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

**Chapter 13 Regulation of Commercial Banks**

1) Banks are generally prohibited from making loans exceeding more than 15 percent of their own equity capital to any one company or borrower.

Answer: TRUE

Difficulty: 2 Medium

Topic: Types of Regulations and the Regulators

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-01 Identify the types of regulations that commercial banks are subject to.

Accessibility: Keyboard Navigation

2) The layers of regulation imposed on banks to protect depositors against bank failure are termed credit allocation regulations.

Answer: FALSE

Difficulty: 1 Easy

Topic: Types of Regulations and the Regulators

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-01 Identify the types of regulations that commercial banks are subject to.

Accessibility: Keyboard Navigation

3) The CRA of 1977 and the HMDA of 1975 are examples of consumer protection regulations.

Answer: TRUE

Difficulty: 1 Easy

Topic: Types of Regulations and the Regulators

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 13-01 Identify the types of regulations that commercial banks are subject to.

Accessibility: Keyboard Navigation

4) The difference between the private costs of regulations and the private benefits for the producers of financial services is called the net regulatory burden.

Answer: TRUE

Difficulty: 1 Easy

Topic: Types of Regulations and the Regulators

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-01 Identify the types of regulations that commercial banks are subject to.

Accessibility: Keyboard Navigation

5) The quantity of notes and coin in the economy is called inside money but the bulk of the money supply is outside money.

Answer: FALSE

Difficulty: 2 Medium

Topic: Types of Regulations and the Regulators

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 13-01 Identify the types of regulations that commercial banks are subject to.

Accessibility: Keyboard Navigation

6) The Investment Company Act of 1940 and the Securities Acts of 1933 and 1934 are examples of investor protection regulations.

Answer: TRUE

Difficulty: 1 Easy

Topic: Types of Regulations and the Regulators

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 13-01 Identify the types of regulations that commercial banks are subject to.

Accessibility: Keyboard Navigation

7) A financial intermediary that can engage in a broad range of financial service activities is termed a universal FI.

Answer: TRUE

Difficulty: 1 Easy

Topic: Regulation of Product and Geographic Expansion

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-02 Review major bank regulations.

Accessibility: Keyboard Navigation

8) A securities subsidiary of a bank holding company that engages in investment banking is called a Riegle-Neal affiliate.

Answer: FALSE

Difficulty: 1 Easy

Topic: Regulation of Product and Geographic Expansion

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 13-03 Examine how commercial banks reentry into the investment banking business has evolved.

Accessibility: Keyboard Navigation

9) The Financial Services Modernization Act first allowed Section 20 affiliates.

Answer: FALSE

Difficulty: 1 Easy

Topic: Regulation of Product and Geographic Expansion

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-03 Examine how commercial banks reentry into the investment banking business has evolved.

Accessibility: Keyboard Navigation

10) The FDIC insures bank deposits and the OTS insures thrift deposits.

Answer: FALSE

Difficulty: 1 Easy

Topic: Bank and Savings Institution Guarantee Funds

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-03 Examine how commercial banks reentry into the investment banking business has evolved.

Accessibility: Keyboard Navigation

11) Unit banking states are states that do not allow interstate branch banking but allow the creation of intrastate branch banks.

Answer: FALSE

Difficulty: 2 Medium

Topic: Regulation of Product and Geographic Expansion

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-03 Examine how commercial banks reentry into the investment banking business has evolved.

Accessibility: Keyboard Navigation

12) The Financial Services Modernization Act allowed bank holding companies to open insurance underwriting affiliates and allowed insurance companies to open banks.

Answer: TRUE

Difficulty: 2 Medium

Topic: Regulation of Product and Geographic Expansion

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-03 Examine how commercial banks reentry into the investment banking business has evolved.

Accessibility: Keyboard Navigation

13) The Glass-Steagall Act came about due to concerns about excessive risk taking at banks and conflicts of interest between commercial and investment banking activities.

Answer: TRUE

Difficulty: 1 Easy

Topic: Regulation of Product and Geographic Expansion

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 13-03 Examine how commercial banks reentry into the investment banking business has evolved.

Accessibility: Keyboard Navigation

14) A bank holding company that only has one bank is termed a unit bank.

Answer: FALSE

Difficulty: 1 Easy

Topic: Regulation of Product and Geographic Expansion

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-03 Examine how commercial banks reentry into the investment banking business has evolved.

Accessibility: Keyboard Navigation

15) There were a greater number of bank failures from 1980 to 1990 inclusive than from 1934 to 1979.

Answer: TRUE

Difficulty: 2 Medium

Topic: Bank and Savings Institution Guarantee Funds

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-03 Examine how commercial banks reentry into the investment banking business has evolved.

Accessibility: Keyboard Navigation

16) The 1993 Basel Agreement explicitly incorporated the different credit risks of assets into capital adequacy measures.

Answer: TRUE

Difficulty: 1 Easy

Topic: Balance Sheet Regulations

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-07 Assess the capital regulations that commercial banks must meet.

Accessibility: Keyboard Navigation

17) Management of liquidity risk is the major reason why commercial banks are subject to reserve requirements.

Answer: TRUE

Difficulty: 1 Easy

Topic: Balance Sheet Regulations

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-06 Understand why commercial banks are subject to reserve requirements.

Accessibility: Keyboard Navigation

18) In United States, commercial banks are among the least regulated financial institutions.

Answer: FALSE

Difficulty: 1 Easy

Topic: Regulation of Product and Geographic Expansion

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-02 Review major bank regulations.

Accessibility: Keyboard Navigation

19) Periods of high interest rates create the disintermediation phenomena in commercial banks.

Answer: TRUE

Difficulty: 2 Medium

Topic: Bank and Savings Institution Guarantee Funds

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-04 Describe how and why the scope of deposits insured by the FDIC has changed.

Accessibility: Keyboard Navigation

20) FBSEA Act of 1991 extended federal regulatory authority over foreign banking organizations in the United States.

Answer: TRUE

Difficulty: 1 Easy

Topic: Global or international expansion activities

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 13-05 Compare regulations on U.S. commercial banks with those of other countries.

Accessibility: Keyboard Navigation

21) A bank that has an equity to asset ratio equal to 12 percent can normally lend no more than \_\_\_\_\_\_\_\_ of its assets to any one borrower.

A) 1.20 percent

B) 1.50 percent

C) 1.80 percent

D) 12.00 percent

E) 15.00 percent

Answer: C

Explanation: 0.15 × 12 = 1.8%

Difficulty: 2 Medium

Topic: Types of Regulations and the Regulators

Bloom's: Analyze; Apply

AACSB: Analytical Thinking

Learning Goal: 13-01 Identify the types of regulations that commercial banks are subject to.

Accessibility: Keyboard Navigation

22) The term *disintermediation* refers to

A) the policy of not closing insolvent institutions in hopes that they can eventually turn around their performance.

B) the withdrawal of deposits from depository institutions that are reinvested in other types of intermediaries.

C) the policy of regulating the minimum rate of return institutions can pay on deposits.

D) chartering restrictions that limit the ability of new banks to enter into a local market.

E) the policy of not allowing banks to grow by creating a de novo branch outside their traditional market area.

Answer: B

Difficulty: 2 Medium

Topic: Bank and Savings Institution Guarantee Funds

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 13-03 Examine how commercial banks reentry into the investment banking business has evolved.

Accessibility: Keyboard Navigation

23) The reduction in deposit funds cost to an individual bank brought about by government insurance is an example of the

A) social benefit of regulation.

B) private cost of regulation to DIs.

C) private benefits of regulation to DIs.

D) net regulatory burden.

E) None of these options are correct.

Answer: C

Difficulty: 2 Medium

Topic: Types of Regulations and the Regulators

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 13-01 Identify the types of regulations that commercial banks are subject to.

Accessibility: Keyboard Navigation

24) U.S. depository institutions may be subject to as many as \_\_\_\_\_\_\_\_ separate regulators.

A) four

B) five

C) six

D) seven

E) eight

Answer: A

Difficulty: 2 Medium

Topic: Types of Regulations and the Regulators

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-01 Identify the types of regulations that commercial banks are subject to.

Accessibility: Keyboard Navigation

25) FDIC deposit insurance is generally limited to \_\_\_\_\_\_\_\_ per depositor per bank.

A) $50,000

B) $100,000

C) $150,000

D) $200,000

E) $250,000

Answer: E

Difficulty: 1 Easy

Topic: Types of Regulations and the Regulators

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-01 Identify the types of regulations that commercial banks are subject to.

Accessibility: Keyboard Navigation

26) In the post-Depression era the largest number of bank failures occurred in which time period?

A) 1955–1965

B) 1965–1975

C) 1975–1985

D) 1985–1995

E) 1995–2005

Answer: D

Difficulty: 2 Medium

Topic: Bank and Savings Institution Guarantee Funds

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-03 Examine how commercial banks reentry into the investment banking business has evolved.

Accessibility: Keyboard Navigation

27) Major provisions of the Financial Services Modernization Act of 1999 include all of the following except

A) allowing bank holding companies to open insurance underwriting affiliates and vice versa.

B) allowing bank holding companies to open or merge with investment banks.

C) creating one regulator to oversee all activities of financial service firms.

D) All of these choices are correct.

E) None of these options are correct.

Answer: C

Difficulty: 1 Easy

Topic: Regulation of Product and Geographic Expansion

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-02 Review major bank regulations.

Accessibility: Keyboard Navigation

28) Which of the following would increase the value of a bank charter?

I. Tightening restrictions on new charters

II. Broadening the activities banks can engage in

III. Increasing reserve requirements

IV. Doubling capital adequacy requirements

A) I and II only

B) II only

C) III and IV only

D) I and IV only

E) II and III only

Answer: B

Difficulty: 2 Medium

Topic: Types of Regulations and the Regulators

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 13-01 Identify the types of regulations that commercial banks are subject to.

Accessibility: Keyboard Navigation

29) The law that largely repealed the Depression era banking laws was the

A) Depository Institution Deregulation and Monetary Control Act of 1980.

B) Financial Services Modernization Act.

C) FIRREA.

D) International Banking Act.

E) None of these options are correct.

Answer: B

Difficulty: 2 Medium

Topic: Regulation of Product and Geographic Expansion

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-03 Examine how commercial banks reentry into the investment banking business has evolved.

Accessibility: Keyboard Navigation

30) Which act led to interstate banking in the United States?

A) Glass-Steagall Act

B) DIDMCA

C) McFadden Act

D) Riegle-Neal Act

E) Financial Services Modernization Act

Answer: D

Difficulty: 1 Easy

Topic: Regulation of Product and Geographic Expansion

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-03 Examine how commercial banks reentry into the investment banking business has evolved.

Accessibility: Keyboard Navigation

31) Among other things, the Financial Institutions Reform, Recovery, and Enforcement Act stipulated the creation of the

A) FDIC.

B) OTS.

C) OCC.

D) Warren Commission.

E) CRA.

Answer: B

Difficulty: 2 Medium

Topic: Bank and Savings Institution Guarantee Funds

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-04 Describe how and why the scope of deposits insured by the FDIC has changed.

Accessibility: Keyboard Navigation

32) Areas of commercial bank regulation dealing with preventing banks from discriminating unfairly in lending are termed \_\_\_\_\_\_\_\_ regulations.

A) safety and soundness

B) consumer protection

C) investor protection

D) credit allocation

E) monetary policy

Answer: B

Difficulty: 2 Medium

Topic: Types of Regulations and the Regulators

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-01 Identify the types of regulations that commercial banks are subject to.

Accessibility: Keyboard Navigation

33) Areas of commercial bank regulation designed to encourage banks to lend to socially important sectors such as housing and farming are termed \_\_\_\_\_\_\_\_ regulations.

A) safety and soundness

B) consumer protection

C) investor protection

D) credit allocation

E) monetary policy

Answer: D

Difficulty: 2 Medium

Topic: Types of Regulations and the Regulators

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-01 Identify the types of regulations that commercial banks are subject to.

Accessibility: Keyboard Navigation

34) All banks located in the European Union offer deposits that are insured for \_\_\_\_\_\_\_\_ euros, although depositors are subject to a \_\_\_\_\_\_\_\_ in the event of loss.

A) 100,000; 2.5 percent insurance premium

B) 50,000; 95 percent recovery rate

C) 50,000; 10 percent deductible

D) 45,000; 5 percent fine

E) 75,000; 90 percent recovery rate

Answer: C

Difficulty: 2 Medium

Topic: Bank and Savings Institution Guarantee Funds

Bloom's: Remember; Understand

AACSB: Reflective Thinking

Learning Goal: 13-05 Compare regulations on U.S. commercial banks with those of other countries.

Accessibility: Keyboard Navigation

35) To be classified as an adequately capitalized bank, the bank must have a leverage ratio of at least \_\_\_\_\_\_\_\_ percent, Tier I capital to credit risk-adjusted asset ratio of at least \_\_\_\_\_\_\_\_ percent and a total capital to credit risk-adjusted assets ratio of at least \_\_\_\_\_\_\_\_ percent, and does not meet the definition of a well-capitalized bank.

A) 4; 6; 8

B) 5; 6; 10

C) 3; 3; 8

D) 4; 8; 4

E) 4; 6; 10

Answer: A

Explanation: See Table 13-3.

Difficulty: 3 Hard

Topic: Balance Sheet Regulations

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-07 Assess the capital regulations that commercial banks must meet.

Accessibility: Keyboard Navigation

36) To be well-capitalized, a bank must have a leverage ratio of at least \_\_\_\_\_\_\_\_ percent, Tier I capital to credit risk-adjusted asset ratio of at least \_\_\_\_\_\_\_\_ percent, and a total risk-based capital ratio of at least \_\_\_\_\_\_\_\_ percent.

A) 4; 4; 8

B) 5; 8; 10

C) 3; 3; 8

D) 4; 8; 4

E) 4; 6; 10

Answer: B

Explanation: See Table 13-3.

Difficulty: 3 Hard

Topic: Balance Sheet Regulations

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-07 Assess the capital regulations that commercial banks must meet.

Accessibility: Keyboard Navigation

37) The FDIC may require an undercapitalized bank to

I. provide the FDIC with a capital restoration plan.

II. cease acquiring brokered deposits.

III. obtain FDIC approval for all acquisitions.

IV. suspend dividends and management fees.

V. suspend payments on subordinated debt.

A) I and II only

B) III only

C) I, II, III, and IV only

D) I, II, III, IV, and V

E) I, II, III, and V only

Answer: C

Difficulty: 3 Hard

Topic: Balance Sheet Regulations

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-07 Assess the capital regulations that commercial banks must meet.

Accessibility: Keyboard Navigation

38) Recent regulation such as the Riegle-Neal Act of 1994 has removed some of the federal banking laws that formerly constrained profitable opportunities for commercial banks. The Riegle-Neal Act removes the major restrictions on banks' ability to \_\_\_\_\_\_\_\_.

A) diversify geographically

B) diversify their product line

C) engage in securities underwriting

D) engage in insurance underwriting

E) engage in loan brokerage

Answer: A

Difficulty: 1 Easy

Topic: Regulation of Product and Geographic Expansion

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-03 Examine how commercial banks reentry into the investment banking business has evolved.

Accessibility: Keyboard Navigation

39) Tier I (core) capital includes at least some part of which of the following?

I. Common stockholders' equity

II. Retained earnings

III. Subordinated debt

IV. Allowance for loan and lease losses

A) I only

B) I and II only

C) I and IV only

D) II and III only

E) I, II, III, and IV

Answer: B

Difficulty: 2 Medium

Topic: Balance Sheet Regulations

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-07 Assess the capital regulations that commercial banks must meet.

Accessibility: Keyboard Navigation

40) A bank has Tier I capital of $90 million and Tier II capital of $70 million. The bank has total assets of $2,522 million and risk-weighted assets of 2,017.6 million. This bank is

A) critically undercapitalized.

B) significantly undercapitalized.

C) undercapitalized.

D) adequately capitalized.

E) well-capitalized.

Answer: C

Explanation: TC/RWA = (90 + 70)/2,017.6 = 7.93%; Tier I/RWA = 90/2,017.6 = 4.46%; TC/TA = (90 + 70)/2,522 = 6.34%, the first ratio puts the bank in the undercapitalized zone.

Difficulty: 2 Medium

Topic: Balance Sheet Regulations

Bloom's: Understand; Analyze; Apply; Evaluate

AACSB: Analytical Thinking

Learning Goal: 13-07 Assess the capital regulations that commercial banks must meet.

Accessibility: Keyboard Navigation

41) Requiring foreign banks to operate under the same rules as domestic banks is termed

A) favored status.

B) IBA clause.

C) national treatment.

D) NAFTA.

E) post-patriotism requirement.

Answer: C

Difficulty: 1 Easy

Topic: Foreign Versus Domestic Regulation of Commercial Banks

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 13-05 Compare regulations on U.S. commercial banks with those of other countries.

Accessibility: Keyboard Navigation

42) In the United States, regulators currently use a \_\_\_\_\_\_\_\_ to calculate required reserve balances.

A) lagged reserve accounting system

B) contemporaneous reserve system

C) homoscedastic reserve system

D) two-day computation period

E) accrual accounting period

Answer: A

Difficulty: 2 Medium

Topic: Calculating Minimum Required Reserves at U.S. Depository Institutions

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-06 Understand why commercial banks are subject to reserve requirements.

Accessibility: Keyboard Navigation

43) Among other things, the \_\_\_\_\_\_\_\_ prohibits U.S. banks from providing banking services to foreign shell banks.

A) International Banking Act

B) Financial Services Modernization Act

C) USA Patriot Act

D) Foreign Bank Supervision Enhancement Act

E) Foreign Banking Activity Powers Enforcement Act

Answer: C

Difficulty: 2 Medium

Topic: Foreign Versus Domestic Regulation of Commercial Banks

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-05 Compare regulations on U.S. commercial banks with those of other countries.

Accessibility: Keyboard Navigation

44) The \_\_\_\_\_\_\_\_ introduced the prompt corrective action policy that requires federal intervention when a bank's capital falls below certain minimums.

A) Federal Deposit Insurance Corporation Improvement Act

B) Financial Services Modernization Act

C) USA Patriot Act

D) Foreign Bank Supervision Enhancement Act

E) Foreign Banking Activity Powers Enforcement Act

Answer: A

Difficulty: 1 Easy

Topic: Balance Sheet Regulations

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-07 Assess the capital regulations that commercial banks must meet.

Accessibility: Keyboard Navigation

45) Tier II (supplementary) capital includes which of the following?

I. Allowance for loan and lease losses, up to 1.25 percent of risk-weighted assets

II. Subordinated debt with original maturity of at least 5 years

III. Common stock and retained earnings

IV. Nontransaction deposits

A) II and III only

B) I and IV only

C) I and II only

D) I, II, and III only

E) I, III, and IV only

Answer: C

Difficulty: 2 Medium

Topic: Balance Sheet Regulations

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-07 Assess the capital regulations that commercial banks must meet.

Accessibility: Keyboard Navigation

46) The FDIC is required to establish a plan to restore the DIF if the reserve ratio falls below \_\_\_\_\_\_\_\_ of insured deposits.

A) 1.00 percent

B) 1.15 percent

C) 1.50 percent

D) 1.75 percent

E) 2.00 percent

Answer: B

Difficulty: 3 Hard

Topic: Bank and Savings Institution Guarantee Funds

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-04 Describe how and why the scope of deposits insured by the FDIC has changed.

Accessibility: Keyboard Navigation

47) Which act allowed the establishment of full-service financial institutions in the United States?

A) Riegle-Neal Act

B) Financial Services Modernization Act

C) USA Patriot Act

D) Foreign Bank Supervision Enhancement Act

E) Foreign Banking Activity Powers Enforcement Act

Answer: B

Difficulty: 1 Easy

Topic: Regulation of Product and Geographic Expansion

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-03 Examine how commercial banks reentry into the investment banking business has evolved.

Accessibility: Keyboard Navigation

48) The average daily net transaction accounts of a local bank during the most recent reserve computation period is $687 million. The amount of average daily reserves at the Fed during the reserve maintenance period is $35.23 million, and the average daily vault cash corresponding to the maintenance period is $12.74 million. What is the average daily reserve balance required to be held by the bank during the maintenance period?

A) $40.12 million

B) $47.79 million

C) $54.64 million

D) $60.53 million

E) $62.34 million

Answer: B

Explanation: Reserve requirements = (0 × $15.2m) + ($110.2m − $15.2m)(0.03) + ($687m − $110.2m) (0.10) = 0 + $2.85m + $57.68m = $60.53 million

The target average daily reserve balance that the bank needs to maintain will be 60.53 − 12.74 = $47.79 million.

Difficulty: 3 Hard

Topic: Balance Sheet Regulations

Bloom's: Apply

AACSB: Analytical Thinking

Learning Goal: 13-06 Understand why commercial banks are subject to reserve requirements.

Accessibility: Keyboard Navigation

49) The average daily net transaction accounts of a local bank during the most recent reserve computation period is $687 million. The amount of average daily reserves at the Fed during the reserve maintenance period is $35.23 million, and the average daily vault cash corresponding to the maintenance period is $12.74 million. Is this bank in compliance with reserve requirements?

A) Yes, the bank has excess daily reserves of $2.45 million.

B) Yes, the bank has excess daily reserves of $11.71 million.

C) No, the bank is short on daily reserves by $12.56 million.

D) No, the bank is short on daily reserves by $4.36 million.

E) No, the bank is short on daily reserves by $9.17 million.

Answer: C

Explanation: The target average daily reserve balance that the bank needs to maintain is $47.79 million, this bank has only $35.23 million average reserve at the Fed. The bank is short by $12.56 million to meet the requirement.

Difficulty: 3 Hard

Topic: Balance Sheet Regulations

Bloom's: Apply

AACSB: Analytical Thinking

Learning Goal: 13-06 Understand why commercial banks are subject to reserve requirements.

Accessibility: Keyboard Navigation

50) The average daily net transaction accounts of a local bank during the most recent reserve computation period is $589 million. The amount of average daily reserves at the Fed during the reserve maintenance period is $73.31 million, and the average daily vault cash corresponding to the maintenance period is $8.36 million. What is the average daily reserve balance required to be held by the bank during the maintenance period and is this bank in compliance with reserve requirements?

A) $42.37 million; yes

B) $46.79 million; yes

C) $55.14 million; no

D) $60.83 million; no

E) $62.11 million; no

Answer: A

Explanation: Reserve requirements = (0 × $15.2m) + ($110.2m − $15.2m)(0.03) + ($589m − $110.2m) (0.10) = 0 + $2.85m + $47.88m = $50.73 million

The target average daily reserve balance that the bank needs to maintain will be 50.73 – 8.36 = $42.37 million.

The target average daily reserve balance that the bank needs to maintain is $42.37 million. This bank has $73.31 million average reserve at the Fed. The bank meets the requirement.

Difficulty: 3 Hard

Topic: Balance Sheet Regulations

Bloom's: Apply

AACSB: Analytical Thinking

Learning Goal: 13-06 Understand why commercial banks are subject to reserve requirements.

Accessibility: Keyboard Navigation

51) Discuss the four layers of regulation designed to preserve the safety and soundness of DIs.

Answer:

* Imposing lending limits that require diversification.
* Implementing minimum capital requirements that provide a minimum level of protection against insolvency. Risk-based capital requirements force banks to monitor the amount of risk undertaken, particularly in generating growth.
* Providing deposit insurance which forces the government to monitor DI safety because of the large contingent liability created by the insurance. As a result, the FDIC has broad powers to force bank managers to limit risk.
* Requiring monitoring and surveillance including on-site examinations and regular reporting requirements help ensure compliance and maintenance of sound banking practices.

Difficulty: 3 Hard

Topic: Types of Regulations and the Regulators

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 13-01 Identify the types of regulations that commercial banks are subject to.

Accessibility: Keyboard Navigation

52) (a) What are the mandatory Prompt Corrective Action (PCA) Provisions for an undercapitalized bank? Explain why these provisions are required.

(b) Why does one of the mandatory PCA Provisions for a critically undercapitalized bank include appointing a receiver/conservator within 90 days?

Answer:

(a) The mandatory PCA provisions for an undercapitalized bank are as follows:

* Suspend dividends and management fees.
* Require a capital restoration plan.
* Restrict asset growth.
* Require approval for acquisitions.
* Prohibit use of brokered deposits.

These restrictions are designed to force the institution to quickly restore capital adequacy. Dividends reduce retained earnings and, hence, a dividend cut can help build equity more quickly. Bank managers should not be receiving large fees at an ailing bank. Restricting growth and acquisitions is needed because these can be risky activities that hide problems and allow poor asset allocation decisions to continue. Prohibiting brokered deposits restricts liquidity and, ultimately, growth. The capital restoration plan must be approved by the appropriate regulator and will have set time policies and time lines for restoring capital adequacy.

(b) The requirement to appoint a receiver or conservator even before bankruptcy occurs is used to prevent losses from growing. Once bank management makes the decision that the institution is likely to go bankrupt, managers may engage in high-risk activities, hoping they may "get lucky." This can make losses greater for the deposit insurer. This requirement was added because of the regulatory forbearance policies in place during the 1980s S&L crisis that allowed problem and even insolvent institutions to continue to operate and generate even larger losses that were eventually borne by the government.

Difficulty: 3 Hard

Topic: Bank and Savings Institution Guarantee Funds

Bloom's: Remember; Understand; Evaluate

AACSB: Reflective Thinking; Analytical Thinking

Learning Goal: 13-04 Describe how and why the scope of deposits insured by the FDIC has changed.

Accessibility: Keyboard Navigation

53) (a) A bank has risk-weighted assets of $175 and equity of $12.5. If regulators require a minimum risk-weighted capital ratio of 5 percent given the current level of equity, how many new assets with a 100 percent risk weight can the bank add? How many with a 50 percent risk weight?

(b) If the bank had 20 percent more equity, how many new assets with a 100 percent risk weight could the bank add? How many with a 50 percent risk weight? How does having more equity affect a bank's ability to grow? How is this growth affected by the riskiness of the bank's assets?

Answer:

(a) 100 percent risk weight

[$175 + New Assets] × .05 = equity

[$175 + New Assets] × .05 = $12.5

New Assets = $75

Maximum Total Assets = $250

50 percent risk weight

[$175 + 0.50 × New Assets] × 0.05 = equity

[$175 + 0.50 × New Assets] × 0.05 = $12.5

New Assets = $150

Maximum Total Assets = $325

(b) 100 percent risk weight

[$175 + New Assets] × .05 = old equity × 1.2

[$175 + New Assets] × .05 = $12.5 × 1.2 = 15

New Assets = $125

Maximum Total Assets = $300 (a 20 percent increase from before, thus demonstrating that having more equity allows a bank to grow)

50 percent risk weight

[$175 + 0.50 × New Assets] × 0.05 = Equity

[$175 + 0.50 × New Assets] × 0.05 = $15

New Assets = $250

Maximum Total Assets = $425 (For a given capital base, the bank can grow faster if it acquires lower risk assets.)

Difficulty: 3 Hard

Topic: Balance Sheet Regulations

Bloom's: Analyze; Apply; Evaluate

AACSB: Reflective Thinking; Analytical Thinking

Learning Goal: 13-07 Assess the capital regulations that commercial banks must meet.

Accessibility: Keyboard Navigation

54) Cite one law or regulation per each of the following categories:

Answer: Safety and Soundness Regulation

Monetary Policy Regulation

Credit Allocation Regulation

Consumer Protection Regulation

Investor Protection Regulation

Safety and Soundness Regulation: Many answers are possible here: Lending limits, minimum capital requirements, deposit insurance, risk-based deposit insurance premiums, on-site examinations

Monetary Policy Regulation: Reserve requirements

Credit Allocation Regulation: QTL test, SBA lending

Consumer Protection Regulation: Community Reinvestment Act, Home Mortgage Disclosure Act

Investor Protection Regulation: Investment Company Act, Securities Acts

Difficulty: 2 Medium

Topic: Types of Regulations and the Regulators

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-02 Review major bank regulations.

Accessibility: Keyboard Navigation

55) Why have some states placed restrictions on intrastate and interstate branches? What historical laws gave this right to states? What law changed these restrictions?

Answer: States have limited branching to protect small banks that feared that larger, more powerful banks would quickly force the small ones out of business. Some large banks that provided correspondent banking services to small banks also opposed branching, fearing a loss of correspondent business. The McFadden Act of 1927 originally gave the states the right to establish branching and interstate restrictions. The Douglas Amendment of the Bank Holding Company Act closed a potential loophole to interstate banking. In 1994, the Riegle-Neal Act allowed interstate branching via consolidation of affiliates or by merger.

Difficulty: 2 Medium

Topic: Regulation of Product and Geographic Expansion

Bloom's: Understand

AACSB: Reflective Thinking; Analytical Thinking

Learning Goal: 13-03 Examine how commercial banks reentry into the investment banking business has evolved.

Accessibility: Keyboard Navigation

56) Why were the FIRREA of 1989 and the FDICIA of 1991 passed? What were their major provisions? How did these laws differ from earlier acts of the 1980s?

Answer: These two important laws were passed to improve the safety and soundness of the thrift and banking industries. The FIRREA recapitalized the thrift insurance fund, eliminated the FSLIC, stripped the FHLBB of its power, and created the new Office of Thrift Supervision. It also eliminated deceptive accounting practices at savings associations and increased penalties for fraud. The FDICIA increased capital requirements at all depository institutions (DIs), set up prompt corrective actions for banks with insufficient capital, increased FDIC reserves, and created risk-based deposit insurance premiums. These laws were different from those of the early 1980s because they added restrictions to these industries instead of granting new powers to DIs.

Difficulty: 3 Hard

Topic: Bank and Savings Institution Guarantee Funds

Bloom's: Remember; Understand; Evaluate

AACSB: Reflective Thinking; Analytical Thinking

Learning Goal: 13-04 Describe how and why the scope of deposits insured by the FDIC has changed.

Accessibility: Keyboard Navigation

57) A financial service holding company operates a nationally chartered bank, an insurance firm, a securities firm, and a federal savings bank. Who is the primary regulator for this company? Explain.

Answer: Under the FSMA of 1999, financial conglomerates are functionally regulated. That is, the national bank would be regulated by the Federal Reserve and the Comptroller of the Currency, the insurance firm would be regulated by the appropriate state agency, the securities firm would be regulated by the SEC (and the NASD), and the federal savings bank would be regulated by the Office of Thrift Supervision.

Difficulty: 3 Hard

Topic: Regulation of Product and Geographic Expansion

Bloom's: Remember; Understand

AACSB: Reflective Thinking

Learning Goal: 13-03 Examine how commercial banks reentry into the investment banking business has evolved.

Accessibility: Keyboard Navigation

58) How do risk-based deposit insurance premiums and risk-based capital requirements help reduce the moral hazard problem of deposit insurance? (Hint: Moral hazard means that because of deposit insurance, banks may take on excessive amounts of risk.)

Answer: Both force bank managers to be cognizant of the risk level they are undertaking and impose a penalty function on managers who engage in additional risk. This helps replace the lost market discipline (higher borrowing rates for banks that take on more risk) brought about by deposit insurance and the "too big to fail" practice.

Difficulty: 2 Medium

Topic: Bank and Savings Institution Guarantee Funds; Balance Sheet Regulations

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 13-07 Assess the capital regulations that commercial banks must meet.; 13-04 Describe how and why the scope of deposits insured by the FDIC has changed.

Accessibility: Keyboard Navigation

59) What changes to foreign bank operations in the United States have been brought about by the Foreign Bank Supervision and Enhancement Act of 1991?

Answer:

* Entry: Foreign banks must now have the Fed's approval to establish a U.S. operation. The Fed will not grant such approval unless the foreign bank is subject to home country supervision. The Fed also requires the home country regulators to supply information about the applicant bank to the Fed.
* Closures: The Fed may close the U.S. operations of a foreign bank (as they did with Daiwa).
* Examinations: The Fed will examine each U.S. operation of a foreign bank.
* Deposit taking: Only foreign banks with access to FDIC insurance can take retail deposits.
* Activity powers: State-licensed foreign banks must adhere to federal standards.

Difficulty: 2 Medium

Topic: Foreign Versus Domestic Regulation of Commercial Banks

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 13-05 Compare regulations on U.S. commercial banks with those of other countries.

Accessibility: Keyboard Navigation

60) A Bank has the following balance sheet (in millions), with the risk weights in parentheses.

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Assets | | | | | Liabilities and Equity | | | | |
| Cash (0%) | $ | 19 |  |  | | Deposits | $ | 171 |  | |
| Mortgage loans (50%) | $ | 65 |  |  | | Subordinate debt (>5 years) | $ | 8 |  | |
| Consumer loans (100%) | $ | 115 |  |  | | Equity | $ | 16 |  | |
| Reserve for loan losses | ($ | 4 | ) |  | |  |  |  |  | |
| Total Assets | $ | 195 |  |  | | Total Liability and Equity | $ | 195 |  | |

In addition, the bank has $30 million in commercial direct-credit substitute standby letters of credit to a public corporation and $30 million in 10-year FX forward contracts that are in the money by $2 million.

a. What are the risk-adjusted on-balance-sheet assets of the bank as defined under the Basel III?

b. What are the common equity Tier I (CET1) risk-based capital ratio, Tier I risk-based capital ratio, and the total risk–based capital ratio?

c. Disregarding the capital conservation buffer, does the bank have sufficient capital to meet the Basel requirements?

Answer:

a. Risk-adjusted on-balance-sheet assets:

(19 × 0) + (65 × 0.5) + (115 × 1) = $147.5 million

b. Total risk-adjusted on- and off-balance-sheet assets = 147.5 + (30 × 1) + {[(30 × 0.075) + 0] × 1} = $180.75 million

CET1 capital = 16 million

Tier I capital = 16 million

Tier II capital = 28 million

CET1 Risk-based capital ratio = 16/180.75 = 8.85% > 6.5%

Tier I Risk-based capital ratio = 16/180.75 = 8.85% > 8%

Total Risk-based capital ratio = 28/180.75= 15.49% > 10%

c. Yes, the bank is well capitalized and does have sufficient total capital to meet the Basel requirements since the 3 ratios, common equity Tier I (CET1) risk-based capital ratio, Tier I risk-based capital ratio, and total risk–based capital ratio, are higher than the required Basel III levels for well capitalized level.

Difficulty: 3 Hard

Topic: Balance Sheet Regulations; Calculating Risk-Based Capital Ratios

Bloom's: Analyze; Apply; Evaluate

AACSB: Reflective Thinking; Analytical Thinking

Learning Goal: 13-07 Assess the capital regulations that commercial banks must meet.

Accessibility: Keyboard Navigation