Practice Questions and Problems (Answers at End of Book)

2.1 How did concentration in the U.S. banking system change between 1984 and 2017?

2.2 What government policies led to the large number of small community banks in the United States?

2.3 What risks does a bank take if it funds long-term loans with short-term deposits?

2.4 Suppose that an out-of-control trader working for DLC Bank (see Tables 2.2 and 2.3) loses $7 million trading foreign exchange. What do you think would happen?

2.5 What is meant by net interest income?

2.6 Which items on the income statement of DLC Bank in Section 2.2 are most likely to be affected by (a) credit risk, (b) market risk, and (c) operational risk?

2.7 Explain the terms "private placement" and "public offering." What is the difference between "best efforts" and "firm commitment" for a public offering?

2.8 The bidders in a Dutch auction are as follows:

Bidder	Number of Shares	Price
A	20,000	$100.00
B	30,000	$93.00
C	50,000	$110.00
D	70,000	$88.00
E	60,000	$80.00
F	10,000	$105.00
G	90,000	$70.00
H	80,000	$125.00

The number of shares being auctioned is 150,000. What is the price paid by investors? How many shares does each investor receive?

2.9 What is the attraction of a Dutch auction over the normal procedure for an IPO? In what ways was Google's IPO different from a standard Dutch auction?

2.10 Management sometimes argues that poison pills are in the best interests of shareholders because they enable management to extract a higher price from would-be acquirers. Discuss this argument.

2.11 Give three examples of the conflicts of interest in a large bank. How are conflicts of interest handled?

2.12 What is the difference between the banking book and the trading book?

2.13 How has accounting for loans changed since the 2007–2008 financial crisis?

2.14 What is the originate-to-distribute model?

Further Questions

2.15 Regulators calculate that DLC bank (see Section 2.2) will report a profit that is normally distributed with a mean of $0.6 million and a standard deviation of $2 million.

How much equity capital in addition to that in Table 2.2 should regulators require for there to be a 99.9% chance of the capital not being wiped out by losses?

2.16 Explain the moral hazard problems with deposit insurance. How can they be overcome?

2.17 The bidders in a Dutch auction are as follows:

Bidder	**Number of Shares**	**Price**
A	60,000	$50.00
B	20,000	$80.00
C	30,000	$55.00
D	40,000	$38.00
E	40,000	$42.00
F	40,000	$42.00
G	50,000	$35.00
H	50,000	$60.00

The number of shares being auctioned is 210,000. What is the price paid by investors? How many shares does each investor receive?

2.18 An investment bank has been asked to underwrite an issue of 10 million shares by a company. It is trying to decide between a firm commitment where it buys the shares for $10 per share and a best efforts where it charges a fee of 20 cents for each share sold. Explain the pros and cons of the two alternatives.