Question #1 of 35

Regarding the impact on industry of regulation, regulation is *least* likely to:

A) increase the size of an industry.

B) benefit the industry being regulated.

C) reduce inefficiencies in the industry.

RRT is a small democratic country in the South Pacific. Due to advantageous taxation rules it has grown rapidly over the last ten years as an influx of overseas investment gave rise to a significant financial services industry. Tom Wiggins, CFA, covers RRT for the investment firm he works for in the U.S. He correctly predicted RRT's rapid expansion and as a result his monthly research reports are widely distributed. He was recently referenced in a major academic journal as shown in Exhibit 1.

Exhibit 1 – Journal Extract

"...Wiggins, a prominent analyst who covers RRT, predicted the rapid growth in GDP before any of his peers. What is remarkable is that the growth rate was demonstrably higher than the steady state growth rate predicted by the neoclassical model that he himself is a proponent of."

RRT is now facing a challenging period, however, as a high profile scandal has rocked the finance industry and is likely to lead to a series of sweeping reforms. The scandal centered on the two largest commodity futures exchanges which together processed 98% of commodity derivative transactions in the country. A whistleblower revealed that the market participants had colluded over a period of several years to keep spreads and commissions artificially high. There has also been a significant increase in insider trading cases, and an even more alarming increase in the number of such cases which have failed to result in a successful prosecution.

Regulation of the exchanges had been the responsibility of the Market and Trading Commission (MTC), a government agency which gained its authority from the Fair Market Trading Act (1992), a wide reaching but out-of-date piece of legislation that still governs the market today. The MTC in turn delegates responsibility to several other organizations. The two organizations that have been most heavily criticized as a result of the scandal are the Derivatives Trading Commission (DTC) and the Public Audit Commission (PAC).

The DTC is a self-regulating organization whose quoted mission is to 'protect market participants from abusive practices and promote transparent and competitive markets'. In carrying out this mission, the DTC has the power to prosecute under the Fair Market Trading Act and hand out fines of up to the equivalent of USD 50,000,000, in addition to custodial sentences.

The PAC was established by the previous government as a non-profit organization with the aim of overseeing the audit of all public companies. It is funded through a share of audit fees and staffed directly by the MTC.

The DTC has been criticized for failing to pick up on the market collusion and generally failing to utilize its powers to their full extent. The largest fine it has handed out to date is the equivalent of USD 2,500,000.

The PAC has had a troubled history since its formation. An independent review found that the audits of the companies accused of collusion failed to identify 'clear evidence' of collusion that they should 'reasonably' have been expected to uncover.

The PAC's response was that this kind of 'detective' work was not part of the statutory audit requirements and neither audit opinion was found to have been inappropriate.

The suggested reforms will take the form of a new piece of legislation to replace the Fair Market Trading Act (1992) and shake up the structure of market regulation. The reforms that Wiggins thinks will have the biggest impact if enacted are listed in Exhibit 2.

Exhibit 2 – Potential Reforms

Proposal 14a.3 Maximum Spread/Commissions on Futures Transactions

The government has suggested putting a ceiling on spreads and commissions to limit the potential for the two exchanges to exploit their duopoly. Wiggins thinks that the limits are very low and the government may end up having to subsidize losses that the companies may make. His opinion is that the government is using the scandal as an excuse to reduce trading fees and attract trading to the country from overseas.

Proposal 15b.1 New Insider Trading Regulation

A new piece of legislation will seek to extend the definition of insider trading to cover a much wider range of situations. Two of the most debated points are as follows:

- Individuals in a non-business relationship who trade when aware of material non-public information passed on by someone other than a close relative may now be prosecuted.

- Individuals who trade when aware of material non-public information even if the trade was planned before gaining such knowledge may now be prosecuted

Proposal 18.d.5 Increased Disclosure Requirements for Hedge Funds and Private Equity Funds

Historically requirements in this area have been limited. New rules will require a large increase in the amount of reporting required for both type of funds, with a fund's prospectus and annual results likely to be subject to an independent audit.

Question #2 of 35

In Exhibit 1, Wiggins' prediction of the higher than steady state growth rate:

A) is possible if the economy is opened up to world trade

B) is possible as long as the saving rate in RRT is higher than its trading partners

C) contradicts the neoclassical growth theory model

Question #3 of 35

Which of the following organizations is most likely to face conflict of interest issues?

A) The Public Audit Commission.

B) The Market and Trading Commission.

C) The Derivative Trading Commission.

Question #4 of 35

If Wiggins is correct about the government motivation for proposal 14a.3 in Exhibit 2, then this is most likely an example of:

A) Regulatory competition.

B) Regulatory capture.

C) Regulatory arbitrage.

Question #5 of 35

The new rules contained in proposal 15b.1 in Exhibit 2 are most likely examples of the government intervening in the markets using:

A) a restriction on activities.

B) a mandatory activity.

C) a price mechanism.

Question #6 of 35

The disclosure rules being implemented in proposal 18d.5 most likely suggest that:

A) regulations have historically focused on institutional investors.

B) regulations have historically taken a buyer beware approach for retail investors.

C) regulations have historically focused on retail investors.

Question #7 of 35

Which of the following statements is most likely correct regarding the approach a government typically takes to competition?

A) Antitrust laws typically aim to promote competition from overseas and restrict it domestically.

B) Antitrust laws typically aim to restrict competition from overseas and promote competition domestically.

C) Antitrust laws typically aim to restrict competition from overseas and domestically.

Question #8 of 35

Which of the following is *least likely* to be a purpose of regulating commerce:

A) Protect domestic industries from unfair foreign competition.

B) Preserve integrity of stock exchanges.

C) Restrict unfair competition.

Question #9 of 35

The requirement for firms to carry out an annual independent audit is best described as a regulation implemented to address:

A) sub-optimal allocation of resources.

B) externalities.

C) information asymmetry.

Question #10 of 35

Dan Garbutt is studying the burden of regulation that companies in Eglaria, a developing country in Europe, face. He has identified the following regulatory body that he feels places a large regulatory burden on the economy.

> *The Independent Auditing Review Panel (IARP)*
>
> *The IARP is recognized, but not funded by, the government of Eglaria. Funding is via a charge added to the mandatory annual audit for all public companies operating in Eglaria. The IARP's role is to ensure that audits are carried out to a high and consistent standard, and it has the power to revoke the auditing license of any company which it feels is not up to standard. The IARP is run by a board of ten members from a wide range of backgrounds, none of whom are licensed auditors.*

The IARP is *best described* as a:

A) independent regulator

B) government agency

C) self-regulating organization

Question #11 of 35

Which of the following statements is *most accurate* regarding the regulation of security markets?

A) Historically, regulations have focused on large investment schemes such as private equity funds, rather than on retail investors.

B) Regulations requiring the insurance of retail deposits at large banks may increase risk-taking incentives for the bank.

C) Most securities markets require investors to transact through intermediaries to reduce potential agency problems.

Question #12 of 35

Regulations are *least likely* needed under which of the following situations:

A) A small privately-held developing 'Apps' seeks equity investors to finance development of additional software.

B) A small investor is investigating a speculative stock and applies an incorrect growth estimate for the company's earnings.

C) A small town is experiencing large inflow of out-of- town visitors constraining street parking.

Question #13 of 35

After a recent financial crisis, Ruritania and all of its neighbors except one voted to enact stringent regulations prohibiting 100% mortgage loans. (A 100% mortgage is one where the borrower receives a loan amount equal to the total value of the property.) The Ruritanian government is now concerned that firms may leave Ruritania and base themselves in a country without the stringent regulation. This situation is *best described* as an example of:

A) regulatory capture.

B) regulatory burden.

C) regulatory arbitrage.

Question #14 of 35

Gordon Futona is evaluating the regulatory burden faced by a company he follows as an equity analyst. Futona makes the following two statements:

Statement 1	Prudential supervision is a regulatory tool governments may use to limit potential financial contagion.
Statement 2	Antitrust regulation may prevent two companies from merging, but has no power over the pricing policies of firms.

Which of Futona's statement(s) are correct?

A) Statement 2 only.

B) Both statements are correct.

C) Statement 1 only.

CDM is a small country in South East Asia that has seen significant growth in both GDP and GDP per capita over the last decade. Alain Toure runs a large equity fund for an investment house based in the UK and is currently reviewing macroeconomic and political data on CDM to assess its suitability for investment.

One of Toure's main concerns is whether the growth is sustainable. He is particularly interested in two factors which may have influenced recent growth – the size of the labor force and a large increase in tourism. Toure fears that neither factor appears to be sustainable.

Exhibit 1 shows the demographic data that Toure has used to study trends in the population and labor force over recent years.

Exhibit 1 – CDM Demographics

Year	Population (000s)	Participation Rate (%)	Percent of Population under 15	Percent of Population over 65
2000	11,290	72.4	39.50%	2.85%

2005	12,090	73.8	39.40%	2.80%
2010	12,943	78.2	39.20%	2.80%

Using the data in Exhibit 1, Toure draws two conclusions:

Conclusion 1

The population increased between 2000 and 2010 and this increase may explain the increase in the growth rate of GDP per capita over that period.

Conclusion 2

The participation rate increased between 2000 and 2010 and this is another potential reason for the increase in the growth rate of GDP per capita over that period.

Toure believes that the increase in the participation rate is due to a larger percentage of women gaining employment and cannot see this trend lasting indefinitely. In addition, he has concerns that the increase in tourism may falter due to several pieces of negative publicity concerning the two largest destinations in the country. Extracts from a trade journal covering the issues are shown in Exhibit 2:

Exhibit 2 – Tourism Press Articles

"Three Hospitalized in Gas Leak at East Coast Resort"

Three members of the same family were in hospital last night with suspected carbon monoxide poisoning. The suspected leak was from a hot water heating system in the under fire 'Smuggler's Cove' apartment complex. The leak follows three cases of illness which were reported in the last two months as a result of bacterial infections caused by swimming in the complex's indoor heated swimming pool. Health officials said a thorough review would be carried out and a decision on whether to close the complex was pending. A spokesman commented "If it is found that the leak was caused by equipment that does not meet the stringent legal safety standards enacted by the government in 2010, the strongest possible action allowed by the law will be taken."

"Government Seeks Tougher Regulation"

Government officials are meeting with tourism bosses this week as concern grows over mounting negative publicity surrounding the industry. A government source stated that "the rapid growth in the industry is obviously a welcome boost to the economy, but along with growth comes responsibility. There is a very real concern that tourists will turn away from the country unless their health and safety can be guaranteed." Two hotels in the last month have been closed down due to violations of health and safety laws passed by the government in 2010. However, Danish Li, head of the government's culture and tourism department, thinks more regulation is required. Li told tourism bosses that he favored the implementation of a strict code of conduct, written and enforced by a regulatory body made up of industry insiders. However, if this could not be agreed upon he was willing to set up a government agency with sweeping legal powers to oversee the industry and its development.

Toure's colleague Adam Deerstole is less skeptical about CDM's future growth potential, citing government investment in physical capital in the last decade as a reason for optimism. He believes the high levels of investment in capital will benefit CDM significantly as currently the capital per worker ratio is very low. However, Deerstole does admit to concerns that a large percentage of the investment has been in information, computers and technology (ICT) and that network externalities may limit the usefulness of this investment.

Deerstole also believes in the neoclassical growth theory, and that every economy has access to the same technology. Under this theory he believes that the CDM economy will catch up to developed economies and match them in per capita GDP levels as technological growth is endogenous.

Toure does not agree with Deerstole's model, as he believes the endogenous growth theory model better explains how an economy grows, and this theory does not predict any convergence of GDP. He therefore believes that encouraging private investment in new technology is a key factor in promoting growth as positive externalities from research and development mean that private companies often under invest in this area.

Question #15 of 35

Are Toure's conclusions regarding GDP per capita using Exhibit 1 *most likely* correct?

A) Only conclusion 2 is correct

B) Yes

C) Only conclusion 1 is correct

Question #16 of 35

If the Smuggler's Cove complex is shut down due to the carbon monoxide leak, this is *most likely* a result of a:

A) breach of industry standards

B) breach of administrative regulations

C) breach of statute

Question #17 of 35

The approach to regulation for the tourism industry suggested by Li is based on a:

A) Government agency

B) Self-regulating organization

C) Independent regulator

Question #18 of 35

Deerstole's comments about CDM's future growth prospects are *most likely*:

A) correct regarding the benefits of capital deepening for an economy with a low level of capital per worker and the risk that network externalities may reduce the impact of ICT

B) incorrect regarding the benefits of capital deepening for an economy with a low level of capital per worker and the risk that network externalities may reduce the impact of ICT

C) correct regarding the benefits of capital deepening for an economy with a low level of capital per worker but incorrect regarding the risk that network externalities may

---

Question #19 of 35

Deerstole's comments on the neoclassical model and the convergence of GDP are *most likely*:

A) incorrect as the model would not predict convergence of per capita GDP growth rate or GDP levels given the difference in population growth rate.

B) incorrect about technological growth being endogenous under neoclassical model.

C) correct.

Question #20 of 35

Toure's comments regarding endogenous growth theory are *most likely*:

A) incorrect as the endogenous growth theory predicts that all economies will eventually grow at the same rate due to the positive externalities associated with research and

B) correct.

C) incorrect as the constant returns to capital mean that companies will always invest optimally in research and development.

Question #21 of 35

Maldovia is a rapidly growing emerging market economy. To boost the level of capital per worker, the government allows for higher-than-previously allowed levels of depreciation expense for tax purposes on new equipment lowering the effective cost for the business.

This is an example of:

A) a price mechanism regulatory tool.

B) a provision of public good/financing private project regulatory tool

C) requiring certain activity regulatory tool.

Calisto is a developed market nation with large natural resources, oil and precious metals, with growing financial markets. Calisto is a stable constitutional monarchy with elected representatives as the legislative body, appointed and legislative-majority approved judges as the judicial body, and the ruling royal family as the executive body.

Calisto is a member of COPA, an alliance of three bordering countries, Calisto, Olaguay, and Peristan, that formed a regional monetary union. The COPA currency is known as the 'copa' with the symbol COP.

As part of Calisto joining COPA Calisto has standardized their regulations and regulatory institutions. Regulatory standardization among the three countries was part of the prerequisite for each to join. The standardization covers most major governmental agencies but does not cover all industries. Calisto anticipates having to bear additional costs and loss of productivity in some of their business sectors. Oil and precious metal extractions are expected to be affected by environmental regulations.

Calisto has adopted the COPA Financial Intermediaries Standards (COPA FIS). COPA FIS covers all financial institutions: (1) commercial banks, (2) exchanges for bonds, stocks, commodities and derivatives, and (3) insurance companies and pension entities. The COPA FIS were rewritten as legislation by Calisto's representatives and passed unanimously as the Financial Intermediaries Standards Act of 2001 (FISA).

Calisto restructured their financial regulatory institutions into three different organizations with each institution serving as government recognized self regulatory organizations (SRO) for oversight and enforcement for the industry.

- Commercial Banking Standards Board (CBSB) – regulates all commercial banking including capital requirements, underwriting standards for loans and investments. Often coordinates policy and procedures with the independent Central Bank of Calisto (CBoC).
- Exchange Trading Commission (ETC) – regulates all exchanges including margin requirements, counterparty stipulations, transactional information, transparency rules and market making standards.
- Insurance and Pension Oversight Committee (IPOC) – regulates all insurance and pension related matters.

One example of an ETC regulation is: All companies listed on the Calistose Stock Exchange are required to furnish audited financial statements on quarterly and annual basis prepared by Calistose accounting firms. The accounting standards of Calisto are a combination of US GAAP and IFRS that is used throughout COPA.

Before ETC rules and regulations, Calisto's equities markets were less liquid. The volume of trades have increased significantly since ETC has become the self regulatory organization for financial markets. More Calistose citizens are buying stocks and listing of both Calistose and foreign stocks has risen significantly over the last ten years (2002 – 2012).

Calisto	2002	2012	2022 (est.)
Population (in millions)	45.8	55.2	65.1
GDP (in $ billions)	$1,240.0	$2,000.0	$3,280.0

Effective Income Tax Rate	19.5%	20.4%	22.5%
Savings rate (average is 10.0%)	10.0%	9.8%	9.5%
Number of listed stocks	120	1200	2400

Calisto has a three tiered progressive income tax rates of 10%/20%/30%. Sales tax rates are 5% on most goods except food items and higher tax rates on snack foods, tobacco, alcohol and luxury imports. Most food items are not taxed. Government revenues are derived from taxes and oil revenues from government owned lands.

Tobacco and alcohol consumption in Calisto has been on the rise over the last years. Over the same time period smoking rates have fallen in Olaguay, and Peristan. Olaguay and Peristan both have higher tax rates on tobacco products, government warnings on tobacco packaging and anti-smoking marketing campaigns. Tobacco companies have purposefully targeted Calisto by lowering prices because of the higher demand. Calisto government health leaders will combat the higher smoking rates by adopting similar measures of their COPA members or creating a COPA regional policy.

Fines and penalties for insider trading are prohibitive high. Individuals who are fiduciaries and represent financial firms who are caught for insider trading can face more severe punishment for themselves and their firms.

Question #22 of 35

What type of regulation is the Financial Intermediaries Standards Act of 2001 (FISA)?

A) A judicial law.

B) An administrative regulation.

C) A statute.

Question #23 of 35

A possible economic rationale for Calistose increase in demand for equities is that the regulation intervention has lowered:

A) the savings rate.

B) informational friction.

C) externalities of public goods.

Question #24 of 35

The differences in the consumption of tobacco is *most likely* a result of:

A) regulatory arbitrage.

B) regulatory capture theory.

C) using pricing mechanisms.

Question #25 of 35

Which industry could possibly benefit from Calisto's regulatory changes?

A) Tobacco.

B) Accountancy.

C) Oil.

Question #26 of 35

The *most likely* reason for an increase in demand for equities stemming from ETC's regulations is that disclosure requirements lead to:

A) mitigation of agency issues.

B) higher investor confidence.

C) fiduciary responsibilities.

Question #27 of 35

The *least likely* tool of regulatory intervention of the anti-smoking campaign is:

A) warning labels as restricting certain activities.

B) higher taxes as a price mechanism.

C) anti-smoking advertisements as financing of private projects.

Question #28 of 35

Maldovia, an emerging market country in Latin America has joined a trade alliance. To comply with the terms of the alliance, Maldovian government is reducing farm subsidies and increasing taxes on environmentally unfriendly business practices in industrial waste treatment and mining industries.

Due to these changes, which Maldovian industries are least likely to shrink:

A) Airline

B) Food processing

C) Mining

Question #29 of 35

A Swiss company is looking to acquire their main competitor based in Singapore. This acquisition could create a company that represents 55% of the market share. An analyst following this industry must be aware of potential anti-trust regulatory issues in:

A) Switzerland.

B) Singapore.

C) both Singapore and Switzerland.

Question #30 of 35

To combat childhood obesity, the city of San Francisco, CA banned fast food restaurants to bundle free toys with kids menu choices deemed unhealthy. The restaurants simply allowed customers an option to purchase toys at an insignificant cost in lieu of including it free.

This is an example of:

A) Regulatory arbitrage

B) Regulatory failure

C) Regulatory capture

Question #31 of 35

Which of the following regulatory interventions is theoretically *least* effective?

A) Subsidizing the cost of environmentally friendly projects for small firms.

B) Imposing a punitive tax on the consumption of junk food to cut its consumption.

C) Requiring a company to pay a fine if annual financial statements are not filed in a timely fashion.

Question #32 of 35

"Net regulatory burden" is *best* defined as:

A) direct costs of implementation, plus the indirect cost of changes in economic behavior resulting from implementation.

B) direct costs of implementation, less private benefits resulting from implementation.

C) direct costs of implementation, less private benefits resulting from implementation, plus the indirect cost of changes in economic behavior resulting from implementation.

Question #33 of 35

A review of an existing regulation with a sunset clause has revealed that the net regulatory burden is less than the initial estimates. A possible reason for this is that:

A) private benefits were underestimated.

B) regulatory burden was underestimated.

C) indirect costs were underestimated.

Question #34 of 35

Self regulating organizations that are recognized by the government and are given regulatory powers:

A) are common in civil law countries.

B) may be susceptible to political pressures from members.

C) are less effective in carrying out regulatory objectives than are governmental agencies.

Question #35 of 35

Which of the following statements regarding self-regulating organizations is *least accurate*?

A) Non-independent self-regulating organizations may support a regulatory framework.

B) FINRA in the U.S. is an example of a self-regulating organization in the financial markets.

C) Self-regulating organizations are independent regulators.