



STRATHMORE UNIVERSITY BUSINESS SCHOOL
BACHELOR OF FINANCIAL SERVICES
END OF SEMESTER EXAMINATION
BNK 3102: RETAIL BANKING AND OPERATIONS

Date: Tuesday, 26th July 2022

Time: 2 Hours

Instructions

1. This examination consists of **FIVE** questions.
2. Answer **Question ONE (COMPULSORY)** and any other **TWO** questions.

QUESTION ONE

- a. XYZ Bank determines that its basic checking account costs the bank Sh 300 per month in servicing costs (assume the servicing costs are labor and computer time) and Sh 200 per month in overhead expenses. This account requires a Sh50 000 minimum balance. Additionally, the bank also tries to build a Sh 50 per month profit margin on these accounts.

Further analysis of XYZ Bank customer accounts reveals that for each Sh10 000 above the Sh 50 000 minimum balance maintained in its checking accounts, the bank saves about 6% in operating expenses with each customer account. For a customer who is consistent in maintaining an average monthly balance of Sh 70 000, how much should the bank charge to protect its profit margin [4 Marks]

- b. Ms Omar obtained a 5 year loan of Ksh 4 million from KCB bank at an annual interest rate of 12% p.a. The loan is repaid on monthly basis. After repaying the loan for the last 3 years, Omar now wants to pay off the entire outstanding loan balance. As the loan officer advise her how much she will be required to pay [4 Marks]
- c. Assuming that the total primary deposits equals Sh 10 000 and cash reserve requirement is 10% show the balance sheet of a bank at the level of maximum deposit creation [4 Marks]
- d. At any given point in time, a banks bid (buy) quote for a foreign currency will be less than it's ask (sell) quote. The difference [spread] represents the banks profit. Explain any four factors that affects the spread of a currency [4 Marks]

e. **Distinguish the following**

- i. Primary vs derivative deposits [1 Mark]
- ii. Direct vs indirect quotation [1 Mark]
- iii. Overbought vs oversold position [1 Mark]
- iv. Negative amortization vs pre-payment privilege [1 Mark]
- f. Identify any four general utility services banks offer to retail clients [4 Marks]
- g. Market Signals can be used as an indicator of a bank’s liquidity management. Give four examples of these signals [4 Marks]
- h. Explain meaning of “Herstatt risk” as used in forex trading [2 Marks]

QUESTION TWO

Globalization of financial services, together with increased financial innovation, are making the activities of financial institutions and their risk profiles more complex. Due to these developments, operational risk is becoming more pronounced. Explain four examples of these developments [8 Marks]

The following is a balance sheet of a commercial bank

Assets (millions of Kshs)	Liabilities & Equity (millions of Kshs)
Investments under 1 year @ 5% Ksh 100	Deposits < 1 year @ 4% Ksh 900
Loans < 1 year @ 7% Ksh 350	All long-term liabilities @ 7% Ksh 500
Variable rate loans (rate reset in 6 months) @ 6.5 % Ksh 300	Equity Ksh 200
Fixed rate assets > 1 year maturity @ 8% Ksh 850	
Total Ksh 1,600	Total Ksh 1,600

The percentages are the average interest rate earned or paid on the given account. All assets and liabilities that mature in less than one year or have an interest rate reset within one year are potentially rate sensitive because their income could change if interest rates change

Required:

- i. Classify the balance sheet items into their interest rate sensitivity categories and show contribution to profit per category [8 marks]
- ii. Suppose interest rates increases 200 basis points and the spread effect is a negative 100 basis points. Show how profit will be affected [4 Marks]

Hint: Repricing gap model

QUESTION THREE

- a. Banks typically organize their functions broadly into “Front Office”, “Middle Office” and “Back Office” departments and functions. Explain the role of each section [6 Marks]

- b. Explain the functions of the following business areas in a bank
- i. Product control [2 Marks]
 - ii. Trade finance [2 Marks]
 - iii. Operations [2 Marks]
 - iv. Financial control [2 Marks]
 - v. Compliance [2 Marks]
- c. Explain any four methods that can be employed to execute money laundering schemes [4 Marks]

QUESTION FOUR

- a. Detail the information that should be submitted to the Central Bank by the external auditor according to the Banking Act [10 Marks]
- b. Explain five aspects of compliance risk management that the Internal Audit function should cover within its scope of operations [10 Marks]

QUESTION FIVE

- a. Explain the five key reasons for using Management Information System [MIS] in the banking sector [5 Marks]
- b. Explain three uses of MIS in each of the following departments
- i. Credit department [3 Marks]
 - ii. Cash department [3 Marks]
 - iii. Foreign exchange department [3 Marks]
- c. Identify any six relationship marketing tactics that may be employed by a bank [6 Marks]