

## Econ 423: Questions from Previous Versions of Quiz 11 [Fall 2000-present]

1. The declining relative importance of such traditional financial intermediaries as banks, savings and loans, credit unions, and stock brokers across the last four decades is probably most attributable to: (a) improvements in information technology. (b) new government regulations intended to ensure the accuracy of corporate income statements and balance sheets. (c) deregulation that encourages private production and sale of information. (d) increased speculation in financial markets by private individuals. (b) a wave of mergers and acquisitions in the financial services industry.
2. One major reason why financial markets are among the most heavily regulated sectors of the economy is that: (a) financial assets are difficult to identify if stolen. (b) borrowers are prone to the problems of moral hazard after securing loans. (c) adverse selection by decisionmakers who work in financial institutions can affect net savers in very negatively ways. (d) the financial sector of the economy is especially vulnerable to swings in the aggregate level of economic activity.
3. The potential for economic inefficiency associated with legally allowing a single financial institution to offer multiple financial services through a single location would most plausibly include problems posed by predictable increases in: (a) loophole mining. (b) the rate of creative response in financial technologies. (c) transaction costs. (d) the average “spread” in financial intermediation. (e) concentrations of market power in the financial sector.
4. The cost savings a financial institution achieves by engaging in multiple activities derive from economies of: (a) aggregation. (b) scope. (c) complexity. (d) information. (e) scale.
5. Property pledged to the lender by a lien if a borrower fails to make debt payments is: (a) bondage. (b) an asset on the lender’s balance sheet. (c) collateral. (d) garnishment. (e) interest securitization.
6. Changes in financial laws and regulations that stimulate creative responses often involve the process called: (a) loophole mining. (b) price gouging. (c) branching. (c) usury. (e) financial evolution.
7. The existence of such organizations as loan sharks, “rent-to-own” stores, and “payday” lenders reflect creative responses to: (a) legal ceilings on the interest rates that banks can pay depositors. (b) usury laws. (c) prohibitions against branch banking. (d) credit rationing. (e) the “Commerce Clause” of the US Constitution, which forbids regulation of interstate commerce by the federal government.
8. John Kenneth Galbraith’s model predicts an increase in “bezzle” following the financial deregulation that tends to emerge during a period of relative prosperity. This increase in financial fraud can be viewed as an example of: (a) credit rationing. (b) immoral hazard. (c) adaptive expectations. (d) creative response. (e) moral suasion.
9. The structure of demand for financial products changed dramatically over the past thirty years or so primarily as a consequence of: (a) huge decreases in financial uncertainty. (b) huge decreases in rates of personal saving by Americans. (c) dramatic increases in the volatility of interest rates. (d) unexpected increases in transactions costs.

10. Although perfect hedging against *specific risk* is theoretically possible, hedging would be least likely to be even close to perfect if an individual investor tried to eliminate: (a) market risk, also known as *Knightian uncertainty*. (b) interest rate risk. (c) inflation risk. (d) default risk.
11. An equation capable of specifying the location/value of a moving variable at every continuously calculable nanosecond in time would be most likely to entail the use of: (a) the Black-Scholes equation. (b) Ito calculus. (c) Newtonian thermodynamics. (d) Fermat's theorem. (e) Leibniz differentials.
12. The idea that financial portfolios can be shielded against risk through fine-tuned trading in options "at all times, in markets all over the world," is most consistent with the theories underpinning: (a) rational expectations models. (b) technical analysis. (c) Keynesian beauty contests. (d) the Black-Scholes-Merton concept of dynamic hedging. (e) adaptive expectations models.
13. The term "disintermediation" would apply least well to: (a) the planned obsolescence of computer software by some developers as Microsoft releases new generations of its Windows operating system. (b) attempts by students to sell their used textbooks by posting notes on bulletin boards in Gardner Hall. (c) internet purchases of clothing by college students. (d) the reduced importance of depository institutions during the 1970s and the rapid growth of mutual funds. (e) real estate that is offered "for sale by owner" over the internet.
14. Efficient pricing for an option depends **least** on the: (a) current price of the underlying asset. (b) risk averseness of potential purchasers of the option. (c) expected rate of return [interest rate] appropriate for alternative investments with comparable risk. (d) expected price volatility of the underlying asset. (e) strike price.
15. The process of hedging involves: (a) selling a put option if you expect the price of the asset rise, and selling a call option if you expect the price of the asset to fall. (b) buying a call option if you expect the price of an asset to rise, and a put option if you expect the price of the asset to fall. (c) offsetting the risk of potential losses from a possible future event by "betting" that the event will, in fact, occur. (d) trimming the shrubbery between your property and your neighbor's property.
16. The U.S. government agency that requires firms that sell securities in public markets to adhere to standard accounting principles and disclose information about their sales, assets, and earnings is the (a) Federal Corporate Securities Commission. (b) Federal Trade Commission. (c) Securities and Exchange Commission. (d) U.S. Treasury Department. (e) Federal Reserve System.
17. Financial intermediaries, especially banks, can avoid free-riders problem as long as they primarily: (a) make private loans. (b) acquire a diversified portfolio of stocks. (c) buy junk bonds. (d) charge depositors fees that maximize the financial spread. (e) rely on insider information.

18. The combination of activities within a single financial institution least likely to lead to conflicts of interest would be: (a) auditing and management advisory services. (b) commercial banking and investment banking. (c) assessment of credit quality and consulting. (d) consumer lending and business lending.
19. Universal banking refers to combinations of the activities of commercial banking, investment banking, and: (e) venture capital. (b) insurance. (c) credit assessment. (d) consulting. (a) auditing.
20. An equation capable of specifying the location/value of a moving variable at every continuously calculable nanosecond in time would be most likely to entail the use of: (a) Newtonian thermodynamics. (b) Ito calculus. (c) Fermat's theorem. (d) the Black-Scholes equation. (e) Leibniz differentials.
21. A financial investor who sells a short contract is required to: (a) close out the buying investor's position in the near future. (b) deliver securities in the near future that the individual does not currently own. (c) hedge securities in the near the future. (d) buy securities in the future.
22. The price of a call option for a specific stock is least affected by the: (a) strike price. (b) price volatility of the stock and similar stocks within its industry. (c) strict regulations set by the SEC's Options Pricing Regulatory Division. (d) length of time until the option's expiration date. (e) stock's historical market performance. (f) current price of the stock.
23. The pair of Nobel Prize winning economists who had personal financial interests in the fortunes of Long Term Capital Management are: (a) Robert Merton and Myron Scholes. (b) Fisher Black and Paul Samuelson. (c) Merton Miller and John Nash. (d) Edward Prescott and Finn Kydland. (e) Daniel Kahneman and Vernon Smith.
24. The implosion of Long Term Capital Management was caused by the: (a) high management fees charged by the fund's two Nobel Prize winners. (b) fund's high leverage ratio of 20 to 1. (c) sharp decrease in the spread between corporate bonds and Treasury bonds in 1998. (d) Russian default of its international debt, collapse of markets in the Far East, and the sharp increase in the spread between corporate bonds and Treasury bonds. (e) fund's shift away from a market-neutral investment strategy.
25. A contract that gives the owner the right to buy a financial instrument at the exercise price within a specific period of time is a/an: (a) continental option. (b) put option. (c) call option. (d) European option. (e) indexed option.
26. A short-term "bailout" of funding that helped Long Term Capital Management avoid defaulting in 1998 was engineered by the: (a) New York Stock Exchange. (b) Federal Reserve System. (c) International Monetary Fund. (d) Chicago Board of Trade. (e) World Bank. (f) Securities and Exchange Commission.
27. A contract requiring a specified future monetary payment at a specified future point in time in exchange for the delivery of a specific asset is called a: (a) hedge. (b) long contract. (c) nonconvertible option. (d) swap. (e) gamble.

28. A financial institution that sold an asset that it has agreed to deliver to another party at a future date has: (a) taken a long position. (b) hedged against risk. (c) entered a forward transaction. (d) taken a short position.
29. Although perfect hedging against *specific risk* is theoretically possible, hedging would be least likely to be even close to perfect if an individual investor tried to avoid: (a) market risk. (b) interest rate risk. (c) inflation risk. (d) default risk.
30. The individuals or groups that launch a “start-up” company are: (a) capitalists. (b) venture capitalists. (c) entrepreneurs. (d) inventors and innovators. (e) investment bankers.
31. The lower boundary for the annual rate of return expected in business plans submitted to venture capital firms that would be seriously considered by a venture capitalist is roughly: (a) 20 percent. (b) 40 percent. (c) 60 percent. (d) 80 percent. (e) 100 percent.
32. The average annual rate of return realized by typical venture capital firms between 1980 and 2003 was roughly: (a) 8 percent. (b) 20 percent. (c) 40 percent. (d) 60 percent. (e) 80 percent.
33. The discrepancy between the lower boundary for the annual rate of return expected in business plans submitted to venture capital firms that would be considered seriously and the average annual rates of return actually realized by typical venture capital firms is probably most completely explained by the: (a) moral hazard. (b) excessive optimism that seems common to entrepreneurs. (c) adverse selection. (d) bezzle.
34. That dynamic hedging in accord with the Black-Scholes equation can eliminate uncertainty is an erroneous notion expressed in *The Trillion Dollar Bet* by the Nobel Prize winner: (a) Fischer Black. (b) Myron Scholes. (c) Robert Merton. (d) Leo Melamud. (e) Merton Miller.
35. One technique venture capitalists commonly use to deal with problems of moral hazard that would be illegal for banks is to: (a) make a member of the venture capitalist’s firm marry the CEO of the startup firm that secures VC funding. (b) place a member of the venture capitalist firm on the board of directors of the company that secures VC funding. (c) nothing, banks and venture capitalist must follow the same lending restrictions. (d) require a member of the company that secures VC funding to be a member on the venture capitalist board of directors.
36. So-called fallen angels differ from junk bonds in that (a) junk bonds refer to newly issued bonds with low credit ratings, whereas fallen angels refer to previously issued bonds which have had their credit ratings fall below Baa. (b) junk bonds refer to previously issued bonds which have had their credit ratings fall below Baa, whereas fallen angels refer to newly issued bonds with low credit ratings. (c) junk bonds have ratings below Baa, whereas fallen angels have ratings below C. (d) fallen angels have ratings below Baa, whereas junk bonds have ratings below C.
37. Businesses benefit from factoring because financial institutions that purchase a firm’s accounts receivable: (a) assume responsibility for debt collection. (b) specialize in cash-flow accounting. (c) avoid sizable diseconomies of scale. (d) leave firms in control of their accounts receivable. (e) specialize in customer relations.

38. The process of reducing portfolio risk by engaging in two (or more) concurrent transactions, where values of the assets underlying such transactions are negatively correlated when “shocked” by an external event, is known as: (a) pointing-to-counterpoint. (b) arbitrage. (c) hedging. (d) speculation. (e) intermediation.
39. Private placement issues of new securities are most commonly purchased by: (a) insurance companies and pension funds. (b) mutual funds. (c) investment banks. (d) trustees of large inheritances. (e) non-profit corporations.
40. Promising the future delivery of an asset not currently owned is known as: (a) speculative gambling. (b) selling long. (c) buying long. (d) buying short. (e) betting the house. (f) selling short.
41. Probably the most significant factor explaining the drastic drop in the number of bank failures since the Great Depression has been: (a) the creation of the FDIC. (b) rapid economic growth since 1941. (c) the employment of new auditing procedures by the Federal Reserve. (d) better bank management.
42. Investment banking activities of the commercial banks were blamed for many bank failures. This led to the passage of: (a) the National Bank Charter Amendments of 1918. (b) the Glass/St. Germain Act of 1933. (c) the National Bank Act of 1863. (d) the Glass-Steagall Act of 1933. (e) the establishment of the FDIC in 1933.
43. The legislation that effectively prohibited banks from branching across state lines and forced all national banks to conform to the branching regulations in the state in which they reside is the: (a) McFadden Act. (b) National Banking Act. (c) Glass-Steagall Act. (d) Garn-St. Germain Act.
44. The prohibition against banks underwriting corporate securities and engaging in brokerage, real estate, and insurance activities was repealed by the: (a) Gramm-Leach-Bliley Financial Services Modernization Act. (b) Competitive Equality in Banking Act. (c) Depository Institution Deregulation and Monetary Control Act. (d) Glass Steagall Act. (e) McFadden Act.
45. The process of creating more liquid marketable debt instruments backed by otherwise relatively less liquid assets is known as: (a) standardization. (b) homogenization. (c) securitization. (d) adverse selection.
46. Thrift institutions’ importance as a source of funds for borrowers has: (a) shrunk from around 40 percent of total credit advanced in the late 1970s to below 30 percent by 2003. (b) shrunk from over 20 percent of total credit advanced in the late 1970s to below 10 percent by 2003. (c) expanded dramatically, from around 15 percent of total credit advanced in the late 1970s to above 25 percent by 2003. (d) has expanded dramatically, from around 15 percent of total credit advanced in the late 1970s to above 30 percent by 2003.
47. The process in which people seeking higher interest rates take their funds out of financial institutions is called: (a) capital motility. (b) loophole mining. (c) disintermediation. (d) deposit jumping. (e) security skipping.

48. The policy of \_\_\_\_\_ exacerbated \_\_\_\_\_ problems as savings and loans took on increasingly huge levels of risk on the slim chance of returning to solvency. (a) regulatory forbearance; moral hazard (b) regulatory forbearance; adverse selection (c) regulatory agnosticism; moral hazard (d) regulatory agnosticism; adverse selection
49. “Bureaucratic gambling” refers to (a) the strategy of thrift managers that they would not be audited by thrift regulators in the 1980s due to the relatively weak bureaucratic power of thrift regulators. (b) the risk that thrift regulators took in publicizing the plight of the S&L industry in the early 1980s. (c) the strategy adopted by thrift regulators of lowering capital requirements and pursuing regulatory forbearance in the 1980s in the hope that conditions in the S&L industry would improve. (d) none of the above.
50. The “creative response” of the financial system refers to how profit seekers: (a) adjust institutions and practices in response to laws and regulations. (b) are prevented by adaptive laws and regulations from engaging in excessively risky activities. (c) instantaneously exploit new information to ensure that asset prices are always in long run equilibrium. (d) ensue that savings are efficiently channeled to the most profitable forms of investment.
51. One financial intermediary that helps to reduce the moral hazard arising from the principal-agent problem when a new firm is attempting to secure financing is the: (a) venture capital firm. (b) money market mutual fund. (c) pawn broker. (c) savings and loan association. (e) commercial bank.
52. If borrowers find it increasingly attractive to take on even bigger risks after obtaining a loan, then lenders face the problem of: (a) moral hazard. (b) free-riding. (c) adverse selection. (d) costly state verification. (e) inverted default ratios.
53. The bulk of household debt in the United States consists of: (a) credit card debt. (b) consumer installment debt. (c) collateralized loans. (d) unsecured loans, such as student loans.
54. One way for a corporate board of directors to somewhat alleviate potential principal-agent problems in dealing with professional managers is to: (a) reward managerial performance that exceeds industry averages. (b) reward “whistle-blowing” by workers who observe that corporate policies violate federal statutes. (c) use its profits to buy its own stock in the open market. (d) fire managers who don’t exceed profit expectations.
55. The driving force behind the securitization of mortgages and automobile loans has been the (a) rising regulatory constraints on substitute financial instruments. (b) desire of mortgage and auto lenders to exit this field of lending. (c) improvement in computer technology. (d) relaxation of regulatory restrictions on credit card operations.
56. The starting point for understanding how exchange rates are determined is a simple idea called \_\_\_\_\_, which states that if two countries produce an identical good, the price of the good should be the same throughout the world no matter which country produces it. (a) Gresham’s law. (b) the law of one price. (c) purchasing power parity. (d) arbitrage. (e) reciprocity.

57. The theory of purchasing power parity states that exchange rates between any two currencies will adjust to reflect changes in: (a) the trade balances of the two countries. (b) the current account balances of the two countries. (c) fiscal policies of the two countries. (d) the price levels of the two countries.
58. Higher tariffs and quotas cause a country's currency to \_\_\_\_\_ in the \_\_\_\_\_ run. (a) equalize / intermediate (b) appreciate / short (c) depreciate / long (d) depreciate / short (e) appreciate / long
59. If the US inflation rate is higher than the average rate of inflation in Europe, and if productivity is growing more slowly in the US than in Europe, then, in the long run: (a) the euro should appreciate relative to the dollar. (b) the euro should depreciate relative to the dollar. (c) there should be no change in the euro price of dollars. (d) it is not clear what will happen to the euro price of dollars.
60. The government institution that has overall responsibility for the amount of money and credit supplied in the economy as a whole is the (a) central bank. (b) commercial bank. (c) bank of settlement. (d) monetary fund.
61. To reduce abuses from the state chartering of banks, the \_\_\_\_\_ created a new banking system of federally chartered banks, supervised by the \_\_\_\_\_. (a) National Banking Act of 1863; Office of the Comptroller of the Currency. (b) Federal Reserve Act of 1863; Office of the Comptroller of the Currency. (c) National Banking Act of 1863; Office of Thrift Supervision. (d) Federal Reserve Act of 1863; Office of Thrift Supervision.
62. The regulatory system that has evolved in the United States whereby banks are regulated at the state level, the national level, or both, is known as a (a) bilateral regulatory system. (b) tiered regulatory system. (c) two-tiered regulatory system. (d) dual banking system.
63. With the creation of the Federal Deposit Insurance Corporation, member banks of the Federal Reserve System \_\_\_\_\_ to purchase FDIC insurance for their depositors, while non-member commercial banks \_\_\_\_\_ to buy deposit insurance. (a) could choose; were required. (b) could choose; were given the option. (c) were required; could choose. (d) were required; were required.
64. The bank regulatory agency possessing sole regulatory authority over bank holding companies is the: (a) FDIC. (b) Comptroller of the Currency. (c) FHLBS. (d) Federal Reserve System.
65. Deposits in European banks denominated in dollars for the purpose of international transactions are known as (a) Eurodollars. (b) European Currency Units. (c) European Monetary Units. (d) International Monetary Units.
66. The existence of deposit insurance can increase the likelihood that depositors will need deposit protection, as banks with deposit insurance are: (a) likely to take on greater risks than they otherwise would. (b) likely to be too conservative, reducing the probability of turning a profit. (c) likely to regard deposits as an unattractive source of funds due to depositors' demands for safety. (d) placed at a competitive disadvantage in acquiring funds.

67. The legislation that separated investment banking from commercial banking is known as the (a) National Bank Act of 1863. (b) Federal Reserve Act of 1913. (c) Glass-Steagall Act. (d) McFadden Act.
68. The chartering process is especially designed to deal with the \_\_\_\_\_ problem, and regular bank examinations help to reduce the \_\_\_\_\_ problem. (a) adverse selection; adverse selection. (b) adverse selection; moral hazard. (c) moral hazard; adverse selection. (d) moral hazard; moral hazard.
69. If the FDIC decides that a bank is too big to fail, it will tend to use the \_\_\_\_\_ method, effectively ensuring that \_\_\_\_\_ depositors will suffer losses. (a) payoff; large. (b) payoff; no. (c) purchase and assumption; large. (d) purchase and assumption; no.
70. The result of the too-big-to-fail policy is that \_\_\_\_\_ banks will take on \_\_\_\_\_ risks, making bank failures more likely. (a) small; fewer. (b) small; greater. (c) big; fewer. (d) big; greater.
71. Regulators have historically attempted to reduce the riskiness of banks' asset portfolios by (a) limiting the amount of loans in particular categories or to individual borrowers. (b) prohibiting banks from holding risky assets such as common stocks. (c) establishing a minimum interest rate floor that banks can earn on certain assets. (d) doing all of the above. (d) doing only (a) and (b) of the above.
72. The increased integration of financial markets across countries and the need to make the playing field equal for banks from different countries led to the Basel agreement in June 1988 to (a) standardize bank capital requirements internationally. (b) reduce, across the board, bank capital requirements in all countries. (c) sever the link between risk and capital requirements. (d) do all of the above.
73. The Depository Institutions Deregulation and Monetary Control Act of 1980 (a) approved NOW accounts nationwide. (b) imposed uniform reserve requirements. (c) mandated the phase-out of interest rate ceilings on deposits. (d) did all of the above. (e) did none of the above.
74. The Federal Deposit Insurance Corporation Improvement Act of 1991 (a) increased the FDIC's ability to borrow from the Treasury to deal with failed banks. (b) increased the scope of deposit insurance in several ways. (c) eliminated governmentally-administered deposit insurance. (d) eliminated the upper limit on the amounts of deposits that would be insured.
75. The Glass-Steagall Act barred commercial banks from underwriting corporate securities and engaging in brokerage, real estate, and insurance activities. This prohibition was repealed by the: (a) Depository Institution Deregulation and Monetary Control Act. (b) Full Employment and Balanced Growth Act of 1946. (c) Gramm-Leach-Bliley Financial Services Modernization Act. (d) McFadden Act. (e) Competitive Equity in Banking Act.
76. A bank's balance sheet shows that total: (a) assets equal total liabilities plus equity capital. (b) revenues minus total costs equals operating. (c) reserves plus demand deposits equals total assets. (d) stockholder equity equals net income minus dividends paid minus taxes.

77. The instruments that would most readily substitute for a bank's discount loans would be: (a) loans to businesses. (b) repurchase agreements. (c) Eurodollar accounts. (d) loans to bank holding companies. (e) reverse repurchase agreements.
78. Market-value accounting has a number of advantages over historical-cost accounting, including (a) giving regulators the ability to close a bank before its net worth falls to zero. (b) reducing the incidence in the number of banks that "bet-the-bank" by taking excessive risks in hopes of staying in operation. (c) making it more difficult for bank officials to hide insolvencies. (d) making it more difficult for regulators and politicians to hide insolvencies. (e) All of the above.
79. A bank's commitment (for a specified future period of time) to provide a firm with loans up to a given amount at an interest rate that is tied to a market interest rate is called: (a) credit rationing. (b) a line of credit. (c) continuous dealings. (d) none of the above.
80. When a lender refuses to make a loan, although borrowers are willing to pay the stated interest rate or even a higher rate, the bank is said to engage in: (a) coercive bargaining. (b) strategic holding out. (c) credit rationing. (d) collusive behavior.
81. In one sense, \_\_\_\_\_ appears surprising since it means that the bank is not \_\_\_\_\_ its portfolio of loans and thus is exposing itself to more risk: (a) specialization in lending; diversifying. (b) specialization in lending; rationing. (c) credit rationing; diversifying. (d) screening; rationing.
82. If a bank has more rate-sensitive assets than liabilities, then a(n) \_\_\_\_\_ in interest rates will \_\_\_\_\_ bank profits: (a) increase; increase. (b) increase; reduce. (c) decline; increase. (d) decline; not affect.
83. Provisions in loan contracts that proscribe borrowers from engaging in specified risky activities are called: (a) proscription bonds. (b) restrictive covenants. (c) due-on-sale clauses. (d) liens.
84. Charles Keating (a) was allowed to acquire Lincoln Savings and Loan of Irvine, CA, even though he had been accused of fraud by the SEC only four and a half years earlier. (b) fired Lincoln's conservative lending officers and internal auditors, even though he had promised regulators he would keep them. (c) enlisted the help of five senators to delay the seizure of Lincoln's assets. (d) did all of the above.
85. Of the following methods that banks might use to reduce moral hazard problems, the one not legally permitted in the United States is the : (a) requirement that firms keep compensating balances at the banks from which they obtain their loans. (b) requirement that firms place on their board of directors an officer from the bank. (c) inclusion of restrictive covenants in loan contracts. (d) requirement that individuals provide detailed credit histories to bank loan officers.
86. When banks offer borrowers smaller loans than they have requested, banks are said to (a) shave credit. (b) rediscount the loan. (c) raze credit. (d) ration credit.
87. Banks face the problem of \_\_\_\_\_ in loan markets because bad credit risks are the ones most likely to seek bank loans: (a) adverse selection. (b) moral hazard. (c) moral suasion. (d) intentional fraud.

88. Fractional reserve banking systems are more stable if: (a) fiat money is backed by agricultural commodities. (b) people keep stable proportions of their money in banks. (c) banks' excess reserves rise when depressions begin. (d) psychological theories of business cycles are valid.