

Chapter Two

Financial Services: Depository Institutions

True/False

2-1 In recent years, the number of commercial banks in the U.S. has been increasing.

Answer: F

2-2 Most of the change in the number of commercial banks since 1990 has been due to bank failures.

Answer: F

2-3 Commercial banks have had limited power to underwrite corporate securities since 1987.

Answer: T

2-4 Large money center banks finance most of their activities by using retail consumer deposits as the primary source of funds.

Answer: F

2-5 Currently, federal standards do not allow investment banks to convert to a bank holding company structure.

Answer: F

2-6 Prior to the financial crisis of 2008, the return on equity for small community banks had been larger than for large money center banks.

Answer: F

2-7 Commercial banks with under \$1 billion in assets have become a larger segment of the industry in recent years.

Answer: F

2-8 Money center banks rely more heavily on wholesale and borrowed funds as sources of liability funding than do community banks.

Answer: T

2-9 Large banks tend to make business decisions based on personal knowledge of customers creditworthiness and business conditions in the local communities.

Answer: F

2-10 All banks with assets greater than \$10 billion are considered money center banks.

Answer: F

2-11 Since 1990, commercial banks decreased the proportion of business loans and increased the proportion of mortgages in their portfolios.

Answer: T

2-12 The growth of the commercial paper market has led to a decline in the demand for business loans from commercial banks.

Answer: T

2-13 The securitization of mortgages involves the pooling of mortgage loans for sale in the financial markets.

Answer: T

2-14 By converting to a bank holding company, an investment bank gains access to Federal Reserve lending facilities.

Answer: T

2-15 Large money center banks are often primary dealers in the U.S. Treasury markets.

Answer: T

2-16 Because of the large amount of equity on a typical commercial bank balance sheet, credit risk is not a significant risk to bank managers.

Answer: F

2-17 Lehman Brothers failed during the recent financial crisis despite having access to the low cost sources of funds offered by the Federal Reserve.

Answer: F

2-18 A major difference between banks and other nonfinancial firms is the low amount of leverage in commercial banks.

Answer: F

2-19 Money market mutual funds have attracted large amounts of retail savings and retail time deposits from commercial banks in recent years.

Answer: T

2-20 Retail nontransaction savings and time deposits comprise the largest portion of deposits for commercial banks.

Answer: T

2-21 Negotiable certificates of deposits are differentiated from fixed time deposits by their negotiability and active trading in the secondary markets.

Answer: T

2-22 The maturity structure of the assets of commercial banks tends to be shorter than the maturity structure of liabilities.

Answer: F

2-23 The growth in off-balance-sheet activities during the decade of the 1990s was due, in large part, to the use of derivative contracts.

Answer: T

2-24 The movement of an off-balance-sheet asset or liability is dependent on the occurrence of a contingent event.

Answer: T

2-25 The use of off-balance-sheet activities allows banks to practice regulatory tax-avoidance.

Answer: T

2-26 The use of off-balance-sheet activities and instruments will always reduce the risk to a bank.

Answer: F

2-27 Although growing, the notional value of bank OBS activities remained less than the value of on-balance-sheet activities at the end of 2009.

Answer: F

2-28 Commercial banks in the U.S. often are subject to several of the four regulatory agencies.

Answer: T

2-29 The dual banking system in the U.S. refers to the operation and establishment of large regional as well as small community banks.

Answer: F

2-30 As of December 2009, the number of nationally chartered banks was greater than the number of state chartered banks.

Answer: F

2-31 All commercial banks must be members of the Federal Reserve System.

Answer: F

2-32 Small banks make proportionately larger amounts of real estate loans than large banks.

Answer: T

2-33 The Federal Reserve System has regulatory supervision over all holding company banks whether they include national- or state-chartered banks.

Answer: T

2-34 The primary objective of the 1927 McFadden Act was to restrict interstate bank branching.

Answer: T

2-35 The primary objective of the 1933 Glass-Steagall Act was to prevent commercial banks from competing directly with commercial insurance companies.

Answer: F

2-36 The DIDMCA of 1980 and the DIA of 1982 were the initial acts to begin the deregulation of the commercial banking industry.

Answer: T

2-37 The Riegle-Neal Act of 1994 removed many of the restriction on interstate banking that were originally imposed by the 1933 Glass Steagall Act.

Answer: F

2-38 The Financial Services Modernization Act of 1999 allows commercial banking activities and securities underwriting to operate simultaneously under the same ownership structure.

Answer: T

2-39 Savings banks and savings associations are savings institutions; with savings banks serving as the primary providers of residential mortgage loans, and savings associations concentrating on commercial loans and corporate bonds as well as mortgage assets.

Answer: F

2-40 In general, the banking industry performed at higher levels of profitability in the decade of the 1990s than the decade of the 1980s.

Answer: T

2-41 Commercial banks that have invested in Internet banking services and products have outperformed significantly those banks that have chosen to avoid these markets.

Answer: F

2-42 Regulator forbearance is a policy of allowing economically insolvent FIs to continue in operation.

Answer: T

2-43 The primary reason for the decline of the S&L industry was the passage of legislation that gave commercial lending powers to the S&L industry.

Answer: F

2-44 Savings associations and savings banks both are insured by insurance funds that are managed by the FDIC.

Answer: T

2-45 The savings association industry continues to be the primary lender of residential mortgages.

Answer: F

2-46 As a percent of total assets, savings institutions hold lower amounts of cash and U.S. Treasury securities than commercial banks.

Answer: T

2-47 The number of savings associations has been declining since 1990.

Answer: T

2-48 Savings associations and savings banks are chartered and regulated by the Federal Reserve Bank.

Answer: F

2-49 Savings institutions enjoyed record profitability during the late 1990s and early 2000s.

Answer: T

2-50 The common bond principle of credit unions emphasizes the depository and lending needs of credit union members.

Answer: T

2-51 The credit union industry avoided much of the financial distress of the 1980s because of the short maturity and relatively lower credit risk of their assets.

Answer: T

2-52 The primary objective of the Reigle-Neal Act was to ease branching across state lines by banks.

Answer: T

2-53 As with other DIs, profits or return on assets (ROA) is the primary goal of credit union management.

Answer: F

2-54 A significant disadvantage for credit unions in competing with commercial banks is the severe restriction in the variety of products and services that they can offer.

Answer: F

2-55 A significant advantage for credit unions in competing with commercial banks is the tax-exempt status that has been granted to credit unions.

Answer: T

2-56 According to the American Bankers Association, the tax-exempt status of credit unions is the equivalent of a \$1 billion per-year subsidy to the industry.

Answer: T

2-57 Compared to the average commercial bank, credit unions tend to have higher overhead expenses per dollar of assets.

Answer: T

2-58 All credit unions are nationally chartered and regulated by the National Credit Union Administration.

Answer: F

Multiple-Choice

2-59 Which of the following FIs does not currently provide a payment function for their customers?

- a. Depository institutions.
- b. Insurance companies.
- c. Finance companies.
- d. Pension funds.
- e. Mutual funds.

Answer: D

2-60 A consumer lending function is performed by each of the following FIs EXCEPT

- a. mutual funds.
- b. finance companies.
- c. pension funds.
- d. depository institutions.
- e. insurance companies.

Answer: A

2-61 Which of the following FIs does not provide a business lending function?

- a. Depository institutions.
- b. Insurance companies.
- c. Finance companies.
- d. Pension funds.
- e. Mutual funds.

Answer: E

2-62 As of 2009, commercial banks with over \$10 billion in assets constituted approximately ____ percent of the industry assets and numbered approximately ____.

- a. 50; 310
- b. 60; 165
- c. 70; 525
- d. 80; 85
- e. 90; 440

Answer: D

2-63 The largest asset class on U.S. commercial banks' balance sheet as of year-end 2009 was

- a. investment securities.
- b. commercial and industrial loans.

- c. real estate loans.
- d. cash.
- e. deposits.

Answer C

2-64 The largest liability on U.S. commercial banks' balance sheet as of year-end 2009 was

- a. investment securities.
- b. non-transaction accounts.
- c. transaction accounts.
- d. borrowings.
- e. cash.

Answer B

2-65 By late 2009, the number of commercial banks in the U.S. was approximately

- a. 2,200.
- b. 4,680.
- c. 6,900.
- d. 8,100.
- e. 12,700.

Answer: C

2-66 By late 2009, the number of branches of existing commercial banks in the U.S. approximated _____, which was a (an) _____ from 1985.

- a. 88,000; increase
- b. 43,000; increase
- c. 68,000; decrease
- d. 103,000; decrease
- e. 72,000; increase

Answer: A

2-67 The largest asset class on FDIC-insured savings institutions' balance sheet as of year-end 2009 was

- a. mortgage loans.
- b. cash.
- c. investment securities.
- d. deposits.
- e. non-mortgage Loans.

Answer A

2-68 The largest liability on FDIC-insured savings institutions' balance sheet as of year-end 2009 was

- a. commercial paper.
- b. small time and savings deposits.
- c. repurchase agreements.
- d. FHLBB advances.

- e. cash.
- Answer B

- 2-69 The future viability of the savings association industry in traditional mortgage lending has been questioned because of
- a. securitization practices of other FIs.
 - b. the additional risk exposure of long-term mortgage lending.
 - c. intense competition from other FIs.
 - d. the liquidity risks associated with mortgage lending.
 - e. All of the above.

Answer E

- 2-70 Traditionally, the percentage of depository institutions' assets funded by some form of liability is approximately
- a. 50 percent.
 - b. 75 percent.
 - c. 85 percent.
 - d. 90 percent.
 - e. 40 percent.

Answer D

- 2-71 National-chartered commercial banks are most likely to be regulated by
- a. the FDIC only.
 - b. the FDIC and the Federal Reserve System.
 - c. the Federal Reserve System only.
 - d. the FDIC, the Federal Reserve System, and the Comptroller of the Currency.
 - e. the Federal Reserve System and the Comptroller of the Currency.

Answer D

- 2-72 State-chartered commercial banks may be regulated by
- a. the FDIC only.
 - b. the FDIC and the Federal Reserve System.
 - c. the Federal Reserve System only.
 - d. the FDIC, the Federal Reserve System, and the Comptroller of the Currency.
 - e. the FDIC, the Federal Reserve System, the Comptroller of the Currency, and state banking commissions.

Answer E

- 2-73 The strong performance of commercial banks during the decade before 2007 was due to
- a. the stability of interest rates during this period.
 - b. the ability of banks to shift credit risk from their balance sheets to financial markets.
 - c. the contraction of the number of banks and thrifts.
 - d. the growth in the number of thrifts and credit unions.
 - e. All of the above.

Answer B

- 2-74 Money center banks are considered to be any bank which
- has corporate headquarters in either New York City, Chicago, San Francisco, Atlanta, Dallas, or Charlotte.
 - is a net supplier of funds on the interbank market.
 - relies almost entirely on nondeposit and borrowed funds as sources of liabilities.
 - does not participate in foreign currency markets.
 - is not characterized by any of the above.

Answer C

- 2-75 A large number of the savings institution failures during the in the 1980s was a result of
- interest rate risk exposure.
 - excessively risky investments.
 - fraudulent behavior on the part of managers.
 - All of the above.
 - answers B and C only.

Answer D

- 2-76 One of the primary reasons that investment banks were allowed to convert to bank holding companies during the recent financial crisis was recognition that
- their operating activities were too risky and they needed the cushion of bank deposits to alleviate funding risks.
 - the industry had acquired too much capital during the previous decade.
 - bank holding companies needed the ability to underwrite new issues of corporate securities.
 - it was the only way an investment bank could qualify for federal bailout funds.
 - the Federal Reserve was unable to purchase troubled assets from investment banks, but they could from bank holding companies.

Answer: A

- 2-77 Regulatory forbearance refers to a policy of
- allowing insolvent banks to continue to operate.
 - foreclosing real estate properties in the event on non-payments of mortgages.
 - strict regulation of banks, closing them down as soon as they are insolvent.
 - rescheduling of all loans of a client in the event of non-payment.
 - Answers B and C only.

Answer A

- 2-78 The FIRREA Act of 1989 introduced the qualified thrift lender test (QLT), which set the percentage of assets required for qualification to be no less than
- 50 percent.
 - 55 percent.
 - 60 percent.
 - 65 percent.

- e. 68 percent.
- Answer D

2-79 A primary advantage for a depository institution of belonging to the Federal Reserve System is

- a. direct access to correspondent banking services.
- b. the lower deposit reserves required under the Federal Reserve System.
- c. direct access to the discount window of the Fed.
- d. commissionless trading of U.S. government securities.
- e. decreased costs of regulatory compliance.

Answer C

2-80 Customer deposits are classified on a DI's balance sheet as

- a. assets, because the DI uses deposit funds to earn profits.
- b. liabilities, because the DI uses deposits as a source of funds.
- c. assets, because customers view deposits as assets.
- d. liabilities, because the DI must meet reserve requirements on customer deposits.
- e. liabilities, because DIs are required to serve depositors.

Answer B

2-81 Holdings of U.S. Treasury securities are classified on a DI's balance sheet as

- a. assets, because U.S. Treasury securities are default risk-free.
- b. liabilities, because the DI must pay cash in order to acquire the securities.
- c. assets, because securities holdings represent a use of funds for investment.
- d. liabilities, because the Treasury securities must be pledged as collateral against discount window borrowing.
- e. assets, because the market for U.S. Treasury securities is the most liquid in the world.

Answer C

2-82 Customer loans are classified on a DI's balance sheet as

- a. assets, because the DI's major asset is its client base.
- b. liabilities, because the customer may default on the loan.
- c. assets, because the DI earns servicing fees on the loan.
- d. liabilities, because the DI must transfer funds to the borrower at the initiation of the loan.
- e. assets, because DIs originate and monitor loan portfolios.

Answer E

2-83 This broad class of loans constitutes the highest percentage of total assets for all U.S. commercial banks as of the end of 2009.

- a. Commercial and industrial.
- b. Commercial and residential real estate.
- c. Individual loans.
- d. Credit card debt.

- e. Less developed country loans.
- Answer B

2-84 Which of the following dominates the loan portfolios of banks with assets less than one billion dollars?

- a. Commercial loans.
- b. Consumer loans.
- c. Real estate loans.
- d. Credit card debt.
- e. Industrial loans.

Answer C

2-85 Which of the following is true of off-balance-sheet activities?

- a. They involve generation of fees without exposure to any risk.
- b. They include contingent activities recorded in the current balance sheet.
- c. They invite regulatory costs and additional “taxes.”
- d. They have both risk-reducing as well as risk-increasing attributes.
- e. The risk involved is best represented by notional or face value.

Answer D

2-86 Which of the following observations concerning trust departments is true?

- a. They are found only among smaller community banks.
- b. Only the largest banks have sufficient staff to offer trust services.
- c. They provide banking services to other banks.
- d. Pension fund assets are the largest category of assets managed by trust departments.
- e. They primarily handle assets for financially sophisticated investors.

Answer B

2-87 Which of the following identifies the primary function of the Office of the Comptroller of the Currency?

- a. Manage the deposit insurance fund and carry out bank examinations.
- b. Regulate and examine bank holding companies as well as individual commercial banks.
- c. Charter national banks and approve their merger activity.
- d. Determine permissible activities for state chartered banks.
- e. Stand as the “lender of last resort” for troubled banks.

Answer C

2-88 Which of the following currently manages the insurance funds for both commercial banks and savings institutions?

- a. FDIC.
- b. FSLIC.
- c. OCC.
- d. FRS.

- e. State authorities.

Answer A

2-89 What was the primary objective of the Bank Holding Company Act of 1956?

- a. Permitted bank holding companies to acquire banks in other states.
- b. Restricted the banking and nonbanking acquisition activities of multibank holding companies.
- c. Regulated foreign bank branches and agencies in the United States.
- d. Bank holding companies were permitted to convert out-of-state subsidiary banks into branches of a single interstate bank.
- e. Allowed for the creation of a financial services holding company.

Answer B

2-90 These organizations were originated to avoid the legal definition of a bank.

- a. Money center banks.
- b. Savings associations.
- c. Nonbank banks.
- d. Financial services holding companies.
- e. Savings banks.

Answer C

2-91 The qualified thrift lender test is designed to ensure that

- a. a floor is set for the mortgage related assets held by savings institutions.
- b. a ceiling is set on the mortgage related assets held by commercial banks.
- c. savings associations are covered by risk-based deposit insurance premiums.
- d. an interest rate ceiling is imposed on small savings and time deposits at savings institutions.
- e. regulators could close thrifts and banks faster.

Answer A

2-92 Which of the following is the most important source of funds for savings institutions?

- a. Borrowings from the Federal Home Loan Bank.
- b. Small time and savings deposits.
- c. Repurchase agreements.
- d. Direct federal fund borrowings.
- e. Negotiable certificates of deposit.

Answer B

2-93 The primary regulators of savings institutions are

- a. the Federal Reserve and the FDIC.
- b. the Office of Thrift Supervision and the FDIC.
- c. the FDIC and the Office of the Comptroller of the Currency.
- d. the Office of Thrift Supervision and the Comptroller of the Currency.
- e. the Federal Reserve and the Comptroller of the Currency.

Answer: B

- 2-94 The largest asset class on credit unions' balance sheet as of year-end 2009 was
- a. cash.
 - b. investment securities.
 - c. home mortgages.
 - d. checkable deposits.
 - e. consumer credit.

Answer C

- 2-95 The largest liability on credit unions' balance sheet as of year-end 2009 was
- a. small time and savings deposits.
 - b. open-market paper.
 - c. repurchase agreements.
 - d. ownership shares.
 - e. share advances.

Answer A

- 2-96 Credit Unions were generally less affected than other depository institutions by the recent financial crisis because
- a. they had more assets in consumer loans than residential mortgages.
 - b. they had more residential mortgages than consumer loans.
 - c. they hold more government securities, on average.
 - d. they hold less government securities, on average.
 - e. Answers A and C only.

Answer E

- 2-97 The most numerous of the institutions that define the depository institutions segment of the FI industry in the US is (are)
- a. savings associations.
 - b. small commercial banks.
 - c. large commercial banks.
 - d. savings banks.
 - e. credit unions.

Answer E

- 2-98 Which of the following observations concerning credit unions is NOT true?
- a. They invest heavily in corporate securities.
 - b. Member loans constitute a majority of their total assets.
 - c. They tend to invest more of their assets in U.S. Treasuries than other DIs.
 - d. They engage in off-balance-sheet activities.
 - e. They focus more on providing services and less on profitability.

Answer A

- 2-99 Compared to banks and savings institutions, credit unions are able to pay a higher rate on the deposits of members because
- a. they intend to attract new members.

- b. they do not issue common stock.
- c. of their tax-exempt status.
- d. Regulation Q still applies to the industry.
- e. they are subject to the provisions of the Community Reinvestment Act.

Answer C

2-100 Which of the following is NOT an off balance sheet activity for U.S. banks?

- a. Derivative contracts.
- b. Loan commitments.
- c. Standby letters of credit.
- d. Trust services.
- e. When-issued securities.

Answer D

2-101 Correspondent banking may involve

- a. providing banking services to other banks facing shortage of staff.
- b. providing foreign exchange trading services to individuals.
- c. holding and managing assets for individuals or corporations.
- d. acting as transfer and disbursement agents for pension funds.
- e. providing hedging services to corporations.

Answer D

2-102 What is the defining characteristic of the dual banking system?

- a. Coexistence of parent and holding companies.
- b. Coexistence of both nationally chartered and state chartered banks.
- c. Control of nationally chartered and state chartered banks by the state regulators.
- d. Control of nationally chartered banks by both FRS and State bank regulators.
- e. Nonbanking companies carrying out both banking and other activities.

Answer B

Matching

Choose among the following major banking laws to answer questions 2-103 to 2-117.

- a. The McFadden Act of 1927
- b. The Glass-Steagall Act of 1933
- c. The Depository Institutions Deregulation and Monetary Control Act (DIDMCA) of 1980
- d. The Garn-St Germain Depository Institutions Act of 1982
- e. The Competitive Equality in Banking Act of 1987
- f. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989
- g. The Federal Deposit Insurance Corporation Improvement Act (FDICIA) of 1991
- h. The Riegle-Neal Interstate Banking and Branching Efficiency Act

- of 1994
i. Financial Services Modernization Act of 1999

2-103 This legislation sought to limit the growth of non-bank banks.

Answer: E

2-104 This legislation introduced prompt corrective action requiring mandatory intervention by regulators when a bank's capital falls below certain levels.

Answer: G

2-105 This legislation introduced money market deposit accounts.

Answer: D

2-106 This legislation permits bank holding companies to acquire banks in other states.

Answer: H

2-107 This legislation limited interstate branching.

Answer: A

2-108 Eliminated restrictions on banks, insurance companies, and securities firms from entering into each other's areas of business.

Answer: I

2-109 This legislation separated commercial and investment banking.

Answer: B

2-110 This legislation phased out Regulation Q ceilings on deposit interest rates.

Answer: C

2-111 This law allows bank holding companies to convert out-of-state subsidiary banks into branches of a single interstate bank.

Answer: H

2-112 Provided for state regulation of insurance.

Answer: I

2-113 This legislation replaced FSLIC with FDIC-SAIF.

Answer: F

2-114 This legislation limited thrift investments in non-residential real estate.

Answer: F

2-115 This legislation introduced risk based deposit insurance premiums.

Answer: G

2-116 This legislation limited the use of “too big to fail” bailouts.

Answer: G

2-117 This legislation streamlined bank holding company supervision, with the Federal Reserve as the umbrella holding company supervisor.

Answer: I