Chapter 19

Bank Management

1. Which of the following statements is incorrect?
   A) Managers may be tempted to make decisions that are in their own best interests rather than shareholder interests.
   B) The compensation of bank loan officers may be tied to loan volume, which encourages a loan department to extend loans with a very high concern for risk.
   C) To prevent agency problems, some banks provide stock as compensation to managers.
   D) The underlying goal behind the managerial policies of a bank is to maximize the wealth of the bank's shareholders.

   ANSWER: B

2. When cash outflows temporarily exceed cash inflows, banks are *most* likely to experience:
   A) higher dividend payments.
   B) illiquidity.
   C) a negative duration on its assets.
   D) an excess of capital.

   ANSWER: B

3. Banks can resolve cash deficiencies by:
   A) creating additional liabilities.
   B) selling assets.
   C) buying back common stock.
   D) increasing dividend payouts.
   E) creating additional liabilities or selling assets.

   ANSWER: E

4. As the secondary market for loans has become active, banks are more able to satisfy their liquidity needs with a _______ proportion of loans while achieving _______ profitability.
   A) higher; higher
   B) lower; lower
   C) higher; lower
   D) lower; higher

   ANSWER: A

5. If a bank that relies heavily on short-term deposits expects interest rates to consistently decrease over time, it would allocate most of its loans with _______ rates if it desires to maximize its expected returns. It could reduce its exposure to interest rate risk by setting _______ rates on its loans.
   A) fixed; fixed
   B) variable; fixed
   C) variable; variable
   D) fixed; variable

   ANSWER: D

6. During a period of rising interest rates, a bank's net interest margin will likely _______ if its liabilities are _______ its assets.
   A) increase; more rate-sensitive than
   B) decrease; more rate-sensitive than
   C) increase; equally rate-sensitive as
   D) decrease; equally rate-sensitive as

   ANSWER: B

7. If a bank expected interest rates to consistently _______ over time, it will consider allocating most funds to rate-_______ assets.
   A) decrease; sensitive
   B) decrease; insensitive
   C) increase; insensitive
   D) none of these

   ANSWER: B

The following information refers to questions 8 through 10.

Petri Bank had interest revenues of $70 million last year and $30 million in interest expenses. About $300 million of Petri's $800 million in assets are rate-sensitive, while $600 million of its liabilities are rate-sensitive.

8. Petri Bank's net interest margin is _______ percent.
   A) 4.0
   B) 3.6
   C) 6.7
   D) 5.0

   ANSWER: D

9. Petri Bank's gap is $_______ million.
   A) –300
   B) 300
   C) –500
   D) 500

   ANSWER: A

10. Petri Bank's gap ratio is _______ percent.
    A) 37.5
    B) 50.0
    C) 100.0
    D) 40.0

    ANSWER: B

11. The measure of interest rate risk that uses the difference between rate-sensitive assets and rate-sensitive liabilities is called:
    A) gap measurement.
    B) duration measurement.
    C) the duration ratio.
    D) the gap ratio.

    ANSWER: A

12. A gap ratio of less than one suggests that:
    A) rate-sensitive assets exceed rate-sensitive liabilities.
    B) an increase in interest rates would increase the bank's net interest margin.
    C) rate-sensitive liabilities exceed rate-sensitive assets.
    D) a decrease in interest rates would decrease the bank's net interest margin.

    ANSWER: C

13. The duration of zero-coupon bonds will be _______ the duration of coupon bonds with the same maturity.
    A) lower than
    B) higher than
    C) the same as
    D) higher than or lower than, depending on the size of the coupon payment

    ANSWER: B

14. In general, the duration of zero-coupon securities with short maturities is _______ than the duration of zero-coupon securities with long maturities.
    A) higher than
    B) lower than
    C) equal to
    D) higher than or lower than, depending on the issuer of the securities

    ANSWER: B