Spring Examinations 2015

FINM02615N

MODULE TITLE  International Banking and Financial Markets
LEVEL  Seven
TIME ALLOWED  Two hours plus 15 minutes reading time. Students must not commence answering the questions until the reading time has ended.

Instructions to students:
- Enter your student number not your name on all answer booklets.
- During the 15 minutes reading time, students are permitted to make notes on the examination paper but not the answer booklet. Students should begin answering the questions after the reading time has ended.
- Answer four out of seven questions.
- All questions are equally weighted. Where a question has more than one part the division of marks is stated.
- Neither books nor notes may be taken into the examination.
- The use of a non-programmable silent calculator is permitted.

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<tr>
<td>No. of Pages</td>
<td>5</td>
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<tr>
<td>No. of Questions</td>
<td>7</td>
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Answer four out of seven questions.

1. The Bank for International Settlements in Basel has stipulated that banks should maintain a specified level of capital against their balance sheet assets.

   Required:
   
   a. Explain the importance of the capital ratio of a bank and why regulators impose minimum ratios.  
      
      (7 marks)
   
   b. Discuss the impact of the Basel II on banks.  
      
      (8 marks)
   
   c. Explain the key changes to bank capital and liquidity provided by the proposed Basel III. Discuss the likely impact of these regulations.  
      
      (10 marks)
   
      (Total: 25 marks)

2. The collapse in consumer confidence in Northern Rock plc was an early indicator of the impact of the credit crunch in 2008.

   Required:
   
   a. Discuss the importance that maintaining an adequate level of liquidity has in relation to preserving customer and interbank markets confidence.  
      
      (10 marks)
   
   b. Outline the key proposals on liquidity from the Financial Services Authority’s (FSA) Strengthening Liquidity Standards (CP08/22, December 2008), and discuss their impact on UK banks.  
      
      (8 marks)
   
   c. Discuss other factors, apart from liquidity, that impact the level of consumer confidence in a bank and why.  
      
      (7 marks)
   
      (Total: 25 marks)
3. The rise in the use of derivatives by financial institutions since the 1990’s has been one of the most significant changes in banking risk management practices.

Required:

a. Define any derivative financial instrument (apart from swaps) and describe what the perceived benefits of the use of derivatives are for banks.

   (8 marks)

b. Explain the purpose of an interest rate swap, and how it is structured for each counterparty.

   (10 marks)

c. Discuss how the extensive use of derivative products may affect the stability of the financial markets.

   (7 marks)

   (Total: 25 marks)

4. The money markets are an interlinked set of different short term markets for financial instruments.

Required:

a. Describe the key features shared by the main UK money markets and how financial institutions use the different markets.

   (12 marks)

b. Explain the Euro currency money markets and discuss their impact on the UK money markets.

   (8 marks)

c. Discuss the problems that the Euro currency markets bring to domestic financial regulators.

   (5 marks)

   (Total: 25 marks)
5. Three companies have the following financial structure:

<table>
<thead>
<tr>
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<th>Rectory plc</th>
<th>Vicarage plc</th>
<th>Palace plc</th>
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<tbody>
<tr>
<td>£1 Shares in Issue</td>
<td>£250 million</td>
<td>£580 million</td>
<td>£820 million</td>
</tr>
<tr>
<td>Current market price</td>
<td>£2.30</td>
<td>£0.43</td>
<td>£3.20</td>
</tr>
<tr>
<td>Debt</td>
<td>£250 million</td>
<td>£250 million</td>
<td>£250 million</td>
</tr>
<tr>
<td>Gross profit</td>
<td>£64 million</td>
<td>£41 million</td>
<td>£256 million</td>
</tr>
<tr>
<td>Earnings (profit after tax)</td>
<td>£52 million</td>
<td>£7 million</td>
<td>£130 million</td>
</tr>
<tr>
<td>Dividend per share (pence)</td>
<td>8</td>
<td>2.8</td>
<td>17</td>
</tr>
<tr>
<td>Investors required rate of return</td>
<td>8%</td>
<td>15%</td>
<td>10%</td>
</tr>
<tr>
<td>Dividend Growth rate</td>
<td>4.5%</td>
<td>10%</td>
<td>5%</td>
</tr>
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Required:

a. Calculate the following for each company:

i. Debt/equity ratio. (1.5 marks)

ii. Earnings per share. (1.5 marks)

iii. Dividend yield. (1.5 marks)

iv. Earnings yield. (1.5 marks)

v. Price earnings ratio. (1.5 marks)

vi. Theoretical share price under the Gordon Growth model. By how much are these shares over or under priced? (4.5 marks)

b. Discuss the key differences between debt and equity financing for a Bank compared to other financial intermediaries. (6 marks)

c. Discuss why companies holding high levels of gearing, creates concerns for investors (both debt and equity investors). Explain the impact on profitability of a change on the level of a company’s gearing. (7 marks)

(Total: 25 marks)
6. Easy Credit Bank plc is considering securitising a part of its personal loan portfolio.

**Required:**

a. Explain the process of securitisation and the steps taken to securitise a portfolio.  
(12 marks)

b. Explain what are the benefits of securitisation to the issuer.  
(6 marks)

c. What are the credit enhancement techniques that banks employ to improve the credit rating of a SPV?  
(7 marks)

(Total: 25 marks)

7. The management of a country’s money supply in order to control demand, inflation and interest rates is a key objective of a Government’s monetary authority.

**Required:**

a. Explain why the central banks seek to intervene in the money supply of an economy. Discuss what macroeconomic factors the monetary authorities are trying to control.  
(7 marks)

b. Describe the operation of the three main methods that monetary authorities use to control the money supply of a country.  
(9 marks)

c. Explain how Quantitative Easing may provide an inflationary stimulus to the economy.  
(9 marks)

(Total: 25 marks)