This paper is not to be removed from the Examination Halls

UNIVERSITY OF LONDON **FN2029 ZA**

BSc degrees and Diplomas for Graduates in Economics, Management, Finance and the Social Sciences, the Diplomas in Economics and Social Sciences

Financial Intermediation

Wednesday, 18 May 2016 : 10:00 to 13:00

Candidates should answer **FOUR** of the following **EIGHT** questions. All questions carry equal marks.

A calculator may be used when answering questions on this paper and it must comply in all respects with the specification given with your Admission Notice. The make and type of machine must be clearly stated on the front cover of the answer book.

PLEASE TURN OVER

1. Explain how transaction costs and liquidity insurance theories propose the dominance of financial intermediation over direct financing.

2. In an important theoretical model, Diamond and Dybvig (1983) show that a bank run can force a bank to default that would not otherwise have defaulted. Use their model to explain the liquidity insurance theory for the existence of banks and their susceptibility to runs.

3. Discuss the main sources of risk in commercial banking, and critically discuss the Value-at-Risk (VaR) approach to risk measurement.

4. Discuss the methods used by banks to model and manage credit risk.

5. Explain the general risk measurement and risk management functions of banks. Discuss how these functions are applied by banks when they use Asset and Liability Management and gap analysis to manage liquidity risk and interest rate risk.

6. Critically analyse the advantages and disadvantages of banks' use of securitisation and credit derivatives for credit risk transfer.

7. Do you think that it is important to adjust for risk in bank regulation and bank performance measurement? Explain and justify your answer.

8. Using examples, explain the following three hedging techniques: delta hedging, forward hedging, and money market hedging.

END OF PAPER