ECON UN3265: Money and Banking

Summer 2026 — Practice Quiz

Chapter 11 — Practice Quiz

How to use this quiz. These multiple-choice questions are based on the Chapter 11 practice questions on the banking industry. The answer key is on the last page.

Questions

1. Before the National Bank Act of 1863, did prevailing conditions in the U.S. banking industry foster or hinder trade across states?

- **A)** They fostered trade because every state banknote traded at par everywhere in the country.
- **B)** They hindered trade because many different state banknotes circulated at discounts and with uncertain values, raising transaction costs across states.
- **C)** They had no effect on trade because banknotes were not used in transactions.
- **D)** They fostered trade only because the Federal Reserve guaranteed all state banknotes.

2. Why does the United States operate under a dual banking system?

- **A)** Because banks are not allowed to choose between state and federal charters.
- **B)** Because both state governments and the federal government can charter and supervise banks, reflecting historical compromises and competition between regulators.
- **C)** Because commercial banks and credit unions are always supervised by the same agency.
- **D)** Because the Federal Reserve prohibits state-chartered banks from operating.

3. How does the emergence of interest-rate risk help explain financial innovation?

- **A)** It reduced the need for new products because banks no longer faced uncertainty.
- **B)** It made fixed-rate loans completely riskless for banks.
- **C)** Greater volatility in interest rates created incentives to develop instruments and practices that manage or shift rate risk, such as adjustable-rate loans, derivatives, and new deposit products.
- **D)** It explains innovation only in manufacturing, not in finance.

4. How do sweep accounts and money market mutual funds allow banks to avoid reserve requirements?

- **A)** Sweep accounts move funds from reservable checkable deposits into nonreservable accounts, while money market mutual funds provide deposit-like services outside traditional reservable deposits.
- **B)** They convert bank capital into physical currency permanently.
- **C)** They increase required reserves by moving all deposits into vault cash.
- **D)** They are illegal methods that immediately close the bank.

5. What is securitization, and why can it create concerns for effective banking systems?

- **A)** It is the process of banning banks from making loans; it creates no systemic risk.
- **B)** It is the pooling of loans or other assets and the sale of claims on their cash flows; it can improve liquidity but may shift risk into shadow banking and weaken screening incentives.
- **C)** It is the conversion of deposits into required reserves; it always reduces risk.
- **D)** It is the same thing as deposit insurance.

6. Why is loophole mining so prevalent in the U.S. banking industry?

- **A)** Because U.S. banking has historically had many restrictions and fragmented regulators, creating strong incentives to innovate around rules for profit.

B) Because banks never face any regulation.
C) Because all loopholes are created by depositors rather than banks.
D) Because regulators pay banks to ignore the law.

7. Why have banks been losing cost advantages in acquiring funds in recent years?

A) Because depositors and firms have more alternatives, such as money market funds and securities markets, making banks pay more competitively for funds.
B) Because banks are now the only institutions allowed to issue liabilities.
C) Because checkable deposits have become free and unlimited for banks.
D) Because nonbank financial institutions cannot compete for savings.

8. Why have banks been losing income advantages on their assets in recent years?

A) Because banks are prohibited from holding any earning assets.
B) Because information technology, securitization, commercial paper, and bond markets allow many borrowers to obtain funds outside banks, reducing banks' special lending advantage.
C) Because borrowers no longer need credit in modern economies.
D) Because all loans now pay the same regulated interest rate.

9. Why do central banks impose reserve requirements on commercial banks, and why do banks try to avoid them?

A) Reserve requirements can help with monetary control and liquidity, but banks try to avoid them because required reserves often earn less than loans or securities and act like a tax on deposits.
B) Reserve requirements exist only to raise bank profits, so banks try to increase them.
C) Reserve requirements are imposed only on stockbrokers and never on banks.
D) Banks avoid reserve requirements because reserves count as liabilities rather than assets.

10. Why are the number of traditional banking institutions in industrialized and developed countries declining?

A) Because all countries have banned bank mergers.
B) Because deregulation, competition, economies of scale, technology, and mergers have encouraged consolidation in the banking industry.
C) Because demand for financial services has disappeared.
D) Because smaller banks always have lower costs than larger banks.

11. Why has the number of bank holding companies dramatically increased?

A) Because holding companies allowed banking organizations to expand geographically and into related activities while working around branching and activity restrictions.
B) Because holding companies are not allowed to own banks.
C) Because every bank holding company is automatically exempt from all regulation.
D) Because the Federal Reserve required every individual branch to become a separate holding company.

12. Given the role of the loan originator in securitization, will the originator be worried about the household's ability to meet monthly mortgage payments?

A) Not as much if the loan is quickly sold and the originator retains little credit risk; this creates a moral hazard problem in screening borrowers.
B) Yes, always, because securitization forces originators to hold 100% of every loan forever.
C) No, because households are legally prohibited from defaulting on securitized mortgages.
D) Yes, because loan originators are paid only after the borrower fully repays the mortgage.

13. How did competitive forces lead to the repeal of the Glass-Steagall Act's separation of banking and securities industries?

- **A)** Banks and securities firms increasingly competed for the same customers and products, so pressure grew to allow financial firms to combine commercial banking, securities, and other financial services.
- **B)** Competition disappeared, making separation unnecessary.
- **C)** The repeal occurred because securities firms were no longer profitable and banks were forbidden to lend.
- **D)** The Act was repealed before any competition between banks and securities firms emerged.

14. What has been the likely effect of the Gramm-Leach-Bliley Act on financial consolidation?

- **A)** It likely increased consolidation by permitting financial holding companies to combine banking, securities, and insurance activities.
- **B)** It broke up all large financial institutions into single-office banks.
- **C)** It prohibited mergers between any financial firms.
- **D)** It required all banks to exit securities and insurance activities.

15. What factors explain the rapid growth of international banking?

- **A)** Growth in international trade, multinational firms, global capital markets, communications technology, diversification motives, and regulatory or tax advantages.
- **B)** A decline in global trade and the disappearance of multinational corporations.
- **C)** A ban on cross-border lending.
- **D)** The elimination of all foreign exchange transactions.

16. How could the Fed's 1981 approval of International Banking Facilities reduce employment in the banking industry in Europe?

- **A)** By allowing international banking business to be conducted in the United States under favorable conditions, shifting some activity away from European offshore banking centers.
- **B)** By requiring U.S. banks to move all international operations to Europe.
- **C)** By banning dollar-denominated deposits in the United States.
- **D)** By eliminating all European demand for banking services.

17. Is structural separation of commercial banking and investment banking a good way to reduce systemic risks?

- **A)** It is a tradeoff: separation may reduce conflicts and risk spillovers, but it can also reduce diversification and economies of scope and may push risk into less regulated sectors.
- **B)** Yes, because structural separation eliminates every possible bank failure.
- **C)** No, because separation has no possible effect on systemic risk.
- **D)** Yes, because investment banking contains no risks while commercial banking contains all risks.

Answer Key

1. B 2. B 3. C 4. A 5. B 6. A 7. A 8. B 9. A 10. B 11. A 12. A 13. A 14. A 15. A 16. A 17. A