Chapter 12

Liquidity Risk

**True / False Questions**

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| 1. | When liquidity risk problems occur at a DI, they often threaten the solvency of the institution.  True    False |

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| 2. | Depository institutions generally rely on each other for cash and to meet their daily liquidity needs.  True    False |

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| 3. | During the financial crisis of 2008, liquidity problems were avoided as banks continued to provide lending to each other.  True    False |

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| 4. | During the financial crisis of 2008, there were large deposit inflows to the banking system.  True    False |

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| 5. | Mutual funds tend to have less exposure to liquidity risk than banks and thrifts.  True    False |

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| 6. | An FI's most liquid asset is cash.  True    False |

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| 7. | Demand deposits pose a liquidity risk for FIs because funds may be withdrawn at any time.  True    False |

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| 8. | A bank must be ready to pay out all demand deposit liabilities on any given day.  True    False |

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| 9. | Liquidity risk for an FI includes the possibility of an unexpected inflow of funds.  True    False |

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| 10. | Bank runs occur because customers know that banks will be forced to liquidate assets at fire-sale prices.  True    False |

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| 11. | Asset-side liquidity risk may be a result of OBS lending commitments.  True    False |

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| 12. | Core deposits represent a relatively short-term source of funds.  True    False |

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| 13. | An expected net deposit drain on any given day means that deposit withdrawals are less than deposit inflows.  True    False |

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| 14. | Purchased liquidity risk management usually involves purchased funds such as fed funds, repurchase agreements and CDs.  True    False |

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| 15. | Purchased liquidity management carries the potential risk of significant increases in the cost of funds during periods of high interest rate volatility.  True    False |

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| 16. | Because cash reserves at the Federal Reserve do not earn interest, DIs do not hold any excess cash reserves beyond the minimum requirements.  True    False |

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| 17. | Managing asset-side liquidity risk can involve either purchased liquidity management or stored liquidity management.  True    False |

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| 18. | Liquid funds can be obtained by a DI through unlimited borrowing in the money or purchased funds markets.  True    False |

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| 19. | Banks with relatively high loan commitments face less liquidity risk exposure than banks with a low level of loan commitments.  True    False |

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| 20. | The liquidity index should be a number that is either greater than one or less than zero.  True    False |

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| 21. | The greater the difference between fair market prices and fire-sale prices for assets, the less liquid the DI's portfolio of assets.  True    False |

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| 22. | In terms of liquidity risk measurement, the financing gap is defined as rate sensitive assets minus rate sensitive liabilities.  True    False |

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| 23. | Liquidity planning primarily is designed to assist management in dealing with relatively predictable events.  True    False |

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| 24. | Abnormally large and unexpected deposit withdrawals can occur because of concerns by depositors about a bank's solvency relative to other banks.  True    False |

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| 25. | The cost of stored liquidity management is the interest that must be paid on the stored funds.  True    False |

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| 26. | The future liquidity position of a DI cannot be forecasted.  True    False |

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| 27. | Deposit insurance is the only deterrent to bank runs, contagious runs, and bank panics.  True    False |

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| 28. | As of 2012, banks must report their The Liquidity Coverage Ratio (LCR) to the FDIC rather than to the Federal Reserve.  True    False |

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| 29. | When computing the liquidity coverage ratio, high-quality liquid assets are divided into two levels.  True    False |

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| 30. | The net stable funds ratio (NSFR) is a longer-term measure than the liquidity coverage ratio (LCR).  True    False |

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| 31. | A problem exists with the net stable funds ratio (NSFR) in that it does not include off-balance-sheet activities.  True    False |

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| 32. | Even with liquidity planning, net deposit withdrawals and/or the exercise of loan commitments can pose significant liquidity problems for banks.  True    False |

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| 33. | In the event of a bank run, depositor claims on the bank are satisfied on a pro rata basis.  True    False |

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| 34. | A contagious run, or bank panic, differs from a run on a bank in that a contagious run involves loss of faith in the entire banking system as opposed to just one bank.  True    False |

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| 35. | In general, money center banks are exposed to less liquidity risk than smaller, regional banks.  True    False |

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| 36. | The Fed discount window maintains three lending programs to assist DIs in managing liquidity problems.  True    False |

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| 37. | For life insurance companies, the distribution of premium income minus policyholder liquidations is unpredictable.  True    False |

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| 38. | Surrender value is the amount of cash a life insurance policy holder can receive by turning in the policy before it expires or matures.  True    False |

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| 39. | The assets of PC insurers are relatively short term and more liquid than those of life insurance companies.  True    False |

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| 40. | Insurance companies have had to deal with liability runs by policyholders.  True    False |

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| 41. | Government securities represent the reserve asset fund for life insurance companies.  True    False |

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| 42. | Liquidity risk for a life insurance company only occurs when asset returns do not provide sufficient cash flows to meet policyholder liquidations.  True    False |

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| 43. | Open-end mutual funds issue a fixed number of shares as liabilities.  True    False |

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| 44. | Net asset value is the current value of a mutual fund's assets divided by the number of shares outstanding.  True    False |

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| 45. | Liquidation of a mutual fund causes assets to be liquidated and funds received to the dispersed to shareholders on a first come, first served basis.  True    False |

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| 46. | It is impossible for money market mutual fund share prices to fall below $1.00.  True    False |

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| 47. | Hedge funds are not susceptible to liquidity risk or a liquidity crisis.  True    False |

**Multiple Choice Questions**

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| 48. | Which of the following is NOT a potential causes of liquidity risk for a DI?

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| A.  | A decrease in the DI's stock price caused by market factors. |

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| B.  | An increase in requests to fund large amounts of loan commitments. |

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| C.  | A decrease in the availability of short-term borrowed funds. |

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| D.  | An increase in requests by depositors to withdrawal large amounts of deposits. |

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| E.  | A decrease in asset prices of securities held in the investment portfolio. |

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| 49. | Which type of financial intermediary is more highly exposed to liquidity risk?

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| A.  | Property-casualty insurance companies. |

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| B.  | Life insurance companies. |

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| C.  | Mutual funds. |

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| D.  | Depository institutions. |

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| E.  | Pension funds. |

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| 50. | What is a fire-sale price?

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| A.  | Market value of an asset. |

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| B.  | Price received for an asset that has to be liquidated immediately. |

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| C.  | Maximum price that will be received on sale of an asset irrespective of the time of sale. |

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| D.  | Replacement value of an asset. |

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| E.  | Book value of an asset. |

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| 51. | A bank's net deposit drain

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| A.  | is negative if deposits exceed withdrawals. |

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| B.  | is positive if deposits exceed withdrawals. |

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| C.  | decreases during holiday and vacation periods. |

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| D.  | in unaffected by holiday and vacation periods. |

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| E.  | fluctuates unpredictably on any given day. |

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| 52. | Which of the following is a condition for a DI to be growing?

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| A.  | Net positive drain on deposits. |

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| B.  | Peak of the net deposit drain probability distribution should lie at a point to the right of zero. |

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| C.  | Average deposit drain such that new deposit funds more than offset deposit withdrawals. |

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| D.  | The liability side of its balance sheet is decreasing. |

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| E.  | Unused loan commitments is increasing. |

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| 53. | Which of the following balance sheet entries is not a tool used in purchased liquidity management?

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| A.  | Bonds. |

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| B.  | Federal fund. |

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| C.  | Demand deposit. |

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| D.  | Repurchase agreement. |

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| E.  | Subordinated note. |

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| 54. | Which of the following observations is NOT true?

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| A.  | Traditionally, DI managers have relied on purchased liquidity management as the primary mechanism of liquidity management. |

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| B.  | Today, many DIs rely on purchased liquidity management to deal with the risk of cash shortfalls. |

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| C.  | The largest banks with access to the money market and other nondeposit markets for funds rely on purchased liquidity management to deal with the risk of cash shortfalls. |

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| D.  | Purchased liquidity management and stored liquidity management are ways of managing a drain on deposits. |

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| E.  | None of the above. |

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| 55. | A disadvantage of using purchased liquidity management to manage a FI's liquidity risk is

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| A.  | the resulting shrinkage of the FI's balance sheet. |

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| B.  | the relatively high cost of purchased liabilities. |

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| C.  | the accessibility of international money markets. |

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| D.  | tax considerations. |

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| E.  | loss of flexibility as a result of dependence upon purchased liabilities. |

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| 56. | A disadvantage of using stored liquidity management to manage a FI's liquidity risk is

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| A.  | the resulting shrinkage of the FI's balance sheet. |

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| B.  | the high cost of purchased liabilities. |

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| C.  | the accessibility of international money markets. |

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| D.  | tax considerations. |

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| E.  | loss of flexibility as a result of dependence upon purchased liabilities. |

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| 57. | Which of the following statements is NOT true?

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| A.  | Stored liquidity management involves liquidation of assets. |

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| B.  | Traditionally DIs have stored cash reserves at the Federal Reserve and in their vaults to overcome liquidity risk. |

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| C.  | When the DI uses its cash as the liquidity adjustment mechanism, both sides of its balance sheet contract. |

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| D.  | DIs hold cash reserves in excess of the minimum required to meet liquidity drains. |

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| E.  | A DI sustains no cost under stored liquidity risk management. |

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| 58. | Why have purchased liquidity management techniques become very popular in spite of its limitations?

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| A.  | Because it insulates the assets of an FI from normal drains on liability liquidity. |

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| B.  | Because funds can be easily raised in the eventuality of a liquidity crunch. |

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| C.  | Because of decrease in the cost of funds during periods of high interest rate volatility. |

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| D.  | Because the funds are covered by deposit insurance. |

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| E.  | Because the adjustment to the deposit drain occurs on the liability side of the balance sheet. |

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| 59. | When banks use stored liquidity management, they

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| A.  | must pay interest on the funds that are stored. |

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| B.  | store the funds at the U.S. Treasury. |

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| C.  | necessarily increase the asset side of the balance sheet. |

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| D.  | may shrink the balance sheet if cash is used as the liquidity adjustment mechanism. |

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| E.  | threaten the capital position of the institution. |

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| 60. | If purchased liquidity is used by a DI to fund an exercised loan commitment

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| A.  | the balance sheet will decrease by the amount of the new loan. |

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| B.  | only the asset side of the balance sheet will increase. |

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| C.  | the balance sheet will increase by the amount of the new loan. |

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| D.  | only the liability side of the balance sheet will increase. |

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| E.  | there will be no effect on the balance sheet. |

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| 61. | If stored liquidity is used by a DI to fund an exercised loan commitment

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| A.  | the balance sheet will decrease by the amount of the new loan. |

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| B.  | only the asset side of the balance sheet will increase. |

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| C.  | the balance sheet will increase by the amount of the new loan. |

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| D.  | only the liability side of the balance sheet will increase. |

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| E.  | there will be no effect on the balance sheet. |

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| 62. | What is the asset adjustment to a bank's balance sheet if the bank sold a five-year, 7 percent annual coupon $100,000 bond acquired at par, but now yielding 8 percent? The bond was not in the mark-to-market portfolio.

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| A.  | A $96,007 reduction in assets. |

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| B.  | A $96,007 increase in assets. |

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| C.  | A $100,000 reduction in assets. |

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| D.  | A $100,000 increase in assets. |

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| E.  | A $100,000 increase in liabilities. |

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| 63. | An open-end bond mutual fund is holding a three-year, $1 million face value 5 percent annual coupon bond selling at par. What is the impact on the total asset value of the fund of a 1 percent decrease in interest rates?

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| A.  | A decrease of $10,000. |

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| B.  | An increase of $10,000. |

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| C.  | A decrease of $26,730. |

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| D.  | An increase of $27,751. |

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| E.  | The answer depends upon the number of mutual funds shares outstanding. |

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| 64. | What is the impact of a 50 basis point increase in interest rates on the net asset value of an open-end bond mutual fund holding a seven year, $100 million face value 7 percent annual coupon bond selling at par? The fund has 10 million shares.

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| A.  | An increase of $0.24 per share. |

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| B.  | A decrease of $0.265 per share. |

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| C.  | An increase of $0.05 per share. |

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| D.  | A decrease of $0.05 per share. |

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| E.  | An increase of $0.265 per share. |

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| 65. | In the event of financial distress, open-ended mutual fund investors

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| A.  | have an incentive to cash in their shares quickly since they are paid on a first come, first served basis. |

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| B.  | have an incentive to avoid a run since that will deplete the fund net asset value. |

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| C.  | have an incentive to cash in their shares quickly since that will increase the fund's net asset value. |

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| D.  | will switch into low risk bank deposits. |

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| E.  | have an incentive to avoid a run since the Federal Reserve guarantees mutual fund holdings. |

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| 66. | The surrender value of an insurance policy is

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| A.  | its promised payoff. |

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| B.  | normally a portion of the contract's face value. |

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| C.  | its value upon bankruptcy. |

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| D.  | the value of the junk bonds in the insurance company's portfolio. |

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| E.  | its holdup value. |

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| 67. | Which intermediation function results in an FI's exposure to liquidity risk?

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| A.  | Information production. |

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| B.  | Asset transformation. |

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| C.  | Conduit for monetary policy. |

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| D.  | Lender of last resort. |

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| E.  | Brokering between funds deficit units and funds surplus units. |

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| 68. | How does purchased liquidity management affect profitability?

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| A.  | By its impact on the interest rate sensitivity of assets. |

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| B.  | By its impact on the interest rate sensitivity of liabilities. |

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| C.  | By determining the default risk of investment securities. |

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| D.  | By its impact on the cost of purchased funds. |

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| E.  | By enhancing the liquidity of assets held. |

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| 69. | When comparing banks and mutual funds,

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| A.  | mutual funds have more liquidity risk than banks because all shareholders share the loss of value on a pro rata basis. |

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| B.  | mutual funds have less liquidity risk than banks because all shareholders share the loss of value on a pro rata basis. |

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| C.  | mutual funds have more liquidity risk than banks because all shareholders have the ability to withdraw their money on a first-come first basis. |

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| D.  | mutual funds have less liquidity risk than banks because all shareholders have the ability to withdraw their money on a first-come first basis. |

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| E.  | mutual funds have the same liquidity risk as banks because both shareholders and depositors share the fall in the loss of value on a pro rata basis. |

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| 70. | Which of the following is NOT a primary source of liquidity?

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| A.  | Excess cash reserves over and above regulatory reserve requirements. |

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| B.  | Borrowings in the money market. |

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| C.  | Borrowings in the purchased funds market. |

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| D.  | Capital notes and other long-term financing alternatives. |

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| E.  | Cash-type assets that can be sold with little price risk and low transaction costs. |

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| 71. | Which of the following is NOT used as a method of measuring liquidity risk?

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| A.  | Liquidity coverage ratio. |

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| B.  | Liquidity index. |

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| C.  | Financing gap and financing requirement. |

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| D.  | Peer group ratio comparison. |

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| E.  | Current ratio. |

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| 72. | What information does the net liquidity statement provide?

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| A.  | A long-term focus on liquidity. |

|  |  |
| --- | --- |
| B.  | Sources and uses of liquidity. |

|  |  |
| --- | --- |
| C.  | Net asset value. |

|  |  |
| --- | --- |
| D.  | Liquidity index information. |

|  |  |
| --- | --- |
| E.  | Peer group ratio comparison. |

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| 73. | Which of the following is a measure of the potential losses an FI could suffer as the result of fire-sale disposal of assets?

|  |  |
| --- | --- |
| A.  | Quick ratio. |

|  |  |
| --- | --- |
| B.  | Liquidity index. |

|  |  |
| --- | --- |
| C.  | Financing gap and financing requirement. |

|  |  |
| --- | --- |
| D.  | Peer group ratio. |

|  |  |
| --- | --- |
| E.  | Current ratio. |

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| 74. | A DI has two assets: 50 percent in one-month Treasury bills and 50 percent in real estate loans. If the DI must liquidate its T-bills today, it receives $98 per $100 of face value; if it can wait to liquidate them on maturity (in one month's time), it will receive $100 per $100 of face value. If the DI has to liquidate its real estate loans today, it receives $90 per $100 of face value liquidation at the end of one month will produce $92 per $100 of face value. The one-month liquidity index value for this DI's asset portfolio is

|  |  |
| --- | --- |
| A.  | .973. |

|  |  |
| --- | --- |
| B.  | .940. |

|  |  |
| --- | --- |
| C.  | .979. |

|  |  |
| --- | --- |
| D.  | 1.06. |

|  |  |
| --- | --- |
| E.  | 1.10. |

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| 75. | For a DI, what does a high ratio of loans to deposits indicate?

|  |  |
| --- | --- |
| A.  | DI relies heavily on the short-term money market to fund loans. |

|  |  |
| --- | --- |
| B.  | High degree of loan commitments. |

|  |  |
| --- | --- |
| C.  | DI has large amounts of asset-side liquidity. |

|  |  |
| --- | --- |
| D.  | Liquidity concerns are at a bare minimum for the FI. |

|  |  |
| --- | --- |
| E.  | DI relies heavily on core deposits to fund loans. |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 76. | In terms of liquidity risk measurement, the financing gap is defined as

|  |  |
| --- | --- |
| A.  | total deposits minus core deposits. |

|  |  |
| --- | --- |
| B.  | financing requirement plus liquid assets. |

|  |  |
| --- | --- |
| C.  | rate sensitive assets minus rate sensitive liabilities. |

|  |  |
| --- | --- |
| D.  | total assets minus total liabilities. |

|  |  |
| --- | --- |
| E.  | average loans minus average deposits. |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 77. | In terms of liquidity risk measurement, the financing requirement is defined as

|  |  |
| --- | --- |
| A.  | total deposits minus core deposits. |

|  |  |
| --- | --- |
| B.  | financing gap plus liquid assets. |

|  |  |
| --- | --- |
| C.  | rate sensitive assets minus rate sensitive liabilities. |

|  |  |
| --- | --- |
| D.  | total assets minus total liabilities. |

|  |  |
| --- | --- |
| E.  | average loans minus average deposits. |

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| 78. | In a crisis, which of the following are more likely to withdraw funds quickly from banks and thrifts?

|  |  |
| --- | --- |
| A.  | Correspondent banks. |

|  |  |
| --- | --- |
| B.  | Small business corporations. |

|  |  |
| --- | --- |
| C.  | Individual depositors. |

|  |  |
| --- | --- |
| D.  | Mutual funds. |

|  |  |
| --- | --- |
| E.  | Foreign depositors. |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 79. | In a crisis, which of the following are relatively less likely to withdraw funds quickly from banks and thrifts?

|  |  |
| --- | --- |
| A.  | Correspondent banks. |

|  |  |
| --- | --- |
| B.  | Small business corporations. |

|  |  |
| --- | --- |
| C.  | Individual depositors. |

|  |  |
| --- | --- |
| D.  | Mutual funds. |

|  |  |
| --- | --- |
| E.  | Pension funds. |

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| 80. | Which of the following observations concerning the Fed's discount window is true?

|  |  |
| --- | --- |
| A.  | The facility is provided to meet DIs' permanent liquidity needs. |

|  |  |
| --- | --- |
| B.  | Four lending programs are offered through the Fed's discount window. |

|  |  |
| --- | --- |
| C.  | Primary credit is available to sound depository institutions on a very short-term basis. |

|  |  |
| --- | --- |
| D.  | Secondary credit is available only to depository institutions that are eligible for primary credit. |

|  |  |
| --- | --- |
| E.  | Eligible institutions for seasonal credit are big banks located in urban areas. |

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| 81. | What are the two major liquidity risk insulation devices available?

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| --- | --- |
| A.  | Deposit insurance and discount window. |

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| --- | --- |
| B.  | Liquidity planning and maturity ladder. |

|  |  |
| --- | --- |
| C.  | Scenario analysis and liquidity index. |

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| --- | --- |
| D.  | Financing gap and the financing requirement. |

|  |  |
| --- | --- |
| E.  | Secondary credit and seasonal credit. |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 82. | What is the drawback of deposit insurance facility?

|  |  |
| --- | --- |
| A.  | Even when the DI is in trouble, the deposit holder has no incentive to run. |

|  |  |
| --- | --- |
| B.  | DIs are more likely to increase the liquidity risk on their balance sheets. |

|  |  |
| --- | --- |
| C.  | Deposit holder's place in line affects his or her ability to obtain their funds. |

|  |  |
| --- | --- |
| D.  | Deposit insurance does not deter contagious runs and panics. |

|  |  |
| --- | --- |
| E.  | Deposit holders are less likely to panic if there is a perceived bank solvency problem. |

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| 83. | Which of the following is NOT included as high-quality liquid assets when computing a liquidity coverage ratio?

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| --- | --- |
| A.  | Sovereign debt. |

|  |  |
| --- | --- |
| B.  | Bank capital. |

|  |  |
| --- | --- |
| C.  | Government guaranteed mortgage-backed securities. |

|  |  |
| --- | --- |
| D.  | Central bank reserves. |

|  |  |
| --- | --- |
| E.  | Cash. |

 |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 84. | The liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) proposed by the Bank for International Settlements are scheduled to take effect in

|  |  |
| --- | --- |
| A.  | 2011 for LCR and 2014 for NSFR. |

|  |  |
| --- | --- |
| B.  | 2012 for both LCR and NSFR. |

|  |  |
| --- | --- |
| C.  | 2015 for LCR and 2018 for NSFR. |

|  |  |
| --- | --- |
| D.  | 2013 for LCR and 2016 for NSFR. |

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| --- | --- |
| E.  | 2014 for both LCR and NSFR. |

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| 85. | Which of the following statements is true?

|  |  |
| --- | --- |
| A.  | Closed-end funds issue an unlimited number of shares as liabilities. |

|  |  |
| --- | --- |
| B.  | Open-end funds supply limited number of shares to investors. |

|  |  |
| --- | --- |
| C.  | Open-end funds need not stand ready to buy back previously issued shares from investors at the current market price for the fund's shares. |

|  |  |
| --- | --- |
| D.  | At a given market price, the supply of open-end fund shares is perfectly inelastic. |

|  |  |
| --- | --- |
| E.  | The number of outstanding shares of a closed-ended fund may change when the issuing fund chooses to repurchase them. |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 86. | Consider a mutual fund with 100 shareholders who each invested $10 for a total of $1,000. If the assets of the mutual fund are worth $900, what is the net asset value for each one of the mutual fund shares?

|  |  |
| --- | --- |
| A.  | $0.9. |

|  |  |
| --- | --- |
| B.  | $9. |

|  |  |
| --- | --- |
| C.  | $90. |

|  |  |
| --- | --- |
| D.  | $10. |

|  |  |
| --- | --- |
| E.  | $0.10. |

 |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 87. | The price at which an open-end investment fund stands ready to redeem existing shares is the

|  |  |
| --- | --- |
| A.  | strike price. |

|  |  |
| --- | --- |
| B.  | face value. |

|  |  |
| --- | --- |
| C.  | book value. |

|  |  |
| --- | --- |
| D.  | net asset value. |

|  |  |
| --- | --- |
| E.  | net worth. |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 88. | If the bank's expected net deposit drain is +4 percent, what is the bank's expected liquidity requirement?

|  |  |
| --- | --- |
| A.  | $7,560. |

|  |  |
| --- | --- |
| B.  | $6,040. |

|  |  |
| --- | --- |
| C.  | $16,000. |

|  |  |
| --- | --- |
| D.  | $22,000. |

|  |  |
| --- | --- |
| E.  | $14,760. |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 89. | What are the possible ways that the bank can meet an expected net deposit drain of +4 percent using purchased liquidity management techniques?

|  |  |
| --- | --- |
| A.  | Utilize further the Fed funds market. |

|  |  |
| --- | --- |
| B.  | Utilize repurchase agreements. |

|  |  |
| --- | --- |
| C.  | Liquidate all cash holdings. |

|  |  |
| --- | --- |
| D.  | All of the above. |

|  |  |
| --- | --- |
| E.  | Answers A and B only. |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 90. | What are the possible ways that the bank can meet an expected net deposit drain of +4 percent using stored liquidity management techniques?

|  |  |
| --- | --- |
| A.  | Liquidate all cash holdings. |

|  |  |
| --- | --- |
| B.  | Utilize further the Fed funds market. |

|  |  |
| --- | --- |
| C.  | Liquidate some securities and/or loans. |

|  |  |
| --- | --- |
| D.  | Liquidate all cash and use more Fed funds. |

|  |  |
| --- | --- |
| E.  | All of the above are suitable techniques. |

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| 91. | If the bank decides to cut down on interest expenses by reducing its dependence upon borrowed funds, what policy must the bank follow?

|  |  |
| --- | --- |
| A.  | Manage liquidity risk exclusively through reserve asset management. |

|  |  |
| --- | --- |
| B.  | Manage liquidity risk exclusively through liability management. |

|  |  |
| --- | --- |
| C.  | Reduce the bank's dependence upon demand deposits. |

|  |  |
| --- | --- |
| D.  | Increase interest income by increasing lending. |

|  |  |
| --- | --- |
| E.  | Increase interest income by increasing securities holdings. |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 92. | If the bank experiences a $50,000 sudden liquidity drain caused by a loan commitment draw down, what will be the impact on the balance sheet if stored liquidity management techniques are used?

|  |  |
| --- | --- |
| A.  | A reduction in cash of $21,000 and an increase in demand deposits of $29,000. |

|  |  |
| --- | --- |
| B.  | A reduction in securities and/or current loans totaling $50,000. |

|  |  |
| --- | --- |
| C.  | A reduction in cash of $21,000 and a decrease in securities holdings of $29,000. |

|  |  |
| --- | --- |
| D.  | A decrease in equity of $50,000. |

|  |  |
| --- | --- |
| E.  | A decrease in lending of $50,000. |

 |

|  |  |
| --- | --- |
|  |   The average interest earned on the loans is 6 percent and the average cost of deposits is 5 percent. Rising interest rates are expected to reduce the deposits by $3 million. Borrowing more debt will cost the bank 5.5 percent in the short term. |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 93. | What will be the size of the bank if a stored liquidity management strategy is adopted?

|  |  |
| --- | --- |
| A.  | $9 million. |

|  |  |
| --- | --- |
| B.  | $11 million. |

|  |  |
| --- | --- |
| C.  | $12 million. |

|  |  |
| --- | --- |
| D.  | $14 million. |

|  |  |
| --- | --- |
| E.  | $15 million. |

 |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 94. | What will be the cost of using a strategy of reducing its asset base to meet the expected decline in deposits? Assume that the bank intends to keep $2 million in cash as a liquidity precaution.

|  |  |
| --- | --- |
| A.  | $10,000. |

|  |  |
| --- | --- |
| B.  | $15,000. |

|  |  |
| --- | --- |
| C.  | $30,000. |

|  |  |
| --- | --- |
| D.  | $40,000. |

|  |  |
| --- | --- |
| E.  | $50,000. |

 |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 95. | What will be the cost of using a strategy of purchased liquidity management to meet the expected decline in deposits? Assume that the bank intends to keep $2 million in cash as liquidity precaution.

|  |  |
| --- | --- |
| A.  | $10,000. |

|  |  |
| --- | --- |
| B.  | $15,000. |

|  |  |
| --- | --- |
| C.  | $30,000. |

|  |  |
| --- | --- |
| D.  | $40,000. |

|  |  |
| --- | --- |
| E.  | $50,000. |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 96. | What will be the size of the bank if a purchased liquidity management strategy is adopted?

|  |  |
| --- | --- |
| A.  | $9 million. |

|  |  |
| --- | --- |
| B.  | $11 million. |

|  |  |
| --- | --- |
| C.  | $12 million. |

|  |  |
| --- | --- |
| D.  | $14 million. |

|  |  |
| --- | --- |
| E.  | $15 million. |

 |

|  |  |
| --- | --- |
|  | An FI has $5 million in cash reserves with the Fed in excess of its reserve requirements, $5 million in T-Bills, and a credit line of $10 million to borrow in the repo market. It currently has lent $2 million in the Fed Funds market and borrowed $1 million from the Federal discount window to meet its seasonal needs. |

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 97. | What are the bank's total available sources of liquidity?

|  |  |
| --- | --- |
| A.  | $17 million. |

|  |  |
| --- | --- |
| B.  | $18 million. |

|  |  |
| --- | --- |
| C.  | $20 million. |

|  |  |
| --- | --- |
| D.  | $21 million. |

|  |  |
| --- | --- |
| E.  | $22 million. |

 |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 98. | What are the bank's current total uses of liquidity?

|  |  |
| --- | --- |
| A.  | $1 million. |

|  |  |
| --- | --- |
| B.  | $3 million. |

|  |  |
| --- | --- |
| C.  | $8 million. |

|  |  |
| --- | --- |
| D.  | $10 million. |

|  |  |
| --- | --- |
| E.  | $15 million. |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 99. | What is the net liquidity of the bank?

|  |  |
| --- | --- |
| A.  | $7 million. |

|  |  |
| --- | --- |
| B.  | $12 million. |

|  |  |
| --- | --- |
| C.  | $17 million. |

|  |  |
| --- | --- |
| D.  | $21 million. |

|  |  |
| --- | --- |
| E.  | $22 million. |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 100. | Assume that the T-Bills can only be sold at a 10 percent discount, what is the net liquidity of the bank given this information?

|  |  |
| --- | --- |
| A.  | $6.5 million. |

|  |  |
| --- | --- |
| B.  | $11.5 million. |

|  |  |
| --- | --- |
| C.  | $16.5 million. |

|  |  |
| --- | --- |
| D.  | $20.5 million. |

|  |  |
| --- | --- |
| E.  | $21.5 million. |

 |