***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.

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

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

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.

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

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

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

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

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

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

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

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

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.

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

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

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

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

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

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

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

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

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.

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.

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

A) four

B) five

C) six

D) seven

E) eight

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

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

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.

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

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.

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

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.

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

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

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

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

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

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

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

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

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.

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.

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

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

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

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

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

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

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

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.

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

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

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?

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?

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

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?

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?

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.

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.)

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?

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?