# Chapter 02
# Financial Services: Depository Institutions

## True / False Questions

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

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

3. Commercial banks have limited power to underwrite corporate securities since 1987.
**TRUE**

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

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

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.
**FALSE**

7. In terms of total assets, commercial banks with under $1 billion in assets have become a larger segment of the industry in recent years.
**FALSE**

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

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

10. All banks with assets greater than $10 billion are considered money center banks.
**FALSE**

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

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

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

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

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

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.
**FALSE**

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

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

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

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

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

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

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.
**TRUE**

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

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

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

27. Although growing, the notional value of bank OBS activities remained less than the value of on-balance-sheet activities as of mod-2015.
**FALSE**

28. Commercial banks in the U.S. often are subject to more than one of four regulatory agencies.
**TRUE**

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

30. As of 2015, the number of nationally chartered banks was greater than the number of state chartered banks.
**FALSE**

31. All commercial banks must be members of the Federal Reserve System.
**FALSE**

32. Small banks make proportionately larger amounts of real estate loans than large banks.
**TRUE**

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

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

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

36. The Depository Institutions Deregulation and Monetary Control Act (DIDMCA) of 1980 and the Garn-St. Germain Depository Institutions Act (DIA) of 1982 were the initial laws that began deregulation of the commercial banking industry.
**TRUE**

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.
**FALSE**

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

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.
**FALSE**

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

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

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

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

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

45. The savings association industry continues to be the primary lender of residential mortgages.
**FALSE**

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

47. The number of savings associations has been declining since 1990.
**TRUE**

48. Savings associations and savings banks are chartered and regulated by the Federal Reserve Bank.
**FALSE**

49. Savings institutions enjoyed record profitability during the late 1990s and early 2000s.
**TRUE**

50. Credit unions operate on a common bond principle which emphasizes the depository and lending needs of credit union members.
**TRUE**

51. Unlike commercial banks, credit unions may only be chartered in the state in which they operate.
**FALSE**

52. 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.
**TRUE**

53. The primary objective of the Riegle-Neal Act (1994) was to ease branching across state lines by banks.
**TRUE**

54. As with other DIs, profits or return on assets (ROAs) is the primary goal of credit union management.
**FALSE**

55. 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.
**FALSE**

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

57. 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.
**TRUE**

58. Compared to the average commercial bank, credit unions tend to have higher overhead expenses per dollar of assets.
**TRUE**

59. All credit unions are nationally chartered and regulated by the National Credit Union Administration.
**FALSE**

**Multiple Choice Questions**

60. 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.

61. 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.

62. 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.

63. As of 2015, commercial banks with over $10 billion in assets constituted approximately ____ percent of the industry assets and numbered approximately _____.
A. 53; 310
B. 63; 65
C. 73; 525
**D.** 83; 95
E. 93; 440

64. The largest asset class on U.S. commercial banks' combined balance sheet as of June 30, 2015 was
A. investment securities.
B. commercial and industrial loans.
**C.** real estate loans.
D. cash.
E. deposits.

65. The largest liability on U.S. commercial banks' combined balance sheet as of June 30. 2015 was
A. investment securities.
**B.** non-transaction accounts.
C. transaction accounts.
D. borrowings.
E. cash.

66. By late 2015, the number of commercial banks in the U.S. was approximately
A. 2,200.
B. 1,680.
C. 6,170.
**D.** 5,470.
E. 12,700.

67. By late 2015, the number of branches of existing commercial banks in the U.S. approximated ________, which was a(an) _________ from 1985.
A. 96,000; increase
B. 43,8000; increase
C. 68,200; decrease
D. 103,000; decrease
**E.** 82,500; increase

68. The largest asset class on FDIC-insured savings institutions' balance sheet as of mid-2015 was
**A.** mortgage loans.
B. cash.
C. investment securities.
D. deposits.
E. non-mortgage Loans.

69. The largest liability on FDIC-insured savings institutions' balance sheet as of mid-2015 was
A. commercial paper.
**B.** small time and savings deposits.
C. repurchase agreements.
D. FHLBB advances.
E. cash.

70. 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 options.

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.

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.

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 options.

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

75. A large number of the savings institution failures during the in the 1980s was a result of
A. interest rate risk exposure.
B. excessively risky investments.
C. fraudulent behavior on the part of managers.
**D.** All of the options.
E. excessively risky investments and fraudulent behavior on the part of managers.

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
**A.** their operating activities were too risky and they needed the cushion of bank deposits to alleviate funding risks.
B. the industry had acquired too much capital during the previous decade.
C. bank holding companies needed the ability to underwrite new issues of corporate securities.
D. it was the only way an investment bank could qualify for federal bailout funds.
E. the Federal Reserve was unable to purchase troubled assets from investment banks, but they could from bank holding companies.

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

78. The Financial Institutions Reform Recovery and Enforcement Act (FIRREA) of 1989 introduced the qualified thrift lender test (QTL), which set the percentage of assets required for qualification to be no less than
A. 50 percent.
B. 55 percent.
C. 60 percent.
**D.** 65 percent.
E. 68 percent.

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. commission less trading of U.S. government securities.
E. decreased costs of regulatory compliance.

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.

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.

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.

83. This broad class of loans constitutes the highest percentage of total assets for all U.S. commercial banks as of 2015.
A. Commercial and industrial.
**B.** Commercial and residential real estate.
C. Individual loans.
D. Credit card debt.
E. Less developed country loans.

84. Which of the following dominates the loan portfolios of commercial 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.

85. Real estate loans comprise approximately ______ percent of large commercial banks' (assets greater than $1 billion) loan portfolio.
**A.** 46
B. 32
C. 75.5
D. 63
E. 84

86. 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.

87. 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.

88. 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.

89. 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.

90. 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.

91. 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.

92. 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.

93. 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.

94. 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.

95. The two largest asset classes on credit unions' combined balance sheet as of June 30, 2015 were
A. cash and investment.
B. investment securities and share drafts.
**C.** home mortgages and consumer loans.
D. consumer loans and car loans.
E. business loans and consumer loans.

96. The largest liability on credit unions' combined balance sheet as of June 30, 2015 was
A. share drafts.
B. open-market paper.
C. large time deposits.
D. ownership shares.
**E.** small time deposits and savings deposits.

97. Credit Unions were generally less affected than other depository institutions by the recent financial crisis because
A. they had relatively more assets in consumer loans than other DIs.
B. they had relatively more residential mortgages.
C. they hold more government and agency securities, on average.
D. they hold less government and agency securities, on average.
**E.** they had relatively more assets in consumer loans than other DIs and they hold more government and agency securities, on average.

98. The most numerous of the institutions that define the depository institutions segment of the FI industry in the U.S. is(are)
A. savings associations.
B. small commercial banks.
C. large commercial banks.
D. savings banks.
**E.** credit unions.

99. 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.

100. 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.

101. Credit unions may be federally or state chartered. If a credit union is chartered at the federal level, it is subject to the regulations imposed by the
A. Federal Reserve.
**B.** National Credit Union Administration.
C. State Banking Commission.
D. Federal Credit Union Insurance Fund.
E. Office of the Comptroller of the Currency.

102. According to the text, how many of the largest corporate credit unions were ultimately declared insolvent during the recent financial crisis?
A. 0
B. 15
C. 12
D. 7
**E.** 5

103. 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.

104. 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.

105. 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.

**Short Answer Questions**

For the following problems, choose among the following major banking laws.

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 (DIA) of 1982
E. The Competitive Equality in Banking Act (CEBA) of 1987
F. The Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) 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

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

E

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

G

108. This legislation introduced money market deposit accounts.

D

109. This legislation permits bank holding companies to acquire banks in other states.

H

110. This legislation limited interstate branching.

A

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

I

112. This legislation separated commercial and investment banking.

B

113. This legislation phased out Regulation Q ceilings on deposit interest rates.

C

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

H

115. Provided for state regulation of insurance.

I

116. This legislation replaced FSLIC with FDIC-SAIF.

F

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

F

118. This legislation introduced risk based deposit insurance premiums.

G

119. This legislation limited the use of "too big to fail" bailouts.

G

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

I