Kenya School of Monetary Studies

POSTGRADUATE DIPLOMA IN FAINANICAL MANAGEMENT
FIRST TERM EXAMINATIONS, 1999/2000

FM 508: BANKING THEORY AND PRACTICE

DATE: 25 AUGUST 1999 TIME: 9:00-12:00

Answer <u>four questions</u>, at least <u>one from each section</u>. Each question carries equal marks.

Section A: Banking Behavior

1. As the traditional banking activities become less profitable, the banks have begun to engage in riskier activities such as trading derivatives. Discuss this trend in the behavior of the banks and suggest ways of minimizing this type of risk.

2. Accounting standards differ across countries. The most notable example is in evaluation of assets in terms of book and market values. Rationalize this valuation in each standard and explain the preference for market-value-based accounting among the professions in recent years.

Section B: Bank Regulations

3. The economic concepts of adverse selection and moral hazard provide the monetary authorities for setting up bank regulations and analyzing some problems created by deposit insurance. Suggest and discuss ways of minimizing the moral hazard problem created by the deposit insurance.

4. The Bank Supervision Annual Report of the Central Bank of Kenya in recent years places corporate governance as the highest priority among supervisory issues. In your view, what measures and regulations can improve corporate governance of the commercial banks in Kenya?

Section C: Central Banking

5. A recent trend worldwide is for central banks to be independent from any political pressure. Justify this trend and indicate the extent to which your country's central bank is free from such a pressure.

6. Discuss determinants of money supply and give indications of the extent to which the central bank can control the money supply.