1. Bank loans from the Federal Reserve are called ______ and represent a ______ of funds, is a _____ of the bank
   A) discount loans; use; asset
   B) **discount loans; source; liability**
   C) discount loans; source; bank capital
   D) fed funds; source; liability

2. When a $10 check written on the First National Bank of Chicago is deposited in an account at Citibank, then
   A) the liabilities of the First National Bank increase by $10.
   B) the reserves of the First National Bank increase by $10.
   C) **the liabilities of Citibank increase by $10.**
   D) the assets of Citibank fall by $10.

3. In general, banks would prefer to meet deposit outflows by ______ rather than ______.
   A) selling loans; selling securities
   B) selling loans; borrowing from the Fed
   C) **borrowing from the Fed; selling loans**
   D) "calling in" loans; selling securities

4. Bankers' concerns regarding the optimal mix of excess reserves, secondary reserves, borrowings from the Fed, and borrowings from other banks to deal with deposit outflows is an example of
   A) liability management.
   B) **liquidity management.**
   C) managing interest rate risk.
   D) managing credit risk.

5. In order to reduce the ______ problem in loan markets, bankers collect information from prospective borrowers to screen out the bad credit risks from the good ones.
   A) moral hazard
   B) **adverse selection**
   C) moral suasion
   D) adverse lending

6. The U.S. banking system is considered to be a dual system because
   A) banks offer both checking and savings accounts.
   B) it actually includes both banks and thrift institutions.
   C) **it is regulated by both state and federal governments.**
D) it was established before the Civil War, requiring separate regulatory bodies for the North and South.

7. The legislation that separated investment banking from commercial banking until its repeal in 1999 is known as the:
   A) National Bank Act of 1863.
   B) Federal Reserve Act of 1913.
   C) Glass-Steagall Act.
   D) McFadden Act.

8. Loophole mining refers to financial innovation designed to
   A) hide transactions from the IRS.
   B) conceal transactions from the SEC.
   C) get around regulations.
   D) conceal transactions from the Treasury Department.

9. Disintermediation resulted from
   A) interest rate ceilings combine with inflation-driven increases in interest rates.
   B) elimination of Regulation Q (the regulation imposing interest rate ceilings on bank deposits).
   C) increases in federal income taxes.
   D) reserve requirements.

10. Your bank has the following balance sheet:
    Assets | Liabilities
    ------------------------------------|-------------------------------------------
    Reserves $50 million | Checkable deposits $200 million
    Securities $50 million |
    Loans $150 million | Bank capital $50 million
    --------------------------------------------------------------------------------

    If the required reserve ratio is 10%, what actions should the bank manager take if there is an unexpected deposit outflow of $50 million?
    **Answer:** After the deposit outflow, the bank will have a reserve shortfall of $15 million. The bank manager could try to borrow in the Federal Funds market, or take out a discount loan from the Federal Reserve, or sell $15 million of the securities the bank owns, or sell off $15 million of the loans the bank owns, or lastly call-in $15 million of loans. All of the actions will be costly to the bank. The bank manager should try to acquire the funds with the least costly method.

11. What are junk bond, securitization, commercial paper and money market mutual funds? **For answer please refer to lecture notes and handout.**

12. What’s credit rationing? How can credit rationing help banks to solve problems of adverse selection and moral hazard? Would credit rationing reduce default risk, and why? **For answer please refer to lecture notes.**