its \_\_\_\_\_\_\_\_\_\_ of funds

A) uses

B) sources

C) reserves

D) excess

6) Since 1970 there has been a clear increase in the proportion of the banking industry assets made up of

A) mortgage loans.

B) state and local government securities.

C) cash.

D) business loans.

7) What type of loan led the wave of bank lending in the 1970s and 1980s?

A) consumer loan

B) commercial mortgage

C) loans to state and local governments

D) commercial paper

8) Banks are prohibited from holding \_\_\_\_\_\_\_\_\_\_ in their portfolio of assets.

A) commercial paper

B) local government securities

C) farm mortgages

D) corporate stock

9) As a source of bank funds, \_\_\_\_\_\_\_\_\_\_ has fallen by nearly two-thirds in relative importance since 1970.

A) time deposits

B) transactions deposits

C) savings deposits

D) equity

10) Regulation Q was responsible for the drop in importance of \_\_\_\_\_\_\_\_\_\_ as a source of bank funds.

A) time deposits

B) transactions deposits

C) savings deposits

D) equity

11) A package of nontraded financial instruments can be transformed into a traded financial instrument through the process of

A) collateralization.

B) repurchasing.

C) securitization.

D) underwriting.

12) A bank's net interest income is roughly analogous to a manufacturing firm's

A) total reserves.

B) gross profit.

C) total cost.

D) gross interest income.

13) The McFadden Act was passed to prevent

A) banks from competing on the basis of deposit rates.

B) foreign banks from operating in the United States.

C) large nationwide banks from forming.

D) banks from holding corporate stock as an asset.

14) A major loophole was punched through the McFadden Act as banks

A) formed bank holding companies.

B) developed negotiable certificates of deposit.

C) began paying interest on checkable deposits.

D) converted themselves into savings-and-loans.

**Chapter 13: Non-depository financial institutions**

1) Life insurance companies are supervised and regulated by the

A) Federal Home Loan Bank Board.

B) Securities and Exchange Commission.

C) states in which they operate.

D) Federal Reserve.

2) A mutual life insurance company is owned and controlled by its

A) partners.

B) managers.

C) stockholders.

D) policyholders.

3) A stock life insurance company is owned and controlled by its

A) partners.

B) managers.

C) stockholders.

D) policyholders.

4) Over 90 percent of life insurance companies are structured as \_\_\_\_\_\_\_\_\_\_ companies. Over 50 percent of industry assets are controlled by companies structured as \_\_\_\_\_\_\_\_\_\_ companies.

A) mutual, mutual

B) mutual, stock

C) stock, mutual

D) stock, stock

5) In recent years the life insurance industry has emphasized

A) whole life policies.

B) group insurance.

C) less risky investments.

D) the purchase of short-term assets.

6) For a whole life policy, the policy holder pays

A) premiums based on current interest rates.

B) a constant premium.

C) premiums that vary with mortality risk.

D) constantly declining premiums.

7) For term life insurance, the policy holder pays

A) premiums based on current interest rates.

B) a constant premium.

C) premiums that vary with mortality risk.

D) constantly declining premiums.

8) Life insurance companies have increased their purchases of corporate stock in recent years in an effort to

A) reduce risk.

B) increase asset returns.

C) increase liquidity.

D) reduce taxes.

9) Universal life insurance was created in response to

A) the popularity of whole life insurance.

B) the popularity of variable life insurance.

C) high interest rates.

D) deregulation of banking.

10) Mutual funds that offer limited shares that are not redeemable are referred to as

A) open-end.

B) closed-end.

C) negotiable.

D) nonnegotiable.

11) Mutual funds that offer shares that are redeemable are referred to as

A) open-end.

B) closed-end.

C) negotiable.

D) nonnegotiable.

12) Management structures that include money market funds and bond funds in addition to stock funds are known as

A) exchange-traded funds.

B) dealers.

C) brokers.

D) families of mutual funds.

13) The two major types of finance company are

A) captive and specialty.

B) public and private.

C) consumer and commercial.

D) insured and uninsured.