Examination Period 3: 2018/19

Module Title  Global Banking
Level       Six
Time Allowed  Two hours plus fifteen minutes reading time

Instructions to students:
- Enter your student number **not** your name on all answer books.
- Students are encouraged to use the **first fifteen minutes** of the exam to read the questions carefully and to plan answers.
- Answer **four** out of **six** questions.
- All questions carry equal marks
- The use of a calculator **is** permitted.

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<th>No. of Pages</th>
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<td>No. of Questions</td>
<td>6</td>
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Question 1

Discuss **five** circumstances under which regulation might decrease rather than increase the stability of a global banking industry.

**Total: 25 marks**

Question 2

An **option contract** is a type of financial derivative instrument.

**Required:**

a. Using a clear example, explain how an option contract works.  
   **(5 marks)**

b. With example, identify and explain the key features of an option contract.  
   **(10 marks)**

c. Using examples, demonstrate the difference between a put option and a call option.  
   **(5 marks)**

d. Explain why American options are more popular than European options.  
   **(5 marks)**

**Total: 25 marks**

Question 3

Off-balance-sheet activities of banks:

**Required:**

a. What is an off-balance-sheet activity?  
   **(5 marks)**

b. Give **two** examples to illustrate why such activities are referred to as off-balance-sheet (OBS).  
   **(10 marks)**

   **(10 marks)**

**Total: 25 marks**
Question 4

Credit Rating Agencies

a. Describe the roles that credit rating agencies play in the financial markets. (12 marks)

b. Why were credit rating agencies criticised over the recent financial crisis? (13 marks)

Total: 25 marks

Question 5

The risk weighting rules for on-balance sheet asset items can be simplified as follows:

- Cash, government securities (OECD): 0%
- Interbank (OECD): 20%
- Mortgage: 50%
- Loan: 100%

Alpha Bank’s balance sheet is expressed as follows:

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reserve with central bank 150</td>
<td>Demand deposit 845</td>
</tr>
<tr>
<td>Mortgage loans 650</td>
<td>Term deposits 420</td>
</tr>
<tr>
<td>Corporate loans 350</td>
<td>Interbank deposit 460</td>
</tr>
<tr>
<td>Interbank loans 395</td>
<td>Subordinated debt 50</td>
</tr>
<tr>
<td>OECD government bonds 205</td>
<td>Equity 96</td>
</tr>
<tr>
<td>Fixed assets 120</td>
<td></td>
</tr>
<tr>
<td><strong>Total: 1870</strong></td>
<td><strong>Total: 1870</strong></td>
</tr>
</tbody>
</table>

Required:

a. Calculate the bank’s total risk weighted assets (RWA) for Credit Risk. (10 marks)

b. Calculate the bank’s Common Equity Tier 1 and Tier 2 capital ratios. (5 marks)

c. Calculate the bank’s total Basel capital ratio and comment on the result. (5 marks)

d. Explain briefly the requirements for Tier 1 Capital Ratio and Total Capital Ratio under Basel III. (5 marks)

Total: 25 marks
Question 6

Suppose a bank currently has £150 million in deposits, and £15 million in reserves. The required re-reserve ratio is 10% (so this bank holds no excess reserves).

a. If there is a deposit outflow (i.e. some people withdraw funds from their accounts) for £5 million, would this bank still comply with the central bank’s requirement of keeping 10% of its deposits in the form of reserves? (15 marks)

b. What would be the cost for this bank to comply with this regulation if the bank decides to borrow from another bank to eliminate its reserve shortage? Assume an interbank lending rate of 0.25%. (10 marks)

Total 25 marks