Chapter 1: An Introduction to Finance

**MULTIPLE CHOICE QUESTIONS**

1) Which of the following items is not a real asset?

a) Land

b) Television

c) Bond

d) Gold mine

Answer: c

Type: Definition

Level of Difficulty: Easy

Learning Objective: List the major financial and real assets held by Canadians and the major sectors in the financial system.

Section Reference: Real Versus Financial Assets

2) Of the following list, which item is a financial asset?

a) Land

b) Bond

c) Building

d) Inventory

Answer: b

Type: Definition

Level of Difficulty: Easy

Learning Objective: List the major financial and real assets held by Canadians and the major sectors in the financial system.

Section Reference: Real Versus Financial Assets

3) What is the main difference between real assets and financial assets?

a) Real assets are tangible and financial assets are intangible.

b) Real assets have known values, while the values of financial assets are not known.

c) Real assets are intangible and financial assets are tangible.

d) Real assets have unknown values, while the values of financial assets are known.

Answer: a

Type: Definition

Level of Difficulty: Easy

Learning Objective: List the major financial and real assets held by Canadians and the major sectors in the financial system.

Section Reference: Real Versus Financial Assets

4) If Canadian households, in aggregate, own real assets with a market value of $3.194 trillion, and also own net financial assets with a market value of $2.344 trillion, the total net assets of Canadian households have a market value of:

a) $3.194 trillion

b) $5.538 trillion

c) $–0.850 trillion

d) $0.850 trillion

Answer: b, $5.538 trillion = $3.194 + $2.344

Type: Calculation

Level of Difficulty: Easy

Learning Objective: List the major financial and real assets held by Canadians and the major sectors in the financial system.

Section Reference: Real Versus Financial Assets

5) Given the following hypothetical information regarding the real and financial assets in Canada for 2013 (numbers in $ billions):

|  |  |  |
| --- | --- | --- |
|  | Real Assets | Net Financial Assets |
| Government | 677 | –658 |
| Business | 2,202 | –1,635 |
| Households | 3,194 | 2,344 |

What is the total value of the net real assets in Canada for 2013?

a) $5,842 billion

b) $6,086 billion

c) $6,124 billion

d) $6,105 billion

Answer: c, $6,124 billion = 677+2202+3194-658-1635+2344

Type: Calculation

Level of Difficulty: Medium

Learning Objective: List the major financial and real assets held by Canadians and the major sectors in the financial system.

Section Reference: Real Versus Financial Assets

6) You are provided with the following hypothetical information regarding the real and financial assets in Canada for 2013 (numbers in $ billions):

|  |  |  |
| --- | --- | --- |
|  | Real Assets | Net Financial Assets |
| Government | 677 | –658 |
| Business | 2,202 | –1,635 |
| Households | 3,194 | 2,344 |

What is the value of the net financial assets owned by *non-residents* for 2013?

a) $901 billion

b) $51 billion

c) $2,293 billion

d) There is not enough information to answer the question.

Answer: b, $51 billion = 2,344 – 658 – 1,635. The value of net financial assets held by non-residents is equal to the negative of the sum of the net financial assets of government, businesses, and households.

Type: Calculation

Level of Difficulty: Difficult

Learning Objective: List the major financial and real assets held by Canadians and the major sectors in the financial system.

Section Reference: Real Versus Financial Assets

7) Which of the following sectors is not a user of savings in the economy?

a) Business sector

b) Household sector

c) Government sector

d) Banking sector

Answer: b

Type: Concept

Level of Difficulty: Easy

Learning Objective: List the major financial and real assets held by Canadians and the major sectors in the financial system.

Section Reference: Real Versus Financial Assets

8) Entities that invest funds on behalf of others and change the nature of the transactions are called:

a) Brokers

b) Financial intermediaries

c) Dealers

d) Market intermediaries

Answer: b

Type: Definition

Level of Difficulty: Easy

Learning Objective: Explain how money is transferred from lenders to borrowers and the role played by market and financial intermediaries.

Section Reference: The Financial System

9) Joe has just borrowed $5,000 from his aunt in order to make a down payment on a car. This borrowing transaction is an example of:

a) Indirect intermediation

b) Direct intermediation

c) External intermediation

d) Market transaction

Answer: b

Type: Definition

Level of Difficulty: Easy

Learning Objective: Explain how money is transferred from lenders to borrowers and the role played by market and financial intermediaries.

Section Reference: The Financial System

10) An example of direct intermediation would be:

a) An individual borrowing money from a bank

b) An individual borrowing money from her mother

c) An individual using a real estate broker to finance her home purchase

d) A stockbroker selling securities to an individual

Answer: b

Type: Concept

Level of Difficulty: Easy

Learning Objective: Explain how money is transferred from lenders to borrowers and the role played by market and financial intermediaries.

Section Reference: The Financial System

11) The three intermediation channels that transfer money from lenders to borrowers are:

a) Direct, indirect, and financial intermediation

b) Direct, indirect, and monetary intermediation

c) Direct, financial, and monetary intermediation

d) Indirect, financial, and monetary intermediation

Answer: a

Type: Definition

Level of Difficulty: Easy

Learning Objective: Explain how money is transferred from lenders to borrowers and the role played by market and financial intermediaries.

Section Reference: The Financial System

12) Although Canadian banks are involved in almost all areas of the financial system, which of the following is their core activity?

a) Stock market investment activity

b) Retirement planning

c) Wealth management

d) Taking deposits and lending funds

Answer: d

Type: Definition

Level of Difficulty: Easy

Learning Objective: Explain how money is transferred from lenders to borrowers and the role played by market and financial intermediaries.

Section Reference: The Financial System

13) Which of the following is *not* a financial intermediary?

a) Chartered banks

b) Insurance companies

c) Pension funds

d) Mutual funds

Answer: d

Type: Definition

Level of Difficulty: Easy

Learning Objective: Explain how money is transferred from lenders to borrowers and the role played by market and financial intermediaries.

Section Reference: The Financial System

14) Which of the following is *not* one of the main functions performed by mutual funds?

a) Pooling sums of money to make investments

b) Paying out premiums to their clients

c) Providing professional management expertise

d) Acting as a “pass-through” for individuals to invest in the equity and debt markets

Answer: b

Type: Concept

Level of Difficulty: Medium

Learning Objective: Explain how money is transferred from lenders to borrowers and the role played by market and financial intermediaries.

Section Reference: The Financial System

15) What is the major proportion of Canadian households’ financial assets?

a) Stocks and bonds

b) Deposits

c) Foreign investment

d) Claims on retirement and insurance funds

Answer: d

Type: Concept

Level of Difficulty: Easy

Learning Objective: Explain how money is transferred from lenders to borrowers and the role played by market and financial intermediaries.

Section Reference: The Financial System

16) Financial markets are usually classified by the type and maturity of the financial assets traded. The two main classifications are as follows:

a) Bond market and money market

b) Money market and capital market

c) Bond market and foreign-exchange market

d) Commodity market and capital market

Answer: b

Type: Definition

Level of Difficulty: Easy

Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.

Section Reference: Financial Instruments and Markets

17) Of the following list, who are the dominant players in the money market?

I. Individuals

II. Corporations

III. Governments

a) I and II

b) I and III

c) II and III

d) I, II and III

Answer: c

Type: Definition

Level of Difficulty: Easy

Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.

Section Reference: Financial Instruments and Markets

18) All common shares are comprised of which two components?

a) Ownership and voting rights

b) Ownership and dividend rights

c) Voting and dividend rights

d) Dividend and yield rights

Answer: a

Type: Concept

Level of Difficulty: Easy

Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.

Section Reference: Financial Instruments and Markets

19) Though they are classified as equity, why are preferred shares also similar to debt?

a) Both carry the same interest rate.

b) Dividends on preferred shares must be paid out before any common share dividends.

c) The voting structures for preferred shares and debt are equivalent.

d) Preferred shares have similar maturity structures to debt.

Answer: b

Type: Concept

Level of Difficulty: Difficult

Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.

Section Reference: Financial Instruments and Markets

20) Which of the following is *not* a component of debt securities?

a) Maturity

b) Repayment

c) Dividends

d) Interest payments

Answer: c

Type: Definition

Level of Difficulty: Easy

Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.

Section Reference: Financial Instruments and Markets

21) An example of a non-marketable financial asset is a:

a) Demand deposit

b) T-bill

c) Commercial paper

d) Common share

Answer: a

Type: Definition

Level of Difficulty: Easy

Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.

Section Reference: Financial Instruments and Markets

22) How do governments obtain the majority of their short- and long-term financing?

a) T-bills and Canada Savings Bonds

b) T-bills, traditional bonds, and Canada Savings Bonds

c) T-bills, equity, and traditional bonds

d) Traditional bonds and Canada Savings Bonds

Answer: b

Type: Concept

Level of Difficulty: Easy

Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.

Section Reference: Financial Instruments and Markets

23) Which of the following is *not* an example of a capital market security?

a) Bond

b) Debenture

c) Common equity

d) T-bill

Answer: d

Type: Definition

Level of Difficulty: Easy

Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.

Section Reference: Financial Instruments and Markets

24) Which of the following is an existing stock exchange in Canada?

a) Toronto Stock Exchange (TSX)

b) Montreal Exchange (ME)

c) Vancouver Stock Exchange (VSE)

d) Winnipeg Stock Exchange (WSE)

Answer: a

Type: Definition

Level of Difficulty: Easy

Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.

Section Reference: Financial Instruments and Markets

25) Which of the following was *not* one of the major objectives in the restructuring of the Canadian stock exchanges in 1999 and 2000?

a) To create a Canadian market for NASDAQ-listed companies.

b) To combine all futures and options trading on one exchange.

c) To make the TSX the official exchange for the trading of Canadian senior stocks.

d) To create a single national exchange for trading in junior company stocks.

Answer: a

Type: Concept

Level of Difficulty: Medium

Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.

Section Reference: Financial Instruments and Markets

26) A market where transactions are made directly between large institutions and wealthy individuals that bypass brokers and dealers is an example of:

a) The primary market

b) The secondary market

c) The third market

d) The fourth market

Answer: d

Type: Definition

Level of Difficulty: Easy

Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.

Section Reference: Financial Instruments and Markets

27) The main difference between exchanges and dealer/OTC markets is:

a) Exchanges are a part of the primary market, while dealer and OTC markets are part of the secondary market.

b) Transactions in dealer markets are conducted entirely by humans, not electronically.

c) Exchanges have a physical location while dealer and OTC markets do not.

d) All of the above are differences between exchanges and dealer markets.

Answer: c

Type: Concept

Level of Difficulty: Easy

Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.

Section Reference: Financial Instruments and Markets

28) The exchange that acts as the Canadian national derivatives market and conducts all options and futures trading is called the:

a) Bourse de Montreal

b) Winnipeg Commodity Exchange

c) TSX Venture

d) Alpha Exchange

Answer: a

Type: Definition

Level of Difficulty: Easy

Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.

Section Reference: Financial Instruments and Markets

29) Which is the only province where trades in unlisted securities need to be reported?

a) British Columbia

b) Quebec

c) Alberta

d) Ontario

Answer: d

Type: Definition

Level of Difficulty: Easy

Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.

Section Reference: Financial Instruments and Markets

30) Which one of the following is not a function of brokers?

a) Manage money for clients

b) Make the market work

c) Charge a fee for their services

d) Assist with the transaction process

Answer: a

Type: Concept

Level of Difficulty: Easy

Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.

Section Reference: Financial Instruments and Markets

31) What was ***not***a reason for the credit crunch of 2008-09?

a) Mistrust between financial intermediaries

b) Illiquidity of debt markets

c) The arrest of Bernard Madoff

d) Bankruptcy of one of the leading financial institutions

Answer: c

Type: Concept

Level of Difficulty: Easy

Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.

Section Reference: Financial Instruments and Markets

32) Who are the biggest borrower and lender in Canada respectively?

a) Government and households

b) Government and banks

c) Banks and mutual funds

d) Crown corporations and banks

Answer: a

Type: Concept

Level of Difficulty: Easy

Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.

Section Reference: Financial Instruments and Markets

33) Why can’t the Canadian government issue equity?

a) Because assets belong to all Canadians

b) It is not listed in the financial markets

c) It has too much debt

d) Because expenditures exceed revenues

Answer: a

Type: Concept

Level of Difficulty: Medium

Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.

Section Reference: Financial Instruments and Markets

34) If the stock of a listed firm decreases by 50 percent, what does it mean to the shareholders?

a) Their ownership of the firm will decrease by 50 percent

b) Total value of their holdings decreases by 50 percent

c) The debt of the firm decreases by 50 percent

d) Nothing

Answer: b

Type: Concept

Level of Difficulty: Medium

Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.

Section Reference: Financial Instruments and Markets

35) Which of the following is *not* a benefit of global financial markets?

a) They represent important sources of funds for borrowers.

b) They provide diversification benefits to Canadian investors.

c) Canadian companies can list their shares in different markets.

d) The value of Canadian shares becomes more stable.

Answer: d

Type: Concept

Level of Difficulty: Easy

Learning Objective: Explain the importance of the global financial system and how Canada is impacted by events in the U.S mortgage market.

Section Reference: The Global Financial Community

36) Which is the world’s largest and most famous stock market?

a) New York Stock Exchange (NYSE)

b) Toronto Stock Exchange (TSX)

c) Tokyo Stock Exchange (TSE)

d) London Stock Exchange (LSE)

Answer: a

Type: Definition

Level of Difficulty: Easy

Learning Objective: Explain the importance of the global financial system and how Canada is impacted by events in the U.S mortgage market.

Section Reference: The Global Financial Community

37) The spread of the financial crisis in the autumn of 2008 was *not*augmented by:

a) Linkages between global financial markets

b) The cross listing of firms in different markets

c) The consolidation of the global financial system

d) Excessive debt of the government

Answer: d

Type: Concept

Level of Difficulty: Medium

Learning Objective: Explain the importance of the global financial system and how Canada is impacted by events in the U.S mortgage market.

Section Reference: The Global Financial Community

38) What is a ‘Ninja’ loan?

a) Mortgage to individuals with poor credit

b) Mortgage to Japanese

c) Mortgages to individuals with good credit

d) Mortgages backed by unspecified assets

Answer: a

Type: Definition

Level of Difficulty: Easy

Learning Objective: Explain the importance of the global financial system and how Canada is impacted by events in the U.S mortgage market.

Section Reference: The Global Financial Community

**PRACTICE PROBLEMS**

39) How do financial intermediaries help those with “too much money today” and those with “not enough money today”?

Answer: Financial markets provide these surplus- and deficit-spending units with a way to improve their respective situations. Deficit-spending units do not have to postpone profitable investments today, and surplus-spending units can hold financial securities that generate a return. More importantly, financial markets provide a framework that facilitates the “meeting” of these two parties. Financial markets accelerate, simplify, and reduce the cost of contact between borrowers and lenders.

Type: Concept

Level of Difficulty: Medium

Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.

Section Reference: Financial Instruments and Markets

40) What are the differences between the primary markets and the secondary markets?

Answer: The primary market is where a borrower issues new securities and exchanges these securities for cash from investors. The proceeds of the sale of securities in the primary market go to the issuing corporation or government.

In secondary markets, investors trade previously issued securities with other investors. Securities may trade repeatedly in the secondary markets, but the original issuers will be unaffected in the sense that they will not receive any additional cash from these transactions.

Type: Concept

Level of Difficulty: Easy

Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.

Section Reference: Financial Instruments and Markets

41) Why is the secondary market important?

Answer: The secondary market is where investors trade previously issued securities. It is important because it provides liquidity to investors. If an efficient secondary market did not exist, investors would be very reluctant to hold securities with longer maturities. If they are not willing to buy these securities, then securities in the primary market will become more difficult to sell. Hence, the secondary market is necessary for the proper functioning of the primary market.

Type: Definition

Level of Difficulty: Medium

Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.

Section Reference: Financial Instruments and Markets

42) What is an over-the-counter market? Do all bonds in Canada trade over-the-counter?

Answer:

“Over-the-counter” means a large network of dealers make markets in various securities, both debt and equity. The market doesn’t have a physical location but instead consists of a network of dealers who trade with each other over phone or computer networks. Investors can buy and sell with their brokers who then trade with other dealers.

The majority of bonds in Canada trade over-the-counter, although some bonds trade on stock exchanges such as the Toronto Stock Exchange (convertible bonds only) .

Type: Concept

Level of Difficulty: Easy

Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.

Section Reference: Financial Instruments and Markets

43) Explain what an auction market is and how it works.

Answer: Stock exchanges are auction markets. Brokers act on behalf of their clients and arrange to match buyers and sellers through an auction system. Trading takes place either on the floor of an exchange or by computer link. For their services, brokers charge a commission that is a percentage of the value of the transaction.

Type: Definition

Level of Difficulty: Easy

Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.

Section Reference: Financial Instruments and Markets

44) Define and describe the difference between the third and fourth markets.

Answer: The third market is an OTC market for the trading of securities that are listed on organized exchanges. The fourth market refers to transactions made directly between large institutions and/or wealthy individuals, thereby bypassing brokers and dealers.

The difference between the third and fourth market:

The third market involves extremely large transactions and is used primarily to avoid exchange commission fees. The fourth market involves relatively smaller trades and is used to avoid information leaks regarding who is trading which stock(s).

Type: Definition

Level of Difficulty: Easy

Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.

Section Reference: Financial Instruments and Markets

45) Explain the gravity of the situation of pension holders in Quebec after the loss of 25 percent of the caisse de depot’s portfolio (pension fund manager of Quebec) in 2008.

Answer: La caisse de depot is the manager of pensions in Quebec. The loss of 25 percent of its portfolio represents the loss of funds available to pay pensions.

It actually did a good job after the financial crisis. The annualized return in 2009, 2010, and 2011 is 9%. By 2011, its net assets are $159 billion, more than the $155.4 billion in 2007.

Type: Concept

Level of Difficulty: Difficult

Learning Objective: Explain the importance of the global financial system and how Canada is impacted by events in the U.S mortgage market.

Section Reference: The Global Financial Community

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