# Test bank Rose Bank Management

Principle of Banking (Trường Đại học Ngoại thương)

# Chapter 1
# An Overview of the Changing Financial-Services Sector

**Fill in the Blank Questions**

1. ________________________ is a traditional service provided by banks in which the banks store the valuables of their customers and certify their true value.
   Answer: Safekeeping of valuables

2. The fact that financial institutions make loans based on confidential information is the ________________________ theory of banking.
   Answer: delegated monitoring

3. ________________________ refers to when a financial institution trades one form of currency for another. An example of this would be when the bank trades dollars for yen for a fee.
   Answer: currency exchange

4. A(n) ________________________ is a traditional service which permits a depositor to write a draft in payment for goods and services.
   Answer: demand deposit (checking account)

5. ________________________ is a service provided by banks where the bank lends money to individuals for the purchase of durable and other goods.
   Answer: Consumer lending

6. The ________________________ of a bank is a traditional service where the bank manages the financial affairs and property of individuals (and in some cases businesses).
   Answer: trust services

7. Companies such as Merrill Lynch and Sears which offered some but not all banking services in the 1980s were called _______________________.
   Answer: nonbank banks

8. The loosening of government regulation and control of financial institutions is called _______________________.
   Answer: deregulation

9. ____________________________ is an alternative to lending in which the financial institution purchases the equipment and rents it to its customers.
   Answer: Equipment leasing services

10. The___________________________ is a landmark act which allows financial service providers to offer an expanded menu of financial services for the customer. This law allows banks to truly become conglomerate financial service providers.
    Answer: Financial Services Modernization Act (Gramm-Leach-Bliley Act)

11. The country with the most banks is _______________________.
    Answer: United States

12. According to Congress a ____________ is defined as any institution that can qualify for deposit insurance administered by the FDIC.
    Answer: Bank

13. A bank which spans regions, nations, and continents, offering the widest menu of financial services is known as a __________bank.
    Answer: money-center bank

14. _____________ refers to the movement of businesses across industry lines in order to broaden its base.
    Answer: Convergence

15. Banks which serve primarily households and small firms are known as ____________ banks.
    Answer: retail

16. Banks that sell deposits and make loans to businesses and individuals are known as ______banks.
    Answer: commercial

17. Banks which underwrite issues of new securities for their corporate customers are known as ________ banks.
    Answer: investment

18. Banks which function under a federal charter through the Comptroller of the Currency in the United States are known as ____________ banks.
Answer: National

19. Banks which supply both debt and equity capital to businesses are known as _________ banks.
Answer: merchant

20. A bank that offers its services only over the internet is known as a(n) _____________ .
Answer: virtual bank

21. When a local merchant sells the accounts receivables they hold against their customer to a bank this generally known as _____________________________.
Answer: discounting commercial notes

22. A(n) _______________________ offers loans to commercial enterprises (such as appliance dealers) or to individuals using funds borrowed in the open market or from other financial institutions. Examples of this type of financial service provider include GMAC Financial Services and Household Finance.
Answer: finance company

23. A(n) _______________________ buys and sells securities on behalf of their customers and for their own accounts. Examples of this type of financial service provider include Merrill Lynch and Charles Schwab.
Answer: security broker (or dealer)

24. A(n) ______________________________ sells shares mainly to upscale investors in a broad group of different kinds of assets including nontraditional investments in commodities, real estate, loans to ailing companies and other risky assets.
Answer: hedge fund

25. When a bank agrees to handle the cash collections and disbursements for a company and invest any temporary cash surpluses in interest bearing assets, they are providing ___________ services to their customers.
Answer: cash management

**True/False Questions**

T F 26. Under U.S. federal law, an institution making only loans to households and offering uninsured checkable deposits and savings deposits qualifies as a commercial bank.
Answer: False

T F 27. Nonbank banks can offer deposits to the public, but these deposits are not eligible for insurance coverage by the FDIC.
Answer: False

T F 28. The etymological roots of the word "bank" trace this word back to an Italian term referring to a **"money-changer's table".**
Answer: True

T F 29. According to the textbook, banks are those financial institutions that today offer the widest range of financial services of any business firm in the economy.
Answer: True

T F 30. According to the delegated monitoring theory banks are able to attract borrowing customers because they pledge confidentiality.
Answer: True

T F 31. Managing the financial affairs and property of individuals and business firms falls under the type of banking service line known as <u>cash management services.</u>
Answer: False

T F 32. The role performed by banks in the economy in which they transform savings into credit is known as the <u>intermediation role.</u>
Answer: True

T F 33. The role performed by banks in which they stand behind their customers when those customers are unable to pay a debt obligation is known as the <u>guarantor role.</u>
Answer: True

T F 34.When banks serve as conduits for government policy this is referred to as their <u>agency role.</u>
Answer: False

T F 35. According to the textbook, high-volume banking is required to make efficient use of automation and other technological innovations.
Answer: True

T F 36. The number of independently owned banks has risen in the United States over the last decade.
Answer: False

T F 37. Money-center banks usually service local communities, towns, and cities, offering a narrow menu of services to the public.
Answer: False

T F 38. A greater proportion of major corporations have deserted the banking system in recent years to raise borrowed funds directly from the open market.
Answer: True

T F 39. The recent erosion of the banking market share relative to other financial institutions means that banking is a dying industry.
Answer: False

T F 40. Lending institutions act as delegated monitors and can diversify and reduce their risk exposure, resulting in increased safety for savers' funds.
Answer: True

T F 41. Current theory suggests that banks exist because of imperfections in our financial system.
Answer: True

T F 42. Today U.S. banks account for approximately fifty percent of the largest banks in the world.
Answer: False

T F 43. According to the textbook, traditional banking may be on the decline.
Answer: True

T F 44. Convergence refers to the fact that the number of bank mergers has increased in recent years.
Answer: False

T F 45. Banks which offer virtually all financial services are known as **universal banks**.
Answer: True

T F 46. Life insurance companies, securities firms, and mortgage companies all compete with the traditional bank.
Answer: True

**Multiple Choice Questions**

47. In the United States a commercial bank qualifies as a "bank" under federal law if it offers:
    A) Consumer installment loans, CDs
    B) Savings deposits, commercial loans
    C) Checking accounts, commercial loans
    D) Security investments, inventory loans to business customers
    E) Commercial deposit accounts, consumer savings plans
    Answer: C

48. E. F. Hutton, J.C. Penney, and Sears Roebuck are among leading firms that in the1980's organized competitors with banks that are known as:
    A) Nonbank Banks
    B) Discount Security Brokerage Companies
    C) Money Market Funds
    D) Finance Companies
    E) Investment Banking Units
    Answer: A

49. A study of history shows that one of the first services offered by banks was:
    A) Equipment Leasing
    B) Currency Exchange
    C) Security Brokerage and Underwriting
    D) Sale of Real Estate
    E) None of the above
    Answer: B

50. Banks perform the indispensable task of:
    A) Creating money without making loan.
    B) Absorbing the excess liquidity created by other financial institutions
    C) Intermediating between surplus-spending individuals or institutions and deficit-spending individuals or institutions
    D) Issuing risky deposits
    E) None of the above
    Answer: C

51. The view that depositors hire banks to analyze the financial condition of prospective borrowers and continually evaluate the condition of outstanding loans is referred to as:
    A) Delegated monitoring
    B) The concept of financial intermediation

C) The liquidity function in banking
D) Market imperfection theory
E) The efficiency contribution of banking
Answer: A

52. Which of the following has been an important trend regarding consolidation and geographic expansion in banks?
A) Increased bank branching activity
B) The formation of more holding companies to purchase smaller banks
C) Mergers among some of the largest banks in the industry
D) A and C above
E) All of the above.
Answer: E

53. Included among leading structural trends in the U.S. banking industry in recent years are:
A) The number of independently owned banks has declined
B) The average size of individual banking firms has increased
C) Entry across state lines from neighboring states has increased
D) A and B only
E) All of the above.
Answer: E

54. Smaller, locally focused commercial and savings banks that offer narrower but more personalized menu of financial services are known as:
A) Money center banks
B) Community banks
C) Mutual Funds
D) State banks
E) Fringe banks.
Answer: B

55. The banking services that includes executing buy and sell orders for security trading customers and marketing new securities to raise funds for corporations and other institutions is referred to:
A) Comprehensive Packaging
B) Wrap-around Accounts
C) Investment Banking
D) Professional Banking
E) None of the above.
Answer: C

56. A bank that wires funds for the purchase of a beach house in South Carolina for a customer in Oklahoma is carrying out the __________ of banks.
A) The intermediation role
B) The payment role
C) The guarantor role
D) The agency role

E) The policy role
Answer: B

57. Examples of imperfections in the financial system which allow banks to exist include which of the following?
A) Informational asymmetry
B) Efficiency of markets
C) All individuals and businesses have full information about all investment opportunities.
D) All individuals and businesses have no difficulty meeting their liquidity needs on their own.
E) All of the above are examples of the imperfections that exist.
Answer: A

58. A bank which manages the investment portfolio and pays the bills of an elderly customer who is unable to do it for him or herself is carrying out the __________ of banks.
A) The intermediation role
B) The payment role
C) The guarantor role
D) The agency role
E) The policy role
Answer: D

59. Which of the following is a trend that has affected all banks today?
A) Increased isolation of banks in the U.S.
B) Decreased competition from other financial institutions
C) Decreased amount of services provided by modern banks
D) Rising funding costs
E) Increased regulations
Answer: D

60. Which of the following is **not** a current trend in the banking industry?
A) The number of banks is declining
B) The number of bank branches is declining
C) The number of bank services is increasing
D) The number of bank competitors is increasing
E) Bank industry convergence
Answer: B

61. Which of the following types of banks would most likely offer the largest number of financial services?
A) A retail bank
B) A community bank
C) A commercial bank
D) A universal bank
E) An international bank
Answer: D

62. The phenomenon of **convergence** refers to:
A) Financial service firms expanding into other product lines
B) Firms reducing their product lines
C) Bank merger activity
D) Globalization in banking
E) Technological innovation in banking
Answer: A

63. Bank equipment leasing activity involves:
A) A bank leasing its office facilities instead of buying
B) A bank buying equipment and then leasing the item to a customer
C) A customer buying equipment and then leasing it to a bank
D) A bank leasing computer equipment
E) None of the above
Answer: B

64. Wholesale banks are those banks that:
A) Sell at a discount relative to all commercial banks
B) Only make loans to the wholesale industry
C) Lend almost exclusively to farmers
D) Are large banks which serve corporations and government
E) Have only retail customers
Answer: D

65. Jonathan Robbins has an account in a bank that does not have a physical branch. Jonathan does all of his banking business over the internet. What type of bank does Jonathan have his account at?
A) Virtual Bank
B) Mortgage Bank
C) Community Bank
D) Affiliated Bank
E) None of the above
Answer: A

66. The Edmond National Bank serves only the City of Edmond, Oklahoma and concentrates on providing the best possible service to this city. What type of bank is this most likely to be?

A) Virtual Bank
B) Mortgage Bank
C) Community Bank
D) Affiliated Bank
E) None of the above
Answer: C

67. The Charleston Southern Bank makes loans for families to purchase new and existing homes but does not take deposits. What type of bank is this most likely to be?
A) Virtual Bank
B) Mortgage Bank
C) Community Bank
D) Affiliated Bank
E) None of the above
Answer: B

68. Which of the following is considered a fringe bank?
A) Community Bank
B) Wholesale Bank
C) Merchant Bank
D) Payday Lender
E) None of the above
Answer: D

69. During the middle ages, banks encountered religious opposition because:
A) Loans to the poor often carried high interest rates
B) Loans and deposits were primarily for wealthy customers
C) The Industrial Revolution demanded new methods of making payments and obtaining credit
D) Savings and wealth were lost due to war, theft and expropriation by governments
E) All of the above
Answer: A

70. Religious opposition decreased during the Renaissance because:
A) Loans to the poor often carried high interest rates
B) Loans and deposits were primarily for wealthy customers
C) The Industrial Revolution demanded new methods of making payments and obtaining credit
D) Savings and wealth were lost due to war, theft and expropriation by governments
E) All of the above
Answer: B

71. Banks like the Medici Bank in Italy and the Hochstetter Bank in Germany were successful because__________________________________________________ and they responded well to these new needs.
A) Loans to the poor often carried high interest rates
B) Loans and deposits were primarily for wealthy customers
C) The Industrial Revolution demanded new methods of making payments and obtaining credit

D) Savings and wealth were lost due to war, theft and expropriation by governments
E) All of the above
Answer: C

72. Early European banks were places for safekeeping of wealth because:
A) Loans to the poor often carried high interest rates
B) Loans and deposits were primarily for wealthy customers
C) The industrial revolution demanded new methods of making payments and obtaining credit
D) Savings and wealth were lost due to war, theft and expropriation by governments
E) All of the above
Answer: D

73. The U.S. government wants to prevent money laundering by drug cartels. To promote this goal, they have asked banks to report any cash deposits greater than $10,000 to the government. Which of the following roles is the bank performing?
A) The intermediation role
B) The payment role
C) The risk management role
D) The guarantor role
E) The policy role
Answer: E

74. The Edmond Wine and Cheese shop wants to buy 30 cases of French Champagne on credit. Bank of America writes a letter of credit stating that the Edmond Wine and Cheese shop is a good risk and that if they do not pay off the loan, Bank of America will. Which of the following roles is the bank performing?
A) The intermediation role
B) The payment role
C) The risk management role
D) The guarantor role
E) The policy role
Answer: D

75. Alexander Phua goes to his local bank and gets an insurance policy that protects him against loss in case he is in a car accident. Which of the following roles is the bank performing?
A) The intermediation role
B) The payment role
C) The risk management role
D) The guarantor role
E) The policy role
Answer: C

76. Chris Jones gets a cashier's check from Wachovia Bank to make his down payment on a new home. Which of the following roles is the bank performing?
A) The intermediation role
B) The payment role

C) The risk management role
D) The guarantor role
E) The policy role
Answer: B

77. The Bank, N.A. accepts deposits from thousands of individuals and lends that money to (among others) the Stillwater Body Shop to expand their work bays. Which of the following roles is the bank performing?
A) The intermediation role
B) The payment role
C) The risk management role
D) The guarantor role
E) The policy role
Answer: A

78. Major trends affecting the performance of financial firms today include all of these *except*:
A) Greater product-line diversification
B) Reduced branching
C) Geographic diversification
D) Convergence
E) Increasing automation
Answer: B

79. The First National Bank of Lakeland makes risky loans to business to expand and grow their businesses while at the same time accepting funds into checking accounts that are insured by the FDIC. Which of the following services is this bank offering to their customers?
A) Risky arbitrage services
B) Liquidity services
C) Ability of the bank to evaluate information
D) Divisibility of money services
E) Credit services
Answer: A

80. Jonathan Wynn knows that if he wanted to purchase a Treasury Bill, the minimum amount he would spend would be close to $10,000. He also knows that he could deposit $1,000 in a money market deposit account at a bank and earn about the same rate of interest. Jonathan does not have $10,000 to invest in a Treasury Bill. If Jonathan puts his money in the bank, which service that a bank can provide is he taking advantage of?
A) Risky arbitrage services
B) Liquidity services
C) Ability of the bank to evaluate information
D) Divisibility of money services
E) Credit services
Answer: D

81. Nick Rodr gets a loan from the First State Bank of Guthrie to purchase a new refrigerator for his

condo. What service that a bank provides is he taking advantage of?
A) Risky arbitrage services
B) Liquidity services
C) Ability of a bank to evaluate information
D) Divisibility of money services
E) Credit services
Answer: E

82. Drew Davis goes to his local bank to get help developing a financial plan and making investment decisions. Which of the more recent services banks offer is Drew taking advantage of?
A) Getting a consumer loan
B) Getting financial advice
C) Managing cash
D) Getting venture capital services
E) Buying a retirement plan
Answer: B

83. The Bartholemew Bakery receives a lot of payments in cash. They deposit it in their local bank who invests the money in an interest bearing account until it is needed to pay bills. Which of the financial services banks offer is the Bartholemew bakery taking advantage of?
A) Getting a consumer loan
B) Getting financial advice
C) Managing cash
D) Getting venture capital services
E) Buying a retirement plan
Answer: C

84. MyWebCast is a new company that makes it easy for individuals to create streaming videos on the internet to share with friends and family for a small fee. MyWebCast wants to expand their offerings of video streaming services but needs cash to be able to do this. The Second National Bank of Oklahoma City, through a subsidiary, gives them the cash they need for an ownership share in the company. Which of the more recent services that banks offer is MyWebCast taking advantange of?
A) Getting a consumer loan
B) Getting financial advice
C) Managing cash
D) Getting venture capital services
E) Buying a retirement plan
Answer: D

85. Chandriga Suppiah has opened a Roth IRA with North Carolina State Bank and plans on making regular contributions to this account until she retires. Which of the financial services is Chandriga taking advantage of?
A) Getting a consumer loan
B) Getting financial advice
C) Managing cash
D) Getting venture capital services

E) Buying a retirement plan
Answer: E

86. Banks with less than ___________in assets are generally called community banks.
A) More than $1 billion
B) Less than $1 billion
C) More than $10 billion
D) Less than $1 trillion
E) More than $1 trillion
Answer: B

87. The principal functions and services offered by many financial-service firms today include:
A) Lending and investing money
B) Making payments of behalf of customers to facilitate their purchases of goods and services
C) Managing and protecting customers' cash and other property
D) Assisting customers in raising and investing funds profitably
E) All of the above
Answer: E

88. Which of the following is considered a depository financial institution?
A) Mortgage company
B) Mutual fund
C) Savings and Loan associations
D) Federal Reserve
E) Insurance company
Answer: C

89. Which of the following is <u>not</u> a purpose of bank regulation:
A) Guarantee minimal profitability of the banking system
B) Provide monetary stability
C) Ensure safety and soundness of banks
D) Provide competitive financial system
E) Protect consumers from abuses by banks
Answer: A

90. During the financial crisis of 2007-2009, the collapse of Lehman Brothers and the bailout of Bear Stearns reaffirmed the importance of the fundamental principle of:
A) Superior management
B) Globalization
C) Government bailout
D) Regulatory arbitrage
E) Public trust and confidence in the system
Answer: E

## Chapter 10
## The Investment Function in Banking and Financial-Services Management

### Fill in the Blank Questions

1. A(n) __________________________ is a security issued by the federal government which has less than one year to maturity when it is issued.
   Answer: Treasury bill

2. Debt instruments issued by cities, states and other political entities and which are exempt from federal taxes are collectively known as __________________________ .
   Answer: municipal securities

3. The investment maturity strategy which calls for the bank to have one half of its investment portfolio in very short term assets and one half of its investment portfolio in long term assets is known as the __________________________ .
   Answer: barbell strategy

4. A(n) __________________________ is a security where the interest portion of the security is sold separately from the principal portion of the security.
   Answer: stripped security

5. __________________________ are the way the federal, state and local governments guarantee the safety of their deposits with banks.
   Answer: Pledging requirements

6. The most aggressive investment maturity strategy calls for the bank to continually shift the maturities of its securities in responses to changes in interest rates and is called the ___________________.
   Answer: rate expectation strategy

7. __________________________ is the risk that the bank will have to sell part of its investment portfolio before their maturity for a capital loss.
   Answer: Liquidity risk

8. __________________________ is the risk that the economy of the market area they service may take a down turn in the future.

Answer: Business risk

9. __________________ is the risk that the company whose bonds the financial institution owns may retire the entire issue of corporate bonds in advance of their maturity leaving the bank with the risk of earnings losses resulting from reinvesting the cash at lower interest rates.
Answer: Call risk

10. A security issued by the federal government with 1 to 10 years to maturity when it is issued is called a(n) _________________________.
Answer: Treasury note

11. A short term debt security issued by major corporations is known as __________________.
Answer: commercial paper

12. The investment maturity strategy which calls for the bank to have all of their investment assets in very short term maturities is called the _________________________.
Answer: front-end-loaded policy

13. A money market security which represents a bank's commitment to pay a stipulated amount of money on a specific future date under specific conditions and which is often used in international trade is known as a(n) _________________________.
Answer: bankers' acceptance

14. A(n) _________________________ is an interest-bearing receipt for the deposit of funds in a bank for a stipulated time period. Ones that are oriented towards business customers or institutions are known as jumbos.
Answer: certificate of deposit

15. _________________________ are any securities which reach maturity in under one year.
Answer: Money market securities

16. _________________________ are any securities whose original maturity exceeds one year.
Answer: Capital market securities

17. Securities sold by Fannie Mae, Freddie Mac and others are known as _________________________.
Answer: federal agency securities

18. Claims against the expected income and principal generated by a pool of similar-type loans are known as _________________________.
Answer: securitized assets

19. The long term debt obligations of major corporations are known as _________________________.
Answer: corporate bonds

20. The investment maturity strategy which calls for the bank to have all of their investment assets in very long term maturities is known as the __________________________.
Answer: back-end-loaded policy

21. Financial Institutions may invest in municipal bonds issued by smaller local governments. These bonds are known as _____________ bonds.
Answer: bank qualified

22. Marketable notes and bonds sold by agencies owned by the government or sponsored by the government are known as ______________________________________.
Answer: government agency securities

23. A security issued by the federal government with greater than 10 years to maturity when it is issued is called a(n) _________________________________.
Answer: Treasury Bond

24. ________________________ are time deposits of fixed maturity issued by the world's larges banks headquartered in financial centers around the globe. The heart of this market is centered in London.
Answer: Eurocurrency deposits

25. ________________________ are a type of municipal bond that are backed by the full faith and credit of the issuing government.
Answer: General obligation bonds

26. _____________________________ are a type of municipal bond that are paid only from certain stipulated source of funds.
Answer: Revenue bonds

27. _________________________ are closely related to CMOs and partition the cash flow from a pool of mortgage loans or mortgage backed securities into multiple maturity classes in order to reduce the cash-flow uncertainty of investors.
Answer: Real Estate Mortgage Investment Conduits (REMICs)

28. ______________________ is the risk that loans will be terminated or paid off ahead of schedule. This is a particular problem with residential home mortgages and other consumer loans that are pooled and used as collateral in securitized assets.
Answer: Prepayment risk

29. A lending institution that sells lower-yielding securities at a loss in order to reduce current taxable income while simultaneously purchasing higher-yielding new securities in order to boost future returns is doing a(n) ____________________.
Answer: tax swap

30. A(n) ____________________ is a picture of how market interest rates differ across loans securities of varying times to maturity.
Answer: yield curve

**True/False Questions**

T F 31. Investments in securities provide diversification for a bank's assets because most loans come from the local areas served by a bank's offices.
Answer: True

T F 32. Bank income from loans is fully taxable.
Answer: True

T F 33. Investment securities are expected to "dress up" a bank's balance sheet, according to the textbook.
Answer: True

T F 34. Investment securities are expected to help stabilize a financial institutions's income.
Answer: True

T F 35. A short-term IOU offered by major corporations that is of short maturity (most of these lOUs mature in 90 days or less) is known as a CMO.
Answer: False

T F 36. Prepayment risk on securitized assets generally increases when interest rates rise.
Answer: False

T F 37. Stripping a security eliminates prepayment risk.
Answer: False

T F 38. According to the textbook the dominant security held in U.S. bank investment portfolios is state and local government bonds.
Answer: False

T F 39. Interest income and capital gains from a bank's portfolio of investment securities is taxed in the United States as ordinary income.
Answer: True

T F 40. Eurocurrency deposits that some banks purchase as investments generally carry higher market yields than domestic time deposits issued by comparable-size U.S. banks.
Answer: True

T F 41. Bankers' acceptances are considered to be among the safest of all money market instruments.
Answer: True

T F 42. An eligible acceptance is one that can be used as collateral for borrowing from a Federal Reserve bank.
Answer: True

T F 43. When a bank irrevocably guarantees a commercial paper issue, the bank's credit rating substitutes for the borrower's credit rating.
Answer: True

T F 44. The principal risk banks face from investing in structured notes is credit (default) risk.
Answer: False

T F 45. The principal risk to a financial institution buying CMOs is market risk.
Answer: False

T F 46. Stripped mortgage-backed securities fully protect investors from having to reinvest their income at lower and lower interest rates.
Answer: False

T F 47. Stripped mortgage-backed securities make maturity matching of bank assets and liabilities easier to accomplish than do most other investment securities that banks buy.
Answer: False

T F 48. Lower interest rates increase the present value of all projected cash flows from a loan-backed security so that its market value could rise.
Answer: True

T F 49. Treasury bills are the long term debt obligations issued by the federal government.
Answer: False

T F 50. Commercial paper is the short term debt instrument issued by major banks.
Answer: False

T F 51. Treasury notes and bonds are issued by the federal government and are coupon instruments.
Answer: True

T F 52. Interest rate risk is the risk financial institutions face due to changes in market interest rates.
Answer: True

T F 53. One investment maturity strategy popular among smaller institutions is the ladder or spaced maturity policy. It is popular because it does not take much expertise to implement.
Answer: True

T F 54. One investment maturity strategy, called the front end loaded policy, requires that the bank put all of its investment portfolio in long term securities.
Answer: False

T F 55. Business risk is the risk that the bank will experience a cash shortage and will have to sell some of its investments securities.
Answer: False

T F 56. Inflation risk is the possibility that the purchasing power of interest income and repaid principal from a security or loan will be eroded by rising prices for goods and services.
Answer: True

T F 57. Call risk refers to the right of debt collectors to call in the loans in advance of maturity and get an early repayment.
Answer: False

T F 58. If interest rates fall, a callable bond at par has the potential for large increases in price.
Answer: False

T F 59. The yield to maturity is the discount rate that equates a security's purchase price with the stream of income expected until it is sold to another investor.
Answer: False

## Multiple Choice Questions

60. An important investment security popular with banks that must by law mature within one year from the date of issue and which has a high degree of safety and marketability is the:
    A) Treasury bill
    B) Treasury note
    C) FNMA note
    D) Bankers' acceptance
    E) Eurodollar CD
    Answer: A

61. A bank's promise to pay the holder a designated amount of money on a designated future date and is often used in international trade is known as a (or an):
    A) Promissory guarantee
    B) Discount security
    C) Bankers' acceptance
    D) In the money option
    E) Accretion note
    Answer: C

62. Pools of mortgages put together either by a government agency or by a private investment banking corporation to raise more loanable funds for the issuer are known as a (or an):
    A) Accretion bond
    B) Participation certificate
    C) CMO
    D) Stripped security
    E) Commercial paper
    Answer: C

63. Fluctuations in the timing of cash payments flowing from an underlying pool of securitized assets is referred to as:
    A) Income risk
    B) Prepayment risk
    C) Liquidity risk
    D) Capital risk
    E) None of the above
    Answer: B

64. Principal roles that a financial institution's investment portfolio play include which of the following?
    A) Income stability
    B) Geographic diversification
    C) Hedging interest rate risk

D) Backup liquidity
E) All of the above
Answer: E

65. _____________ is the method by which banks can provide a safeguard for the deposits of governmental units.
A) Hedging
B) Collateralization
C) Pledging
D) Securitization
E) Window dressing
Answer: C

66. The most aggressive investment maturity strategy that calls for the bank to continually shift the maturities of its securities in response to changes in interest rates and other economic conditions is the
A) Barbell strategy
B) Rate expectations approach
C) Front-end-loaded policy
D) Ladder approach
E) None of the above
Answer: B

67. Which of the following statements is (are) correct regarding duration?
A) In comparing two bonds with the same yield to maturity and the same maturity, a bond with a higher coupon rate will have a longer duration.
B) In comparing two loans with the same maturity and the same interest rate, a fully amortized loan will have a shorter duration than a loan with a balloon payment.
C) The duration will always be shorter than the maturity for all debt instruments.
D) All of the above
E) B and C
Answer: B

68. Which of the following is not one of the Capital Market instruments in which banks invest?
A) U.S. Treasury notes
B) Corporate notes and bonds
C) U.S. Treasury bonds
D) Municipal bonds
E) Commercial paper
Answer: E

69. Which of the following is true of Treasury bills?
A) Interest on Treasury bills is exempt from state income taxes.
B) Interest on Treasury bills is exempt from federal income taxes.
C) Treasury bills pay a lower pretax yield than comparable corporate securities.
D) All of the above are true.

E) A and C only
Answer: E

70. In recent years security dealers have assembled pools of federal agency securities whose principal interest yield may be periodically reset based on what happens to a stated interest rate or may carry multiple coupon rates that are periodically adjusted; the foregoing describes a:
A) Financial futures contract
B) Revenue-anticipation note
C) Zero coupon instrument
D) Structured note
E) None of the above
Answer: D

71. Banks are generally not allowed to invest in speculative grade bonds. What kind of risk is this designed to limit?
A) Liquidity risk
B) Business risk
C) Credit risk
D) Tax exposure
E) Interest rate risk
Answer: C

72. A security where the interest payments and the principal payments are sold separately is called:
A) A Treasury note
B) An accretion
C) A structured note
D) A stripped security
E) None of the above
Answer: D

73. Which of the following is true? Mortgage prepayment risk:
A) Is higher on high interest rate mortgages
B) Is felt most dramatically when interest rates rise
C) Is eliminated by the use of mortgage backed securities
D) Is eliminated by the purchase of a stripped mortgage obligation
E) All of the above are true
Answer: A

74. A bank replaces 5-year corporate bonds with a yield to maturity of 9.75 percent with 5-year municipal bonds with a yield to maturity of 7 percent. This bank is in the 35 percent tax bracket and these bonds have the same default risk. What is the most likely reason this bank changed from the corporate to the municipal bonds?
A) Liquidity risk

B) Business risk
C) Credit risk
D) Tax exposure
E) Interest rate risk
Answer: D

75. Suppose a bank has found bank qualified municipal bonds which have a nominal gross rate of return of 8 percent and that it can borrow funds needed for this purchase at a rate of 6.25 percent. This bond is in the 35 percent tax bracket. What is the net after-tax return on this bond?
A) 5.20 percent
B) 3.5 percent
C) 1.75 percent
D) 0 percent
E) None of the above
Answer: B

76. An investor can invest in either a tax-exempt security that pays 5% or a taxable corporate security of comparable risk and maturity that pays 8%. At what marginal tax rate will the investor be indifferent between these two securities?
A) 25.0%
B) 32.5%
C) 37.5%
D) 57.5%
E) 62.5%
Answer: C

77. Which of the following would not be considered a bank qualified municipal security?
A) A Columbia County general obligation bond to modernize the county fire department.
B) A Bucks County general obligation bond to build a new sewer plant.
C) A City of San Marcos general obligation bond to pay for street repairs.
D) A City of Chicopee general obligation bond to pay for a new city jail.
E) A Treasury bond to finance government debt.
Answer: E

78. A bond has three years to maturity and has a coupon rate of 15 percent. This bond is selling in the market for $1072 and has a yield to maturity of 12%. What is the duration of this bond?
A) 3 years
B) 1 year
C) 1.92 years
D) 2.45 years
E) 2.64 years
Answer: E

79. A bond has six years to maturity and has a coupon rate of 7.5 percent. Coupon payments are made annually and this bond has a face value of $1000. This bond is selling in the market for $1127. What is the yield to maturity on this bond?
A) 7.5 percent
B) 5 percent

C) 11.5 percent
D) 2.5 percent
E) None of the above
Answer: B

80. A bond has eight years to maturity and a coupon rate of 6.5 percent. Coupon payments are made annually and this bond has a face value of $1000. This bond is selling in the market for $862. What is the yield to maturity on this bond?
A) 6.5 percent
B) 10 percent
C) 8.5 percent
D) 9 percent
E) None of the above
Answer: D

81. A bond has eight years to maturity and a coupon rate of 6.5 percent. Coupon payments are made annually and this bond has a face value of $1000. This bond is selling in the market for $862. If this bond is sold at the end of four years for $1046, what is the holding period return on this bond?
A) 6.5 percent
B) 12 percent
C) 9 percent
D) 6 percent
E) None of the above
Answer: B

82. A security which was created by the Treasury to protect against inflation risk is called a(n):
A) CMO
B) FNMA
C) GNMA
D) TIPS
E) CD
Answer: D

83. A financial institution that is concerned about the possibility that the purchasing power of both the interest income and principal income will decline on a loan is concerned about which of the following things?
A) Business risk
B) Liquidity risk
C) Tax exposure
D) Credit risk
E) Inflation risk
Answer: E

84. A bank that is concerned that the economic conditions of the market area they serve may take a

downturn with falling demand for loans and higher bankruptcies in the areas is concerned about which of the following things?
A) Business risk
B) Liquidity risk
C) Tax exposure
D) Credit risk
E) Inflation risk
Answer: A

85. Which of the following is a characteristic of Treasury bills?
A) They are coupon instruments
B) They are the short term debt instruments issued by major corporations
C) They are discount securities
D) They have more risk than other money market securities
E) All of the above are characteristics of Treasury bills
Answer: C

86. The investment maturity strategy which calls for the bank to put all of their investment assets into very long term securities is called the:
A) Front-end-loaded maturity policy
B) Back-end-loaded maturity policy
C) Ladder or spaced maturity policy
D) Barbell investment portfolio strategy
E) Rate expectation approach
Answer: B

87. The Lancaster State Bank is thinking about purchasing a corporate bond that has a yield of 8.5%. This bank has a marginal tax rate of 25%. What is the after-tax yield on this bond?
A) 11.33%
B) 8.5%
C) 6.375%
D) 2.125%
E) None of the above
Answer: C

88. The Ferson National Bank is thinking about purchasing a municipal bond that has a yield of 5.5%. This bank has a marginal tax rate of 30%. What is the after-tax yield on this bond?
A) 7.86%
B) 5.5%
C) 3.85%
D) 1.65%
E) None of the above
Answer: B

89. The Stumbaugh State Bank is thinking about purchasing a corporate bond that has a yield of 9%.

This bank has a marginal tax rate of 40%. What is the after-tax yield on this bond?
A) 15%
B) 9%
C) 5.4%
D) 3.6%
E) None of the above

90. The Price Perpetual Bank has purchased a bond that has a coupon rate of 5.5% and a face value of $1000. It has 11 years to maturity and is selling in the market for $887.52. The bond makes annual coupon payments. What is the yield to maturity on this bond?
A) 7%
B) 5.5%
C) 11%
D) 4.70%
E) None of the above
Answer: A

91. The Price Perpetual Bank has purchased a bond that has a coupon rate of 5.5% and a face value of $1000. It has 11 years to maturity and is selling in the market for $887.52. The bond makes annual coupon payments. The Price Perpetual Bank is planning on selling this bond at the end of 5 years for $1036.50. What is the holding period return on this bond?
A) 5.5%
B) 7%
C) 11%
D) 9%
E) None of the above
Answer: D

92. The Farmer National Bank has purchased a bond that has a coupon rate of 11.5% and a face value of $1000. It has 16 years to maturity and is selling in the market for $1309.80. The bond makes annual coupon payments. What is the yield to maturity on this bond?
A) 11.5%
B) 16%
C) 8%
D) 12.21%
E) None of the above
Answer: C

93. The Farmer National Bank has purchased a bond that has a coupon rate of 11.5% and a face value of $1000. It has 16 years to maturity and is selling in the market for $1309.80. The bond makes annual coupon payments. The Farmer National Bank plans on selling this bond at the end of 8 years for $1071. What is the holding period return on this bond?
A) 7%
B) 8%
C) 11.5%
D) 16%
E) None of the above

Answer: A

94. The Johnson National Bank has purchased a bond that has a coupon rate of 5.5% and a face value of $1000. It has 4 years to maturity and is selling in the market for $917. The bond makes annual coupon payments. What is the yield to maturity on this bond?
A) 5.5%
B) 4.0%
C) 1.5%
D) 8%
E) None of the above

95. The Johnson National Bank has purchased a bond that has a coupon rate of 5.5% and a face value of $1000. It has 4 years to maturity and is selling in the market for $917. The bond makes annual coupon payments. What is the duration of this bond?
A) 3.38 years
B) 3.68 years
C) 4.00 years
D) 5.50 years
E) None of the above
Answer: B

96. The Sheets Savings and Loan Association has purchased a bond that has a coupon rate of 7.5% and a face value of $1000. It has 5 years to maturity and is selling in the market for $1063. The bond makes annual coupon payments. What is the duration of this bond?
A) 7.50 years
B) 5.00 years
C) 4.65 years
D) 4.37 years
E) None of the above
Answer: D

97. The Dillinger State Bank has purchased a bond from the Interstate Manufacturing Company that has 15 years to maturity and has a coupon rate of 12.5%. Market interest rates have recently declined to 8% and the Dillinger State Bank is worried that the Interstate Manufacturing Company will retire the bond and issue new ones with a lower coupon rate. What type of risk is the Dillinger State Bank worried about?
A) Credit risk
B) Interest-rate risk
C) Business- risk
D) Call risk
E) Prepayment risk
Answer: E

98. The Terrell State Bank is a small bank located in Guyman, Oklahoma. All of their loans are agriculture and small business loans in Guyman. They want to buy a municipal bond from the

state of South Carolina. What type of risk are they likely trying to reduce with this purchase?
A) Credit risk
B) Interest-rate risk
C) Business risk
D) Call risk
E) Prepayment risk
Answer: C

99. The Caldwell National Bank has purchased a bond that pays a coupon rate of 10.5%. They are a little concerned because they believe rates will decrease in the future and they will not be able to reinvest the coupon payments at the same rate. What type of risk are they concerned about?
A) Credit risk
B) Interest rate risk
C) Business risk
D) Call risk
E) Prepayment risk
Answer: B

100. Moody's Investor Service has added the numbers 1, 2 and 3 to some of their ratings. What type of risk are these ratings attempting to measure?
A) Credit risk
B) Interest rate risk
C) Business risk
D) Call risk
E) Prepayment risk
Answer: A

101. The Roy State Bank has just purchase a portfolio of asset backed securities. What type of risk do these securities have that other securities do not have?
A) Credit risk
B) Interest rate risk
C) Business risk
D) Call risk
E) Prepayment risk
Answer: E

102. The Carey State Bank has purchased a bank-qualified municipal bond with a yield of 6%. This bank has had to borrow funds to make this purchase at a cost of 5.25%. This bank is in the 40% tax bracket. What is the net after-tax return on this bank-qualified municipal bond?
A) 6.00%
B) .75%
C) 2.85%
D) 2.43%
E) None of the above
Answer: D

103. The Wesson Wisconsin State Bank has purchased a bank-qualified municipal bond with a yield of 7.5%. This bank had to borrow funds to make this purchase at a cost of 6%. This bank is in the 25% tax bracket. What is the net after-tax return on this bank-qualified municipal bond?
A) 7.5%
B) 2.7%
C) 3.0%
D) 1.5%
E) None of the above
Answer: B

104. The Goodknight Company has issued securities with 45 days to maturity. What type of security have they issued?
A) Commercial Paper
B) Banker's Acceptance
C) Corporate Bond
D) Certificate of Deposit
E) Municipal Bond
Answer: A

105. The Dakota National Bank has purchased a security issued by the state of Tennessee that has 20 years to maturity. What type of security have they purchased?
A) Commercial Paper
B) Banker's Acceptance
C) Corporate Bond
D) Certificate of Deposit
E) Municipal Bond
Answer: E

# Chapter 12
# Managing and Pricing Deposit Services

## Fill in the Blank Questions

1. A(n) __________________________ requires the bank to honor withdrawals immediately upon request.
   Answer: demand deposit

2. A(n) __________________________ is an interest bearing checking account and gives the bank the right to insist on prior notice before customer withdrawals can be honored.
   Answer: Negotiable order of withdrawal (NOW)

3. A(n) __________________________ is a short-maturity deposit which pays a competitive interest rate. Only 6 preauthorized drafts per month are allowed and only 3 of these can be by check.
   Answer: money market deposit account

4. __________________________ are designed to attract funds from customers who wish to set aside money in anticipation of future expenditures or financial emergencies.
   Answer: Thrift deposits

5. __________________________ are the stable base of deposited funds that are not highly sensitive to movements in market interest rates and tend to remain with a depository institution.
   Answer: Core deposits

6. Some people feel that everyone is entitled access to a minimum level of financial service no matter their income level. This issue is called the issue of __________________________.
   Answer: basic (lifeline) banking

7. __________________________ is a way of pricing deposit services in which the rate or return or fees charged on the deposit account are based on the cost of offering the service plus a profit margin.
   Answer: Cost plus pricing

8. When financial institutions tempt customers by paying postage both ways in bank-by-mail services or by offering free gifts such as teddy bears, they are practicing ___________.
   Answer: nonprice competition

9. The __________________________is the added cost of bringing in new funds.
Answer: marginal cost

10. __________________________ pricing is where the financial institution sets up a schedule of fees in which the customer pays a low or no fee if the deposit balance stays above some minimum level and pays a higher fee if the balance declines below that minimum level.
Answer: Conditional

11. When a customer is charged a fixed charge per check this is called ___________________ pricing.
Answer: flat rate

12. When a customer is charged based on the number and kinds of services used, with the customers that use a number of services being charged less or having some fees waived, this is called ___________________ pricing.
Answer: relationship

13. __________________________ is part of the new technology for processing checks where the bank takes a picture of the back and the front of the original check and which can now be processed as if they were the original.
Answer: Check imaging

14. A(n) __________________________ is a thrift account which carries a fixed maturity date and generally carries a fixed interest rate for that time period.
Answer: time deposit

15. A(n) __________________________ is a conditional method of pricing deposit services in which the fees paid by the customer depend mainly on the account balance and volume of activity.
Answer: deposit fee schedule

16. The __________________________ was passed in 1991 and specifies the information that institutions must disclose to their customers about deposit accounts.
Answer: Truth in Savings Act

17. The __________________________ must be disclosed to customers based on the formula of one plus the interest earned divided by the average account balance adjusted for an annual 365 day year.  It is the interest rate the customer has actually earned on the account.
Answer: annual percentage yield (APY)

18. A(n) __________________________ is a retirement plan that institutions can sell which is designed for self-employed individuals.
Answer: Keogh plan

19. Deposit institution location is most important to ______-income consumers.
Answer: low

20. _____-income consumers appear to be more influenced by the size of the financial institution.
Answer: high

21. For decades depository institutions offered one type of savings plan. _______could be opened with as little as $5 and withdrawal privileges were unlimited.
Answer: Passbook savings deposits

22. _____________________CD's allow depositors to switch to a higher interest rate if market rates rise.
Answer: Bump-up

23. __________________CD's permit periodic adjustments in promised interest rates.
Answer: Step-up

24. __________________CD's allow the depositor to withdraw some of his or her funds without a withdrawal penalty.
Answer: Liquid

25. A(n) _____________________, which was authorized by Congress in 1997, allows individuals to make non-tax-deductible contributions to a retirement fund that can grow tax free and also pay no taxes on their investment earnings when withdrawn.
Answer: Roth IRA

26. Due to the fact that they may be perceived as more risky, ______________ banks generally offer higher deposit rates than traditional banks.
Answer: virtual

27. ________________________ are accounts in domestic banking institutions where the U.S. Treasury keeps most of their operating funds.
Answer: Treasury Tax and Loan Accounts (TT&L accounts)

28. _______________________ is a process where merchants and utility companies take the information from a check an individual has just written and electronically debits the individual's account instead of sending the check through the regular check clearing process.
Answer: electronic check conversion

29. On October 28, 2004, __________________ became the law, permitting depository institutions to electronically transfer check images instead of the checks themselves.
Answer: Check 21

30. The ________________________ to the cost plus pricing derives the weighted average cost of all funds raised and is based on the assumption that it is not the cost of each type of deposit that matters but rather the weighted average cost of all funds that matters.
Answer: pooled-funds cost approach

**True/False Questions**

T F 31. The volume of <u>core deposits</u> at U.S. banks has been growing in recent years relative to other categories of deposits.
Answer: False

T F 32. The U.S. Treasury keeps most of its operating funds in TT&L deposits, according to the textbook.
Answer: True

T F 33. Deposits owned by commercial banks and held with other banks are called <u>correspondent deposits.</u>
Answer: True

T F 34. The <u>implicit</u> <u>interest rate</u> on checkable deposits equals the difference between the cost of supplying deposit services to a customer and the amount of the service charge actually assessed that customer.
Answer: True

T F 35. Legally imposed interest-rate ceilings on deposits were first set in place in the United States after passage of the Bank Holding Company Act.
Answer: False

T F 36. Gradual phase-out of legal interest-rate ceilings on deposits offered by U.S. banks was first authorized by the Glass-Steagall Act.
Answer: False

T F 37. The contention that there are certain banking services (such as small loans or savings and checking accounts) that every citizen should have access to is usually called <u>socialized banking.</u>
Answer: False

T F 38. Domestic deposits generate legal reserves.
Answer: True

T F 39. Excess legal reserves are the source out of which new bank loans are created.
Answer: True

T F 40. Demand deposits are among the most volatile and least predictable of a bank's sources of funds with the shortest potential maturity.
Answer: True

T F 41. IRA and Keogh deposits have great appeal for bankers principally because they can be sold bearing relatively low (often below-market) interest rates.
Answer: False

T F 42. In general, the longer the maturity of a deposit, the lower the yield a financial institution must offer to its depositors because of the greater interest-rate risk the bank faces with longer-term deposits.
Answer: False

T F 43. The availability of a large block of core deposits decreases the duration of a bank's liabilities.
Answer: False

T F 44. Interest-bearing checking accounts, on average, tend to generate lower net returns than regular (noninterest-bearing) checking accounts.
Answer: False

T F 45. Personal checking accounts tend to be more profitable than commercial checking accounts.
Answer: False

T F 46. NOW accouts can be held by businesses and individuals and are interest bearing checking accounts.
Answer: False

T F 47. A MMDA is a short term deposit where the bank can offer a competitive interest rate and which allows up to 6 preauthorized drafts per month.
Answer: True

T F 48. A Roth IRA allows an individual to accumulate investment earnings tax free and also pay no tax on their investment earnings when withdrawn provided the taxpayer follows the rules on this new account.
Answer: True

T F 49. Competition tends to raise deposit interest costs.
Answer: True

T F 50. Competition lowers the expected return to a bank from putting its deposits to work.
Answer: True

T F 51. A bank has full control of its deposit prices in the long run.
Answer: False

T F 52. Nonprice competition for deposits has tended to distort the allocation of scarce resources in the banking sector.
Answer: True

T F 53. Deposits are usually priced separately from loans and other bank services.
Answer: True

T F 54. According to recent Federal Reserve data no-fee savings accounts are on the decline.
Answer: True

T F 55. According to recent survey information provided by the staff of the Federal Reserve Board the average level of fees on most types of checking and NOW accounts appear to have risen.
Answer: True

T F 56. The Truth in Savings Act requires a bank to disclose to its deposit customer the frequency with which interest is compounded on all interest-bearing accounts.
Answer: True

T F 57. Under the Truth in Savings Act customers must be informed of the impact of any early deposit withdrawals on the annual percentage yield they expect to receive from an interest-bearing deposit.
Answer: True

T F 58. The number one factor households consider in selecting a bank to hold their checking account is, according to recent studies cited in this chapter, low fees and low minimum balance.
Answer: False

T F 59. The number one factor households consider in choosing a bank to hold their savings deposits, according to recent studies cited in this chapter, is location.
Answer: False

T F 60. Conditionally free deposits for customers mean that as long as the customers do not go above a certain level of deposits there are no monthly fees or per transaction charges.
Answer: False

T F 61. When a bank temporarily offers higher than average interest rates or lower than average customer fees in order to attract new business they are practicing conditional pricing.
Answer: False

T F 62. Web-centered banks with little or no physical facilities are known as ________ banks
Answer: True

T F 63. The total dollar value of checks paid in the United States has grown modestly in recent years.
Answer: False

T F 64. There are still a number of existing problems with online bill-paying services which has limited the growth.
Answer: True

T F 65. The depository institutions which tend to have the highest deposit yields are credit unions.
Answer: False

T F 66. Urban markets are more responsive to deposit interest rates and fees than rural markets.
Answer: False

T F 67. Research indicates that at least half of all households and small businesses hold their primary checking account at a depository institution situated within 3 miles of their location.
Answer: True

**Multiple Choice Questions**

68. Deposit accounts whose principal function is to make payments for purchases of goods and services are called:
A) Drafts
B) Second-party payments accounts
C) Thrift deposits
D) Transaction accounts
E) None of the above
Answer: D

69. Interest payments on regular checking accounts were prohibited in the United States under terms of the:
A) Glass-Steagall Act
B) McFadden-Pepper Act
C) National Bank Act
D) Garn-St. Germain Depository Institutions Act
E) None of the above
Answer: A

70. Money-market deposit accounts (MMDAs), offering flexible interest rates, accessible for payments purposes, and designed to compete with share accounts offered by money market mutual funds, were authorized by the:
A) Glass-Steagall Act
B) Depository Institutions Deregulation and Monetary Control Act (DIDMCA)
C) Bank Holding Company Act
D) Garn-St.Germain Depository Institutions Act
E) None of the above
Answer: D

71. The stable and predictable base of deposited funds that are not highly sensitive to movements in market interest rates but tend to remain with the bank are called:
A) Time deposits
B) Core deposits
C) Consumer CDs
D) Nontransaction deposits
E) None of the above
Answer: B

72. Noegotiable Orders of Withdrawal (NOW) accounts, interest-bearing savings accounts that can be used essentially the same as checking accounts, were authorized by:
A) Glass-Steagall Act
B) Depository Institutions Deregulation and Monetary Control Act (DIDMCA)
C) Bank Holding Company Act
D) Garn-St. Germain Depository Institutions Act
E) None of the above
Answer: B

74. A deposit which offers flexible money market interest rates but is accessible for spending by writing a limited number of checks or executing preauthorized drafts is known as a:
A) Demand deposit
B) NOW account
C) MMDAs
D) Time deposit
E) None of the above
Answer: C

75. The types of deposits that will be created by the banking system depend predominantly upon:
A) The level of interest rates
B) The state of the economy
C) The monetary policies of the central bank
D) Public preference
E) None of the above.
Answer: D

76. The most profitable deposit for a bank is a:
A) Time deposit
B) Commercial checking account
C) Personal checking account
D) Passbook savings deposit
E) Special checking account
Answer: B

77. Some people feel that individuals are entitled to some minimum level of financial services no matter what their income level. This issue is often called:
A) Lifeline banking
B) Preference banking
C) Nondiscriminatory banking
D) Lifeboat banking
E) None of the above
Answer: A

78. The formula Operating Expense per unit of deposit service + Estimated overhead expense + Planned profit from each deposit service unit sold reflects what deposit pricing method listed below?
A) Marginal cost pricing
B) Cost plus pricing
C) Conditional pricing
D) Upscale target pricing
E) None of the above.
Answer: B

79. Using deposit fee schedules that vary deposit prices according to the number of transactions, the average balance in the deposit account, and the maturity of the deposit represents what deposit pricing method listed below?
A) Marginal cost pricing
B) Cost plus pricing
C) Conditional pricing
D) Upscale target pricing
E) None of the above.
Answer: C

80. The deposit pricing method that favors large-denomination deposits because services are free if the deposit account balance stays above some minimum figure is called:
A) Free pricing
B) Conditionally free pricing
C) Flat-rate pricing
D) Upscale target pricing
E) Marginal cost pricing
Answer: B

81. The federal law that requires U.S. depository institutions to make greater disclosure of the fees, interest rates, and other terms attached to the deposits they sell to the public is called the:
A) Consumer Credit Protection Act
B) Fair Pricing Act
C) Consumer Full Disclosure Act
D) Truth in Savings Act
E) None of the above.
Answer: D

82. Depository institutions selling deposits to the public in the United States must quote the rate of return pledged to the owner of the deposit which reflects the customer's average daily balance kept in the deposit. This quoted rate of return is known as the:
A) Annual percentage rate (APR)
B) Annual percentage yield (APY)
C) Daily deposit yield (DDY)
D) Daily average return (DAR)
E) None of the above.
Answer: B

83. According to recent studies cited in this book, in selecting a bank to hold their checking accounts household customers rank first which of the following factors?
A) Safety
B) High deposit interest rates
C) Convenient location
D) Availability of other services
E) Low fees and low minimum balance.
Answer: C

84. According to recent studies cited in this chapter, in choosing a bank to hold their savings deposits household customers rank first which of the following factors?
A) Familiarity
B) Interest rate paid
C) Transactional convenience
D) Location
E) Fees charged.
Answer: A

85. According to recent studies cited in this chapter, in choosing a bank to supply their deposits and other services business firms rank first which of the following factors?
A) Quality of financial advice given
B) Financial health of lending institution
C) Whether loans are competitively priced
D) Whether cash management and operations services are provided.
E) Quality of bank officers.
Answer: B

86. A financial institution that charges customers based on the number of services they use and gives lower deposit fees or waives some fees for a customer that purchases two or more services is practicing:
A) Marginal cost pricing
B) Conditional pricing
C) Relationship pricing
D) Upscale target pricing
E) None of the above
Answer: C

87. A bank determines from an analysis on its deposits that account processing and other operating expenses cost the bank $3.95 per month. It has also determined that its non operating expenses on its deposits are $1.35 per month. The bank wants to have a profit margin which is 10 percent of monthly costs. What monthly fee should this bank charge on its deposit accounts?
A) $5.30 per month
B) $3.95 per month
C) $5.83 per month
D) $5.70 per month
E) None of the above
Answer: C

88. A bank determines from an analysis on its deposits that account processing and other operating expenses cost the bank $4.45 per month. The bank has also determined that nonoperating expenses on deposits are $1.15 per month. It has also decided that it wants a profit of $.45 on its deposits. What monthly fee should this bank charge on its deposit accounts?
A) $6.05
B) $5.60
C) $5.15
D) $4.45
E) None of the above
Answer: A

89. A customer has a savings deposit for 45 days. During that time they earn $5 in interest and have an average daily balance of $1000. What is the annual percentage yield on this savings account?
A) 0.5%
B) 4.13%
C) 4.07%
D) 4.5%
E) None of the above
Answer: B

90. A customer has a savings account for one year. During that year they earn $65.50 in interest. For 180 days they have $2000 in the account for the other 180 days they have $1000 in the account. What is the annual percentage yield on this savings account.
A) 6.55%
B) 3.28%
C) 4.37%
D) 8.73%
E) None of the above
Answer: C

1. If you deposit $1,000 into a certificate of deposit that quotes you a 5.5% APY, how much will you have at the end of 1 year?
A) $1,050.00
B) $1,055.00
C) $1,550.00
D) $1,005.50
E) None of the above.
Answer: B

92. A bank quotes an APY of 8%. A small business that has an account with this bank had $2,500 in their account for half the year and $5,000 in their account for the other half of the year. How much in total interest earnings did this bank make during the year?
A) $300
B) $200
C) $400
D) $150
E) None of the above
Answer: A

93. Conditional deposit pricing may involve all of the following factors except:
A) The level of interest rates
B) The number of transactions passing through the account
C) The average balance in the account
D) The maturity of the account
E) All of the above are used
Answer: A

94. Customers who wish to set aside money in anticipation of future expenditures or financial emergencies put their money in
A) Drafts
B) Second-party payment accounts
C) Thrift Deposits
D) Transaction accounts
E) None of the above
Answer: C

95. A savings account evidenced only by computer entry for which the customer gets a monthly printout is called:
A) Passbook savings account
B) Statement savings plan
C) Negotiable order of withdrawal
D) Money market mutual fund
E) None of the above
Answer: B

96. A traditional savings account where evidenced by the entries recorded in a booklet kept by the customer is called:
A) Passbook savings account
B) Statement savings plan
C) Negotiable order of withdrawal
D) Money market mutual fund
E) None of the above
Answer: A

97. An account at a bank that carries a fixed maturity date with a fixed interest rate and which often carries a penalty for early withdrawal of money is called:
A) Demand deposit
B) Transaction deposit
C) Time deposit
D) Money market mutual deposit
E) None of the above
Answer: C

98. A time deposit that has a denominations greater than $100,000 and are generally for wealthy individuals and corporations is known as a:
A) Negotiable CD
B) Bump-up CD
C) Step-up CD
D) Liquid CD
E) None of the above
Answer: A

99. A time deposit that is non-negotiable but where the promised interest rate can rise with market interest rates is called a:
A) Negotiable CD
B) Bump-up CD
C) Step-up CD
D) Liquid CD
E) None of the above
Answer: B

100. A time deposit that allows for a periodic upward adjustment to the promised rate is called a:
A) Negotiable CD
B) Bump-up CD
C) Step-up CD
D) Liquid CD
E) None of the above
Answer: C

101. A time deposit that allows the depositor to withdraw some of his or her funds without a

withdrawal penalty is called a:
A) Negotiable CD
B) Bump-up CD
C) Step-up CD
D) Liquid CD
E) None of the above
Answer: D

102. What has made IRA and Keogh accounts more attractive to depositors recently?
A) Allowing the bank to have FDIC insurance on these accounts
B) Allowing the fund to grow tax free over the life of the fund
C) Allowing the depositor to pay no taxes on investment earnings when withdrawn
D) Requiring banks to pay at least 6% on these accounts to depositors
E) Increasing FDIC insurance coverage to $250,000 on these accounts
Answer: E

103. The dominant holder of bank deposits in the U.S. is:
A) The private sector
B) State and local governments
C) Foreign governments
D) Deposits of other banks
E) None of the above
Answer: A

104. The deposit pricing method absent of any monthly account maintenance fee or per-transaction fee is called:
A) Free pricing
B) Conditionally free pricing
C) Flat-rate pricing
D) Marginal cost pricing
E) Nonprice competition
Answer: A

105. The deposit pricing method that charges a fixed charge per check or per period or both is called:
A) Free pricing
B) Conditionally free pricing
C) Flat-rate pricing
D) Marginal cost pricing
E) Nonprice competition
Answer: C

106. The deposit pricing method that focuses on the added cost of bringing in new funds is called:
A) Free pricing
B) Conditionally free pricing
C) Flat-rate pricing
D) Marginal cost pricing

E) Nonprice competition
Answer: D

107. Prior to Depository Institution Deregulation and Control Act (DIDMCA), banks used _______. This tended to distort the allocation of scarce resources.
A) Free pricing
B) Conditionally free pricing
C) Flat-rate pricing
D) Marginal cost pricing
E) Nonprice competition
Answer: E

108. A customer has a savings deposit for 60 days. During that time they earn $11 and have an average daily balance of $1500. What is the annual percentage yield on this savings account?
A) .73%
B) 4.3%
C) 4.5%
D) 4.7%
E) None of the above
Answer: C

109. A customer has a savings deposit for 15 days. During that time they earn $15 and have an average daily balance of $2200. What is the annual percentage yield on this savings account?
A) .68%
B) 16.36%
C) 16.59%
D) 17.98%
E) None of the above
Answer: D

110. A bank determines from an analysis on its deposits that account processing and other operating expenses cost the bank $4.15 per month. It has also determined that its none operating expenses on its deposits are $1.65 per month. The bank wants to have a profit margin which is 10 percent of monthly costs. What monthly fee should this bank charge on its deposit accounts?
A) $6.38 per month
B) $5.80 per month
C) $4.57 per month
D) $4.15 per month
E) None of the above
Answer: A

111. A bank has $200 in checking deposits. Interest and noninterest costs on these accounts are 4%. This bank has $400 in savings and time deposits with interest and noninterest costs of 8%. This bank has $200 in equity capital with a cost of 24%. This bank as estimated that reserve requirements, deposit insurance fees and uncollected balances reduce the amount of money

available on checking deposits by 10% and on savings and time deposits by 5%. What is this bank's before-tax cost of funds?
A) 11.00%
B) 11.32%
C) 11.50%
D) 12.00%
E) None of the above
Answer: B

112. A bank has $100 in checking deposits. Interest and noninterest costs on these accounts are 8%. This bank has $600 in savings and time deposits with interest and noninterest costs of 12%. This bank has $100 in equity capital with a cost of 26%. This bank has estimated that reserve requirements, deposit insurance fees and uncollected balances reduce the amount of money available on checking deposits by 20% and on savings and time deposits by 5%. What is the bank's before-tax cost of funds?
A) 13.05%
B) 13.25%
C) 15.33%
D) 19.17%
E) None of the above
Answer: A

113. A bank has $500 in checking deposits. Interest and noninterest costs on these accounts are 6%. This bank has $250 in savings and time deposits with interest and noninterest costs of 14%. This bank has $250 in equity capital with a cost of 25%. This bank has estimated that reserve requirements, deposit insurance fees and uncollected balances reduce the amount of money available on checking deposits by 15% and on savings and time deposits by 4%. What is the bank's before-tax cost of funds?
A) 15.00%
B) 12.75%
C) 13.42%
D) 15.74%
E) None of the above
Answer: C

114. A bank expects to raise $30 million in new money if it pays a deposit rate of 7%. It can raise $60 million in new money if it pays a deposit rate of 7.5%. It can raise $80 million in new money if it pays a deposit rate of 8% and it can raise $100 million in new money if it pays a deposit rate of 8.5%. This bank expects to earn 9% on all money that it receives in new deposits. What deposit rate should the bank offer on its deposits, if they use the marginal cost method of determining deposit rates?
A) 7%
B) 7.5%
C) 8%
D) 8.5%
E) None of the above
Answer: B

115. A bank expects to raise $30 million in new money if it pays a deposit rate of 7%. It can raise $60 million in new money if it pays a deposit rate of 7.5%. It can raise $80 million in new money if it pays a deposit rate of 8% and it can raise $100 million in new money if it pays a deposit rate of 8.5%. This bank expects to earn 9% on all money that it receives in new deposits. What is the marginal cost of deposits if the bank raises their deposit rate from 7 to 7.5%?
A) .5%
B) 7.5%
C) 8.0%
D) 9.5%
E) 10.5%
Answer: C

116. Under the Truth in Savings Act, a bank must inform its customers of the terms being quoted on their deposits. Which of the following is <u>not</u> one of the terms listed?
A) Loan rate information
B) Balance computation method
C) Early withdrawal penalty
D) Transaction limitations
E) Minimum balance requirements
Answer: A

117. Which of these Acts is attempting to address the low savings rate of workers in the U.S. by including an automatic enrollment ("default option") in employees' retirement accounts?
A) The Economic Recovery Tax Act of 1981
B) The Tax Reform Act of 1986
C) The Tax Relief Act of 1997
D) The Pension Protection Act of 2006
E) None of the above
Answer: D

118. Business (commercial) transaction accounts are generally more profitable than personal checking accounts, according to the textbook. Which of the following explain the reasons for this statement:
A) The average size of the business transaction is smaller than the personal transaction
B) Lower interest expenses are associated with commercial deposit transaction
C) The bank receives more investable funds in the commercial deposits transaction
D) A and B
E) B and C
Answer: E

119. A bank expects to raise $30 million in new money if it pays a deposit rate of 7%. It can raise $60 million in new money if it pays a deposit rate of 7.5%. It can raise $80 million in new money if it pays a deposit rate of 8% and it can raise $100 million in new money if it pays a deposit rate of 8.5%. This bank expects to earn 9% on all money that it receives in new deposits. What is the marginal cost of deposits if this bank raises their deposit rate from 7.5% to 8%?
A) .5%
B) 7.5%
C) 8.0%
D) 9.5%
E) 10.5%
Answer: D

120. A bank expects to raise $30 million in new money if it pays a deposit rate of 7%. It can raise $60 million in new money if it pays a deposit rate of 7.5%. It can raise $80 million in new money if it pays a deposit rate of 8% and it can raise $100 million in new money if it pays a deposit rate of 8.5%. This bank expects to earn 9% on all money that it receives in new deposits. What is the marginal cost of deposits if this bank raises their deposit rate from 8% to 8.5%?
A) .5%
B) 7.5%
C) 8.0%
D) 9.5%
E) 10.5%
Answer: E

121. A bank expects to raise $20 million in new money if it pays a deposit rate of 7%. It can raise $60 million in new money if it pays a deposit rate of 7.5%. It can raise $100 million in new money if it pays a deposit rate of 8% and it can raise $120 in new money if it pays a deposit rate of 8.5%. This bank expects to earn 9.5% on all money that it receives in new deposits. What deposit rate should the bank offer on its deposits, if it uses the marginal cost method of determining deposits rates?
A) 7%
B) 7.5%
C) 8%
D) 8.5%
E) None of the above
Answer: C

122. A bank expects to raise $20 million in new money if it pays a deposit rate of 7%. It can raise $60 million in new money if it pays a deposit rate of 7.5%. It can raise $100 million in new money if

it pays a deposit rate of 8% and it can raise $120 in new money if it pays a deposit rate of 8.5%. This bank expects to earn 9.5% on all money that it receives in new deposits. What is the marginal cost of deposits if this bank raises their deposit rate from 8 to 8.5%?

A) 11%
B) 8.75%
C) 7.75%
D) 7%
E) .5%

Answer: A

123. A bank expects to raise $20 million in new money if it pays a deposit rate of 7%. It can raise $60 million in new money if it pays a deposit rate of 7.5%. It can raise $100 million in new money if it pays a deposit rate of 8% and it can raise $120 in new money if it pays a deposit rate of 8.5%. This bank expects to earn 9.5% on all money that it receives in new deposits. What is the marginal cost of deposits if this bank raises their deposit rate from 7.5% to 8%?

A) 11%
B) 8.75%
C) 7.75%
D) 7%
E) .5%

Answer: B

# Chapter 16
# Lending Policies and Procedures: Managing Credit Risk

## Fill in the Blank Questions

1. The_______________ is a uniform rating system developed by regulators where banks are given a rating from one to five in each of six categories and an overall rating from one to five.
   Answer: CAMELS

2. One of the 6 C's of lending,_______________ suggests that the lender must look at the position of the business firm in the industry and the outlook of the industry to evaluate a loan.
   Answer: condition

3. One of the 6 C's of lending,_______________ suggests that the lender must look to see if the borrower is legally entitled to sign a binding loan agreement. For an individual this entails making sure the borrower is of legal age to sign a contract.
   Answer: capacity

4. When a bank purchases a whole loan or a piece of a loan from another bank they are purchasing what is known as a______________________________.
   Answer: participation

5. Loans that have minor weaknesses because the bank has not followed its written loan policy or which have missing documentation are called_______________ by regulators.
   Answer: criticized

6. ______________________________ are loans extended to farmers and ranchers to assist in planting crops, harvesting crops and to support the feeding and care of livestock.
   Answer: Agriculture loans

7. ______________________________ devote the bulk of their credit portfolio to large-denomination loans to corporations and other businesses and tend to be large banks.
   Answer: Wholesale lenders

8. ______________________________ are loans which are secured by land buildings and other structures. These loans can be short term construction loans or longer term loans to finance the purchase of homes and apartments among others.
   Answer: Real estate loans

9. A______________ is signed by the borrower and indicates the principal amount of the loan, the interest rate on the loan and the terms under which repayment must take place.
Answer: Promissory note

10. _____________________________ are those things a borrower must do. They are actions the borrower must take. Examples include filing periodic financial statements with the bank and purchasing insurance on any collateral pledged.
Answer: Affirmative covenants

11. ____________________________ are when lenders extend credit to banks, insurance companies, and finance companies among others.
Answer: Financial institution loans

12. ______________ are loans that carry a strong probability of loss to the bank.
Answer: Doubtful loans

13. A(n)______________ is the process of resolving a troubled loan so the bank can recover its funds.
Answer: loan workout

14. ______________ is one of the key features of any loan. This C of lending examines whether the borrower will have enough sales or income to repay the loan.
Answer: cash

15. A bank's____________________________________________ gives loan officers specific guidelines in making individual loan decisions and in shaping the overall loan portfolio.
Answer: written loan policy

16. An approach in which the lending officer focuses on changes in borrower cash flows over time is known as the _____________ cash flow method.
Answer: direct

17. _________________________ are loans granted to businesses to cover purchases of inventory, paying taxes and meeting payrolls.
Answer: Commercial and industrial loans (C&I Loans)

18. ________________________ include credit to finance the purchase of automobiles, mobile homes, appliances and other retail goods and many other purchases by consumers.
Answer: Loans to individuals (consumer loans)

19. ______________________ is where the lender buys equipment or vehicles and rents them to its customers.
Answer: Lease financing receivables

20. Smaller banks tend to emphasize ___________________ in the form of smaller denomination personal cash loans and home mortgage loans to extended to individuals and families as well as smaller business loans.
Answer: retail credit

21. The loan mix of any lending institution depends heavily on the _____________ that each loan offers compared to all other assets the lending institution can acquire.
Answer: expected yield

22. Under the ____________________________ no individual can be denied credit because of race, sex, religious affiliation, age or receipt of public assistance.
Answer: Equal Credit Opportunity Act (1974)

23. One aspect of the CAMELS rating system is ___________________ which looks at the quality of the bank's loans. Examiners look at all loans over a certain size and a random selection of all other loans when looking at this aspect of a bank.
Answer: asset quality

24. One part of the 6 C's of lending is _________________ which looks at whether the borrower has a well-defined purpose for the loan and a serious intent to repay the loan.
Answer: character

25. One of the most widely consulted sources of data on business firms is __________ which was founded in Philadelphia in 1914 to exchange credit information among business lending institutions and to organize conferences and publish educational materials to train loan officers and credit analysts.
Answer: Risk Management Associates (RMA)

26. One problem with the newer lending model called _________________ was found to at least partially contribute to the recent crisis in the mortgage market.
Answer: "Streamlining"

27. In the mortgage environment of the early 2000s, lenders were encouraged to sell individual loans and packages of loans to buy more liquid securities instead, thus shifting much of the risk of lending to capital markets. This process is referred to as __________________.
Answer: Securitization

28. Factors such as changes in the economy, natural disasters, and regulation are referred to as __________ factors, while management errors, illegal manipulation, and ineffective lending policies are considered ___________ factors.
Answer: External; internal

29. In the loan workout process, the preferred option is nearly always to seek a _______________, which gives both the lending institution and its customer the chance to restore normal operations.
Answer: Revised loan agreement

**True/False Questions**

T F 30. The principal reason banks are chartered by federal and state governments is to make loans to their customers.
Answer: True

T F 31. Risk in banking tends to be concentrated in a bank's loan portfolio.
Answer: True

T F 32. The largest banks have, on average, reduced their dependence on real estate loans relative to smaller banks.
Answer: True

T F 33. Real estate lending is popular with bank, in part, due to the growth of the secondary mortgage market.
Answer: True

T F 34. Banks in the United States are, on average, examined at least once every three years.
Answer: True

T F 35. Smaller banks tend to emphasize <u>wholesale</u> banking services.
Answer: False

T F 36. <u>Retail credit</u> in banking refers to such loans as residential mortgages and installment loans to individuals.
Answer: True

T F 37. Loans made by a particular bank secured by the bank's own stock are not usually permitted except under special circumstances.
Answer: True

T F 38. Federally-supervised banks in the U.S. must make an "affirmative effort" to provide loans and other services to all credit-worthy borrowers in their chosen service area.
Answer: True

T F 39. Loans to minors are not legally enforceable contracts in most states.
Answer: True

T F 40. The letter "C" in the CAMELS rating system for banks in the U.S. refers to the "condition" of a bank.

Answer: False

T F 41. The letter “M” in the CAMELS rating system for banks in the U.S. refers to the “management quality” of a bank.
Answer: True

T F 42. The process of loan review means that a loan committee must generally approve a loan before the borrower is told the loan is approved.
Answer: False

T F 43. Troubled loans normally are subject to more frequent review than are sound loans.
Answer: True

T F 44. Credit card loans are generally more profitable for small and medium-size banks than for the largest banks.
Answer: False

T F 45. Banks should concentrate their lending on those loans in which they have the greatest cost advantage.
Answer: True

T F 46. The type of bank loan experiencing the largest losses per dollar of loan is credit card loans.
Answer: True

T F 47. Construction loans by a bank fit under the loan category known as commercial and industrial loans.
Answer: False

T F 48. If the economy slows down a bank should review its outstanding loans more frequently.
Answer: True

T F 49. Foreclosure on property pledged behind a bank loan does not subject a bank to liability to clean up any environmental damage the borrower may have caused to happen.
Answer: False

T F 50. Loans granted to businesses appear to convey positive information to the market place about a borrower’s credit quality, enabling a borrower to obtain more and cheaper funds from other sources.
Answer: True

T F 51. Loans to a bank's officers can never exceed 2.5 percent of a bank's capital and unimpaired surplus or $25,000 whichever is larger and cannot be more than $100,000.
Answer: True

T F 52. Financial institutions that disagree with examiner classifications of their loans can appeal these examiner ratings.
Answer: True

T F 53. A rating of "5" is the highest and best rating that a U.S. bank can receive under the CAMEL rating system.
Answer: False

T F 54. <u>Accounts receivable financing</u> means that a bank actually takes over ownership of receivables, whereas <u>factoring</u> means that a bank merely lends money on a borrowing customer's receivables and the customer still has ownership of the receivables.
Answer: False

T F 55. A restriction against a borrower taking on new debt is an <u>affirmative covenant</u> in a loan contract.
Answer: False

T F 56. Loan review is considered to be a luxury, not a necessity for most banks, especially those with sound lending policies.
Answer: False

T F 57. Cash is one of the 6 C's of lending and refers to the fact that the lender wants to make sure the borrower has the ability to generate enough cash to repay the loan.
Answer: True

T F 58. There are three principal sources of cash to repay a loan. These are cash flows generated from sales or income, funds generated from the liquidation of assets and funds raised by selling debt or equity securities.
Answer: True

T F 59. Negative covenants require the borrower to take certain actions.
Answer: False

T F 60. Affirmative covenants restrict a borrower from doing certain things.
Answer: False

T F 61. For ease and convenience most banks have the loan review conducted by the same person who makes the loan. This is particularly true of large banks.
Answer: False

T F 62. A loan workout is when the bank and the customer initially negotiate the terms of the loan.
Answer: False

T F 63. A written loan policy gives loan officers and the bank's management specific guidelines in making individual loan decisions and in forming the bank's loan portfolio.
Answer: True

T F 64. Commercial and industrial loans are loans to businesses to cover such things as purchasing inventory, paying taxes and meeting payroll expenses.
Answer: True

T F 65. Agriculture loans are loans that are made to individuals to finance vacations, purchase durable goods and other retail goods.
Answer: False

T F 66. The A in the CAMELS rating system stands for asset quality.
Answer: True

T F 67. Net cash flow from operations is the borrower's net income expressed in cash rather than on an accrual basis.
Answer: True

T F 68. The "direct cash flow" method and "cash flow by origin" are two very different ways of assessing the cash flows of a potential borrower.
Answer: False

T F 69. Commercial banks are the largest originator of household loans.
Answer: True

T F 70. Following the recent global credit crisis, regulators have begun to emphasize the need for loan originators to know their borrowers better and retain some of the risk on loans that they sell.
Answer: True

**Multiple Choice Questions**

71. The principal economic function of banks is to:
    A) Take deposits
    B) Make loans
    C) Sell financial services
    D) Encourage spending
    E) None of the above
    Answer: B

72. Loans extended to finance the purchase of automobiles, mobile homes, home appliances, and vacations are classified as:
    A) Real estate loans
    B) Financial institutions
    C) Agricultural loans
    D) Commercial and industrial loans
    E) None of the above
    Answer: E

73. According to the textbook the largest category (by dollar volume) of loans extended by U.S. banks is:
    A) Real estate loans
    B) Financial institutions
    C) Agricultural loans
    D) Commercial and industrial loans
    E) None of the above
    Answer: A

74. Banks that emphasize lending to commercial customers are labeled:
    A) Wholesale banks
    B) Retail banks
    C) Personal banks
    D) Nonbank banks
    E) Regional banks
    Answer: A

75. The vast majority of FDIC-insured institutions are classified as:
    A) Credit card banks
    B) Agricultural banks
    C) Consumer lenders
    D) Commercial lenders
    E) Mortgage lenders
    Answer: D

76. In the United States national banks cannot extend an unsecured loan to a single borrower that exceeds ______ of a national bank's capital and surplus. The correct figure that fills in the blank in the preceding sentence is:
A) 25 percent
B) 10 percent
C) 15 percent
D) 20 percent
E) None of the above
Answer: C

77. Real estate loans made by national banks in the U.S. cannot exceed:
A) 15 percent of a national bank's total assets or 25 percent of its total capital.
B) A national bank's total capital and surplus or 70 percent of time and savings deposits, whichever is greater.
C) 20 percent of a national bank's capital and surplus or 80 percent of its savings deposits, whichever is smaller in amount.
D) 25 percent of capital or 10 percent of the core deposits of a national bank, whichever gives the largest amount.
E) None of the above.
Answer: B

78. Loans to finance one-to-four family homes fall under which loan category?
A) Commercial and industrial loans
B) Real estate loans
C) Loans to individuals
D) Single-payment loans
E) None of the above.
Answer: B

79. The loan category experiencing the largest losses (loan defaults) is usually:
A) Credit card loans
B) Real estate loans
C) Agricultural loans
D) Commercial and industrial loans
E) None of the above
Answer: A

80. The most costly type of loan to make (measured by the cost per dollar of loan) for a bank is usually:
A) Real estate loans
B) Agricultural loans
C) Commercial and industrial loans
D) Loans to financial institutions
E) None of the above.
Answer: E

81. Loans providing credit to finance the purchase of automobiles, mobile homes, appliances, and other retail goods to repair and modernize homes are classified under the category:
A) Financial institution loans
B) Commercial industrial
C) Loans to individuals
D) Miscellaneous loans
E) None of the above
Answer: C

82. Loans extended to farm and ranch operations to assist in planting and harvesting crops and to support the feeding and care of livestock are known as:
A) Real estate loans
B) Commercial and industrial loans
C) Land loans
D) Agricultural loans
E) None of the above.
Answer: D

83. Loans granted to businesses to cover such expenses as purchasing inventories, paying taxes, and meeting payrolls are known as:
A) Commercial and industrial loans
B) Agricultural loans
C) Real estate loans
D) Loans to individuals
E) None of the above.
Answer: A

84. A lender that makes a loan to a minor would be violating which of the 6 C's of lending?
A) Character
B) Capacity
C) Cash
D) Control
E) Collateral
Answer: B

85. A lender that makes a loan that violates its written loan policy would be violating which of the 6 C's of lending?

A) Character
B) Capacity
C) Cash
D) Control
E) Collateral
Answer: D

86. Which of the following is a factor in determining the mix of loans that a bank has?
A) The location of the bank
B) The size of the bank

C) The written loan policy of the bank
D) The experience and expertise of the management
E) All of the above are factors in determining the mix of loans
Answer: E

87. A loan to a local business to purchase a new machine would be categorized as:
A) A consumer loan
B) An agriculture loan
C) A commercial and industrial loan
D) A real estate loan
E) None of the above
Answer: C

88. The lender's secondary source of repayment in case of default is:
A) Capacity.
B) Collateral.
C) Character.
D) Capital.
E) Credit.
Answer: B

89. A lender that makes a loan to an individual whose only income is commission based and who hasn't made a sale in six weeks may be violating which of the 6 C's of lending?
A) Character
B) Capacity
C) Cash
D) Control
E) Collateral
Answer: C

90. Sean Carter has an excellent credit rating. Which of the 6 C's of lending would this piece of information belong to?
A) Character
B) Capacity
C) Cash
D) Collateral
E) Conditions
Answer: A

91. First National Bank of Edmond asks a prospective customer for her driver's license. Which of the 6 C's of lending would this piece of information belong to?

A) Character
B) Capacity
C) Cash
D) Collateral
E) Conditions
Answer: B

92. The loan officer of Second National Bank of Laramie decides to review the insurance coverage of one of its business customers. Which of the 6 C's of lending would this piece of information belong to?
A) Character
B) Capacity
C) Cash
D) Collateral
E) Conditions
Answer: D

93. The TRC Company is required by its bank to pay no dividend over $3 per share. What is this?
A) An affirmative covenant
B) A negative covenant
C) A Special covenant
D) A horizontal covenant
E) None of the above
Answer: B

94. A bank that primarily makes its loans to individuals, families and small businesses is:
A) A retail bank
B) A wholesale lender
C) A money center bank
D) A money market bank
E) None of the above
Answer: A

95. The process of resolving a troubled loan so the lender can recover its funds is called the:
A) Loan Review
B) Written Loan Policy
C) Loan Workout
D) Loan Commitment Agreement
E) None of the above
Answer: C

96. Which of the following is a sign of a potential loan problem?

A) Timely receipt of financial statements from the company with a loan
B) Increases in the stock price of the company that has a loan
C) Increases in earnings for each of the last three years of a company
D) Changes in the methods used to account for inventory, depreciation and other items
E) All of the above are signs of problems with the loan
Answer: D

97. Which of the following should be part of the written loan policy?
A) Lending authority of each loan officer and loan committee
B) Lines of responsibility for finding and reporting information within the loan department
C) A statement of quality standards for all loans

D) A statement for the preferred upper limit for total loans outstanding
E) All of the above should be part of the written loan policy
Answer: E

98. A lender reviews the partnership agreement of one of its small business customers. Which of the 6 C's of lending would this piece of information belong to?
A) Character
B) Capacity
C) Cash
D) Collateral
E) Conditions
Answer: B

99. Which act requires that bank loans to insiders be priced at market?
A) Community Reinvestment Act of 1977
B) Equal Credit Opportunity Act of 1974
C) Sarbanes-Oxley Act of 2002
D) Bank Lending Act of 2003
E) U.S. Patriot Act
Answer: C

100. A method whereby the loan officer focuses on how the borrower cash flows may change over time is known as:
A) Indirect cash flow
B) Direct cash flow
C) Pervasive cash flow
D) Variable cash flow
E) Total cash flow
Answer: B

101. The South Carolina National Bank makes a loan to the Heritage Credit Union. What type of loan did this bank make?
A) Financial institution loan
B) Commercial and industrial loan
C) Loans to individuals
D) Miscellaneous loans
E) Lease financing receivables
Answer: A

102. A loan for Colin Beverly to purchase a new Mazda Miata would fit into which of the following categories of bank loans?
A) Financial institution loan
B) Commercial and industrial loan
C) Loan to an Individual
D) Miscellaneous loan
E) Lease financing receivables
Answer: C

103. The Price Bank of Edmond makes a loan to Home Depot. What type of loan has this bank made?
A) Financial institution loan
B) Commercial and industrial loan
C) Loan to an individual
D) Miscellaneous loan
E) Lease financing receivables
Answer: B

104. The First State Bank of Duncan buys railroad cars and rents them to the Santa Fe Railroad Company. What type of loan has this bank made?
A) Financial institution loan
B) Commercial and industrial loan
C) Loan to an individual
D) Miscellaneous loan
E) Lease financing receivables
Answer: E

105. The Third National Bank of Wichita makes a loan so that Tim Bridges can buy 1000 shares of Coca Cola stock. Which category of loans would this loan fit in best?
A) Financial institution loan
B) Commercial and industrial loan
C) Loan to an individual
D) Miscellaneous loan
E) Lease financing receivables
Answer: D

106. The First State Bank is located in Guyman, Oklahoma which is in the middle of the wheat country of Oklahoma and as a result many of its loans are agriculture loans. What factor determining the growth and mixture of loans does this fact reflect?
A) Characteristics of the market area
B) Lender size
C) The experience and expertise of management
D) The written loan policy of the bank
E) Bank regulations
Answer: A

107. The Second State Bank has less than $100 million in assets and as a result primarily makes real estate loans, other consumer loans and loans to very small businesses. What factor determining the growth and mixture of loans does this fact reflect?
A) Characteristics of the market area
B) Lender size
C) The experience and expertise of management
D) The written loan policy of the bank
E) Bank regulations

Answer: B

108. Geoff Willis and Mary Williams the president and CEO of the First National Bank of Edmond both come from a background of retail banking. As a result they have decided to focus their lending activities on consumer loans and loans to small business. What factor determining the growth and mixture of loans does this fact reflect?
A) Characteristics of the market area
B) Lender size
C) The experience and expertise of management
D) The written loan policy of the bank
E) Bank regulations
Answer: C

109. First State Bank's loan policy manual states 'that the goal of the bank is to make high quality loans for home mortgages, the purchase of automobiles and small business accounts receivables'. What factor determining the growth and mixture of loans does this fact reflect?
A) Characteristics of the market area
B) Lender Size
C) The experience and expertise of management
D) The written loan policy of the bank
E) Bank regulations
Answer: D

110. The Second National Bank has capital and surplus of $100 million. The bank has decided that the most that it can loan to the Krumlova Manufacturing Company is $15 million. What factor determining the growth and mixture of loans does this most likely reflect for this bank?
A) Characteristics of the market area
B) Lender size
C) The experience and expertise of management
D) The written loan policy of the bank
E) Bank regulations
Answer: E

111. A loan that appears to examiners to contain significant weaknesses or that represent a dangerous concentration of credit in one borrower or industry are called:
A) Criticized loans
B) Scheduled loans
C) Substandard loans
D) Doubtful loans
E) Loss loans
Answer: B

112. A loan that examiners regard as uncollectible and unsuitable to be called a bank asset is called a:
A) Criticized loan
B) Scheduled loan
C) Substandard loan

D) Doubtful loan
E) Loss loan
Answer: E

113. The law that requires banks to make 'an affirmative effort' to meet the credit needs of individuals and businesses in their trade territories is called:
A) The Sarbanes-Oxley Act
B) The Community Reinvestment Act
C) The Equal Credit Opportunity Act
D) The Truth in Lending Act
E) None of the above
Answer: B

114. The law that prevents individuals from being denied credit because of race, sex, religious affiliation, age or receipt of public assistance is called:
A) The Sarbanes-Oxley Act
B) The Community Reinvestment Act
C) The Equal Credit Opportunity Act
D) The Truth in Lending Act
E) None of the above
Answer: C

115. Dan Cross is a junior loan officer with First State Bank of Durant. He has been busy visiting local businesses to see of any of them need credit. Which step in the lending process is Dan performing?
A) Finding prospective customers
B) Evaluating a customer's character and sincerity
C) Making a site visit and evaluating a customer's credit history
D) Evaluating a prospective customer's financial condition
E) Assessing possible collateral and signing the loan agreement
Answer: A

116. Shelby Mann is a loan officer with the First National Bank. She interviews a potential loan customer to find out exactly why the person needs the loan and whether they would be serious about repaying the loan. Which step in the lending process is Shelby performing?
A) Finding prospective customers
B) Evaluating a customer's character and sincerity
C) Making a site visit and evaluating a customer's credit history
D) Evaluating a prospective customer's financial condition
E) Assessing possible collateral and signing the loan agreement
Answer: B

117. Jessica Simpson, a loan officer with First National Bank, visits the Tate Manufacturing Company and talks to other lenders to see their experience with Tate Manufacturing. What step in the lending process is Jessica performing?

A) Finding prospective customers
B) Evaluating a customer's character and sincerity
C) Making a site visit and evaluating a customer's credit history
D) Evaluating a prospective customer's financial condition
E) Assessing possible collateral and signing the loan agreement
Answer: C

118. Terry May, a loan officer with First National Bank, calculates liquidity and debt ratios for the Lava Lamp Company and also examines their cash flow statement. What step in the lending process is Terry performing?
A) Finding prospective customers
B) Evaluating a customer's character and sincerity
C) Making a site visit and evaluating a customer's credit history
D) Evaluating a prospective customer's financial condition
E) Assessing possible collateral and signing the loan agreement
Answer: D

119. Jerry LeGere, a loan officer with First National Bank, checks to see if the house pledged to back up a home mortgage has a clear title and proper insurance. What step in the lending process is Jerry performing?
A) Finding prospective customers
B) Evaluating a customer's character and sincerity
C) Making a site visit and evaluating a customer's credit history
D) Evaluating a prospective customer's financial condition
E) Assessing possible collateral and signing the loan agreement
Answer: E

120. The Tate Manufacturing Company has $150 million in sales revenue with $90 million in cost of goods sold. It has selling and administrative expenses of $10, pays annual taxes in the amount of $10 and has depreciation and other non cash expenses of $30 million. What are this firm's annual projected cash flows?
A) $150
B) $60
C) $70
D) $40
E) None of the above
Answer: C

# Chapter 17
# Lending to Business Firms and Pricing Business Loans

### Fill in the Blank Questions

1. A(n)______________________________________________ is generally used to finance the purchase of inventory to sell and take advantage of the firm's normal cash cycle to repay the loan.
Answer: self-liquidating inventory loan

2. A(n)_______________________ is generally used to support the construction of homes, apartments, office buildings and other permanent structures.
Answer: interim construction loan

3. Working capital loans often require _______________________. These are required deposits in the bank by the borrower whose size is dependent on the size of the credit line.
Answer: compensating deposit balances

4. When the title to accounts receivables pledged in an asset based loan is passed to the lender and the lender takes some of the responsibility for collecting the accounts receivables this is called ______________________.
Answer: factoring

5. A(n)_______________________ is the purchase of a publicly traded company by a small group of investors. These investors often borrow very heavily to finance the purchase of the stock of the company.
Answer: LBO

6. _______________________________________________ are potential claims against the borrower which do not show up on the borrower's balance sheet. One new form of this is due to environmental damage by the borrower.
Answer: Contingent liabilities

7. _______________________ are designed to fund long- and medium-term investments such as the purchase of equipment. Money is borrowed in one lump sum and repayments are generally made in installments.
Answer: Term loans

8. A(n)_____________________________________________ is a contractual promise by a bank to lend to a customer up to a maximum amount of money at a set interest rate (or rate mark up over prime or LIBOR). The only way the bank can renege on its promise is if there has been a "material adverse change" in the borrower's financial condition.
Answer: formal loan commitment

9. ______________________ examines how effectively assets are being utilized to generate sales and how efficiently sales are converted into cash.
Answer: Operating efficiency

10. A(n)______________________ is a loan extended to a business firm by a group of lenders in order to reduce the risk exposure to any one lending institution.
Answer: syndicated loan

11. ______________________ refers to the protection afforded creditors of a firm based on the amount of the firm's earnings.
Answer: Coverage

12. The borrower's______________________ reflects his or her ability to raise cash in a timely fashion at a reasonable cost.
Answer: liquidity

13. _____________________________________________ are the ultimate standard of performance in a market oriented economy. These measure the net income that remains for owners after all expenses have been charged against revenues.
Answer: Profitability measures

14. ______________________ refers to the borrowers' use of debt in their firm.
Answer: Leverage

15. Wages and salaries to net sales, overhead expenses to net sales and cost of goods sold to net sales are all measures of _____________________________________________.
Answer: a business customer's control over expenses

16. _____________________________________________ is a way to price loans which starts with the costs of making a loan and adds to it a risk premium for default risk and a desired profit margin.
Answer: Cost plus loan pricing

17. The______________________ approach to pricing a loan starts with a base interest rate and adds a risk premium for default and for time to maturity.
Answer: price leadership

18. The______________________ is the interest rate charged the bank's most creditworthy customers on short-term working capital loans.
Answer: prime rate

19. _____________________ is the rate on short-term Eurocurrency deposits which range in maturity from a few days to a few months.
Answer: LIBOR

20. The______________________________________ is a way to price loans which allows banks to compete with the commercial paper market.
Answer: below prime rate pricing

21. The______________________ is a way of pricing loans that allows a bank to take into account the entire relationship the bank has with the customer when pricing the loan.
Answer: customer profitability analysis

22. ______________________ is the average deposit balance by the customer minus the average float adjusted for reserve requirements.
Answer: Net investable funds

23. The_____________________________________ is the risk premium that has to do with the quality of the borrower.
Answer: default risk premium

24. The______________________ is the risk premium that has to do with the time to maturity on the borrowed funds.
Answer: term-risk premium

25. __________________________is the base of the cost-plus loan pricing model.

Answer: Marginal cost of raising loanable funds

26. In the price leadership model, the amount above the price rate is often called the _____________.
Answer: markup

27. A proposed loan is acceptable when the net rate of return from a customer profitability analysis is______________________ .
Answer: positive

28. SNCs are also known as _____________ loans.
Answer: syndicated

29. Weak loans considered to be substandard or doubtful in quality are also known as __________ credits.

Answer: classified

30. An interest rate most widely used to price loans extended by banks operating in the U.S. is _________.
Answer: LIBOR

31. The _______________________ is the rate considered to the most common base rate figure announced by the majority of the 25 largest banks that publish their prime rates regularly.
Answer: prevailing prime rate

32. With the advent of inflation and more volatile interest rates gave rise to a(n) ___________, tied to changes in important money market interest rates such as the 90 day commercial paper rate.
Answer: floating prime rate

33. ____________________________ loans represent the earliest form of lending that banks have carried out in their more than 2000 year history.
Answer: Commercial and industrial

34. _________________________ provide businesses with short-term credit lasting from a few days to about one year. These loans come close to self-liquidating loans.
Answer: Working capital loans

35. ____________________________ support installment purchases of automobiles, home appliances, furniture, business equipment and other durable goods by financing the receivables that dealers take on when they write installment contracts to cover customer purchases.
Answer: Retailer and equipment financing

36. One of the most aggressive competitors with banks today are ___________________. Examples include GMAC, Ford Motor Credit and GE Capital.
Answer: captive finance companies

37. The apparent size bias in the financial marketplace led to the creation of the ____________ in the 1950's to guarantee loans made to small businesses by private lending institutions.
Answer: Small Business Administration (SBA)

38. The most risky of all business loans are ________________. This is credit to finance the construction of fixed assets designed to generate a flow or revenue in future periods. This can include financing a new oil refinery or power plant or other similar fixed assets.
Answer: project loans

39. A firm's balance sheet and income statement expressed as a percentage of total assets or total sales are often called _______________.
Answer: common size ratios

40. A third financial statement used in addition to the income statement and balance sheet by lenders is the ________________. It is required by FASB and is usually readily available from borrowers.
Answer: Statement of Cash Flows

**True/False Questions**

T F 41. Foreclosure on property pledged behind a bank loan does not subject a bank to liability to clean up any environmental damage the borrower may have caused to happen.
Answer: False

T F 42. In the United States about 25 percent of banks' total loans consist of commercial and industrial loans.
Answer: True

T F 43. Self-liquidating business loans are designed to take advantage of the normal cash cycle in a business firm.
Answer: True

T F 44. Short-term (under one year) loans to business firms account for over half of all bank loans to businesses in the United States.
Answer: True

T F 45. Working-capital loans are normally secured by a business firm's plant and equipment.
Answer: False

T F 46. Working-capital loans, unlike most other types of business loans, usually do not require the customer to keep a compensating deposit balance with the lending bank.
Answer: True

T F 47. Leveraged buyouts (LBOs) involve the purchase of businesses or of selected assets from business firms with at least 75 percent of the cost of the purchase funded by current earnings and sales of stock.
Answer: False

T F 48. A project loan secured by the credit of the company or companies sponsoring the project is called a project loan granted on a recourse basis.
Answer: True

T F 49. Term loans normally are secured by accounts receivable and inventory.
Answer: False

T F 50. Term loans look primarily to the flow of future earnings of the borrowing business firm to amortize and retire its loan.
Answer: True

T F 51. Under recent EPA guidelines if a lender forecloses on environmentally damaged property, the lender must post that property for sale within 12 months after securing marketable title.
Answer: True

T F 52. To avoid environmental liability under recent EPA guidelines a lender must accept any bona fide offer for property foreclosed upon if the offer would fully repay the remaining amounts owed.
Answer: True

T F 53. Under current federal laws a lender is required to make an environmental site assessment of the borrower's property in order to avoid environmental liability.
Answer: False

T F 54. Floorplanning agreements typically include a loan-loss reserve, built up from interest earned as borrowers repay their installment loans.
Answer: True

T F 55. If a bank's agent visits a dealer using floorplanning and finds any inventory items sold for which the bank providing financing has not received payment, the loan will be immediately foreclosed upon.

Answer: False

T F 56. When a bank examines a borrower's operating efficiency they are looking at the protection afforded creditors from the borrower's earnings.
Answer: False

T F 57. The firm's coverage ratios measure how carefully the firm's management monitor and control its expenses.
Answer: False

T F 58. Liquidity measure a business firm's ability to raise cash in a timely fashion at a reasonable cost.
Answer: True

T F 59. The ultimate standard of performance in a market-oriented economy is how much net income remains after all expenses have been charged against revenues.
Answer: True

T F 60. The business loan pricing method that relies upon banks knowing what their costs are is the price leadership model.
Answer: False

T F 61. The price leadership method of loan pricing includes a markup for default risk, but not for term risk.
Answer: False

T F 62. The sum of the default-risk premium plus the term risk premium on a business loan is one of the elements of the cost-plus loan pricing method.
Answer: False

T F 63. In order to control the risk exposure on their business loans most banks use both price and credit rationing to regulate the size and composition of their loan portfolios.
Answer: True

T F 64. In a period of rising interest rates the times-prime method causes the customer's loan rate to rise faster than the prime-plus method.
Answer: True

T F 65. If interest rates fall, a customer's loan rate will decline more rapidly under the times-prime method than under the prime-plus method of business loan pricing.

Answer: True

T F 66. Banks attempting to compete with the growing commercial paper market developed the cost-plus business loan pricing method.
Answer: False

T F 67. The loan-pricing method that takes the whole customer relationship into account when pricing each loan request is known as the cost-benefit loan pricing method.
Answer: False

T F 68. The loan-pricing technique known as CPA can be used to identify the most profitable types of bank customers and loans and also who are the most successful loan officers.
Answer: True

T F 69. The basic strength of the cost plus loan pricing method is that it considers the competition from other lenders.
Answer: False

T F 70. The basic weakness of the cost plus loan pricing method is that it does not consider the competition from other lenders when setting the loan price.
Answer: True

T F 71. The basic strength of the below prime market pricing model is that it allows the bank to compete with the commercial paper market.
Answer: True

T F 72. The basic weakness of the below prime market pricing model is that there are narrow margins or markups on loans.
Answer: True

T F 73. The majority of syndicated loans are held by banks.
Answer: False

T F 74. Syndicated loans are a type of working capital loan.
Answer: False

T F 75. According to the textbook, small business lending by banks is on the decline.
Answer: True

T F 76. The amount of business lending tends to rise during periods of expansion.
Answer: True

T F 77. The amount of business lending tends to fall during recessionary periods.
Answer: True

T F 78. Financial institutions generally use internal credit rating systems to evaluate credit quality.
Answer: True

**Multiple Choice Questions**

79. Short-term lending to support the construction of homes, apartments, office buildings, shopping centers, and other permanent structures is known as a (or an):
A) Self-liquidating
B) Working capital loan
C) Interim construction loan
D) Asset-based loan
E) None of the above
Answer: C

80. Business loans designed to fund long- and medium-term business investments, such as the purchase of equipment or the construction of physical facilities, covering a period longer than one year are known as:
A) Working capital loans
B) Term loans
C) Interim construction financing
D) Durable goods loan
E) None of the above
Answer: B

81. A loan whose principal is not due to be paid back until the loan's term ends and in which only interest is paid periodically during the life of the loan is called a (or an):
A) Working capital loan
B) Project loan
C) Bullet loan
D) Interim construction loan
E) None of the above
Answer: C

82. A credit agreement in which a business customer may borrow up to a pre-specified limit, repay all or a portion of the borrowing, and reborrow as necessary until the credit line matures is known as a (an):
A) Interim construction
B) Project loan
C) Working-capital loan
D) Revolving line of credit
E) None of the above
Answer: D

83. When analyzing a commercial loan credit request, which of the following statements is (are) correct?
A) The lender should evaluate the potential income available to service the loan.
B) The lender should evaluate the potential cash flow available to service the loan.
C) The lender should be certain that the loan is adequate to meet the needs of the borrower.
D) A and B
E) B and C
Answer: E

84. Banks oftentimes bid on the opportunity to finance the entire inventory of an automobile dealer through a ___________ arrangement.
A) Factoring
B) Floorplanning
C) Project loan
D) Revolving line of credit
E) None of the above
Answer: B

85. The most common sources that lenders look to for repayment of business loans include all of the following except:
A) The borrower's cash flow
B) Assets pledged as collateral
C) Relatives of the borrowe.
D) The borrowers net worth
E) None of the above
Answer: C

86. When analyzing the financial statements of a business, a credit analyst will look for ratios in which of the following categories:
A) Profitability.
B) Coverage
C) Efficiency
D) Liquidity
E) All of the above are categories of ratios bankers will look for
Answer: E

87. Recent federal guidelines put in place by the Federal Deposit Insurance Corporation require banks to develop written procedures to protect against loss from environmental damage. These procedures are known as the:
A) Lender Protection Program
B) Environmental Risk Assessment Program
C) Lender Liability Security Program
D) Environmental Pollution Control Program
E) None of the above.
Answer: B

88. Term loans normally are secured by:
A) Fixed assets
B) Accounts receivable
C) Inventories
D) Personal property
E) None of the above.
Answer: A

89. Under court interpretation of the Comprehensive Environmental Response, Compensation and Liability Act of 1980 lenders may be liable for clean-up costs of hazardous substances if:
A) The lender in involved in managing property with hazardous wastes
B) The lender has a strong association with the property owner
C) The lender has managed its customer's firms and there are toxic wastes involved
D) All of the above
E) None of the above
Answer: D

90. A bank that wants to examine the operating efficiency of a borrower would most likely examine which of the following ratios?
A) Cost of Goods Sold/ Average Inventory
B) Income Before Interest and Taxes/ Interest Payments
C) Cost of Goods Sold/ Net Sales
D) Current Assets/ Current Liabilities
E) All of the Above
Answer: A

91. A bank that wants to examine the liquidity of a borrower would most likely examine which of the following ratios?
A) Costs of Goods Sold/ Average inventory
B) Income Before Interest and Taxes/ Interest Payments
C) Cost of Goods Sold/ Net Sales
D) Current Assets/ Current Liabilities
E) All of the Above
Answer: D

92. A bank wants to examine whether the borrower can raise cash in a timely fashion to pay bills that are coming due. This bank would most likely examine which of the following categories of ratios?
A) Customer's Control over Expenses
B) Customer's Liquidity
C) Customer's Operating Efficiency
D) Customer's Profitability
E) None of the Above
Answer: B

93. A government security dealer requires credit to add new government securities to his security portfolio. What type of loan is this?
A) Self-liquidating inventory loan
B) Working capital loan
C) Security dealer financing
D) Revolving line of credit
E) None of the above
Answer: C

94. Credit is extended to a company up to one year to purchase raw materials and cover a seasonal peak need for cash. What type of loan is this?
A) Self-liquidating inventory loan
B) Working capital loan
C) Security dealer financing
D) Revolving line of credit
E) None of the above
Answer: B

95. The term of an inventory loan is being set to match the exact length of time needed to generate sufficient cash to repay the loan. What type of loan is this?
A) Self-liquidating inventory loan
B) Working capital loan
C) Security dealer financing
D) Revolving line of credit
E) None of the above
Answer: A

96. A business receives a three year line of credit against which it can borrow, repay and borrow again if necessary during the loan's three year term. What type of loan is this?
A) Self-liquidating inventory loan
B) Working capital loan
C) Security dealer financing
D) Revolving line of credit
E) None of the above

Answer: D

97. A loan or line of credit extended to a business by a group of lending institutions in order to reduce the risk exposure is known as:
A) An LBO
B) A revolving line of credit
C) A working capital loan
D) A syndicated loan
E) None of the above
Answer: D

98. A bank that is examining the ratio of total liabilities to total assets is examining which category of ratios?
A) Expense Control Measures
B) Operating Efficiency Measures
C) Coverage Measures
D) Liquidity Measures
E) Leverage Measures
Answer: E

99. A bank that is examining the ratio of costs of goods sold to inventory is examining which category of ratios?
A) Expense Control Measures
B) Operating Efficiency Measures
C) Coverage Measures
D) Liquidity Measures
E) Leverage Measures
Answer: B

100. A bank that is examining the ratio of overhead expenses to net sales is examining which category of ratios?
A) Expense Control Measures
B) Operating Efficiency Measures
C) Coverage Measures
D) Liquidity Measures
E) Leverage Measures
Answer: A

101. Which dimension of a business firm's financial and operating performance would unfunded pension liabilities fit best?
A) Profitability measure
B) Market indicator
C) Contingent liability
D) Marketability of the product or service
E) None of the above

Answer: C

102. Which dimension of a business firm's financial and operating performance would the percentage change in the firm's stock price fit best?
A) Profitability measure
B) Market indicator
C) Contingent liability
D) Marketability of the product or service
E) None of the above
Answer: B

103. Which dimension of a business firm's financial and operating performance would the gross profit margin fit best?
A) Liquidity measure
B) Market indicator
C) Contingent liability
D) Marketability of the product or service
E) None of the above
Answer: D

104. According to the cost-plus model for pricing loans, factors that should be considered in pricing a loan include:
A) The marginal cost of raising loanable funds to support the loan request
B) Nonfunds operating costs
C) An appropriate margin to compensate the bank for default risk.
D) The bank's desired profit margin
E) All of the above
Answer: E

105. The business loan pricing method that includes the nonfunds operating costs of making a loan plus the bank's desired profit margin is:
A) The Cost-Plus Loan-Pricing Method
B) The Price Leadership Model
C) The Markup Model
D) Customer Profitability Analysis
E) None of the above
Answer: A

106. The business loan pricing method that estimates the total revenues a loan will generate, the net amount of loanable funds the bank must turn over to the borrower, and the before-tax yield expected from the loan is the:
A) The Cost-Plus Loan-Pricing Method
B) The Price Leadership Model
C) The Below Prime Rate Pricing Model
D) Customer Profitability Analysis

E) None of the above
Answer: D

107. Suppose a business borrower is quoted a loan rate of two percentage points above the prevailing prime interest rate posted by leading U.S. banks. This is an example of the:
A) Times-prime pricing method.
B) Market-based pricing method.
C) Cost-plus loan-pricing method.
D) Prime-plus pricing method.
E) Customer profitability analysis pricing method.
Answer: D

108. The method of pricing a business loan that contends that a bank should take the whole customer relationship into account when pricing each loan request is the:
A) Cost-Plus Loan-Pricing Method
B) Price Leadership Model
C) Below Prime Rate Pricing Model
D) Customer Profitability Analysis
E) None of the above.
Answer: D

109. The business loan pricing method that bases a loan rate on a relatively low money market interest rate (such as the federal funds rate) plus a small margin to cover risk exposure, other operating costs, and a profit margin is known as the:
A) Price Leadership Model
B) Below Prime Rate Pricing Model
C) Cost-Plus Loan Pricing Method
D) Customer Profitability Analysis
E) None of the above.
Answer: B

110. Which of the following is a strength of the cost-plus loan pricing method?
A) It considers the competition from other lenders
B) It allows the bank to compete more aggressively with the commercial paper market
C) It considers the cost of loanable funds and the operating costs of running the bank
D) It takes the whole customer relationship into account
E) None of the above
Answer: C

111. Which of the following is a weakness of the price leadership loan pricing method?
A) It does not consider the marginal cost of raising funds
B) It does not give much regard for the competition from other lenders
C) The bank must know what their costs are in order to make correctly price loans
D) The bank must consider the revenues and expenses from all of the bank's dealings with the customer

E) None of the above
Answer: A

112. Which of the following is a strength of the markup (or below prime market) loan pricing method?
A) It considers the competition from other lenders
B) It allows the bank to compete more aggressively with the commercial paper market
C) It considers the cost of loanable funds and the operating costs of running the bank
D) It takes the whole customer relationship into account
E) None of the above
Answer: B

113. Which of the following is a weakness of the cost-plus loan pricing method?
A) It does not consider the marginal cost of raising funds
B) It does not give much regard for the competition from other lenders
C) The bank must know what their costs are in order to make correctly price loans
D) B and C above
E) All of the above
Answer: D

114. Which of the following is a strength of the price leadership loan pricing method?
A) It considers the competition from other lenders
B) It allows the bank to compete more aggressively with the commercial paper market
C) It considers the cost of loanable funds and the operating costs of running the bank
D) It takes the whole customer relationship into account
E) None of the above
Answer: A

115. Which of the following is a strength of the customer profitability analysis method for pricing loans?
A) It considers the competition from other lenders
B) It allows the bank to compete more aggressively with the commercial paper market
C) It considers the cost of loanable funds and the operating costs of running the bank
D) It takes the whole customer relationship into account
E) None of the above
Answer: D

116. The business loan pricing method which starts with a base rate such as the bank's prime rate and adds a markup for default and term risk is known as:
A) The Cost-Plus Loan-Pricing Method
B) The Price Leadership Model
C) The Below Prime Rate Pricing Model
D) Customer Profitability Analysis
E) None of the above
Answer: B

117. A bank has determined that its marginal cost of raising funds is 4.5 percent and that its nonfunds costs to the bank are .5 percent. It has also determined that its margin to compensate the bank for default risk for a particular customer is .30 percent. It has also determined that it wants to have a profit margin of .3 percent. If this customer wants to borrow $10,000,000, how much in total interest costs will this customer pay in one year?
A) $450,000
B) $480,000
C) $510,000
D) $560,000
E) None of the above
Answer: D

118. A bank has determined that its marginal cost of raising funds is 4.5 percent and that its nonfunds costs to the bank are .5 percent. It has also determined that its margin to compensate the bank for default risk for a particular customer is .30 percent. It has also determined that it wants to have a profit margin of .3 percent. What business loan model is this bank using to price the loan for this customer?
A) The Cost-Plus Loan-Pricing Method
B) The Price Leadership Model
C) The Below Prime Rate Pricing Model
D) Customer Profitability Analysis
E) None of the above
Answer: A

119. A bank has a prime rate of 6 percent for its best customers. It has determined that the default risk premium for a particular customer is .4% and the term-risk premium for this loan is .25 percent. If this customer wants to borrow $5.0 million from the bank, how much in interest will this customer pay in one year?
A) $332,500
B) $665,000
C) $300,000
D) $320,000
E) None of the above
Answer: A

120. The bank has determined the information below for one of its customers. This customer wants to borrow $1,000,000 but will maintain an average deposit balance in its account of $200,000. What is the expected net rate of return on this loan?

| Expected Revenues | | Expected Costs | |
|---|---|---|---|
| Interest Revenues | $1,000,000 | Deposit Interest | $30,000 |
| Commitment Fee | $15,000 | Cost of Other Funds Raised | $890,000 |
| Deposit Service Fees | $5,000 | Loan Processing Costs | $8000 |
| Agency Fees | $6000 | Activity and Record Keeping Costs | $16,000 |

A) 10.00 percent
B) 8.20 percent
C) 10.25 percent
D) 13.75 percent
E) None of the above
Answer: C

121. The bank has determined the information below for one of its customers. This customer wants to borrow $1,000,000 but will maintain an average deposit balance in its account of $200,000. What is the interest rate the bank is charging the customer on the funds they have borrowed?

| Expected Revenues | | Expected Costs | |
|---|---|---|---|
| Interest Revenues | $1,000,000 | Deposit Interest | $30,000 |
| Commitment Fee | $15,000 | Cost of Other Funds Raised | $890,000 |
| Deposit Service Fees | $5,000 | Loan Processing Costs | $8000 |
| Agency Fees | $6000 | Activity and Record Keeping Costs | $16,000 |

A) 10.00 percent
B) 12.50 percent
C) 10.25 percent
D) 13.75 percent
E) None of the above
Answer: A

122. SNCs are also known as:
A) Working capital loans
B) Asset-backed loans
C) Syndicated loans
D) Construction loans
E) Inventory loans
Answer: C

123. Small business lending by banks is
A) Declining
B) Rising
C) Relatively constant
D) One with no pattern
E) One with an unknown pattern
Answer: A

124. The most common type of loan foreign banks make in the U.S. are:
A) Commercial loans
B) Retail loans
C) Real estate loans
D) Credit card loans
E) None of the above

Answer: A

125. Which of the following is an example of a captive finance company?
A) Bank of America
B) GMAC
C) Toyota Motors
D) Koch Industries
E) All of the above
Answer: B

126. Lloyd Blenman is building a shopping center in Charlotte and needs to get a loan until the shopping center is finished and he can get a mortgage on the property. What type of loan does he need?
A) Self-liquidating inventory loan
B) Working capital loan
C) Interim construction financing
D) Security dealer financing
E) Retailer and equipment financing
Answer: C

127. Dick Dowen needs a loan to buy plants and fertilizer for his nursery for the spring planting season. This loan will automatically be paid off as the plants and fertilizer are sold to his customers. What type of loan does Dick need?
A) Self-liquidating inventory loan
B) Working capital loan
C) Interim construction financing
D) Security dealer financing
E) Retailer and equipment financing
Answer: A

128. Randal Ice needs a loan to purchase pet food and other pet supplies for his local pet store over the next six months. He has estimated that the maximum amount of inventory he will need in the next six months is $200,000 and he knows that he will have to use accounts receivables and the inventory he purchases as collateral for the loan. At the end of six months, he hopes he can get the loan renewed. What type of loan does Randal need?
A) Self-liquidating inventory loan
B) Working capital loan
C) Interim construction financing
D) Security dealer financing
E) Retailer and equipment financing
Answer: B

129. Barbara Miller is a small dealer who specializes in healthcare stocks. She needs a loan so that she can sustain her portfolio of stocks until customer buy orders catch up with what she has already

purchased from the market. She only expects to need this loan for a week. What type of loan does Barbara need?
A) Self-liquidating inventory loan
B) Working capital loan
C) Interim construction financing
D) Security dealer financing
E) Retailer and equipment financing
Answer: D

130. Sight n' Sound is a retail store that sells refrigerators, washers, dryers and other consumer appliances. They need a loan so they can place an order with Whirlpool. The appliances will be the collateral for the loan and as an appliance is sold, the money will be passed on to the lender. An employee of the lender will periodically check to make sure what has sold and what remains in the store. What type of loan does Sight n' Sound need?
A) Self-liquidating inventory loan
B) Working capital loan
C) Interim construction financing
D) Security dealer financing
E) Retailer and equipment financing
Answer: E

131. Mary Williams needs to purchase a new bulldozer and excavator for her construction business and wants to repay the loan over the next three years in regularly scheduled payments. What type of loan does Mary need?
A) Term business loan
B) Revolving credit financing
C) Long term project loan
D) LBO loan
E) Syndicated loan
Answer: A

132. The Ford Motor Company needs to borrow $50 million. The First National Bank creates a packaged loan with several other banks to lend to Ford Motor Company. This loan package can be sold on the secondary market and carries a rate that is 500 basis points above LIBOR. The First National Bank expects this loan package to ultimately be held by a finance company looking for a good return on their money? What type of loan is this mostly likely to be?
A) Term business loan
B) Revolving credit financing
C) Long term project loan
D) LBO loan
E) Syndicated loan
Answer: E

133. The Wabash Washing Machine Company has arranged to get a loan from their bank over the next five years. They can borrow up to a pre-specified limit and repay it as many times as they need

until the loan matures. The Wabash Washing Machine Company has not pledged any specific collateral for this loan. What type of loan is this mostly likely to be?
A) Term business loan
B) Revolving credit financing
C) Long term project loan
D) LBO loan
E) Syndicated loan
Answer: B

134. The Jung Company and the Nguyen Company have combined to build a new container ship docking facility in Charleston Harbor. The facility is expected to take two years to complete and cost $3 billion to construct. These companies want to borrow money in order to build this facility. What type of loan is this most likely to be?
A) Term business loan
B) Revolving credit financing
C) Long term project loan
D) LBO loan
E) Syndicated loan
Answer: C

135. The management of the Frickel Frontier Freight Company wants to take the company private by borrowing money and using the proceeds of the loan to purchase the shares of the company in the market. Management believes they can increase revenues enough to be able to pay off the loan. What type of loan is management getting?
A) Term business loan
B) Revolving credit financing
C) Long term project loan
D) LBO loan
E) Syndicated loan
Answer: D

136. A bank wants to examine how well customer controls their expenses. They are most likely to look at which of the following ratios?
A) Wages and Salaries/Net Sales
B) Accounts Receivables/(Annual credit sales/360)
C) Net income after taxes/Net Sales
D) Income before interest and taxes/Interest payments
E) (Current assets – Inventory)/Current liabilities
Answer: A

137. A bank wants to examine how well a customer uses assets to generate sales. They are most likely to look at which of the following ratios?
A) Wages and Salaries/Net Sales
B) Accounts Receivables/(Annual credit sales/360)
C) Net income after taxes/Net Sales
D) Income before interest and taxes/Interest payments
E) (Current assets – Inventory)/Current liabilities

Answer: B

138. A bank wants to examine how well a customer markets their goods and services. They are most likely to look at which of the following ratios?
A) Wages and Salaries/Net Sales
B) Accounts Receivables/(Annual credit sales/360)
C) Net income after taxes/Net Sales
D) Income before interest and taxes/Interest payments
E) (Current assets – Inventory)/Current liabilities
Answer: C

139. A bank wants to examine the adequacy of a business customer's earnings based on the coverage ratios. They are most likely to look at which of the following ratios?
A) Wages and Salaries/Net Sales
B) Accounts Receivables/(Annual credit sales/360)
C) Net income after taxes/Net Sales
D) Income before interest and taxes/Interest payments
E) (Current assets – Inventory)/Current liabilities
Answer: D

140. A bank wants to know whether a customer can raise cash in a timely fashion at a reasonable cost. They are mostly likely to look at which of the following ratios?
A) Wages and Salaries/Net Sales
B) Accounts Receivables/(Annual credit sales/360)
C) Net income after taxes/Net Sales
D) Income before interest and taxes/Interest payments
E) (Current assets – Inventory)/Current liabilities
Answer: E

141. A bank has a concern about the Wilson Company's debt level. They feel that it is too high. What ratio are they most likely to examine to answer this question?
A) Selling and administrative expenses/Net sales
B) Net sales/Total assets
C) Current assets-Current liabilities
D) Net income/Total assets
E) Long term debt/(Long term debt + Net worth)
Answer: E

142. A bank has a concern because they feel that a firm has an excessive amount of assets. They do not feel that the firm is efficient in generating sales from their current level of assets. What ratio are they most likely to examine to answer this question?
A) Selling and administrative expenses/Net sales
B) Net sales/Total assets
C) Current assets-Current liabilities

D) Net income/Total assets
E) Long term debt/(Long term debt + Net worth)
Answer: B

143. A bank feels that a firm has expenses that are too high. What ratio are they most likely to examine to address this concern?
A) Selling and administrative expenses/Net sales
B) Net sales/Total assets
C) Current assets-Current liabilities
D) Net income/Total assets
E) Long term debt/(Long term debt + Net worth)
Answer: A

144. A bank is concerned because they feel that a firm will not be able to raise enough cash to pay bills that are due within the next year. What ratio are they most likely to examine to address this concern?
A) Selling and administrative expenses/Net sales
B) Net sales/Total assets
C) Current assets-Current liabilities
D) Net income/Total assets
E) Long term debt/(Long term debt + Net worth)
Answer: C

145. A bank wants to examine the financial success of a company by examining the profits of a company. What ratio will help the bank examine this issue?
A) Selling and administrative expenses/Net sales
B) Net sales/Total assets
C) Current assets-Current liabilities
D) Net income/Total assets
E) Long term debt/(Long term debt + Net worth)
Answer: D

146. A firm submits their financial records to a bank. Upon examination, the bank discovers that this firm has $500 in cash, $2500 in accounts receivables, $1000 in inventory, $5000 in plant and equipment and that their assets totaled $9000. In addition this bank discovered that the firm had $2000 in current liabilities, $2500 in long term debt and $4500 in net worth. Finally this bank discovered that this firm had $20,000 in net sales and $2000 in net income. What is this firm's net profit margin?
A) 10.00%
B) 22.22%
C) 44.44%
D) 50%
E) None of the above
Answer: A

147. A firm submits their financial records to a bank. Upon examination, the bank discovers that this

firm has $500 in cash, $2500 in accounts receivables, $1000 in inventory, $5000 in plant and equipment and that their assets totaled $9000. In addition this bank discovered that the firm had $2000 in current liabilities, $2500 in long term debt and $4500 in net worth. Finally this bank discovered that this firm had $20,000 in net sales (all of which are on credit and $2000 in net income. What is this firm's average collection period?
A) 18 days
B) 45 days
C) 72 days
D) 162 days
E) None of the above
Answer: B

148. A firm submits their financial records to a bank. Upon examination, the bank discovers that this firm has $500 in cash, $2500 in accounts receivables, $1000 in inventory, $5000 in plant and equipment and that their assets totaled $9000. In addition this bank discovered that the firm had $2000 in current liabilities, $2500 in long term debt and $4500 in net worth. Finally this bank discovered that this firm had $20,000 in net sales and $2000 in net income. What is this firm's net working capital?
A) $9000
B) $4500
C) $4000
D) $2000
E) None of the above
Answer: D

149. A firm submits their financial records to a bank. Upon examination, the bank discovers that this firm has $500 in cash, $2500 in accounts receivables, $1000 in inventory, $5000 in plant and equipment and that their assets totaled $9000. In addition this bank discovered that the firm had $2000 in current liabilities, $2500 in long term debt and $4500 in net worth. Finally this bank discovered that this firm had $20,000 in net sales and $2000 in net income. What is this firm's leverage ratio?
A) 22.50%
B) 44.44%
C) 50.00%
D) 88.89%
E) None of the above
Answer: C

150. A firm submits their financial records to a bank. Upon examination, the bank discovers that this firm has $500 in cash, $2500 in accounts receivables, $1000 in inventory, $5000 in plant and equipment and that their assets totaled $9000. In addition this bank discovered that the firm had $2000 in current liabilities, $2500 in long term debt and $4500 in net worth. Finally this bank discovered that this firm had $20,000 in net sales and $2000 in net income. What is this firm's acid test ratio?
A) 1.00
B) 2.00
C) 0.33

D) 3.00
E) 1.50
Answer: E

151. Banks need to be able to compare the firm they are examining to its industry. One company that provides information to banks about the industries their customers are in is:
A) Standard and Poors
B) Moody's
C) Dun and Bradstreet
D) Morgan Stanley
E) None of the above
Answer: C

152. A firm has net sales of $25,000, costs of goods sold of $10,000, selling, general and administrative expenses of $8000 (of which $2000 are depreciation expenses) and taxes (in cash) of $3000. What is this firm's operating cash flow (using the traditional or direct method)?
A) $4,000
B) $15,000
C) $5,000
D) $8,000
E) None of the above
Answer: C

153. A bank wants to estimate a firm's future financial condition. Which of the following is something that allows a bank to do this?
A) Statement of cash flows
B) Pro forma statement
C) Balance sheet
D) Income statement
E) None of the above
Answer: B

154. A bank has a listed prime rate of 7%. They have estimated that the marginal cost of raising funds is 5%, their default risk premium on a loan is 1.5% and that they want a profit margin of 2%. They have also estimated that the term risk premium is .5%. What is the interest rate this bank will charge if they use the cost plus pricing model?
A) 8.5%
B) 9%
C) 12%
D) 9.5%
E) None of the above
Answer: A

155. A bank has a listed prime rate of 7%. They have estimated that the marginal cost of raising funds is 5%, their default risk premium on a loan is 1.5% and that they want a profit margin of 2%.

They have also estimated that the term risk premium is .5%. What is the interest rate this bank will charge if they use the price leadership model (and the prime rate as their base rate)?
A) 8.5%
B) 9%
C) 12%
D) 9.5%
E) None of the above
Answer: B

# Chapter 18
# Consumer Loans, Credit Cards, and Real Estate Lending

**Fill in the Blank Questions**

1. The purchase of a house or a multifamily dwelling such as a duplex, triplex or apartment building is usually financed through the use of a_______________________ loan.
   Answer: residential mortgage

2. A(n)_______________________ loan is a short- or medium-term loan repayable in two or more consecutive payments, usually monthly or quarterly.
   Answer: installment

3. Household borrowings tend to be _______________________. Consumers are more concerned about the size of the debt repayments than the interest rate charged.
   Answer: interest inelastic

4. The fact that a consumer feels a strong moral and ethical responsibility to repay a loan on time refers to the _______________________ of that individual. The loan officer must be assured that the borrower is serious about repaying the loan before they are willing to make a loan.
   Answer: character

5. When a borrower receives a loan at one lending institution to repay another it is called ________ ____________________
   Answer: pyramiding of debt

6. The_______________________ allows a bank to call a loan that is in default and seize any checking or savings deposits the customer may hold with the bank in order to recover its funds.
   Answer: right of offset

7. _______________________ is a method to evaluate a large volume of consumer loans quickly with minimum labor. This method is a statistical model which predicts whether the consumer will repay the loan or not.
   Answer: Credit scoring

8. A(n)______________________________________________ is where the customer can use the difference between some percentage of the appraised value of their home and the mortgage remaining to secure a loan. This loan can be used to fund a college education, pay for a vacation or pay for home improvements.
   Answer: home equity loan

9. The law that requires the full disclosure of credit terms and which promotes the informed use of credit is the ______________________. This law requires the bank to report the APR of the loan, the dollar amount of all finance charges and, where appropriate, all fees.
Answer: Truth in Lending Act

10. The law that limits how far a creditor or credit collection agency can go in pressing a customer to pay a past due debt is the ______________________. It does not allow a debt collector to "harass" a debtor.
Answer: Fair Debt Collection Practices Act

11. Short-term credit to finance the building of homes or other dwellings is called ______________________.
Answer: construction loans

12. A(n)______________________ is a credit-rating agency that keeps records of borrowers' loan payment histories.
Answer: credit bureau

13. The____________________________________________ permits consumers to dispute billing errors with a merchant or credit card company and receive a prompt investigation into any billing errors.
Answer: Fair Credit Billing Act

14. The____________________________________________ prevents redlining out certain neighborhoods and refusing to provide loans and other services in those areas.
Answer: Community Reinvestment Act

15. ____________________________________________ is the granting of loans to weaker borrowers and charging them excessive fees and interest rates, increasing their risk of default
Answer: Predatory lending

16. The______________________ is the internal rate of return that equates present value of the payments with the amount of the loan. It is the rate required to be reported under the Truth in Lending Act.
Answer: annual percentage rate (APR)

17. The interest rate method which requires the interest on the loan to be paid in advance is called the______________________ method.
Answer: discount rate

18. The interest rate method that adds the interest owed to the principal is called the __________ method.
Answer: add-on

19. A rule of thumb used to determine how much interest income a bank is allowed to accrue at any point in time from a consumer loan paid off in monthly installments is called the _____________.
Answer: Rule of 78s

20. A(n)_____________________________________________ is an agreement drawn up by the bank that gives the bank control of the property if the loan cannot be repaid as planned.
Answer: chattel mortgage

21. The interest rate on most consumer loans is based on the cost of loanable funds to the bank plus nonfunding cost plus premiums for default and time to maturity and also includes the desired profit margin on the loan. This method of pricing loans is known as______________________ .
Answer: cost plus pricing

22. ______________________ is a basic method for calculating the interest owed on a loan that adjusts for declining balances and the time remaining on the loan.
Answer: Simple interest

23. A variable rate loan on a residential mortgage is called a(n)______________________.
Answer: adjustable rate mortgage or ARM

24. Many home mortgage agreements include______________________ which is an additional charge up front. Generally, each of these corresponds to one percent of the face value of the amount borrowed.
Answer: points

25. A popular prepaid card used like a credit card, especially in Europe, is the _________ card.
Answer: smart

26. A popular credit scoring system developed and sold by Fair Issac Corporation is known as ____________.
Answer: FICO

27. Traditional home equity loans are usually priced using ________-term interest rates while home equity lines of credit are priced using __________-term interest rates.
Answer: longer, shorter

28. ________________________ are loans that families and individuals can draw upon for immediate cash needs that are repayable in one lump sum. These loans often cover the cost of a vacation, medical care, the purchase of a home appliance or home repairs.
Answer: Noninstallment loans

29. Credit cards are the best example of a __________________ that offer consumers convenience and flexibility. Consumers can access them whenever the need arises.
Answer: revolving lines of credit (revolving credit loans)

30. _____________ are plastic cards that can be used to pay for goods and services but where credit is not extended. They are a convenient way to make deposits into and withdrawals from an ATM.
Answer: Debit cards

31. Consumer loans tend to be _____________________. They tend to rise in periods of economic expansion and tend to fall in periods of economic downturn.
Answer: cyclically sensitive

32. In the case of a borrower without a credit record or a very poor track record, a _______ may be requested to support repayment. Technically if the borrower defaults on the payment, they are obligated to repay the loan.
Answer: cosigner

33. A bank generally prefers the borrower report _____________ rather than gross salary.
Answer: net income (or take-home pay)

34. One of the three biggest credit bureaus includes ________________.
Answer: Experian (Equifax, Transunion)

35. The ______________________ prohibits lenders from asking certain questions of a customer, such as a customer's age or race.
Answer: Equal Credit Opportunity Act

36. The fastest rising financial crime against individuals today is ____________. This is the deliberate attempt to take unauthorized use of someone else's personal information in order to fraudulently obtain money, credit or other property.
Answer: identity theft

37. The __________________ Act provides consumers with the opportunity to order one free credit report annually from each of the three nationwide credit bureaus.
Answer: Fair and Accurate Credit Transactions (FACT)

38. ___________________ is the granting of loans to borrowers with below-average credit records. These loans tend to go to borrowers with a record of delinquent payments, previously charged-off loans, bankruptcies or court judgments.
Answer: Subprime lending

39. In real estate lending, the property must be _______________. The value and condition of the property are determined by an independent party. These must conform to industry and government standards.
Answer: appraised

40. One new type of mortgage where no principal payments are made is called a(n) ___________.
Interest-only mortgage

**True/False Questions**

T F 41. The dominant lender in the United States to households is the finance company with commercial banks ranked second as consumer lenders.
Answer: False

T F 42. Nonresidential consumer loans include credit to finance the purchase of home appliances.
Answer: True

T F 43. Credit cards offer convenience to customers plus a revolving line of credit.
Answer: True

T F 44. Consumer loans appear to have virtually no sensitivity to the business cycle, staying relatively level through both recessions and expansions.
Answer: False

T F 45. Households tend to be interest-inelastic borrowers.
Answer: True

T F 46. Lenders in the consumer loan field prefer to measure a borrowing customer's income by the amount of take-home pay.
Answer: True

T F 47. The "right of offset" allows a bank to sell a customer's property to the highest bidder to repay a customer's loan if the loan is in default.
Answer: False

T F 48. "Pyramiding of debt" refers to borrowing from one lender to repay another lender.
Answer: True

T F 49. Credit-scoring systems tend to be valid over long periods of time (usually several years) and need not be periodically retested.
Answer: False

T F 50. The Truth-in-Lending Act of 1968 gave consumers access to the information from their credit files kept at local and regional credit bureaus.
Answer: False

T F 51. Small business owners with gross annual revenues of $1 million or less who apply for credit have the right to receive a written notice if their loan request is turned down by a bank.
Answer: True

T F 52. The symbol "SN" indicates that a bank has been judged to be an outstanding performer under the terms of the Community Reinvestment Act.
Answer: False

T F 53. Banks awarded top CRA marks usually get strong commitments from their boards of directors and senior management to promote community involvement.
Answer: True

T F 54. FNMA will buy home mortgages provided the borrower's monthly house payment does not exceed 35 percent of monthly gross income.
Answer: False

T F 55. Under FNMA rules for buying home mortgages FNMA will not usually purchase a borrower's mortgage if the borrower's credit report is more than 45 days old.
Answer: False

T F 56. An installment loan is a loan in which the customer repays the loan in two or more consecutive payments. These payments are often monthly or quarterly.
Answer: True

T F 57. The Equal Credit Opportunity Act authorizes individuals and families to review their credit file for accuracy and to demand an investigation and correction of any apparent inaccuracies.
Answer: False

T F 58. The burden of proof is on the bank to demonstrate that its credit scoring system successfully identifies quality loan applications at a statistically significant level.
Answer: True

T F 59. Real estate loans are smaller in size and shorter in maturity than most other types of bank loans.
Answer: False

T F 60. The Community Reinvestment Act is designed to prevent a lender from arbitrarily marking out certain neighborhoods as undesirable and refusing to lend to people who live in those neighborhoods.
Answer: True

T F 61. There is usually a positive relationship between the interest rate a consumer is asked to pay and the amount of deposits the consumer is willing to keep with the bank.
Answer: False

T F 62. Competition for consumer loans tends to drive the interest rates on these loans down closer to loan production costs.
Answer: True

T F 63. Shorter term cash loans to consumers are normally secured, but longer-term consumer loans are usually unsecured.
Answer: False

T F 64. An auto loan usually carries with it a chattel mortgage, giving the bank a claim against the property covered by the loan.
Answer: True

T F 65. Most consumer loans are priced off some base or cost rate.
Answer: True

T F 66. The APR is the internal rate of return on a loan that equates total payments with the amount of the loan.
Answer: True

T F 67. The quotation to customers of the APR on the loan they are requesting usually discourages consumers from shopping around according to recent research findings.
Answer: False

T F 68. Unlike the APR method for calculating consumer loan rates, the simple interest approach adjusts for the length of time a borrower actually has use of credit.
Answer: False

T F 69. Under the simple interest method the customer saves on interest as an installment loan approaches maturity.
Answer: True

T F 70. With the discount rate method interest is deducted first before the customer has use of the proceeds of a loan.
Answer: True

T F 71. The majority of installment and lump-sum payment loans to families and individuals are made with floating interest rates.
Answer: False

T F 72. Points on a home mortgage loan result in a lender earning a higher effective interest rate on the loan than just the loan rate quoted to the borrower.
Answer: True

T F 73. According to the table presented in the book personal loans tend to have lower rates than automobile loans.
Answer: False

T F 74. According to the table presented in the book credit card loans tend to have the highest interest rates of all consumer loans.
Answer: True

T F 75. According to the table presented in the book new car loans have a lower interest rate than used car loans.
Answer: True

T F 76. There are very little economies of scale (cost savings) in the credit card business.
Answer: False

T F 77. Currently the debit card market is almost as large as the credit card market.
Answer: False

T F 78. One of the elements used in the FICO credit scoring system is the borrower's employment history and salary.
Answer: False

T F 79. The most important factor used in the FICO credit score is the borrower's payment history.
Answer: True

T F 80. Home mortgage real estate loans soared to record levels at the beginning of the 21st century.
Answer: True

**Multiple Choice Questions**

81. Short-term to medium-term loans repayable in two or more consecutive payments are known as:
A) Noninstallment loans
B) Installment loans
C) Residential mortgage loans
D) Nonresidential cash loans
E) None of the above
Answer: B

82. Loans to individuals and families to finance the purchase of new homes are known as:
A) Noninstallment loans
B) Installment loans
C) Residential mortgage loans
D) Nonresidential cash loans
E) None of the above
Answer: C

83. Short-term loans drawn upon by individuals and families for immediate cash needs and repayable in a lump sum when the borrower's note matures are known as:
A) Noninstallment loans
B) Installment loans
C) Residential mortgage loans
D) Nonresidential cash loans
E) None of the above
Answer: A

84. The federal law that requires banks to notify their credit customers <u>in writing</u> when a loan request is denied is known as the:
A) Equal Credit Opportunity Act
B) Competitive Equality in Banking Act
C) Truth-in-Lending Act
D) Community Reinvestment Act
E) None of the above.
Answer: A

85. Major laws and regulations which must be complied with in the mortgage lending area include which of the following?
A) National Affordable Housing Act
B) Community Reinvestment Act
C) Financial Institution Reform Recovery and Enforcement Act
D) All of the above
E) B and C only
Answer: D

86. Which of the following factors have proven most important in credit scoring models?
A) Credit Bureau ratings
B) Income bracket
C) Number of loans the customer has had
D) All of the above
E) A and B only
Answer: E

87. The requirement that banks must provide their consumer loan customers with a statement of the APR for the proposed loan was established by:
A) The Fair Credit Reporting Act.
B) The Equal Credit Opportunity Act.
C) The Truth-in-Lending Act.
D) The Community Reinvestment Act.
E) None of the above
Answer: C

88. Which of the following consumer loans has grown in popularity as a result of the passage of the Tax Reform Act of 1986?
A) Credit card loans
B) Home equity loans
C) Long-term, noninstallment loans
D) Short-term, installment loans
E) All of the above
Answer: B

89. A bank that is judged by examiners as needing to improve under the performance requirements of the Community Reinvestment Act will receive an examiner rating of:
A) 0
B) S
C) N
D) SN
E) None of the above
Answer: C

90. In order to be eligible for purchase by FNMA a home mortgage cannot have a maturity of less than 10 years nor more than:
A) 25 years
B) 30 years
C) 35 years
D) 40 years
E) None of the above
Answer: B

91. FNMA will <u>not</u> purchase home mortgages in the secondary market if the borrower's monthly debt repayments (including housing costs) exceed _________ percent of the borrower's monthly gross income. The correct percentage figure to complete the sentence above is:
A) 28
B) 30
C) 36
D) 40
E) None of the above
Answer: C

92. How did the Tax Reform Act of 1986 increase the appeal of home equity loans?
A) It allowed customers to borrow up to 100 percent of the value of their home
B) It eliminated bank income taxes from this type of loan
C) It protected homes under Chapter 13 bankruptcy
D) It eliminated individuals' tax deduction for interest payments on other types of loans
E) It required banks to lend on homes in the geographic area of their deposits
Answer: D

93. The federal law that permits consumers to dispute billing errors with a merchant or credit card company and receive a prompt investigation of any billing disputes is the:
A) Fair Credit Reporting Act
B) Fair Credit Billing Act
C) Fair Debt Collection Practices Act
D) Truth in Lending Act
E) None of the above
Answer: B

94. The bank's real estate loan officer should consider which of the following aspects of the customer's loan application carefully when making a home mortgage?
A) The amount and stability of the borrower's income
B) The borrower's available savings and where the down payment is coming from
C) The borrower's track record in caring for and managing property.
D) The outlook for real estate sales in the local market area
E) All of the above are things that need to be looked at carefully
Answer: E

95. An abusive practice is which lenders grant loans to weak borrowers and charge them high fees and interest rates which may cause the borrower to default on the loan is known as:
A) Installment loans
B) Credit card loans
C) Predatory lending
D) Herbivore lending
E) None of the above
Answer: C

96. The law which was passed to reduce predatory lending is known as:
A) Community Reinvestment Act
B) Home Ownership and Equity Protection Act
C) Equal Credit Opportunity Act
D) Fair Debt Collection Practices Act
E) None of the above
Answer: B

97. Which of the following is true regarding credit card loans?
A) There is evidence that considerable economies of scale exist
B) Credit cards cannot act as installment loans
C) Credit cards are very inconvenient for consumers
D) Credit cards are very inflexible for consumers
E) All of the above are true
Answer: A

98. A loan officer asks a customer what race she belongs to. Which law prohibits the loan officer from asking that question?
A) Truth in Lending Act
B) Equal Credit Opportunity Act
C) Community Reinvestment Act
D) Fair Debt Collection Practices Act
E) None of the above
Answer: B

99. Which of the following is not part of the evaluation of an installment loan?
A) The borrower's track record in caring for and maintaining property
B) Evidence of stable employment
C) Evidence of residence stability
D) Evidence of income stability
E) All of the above are part of the evaluation of an installment loan
Answer: A

100. Which of the following is an advantage of a credit scoring model?
A) Credit scoring models rely on the evaluation of an experienced credit officer
B) Credit scoring models are immune from charges of discrimination
C) Credit scoring models never make mistakes
D) Credit scoring models can handle a large volume of applications in a short period of time
E) All of the above are advantages of credit scoring models
Answer: D

101. When interest owed on a loan is added to the principal amount of the loan to determine a borrowing customer's required installment payments, this is known as the __________method for figuring a customer's loan rate. Fill in the blank with an appropriate response below.
A) Simple interest
B) APR
C) Discount
D) Add-on
E) None of the above
Answer: D

102. The symbols ARM in lending means:
A) Automatic rate modulation
B) Amortization rate method
C) Adjustable rate mortgage
D) Adaptable readjusted mortgage
E) None of the above.
Answer: C

103. The charge on a home mortgage loan that a borrower may be asked to pay up front is referred to as:
A) Loan Interest Owed
B) Points
C) Loading
D) Tax equity
E) None of the above.
Answer: B

104. Which of the following has the highest interest rate according to the book?
A) New automobile loan
B) Used automobile loan
C) Personal loan
D) Credit card loan
E) All of these have the same interest rate
Answer: D

105. Which of the following has the lowest interest rate according to the book?
A) New automobile loan
B) Used automobile loan
C) Personal loan
D) Credit card loan
E) All of these have the same interest rate
Answer: A

106. A customer seeks a $150,000 home mortgage. The bank requires the customer to pay 1 ¾ points up front. How much of the loan is actually available to the customer?
A) $150,000
B) $152,625
C) $147,375
D) $148,000
E) None of the above
Answer: C

107. A customer wants to borrow $1200 from Edmond State Bank. Edmond State Bank has an add-on loan with an interest rate of 12 percent and monthly payments for one year. What are the monthly payments this customer will need to make on this loan?
A) $100 per month
B) $112 per month
C) $107 per month
D) $88 per month
E) None of the above
Answer: B

108. A customer wants to borrower $25,000 for one year. TRC State Bank has a discount loan with an interest rate of 15 percent. How much of the loan will be available to the customer?
A) $25,000
B) $28,750
C) $22,500
D) $21,250
E) None of the above
Answer: D

109. A customer wants to borrow $125,000 to purchase a new home. The APR on this loan is 10 percent and it is a 30-year mortgage with monthly payments. What monthly payment will this customer face on this loan?
A) $1097
B) $55
C) $12,500
D) $13,260
E) None of the above
Answer: A

110. Mark Brown receives a $2000 loan with the intention of repaying the loan in 12 months. However, at the end of one month, Mr. Brown discovers he can repay the loan in full. What percentage of the interest charge is Mr. Brown entitled to receive as a rebate?
A) 36.67 percent
B) 50.00 percent
C) 91.67 percent
D) 63.33 percent
E) None of the above
Answer: D

111. Paul Carter requests an automobile loan of $15,000 that will be repaid over the next four years in monthly repayments. The First National Bank tells Mr. Carter that his total finance charges will be $4675.20. What is the APR on this loan?
A) 16 percent
B) 1 percent
C) 14 percent
D) 7 percent
E) None of the above
Answer: C

112. Jane Smith has asked for a 30 year mortgage to purchase a home in Oklahoma City, Oklahoma. The purchase price of the home is $150,000 of which $125,000 must be borrowed. If the APR on this loan is 8 percent, how much will Jane's total financing charges be?
A) $246,233
B) $205,194
C) $180,194
D) $165,097
E) None of the above
Answer: B

113. Beverly Frickerson asks for a $15,000 loan for one year. The bank tells her that they will give her $13,050 immediately and deduct $1950 in interest up front. What is the effective rate of interest on this loan?
A) 14.94 percent
B) 13.00 percent
C) 19.50 percent
D) 11.50 percent
E) None of the above
Answer: A

114. The largest credit card lender (as a group) in the U.S. are:
A) Thrifts
B) Insurance companies
C) Finance companies
D) Oil companies
Answer: C

115. Prepaid cards which compete with credit cards and debit cards are:
A) Smart cards
B) Deposit cards
C) Match cards
D) All of the above
E) None of the above
Answer: A

116. The first major bank within the U.S. to establish a separate department for granting household loans was:
A) First National City Bank of New York
B) BankAmerica
C) Bank One
D) State Street Bank
E) Bank of New York
Answer: A

117. The fastest growing consumer loan category is:
A) Credit card loans
B) Auto loans
C) Home mortgages
D) Personal loans
E) Education loans
Answer: C

118. The very popular FICO credit scoring system provides credit scores in the range:
A) 0 to 10
B) 0 to 1000
C) 100 to 1000
D) 300 to 850
E) 20 to 80
Answer: D

119. The most important factor used in the FICO credit scoring system is:
A) The borrower's payment history
B) The amount of money owed
C) Marital status
D) Employment history and salary
E) Age
Answer: A

120. Jeremiah Uselton needs a loan to purchase a condo in Sarasota, Florida. What type of loan does Jeremiah need?
A) Residential mortgage loan
B) Installment loan
C) Noninstallment loan
D) Revolving line of credit
E) None of the above
Answer: A

121. Tammy Payne wants to buy a used car and wants a loan that she will pay off over the next three years with monthly payments. What type of loan does Tammy want?
A) Residential mortgage loan
B) Installment loan
C) Noninstallment loan
D) Revolving line of credit
E) None of the above
Answer: B

122. Emily Barnes has gone to the First State Bank and gotten a loan of $5000 so she can go on vacation. She plans on paying the loan back in one payment in three months. What type of loan has Emily gotten?
A) Residential mortgage loan
B) Installment loan
C) Noninstallment loan
D) Revolving line of credit
E) None of the above
Answer: C

123. Bill Wells uses his Discover card to buy new furniture for his apartment. The interest rate on this card is 18% and the minimum payment that is due is $100. What type of loan has Bill gotten?
A) Residential mortgage loan
B) Installment loan
C) Noninstallment loan
D) Revolving line of credit
E) None of the above
Answer: D

124. Jerry McGuire uses his Visa card to buy a new washer and dryer and a new refrigerator for his home. He plans on paying off the credit card over the next two years. How is Jerry using his credit card?
A) As an installment loan
B) As a noninstallment loan
C) As a lump sum payer
D) As a debit card
E) None of the above
Answer: A

125. The most profitable credit card customers for a bank are those that:
A) Use their credit card frequently
B) Pay off any charges incurred within a few days
C) Charge at least $10,000 per year
D) Use their credit card as a source of installment loans
E) None of the above
Answer: D

126. Alexis Downs uses her credit card to buy furniture but pays off the credit card at the end of the month before she incurs any interest costs. How is Alexis using her credit card?
A) As an installment loan
B) As a noninstallment loan
C) As a lump sum payer
D) As a debit card
E) None of the above
Answer: B

127. Donna Carlon is using her plastic card to buy groceries. The money is taken from her checking account immediately to pay for her groceries. How is Donna using her card?
A) As an installment loan
B) As a noninstallment loan
C) As a lump sum payer
D) As a debit card
E) None of the above
Answer: D

128. A bank is considering making a loan to Alice Granger. The bank is looking at her credit report from Equifax and also examining the reason Alice has put on the loan application for needing the loan? What aspect of evaluating a consumer loan application is the bank looking at?
A) Character and purpose
B) Income level
C) Deposit balance
D) Employment and residential stability
E) Pyramiding of debt
Answer: A

129. A bank is considering making a loan to Ron Weasley. Ron has a gross salary per month of $4000 but has take-home pay of $2800 per month. What aspect of evaluating a consumer loan application is this fact most concerned with?
A) Character and purpose
B) Income level
C) Deposit balance
D) Employment and residential stability
E) Pyramiding of debt
Answer: B

130. A bank is considering making a loan to Sean Finnigan. Sean owns his own home and has lived there for the past four years. What aspect of evaluating a consumer loan application is this fact most concerned with?
A) Character and purpose
B) Income level
C) Deposit balance
D) Employment and residential stability
E) Pyramiding of debt
Answer: D

131. A bank is considering making a loan to Sam Snape. Mr. Snape has $1000 in the bank right now but generally keeps a balance of $4500 most of the year. What aspect of evaluating a consumer loan application is this fact concerned with?
A) Character and purpose
B) Income level
C) Deposit balance
D) Employment and residential stability
E) Pyramiding of debt
Answer: C

132. A bank is considering making a loan to Neville Langdon. Neville has bounced three checks in the last year and already has $10,000 on a credit card and an automobile loan with a large balance. What aspect of evaluating a consumer loan application is this fact concerned with?
A) Character and purpose
B) Income level
C) Deposit balance
D) Employment and residential stability
E) Pyramiding of debt
Answer: E

133. A bank is considering making a loan to John Carter. John is a commissioned sales broker. Some months he earns as much as $10,000 and in other months he earns virtually nothing. Which aspect of evaluating a consumer loan would this be concerned with?
A) Character and purpose
B) Income level
C) Deposit balance
D) Employment and residential stability
E) Pyramiding of debt
Answer: B

134. Which of the following is a challenge of making a consumer loan?
A) Audited financial statements are provided by consumers quarterly
B) Consumers must disclose publicly any changes in their health that would affect the loan
C) Consumers can more easily hide pertinent information
D) Consumers can more easily adjust to financial setbacks than can businesses
E) All of the above are challenges of making a consumer loan
Answer: C

135. Mark Green is considering buying a new Honda Accord. The purchase price of the car is $21,000 but Mark has a trade-in worth $4500. Mark needs a loan to buy the car and knows that his local bank requires him to put down 10% of the purchase price after the value of the trade-in is considered. Mark also knows that bank will charge 8% for the loan and require monthly payments over the next 4 years. What is the minimum down payment that Mark can make?
A) $2,100
B) $450
C) $1,650
D) $2,550
E) None of the above
Answer: C

136. Mark Green is considering buying a new Honda Accord. The purchase price of the car is $21,000 but Mark has a trade-in worth $4500. Mark needs a loan to buy the car and knows that his local bank requires him to put down 10% of the purchase price after the value of the trade-in is considered. Mark also knows that bank will charge 8% for the loan and require monthly payments over the next 4 years. If Mark makes the minimum down payment on the car, what is the amount of the loan that Mark will receive?

A) $18,900
B) $14,850
C) $16,500
D) $14,400
E) None of the above
Answer: B

137. Mark Green is considering buying a new Honda Accord. The purchase price of the car is $21,000 but Mark has a trade-in worth $4500. Mark needs a loan to buy the car and knows that his local bank requires him to put down 10% of the purchase price after the value of the trade-in is considered. Mark also knows that bank will charge 8% for the loan and require monthly payments over the next 4 years. What is the size of Mark's monthly payments if he makes the minimum down payment on the car?

A) $353.50
B) $301.67
C) $512.67
D) $402.81
E) None of the above
Answer: A

138. Mark Green is considering buying a new Honda Accord. The purchase price of the car is $21,000 but Mark has a trade-in worth $4500. Mark needs a loan to buy the car and knows that his local bank requires him to put down 10% of the purchase price after the value of the trade-in is considered. Mark also knows that bank will charge 8% for the loan and require monthly payments over the next 4 years. Mark's monthly payments are 353.50 per month. What is Mark's total finance charge if he takes the full 4 years to pay off the loan?

A) $468
B) $4,032
C) $4,500
D) $2,488
E) None of the above
Answer: D

139. The Equal Credit Opportunity Act requires that:

A) A bank make loans to all minority applicants
B) A bank only make loans to white male applicants
C) A bank give reasons in writing for denying the loan
D) A bank deny loans if the borrower has only been employed for three months
E) None of the above
Answer: C

140. Credit reports provided by credit bureaus provide lenders:
  A) With personal identifying data
  B) With personal credit histories derived from data submitted by lenders
  C) With public information that may bear on a borrower's honesty and stability
  D) With the volume of inquiries from lenders about the borrower
  E) All of the above
  Answer: E

141. Which regulation requires out-of-state-banks that acquire local banks to commit to continued lending in the area and not use the acquired banks simply as deposit gatherers?
  A) Equal Credit Opportunity Act
  B) National Bank Act
  C) Federal Lending Act
  D) Fair Credit Reporting Act
  E) Community Reinvestment Act
  Answer: E

142. A bank customer is granted credit for a $2,000 loan at 10% to be repaid in 12 equal installments. If the loan is a discount loan, what is the monthly payment?
  A) 200.00
  B) $192.35
  C) $184.20
  D) $173.12
  E) $166.67
  Answer: E

143. A bank customer is granted credit for a $2,000 loan at 10% to be repaid in 12 equal installments. If the loan quoted has an add-on rate, what are the net proceeds of the loan?
  A) $2,200
  B) $2,100
  C) $2,000
  D) $1.800
  E) Cannot be determined
  Answer: c

144. A bank customer is granted credit for a $2,000 loan at 10% to be repaid in 12 equal installments. If the loan quoted has an add-on rate, what is the approximate annual percentage rate (APR) on the loan?
  A) 20%
  B) 18%
  C) 14%
  D) 12%
  E) 10%

Answer: B

145. As part of the new regulations of the mortgage market, the Federal Reserve Board moved to tighten the rules on mortgage lending in 2008. All of the following would improve transparency of the market except for:
A) Lenders must verify the borrower's reported income
B) Lenders cannot rely on a home's current market value to judge a borrower's creditworthiness
C) Lenders must rely on a borrower's stated income
D) Lenders must disclose more about the actual terms of a home mortgage loan to a borrower
E) All of the above are included in the new rules
Answer: C