QUIZ BOMB

Indicate whether the following statements are 'True' or 'False'. Support your answer with reasons.

1. Primary markets are markets where users of funds raise cash by selling securities to funds suppliers.

   True. In primary market, funds are raised by selling securities for example, selling of common stock and debt securities.

2. Secondary markets are markets used by corporations to raise cash by issuing securities for a short time period.

   False. Secondary market is the market where second hand securities for example common stock, preferred stock and bonds are traded. In case of Nepal, NEPSE is the secondary market.

3. In a private placement, the issuer typically sells the entire issue to one or only a few institutional buyers.

   True. In private placement, the firm sells the securities to the institutional buyers directly without the help of issue managers.

4. Financial intermediaries such as banks typically have assets that are riskier than their liabilities

   True. Bank's major assets are loans and major liabilities are deposits and they are more risky than their liabilities.

5. A derivative security is a security that has a maturity of greater than one year.

   False. Derivative security is the future contract and its value derives from the underlying assets and the maturity of the contract will be less than one year.

6. Financial market links savers and borrowers.

   True. Financial market links between savers and borrowers. Savers purchase the securities and borrower issues the securities in the financial market. For example, initial public offering market.

7. Financial intermediaries play the major role in the transfer of resources from spending units with surplus to those with deficits.

True. Financial intermediaries transfer the funds between borrowers and savers. For example, savers deposit money at bank and bank will provide to the other borrowers.

8. A credit union is a depository financial institution composed of members who have a common bond.

   True. Credit union is a depository institution composed of members who have a common bond. Members will deposit money and will take loan from the union. It is nonprofit depository institution.

9. Financial market is a place where funds are transferred from deficit units to surplus units.

   True. Financial market is a place where funds transferred between surplus units and deficit units.

10. Credit unions are contractual institutions; pension funds are depository institutions.

    False. Credit unions are depository institutions where members deposits money. On the other hand, pension funds are contractual institutions.

11. Households are the major source of funds to the financial system.

    True. Households are the major source of funds to the financial system because the households the saves the money in the financial system and borrows money from financial system in case of deficit.

12. The NEPSE is an example of a secondary market.

    True. NEPSE is an example of a secondary market where second hand securities (bonds and stocks) are traded.

13. The real interest rate is the increment to purchasing power that the lender earns in order to induce him or her to forego current consumption.

    True. The real interest rate on an investment is the percentage change in buying power of a rupee.

14. Simple interest calculations assume that interest earned is never reinvested.

    True. Simple interest calculations is based on no reinvestment of earnings.

15. An investor earned a 5% nominal rate of return over the year. However, over the year, prices increased by 2%. The investor's real rate of return was less than his nominal rate of return.

    True. Nominal rate = Real rate + inflation rate Or, 5% = Real rate + 2 Or, Real rate = 3%

16. Households generally supply more funds to the markets as their income and wealth increase, ceteris paribus.

    True. As the total wealth of financial market participants (household, business etc) increases the absolute rupee value available for investment purposes increases.

17. An increase in the perceived riskiness of investments would cause a movement up along the supply curve.

    False. As the risk of investment increases, it becomes more attractive to supplier of funds. At every interest rate the supply of loanable funds increases or the supply curve shifts down and to the right.

18. An increase in the marginal tax rates for all Nepalese taxpayers would probably result in reduced supply of funds by households.

    True. If the tax rates increases by government and the households must pay high taxes and savings will be lower and supply of funds will be lower and viceversa.

19. When the quantity of a financial security supplied or demanded changes at every given interest rate in response to a change in a factor, this causes a shift in the supply or demand curve.

    True. If the supply of securities changes with given interest rate, and decreases the value of the securities and this cause shift in the supply or demand curve.

20. An improvement in economic conditions would likely shift the supply curve down and to the right and shift the demand curve for funds up and to the right.

    True. When the economy is experiencing a period of growth, market participants are willing to borrow more heavily. Accordingly, at every interest rate the demand of loanable funds increase, or the demand curve shifts up and to the right.

21. The risk that a security cannot be sold at a predictable price with low transaction costs at short

notice is called liquidity risk.

True. If the security cannot be sold at a predictable price with given transaction cost at short notice is called liquidity risk. On the other hand, it is the risk of converting security into cash without any additional cost.

22. Convertible bonds will normally have lower promised yields than straight bonds of similar terms and quality.

    True. Convertible bonds is issued with lower coupon rate than straight bonds of similar terms and quality, therefore the promised yield will be lower because of lower coupon rate.

23. We expect liquidity premiums to move inversely with interest rate volatility.

    False. Liquidity premium is the premium paid for the long term maturity security because of lower liquidity. Higher the maturity period, higher will be the premium and vice versa.

24. Everything else equal, the interest rate required on a callable bond will be less than the interest rate on a convertible bond.

    False. Interest rate on convertible bond will be lower than the callable bond because convertible option reduces the coupon rate. On the other hand, callable bond is awarded by call premium when bond is called and no need to lower coupon rate.

25. The term structure of interest rates is the relationship between interest rates on bonds similar in terms except for maturity.

    True. Term structure of interest rates shows the relationship between the interest rates and maturity of the bond with similar quality.

26. The unbiased expectations hypothesis of the term structure posits that long-term interest rates are unrelated to expected future short-term rates.

    False. According to expectation hypothesis, long term interest rate is the geometric average of the short term interest rates.

27. The traditional liquidity premium theory states that long-term interest rates are greater than the average of expected future interest rates.

    True. According to liquidity premium theory, long term bond must be higher interest rate than short term bond because higher maturity bond provide higher liquidity premium for less liquidity.

28. According to the market segmentation theory short-term investors will not normally switch to intermediate- or long-term investments.

    True. According to market segmentation theory interest rate is determined by demand and supply of loanable funds in the each segment of market. For example, short term segment and long term segment. But investors will not switch from one segment to another segment.

29. The monetary base is the amount of coin and currency in circulation plus reserves.

    True. Monetary base = Coin + Currency in circulation + Reserves

30. The major asset of the central bank is currency outside banks and the major liability is Treasury securities.

    True. The major assets of the central bank is currency outside the bank and the major liability if Treasury securities sold by central banks.

31. Nepal Rastra Bank published monetary policy in every quarter like financial statements.

    False. Nepal Rastra Bank must published monetary policy once in a year after the publishment of annual budget.

32. An increase in Treasury securities held by the central bank leads to a decrease in the money supply.

    True. If central bank wants to decrease the money supply in the banking system, central bank issued the Treasury securities and collect the funds from the banking system and it decrease in the money supply in the banking system.

33. Central bank will increase interest rate of discount loan if the money is tight in the banking system.

    False. Central bank will increase interest rate of discount loan if the liquidity is high in the banking system.

34. Total reserve consists of required reserve plus excess reserve.

    True. Total reserve = Required reserve + Excess reserve

35. Money multiplier is the product of required reserve ratio and change in deposits.

    False. Money multiplier is the amount of money that banks generate with each rupee of reserves. Money multiplier = 1/required reserve ratio

36. Nepal Rastra Bank Act is related with controlling the banking system in Nepal.

    False. Central bank of the country is empowered by the Nepal Rastra Bank Act to regulate, monitor, and control the entire banking system in the economy.

37. BAFIA is related with the licensing and operating activities of the banking system of Nepal.

    True. BAFIA is issued with an objective of controlling and monitoring the entire commercial banks in Nepal.

38. Nepal Rastra Bank issue reserve repo to borrow money from the banking system.

    True. If NRB wants to borrow money from the banking system and control the money supply then NRB issue reverse repo.

39. All money market instruments are short-term debt.

    True. Money market securities are those securities having the maturity period of one year or less than one year.

40. Bankers' acceptances are used primarily for financing international trade.

    True. Banker acceptance is used in international trade though letter of credit. If the document is traded in the secondary market it is called banker acceptance.

41. The money market is a dealer market, not an exchange, and has no specific location.

    True. The money market is the dealer market where short term securities buy and sell and there is no specific location for this market.

42. Commercial banks are the major issuer and investor of money market securities.

    True. Commercial banks are involved in the all types of money market securities directly and indirectly so commercial bank is the major participants in the money market.

43. Reverse repos are contracts that require a firm to first sell securities with the agreement to buy them back in a short period at a higher price.

False. Repos are contracts that require a firm to first sell securities with the agreement to buy them back in a short period at a higher price.

44. Competitive bids in T-bill auctions require the bidder to specify only the quantity desired.

    False. In competitive bids of T-bills auctions the bidder must specify the quantity and price.

45. Non-competitive bidders in the Treasury security auctions pay the weighted average price of all accepted competitive bids.

    True. Non-competitive bidders in the Treasury security auctions must pay the price at the weighted average price of the accepted competitive bids.

46. Treasury bills are sold on a discount basis, with interest paid separately at maturity.

    False. Treasury bills are sold on discount and investors must pay less than par value at purchase time and will received face value at maturity and the difference amount is the discount for the issuer and returns for the investor.

47. For large corporations, commercial paper is more expensive but is a more assured alternative to bank borrowing.

    False. For large and blue chip corporation, commercial paper is less expensive sources of financing then bank borrowing.

48. Eurodollars are dollar denominated, foreign-owned deposits in U.S. banks.

    False. Eurodollars are the U.S. dollar fixed deposit having maturity period of 1 year or less than one year in the bank outside the USA.

49. Money market deals with Commercial paper.

    False. Money market deals with the short term securities having the maturity period of one year or less than one year. Commercial paper is also example of money market security and it is traded in money market.

50. Commercial paper is a long-term secured promissory notes issued by companies.

    False. Commercial paper is the money market security issued by blue chip corporation, having the maturity period of one year or less.

51. The bond equivalent yield is more than the discount yield of a treasury bill.

    True. First, the bank discount rate divides the rupees earned by the face value of the T-bills, while the bond equivalent yield divides by the amount paid for the bills. Second, the discount rate multiplies by 360 days, while the investment rate multiplies by 365. The discount rate yield is dividing by a bigger number and multiplying by a smaller number – in comparison with the bond equivalent yield. So, when applied to the same T-bills, the discount yield will always be smaller than the bond equivalent yield.

52. A treasury bill is less risky security.

    True. Treasury bill is issued by central bank on behalf of government and it is less risky among other money market securities because of zero default risk.

53. A repurchase agreement arises when one party sells a security to another party without an agreement to buy it back.

    True. A repurchase agreement (Repo) arises when one party sells a security to another party without an agreement to buy it back. The security used as collateral and the government securities are used for collateral.

54. A treasury bill is an interest bearing instrument.

    False. Treasury bill is discount bearing instrument which is sold on discount basis i.e. sold at less than par value.

55. A discount bond always sells below par value.

    True. Discount bond is selling at lower than par value.

56. Money market is a market for short-term security.

    True. Money market is the market where short term security having short term maturity, high liquidity, low default risk and low transaction cost security are traded.

57. Money market instruments cover a maturity of more than one year.

    False. Money market instruments are those securities having the maturity of one year or less than one year.

58. Discount papers use purchase price as a base price.

    False. False discount paper uses face value as base price to calculate yield because discount yield is the nominal yield and it is always based on face value.

59. Money market instruments carry high degree of marketability.

    True. Money market instruments issued by government and blue chip corporations and carrying high level of marketability or high liquidity.

60. Treasury bills issued by Government of Nepal are traded in Nepal Stock Exchange.

    False. Treasury bills is not traded in the NEPSE. It is traded through dealer.

61. A T-bill with a face value of Rs 10,000 is purchased for Rs 9,850. If maturity of the bill is 45 days, the discount yield of the bill will be 12 percent.

    True. **True.** T discount rate is 12%.

    Discount rate = $\frac{FV - P}{FV} \times \frac{360}{t} = \frac{\text{Rs } 10{,}000 - \text{Rs } 9{,}850}{\text{Rs } 10{,}000} \times \frac{360}{45} = 0.015 \times 8 = 0.12$ Or 12%

62. Individual and family participates in money market because it deals with small size funds.

    False. Individual and family are the important participants in the money market. Individual and family participates in the money market as savers or investors and borrowers.

63. Money market securities are all debt securities, while capital market securities are either debt or equity securities.

    True. Money market securities are all debt securities having the maturity period of one year or less than one year. On the other hand, capital market securities are the securities having the maturity period of more than one year. Capital market securities included long term debt and equity securities.

64. Discount yield and coupon equivalent yield become same if both of them use a year of 360 days.

    False. First, the bank discount rate divides the rupees earned by the face value of the T-bills, while the bond equivalent yield divides by the amount paid for the bills. Second, the discount rate multiplies by 360 days, while the investment rate multiplies by 365. The discount rate yield is dividing by a bigger number and multiplying by a smaller number – in comparison with the bond equivalent yield. So, when applied to the same T-bills, the discount yield will always be smaller than the bond equivalent yield.

65. If interest rates increase, the value of a fixed income contract decreases and vice versa.

    True. There is inverse relationship between value of fixed income securities and interest rates. Higher the interest rate, lower the value of fixed income securities and vice versa.

66. At equilibrium a security's required rate of return will be less than its expected rate of return.

    False. At equilibrium, security's required rate of return must be equal with its expected rate of return. Investment decision will be no action or indifferent in this case.

67. If a security's realized return is negative, it must have been true that the expected return was greater than the required return.

False. If the expected return is greater than the required rate of return, the security's realized return is positive because the security is undervalued in this case and undervalued security will provide positive return.

68. Suppose two bonds of equivalent risk and maturity have different prices such that one is a premium bond and one is a discount bond. The premium bond must have a greater expected return than the discount bond.
False. Discount bond provide higher expected return because this bond is purchased at less than par value and received par value at maturity. On the other hand, premium bond is purchased at higher than par value and received par value at maturity and expected return will be lower in this case.

69. A bond with an 11% coupon and a 9% required return will sell at a premium to par.
True. Premium bond is that bond which is selling at higher than par value. For bond selling higher than par value, required return must be lower than the coupon rate. i.e. coupon rate (11%) > required return (9%).

70. A fairly priced bond with a coupon less than the expected return must sell at a discount from par.
True. The expected return from this bond is higher than coupon rate, therefore the bond must be sell at discount.

71. All else equal, the holder of a fairly priced premium bond must expect a capital loss over the holding period.
True. Premium bond is purchased with higher price than par value and it can be sold less than purchased price for the given holding period. So, the investor expect loss by selling this bond before maturity.

72. The longer the time to maturity, the lower the security's price sensitivity to an interest rate change, ceteris paribus.
False. Longer the maturity period, higher the sensitivity of the price due to change in interest rate change than short term bond.

73. The greater a security's coupon, the lower the security's price sensitivity to an interest rate change, ceteris paribus.
True. Higher the coupon rate, lower will be the security's price sensitivity to an interest rate change than lower coupon rate.

74. For a given interest rate change, a 20-year bond's price change will be twice that of a 10-year bond's price change.
True. For a given interest rate change, a 20 year bond’s price change will be approximately twice that of a 10 year bond’s price change.

75. Any security that returns a greater percentage of the price sooner is less price-volatile.
True. If any security that returns a greater percentage of the price sooner than the price of the security is less volatile because of returns are received earlier.

76. The lower the level of interest rates, the greater a bond's price sensitivity to interest rate changes.
True. If the level of interest rate is lower, the bond’s price sensitively to interest rate change will be higher and vice versa.

77. Ignoring default risk, if a bond's expected return is greater than its required return, then the bond's market price must be greater than the present value of the bond's cash flows.
False. If a bond’s expected return is greater than its required rate of return, the intrinsic or present value of bond must be greater than market price. This situation of bond is known as undervalued bond.

78. TIPS are a Treasury offering that protects investors from unexpected increases in inflation.
True. Treasury Inflation Protected Securities (TIPS) are securities that protects investors from unexpected increases in the inflation. Inflation is adjusted in par value and coupon is calculated from adjusted par value.

79. A callable bond is one where the issuer is required to retire a certain amount of the outstanding bonds each year to ensure that all the bond principle is paid by final maturity.
False. Callable bond is the bond that can be called by company at given time period at given call price.

80. Treasury notes and bonds and municipal bonds are default risk free.
False. Treasury notes and bonds are default risk free securities which is issued by government. On the other hand, municipal bond is less default risk free because it is issued by state and local government.

81. T-notes and T-bonds are issued in minimum denominations of $1,000 or multiples of $1,000.
True. T-notes and T-bonds are issued with the face value of $1,000.

82. The dirty price plus accrued interest is called the clean price of the security.
False. Dirty price consists of clean price and accrued interest.

83. Accrued interest owed to the bond seller increases as the next coupon payment date approaches.
True. If the next coupon payment date approaches then the accrued interest owned increases and accrued interest owned increases because interest calculation time is increases.

84. Revenue bonds are backed by the full revenue of the municipality.
False. Revenue bond are backed by the revenue generated by the specific project . On the other hand, general obligation bond are backed by the full revenue of the municipality.

85. In a Treasury bond quote with a $1000 face value, you find the bid is equal to 100:24 and the ask is equal to 100:26. You could buy this bond for $1008.125.
True. Buying price is asked price. Asked price = (100 + 26 × 1/32) = $1008.125.

86. An unsecured bond that has no specific collateral other than the general creditworthiness of the issuing firm is called a debenture.
True. Debenture is the unsecured debt issuing without any collateral.

87. With TIPS, the security's coupon rate is changed every six months by the inflation rate as measured by the CPI.
False. With TIPS, the principal amount on these bonds is adjust4ed in proportion to increases in the CPI. and coupon payment is calculated from the adjusted face value every six month.

88. Bond ratings use a classification system to give investors an idea of the amount of default rate risk associated with the bond issue.
True. Bond ratings measure the default risk associated with the bond issue. High classification means lower default risk and vice versa.

89. Bonds rated below Baa by Moody's or BBB by S&P are junk bonds.
True. Bond rated below Baa or BBB are considered as junk bonds and bond rated Baa or BBB and above are considered as investment grade bonds.

90. Eurobonds are bonds denominated in the issuer's home currency, but are issued outside their home country.
True. A eurobond is a bond denominated in a currency not native to the issuer's home country. Eurobonds are commonly issued by governments, corporations, and international organizations.

91. Callable bonds have lower required yields than similar convertible bonds, ceteris paribus.

False. Required yield will be lower for convertible bonds because convertible bonds provide sweetener to the issue with lower coupon rate.

92. Loans comprise the single largest asset category for a bank.
True. Commercial bank is the high leverage company and it comprise largest amount of loan assets in the assets.

93. Banks have an average total debt ratio of about 90%.
True. Bank is the high leverage company and its average debt ratio is about 90 percent of total assets.

94. On average, bank liabilities tend to have shorter maturities and greater liquidity than bank assets.
True. Bank liabilities consist of deposits and major type of deposit is savings deposits and which is highly liquidity and shorter maturity.

95. Non-transaction deposits at banks include NOW accounts and demand deposits.
False. A transaction account is an account from which the depositor or account holder is permitted to ''make transfers or withdrawals by negotiable or transfer- able instrument, payment order of withdrawal, telephone transfer, or other similar device for the purpose of making payments or transfers to third persons or others or from which the depositor may make third-party payments at an automated teller machine or a remote service unit, or other electronic device, including by debit card

96. Banks have higher leverage than most manufacturing firms.
True. Bank is high leverage company. In average bank uses 90 percent debt financing.

97. Loans to consumers and to individuals are jointly termed C&I loans on a bank's balance sheet.
False. Loans to consumers and individuals are shown separately in the balance sheet.

98. MMDAs are a type of savings account that has some limited checking features. These accounts were designed to help banks compete with MMMFs.
True. A money market account (MMA) or money market deposit account (MMDA) is a deposit account that pays interest based on current interest rates in the money markets.[1] The interest rates paid are generally higher than those of savings accounts and transaction accounts; however, some banks will require higher minimum balances in money market accounts to avoid monthly fees and to earn interest.

99. The provision for loan loss account is actual loan losses less loan recoveries in a given time period.
False. Loan loss provision is an expense set aside as an allowance for uncollected loans and loan payments. This provision is used to cover a number of factors associated with potential loan losses including bad loans, customer defaults and renegotiated terms of a loan that incur lower than previously estimated payments. Loan loss provisions are an adjustment to loan loss reserves and can also be known as valuation allowances.

100. The allowance for loan and lease losses is bank management's estimate of the amount of gross loans and leases that will not be repaid to the bank.
True. The Allowance for Loan and Lease Losses (ALLL), formerly known as the reserve for bad debts, is a calculated reserve that financial institutions establish in relation to the estimated credit risk within the institution's assets.

101. In ratio analysis, the profit margin times the asset utilization ratio equals return on assets.
True. ROA = Profit margin × Asset utilization according to Dupont equation.

102. Loans are the major item on a bank's balance sheet, and they generate the largest amount of revenue.
True. Bank is the high leverage company and its major assets are loans and loans are the major earnings assets of the banks. Major income is the interest income of the bank.

103. Both retail and wholesale CDs are negotiable instruments despite their different denominations.
False. Retail and wholesale CDs are not negotiable instruments. Only negotiable CD (NCD) are negotiable and traded in the secondary markets.

104. Banks generally pay higher interest rates on NOW accounts than on MMDAs.
False. Interest rate on MMDA is set about money market instruments which is higher than NOW account.

105. Wholesale CDs obtained from an investment house rather than directly from a customer are referred to as brokered deposits.
True. Brokered deposits involve deposit brokers, who place these investment instruments in investors' hands. Banks sell deposits or certificates of deposit with large denominations to brokers, who then divide these huge amounts into smaller, more manageable "pieces." The brokers then resell these smaller denominations to their customers, sometimes even to qualified smaller banks. Brokered deposits are attractive to individuals and banks because they tend to offer higher than typical interest rates.

106. At almost all banks noninterest expense is greater than noninterest income; hence, the overhead efficiency ratio is usually greater than 100%.
False. The bank's overhead efficiency ratio is a measure of the bank's overhead (operational expenses) as a percent of its revenue.
Overhead efficiency ratio = Non-interest Expenses / Revenue
The lower the ratio, the better (50% is generally regarded as the maximum optimal ratio). An increase in the efficiency ratio indicates either increasing costs or decreasing revenues.

107. Banks are generally prohibited from making loans exceeding more than 15% of their own equity capital to any one company or borrower.
True. A s a rule banks cannot provide loan of more than 15% of equity capital to single borrower

108. A man has what he believes is a mild heart attack but he doesn't go to the hospital. Instead he calls his insurance agent and doubles the amount of his life insurance. This is an example of the moral hazard problem in insurance.

False. A moral hazard is a situation where a person or business will have a tendency to take risks or alter their behavior, because the negative costs or consequences that could result will not be felt by the person taking the risk. Simply stated, the financial cost or consequence will be felt by someone else.

For example, that person who maxed out their credit cards knew he would not have to pay for all the additional debt he was bringing on when he made the decision to file for bankruptcy protection. The credit card companies would simply have to take those charges as a loss since they wouldn't collect payment. The friend driving the vehicle carelessly was shifting all of the risk to his insurance company to pay for his poor decisions in how he parked or drove his car.

109. In a typical variable life policy the policyholder may vary the premium payments and the maturity date of the policy.

False. Variable life insurance is a permanent life insurance policy with an investment component. The policy has a cash value account, which is invested in a number of sub-accounts available in the policy. A sub-account acts similar to a mutual fund, except it's only available within a variable life insurance policy.

110. In a universal life policy the cash value of the contract grows at a fixed-rate set by the life insurer.

False. Under the terms of the policy, the excess of premium payments above the current cost of insurance is credited to the cash value of the policy. The cash value is credited each month with interest, and the policy is debited each month by a cost of insurance (COI) charge, as well as any other policy charges and fees drawn from the cash value, even if no premium payment is made that month.

111. A 65-year-old person has saved $1,250,000 and wishes to receive 10 annual annuity payments, beginning in one year. If the annuity rate is 5.75%, he can expect to receive $167,829 per year.

False. $PMT = PVA/PVIFA_{5.75,\,10\,(1 + 0.0575)}$ = Rs 1,250,000/ 7.4481 (1 + 0.0575) = Rs 1,250,000/7.8763 = Rs 158,703.96

112. Premiums on standard annual renewable term life will generally increase as the policyholder ages.

True. A form of term life insurance that offers a guarantee of future insurability for a set period of years, although premiums are paid every year on the basis of a one-year contract. As such, the premiums will rise over time as the insured person ages. This type of insurance is designed for short-term insurance needs.

113. Policy reserves are the primary asset of the typical life insurer.

False. Policy reserves are the primary liabilities of the life insurance company.

114. Life insurance policy reserves are the estimated current worth of expected future payouts.
True. Life insurance policy reserves are total estimated current worth of expected future payouts.

115. The cash surrender value of a life insurance policy is the present value of expected future payouts on the policy.
False. The cash surrender value is the sum of money an insurance company pays to the policyholder or annuity holder in the event his policy is voluntarily terminated before its maturity or the insured event occurs.

116. The primary asset for P&C insurers are bonds.
True. The primary asset for P& C insurers are bonds (government bond and corporate bonds).

117. For securities firms, income from investment management is more stable than income from underwriting or trading activities.
True. Income from investment management is more stable but income from the underwriting is more volatile because uncertainty of selling price of underwriting securities.

118. Diversified full-line investment banks act as both broker dealers and securities underwriters.
True. Diversified full line investment banks can work as broker, dealer and security underwrites.

119. In a best efforts offering, the investment banker acts as an agent for the issuer rather than as a principal.
True. In a best efforts offering, the investment banker act as an agent and they sold the securities on commission basis.

120. A market maker buys IBM at $185 for his own account and sells the stock later in the day at $187. He is acting as a broker in this transaction.
False. This transaction is done by dealers. Market maker is a dealer.

121. Buying large blocks of securities and holding them until the price rises sufficiently to warrant a sale is an example of pure arbitrage.
False. Pure arbitrate entails buying an asset in one market at one price and selling it immediately in another market at a higher price.

122. An example of a pure arbitrage strategy is to simultaneously buy and sell the same security in two different markets at different prices.

True. Pure arbitrate entails buying an asset in one market at one price and selling it immediately in another market at a higher price.

123. A stock broker acts as a principal on behalf of the customer.
False. Stock broker involves the trading of securities on behalf of individual who want to transact in the money or capital markets.

124. Cash management accounts offered by a securities firm allow investors to write checks on funds invested in money market securities.
True. Securities firms offer bank deposit like cash management accounts to individual investors. Most of these accounts allow customers the ability to write checks against some type of mutual fund account.

125. Program trading is the simultaneous buying and selling of at least 15 stocks worth a total of $1 million or more.
True. Program trading is defined by the New York Stock Exchange as the simultaneous buying and selling of a portfolio of at least 15 different stocks valued at more than $1 million, using computer programs to initiate such trades.

126. If you buy 100 shares of IBM stock in anticipation that earnings will increase by more than anticipated, you are engaging in what is termed a risky arbitrage.
True. Risk arbitrage involves buying securities in anticipation of some information release—such as a merger or takeover announcement or a central bank interest rate announcement. It is termed risk arbitrage because if the event does not actually occur— for example, if a merger does not take place or the central bank does not change interest rates—the trader stands to lose money.

127. Angel venture capitalists have invested more in startup firms than institutional venture capital firms.
True. Angel venture capitalists (or angels) are wealthy individuals who make equity investments. Angel venture capitalists have invested much more in new and small firms than institutional venture capital firms.

128. The shares of a closed-end fund with market value of assets of $200 million and 2 million shares outstanding will always trade at a market value of $100 per share.
False. Its net assets value is 100. i.e. NAV = Total assets – liabilities/Shares outstanding
= (200 – 0)/2 = Rs 100; if the NAV is 100 then it is not necessary that the market price must be equal with NAV because closed end fund is traded at stock exchange and price will determine by demand and supply in the market.

129. If you invest $10,000 in a mutual fund with a NAV of $50 per share and a 5.5% back end load, you will receive less than 200 shares in the fund.

False. Number of shares can purchased = [10,000 (1 – 0.055)]/Rs 50 = 189 shares. Because of load fee investor can purchase only 189 shares.

130. The market value of a fund's net assets divided by the number of mutual fund shares outstanding is called the NAV of the fund.

True. NAV = (Total market value – Liabilities)/Shares outstanding

131. Open-end fund shares often trade at a discount or premium relative to NAV.

False. Only closed end funds traded at discount and premium relative to NAV because the shares of closed end funds are traded at stock exchange.

132. Load funds typically provide investors with higher rates of return and offer more services such as check writing, transfers between funds, etc., than no load funds.

False. Load funds decreases the amount of investment and it decreases the rate of return for the investors than no load funds.

133. A 12b-1 fee is an implicit load charge.

True. 12b-1 fees is the marketing expenses borne by mutual funds.

134. Of the different types of defined benefit plans, plans using the final pay method will usually produce the biggest retirement benefit to employees.

True. Final pay formula will produce highest retirement benefits to employees because this methods uses the average salary of last some years' which is higher than in other method.

135. A Keogh plan is designed for self-employed individuals.

True. A Keogh account is a retirement account available to self-employed individuals. Contributions by the individual may be deposited in a tax-deferred account administered by a life insurance company, a bank, or other financial institution. As with 401(k) plans, the participant in a Keogh account is given some discretion as to how the funds are to be invested.

136. Pension plans administered by the federal government are called insured pension plans.

False. Pension funds administered by life insurance companies (almost 30 percent of the industry's assets) are termed insured pension funds.

137. There are now Roth versions of 401(k) plans and 403(b) plans as well as Roth IRAs.

True.

Private defined benefit and defined contribution pension funds come in various types. Employees may participate in 401(k) and 403(b) plans, individual retirement accounts (IRAs), and Keogh accounts. 401(k) and 403(b) Plans.

138. Most state and local pension funds are unfunded.

True. Employees of state or local governments may contribute to pension funds sponsored by these employers. Most of these are funded on a "pay as you go" basis, meaning that contributions collected from current employees are the source of payments to the current retirees. As a result of the increasing number of retirees relative to workers, some of these pension funds have experienced a situation in which contributions have not been high enough to cover the increases in required benefit payments

139. Discount papers use purchase price as a base price.
True. Discount papers use purchase price as a base price because The initial price of any assets without the additional charges that may be added, such as handling or shipping charges, sales tax, optional equipment charges, etc.

140. The mortgage down payment increases the borrower's probability of loan default.
False. It is a portion of any mortgage agreements paid by borrower in advance that reduce the borrower's probability of loan default. A mortgage borrower who makes a large down payments is less likely to walk away from the houses should property values fall.

141. Credit unions are contractual institutions; pension funds are depository institutions.
False. Credit unions are depository institutions that directly accept deposit from their member and pension funds are non depository institutions.

142. Either you hold a seven year Treasury bond for seven years or a three year Treasury bond followed by a four year Treasury bond, the bonds are providing equal annual returns for seven years investment. In such situation unbiased expectation theory is correct.
True. According to this theory long term interest rate is the average of short term interest rate and forecasted future interest rate. Forward rates are unbiased estimators of future interest rates. So forward rates are calculated based on the principal that returns over a given period of time are all equal, no matter which maturities are held over that span of time.

143. Security Board of Nepal (SEBON) is an apex regulatory body in security market in Nepal.
True. It has been regulating the market under the Securities Act, 2006. The Governing Board of SEBON is composed of seven members including one full time chairman appointed by the Government for tenure of four years. Other members of the Board include joint secretary of Ministry of Finance, joint secretary of Ministry of Law, Justice and Parliamentary Affairs, representative from Nepal Rastra Bank, representative from Institute of Chartered Accountants of Nepal, representative from Federation of Nepalese Chambers of Commerce and Industries, and one member appointed by the Government from amongst the experts pertaining to management of securities market, development of capital market, financial or economic sector.

144. Lower interest rates discourage savings and reduce lending activities.
True. Interest rate is the return for supplier (savers) so that a rational investor always prefer higher level of return in his/her investment.
145. Market makers create secondary market for financial instruments.
True. In case of a company going public for the first time the investment bankers is under an obligation to maintain a market for the shares after the issue has been completed.

146. Individuals and family participates in money market because it deals with small size funds.
False. The purpose of money market is to meeting the short term cash needs of companies, individuals, and government as well as provides the opportunities to supply funds to investing low yielding assets. Money market serves the purpose of meeting the larger requirement of participants and thus generally sold the instruments in large denomination.

147. Investors strong desire for current consumption against future consumption cause to decline in real rate of return.
False. An investor always expect positive return from his/her investment so that return is the reward of sacrifice of present consumption for future consumption therefore Investors strong desire for current consumption against future consumption cause to increase in real rate of return.

148. Financial institutions become insolvent when value of equity drives to negative.
True. If the value of equity drives to negative, then there is high chance of insolvency of financial institutions.

149. The financial firms with more predictive cash flows maintain lower liquidity.
True. If financial firms can have more predictive cash flows than the firm maintain low level of liquidity.

150. Nepal stock exchange and securities board of Nepal are examples of secondary security market in Nepal.
False. NEPSE is a example of secondary market but SEBON is a regulatory body that regulate the NEPSE.

151. Every IPO requires approval from SEBON.
True. After receiving the approval from the registering of companies, the issue manager receive the approval from the SEBON for the purpose the issue manager with the consent of issuing company submit the prospectus and the required documents in the SEBON.

152. Money market securities are all debts securities, while capital market securities are either debt or equity securities.
True. Money market securities are all debt securities having the maturity period of one year or less than one year. Capital market securities are the securities having the maturities period of more than one year including long term debt and equity securities.

153. Low coupon bonds have lower price volatility than high coupon bonds.
False. A higher coupon means that more cash in the form of interest payments flows to the investor before maturity than is the case with a lower coupon bond. What this means is that when interest rates rise and future cash flows are discounted at a higher rate, the lower coupon bond has relatively more cash flow in the distant future, the maturity value of the bond

represents a greater portion of the total cash flow, and the bond's value today will fall relatively more. Thus, lower coupon bonds have more price volatility than high coupon bonds.

154. Potential effects of yield fluctuations on security prices and reinvestment income represents interest rate risk.
True. Interest rate risk is the composition of price risk and reinvestment risk. Price risk arises due to change in market interest rate and reinvestment risk is arises due to change in reinvestment rate.

155. According to expectation theory, if the market believes that interest rates are likely to decrease in the near future, it will lead to increase in the demand for long term securities.
True. According to the expectations hypothesis, if future interest rates are expected to rise, then the yield curve slopes upward, with longer term bonds paying higher yields. However, if future interest rates are expected to decline, then this will cause long term bonds to have lower yields than short-term bonds, resulting in an **inverted yield curve**. The inverted yield curve often results when short-term interest rates are higher than historical averages, since there is a greater expectation that rates will decline, so long term bond issuers would be reluctant to issue bonds with higher rates when the expectation is that lower rates will prevail in the near future.

156. A lender with fixed rate mortgage bears the risk of future inflation.
False. Fixed rate mortgage is a loan that is not affected by future inflation rate because a fixed rate mortgage locks in the borrower's interest rate and thus the required monthly payments over the life of the mortgage, regardless of how market rates change.

157. STRIPs are similar to zero coupon bonds.
True. A STRIP is a treasury security in which periodic coupon interest payments can be separated from each other and from the final principal payment. Each of the components of the STRIP are often referred to a treasury Zero bond or Treasury Zero coupon bond because inventor in the individual components only received the final single stripped payments such a third semiannual coupon in which they invest (i.e. STRIPs are issued by central bank on the basis of discount and investor will receive face value of STRIPs in single time at the end of maturity therefore STRIPs are similar to zero coupon bonds).

158. Creditworthiness of borrowers increases bargaining strength against financial institutions.
True. If customer is in high creditworthy then customer can bargain for the terms and conditions of the loan contract.

159. Underwriters do not guarantee of the issue they float.
False: If the issue is underwritten the investment banker agrees to buy the entire issue at a set price and then resell the stock at the offering price. Thus, the risk of selling the issue rests with the underwriters.

160. One good way for small investors to diversify their holdings is to purchase mutual funds.
True. By owning shares in a mutual fund instead of owning individual stocks or bonds, investment risk is spread out. The idea behind diversification is to invest in a large number of assets so that a loss in any particular investment is minimized by gains in others. In other

words, the more stocks and bonds an investor owns, the less is the risk of loss. Large mutual funds typically own hundreds of different stocks in many different industries. It wouldn't be possible for an investor to build this kind of a portfolio with a small amount of money.

161. A finance company in a recession would worry more about credit risk than interest rate risk.

True. There are two different sources of credit risk, one is specific risk (the firm specific credit risk arises from the default made by the borrowing firm associated with the specific types of project risk taken by the firm.) and systematic credit risk (the systematic credit risk is the risk of default associated with the general economic conditions affecting all borrowers). But financial company expose to interest rate risk when the maturities of its assets and liabilities are mismatched and interest rate volatile. Therefore, a finance company in a recession would worry more about credit risk then interest rate risk.

162. Keogh plans and IRAs are government sponsored retirement programs.

False. Keogh Plans and Individual Retirement Accounts (IRAs) are types of private pension funds because a Keogh account is a retirement account available to self employed individuals. Contribution by the individual may be deposited in a tax deferred account administered by a life insurance company, a bank as other financial institutions and IRAs is a self directed retirement accounts set up by employees who may also be covered by employer sponsored pension plans.

163. Thrift institutions generate revenues in the form of premiums paid by policyholders.

False. Thrift institutions are the small size depository institutions performing the jobs similar like commercial banks but more concentrate on residential mortgages and commercial loans. Therefore, thrift institutions (savings and loan association, savings bank and credit unions) generate revenues by accepting deposits and providing lending services to customers are the important financial services.

164. Foreign activities lower information costs to banks.

False. Foreign activities means international trade of banking sector lower information costs because foreign exchange traders are generally located in one larger trading room at a bank where bank have access to foreign exchange data and telecommunications equipment. Due to the interest based trading an ideal platform for foreign activities and online trading portals –

terminals where currency transactions are being executed are a low cost way of conducting spot and forward foreign exchange transactions.

165. Difference between interest income and interest expenses represent net interest margin.

False. The difference between interest income and interest expenses is net interest income. on the other hand, net interest margin is the ratio of net interest income and total assets.

166. Firms become conglomerates when independent corporate entities offered varieties of services under separate ownership.

True. Financial conglomerates consist of many pieces, each of which is itself a business engaged in providing some type of financial services. it is a firm offering mix of financial services that many range from banking related activities to real estate. these varied financial services may be

167. An affiliated bank is one that is partially owned but not controlled by its foreign parent.

True. An affiliate bank is one that is only partially owned but not controlled by its foreign parent (or international bank), but both subsidiary and affiliate banks operate under the banking laws of the country in which they are incorporated.

168. In a long run, bond price risk is not a problem but reinvestment risk is a considerable concern.

False. The risk that the returns on funds to be reinvested will fall below the cost of funds is called reinvestment risk. The risk that on assets sale price will be lower than its purchase price is called price risk. Therefore, in long run, there will be chance to increase interest rate ($k = k^* + IP + MRP$) than that of short run and price sensitivity of the bond with interest rate change, is higher to bond with longer maturity.

169. ROE of a bank has nothing to do with its leverage, the proportion of debt and equity.

False. ROE = Net profit margin × Assets turnover × Equity multiplier

Therefore, clearly ROE is directly related to profit margin, turnover and equity multiplier (leverage ratio). Therefore, decrease in any of these ratios may fall in ROE.

170. Credit risk diversification occurs when combining loans with similar payment patterns in a single portfolio.

False. Credit risk is concerned with risk that promised cash flows from loan and securities held by financial institutions may not be paid in full. Therefore, credit risk can be diversifying through credit analysis of real estate lending, small business lending, commercial lending and large commercial lending that measures applicants ability and willingness to pay, value of collateral and loan rate.

171. An investment in a 3 percent front-end load mutual fund with a Rs 20 NAV would cost the investors Rs 23.00.

Fasle. Load fee adjusted price is known as offering price or asked price.

Offering price = NAV/(1 – load fee) = Rs 20 /(1 – 0.03) = Rs 20.6186

172. There exists longevity risk in defined contributor pension plan.

True. Pension fund in which the employer agrees to make a specified contribution to the pension fund during the employee's working years. Thus defined contribution pension funds provide benefits to employees in the form of higher potential returns than offered by defined benefit funds but employees also must accept the increased risk of uncertain pension fund payouts. Therefore, defined contribution plan exists longevity and social security risk.

173. Major asset of the bank is non-financial asset such as buildings and machinery.

False. Loans made are the major assets of the commercial banks that generate the largest flow of revenue income.

174. Unlike commercial banks, finance companies only focus their loans to prime borrowers.

True. Finance companies provide short term loan whereas commercial banks provide longer term loans to prime customers. Commercial banks flows their loans for high quality customers, whereas finance companies services those sub-prime (high risky) borrowers deemed too risky for depository institutions.

175. Insurance companies easily reduce risk because they sell insurance policy to large number of policyholders who are dependent with each other.

False. Insurance companies are the most important non-depository financial institutions. They provide risk hedging facility to individuals and corporations. By pooling many independent risks, insurance companies significantly reduce the risk they bear, provided that they are well equipped to manage risk.

176. Disintermediation occurs when funds are deposited into banks and lent to borrowers.

False. Disintermediation is the withdrawal of funds from financial intermediaries by savers and the placement of those funds into financial assets through direct or semi-direct investments.

177. Equity management is major concerned of bank managers even the bank maintains low equity capital ratio.

True. Commercial bank must maintain 10 percent minimum equity capital but it is major concern to manage equity management because of immunizing portfolio of security. Any change in market interest rate directly affects their income and market values of assets and liabilities that result in change in value of equity. Thus, bank assets and liabilities are exposed to interest rate risk. So banks can manage their risk is immunize equity value by using duration.

178. Monetary policy first affects financial markets and institutions, then the real economy.

True. Monetary policy is related with to control money supply or expansion of money in economy through financial institutions and markets. Central bank of any country is regulates to control or expansion of money by using discount rate, reserve ratio and open market operations (i.e. buying and selling of Treasury bills). These all three tools can be only used in financial depository institutions) and markets.

179. Securitization is the process of transforming illiquid financial assets such as residential mortgages into marketable securities.

True. Loan securitization is the useful in improving the risk return trade off for financial institutions. Therefore, securitization is the process of turning assets into securities. Generally this involves an arrangement in which one party (the originates) sells a portfolio of assets, such as house mortgages or bank loans to a special purpose vehicle (the issuer), who finances the purchase by packaging the cash flows from these assets as tradable financial assets which are sold to the investors.

180. In financial markets, lenders typically have inferior information about potential returns and risks associated with any investment project. This difference in information is called asymmetric information.

True. The presence of transaction costs in financial markets explains, in past, why financial intermediaries play such an important role in financial market. An additional reason is that in financial markets, one party often does not know enough about the either party to make accurate decisions. This inequality is called asymmetric information. Asymmetric information arises two problems in financial institutions they are adverse selection and moral hazard.

181. ICRA Nepal works as credit rating agency in Nepal.

True. ICRA Nepal Limited (ICRA Nepal), the first Credit Rating Agency in Nepal, is a Subsidiary of ICRA Limited (ICRA) of India. It was incorporated on November 11, 2011 and granted licence by the Securities Board of Nepal (SEBON) on October 3, 2012. ICRA Nepal is supported by ICRA Limited through a Technical Support Services Agreement, which envisages ICRA helping ICRA Nepal in such areas as rating process & methodologies, analytical software, research, training, and technical & analytical skill augmentation.

182. NRB is the regulator of all Nepalese financial institutions.

False. NRB is the bank of bank that only regulates depository institutions. Financial institutions are divided into two parts on the basis of deposits, such as depository (institutions that takes deposit directly from customers like banks) and non-depository (e.g. insurance co, pension fund, providend fund, mutual funds etc.). But NRB is only regulate depository institutions (banking institutions).

183. The non-depository financial intermediary takes loans from commercial banks as source of fund and lend to other demanders.

False. Non-depository financial institutions can collect funds by selling their products. For example, insurance companies sells insurance policies to collect funds. Pension funds collect the funds from the contribution of employees and Mutual funds collect the funds by selling the shares to the public.

184. Expenses control efficiency ratio and return on equity are negatively related as banks use more debt and less equity capital.

False. ROE is the product of tax management efficiency ratio, expense control efficiency ratio, asset management efficiency ratio, and funds management efficiency ratio. If expense control efficiency increases then the ROE is also increases, thus there is positive relationship between ROE and expense control efficiency ratio.

185. A bank is stricter in lending criteria if it is playing in low spread.

True. Bank always try to increase net income. For high net income, the spread must be higher. Thus, bank will provide stricter in lending criteria.

186. Finance companies take more risk in their lending than that of commercial banks.

True. The primary function of finance companies is to make loans to individuals and corporations. Finance companies do not accept deposits, but borrow short- and long-term debt, such as commercial paper and bonds, to finance the loans. The heavy reliance on borrowed money has caused finance companies to hold more equity than banks for the purpose of signaling solvency to potential creditors. Finally, finance companies are less regulated than commercial banks, in part because they do not rely on deposits as a source of funds.

187. Average maturity of deposits of depository institutions is usually lesser than average maturity of loans given.

True. Depository institutions prefer to provide long term loans and deposits having the maturity of lower maturity periods than loan.

188. People under low income group can be benefited more from investment companies.

True. Buying a mutual fund is easy and the minimum investment is small. In the context of Nepal, the minimum investment amount is just Rs. 1,000. Mutual fund collected huge amount of money from number of small investors and then invested in large number of assets so that a loss in any particular investment is minimized by gains in others. In other words, the more stocks and bonds an investor owns, the less is the risk of loss. Large mutual funds typically own hundreds of different stocks in many different industries. It wouldn't be possible for an investor to build this kind of a portfolio with a small amount of money.

189. Insurance is more a risk management tools, so, in some cases, policyholders may pay more premium than what is provided as benefits by company.

False. Insurance companies are financial intermediaries because they collect and invest large amount of premiums; they provide means for accumulating savings and channelize these funds to various sectors. Insurance is a risk management technique. Insurance company will pay benefits to its beneficiaries which is higher than total premium paid because of time value of money.

190. Pension fund is a scheme that provides retirement benefits to retirees.

True. Pension fund set up by a corporation, labor union, government entity, or other organization to pay the pension benefits of retired workers. Pension funds invest annually in the stock and bond markets, and are therefore a major factor in the supply demand balance of the markets. Earnings on the investment portfolios of pension funds are tax deferred. Fund managers make actuarial assumptions about how much they will be required to pay out to pensioners and then try to ensure that the rate of return on their portfolios equals or exceeds that anticipated payout need.

191. It cannot be an international bank when it is established with 100% local investors.

True. An international bank is a financial entity that offers financial services, such as payment accounts and lending opportunities, to foreign clients. These foreign clients can be individuals and companies, though every international bank has its own policies outlining with whom they do business. International bank is established by distributing certain shares to the local people not 100%.

The end