***Money, Banking, and the Financial System, 3e* (Hubbard/O'Brien)**

**Chapter 1 Introducing Money and the Financial System**

1.1 Key Components of the Financial System

1) The financial system is primarily a means by which

A) funds are transferred from savers to borrowers.

B) money is put into circulation.

C) the government puts into operation its plans for the economy.

D) business firms distribute their goods.

Answer: A

Diff: 1 Page Ref: 4

Topic: financial system

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

2) Which of the following is NOT a financial asset?

A) a bond issued by Google

B) Wells Fargo Bank

C) a home mortgage loan

D) a certificate of deposit

Answer: B

Diff: 1 Page Ref: 2

Topic: financial assets

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

3) If you buy a bond issued by Intel, the bond is a(n)

A) liability to Intel and an asset to you.

B) liability to you and an asset to Intel.

C) liability to both you and Intel.

D) asset to both you and Intel.

Answer: A

Diff: 2 Page Ref: 4

Topic: financial assets

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

4) Which of the following forms the largest share of household holdings of financial assets?

A) corporate stocks

B) bonds

C) pension fund reserves

D) equity in unincorporated businesses

Answer: C

Diff: 1 Page Ref: 9-10

Topic: financial assets

Special Feature: Making the Connection: What Do People Do with Their Savings?

Objective: Identify the key components of the financial system

AACSB: Reflective Thinking

5) From 1978 to 2016, the percentage of wealth held by households decreased for all of the following categories of assets EXCEPT

A) corporate stocks.

B) bonds.

C) deposits.

D) equity in unincorporated businesses.

Answer: A

Diff: 1 Page Ref: 9-10

Topic: financial assets

Special Feature: Making the Connection: What Do People Do with Their Savings?

Objective: Identify the key components of the financial system

AACSB: Reflective Thinking

6) Which of the following is NOT a key financial service provided by the financial system?

A) risk sharing

B) profitability

C) liquidity

D) information

Answer: B

Diff: 1 Page Ref: 13

Topic: financial system

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

7) Economists define risk as

A) the difference between the interest rate borrowers pay and the interest rate lenders receive.

B) the chance that the value of financial assets will change from what you expect.

C) the ease with which an asset can be exchanged for other assets or for goods and services.

D) the difference between the return on common stock and the return on corporate bonds.

Answer: B

Diff: 1 Page Ref: 13

Topic: financial system

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

8) Economists define liquidity as

A) the difference between the return on the asset and the return on a long-term U.S. Treasury bond.

B) the fraction the asset makes up of an investor's portfolio.

C) the ease with which an asset can be exchanged for money.

D) the difference between the total demand for an asset and the total supply of the asset.

Answer: C

Diff: 1 Page Ref: 13

Topic: financial system

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

9) Which of the following assets is the most liquid?

A) money market mutual fund

B) computer

C) washing machine

D) U.S. Treasury bond

Answer: A

Diff: 2 Page Ref: 13-14

Topic: financial system

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

10) By providing and communicating information, the financial system

A) reduces the difference between the return on three-month U.S. Treasury bills and the return on thirty-year U.S. Treasury bonds.

B) relieves individual savers from the necessity of searching out individual borrowers.

C) eliminates the risk in investing in the stock market.

D) guarantees investors a reasonable return on their money.

Answer: B

Diff: 2 Page Ref: 14

Topic: financial system

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

11) Financial securities that represent partial ownership of a corporation are known as

A) bonds.

B) stocks.

C) coupons.

D) dividends.

Answer: B

Diff: 1 Page Ref: 3

Topic: financial assets

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

12) Securitization is the process of

A) issuing stocks to finance capital spending.

B) issuing bonds to finance purchases of equipment and structures.

C) reducing risk by decreasing corporate debt loads.

D) converting loans into securities.

Answer: D

Diff: 1 Page Ref: 4

Topic: financial assets

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

13) If a bank grants you a mortgage, the mortgage is

A) an asset to you as well as an asset to the bank.

B) an asset to you, but a liability to the bank.

C) a liability to you, but an asset to the bank.

D) a liability to you as well as a liability to the bank.

Answer: C

Diff: 2 Page Ref: 4

Topic: financial assets

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

14) Financial markets

A) channel funds indirectly between borrowers and lenders.

B) channel funds directly from lenders to borrowers.

C) act as go-betweens by holding a portfolio of assets and issuing claims based on that portfolio to savers.

D) generally provide lenders with lower returns than do financial intermediaries.

Answer: B

Diff: 2 Page Ref: 4

Topic: financial institutions

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

15) If you purchase a Treasury bond, the Treasury bond is

A) an asset to you as well as an asset to the U.S. government.

B) an asset to you, but a liability to the U.S. government.

C) a liability to you, but an asset to the U.S. government.

D) a liability to you as well as a liability to the U.S. government.

Answer: B

Diff: 2 Page Ref: 4

Topic: financial assets

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

16) Funds flow from lenders to borrowers

A) indirectly through financial markets.

B) directly through financial intermediaries.

C) indirectly through financial intermediaries.

D) primarily through government agencies.

Answer: C

Diff: 1 Page Ref: 4

Topic: financial institutions

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

17) Which of the following is NOT a financial intermediary?

A) NASDAQ

B) Allstate Insurance Company

C) Bank of America

D) Vanguard Total Stock Market Index Fund

Answer: A

Diff: 1 Page Ref: 4

Topic: financial institutions

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

18) Which of the following is NOT a financial intermediary?

A) mutual fund

B) bank

C) stock exchange

D) insurance company

Answer: C

Diff: 1 Page Ref: 4

Topic: financial institutions

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

19) The main role of financial intermediaries is to

A) provide funds to the federal government to cover the budget deficit.

B) borrow funds from savers and lend them to borrowers.

C) provide advice to consumers on how they should handle their finances.

D) help ensure that there is enough money in circulation.

Answer: B

Diff: 1 Page Ref: 4

Topic: financial institutions

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

20) Financial intermediaries

A) include banks and other depository institutions.

B) include the New York and American Stock exchanges.

C) directly issue claims on individual borrowers to savers.

D) are owned and operated by the federal government.

Answer: A

Diff: 1 Page Ref: 4

Topic: financial institutions

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

21) A "primary market" is a market

A) for government securities.

B) in which newly issued claims are sold to buyers by borrowers.

C) in which newly issued claims are sold by savers to borrowers.

D) for debt by large or "primary" corporations.

Answer: B

Diff: 1 Page Ref: 9

Topic: financial institutions

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

22) A bank lending depositors' money to a local business and a pension fund investing contributions in shares of a company are similar financial activities in that

A) both involve the use of financial markets.

B) both involve funds being channeled from savers to borrowers through financial intermediaries.

C) both involve a reduction in the overall level of liquidity in the financial system.

D) both involve in an increase in the overall level of risk in the financial system.

Answer: B

Diff: 2 Page Ref: 4, 8

Topic: financial system

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

23) The leading federal regulatory body for financial markets in the United States is the

A) Federal Bureau of Investigation.

B) Securities and Exchange Commission.

C) Federal Financial Market Bureau.

D) Investors Protection Agency.

Answer: B

Diff: 1 Page Ref: 10

Topic: financial institutions

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

24) Economists define money as

A) cash in circulation.

B) deposits in commercial banks.

C) anything that people are willing to accept in payment for goods and services or to pay off debts.

D) bonds issued by large corporations.

Answer: C

Diff: 1 Page Ref: 3

Topic: financial system

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

25) The Federal Reserve System

A) is in charge of managing the New York Stock Exchange.

B) is headed by the Secretary of the Treasury.

C) is the central bank of the United States.

D) is responsible for conducting fiscal policy for the United States.

Answer: C

Diff: 1 Page Ref: 11

Topic: Federal Reserve

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

26) Monetary policy refers to the government's

A) decisions on how much money to spend.

B) decisions on how much money to collect in taxes.

C) plans for retiring the national debt.

D) management of the money supply and interest rates to achieve macroeconomic objectives.

Answer: D

Diff: 1 Page Ref: 11

Topic: Federal Reserve

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

27) Diversification refers to the

A) splitting of wealth into many assets.

B) difference between the liquidity of an asset and its risk.

C) difficulty of converting investments in common stocks into investments in bonds.

D) difficulty of selling common stocks in a weak market.

Answer: A

Diff: 1 Page Ref: 13

Topic: financial system

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

28) The purpose of diversification is to

A) increase the liquidity of a financial portfolio.

B) reduce the brokerage fees involved in managing a financial portfolio.

C) reduce risk.

D) reduce tax liability.

Answer: C

Diff: 1 Page Ref: 13

Topic: financial system

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

29) The financial system provides risk sharing by allowing

A) borrowers to obtain funds either directly or indirectly.

B) savers to earn interest tax-free.

C) borrowers to convert liabilities into assets.

D) savers to hold many assets.

Answer: D

Diff: 2 Page Ref: 13

Topic: financial system

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

30) Liquidity

A) is the best available measure of the riskiness of an asset.

B) is a characteristic of money, and of no other asset.

C) is the ease with which an asset can be exchanged for money.

D) was declining for many financial assets during the 1990s.

Answer: C

Diff: 1 Page Ref: 13

Topic: financial system

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

31) Which of the following assets is the least liquid?

A) money market mutual fund

B) stock

C) treasury bond

D) house

Answer: D

Diff: 1 Page Ref: 13-14

Topic: financial system

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

32) Increased liquidity in recent decades has reduced interest rates on which of the following assets (holding constant all other things that affect interest rates)?

A) U.S. government bonds

B) bonds issued by large corporations

C) business loans

D) bonds issued by state governments

Answer: C

Diff: 2 Page Ref: 14

Topic: financial system

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

33) The financial system performs the role of communicating information by

A) constantly increasing the liquidity of most assets.

B) constantly reducing the riskiness of most assets.

C) incorporating all available information into the prices of financial assets.

D) providing to investors for a nominal charge all government reports available about a particular company.

Answer: C

Diff: 2 Page Ref: 14

Topic: financial system

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

34) The distinguishing feature of a well-functioning financial market is the

A) continual increase in the liquidity of most assets.

B) continual reduction in the riskiness of most assets.

C) increased ease of converting common stocks into bonds.

D) incorporation of available information into asset prices.

Answer: D

Diff: 2 Page Ref: 14

Topic: financial system

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

35) In the United States, monetary policy is carried out by

A) the Federal Reserve System.

B) Congress.

C) the President.

D) Congress and the President acting together.

Answer: A

Diff: 1 Page Ref: 11

Topic: Federal Reserve

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

36) In the United States, the lender of last resort is

A) Fannie Mae.

B) the Federal Reserve.

C) the Federal Deposit Insurance Corporation.

D) the Securities and Exchange Commission.

Answer: B

Diff: 1 Page Ref: 11

Topic: Federal Reserve

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

37) A decline in bank lending has the most significant effect on

A) small businesses.

B) large businesses.

C) state governments.

D) the federal government.

Answer: A

Diff: 2 Page Ref: 6-7

Topic: financial institutions

Special Feature: Making the Connection: The Rise of Peer-to-Peer Lending and Fintech

Objective: Identify the key components of the financial system

AACSB: Reflective Thinking

38) All of the following took place during the economic crisis that began in 2007 EXCEPT

A) the financial system was disrupted.

B) large portions of the U.S. economy were cut off from the funds they needed to thrive.

C) there was a devastating decline in the production of goods and services throughout the economy.

D) unlike households, most businesses still had easy access to funds.

Answer: D

Diff: 2 Page Ref: 1-2

Topic: financial crisis of 2007-2009

Special Feature: Chapter Opener: You Get a Bright Idea ... but Then What?

Objective: Provide an overview of the financial crisis of 2007-2009

AACSB: Reflective Thinking

39) By the end of 2009, loan losses were \_\_\_\_\_\_\_\_ at the end of 2007.

A) equal to those

B) two times less than

C) four times greater than

D) twenty-five times greater than

Answer: C

Diff: 1 Page Ref: 6-7

Topic: financial crisis of 2007-2009

Special Feature: Making the Connection: The Rise of Peer-to-Peer Lending and Fintech

Objective: Provide an overview of the financial crisis of 2007-2009

AACSB: Reflective Thinking

40) The funds for loans from peer-to-peer lenders come from three key sources. Which of the following is NOT one of those key sources?

A) individuals

B) government

C) financial firms

D) other businesses

Answer: B

Diff: 1 Page Ref: 6-7

Topic: financial institutions

Special Feature: Making the Connection: The Rise of Peer-to-Peer Lending and Fintech

Objective: Identify the key components of the financial system

AACSB: Reflective Thinking

41) The interest rate on loans made by peer-to-peer lenders tends to be

A) lower than the interest rate on bonds and lower than the interest rate on credit cards.

B) higher than the interest rate on bonds and higher than the interest rate on credit cards.

C) lower than the interest rate on bonds and higher than the interest rate on credit cards.

D) higher than the interest rate on bonds and lower than the interest rate on credit cards.

Answer: D

Diff: 1 Page Ref: 6-7

Topic: financial institutions

Special Feature: Making the Connection: The Rise of Peer-to-Peer Lending and Fintech

Objective: Identify the key components of the financial system

AACSB: Reflective Thinking

42) Which of the following does NOT describe the relationship between banks and small business during the 2000s (prior to the financial crisis)?

A) Banks typically applied fixed guidelines for granting loans, leaving little room for personal judgment.

B) Fewer small businesses received loans as banks shifted their focus to mortgages.

C) Many small businesses were receiving loans from regional and national banks.

D) More banks became convinced that it would be profitable to loosen their loan guidelines to make more borrowers eligible to receive credit.

Answer: B

Diff: 2 Page Ref: 6-7

Topic: financial institutions

Special Feature: Making the Connection: The Rise of Peer-to-Peer Lending and Fintech

Objective: Identify the key components of the financial system

AACSB: Reflective Thinking

43) The process by which investment banks guarantee a certain price to a firm issuing stocks or bonds is known as

A) underwriting.

B) securitization.

C) proprietary trading.

D) peer-to-peer lending.

Answer: A

Diff: 2 Page Ref: 8

Topic: financial institutions

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

44) Until very recently, investment banks rarely engaged in which of the following?

A) proprietary trading

B) securitization

C) lending to households

D) underwriting

Answer: C

Diff: 2 Page Ref: 8

Topic: financial institutions

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

45) All of the following represent returns to savers EXCEPT

A) dividends on stocks.

B) fees on loans.

C) interest on deposits.

D) coupon payments on bonds.

Answer: B

Diff: 1 Page Ref: 5

Topic: financial system

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

46) The role of the financial system is to

A) channel funds from households and other savers to businesses.

B) protect commercial banks from government regulation.

C) ensure that investment banks remain profitable.

D) provide loans from the Federal Reserve to households and businesses.

Answer: A

Diff: 1 Page Ref: 1-2

Topic: financial system

Special Feature: Chapter Opener: You Get a Bright Idea ... but Then What?

Objective: Identify the key components of the financial system

AACSB: Reflective Thinking

47) Ordinary (non-securitized) loans cannot be resold after they have been granted by a bank or another lender. Therefore, these loans are

A) financial assets but not financial securities.

B) financial securities but not financial assets.

C) both financial assets and financial securities.

D) neither financial assets nor financial securities.

Answer: A

Diff: 2 Page Ref: 15

Topic: financial system

Special Feature: Solved Problem: The Services Securitized Loans Provide

Objective: Identify the key components of the financial system

AACSB: Reflective Thinking

48) Because securitized loans are loans that have been bundled with other loans and sold to investors, they are

A) financial assets but not financial securities.

B) financial securities but not financial assets.

C) both financial assets and financial securities.

D) neither financial assets nor financial securities.

Answer: C

Diff: 2 Page Ref: 15

Topic: financial system

Special Feature: Solved Problem: The Services Securitized Loans Provide

Objective: Identify the key components of the financial system

AACSB: Reflective Thinking

49) All of the following are true regarding securitized loans EXCEPT

A) they provide risk sharing.

B) they provide information.

C) they provide liquidity.

D) they cannot be resold.

Answer: D

Diff: 2 Page Ref: 15

Topic: financial system

Special Feature: Solved Problem: The Services Securitized Loans Provide

Objective: Identify the key components of the financial system

AACSB: Reflective Thinking

50) Briefly discuss three reasons why firms may borrow funds from a bank.

Answer: Many firms rely on bank loans to meet their short-term needs for credit, such as funds to pay for inventories or to meet their payrolls. Many firms rely on bank loans to bridge the gap between the time they must pay for inventories or meet their payrolls and when they receive revenues from the sales of goods and services. Some firms also rely on bank loans to meet their long-term credit

needs, such as funds they require to physically expand the firm.

Diff: 2 Page Ref: 6

Topic: financial system

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

51) Briefly explain the process of securitizing mortgages.

Answer: The mortgage lender sells the loan to a government-sponsored enterprise or financial firm that bundles the mortgage with mortgages from other lenders, providing the basis for a mortgage-backed security.

Diff: 2 Page Ref: 4

Topic: financial assets

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

52) How are interest payments on mortgages distributed to investors who own mortgage-backed securities?

Answer: The banks that grants, or *originates*, the original mortgages will still collect the interest paid by the borrowers and send those interest payments on to the government agency or financial firm to distribute to the investors who have bought the mortgage-backed security.

Diff: 2 Page Ref: 4

Topic: financial assets

Objective: Identify the key components of the financial system

\*: Recurring

AACSB: Reflective Thinking

53) Briefly explain the difference in how banks and peer-to-peer lenders make profits on loans.

Answer: Banks have traditionally earned profits on loans by paying a lower interest rate to depositors than they charge to borrowers. Peer-to-peer lenders make profits by charging borrowers a one-time fee and charging the people providing funds a fee for collecting the payments from borrowers.

Diff: 2 Page Ref: 6-7

Topic: financial institutions

Special Feature: Making the Connection: The Rise of Peer-to-Peer Lending and Fintech

Objective: Identify the key components of the financial system

AACSB: Reflective Thinking

1.2 The Financial Crisis of 2007-2009

1) Which president said, "Prosperity is just around the corner"?

A) Herbert Hoover near the start of the Great Depression

B) Franklin Delano Roosevelt near the start of the Great Depression

C) George W. Bush near the start of the Great Recession

D) Barack Obama near the start of the Great Recession

Answer: A

Diff: 1 Page Ref: 16

Topic: financial crisis of 2007-2009

Objective: Provide an overview of the financial crisis of 2007-2009

\*: Recurring

AACSB: Reflective Thinking

2) What made the recession of 2007-2009 different than any other recession since the Great Depression?

A) The government did not implement a fiscal stimulus.

B) The Fed failed to reduce interest rates.

C) It was accompanied by a financial crisis.

D) The impact was primarily limited to the financial sector.

Answer: C

Diff: 2 Page Ref: 16

Topic: financial crisis of 2007-2009

Objective: Provide an overview of the financial crisis of 2007-2009

\*: Recurring

AACSB: Reflective Thinking

3) Fannie Mae and Freddie Mac both

A) sell bonds to investors and use the funds to purchase mortgages.

B) help regulate the banking system.

C) directly lend funds to people seeking mortgages.

D) reduce access to funds for mortgages by purchasing existing mortgages.

Answer: A

Diff: 2 Page Ref: 16

Topic: financial crisis

Objective: Provide an overview of the financial crisis of 2007-2009

\*: Recurring

AACSB: Reflective Thinking

4) All of the following are examples of risky mortgages that became more common in the 2000s EXCEPT

A) alt-A mortgages.

B) adjustable-rate mortgages with low rates for a few years and then higher rates in later years.

C) mortgages requiring down payments of at least 20%.

D) subprime mortgages.

Answer: C

Diff: 1 Page Ref: 17

Topic: financial crisis

Objective: Provide an overview of the financial crisis of 2007-2009

\*: Recurring

AACSB: Reflective Thinking

5) Which of the following best describes a "bubble"?

A) when the price of an asset reaches a new high

B) an unsustainable increase in the price of a class of assets

C) rapid increases in inflation

D) when bond prices rise more quickly than stock prices

Answer: B

Diff: 1 Page Ref: 16

Topic: financial crisis

Objective: Provide an overview of the financial crisis of 2007-2009

\*: Recurring

AACSB: Reflective Thinking

6) All of the following were significant changes in the mortgage market in the 2000s EXCEPT

A) investment banks became significant participants in the secondary mortgage market.

B) lenders loosened lending standards.

C) mortgage-backed securities became more popular with investors.

D) borrowers tended to increase the amount of their down payments.

Answer: D

Diff: 2 Page Ref: 17

Topic: financial crisis

Objective: Provide an overview of the financial crisis of 2007-2009

\*: Recurring

AACSB: Reflective Thinking

7) Which type of borrowers were *least* likely to default in their mortgage at the beginning of the financial crisis?

A) those with fixed-rate mortgages who made large down payments

B) those with alt-A loans

C) subprime borrowers

D) those with adjustable-rate mortgages

Answer: A

Diff: 1 Page Ref: 17

Topic: financial crisis

Objective: Provide an overview of the financial crisis of 2007-2009

\*: Recurring

AACSB: Reflective Thinking

8) The Troubled Asset Relief Program (TARP) allowed

A) the Treasury to inject funds into commercial banks in return for stock in the banks.

B) the Fed to provide funds to commercial banks in return for stock.

C) the Treasury to insure bank deposits at major U.S. banks.

D) the Fed to make loans to banks as the lender of last resort.

Answer: A

Diff: 1 Page Ref: 18-19

Topic: financial crisis

Objective: Provide an overview of the financial crisis of 2007-2009

\*: Recurring

AACSB: Reflective Thinking

9) Which firm did the Treasury allow to fail during the financial crisis?

A) J.P. Morgan

B) Bear Stearns

C) Lehman Brothers

D) American International Group (AIG)

Answer: C

Diff: 1 Page Ref: 18

Topic: financial crisis

Objective: Provide an overview of the financial crisis of 2007-2009

\*: Recurring

AACSB: Reflective Thinking

10) Alt-A borrowers were those who

A) used mortgages to purchase apartments.

B) chose adjustable-rate mortgages instead of fixed-rate mortgages.

C) borrowed using "interest-only" mortgages.

D) did not provide documentation of their income when applying for a mortgage.

Answer: D

Diff: 1 Page Ref: 17

Topic: financial crisis

Objective: Provide an overview of the financial crisis of 2007-2009

\*: Recurring

AACSB: Reflective Thinking

11) The financial crisis of 2007-2009 worsened after the failure of which firm?

A) General Motors

B) Lehman Brothers

C) Bear Stearns

D) American International Group (AIG)

Answer: B

Diff: 1 Page Ref: 18

Topic: financial crisis

Objective: Provide an overview of the financial crisis of 2007-2009

\*: Recurring

AACSB: Reflective Thinking

12) At the beginning of the financial crisis, banks were hurt by all of the following EXCEPT

A) declines in the value of mortgage-backed securities.

B) defaults on mortgages by those with subprime mortgages.

C) holding too many Treasury bonds.

D) not being repaid on loans to real estate developers.

Answer: C

Diff: 2 Page Ref: 18

Topic: financial crisis

Objective: Provide an overview of the financial crisis of 2007-2009

\*: Recurring

AACSB: Reflective Thinking

13) Borrowers who stated but did not document their incomes are referred to as

A) subprime.

B) alt-A.

C) adjustable.

D) securitized.

Answer: B

Diff: 1 Page Ref: 17

Topic: financial crisis of 2007-2009

Objective: Provide an overview of the financial crisis of 2007-2009

\*: Recurring

AACSB: Reflective Thinking

14) The Fed and Treasury took action to restore the flow of funds from savers to borrowers in order to encourage all of the following EXCEPT

A) increase the return to savers.

B) enable households to purchase durable goods.

C) increase the likelihood of purchases of houses.

D) allow firms to finance purchases of structures and equipment.

Answer: A

Diff: 2 Page Ref: 19

Topic: financial crisis

Objective: Provide an overview of the financial crisis of 2007-2009

\*: Recurring

AACSB: Reflective Thinking

15) Why did some economists and policymakers criticize the Fed and Treasury for arranging the sale of Bear Stearns to JP Morgan Chase in 2008?

Answer: The main concern was with the *moral hazard problem*, which is the possibility that managers of financial firms such as Bear Stearns might make riskier investments if they believe that the federal government will save them from bankruptcy.

Diff: 2 Page Ref: 18

Topic: financial crisis

Objective: Provide an overview of the financial crisis of 2007-2009

\*: Recurring

AACSB: Analytical Thinking

16) What was the intent behind the intervention of the Fed and Treasury in financial markets during the Financial Crisis of 2007-2009?

Answer: The actions by the Fed and Treasury were meant to restore the flow of funds between savers and borrowers. Without an increase in the flow of funds to a more normal level, households would have a difficult time making certain purchases and businesses would have difficulty financing investments and inventories.

Diff: 2 Page Ref: 19

Topic: financial crisis

Objective: Provide an overview of the financial crisis of 2007-2009

\*: Recurring

AACSB: Reflective Thinking

17) How did securitization and the bursting of the housing bubble contribute to the Financial Crisis of 2007-2009?

Answer: Many investment banks and other investors purchased mortgage-backed securities because they paid higher interest rates than securities of comparable default risk. When the housing bubble burst, the value of the mortgage-backed securities declined significantly, resulting in massive losses for those who owned them, including many investment banks.

Diff: 2 Page Ref: 17-18

Topic: financial crisis

Objective: Provide an overview of the financial crisis of 2007-2009

\*: Recurring

AACSB: Analytical Thinking