MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

1) A well-capitalized bank has _____ to lose if it fails and thus is _____ likely to pursue risky activities.
   A) more; more  B) more; less  C) less; less  D) nothing; more  E) less; more

2) In the early stages of the 1980s banking crisis, financial institutions were especially hurt by
   A) the sharp increases in interest rates from late 1979 until 1981.
   B) the severe recession in 1981-82.
   C) the sharp decline in the price level from mid 1980 to early 1983.
   D) all of the above.
   E) only A and B of the above.

3) Deposit insurance has not worked well in countries with
   A) strong supervision and regulation.
   B) a weak institutional environment.
   C) a tradition of the rule of law.
   D) all of the above.
   E) both A and B of the above.

4) Regulations that reduce competition between banks include
   A) branching restrictions.
   B) prohibitions preventing nonbank institutions from engaging in banking activities.
   C) the dual system of granting bank charters.
   D) all of the above.
   E) both A and B of the above.
5) Depositors have a strong incentive to show up first to withdraw their funds during a bank crisis because banks operate on a
   A) sequential service constraint.
   B) last-in, first-out constraint.
   C) everyone-shares-equally constraint.
   D) double-coincidence of wants constraint.
   E) first-come, last-served constraint.

6) The primary difference between the "payoff" and the "purchase and assumption" methods of handling failed banks is
   A) that the FDIC guarantees all deposits, not just those under the $100,000 limit, when it uses the "payoff" method.
   B) that the FDIC guarantees all deposits, not just those under the $100,000 limit, when it uses the "purchase and assumption" method.
   C) that the FDIC is less likely to use the "payoff" method when the bank is large and it fears that depositor losses may spur business bankruptcies and other bank failures.
   D) both A and B of the above.
   E) both B and C of the above.

7) The major provisions of the Competitive Equality Banking Act of 1987 include
   A) directing the Federal Home Loan Bank Board to continue to pursue regulatory forbearance.
   B) expanding the responsibilities of the FDIC, which is now the sole administrator of the federal deposit insurance system.
   C) the establishment of the Resolution Trust Corporation to manage and resolve insolvent thrifts placed in conservatorship or receivership.
   D) all of the above.
   E) only A and B of the above.

8) The too-big-to-fail policy
   A) exacerbates moral hazard problems.
   B) puts large banks at a competitive disadvantage in attracting large deposits.
   C) treats large depositors of small banks inequitably when compared to depositors of large banks.
   D) does only A and C of the above.
9) The major provisions of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 include:

A) expanding the responsibilities of the FDIC, which is now the sole administrator of the federal deposit insurance system.

B) transferring the regulatory role of the Federal Home Loan Bank Board to the Office of Thrift Supervision, a bureau within the U.S. Treasury Department.

C) the abolishment of the Federal Home Loan Bank Board and the FSLIC.

D) all of the above.

E) only A and B of the above.

10) Under the Basel Plan,

A) assets and off-balance-sheet activities are assigned to different categories to reflect the degree of credit risk.

B) a bank’s “core” capital must equal or exceed 10 percent of total risk-adjusted assets.

C) a bank’s total capital must equal or exceed 8 percent of total risk-adjusted assets.

D) all of the above.

E) only A and C of the above.

11) An analysis of the political economy of the savings and loan crisis helps one to understand:

A) why thrift regulators were so reluctant to admit that any problem even existed in the thrift industry.

B) why thrift regulators willingly acceded to pressures placed upon them by members of Congress.

C) why politicians hampered the efforts of thrift regulators, cutting regulatory appropriations and encouraging regulatory forbearance.

D) all of the above.

E) only A and B of the above.

12) Because the _____ costs of bank failure are greater than bank’s _____ costs, banks may hold assets that are too risky.

A) social; social  
B) social; private  
C) private; private  
D) private; social

13) Common to all the recent banking crises in the United States, Scandinavia, Latin America, Japan, Russia, and Eastern Europe was the

A) the financial liberalization that occurred in the 1980s.

B) the regulators’ lack of expertise in monitoring banking activities.

C) the banks’ lack of expertise in screening borrowers and monitoring loans.

D) all of the above.

E) only A and B of the above.
14) The Federal Deposit Insurance Corporation Improvement Act of 1991
   A) requires the FDIC to intervene earlier when a bank gets into trouble.
   B) reduced the scope of deposit insurance in several ways.
   C) limited the FDIC’s ability to use the “too-big-to-fail” policy.
   D) did all of the above.

15) The chartering process is especially designed to deal with the _____ problem, and regular bank examinations help to reduce the _____ problem.
   A) moral hazard; moral hazard
   B) adverse selection; adverse selection
   C) moral hazard; adverse selection
   D) adverse selection; moral hazard
Answer Key
Testname: PRACTICE_CH11

1) B
2) E
3) B
4) E
5) A
6) E
7) A
8) D
9) D
10) E
11) D
12) B
13) D
14) D
15) D