Chapter 02 - Test Bank

Multiple Choice Questions

1. Deregulation of the banking sector throughout the late 1970s and the 1980s sought to:

   A. reduce the reliance of major Australian companies on international capital markets.
   B. reduce the excess profits of banks.
   C. reduce the discrimination against banks owing to direct controls on them only.
   D. provide reduced control on the money supply.

2. The changes to the regulations for the banking industry under deregulation in the mid 1980s have resulted in _______ the growth of bank sector.

   A. decreasing
   B. increasing
   C. not altering
   D. dramatically decreasing

3. Which of the following statements concerning banks is incorrect?

   A. In Australia, banks currently account for the largest share of assets of all financial institutions.
   B. Bank loans and commitments must be supported by a minimum specified amount of capital.
   C. At least 50% of the capital requirement must be in the form of Tier 1 capital.
   D. The Australian Reserve Bank monitors capital adequacy requirements for banks.

4. Unlike most other businesses, a bank's balance sheet is made up mainly of:

   A. real assets and financial liabilities.
   B. real liabilities and financial liabilities.
   C. real assets and real liabilities.
   D. financial assets and liabilities.

5. The level of banks' share of assets of all Australian financial institutions from the 1950s onwards first _______, then in the 1980s _______ and recently has _______ owing to banks forming consolidated corporate entities.

   A. increased; decreased; increased
   B. increased; decreased; remained stable
   C. decreased; increased; decreased
   D. decreased; increased; remained stable

6. The market structure of the banking sector has changed since deregulation of the financial system during the 1980s. Which statement most closely reflects the current structure of the banking sector in Australia?

A. Foreign banks dominate in number and share of total assets.
B. Major Australian banks no longer hold the largest share of total assets.
C. Total assets are fairly evenly distributed between the major, regional and foreign banks.
D. Major banks maintain the highest percentage of branches and share of total assets.

7. Which of the following features is a role of a bank?

A. Attracting funds from the capital markets to facilitate borrowing by the household sector
B. Facilitating the flow of funds from borrowers to lenders
C. Facilitating the flow of funds from savers to borrowers
D. Managing the level of interest rates

8. Banks have gradually moved to liability management in the management of their balance sheets. Which statement best describes liability management?

A. The loan portfolio is tailored to match the available deposit base.
B. The deposit base and other funding sources are managed in order to fund loan and other commitments.
C. The ratio of debt to equity is managed to meet capital adequacy requirements.
D. The liability to assets ratio is maintained within central bank standards.

9. For banks, asset management refers to:

A. managing the assets of the banks; that is, their deposits.
B. managing the real assets, the bank buildings.
C. managing the loans portfolio.
D. protecting the deposits by using derivatives.

10. For banks, liability management refers to:

A. managing the liabilities of the banks; that is, the loans.
B. banks ensuring they have sufficient funds by managing their deposit base.
C. managing the real assets, the bank buildings.
D. protecting the loans and other commitments by using derivatives.

11. When a bank raises funds in the international markets to fund new lending growth, it is involved in:

A. asset management.
B. off-balance-sheet business.
C. liability management.
D. derivative management.

12. Off-balance-sheet business for a bank refers to:

A. a bank's income.
B. a bank's contingent liabilities.
C. assets that will appear on the forthcoming balance sheet.
D. transactions recorded on the previous balance sheet.

13. Which of the following about a bank's activities is incorrect?

A. A bank's loans are its assets.
B. Off-balance-sheet business items are contingent liabilities.
C. Liability management is the management of a bank's loans.
D. Banks typically have high credit ratings.

14. The assets on a bank's balance sheet are:

A. the sources of funds.
B. the uses of funds.
C. the different types of deposits the bank offers.
D. equal to the liabilities of the banks.

15. The liabilities on a bank's balance sheet are:

A. the sources of funds.
B. the uses of funds.
C. the different types of loans the bank offers.
D. equal to the assets of the banks.

16. Each of the following balance sheet portfolio items are liabilities of a bank, except:

A. term deposits.
B. bill acceptance facilities.
C. certificates of deposit.
D. overdrafts.

17. Each of the following balance sheet portfolio items are sources of funds for a bank, except:

A. term deposits.
B. bill acceptance facilities.
C. certificates of deposit.
D. overdrafts.

18. Which of the following is a bank liability?

A. Consumer loans
B. Lease finance
C. Bills receivable
D. Certificates of deposit

19. Which of the following statements about deposits is correct?

A. Call accounts represent a fluctuating source of funds for banks.
B. Term deposits are funds lodged with a bank for longer than two weeks.
C. As current accounts are highly liquid, they form an unstable source of funds for a bank.
D. A cheque account may pay interest.

20. Which of the following statements about banks' current accounts is incorrect?

A. Current accounts today generally pay interest.
B. Current accounts are a relatively stable source of bank funds.
C. Deregulation had a major impact on current accounts.
D. Current accounts form an increasingly important type of asset for banks.

21. Which of the following statements is NOT true of term deposits?

A. They are less liquid than a current deposit.
B. They usually offer a higher return than a current deposit.
C. They are attractive to investors who expect interest rates to fall.
D. They are generally negotiable instruments.

22. As a depositor shifts funds from current deposits to term deposits in a bank, generally the depositor's:

A. liquidity increases and credit risk increases.
B. liquidity decreases and interest income increases.
C. liquidity decreases and interest income decreases.
D. implicit interest increases and explicit interest decreases.

23. If a bank required more short-term funding, it would issue:

A. a certificate of deposit.
B. a debenture.
C. an unsecured note.
D. preference shares.

24. Which of the following is generally a highly liquid instrument?

A. A bank bill
B. A certificate of deposit
C. Neither a bank bill nor a certificate of deposit
D. Both bank bills and certificates of deposit are liquid instruments

25. The term ‘negotiable' in relation to a security means:

A. its price can be bargained for when sold.
B. it can be sold easily.
C. its buyer can negotiate its price when buying.
D. it is reasonably illiquid and will drop in price when sold.

26. Which of the following regarding certificates of deposit (CDs) is correct?

A. CDs pay daily interest instead of monthly as for ordinary deposits.
B. CDs generally pay higher interest because they are not liquid.
C. The rate of interest on a CD can be adjusted quickly.
D. CDs with a face value of more than $100 000 are non-negotiable.

27. The advantage of a CD to a bank is/are:

A. its rate of interest may be adjusted quickly.
B. it can be sold quickly in the money market for cash.
C. it is a negotiable instrument.
D. all of the given choices.

28. A major difference between a bank's term deposit and a certificate of deposit is:

A. a term deposit represents an asset for a bank, while a certificate of deposit is a liability.
B. a certificate of deposit does not pay interest until maturity.
C. a certificate of deposit is illiquid when compared with a term deposit.
D. a certificate of deposit is a high-credit-risk instrument when compared with a term deposit.

29. Which of the following about CDs is incorrect?

A. CDs are issued directly into the money markets.
B. CDs don't include interest until maturity.
C. CDs are called discount securities.
D. CDs are issued by large, creditworthy companies.

30. With regard to bank bills, the bill is sold at a discount:

A. because the bank needs to find a buyer.
B. to encourage buyers.
C. because the difference between the initial price and the final sale price is the return to the holder.
D. because the bank pays the face value of the funds to the borrower at maturity.

31. With regard to bank bills, the expression ‘the issuer sells the bill at the best discount’ means the issuer:

A. is providing the funding.
B. is acting as mediator between the borrower and the bank.
C. is selling the bill into the market at the lowest yield.
D. pays the lowest face value of the funds to the holder at maturity.

32. With regard to bank bills, the actual role of the acceptor is to:

A. provide the initial funding.
B. act as mediator between the borrower and bank.
C. issue the bank bill.
D. pay the face value of the funds to the holder at maturity.

33. Which of the following is incorrect in relation to bill financing?

A. The drawer is the party seeking the funds.
B. If a bank accepts the bill this enhances its credit quality.
C. An issuer will seek to sell the bill in the market at the highest yield.
D. Bills are sold at a discount to face value.

34. For a bank, an advantage of bill financing is:

A. the bank earns income from accepting bills.
B. the bank doesn't necessarily have to use its own funds.
C. interest rates on bill funding can be adjusted rapidly.
D. all of the given answers.

35. Which of the following statements about bill acceptance facilities is incorrect?

A. When a bank discounts a bill for the issuer, it buys it.
B. When a bank that holds a bill rediscounts it the bank onsells it.
C. When a bank acts as an acceptor it will pay the face value of the bill to the holder at maturity.
D. If interest rates change before a bank bill matures, the bank can change the interest rate on it.

36. Commercial banks take part in the money markets as:

A. lenders of funds only.
B. borrowers of funds only.
C. both lenders and borrowers of funds.
D. underwriters only.

37. Foreign currency liabilities have increased in importance as a source of funds for Australian banks. Which of the following statements is NOT a major reason?
i. deregulation of the foreign exchange market
ii. diversification of funding sources
iii. demand from multinational corporate clients
iv. internationalisation of global financial markets
v. avoidance of the non-callable deposit prudential requirement
vi. expansion of banks' asset-base denominated in foreign currencies

A. v
B. ii
C. i
D. All of the given answers are correct.

38. Alternatives to the usual source of long-term bank funds that have the characteristics of both debt and equity are called:

A. secured debentures.
B. transferable certificates of deposit.
C. promissory notes.
D. subordinated notes.

39. The following balance sheet portfolio items are all assets of a bank, except:

A. overdrafts.
B. lease finance.
C. certificates of deposit.
D. credit card draw-downs.

40. A short-term discount security issued by a drawer at a discount, with the promise to repay the face value at maturity, is called:

A. a commercial paper.
B. a commercial bill.
C. a certificate of deposit.
D. all of the given answers.

41. Which of the following statements regarding the foreign currency liabilities of a bank is incorrect?

A. The large international markets are important sources of funds for commercial banks.
B. Australian banks occasionally issue debt securities into the international markets to raise sums ranging from $20 million to $50 million.
C. Foreign currency liabilities issued into the euromarkets are typically denominated in US dollars.
D. After deregulation commercial banks were able to expand their international funding sources.

42. All of the following financial securities are considered ‘uses of funds' by banks except:

A. commercial bills.
B. credit cards.
C. certificates of deposit.
D. overdrafts.

43. If you take out a mortgage from a bank, the mortgage is a/an:

A. liability to the bank and an asset to you.
B. liability to you and an asset to the bank.
C. liability to both you and the bank.
D. asset to both you and the bank.

44. The interest rate BBSW refers to:

A. the reference rate for medium-term funding.
B. a rate calculated each day from the offer rate of the last daily sale in the bank bill market.
C. the average mid-point of the bid and offer rates in the bank bill market.
D. the bank bill security rate.

45. Banks invest in government securities because:

A. they offer high yield owing to their risk.
B. they offer a low yield owing to their illiquidity.
C. all government bonds offer protection against inflation risk.
D. they can be used as security against banks' borrowing.

46. Which of the following statements about commercial lending is incorrect?

A. The term loan is the main type of lending provided by banks to firms.
B. Typically, term loans are for maturities ranging from 5 to 15 years.
C. To extend commercial bill financing a bank may provide the firm with a rollover facility.
D. Banks can provide flexible funding called an overdraft to firms.

47. Which of the following about bank lending to government is incorrect?

A. Securities issued by governments are usually regarded as low risk.
B. Banks invest in government securities because they are a source of liquidity.
C. Banks invest in T-notes because they provide short-term income streams.
D. Government securities enable a bank to manage the maturity structure of its balance sheet.

48. Off-balance-sheet business for a bank refers to:

A. deposits and loans longer than one year.
B. transactions that are currently only a contingent liability.
C. call deposits that may be withdrawn on demand.
D. consumer loans that are in default.

49. All of the following are off-balance-sheet transactions of a bank except:

A. documentary letters of credit.
B. performance guarantees.
C. underwriting facilities.
D. bills receivable.

50. In recent times, there had been a substantial expansion in fee-related income for banks. What is the principal reason for this?

A. Increased confidence in banks by individual investors
B. Increased off-sheet business (OBS) for banks
C. Reduced guidelines by Australian bank supervisor APRA
D. Increased deposits in banks

51. Which of the following statements is true for off-balance-sheet business for banks?

A. Off-balance-sheet business is a small part of a bank's income.
B. Off-balance-sheet business is recorded on a bank's statement of income and expense.
C. Off-balance-sheet business represents fee-based income.
D. Off-balance-sheet business records deposits that do not fit on the balance sheet.

52. Which of the following statements about market-rate-related items such as forward-rate agreements is incorrect?

A. They are generally called off-balance-sheet items.
B. They are liabilities that may require an outflow of funds for a bank.
C. They are included in the BIS capital-adequacy guidelines.
D. They form a small part of banks' OBS business.

53. Which of the following categories represents the most significant proportion of total off-balance-sheet business of the banks?

A. Direct credit substitutes
B. Trade and performance-related items
C. Commitments
D. Market-rate-related transactions

54. Which of the following categories represents the most significant proportion of total market-rate-related off-balance-sheet business of the banks?

A. Currency swap agreements
B. Foreign exchange contracts
C. Interest rate swaps
D. Interest rate futures

55. An example of an ‘off-sheet business' transaction that banks are generally involved in is:

A. providing a ‘standby letter of credit'.
B. providing a note issuance facility.
C. providing a short-term, self-liquidating trade contingency.
D. all of the given answers.

56. Which of the following statements about direct credit substitutes provided by a commercial bank is incorrect?

A. They are provided to support a client's financial obligations.
B. An example of a direct credit substitute is a bank guarantee.
C. The bank provides funding to a third party instead of the client providing the funding.
D. With a direct credit substitute a bank's client can raise funds directly from the financial markets.

57. Off-balance-sheet business is usually divided into four major categories:

A. Direct credit substitutes, trade and performance-related items, commitments and trade guarantees.
B. Direct credit substitutes, trade and performance-related items, commitments and market-related transactions.
C. Direct credit substitutes, trade and performance-related items, commitments and underwriting facilities.
D. Direct credit substitutes, ‘standby letters of credit', commitments and market-related transactions.

58. A ‘commitment’ by a bank is:

A. a form of swap.
B. a promise by a large depositor to provide extra funds to the bank.
C. the unused balance on a bank credit card.
D. an undertaking to advance funds or to acquire an asset in the future.

59. Which of the following is not a commitment by a bank?

A. Outright forward purchase agreement
B. Underwriting facilities
C. Credit card limit approvals unused by cardholder
D. Currency swap

60. Which of the following is NOT an argument for some form of government regulation of the banking system?

A. The money-creation role of banks
B. A major source of funds to the banks comes from households who need their savings protected
C. The excess return on assets that banks have been making in recent years
D. Maintaining confidence in the financial system

61. Which of the following is NOT associated with the purpose of regulating financial institutions?

A. Providing stability of the money supply
B. Directing flow of funds to priority areas
C. Maintaining the soundness and stability of the financial system
D. Lowering the cost of funds

62. The Australian institution APRA is responsible for the regulatory supervision of financial institutions such as banks and credit unions. APRA stands for:

A. Australian Practice and Regulatory Association.
B. Australian Prudential Regulation Authority.
C. Australian Prudential Rule Authority.
D. Australian Practice and Regulatory Authority.

63. Which of the following institutions are supervised by APRA?

A. Building societies
B. Commercial banks
C. Credit unions
D. All of the given answers

64. Within the context of the Corporations Law in Australia, the supervision of financial market integrity and consumer protection is done by:

A. APRA.
B. ASIC.
C. RBA.
D. ACCC.

65. The requirement and observation of standards designed to ensure the stability and soundness of a financial system is called:

A. fiscal policy.
B. monetary policy.
C. prudential supervision.
D. the Basel accord.

66. The Basel capital adequacy requirements apply to:

A. all financial institutions.
B. banks, investment banks and merchant banks only.
C. all financial institutions supervised by ASIC.
D. all banks registered with APRA and some other financial institutions.

67. Some of the elements in assessing capital adequacy requirements for banks under the Basel II capital accord are:

A. credit risk, liquidity risk and interest rate risk.
B. credit risk, market risk and type of capital held.
C. default risk, interest rate risk and market risk.
D. default risk, liquidity risk and type of capital held.

68. According to the textbook, the Basel II approach to capital adequacy for banks involves ____ main elements.

A. three
B. four
C. five
D. six

69. Which of the following does NOT apply to Tier 1 capital?

A. Tier 1 capital is described as ‘core capital'.
B. Tier 1 capital must constitute at least 50% of a bank's capital base.
C. Paid-up ordinary shares can be included in Tier 1 capital.
D. Cumulative irredeemable APRA-approved preference shares can be included in Tier 1 capital.

70. Under Basel II prudential standards, an institution is required to maintain a risk-based capital ratio of _____ of total-risk-weighted assets.

A. 2.00 percent
B. 4.00 percent
C. 8.00 percent
D. 10.00 percent

71. Which of the following statements about regulatory capital is false?

A. Tier 1 capital includes paid-up ordinary shares, retained earnings, non-cumulative irredeemable preference shares and general reserves.
B. Tier 2 capital includes general provision for doubtful debts, revaluation reserves of premises, mandatory convertible notes and approved perpetual subordinated debt.
C. Tier 1 capital is core capital, including paid-up ordinary shares, non-cumulative irredeemable preference shares and general reserves.
D. Tier 2 capital includes general reserves for doubtful debts, asset revaluation reserves of premises, other preference shares, mandatory convertible notes, cumulative redeemable preference shares and perpetual subordinated debt.

72. The Pillar 1 approach of Basel II capital adequacy incorporates the following three risk components:

A. credit risk, interest-rate risk and market risk.
B. default risk, interest-rate risk and operational risk.
C. credit risk, market risk and operational risk.
D. default risk, foreign exchange risk and operational risk.

73. Which of the following statements regarding capital adequacy requirements is incorrect?

A. Existing credit-risk guidelines are extended to include market risk arising from a bank's trading activities.
B. Regulators focus on credit risk, market risks, operational risk and type of capital held.
C. Eligible Tier 1 capital must constitute at least 70% of a bank's capital base.
D. Tier 2 capital is divided into upper and lower Tier 2 parts.

74. Under the capital adequacy requirement for banks, in order to fund a $100 000 loan for a multinational corporate client with a Standard & Poor's rating of AA, a bank will:

A. assign a risk-weighting of 20% for the balance.
B. allocate Tier 1 and Tier 2 capital to the loan according to the riskiness of the company.
C. seek funding in the euromarkets to minimise the capital adequacy requirements.
D. apply a risk weighting of 50% to the loan to determine the total capital requirement.

75. In the Basel II standardised approach to external rating grades, the asset counterparty weights for capital adequacy guidelines are:

A. 10%, 20%, 50% and 100%.
B. 10%, 50%, 100% and 150%.
C. 20%, 50%, 100% and 150%.
D. 20%, 50%, 100% and 200%.

76. The Basel II risk weighting factor for a bank loan to an Australian company with a Moody's Investors Service rating of C is:

A. 20%.
B. 50%.
C. 100%.
D. 150%.

77. Under Pillar 1 of the Basel II framework, the risk weight for a residential housing loan is determined by the:

A. amount borrowed.
B. level of mortgage insurance.
C. house valuation.
D. all of the given answers.

78. A bank provides a loan of $1 million to a company that has an A rating. Calculate the dollar value of capital required under the capital adequacy requirements to support the facility.

A. $16 000
B. $40 000
C. $80 000
D. $120 000

79. A bank provides documentary letters of credit for a company that has a credit rating of A+. The face value of contracts outstanding is $2 million. Calculate the dollar value of capital required under the capital adequacy requirements to support these facilities, given that the bank supervisor's credit conversion factor is 20%.

A. $6 400
B. $16 000
C. $160 000
D. $240 000

80. A large commercial bank operating in the international markets will generally apply to the banks' supervisor to use the _____ to credit risk.

A. advanced internal ratings-based approach
B. foundation external ratings-based approach
C. standardised approach
D. standardised approach with external ratings

81. Under Basel II capital accord, the approach to credit risk that requires a bank to assign risk weights given by the prudential supervisor is called:

A. an advanced approach.
B. a foundation approach.
C. a standardised approach.
D. advanced-internal ratings.

82. The risk that arises from chance of loss as a result of inadequate internal bank processes is called:

A. default risk.
B. interest rate risk.
C. market risk.
D. operational risk.

83. Which of the following statements about recently adopted guidelines covering capital requirements for market risk that banks are required to perform is false?

A. Banks use a risk measurement model based on a VaR approach.
B. Banks estimate the sensitivity of portfolio components to small changes in prices.
C. Banks must hold capital against risk of loss from changes in interest rates.
D. Banks hold a fixed allocation of funds between various balance sheet assets and off-balance-sheet business.

84. For a commercial bank operating in foreign exchange, interest rate and equity markets, the capital adequacy guidelines for the market risk it is exposed to fall under:

A. Pillar 1.
B. Pillar 2.
C. Pillar 3.
D. Pillar 4.

85. For a commercial bank's normal day-to-day business, the capital adequacy guidelines for the operational risk it is exposed to fall under:

A. Pillar 1.
B. Pillar 2.
C. Pillar 3.
D. Pillar 4.

86. For a commercial bank's market discipline, the capital adequacy guidelines for its disclosure and transparency requirements fall under:

A. Pillar 1.
B. Pillar 2.
C. Pillar 3.
D. Pillar 4.

87. Under _____ of Basel II, bank supervisors should review and evaluate banks' internal capital adequacy assessments.

A. Pillar 4
B. Pillar 3
C. Pillar 1
D. Pillar 2

88. Part of a bank's liquidity management is to hold a portfolio of:

A. term loans.
B. mortgages.
C. Commonwealth government securities.
D. credit card loans.

89. In relation to a bank, liquidity management means:

A. the bank's ability to quickly convert deposits into loans.
B. the bank's ability to onsell its loans.
C. the bank's ability to have funds available when depositors' funds mature.
D. the bank's policies and practices in identifying and managing its loans portfolios.

True / False Questions

90. Commercial banks are the main type of financial institution in a financial system because they hold the largest amounts of financial assets.

True False

91. The greater the dominance of commercial banks in an economy, the less regulation required.

True False

92. Banks obtain funds from many areas. These sources of funds appear as liabilities on a bank's balance sheet.

True False

93. Liability management is where banks actively manage their liabilities in order to meet future loan demand.

True False

94. Call deposits are funds lodged in a bank account for a specified short-term period.

True False

95. A bank may either issue a negotiable certificate of deposit directly into the money markets or place it directly with another bank with surplus funds.

True False

96. One of the important attributes of certificates of deposit for a bank is the ability to adjust the yields on new issues.

True False

97. As the majority of banks' assets are short-term loans, they are active in the money markets in order to fund part of their lending.

True False

98. A bank may seek to obtain funds by issuing unsecured notes with a collaterised floating charge over its deposits.

True False

99. Foreign currency liabilities are debt instruments issued into another country but not denominated in the currency of that country.

True False

Short Answer Questions

100. Briefly discuss the sources of funds for a commercial bank.

101. Describe how a bill acceptance facility works.

102. Discuss the main features of housing finance.

103. Discuss the main features of a bank's commercial lending.

104. Within the context of off-balance-sheet business, explain direct credit substitutes, trade- and performance-related items and any differences between these items.

Chapter 02 - Test Bank Key

Multiple Choice Questions

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A. reduce the reliance of major Australian companies on international capital markets.
B. reduce the excess profits of banks.
C. reduce the discrimination against banks owing to direct controls on them only.
D. provide reduced control on the money supply.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-01 Evaluate the functions and activities of commercial banks within the financial system.
Section: Introduction

2. The changes to the regulations for the banking industry under deregulation in the mid 1980s have resulted in ________ the growth of bank sector.

A. decreasing
B. increasing
C. not altering
D. dramatically decreasing

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D. The Australian Reserve Bank monitors capital adequacy requirements for banks.

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4. Unlike most other businesses, a bank's balance sheet is made up mainly of:

A. real assets and financial liabilities.
B. real liabilities and financial liabilities.
C. real assets and real liabilities.
D. financial assets and liabilities.

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5. The level of banks' share of assets of all Australian financial institutions from the 1950s onwards first _______, then in the 1980s _______ and recently has _______ owing to banks forming consolidated corporate entities.

A. increased; decreased; increased
B. increased; decreased; remained stable
C. decreased; increased; decreased
D. decreased; increased; remained stable

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6. The market structure of the banking sector has changed since deregulation of the financial system during the 1980s. Which statement most closely reflects the current structure of the banking sector in Australia?

A. Foreign banks dominate in number and share of total assets.
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7. Which of the following features is a role of a bank?

A. Attracting funds from the capital markets to facilitate borrowing by the household sector
B. Facilitating the flow of funds from borrowers to lenders
C. Facilitating the flow of funds from savers to borrowers
D. Managing the level of interest rates

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C. The ratio of debt to equity is managed to meet capital adequacy requirements.
D. The liability to assets ratio is maintained within central bank standards.

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Est time: <1 minute

Learning Objective: 02-01 Evaluate the functions and activities of commercial banks within the financial system.
Section: 2.1 The main activities of commercial banking

9. For banks, asset management refers to:

A. managing the assets of the banks; that is, their deposits.
B. managing the real assets, the bank buildings.
C. managing the loans portfolio.
D. protecting the deposits by using derivatives.

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Learning Objective: 02-01 Evaluate the functions and activities of commercial banks within the financial system.
Section: 2.1 The main activities of commercial banking

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Difficulty: Easy
Est time: <1 minute
Learning Objective: 02-01 Evaluate the functions and activities of commercial banks within the financial system.
Section: 2.1 The main activities of commercial banking

11. When a bank raises funds in the international markets to fund new lending growth, it is involved in:

A. asset management.
B. off-balance-sheet business.
C. liability management.
D. derivative management.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-01 Evaluate the functions and activities of commercial banks within the financial system.
Section: 2.1 The main activities of commercial banking

12. Off-balance-sheet business for a bank refers to:

A. a bank's income.
B. a bank's contingent liabilities.
C. assets that will appear on the forthcoming balance sheet.
D. transactions recorded on the previous balance sheet.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-01 Evaluate the functions and activities of commercial banks within the financial system.
Section: 2.1 The main activities of commercial banking

13. Which of the following about a bank's activities is incorrect?

A. A bank's loans are its assets.
B. Off-balance-sheet business items are contingent liabilities.
C. Liability management is the management of a bank's loans.
D. Banks typically have high credit ratings.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-01 Evaluate the functions and activities of commercial banks within the financial system.
Section: 2.1 The main activities of commercial banking

14. The assets on a bank's balance sheet are:

A. the sources of funds.
B. the uses of funds.
C. the different types of deposits the bank offers.
D. equal to the liabilities of the banks.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

15. The liabilities on a bank's balance sheet are:

A. the sources of funds.
B. the uses of funds.
C. the different types of loans the bank offers.
D. equal to the assets of the banks.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

16. Each of the following balance sheet portfolio items are liabilities of a bank, except:

A. term deposits.
B. bill acceptance facilities.
C. certificates of deposit.
D. overdrafts.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

17. Each of the following balance sheet portfolio items are sources of funds for a bank, except:

A. term deposits.
B. bill acceptance facilities.
C. certificates of deposit.
D. overdrafts.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

18. Which of the following is a bank liability?

A. Consumer loans
B. Lease finance
C. Bills receivable
D. Certificates of deposit

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

19. Which of the following statements about deposits is correct?

A. Call accounts represent a fluctuating source of funds for banks.
B. Term deposits are funds lodged with a bank for longer than two weeks.
C. As current accounts are highly liquid, they form an unstable source of funds for a bank.
D. A cheque account may pay interest.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

20. Which of the following statements about banks' current accounts is incorrect?

A. Current accounts today generally pay interest.
B. Current accounts are a relatively stable source of bank funds.
C. Deregulation had a major impact on current accounts.
D. Current accounts form an increasingly important type of asset for banks.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

21. Which of the following statements is NOT true of term deposits?

A. They are less liquid than a current deposit.
B. They usually offer a higher return than a current deposit.
C. They are attractive to investors who expect interest rates to fall.
D. They are generally negotiable instruments.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

22. As a depositor shifts funds from current deposits to term deposits in a bank, generally the depositor's:

A. liquidity increases and credit risk increases.
B. liquidity decreases and interest income increases.
C. liquidity decreases and interest income decreases.
D. implicit interest increases and explicit interest decreases.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

23. If a bank required more short-term funding, it would issue:

A. a certificate of deposit.
B. a debenture.
C. an unsecured note.
D. preference shares.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

24. Which of the following is generally a highly liquid instrument?

A. A bank bill
B. A certificate of deposit
C. Neither a bank bill nor a certificate of deposit
D. Both bank bills and certificates of deposit are liquid instruments

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

25. The term ‘negotiable' in relation to a security means:

A. its price can be bargained for when sold.
B. it can be sold easily.
C. its buyer can negotiate its price when buying.
D. it is reasonably illiquid and will drop in price when sold.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

26. Which of the following regarding certificates of deposit (CDs) is correct?

A. CDs pay daily interest instead of monthly as for ordinary deposits.
B. CDs generally pay higher interest because they are not liquid.
C. The rate of interest on a CD can be adjusted quickly.
D. CDs with a face value of more than $100 000 are non-negotiable.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

27. The advantage of a CD to a bank is/are:

A. its rate of interest may be adjusted quickly.
B. it can be sold quickly in the money market for cash.
C. it is a negotiable instrument.
D. all of the given choices.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

28. A major difference between a bank's term deposit and a certificate of deposit is:

A. a term deposit represents an asset for a bank, while a certificate of deposit is a liability.
B. a certificate of deposit does not pay interest until maturity.
C. a certificate of deposit is illiquid when compared with a term deposit.
D. a certificate of deposit is a high-credit-risk instrument when compared with a term deposit.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

29. Which of the following about CDs is incorrect?

A. CDs are issued directly into the money markets.
B. CDs don't include interest until maturity.
C. CDs are called discount securities.
D. CDs are issued by large, creditworthy companies.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

30. With regard to bank bills, the bill is sold at a discount:

A. because the bank needs to find a buyer.
B. to encourage buyers.
C. because the difference between the initial price and the final sale price is the return to the holder.
D. because the bank pays the face value of the funds to the borrower at maturity.

Difficulty: Hard
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

31. With regard to bank bills, the expression 'the issuer sells the bill at the best discount' means the issuer:

A. is providing the funding.
B. is acting as mediator between the borrower and the bank.
C. is selling the bill into the market at the lowest yield.
D. pays the lowest face value of the funds to the holder at maturity.

Difficulty: Hard
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

32. With regard to bank bills, the actual role of the acceptor is to:

A. provide the initial funding.
B. act as mediator between the borrower and bank.
C. issue the bank bill.
D. pay the face value of the funds to the holder at maturity.

Difficulty: Hard
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

33. Which of the following is incorrect in relation to bill financing?

A. The drawer is the party seeking the funds.
B. If a bank accepts the bill this enhances its credit quality.
C. An issuer will seek to sell the bill in the market at the highest yield.
D. Bills are sold at a discount to face value.

Difficulty: Hard
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

34. For a bank, an advantage of bill financing is:

A. the bank earns income from accepting bills.
B. the bank doesn't necessarily have to use its own funds.
C. interest rates on bill funding can be adjusted rapidly.
D. all of the given answers.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

35. Which of the following statements about bill acceptance facilities is incorrect?

A. When a bank discounts a bill for the issuer, it buys it.
B. When a bank that holds a bill rediscounts it the bank onsells it.
C. When a bank acts as an acceptor it will pay the face value of the bill to the holder at maturity.
D. If interest rates change before a bank bill matures, the bank can change the interest rate on it.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-01 Evaluate the functions and activities of commercial banks within the financial system.
Section: 2.1 The main activities of commercial banking

36. Commercial banks take part in the money markets as:

A. lenders of funds only.
B. borrowers of funds only.
C. both lenders and borrowers of funds.
D. underwriters only.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

37. Foreign currency liabilities have increased in importance as a source of funds for Australian banks. Which of the following statements is NOT a major reason?

i. deregulation of the foreign exchange market
ii. diversification of funding sources
iii. demand from multinational corporate clients
iv. internationalisation of global financial markets
v. avoidance of the non-callable deposit prudential requirement
vi. expansion of banks' asset-base denominated in foreign currencies

A. v
B. ii
C. i
D. All of the given answers are correct.

Difficulty: Hard
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

38. Alternatives to the usual source of long-term bank funds that have the characteristics of both debt and equity are called:

A. secured debentures.
B. transferable certificates of deposit.
C. promissory notes.
D. subordinated notes.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

39. The following balance sheet portfolio items are all assets of a bank, except:

A. overdrafts.
B. lease finance.
C. certificates of deposit.
D. credit card draw-downs.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

40. A short-term discount security issued by a drawer at a discount, with the promise to repay the face value at maturity, is called:

A. a commercial paper.
B. a commercial bill.
C. a certificate of deposit.
D. all of the given answers.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

41. Which of the following statements regarding the foreign currency liabilities of a bank is incorrect?

A. The large international markets are important sources of funds for commercial banks.
B. Australian banks occasionally issue debt securities into the international markets to raise sums ranging from $20 million to $50 million.
C. Foreign currency liabilities issued into the euromarkets are typically denominated in US dollars.
D. After deregulation commercial banks were able to expand their international funding sources.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

42. All of the following financial securities are considered ‘uses of funds' by banks except:

A. commercial bills.
B. credit cards.
C. certificates of deposit.
D. overdrafts.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-03 Identify the main uses of funds by commercial banks, including personal and housing lending, commercial lending, lending to government, and other bank assets.
Section: 2.3 Uses of funds

43. If you take out a mortgage from a bank, the mortgage is a/an:

A. liability to the bank and an asset to you.
B. liability to you and an asset to the bank.
C. liability to both you and the bank.
D. asset to both you and the bank.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-03 Identify the main uses of funds by commercial banks, including personal and housing lending, commercial lending, lending to government, and other bank assets.
Section: 2.3 Uses of funds

44. The interest rate BBSW refers to:

A. the reference rate for medium-term funding.
B. a rate calculated each day from the offer rate of the last daily sale in the bank bill market.
C. the average mid-point of the bid and offer rates in the bank bill market.
D. the bank bill security rate.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-03 Identify the main uses of funds by commercial banks, including personal and housing lending, commercial lending, lending to government, and other bank assets.
Section: 2.3 Uses of funds

45. Banks invest in government securities because:

A. they offer high yield owing to their risk.
B. they offer a low yield owing to their illiquidity.
C. all government bonds offer protection against inflation risk.
D. they can be used as security against banks' borrowing.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-03 Identify the main uses of funds by commercial banks, including personal and housing lending, commercial lending, lending to government, and other bank assets.
Section: 2.3 Uses of funds

46. Which of the following statements about commercial lending is incorrect?

A. The term loan is the main type of lending provided by banks to firms.
B. Typically, term loans are for maturities ranging from 5 to 15 years.
C. To extend commercial bill financing a bank may provide the firm with a rollover facility.
D. Banks can provide flexible funding called an overdraft to firms.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-03 Identify the main uses of funds by commercial banks, including personal and housing lending, commercial lending, lending to government, and other bank assets.
Section: 2.3 Uses of funds

47. Which of the following about bank lending to government is incorrect?

A. Securities issued by governments are usually regarded as low risk.
B. Banks invest in government securities because they are a source of liquidity.
C. Banks invest in T-notes because they provide short-term income streams.
D. Government securities enable a bank to manage the maturity structure of its balance sheet.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-03 Identify the main uses of funds by commercial banks, including personal and housing lending, commercial lending, lending to government, and other bank assets.
Section: 2.3 Uses of funds

48. Off-balance-sheet business for a bank refers to:

A. deposits and loans longer than one year.
B. transactions that are currently only a contingent liability.
C. call deposits that may be withdrawn on demand.
D. consumer loans that are in default.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-04 Outline the nature and importance of banks' off - balance-sheet business, including direct credit substitutes, trade- and performance-related items, commitments and market-rate-related contracts.
Section: 2.4 Off-balance-sheet business

49. All of the following are off-balance-sheet transactions of a bank except:

A. documentary letters of credit.
B. performance guarantees.
C. underwriting facilities.
D. bills receivable.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-04 Outline the nature and importance of banks' off - balance-sheet business, including direct credit substitutes, trade- and performance-related items, commitments and market-rate-related contracts.
Section: 2.4 Off-balance-sheet business

50. In recent times, there had been a substantial expansion in fee-related income for banks. What is the principal reason for this?

A. Increased confidence in banks by individual investors
B. Increased off-sheet business (OBS) for banks
C. Reduced guidelines by Australian bank supervisor APRA
D. Increased deposits in banks

Difficulty: Easy
Est time: <1 minute
Learning Objective: 02-04 Outline the nature and importance of banks' off - balance-sheet business, including direct credit substitutes, trade- and performance-related items, commitments and market-rate-related contracts.
Section: 2.4 Off-balance-sheet business

51. Which of the following statements is true for off-balance-sheet business for banks?

A. Off-balance-sheet business is a small part of a bank's income.
B. Off-balance-sheet business is recorded on a bank's statement of income and expense.
C. Off-balance-sheet business represents fee-based income.
D. Off-balance-sheet business records deposits that do not fit on the balance sheet.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-04 Outline the nature and importance of banks' off - balance-sheet business, including direct credit substitutes, trade- and performance-related items, commitments and market-rate-related contracts.
Section: 2.4 Off-balance-sheet business

52. Which of the following statements about market-rate-related items such as forward-rate agreements is incorrect?

A. They are generally called off-balance-sheet items.
B. They are liabilities that may require an outflow of funds for a bank.
C. They are included in the BIS capital-adequacy guidelines.
D. They form a small part of banks' OBS business.

Difficulty: Hard
Est time: <1 minute
Learning Objective: 02-04 Outline the nature and importance of banks' off - balance-sheet business, including direct credit substitutes, trade- and performance-related items, commitments and market-rate-related contracts.
Section: 2.4 Off-balance-sheet business

53. Which of the following categories represents the most significant proportion of total off-balance-sheet business of the banks?

A. Direct credit substitutes
B. Trade and performance-related items
C. Commitments
D. Market-rate-related transactions

Difficulty: Hard
Est time: <1 minute
Learning Objective: 02-04 Outline the nature and importance of banks' off - balance-sheet business, including direct credit substitutes, trade- and performance-related items, commitments and market-rate-related contracts.
Section: 2.4 Off-balance-sheet business

54. Which of the following categories represents the most significant proportion of total market-rate-related off-balance-sheet business of the banks?

A. Currency swap agreements
B. Foreign exchange contracts
C. Interest rate swaps
D. Interest rate futures

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-04 Outline the nature and importance of banks' off - balance-sheet business, including direct credit substitutes, trade- and performance-related items, commitments and market-rate-related contracts.
Section: 2.4 Off-balance-sheet business

55. An example of an 'off-sheet business' transaction that banks are generally involved in is:

A. providing a 'standby letter of credit'.
B. providing a note issuance facility.
C. providing a short-term, self-liquidating trade contingency.
D. all of the given answers.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-04 Outline the nature and importance of banks' off - balance-sheet business, including direct credit substitutes, trade- and performance-related items, commitments and market-rate-related contracts.
Section: 2.4 Off-balance-sheet business

56. Which of the following statements about direct credit substitutes provided by a commercial bank is incorrect?

A. They are provided to support a client's financial obligations.
B. An example of a direct credit substitute is a bank guarantee.
C. The bank provides funding to a third party instead of the client providing the funding.
D. With a direct credit substitute a bank's client can raise funds directly from the financial markets.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-04 Outline the nature and importance of banks' off - balance-sheet business, including direct credit substitutes, trade- and performance-related items, commitments and market-rate-related contracts.
Section: 2.4 Off-balance-sheet business

57. Off-balance-sheet business is usually divided into four major categories:

A. Direct credit substitutes, trade and performance-related items, commitments and trade guarantees.
B. Direct credit substitutes, trade and performance-related items, commitments and market-related transactions.
C. Direct credit substitutes, trade and performance-related items, commitments and underwriting facilities.
D. Direct credit substitutes, ‘standby letters of credit', commitments and market-related transactions.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-04 Outline the nature and importance of banks' off - balance-sheet business, including direct credit substitutes, trade- and performance-related items, commitments and market-rate-related contracts.
Section: 2.4 Off-balance-sheet business

58. A ‘commitment’ by a bank is:

A. a form of swap.
B. a promise by a large depositor to provide extra funds to the bank.
C. the unused balance on a bank credit card.
D. an undertaking to advance funds or to acquire an asset in the future.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-04 Outline the nature and importance of banks' off - balance-sheet business, including direct credit substitutes, trade- and performance-related items, commitments and market-rate-related contracts.
Section: 2.4 Off-balance-sheet business

59. Which of the following is not a commitment by a bank?

A. Outright forward purchase agreement
B. Underwriting facilities
C. Credit card limit approvals unused by cardholder
D. Currency swap

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-04 Outline the nature and importance of banks' off - balance-sheet business, including direct credit substitutes, trade- and performance-related items, commitments and market-rate-related contracts.
Section: 2.4 Off-balance-sheet business

60. Which of the following is NOT an argument for some form of government regulation of the banking system?

A. The money-creation role of banks
B. A major source of funds to the banks comes from households who need their savings protected
C. The excess return on assets that banks have been making in recent years
D. Maintaining confidence in the financial system

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-05 Consider the regulation and prudential supervision of banks.
Section: 2.5 Regulation and prudential supervision of commercial banks

61. Which of the following is NOT associated with the purpose of regulating financial institutions?

A. Providing stability of the money supply
B. Directing flow of funds to priority areas
C. Maintaining the soundness and stability of the financial system
D. Lowering the cost of funds

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-05 Consider the regulation and prudential supervision of banks.
Section: 2.5 Regulation and prudential supervision of commercial banks

62. The Australian institution APRA is responsible for the regulatory supervision of financial institutions such as banks and credit unions. APRA stands for:

A. Australian Practice and Regulatory Association.
B. Australian Prudential Regulation Authority.
C. Australian Prudential Rule Authority.
D. Australian Practice and Regulatory Authority.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 02-05 Consider the regulation and prudential supervision of banks.
Section: 2.5 Regulation and prudential supervision of commercial banks

63. Which of the following institutions are supervised by APRA?

A. Building societies
B. Commercial banks
C. Credit unions
D. All of the given answers

Difficulty: Easy
Est time: <1 minute
Learning Objective: 02-05 Consider the regulation and prudential supervision of banks.
Section: 2.5 Regulation and prudential supervision of commercial banks

64. Within the context of the Corporations Law in Australia, the supervision of financial market integrity and consumer protection is done by:

A. APRA.
B. ASIC.
C. RBA.
D. ACCC.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-05 Consider the regulation and prudential supervision of banks.
Section: 2.5 Regulation and prudential supervision of commercial banks

65. The requirement and observation of standards designed to ensure the stability and soundness of a financial system is called:

A. fiscal policy.
B. monetary policy.
C. prudential supervision.
D. the Basel accord.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 02-05 Consider the regulation and prudential supervision of banks.
Section: 2.6 A background to the capital adequacy standards

66. The Basel capital adequacy requirements apply to:

A. all financial institutions.
B. banks, investment banks and merchant banks only.
C. all financial institutions supervised by ASIC.
D. all banks registered with APRA and some other financial institutions.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 02-06 Understand the background and application of the capital adequacy standards.
Section: 2.6 A background to the capital adequacy standards

67. Some of the elements in assessing capital adequacy requirements for banks under the Basel II capital accord are:

A. credit risk, liquidity risk and interest rate risk.
B. credit risk, market risk and type of capital held.
C. default risk, interest rate risk and market risk.
D. default risk, liquidity risk and type of capital held.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-06 Understand the background and application of the capital adequacy standards.
Section: 2.7 Basel II capital accord

68. According to the textbook, the Basel II approach to capital adequacy for banks involves ____ main elements.

A. three
B. four
C. five
D. six

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-06 Understand the background and application of the capital adequacy standards.
Section: 2.7 Basel II capital accord

69. Which of the following does NOT apply to Tier 1 capital?

A. Tier 1 capital is described as ‘core capital'.
B. Tier 1 capital must constitute at least 50% of a bank's capital base.
C. Paid-up ordinary shares can be included in Tier 1 capital.
D. Cumulative irredeemable APRA-approved preference shares can be included in Tier 1 capital.

Difficulty: Hard
Est time: <1 minute
Learning Objective: 02-06 Understand the background and application of the capital adequacy standards.
Section: 2.7 Basel II capital accord

70. Under Basel II prudential standards, an institution is required to maintain a risk-based capital ratio of _____ of total-risk-weighted assets.

A. 2.00 percent
B. 4.00 percent
C. 8.00 percent
D. 10.00 percent

Difficulty: Easy
Est time: <1 minute
Learning Objective: 02-05 Consider the regulation and prudential supervision of banks.
Section: 2.5 Regulation and prudential supervision of commercial banks

71. Which of the following statements about regulatory capital is false?

A. Tier 1 capital includes paid-up ordinary shares, retained earnings, non-cumulative irredeemable preference shares and general reserves.
B. Tier 2 capital includes general provision for doubtful debts, revaluation reserves of premises, mandatory convertible notes and approved perpetual subordinated debt.
C. Tier 1 capital is core capital, including paid-up ordinary shares, non-cumulative irredeemable preference shares and general reserves.
D. Tier 2 capital includes general reserves for doubtful debts, asset revaluation reserves of premises, other preference shares, mandatory convertible notes, cumulative redeemable preference shares and perpetual subordinated debt.

Difficulty: Hard
Est time: <1 minute
Learning Objective: 02-06 Understand the background and application of the capital adequacy standards.
Section: 2.7 Basel II capital accord

72. The Pillar 1 approach of Basel II capital adequacy incorporates the following three risk components:

A. credit risk, interest-rate risk and market risk.
B. default risk, interest-rate risk and operational risk.
C. credit risk, market risk and operational risk.
D. default risk, foreign exchange risk and operational risk.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-06 Understand the background and application of the capital adequacy standards.
Section: 2.7 Basel II capital accord

73. Which of the following statements regarding capital adequacy requirements is incorrect?

A. Existing credit-risk guidelines are extended to include market risk arising from a bank's trading activities.
B. Regulators focus on credit risk, market risks, operational risk and type of capital held.
C. Eligible Tier 1 capital must constitute at least 70% of a bank's capital base.
D. Tier 2 capital is divided into upper and lower Tier 2 parts.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-06 Understand the background and application of the capital adequacy standards.
Section: 2.7 Basel II capital accord

74. Under the capital adequacy requirement for banks, in order to fund a $100 000 loan for a multinational corporate client with a Standard & Poor's rating of AA, a bank will:

A. assign a risk-weighting of 20% for the balance.
B. allocate Tier 1 and Tier 2 capital to the loan according to the riskiness of the company.
C. seek funding in the euromarkets to minimise the capital adequacy requirements.
D. apply a risk weighting of 50% to the loan to determine the total capital requirement.

Difficulty: Hard
Est time: <1 minute
Learning Objective: 02-08 Understand the standardised approach to credit risk and compute the capital requirements for particular transactions.
Section: Extended learning A

75. In the Basel II standardised approach to external rating grades, the asset counterparty weights for capital adequacy guidelines are:

A. 10%, 20%, 50% and 100%.
B. 10%, 50%, 100% and 150%.
C. 20%, 50%, 100% and 150%.
D. 20%, 50%, 100% and 200%.

Difficulty: Hard
Est time: <1 minute
Learning Objective: 02-08 Understand the standardised approach to credit risk and compute the capital requirements for particular transactions.
Section: Extended learning A

76. The Basel II risk weighting factor for a bank loan to an Australian company with a Moody's Investors Service rating of C is:

A. 20%.
B. 50%.
C. 100%.
D. 150%.

Difficulty: Hard
Est time: <1 minute
Learning Objective: 02-08 Understand the standardised approach to credit risk and compute the capital requirements for particular transactions.
Section: Extended learning A

77. Under Pillar 1 of the Basel II framework, the risk weight for a residential housing loan is determined by the:

A. amount borrowed.
B. level of mortgage insurance.
C. house valuation.
D. all of the given answers.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-08 Understand the standardised approach to credit risk and compute the capital requirements for particular transactions.
Section: Extended learning A

78. A bank provides a loan of $1 million to a company that has an A rating. Calculate the dollar value of capital required under the capital adequacy requirements to support the facility.

A. $16 000
B. $40 000
C. $80 000
D. $120 000

Difficulty: Hard
Est time: <1 minute
Learning Objective: 02-08 Understand the standardised approach to credit risk and compute the capital requirements for particular transactions.
Section: Extended learning A

79. A bank provides documentary letters of credit for a company that has a credit rating of A+. The face value of contracts outstanding is $2 million. Calculate the dollar value of capital required under the capital adequacy requirements to support these facilities, given that the bank supervisor's credit conversion factor is 20%.

A. $6 400
B. $16 000
C. $160 000
D. $240 000

Difficulty: Hard
Est time: <1 minute
Learning Objective: 02-08 Understand the standardised approach to credit risk and compute the capital requirements for particular transactions.
Section: Extended learning A

80. A large commercial bank operating in the international markets will generally apply to the banks' supervisor to use the _____ to credit risk.

A. advanced internal ratings-based approach
B. foundation external ratings-based approach
C. standardised approach
D. standardised approach with external ratings

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-06 Understand the background and application of the capital adequacy standards.
Section: 2.7 Basel II capital accord

81. Under Basel II capital accord, the approach to credit risk that requires a bank to assign risk weights given by the prudential supervisor is called:

A. an advanced approach.
B. a foundation approach.
C. a standardised approach.
D. advanced-internal ratings.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-06 Understand the background and application of the capital adequacy standards.
Section: 2.7 Basel II capital accord

82. The risk that arises from chance of loss as a result of inadequate internal bank processes is called:

A. default risk.
B. interest rate risk.
C. market risk.
D. operational risk.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-06 Understand the background and application of the capital adequacy standards.
Section: 2.7 Basel II capital accord

83. Which of the following statements about recently adopted guidelines covering capital requirements for market risk that banks are required to perform is false?

A. Banks use a risk measurement model based on a VaR approach.
B. Banks estimate the sensitivity of portfolio components to small changes in prices.
C. Banks must hold capital against risk of loss from changes in interest rates.
D. Banks hold a fixed allocation of funds between various balance sheet assets and off-balance-sheet business.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-06 Understand the background and application of the capital adequacy standards.
Section: 2.7 Basel II capital accord

84. For a commercial bank operating in foreign exchange, interest rate and equity markets, the capital adequacy guidelines for the market risk it is exposed to fall under:

A. Pillar 1.
B. Pillar 2.
C. Pillar 3.
D. Pillar 4.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-06 Understand the background and application of the capital adequacy standards.
Section: 2.7 Basel II capital accord

85. For a commercial bank's normal day-to-day business, the capital adequacy guidelines for the operational risk it is exposed to fall under:

A. Pillar 1.
B. Pillar 2.
C. Pillar 3.
D. Pillar 4.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-06 Understand the background and application of the capital adequacy standards.
Section: 2.7 Basel II capital accord

86. For a commercial bank's market discipline, the capital adequacy guidelines for its disclosure and transparency requirements fall under:

A. Pillar 1.
B. Pillar 2.
C. Pillar 3.
D. Pillar 4.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-06 Understand the background and application of the capital adequacy standards.
Section: 2.7 Basel II capital accord

87. Under _____ of Basel II, bank supervisors should review and evaluate banks' internal capital adequacy assessments.

A. Pillar 4
B. Pillar 3
C. Pillar 1
D. Pillar 2

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-06 Understand the background and application of the capital adequacy standards.
Section: 2.7 Basel II capital accord

88. Part of a bank's liquidity management is to hold a portfolio of:

A. term loans.
B. mortgages.
C. Commonwealth government securities.
D. credit card loans.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-06 Understand the background and application of the capital adequacy standards.
Section: 2.7 Basel II capital accord

89. In relation to a bank, liquidity management means:

A. the bank's ability to quickly convert deposits into loans.
B. the bank's ability to onsell its loans.
C. the bank's ability to have funds available when depositors' funds mature.
D. the bank's policies and practices in identifying and managing its loans portfolios.

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-07 Examine liquidity management and other supervisory controls applied by APRA.
Section: 2.8 Liquidity management and other supervisory controls

True / False Questions

90. Commercial banks are the main type of financial institution in a financial system because they hold the largest amounts of financial assets.

TRUE

Banks have long been the dominant type of financial institution, although in recent years managed funds have close to having the same amount of financial assets under management.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 02-01 Evaluate the functions and activities of commercial banks within the financial system.
Section: Introduction

91. The greater the dominance of commercial banks in an economy, the less regulation required.

FALSE

Because of the dominance of banks and the correlation between their business and a country's economy, there are strong arguments for regulation to constrain a bank's business.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 02-01 Evaluate the functions and activities of commercial banks within the financial system.
Section: Introduction

92. Banks obtain funds from many areas. These sources of funds appear as liabilities on a bank's balance sheet.

TRUE

Deposits are a major part of a bank's sources of funds and a bank needs to pay interest expenses.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 02-01 Evaluate the functions and activities of commercial banks within the financial system.
Section: 2.1 The main activities of commercial banking

93. Liability management is where banks actively manage their liabilities in order to meet future loan demand.

TRUE

Difficulty: Easy
Est time: <1 minute
Learning Objective: 02-01 Evaluate the functions and activities of commercial banks within the financial system.
Section: 2.1 The main activities of commercial banking

94. Call deposits are funds lodged in a bank account for a specified short-term period.

FALSE

Difficulty: Easy
Est time: <1 minute
Learning Objective: 02-01 Evaluate the functions and activities of commercial banks within the financial system.
Section: 2.1 The main activities of commercial banking

95. A bank may either issue a negotiable certificate of deposit directly into the money markets or place it directly with another bank with surplus funds.

FALSE

Difficulty: Medium
Est time: <1 minute
Learning Objective: 02-01 Evaluate the functions and activities of commercial banks within the financial system.
Section: 2.1 The main activities of commercial banking

96. One of the important attributes of certificates of deposit for a bank is the ability to adjust the yields on new issues.

TRUE

The yield on a CD cannot be adjusted until it reaches maturity and a new CD is issued.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 02-01 Evaluate the functions and activities of commercial banks within the financial system.
Section: 2.1 The main activities of commercial banking

97. As the majority of banks' assets are short-term loans, they are active in the money markets in order to fund part of their lending.

FALSE

A normal bank acquires most of its funding from deposits.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

98. A bank may seek to obtain funds by issuing unsecured notes with a collaterised floating charge over its deposits.

FALSE

Unsecured notes do not have any security attached.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

99. Foreign currency liabilities are debt instruments issued into another country but not denominated in the currency of that country.

FALSE

Foreign currency liabilities are typically denominated in foreign currencies such as US dollars, the yen and pound sterling.

Difficulty: Easy
Est time: <1 minute
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: Introduction

Short Answer Questions

100. Briefly discuss the sources of funds for a commercial bank.

Est time: 1-3 minutes
Learning Objective: 02-01 Evaluate the functions and activities of commercial banks within the financial system.
Section: 2.2 Sources of funds

101. Describe how a bill acceptance facility works.

If a company with a good credit record is looking to raise funds through the issue of a bill of exchange into the money markets, a bank may have the role of acceptor for the bill where the bank agrees to pay the face value of the bill to the holder at maturity and will have a separate arrangement to recover the funds from the issuer. The bank will earn fees for providing this service. Alternatively, the bank may provide the funds directly for the bill by agreeing to discount the bill and buy it from the issuer, and usually rediscount the bill subsequently. Consequently, the bank could provide both a bill acceptance facility and a bill discount facility.

Est time: 1-3 minutes
Learning Objective: 02-02 Identify the main sources of funds of commercial banks, including current deposits, demand deposits, term deposits, negotiable certificates of deposit, bill acceptance liabilities, debt liabilities, foreign currency liabilities and loan capital.
Section: 2.2 Sources of funds

102. Discuss the main features of housing finance.

This involves the lending of long-term funds to individuals so that they can buy residential property. As security for the loan, the bank lender registers a mortgage over the property. In recent years commercial banks and specialist mortgage lenders have used securitisation to refinance their lending.

Est time: 1-3 minutes
Learning Objective: 02-03 Identify the main uses of funds by commercial banks, including personal and housing lending, commercial lending, lending to government, and other bank assets.
Section: 2.3 Uses of funds

103. Discuss the main features of a bank's commercial lending.

Commercial lending is when banks lend to the business sector and other financial institutions. This is considered essential if economic growth is to be achieved within a country. Commercial banks offer borrowers both short-term and long-term loans of various types such as overdraft facilities.

Est time: 1-3 minutes
Learning Objective: 02-03 Identify the main uses of funds by commercial banks, including personal and housing lending, commercial lending, lending to government, and other bank assets.
Section: 2.3 Uses of funds

104. Within the context of off-balance-sheet business, explain direct credit substitutes, trade- and performance-related items and any differences between these items.

Direct credit substitutes are where a bank supports a client's financial obligation such as providing a ‘standby letter of credit' so that a company may raise funds directly in the market place. Trade- and performance-related items are when a bank offers guarantees to support a client's non-financial obligations. Both of these items are not recorded on a bank's balance sheet.

Est time: 1-3 minutes
Learning Objective: 02-04 Outline the nature and importance of banks' off - balance-sheet business, including direct credit substitutes, trade- and performance-related items, commitments and market-rate-related contracts.
Section: 2.4 Off-balance-sheet business

Chapter 02 - Test Bank Summary

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