# Chapter 3 - Test Bank

###  Multiple-choice questions

[Go to ⇨ Multiple choice questions - Memorandum](#AC3MCQ)

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

**Which of the following are regarded as part of the M1 money supply in South Africa?**

1. Public-sector notice deposits
2. Current accounts held by government
3. Private-sector cheque accounts
4. Banknotes and coins held by the public
5. (i) and (ii) only
6. (iii) and (iv) only
7. (i), (ii) and (iii) only
8. (i), (iii) and (iv) only

**Assume the central bank transfers a net amount of R200 000 to one of the local banks. How much additional money can be potentially injected into the financial system if the current cash reserve requirement is 25 per cent?**

1. R250 000
2. R400 000
3. R600 000
4. R800 000

**Which of the following actions are likely to cause a decline in demand deposits held with banks?**

1. The central bank raises the statutory reserve requirement.
2. The central bank sells securities via open-market operations.
3. The central bank lowers the statutory reserve requirement.
4. The central bank buys securities via open-market-operations.
5. (i) and (ii) only
6. (iii) and (iv) only
7. (i), (ii) and (iii) only
8. (i), (iii) and (iv) only

**Which ONE of the following is an example of market liquidity risk faced by banks?**

1. Depositors withdrawing large sums of funds at the same time
2. A borrower unable to service the debt owed to the bank
3. The central bank unwilling to extend additional funds to the bank
4. When an asset is traded into cash the bank experiences the loss of value

**Funding liquidity risklies at the heart of banking because**

1. Banks borrow long and lend short
2. Banks borrow short and lend long
3. Depositors want to withdraw their deposits from time to time
4. A bank typically does not have enough cash and other liquid assets to repay all depositors
5. Some customers attempt to defraud the bank
6. (i) and (iv) only
7. (ii) and (iv) only
8. (ii) , (iii) and (iv) only
9. (v) only

**Which of the following form part of the net non-interest income of a bank?**

1. Service levies charged on current accounts
2. Capital losses from investing activities
3. Investment fund management fees received
4. Fixed-term funds deposited with the bank
5. (i) and (ii) only
6. (iii) and (iv) only
7. (i), (ii) and (iii) only
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**Which ONE of the following pieces of legislation incorporates minimum capital requirements for clearing (commercial) banks?**

1. The South African Reserve Bank Act
2. The National Payment System of South Africa Act
3. The Financial Advisory and Intermediary Services Act
4. The Banks Act

**A bank is in the business of risk taking. Some of the risks it takes are the following:**

1. Risk of default; certain borrowers will be unable to service the debt owed to the bank
2. Market liquidity risk or liquidity risk in trading; the risk that the bank will be unable to turn an asset into cash without the loss of value
3. Funding liquidity risk; the risk that funders will stop providing liquidity
4. The risk that in borrowing short and lending long, the bank will have to drain out its liquidity to repay its depositors
5. (i) and (ii) only
6. (i), (ii) and (iv) only
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**Which of the following are characteristics of the current banking landscape in South Africa?**

1. Market share is spread almost equally among all registered banks.
2. The ratio of loans and advances to GDP in South Africa is less than 25%.
3. The foreign shareholding in local banks has been increasing substantially in recent years.
4. South Africa’s major banks have been increasingly establishing banking operations globally.
5. (i) and (iii) only
6. (ii) and (iv) only
7. (i), (iii) and (iv) only
8. (ii), (iii) and (iv) only

**The concepts of transformation and financial inclusion in the South African banking sector have been implemented as a consequence of**

1. Financial Sector Charter
2. Basel III report
3. “Twin peaks” model
4. Treating customers fairly initiative

###  Written questions

[Go to ⇨ Written questions - Memorandum](#AC3WQ)

*Answer the following questions.*

**Differentiate between money and currency.**

**List the factors that play a role in determining the size of additional demand deposits being created with clearing banks and the manner in which these factors affect the size of demand deposit.**

**Describe the functions that a bank performs in order to earn non-interest income.**

####

**What will be the effect on the reserves of bank B if John, a client of bank B, makes an electronic transfer to his son, also a client of bank B?**

**Explain why banks experience a mismatch between assets and liabilities.**

####

**Define systemic risk within the context of the financial system.**

**Differentiate between the liquid asset requirement and the cash reserve requirement.**

**Which Act requires that banks obtain and retain appropriate information about each client, with the primary motivation being to combat money laundering and financial terrorism?**

**List the measures by which the significance of banks within the economy can be measured.**

**Discuss the consequences of the 2007/08 sub-prime crisis on banking regulation globally.**

###  True or false questions

[Go to ⇨ True/False questions - Memorandum](#AC3TFQ)

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

**The money supply (M1) includes reserves deposits held with the central bank as well as notes and coins held by the bank in their vaults in order to serve the demand requirements of the public.**

**In the banking world, the panic associated with not being able to withdraw funds from one bank, which leads to panic withdrawals at other banks, is known as a bank race and could lead to a systematic crisis.**

**The non-interest income of banks has become increasingly important as it tends to be less cyclical than interest income.**

**Demand deposits made by the public represent the assets of a commercial bank.**

####

**The Registrar of Banks is responsible for the regulation and supervision of banks under the auspices of the SARB’s Bank Supervision Department.**

###  Choose the correct term

 [Go to ⇨ Choose the correct term - Memorandum](#AC3CTCT)

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

**The percentage of current account deposits that is required to be held by banks with the central bank is referred to as the reserve ratio/credit multiplier.**

**Interbank transfers in South Africa are done via the net/gross settlement method**.

**The risk faced by banks that depositors may withdraw large amounts of funds at the same time is referred to as funding/market liquidity risk.**

**The International Monetary Fund (IMF)/Bank for International Settlements (BIS) sets international** **guidelines in respect of aspects pertaining to the financial soundness of clearing (commercial) banks.**

**Regulation focused, among other things, on improving disclosure to consumers is referred to as market conduct/prudential regulation.**

# Chapter 3 - Memorandum

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[Go back to ⇦Multiple choice questions](#C3MCQ)

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###  Written questions

[Go back to ⇦ Written questions](#C3WQ)

*Answer the following questions.*

**Differentiate between money and currency.**

**Currency is the banknotes and coins supplied within the country by the central bank, whereas money consist of all currency (banknotes and coins) and all current account deposits held by the private, non-bank sector held with monetary institutions.**

**List the factors that play a role in determining the size of additional demand deposits being created with clearing banks and the manner in which these factors affect the size of demand deposit.**

* ***The reserve ratio:* If the central bank raises the reserve ratio, this will have a restrictive effect on the money supply, since banks will have to take steps to acquire more reserves and will have to restrict lending. This is turn will reduce the amount of demand deposits. A lowering of the reserve ratio by the central bank will have the opposite effect.**
* ***Currency ratio:* Individuals keep a fraction of demand deposits in the form of coins and banknotes. If the public decides that they wish to transact more with the aid of coins and banknotes, the demand for demand deposits will decline.**
* ***Excess reserves:* Depending on their assessment of risk factors, commercial banks may wish to hold more reserves, thus the commercial banks will not extend loans to the full amount available, which will mean that the size of demand deposits will not increase.**
* ***Demand for loans:* At times the public might become more reluctant to enter into debt and this in turn will have a negative effect on the size of demand deposits as the commercial banks will have a reduced market in which to extend loans.**
* ***Central bank open-market operations:* The central bank can influence the size of demand deposits by open-market operations. If the central bank buys bonds and other securities from the private sector, demand deposits will increase whereas sales of bonds and other securities by the central bank will have a negative effect on demand deposits.**

**Describe the functions that a bank performs in order to earn non-interest income.**

* **Transaction income for payment services, such as for processing a debit order or drawing cash at an ATM, or for current account facilities and Internet banking**
* **Investment-related and trading-related activities (such as acting as the underwriter to securities issues)**
* **Financial advice**
* **The management of investment funds**

**What will be the effect on the reserves of bank B if John, a client of bank B, makes an electronic transfer to his son, also a client of bank B?**

**The reserves of bank B will be unchanged.**

**Explain why banks experience a mismatch between assets and liabilities.**

**Banks experience a mismatch between assets and liabilities as they borrow funds from individuals and firms in the form of deposits (liabilities of the bank) that need to be repaid on short notice. On the other hand, banks lend money to individuals and firms (assets of the bank) that are repayable over a longer term, i.e. the liabilities of banks are short term and liquid, whereas their assets are long term and less liquid.**

####

**Define systemic risk within the context of the financial system.**

**Systemic risk is the risk of a sudden and unexpected collapse of a significant portion of the financial sector so that economic activity in the wider economy suffers.**

**Differentiate between the liquid asset requirement and the cash reserve requirement.**

**The cash reserve requirement is the portion of depositors’ balances banks must keep in the form of currency or in the form of deposits at the central bank (as is the case in South Africa). The liquid asset requirement is the portion of depositors’ balances that banks must invest in certain prescribed liquid assets over and above the capital-adequacy requirements. The latter is additional to the cash reserve requirement. Another distinguishing feature is that (in South Africa) the cash reserve requirement falls under the Reserve Bank Act, while the liquid asset requirement is prescribed by the Banks Act.**

**Which Act requires that banks obtain and retain appropriate information about each client, with the primary motivation being to combat money laundering and financial terrorism?**

**The Financial Intelligence Centre Act 38 of 2001 (FICA)**

**List the measures by which the significance of banks within the economy can be measured.**

* **The banking industry’s contribution to the gross domestic product (GDP) of the country**
* **The size of the assets of the banking industry as a percentage of GDP**

**Discuss the consequences of the 2007/08 sub-prime crisis on banking regulation globally.**

1. **The proposed banking requirements set by Basel II were replaced by new requirements under Basel III before being fully implemented.**
2. **The view that bank regulation is primarily a matter of prudential soundness is being considered as outdated. Market conduct regulation which aims at fair treatment of consumers through a range of consumer protection and disclosure mechanisms is now seen to be crucial for financial stability.**

###  True or false questions

[Go back to ⇦ True/False questions](#C3TFQ)

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

**The money supply (M1) includes reserves deposits held with the central bank as well as notes and coins held by the bank in their vaults in order to serve the demand requirements of the public.**

**False – the money supply (M1) *excludes* reserves deposits held with the central bank as well as notes and coins held by the bank in their vaults in order to serve the demand requirements of the public. Only notes and coins in circulation *outside* the monetary sector form part of M1.**

**In the banking world, the panic associated with not being able to withdraw funds from one bank, that leads to panic withdrawals at other banks, is known as a bank race and could lead to a systematic crisis.**

**False – it is known as a bank run and potentially leads to a systemic crisis.**

**The non-interest income of banks has become increasingly important as it tends to be less cyclical than interest income.**

**True**

**Demand deposits made by the public represent the assets of a commercial bank.**

**False – demand deposits made represent the liabilities of a commercial bank.**

####

**The Registrar of Banks is responsible for the regulation and supervision of banks under the auspices of the SARB’s Bank Supervision Department.**

**True**

###  Choose the correct term

 [Go back to ⇦ Choose the correct term](#C3CTCT)

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

**The percentage of current account deposits that is required to be held by banks with the central bank is referred to as the reserve ratio/credit multiplier.**

**Reserve ratio**

**Interbank transfers in South Africa are done via the net/gross settlement method**.

**Gross**

**The risk faced by banks that depositors may withdraw large amounts of funds at the same time is referred to as funding/market liquidity risk.**

**Funding**

**The International Monetary Fund (IMF)/Bank for International Settlements (BIS) sets international** **guidelines in respect of aspects pertaining to the financial soundness of clearing (commercial) banks.**

**Bank of International Settlements (BIS)**

**Regulation focused, among other things, on improving disclosure to consumers is referred to as market conduct/prudential regulation.**

**Market conduct**