1. Multiple Choice

1. Which one of the following statements best describes the philosophy behind the regulation of the financial (i.e., the securities) markets in the U.S.?
   A. The regulation of the U.S. securities markets revolves around protecting individual investors by both disclosure requirements and government assessment of issuer risk.
   B. The regulation of the U.S. securities markets revolves around protecting individual investors by requiring full disclosure of information about the firms who issue securities.
   C. The regulation of the U.S. securities markets revolves around protecting individual investors through government assessment and dissemination of information about the risk of individual securities.
   D. The regulation of U.S. securities markets revolves around insuring individual investors against major losses through various government guarantee programs.

2. Companies that have issued registered securities must annually file a report with the SEC disclosing relevant information about the firm's performance and activities. This report is called __.
   A. a red herring
   B. a final prospectus
   C. a preliminary prospectus
   D. a 10K report

3. Which one of the following best describes the legality of insider trading in the U.S.?
   A. Insider trading is illegal in the U.S. despite the fact that it promotes efficiency of stock prices.
   B. Insider trading is illegal in the U.S. because it diminishes the efficiency of stock prices.
   C. Insider trading is legal in the U.S. despite the fact that it diminishes the efficiency of stock prices.
   D. Insider trading is legal in the U.S. because it promotes the efficiency of stock prices.

4. The regulation of commercial banking in the U.S. is characterized by a “dual banking system.” This refers to __.
   A. the presence of both domestic and foreign banks in the U.S.
   B. the fact that U.S. banks are both consumer and wholesale banks
   C. the existence of commercial and investment banks
   D. the fact that banks can be chartered either at the state or national level

5. Which one of the following statements best describes the philosophy behind the regulation of commercial banks in the U.S. and its implementation?
   A. The regulation of commercial banks centers around deposit insurance. Regulation of commercial banks is principally focused on protecting the FDIC who
provides this insurance. The most critical information about bank performance is generated by regulators who make this information available to the public so that depositors can make informed decisions.

B. The regulation of commercial banks centers around deposit insurance. Regulation of commercial banks is principally focused on protecting the FDIC who provides this insurance. The most critical information about bank performance is generated by regulators through bank examinations and is not divulged to the public because it might cause a bank run.

C. The philosophy of bank regulation is similar to the philosophy of securities market regulation in its emphasis on public disclosure of information. A cornerstone of this philosophy is the bank examination whose results are made available to the public.

D. The philosophy of bank regulation is similar to the philosophy of securities market regulation in its emphasis on public disclosure of information. Because most banks are publicly traded, this information is principally provided through SEC-required reporting. In addition, the results of bank examinations are made public so that depositors can make informed decisions.

6. Which one of the following would tend to make the moral hazard problem in deposit insurance more acute?
   A. substituting risk-based capital requirements for non-risk-based capital requirements
   B. substituting fixed deposit insurance premiums for risk-based insurance premiums
   C. introducing prompt corrective action
   D. increasing the frequency of bank examinations

7. Suppose that First National Bank has $1 billion of assets and $100 million of capital. Assume that Category 1, 2, 3, and 4 assets have risk weights of 0%, 20%, 50% and 100% respectively. Also assume First National Bank’s assets are as follows:

<table>
<thead>
<tr>
<th>Cash</th>
<th>$50,000,000</th>
</tr>
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<tbody>
<tr>
<td>U.S. Treasury Securities</td>
<td>$250,000,000</td>
</tr>
<tr>
<td>General Obligation Municipal Bonds</td>
<td>$50,000,000</td>
</tr>
<tr>
<td>Residential Mortgages</td>
<td>$250,000,000</td>
</tr>
<tr>
<td>Consumer/Commercial Loans</td>
<td>$400,000,000</td>
</tr>
</tbody>
</table>

Total Assets $1,000,000,000

What is First National Bank’s risk-based capital ratio?
   A. 10%
   B. 15.4%
   C. 18.7%
   D. 40%

8. Pension funds are __.
   A. highly regulated and insured by the SEC
B. highly regulated according to ERISA and insured (up to an individual maximum) by the Pension Benefit Guarantee Corporation
C. highly regulated according to ERISA but not insured
D. highly regulated by the SEC but not insured

9. Which one of the following is not a true statement about the Glass-Steagall Act and the regulation of investment banking activities by commercial banks?
A. The Glass-Steagall Act separated investment banking (specifically securities underwriting) from commercial banking.
B. The Glass-Steagall Act was responsible for splitting the house of Morgan into J.P. Morgan and Morgan Stanley.
C. The Federal Reserve become responsible for determining what was a permissible activity for commercial banks.
D. The empirical evidence present at the Congressional hearings on the Glass-Steagall Act before it was passed provided a strong case that the securities underwriting activities of commercial banks was a major contributor to the financial collapse of the 1930s.

10. Which one the following is not a true statement about the relatively recent erosion of the Glass-Steagall Act?
A. Modern portfolio theory tells us that because securities underwriting is a riskier activity than commercial banking the combination of the two might be risk-reducing.
B. Universal banking in which banks offer investment banking and commercial banking services has been permitted in much of Europe for some time.
C. Banks must conduct their underwriting activities in a separate subsidiary that is insulated from the commercial bank through firewalls.
D. New legislation in the 1980s was principally responsible for changes in regulation that have recently permitted banks to underwrite corporate securities.

II. True or False
11. Small businesses typically cannot get a line of credit at a bank.
12. Banks lend to small businesses so they can get plant and equipment as well as inventories.
13. A loan officer is allowed to consult a credit report from a commercial credit agency regarding a potential borrower.
14. A loan officer sometimes submits a borrowing request to a loan committee at his bank for a vote.
15. “Inside” collateral are personal assets held by the owner of a business.
16. A bank may require a small business owner seeking a loan to provide a statement of his or her personal finances and a personal balance sheet.
17. By law, restrictive covenants cannot be waived over the course of a business loan.
18. By law, a bank cannot require a business owner to be personally liable for repaying a loan to her business.

19. It is common for the terms of a private placement to be renegotiated at least once.

20. Private placements are never collateralized.


22. Corporate bonds contain no restrictive covenants.

23. Equities are commonly “shelf-registered” at the SEC.

24. Commercial paper is sometimes issued with a maturity as short as one day.

25. An adverse selection problem arises as the lender shares disproportionately in the downside of risk-switching.