# Chapter 1 - Test Bank

### Multiple-choice questions

[Go to ⇨ Multiple choice questions - Memorandum](#AC1MCQ)

*Answer the following questions by selecting the appropriate answer from the list below.*

**Which ONE of the following role players within the financial system determines the probability of an issuer of securities meeting their financial obligations by analysing relevant financial and economic data pertaining to the issuer?**

1. Brokers and dealers
2. Financial exchanges
3. Credit rating agencies
4. Financial regulators

**Which of the following can be classified as contractual intermediaries?**

1. Hedge funds
2. Private sector banks
3. Short-term insurers
4. Retirement funds
5. (i) and (ii) only
6. (iii) and (iv) only
7. and (iii) only
8. (i), (iii) and (iv) only

**Which of the following markets are considered to be over-the-counter markets in South Africa?**

1. The money market
2. The foreign exchange market
3. The equity market
4. The bond market
5. (i) and (ii) only
6. (iii) and (iv) only
7. (ii) and (iii) only
8. (i), (iii) and (iv) only

#### 

**Monetary policy is played out mainly in which ONE of the following markets?**

1. The equity market
2. The bond market
3. The money market
4. The foreign exchange market

**Which ONE of the following statements with regard to the financial markets is correct?**

1. The equity market is also referred to as the fixed-income market.
2. The share market and the money market together form the capital market.
3. The retail foreign exchange market is as large as the wholesale foreign exchange market.
4. The bond market is the market for marketable long-term debt instruments.

**In the event of liquidation a company’s obligations will be served in the following order:**

1. Bondholders will be paid first, then ordinary shareholders; preference shareholders will be paid last.
2. Preference shareholders will be paid first, then ordinary-shareholders; bondholders will be paid last.
3. Bondholders will be paid first then preference shareholders; ordinary shareholders will be paid last.
4. Preference shareholders will be paid first then bondholders; ordinary shareholders will be paid last.

**Settlement of bonds takes place on which of the following conventions?**

1. T+1
2. T+2
3. T+3
4. T+5

**Which ONE of the following rates is the reference rate for all other rates in the South African financial system?**

1. Prime lending rate
2. Call deposit rate
3. Interbank loan rate
4. Central bank repo rate

**Which of the following statements with regard to the financial system are correct? The financial system:**

1. channels savings into investment through time and across industries
2. assists investment decisions by providing information to the public
3. allows households to participate in investments that require large sums of money
4. ensures that funds are allocated to borrowers that will utilise the funds prudently
5. (ii) and (iv) only
6. (i), (ii) and (iii) only
7. (i), (iii) and (iv) only
8. (i), (ii), (iii) and (iv)

**Which ONE of the following systems is used to transfer large (> R5 million) amounts of funds between banks in South Africa?**

1. Bankservafrica
2. SACSS
3. SAMOS
4. Intraclear

### Written questions

[Go to ⇨ Written questions - Memorandum](#_Written_questions)

*Answer the following questions.*

**List and define the allied participant/players/entities within the financial system.**

**Name the four broad sectors of the economy that participate as both ultimate borrowers and ultimate lenders within the financial system.**

**Why do financial intermediaries exist within the financial system?**

**Differentiate between non-marketable and marketable financial instruments.**

**Describe the essence of monetary policy.**

**Differentiate between the primary and the secondary bond market.**

#### 

**Name the two components of money held by the local non-bank private sector (NBPS).**

**Provide an example of how the risk of the ultimate lenders is managed by financial intermediaries.**

**Name the two legs of financial stability.**

**Describe the factors that led to the 2007/2008 international financial crisis.**

### True or false questions

[Go to ⇨ True/False questions - Memorandum](#AC1TFQ)

*Read the statements below and indicate whether they are true or false.*

**Exchange-traded funds (EFTs) are classified as a contractual intermediary.**

**The money market is the market for the issue and trading of securities with maturities of less than one year.**

#### 

**The prime lending rate directly influences the interbank lending rate, the call deposit and other deposit rates.**

**Transfer of funds between banks take place over their reserve accounts held with the central bank.**

**Inflation of 2 to 3 per cent per annum is tolerable as this level of inflation has no material impact on the decision-making process of economic units.**

### Choose the correct term

[Go to ⇨Choose the correct term - Memorandum](#AC1CTC)

*Select the correct term to make the statement accurate.*

**Once issued, financial instruments can be traded in the primary/secondary market.**

**The outstanding amount of ordinary shares makes up the permanent/long-term capital of a company.**

**Almost all currencies are referenced against the USD, and generally in an exchange rate the USD is the base/variable currency.**

**In an economy it is argued that an increase in real gross domestic product cannot take place without an increase/decrease in the money supply.**

**When interest rates are plotted over a period of time this is called a yield curve/time series.**

# Chapter 1 - Memorandum

### Multiple-choice questions

[Go back to ⇦ Multiple choice questions](#NEWC1MCQ)

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### Written questions

[Go back to ⇦ Written questions](#C1WQ)

*Answer the following questions.*

**List and define the allied participant/players/entities within the financial system.**

* **Brokers and dealers: Brokers and dealers are members of exchanges and/or financial intermediaries that facilitate the trade in financial instruments.**
* **Fund managers (portfolio managers): Fund managers are corporate entities or departments of financial intermediaries that manage funds on behalf of principals.**
* **Financial exchanges: Exchanges allow the broker-dealers to facilitate trading in securities, and to create the mechanism for the clearing and settlement of trades in a risk-minimising manner.**
* **Credit rating agencies: Credit rating agencies analyse relevant financial and economic data pertaining to the issuers of securities, and assign ratings to the securities reflecting the probability of the issuers meeting their financial obligations.**
* **Financial regulators: Financial regulators regulate and supervise all players within the financial system.**

**Name the four broad sectors of the economy that participate as both ultimate borrowers and ultimate lenders within the financial system.**

* **Household sector**
* **Corporate (business) sector**
* **Government sector**
* **Foreign sector**

**Why do financial intermediaries exist within the financial system?**

**Financial intermediaries exist as there is a conflict between lenders and borrowers in terms of their financial requirements such as term, risk and volume.**

**Differentiate between non-marketable and marketable financial instruments.**

**Non-marketable financial instruments are not tradable, for example personal loans, whereas marketable financial instruments are tradable in the secondary market, for example commercial paper (CP).**

**Describe the essence of monetary policy.**

**The essence of monetary policy is that the central bank undertakes transactions in the money market in the form of open-market operations in order to establish a certain desired “liquidity shortage” within that market. This is a managed level of “borrowed reserves”. These borrowed reserves are provided at the central bank’s accommodation rate, the repo rate.**

**Differentiate between the primary and the secondary bond market.**

**The primary bond market is for the issue of long-term wholesale marketable securities whereas the secondary bond market is for the trading of long-term wholesale marketable securities.**

#### 

**Name the two components of money held by the local non-bank private sector (NBPS).**

* **Central bank notes and coins**
* **Bank deposits**

**Provide an example of how the risk of the ultimate lenders is managed by financial intermediaries.**

**Banks make a wide variety of loans to government, companies and individuals. The depositor of a bank is essentially invested in this well-diversified asset portfolio and thus the risk of the ultimate lender is reduced.**

**Name the two legs of financial stability.**

* **Price stability**
* **Stable conditions in the financial system**

**Describe the factors that led to the 2007/2008 international financial crisis.**

* **Interest rates in the US were kept too low for too long, which encouraged excessive bank borrowing and spending especially by sub-prime borrowers.**
* **The banks placed much of the mortgage business in collateralised debt obligations (CDOs) by creating special purpose vehicles (SPVs). These structures were rated by the rating agencies based on the default probabilities of prime borrowers thus not accurately reflecting the risk of the investments.**
* **The AAA-rated tranches of the SPVs were sold to local and foreign investors while the BBB and unrated tranches were held mainly by the financial intermediaries (banks). When interest rates increased, the sub-prime borrowers defaulted on their debt and the SPVs were not able to service the interest payments on the CDOs issued. The default experience was so severe that defaulting on the AAA-rated tranches also took place apart from the unrated and the BBB-rated tranches, thus spreading the crisis to the rest of the world.**

### True or false questions

[Go back to ⇦ True/False questions](#C1TFQ)

*Read the statements below and indicate whether they are true or false.*

**Exchange-traded funds (EFTs) are classified as a contractual intermediary.**

**False – Exchange-traded funds (EFTs) are classified as a collective investment scheme (CIS).**

**The money market is the market for the issue and trading of securities with maturities of less than one year.**

**True**

#### 

**The prime lending rate directly influences the interbank lending rate, the call deposit and other deposit rates.**

**False – The *repo rate* directly influences the prime lending rate, the interbank lending rate, the call deposit rates and the banks’ lending and deposit rates.**

**Transfer of funds between banks take place over their reserve accounts held with the central bank.**

**False – Transfer of funds between banks take place over their *settlement accounts* held with the central bank.**

**Inflation of 2 to 3 per cent per annum is tolerable as this level of inflation has no material impact on the decision-making process of economic units.**

**True**

### Choose the correct term

[Go back to ⇦ Choose the correct term](#C1CTCT)

*Select the correct term to make the statement accurate.*

**Once issued, financial instruments can be traded in the primary/secondary market.**

**Secondary**

**The outstanding amount of ordinary shares makes up the permanent/long-term capital of a company.**

**Permanent**

**Almost all currencies are referenced against the USD, and generally in an exchange rate the USD is the base/variable currency.**

**Base**

**In an economy it is argued that an increase in real gross domestic product cannot take place without an increase/decrease in the money supply.**

**Increase**

**When interest rates are plotted over a period of time this is called a yield curve/time series.**

**Time series**