ZCAS University

MASTER OF SCIENCE

BBF 5101 INTERNATIONAL BANKING AND FINANCE

MID SEMESTER EXAMINATION

THURSDAY 19TH OCTOBER 2023

16:30 – 19:30 HRS

TIME ALLOWED: THREE HOURS (plus 5 minutes to read through the paper)

INSTRUCTIONS:

1. Section A: Question One in Section A is **compulsory**.
2. Sections B: Answer Two (2) questions from this section.
3. This question paper carries a total of **100 marks**.
4. Candidates must **not turn this page** until the invigilator tells them to do so.

SECTION A: Question 1 is compulsory and must be attempted

Question 1

The foreign exchange market (forex, or FX, market) is a market for the exchange of one country's currency with that of another country. Foreign exchange markets are actually made up of many different markets, because the trade between individual currencies—say, the euro and the U.S. dollar—each constitutes a market. The foreign exchange markets are the original and oldest financial markets and remain the basis upon which the rest of the financial structure exists and is traded: foreign exchange markets provide international liquidity, preferably with relative stability.

A foreign exchange market is a 24-hour over-the-counter (OTC) and dealers' market, meaning that transactions are completed between two participants via telecommunications technology. The currency markets are also further divided into spot markets—which are for two-day settlements—and the forward, swap, interbank futures, and options markets. London, New York, and Tokyo dominate foreign exchange trading. The currency markets are the largest and most liquid of all the financial markets; the triennial figures from the Bank for International Settlements (BIS) put daily global turnover in the foreign exchange markets in trillions of dollars. It is sobering to consider that in the early 21st century an annual world trade's foreign exchange is traded in just less than every five days on the currency markets, although the widespread use of hedging and exchanges into and out of vehicle currencies—as a more liquid medium of exchange—means that such measures of financial activity can be exaggerated.

Required:

(a) Identify the market players in the foreign exchange market above and write short notes on each identified player explaining how each players' needs are met in this market.

[10 marks]

(b) Complete the table below for the US Dollar/South African Rand Forward Rates (the South African Rand as the base currency):

	Dollar-South African Rand exchange rate	**Rand eurocurrency interest rate**	**Dollar eurocurrency interest rate**
Spot rate	0.60		
One-month		3.50	1.50

Three-month		4.00	1.80
Six-month		5.25	2.20

(Show all your calculations)

[6 marks]

(c) Discuss the different types of foreign exchange exposure that an international customer is exposed to and identify how these exposures can be mitigated against.

[15 Marks]

(d) Discuss the determinants of exchange rates.

[5 Marks]

(e) Discuss briefly the shortcomings of the purchasing power parity principle.

[5 Marks]

(f) Write brief key notes on each one of the following concepts:

(i) Spot Rates;

(ii) Forward Rates; and

(iii) Foreign Exchange swaps.

[9 Marks]

(Total: 50 Marks)

SECTION B: Attempt any TWO questions in this section

Question 2

The landscape of financial market has been changed very rapidly through last few decades. Various elements like; globalization, cross border/section merger and acquisition, growing strategic partnering among the companies, changes in regulatory environment and changes in micro/macro elements have created not only many opportunities but also many threats. All these changes have made the market much more complex and less transparent for financial institutions. The widening scope and scale, both in products and services, within the companies have forced the conglomerates to operate at the edge regulatory framework. These unprecedented changes are demanding more attention from the FIs in assessing their creditworthiness, not only on individual

basis as before but also on risk modelling based on entire portfolio. To maintain and monitor the financial activities within the financial institutions there are various prudential organizations and authorities at national and international level. The main objective of such organization is to promote the awareness of matters that are relevant for safeguarding the financial stability in all levels in the financial institutions. So, the central banks determine the capital requirement that the banks are required to retain as buffer to overcome the unexpected losses. Through monitoring, supervision and creation of regulations the BIS tries to facilitate for a smooth and efficient reallocation of financial resources among the various partners. Due to these changes in financial institutions the usefulness of the credit risk management has been increased to unprecedented levels.

Required:

(a) Define the Basel Accords and discuss the main general functions of Basel Accords.

[10 Marks]

(b) Outline the main pillars of:

- (i) Basel Accords I,
- (ii) Basel Accords II; and
- (iii) Basel Accord III.

[10 marks]

(c) Critically analyse the importance of the accords on the management of risks in International Banks. **[5 marks]**

(Total: 25 marks)

Question 3

Between the late 1980s and early 2000s, banks were forced to redefine themselves in order to compete effectively for the business of international clients. The main drivers of this process were regulatory reform, including deregulation that reduced the barriers-to-entry by banks into new jurisdictions, technological change, and, in conjunction with these changes, the explosive growth of securities markets. The role of the government as controlling shareholder in major banks waned as banks, especially in continental Europe, were denationalised and privatised.

On the regulatory front, the Financial Services Action Plan in the European Union (EU) formalised a series of measures to implement a single wholesale financial market and a more open retail market, completing a process of gradual reduction of the barriers to cross-border financial intermediation, first established with the EU Second Banking Directive of 1989. In the United States, over six decades of regulatory firewalls limiting interstate and universal banking were

removed. The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 revoked restrictions on interstate mergers among banks put in place by the McFadden Act (1927). The Gramm-Leach-Bliley Act of 1999 completed the elimination of regulatory constraints on the securities underwriting activities of commercial banks, introduced by the Glass-Seagall Act in 1933. These major regulatory reforms opened the door to a wave of mergers and acquisitions in the United States and Europe that resulted in the creation of a group of important international universal banks or financial supermarkets.

On the technological front, an acceleration of paper-to-digital operations revolutionised how financial information was assembled and disseminated, credit risk assessed, priced and provisioned against, large volumes of loans classified, bundled and securitised, contractual obligations established and monitored, and trades conducted and settled.

Deregulation and technological change combined to facilitate the explosive growth of securities markets, putting downward pressure on the spreads that commercial banks could earn from loans, and pushing them into capital market activities and higher margin consumer finance endeavours, at home and abroad.

Finally, stricter enforcement of legislation against tax evasion, particularly after 2000, further accelerated a shift in priority by high-net-worth individuals away from the discrete protection of wealth towards yield.

The stage was set for banks to become more universal (in terms of scope of activities) and/or more international (in terms of geographic reach). A fundamentally market-driven expansion of the scope of activities and the broadening of geographic reach by leading OECD banks followed.

However, this accelerated process of internationalisation came to a halt in 2008, as the US subprime crisis, the ensuing global liquidity crunch, and threat of a major economic recession forced governments to come to the rescue of many of their major banks. (Finel-Honigman & Sotelino)

Required:

(a) Explain how deregulation and technological change have impacted on international banking and finance. **[10 Marks]**

(b) Explain the different forms that international banking operations can take.

[5 Marks]

(c) Trace the evolution and development of International Banking and then list the main players that characterises the international banking and finance industry.

[10 Marks]

(Total:25 Marks)

Question 4

Mr. John Dunning, a Fund Manager for a local pension fund, is contemplating on investing part of the pension funds he manages in an international bond. Despite the complexity associated with the bond market, a bond is simple and it might be considered a bit boring when compared with a stock. After all, a stock represents a piece of a company's wealth. An evaluation of a stock requires an evaluation of the entire company's worth.

Debt certificates have been traded internationally for several centuries. Kings and emperors borrowed heavily to finance their wars. In the 14th century, for example, Edward I financed his wars through bond issues launched in Italy by the then big banking families. Centuries later, the great coalition against Louis XIV led by William of Orange was financed by a group of Dutch families operating from The Hague. Later, the Rothschilds became famous for supporting the British war effort against Napoleon I through their European family network. Although debt financing has always been international in nature, there is still no unified international bond market.

Required:

(a) Identify the two types of international bonds that can be issued by a company to raise capital in the international capital markets. Further state which of the two identified bonds the Fund Manager would prefer and give a justification for the choice.

[8 Marks]

(b) Briefly discuss other instruments other than bonds, a company may use to raise capital

[7 Marks]

(c) Justify why a company may opt to raise capital by issuance of an international bond and the benefits to an investor of buying the international bond. **[5 Marks]**

(d) Discuss the role that an international bank plays in the issuance of the international bond.

[5 Marks]

(Total: 25 Marks)

END OF MID SEMESTER EXAMINATION