Chapter 01 Testbank

Student: ____

1.

A loan covenant is:

A. a legal clause in a borrowing contract that requires the lender to avoid certain actions
B. a legal clause in a borrowing contract that requires the lender to take certain actions
C. a legal clause in a borrowing contract that requires the borrower to take certain actions
D. a legal clause in a borrowing contract that requires the borrower to either take certain actions or avoid certain actions

2.

When a DI makes a shift from an 'originate-to-hold' banking model to an 'originate-to-distribute' banking model, the change is likely to result in:

A.

increased operating costs

B. increased interest rate and liquidity risk
C. decreased monitoring costs
D. decreased fee income

3.

In the traditional 'originate-to-hold' banking model, where a DI takes short-term deposits and uses them to make loans, the bank usually holds these loans until maturity. This exposes the bank to increased:

A. operating costs
B. interest rate and liquidity risk
C. monitoring costs
D. All of the listed options are correct.

4.

FIs perform their intermediary function in two ways:

A. They specialise as brokers between savers and users and they directly control the quantity of outside money in the economy.
B. They serve as asset transformers by purchasing primary securities and issuing secondary securities and by purchasing secondary securities and issuing primary securities.
C. They serve as asset transformers by purchasing secondary securities and issuing primary securities and they directly control the quantity of outside money in the economy.
D. They specialise as brokers between savers and users and they serve as asset transformers by purchasing primary securities and issuing secondary securities.

5.

Price risk refers to:

A. the risk that the sale price of an asset will be lower than the purchase price of that asset.
B. the risk that the purchase price of an asset will be lower than the sale price of that asset.
C. the risk that the sale price of an asset will be higher than the purchase price of that asset.
D. None of the listed options are correct.

6.

Economies of scale is the concept that:

A. a cost reduction in trading and other transaction services results from increased efficiency when FIs perform these services.
B. a profitability decrease in trading and other transaction services results from increased efficiency when FIs perform these services.
C. a cost reduction in trading and other transaction services results from stable efficiency when FIs perform these services.
D. None of the listed options are correct.

7.

Which of the following statements is true?

A. Primary securities are securities issued by corporations and backed by the real assets of those corporations.
B. Secondary securities are securities issued by corporations and backed by the real assets of those corporations.
C. Dominant securities are securities issued by corporations and backed by the real assets of those corporations.
D. Preliminary securities are securities issued by corporations and backed by the real assets of those corporations.

8.

Secondary securities are securities issued by FIs and backed by:

A. the real assets of the FI
B. primary securities
C. guarantees
D. any type of collateral

9.

Which of the following is an adequate definition of an asset transformer?

A. A corporation that issues financial claims that are more attractive to household savers than the claims issued by other corporations.
B. An FI that issues financial claims that are more attractive to household savers than the claims issued by other FIs.
C. A corporation that issues financial claims that are more attractive to household savers than the claims directly issued by FIs.
D. An FI that issues financial claims that are more attractive to household savers than the claims directly issued by corporations.

10.

Which of the following is an adequate definition of a delegated monitor?

A. An economic agent appointed to act on behalf of large groups of agents and principals in collecting information and/or investing funds.
B. An economic agent appointed to act on behalf of large groups of principals in collecting information and/or investing funds.
C. An economic agent appointed to act on behalf of smaller agents in collecting information and/or investing funds.
D. An economic agent appointed to act on behalf of smaller principals in collecting information and/or investing funds.

11.

The ability of an economic agent to reduce risk by holding a number of securities in a portfolio is called:

A. asset management
B. efficiency
C. arbitrage
D. diversification

12.

An action by an economic agent that imposes costs on other economic agents is referred to as a:

A. negative endogenous reaction
B. positive endogenous reaction
C. positive externality
D. negative externality

13.

Net regulatory burden is defined as the difference between the:

A. private costs of regulations and the private benefits for the producers of financial services
B. public costs of regulations and the public benefits for the producers of financial services
C. private costs of regulations and the public benefits for the producers of financial services
D. public costs of regulations and the private benefits for the producers of financial services

14.

The part of the money supply directly produced by the government or central bank is called:

A. inside money
B. outside money
C. direct money
D. indirect money

15.

The part of the money supply produced by the private banking system is called:

A. inside money
B. outside money
C. indirect money
D. None of the options listed. The private banking system does not produce part of the money supply.

16.

Which of the following are reasons for the specialness of financial intermediaries?

A. higher average information costs
B. lower price risk and superior liquidity attributes for financial claims to household savers.
C. higher average transaction costs
D. All of the listed options are correct.

17.

Which of the following statements is true?

A. In a world without financial intermediaries the level of fund flows between household savers and the corporate sector is likely to be as high as it is with financial intermediaries.
B. In a world without financial intermediaries funds would directly flow from surplus units to deficit units.
C. In a world without financial intermediaries lenders (households) would need to monitor the actions of the firms to which they have lent their funds.
D. In a world without financial intermediaries funds would directly flow from surplus units to deficit units and lenders (households) would need to monitor the actions of the firms to which they have lent their funds.

18.

The following are protective mechanisms that have been developed by regulators to promote the safety and soundness of the banking system except:

A. encouraging banks to rely more on deposits rather than debt or capital as a cushion against failure
B. encouraging banks to limit lending to a single customer to no more than 10 per cent of capital
C. the provision of deposit insurance
D. the periodic monitoring of banks

19.

Which of the following statements is true?

A. Household savers are likely to be attracted to direct investments in corporate securities because of lower monitoring costs compared to using financial intermediaries.
B. Household savers are likely to be attracted to direct investments in corporate securities because of lower liquidity costs compared to using financial intermediaries.
C. Household savers are likely to be attracted to direct investments in corporate securities because of lower price risk compared to using financial intermediaries.
D. None of the listed options are correct.

20.

Which of the following statements is true?

A. Agency costs arise whenever economic agents enter into a contract in a world of incomplete information.
B. Monitoring costs are part of overall agency costs.
C. The more difficult and costly it is to collect information, the more likely it is that contracts will be broken.
D. Agency costs arise whenever economic agents enter into a contract in a world of incomplete information, monitoring costs are part of overall agency costs and the more difficult and costly it is to collect information, the more likely it is that contracts will be broken.

21.

Which of the following statements is true?

A. Loan contracts are bank debt contracts that generally have longer term to maturity than bond contracts.
B. The longer term nature of loans allows the financial intermediary to exercise more monitoring power and control over the borrower.
C. When bank loan contracts are sufficiently long term, the banker almost becomes like an insider to the firm.
D. None of the listed options are correct.

22.

Which of the following statements is true in the context of diversification?

A. As long as the return on different investments is not perfectly positively correlated, financial intermediaries can diversify away significant amounts of portfolio risk.
B. As long as the return on different investments is not perfectly negatively correlated, financial intermediaries can diversify away significant amounts of portfolio risk.
C. As long as the return on different investments is perfectly positively correlated, financial intermediaries can diversify away significant amounts of portfolio risk.
D. None of the listed options are correct.

23.

Which of the following statements is true?

A. Secondary claims often have inferior liquidity attributes compared to primary securities.
B. Secondary claims often have superior liquidity attributes compared to primary securities.
C. Secondary claims and primary claims often have the same liquidity attributes.
D. There is no general relationship between the liquidity attributes of primary and secondary claims.

24.

Why do households prefer to use FIs as intermediaries to invest their surplus funds?

A. Transaction costs are low to the household since FIs are more efficient in monitoring and gathering investment information.
B. To receive the benefits of diversification that households may not be able to achieve on their own.
C. The FI can benefit from combining funds and negotiating lower asset prices and transaction costs
D. All of the listed options are correct.

25.

Which of the following statements is true?

A. The more diversified a financial intermediary, the higher the probability that it will default on its obligations and the more risky and illiquid the claims.
B. The less diversified a financial intermediary, the higher the probability that it will default on its obligations and the more risky and illiquid the claims.
C. The more diversified a financial intermediary, the lower the probability that it will default on its obligations and the more risky but also the more liquid the claims.
D. The more diversified a financial intermediary, the higher the probability that it will default on its obligations and the more risky but also the more liquid the claims.

26.

Negative externalities exist in the depository sector when:

A. the fear of DI insolvency leads to bank deposit runs
B. lending activity is impaired or constrained
C. there are delays in disbursements from insolvent DIs
D. All of the listed options are correct.

27.

Which of the following is an adequate definition of broad money?

A. Currency plus bank current deposits of the private non-bank sector
B.

'M1' plus borrowings from the private sector by non-bank financial institutions less the latter's holdings of currency and bank deposits

C.

'M3' plus non-deposit borrowings from the private sector by all financial intermediaries (AFIs), less the holdings of currency and bank deposits by RFCs and cash management trusts

D. None of the listed options are correct.

28.

What does APCA and APRA stand for?

A. Australian Payments Clearing Association; Australian Prudential Regulatory Association
B. Australian Payments and Cheques Association; Australian Payments and Regulatory Authority
C. Australian Payments Cheques Association; Australian Prudential Regulatory Association
D. Australian Payments Clearing Association; Australian Prudential Regulatory Authority

29.

Which of the following are areas of institution-specific specialness?

A. money supply transmission
B. payment services
C. intergenerational transfers
D. All of the listed options are correct.

30.

Which of the following are types of regulation that seek to enhance the net social welfare benefits of financial intermediaries' services?

A. exit regulation
B. issuer protection regulation
C. credit allocation regulation
D. All of the listed options are correct.

31.

Which of the following statements is true?

A.

Bank failures may destroy household savings and restrict a firm's access to credit.

B.

Bank failures may create doubts in savers' minds regarding the stability and solvency of financial intermediaries in general.

C. Bank failures may threaten the stability of the financial system.
D. All of the listed options are correct.

32.

Which of the following statements is true?

A.

Bank loans that represent more than 5 per cent of a banking group's capital must be reported quarterly to APRA.

B.

Bank loans that represent more than 10 per cent of a banking group's capital must be reported quarterly to APRA.

C.

Bank loans that represent more than 5 per cent of a banking group's liabilities must be reported quarterly to APRA.

D.

Bank loans that represent more than 10 per cent of a banking group's liabilities must be reported quarterly to APRA.

33.

Net regulatory burden for FIs is higher because regulators may require the FI to:

A. hold more capital than what would be held without regulation
B. produce less information than would be produced without regulation
C. hold more debt than what would be held without regulation
D. hold fewer reserves than they would without regulation

34.

Which of the following statements is true?

A.

FI losses are borne by equity holders last; hence they are junior claimants to an FI's assets.

B.

FI losses are borne by equity holders last; hence they are senior claimants to an FI's assets.

C.

FI losses are borne by equity holders first; hence they are junior claimants to an FI's assets.

D.

FI losses are borne by equity holders first; hence they are senior claimants to an FI's assets.

35.

Which of the following statements is true?

A.

The lower the net regulatory burden on FIs, the more inefficiently they produce any given set of financial services from a private (FI) owner's perspective.

B.

The higher the net regulatory burden on FIs, the more inefficiently they produce any given set of financial services from a private (FI) owner's perspective.

C.

The higher the net regulatory burden on FIs, the less inefficiently they produce any given set of financial services from a private (FI) owner's perspective.

D. None of the listed options are correct.

36.

Which of the following statements is true?

A. The RBA controls outside money, while inside money is determined by the private banking system.
B. The RBA controls inside money, while outside money is determined by the private banking system.
C. The RBA controls both inside and outside money.
D. The private banking system controls both inside and outside money.

37.

Safety and soundness regulations include all of the following layers of protection except:

A. the provision of guaranty funds
B. requirements encouraging diversification of assets
C. the creation of money for those FIs in financial trouble
D. requiring minimum levels of capital

38.

The following are protective mechanisms that have been developed by regulators to promote the safety and soundness of the banking system except:

A. encouraging banks to rely more on deposits rather than debt or capital as a cushion against failure
B. encouraging banks to limit lending to a single customer to no more than 10 per cent of capital
C. the provision of deposit insurance
D. the periodic monitoring of banks

39.

Which of the following statements is false?

A. A financial intermediary specialises in the production of information.
B. A financial intermediary reduces its risk exposure by pooling its assets.
C. A financial intermediary benefits society by providing a mechanism for payments.
D. A financial intermediary acts as a lender of last resort.

40.

Which function of an FI reduces transaction and information costs between a corporation and an individual and may encourage a higher rate of savings?

A. brokerage services
B. asset transformation services
C. information production services
D. money supply management

41.

In its role as a delegated monitor, an FI:

A. keeps track of required interest and principal payments on loans it originates
B. works with financially distressed borrowers in danger of defaulting on their loans
C. holds portfolios of loans that they continue to service
D. All of the listed options are correct.

42.

Which of the following is not a major function of financial intermediaries?

A. brokerage services
B. asset transformation services
C. information production
D.

management of the nation's money supply

43.

Advantages of depositing funds into a typical bank account instead of directly buying corporate securities include all of the following except:

A. monitoring done by the bank on your behalf
B. increased liquidity if funds are needed quickly
C. increased transactions costs
D. less price risk when funds are needed

44.

Many households place funds with financial institutions because many FI accounts provide:

A. lower denominations than other securities
B. flexible maturities versus other interest-earning securities
C. better liquidity than directly negotiated debt contracts
D. All of the listed options are correct.

45.

The reason FIs can offer highly liquid, low price-risk contracts to savers while investing in relatively illiquid and higher risk assets is:

A. because diversification allows an FI to predict more accurately the expected returns on its asset portfolio
B. significant amounts of portfolio risk are diversified away by investing in assets that have correlations between returns that are less than perfectly positive
C. because individual savers cannot benefit from risk diversification
D. All of the listed options are correct.

46.

The asset transformation function of FIs typically involves:

A. receipt of securities through electronic payments systems
B.

altering the liquidity and maturity features of funds sources used to finance the FI's asset portfolio

C. granting loans to transform funds deficit units into funds surplus units
D. investing short-term funds in off-balance-sheet activities

47.

Which of the following refers to the possibility that a firm's owners or managers will take actions contrary to the promises contained in the covenants of the securities the firm issues to raise funds?

A. liquidity risk
B. price risk
C. credit risk
D. agency costs

48.

Which of the following refers to the term 'maturity intermediation'?

A. creation of a secondary market mature enough to withstand volatility
B. overcoming constraints to buying assets imposed by large minimum denomination size
C. mismatching the maturities of assets and liabilities
D. reducing information costs or imperfections between households and corporations

49.

Depository institutions (DIs) play an important role in the transmission of monetary policy from the central bank (RBA) to the rest of the economy primarily because:

A. loans to corporations are part of the money supply
B. bank loans are highly regulated
C. depository institutions provide a large amount of credit to finance residential real estate
D. DI deposits are a major portion of the money supply

50.

Why is the failure of a large bank more detrimental to the economy than the failure of a large steel manufacturer?

A. The bank failure usually leads to a government bailout.
B. There are fewer steel manufacturers than there are banks.
C. The large bank failure reduces credit availability throughout the economy.
D.

Since the steel company's assets are tangible, they are more easily reallocated than the intangible bank assets.

51.

Which of the following statements is true regarding the percentage share of assets of financial institutions in Australia as of end June 2013?

A. The largest percentage of assets is held by money market corporations.
B. The largest percentage of assets is held by credit unions.
C. The largest percentage of assets is held by permanent building societies.
D. The largest percentage of assets is held by banks.

52.

Agency costs are costs relating to the risk that the owners and managers of firms that receive savers' funds will take action with those funds contrary to the best interests of the saver.

True False

53.

Due to the costs of monitoring, liquidity and price risk savers often prefer to hold the financial claims issued by FIs rather than those issued by corporations.

True False

54.

In the principal-agent relationship between savers and a borrowing firm the savers are the agents and the borrowing firm is the principal.

True False

55.

By acting as a delegated monitor, financial intermediaries reduce the degree of information imperfection and asymmetry between the ultimate suppliers and users of funds.

True False

56.

FIs are better able to manage the risk of mismatching maturities of assets and liabilities than household savers.

True False

57.

FIs play a significant role in the transmission of monetary policy.

True False

58.

An example of negative externality is the costs faced by small businesses in a one-bank town if the local bank fails.

True False

59.

In most countries regulators require financial intermediaries to hold a minimum level of cash reserves against their deposits. There is no such regulation in Australia.

True False

60.

The risk that the sale price of an asset will be less than the purchase price of an asset is called liquidity risk

True False

61.

In an attempt to enhance the net social welfare benefits of the services provided by financial intermediaries, safety and soundness regulation requires a DI to hold a minimum level of cash reserves against deposits.

True False

62.

Because the average maturity of assets and the average maturity of liabilities are often different on an FI's balance sheet, the FI is exposed to liquidity risk

True False

63.

None of the commercial banks in Australia defaulted during the global financial crisis.

True False

64.

None of the commercial banks in the US defaulted during the global financial crisis.

True False

65.

Lehman Brothers defaulted during the global financial crisis.

True False

66. Why are financial institutions special? Give three concrete examples.

67. What are the entry costs for the financial intermediation sector in Australia? Would you consider entry to be easy or difficult? Explain.

68. Explain the causes of the global financial crisis (GFC) and outline how and why the Australian government implemented the financial claims scheme.

Chapter 01 Testbank Key

1.

A loan covenant is:

A. a legal clause in a borrowing contract that requires the lender to avoid certain actions
B. a legal clause in a borrowing contract that requires the lender to take certain actions
C. a legal clause in a borrowing contract that requires the borrower to take certain actions
D. a legal clause in a borrowing contract that requires the borrower to either take certain actions or avoid certain actions

AACSB: Analytic
Bloom's: Knowledge
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.5 Understand how the failure of FIs to perform the specialist functions of risk measurement and management can lead to systemic risk in the domestic and global financial systems

2.

When a DI makes a shift from an 'originate-to-hold' banking model to an 'originate-to-distribute' banking model, the change is likely to result in:

A.

increased operating costs

B. increased interest rate and liquidity risk
C. decreased monitoring costs
D. decreased fee income

AACSB: Analytic
Bloom's: Application
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.5 Understand how the failure of FIs to perform the specialist functions of risk measurement and management can lead to systemic risk in the domestic and global financial systems

3.

In the traditional 'originate-to-hold' banking model, where a DI takes short-term deposits and uses them to make loans, the bank usually holds these loans until maturity. This exposes the bank to increased:

A. operating costs
B. interest rate and liquidity risk
C. monitoring costs
D. All of the listed options are correct.

AACSB: Analytic
Bloom's: Application
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.5 Understand how the failure of FIs to perform the specialist functions of risk measurement and management can lead to systemic risk in the domestic and global financial systems

4.

FIs perform their intermediary function in two ways:

A. They specialise as brokers between savers and users and they directly control the quantity of outside money in the economy.
B. They serve as asset transformers by purchasing primary securities and issuing secondary securities and by purchasing secondary securities and issuing primary securities.
C. They serve as asset transformers by purchasing secondary securities and issuing primary securities and they directly control the quantity of outside money in the economy.
D. They specialise as brokers between savers and users and they serve as asset transformers by purchasing primary securities and issuing secondary securities.

AACSB: Analytic
Bloom's: Application
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.1 Understand why financial institutions (FIs) are different from commercial firms
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

5.

Price risk refers to:

A. the risk that the sale price of an asset will be lower than the purchase price of that asset.
B. the risk that the purchase price of an asset will be lower than the sale price of that asset.
C. the risk that the sale price of an asset will be higher than the purchase price of that asset.
D. None of the listed options are correct.

AACSB: Analytic
Bloom's: Knowledge
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

6.

Economies of scale is the concept that:

A. a cost reduction in trading and other transaction services results from increased efficiency when FIs perform these services.
B. a profitability decrease in trading and other transaction services results from increased efficiency when FIs perform these services.
C. a cost reduction in trading and other transaction services results from stable efficiency when FIs perform these services.
D. None of the listed options are correct.

AACSB: Analytic
Bloom's: Knowledge
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

7.

Which of the following statements is true?

A. Primary securities are securities issued by corporations and backed by the real assets of those corporations.
B. Secondary securities are securities issued by corporations and backed by the real assets of those corporations.
C. Dominant securities are securities issued by corporations and backed by the real assets of those corporations.
D. Preliminary securities are securities issued by corporations and backed by the real assets of those corporations.

AACSB: Analytic
Bloom's: Knowledge
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

8.

Secondary securities are securities issued by FIs and backed by:

A. the real assets of the FI
B. primary securities
C. guarantees
D. any type of collateral

AACSB: Analytic
Bloom's: Knowledge
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

9.

Which of the following is an adequate definition of an asset transformer?

A. A corporation that issues financial claims that are more attractive to household savers than the claims issued by other corporations.
B. An FI that issues financial claims that are more attractive to household savers than the claims issued by other FIs.
C. A corporation that issues financial claims that are more attractive to household savers than the claims directly issued by FIs.
D. An FI that issues financial claims that are more attractive to household savers than the claims directly issued by corporations.

AACSB: Analytic
Bloom's: Knowledge
Difficulty: Hard
Est time: 1–3
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

10.

Which of the following is an adequate definition of a delegated monitor?

A. An economic agent appointed to act on behalf of large groups of agents and principals in collecting information and/or investing funds.
B. An economic agent appointed to act on behalf of large groups of principals in collecting information and/or investing funds.
C. An economic agent appointed to act on behalf of smaller agents in collecting information and/or investing funds.
D. An economic agent appointed to act on behalf of smaller principals in collecting information and/or investing funds.

AACSB: Analytic
Bloom's: Knowledge
Difficulty: Hard
Est time: 1–3
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

11.

The ability of an economic agent to reduce risk by holding a number of securities in a portfolio is called:

A. asset management
B. efficiency
C. arbitrage
D. diversification

AACSB: Analytic
Bloom's: Knowledge
Difficulty: Easy
Est time: <1
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

12.

An action by an economic agent that imposes costs on other economic agents is referred to as a:

A. negative endogenous reaction
B. positive endogenous reaction
C. positive externality
D. negative externality

AACSB: Analytic
Bloom's: Knowledge
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.3 Discover why FIs' very specialness results in increased regulation and regulatory oversight that other corporations do not require, which imposes a regulatory burden on financial institutions

13.

Net regulatory burden is defined as the difference between the:

A. private costs of regulations and the private benefits for the producers of financial services
B. public costs of regulations and the public benefits for the producers of financial services
C. private costs of regulations and the public benefits for the producers of financial services
D. public costs of regulations and the private benefits for the producers of financial services

AACSB: Analytic
Bloom's: Knowledge
Difficulty: Hard
Est time: 1–3
Learning Objective: 1.3 Discover why FIs' very specialness results in increased regulation and regulatory oversight that other corporations do not require, which imposes a regulatory burden on financial institutions
Learning Objective: 1.4 Gain knowledge of how regulation can and does affect the efficiency with which FIs produce financial services

14.

The part of the money supply directly produced by the government or central bank is called:

A. inside money
B. outside money
C. direct money
D. indirect money

AACSB: Analytic
Bloom's: Knowledge
Difficulty: Easy
Est time: <1
Learning Objective: 1.3 Discover why FIs' very specialness results in increased regulation and regulatory oversight that other corporations do not require, which imposes a regulatory burden on financial institutions
Learning Objective: 1.4 Gain knowledge of how regulation can and does affect the efficiency with which FIs produce financial services

15.

The part of the money supply produced by the private banking system is called:

A. inside money
B. outside money
C. indirect money
D. None of the options listed. The private banking system does not produce part of the money supply.

AACSB: Analytic
Bloom's: Knowledge
Difficulty: Easy
Est time: <1
Learning Objective: 1.3 Discover why FIs' very specialness results in increased regulation and regulatory oversight that other corporations do not require, which imposes a regulatory burden on financial institutions
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B. lower price risk and superior liquidity attributes for financial claims to household savers.
C. higher average transaction costs
D. All of the listed options are correct.

AACSB: Analytic
Bloom's: Knowledge
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

17.

Which of the following statements is true?

A. In a world without financial intermediaries the level of fund flows between household savers and the corporate sector is likely to be as high as it is with financial intermediaries.
B. In a world without financial intermediaries funds would directly flow from surplus units to deficit units.
C. In a world without financial intermediaries lenders (households) would need to monitor the actions of the firms to which they have lent their funds.
D. In a world without financial intermediaries funds would directly flow from surplus units to deficit units and lenders (households) would need to monitor the actions of the firms to which they have lent their funds.

AACSB: Analytic
Bloom's: Application
Difficulty: Hard
Est time: 3–5
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

18.

The following are protective mechanisms that have been developed by regulators to promote the safety and soundness of the banking system except:

A. encouraging banks to rely more on deposits rather than debt or capital as a cushion against failure
B. encouraging banks to limit lending to a single customer to no more than 10 per cent of capital
C. the provision of deposit insurance
D. the periodic monitoring of banks

AACSB: Analytic
Bloom's: Application
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.3 Discover why FIs' very specialness results in increased regulation and regulatory oversight that other corporations do not require, which imposes a regulatory burden on financial institutions
Learning Objective: 1.4 Gain knowledge of how regulation can and does affect the efficiency with which FIs produce financial services

19.

Which of the following statements is true?

A. Household savers are likely to be attracted to direct investments in corporate securities because of lower monitoring costs compared to using financial intermediaries.
B. Household savers are likely to be attracted to direct investments in corporate securities because of lower liquidity costs compared to using financial intermediaries.
C. Household savers are likely to be attracted to direct investments in corporate securities because of lower price risk compared to using financial intermediaries.
D. None of the listed options are correct.

AACSB: Analytic
Bloom's: Application
Difficulty: Hard
Est time: 3–5
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

20.

Which of the following statements is true?

A. Agency costs arise whenever economic agents enter into a contract in a world of incomplete information.
B. Monitoring costs are part of overall agency costs.
C. The more difficult and costly it is to collect information, the more likely it is that contracts will be broken.
D. Agency costs arise whenever economic agents enter into a contract in a world of incomplete information, monitoring costs are part of overall agency costs and the more difficult and costly it is to collect information, the more likely it is that contracts will be broken.

AACSB: Analytic
Bloom's: Application
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

21.

Which of the following statements is true?

A. Loan contracts are bank debt contracts that generally have longer term to maturity than bond contracts.
B. The longer term nature of loans allows the financial intermediary to exercise more monitoring power and control over the borrower.
C. When bank loan contracts are sufficiently long term, the banker almost becomes like an insider to the firm.
D. None of the listed options are correct.

AACSB: Analytic
Bloom's: Application
Difficulty: Hard
Est time: 1–3
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

22.

Which of the following statements is true in the context of diversification?

A. As long as the return on different investments is not perfectly positively correlated, financial intermediaries can diversify away significant amounts of portfolio risk.
B. As long as the return on different investments is not perfectly negatively correlated, financial intermediaries can diversify away significant amounts of portfolio risk.
C. As long as the return on different investments is perfectly positively correlated, financial intermediaries can diversify away significant amounts of portfolio risk.
D. None of the listed options are correct.

AACSB: Analytic
Bloom's: Application
Difficulty: Hard
Est time: 3–5
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

23.

Which of the following statements is true?

A. Secondary claims often have inferior liquidity attributes compared to primary securities.
B. Secondary claims often have superior liquidity attributes compared to primary securities.
C. Secondary claims and primary claims often have the same liquidity attributes.
D. There is no general relationship between the liquidity attributes of primary and secondary claims.

AACSB: Analytic
Bloom's: Application
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

24.

Why do households prefer to use FIs as intermediaries to invest their surplus funds?

A. Transaction costs are low to the household since FIs are more efficient in monitoring and gathering investment information.
B. To receive the benefits of diversification that households may not be able to achieve on their own.
C. The FI can benefit from combining funds and negotiating lower asset prices and transaction costs
<u>D.</u> All of the listed options are correct.

AACSB: Analytic
Bloom's: Application
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.1 Understand why financial institutions (FIs) are different from commercial firms
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

25.

Which of the following statements is true?

A. The more diversified a financial intermediary, the higher the probability that it will default on its obligations and the more risky and illiquid the claims.
<u>B.</u> The less diversified a financial intermediary, the higher the probability that it will default on its obligations and the more risky and illiquid the claims.
C. The more diversified a financial intermediary, the lower the probability that it will default on its obligations and the more risky but also the more liquid the claims.
D. The more diversified a financial intermediary, the higher the probability that it will default on its obligations and the more risky but also the more liquid the claims.

AACSB: Analytic
Bloom's: Application
Difficulty: Hard
Est time: 3–5
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

26.

Negative externalities exist in the depository sector when:

A. the fear of DI insolvency leads to bank deposit runs
B. lending activity is impaired or constrained
C. there are delays in disbursements from insolvent DIs
<u>D.</u> All of the listed options are correct.

AACSB: Analytic
Bloom's: Application
Difficulty: Easy
Est time: <1
Learning Objective: 1.3 Discover why FIs' very specialness results in increased regulation and regulatory oversight that other corporations do not require, which imposes a regulatory burden on financial institutions
Learning Objective: 1.4 Gain knowledge of how regulation can and does affect the efficiency with which FIs produce financial services

27.

Which of the following is an adequate definition of broad money?

A. Currency plus bank current deposits of the private non-bank sector
B.

'M1' plus borrowings from the private sector by non-bank financial institutions less the latter's holdings of currency and bank deposits

C.

'M3' plus non-deposit borrowings from the private sector by all financial intermediaries (AFIs), less the holdings of currency and bank deposits by RFCs and cash management trusts

D. None of the listed options are correct.

AACSB: Analytic
Bloom's: Knowledge
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.3 Discover why FIs' very specialness results in increased regulation and regulatory oversight that other corporations do not require, which imposes a regulatory burden on financial institutions

28.

What does APCA and APRA stand for?

A. Australian Payments Clearing Association; Australian Prudential Regulatory Association
B. Australian Payments and Cheques Association; Australian Payments and Regulatory Authority
C. Australian Payments Cheques Association; Australian Prudential Regulatory Association
D. Australian Payments Clearing Association; Australian Prudential Regulatory Authority

AACSB: Analytic
Bloom's: Knowledge
Difficulty: Easy
Est time: 1–3
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

29.

Which of the following are areas of institution-specific specialness?

A. money supply transmission
B. payment services
C. intergenerational transfers
D. All of the listed options are correct.

AACSB: Analytic
Bloom's: Knowledge
Difficulty: Easy
Est time: <1
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

30.

Which of the following are types of regulation that seek to enhance the net social welfare benefits of financial intermediaries' services?

A. exit regulation
B. issuer protection regulation
C. credit allocation regulation
D. All of the listed options are correct.

AACSB: Analytic
Bloom's: Knowledge
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

31.

Which of the following statements is true?

A.

Bank failures may destroy household savings and restrict a firm's access to credit.

B.

Bank failures may create doubts in savers' minds regarding the stability and solvency of financial intermediaries in general.

C. Bank failures may threaten the stability of the financial system.
D. All of the listed options are correct.

AACSB: Analytic
Bloom's: Application
Difficulty: Easy
Est time: 1–3
Learning Objective: 1.3 Discover why FIs' very specialness results in increased regulation and regulatory oversight that other corporations do not require, which imposes a regulatory burden on financial institutions
Learning Objective: 1.4 Gain knowledge of how regulation can and does affect the efficiency with which FIs produce financial services

32.

Which of the following statements is true?

A.

Bank loans that represent more than 5 per cent of a banking group's capital must be reported quarterly to APRA.

B.

Bank loans that represent more than 10 per cent of a banking group's capital must be reported quarterly to APRA.

C.

Bank loans that represent more than 5 per cent of a banking group's liabilities must be reported quarterly to APRA.

D.

Bank loans that represent more than 10 per cent of a banking group's liabilities must be reported quarterly to APRA.

AACSB: Analytic
Bloom's: Application
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.3 Discover why FIs' very specialness results in increased regulation and regulatory oversight that other corporations do not require, which imposes a regulatory burden on financial institutions
Learning Objective: 1.4 Gain knowledge of how regulation can and does affect the efficiency with which FIs produce financial services

33.

Net regulatory burden for FIs is higher because regulators may require the FI to:

A. hold more capital than what would be held without regulation
B. produce less information than would be produced without regulation
C. hold more debt than what would be held without regulation
D. hold fewer reserves than they would without regulation

AACSB: Analytic
Bloom's: Application
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.3 Discover why FIs' very specialness results in increased regulation and regulatory oversight that other corporations do not require, which imposes a regulatory burden on financial institutions
Learning Objective: 1.4 Gain knowledge of how regulation can and does affect the efficiency with which FIs produce financial services

34.

Which of the following statements is true?

A.

FI losses are borne by equity holders last; hence they are junior claimants to an FI's assets.

B.

FI losses are borne by equity holders last; hence they are senior claimants to an FI's assets.

C.

FI losses are borne by equity holders first; hence they are junior claimants to an FI's assets.

D.

FI losses are borne by equity holders first; hence they are senior claimants to an FI's assets.

AACSB: Analytic
Bloom's: Application
Difficulty: Hard
Est time: 3–5
Learning Objective: 1.3 Discover why FIs' very specialness results in increased regulation and regulatory oversight that other corporations do not require, which imposes a regulatory burden on financial institutions
Learning Objective: 1.4 Gain knowledge of how regulation can and does affect the efficiency with which FIs produce financial services

35.

Which of the following statements is true?

A.

The lower the net regulatory burden on FIs, the more inefficiently they produce any given set of financial services from a private (FI) owner's perspective.

B.

The higher the net regulatory burden on FIs, the more inefficiently they produce any given set of financial services from a private (FI) owner's perspective.

C.

The higher the net regulatory burden on FIs, the less inefficiently they produce any given set of financial services from a private (FI) owner's perspective.

D. None of the listed options are correct.

AACSB: Analytic
Bloom's: Application
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.3 Discover why FIs' very specialness results in increased regulation and regulatory oversight that other corporations do not require, which imposes a regulatory burden on financial institutions
Learning Objective: 1.4 Gain knowledge of how regulation can and does affect the efficiency with which FIs produce financial services

36.

Which of the following statements is true?

A. The RBA controls outside money, while inside money is determined by the private banking system.
B. The RBA controls inside money, while outside money is determined by the private banking system.
C. The RBA controls both inside and outside money.
D. The private banking system controls both inside and outside money.

AACSB: Analytic
Bloom's: Application
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.3 Discover why FIs' very specialness results in increased regulation and regulatory oversight that other corporations do not require, which imposes a regulatory burden on financial institutions
Learning Objective: 1.4 Gain knowledge of how regulation can and does affect the efficiency with which FIs produce financial services

37.

Safety and soundness regulations include all of the following layers of protection except:

A. the provision of guaranty funds
B. requirements encouraging diversification of assets
C. the creation of money for those FIs in financial trouble
D. requiring minimum levels of capital

AACSB: Analytic
Bloom's: Application
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.1 Understand why financial institutions (FIs) are different from commercial firms
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

38.

The following are protective mechanisms that have been developed by regulators to promote the safety and soundness of the banking system except:

A. encouraging banks to rely more on deposits rather than debt or capital as a cushion against failure
B. encouraging banks to limit lending to a single customer to no more than 10 per cent of capital
C. the provision of deposit insurance
D. the periodic monitoring of banks

AACSB: Analytic
Bloom's: Application
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.3 Discover why FIs' very specialness results in increased regulation and regulatory oversight that other corporations do not require, which imposes a regulatory burden on financial institutions
Learning Objective: 1.4 Gain knowledge of how regulation can and does affect the efficiency with which FIs produce financial services

39.

Which of the following statements is false?

A. A financial intermediary specialises in the production of information.
B. A financial intermediary reduces its risk exposure by pooling its assets.
C. A financial intermediary benefits society by providing a mechanism for payments.
D. A financial intermediary acts as a lender of last resort.

AACSB: Analytic
Bloom's: Application
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

40.

Which function of an FI reduces transaction and information costs between a corporation and an individual and may encourage a higher rate of savings?

A. brokerage services
B. asset transformation services
C. information production services
D. money supply management

AACSB: Analytic
Bloom's: Application
Difficulty: Easy
Est time: 1–3
Learning Objective: 1.1 Understand why financial institutions (FIs) are different from commercial firms
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

41.

In its role as a delegated monitor, an FI:

A. keeps track of required interest and principal payments on loans it originates
B. works with financially distressed borrowers in danger of defaulting on their loans
C. holds portfolios of loans that they continue to service
D. All of the listed options are correct.

AACSB: Analytic
Bloom's: Application
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.1 Understand why financial institutions (FIs) are different from commercial firms

42.

Which of the following is not a major function of financial intermediaries?

A. brokerage services
B. asset transformation services
C. information production
D.

management of the nation's money supply

AACSB: Analytic
Bloom's: Application
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.1 Understand why financial institutions (FIs) are different from commercial firms

43.

Advantages of depositing funds into a typical bank account instead of directly buying corporate securities include all of the following except:

A. monitoring done by the bank on your behalf
B. increased liquidity if funds are needed quickly
C. increased transactions costs
D. less price risk when funds are needed

AACSB: Analytic
Bloom's: Application
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.1 Understand why financial institutions (FIs) are different from commercial firms

44.

Many households place funds with financial institutions because many FI accounts provide:

A. lower denominations than other securities
B. flexible maturities versus other interest-earning securities
C. better liquidity than directly negotiated debt contracts
D. All of the listed options are correct.

AACSB: Analytic
Bloom's: Application
Difficulty: Easy
Est time: 1–3
Learning Objective: 1.1 Understand why financial institutions (FIs) are different from commercial firms
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

45.

The reason FIs can offer highly liquid, low price-risk contracts to savers while investing in relatively illiquid and higher risk assets is:

A. because diversification allows an FI to predict more accurately the expected returns on its asset portfolio
B. significant amounts of portfolio risk are diversified away by investing in assets that have correlations between returns that are less than perfectly positive
C. because individual savers cannot benefit from risk diversification
D. All of the listed options are correct.

AACSB: Analytic
Bloom's: Application
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.1 Understand why financial institutions (FIs) are different from commercial firms
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

46.

The asset transformation function of FIs typically involves:

A. receipt of securities through electronic payments systems
B.

altering the liquidity and maturity features of funds sources used to finance the FI's asset portfolio

C. granting loans to transform funds deficit units into funds surplus units
D. investing short-term funds in off-balance-sheet activities

AACSB: Analytic
Bloom's: Application
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.1 Understand why financial institutions (FIs) are different from commercial firms
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

47.

Which of the following refers to the possibility that a firm's owners or managers will take actions contrary to the promises contained in the covenants of the securities the firm issues to raise funds?

A. liquidity risk
B. price risk
C. credit risk
D. agency costs

AACSB: Analytic
Bloom's: Knowledge
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.1 Understand why financial institutions (FIs) are different from commercial firms
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

48.

Which of the following refers to the term 'maturity intermediation'?

A. creation of a secondary market mature enough to withstand volatility
B. overcoming constraints to buying assets imposed by large minimum denomination size
C. mismatching the maturities of assets and liabilities
D. reducing information costs or imperfections between households and corporations

AACSB: Analytic
Bloom's: Knowledge
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

49.

Depository institutions (DIs) play an important role in the transmission of monetary policy from the central bank (RBA) to the rest of the economy primarily because:

A. loans to corporations are part of the money supply
B. bank loans are highly regulated
C. depository institutions provide a large amount of credit to finance residential real estate
D. DI deposits are a major portion of the money supply

AACSB: Analytic
Bloom's: Application
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

50.

Why is the failure of a large bank more detrimental to the economy than the failure of a large steel manufacturer?

A. The bank failure usually leads to a government bailout.
B. There are fewer steel manufacturers than there are banks.
C. The large bank failure reduces credit availability throughout the economy.
D.

Since the steel company's assets are tangible, they are more easily reallocated than the intangible bank assets.

AACSB: Analytic
Bloom's: Application
Difficulty: Medium
Est time: 1–3
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

51.

Which of the following statements is true regarding the percentage share of assets of financial institutions in Australia as of end June 2013?

A. The largest percentage of assets is held by money market corporations.
B. The largest percentage of assets is held by credit unions.
C. The largest percentage of assets is held by permanent building societies.
D. The largest percentage of assets is held by banks.

AACSB: Analytic
Bloom's: Application
Difficulty: Easy
Est time: 1–3
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services
Learning Objective: 1.3 Discover why FIs' very specialness results in increased regulation and regulatory oversight that other corporations do not require, which imposes a regulatory burden on financial institutions

52.

Agency costs are costs relating to the risk that the owners and managers of firms that receive savers' funds will take action with those funds contrary to the best interests of the saver.

TRUE

AACSB: Analytic
Bloom's: Knowledge
Difficulty: Medium
Est time: <1
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

53.

Due to the costs of monitoring, liquidity and price risk savers often prefer to hold the financial claims issued by FIs rather than those issued by corporations.

TRUE

AACSB: Analytic
Bloom's: Application
Difficulty: Medium
Est time: <1
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

54.

In the principal-agent relationship between savers and a borrowing firm the savers are the agents and the borrowing firm is the principal.

FALSE

AACSB: Analytic
Bloom's: Application
Difficulty: Medium
Est time: <1
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

55.

By acting as a delegated monitor, financial intermediaries reduce the degree of information imperfection and asymmetry between the ultimate suppliers and users of funds.

TRUE

AACSB: Analytic
Bloom's: Application
Difficulty: Medium
Est time: <1
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

56.

FIs are better able to manage the risk of mismatching maturities of assets and liabilities than household savers.

TRUE

AACSB: Analytic
Bloom's: Application
Difficulty: Easy
Est time: <1
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

57.

FIs play a significant role in the transmission of monetary policy.

TRUE

AACSB: Analytic
Bloom's: Application
Difficulty: Easy
Est time: <1
Learning Objective: 1.3 Discover why FIs' very specialness results in increased regulation and regulatory oversight that other corporations do not require, which imposes a regulatory burden on financial institutions

58.

An example of negative externality is the costs faced by small businesses in a one-bank town if the local bank fails.

TRUE

AACSB: Analytic
Bloom's: Application
Difficulty: Medium
Est time: <1
Learning Objective: 1.3 Discover why FIs' very specialness results in increased regulation and regulatory oversight that other corporations do not require, which imposes a regulatory burden on financial institutions
Learning Objective: 1.4 Gain knowledge of how regulation can and does affect the efficiency with which FIs produce financial services

59.

In most countries regulators require financial intermediaries to hold a minimum level of cash reserves against their deposits. There is no such regulation in Australia.

TRUE

AACSB: Analytic
Bloom's: Application
Difficulty: Medium
Est time: <1
Learning Objective: 1.3 Discover why FIs' very specialness results in increased regulation and regulatory oversight that other corporations do not require, which imposes a regulatory burden on financial institutions
Learning Objective: 1.4 Gain knowledge of how regulation can and does affect the efficiency with which FIs produce financial services

60.

The risk that the sale price of an asset will be less than the purchase price of an asset is called liquidity risk

FALSE

AACSB: Analytic
Bloom's: Knowledge
Difficulty: Medium
Est time: <1
Learning Objective: 1.1 Understand why financial institutions (FIs) are different from commercial firms
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

61.

In an attempt to enhance the net social welfare benefits of the services provided by financial intermediaries, safety and soundness regulation requires a DI to hold a minimum level of cash reserves against deposits.

FALSE

AACSB: Analytic
Bloom's: Application
Difficulty: Hard
Est time: <1
Learning Objective: 1.3 Discover why FIs' very specialness results in increased regulation and regulatory oversight that other corporations do not require, which imposes a regulatory burden on financial institutions
Learning Objective: 1.4 Gain knowledge of how regulation can and does affect the efficiency with which FIs produce financial services

62.

Because the average maturity of assets and the average maturity of liabilities are often different on an FI's balance sheet, the FI is exposed to liquidity risk

FALSE

AACSB: Analytic
Bloom's: Application
Difficulty: Medium
Est time: <1
Learning Objective: 1.1 Understand why financial institutions (FIs) are different from commercial firms
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

63.

None of the commercial banks in Australia defaulted during the global financial crisis.

TRUE

AACSB: Analytic
Bloom's: Application
Difficulty: Easy
Est time: <1
Learning Objective: 1.6 Comprehend the causes of the sub-prime crisis in the US and how this led to the global financial crisis

64.

None of the commercial banks in the US defaulted during the global financial crisis.

FALSE

AACSB: Analytic
Bloom's: Application
Difficulty: Easy
Est time: <1
Learning Objective: 1.6 Comprehend the causes of the sub-prime crisis in the US and how this led to the global financial crisis

65.

Lehman Brothers defaulted during the global financial crisis.

TRUE

AACSB: Analytic
Bloom's: Application
Difficulty: Easy
Est time: <1
Learning Objective: 1.6 Comprehend the causes of the sub-prime crisis in the US and how this led to the global financial crisis

66. Why are financial institutions special? Give three concrete examples.

Financial institutions are considered special because of the special functions they provide, such as asset transformation, provision of liquidity services and transformation of monetary policy. Examples of financial institutions specialness include the following. First, commercial banks and other depository institutions are key players for the transmission of monetary policy from the central bank to the rest of the economy. Second, specific FIs often are identified as the major source of finance for certain sectors of the economy. For example, savings institutions traditionally serve the credit needs of the residential real estate market. Third, life insurance and superannuation funds provide savers with the ability to transfer wealth from one generation to the next.

AACSB: Reflective thinking
Bloom's: Application
Difficulty: Medium
Est time: 5–10
Learning Objective: 1.1 Understand why financial institutions (FIs) are different from commercial firms
Learning Objective: 1.2 Learn how financial institutions—especially banks—provide a special set of services to households and firms, and the uniqueness of these services

67. What are the entry costs for the financial intermediation sector in Australia? Would you consider entry to be easy or difficult? Explain.

Increasing or decreasing the cost of entry into a financial sector affects the profitability of firms already competing in that industry. Thus, the industries are heavily protected against new entrants by high direct and indirect entry costs Direct costs include the actual physical and financial costs of establishing a business. In the case of FIs, the financial costs include raising the necessary minimum capital to receive a charter. Indirect costs of entry include restricting the number of individuals who can establish FIs.

In Australia, only locally incorporated banks and foreign bank subsidiaries, branches or representative offices can gain authorities to operate in Australia under the Banking Act 1959 (amended in 1997), and APRA requires all institutions that have been authorised to comply with its prudential requirements.

AACSB: Analytic
Bloom's: Analysis
Difficulty: Hard
Est time: 5–10
Learning Objective: 1.4 Gain knowledge of how regulation can and does affect the efficiency with which FIs produce financial services

68. Explain the causes of the global financial crisis (GFC) and outline how and why the Australian government implemented the financial claims scheme.

The main cause of the global financial crisis (GFC) was the sub-prime crisis in the US in the late 2000s, during which we witnessed the failure of many US FIs. Afterwards, the financial crisis in the US became a global crisis of confidence. The result was a worldwide breakdown in credit markets, as well as an enhanced level of equity market volatility and a critical crisis of confidence that disrupted global financial markets from 2007 to 2012 and possibly beyond. At the time of writing, confidence in the global financial markets continues to decline with the sovereign debt crisis in Europe.

Individual FI failures may create doubts in savers' minds regarding the stability and solvency of FIs in general, and cause panics and even runs on sound institutions. Indeed, this possibility provided the reasoning in 2008 for the introduction of the Australian government's deposit guarantee schemes—the financial claims scheme (FCS) and the guarantee scheme for large deposits (Guarantee Scheme). The FCS initially guaranteed deposits up to $1 million, although this was reduced to $250 000 on 1 February 2012. The Guarantee Scheme was temporary only and was closed in March 2010. At the time, the government was more concerned about the possibility of contagious runs rather than bank failures. Its objective was to instil confidence in the Australian banking system, both locally and globally, at a time of global uncertainty. This was a radical move and was the first time the government had provided explicit guarantees of all Australian deposits up to $1 million.

AACSB: Reflective thinking
Bloom's: Analysis
Difficulty: Hard
Est time: 10–20
Learning Objective: 1.3 Discover why FIs' very specialness results in increased regulation and regulatory oversight that other corporations do not require, which imposes a regulatory burden on financial institutions
Learning Objective: 1.6 Comprehend the causes of the sub-prime crisis in the US and how this led to the global financial crisis

Chapter 01 Testbank Summary

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Bloom's: Application	45
Bloom's: Knowledge	21
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Difficulty: Hard	12
Difficulty: Medium	41
Est time: 1–3	41
Est time: 10–20	1
Est time: 3–5	5
Est time: 5–10	2
Est time: <1	19
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Learning Objective: 1.4 Gain knowledge of how regulation can and does affect the efficiency with which FIs produce financial services	16
Learning Objective: 1.5 Understand how the failure of FIs to perform the specialist functions of risk measurement and management can lead to systemic risk in the domestic and global financial systems	3
Learning Objective: 1.6 Comprehend the causes of the sub-prime crisis in the US and how this led to the global financial crisis	4