**Chapter 21**

**Investment Banks, Brokerage Firms, and Mutual Funds**

21.1 Multiple Choice

1) An investment bank is a financial institution that

A) bundles small deposits into larger loans.

B) helps corporations raise funds.

C) holds most of its assets in commercial paper.

D) does all of the above.

E) does only (A) and (B) of the above.

Answer: B

2) The Glass-Steagall Act

A) separated commercial and investment banking.

B) made it illegal for a commercial bank to buy or sell securities on behalf of its

customers.

C) made it illegal for investment banks to engage in the underwriting of corporate

securities.

D) did all of the above.

E) did only (A) and (B) of the above.

Answer: E

3) Investment banks sell \_\_\_\_\_ securities to the public, and brokerage firms sell \_\_\_\_\_

securities to the public.

A) new; existing

B) new and existing; existing

C) existing; new

D) existing; new and existing

Answer: A

4) The primary function of investment banks is

A) the bundling of deposits into loans.

B) extending long-term credit to other financial institutions.

C) helping corporations raise funds.

D) providing credit to firms engaged in international trade.

Answer: C

5) Tasks that investment bankers perform when acting as an underwriter to sell securities

to the public include:

A) pricing the security.

B) preparing the filings required by the Securities and Exchange Commission.

C) arranging for the security to be rated.

D) all of the above.

E) only (A) and (B) of the above.

Answer: D

6) Investment banks find it less difficult to price securities if the firm has prior issues

currently selling in the market, called

A) secondary issues.

B) seasoned issues.

C) sustained issues.

D) scarf issues.

Answer: B

7) The process of underwriting a stock or bond issue requires that the securities firm

A) assure the public that the issue is legitimate and not a fraudulent confidence

game.

B) purchase the entire issue at a predetermined price if the quantity demanded by

consumers is insufficient at the predetermined price.

C) purchase the entire issue at a predetermined price and then resell it in the

market.

D) do both (A) and (B) of the above.

Answer: C

8) Underwriters assist firms with filing documents required by the SEC. The registration

statement contains information

A) about the firm’s financial condition, management, competition, industry, and

experience.

B) disclosing how the funds will be used.

C) about management’s assessment of the risk of the securities.

D) about all of the above.

E) about only (A) and (B) of the above.

Answer: D

9) By law, investors must be given a portion of the registration statement before they can

invest in a new security. This document is called a

A) prospectus.

B) proxy statement.

C) fiduciary warrant.

D) fiduciary warranty.

Answer: A

10) Investment banks advertise upcoming securities offerings with block ads in the Wall

Street Journal. Such an ad is called a

A) tombstone.

B) marker.

C) prospectus.

D) registration statement.

Answer: A

11) Most investment banks are attached to

A) large commercial banks.

B) large brokerage houses.

C) finance companies.

D) large nonfinancial corporations, such as automobile manufacturers.

Answer: B

12) From an investment banker’s perspective, the best outcome occurs when a new issue is

A) undersubscribed.

B) fully subscribed.

C) oversubscribed.

D) syndicated.

Answer: B

13) The largest underwriter of debt and equity issues in the United States, as of 2001, was

A) Morgan Stanley.

B) Citicorp/Salomon Smith Barney

C) Lehman Brothers.

D) Goldman, Sachs.

Answer: B

14) Often investment bankers will form a group, each one buying only a portion of the new

securities to be issued. Such a group is called a

A) posse.

B) syndicate.

C) underwriting club.

D) debt pack.

Answer: B

15) If the investment banker makes no guarantee regarding the price the issuing firm will

receive, but agrees to sell the securities on a commission basis, the agreement is called

a

A) best-effort agreement.

B) brokered agreement.

C) private-placement agreement.

D) jump-start agreement.

Answer: A

16) Under best-efforts underwriting,

A) the underwriter pays for the entire security issue.

B) the underwriter sells the security on a commission basis.

C) the underwriter spreads the risk among different brokerage houses.

D) the underwriter makes a special appeal to the Securities and Exchange

Commission to delay the issue.

Answer: B

17) Private placements

A) do not require the services of investment bankers.

B) need not be registered with the SEC.

C) are more common in the sale of stocks than for bonds.

D) are all of the above.

E) are only (A) and (B) of the above.

Answer: E

18) The most active investment banking firm in the private placement market is

A) Merrill Lynch.

B) Lehman Brothers.

C) Goldman, Sachs.

D) Morgan Stanley.

Answer: C

19) The buyers of private placement issues are most likely to be

A) insurance companies.

B) pension funds.

C) investment banks.

D) all of the above.

E) only (A) and (B) of the above.

Answer: E

20) The buyers of private placement securities are most likely to be

A) insurance companies.

B) pension funds and mutual funds.

C) commercial banks.

D) all of the above.

E) only (A) and (B) of the above.

Answer: D

21) Which of the following statements about private placements are true?

A) Private placements are more common for the sale of bonds than for stocks.

B) Investment bankers, though not required for a private placement, often

facilitate the transaction.

C) Investment bankers help the issuing firm file the paperwork required by the

SEC.

D) All of the above are true.

E) Only (A) and (B) of the above are true.

Answer: E

22) Investment bankers have been active in the mergers and acquisitions market since the

1960s. Their contributions have included

A) helping firms that want to acquire another firm locate a firm to pursue.

B) helping would-be acquirers solicit shareholders through a tender offer.

C) helping target firms ward off undesired takeover attempts.

D) all of the above.

E) only (A) and (B) of the above.

Answer: D

23) The best known investment banker involved in mergers and acquisitions, and the man

credited with inventing the junk bond market, is

A) Ivan Boskey.

B) Michael Milken.

C) James Garner.

D) Michael Douglas.

Answer: B

24) \_\_\_\_\_\_ perform their main function in the primary market for securities and \_\_\_\_\_\_

perform theirs in the secondary market.

A) investment banks; securities brokers and dealers

B) securities brokers and dealers; investment banks

C) securities brokers; securities dealers

D) securities dealers; securities brokers

Answer: A

25) Which of the following best explains the difference between brokers and dealers?

A) Brokers are pure middlemen; dealers make markets by standing ready to buy

and sell at given prices.

B) Dealers are pure middlemen; brokers make markets by standing ready to buy

and sell at given prices.

C) Dealers link up buyers and sellers, but do not stand ready to buy and sell from

their inventories of securities; brokers stand ready to buy and sell from their

inventories of securities.

D) There is no difference between brokers and dealers.

Answer: A

26) Securities dealers

A) hold inventories of securities, which they sell to customers who want to buy.

B) hold securities that they have purchased from customers who wanted to sell.

C) are called market takers, as they have significantly cut into the market that

brokers used to dominate.

D) do all of the above.

E) do only (A) and (B) of the above.

Answer: E

27) Securities dealers

A) sell securities out of their inventories to customers who want to buy.

B) buy securities, which they add to their inventories, from customers who want

to sell.

C) are largely responsible for the health and growth of small businesses in the

United States.

D) do all of the above.

E) do only (A) and (B) of the above.

Answer: D

28) An instruction to a securities agent to buy or sell the security at the current market

price is called

A) a limit order.

B) a market order.

C) a pit order.

D) an option order.

Answer: B

29) To take advantage of stock price decreases, an investor would use a

A) market order.

B) limit order.

C) short sale.

D) margin credit.

Answer: C

30) Which of the following statements about cash management accounts (CMAs) are true?

A) The cash management account was developed in 1977 by Merrill Lynch.

B) The advantage of brokerage-based cash management accounts is that they

make it easier to buy and sell securities.

C) As a result of CMAs, the distinction between banking activities and the

activities of nonbank financial institutions has become more clearly defined.

D) All of the above are true.

E) Only (A) and (B) of the above are true.

Answer: E

31) An investment pool is formed

A) to manipulate the market by spreading false rumors.

B) to lower brokerage fees by combining security purchases.

C) to share investment advice among member investors.

D) to take advantage of tax breaks introduced by the 1933 and 1934 securities

acts.

Answer: A

32) SEC registration is

A) not required for securities that are sold through a private placement.

B) required for all securities.

C) not required if less than $1.5 million in securities are issued per year.

D) not required if the securities mature in less than one year.

E) not required if securities are underwritten by an investment bank.

Answer: C

33) Mutual funds offer investors all of the following except

A) greater-than-average returns.

B) diversified portfolios.

C) lower transaction costs.

D) professional investment management.

Answer: A

34) Mutual funds

A) pool the resources of many small investors by selling these investors shares

and using the proceeds to buy securities.

B) allow small investors to obtain the benefits of lower transaction costs in

purchasing securities.

C) provide small investors a diversified portfolio that reduces risk.

D) do all of the above.

E) do only (A) and (B) of the above.

Answer: D

35) Most mutual funds are structured in two ways. The most common structure is a(n)

\_\_\_\_\_ fund, from which shares can be redeemed at any time at a price that is tied to the

asset value of the fund. A(n) \_\_\_\_\_ fund has a fixed number of nonredeemable shares

that are traded in the over-the-counter market.

A) close-end; open-end

B) open-end; close-end

C) no-load; close-end

D) no-load; load

E) load; no-load

Answer: B

36) \_\_\_\_\_\_\_\_\_ funds are the simplest type of investment funds to manage.

A) Balanced

B) Global equity

C) Growth

D) Index

Answer: D

37) The majority of mutual fund assets are now owned by

A) individual investors.

B) institutional investors.

C) fiduciaries.

D) business organizations.

E) retirees.

Answer: A

38) Which of the following is most likely to be a no-load fund?

A) Value funds

B) Hedge funds

C) Growth funds

D) Index funds

Answer: D

39) When investors switch between funds in different families, mutual funds may charge

A) a contingent deferred sales charge.

B) a redemption fee.

C) an exchange fee.

D) 12b-1 fees.

E) an account maintenance fee.

Answer: C

40) The Securities Acts of 1933 and 1934 did not

A) regulate the activities of investment funds.

B) require funds to register with the SEC.

C) include antifraud rules covering the purchase and sale of fund shares.

D) apply to investment funds.

Answer: B

41) The largest share of total investment in mutual funds is in

A) stock funds.

B) hybrid funds

C) bond funds.

D) money market funds.

Answer: A

42) Hedge funds

A) are low risk because they are market-neutral.

B) are low risk if they buy Treasury bonds.

C) are low risk because they hedge their investments.

D) are high risk because they are market-neutral.

E) are high risk, even though they may be market-neutral.

Answer: E

43) The near collapse of Long Term Capital Management was caused by

A) the high management fees charged by the fund’s two Nobel Prize winners.

B) the fund’s high leverage ratio of 20 to 1.

C) a sharp decrease in the spread between corporate bonds and Treasury bonds.

D) a sharp increase in the spread between corporate bonds and Treasury bonds.

E) the fund’s shift away from a market-neutral investment strategy.

Answer: D

21.2 True/False

1) The Glass-Steagall Act made it illegal for an investment bank to buy or sell

securities on behalf of its customers.

Answer: FALSE

2) When a firm issues stock for the first time in an initial public offering, it is difficult

for an investment bank to determine what the correct price should be.

Answer: TRUE

3) An undersubscribed issue occurs when sales agents have been unable to generate

sufficient interest among their customers to sell all the securities by the issue date.

Answer: TRUE

4) Resisted takeovers are called hostile.

Answer: TRUE

5) Private placements are more common for the sale of stocks than for bonds.

Answer: FALSE

6) Investment bankers perform a number of tasks required to sell securities to the

public, among them pricing the security, preparing the filings required by the SEC,

arranging for the security to be rated, and marketing the security through their

contacts with brokerage houses.

Answer: FALSE

7) One disadvantage of the private placement of securities issues is the high cost of

registering the issue.

Answer: FALSE

8) Junk bonds are high-risk, high-return equity securities that were used primarily to

finance takeover attempts.

Answer: FALSE

9) The Securities Acts Amendment of 1975 abolished fixed commissions.

Answer: TRUE

10) An investment pool is formed to manipulate the market for a stock by spreading

false rumors about the health of the firm.

Answer: TRUE

11) One factor explaining the rapid growth in mutual funds is that they are financial

intermediaries that are not regulated by the federal government.

Answer: FALSE

21.3 Essay

1) Explain how rulings by the courts and regulators have made the markets served by

both commercial and investment banks more competitive markets.

2) What services do investment bankers provide for firms that are issuing new

securities?

3) What is underwriting?

4) Explain why private placements of securities are an attractive way of raising funds

for some firms.

5) Describe the differences between brokers and securities dealers.

6) Explain the popularity of mutual funds.