# Quiz: Lesson 1.2 – The Economics of Financial Intermediation

## Module 1: The Cost Problem

Prof. Dr. Joerg Osterrieder

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# Question 1 (Understand)

According to Coase (1937), why do firms exist?

- A. Governments require economic activity to be organized through firms
- B. Firms can avoid paying taxes that market participants must pay
- C. Firms always produce goods at lower marginal cost than individuals
- D. **Using the market price mechanism involves transaction costs that firms can reduce**

# Question 2 (Apply)

A payment network requires specialized fraud-detection infrastructure, faces unpredictable chargeback volumes, and processes millions of transactions daily. Using Williamson's framework, which governance structure is predicted?

- A. Pure market exchange with spot contracts
- B. Bilateral barter between merchants and consumers
- C. Government-operated public utility
- D. **Hierarchical governance (intermediary/firm)**

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# Question 3 (Apply)

An interchange fee of 0.3% + €0.05 is charged on a €80 purchase. What is the total interchange amount?

- A €0.05
- B €0.35
- C €0.24
- D **€0.29**

# Question 4 (Understand)

In Williamson's Transaction Cost Economics framework, which of the following is NOT one of the three key dimensions?

- A Frequency
- B **Market capitalization**
- C Uncertainty
- D Asset specificity

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# Question 5 (Apply)

A correspondent bank charges 15 basis points on a $10,000 cross-border payment. What is the fee in dollars?

- A $150.00
- B $0.15
- C **$15.00**
- D $1.50

# Question 6 (Analyze)

A bank introduces a $50 annual card fee shortly after interchange caps reduce issuer revenue. This is best described as:

- (A) A network effect failure
- (B) **The waterbed effect**
- (C) A Coasian externality
- (D) Two-sided market optimization

# Question 7 (Apply)

Bank A in Country X holds an account denominated in Country Y's currency at Bank B in Country Y. From Bank A's perspective, this account is:

- A **A nostro account**
- B A clearing account
- C A reserve account
- D A vostro account

# Question 8 (Analyze)

A remittance provider advertises "zero transfer fees" but offers an exchange rate 4% worse than the mid-market rate on a $500 transfer. What is the actual total cost to the sender?

- A **$20.00**
- B $40.00
- C $5.00
- D $0 (fees are zero)

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# Question 9 (Understand)

In a two-sided card network, which side is typically subsidized by interchange?

A. **The cardholder (consumer) side**
B. The card network itself
C. The regulator
D. The merchant side

# Question 10 (Apply)

A cross-border payment passes through Sender $\rightarrow$ Sender's Bank $\rightarrow$ Correspondent A $\rightarrow$ Correspondent B $\rightarrow$ Receiver's Bank $\rightarrow$ Receiver. How many intermediaries handle the funds?

- A 3
- B **4**
- C 2
- D 5

# Question 11 (Analyze)

Why do low-volume remittance corridors tend to have higher costs per transaction?

A. The currencies involved are always more volatile
B. **Fixed infrastructure costs are spread over fewer transactions, and fewer providers reduce competition**
C. Regulators intentionally set higher fees for small corridors
D. Correspondent banks refuse to serve these corridors entirely

# Question 12 (Apply)

The EU Interchange Fee Regulation (IFR) caps consumer debit card interchange at:

A. **0.2% of transaction value**
B. 0.1% of transaction value
C. 0.3% of transaction value
D. 0.5% of transaction value

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# Question 13 (Analyze)

A FinTech uses peer-to-peer currency matching to avoid correspondent banks for FX conversion. Which transaction cost component does this primarily reduce?

- A Compliance costs
- B Enforcement costs
- C **Search and bargaining costs (plus FX intermediary spreads)**
- D Monitoring costs

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# Question 14 (Understand)

What is the primary function of SWIFT in cross-border payments?

A. Setting interchange fees for international transactions
B. Moving funds between bank accounts
C. Converting currencies at the mid-market rate
D. **Providing a secure messaging network for payment instructions**

# Question 15 (Apply)

A merchant pays a Merchant Service Charge (MSC) of 1.10%. If interchange is 0.30%, the network fee is 0.10%, and the acquirer takes the remainder, what is the acquirer's margin?

- A 0.30%
- B 0.60%
- C **0.70%**
- D 0.80%

# Question 16 (Analyze)

After interchange caps are introduced, a study finds that retail prices did not decrease despite lower merchant fees. Which explanation is most consistent with this finding?

- A. Consumer demand increased simultaneously
- B. Merchants illegally retained the savings
- C. The caps were not effectively enforced
- D. **Merchant cost pass-through to consumers is incomplete due to competitive dynamics**

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# Question 17 (Apply)

A bank maintains nostro accounts in 15 different currencies, each pre-funded with the equivalent of $2 million. What is the total trapped liquidity?

- A $15 million
- B $2 million
- C **$30 million**
- D $150 million

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# Question 18 (Evaluate)

A policy advisor argues that interchange should be banned entirely (set to zero). Using two-sided market theory, what is the strongest counter-argument?

- A **Zero interchange would under-subsidize the consumer side, reducing card adoption and harming the platform equilibrium**
- B Card networks would relocate to unregulated jurisdictions
- C Merchants would have no incentive to accept cards
- D Banks would go bankrupt without interchange revenue

# Question 19 (Analyze)

The US Durbin Amendment caps debit interchange for large banks but exempts small banks. What is the most likely competitive effect?

- A. Small banks lose market share because they cannot offer rewards
- B. **Merchants may prefer routing transactions to networks with lower (capped) interchange, disadvantaging exempt small banks**
- C. The exemption has no practical effect on competition
- D. Large banks benefit because they can charge higher credit card interchange

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# Question 20 (Evaluate)

A developing country has high remittance costs (approximately 12%) due to de-risking, few providers, and cash-dependent last-mile delivery. Rank the following interventions from most to least effective at reducing costs:

**(i)** Mandate interchange caps **(ii)** Invest in digital payment infrastructure **(iii)** License new money transfer operators

- A (iii), (i), (ii) — more operators drive competition
- B (i), (ii), (iii) — caps always reduce costs first
- C **(ii), (iii), (i) — infrastructure enables digital channels; more providers add competition; interchange caps address card payments, not remittances directly**
- D (i), (iii), (ii) — regulation should come before infrastructure

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