Review Questions for Second Exam

True/False Questions

1. Short-selling causes a stock to fall farther than it would if there were no short-selling.
2. A change in a stock’s perceived risk will change investors’ required rate of return.
3. A bank is insolvent when it runs out of ready cash.
4. Bank regulations are the only way to ensure bank safety and soundness.
5. Adverse selection can occur when borrowers use funds for other than their intended purposes.

Multiple Choice Questions

1. Transactions costs are
   a. zero in financial markets.
   b. zero where financial intermediaries operate efficiently.
   c. the cost of actually buying and selling financial instruments.
   d. Equal to the tax paid on financial transactions.

2. Since social security benefits are paid from current contributions, the system is a
   a. privatized system.
   b. defined contribution system.
   c. overfunded system.
   d. fully funded system.
   e. "pay-as-you-go" system.

3. A “Load” fund
   a. Charges a commission on purchases or sales in the fund
   b. Is not obligated to redeem shares
   c. Earns income only from management fees
   d. Issues shares that may sell at a discount to the market value of the underlying asset

4. Because of the adverse selection problem,
   a. lenders may refuse loans to individuals with high net worth, because of their greater proclivity to “skip town.”
   b. poor credit risks are more likely to seek loans causing lenders to make a disproportionate amount of loans to poor credit risks.
   c. lenders are willing to make loans that are not secured by collateral.
   d. all of the above.

5. The “Efficient Markets Hypothesis predicts that an investor:
   a. Will not be able to earn above-average profits consistently from actively buying or selling stocks.
   b. Will be able to earn above-average profits consistently from buying or selling stock so long as he or she makes use of rational expectations
   c. Will be able to earn above-average profits consistently from buying or selling stock so long as he or she makes use of adaptive expectations.
   d. Will be able to earn above-average profits consistently from buying or selling stock so long as stock prices in general are rising.

6. In financial markets, “efficiency” refers to:
   a. How cheaply a borrower may borrow funds
   b. The speed with which borrowers and savers are matched through intermediaries
   c. The speed with which new information is incorporated into asset prices
   d. The absence of arbitrage profit opportunities.
7. Historically, of the forces contributing to fragility of the US banking system, by far, the most persistent and important has been:
   a. the financing demands placed on it by the US government
   b. until recently, the system’s highly fragmented nature with no interstate branching
   c. the self-interested motivations of policy makers
   d. the system’s inherent instability stemming from its crucial role in payments processing

9. Which of the following are liabilities on a bank’s balance sheet?
   a. Loans
   b. Reserves
   c. Deposits
   d. All of the above
   e. Only (a) and (b) of the above

10. When you deposit $50 in currency at Old National Bank,
    a. its reserves increase by $50.
    b. its liabilities increase by $50.
    c. its assets increase by $50.
    d. each of the above occurs.
    e. only (a) and (b) of the above occur.

11. A bank has $10 million in reserves, $60 million each in loans and deposits, and $10 million in capital. Based just on this data, what is the bank’s capitalization ratio?
    a. 10%
    b. 15%
    c. 60%
    d. 86%

12. A bank failure occurs whenever
    a. a bank suffers a large deposit outflow.
    b. a bank borrows from the Fed.
    c. a bank has to call in a large volume of loans.
    d. a bank cannot satisfy its obligations to pay its depositors and have enough reserves to meet its reserve requirements.