



### Exercise on Alternative Strategies for Depository Institutions

#### Financial Regulation Case Study

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This exercise involves a depository institution with \$100 in assets, funded by \$99 of deposits and \$1 of capital. The firm's annual cost of funds and operating expenses total \$7. The strategies listed below summarize expected results from four alternative business plans the institution might pursue. Each strategy (Exhibit 1) offers a different set of potential returns for the institution's owners as well as different consequences for depositors of the institution. For each strategy, there are three possible outcomes: a middle case, that has a fifty percent likelihood as well as best and worst case scenarios, each with a twenty-five percent chance of occurring. If you were a potential investor seeking to allocate funds from a diversified portfolio of funds earmarked for investments in financial services, which strategy should the institution pursue? What if you were the CEO of the firm? What if you were a public official?

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## Exhibit 1

Strategy A		Strategy C	
Scenario	Yield on Assets	Scenario	Yield on Assets
Worst Case (25%)	7 %	Worst Case (25%)	5 %
Middle Case (50%)	8 %	Middle Case (50%)	9 %
Best Case (25%)	9 %	Best Case (25%)	13%

  

Strategy B		Strategy D	
Scenario	Yield on Assets	Scenario	Yield on Assets
Worst Case (25%)	7.25 %	Worst Case (25%)	4 %
Middle Case (50%)	7.5 %	Middle Case (50%)	8.5 %
Best Case (25%)	7.75 %	Best Case (25%)	14 %