END OF CHAPTER EXERCISES

Chapter 20 : Regulation of Financial Institutions

Financial Engineering : Derivatives And Risk Management

(Keith Cuthbertson, Dirk Nitzsche)

1. Applied to banks, give an example of "adverse selection".

2. What is 'asymmetric information' and why is it a problem for the financial system?

3. What is systemic risk in the context of the financial system ?

4. Why does deposit insurance (backed by the government) lead to moral hazard problems?

5. What is the function of 'bank capital'?

6. Your bank is in danger of falling below the 'Basle' capital adequacy ratio, as set by the home regulator. How might you rebuild your capital ratio?

7. In what way might the choice of risk weights in the 1988 Basle Accord lead to higher actual 'economic' risk (even though the Basle measure of risk remains unchanged or falls)?