***Financial Markets and Institutions, 7e* (Saunders)**

**Chapter 16 Securities Firms and Investment Banks**

1) For securities firms, income from investment management is more stable than income from underwriting or trading activities.

2) Diversified full-line investment banks act as both broker-dealers and securities underwriters.

3) An example of a national full-line investment banker that specializes in corporate finance is Goldman Sachs.

4) The process of creating a secondary market for securities or contracts is termed brokerage.

5) In a best efforts offering, the investment banker acts as an agent for the issuer rather than as a principal.

6) 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.

7) Buying large blocks of securities and holding them until the price rises sufficiently to warrant a sale is an example of pure arbitrage.

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

9) A stockbroker acts as a principal on behalf of the customer.

10) Cash management accounts offered by a securities firm allow investors to write checks on funds invested in money market securities.

11) Program trading is the simultaneous buying and selling of at least 15 stocks worth a total of $1 million or more.

12) 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.

13) Although an investor can write checks on a cash management account held with a broker, regulations prevent the use of ATMs or debit cards on these accounts.

14) Profitability at investment banking firms has been very stable each year since 2001.

15) The Securities Investor Protection Corporation protects investors against losses due to unfavorable market moves of up to $500,000.

16) Angel venture capitalists have invested more in start-up firms than institutional venture capital firms.

17) Brokerage commission income and stock market valuations tend to move inversely in most years, including in 2010.

18) FINRA is a government agency with mandate to protect America's investors by making sure the securities industry operates fairly and honestly.

19) An advantage of private placements is no requirement to register with the SEC since the placements are made only to large, sophisticated investors; therefore, the cost of issuance gets lower.

20) Firms underwriting securities assist corporate clients in selling them in secondary markets.

21) Diversified full-line securities firms engage in all but which one of the following?

A) Trading and brokerage of existing securities

B) Corporate restructuring and advice

C) Issuing new securities

D) Raising money via insured deposits

22) A best efforts offering is one in which

A) the underwriter bears the risk of an unsuccessful offering.

B) the bid-ask spread is exceptionally high, but the investment banker does his best to sell the issue anyway.

C) the investment banker acts as a principal for the issuer.

D) the investment banker acts only as a distribution agent.

E) the issue can only be privately placed.

23) If an underwriter overestimates the demand for a firm's securities in a firm commitment offering, the underwriter can

A) sell the shares back to the issuing firm at a discount.

B) lower the bid price to the issuing firm.

C) increase the fees charged to the issuing firm.

D) cancel the issue and refund the fees paid by the issuing firm.

E) None of these options are correct.

24) Investment firms that pool money from individuals and/or institutions and invest equity funds in start-up firms are called

A) top-tier bankers.

B) Section 20 affiliates.

C) venture capital firms.

D) ECNs.

E) discount brokerage houses.

25) You buy euros in New York from Deutsche Bank and simultaneously sell them in London to Barclays for a gain. This is an example of

A) position trading.

B) program trading.

C) risk arbitrage.

D) pure arbitrage.

E) hedging.

26) An unregistered issue sold to a few large institutional buyers is an example of a(n)

A) best efforts offering.

B) fully underwritten public offering.

C) shelf offering.

D) private placement.

E) SEC Rule 415 offering.

27) An investment banker agrees to a firm commitment offering of two million shares of Ace stock. The offer price is set at $55 and the spread is 50 cents per share. If the stock is actually sold to the public at $53.80, however, what is the investment banker's gain or loss?

A) $1,400,000 gain

B) $1,400,000 loss

C) $500,000 gain

D) $500,000 loss

E) None of these options are correct.

28) Day-to-day trading practices of securities firms currently may be regulated by which of the following?

I. FINRA

II. SEC

III. Federal Reserve

IV. SIPC

A) I only

B) II only

C) I and II only

D) I and III only

E) II and IV only

29) Firms in the securities industry are required to maintain a minimum capital to asset ratio of \_\_\_\_\_\_\_\_.

A) 2 percent.

B) 4 percent.

C) 6 percent.

D) 8 percent.

E) 10 percent.

30) An investment banker agrees to a firm commitment offering of 1.2 million shares of Bally stock. The offer price is set at $25.50 and the spread is 30 cents per share. If the stock is actually sold to the public at $26.00, however, what is the amount of funds Bally receives? (Ignore any other fees or expenses.)

A) $31,200,000

B) $30,600,000

C) $30,240,000

D) $29,280,000

E) $28,120,000

31) The major result of the NSMIA was to

A) reduce state regulatory powers over securities firms.

B) establish the SIPC.

C) create the NASD.

D) All of these choices are correct.

E) None of these choices are correct.

32) An investment banker agrees to a best efforts offering of 2.5 million shares of Crew stock. The offer price is set at $35 per share. If the stock is actually sold to the public at $34.50 and the banker charges a 3.45 cent commission per share sold, what is the amount of funds Crew receives? (Ignore any other fees or expenses.)

A) $88,750,000

B) $87,500,000

C) $86,163,750

D) $85,176,430

E) $84,122,560

33) \_\_\_\_\_\_\_\_ are examples of investment bankers offering traditional commercial banking services.

A) Online brokers

B) Cash management accounts

C) Underwriting corporate debt and equity offers

D) Venture capital funds

E) Mergers and acquisition services

34) The trading activity involving purchases of large blocks of securities on the expectation of a favorable price move over the next several weeks or months is called

A) program trading.

B) pure arbitrage.

C) day trading.

D) position trading.

E) hedging.

35) An entrepreneur looking for financing to get her small personally owned business up and running should probably consider

A) an IPO.

B) a seasoned stock offering.

C) a public debt offering.

D) a venture capitalist.

E) a syndicated loan.

36) Which one of the following statements about venture capitalists is not correct?

A) Venture capitalists contribute to equity financing rather than make loans.

B) Venture capitalists are passive investors.

C) Most private venture capitalists are organized as limited partnerships.

D) The federal government licenses some private firms to provide lower-cost funds to entrepreneurs.

E) Angel venture capitalists are wealthy individuals who fund business start-ups.

37) In 2016, the greatest dollar volume of U.S. corporate underwriting occurred for which type of security?

A) Straight corporate debt

B) Asset-backed debt

C) Common stock

D) Preferred stock

E) Convertible debt

38) The \_\_\_\_\_\_\_\_ insures losses of funds deposited with securities firms in the event of failure of a securities firm.

A) SEC

B) NASD

C) SIA

D) SIPC

E) FDIC

39) In 2016, the top five underwriters engaged in about \_\_\_\_\_\_\_\_ of total U.S. underwriting volume.

A) 15.8 percent

B) 22.4 percent

C) 26.7 percent

D) 44.7 percent

E) 56.2 percent

40) Which one of the following securities firms' activities is normally the most risky?

A) Best efforts offering

B) Private placement

C) Firm commitment offering

D) Pure arbitrage

E) Program trading

41) The largest asset on the typical broker-dealers' balance sheet in 2015 was

A) receivables from other broker-dealers.

B) long positions in securities and commodities.

C) reverse repurchase agreements.

D) repurchase agreements.

E) cash.

42) The largest liability of broker-dealers in 2015 was

A) bank loans payable.

B) short positions in securities and commodities.

C) subordinated debt.

D) repurchase agreements.

E) equity.

43) As a result of the alleged conflicts of interest between analysts and underwriting, which of the following changes were implemented?

I. Analysts cannot participate in nor attend certain presentations to potential investors conducted by investment bankers associated with underwriting an issue.

II. Analyst compensation can no longer be tied to the amount of underwriting business a firm generates.

III. Securities firms must divest stock research divisions to ensure independence from their investment banking business.

A) I only

B)  I and II only

C) I and III only

D) II and III only

E) I, II, and III

44) Underwriting new securities issuance requires that the investment bank

A) buys the issue at a certain price and then sells it in the primary market.

B) provides research and legal advice only to the issuing company.

C) buys the issue at a certain price and then sells it in the secondary market.

D) provides its best effort to sell the securities, the unsold portion goes back to the issuer.

E) purchases securities in the secondary market when they are undervalued.

45) When the investment banker sells the new securities on commission without guaranteeing the sale of the whole issue, the process is called:

A) Private placement

B) Best effort

C) Brokered sale

D) Underwriting

E) Syndicate offering

46) An investment manager directs a certain client's orders to a certain broker for execution in exchange for research from the broker. This arrangement is referred to as a:

A) Soft dollar arrangement

B) Best effort arrangement

C) Position trading

D) Private placement

E) Commission trades

47) Security dealers who will buy or sell securities at any time in the market are called:

A) Brokers

B) Program traders

C) Underwriters

D) Market makers

E) Dealers

48) A company issued 5 million new shares of stock. An investment bank agrees to underwrite these shares on a best efforts basis. The investment bank is able to sell 3.7 million shares for $34.50 per share, and it charges commission of $0.52 per share sold. How much money will the company receive?

A) $125,726,000

B) $127,650,000

C) $130,000,000

D) $169,900,000

E) $172,500,000

49) An investment bank agrees to pay $26.75 for 5 million shares of a company in a firm commitment stock offering. It then can sell those shares to the public for $25.50 per share. What is the profit to the investment bank?

A) Profit of $6,250,000

B) Loss of $6,250,000

C) Loss of $5,000,000

D) Loss of $7,500,000

E) Profit of $1,000,000

50) An investment bank agrees to underwrite a $100 million, 15-year, 10 percent semiannual bond issue for a company on a firm commitment basis. The investment bank pays the company on Monday and plans to begin a public sale on Tuesday. If interest rates rise 0.5 percent, or fifty basis points, overnight, what will be the impact on the profits of the investment bank?

A) $4,258,365; loss

B) $4,258,365; gain

C) $3,735,975; loss

D) $3,735,975; gain

E) $1,239,175; gain

51) What are the major types of firms in the investment banking industry? Briefly describe each.

52) Why is capital a more important measure of the size of a securities firm than the amount of assets? What other measures would be useful, given the diversity of this industry?

53) Describe an agency transaction (brokerage) and a principal transaction (dealer) that is involved in trading. What determines profits in each activity? Which is riskier?

54) Classify the following trading activities as either a position trade, a pure arbitrage trade, or a risk arbitrage trade.

I. Buy Intel at $120 and hold it for six months in hopes of a price rise.

II. Buy GE on the NYSE and immediately sell it at a higher price on the Pacific Exchange.

III. Short sell Dell in anticipation of a poor quarterly earnings report.

55) What are soft dollar fees or commissions? How can these lead to conflicts of interest for investment bankers?

56) Why did profitability of security firms drop precipitously in 2005 and rebound in 2006 only to fall again in 2007?

57) Darby Minerals wants to hire an investment banker to sell two million shares of stock to the public. Darby is considering using either a firm commitment or a best efforts offering.

(a) If Darby goes with a firm commitment, the offer price will be $15.00 per share and the spread will be 25 cents a share and all two million shares will be sold. The actual sale price to the public is $14.55.

(b) Suppose that Darby uses a best efforts offering. The actual sale price to the public is again $14.55 and the investment banker charges 4 cents per share sold as commission. Assume that in the best efforts offer only 1.85 million shares can be sold.

What are the proceeds to Darby from the sale of stock in the firm commitment and the best efforts and what is the investment banker's gain or loss in each case? Ignore any other costs and expenses.