

UNIVERSITY OF COLOMBO, SRI LANKA

FACULTY OF MANAGEMENT AND FINANCE

Bachelor of Business Administration (Level II - Semester VI) Examination  
December 2017

**FIN 2304 – Theory and Practice of Banking**

**Three (03) Hours**

Instructions to candidates:

1. Answer **ALL** Questions.
2. The use of calculators is permitted.
3. Normal distribution and present value tables are provided.

1.

- i. The banks face the agency problem due to information asymmetry. Explain the methods that a bank can use to overcome the agency problem.

(05 Marks)

- ii. The Basel Committee issued advanced global standards (Basel III) for strengthening the capital adequacy framework (Central Bank Annual Report, 2016). Briefly explain the following two salient features of Basel III.

- a. Introducing the Bail-in Provisions
- b. Introducing the Countercyclical Buffer

(05 Marks)

- iii. "Bank governance is different from non-financial organizations because of the nature of banking business." Briefly explain five (05) reasons to justify this statement.

(10 Marks)

**(Total Marks 20)**

2.

- i. Briefly explain four (04) cost management strategies a bank can use to improve its business operations.

(06 Marks)

- ii. Bank A and Bank B are two licensed commercial banks which conduct the same volume and type of business. The following information is given with respect to Bank A and Bank B.

	Bank A	Bank B
	Rs.	Rs.
Assets	525,000,000	525,000,000
Assets per employee	1,250,000	1,500,000
Personnel expense per employee	40,350	45,550

Which bank shows the better productivity? Justify your answer.

(06 Marks)

- iii. Open market operation (OMO) is one of the quantitative credit control techniques use by the Central Bank to control the supply of credit in an economy. Explain the functionality of OMO of the Central Bank.

(08 Marks)

**(Total Marks 20)**

3.

- i. "Banks need to increase the gearing level to improve the return to their shareholders". Describe the use of Du Pont Analysis in order to support this statement.

(04 Marks)

- ii. Mr. Nimal Fernando is the Managing Director of Ceylon Bank PLC. The Board of Directors of the bank has recently decided to have a bond issue at the beginning of the next financial year in order to fund the new system

development project of the bank. Due to the current economic condition of the country, the Managing Director is facing some difficulties in deciding the coupon rate that should be offered for this bond issue. Mr. Fernando wants you to explain to him the impact of different coupon rates on the market value of the bonds graphically as he has to prepare for a presentation to be presented at the next board meeting.

(06 Marks)

- iii. "Bets the bank is one of the problems in duration gap analysis". Do you agree with this statement? Justify your answer.

(10 Marks)

**(Total Marks 20)**

4. The following information is relating to Siyapatha Bank Plc.

	Rs. (Millions)
Rate sensitive assets	185
Rate sensitive liabilities	235

- i. Siyapatha Bank PLC enters into a 4 vs. 10 forward rate agreement (FRA) with Asian Bank at 7% on Rs. 1 million notional amount. Calculate the interest settlement amount and the present value of the interest receipt or payment amount of Siyapatha Bank PLC, if the actual rate of interest in 4-month equals,

a. 8%

b. 5%

(06 Marks)

- ii. Draw the payoff graphs of Asian Bank for the above mentioned forward rate agreement.

(03 Marks)

iii. Explain how Siyapatha Bank PLC should use an option contract to manage the interest rate risk.

(06 Marks)

iv. Siyapatha Bank PLC has estimated that the expected value of its asset portfolio in two weeks time will be Rs.210.038 million, with a variation of Rs. 73.96 million. Using 99% confidence level, calculate the value at risk and interpret your answer.

(05 Marks)

**(Total Marks 20)**

5.

i. Briefly explain four (04) barriers for e-banking.

(04 Marks)

ii. In addition to interest rate risk and other risks, the main risk on a bank's loans is default risk. Explain the functionality of a marketable instrument which a bank can use to minimize the impact of default risk.

(06 Marks)

iii. "Credit risk transfer model has created less need to manage the risks on a bank's assets and perhaps the risks on mismatches between assets and liabilities". Do you agree with this statement? Elaborate your answer.

(10 Marks)

**(Total Marks 20)**

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