

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

- 1) The fact that depositors cannot distinguish good from bad banks is a(n)
 - A) moral hazard problem.
 - B) adverse selection problem.
 - C) asymmetric information problem.
 - D) too-big-to-fail problem.
 - E) none of the above.

- 2) When one party to a transaction has incentives to engage in activities detrimental to the other party, there exists a problem of
 - A) ex ante shirking.
 - B) pre-contractual opportunism.
 - C) split incentives.
 - D) moral hazard.

- 3) The existence of deposit insurance can increase the likelihood that depositors will need deposit protection, as banks with deposit insurance
 - A) are placed at a competitive disadvantage in acquiring funds.
 - B) are likely to regard deposits as an unattractive source of funds due to depositors' demands for safety.
 - C) are likely to take on greater risks than they otherwise would.
 - D) are likely to be too conservative, reducing the probability of turning a profit.

- 4) The result of the too-big-to-fail policy is that ____ banks will take on ____ risks, making bank failures more likely.
 - A) small; greater
 - B) big; fewer
 - C) small; fewer
 - D) big; greater

- 5) Financial consolidation poses challenges to banking regulation because
 - A) it increases the number of banks that are too big to fail.
 - B) it extends the government safety net to new activities.
 - C) it extends deposit insurance to stock brokers.
 - D) all of the above.
 - E) both A and B of the above.

- 6) Banks do not want to hold too much capital because
 - A) they do not bear fully the costs of bank failures.
 - B) higher returns on equity are earned when bank capital is smaller.
 - C) higher capital levels attract the scrutiny of regulators.
 - D) all of the above.
 - E) only A and B of the above.

- 7) The leverage ratio is the ratio of a bank's
 - A) assets divided by its liabilities.
 - B) capital divided by its earnings.
 - C) income divided by its assets.
 - D) capital divided by its total assets.
 - E) capital divided by its total liabilities.

- 8) The chartering process is especially designed to deal with the ____ problem, and regular bank examinations help to reduce the ____ problem.
- A) adverse selection; adverse selection
 - B) moral hazard; adverse selection
 - C) adverse selection; moral hazard
 - D) moral hazard; moral hazard
- 9) Competition between banks
- A) encourages conservative bank management.
 - B) encourages greater risk taking.
 - C) increases bank profitability.
 - D) all of the above.
 - E) both A and C of the above.
- 10) A bank failure is less likely to occur when
- A) a bank holds less U.S. government securities.
 - B) a bank suffers large deposit outflows.
 - C) a bank holds more excess reserves.
 - D) a bank has more bank capital.

Answer Key

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- 1) C
- 2) D
- 3) C
- 4) D
- 5) E
- 6) E
- 7) D
- 8) C
- 9) B
- 10) D