

Economics 252 – Financial Markets

Spring 2011

Lecture 16: First Half: Investment Banks,
Second Half: Guest Lecture by Jon Fougner, former student in ECON 252, worked at Goldman Sachs and is currently working for Facebook

April 6, 2011

Multiple Choice Questions

Question 19.1

What is a bought deal?

- (a) The underwriter of a security issuance buys all the securities and subsequently worries about reselling them in financial markets.
- (b) The underwriter of a security issuance neither buys any securities nor provides any guarantees to be able to place the securities. The underwriter merely promises its best efforts during the issuance process.
- (c) It is a deal in which an investment banking division accepts deposits from its client.
- (d) It is a deal that an investment banker makes while attending a symphony concert.

Question 19.2

John Whitehead, the former chairman of Goldman Sachs, has formulated a list of principles that guide Goldman Sachs. Which of the following statements are not on this list?

(More than one answer may apply.)

- (a) You never learn anything when you are talking.
- (b) Our assets are people, capital, and reputation.
- (c) The boss usually decides, not the assistant treasurer. Do you know the boss?
- (d) The acquaintance with 100 people is worth more than the respect of one person.

Question 19.3

Which of the following are important pieces of legislation for the investment banking business and what is their main content?

(More than one answer may apply.)

- (a) The Glass-Steagall Act from 1933 separated investment banking and commercial banking all over the world.
- (b) In the spirit of the Volcker Rule, the Dodd-Frank Act from 2010 in the U.S. prohibits proprietary trading at commercial banks and states that commercial banks cannot own hedge funds or private equity funds.
- (c) The Lincoln Rule in the Dodd-Frank Act from 2010 in the U.S. bars the access of swap dealers to the Federal Reserves discount window.
- (d) The Churchill Rule, introduced by the Financial Services Authority in the U.K. in 2009, mandates that all banks the want to operate at the London Stock Exchange must move their world headquarters to London.

Question 19.4

What does Gary Gorton mean, when he claims that the propagation of the financial crisis from 2007-2008 was due to a run on the repo?

- (a) Repo Bank was the largest bank in Europe and it become insolvent because of a bank run.
- (b) Repos is the nickname for so-called shadow banks, which are small commercial banks in the U.S. During the financial crisis, many of these small commercial banks had to be rescued by the Federal Deposit Insurance Corporation (FDIC).
- (c) Repos, which is short for repurchase agreements, are credit default swaps that protect against losses of Lehman Brothers. After Lehman's collapse on September 15, 2008, there was a run on these contracts.
- (d) Repos, which is short for repurchase agreements, are short-term loans between institutional investors that in principle share many similarities with deposits at commercial banks. A loss of confidence in this market led to a run in this market, leading to a withdrawal of funding, which shares qualitative characteristics with a bank run on a commercial bank.

Question 19.5

Which of the following are true about Jon Fougner's career?
(More than one answer may apply.)

- (a) He worked as a research assistant for Professor Shiller for the book *The New Financial Order*.
- (b) After graduating from Yale and a year in Norway on a Fulbright scholarship, he started working for Goldman Sachs.
- (c) He switched from Goldman Sachs to Facebook and is now working in "local inbound product marketing".
- (d) He is very grateful for the support that he has received early in his career from professors at Yale, including Ray Fair, Robert Shiller, and David Swensen.

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Correct Answers

19.1: (a)

19.2: (a), (b), and (c)

19.3: (b) and (c)

19.4: (d)

19.5: (a), (b), (c), and (d)