

ch04

Student: _____

1. Investment banks specialize in the origination, underwriting, and distribution of securities issues.
True False
2. Investment banks engage in activities such as advising on mergers, acquisitions, and corporate restructuring.
True False
3. Securities trading and underwriting is a profit generating activity that requires FIs to hold an inventory of securities they trade.
True False
4. The concentration of business among the largest firms in the securities firm/investment banking business has increased significantly since the stock market crash of 1987.
True False
5. Securities underwriting and trading is an activity that requires a considerable investment in long-term assets and relatively small investments in short-term assets.
True False
6. The Financial Services Modernization Act of 1999 and other regulatory changes have been the cause of the increase in interindustry mergers of investment banks and securities firms.
True False
7. The number of investment banks and securities firms expanded rapidly from 1980 to October 1987.
True False
8. As of October 1987, there were over 9,500 securities firms and investment banks.
True False
9. As of the first half of 2009, income generated by securities brokerage accounted for over 65% of commercial bank holding company fee income.
True False
10. As of the first half of 2009, there were over 5,900 securities firms in operation.
True False
11. National full-line investment banks and securities firms provide business services to both retail and corporate customers.
True False
12. The objective of funds management is to allocate assets so that they outperform relative risk-return tradeoffs.
True False
13. Because the business of funds management generates fees based on the size of the pool of assets managed, the flow of income is larger than either investment banking function or the trading function.
True False
14. In a public offering, an investment banker places new issues of securities with a handful of private, usually large, investors.
True False

15. Initial public offerings (IPOs) are first-time issues of firms whose equity has not previously traded in an organized market.
True False
16. In order for an investment bank to perform a firm commitment offering of securities, they must maintain at least 20% equity on their balance sheet.
True False
17. A best-efforts offering of a security is more risky for an investment bank than a firm commitment offering.
True False
18. Brokerage commissions for securities firms decreased after fixed commissions on trades were abandoned by the SEC in May 1975.
True False
19. Market making involves creating a primary market in a financial asset.
True False
20. Market makers in a stock are obliged to buy shares from sellers when the market for the stock is declining.
True False
21. Agency transactions of market makers are two-way transactions on behalf of customers.
True False
22. Principal transactions allow the market maker to always make a profit whether or not the market price for a specific stock is rising or falling.
True False
23. Decimalization involves making quotes in the equities markets in units of 1 cent (\$0.01) rather than in units of one-eighths of a dollar (\$0.125).
True False
24. The change to decimalization of stock market transactions has lead to an increase in income from the market making activity of investment banks and securities firms.
True False
25. In pure arbitrage, a trader would sell an asset in one market at one price while buying the same asset in another market at a higher price.
True False
26. Cash management accounts were an early attempt by commercial banks to provide investment banking services.
True False
27. Cash management accounts did not exist before 1999.
True False
28. The principal reasons for the growth in profitability of the securities industry in the middle 1990s were the trading profits from fixed income securities and the growth in new issue underwriting.
True False
29. Activity and performance trends in the investment banking industry are highly correlated with general economic expansions and recessions.
True False
30. Most securities firms are subject to large amounts of interest rate and market risk because of the large amount financial assets on the balance sheet.
True False

31. The largest source of funding for securities services firms and investment banks is broker-call loans from commercial banks.
True False
32. The goal of the Sarbanes-Oxley Act is to prevent deceptive accounting and management practices and thus to increase confidence in corporate governance.
True False
33. The U.S.A. Patriot Act requires firms to implement processes to deter money laundering.
True False
34. Seeking international partners is a recent trend among securities firms and investment banks.
True False
35. Investment banks and securities firms are less internationally involved than other domestic financial service industries.
True False
36. Securities firms and investment banks are more involved internationally than other member of the financial services industries.
True False
37. By mid-year 2009, there were approximately _____ securities firms and investment banks operating.
A. 9,100
B. 7,600
C. 5,200
D. 4,800
E. 2,200
38. The most common benchmark of relative size of a firm in the securities trading and underwriting industry is based on
A. total asset value.
B. total equity.
C. total debt.
D. annual sales.
E. annual profits.
39. Which of the following differentiates securities firms from investment banks?
A Securities firms are concerned with the commercial side of the business while investment banks are . concerned with the retail side of the business.
B. Securities firms assist in trading of existing securities while investment banks specialize in underwriting new securities.
C. Securities firms underwrite new issues of securities while investment banks provide brokerage services.
D. Securities firms originate new issues of securities and investment banks underwrite the securities.
E Securities firms are concerned with private placements of securities whereas investment banks are . concerned with publicly traded securities.
40. Which of the following would be a key area of activity for an investment bank specializing in the commercial side of the business?
A. Purchase of existing securities.
B. Sale of securities in the secondary market.
C. Brokerage of existing securities.
D. Underwriting issues of new securities.
E. All of the above.

41. Which of the following is true?
- A. Investment bankers earn fees based on the success of their placements when they underwrite using a best-efforts basis.
 - B. Investment bankers earn fees based on the success of their placement when they underwrite using firm-commitment basis.
 - C. With best-efforts underwriting, investment bankers act as principals where they purchase the securities from the issuer and sell them at a higher price.
 - D. Answers A and B only.
 - E. Answers B and C only.
42. Discount brokers
- A. are securities firms focused on providing research support for customers.
 - B. conduct trades for customers but do not offer investment advice.
 - C. allow customers to receive investment advice at very low rates.
 - D. effect trades for customers on- or offline while offering investment advice.
 - E. are electronic trading securities firms that allow customers to trade without the use of a broker.
43. Which of the following is most typical of broker-dealers?
- A. They assist in underwriting of new securities.
 - B. They assist in trading of existing securities.
 - C. They assist in issuing new securities.
 - D. They assist in underwriting and distribution of new securities.
 - E. All of the above.
44. Which of the following is true of private placements?
- A. Securities are placed with few large institutional investors.
 - B. Securities of private firms are sold to the investing public at lower prices.
 - C. They must be registered with the SEC.
 - D. Public trading in these securities is not allowed.
 - E. Subject to more stringent disclosure and informational requirements than those imposed by the SEC on publicly registered issues.
45. In market-making
- A. agency transactions are two-way transactions on behalf of customers, such as a dealer working for a fee or commission.
 - B. agency transactions are when market makers take long or short positions and seek profits on price movements.
 - C. market makers take inventory positions to stabilize the market in the securities.
 - D. Answers A and C only.
 - E. Answers B and C only.
46. In market-making
- A. principal transactions are two-way transactions on behalf of customers, such as a dealer working for a fee or commission.
 - B. principal transactions are when market makers take long or short positions and seek profits on price movements.
 - C. market makers take inventory positions to stabilize the market in the securities.
 - D. Answers A and C only.
 - E. Answers B and C only.
47. What term refers to the process in which an IPO share allocation is used for the purpose of enticing future investment banking business from customers?
- A. Dumping.
 - B. Redlining.
 - C. Intermediation.
 - D. Externalization.
 - E. Spinning.

48. Which of the following is NOT considered a trading activity of securities firms?
- A. Position trading.
 - B. Pure arbitrage.
 - C. Liquidity trading.
 - D. Risk arbitrage trading.
 - E. Program trading.
49. Pure arbitrage trading involves
- A. buying blocks of securities in anticipation of some information release.
 - B. purchase of stock in a company being acquired and the sale of stock in the acquiring company.
 - C. exploitation of a difference between a company's current value and its estimated liquidation value.
 - D. buying an asset in one market at one price and selling it immediately in another market at a higher price.
 - E. simultaneous purchase and sale of similar shares in a single market.
50. The largest category of assets for broker-dealers as of the beginning of 2009 was
- A. receivables from other broker-dealers.
 - B. securities purchased under agreement to resell.
 - C. receivables from customers.
 - D. exchange membership.
 - E. long position in securities and commodities.
51. The largest category of liabilities of broker-dealers as of the beginning of 2009 was
- A. bank loans payable.
 - B. securities sold under repurchase agreements.
 - C. payables to customers.
 - D. short positions in securities and commodities.
 - E. payables to non-customers.
52. In comparison to a typical commercial bank, an investment bank is likely to have
- A. lower levels of capital.
 - B. higher reliance on long-term debt.
 - C. lower levels of repurchase agreements.
 - D. higher levels of net interest margin.
 - E. higher levels of loans to customers.
53. National full-line firms
- A. may specialize in providing service to both retail and corporate customers.
 - B. usually serve only as discount brokers without offering investment advice.
 - C. may specialize more in corporate finance with high activity in trading securities.
 - D. All of the above.
 - E. Answers A and C only.
54. The management of pools of assets by securities firms is considered to be the function of
- A. market making.
 - B. investment banking.
 - C. trading.
 - D. investing.
 - E. cash management.
55. Creating a secondary market in an asset by a securities firm involves the function of
- A. cash management.
 - B. investing.
 - C. market making.
 - D. trading.
 - E. investment banking.

56. Participation in the activities relating to the underwriting and distribution of new issues of debt and equity by a securities firm involves the function of
- A. investing.
 - B. merger and acquisitions.
 - C. market making.
 - D. investment banking.
 - E. trading.
57. Offering bank deposit-like accounts to individual customers by a securities firm involves
- A. the function of investing.
 - B. the function of cash management.
 - C. the function of market making.
 - D. the function of trading.
 - E. the function of investment banking.
58. The primary advantage to the investor of a brokerage firm cash management account (CMA) over commercial bank deposit accounts is that
- A. no FDIC insurance is required on CMAs.
 - B. no regulatory oversight of CMAs.
 - C. they make it easier to buy and sell securities using funds from the CMA.
 - D. CMAs guarantee higher rates of return than money market deposit accounts.
 - E. Regulation Q interest rate ceilings do not apply to CMAs.
59. The process of providing custody and escrow services, clearance and settlement services, and research and other advisory services by a securities firm involves the function of
- A. mergers and acquisitions.
 - B. market making.
 - C. investment banking.
 - D. back-office functions.
 - E. cash management services.
60. Which of the following is NOT a back-office service function in the securities industry?
- A. Correspondent banking services.
 - B. Escrow services.
 - C. Clearance of securities transactions.
 - D. Research services.
 - E. Services related to settlement of securities transactions.
61. An attempt by a market maker to earn a profit on the price movements of securities by taking inventory positions for its own account is called
- A. risk arbitrage.
 - B. an agency transaction.
 - C. best efforts underwriting.
 - D. spinning.
 - E. a principal transaction.
62. Soft dollars is a term often used in reference to the portion of a fee or commission that is allocated to
- A. research and other advisory services.
 - B. custody and escrow services.
 - C. clearance and settlement services.
 - D. banking services.
 - E. back office services.

63. Securities firms have equity ratios that are lower than those for commercial banks because their balance sheets contain a larger portion of
- A. illiquid assets.
 - B. current liabilities.
 - C. long term liabilities.
 - D. fixed assets.
 - E. liquid assets.
64. Program trading involves
- A. online trading services provided to customers by electronic trading securities firms.
 - B. computer-driven buying or selling of baskets of 15 or more stocks by institutional traders.
 - C. purchase and sale of assets that are potentially but not necessarily equivalent.
 - D. buying blocks of securities in anticipation of some information release.
 - E. providing a platform for customers to trade without the use of a broker.
65. SEC Rule 415 relates to
- A. private placements.
 - B. shelf-offerings.
 - C. ownership reports.
 - D. insider trading.
 - E. margin requirements.
66. Legislation designed to improve corporate governance practices, especially as they relate to accounting practices, is the
- A. National Securities Markets Improvement Act of 1996.
 - B. Sarbanes-Oxley Act.
 - C. U.S.A. Patriot Act.
 - D. Financial Services Modernization Act of 1999.
 - E. Bank Holding Company Act.
67. The U.S.A. Patriot Act requires financial services firms to
- A. verify the identity of any person seeking to open an account.
 - B. maintain records of the information used to verify a person's identity.
 - C. determine whether a person opening an account is on a list of suspected terrorists.
 - D. All of the above.
 - E. Answers A and C only.
68. The Securities Investor Protection Corporation (SIPC) protects investors against losses of up to ____ on securities firm failures.
- A. \$100,000
 - B. \$200,000
 - C. \$500,000
 - D. \$1,000,000
 - E. \$50,000
69. According to SEC Rule 415,
- A. larger corporations can register their new issues with the SEC up to two years in advance.
 - B. firms should disclose soft dollar arrangements to their clients.
 - C. large investors are allowed to begin trading privately placed securities among themselves.
 - D. firms are required to maintain records of the information used to verify the identity of a person opening an account.
 - E. publicly held companies must disclose all material information that might affect investment decisions to all investors at the same time.

70. Identify a major reason behind the increase in domestic underwriting activity during the 1990s.
- A. Enhanced non-trading profits.
 - B. High long-term interest rates.
 - C. Low long-term dividend rates.
 - D. Growth in the asset-backed securities market.
 - E. Decreased securitization of debt.
71. Which of the following is true about reverse repurchase agreements?
- A. They are securities purchased under agreements to resell.
 - B. They account for less than 5 percent of assets of broker-dealers.
 - C. They amount to 40.8 percent of total liabilities and equity of broker-dealers.
 - D. They are treated as liabilities.
 - E. They are securities temporarily lent in exchange for cash received.
72. Which of the following is NOT a provision of Sarbanes-Oxley Act?
- A. Created an independent auditing oversight board.
 - B. Increased penalties for corporate wrongdoers.
 - C. Forced faster and more extensive financial disclosure.
 - D. Created avenues of recourse for aggrieved shareholders.
 - E. Required investment analysts' compensation to be a function of the quality and accuracy of research they produce.
73. Which of the following is a self-regulatory organization involved in the day-to-day regulation of trading practices?
- A. Securities and Exchange Commission.
 - B. New York Stock Exchange.
 - C. Securities Investor Protection Corporation.
 - D. Chicago Board of Trade.
 - E. All of the above.
74. Considering the securities firms and investment banking industries, The National Securities Markets Improvement Act (NSMIA) of 1996
- A. appointed the Federal Reserve System as the primary regulator of the industry.
 - B. diminished the role of the National Association of Securities Dealers (NASD) in regulating the industry.
 - C. allowed individual states the right to require registration of firms operating in the state.
 - D. effectively affirmed the SEC as the primary regulator of the industry.
 - E. required all firms in the industry to maintain minimum amounts of capital.
75. Which of the following 2 firms survived as investment banks following the most recent financial crisis?
- A. Morgan Stanley and Bear Stearns.
 - B. Goldman Sachs and Merrill Lynch.
 - C. Lehman Brothers and Morgan Stanley.
 - D. Merrill Lynch and Lehman Brothers.
 - E. None of the above.
76. Which of the following investment banks failed as a result of the most recent financial crisis?
- A. Morgan Stanley.
 - B. Bear Stearns.
 - C. Lehman Brothers.
 - D. Goldman Sachs.
 - E. Merrill Lynch.

77. Which of the following two investment banks were acquired by financial services holding companies during the most recent financial crisis?
- A. Merrill Lynch and Bear Stearns.
 - B. Goldman Sachs and Morgan Stanley.
 - C. Bear Stearns and Lehman Brothers.
 - D. Merrill Lynch and Morgan Stanley.
 - E. Lehman Brothers and Goldman Sachs.
78. Which of the following two investment banks were granted approval to be chartered as commercial banks during the most recent financial crisis?
- A. Merrill Lynch and Bear Stearns.
 - B. Goldman Sachs and Morgan Stanley.
 - C. Bear Stearns and Lehman Brothers.
 - D. Merrill Lynch and Morgan Stanley.
 - E. Lehman Brothers and Goldman Sachs.
79. As of mid-year 2009, approximately _____ of the industry total brokerage fee income was generated by firms operating as subsidiaries of commercial bank holding companies.
- A. 15 percent
 - B. 25 percent
 - C. 40 percent
 - D. 50 percent
 - E. 65 percent
80. As of mid-year 2009, approximately _____ of the industry total brokerage fee income was generated by firms operating as subsidiaries of commercial bank holding companies.
- A. \$2.1 billion
 - B. \$8.6 billion
 - C. \$14.7 billion
 - D. \$16.4 billion
 - E. \$19.2 billion
81. One of the primary reasons that investment banks were allowed to convert to bank holding companies during the recent financial crisis was recognition that
- A. their operating activities were too risky and they needed the cushion of bank deposits to alleviate funding risks.
 - B. the industry had acquired too much capital during the previous decade.
 - C. bank holding companies needed the ability to underwrite new issues of corporate securities.
 - D. it was the only way an investment bank could qualify for federal bailout funds.
 - E. the Federal Reserve was unable to purchase troubled assets from investment banks, but they could from bank holding companies.

An investment banker agrees to underwrite an issue of 10 million shares of stock for TWResearch, Inc. on a firm commitment basis. The investment banker pays \$10.50 per share to TWResearch, Inc. for the 10 million shares of stock. It then sells those shares to the public for \$11.20 per share.

82. How much money does TWResearch receive?
- A. \$105,000,000.
 - B. \$150,000,000.
 - C. \$112,000,000.
 - D. \$125,000,000.
 - E. \$110,000,000.
83. What is the profit (loss) to the investment banker?
- A. Profit of \$1,000,000.
 - B. Profit of \$2,000,000.
 - C. Profit of \$7,000,000.
 - D. Loss of \$7,500,000.
 - E. Loss of \$1,000,000.

84. If the investment bank can sell the shares for \$9.75 per share, how much money does TWResearch receive?
- A. \$105,000,000.
 - B. \$150,000,000.
 - C. \$112,000,000.
 - D. \$125,000,000.
 - E. \$110,000,000.
85. If the investment bank can sell the shares for \$9.75 per share, what is the profit (loss) to the investment banker?
- A. Profit of \$1,000,000.
 - B. Loss of \$7,500,000.
 - C. Profit of \$7,000,000.
 - D. Loss of \$7,000,000.
 - E. Loss of \$1,000,000.

An investment banker agrees to underwrite an issue of 10 million shares of stock for TWResearch, Inc. on a best-efforts basis. The investment banker is able to sell 8 million shares for \$10.50 per share, and it charges TWResearch, Inc. \$0.225 per share sold.

86. How much money does TWResearch receive?
- A. \$15,000,000.
 - B. \$84,000,000.
 - C. \$76,200,000.
 - D. \$82,200,000.
 - E. \$110,000,000.
87. What is the profit to the investment banker if it is able to sell 8 million shares for \$10.50 per share?
- A. Profit of \$1,000,000.
 - B. Loss of \$7,500,000.
 - C. Profit of \$7,000,000.
 - D. Loss of \$7,000,000.
 - E. Profit of \$1,800,000.
88. If the investment bank sells 8 million shares for \$9.75 per share, how much money does TWResearch receive?
- A. \$76,200,000.
 - B. \$84,000,000.
 - C. \$105,000,000.
 - D. \$82,200,000.
 - E. \$78,000,000.
89. What is the profit to the investment banker it sells 8 million shares for \$9.75 per share?
- A. Profit of \$1,000,000.
 - B. Loss of \$7,500,000.
 - C. Profit of \$7,000,000.
 - D. Loss of \$7,000,000.
 - E. Profit of \$1,800,000.
90. If the investment bank is able to sell all 10 million shares for \$12.75 per share, how much money does TWResearch receive?
- A. \$127,500,000.
 - B. \$123,750,000.
 - C. \$105,675,000.
 - D. \$102,000,000.
 - E. \$99,000,000.

91. What is the profit to the investment banker if it is able to sell all 10 million shares for \$12.75 per share?
- A. Profit of \$2,250,000.
 - B. Loss of \$7,500,000.
 - C. Profit of \$7,500,000.
 - D. Loss of \$3,000,000.
 - E. Profit of \$3,750,000.

An investment banker agrees to underwrite an issue of 5 million shares of stock for NetChoice, Inc. on a firm commitment basis. The investment banker pays \$31.50 per share to NetChoice, Inc. for the 5 million shares of stock. It then sells those shares to the public for \$30.00 per share.

92. How much money does NetChoice, Inc. receive?
- A. \$150,000,000.
 - B. \$157,500,000.
 - C. \$112,000,000.
 - D. \$125,000,000.
 - E. \$105,000,000.
93. What is the profit (loss) to the investment banker?
- A. Profit of \$7,500,000.
 - B. Profit of \$2,000,000.
 - C. Profit of \$7,000,000.
 - D. Loss of \$7,500,000.
 - E. Loss of \$2,000,000.
94. If the investment bank can sell the shares for \$34 per share, how much money does NetChoice, Inc. receive?
- A. \$150,000,000.
 - B. \$157,500,000.
 - C. \$112,000,000.
 - D. \$125,000,000.
 - E. \$105,000,000.
95. If the investment bank can sell the shares for \$34 per share, what is the profit (loss) to the investment banker?
- A. Profit of \$12,500,000.
 - B. Profit of \$10,000,000.
 - C. Profit of \$7,000,000.
 - D. Loss of \$7,500,000.
 - E. Loss of \$12,500,000.

An investment banker agrees to underwrite an issue of 5 million shares of stock for NetChoice, Inc. on a best-efforts basis. The investment banker is able to sell 4.5 million shares for \$31.00 per share and it charges NetChoice, Inc. \$0.375 per share sold.

96. How much money does NetChoice, Inc. receive?
- A. \$139,500,500.
 - B. \$137,812,500.
 - C. \$155,000,000.
 - D. \$153,125,000.
 - E. \$105,000,000.
97. What is the profit to the investment banker if it is able to sell 4.5 million shares for \$31 per share?
- A. Profit of \$1,875,000.
 - B. Loss of \$1,875,000.
 - C. Profit of \$1,687,500.
 - D. Loss of \$3,125,000.
 - E. Profit of \$3,125,500.

98. If the investment bank sells 4.5 million shares for \$29 per share, how much money does NetChoice, Inc. receive?
- A. \$145,000,000.
 - B. \$130,500,000.
 - C. \$143,125,000.
 - D. \$128,812,500.
 - E. \$115,762,500.
99. What is the profit to the investment banker it sells 4.5 million shares for \$29 per share?
- A. Profit of \$1,687,500.
 - B. Loss of \$1,687,500.
 - C. Profit of \$1,875,000.
 - D. Loss of \$3,125,000.
 - E. Profit of \$3,125,500.
100. If the investment bank is able to sell all 5 million shares for \$35, how much money does NetChoice, Inc. receive?
- A. \$195,675,000.
 - B. \$187,500,000.
 - C. \$130,250,000.
 - D. \$175,000,000.
 - E. \$173,125,000.
101. What is the profit to the investment banker all 5 million shares are sold for \$35 per share?
- A. Profit of \$1,875,000.
 - B. Loss of \$1,875,000.
 - C. Profit of \$1,687,500.
 - D. Loss of \$3,125,000.
 - E. Profit of \$3,125,500.

ch04 Key

1. TRUE
2. TRUE
3. FALSE
4. TRUE
5. FALSE
6. TRUE
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10. FALSE
11. TRUE
12. TRUE
13. FALSE
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34. TRUE
35. FALSE
36. TRUE

37. D
38. B
39. B
40. D
41. A
42. B
43. B
44. A
45. D
46. E
47. E
48. C
49. D
50. A
51. B
52. A
53. E
54. D
55. C
56. D
57. B
58. C
59. D
60. A
61. E
62. A
63. E
64. B
65. B
66. B
67. D
68. C
69. A
70. D
71. A
72. E
73. B
74. D

75. E
76. C
77. A
78. B
79. E
80. D
81. A
82. A
83. C
84. A
85. B
86. D
87. E
88. A
89. E
90. B
91. E
92. B
93. D
94. B
95. A
96. B
97. C
98. D
99. A
100. E
101. A

ch04 Summary

<u>Category</u>	<u># of Questions</u>
Saunders - Chapter 04	105