# Chapter 5 - Test Bank

### Multiple-choice questions

[Go to ⇨ Multiple choice questions - Memorandum](#AC5MCQ)

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

**Government intervention in the free market economy by way of regulatory measures would be justified in which of the following cases?**

1. If the regulatory benefit will outweigh the cost
2. If it is necessary for the protection of consumers
3. If it concerns securities transactions
4. If consumers are too uneducated to look after their own interests
5. (i) and (iii) only
6. (i), (ii) and (iv) only
7. (i), (iii) and (iv) only
8. (ii), (iii) and (iv) only

**Regulators monitor compliance by regulated entities with laws and other rules by way of which of the following methods?**

1. Electronic surveillance of capital markets
2. Analysis of annual returns
3. Routine inspections
4. Compliance reports
5. (ii) and (iv) only
6. (i), (ii) and (iii) only
7. (i), (iii) and (iv) only
8. (i), (ii), (iii) and (iv)

**How do regulators ensure fair securities markets?**

1. Prices of securities are tightly controlled.
2. The numbers of listings that take place are strictly limited.
3. Trading rules are approved.
4. The operators of the exchange are approved.
5. (i) and (ii) only
6. (iii) and (iv) only
7. (i), (ii) and (iii) only
8. (i), (iii) and (iv) only

**Other than for enhancing investor protection, why are fair, efficient and transparent securities markets important?**

1. The securities markets are used to finance businesses.
2. The derivative markets are used to manage financial risk.
3. Secondary markets create the confidence for issues in the primary markets.
4. Economic growth is enhanced by efficient securities markets.
5. (ii) and (iv) only
6. (i), (ii) and (iii) only
7. (i), (iii) and (iv) only
8. (i), (ii), (iii) and (iv)

**Which is the key feature that is recognised in the aftermath of the financial crisis that must be emphasised to identify the development of systemic risk timeously?**

1. Exchange control
2. Banning OTC transactions
3. Transparency at market, product and participant level
4. Limiting cross-border transactions

**Which ONE of the following statements with regard to the regulatory framework in South Africa is correct?**

1. The granting of loans and credit is regulated by the Bank Supervision Department of the South African Reserve Bank (SARB).
2. The Financial Services Board (FSB) is responsible for electronic market surveillance of securities markets.
3. STRATE, a registered central securities depository organisation, is licensed by the FSB.
4. The Financial Intelligence Centre (FIC) is a self-regulatory organisation.

**The regulatory framework created by the Financial Advisory and Intermediary Services (FAIS) Act involves which of the following regulatory interventions?**

1. Fit and proper operators
2. Compliance function
3. Capital adequacy requirements
4. Prudential investment guidelines
5. (i) and (ii) only
6. (iii) and (iv) only
7. (i), (ii) and (iii) only
8. (i), (iii) and (iv) only

**Which of the following statements with regard to the regulatory framework created in the Financial Markets Act are correct?**

1. An infrastructure that brings together buyers and sellers of securities may be licensed as an exchange.
2. Exchanges must provide a guarantee fund or other kind of warranty for prejudiced investors.
3. An exchange must ensure compliance with rules by authorised users.
4. Off-market transactions are illegal, and such transactions will be void.
5. (i) and (iii) only
6. (i), (ii) and (iii) only
7. (i), (ii) and (iv) only
8. (ii), (iii) and (iv) only

**Which of the following are legitimate powers of an inspector authorised to conduct an inspection by the Registrar?**

1. Examining a shareholder of the financial institution concerned
2. Without notice entering and searching the financial institution’s premises
3. Opening a strong room in which the inspector suspects documents may be kept
4. Seizing any document without issuing a receipt
5. (i) and (iii) only
6. (i), (ii) and (iii) only
7. (i), (ii) and (iv) only
8. (ii), (iii) and (iv) only

**Which ONE of the following actions is used by the Financial Services Board to regulate retirement finds?**

1. Registration of funds
2. Electronic surveillance of trustee meetings
3. Requiring actuaries to take all investment decisions
4. Requiring the fund’s investment manager to guarantee minimum returns

### Written questions

[Go to ⇨ Written questions - Memorandum](#AC5WQ)

*Answer the following questions.*

**What is the rationale for imposing regulatory measures on financial markets? Explain the shift in thinking that has taken place following the financial crisis in 2007/08.**

**List the requirements that regulation should comply with to fulfil its objectives.**

**Describe some of the methods used by regulatory authorities to monitor whether rules laid down are being complied with.**

**Name some of the methods used by regulatory authorities to enforce compliance with rules.**

**What dispute resolution mechanisms are available to consumers in South Africa if they have been prejudiced through unlawful actions in the financial services field?**

**Why is consumer education so important in South Africa to promote consumer protection?**

**The fairness of the financial markets impacts investor protection. Describe the measures that are employed to ensure fair markets.**

**As the markets have become globally more integrated, they are vulnerable to shocks from other jurisdictions. Explain this statement in the light of the financial crisis of 2007/08.**

**Explain the concept of macroprudential regulation.**

**Discuss the changes to the regulatory landscape in South Africa that will be implemented shortly arising from the financial crisis.**

### True or false questions

[Go to ⇨ True/False questions - Memorandum](#AC5TFQ)

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

**Regulatory authorities are sometimes not part of the government, but a separate regulatory agency.**

**The Bank Supervision Department of the SARB is responsible for the regulation of the granting of loans and credit by banks.**

**Regulation includes establishing rules relating to a particular industry, monitoring whether those rules are complied with and enforcing them by taking action against non-compliant persons.**

**The trading of financial instruments takes place on the primary market while new financial instruments are issued to raise funds for corporate endeavours in the secondary market.**

**The financial soundness of financial institutions is relevant for the economy as a whole, as the failure of one institution may affect the stability of the financial system.**

### Insert the missing word/s

[Go to ⇨ Insert the missing word/s - Memorandum](#_Insert_the_missing)

*Insert the correct word/s to make the statement accurate.*

**Surveillance of securities markets take place by an exchange to establish ­­­­­­­­­­\_\_\_\_\_\_\_\_\_\_\_\_\_that may indicate irregular activities such as insider trading.**

**Proper regulation of the securities and derivatives markets to ensure fairness, efficiency and \_\_\_\_\_\_\_\_\_\_\_\_\_ is of the utmost importance.**

**In the financial markets, consumers do not have as much \_\_\_\_\_\_\_\_\_\_\_ as the suppliers of financial services, which makes them vulnerable to exploitation.**

**The regulator must ensure that only ­­­­\_\_\_\_\_\_\_\_\_\_ persons, in other words those who have no dishonesty in their past and who are properly qualified to render the service, are licensed or authorised as financial services providers.**

**The rationale of capital requirements is to ensure that the financial institution remains financially \_\_\_\_\_\_\_\_\_\_.**

# Chapter 5 - Memorandum

### Multiple-choice questions

[Go back to ⇦ Multiple choice questions](#C5MCQ)

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

**Government intervention in the free market economy by way of regulatory measures would be justified in which of the following cases?**

1. If the regulatory benefit will outweigh the cost
2. If it is necessary for the protection of consumers
3. If it concerns securities transactions
4. If consumers are too uneducated to look after their own interests
5. (i) and (iii) only
6. (i), (ii) and (iv) only
7. (i), (iii) and (iv) only
8. (ii), (iii) and (iv) only

**Regulators monitor compliance by regulated entities with laws and other rules by way of which of the following methods?**

1. Electronic surveillance of capital markets
2. Analysis of annual returns
3. Routine inspections
4. Compliance reports
5. (ii) and (iv) only
6. (i), (ii) and (iii) only
7. (i), (iii) and (iv) only
8. (i), (ii), (iii) and (iv)

**How do regulators ensure fair securities markets?**

1. Prices of securities are tightly controlled.
2. The numbers of listings that take place are strictly limited.
3. Trading rules are approved.
4. The operators of the exchange are approved.
5. (i) and (ii) only
6. (iii) and (iv) only
7. (i), (ii) and (iii) only
8. (i), (iii) and (iv) only

**Other than for enhancing investor protection, why are fair, efficient and transparent securities markets important?**

1. The securities markets are used to finance businesses.
2. The derivative markets are used to manage financial risk.
3. Secondary markets create the confidence for issues in the primary markets.
4. Economic growth is enhanced by efficient securities markets.
5. (ii) and (iv) only
6. (i), (ii) and (iii) only
7. (i), (iii) and (iv) only
8. (i), (ii), (iii) and (iv)

**Which is the key feature that is recognised in the aftermath of the financial crisis that must be emphasised to identify the development of systemic risk timeously?**

1. Exchange control
2. Banning OTC transactions
3. Transparency at market, product and participant level
4. Limiting cross-border transactions

**Which ONE of the following statements with regard to the regulatory framework in South Africa is correct?**

1. The granting of loans and credit is regulated by the Bank Supervision Department of the South African Reserve Bank (SARB).
2. The Financial Services Board (FSB) is responsible for electronic market surveillance of securities markets.
3. STRATE, a registered central securities depository organisation, is licensed by the FSB.
4. The Financial Intelligence Centre (FIC) is a self-regulatory organisation.

**The regulatory framework created by the Financial Advisory and Intermediary Services (FAIS) Act involves which of the following regulatory interventions?**

1. Fit and proper operators
2. Compliance function
3. Capital adequacy requirements
4. Prudential investment guidelines
5. (i) and (ii) only
6. (iii) and (iv) only
7. (i), (ii) and (iii) only
8. (i), (iii) and (iv) only

**Which of the following statements with regard to the regulatory framework created in the Securities Services Act are correct?**

1. An infrastructure that brings together buyers and sellers of securities may be licensed as an exchange.
2. Exchanges must provide a guarantee fund or other kind of warranty for prejudiced investors.
3. An exchange must ensure compliance with rules by authorised users.
4. Off-market transactions are illegal, and such transactions will be void.
5. (i) and (iii) only
6. (i), (ii) and (iii) only
7. (i), (ii) and (iv) only
8. (ii), (iii) and (iv) only

**Which of the following are legitimate powers of an inspector authorised to conduct an inspection by the Registrar?**

1. Examining a shareholder of the financial institution concerned
2. Without notice entering and searching the financial institution’s premises
3. Opening a strong room in which the inspector suspects documents may be kept
4. Seizing any document without issuing a receipt
5. (i) and (iii) only
6. (i), (ii) and (iii) only
7. (i), (ii) and (iv) only
8. (ii), (iii) and (iv) only

**Which ONE of the following actions is used by the Financial Services Board to regulate retirement finds?**

1. Registration of funds
2. Electronic surveillance of trustee meetings
3. Requiring actuaries to take all investment decisions
4. Requiring the fund’s investment manager to guarantee minimum returns

### Written questions

[Go back to ⇦ Written questions](#C5WQ)

*Answer the following questions.*

**What is the rationale for imposing regulatory measures on financial markets? Explain the shift in thinking that has taken place following the financial crisis in 2007/08.**

**In the past, regulatory measures was deemed necessary in certain cases where market imperfections arose but authorities had to ensure that economic growth and market innovation were not stifled by unnecessary regulatory burdens. A cost-benefit analysis thus had to be conducted by regulatory authorities before implementing regulation. This “light touch” regulatory philosophy originated in the US and was followed largely in the Western world and developed economies.**

**The financial crisis that started with the sub-prime home loans in 2007 in the US rapidly spread to other banks and countries, with systemic implications never seen before. Attitudes towards the market’s ability to regulate itself have hardened and it is now acknowledged that the complexity of the financial markets and opacity of certain financial instruments have led to abuses, with consequences far beyond the original transactions. Consequently many previously OTC instruments are under scrutiny and will in time be regulated while pressure on banks to increase capital and liquidity are ongoing.**

**List the requirements that regulation should comply with to fulfil its objectives.**

* **Barriers to entry and exit from markets and products should be kept at a minimum to ensure access for the widest possible range of participants.**
* **Regulatory measures should not be implemented if their impact and consequent cost to the economy have not been evaluated. The benefits of regulation should always exceed the cost of regulation.**
* **Restrictions and requirements for participants offering a particular product should be equal. For example there should be no difference between the regulatory requirements for banks and insurance companies if both wish to offer investment management services.**
* **A regular review of the perimeter or scope of regulation should take place, i.e. what should be regulated and what not.**

**Describe some of the methods used by regulatory authorities to monitor whether rules laid down are being complied with.**

**A regulator can monitor whether rules are complied with by**

* **analysing annual returns (documents containing certain prescribed information about the business of the regulated firm) and audit reports**
* **surveillance of securities markets (to establish trade patterns that may indicate irregular activities such as insider trading) and routine inspections**
* **requiring such information about the business of the regulated institution as it may deem necessary**
* **requiring the appointment of compliance officers who report directly to senior management and submit compliance reports directly to the regulator.**

**Name some of the methods used by regulatory authorities to enforce compliance with rules.**

* **Referral for criminal prosecution**
* **Withdrawal of authorisation or licences to do business and the consequent winding down of the business**
* **Curatorships to take over control of the business of the regulated firm**
* **Judicial management**
* **Penalties and orders to compensate prejudiced consumers**

**What dispute resolution mechanisms are available to consumers in South Africa if they have been prejudiced through unlawful actions in the financial services field?**

**Complaint resolution mechanisms and a voluntary or statutory ombudsman**

**Why is consumer education so important in South Africa to promote consumer protection?**

**Disclosure of information as a consumer protection measure is not effective if the consumer cannot understand the information received. The FSB therefore aims to educate South African citizens in financial matters as part of its overall objective to promote consumer protection.**

**The fairness of the financial markets impacts investor protection. Describe the measures that are employed to ensure fair markets.**

**The regulator ensures fair markets by approving the operators of the exchange and trading rules. It should ensure that market structures do not favour some market participants over others, and prevent market manipulation and other unfair trading practices. Strict action should be taken against anyone found guilty of these practices.**

**Investors should be given fair access to market facilities and price information. Regulators should require market practices that ensure fair treatment of orders and a price formation process that is transparent and reliable. Regulation should promote efficiency in the market. The dissemination of information must be timely and widespread to ensure that information is reflected in the price formation process.**

**Regulation should also promote transparency – the public availability of trading information on an immediate basis. This applies to pre-trade information about the available prices at which transactions may take place and post-trade information on trades that actually took place.**

**As the markets have become globally more integrated, they are vulnerable to shocks from other jurisdictions. Explain this statement in the light of the financial crisis of 2007/08.**

**The global financial meltdown in 2007/08 illustrated the risk of contagion very clearly. The crisis was caused by large savings in emerging economies like China flowing to industrialised countries which funded high levels of debt-financed consumption in those countries. This resulted in the formation of asset bubbles – rapid and unsustainable increases in asset prices. This state of affairs combined with a “light touch” approach to regulation allowed risky products, inappropriately priced for the amount of risk that they represented, to proliferate. Sub-prime mortgages, repackaged as securitised assets were sold to investors around the world, ensuring worldwide repercussions when the housing bubble in the US burst. In many cases these instruments were miss-sold to borrowers. This highlights the vulnerability of consumers (even relatively sophisticated ones) and the importance of consumer protection measures.**

**Explain the concept of macroprudential regulation.**

**Macroprudential regulation: Regulation that focuses on system-wide risk over the entire financial sector. It entails the study of the interaction of macroeconomic developments and the financial soundness and stability of financial institutions and the financial system.**

**Discuss the changes to the regulatory landscape in South Africa that will be implemented shortly arising from the financial crisis.**

**The South African government decided to strengthen the financial regulatory system to prevent financial crises in South Africa. Some of the proposals to enhance the regulatory system include the following:**

* **Changing to a macroprudential approach to regulation that implies analysing macroeconomic trends and their influence on the financial soundness of financial institutions and the financial system. This will ensure that macroeconomic risks such as asset bubbles, over-indebtedness of households and interconnectedness of financial institutions within and across borders become apparent at an early stage. Risks to the entire financial system and not only those pertaining to individual institutions must be considered.**
* **Changing the regulatory framework to a “twin peaks” approach in terms of which prudential regulation ensuring safety, soundness and solvency of financial institutions are separated from market conduct regulation, which focuses on the welfare of the consumer. The Reserve Bank will play the role of macroprudential supervisor of the financial system. Other financial regulators must, however, also consider the financial stability implications of their activities, and assess the risks that may arise from the financial institutions they supervise.**
* **Two committees will coordinate the activities of financial regulators:**
  + **The Financial Stability Oversight Committee will be responsible for coordinating financial stability, mitigating the risk of any crisis and resolving any crisis that should arise.**
  + **The Council of Financial Regulators will ensure information sharing between regulators and coordination of regulatory activities, including enforcement, market conduct and legislation.**
* **The perimeter of financial regulation must be expanded to include all unregulated financial activities such as private pools of capital, hedge funds, OTC derivatives and credit rating agencies.**
* **The implementation of the Basel III framework in South Africa is based on a phased-in approach that commenced on 1 January 2013 and will continue up to 2018, in line with the timelines determined by the Basel Committee.**
* **The FSB is in the process of formulating a regulatory framework for over-the counter (OTC) derivatives. Working groups focus on three aspects: licensing of and a code of conduct for OTC derivatives providers, central reporting of OTC derivatives to a trade repository, and the central clearing of standardised OTC derivatives**

### True or false questions

[Go back to ⇦ True/False questions](#_True_or_false_1)

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

**Regulatory authorities are sometimes not part of the government, but a separate regulatory agency.**

**True**

**The Bank Supervision Department of the SARB is responsible for the regulation of the granting of loans and credit by banks.**

**False**

**Regulation includes establishing rules relating to a particular industry, monitoring whether those rules are complied with and enforcing them by taking action against non-compliant persons.**

**True**

**The trading of financial instruments takes place on the primary market while new financial instruments are issued to raise funds for corporate endeavours in the secondary market.**

**False**

**The financial soundness of financial institutions is relevant for the economy as a whole, as the failure of one institution may affect the stability of the financial system.**

**True**

### Insert the missing word/s

[Go back to ⇦ Insert the missing word/](#C5ITMWQ)s

*Insert the correct word/s to make the statement accurate.*

**Surveillance of securities markets take place by an exchange to establish ­­­­­­­­­­\_\_\_\_\_\_\_\_\_\_\_\_\_that may indicate irregular activities such as insider trading.**

**trade patterns**

**Proper regulation of the securities and derivatives markets to ensure fairness, efficiency and \_\_\_\_\_\_\_\_\_\_\_\_\_ is of the utmost importance.**

**transparency**

**In the financial markets, consumers do not have as much \_\_\_\_\_\_\_\_\_\_\_ as the suppliers of financial services, which makes them vulnerable to exploitation.**

**information**

**The regulator must ensure that only ­­­­\_\_\_\_\_\_\_\_\_\_ persons, in other words those who have no dishonesty in their past and who are properly qualified to render the service, are licensed or authorised as financial services providers.**

**fit and proper**

**The rationale of capital requirements is to ensure that the financial institution remains financially \_\_\_\_\_\_\_\_\_\_.**

**sound**