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ECONOMICS OF  
REGULATION

1. Self regulating bodies that are recognized by the government and are given regulatory powers:
  - (A) may be susceptible to political pressures from members.
  - (B) are common in civil law countries.
  - (C) are less effective in carrying out regulatory objectives than are governmental agencies.
  
2. Which of the following statements is most accurate regarding the regulation of security markets?
  - (A) Most securities markets require investors to transact through intermediaries to reduce potential agency problems.
  - (B) Regulations requiring the insurance of retail deposits at large banks may increase risk-taking incentives for the bank.
  - (C) Historically, regulations have focused on large investment schemes such as private equity funds, rather than on retail investors.
  
3. 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) Singapore.
  - (B) Switzerland.
  - (C) both Singapore and Switzerland.
  
4. Regulations are least likely needed under which of the following situations:
  - (A) A small town is experiencing large inflow of out-of-town visitors constraining street parking.
  - (B) A small privately-held developing 'Apps' seeks equity investors to finance development of additional software.
  - (C) A small investor is investigating a speculative stock and applies an incorrect growth estimate for the company's earnings.

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5. Moldova 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) requiring certain activity regulatory tool.
  - (B) a price mechanism regulatory tool.
  - (C) a provision of public good/financing private project regulatory tool.
6. The requirement for firms to carry out an annual independent audit is best described as a regulation implemented to address:
- (A) externalities.
  - (B) information asymmetry.
  - (C) sub-optimal allocation of resources.
7. 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) Both statements are correct.
  - (B) Statement 1 only.
  - (C) Statement 2 only.
8. Which of the following statements regarding self-regulating bodies is least accurate?
- (A) FINRA in the U.S. is an example of a self-regulating organization in the financial markets.
  - (B) Self-regulating bodies are recognized by the government.
  - (C) Self-regulatory bodies are private organizations that both represent and regulate their members.
9. Which of the following regulatory interventions is theoretically least effective?
- (A) Subsidizing the cost of environmentally friendly projects for small firms.
  - (B) Requiring a company to pay a fine if annual financial statements are not filed in a timely fashion.
  - (C) Imposing a punitive tax on the consumption of junk food to cut its consumption.

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10. 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 capture
- (B) Regulatory arbitrage
- (C) Regulatory failure

11. Maldives, an emerging market country in Latin America has joined a trade alliance. To comply with the terms of the alliance, Maldivian 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 Maldivian industries are least likely to shrink:

- (A) Airline
- (B) Mining
- (C) Food processing

12. "Net regulatory burden" is best defined as:

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

13. 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.

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

- (A) Preserve integrity of stock exchanges.
- (B) Protect domestic industries from unfair foreign competition.
- (C) Restrict unfair competition.

15. 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
16. 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) indirect costs were underestimated.
  - (C) regulatory burden was underestimated.
17. 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 arbitrage.
  - (C) regulatory burden.

