Study Questions No. 4 (February 11, 2012)
Economics 130
Winter 2012

These key terms and questions are designed to help you in your understanding of the material covered in class and in the textbook.

Key terms:
Bank Run
Bank Panic
Suspension of payments
Deposit insurance
FDIC
Moral hazard with deposit insurance, also associated with principal-agent problem
Bank charters
National banks
State Banks
Office of the Comptroller of the Currency (OCC)
Separation of Banking and Commerce
Restrictions on bank balance sheets
Risk adjusted assets
Basel Accord—capital of 8% of risk adjusted assets
Minimum capital levels
Strategic response to Basel Accord (moving to off balance sheet activities)
Structured Investment Vehicle (SIV)—ties to banks, operations (assets, liabilities), shell co.
Bank supervision
Call reports
CAMEL ratings
Bank examination
Payoff method of bank closure
Purchase and assumption method of bank closure
Forbearance of regulators
TARP
Credit crunch
Vicious cycles of asset price declines, credit crunch, recession and further asset price declines
Lender of last resort
Too big to fail (TBTF)
Costs of government bailouts: solvency or liquidity problems of banks and repayment of govt.
Subprime crisis
Bear Stearns, Lehman Bros., AIG, Fannie Mae and Freddie Mac--- roles in subprime crisis
Money market crisis—“breaking the buck” of MMMF, Treasury insurance to MMMFs
“Modern” bank runs versus traditional runs on banks (depositor runs)
Questions:

1. Page 587, questions: 1, 3, 4 and 5
2. Page 313, questions: 1, 2, 3, 6, 7.
3. What did Federal reserve policy, in attempting to reduce inflation, also induce a solvency crisis in the Savings and Loan (S&L) industry?
4. How did the principal-agent problem contribute to the S&L crisis and the sub-prime financial crisis? Why was the principal-agent problem more acute with investment banks after they converted to public (stock) companies from private partnerships?
5. Identify and discuss importance of: Charles Keating, the Keating Five (not a 60s era rock group!), and Lincoln Savings and Loan.
6. WaMu was highlighted in the Levin report as an example of high risk lending. What specific business practices did WaMu do wrong?
7. OTS was highlighted in the Levin report as an example of regulatory failure. How did OTS fail to be a good regulator? What was it supposed to regulate?
8. Moody’s and Standard and Poor’s were highlighted in the Levin report as examples of firms providing inflated credit ratings? What did they do wrong? What exactly were they rating? What conflicts of interest were they facing?
9. Goldman Sachs was highlighted in the Levin report as an investment bank with “abusive” business practices. What did they do to bring this attention to themselves? What business practices were risky? Why did they do it? What business practices were unethical if not outright illegal?
10. The Levin report makes recommendations in four areas: high risk lending, regulatory failure, inflation credit ratings and investment bank abuses. Using your judgment, list and explain the two most important recommendations from each category.
11. Compare and contrast the Icelandic, Irish and Greek financial crises. What are the main similarities? What are the main differences? How were the policy responses similar and how were they different? How did the population respond to the policy responses?