

## Chapter 02 Security Markets

### True / False Questions

1. Deregulation of financial institutions and mergers has created a more competitive environment for retail brokerage houses.  
True False
  
2. International competition from world markets has had very little effect on U.S. exchanges.  
True False
  
3. When an investment bank sells securities on a best efforts basis, it assumes all risk of the offering.  
True False
  
4. In the distribution of corporate bond issues, private placements to large insurance companies dominate the volume of public offerings.  
True False
  
5. A shelf registration enables an investment banker to sell a small portion of an issue without forming a syndicate.  
True False
  
6. The regional exchange plays an important part in the trading markets.  
True False
  
7. The American Stock Exchange's main competitor in the options and futures markets is the New York Stock Exchange.  
True False

8. During the last decade, the financial markets have changed at a rapid pace.

True False

9. At the end of 2009, Citigroup (Smith Barney), JPMorgan, and Barclay's Capital were three of the top ranked investment bankers in the underwriting of both global and domestic equity issues.

True False

10. Bringing private companies public for the first time is called an initial public offering.

True False

11. The Chicago Stock Exchange is the only one of the regional stock exchanges still viable.

True False

12. NASDAQ ranks as the largest equity market in the world.

True False

13. Stocks traded over-the-counter, like through NASDAQ, have no centrally located market location.

True False

14. The rise of financial-service firms through mergers and the consolidation of brokerage companies have resulted from significant changes in the banking laws.

True False

15. The NASDAQ stock market is a publicly traded corporation.

True False

16. A market is a way of exchanging assets.

True False

17. All markets must have a physical central trading location.

True False

18. One characteristic of efficient markets is that prices adjust rapidly to new information.

True False

19. Efficient markets need not be liquid, as long as buyers and sellers can eventually get a fair price for the assets they trade.

True False

20. Primary markets are for new issues of securities.

True False

21. Secondary markets are for existing securities.

True False

22. The investment banker assumes a price risk under a best efforts agreement.

True False

23. When investment bankers underwrite a security, they usually guarantee purchase of the securities at a fixed price for the selling firm.

True False

24. The major functions of an investment banker are performed as part of the operations of the secondary market.

True False

25. Super Dot refers to the New York Stock Exchange's designated order transfer system, which allows NYSE member firms to electronically transmit all market and limit orders directly to the specialist at the trading post.

True False

26. As a part of Super Dot, specialists are informed through Opening Automated Report Service (OARS) of market orders received before the opening bell.

True False

27. Specialists buy and sell for their own account.

True False

28. Secondary markets include only organized exchanges such as the NYSE and the regional exchanges.

True False

29. The U.S. treasury often uses investment bankers to sell new issues of government securities.

True False

30. Under the Securities Act of 1933, the SEC can certify that a stock is fairly priced.

True False

31. Only the Chicago regional exchange is still viable, with Philadelphia and Boston being bought by NASDAQ.

True False

32. A security traded on an exchange must meet listing requirements.

True False

33. Floor brokers act as agents for clients and execute buy and sell orders on the floor of the NYSE exchange.

True False

34. A specialist is supposed to maintain an orderly market.

True False

35. Specialists are now able to keep their limit orders in the Electronic Book rather than the old manual "specialist's book."

True False

36. NASDAQ is directly related to the operations of the NYSE.

True False

37. Based on dollar volume of stocks and bonds, the NASDAQ is the second largest of all markets in the United States.

True False

38. According to insider trading rules of the SEC, securities analysts and financial writers may not trade on insider information, but these rules do not extend to relatives and friends.

True False

39. The Intercontinental Exchange (ICE) is now operating 24 hours per day using a computerized trading system.

True False

40. The use of the NASDAQ Automated Quotation System has increased the number of equity trades on the American Stock Exchange.

True False

41. Program trading decreases market efficiency by exaggerating price discrepancies between the cash and futures markets.

True False

42. Shelf registration is more popular with new bond offerings than with new stock offerings.

True False

43. Underwriters are less concerned with the fees from their activities than simply the amount of dollars underwritten.

True False

44. The investment banker acts as a middleman in the process of raising new funds for corporations and governments.

True False

45. In the NASDAQ market, it is now permitted to charge fees for data feeds and market information.

True False

46. The largest segment of the Over-the-Counter (OTC) Market, in terms of dollar volume, is the U.S. government securities markets.

True False

47. Program trading simply means that trades are executed on computer programs written by the SEC.

True False

48. Electronic communication networks (ECNs) automatically match buy and sell orders at specified prices, and orders are not routed to the floor of an exchange before processing.

True False

49. The Gramm-Leach-Bliley Act repealed the Glass-Steagall Act, which restricted commercial banks from also being in the investment banking business.

True False

50. One of the main reasons institutional investors like ECNs is that they allow anonymity in trading.

True False

51. There is concern by the SEC and Congress that dark pools create a two-tier market.

True False

52. Circuit breakers will shut down the market for a period of time if a dramatic drop in stock prices occurs.

True False

53. If the DJIA declines by 10% in the time between 2:00-2:30 PM, a 30 minute halt to trading occurs.

True False

54. Because of the 1987 market collapse, the SEC put circuit breakers into effect.

True False

55. The cost of compliance with the Sarbanes-Oxley Act has had little effect on the willingness of foreign companies to list their shares on U.S. stock exchanges.

True False

56. Many large technology companies listed on NASDAQ could easily meet the NYSE listing standards.

True False

#### Multiple Choice Questions

57. A means of exchanging assets, which may or may not include a specified location, and in which the seller may or may not own the assets being sold, is called:

- A. an organized exchange.
- B. an options market.
- C. a market.
- D. None of the above

58. Creating prices for securities and allowing for liquidity are functions of:

- A. the primary market.
- B. the secondary market.
- C. the third market.
- D. the fourth market.
- E. the real estate market.

59. In the \_\_\_\_\_ market, existing assets are exchanged between investors, while in the \_\_\_\_\_ market, participants buy their assets directly from the source of the asset.

- A. primary; secondary
- B. secondary; primary
- C. tertiary; primary
- D. primary; OTC
- E. prime; subprime

60. Which of the following best describes the function of an investment banker selling an issue on a "best efforts" basis?

- A. Return unsold securities to the firm
- B. Create a market for the securities
- C. Guarantee a continuous liquid market
- D. Private placements to financial institutions
- E. More than one of the above

61. The process of selling a new issue of securities so that the price is guaranteed to the selling firm is referred to as:

- A. underwriting.
- B. best efforts.
- C. direct by issuer.
- D. shelf registration.
- E. All of the above involve a price guarantee

62. The least popular form of distributing corporate securities is:

- A. underwriting.
- B. best efforts.
- C. firm commitment.
- D. syndicated offering.
- E. direct by issuer.

63. Bringing private companies public for the first time is called:

- A. a private placement.
- B. an initial public offering (IPO).
- C. a secondary offering.
- D. a founders sale.
- E. a shelf registration.

64. From the investment banker's point of view, the major reason syndicates are formed in the distribution of large issues is for the purpose of:

- A. improving the liquidity of the issue.
- B. improving geographic distribution.
- C. reducing the underwriter's risk.
- D. improving brand recognition.
- E. All of the above

65. A syndicate is formed to:

- A. share the risk between investment bankers.
- B. distribute securities to a wide group of investors.
- C. improve the liquidity/marketability of an offering.
- D. All of the above

66. Which of the following is NOT a characteristic of an organized exchange?

- A. It functions as a primary market
- B. Securities are bought and sold in an auction market by brokers acting as agents for buyers and sellers in a central location
- C. It may be either national or regional
- D. It has a central location where all trading takes place
- E. It functions as a secondary market

67. The exchange with the largest dollar volume in major companies and which has the most restrictive listing requirements is:

- A. the New York Stock Exchange.
- B. the American Exchange.
- C. the NASDAQ Stock Market.
- D. the Securities Exchange.

68. Dual trading creates the following benefit:

- A. it improves liquidity of a security.
- B. it allows securities to be traded domestically and internationally.
- C. it creates competition between the exchange and NASDAQ.
- D. All of the above are benefits of dual trading

69. An employee of an investment house who executes orders on the floor of the exchange for customers of the firm is called a:

- A. floor broker.
- B. registered trader.
- C. commission broker.
- D. specialist.
- E. dealer.

70. A person who is registered to trade on an exchange, who owns a seat but is not an employee of any member firm is a:

- A. commission broker.
- B. floor broker.
- C. registered trader.
- D. dealer.
- E. B and C

71. \_\_\_\_\_ has two major functions: to handle special orders, such as purchases with a price contingency, and to maintain continuous, liquid, orderly markets.

- A. A registered trader
- B. A specialist
- C. An odd-lot dealer
- D. A commission broker

72. The major exchange for warrants, options, and commodity futures is the:

- A. American Stock Exchange.
- B. New York Stock Exchange.
- C. NASDAQ.
- D. None of the above

73. The \_\_\_\_\_ is a futures market for common stock, while the \_\_\_\_\_ is a futures market for commodities and financial instruments.

- A. Chicago Board Options Exchange; Chicago Mercantile Exchange
- B. Chicago Mercantile Exchange; Chicago Board Options Exchange
- C. Chicago Board of Trade; Chicago Board Options Exchange
- D. New York Stock Exchange; American Stock Exchange

74. Which of the following is true of over-the-counter markets?

- A. Trading takes place by telephone or electronic network
- B. It is regulated by the Securities and Exchange Commission and the National Association of Securities Dealers
- C. The total securities traded represent the largest dollar volume in the U.S.
- D. All of the above are true

75. ECNs provide several advantages to investors. Which of the following is not an advantage?

- A. They lower the cost of trading compared to organized exchanges with floor trading
- B. They let everyone know who is making the trade and at what price
- C. They provide the ability to trade after hours when the exchanges are closed
- D. They provide more price transparency than organized exchanges

76. Electronic communication systems:

- A. allow investors to communicate with others in investor chat rooms.
- B. allow markets to trade American Depository Receipts online in Europe and Asia.
- C. automatically match buy and sell orders at specified prices.
- D. are operated by the investment bankers to stabilize new issue markets.

77. Full disclosure of all pertinent investment information in the sale of new securities is a provision of the:

- A. Securities Act of 1933.
- B. Securities Exchange Act of 1934.
- C. Securities Acts Amendments of 1975.
- D. Sarbanes-Oxley Act of 2002.
- E. More than one of the above

78. The Securities and Exchange Commission was created by the:

- A. Securities Act of 1933.
- B. Securities Exchange Act of 1934.
- C. Investment Advisor Act of 1940.
- D. None of the above

79. Program trading

- A. means that when a given market indicator reaches a certain point, a large sale or purchase of securities may take place.
- B. has been argued to affect the market by accelerating price movements.
- C. is likely to be voluntarily restricted by the securities exchanges and their member firms.
- D. All of the above

80. The Securities Investor Protection Corporation (SIPC) was established to:

- A. oversee the liquidation of brokerage firms, and insure an investor's accounts to a maximum value of \$500,000 in case of bankruptcy by the broker.
- B. protect investors from corporate insider trading, and insure their accounts for \$500,000 in case corporate fraud caused a company to go bankrupt.
- C. cover the total market loss on an investor's brokerage account in case of the bankruptcy of the broker.
- D. create an insurance pool for brokerage firms, so that if one firm went bankrupt, all investor losses would be covered out of the insurance pool.

81. In order to be listed on an exchange, a firm must meet minimum standards pertaining to the following criteria:

- A. the number of common shares publicly held.
- B. the net income of the firm.
- C. the number of stockholders owning a minimum of 100 shares.
- D. All of the above are requirements

82. In general, markets are efficient when:

- A. prices respond quickly to new information.
- B. each successive trade is made at a price close to the preceding price.
- C. they can absorb large amounts of securities or assets without changing the price significantly.
- D. All of the above

83. Secondary markets provide everything except:

- A. illiquidity.
- B. efficiency.
- C. continuity.
- D. competition.

84. A difference between the primary market and the secondary market is:

- A. liquidity.
- B. that primary markets allow corporations, government units, and others to raise needed funds for the expansion of their capital base.
- C. that price competition in the secondary markets between different risk-return classes enables the primary market to price new issues at higher prices to reflect existing risk-return relationships.
- D. that the secondary market is much more competitive than the primary market.

85. The investment banker is responsible for everything except:

- A. underwriting an issue of securities.
- B. being the leader and a part of the syndicate of large issues, providing that one is formed.
- C. the distribution process of a security issue.
- D. selling an agreed-upon number of bonds and stocks.

86. A house broker is one who:

- A. is registered to trade on the exchange but is not an employee of a member firm.
- B. is not associated with a member firm.
- C. represents a retail brokerage firm and transacts business on the floor for customers of that firm.
- D. transacts orders for individuals buying or selling less than 100 shares.

87. One of the functions of a specialist is:

- A. to manipulate price continuity.
- B. to change quotation spreads.
- C. to measure market depth as needed.
- D. to execute special orders for floor brokers.

88. The Gramm-Leach-Bliley Act was passed in 1999 by the U.S. Congress to allow:

- A. financial institutions to offer full financial services, such as insurance and investment banking, as well as traditional commercial banking.
- B. financial institutions to be sued by stockholders for off-balance sheet accounting errors.
- C. savings and loans to compete with commercial banks in both the commercial banking arena and mortgage loans.
- D. European banks to acquire U.S. financial institutions.

89. The first exchange to become a publicly traded company was the:

- A. New York Stock Exchange.
- B. Chicago Board of Trade.
- C. NASDAQ Stock Market.
- D. American Stock Exchange.
- E. Chicago Mercantile Exchange.

90. The accounting frauds and scandals that took place during the stock market boom of the late 1990s resulted in what significant Act?

- A. Sarbanes-Oxley Act
- B. Gramm-Leach Bliley Act
- C. Glass-Steagall Act
- D. Honesty in Financial Reporting Act
- E. Securities Exchange Act

91. The Sarbanes-Oxley Act:

- A. has reduced the number of foreign companies willing to list their shares on U.S. exchanges.
- B. was enacted under the Securities Exchange Act of 1934.
- C. reduces the reporting requirements for publicly traded firms.
- D. has made it possible for small firms to list their shares in the public markets.
- E. was the loophole that enabled corporate executives to misrepresent their financial statements during the late 1990s and early 2000s.

92. The \_\_\_\_\_ has/have the most restrictive listing requirements.

- A. Regional exchanges
- B. ECNs
- C. NASDAQ Stock market
- D. New York Stock Exchange
- E. American Stock Exchange

93. Initial and annual listing fees are highest for \_\_\_\_\_ -listed stocks.

- A. Chicago Mercantile Exchange
- B. ECN
- C. NASDAQ Stock market
- D. New York Stock Exchange
- E. American Stock Exchange

**Essay Questions**

94. Why was the Sarbanes-Oxley Act enacted?

95. What are ECNs?

## Chapter 02 Security Markets **Answer Key**

### **True / False Questions**

1. Deregulation of financial institutions and mergers has created a more competitive environment for retail brokerage houses.

**TRUE**

Financial institutions may now offer the full financial services of commercial banking, insurance, and brokerage firms after passage of the Graham- Leach-Bliley Act of 1999.

*AACSB: Reflective Thinking*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: The Market Environment*

2. International competition from world markets has had very little effect on U.S. exchanges.

**FALSE**

The Graham-Leach-Bliley Act of 1999 allowed U.S. financial institutions to offer full services, putting them in competition with other institutions, some of which were international. The Sarbanes-Oxley Act strengthened the U.S. securities laws, making it attractive for U.S. exchanges to merge with foreign exchanges in order to allow companies to list on the exchange of their choice. With U.S. exchanges merged with foreign exchanges, the ability to bypass the stringent regulations of the Sarbanes-Oxley Act was achieved. Also, as more international and multi-national companies raise capital around the world, investment banking has become global.

*AACSB: Reflective Thinking*

*Blooms: Analyze*

*Difficulty: 3 Hard*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: The Market Environment*

3. When an investment bank sells securities on a best efforts basis, it assumes all risk of the offering.

**FALSE**

On a best efforts basis, the issuing firm assumes the risk and simply buys back any securities not sold after a fixed period.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-02 Explain the role that the investment banker plays in an initial public offering.*

*Topic: Organization of the Primary Markets: The Investment Banker*

4. In the distribution of corporate bond issues, private placements to large insurance companies dominate the volume of public offerings.

**FALSE**

Publicly offered bonds issued through underwriters, as opposed to privately placed issues, are by far the most popular method of raising debt capital.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-02 Explain the role that the investment banker plays in an initial public offering.*

*Topic: Organization of the Primary Markets: The Investment Banker*

5. A shelf registration enables an investment banker to sell a small portion of an issue without forming a syndicate.

**TRUE**

A shelf registration allows issuing firms to register their securities with the SEC and then sell them at will as funds are needed in the future. Over time, this allows bankers to buy portions of the shelf issue and immediately resell the securities to institutional clients, without forming the normal syndicate of tying up capital for several weeks.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Organization of the Primary Markets: The Investment Banker*

6. The regional exchange plays an important part in the trading markets.

**FALSE**

Regional exchanges began their existence trading the stock of local companies. But these companies grew and began trading on the larger exchanges. Very few trades are now done in local companies since the rise of electronic trading. Regional exchanges have essentially lost their reason for existence.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Organization of the Primary Markets: The Investment Banker*

7. The American Stock Exchange's main competitor in the options and futures markets is the New York Stock Exchange.

**FALSE**

The AMEX became part of the NYSE Euronext group of exchanges in 2008. Therefore, it is not in competition with the NYSE. Before becoming part of the NYSE Euronext group, it was focused on other areas, such as put and call options, not options and futures.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Organization of the Secondary Market*

8. During the last decade, the financial markets have changed at a rapid pace.

**TRUE**

The last ten years have been ones of deregulation, new laws, mergers, global consolidation, online brokerage (Internet), electronic communication networks (ECNs), and the transformation of most securities markets from not-for-profit organizations to for-profit organizations with common stock available for purchase by the public.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: The Market Environment*

9. At the end of 2009, Citigroup (Smith Barney), JPMorgan, and Barclay's Capital were three of the top ranked investment bankers in the underwriting of both global and domestic equity issues.

**TRUE**

Refer to Table 2-1. Table 2-1 gives the rankings of the investment bankers in the underwriting of both global and domestic issues.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-02 Explain the role that the investment banker plays in an initial public offering.*

*Topic: Organization of the Primary Markets: The Investment Banker*

10. Bringing private companies public for the first time is called an initial public offering.

**TRUE**

This is the definition of an initial public offering (IPO).

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-02 Explain the role that the investment banker plays in an initial public offering.*

*Topic: Organization of the Primary Markets: The Investment Banker*

11. The Chicago Stock Exchange is the only one of the regional stock exchanges still viable.

**TRUE**

With the advent of electronic trading, the regional stock exchanges have lost their reason for existence. Boston and Philadelphia were bought by NASDAQ.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Organization of the Secondary Market*

12. NASDAQ ranks as the largest equity market in the world.

**FALSE**

The world's largest exchange is the NYSE Euronext exchange.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-03 Discuss the difference between floor trading and electronic trading.*

*Topic: The Organization of the NYSE*

13. Stocks traded over-the-counter, like through NASDAQ, have no centrally located market location.

**TRUE**

Stocks sold over-the-counter, like those traded on NASDAQ, have no centrally located markets. They are sold over a network of computers by individual brokerages that form the network.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-03 Discuss the difference between floor trading and electronic trading.*

*Topic: Organization of the Secondary Market*

14. The rise of financial-service firms through mergers and the consolidation of brokerage companies have resulted from significant changes in the banking laws.

**TRUE**

These mergers and acquisitions were made possible by changes to the banking laws, allowing financial institutions to offer the full financial services of commercial banking, investment banking, insurance, and brokerage firms.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: The Market Environment*

15. The NASDAQ stock market is a publicly traded corporation.

**TRUE**

Like the NYSE, NASDAQ has gone from a not-for-profit organization to a for-profit organization.

*AACSB: Reflective Thinking  
Blooms: Remember  
Difficulty: 1 Easy  
Learning Objective: 02-01 Understand the functions of financial markets.  
Topic: The NASDAQ Stock Market*

16. A market is a way of exchanging assets.

**TRUE**

A market is a way of exchanging assets, usually cash.

*AACSB: Reflective Thinking  
Blooms: Remember  
Difficulty: 1 Easy  
Learning Objective: 02-01 Understand the functions of financial markets.  
Topic: Market Functions*

17. All markets must have a physical central trading location.

**FALSE**

There does not have to be a central location for a market. As long as there can be communication between buyers and sellers, the exchange of assets can occur.

*AACSB: Reflective Thinking  
Blooms: Remember  
Difficulty: 1 Easy  
Learning Objective: 02-01 Understand the functions of financial markets.  
Topic: Market Functions*

18. One characteristic of efficient markets is that prices adjust rapidly to new information.

**TRUE**

An efficient market occurs when prices respond quickly to new information, when each successive trade is made at a price close to the preceding price, and when the market can absorb large amounts of securities or assets without changing the price significantly.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Market Functions*

19. Efficient markets need not be liquid, as long as buyers and sellers can eventually get a fair price for the assets they trade.

**FALSE**

The more efficient the market, the faster the price reacts to new information; the closer in price is each successive trade; and the greater the amount of securities that can be sold without changing the price. For markets to be efficient in this context, they must be liquid.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Market Functions*

20. Primary markets are for new issues of securities.

**TRUE**

Participants in the primary market buy the new issues of securities directly from the source of the assets.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Market Functions*

21. Secondary markets are for existing securities.

**TRUE**

Secondary markets are for existing assets that are currently traded between investors.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Market Functions*

22. The investment banker assumes a price risk under a best efforts agreement.

**FALSE**

On a best efforts basis, the issuing firm assumes the risk, and simply takes back any securities not sold after a fixed period.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-02 Explain the role that the investment banker plays in an initial public offering.*

*Topic: Organization of the Primary Markets: The Investment Banker*

23. When investment bankers underwrite a security, they usually guarantee purchase of the securities at a fixed price for the selling firm.

**TRUE**

This is the definition of what an investment banker does in the underwriting function.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-02 Explain the role that the investment banker plays in an initial public offering.*

*Topic: Organization of the Primary Markets: The Investment Banker*

24. The major functions of an investment banker are performed as part of the operations of the secondary market.

**FALSE**

The most active participant in the primary market is the investment banker. Investment bankers do not participate in the secondary market. Investment bankers help companies sell new securities in the primary market.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-02 Explain the role that the investment banker plays in an initial public offering.*

*Topic: Organization of the Primary Markets: The Investment Banker*

25. Super Dot refers to the New York Stock Exchange's designated order transfer system, which allows NYSE member firms to electronically transmit all market and limit orders directly to the specialist at the trading post.

**TRUE**

In response to criticism from market watchers that NASDAQ provided more price stability and fluid markets than the NYSE, the NYSE created computer systems that help the specialists manage order inflows more efficiently. This is Super Dot, a designated order transfer system.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-03 Discuss the difference between floor trading and electronic trading.*

*Topic: The Organization of the NYSE*

26. As a part of Super Dot, specialists are informed through Opening Automated Report Service (OARS) of market orders received before the opening bell.

**TRUE**

This is the definition of OARS.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-03 Discuss the difference between floor trading and electronic trading.*

*Topic: The Organization of the NYSE*

27. Specialists buy and sell for their own account.

**TRUE**

As the second major task of a specialist, when a broker gets an order to buy an amount of stock, and when reaching the trading post no seller is present, the broker can't wait for one to appear, since he has other orders to execute. In this case, the broker can buy the shares from the specialist, who acts as a dealer, in this case buying for and selling from his own inventory.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-03 Discuss the difference between floor trading and electronic trading.*

*Topic: The Organization of the NYSE*

28. Secondary markets include only organized exchanges such as the NYSE and the regional exchanges.

**FALSE**

Secondary markets include markets with central locations and also electronic markets such as over-the-counter markets and the electronic communication network (ECN).

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Organization of the Secondary Market*

29. The U.S. treasury often uses investment bankers to sell new issues of government securities.

**FALSE**

The U.S. Treasury issues securities through the Federal Reserve, essentially acting as an investment banker.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Organization of the Secondary Market*

30. Under the Securities Act of 1933, the SEC can certify that a stock is fairly priced.

**FALSE**

The SEC in no way certifies that the security is fairly priced, but only that the information seems to be factual and accurate.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-05 Understand the important legislation that affects the operations of the capital markets.*

*Topic: Regulation of the Securities Markets*

31. Only the Chicago regional exchange is still viable, with Philadelphia and Boston being bought by NASDAQ.

**TRUE**

The regional exchanges have lost their viability with the advent of electronic trading, and only the Chicago regional exchange is still viable after NASDAQ purchased the Philadelphia and Boston regional exchanges.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Organization of the Secondary Market*

32. A security traded on an exchange must meet listing requirements.

**TRUE**

The only way that a firm's securities can be traded on an exchange is if the company meets the listing requirements.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: The Organization of the NYSE*

33. Floor brokers act as agents for clients and execute buy and sell orders on the floor of the NYSE exchange.

**TRUE**

This is the definition of a floor trader on the NYSE.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-03 Discuss the difference between floor trading and electronic trading.*

*Topic: The Organization of the NYSE*

34. A specialist is supposed to maintain an orderly market.

**TRUE**

The second major task of specialists is to maintain continuous, liquid, and orderly markets in their assigned stocks.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-03 Discuss the difference between floor trading and electronic trading.*

*Topic: The Organization of the NYSE*

35. Specialists are now able to keep their limit orders in the Electronic Book rather than the old manual "specialist's book."

**TRUE**

The Electronic Book is a feature of Super Dot. This database covers stocks listed on the NYSE and keeps track of limit orders and market orders for the specialist.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-03 Discuss the difference between floor trading and electronic trading.*

*Topic: The Organization of the NYSE*

36. NASDAQ is directly related to the operations of the NYSE.

**FALSE**

The NASDAQ became a nationally recognized national securities exchange in 2006. It is separate from the NYSE.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: The NASDAQ Stock Market*

37. Based on dollar volume of stocks and bonds, the NASDAQ is the second largest of all markets in the United States.

**TRUE**

NASDAQ is the second largest securities market in the U.S. by dollar volume but often trades more shares on a daily basis than the NYSE.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: The NASDAQ Stock Market*

38. According to insider trading rules of the SEC, securities analysts and financial writers may not trade on insider information, but these rules do not extend to relatives and friends.

**FALSE**

The Securities Exchange Act of 1934 (and amended over the last two decades) set the guidelines for insider trading, which now includes securities analysts, financial writers, relatives, friends, and anyone having information which was not public knowledge.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-05 Understand the important legislation that affects the operations of the capital markets.*

*Topic: Regulation of the Securities Markets*

39. The Intercontinental Exchange (ICE) is now operating 24 hours per day using a computerized trading system.

**TRUE**

ICE was created in 2000 to create a 24 hour electronic market for energy contracts.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-03 Discuss the difference between floor trading and electronic trading.*

*Topic: Other Exchanges*

40. The use of the NASDAQ Automated Quotation System has increased the number of equity trades on the American Stock Exchange.

**FALSE**

The NASDAQ is separate from the American Stock Exchange, which is now part of the NYSE Euronext group of exchanges.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: The NASDAQ Stock Market*

41. Program trading decreases market efficiency by exaggerating price discrepancies between the cash and futures markets.

**FALSE**

Program Trading simply means that computer trigger points are established in which large volume trades can be initiated by institutional investors.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Institutional Trading*

42. Shelf registration is more popular with new bond offerings than with new stock offerings.

**TRUE**

A shelf registration allows issuing firms to register their securities with the SEC and then sell them at will as funds are needed in the future. Shelf registration is more popular with bond offerings than with stock offerings.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Organization of the Primary Markets: The Investment Banker*

43. Underwriters are less concerned with the fees from their activities than simply the amount of dollars underwritten.

**FALSE**

Investment bankers make a commitment to purchase shares at a discount to the public price and sell at the offered price. The difference is their fee, which is their profit. A company must be concerned with profit to stay in business.

*AACSB: Reflective Thinking*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-02 Explain the role that the investment banker plays in an initial public offering.*

*Topic: Organization of the Primary Markets: The Investment Banker*

44. The investment banker acts as a middleman in the process of raising new funds for corporations and governments.

**TRUE**

This is the definition of an investment banker, who also takes a risk by underwriting an issue of securities.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-02 Explain the role that the investment banker plays in an initial public offering.*

*Topic: Organization of the Primary Markets: The Investment Banker*

45. In the NASDAQ market, it is now permitted to charge fees for data feeds and market information.

**TRUE**

Now that NASDAQ is officially recognized as a national securities exchange by the SEC, it is allowed to charge fees for data feeds and market information.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: The NASDAQ Stock Market*

46. The largest segment of the Over-the-Counter (OTC) Market, in terms of dollar volume, is the U.S. government securities markets.

**TRUE**

The U.S. government securities market accounts for the largest segment of the OTC market in dollar volume. The volume is in the billions of dollars.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Over-the-Counter Markets*

47. Program trading simply means that trades are executed on computer programs written by the SEC.

**FALSE**

Program trading simply means that computer trigger points are established, in which large volume trades can be initiated by institutional investors.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Institutional Trading*

48. Electronic communication networks (ECNs) automatically match buy and sell orders at specified prices, and orders are not routed to the floor of an exchange before processing.

**TRUE**

This is the definition of ECNs. They are not routed to the floor of an exchange. Both the NYSE and NASDAQ have acquired the leading ECNs.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Electronic Communication Networks*

49. The Gramm-Leach-Bliley Act repealed the Glass-Steagall Act, which restricted commercial banks from also being in the investment banking business.

**TRUE**

The Gramm-Leach-Bliley Act repealed the Glass-Steagel Act, enabling commercial banks to be in the investment banking business.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: The Market Environment*

50. One of the main reasons institutional investors like ECNs is that they allow anonymity in trading.

**TRUE**

Institutional investors have developed electronic networks called dark pools to cross trades anonymously so that the trade cannot be seen by competitors.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Institutional Trading*

51. There is concern by the SEC and Congress that dark pools create a two-tier market.

**TRUE**

Refer to Real World of Investing box, Dark Pools. The SEC and Congress want more transparency to trades so all can see the information necessary.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Institutional Investing*

52. Circuit breakers will shut down the market for a period of time if a dramatic drop in stock prices occurs.

**TRUE**

Refer to Figure 2-2. Circuit breakers are designed to prevent large declines in the market in a short period of time. They are a function of the time of day and the percentage decrease. They are a safeguard against a catastrophic market collapse.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-04 Explain the potential impact of algorithmic program trading.*

*Topic: Institutional Trading*

53. If the DJIA declines by 10% in the time between 2:00-2:30 PM, a 30 minute halt to trading occurs.

**TRUE**

Refer to Figure 2-2. Figure 2-2 gives the time intervals when trading halts occur.

*AACSB: Reflective Thinking*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-04 Explain the potential impact of algorithmic program trading.*

*Topic: Institutional Trading*

54. Because of the 1987 market collapse, the SEC put circuit breakers into effect.

**TRUE**

The 22% decline in the market on October 19, 1987, encouraged the SEC to institute circuit breakers to prevent a catastrophic market collapse due to program trading, as was thought by some to be the reason for the 1987 market fall.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-04 Explain the potential impact of algorithmic program trading.*

*Topic: Institutional Investing*

55. The cost of compliance with the Sarbanes-Oxley Act has had little effect on the willingness of foreign companies to list their shares on U.S. stock exchanges.

**FALSE**

The costs of the Sarbanes-Oxley Act, and the heavy penalties for those found guilty of improprieties, have had a significant negative effect on the willingness of foreign companies to list their shares on U.S. exchanges. This has been a reason for U.S. exchanges to merge with foreign exchanges.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: The Market Environment*

56. Many large technology companies listed on NASDAQ could easily meet the NYSE listing standards.

**TRUE**

The listing requirements are lower on the NASDAQ than on the NYSE. Small companies that chose to list on the NASDAQ early in their life decided to stay even after they exceeded the NYSE requirements.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: The NASDAQ Stock Market*

**Multiple Choice Questions**

57. A means of exchanging assets, which may or may not include a specified location, and in which the seller may or may not own the assets being sold, is called:

- A. an organized exchange.
- B. an options market.
- C. a market.**
- D. None of the above

The means of exchanging assets defines a market. As long as the buyer and seller can communicate, the exchange can occur. Also, an agent can act for the owner, so a seller may not own the assets.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Market Functions*

58. Creating prices for securities and allowing for liquidity are functions of:

- A. the primary market.
- B. the secondary market.**
- C. the third market.
- D. the fourth market.
- E. the real estate market.

The secondary market functions to create prices and allow liquidity through trading of existing assets between investors.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Market Functions*

59. In the \_\_\_\_\_ market, existing assets are exchanged between investors, while in the \_\_\_\_\_ market, participants buy their assets directly from the source of the asset.

- A. primary; secondary
- B. secondary; primary**
- C. tertiary; primary
- D. primary; OTC
- E. prime; subprime

Instead of trading between investors as in the secondary market, participants in the primary market buy their assets directly from the source of the asset.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Market Functions*

60. Which of the following best describes the function of an investment banker selling an issue on a "best efforts" basis?

- A. Return unsold securities to the firm**
- B. Create a market for the securities
- C. Guarantee a continuous liquid market
- D. Private placements to financial institutions
- E. More than one of the above

On a best efforts basis, the issuing firm assumes the risk, and buys back any securities not sold after a fixed period.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-02 Explain the role that the investment banker plays in an initial public offering.*

*Topic: Organization of the Primary Markets: The Investment Banker*

61. The process of selling a new issue of securities so that the price is guaranteed to the selling firm is referred to as:

- A. underwriting.
- B. best efforts.
- C. direct by issuer.
- D. shelf registration.
- E. All of the above involve a price guarantee

Underwriting is the guarantee the investment banking firm gives the selling firm to purchase its securities at a fixed price, thereby eliminating the risk of not selling the whole issue of securities and having less cash than desired.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-02 Explain the role that the investment banker plays in an initial public offering.*

*Topic: Organization of the Primary Markets: The Investment Banker*

62. The least popular form of distributing corporate securities is:

- A. underwriting.
- B. best efforts.
- C. firm commitment.
- D. syndicated offering.
- E. direct by issuer.

Since corporations, states, and local governments do not sell new securities on any time basis, they usually rely on the expertise of the investment banker when selling securities.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-02 Explain the role that the investment banker plays in an initial public offering.*

*Topic: Organization of the Primary Markets: The Investment Banker*

63. Bringing private companies public for the first time is called:

- A. a private placement.
- B.** an initial public offering (IPO).
- C. a secondary offering.
- D. a founders sale.
- E. a shelf registration.

An IPO is an Initial Public Offering handled by the investment banker. It is an offering of stock to the public for the first time.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-02 Explain the role that the investment banker plays in an initial public offering.*

*Topic: Organization of the Primary Markets: The Investment Banker*

64. From the investment banker's point of view, the major reason syndicates are formed in the distribution of large issues is for the purpose of:

- A. improving the liquidity of the issue.
- B. improving geographic distribution.
- C.** reducing the underwriter's risk.
- D. improving brand recognition.
- E. All of the above

Investment banking firms will share the risk and burden of distribution by forming a group called a syndicate.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-02 Explain the role that the investment banker plays in an initial public offering.*

*Topic: Organization of the Primary Markets: The Investment Banker*

65. A syndicate is formed to:

- A. share the risk between investment bankers.
- B. distribute securities to a wide group of investors.
- C. improve the liquidity/marketability of an offering.
- D. All of the above**

Syndicates are formed to share the risk of distribution among members, and since they are often numerous, they are able to distribute the securities to a wide group of investors and improve the liquidity and marketability of an offering through continuous trading.

*AACSB: Reflective Thinking*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-02 Explain the role that the investment banker plays in an initial public offering.*

*Topic: Organization of the Primary Markets: The Investment Banker*

66. Which of the following is NOT a characteristic of an organized exchange?

- A. It functions as a primary market**
- B. Securities are bought and sold in an auction market by brokers acting as agents for buyers and sellers in a central location
- C. It may be either national or regional
- D. It has a central location where all trading takes place
- E. It functions as a secondary market

Organized exchanges are part of the secondary market.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Organization of the Secondary Market*

67. The exchange with the largest dollar volume in major companies and which has the most restrictive listing requirements is:

- A. the New York Stock Exchange.
- B. the American Exchange.
- C. the NASDAQ Stock Market.
- D. the Securities Exchange.

The NYSE handles the largest dollar volume of all exchanges, and since it deals primarily with large companies who have large cash needs, it also has the most restrictive listing requirements.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: The Organization of the NYSE*

68. Dual trading creates the following benefit:

- A. it improves liquidity of a security.
- B. it allows securities to be traded domestically and internationally.
- C. it creates competition between the exchange and NASDAQ.
- D. All of the above are benefits of dual trading

Dual trading means being listed on more than one market. Liquidity is improved, since with exposure to more participants, more continuous trading occurs.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Organization of the Secondary Market*

69. An employee of an investment house who executes orders on the floor of the exchange for customers of the firm is called a:

- A. floor broker.
- B. registered trader.
- C. commission broker.
- D. specialist.
- E. dealer.

This is the definition of a floor broker.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-03 Discuss the difference between floor trading and electronic trading.*

*Topic: The Organization of the NYSE*

70. A person who is registered to trade on an exchange, who owns a seat but is not an employee of any member firm is a:

- A. commission broker.
- B. floor broker.
- C. registered trader.
- D. dealer.
- E. B and C

A floor broker who isn't employed by a firm is a type of floor broker called an independent broker. Since independent brokers are registered to sell securities, they are registered traders.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: The Organization of the NYSE*

71. \_\_\_\_\_ has two major functions: to handle special orders, such as purchases with a price contingency, and to maintain continuous, liquid, orderly markets.

- A. A registered trader
- B. A specialist**
- C. An odd-lot dealer
- D. A commission broker

The five major functions of a specialist can be summarized in two duties: handle special orders, and maintain continuous, liquid, orderly markets.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: The Organization of the NYSE*

72. The major exchange for warrants, options, and commodity futures is the:

- A. American Stock Exchange.
- B. New York Stock Exchange.
- C. NASDAQ.
- D. None of the above**

There is no major exchange for all of these investments. The NYSE and NASDAQ trade warrants and options; the Chicago Mercantile Exchange (CME) Group is the largest commodity futures market.

*AACSB: Reflective Thinking*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: The Organization of the NYSE*

73. The \_\_\_\_\_ is a futures market for common stock, while the \_\_\_\_\_ is a futures market for commodities and financial instruments.

- A.** Chicago Board Options Exchange; Chicago Mercantile Exchange
- B. Chicago Mercantile Exchange; Chicago Board Options Exchange
- C. Chicago Board of Trade; Chicago Board Options Exchange
- D. New York Stock Exchange; American Stock Exchange

CME (Chicago Mercantile Exchange) Group merged with the Chicago Board of Trade, and is now the world's largest futures market.

*AACSB: Reflective Thinking*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Other Exchanges*

74. Which of the following is true of over-the-counter markets?

- A. Trading takes place by telephone or electronic network
- B. It is regulated by the Securities and Exchange Commission and the National Association of Securities Dealers
- C. The total securities traded represent the largest dollar volume in the U.S.
- D.** All of the above are true

All the above are true of OTC markets.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Over-the-Counter Markets*

75. ECNs provide several advantages to investors. Which of the following is not an advantage?

- A. They lower the cost of trading compared to organized exchanges with floor trading
- B.** They let everyone know who is making the trade and at what price
- C. They provide the ability to trade after hours when the exchanges are closed
- D. They provide more price transparency than organized exchanges

ECNs match buy and sell orders from individual or institutional investors. They do not let everyone know who is making the trade.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Electronic Communication Networks*

76. Electronic communication systems:

- A. allow investors to communicate with others in investor chat rooms.
- B. allow markets to trade American Depository Receipts online in Europe and Asia.
- C.** automatically match buy and sell orders at specified prices.
- D. are operated by the investment bankers to stabilize new issue markets.

This is the definition of ECNs.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Electronic Communication Networks*

77. Full disclosure of all pertinent investment information in the sale of new securities is a provision of the:

- A.** Securities Act of 1933.
- B. Securities Exchange Act of 1934.
- C. Securities Acts Amendments of 1975.
- D. Sarbanes-Oxley Act of 2002.
- E. More than one of the above

The detailed summary of all the pertinent information in the sale of securities is called a prospectus, and is required by the SEC under the Securities Act of 1933.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-05 Understand the important legislation that affects the operations of the capital markets.*

*Topic: Regulation of the Securities Markets*

78. The Securities and Exchange Commission was created by the:

- A. Securities Act of 1933.
- B.** Securities Exchange Act of 1934.
- C. Investment Advisor Act of 1940.
- D. None of the above

This act created the SEC.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-05 Understand the important legislation that affects the operations of the capital markets.*

*Topic: Regulation of the Securities Markets*

79. Program trading

- A. means that when a given market indicator reaches a certain point, a large sale or purchase of securities may take place.
- B. has been argued to affect the market by accelerating price movements.
- C. is likely to be voluntarily restricted by the securities exchanges and their member firms.
- D.** All of the above

Program trading has caused some serious declines in the market, most notably in 1987. The SEC instituted circuit breakers to prevent catastrophic collapse of the market. Securities exchanges are likely to institute program trading restrictions before the government further regulates them.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-05 Understand the important legislation that affects the operations of the capital markets.*

*Topic: Institutional Trading*

80. The Securities Investor Protection Corporation (SIPC) was established to:

- A.** oversee the liquidation of brokerage firms, and insure an investor's accounts to a maximum value of \$500,000 in case of bankruptcy by the broker.
- B. protect investors from corporate insider trading, and insure their accounts for \$500,000 in case corporate fraud caused a company to go bankrupt.
- C. cover the total market loss on an investor's brokerage account in case of the bankruptcy of the broker.
- D. create an insurance pool for brokerage firms, so that if one firm went bankrupt, all investor losses would be covered out of the insurance pool.

The SIPC was established to protect investors, much like the FDIC protects bank depositors.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-05 Understand the important legislation that affects the operations of the capital markets.*

*Topic: Other Legislation*

81. In order to be listed on an exchange, a firm must meet minimum standards pertaining to the following criteria:

- A. the number of common shares publicly held.
- B. the net income of the firm.
- C. the number of stockholders owning a minimum of 100 shares.
- D.** All of the above are requirements

These criteria must be met to be listed on an exchange.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Organization of the Secondary Market*

82. In general, markets are efficient when:

- A. prices respond quickly to new information.
- B. each successive trade is made at a price close to the preceding price.
- C. they can absorb large amounts of securities or assets without changing the price significantly.
- D.** All of the above

Markets are efficient when prices respond quickly to new information, each successive trade is made at a price close to the preceding price, and they can absorb large amounts of securities or assets without changing the price significantly.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Market Functions*

83. Secondary markets provide everything except:

- A. illiquidity.
- B. efficiency.
- C. continuity.
- D. competition.

Secondary markets create prices and allow for liquidity. They also provide continuity, efficiency, and competition.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Market Functions*

84. A difference between the primary market and the secondary market is:

- A. liquidity.
- B. that primary markets allow corporations, government units, and others to raise needed funds for the expansion of their capital base.
- C. that price competition in the secondary markets between different risk-return classes enables the primary market to price new issues at higher prices to reflect existing risk-return relationships.
- D. that the secondary market is much more competitive than the primary market.

Price competition in the secondary markets between different risk-return classes enables the primary market to price new issues at higher prices to reflect existing risk-return relationships.

*AACSB: Reflective Thinking*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Organization of the Secondary Market*

85. The investment banker is responsible for everything except:

- A. underwriting an issue of securities.
- B. being the leader and a part of the syndicate of large issues, providing that one is formed.
- C.** the distribution process of a security issue.
- D. selling an agreed-upon number of bonds and stocks.

The investment banker shares the distribution process with the syndicate. When the issue is large, there will be more participants in the syndicate. This provides for a wider distribution.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-02 Explain the role that the investment banker plays in an initial public offering.*

*Topic: Organization of the Primary Markets: The Investment Banker*

86. A house broker is one who:

- A. is registered to trade on the exchange but is not an employee of a member firm.
- B. is not associated with a member firm.
- C.** represents a retail brokerage firm and transacts business on the floor for customers of that firm.
- D. transacts orders for individuals buying or selling less than 100 shares.

A house broker represents NYSE firms. They either trade for clients of the investment house or for the firm's direct account.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-03 Discuss the difference between floor trading and electronic trading.*

*Topic: The Organization of the NYSE*

87. One of the functions of a specialist is:

- A. to manipulate price continuity.
- B. to change quotation spreads.
- C. to measure market depth as needed.
- D.** to execute special orders for floor brokers.

The five functions of a specialist: (1) manage the auction process, (2) execute special orders for floor brokers, (3) serve as catalysts, (4) provide capital, and (5) stabilize prices.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-03 Discuss the difference between floor trading and electronic trading.*

*Topic: The Organization of the NYSE*

88. The Gramm-Leach-Bliley Act was passed in 1999 by the U.S. Congress to allow:

- A.** financial institutions to offer full financial services, such as insurance and investment banking, as well as traditional commercial banking.
- B. financial institutions to be sued by stockholders for off-balance sheet accounting errors.
- C. savings and loans to compete with commercial banks in both the commercial banking arena and mortgage loans.
- D. European banks to acquire U.S. financial institutions.

The Gramm-Leach-Bliley Act was passed in 1999 by the U.S. Congress to allow financial institutions to offer full financial services, such as insurance and investment banking, as well as traditional commercial banking.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: The Market Environment*

89. The first exchange to become a publicly traded company was the:

- A. New York Stock Exchange.
- B. Chicago Board of Trade.
- C. NASDAQ Stock Market.
- D. American Stock Exchange.
- E. Chicago Mercantile Exchange.**

The first exchange to become a publicly traded company was the Chicago Mercantile Exchange, at the end of 2001.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: The Market Environment*

90. The accounting frauds and scandals that took place during the stock market boom of the late 1990s resulted in what significant Act?

- A. Sarbanes-Oxley Act**
- B. Gramm-Leach Bliley Act
- C. Glass-Steagall Act
- D. Honesty in Financial Reporting Act
- E. Securities Exchange Act

The Sarbanes-Oxley Act was enacted after the accounting frauds and scandals that took place during the stock market boom of the late 1990s.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: The Market Environment*

91. The Sarbanes-Oxley Act:

- A.** has reduced the number of foreign companies willing to list their shares on U.S. exchanges.
- B. was enacted under the Securities Exchange Act of 1934.
- C. reduces the reporting requirements for publicly traded firms.
- D. has made it possible for small firms to list their shares in the public markets.
- E. was the loophole that enabled corporate executives to misrepresent their financial statements during the late 1990s and early 2000s.

The cost of compliance with the Sarbanes-Oxley Act, and the heavy penalties for those found guilty of violating it, have had a significant negative effect on the willingness of foreign companies to list their shares on U.S. stock exchanges.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: The Market Environment*

92. The \_\_\_\_\_ has/have the most restrictive listing requirements.

- A. Regional exchanges
- B. ECNs
- C. NASDAQ Stock market
- D.** New York Stock Exchange
- E. American Stock Exchange

Since the NYSE is the biggest exchange and generates the most dollar volume in large, well-known companies, its listing requirements are the most restrictive.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Organization of the Secondary Market*

93. Initial and annual listing fees are highest for \_\_\_\_\_ -listed stocks.

- A. Chicago Mercantile Exchange
- B. ECN
- C. NASDAQ Stock market
- D. New York Stock Exchange**
- E. American Stock Exchange

According to the NASDAQ, a company having 100,000,000 shares outstanding would pay an annual listing fee of \$61,750 to NASDAQ or \$93,000 to the NYSE. The initial listing fee for NASDAQ is \$150,000 while the NYSE initial listing fee is \$250,000.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Organization of the Secondary Market*

#### **Essay Questions**

94. Why was the Sarbanes-Oxley Act enacted?

The Sarbanes-Oxley Act was enacted after the accounting frauds and scandals of the 1990s.

Feedback: The Sarbanes-Oxley Act was enacted after the accounting frauds and scandals of the 1990s.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: The Market Environment*

95. What are ECNs?

ECNs are electronic trading systems that automatically match buy and sell orders at specified prices.

Feedback: ECNs are electronic trading systems that automatically match buy and sell orders at specified prices.

*AACSB: Reflective Thinking*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Understand the functions of financial markets.*

*Topic: Electronic Communication Networks*