

ALTERNATIVE STRATEGIES FOR DEPOSITORY INSTITUTIONS

Regulation of Financial Institutions

Professor Howell Jackson

March 15, 1999

This exercise involves a depository institution with \$100 in assets, funded by \$99 of deposits and \$1 of capital. Its 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 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 worse case scenarios, each with a twenty-five percent chance of occurring. Which strategy should the institution pursue? Why?

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

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