

- _____ 1. When banks and other financial institutions fund long-term lending through short-term borrowing there is:
- a high leverage ratio
 - an interconnectedness externality
 - a procyclical capital requirement
 - d. maturity mismatch***
- _____ 2. When a bank or other financial institution has a high ratio of assets to capital, there is:
- a. a high leverage ratio***
 - an interconnectedness externality
 - a procyclical capital requirement
 - maturity mismatch
- _____ 3. Suppose that financial institutions must repay short-term lenders, so they sell assets. When many financial institutions are selling assets, the prices of assets fall. This leads financial institutions want to sell even more of their devalued assets. This phenomenon is called:
- a default swap
 - a debt overhang problem
 - c. a liquidity spiral***
 - a prompt corrective action
- _____ 4. Under the Basel II banking regulations, banks are required to raise their capital requirements when the risk of default on their assets increases. During a recession, there is usually a widespread increase in default risk. This phenomenon is an example of:
- a high leverage ratio
 - an interconnectedness externality
 - c. a procyclical capital requirement***
 - maturity mismatch
- _____ 5. A security that is a contract in which the seller insures protection against credit risk on some underlying security (for example, a security that provides insurance against default on a bond) is known as a:
- a. credit default swap***
 - collateralized debt obligation
 - mortgage-backed security
 - barrel option

- _____6. Which of these is the highest credit rating?
- a. A
 - b. AA
 - c. AAA**
 - d. AAAA
- _____7. A term used for risk to the financial system as a whole is:
- a. default risk
 - b. systemic risk**
 - c. market risk
 - d. covariance risk
- _____8. Any asset or a financial contract (such as an option or a credit default swap) that has a value that is obtained from the value of some other asset is called:
- a. an equity
 - b. a forward contract
 - c. a derivative**
 - d. a financial
- _____9. Under current practices
- a. credit rating agencies are paid by investors
 - b. credit rating agencies are paid by issuers of assets**
 - c. credit rating agencies are run by governments
 - d. credit rating agencies are financed by advertisements