Quiz: Lesson 1.2 – The Economics of Financial Intermediation

Module 1: The Cost Problem

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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. **Using the market price mechanism involves transaction costs that firms can reduce**
D. Firms always produce goods at lower marginal cost than individuals

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. **Hierarchical governance (intermediary/firm)**
C. Government-operated public utility
D. Bilateral barter between merchants and consumers

Question 3 (Apply)

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

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

Question 4 (Understand)

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

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

Question 5 (Apply)

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

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

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 Coasian externality
B. A network effect failure
C. **The waterbed effect**
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 vostro account
B. A clearing account
C. A reserve account
D. **A nostro 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. $0 (fees are zero)

B. $5.00

C. **$20.00**

D. $40.00

Question 9 (Understand)

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

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

Question 10 (Apply)

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

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

Question 11 (Analyze)

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

A. Regulators intentionally set higher fees for small corridors

B. The currencies involved are always more volatile

C. **Fixed infrastructure costs are spread over fewer transactions, and fewer providers reduce competition**

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. 0.1% of transaction value

B. **0.2% of transaction value**

C. 0.3% of transaction value

D. 0.5% of transaction value

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. Enforcement costs

B. **Search and bargaining costs (plus FX intermediary spreads)**

C. Compliance costs

D. Monitoring costs

Question 14 (Understand)

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

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

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 0.80%
- C 0.60%
- D **0.70%**

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. Merchants illegally retained the savings

B. **Merchant cost pass-through to consumers is incomplete due to competitive dynamics**

C. The caps were not effectively enforced

D. Consumer demand increased simultaneously

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. $2 million
B. $15 million
C. **$30 million**
D. $150 million

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. Banks would go bankrupt without interchange revenue

B. Merchants would have no incentive to accept cards

C. **Zero interchange would under-subsidize the consumer side, reducing card adoption and harming the platform equilibrium**

D. Card networks would relocate to unregulated jurisdictions

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. Large banks benefit because they can charge higher credit card interchange

D. The exemption has no practical effect on competition

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. (i), (ii), (iii) — caps always reduce costs first

B. (iii), (i), (ii) — more operators drive competition

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

Answer Key

1. (C) – Market transaction costs
2. (B) – Hierarchical governance
3. (C) – €0.29
4. (D) – Market capitalization
5. (C) – $15.00
6. (C) – Waterbed effect
7. (D) – Nostro account
8. (C) – $20.00
9. (A) – Cardholder side
10. (C) – 4 intermediaries
11. (C) – Fixed costs / low competition
12. (B) – 0.2%
13. (B) – Search/bargaining + FX spreads
14. (C) – Secure messaging network
15. (D) – 0.70%
16. (B) – Incomplete pass-through
17. (C) – $30 million
18. (C) – Platform equilibrium argument
19. (B) – Routing disadvantage
20. (C) – Infrastructure, operators, caps