Financial Institution Management 3rd Edition Lange Test Bank
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Chapter 02 - Testbank

Student: ____

1. Which of the following statements is true?
A. Non-bank depository institutions include building societies and credit unions.
B. A non-bank depository institution meets the legal definition of a bank.
C. A non-bank depository institution does not meet the legal definition of a bank.
D. A non-bank depository institution may be a building society or a credit union and a non-bank depository institution undertakes many of the same activities of a bank without meeting the legal definition of a bank.

2. Which of the following statements is true?
A. Authorised depository institutions are those that have been granted an authority by the RBA to operate in Australia.
B. Authorised depository institutions are those that have been granted an authority by APRA to operate in Australia.
C. Authorised depository institutions are those that have been granted an authority by the Australian Government to operate in Australia.
D. Authorised depository institutions are those that have been granted an authority by ASIC to operate in Australia.

3. Which of the following statements is true?
A. Building societies are depository institutions.
B. Building societies usually operate on a cooperative basis.
C. In case of building societies the depositors are also members of the society.
D. All of the listed options are correct.

4. Which of the following statements is true?
A. Credit unions are mutual cooperative organisations.
B. Credit unions provide deposit facilities, personal and housing loans and payments services to their members.
C. In case of credit unions the depositors are also members of the society.
D. Credit unions are mutual cooperative organisations that provide deposit facilities, personal and housing loans and payments services to their members.

5. Which of the following statements is true?
A. An off-balance-sheet item is recorded on the balance sheet of a financial institution when the annual report is being prepared.
B. An off-balance-sheet liability is an item that moves onto the liability side of the balance sheet when a contingent event occurs.
C. An off-balance-sheet asset is an item that moves onto the asset side of the balance sheet when a contingent event occurs or at the end of a financial period.
D. All of the listed options are correct.

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6. Which of the following is a reason for the increase in the number of banks since the mid-1980s?
A. Relaxation of entry requirements into the Australian banking industry.
B. Changes in the regulatory requirements of non-bank depository institutions.
C. The need for a more sophisticated banking system in Australia.
D. Relaxation of entry requirements into the Australian banking industry and changes in the regulatory requirements of non-bank depository institutions.

7. Which of the following statements is true for the Australian banking industry?
A. The Australian banking industry is highly concentrated.
B. There are four major banks in Australia.
C. The four major banks and the five regional banks offer a full range of commercial and investment banking services.
D. All of the listed options are correct.

8. Which of the following is true of off-balance-sheet activities?
A. They involve generation of fees without exposure to any risk.
B. They include contingent activities recorded in the current balance sheet.
C. They invite regulatory costs and additional 'taxes.'
D. They have both risk-reducing as well as risk-increasing attributes.

9. Following the global financial crisis, banks strengthened their funding and liquidity profiles by:
A. reducing their holdings of liquid assets.
B. increasing their holdings of liquid assets.
C. reducing their use of wholesale funds and increasing their holdings of liquid assets.
D. increasing their use of wholesale funds and decreasing their holdings of liquid assets.

10. The collapse of Lehman Brothers in 2008 and the impact of the global financial crisis made it difficult for Australian banks to obtain off-shore funding. As a consequence banks pursued more stable sources of: funds. These strategies include:
A. increased use of wholesale long-term funding.
B. decreased use of wholesale long-term funding.
C. decreased holdings of liquid assets.
D. decreased use of wholesale long-term funding and increased holdings of liquid assets.

11. Which of the following statements is true?
A. The net interest margin is a profitability indicator and is measured as net income divided by earning assets.
B. The net interest margin is a profitability indicator and is measured by interest income minus interest expense, divided by earning assets.
C. The net interest margin is a profitability indicator and is measured by interest income plus interest expense, divided by earning assets.
D. The net interest margin is a profitability indicator and is measured as interest income minus non-interest income divided by total assets.

12. The market structure of the banking sector has changed since deregulation of the financial system during the 1980s. Which statement more closely reflects the current structure of the banking sector in Australia?
A. Foreign banks dominate in number and share of total assets.
B. The major banks no longer hold the largest share of total assets.
C. Total assets are fairly evenly distributed between the major, regional and foreign banks.
D. The number of banks has grown steadily since the 1980s and the major banks maintain the highest percentage share of total assets.

13. Which of the following is a role of a bank?
A. Attract funds from the capital markets to facilitate borrowing by the household sector.
B. Accept deposits and make loans and in doing so facilitate the flow of funds from borrowers to lenders.
C. Accept deposits and make loans and in doing so facilitate the flow of funds from savers to borrowers.
D. Manage the level of interest rates.

14. Which of the following is true?
A. All banks are depository institutions and are authorised by APRA to carry out financial intermediation
B. All authorised depository institutions are banks.
C. All financial intermediaries are authorised depository institutions by APRA to carry out financial intermediation.
D. All of the listed options are correct.

15. The number of banks has grown steadily since the middle of the 1980s for the following reasons:
A. liberalisation of conditions for foreign bank entry by APRA.
B. deregulation of the banking industry, including the relaxation of bank entry requirements.
C. changes to the regulatory regime for non-bank depository institutions favoured conversion from building society to banks.
D. All of the listed options are correct.

16. The main features of the local banking industry over the two decades to 2010 have been an increase in concentration. This has occurred due to mergers and acquisitions motivated by the desire to:
A. be competitive in global markets.
B. protect against takeover by foreign competitors.
C. increase efficiency in terms of economies of scale and scope.
D. All of the listed options are correct.

17. Which of the following statements is true?
A. Australian banks' decreased reliance on off-shore funding post GFC led to funding pressures and increased the costs of obtaining funds.
B. Australian banks' increased reliance on off-shore funding post GFC led to funding pressures and increased the costs of funding.
C. Australian banks reduced their reliance on on-shore funding in an effort to reduce the costs of funding and ease pressure on mortgage interest rates.
D. Australian banks increased their reliance on on-shore funding post GFC which led to funding pressures and increased the costs of obtaining funds.

18. In response to the GFC and the global liquidity crisis the Australian government introduced the following measure in 2008:
A. A Financial Claims Scheme that provided coverage to all depositors in any financial institution.
B. A Financial Claims Scheme that guaranteed bank deposits coverage to depositors up to a million dollars per depositor.
C. A Financial Claims Scheme that guaranteed bank deposits coverage to depositors up to a million dollars per depositor and provided a temporary wholesale funding guarantee.
D. All of the listed options are correct.

19. The term 'spread' refers to the difference between an FI's:
A. assets and liabilities.
B. liabilities and equity.
C. short-term lending rates and long-term lending rates.
D. lending and deposit rates.

20. Which of the following statements is true?
A. Capital adequacy regulations of banks were introduced in 1989.
B. Capital adequacy regulations require banks to hold, on average, less capital for low-risk assets such as housing loans compared to higher-risk assets such as commercial loans.
C. Capital adequacy regulations were abolished in 2000.
D. Capital adequacy regulations of banks were introduced in 1989 and Capital adequacy regulations require banks to maintain levels of capital adequate for the type of activity undertaken, on average, less capital for low-risk assets such as housing loans compared to higher-risk assets such as commercial loans.

21. The major reasons for the shift in the composition of bank lending commitments from the retail market to the commercial market are the:
A. introduction of capital adequacy regulations in 1989.
B. number of non-bank depository institutions that gained banking licences in the early 1990s.
C. fact that commercial loans paid higher returns than housing loans.
D. None of the listed options are correct as the shift was from commercial loans to housing loans.

22. Depository institutions are required by APRA to be responsible for:
A. their own liquidity management strategy that must include scenario analysis.
B. their own capital management strategy that must include risk analysis.
C. both their own liquidity, capital management strategies and a business continuity plan.
D. None of the listed options are correct. APRA is responsible for the supervision and oversight of all depository institutions.

23. Which of the following statements is true?
A. Off-balance-sheet transactions for Australian banks include direct credit substitutes, interest rate derivative contracts and foreign exchange derivative contracts.
B. On-balance-sheet transactions for Australian banks include direct futures and forward contracts.
C. Off-balance-sheet transactions for Australian banks include the commercial loans and term-deposits.
D. All of the listed options are correct.

24. Which of the following statements is true?
A. On average building societies are larger than credit unions and their total share of the depository institution market has increased since 1992.
B. On average building societies are smaller than credit unions and their total share of the depository institution market has decreased significantly since 1992.
C. On average building societies are larger than credit unions and their total share of the depository institution market has decreased significantly since 1992.
D. On average building societies are smaller than credit unions and their total share of the depository institution market has increased since 1992.

25. Which of the following statements is true?
A. The majority of players in terms of asset value as a percentage of GDP in the Australian financial system are credit unions.
B. The majority of players in terms of asset value as a percentage of GDP in the Australian financial system are building societies.
C. The majority of players in terms of asset value as a percentage of GDP in the Australian financial system are banks.
D. The majority of players in terms of asset value as a percentage of GDP in the Australian financial system are superannuation funds.

26. Which of the following statements is true?
A. During the 1960s and 1970s, the growth of building societies ensured an increasing supply of funds for housing loans at reasonable rates.
B. During the 1960s and 1970s, the credit union expansion ensured the availability of relatively low cost unsecured and secured personal loans.
C. During the 1960s and 1970s, regulatory constraints meant that banks could not in general satisfy the demand for consumer credit.
D. All of the listed options are correct.

27. Which of the following statements is true?
A. Deregulation of the banking system in the 1980s brought greater competition from the banks.
B. Deregulation of the banking system in the 1980s resulted in loss of market share by non-bank depository institutions.
C. Deregulation of the banking system in the 1980s brought greater competition from the non-bank depository institutions.
D. Deregulation of the banking system in the 1980s brought greater competition from the banks and resulted in loss of market share by non-bank depository institutions.

28. In which way did building societies respond to the competitive pressures resulting from the deregulation of the banking system in the 1980s?
A. They engaged in mergers for efficiency and scale reasons.
B. They adopted improved technology.
C. They diversified their products and activities.
D. All of the listed options are correct.

29. Which of the following statements is true?
A. Key performance ratios for credit unions and building societies indicate that from 2005 to 2011 their cost structures were higher than for banks.
B. Key performance ratios for credit unions and building societies indicate that from 2005 to 2011 their cost structures were lower than for banks.
C. Deposits are a higher proportion of the funding base for banks than for credit unions and building societies.
D. Despite credit unions and building societies having higher cost structures over the period 2005-2011 than banks, they have much lower bad debt expenses than banks and hence have navigated the GFC well in terms of their overall performance.

30. Which of the following statements are not true?
A. ACCC is responsible for market integrity and consumer protection across the financial system.
B. The RBA is responsible for prudential supervision and the promotion of financial system stability.
C. The RBA is responsible for monetary policy and for overall financial system stability.
D. APRA is responsible for prudential supervision of the financial services industry and supervises all deposit-taking institutions

31. Which of the following statements is true?
A. Australia's current financial regulatory system has its origins in the late 1990s' Financial System Inquiry, commonly known as the Campbell Committee.
B. Australia's current financial regulatory system has its origins in the late 1990s' Financial System Inquiry, commonly known as the Wallis Committee.
C. Australia's current financial regulatory system has its origins in the late 1990s' Financial System Inquiry, commonly known as the Martin Committee.
D. Australia's current financial regulatory system has its origins in the late 1990s' Financial System Inquiry, commonly known as the Valentine Committee.

32. The current financial system in Australia consists of three major agencies, these being:
A. APRA, ASIC and the Australian Government.
B. APRA, the RBA and the Australian Government.
C. APRA, ASIC and the RBA.
D. The RBA, ASIC and the Australian Government.

33. Which of the following statements is true?
A. APRA stands for Australian Prudential Regulation Authority.
B. APRA stands for Australian Payments Regulation Association.
C. APRA stands for Australian Payments Review Authority.
D. None of the listed options are correct.

34. Which of the following statements is true?
A. APRA is responsible for market integrity and consumer protection across the financial system.
B. The RBA is responsible for prudential supervision.
C. ASIC is responsible for monetary policy and for overall financial system stability.
D. None of the listed options are correct.

35. APRA's aim is to develop prudential policies that:
A. promote financial safety and efficiency and that enable smaller institutions to put competitive pressures on larger institutions.
B. balance financial safety and efficiency, competition contestability and competitive neutrality.
C. promote financial system stability and fair interest rates.
D. protect consumers from predatory behaviour of financial institutions.

36. The Probability and Impact Rating System (PAIRS):
A. determines the response ASIC should make to the outcomes of PAIRS ratings.
B. determines the response the RBA should make to the outcomes of bank failures.
C. determines the response the RBA should make to the outcomes of financial crisis.
D. None of the listed options are correct.

37. Some prudential standards issued by APRA include regulations regarding:
A. capital adequacy for market risk and liquidity.
B. credit quality and capital adequacy for credit risk.
C. large exposures, business continuity management and securitisation.
D. All of the listed options are correct.

38. APRA's supervisory oversight and response system (SOARS) is designed to assess the:
A. likelihood of FI failure.
B. impact of the FI failure.
C. impact of FI failure and provide the appropriate supervisory response, which in the case of a low PAIRS probability rating will require restructure.
D. impact of FI failure and provide the appropriate supervisory response, which in the case of an extreme PAIRS probability rating will require restructure.

39. Off-balance-sheet activities are:
A. not shown on the current balance sheet.
B. not shown on the balance sheet but after the completion of the financial year are recorded on the balance sheet.
C. not shown on the current balance sheet but are an off-balance-sheet asset/liability, if when a contingent event occurs, the activity moves onto the asset/liability side of the balance sheet.
D. contingent events which move the asset or liability from the balance sheet to off-balance-sheet.

40. Which of the following is true?
A. PAIRS provides APRA with a score-card approach to assessing the risk of FI failure and the impact of any failure.
B. PAIRS provides APRA with a single rating which incorporates both the probability that the FI will fail and the impact of any failure.
C. PAIRS provides APRA with a rating that assesses the risk of FI failure.
D. PAIRS provides APRA with an impact factor that determines what regulatory response needs to be implemented to prevent FI failure.

41. Customer loans are classified on a DI's balance sheet as:
A. liabilities, because the customer may default on the loan.
B. assets, because the DI earns servicing fees on the loan.
C. liabilities, because the DI must transfer funds to the borrower at the initiation of the loan.
D. assets, because DIs originate and monitor loan portfolios.

42. Which of the following is true of off-balance-sheet activities?
A. They involve generation of fees without exposure to any risk.
B. They include contingent activities recorded in the current balance sheet.
C. They invite regulatory costs and additional 'taxes'.
D. They have both risk-reducing as well as risk-increasing attributes.

43. Which of the following is not an off-balance-sheet activity for banks?
A. derivative contracts
B. loan commitments
C. standby letters of credit
D. trust services

44. Which of the following observations concerning credit unions is not true?
A. They invest heavily in corporate securities.
B. Member loans constitute a majority of their total assets.
C. They engage in off-balance-sheet activities.
D. They focus more on providing services and less on profitability.

45. Which of the following is part of the supervisory activities of APRA?
A. Prudential review is the most important as it provides a detailed assessment of a FIs inherent risks and the adequacy of its risk management controls.
B. Licensing is the last stage of APRA's supervision which ensures that only FIs that have the capacity to successfully operate can operate the market.
C. Enforcement supervision is not part of APRA supervisory activity as it would involve enforcement teams to specifically intervene in the running of the FI.
D. Entity financial analysis is the FIs own assessment of its financial position.

46. Which of the following statements is not correct concerning credit risk?
A. Credit risk is the risk of counterparty default and is usually the single largest risk facing a FI.
B. Credit risk occurs when borrowers are unable to repay their loans on time.
C. Credit risk decreases when FIs concentrate their loan exposures on a few counterparties and APRA requires that FIs have appropriate polices to manage such risk.
D. Credit risk increases when FIs concentrate their loan exposures on a few counterparties.

47. Business continuity relates to:
A. an FI that has a business plan that meets the liquidity and capital requirements of APRA.
B. a whole-of-business approach to FI operations and profitability.
C. a business continuity plan which reduces the impact of any disruption on FI operations, reputation, profitability, depositors and other stakeholders of a FI.
D. a business continuity plan which increases profitability of a FI.

48. Credit unions were generally less affected than other depository institutions by the recent financial crisis because:
A. they hold more government securities, on average.
B. they hold less government securities, on average.
C. they had a focus on high quality domestic assets.
D. they had a focus on domestic deposits and more assets in residential mortgages.

49. Responding to the financial crisis, the Australian government introduced a number of measures to ease liquidity issues and included the following:
A. a permanent financial claims scheme (FCS) in October 2008, which explicitly guaranteed bank deposits with a $1 million cap.
B. a semi-permanent financial claims scheme (FCS), which implicitly guaranteed bank deposits.
C. a permanent guarantee scheme for large deposits and wholesale funding, which for a fee, guaranteed bank deposits greater than $1 million.
D. a permanent financial claims scheme (FCS) in October 2008, which explicitly guaranteed bank deposits with a $1 million cap; the guarantee was reduced to $250 000 per depositor from 2012.

50. Covered bonds:
A. were introduced following the GFC to ease liquidity pressures on the bank's balance sheet.
B. are issued by a bank, backed by a pool of assets, which remain on the balance sheet of the issuing bank.
C. are issued by a bank, backed by a pool of assets, which are off-balance-sheet items of the issuing bank.
D. are issued by the Reserve Bank of Australia to FIs with liquidity problems.

51. Depository institutions are financial institutions that only take deposits from savers, but do not lend money to borrowers.
True False

52. Non-bank depository institutions are also referred to as CUBS.
True False

53. In case of building societies, the members are usually linked to the society by some common bond such as locality or trade union.
True False

54. A financial institution is an institution that performs financial intermediary services and/or services requiring transactions in the capital markets.
True False

55. Most foreign banks have succeeded in establishing a well-developed and profitable retail banking network in Australia.
True False

56. The growth in off-balance-sheet activities during the two decades from 1990 to 2010 was due, in large part, to the use of derivative contracts.
True False

57. During the 1960s and 1970s, the growth of credit unions ensured an increasing supply of funds for housing loans at reasonable rates, while the building society expansion ensured the availability of relatively low cost unsecured and secured personal loans.
True False

58. The use of off-balance-sheet activities and instruments will always reduce the risk to a bank.
True False

59. The major banks' return on equity, a measure of bank profitability has been lower than the regional banks with the gap widening since 2007.
True False

60. ASIC stands for Australian Society of Inter-bank Cooperation and ASIC is responsible for market integrity and consumer protection across the financial system.
True False

61. Australia's current financial regulatory framework was reformed in 1999 and moved from industry-based regulation to functional regulation of financial institutions.
True False

62. PAIRS provides APRA with a score-card approach to assessing the risk of FI failure and the impact of any failure by detailing the 12 risk elements separately and disclosing the result to the FI being investigated.
True False

63. Discuss the factors that contributed to Australia's financial resilience and relatively strong performance during the global financial crisis.

64. Explain the Post Wallis Inquiry regulatory framework in Australia.

65. Compare and contrast credit unions with the major banks.

66. APRA conducts a prudential supervisory framework that assesses FI risk and likelihood of FI failure and determines an appropriate supervisory response. Outline the two systems implemented by APRA—PAIRS and SOARS—and the purpose of the assessment system.

Chapter 02 - Testbank Key

1. Which of the following statements is true?
A. Non-bank depository institutions include building societies and credit unions.
B. A non-bank depository institution meets the legal definition of a bank.
C. A non-bank depository institution does not meet the legal definition of a bank.
D. A non-bank depository institution may be a building society or a credit union and a non-bank depository institution undertakes many of the same activities of a bank without meeting the legal definition of a bank.

Difficulty: Medium
Learning Objective: 02-01 Learn the different types of depository institutions in Australia and how they compete in the same market and face similar risks.

2. Which of the following statements is true?
A. Authorised depository institutions are those that have been granted an authority by the RBA to operate in Australia.
B. Authorised depository institutions are those that have been granted an authority by APRA to operate in Australia.
C. Authorised depository institutions are those that have been granted an authority by the Australian Government to operate in Australia.
D. Authorised depository institutions are those that have been granted an authority by ASIC to operate in Australia.

Difficulty: Easy
Learning Objective: 02-05 Learn the history of the industry comprising credit unions and building societies and the structure of their industry.

3. Which of the following statements is true?
A. Building societies are depository institutions.
B. Building societies usually operate on a cooperative basis.
C. In case of building societies the depositors are also members of the society.
D. All of the listed options are correct.

Difficulty: Easy
Learning Objective: 02-05 Learn the history of the industry comprising credit unions and building societies and the structure of their industry.

4. Which of the following statements is true?
A. Credit unions are mutual cooperative organisations.
B. Credit unions provide deposit facilities, personal and housing loans and payments services to their members.
C. In case of credit unions the depositors are also members of the society.
D. Credit unions are mutual cooperative organisations that provide deposit facilities, personal and housing loans and payments services to their members.

Difficulty: Medium
Learning Objective: 02-05 Learn the history of the industry comprising credit unions and building societies and the structure of their industry.

5. Which of the following statements is true?
A. An off-balance-sheet item is recorded on the balance sheet of a financial institution when the annual report is being prepared.
B. An off-balance-sheet liability is an item that moves onto the liability side of the balance sheet when a contingent event occurs.
C. An off-balance-sheet asset is an item that moves onto the asset side of the balance sheet when a contingent event occurs or at the end of a financial period.
D. All of the listed options are correct.

Difficulty: Hard
Learning Objective: 02-03 Gain an insight into the balance sheet of banks and the trends in assets, liabilities and capital.

6. Which of the following is a reason for the increase in the number of banks since the mid-1980s?
A. Relaxation of entry requirements into the Australian banking industry.
B. Changes in the regulatory requirements of non-bank depository institutions.
C. The need for a more sophisticated banking system in Australia.
D. Relaxation of entry requirements into the Australian banking industry and changes in the regulatory requirements of non-bank depository institutions.

Difficulty: Medium
Learning Objective: 02-02 Gain an understanding of the major activities of banks and the industry structure.

7. Which of the following statements is true for the Australian banking industry?
A. The Australian banking industry is highly concentrated.
B. There are four major banks in Australia.
C. The four major banks and the five regional banks offer a full range of commercial and investment banking services.
D. All of the listed options are correct.

Difficulty: Easy
Learning Objective: 02-01 Learn the different types of depository institutions in Australia and how they compete in the same market and face similar risks.
Learning Objective: 02-02 Gain an understanding of the major activities of banks and the industry structure.

8. Which of the following is true of off-balance-sheet activities?
A. They involve generation of fees without exposure to any risk.
B. They include contingent activities recorded in the current balance sheet.
C. They invite regulatory costs and additional 'taxes.'
D. They have both risk-reducing as well as risk-increasing attributes.

Difficulty: Hard
Learning Objective: 02-03 Gain an insight into the balance sheet of banks and the trends in assets, liabilities and capital.

9. Following the global financial crisis, banks strengthened their funding and liquidity profiles by:
A. reducing their holdings of liquid assets.
B. increasing their holdings of liquid assets.
C. reducing their use of wholesale funds and increasing their holdings of liquid assets.
D. increasing their use of wholesale funds and decreasing their holdings of liquid assets.

Difficulty: Medium
Learning Objective: 02-03 Gain an insight into the balance sheet of banks and the trends in assets, liabilities and capital.

10. The collapse of Lehman Brothers in 2008 and the impact of the global financial crisis made it difficult for Australian banks to obtain off-shore funding. As a consequence banks pursued more stable sources of: funds. These strategies include:
A. increased use of wholesale long-term funding.
B. decreased use of wholesale long-term funding.
C. decreased holdings of liquid assets.
D. decreased use of wholesale long-term funding and increased holdings of liquid assets.

Difficulty: Medium
Learning Objective: 02-03 Gain an insight into the balance sheet of banks and the trends in assets, liabilities and capital.

11. Which of the following statements is true?
A. The net interest margin is a profitability indicator and is measured as net income divided by earning assets.
B. The net interest margin is a profitability indicator and is measured by interest income minus interest expense, divided by earning assets.
C. The net interest margin is a profitability indicator and is measured by interest income plus interest expense, divided by earning assets.
D. The net interest margin is a profitability indicator and is measured as interest income minus non-interest income divided by total assets.

Difficulty: Medium
Learning Objective: 02-02 Gain an understanding of the major activities of banks and the industry structure.

12. The market structure of the banking sector has changed since deregulation of the financial system during the 1980s. Which statement more closely reflects the current structure of the banking sector in Australia?
A. Foreign banks dominate in number and share of total assets.
B. The major banks no longer hold the largest share of total assets.
C. Total assets are fairly evenly distributed between the major, regional and foreign banks.
D. The number of banks has grown steadily since the 1980s and the major banks maintain the highest percentage share of total assets.

Difficulty: Medium
Learning Objective: 02-02 Gain an understanding of the major activities of banks and the industry structure.

13. Which of the following is a role of a bank?
A. Attract funds from the capital markets to facilitate borrowing by the household sector.
B. Accept deposits and make loans and in doing so facilitate the flow of funds from borrowers to lenders.
C. Accept deposits and make loans and in doing so facilitate the flow of funds from savers to borrowers.
D. Manage the level of interest rates.

Difficulty: Medium
Learning Objective: 02-02 Gain an understanding of the major activities of banks and the industry structure.

14. Which of the following is true?
A. All banks are depository institutions and are authorised by APRA to carry out financial intermediation
B. All authorised depository institutions are banks.
C. All financial intermediaries are authorised depository institutions by APRA to carry out financial intermediation.
D. All of the listed options are correct.

Difficulty: Medium
Learning Objective: 02-01 Learn the different types of depository institutions in Australia and how they compete in the same market and face similar risks.

15. The number of banks has grown steadily since the middle of the 1980s for the following reasons:
A. liberalisation of conditions for foreign bank entry by APRA.
B. deregulation of the banking industry, including the relaxation of bank entry requirements.
C. changes to the regulatory regime for non-bank depository institutions favoured conversion from building society to banks.
D. All of the listed options are correct.

Difficulty: Easy
Learning Objective: 02-02 Gain an understanding of the major activities of banks and the industry structure.

16. The main features of the local banking industry over the two decades to 2010 have been an increase in concentration. This has occurred due to mergers and acquisitions motivated by the desire to:
A. be competitive in global markets.
B. protect against takeover by foreign competitors.
C. increase efficiency in terms of economies of scale and scope.
D. All of the listed options are correct.

Difficulty: Hard
Learning Objective: 02-02 Gain an understanding of the major activities of banks and the industry structure.

17. Which of the following statements is true?
A. Australian banks' decreased reliance on off-shore funding post GFC led to funding pressures and increased the costs of obtaining funds.
B. Australian banks' increased reliance on off-shore funding post GFC led to funding pressures and increased the costs of funding.
C. Australian banks reduced their reliance on on-shore funding in an effort to reduce the costs of funding and ease pressure on mortgage interest rates.
D. Australian banks increased their reliance on on-shore funding post GFC which led to funding pressures and increased the costs of obtaining funds.

Difficulty: Hard
Learning Objective: 02-03 Gain an insight into the balance sheet of banks and the trends in assets, liabilities and capital.

18. In response to the GFC and the global liquidity crisis the Australian government introduced the following measure in 2008:
A. A Financial Claims Scheme that provided coverage to all depositors in any financial institution.
B. A Financial Claims Scheme that guaranteed bank deposits coverage to depositors up to a million dollars per depositor.
C. A Financial Claims Scheme that guaranteed bank deposits coverage to depositors up to a million dollars per depositor and provided a temporary wholesale funding guarantee.
D. All of the listed options are correct.

Difficulty: Medium
Learning Objective: 02-03 Gain an insight into the balance sheet of banks and the trends in assets, liabilities and capital.

19. The term 'spread' refers to the difference between an FI's:
A. assets and liabilities.
B. liabilities and equity.
C. short-term lending rates and long-term lending rates.
D. lending and deposit rates.

Difficulty: Easy
Learning Objective: 02-02 Gain an understanding of the major activities of banks and the industry structure.

20. Which of the following statements is true?
A. Capital adequacy regulations of banks were introduced in 1989.
B. Capital adequacy regulations require banks to hold, on average, less capital for low-risk assets such as housing loans compared to higher-risk assets such as commercial loans.
C. Capital adequacy regulations were abolished in 2000.
D. Capital adequacy regulations of banks were introduced in 1989 and Capital adequacy regulations require banks to maintain levels of capital adequate for the type of activity undertaken, on average, less capital for low-risk assets such as housing loans compared to higher-risk assets such as commercial loans.

Difficulty: Medium
Learning Objective: 02-08 Understand the key areas of regulation and the reasons why these areas are targeted for regulation.

21. The major reasons for the shift in the composition of bank lending commitments from the retail market to the commercial market are the:
A. introduction of capital adequacy regulations in 1989.
B. number of non-bank depository institutions that gained banking licences in the early 1990s.
C. fact that commercial loans paid higher returns than housing loans.
D. None of the listed options are correct as the shift was from commercial loans to housing loans.

Difficulty: Hard
Learning Objective: 02-03 Gain an insight into the balance sheet of banks and the trends in assets, liabilities and capital.

22. Depository institutions are required by APRA to be responsible for:
A. their own liquidity management strategy that must include scenario analysis.
B. their own capital management strategy that must include risk analysis.
C. both their own liquidity, capital management strategies and a business continuity plan.
D. None of the listed options are correct. APRA is responsible for the supervision and oversight of all depository institutions.

Difficulty: Medium
Learning Objective: 02-08 Understand the key areas of regulation and the reasons why these areas are targeted for regulation.

23. Which of the following statements is true?
A. Off-balance-sheet transactions for Australian banks include direct credit substitutes, interest rate derivative contracts and foreign exchange derivative contracts.
B. On-balance-sheet transactions for Australian banks include direct futures and forward contracts.
C. Off-balance-sheet transactions for Australian banks include the commercial loans and term-deposits.
D. All of the listed options are correct.

Difficulty: Easy
Learning Objective: 02-03 Gain an insight into the balance sheet of banks and the trends in assets, liabilities and capital.

24. Which of the following statements is true?
A. On average building societies are larger than credit unions and their total share of the depository institution market has increased since 1992.
B. On average building societies are smaller than credit unions and their total share of the depository institution market has decreased significantly since 1992.
C. On average building societies are larger than credit unions and their total share of the depository institution market has decreased significantly since 1992.
D. On average building societies are smaller than credit unions and their total share of the depository institution market has increased since 1992.

Difficulty: Medium
Learning Objective: 02-05 Learn the history of the industry comprising credit unions and building societies and the structure of their industry.

25. Which of the following statements is true?
A. The majority of players in terms of asset value as a percentage of GDP in the Australian financial system are credit unions.
B. The majority of players in terms of asset value as a percentage of GDP in the Australian financial system are building societies.
C. The majority of players in terms of asset value as a percentage of GDP in the Australian financial system are banks.
D. The majority of players in terms of asset value as a percentage of GDP in the Australian financial system are superannuation funds.

Difficulty: Medium
Learning Objective: 02-01 Learn the different types of depository institutions in Australia and how they compete in the same market and face similar risks.

26. Which of the following statements is true?
A. During the 1960s and 1970s, the growth of building societies ensured an increasing supply of funds for housing loans at reasonable rates.
B. During the 1960s and 1970s, the credit union expansion ensured the availability of relatively low cost unsecured and secured personal loans.
C. During the 1960s and 1970s, regulatory constraints meant that banks could not in general satisfy the demand for consumer credit.
D. All of the listed options are correct.

Difficulty: Medium
Learning Objective: 02-06 Gain an understanding of the changing shape of the market for credit unions and building societies and how they have performed.

27. Which of the following statements is true?
A. Deregulation of the banking system in the 1980s brought greater competition from the banks.
B. Deregulation of the banking system in the 1980s resulted in loss of market share by non-bank depository institutions.
C. Deregulation of the banking system in the 1980s brought greater competition from the non-bank depository institutions.
D. Deregulation of the banking system in the 1980s brought greater competition from the banks and resulted in loss of market share by non-bank depository institutions.

Difficulty: Medium
Learning Objective: 02-06 Gain an understanding of the changing shape of the market for credit unions and building societies and how they have performed.

28. In which way did building societies respond to the competitive pressures resulting from the deregulation of the banking system in the 1980s?
A. They engaged in mergers for efficiency and scale reasons.
B. They adopted improved technology.
C. They diversified their products and activities.
D. All of the listed options are correct.

Difficulty: Easy
Learning Objective: 02-06 Gain an understanding of the changing shape of the market for credit unions and building societies and how they have performed.

29. Which of the following statements is true?
A. Key performance ratios for credit unions and building societies indicate that from 2005 to 2011 their cost structures were higher than for banks.
B. Key performance ratios for credit unions and building societies indicate that from 2005 to 2011 their cost structures were lower than for banks.
C. Deposits are a higher proportion of the funding base for banks than for credit unions and building societies.
D. Despite credit unions and building societies having higher cost structures over the period 2005-2011 than banks, they have much lower bad debt expenses than banks and hence have navigated the GFC well in terms of their overall performance.

Difficulty: Medium
Learning Objective: 02-06 Gain an understanding of the changing shape of the market for credit unions and building societies and how they have performed.

30. Which of the following statements are not true?
A. ACCC is responsible for market integrity and consumer protection across the financial system.
B. The RBA is responsible for prudential supervision and the promotion of financial system stability.
C. The RBA is responsible for monetary policy and for overall financial system stability.
D. APRA is responsible for prudential supervision of the financial services industry and supervises all deposit-taking institutions

Difficulty: Medium
Learning Objective: 02-07 Appreciate the regulatory framework governing the activities of Australian depository institutions and the key regulatory agencies.

31. Which of the following statements is true?
A. Australia's current financial regulatory system has its origins in the late 1990s' Financial System Inquiry, commonly known as the Campbell Committee.
B. Australia's current financial regulatory system has its origins in the late 1990s' Financial System Inquiry, commonly known as the Wallis Committee.
C. Australia's current financial regulatory system has its origins in the late 1990s' Financial System Inquiry, commonly known as the Martin Committee.
D. Australia's current financial regulatory system has its origins in the late 1990s' Financial System Inquiry, commonly known as the Valentine Committee.

Difficulty: Easy
Learning Objective: 02-07 Appreciate the regulatory framework governing the activities of Australian depository institutions and the key regulatory agencies.

32. The current financial system in Australia consists of three major agencies, these being:
A. APRA, ASIC and the Australian Government.
B. APRA, the RBA and the Australian Government.
C. APRA, ASIC and the RBA.
D. The RBA, ASIC and the Australian Government.

Difficulty: Easy
Learning Objective: 02-07 Appreciate the regulatory framework governing the activities of Australian depository institutions and the key regulatory agencies.

33. Which of the following statements is true?
A. APRA stands for Australian Prudential Regulation Authority.
B. APRA stands for Australian Payments Regulation Association.
C. APRA stands for Australian Payments Review Authority.
D. None of the listed options are correct.

Difficulty: Easy
Learning Objective: 02-07 Appreciate the regulatory framework governing the activities of Australian depository institutions and the key regulatory agencies.

34. Which of the following statements is true?
A. APRA is responsible for market integrity and consumer protection across the financial system.
B. The RBA is responsible for prudential supervision.
C. ASIC is responsible for monetary policy and for overall financial system stability.
D. None of the listed options are correct.

Difficulty: Medium
Learning Objective: 02-07 Appreciate the regulatory framework governing the activities of Australian depository institutions and the key regulatory agencies.

35. APRA's aim is to develop prudential policies that:
A. promote financial safety and efficiency and that enable smaller institutions to put competitive pressures on larger institutions.
B. balance financial safety and efficiency, competition contestability and competitive neutrality.
C. promote financial system stability and fair interest rates.
D. protect consumers from predatory behaviour of financial institutions.

Difficulty: Medium
Learning Objective: 02-07 Appreciate the regulatory framework governing the activities of Australian depository institutions and the key regulatory agencies.

36. The Probability and Impact Rating System (PAIRS):
A. determines the response ASIC should make to the outcomes of PAIRS ratings.
B. determines the response the RBA should make to the outcomes of bank failures.
C. determines the response the RBA should make to the outcomes of financial crisis.
D. None of the listed options are correct.

Difficulty: Medium
Learning Objective: 02-07 Appreciate the regulatory framework governing the activities of Australian depository institutions and the key regulatory agencies.

37. Some prudential standards issued by APRA include regulations regarding:
A. capital adequacy for market risk and liquidity.
B. credit quality and capital adequacy for credit risk.
C. large exposures, business continuity management and securitisation.
D. All of the listed options are correct.

Difficulty: Medium
Learning Objective: 02-08 Understand the key areas of regulation and the reasons why these areas are targeted for regulation.

38. APRA's supervisory oversight and response system (SOARS) is designed to assess the:
A. likelihood of FI failure.
B. impact of the FI failure.
C. impact of FI failure and provide the appropriate supervisory response, which in the case of a low PAIRS probability rating will require restructure.
D. impact of FI failure and provide the appropriate supervisory response, which in the case of an extreme PAIRS probability rating will require restructure.

Difficulty: Medium
Learning Objective: 02-07 Appreciate the regulatory framework governing the activities of Australian depository institutions and the key regulatory agencies.

39. Off-balance-sheet activities are:
A. not shown on the current balance sheet.
B. not shown on the balance sheet but after the completion of the financial year are recorded on the balance sheet.
C. not shown on the current balance sheet but are an off-balance-sheet asset/liability, if when a contingent event occurs, the activity moves onto the asset/liability side of the balance sheet.
D. contingent events which move the asset or liability from the balance sheet to off-balance-sheet.

Difficulty: Medium
Learning Objective: 02-03 Gain an insight into the balance sheet of banks and the trends in assets, liabilities and capital.

40. Which of the following is true?
A. PAIRS provides APRA with a score-card approach to assessing the risk of FI failure and the impact of any failure.
B. PAIRS provides APRA with a single rating which incorporates both the probability that the FI will fail and the impact of any failure.
C. PAIRS provides APRA with a rating that assesses the risk of FI failure.
D. PAIRS provides APRA with an impact factor that determines what regulatory response needs to be implemented to prevent FI failure.

Difficulty: Medium
Learning Objective: 02-07 Appreciate the regulatory framework governing the activities of Australian depository institutions and the key regulatory agencies.
Learning Objective: 02-08 Understand the key areas of regulation and the reasons why these areas are targeted for regulation.

41. Customer loans are classified on a DI's balance sheet as:
A. liabilities, because the customer may default on the loan.
B. assets, because the DI earns servicing fees on the loan.
C. liabilities, because the DI must transfer funds to the borrower at the initiation of the loan.
D. assets, because DIs originate and monitor loan portfolios.

Difficulty: Medium
Learning Objective: 02-03 Gain an insight into the balance sheet of banks and the trends in assets, liabilities and capital.

42. Which of the following is true of off-balance-sheet activities?
A. They involve generation of fees without exposure to any risk.
B. They include contingent activities recorded in the current balance sheet.
C. They invite regulatory costs and additional 'taxes'.
D. They have both risk-reducing as well as risk-increasing attributes.

Difficulty: Medium
Learning Objective: 02-03 Gain an insight into the balance sheet of banks and the trends in assets, liabilities and capital.

43. Which of the following is not an off-balance-sheet activity for banks?
A. derivative contracts
B. loan commitments
C. standby letters of credit
D. trust services

Difficulty: Medium
Learning Objective: 02-03 Gain an insight into the balance sheet of banks and the trends in assets, liabilities and capital.

44. Which of the following observations concerning credit unions is not true?
A. They invest heavily in corporate securities.
B. Member loans constitute a majority of their total assets.
C. They engage in off-balance-sheet activities.
D. They focus more on providing services and less on profitability.

Difficulty: Medium
Learning Objective: 02-06 Gain an understanding of the changing shape of the market for credit unions and building societies and how they have performed.

45. Which of the following is part of the supervisory activities of APRA?
A. Prudential review is the most important as it provides a detailed assessment of a FIs inherent risks and the adequacy of its risk management controls.
B. Licensing is the last stage of APRA's supervision which ensures that only FIs that have the capacity to successfully operate can operate the market.
C. Enforcement supervision is not part of APRA supervisory activity as it would involve enforcement teams to specifically intervene in the running of the FI.
D. Entity financial analysis is the FIs own assessment of its financial position.

Difficulty: Medium
Learning Objective: 02-07 Appreciate the regulatory framework governing the activities of Australian depository institutions and the key regulatory agencies.
Learning Objective: 02-08 Understand the key areas of regulation and the reasons why these areas are targeted for regulation.

46. Which of the following statements is not correct concerning credit risk?
A. Credit risk is the risk of counterparty default and is usually the single largest risk facing a FI.
B. Credit risk occurs when borrowers are unable to repay their loans on time.
C. Credit risk decreases when FIs concentrate their loan exposures on a few counterparties and APRA requires that FIs have appropriate polices to manage such risk.
D. Credit risk increases when FIs concentrate their loan exposures on a few counterparties.

Difficulty: Medium
Learning Objective: 02-08 Understand the key areas of regulation and the reasons why these areas are targeted for regulation.

47. Business continuity relates to:
A. an FI that has a business plan that meets the liquidity and capital requirements of APRA.
B. a whole-of-business approach to FI operations and profitability.
C. a business continuity plan which reduces the impact of any disruption on FI operations, reputation, profitability, depositors and other stakeholders of a FI.
D. a business continuity plan which increases profitability of a FI.

Difficulty: Medium
Learning Objective: 02-08 Understand the key areas of regulation and the reasons why these areas are targeted for regulation.

48. Credit unions were generally less affected than other depository institutions by the recent financial crisis because:
A. they hold more government securities, on average.
B. they hold less government securities, on average.
C. they had a focus on high quality domestic assets.
D. they had a focus on domestic deposits and more assets in residential mortgages.

Difficulty: Medium
Learning Objective: 02-05 Learn the history of the industry comprising credit unions and building societies and the structure of their industry.

49. Responding to the financial crisis, the Australian government introduced a number of measures to ease liquidity issues and included the following:
A. a permanent financial claims scheme (FCS) in October 2008, which explicitly guaranteed bank deposits with a $1 million cap.
B. a semi-permanent financial claims scheme (FCS), which implicitly guaranteed bank deposits.
C. a permanent guarantee scheme for large deposits and wholesale funding, which for a fee, guaranteed bank deposits greater than $1 million.
D. a permanent financial claims scheme (FCS) in October 2008, which explicitly guaranteed bank deposits with a $1 million cap; the guarantee was reduced to $250 000 per depositor from 2012.

Difficulty: Medium
Learning Objective: 02-05 Learn the history of the industry comprising credit unions and building societies and the structure of their industry.

50. Covered bonds:
A. were introduced following the GFC to ease liquidity pressures on the bank's balance sheet.
B. are issued by a bank, backed by a pool of assets, which remain on the balance sheet of the issuing bank.
C. are issued by a bank, backed by a pool of assets, which are off-balance-sheet items of the issuing bank.
D. are issued by the Reserve Bank of Australia to FIs with liquidity problems.

Difficulty: Medium
Learning Objective: 02-03 Gain an insight into the balance sheet of banks and the trends in assets, liabilities and capital.

51. Depository institutions are financial institutions that only take deposits from savers, but do not lend money to borrowers.
FALSE

Difficulty: Medium
Learning Objective: 02-01 Learn the different types of depository institutions in Australia and how they compete in the same market and face similar risks.

52. Non-bank depository institutions are also referred to as CUBS.
TRUE

Difficulty: Easy
Learning Objective: 02-05 Learn the history of the industry comprising credit unions and building societies and the structure of their industry.

53. In case of building societies, the members are usually linked to the society by some common bond such as locality or trade union.
FALSE

Difficulty: Medium
Learning Objective: 02-05 Learn the history of the industry comprising credit unions and building societies and the structure of their industry.

54. A financial institution is an institution that performs financial intermediary services and/or services requiring transactions in the capital markets.
TRUE

Difficulty: Medium
Learning Objective: 02-01 Learn the different types of depository institutions in Australia and how they compete in the same market and face similar risks.

55. Most foreign banks have succeeded in establishing a well-developed and profitable retail banking network in Australia.
FALSE

Difficulty: Medium
Learning Objective: 02-02 Gain an understanding of the major activities of banks and the industry structure.

56. The growth in off-balance-sheet activities during the two decades from 1990 to 2010 was due, in large part, to the use of derivative contracts.
TRUE

Difficulty: Medium
Learning Objective: 02-03 Gain an insight into the balance sheet of banks and the trends in assets, liabilities and capital.

57. During the 1960s and 1970s, the growth of credit unions ensured an increasing supply of funds for housing loans at reasonable rates, while the building society expansion ensured the availability of relatively low cost unsecured and secured personal loans.
FALSE

Difficulty: Medium
Learning Objective: 02-06 Gain an understanding of the changing shape of the market for credit unions and building societies and how they have performed.

58. The use of off-balance-sheet activities and instruments will always reduce the risk to a bank.
FALSE

Difficulty: Medium
Learning Objective: 02-03 Gain an insight into the balance sheet of banks and the trends in assets, liabilities and capital.

59. The major banks' return on equity, a measure of bank profitability has been lower than the regional banks with the gap widening since 2007.
FALSE

Difficulty: Medium
Learning Objective: 02-02 Gain an understanding of the major activities of banks and the industry structure.

60. ASIC stands for Australian Society of Inter-bank Cooperation and ASIC is responsible for market integrity and consumer protection across the financial system.
FALSE

Difficulty: Easy
Learning Objective: 02-07 Appreciate the regulatory framework governing the activities of Australian depository institutions and the key regulatory agencies.

61. Australia's current financial regulatory framework was reformed in 1999 and moved from industry-based regulation to functional regulation of financial institutions.
TRUE

Difficulty: Medium
Learning Objective: 02-07 Appreciate the regulatory framework governing the activities of Australian depository institutions and the key regulatory agencies.

62. PAIRS provides APRA with a score-card approach to assessing the risk of FI failure and the impact of any failure by detailing the 12 risk elements separately and disclosing the result to the FI being investigated.
FALSE

Difficulty: Hard
Learning Objective: 02-08 Understand the key areas of regulation and the reasons why these areas are targeted for regulation.

63. Discuss the factors that contributed to Australia's financial resilience and relatively strong performance during the global financial crisis.

The maintenance of high lending standards and risk conservatism during the 2000s was one of the reasons why the Australian economy generally was less impacted by the GFC than many other countries. Despite the changes in structure of the banking industry, the Australian banks' performance during the GFC was relatively good compared to global markets. Some features that prevented excessive risk-taking by Australian financial institutions include the following:
a. Internal governance characteristics are one possible factor. Inherent conservatism induced by memory of the banking crisis at the start of the 1990s may have been another, inducing lower risk lending and limiting exposure.
b. External influences may also have been important influences upon risk-taking. For example, deposit and debt markets could have exerted discipline against excessive risk-taking, if depositors believed that their funds were at risk and subordination of debt holder claims due to depositor preference increased monitoring.
c. Another external influence is regulation and strong prudential supervision. The 'twin-peaks' model adopted just prior to the start of the decade created a specialist prudential regulator (APRA) and a specialist corporate, markets and financial services regulator (ASIC). Such specialisation may have facilitated more effective prudential regulation and prevention of excessive risk-taking. Also, with the collapse of the major insurance company HIH at the start of the decade, a tougher approach to prudential regulation was induced.
d. Another factor may have been the overall structure of financing in the economy. With (major) Australian banks borrowing extensively offshore (helping to finance Australia's current account deficit) and able to profitably use those funds for housing and other domestic lending, there were limited incentives to invest in ultimately 'toxic' assets and have very limited involvement in securities trading on their own account and consequently did not have material holdings of assets (such as collateralised debt obligations) that caused large asset write downs by many large international banks.

Est time: 10–15 minutes
Learning Objective: 02-03 Gain an insight into the balance sheet of banks and the trends in assets, liabilities and capital.

64. Explain the Post Wallis Inquiry regulatory framework in Australia.

Australia's current financial regulatory framework has its origins in the Wallis Committee's *Financial System Inquiry* of the late 1990s. The main elements of the new regulatory framework recommended by the Wallis Committee were fully implemented by 1999. The changes included wide-ranging reforms to the structure of financial regulation based on function rather than industry, and were designed to improve financial system efficiency and competitiveness. Prior to these reforms FI regulation
was based on industry, while financial markets, such as securities, futures and foreign exchange markets and products, were regulated on a functional basis. Consequently, with FIs covering many functional types, regulatory supervision was complex and involved a number of different authorities. For example, banks were regulated by the RBA, yet their growing funds management, superannuation and insurance activities were supervised by different agencies. As the distinction between the activities of different types of FIs became increasingly blurred in the deregulated financial environment of the 1990s, the unwieldy regulation resulted in duplication, inconsistencies, inefficiencies and unintended regulatory gaps. These challenges were overcome by the Wallis Committee's regulatory reforms. By 1999, the regulatory framework consisted of three agencies, each with specific functional responsibilities:
1. Australian Prudential Regulation Authority (APRA), with responsibility for prudential regulation and supervision of financial institutions
2. Australian Securities and Investments Commission (ASIC), with responsibility for market integrity and consumer protection across the financial system
3. Reserve Bank of Australia (RBA), with responsibility for monetary policy and for overall financial system stability.

Est time: 10–15 minutes
Learning Objective: 02-07 Appreciate the regulatory framework governing the activities of Australian depository institutions and the key regulatory agencies.

65. Compare and contrast credit unions with the major banks.

In Australia, banks and credit unions are classified as depository institutions (DIs) and are both regulated by APRA. Credit unions are subject to the same prudential regulations as banks.

Historically, Australia's largest banks have operated as well-diversified financial institutions, with large holdings of residential mortgages as well as personal and commercial loans, thus covering both retail and business sectors. Credit unions tend to concentrate on retail finance-related activities, such as personal and small business loans, and residential mortgages tend to dominate their asset portfolios.

Bank assets have grown from 50 per cent of GDP in 1990 to more than 200 per cent in 2010, whereas the non-bank depository institutions including credit unions have fluctuated between 10 and 20 per cent of GDP. In terms of total FI assets, banks again dominate, holding more than 60 per cent of total FI assets.

Credit unions' market share changed very little from 1992 to 2011 (at 2 per cent); although during this period it rose as high as 2.9 per cent. The most notable changes in credit union assets are the fall in cash and liquid assets (from 11.4 per cent of total assets in 1990 to 3.8 per cent in 2011) and the rise in housing loans (from 17.8 per cent in 1990 to 69.8 per cent in 2011).

Deposits form the priority funding base for credit unions, representing nearly 83 per cent in 2011, a much higher proportion than banks with only 60.6 per cent in 2011. Moreover, the cost structure of credit unions is higher than for banks, credit union expenses represent more than 2.5 per cent of assets. Also credit unions operate on higher interest margins than major banks.

Est time: 10–15 minutes
Learning Objective: 02-02 Gain an understanding of the major activities of banks and the industry structure.
Learning Objective: 02-05 Learn the history of the industry comprising credit unions and building societies and the structure of their industry.
Learning Objective: 02-06 Gain an understanding of the changing shape of the market for credit unions and building societies and how they have performed.

66. APRA conducts a prudential supervisory framework that assesses FI risk and likelihood of FI failure and determines an appropriate supervisory response. Outline the two systems implemented by APRA—PAIRS and SOARS—and the purpose of the assessment system.

The main objectives of the FI risk assessment are to:

- determine the probability that an FI will not meet its financial commitments
- measure the impact of the potential consequences of not meeting those commitments
- determine an appropriate supervisory action plan to address the key issues identified.

The risk assessment is made using two APRA systems (PAIRS and SOARS) which together provide a structure to guide APRA in gauging risks and determining the appropriate supervisory response.

A Probability and Impact Rating System (PAIRS) assessment details APRA's assessment of key risks, management and controls and capital support for the institution and its supervisory action plan. APRA's supervisory actions are driven by its Supervisory Oversight and Response System (SOARS). The outcome of the PAIRS process determines the SOARS response. SOARS sorts FIs into four types of supervisory responses: normal, oversight, mandated improvement and restructure.

Est time: 10–15 minutes
Learning Objective: 02-07 Appreciate the regulatory framework governing the activities of Australian depository institutions and the key regulatory agencies.
Learning Objective: 02-08 Understand the key areas of regulation and the reasons why these areas are targeted for regulation.

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Chapter 02 - Testbank Summary

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