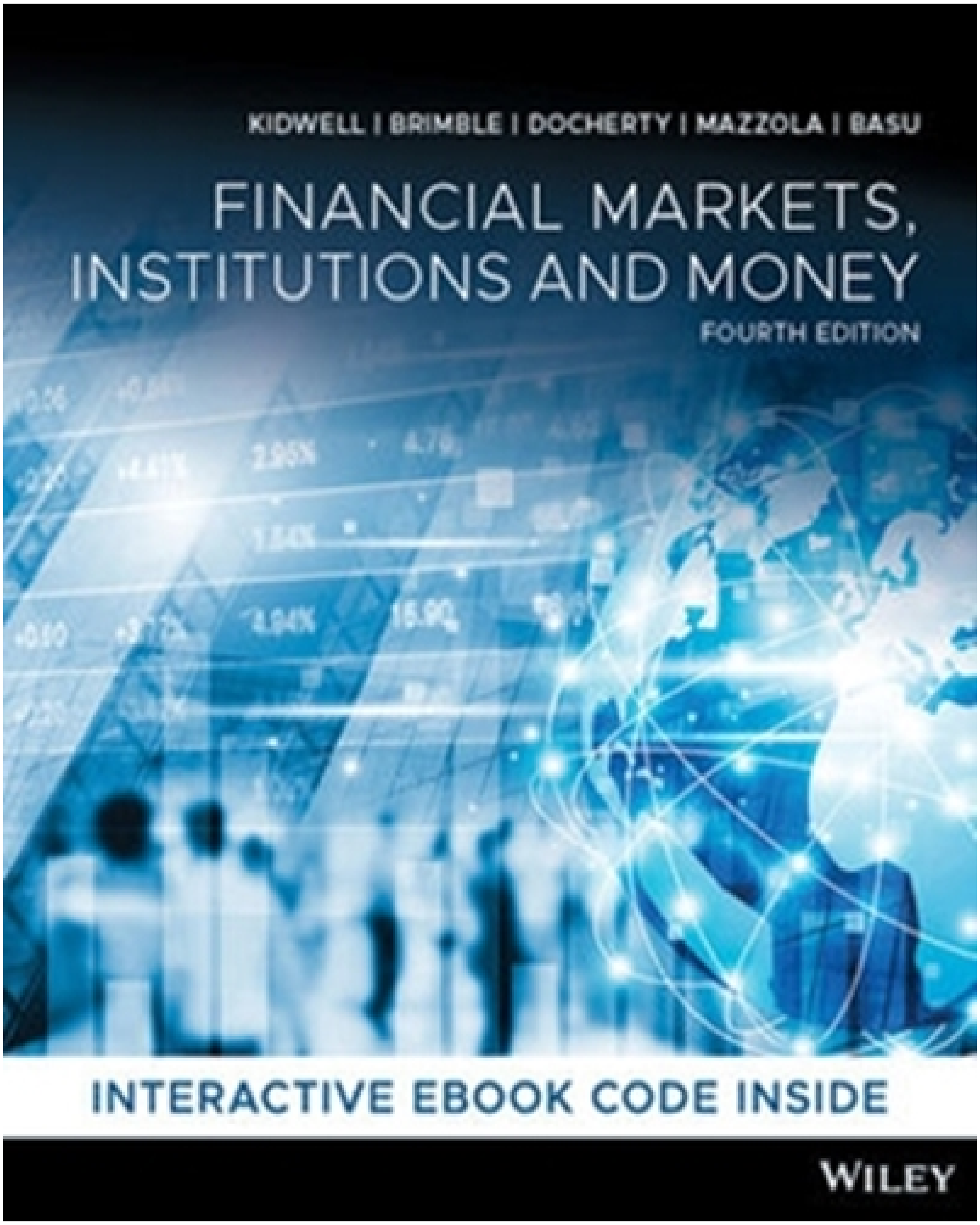
Test Bank for Financial Markets Institutions and Money 4th Edition by Kidwell



Test Bank

Testbank

to accompany

Financial markets, institutions and money

4th edition

by

Kidwell et al.

WILEY

Chapter 2: Financial markets

Multiple-choice questions

1. Investors purchase Treasury Notes:

a. in multiples of $10,000.
b. at par value.
*c. on a discount basis.
d. both A and C.

Feedback: Treasury Notes are sold to investors on a discount basis and pay no coupon interest. Thus, the interest income to the investors is the difference between the purchase price and face value of the note at maturity.

Answer: c
Learning objective 2.1: explain the characteristics of money market instruments.

2. When a commercial bank issues a payment guarantee on behalf of an importer, that guarantee is a:

a. documented transfer.
*b. letter of credit.
c. time draft.
d. sight draft.

Feedback: A letter of credit is a financial instrument issued by in importer's bank that obligates the bank to pay the exporter a specified amount of money.

Answer: b
Learning objective 2.1: explain the characteristics of money market instruments.

3. Which of the following statements is correct?

a. Money market transactions are seldom over $1 million.
b. Most money market transactions involve retail investors.
*c. The money market is a dealer market linked by efficient communications systems.
d. Market transactions in money market securities include more primary market trades than secondary market trades.

Answer: c
Learning objective 2.1: explain the characteristics of money market instruments.

4. Low credit rated commercial companies typically raise funds using which money market instrument?

a. Treasury notes.
*b. Bank-accepted bills.
c. Commercial paper.
d. Negotiable CDs.

Answer: b
Learning objective 2.1: explain the characteristics of money market instruments.

5. Money market securities are:

a. risk free assets.
b. long-term securities.
c. not traded before maturity date.
*d. an alternative to bank borrowing for corporations' funding.

Answer: d
Learning objective 2.1: explain the characteristics of money market instruments.

6. In a bank-accepted bill, the bank is:

a. the lender of funds.
b. the issuer of the bill.
*c. the payer of the face value to the investor if the issuer defaults.
d. the borrower of funds.

Feedback: The issuer/borrower is the commercial company not the bank. The lenders are the investors in the bill not the bank.

Answer: c
Learning objective 2.1: explain the characteristics of money market instruments.

7. ________________ is (are) the largest class of participants in the Australian money markets.

*a. Commercial banks.
b. Non-financial corporations.
c. The Commonwealth government.
d. The Reserve Bank of Australia.

Answer: a
Learning objective 2.1: explain the characteristics of money market instruments.

8. The cash rate is an interest rate prevailing on the:

a. repo market.
b. Treasury notes market.
c. bank-accepted bills market.
*d. unsecured interbank market.

Answer: d
Learning objective 2.1: explain the characteristics of money market instruments.

9. Which of the following securities is *not* a one-name paper?

a. Treasury notes.
b. Commercial paper.
*c. Bank-accepted bills.
d. Certificates of deposit.

Feedback: Bank accepted bills imply that the bank will pay if the drawer of the bill cannot pay. The issuer and the bank have a joint liability.

Answer: c
Learning objective 2.1: explain the characteristics of money market instruments.

10. If a security receives a bank acceptance, the instrument is a(n):

a. equity paper.
b. one-name paper.
*c. two-name paper.
d. commercial paper.

Feedback: 'Two names' refers to the issuer and to the acceptor, who share the liability.

Answer: c
Learning objective 2.1: explain the characteristics of money market instruments.

11. The price paid by investors to buy Treasury notes from a dealer is the:

a. bid price.
*b. ask price.
c. face value.
d. market-clearing price.

Feedback: The ask price is the price asked by dealers for selling securities to customers while the bid price is the price that the dealer is ready to pay to buy from customers. The face value is the amount to be repaid at the maturity date and will always be higher than the trading price to account for interest.

Answer: b
Learning objective 2.1: explain the characteristics of money market instruments.

12. Which of the following statements is NOT correct? In the bidding process in a Treasury notes auction,

*a. the minimum bid is $1,000,000.
b. the bidder specifies the quantity of notes desired.
c. the bidder specifies the yield he/she is willing to get.
d. only registered bidders can participate in the auction.

Feedback: The minimum bid is $100,000

Answer: a
Learning objective 2.1: explain the characteristics of money market instruments.

13. In a Treasury note offering,

*a. the bidders with the lowest yield in their bid are allocated the notes first.
b. AOFM is committed to buy the unsold Treasury notes.
c. the yield is fixed and announced before the tender.
d. bidders bid only quantities of securities.

Feedback: Treasury notes are issued through a discriminatory auction, meaning that the bids are both yield and quantity, and the yields paid are the ones in the bids of the bidders with the lowest yields down to exhaustion of the notes on issue.

Answer: a
Learning objective 2.1: explain the characteristics of money market instruments.

14. In Australia, transfer of ownership of Treasury notes is performed by:

*a. Austraclear.
b. RITS.
c. the Reserve Bank of Australia.
d. AOFM.

Answer: a
Learning objective 2.1: explain the characteristics of money market instruments.

15. When firms issuing commercial paper (CP) use a backup line of credit offered by banks, it:

a. has no impact on CP investors.
b. decreases the marketability of CP.
c. increases the credit risk for CP investors.
*d. decreases the credit risk for CP investors.

Answer: d
Learning objective 2.1: explain the characteristics of money market instruments.

16. In an underwritten offer, the firm issuing the commercial paper is guaranteed that:

*a. the entire issue will be sold.
b. the entire issue will be taken up by the investment bank.
c. a discriminatory auction will be used to allocate the issue.
d. the investment bank will attract enough investors to sell the entire issue.

Answer: a
Learning objective 2.1: explain the characteristics of money market instruments.

17. A _____________ is a discount security.

a. share.
b. debenture.
*c. commercial bill.
d. corporate bond.

Feedback: A commercial bill is a discount security. A share is an equity security. Debentures and corporate bonds are coupon securities.

Answer: c
Learning objective 2.1: explain the characteristics of money market instruments.

18. Which of the following is not an instrument traded in the money market?

*a. Debentures.
b. Promissory notes.
c. Commercial bills.
d. Certificates of deposit.

Feedback: Debentures are traded in capital markets.

Answer: a
Learning objective 2.1: explain the characteristics of money market instruments.

19. Convertible notes are hybrid securities that:

a. can be converted into bonds at the discretion of the holder.
b. can be converted into debentures at the discretion of the holder.
c. can be converted into Treasury notes at the discretion of the holder.
*d. can be converted into shares of common stock at the discretion of the holder.

Feedback: Their convertibility feature permits the holder to share in the good fortune of the firm if the stock price rises above a certain level. That is, if the market value of the stock the holder receives at conversion exceeds the market value of the notes, it is to the investor's advantage to exchange the notes for stock, thus making a profit.

Answer: d
Learning objective 2.2: explain the role and function of capital markets, and how their role differs from that of the money markets.

20. Adjustable-rate preference shares are:

*a. shares issued with adjustable rates.
b. shares that can be converted into ordinary shares at a predetermined ratio.
c. shares issued when partly paid for, so that there is an obligation on the holder to contribute the balance.
d. shares in which the preference dividend remains constant regardless of any increase in the firm's earnings.

Feedback: The dividends are adjusted periodically in response to changing market interest rates.

Answer: a
Learning objective 2.2: explain the role and function of capital markets, and how their role differs from that of the money markets

21. The term shareholder equity implies:

a. a right to dividends.
*b. an ownership claim.
c. a prior claim on income and assets.
d. a contractual relationship with a corporation.

Feedback: In business and accounting, the shareholders' equity refers to the amount of assets that are owned by a company's shareholders.

Answer: b
Learning objective 2.2: explain the role and function of capital markets, and how their role differs from that of the money markets.

22. A _____________is *not* an example of a capital market security.

a. Commonwealth government bond.
b. Share.
*c. Commercial paper.
c. Corporate bond.

Feedback: Commercial paper belongs to the money markets as its original maturity is shorter than one year.

Answer: c
Learning objective 2.2: explain the role and function of capital markets, and how their role differs from that of the money markets.

23. _____________ is (are) the biggest net supplier of funds in the capital markets.

a. financial institutions.
b. state and local governments.
c. federal government.
*d. individuals and households.

Answer: d
Learning objective 2.2: explain the role and function of capital markets, and how their role differs from that of the money markets.

24. A capital market financing is most likely used to finance:

a. suppliers' bills.
b. the employees' wages.
*c. new plant and equipment.
d. seasonal inventory needs.

Answer: c
Learning objective 2.2: explain the role and function of capital markets, and how their role differs from that of the money markets.

25. Australian Treasury bonds pay coupons:

a. monthly.
b. annually.
c. at maturity.
*d. semi-annually.

Answer: d
Learning objective 2.2: explain the role and function of capital markets, and how their role differs from that of the money markets.

26. The RBA is a large investor in Treasury bonds and notes due to its role:

a. as the bank of the government.
b. in the stability of the government.
*c. in the conduct of monetary policy.
d. as a supervisor of the financial system.

Feedback: In order to influence the stock of central bank money in the banking system, the RBA conducts open market operations where the government securities are bought by the RBA from banks and then resold to banks at a later date (Reverse repos). The banks try to influence the stock of reserves in order to affect the cash rate, the overnight unsecured interbank rate.

Answer: c
Learning objective 2.2: explain the role and function of capital markets, and how their role differs from that of the money markets.

27. In the tenders organised by the AOFM to issue Treasury bonds:

a. bidders win if the quantity in their bid is among the highest.
b. bidders win if the yield in their bid is among the highest.
*c. AOFM serves the bidders with the lowest yields first and then accepts highest yields up to the exhaustion of the quantity on issue.
d. bidders bid quantities at the yield announced by AOFM.

Feedback: Treasury bonds are issued through discriminatory auctions where bidders (mainly banks) bid a yield and a quantity and the winners are the bidders with the lowest yields. Each winner pays the price implicit in the yield in its bid.

Answer: c
Learning objective 2.2: explain the role and function of capital markets, and how their role differs from that of the money markets.

28. Which of the following are features of some preference shares?

a. participating.
b. cumulativeness.
c. non-participating.
*d. all of the above.

Answer: d
Learning objective 2.2: explain the role and function of capital markets, and how their role differs from that of the money markets.

29. Which of the following is *not* an advantage of issuing preference shares?

*a. ownership rights are diluted.
b. non-payment of dividends cannot pose a solvency risk of debt.
c. the fixed cost of preference share capital allows firms to enhance earnings per ordinary share.
d. both a and b.

Answer: a
Learning objective 2.2: explain the role and function of capital markets, and how their role differs from that of the money markets.

30. Dealer panels are:

a. similar to brokers in the stock market.
b. a small set of bond dealers acting on behalf of the governments.
c. a small set of bond dealers acting on behalf of the households and non-profit organisations.
*d. a small set of bond dealers that agree to buy semis from state governments in either closed auctions or through agreeing to buy a given amount at a given price.

Feedback: This is a small set of bond dealers of up to 12 members and agree to buy semis from state governments in either closed auctions (in which stock is assigned to the best bids) or through agreeing to buy a given amount at a given price. (see State government bonds)

Answer: d
Learning objective 2.3: differentiate treasury bonds, semis and corporate bonds.

31. Life insurance companies and superannuation funds buy corporate bonds for which two major reasons?

a. low risk and liquidity.
b. tax sheltering and high yield.
c. liquidity and high after-tax returns.
*d. liability maturity matching and high after-tax returns.

Feedback: By investing in long-term corporate bonds, these firms are able to lock in high market yields with maturities that closely match the maturity structure of their liabilities, thereby reducing their interest rate risk.

Answer: d
Learning objective 2.3: differentiate treasury bonds, semis and corporate bonds.

32. An unsecured note is a bond:

*a. for which there is no underlying specified security as collateral in the case of default.
b. for which there is some underlying specified security as collateral in the case of default.
c. which has a call provision.
d. with sinking fund.

Feedback: An unsecured note is a bond that has no specified security attached as collateral in the case of default.

Answer: a
Learning objective 2.3: differentiate treasury bonds, semis and corporate bonds.

33. Fixed-charge debenture holders have the right to the proceeds of the sale of the assets:

*a. specified in the debenture, should the bond default.
b. specified in the debenture that is not already pledged against a fixed charge in any other debenture.
c. specified in a trust.
d. at all times.

Feedback: Fixed-charge debenture holders have the right to the proceeds of the sale of the assets specified in the debenture, should the bond default. A floating-charge debenture holder has the right to the proceeds of sale of the assets specified in the debenture that are not already pledged against a fixed charge in any other debenture, in the case of default as well.

Answer: a
Learning objective 2.3: differentiate treasury bonds, semis and corporate bonds.

34. State government bonds ________ than Commonwealth government bonds.

*a. pay higher yields.
b. have higher liquidity.
c. have lower default risk.
d. have higher marketability.

Answer: a
Learning objective 2.3: differentiate treasury bonds, semis and corporate bonds

35. Corporate bonds:

a. are discount securities.
b. do not need to be paid back.
c. pay interest at maturity date.
*d. make periodic payments of interest and repay principal at the maturity date.

Answer: d
Learning objective 2.3: differentiate treasury bonds, semis and corporate bonds.

36. Everything else being equal, a corporate bond will sell at a higher yield if it:

a. is senior debt.
*b. has a call provision.
c. has lower default risk.
d. can be converted to shares.

Feedback: Any feature in the bond that is detrimental to investors will sell at a higher yield. All features in the list except call provisions are beneficial to the investors and will require a lower yield.

Answer: b
Learning objective 2.3: differentiate treasury bonds, semis and corporate bonds.

37. Hybrid securities are financial products that have characteristics of:

*a. debt and equity.
b. government bonds.
c. discount securities.
d. credit-wrapped bonds.

Answer: a
Learning objective 2.3: differentiate treasury bonds, semis and corporate bonds.

38. Senior debt

a. is debt issued by the commonwealth government.
b. has a higher probability of payment than junior debt.
*c. is debt that has priority in the event of default of the issuer.
d. is the debt issued by good credit rated companies.

Feedback: Senior debt applies to unsecured corporate debt. It can exist even for not so good credit rated companies. The investors of senior debt have priority over the assets in case of default. Therefore, they are more likely to receive payments in case of defaults than other investors in unsecured debt.

Answer: c
Learning objective 2.3: differentiate treasury bonds, semis and corporate bonds.

39. Which of the following can best be described as a hybrid equity instrument with some characteristics of both equity and debt?

a. debentures.
b. partly paid shares.
*c. preference shares.
d. promissory notes.

Feedback: Preference shares are a hybrid equity instrument with some characteristics of equity and some of debt. Debentures and promissory notes are debt instruments, while partly paid shares are an equity instrument.

Answer: c
Learning objective 2.3: differentiate treasury bonds, semis and corporate bonds.

40. Interest on corporate bonds is usually paid:

a. monthly.
*b. six-monthly.
c. annually.
d. at maturity.

Feedback: Interest on corporate bonds is usually paid six-monthly.

Answer: b
Learning objective 2.3: differentiate treasury bonds, semis and corporate bonds.

41. Unsecured notes usually pay ____________ coupons.

*a. fixed.
b. floating.
c. no.
d. fixed and floating.

Answer: a
Learning objective 2.3: differentiate treasury bonds, semis and corporate bonds.

42. Generally, Commonwealth government bonds are assigned a ___________ rating.

*a. AAA.
b. AA.
c. A.
d. BBB.

Answer: a
Learning objective 2.3: differentiate treasury bonds, semis and corporate bonds.

43. Assuming the only difference between bonds is their level of risk, we would expect bonds with a _______ rating to trade at the highest yields.

a. AAA.
b. AA.
c. A.
*d. BBB.

Answer: d
Learning objective 2.3: differentiate treasury bonds, semis and corporate bonds.

44. Which of the following is *not* a feature of a debenture?

*a. unsecured.
b. fixed term.
c. regular coupons.
d. redemption at face value.

Feedback: Debentures are usually secured.
Answer: a
Learning objective 2.3: differentiate treasury bonds, semis and corporate bonds.

45. Which of the following statements is true?

*a. subordinated debt ranks above ordinary shareholders in the event of liquidation.
b. unsubordinated debt takes a lower ranking than other debt of similar characteristics.
c. subordinated debt ranks above other similar classes of debt in the event that a firm is liquidated.
d. all of the above.

Answer: a
Learning objective 2.3: differentiate treasury bonds, semis and corporate bonds.

46. The secondary markets for capital market securities have facilitated economic growth in general because:

a. they make people more willing to invest because they can more easily diversify their risk.
b. they help provide marketability for capital market claims.
c. they have increased people's willingness to buy capital market claims.
*d. all of the above.

Feedback: The secondary market for capital markets securities is important because it allows investors to alter the risk exposure of their portfolios before maturity. Thus a working secondary market enhances the primary market. Investors are encouraged to buy new securities if a secondary market is present to provide liquidity.

Answer: d
Learning objective 2.4: explain how equity securities are traded in the secondary markets and discuss how the markets are operated.

47. A dividend reinvestment scheme is:

a. an offering of new issues of shares or bonds.
b. the date on which a company ceases to effect transfers of its shares.
c. the amount that must be paid per share to buy a new issue.
*d. a scheme in which shareholders are allowed to reinvest dividends into shares.

Feedback: The scheme allows shareholders to increase their shareholdings gradually by automatically reinvesting their dividends in extra shares as each dividend is ‘paid’. The issued shares are normally issued at either the market price averaged over several days’ trading or at a slight discount to this price.

Answer: d
Learning objective 2.4: explain how equity securities are traded in the secondary markets and discuss how the markets are operated.

48. Share amalgamations:

a. try to prevent excessive speculation from destabilising the market.
b. encompass the division of the entity’s shares into units of smaller value.
c. is a system in which larger institutions submit bids for blocks of stock in an IPO.
*d. are the revaluation and elimination of some of the firm’s issued shares, resulting in a smaller number of shares of a higher value, with the overall market capitalisation of the company remaining unchanged.

Feedback: Share amalgamations, the revaluation and elimination of some of the firm’s issued shares, encompass the reduction of issued shares, accompanied by a rise in value.

Answer: d
Learning objective 2.4: explain how equity securities are traded in the secondary markets and discuss how the markets are operated.

49. Nonparticipating preference shares imply that:

a. the issuer has the right to buy back shares from the holders.
b. the dividend adjusts in response to a change in market interest rates.
*c. the preference dividend remains constant regardless of any increase in the firm's earnings.
d. the firm cannot pay a dividend on its ordinary shares until it has paid the preference shareholders the dividends in arrears.

Feedback: 'The firm cannot pay a dividend on its ordinary shares until it has paid the preference shareholders the dividends in arrears' is a description of the cumulative feature of preference shares. 'The issuer has the right to buy back shares from the holders' is a description of the redeemable feature of preference shares.

Answer: c
Learning objective 2.4: explain how equity securities are traded in the secondary markets and discuss how the markets are operated.

50. Which of the following characteristics is *not* associated with ordinary shares?

a. vote by proxy.
b. limited liability.
*c. cumulative dividends.
d. residual claim on income and assets.

Answer: c
Learning objective 2.4: explain how equity securities are traded in the secondary markets and discuss how the markets are operated.

51. When an investor buys convertible preference shares, the investor:

a. can replace fixed dividends by coupons.
b. is personally liable for the firm's obligations.
*c. has a set dividend rate usually for a five-year period.
d. can convert into preference shares at a predetermined ratio.

Answer: c
Learning objective 2.4: explain how equity securities are traded in the secondary markets and discuss how the markets are operated.

52. Which of the following statements is *not* correct? An ordinary shareholder in a troubled corporation:

*a. may lose his/her house.
b. does not receive dividends.
c. records a decrease in the value of his/her assets.
d. receives the proceeds from the sale of the assets after the creditors and the preference shareholders are paid, if the company goes bankrupt.

Feedback: Limited liability implies that the personal assets of the shareholders cannot be claimed by the creditors of the defaulting company.

Answer: a
Learning objective 2.4: explain how equity securities are traded in the secondary markets and discuss how the markets are operated.

53. An initial public offering of shares is:

a. an issue of new shares to existing shareholders.
b. an offering of new shares privately to a specific institutional investor.
*c. an issue of shares that have never before been offered to the public.
d. a rights issue.

Feedback: The IPO is the very first issue of shares to the public so the ownership structure before that moment is private ownership.

Answer: c
Learning objective 2.4: explain how equity securities are traded in the secondary markets and discuss how the markets are operated.

54. Non-renounceable rights:

a. trade in a secondary market until the exercise date.
*b. cannot be sold on the market and shareholders have the option to subscribe to the rights issue or let the offer lapse.
c. may be sold on the market if shareholders do not want to subscribe to a rights issue and increase their shareholdings.
d. are rights given to an investor who acquired them from the issuer or from another investor to purchase additional shares at a slightly below-market price.

Feedback: Non-renounceable rights have no secondary markets and must stay in the hands of the existing shareholders.

Answer: b
Learning objective 2.4: explain how equity securities are traded in the secondary markets and discuss how the markets are operated.

55. The sale of securities to the public via an investment banker by a privately owned corporation raising funds is called:

a. a seasoned offering.
b. a secondary offering.
c. a best efforts offering.
*d. an initial public offering.

Answer: d
Learning objective 2.4: explain how equity securities are traded in the secondary markets and discuss how the markets are operated.

56. In its capacity as the regulator of the financial markets, ASIC:

a. supervises the entities listed on the ASX.
b. conducts surveillance to detect insider trading on ASX.
c. conducts surveillance to detect market manipulations on ASX.
*d. investigates and prosecutes in case of illegal activities in the share market.

Feedback: ASX is responsible for the surveillance of its market and the companies listed on it. When ASX suspects an illegal activity in its market it refers it to ASIC, which investigates the case and prosecute the offenders.

Answer: d
Learning objective 2.4: explain how equity securities are traded in the secondary markets and discuss how the markets are operated.

57. A limit sell order at $20 for a particular share means that the investor:

a. only accepts to sell for a price of $20.
b. will not trade for prices higher than $20.
c. accepts to sell for prices equal or lower than $20.
*d. accepts to sell for prices equal or higher than $20.

Answer: d
Learning objective 2.4: explain how equity securities are traded in the secondary markets and discuss how the markets are operated.

58. The extent to which orders exist both above and below the price at which the share currently trades reflects the share market's:

*a. depth.
b. breadth.
c. resilience.
d. short position.

Answer: a
Learning objective 2.4: explain how equity securities are traded in the secondary markets and discuss how the markets are operated.

59. Which of the following statements is *not* correct? A stock market crash can lead to an economic recession through:

a. the decrease in wealth resulting in a decrease in consumption.
b. the rise in the cost of raising capital resulting in a decrease in investment.
*c. the decrease in share issuers' equity resulting in a decrease in investment.
d. the decrease in consumer confidence resulting in a decrease in consumption.

Feedback: The decrease in shares prices does not affect the equity of the issuers. It affects the value of the assets of the investors and possibly through mark-to-market accounting the equity of these investors.

Answer: c
Learning objective 2.4: explain how equity securities are traded in the secondary markets and discuss how the markets are operated.

60. Which of the following is not an equity instrument?

*a. a debenture.
b. a preference share.
c. a fully paid ordinary share.
d. a partly paid ordinary share.

Feedback: A debenture is a debt instrument. The other three are types of equity instruments.

Answer: a
Learning objective 2.4: explain how equity securities are traded in the secondary markets and discuss how the markets are operated.

61. The listing requirements of the ASX apply to:

*a. companies whose shares trade on the ASX.
b. merchant bankers.
c. stockbrokers.
d. all of the above.

Answer: a
Learning objective 2.4: explain how equity securities are traded in the secondary markets and discuss how the markets are operated.

62. Futures contracts differ from forward contracts in that:

a. forward contracts always require a margin deposit.
b. futures contracts are between the individual hedger and speculator.
c. futures contracts are personalised, unique contracts; forwards are standardised.
*d. futures contracts are marked to market daily with changes in value added or subtracted from buyer and seller.

Feedback: Market participants post margin money (if necessary) to take account of gains or losses accruing from daily price fluctuations; we will come back to margins later and explain them in more detail.

Answer: d
Learning Objective 2.5: describe the most common types of derivative contracts.

63. A hedger in the financial futures market:

a. only sells futures contracts.
b. only buys futures contracts.
*c. aims to reduce their price risk.
d. either buys or sells future contracts in the expectation of earning a high return.

Answer: c
Learning Objective 2.5: describe the most common types of derivative contracts.

64. The purchase of one million dollars of Treasury Bonds, delivered in 60 days, from a government securities dealer is:

a. a put.
b. a call.
c. a swap.
*d. a forward contract.

Answer: d
Learning Objective 2.5: describe the most common types of derivative contracts.

65. Futures contracts differ from forward contracts in all of the following ways except:

a. delivery is made most often in forward contracts.
b. futures markets are more formal than forward markets.
*c. forward contracts involve an intermediary or exchange.
d. futures contracts are standardised; forward contracts are not.

Answer: c
Learning Objective 2.5: describe the most common types of derivative contracts.

66. Settlement date in a forward contract means:

a. forward prices are always higher than spot prices.
b. spot prices are always higher than forward prices.
*c. the future date on which the buyer pays the seller and the seller delivers the assets to the buyer.
d. the contracted party that exchanges one item for another for a predetermined price at a predetermined point in time.

Answer: c
Learning Objective 2.5: describe the most common types of derivative contracts.

67. The forward price for an asset is the price that makes the forward contract:

*a. have zero net present value.
b. have negative net present value.
c. have positive net present value.
d. have zero or positive net present value.

Answer: a
Learning Objective 2.5: describe the most common types of derivative contracts.

68. Which of the following statements best describes marking to market?

a. The process of personalising futures contracts.
b. The final day on which trading occurs in a particular contract.
*c. The requirement of a futures exchange for daily cash settlement of all contracts.
d. The process of setting up a contract with a clearinghouse to operate as counterparty between the buyer and seller of a futures contract.

Answer: c
Learning Objective 2.5: describe the most common types of derivative contracts.

69. Novation in futures exchange means:

a. a place in which buyers and sellers can exchange futures contracts. the exchange keeps the books for buyers and sellers when contracts are initiated or liquidated.
*b. the process of setting up a contract with a new party, such as occurs when clearinghouses insert themselves between the buyer and seller of a futures contract.
c. a requirement that gains or losses on futures positions be taken into account in determining the value of all contracts each day.
d. the back office that records, clears and settles contracts and acts as counterparty in futures trading.

Answer: b
Learning Objective 2.5: describe the most common types of derivative contracts.

70. An investor planning to buy NAB Bank shares in 30 days can protect himself against price risk by:

a. selling a NAB bank put option that matures in 30 days.
*b. buying a NAB bank call option that matures in 30 days.
c. selling a NAB bank call option that matures in 30 days.
d. none of the above options are correct.

Answer: b
Learning Objective 2.5: describe the most common types of derivative contracts.

71. Put options:

a. give the option buyer the right to buy a security at the strike price.
*b. give the option buyer the right to sell a security at the strike price.
c. give the option buyer the right to buy or sell a security at the strike price.
d. give the option buyer the right to sell a security at the mark to market price.

Answer: b
Learning Objective 2.5: describe the most common types of derivative contracts.

72. Which of the following is not a derivative?

*a. an ordinary share in a company.
b. a futures contract.
c. an options contract.
d. a swap contract.

Feedback: An ordinary share in a company is not a derivative. The other alternatives are all examples of derivatives.

Answer: a
Learning Objective 2.5: describe the most common types of derivative contracts.

73. The part of a futures market that facilitates settlement of contracts and transfer of ownership between the parties to transactions is correctly referred to as a:

*a. clearing house.
b. counting house.
c. central registry.
d. settlement facility.

Feedback: A clearing house facilitates settlement of contracts and transfer of ownership between the parties to transactions.

Answer: a
Learning Objective 2.5: describe the most common types of derivative contracts.

74. ________________ is the first payment required for a futures contract.

a. a bond.
b. a deposit.
c. a premium.
*d. an initial margin.

Feedback: An initial margin is the first payment required for a futures contract.

Answer: d
Learning Objective 2.5: describe the most common types of derivative contracts.

75. If a futures trader fails to pay a margin call on a futures contract, the contract is:

a. closed out by the counterparty.
b. allowed to lapse.
c. cancelled by the futures exchange.
*d. closed out by the clearing house.

Feedback: If a futures trader fails to pay a margin call on a futures contract, the contract is closed out by the clearing house.

Answer: d
Learning Objective 2.5: describe the most common types of derivative contracts.

76. _______________ are always obligations for the buyer.

a. Call options.
b. Put options.
*c. Futures contracts.
d. All of the above.

Answer: c
Learning Objective 2.5: describe the most common types of derivative contracts.

77. Which of the following are always obligations for the seller:

a. Put options.
b. Futures contracts.
c. Call options.
*d. All of the above.

Answer: d
Learning Objective 2.5: describe the most common types of derivative contracts.

78. Which of the following statements regarding forward rate agreements (FRAs) is false:

a. FRAs are settled by the payment of the difference in interest payable on a notional principal at the agreed rate and at the current market rate.
*b. if the market has risen, the buyer must pay the seller of the FRA.
c. FRAs are signed on the trade date.
d. none of the above.

Answer: b
Learning Objective 2.5: describe the most common types of derivative contracts.

79. A put option written on a futures contract gives the buyer the right to:

a. sell the asset underlying the futures contract.
b. buy the asset underlying the futures contract.
*c. sell the futures contract underlying the option contract.
d. buy the futures contract underlying the option contract.

Answer: c
Learning Objective 2.5: describe the most common types of derivative contracts.

80. If a country experiences inflation, generally:

a. its interest rates will fall.
b. its exports will increase significantly.
c. the forward exchange rate will fall relative to all other countries.
*d. its forward exchange rate will fall relative to countries with lower inflation.

Feedback: When people expect to have more inflation, they tend to buy from other country hence driving down the spot exchange rate. Because forward exchange rate partly based on spot rate, forward rate tend to fall as spot rate falls.

Answer: d
Learning objective 2.6: explain how the foreign exchange markets operate and facilitate international trade.

81. A crawling peg is:

a. an exchange rate that is allowed to float or move within a defined or set band relative to another currency.
*b. a managed float where an exchange rate is allowed to appreciate in controlled steps over time.
c. an exchange rate determined by the supply and demand factors in the FX markets.
d. a constant rate of exchange between currencies.

Feedback: For example, China applies a crawling peg foreign exchange regime that allows is currency to appreciate gradually over time within a limited range determined by its government. (see The operations of foreign exchange markets).

Answer: b
Learning objective 2.6: explain how the foreign exchange markets operate and facilitate international trade.

82. Investment flows from one country to another occur based on the investors'

a. spot exchange rate when making the investment.
b. nominal rate of return on the foreign investment.
*c. expected real rate of return on the foreign investment.
d. the realised real rate of return on the foreign investment.

Feedback: Investment capital flows are either short-term money market flows motivated by differences in interest rates or long-term capital investments in a nation's real or financial assets. (see Investment capital flows)

Answer: c
Learning objective 2.6: explain how the foreign exchange markets operate and facilitate international trade.

83. A base currency is:

a. the rate at which one nation's currency can be exchanged for another's at the present time.
b. the second-named currency in the foreign exchange quote used to express the value or price of the base currency.
*c. the first-named currency in the foreign exchange quote where one unit expressed in terms of another currency being traded.
d. none of the above.

Feedback: A base currency is the first-named currency in the foreign exchange quote where one unit expressed in terms of another currency being traded.

Answer: c
Learning objective 2.6: explain how the foreign exchange markets operate and facilitate international trade.

84. Foreign exchange rates are best described as:

a. the current interest rates of varying countries.
b. the cost of a unit of foreign currency.
c. the expected change in prices of international goods.
*d. the cost of a unit of foreign currency in terms of another currency.

Answer: d
Learning objective 2.6: explain how the foreign exchange markets operate and facilitate international trade.

85. A government that believes its currency is becoming overvalued may fear that currency appreciation will hinder its producers' abilities to export goods and will encourage imports. In this case, a government may:

a. sell foreign currencies in the foreign exchange markets.
b. buy foreign currencies in the foreign exchange markets.
*c. buy assets from abroad.
d. sell assets abroad.

Answer: c
Learning objective 2.6: explain how the foreign exchange markets operate and facilitate international trade.

86. Countertrade in an international transaction is:

a. passing the risk associated with changes in exchange rates to another.
*b. the practice of accepting locally produced merchandise in lieu of money as payment for goods and services.
c. a market in which parties agree to exchange a fixed amount of one currency for a fixed amount of a second currency.
d. transferring purchasing power from those who normally deal in one currency to those who generally do business in another.

Answer: b
Learning objective 2.6: explain how the foreign exchange markets operate and facilitate international trade.

87. An importer who must pay yen in 60 days may hedge the foreign exchange risk:

a. in the spot market 60 days from now.
b. in the spot market today.
*c. in the forward market.
d. all of the above.

Answer: c
Learning objective 2.6: explain how the foreign exchange markets operate and facilitate international trade.

88. if the cost of yen per dollar changes from 100 to 110 yen per dollar,

a. the cost of a yen has increased in terms of dollars.
b. the yen has appreciated against the dollar.
*c. the dollar has appreciated against the yen.
d. the dollar has depreciated against the yen.

Answer: c
Learning objective 2.6: explain how the foreign exchange markets operate and facilitate international trade.

89. Differences in real interest rates between countries produce the following type of capital flows:

a. speculative capital flows.
*b. investment capital flows.
c. political capital flows.
d. capital flight.

Answer: b
Learning objective 2.6: explain how the foreign exchange markets operate and facilitate international trade.

90. If interest rates in Australia are high and Australian inflation is expected to be low:

a. foreigners will not invest in Australia because of the uncertainty.
*b. foreigners can expect to earn high real returns if they invest in Australia.
c. foreigners can expect to earn low real returns if they invest in Australia.
d. foreigners can expect to earn between high and low real returns if they invest in Australia.

Feedback: A high interest rate (relative to other countries) coupled with low inflation will attract foreign investors. These investors will secure higher returns in Australia (due to the higher interest rates on offer).

Answer: b
Learning objective 2.6: explain how the foreign exchange markets operate and facilitate international trade.

91. The balance of payments financial account measures:

a. any errors or omissions between a country's current account and its long-term trading account.
b. both short term and long term capital flows into or out of the country.
*c. long term capital flows into or out of the country.
d. short term capital flows into or out of the country.

Feedback: The balance of payments financial account measures capital flows into or out of the country.

Answer: c
Learning objective 2.6: explain how the foreign exchange markets operate and facilitate international trade.

92. Which of the following types of international capital flows can affect a currency's exchange rate:

a. political capital flows only and central banks' foreign exchange market operations.
*b. investment capital flows, political capital flows and central banks' foreign exchange market operations.
c. investment and political capital flows.
d. investment capital flows only.

Answer: b
Learning objective 2.6: explain how the foreign exchange markets operate and facilitate international trade.

93. To be admitted into the single currency community, a prospective EU member must meet:

a. strict foreign exchange regulations.
b. the European Central Bank directives.
*c. strict fiscal and monetary qualifications.
d. all of the above.

Answer: c
Learning objective 2.6: explain how the foreign exchange markets operate and facilitate international trade.

94. The EU motivation for adopting a common currency is to:

a. make member countries more competitive in global markets.
b. to set a single monetary policy and interest rates for member countries.
c. reduce the economic inefficiency caused by large fluctuations in foreign exchange rates.
*d. both a and c.

Answer: d
Learning objective 2.6: explain how the foreign exchange markets operate and facilitate international trade.

95. Which of the following is not a tool for managing foreign exchange risk?
Feedback: Company-issued options cannot be used for managing foreign exchange risk, as can the other alternatives.

a. Forward contracting.
*b. Company-issued options.
c. Futures contracts.
d. Swaps.

Answer: b
Learning objective 2.6: explain how the foreign exchange markets operate and facilitate international trade.

