



Roll No.....

Membership No.....

**The Institute of Chartered Accountants of India
Forex & Treasury Management Certificate Course
Evaluation Test Booklet**

Paper 2

24th April,2016

Duration- 3 Hours

Total Marks- 100

INSTRUCTIONS:

1. Please read the instructions carefully given in the question paper and solve it in the space provided.
2. The candidates are not allowed to carry the evaluation test booklet with them. This should be tied up with sheets provided to answer the question Paper.
3. Use Blue/Black pen only.
4. Do not write your Roll No. or Name or other identification other than in the space (perforated) provided on this sheet.
5. Please show Identity Card to the invigilator for verification of your identity, when asked.
6. The candidates may use the simple calculator.
7. In order to get full credit on the problems, the candidates must show all their rough work/ other workings.

(Participant Signature)

(Invigilator Signature)

PLEASE RETURN THIS BOOKLET BEFORE LEAVING THE EXAMINATION HALL

Date : 24th April,2016
Centre : Mumbai/Noida/ Kolkata/ Chennai

(Do not write your Roll No. and Membership number anywhere in the answer sheet except as mentioned above)

Checked by

Verified by

**CERTIFICATION COURSE ON FOREX AND TREASURY
MANAGEMENT**

S. No.	Total Number of Questions	Questions to be answered	Total Marks	Marks Obtained
Multiple Choice - Section A	65	65	65	
Short Notes – Section B	7	5	25	
Case Study – Section C	2	1	10	
Total	74	71	100	

Section A

Number of questions: 65

Marks: 65

Multiple choices: There may be more than one correct answer. Please [✓] mark for the correct answer.

Part A: Answer all questions.

1 mark each

1. The internal audit of treasury operations has different stages and following is the correct flow of the stages:
 - a. **Pre-commencement Work, Audit Program, Audit Documentation, Audit Procedures, Internal Audit Report**
 - b. Pre-commencement Work, Audit Documentation, Audit Procedures, Audit Program, Internal Audit Report
 - c. Pre-commencement Work, Audit Program, Audit Procedures, Audit Documentation, Internal Audit Report
 - d. Pre-commencement Work, Internal Audit Report, Audit Program, Audit Documentation, Audit Procedures
2. The basic objective of integration of components of a treasury is not
 - a. Improving portfolio profitability
 - b. Risk-insulation
 - c. Synergizing banking assets with trading assets
 - d. **Staff optimization**
3. A bank should decide, in connection with Government securities trading operations, to which of the three categories the security belongs at the time of its
 - a. **Acquisition**
 - b. Sale
 - c. Valuation
 - d. Yearend book closure
4. Overall net foreign exchange position of a bank is
 - a. The sum of all net short positions
 - b. The sum of all net long positions
 - c. **The sum of all net short positions & net long positions, whichever is higher**
 - d. The sum of all net short positions & net long positions, whichever is lower
5. Which of the following statements is false in managing liquidity through cash forecasts?
 - a. Long-term cash forecasts have little use in the management of liquidity
 - b. Medium-term forecasts strategically manage short-term liquidity
 - c. Short-term cash forecasts are usually used exclusively by treasury to manage liquidity on a day-to-day basis.
 - d. **Cash forecasts are of no relevance in managing liquidity as the latter's components are different**

6. A Kerala based bank with huge nonresident Indian customers has entered into rupee drawing arrangement with a large number of private exchange houses in Middle East to facilitate their inward remittances.
 - a. This results in large number of vostro accounts and audit work of the exchange companies' accounts
 - b. This results in large number of nostro accounts resulting in higher reconciliation work
 - c. This results in large number of nostro accounts and audit work of the exchange companies' accounts
 - d. This results in large number of vostro accounts requiring close monitoring of debits & funding**
7. Following is not a type of hedge accounting
 - a. Cash flow hedges
 - b. Synthetic hedges**
 - c. Fair value hedges
 - d. Hedges of net investment in a foreign operation.
8. Current exposure is a sum of the replacement cost and
 - a. Market value
 - b. Discounted value
 - c. Future exposure
 - d. Potential future exposure**
9. In-house bank
 - a. Is a concept not popular in India yet**
 - b. Is a bank licenced by RBI to a corporate to take care of its banking requirements
 - c. Requires RBI licence to establish
 - d. Does not cause any impact on bank reconciliation work
10. 'Tobin tax' is not an example of
 - a. Financial transaction tax
 - b. A step to dissuade speculators
 - c. Currency conversion tax
 - d. International taxation**
11. For taxation purpose, currency is treated as a commodity. This is supported by the following. Mark the wrong statement.
 - a. The tribunal in India has followed that view in the context of other assets
 - b. Currency derivative is traded on stock exchange and hence it is a security
 - c. This has been specifically notified so by RBI and hence currency is treated as a commodity**
 - d. There is an old decision of the Court of Appeals in England, where the court has taken the view that foreign currency is a commodity
12. While comparing taxation applicable to financial securities, it can be said that there is no return on initial investment in the case of
 - a. Equity security
 - b. Debt security

- c. **Financial derivatives**
 - d. Foreign currency
- 13. As per statutory accounting principles in USA, insurance derivatives
 - a. **Are covered under hedge accounting if they actually cover insurance risks**
 - b. Are invariably covered under hedge accounting
 - c. Lead changes in the fair value of the derivative contract are accounted under main income
 - d. Accounting is not yet finalized across all entities
- 14. Following is a true statement while comparing an option and an insurance:
 - a. Suffering a loss is a common feature
 - b. An insurable interest is a must for both
 - c. The owner of the option has an ownership in the underlying
 - d. **Insurance interest is needed only for insurance**
- 15. The following statement is true in respect of hedge accounting
 - a. **Entities can only obtain the right to achieve hedge accounting if they meet the requirements set out in IAS 39**
 - b. It expects the effects of the derivative and the risk being hedged at different periods to be reported
 - c. Hedge accounting does not allow entities to adjust the carrying value of assets and liabilities.
 - d. Hedge accounting does not allow entities to override the normal accounting treatment for derivatives
- 16. Barclays bank is maintaining a rupee account with United Bank Kolkatta. The reconciliation of the account
 - a. Is to be checked by the auditors of United Bank
 - b. **Is the responsibility of Barclays bank**
 - c. Has to be done by United Bank
 - d. Is automatically done in the automated system now
- 17. Which of the following best describes contribution analysis?
 - a. It is an approach for assessing casual questions that may arise during project implementation
 - b. It contributes to the causality in real-life program evaluations
 - c. A roadmap of contributions of programs to particular outcomes
 - d. **An approach to reduce uncertainty about intervention's contribution**
- 18. Leveraging can be inferred with the following in case of banking companies
 - a. Credit deposit ratio
 - b. Debt equity ratio
 - c. **Capital adequacy ratio**
 - d. Cash reserve ratio
- 19. Following is an example of a synthetic hedge
 - a. Leading and lagging
 - b. Matching receipts and payments
 - c. Invoice in home currency

- d. Forward contracts**
20. Which of the following statements is true in relation to credit risk?
- a. Bank treasury does not have credit risk as it does not handle credit sanctioning
 - b. Corporate treasury has no credit risk as it deals with banks
 - c. Counterparty limit is decided by the mid office of treasury before each transaction
 - d. Credit default swap is an instrument used to mitigate credit risk**
21. CDR Mechanism in India stands on the strength of a three-tier structure. Which of the following is a correct statement?
- a. CDR Empowered Group comprises of Chief Executives of All-India Financial institutions and Scheduled Banks
 - b. The Standing Forum includes EDs of respective banks of the corporate concerned
 - c. All references for CDR are received at CDR Core group
 - d. The decision of the Empowered Group is final and binding**
22. The Basel Committee has progressively published rules regarding capital requirements. Mark the correct statement among the following.
- a. Basel I focused only on market risks
 - b. Basel II includes credit, market and financial risks
 - c. Basel III capital regulation has been fully implemented in India from April 1, 2013 in phases
 - d. Basel III lays more focus on quality, consistency & transparency of the capital base**
23. A company exports goods on credit and hence it has outstanding under debtors in its accounts. What type of risk, this can lead to?
- a. Economic risk
 - b. Pre-transaction risk
 - c. Transaction risk**
 - d. Translation risk
24. The concept of Asset Liability management has assumed significance to banks because
- a. The types of risks faced by banks have widened both in depth and breadth
 - b. Of the deregulation implemented by the Central Banking authorities**
 - c. Of the huge growth of banking system resulting in bloated book size
 - d. There is larger movement of capital funds across borders leading to globalization
25. Which one of the following is not a part of the three pillars on which the ALM process rests?
- a. ALM Information Systems
 - b. ALM Organization
 - c. ALM Process
 - d. ALM Regulatory Guidelines**
26. The investment requirement of insurance companies are regulated and following is true
- a. The Life insurance company has to invest a larger percentage of its assets in Central Government securities than general insurance company**
 - b. The General insurance company has to invest a larger percentage of its assets in Central Government securities than life insurance company

- c. Life insurance company has greater freedom to invest in equity compared to general insurance company
 - d. Life insurance company has to invest minimum of 30% of its assets in Central Government and State government securities (and in securities guaranteed by those governments)
27. A Mutual Fund which is classified as balanced fund based on its investment objective is likely to mean
- a. It will invest in a balanced way to enhance the growth
 - b. Its growth is expected to be moderate compared to other schemes
 - c. It will invest both in equities and debt securities**
 - d. It will guarantee a balanced return to investors
28. Following is true with reference to chit funds
- a. SEBI is the regulator
 - b. Respective State Government is the regulator**
 - c. Registrar of companies is the regulator
 - d. During auction all subscribers bid by quoting the highest amount of subscription
29. Mark the statement which is incorrect relating to Budget Division of Central Government
- a. The major work undertaken in the Budget Division relates to the Scrutiny of Receipt and Expenditure Estimates in the process of preparation of Budget Estimates and Revised Estimates, and related Statements, and Annexures of the various budget documents
 - b. Budget Division also performs the functions in relation to the administration of Fiscal Responsibility and Budget Management Act, 2003
 - c. The Budget Division is responsible for the preparation and submission to Parliament of the Central Government's Budget other than Railways, as well as the supplementary Demands for Grants and Demands for Excess Grants
 - d. The Budget Division coordinates the fiscal deficit estimates with RBI and the required changes in interest rate scenario in the country to rein in inflation and money supply**
30. Following is the increasing order of priority while managing the external reserves of the country by RBI
- a. Safety, yield, liquidity
 - b. Liquidity, yield, safety
 - c. Yield, liquidity, safety**
 - d. Liquidity, safety, yield
31. Building a robust institutional framework of primary dealers is undertaken by the following department of RBI
- a. Internal debt management department**
 - b. Financial Markets Regulation Department
 - c. Financial Markets Operation Department
 - d. Department of Government and Bank Accounts
32. If treasury is treated as a profit centre in a large corporate, following is likely to be true

- a. Establishing a satisfactory charge for treasury's services to other departments/subsidiaries is not a challenge
 - b. There is no additional administrative cost in managing it and getting basic input data
 - c. It may speculate in derivative products and then try to trade its way out of the problem**
 - d. It will achieve the purpose of establishing the centre viz.: giving employment to specialist category of professionals
33. Central Government security is considered as the safest investment because
- a. Central Government is the largest borrower and hence cannot go bankrupt
 - b. RBI guarantees the G Sec investments
 - c. It is a sovereign risk and hence considered as safest**
 - d. It yields lower return and hence should be safer
34. In the world of finance, risk management refers to following practice
- a. Identifying potential risks in advance
 - b. Advising the management how to avoid any risk
 - c. Identifying and taking precautionary steps to reduce risk**
 - d. Finding out good risks which help in enhancing the potential profit
35. While calculating the buckets into which the funds flow are to be grouped under ALM
- a. The time buckets are exactly same for arriving at liquidity risk and interest rate risk
 - b. The near time buckets are narrower under interest rate risk because of sensitivity involved
 - c. The near time buckets are narrower under liquidity risk because of sensitivity involved**
 - d. The concept of time bucket arises only for liquidity risk management because flows cannot be bucketed interest rate wise
36. While calculating interest rate risk, the concept of Gap refers to the following
- a. The difference between Assets and Liabilities for each time bucket
 - b. The difference between Rate Sensitive Assets and Rate Sensitive Liabilities for each time bucket**
 - c. The difference between Rate Sensitive Assets and Rate Sensitive Liabilities for aggregate of all time buckets
 - d. The sum total of Rate Sensitive Assets and Rate Sensitive Liabilities
37. In the context of interest rate risk the following is true
- a. By having a positive Gap an institution always gains
 - b. Gap is an indicator of liquidity
 - c. With negative Gap an institution gains if rate declines**
 - d. There should be no Gap
38. While understanding market risk, the following conclusion can be arrived at
- a. It is on account of factors determined by market and hence no mitigating steps can be taken
 - b. Market risk includes foreign exchange risk but not liquidity risk

- c. **Even a small change in market variables may cause substantial changes in economic value**
 - d. In markets, where the forex rates are Government determined, there is no market risk
39. Credit risk
- a. Can be prevented by establishing a letter of credit
 - b. Does not arise if you are dealing with sovereign counterparty
 - c. **Includes the risk of nonpayment due to Embargo**
 - d. Is the only risk, a treasurer does not face
40. Applying the principles of risk classification, we can say that if a person loses his or her credit & debit card while travelling, he or she has an immediate
- a. Credit risk
 - b. Market risk
 - c. Operational risk
 - d. **Liquidity risk**
41. To prevent legal risks in financial markets
- a. Internationally accepted agreements like ISDA are obtained for each transaction
 - b. **Internationally accepted agreements like ISDA are obtained on one time basis bilaterally**
 - c. Internationally accepted agreements like ISDA are obtained once in every three years
 - d. Internationally accepted agreements like ISDA are obtained for all the market participants by the Central counter party [CCP]
42. Compare two investments viz.: (A) = 10 year zero coupon bond & (B) = 10 year locked up venture capital investment. Which of the following is true relating to price volatility and risk?
- a. Both investments are volatile in nature
 - b. B is risky but A is not
 - c. A has no risk but volatility
 - d. **B has risk but no volatility**
43. The risk factors that are normally identified at the portfolio manager level can be organized as market and non-market related. Which of the following classification rule is *incorrect*?
- a. Directional factor like long bias is market related
 - b. Technical factor like volatility is market related
 - c. Trading behavior like cut losses vs. average down is non-market related
 - d. **Portfolio factor like Illiquidity is market related**
44. Which of the following is true relating to Net Overnight Open Position Limit [NOOPL] for calculation of capital charge on forex risk?
- a. **NOOPL is fixed by the boards of the respective banks and communicated to RBI**
 - b. NOOPL is approved by RBI for each bank separately, depending on the size of the bank

- c. NOOPL should not exceed 10% of the total capital (Tier I and Tier II) of the bank.
 - d. NOOPL is fixed by ALCO of the respective bank and approved by RBI.
45. While including net delta position in the aggregation of Net Open Position in a Single Currency, the option position is the
- a. "Alpha-equivalent" spot currency position as reflected in the bank's options risk management system
 - b. "Gamma-equivalent" spot currency position as reflected in the bank's options risk management system
 - c. "Delta-equivalent" spot currency position as reflected in the bank's options risk management system**
 - d. "Theta-equivalent" spot currency position as reflected in the bank's options risk management system
46. Using a risk immunization policy,
- a. A bank will be able to protect market value of equity when the interest rate moves adversely**
 - b. A bank will be able to enhance market value of equity when the interest rate moves favorably
 - c. A bank will be able to achieve something more than what a hedging technique provides
 - d. A bank will be able to insulate itself from all the risks that arise out of market variables
47. Contingency funding plan for liquidity management by a bank [*mark the incorrect one*]
- a. Is a document prepared as a directive for a future emergency
 - b. Is a document with an objective to predict the future**
 - c. Has to be tested regularly to ensure its effectiveness & operational feasibility
 - d. Should be reviewed by the Board at least on an annual basis
48. Mauritius has become the most popular destination for PE/VC funds to set up for investments in India because
- a. There is no capital gains tax on the sale of shares in an Indian company as per the applicable DTAA
 - b. There is no capital gains tax on the sale of shares in an Indian company as per the extant FDI rules
 - c. Mauritius does not have tax capital gains
 - d. Of conditions a & c operating together**
49. Following can be considered as an example of cost of borrowing reviews by a corporate treasurer
- a. Deciding to borrow packing credit in foreign currency [PCFC] rather than in INR as rupee PC**
 - b. Switching over from existing bank to another bank which offers much better exchange rate on its export collection bills
 - c. Booking forward contracts for all its export bills
 - d. Negotiating with overseas buyers to have all invoices drawn in convertible rupee

50. A leading software exporter X Ltd has a WOS in USA. X Ltd deposes manpower to this WOS and the latter handles all the business including invoicing, receiving payment etc. It transfers the surplus to X Ltd periodically when the Indian rupee is weak. X Ltd has a huge external borrowing to finance its capital assets in India for which the servicing outflow is fully covered by the remittances from the WOS. We can conclude that
- What X Ltd is doing is illegal
 - X Ltd has a natural hedge against exchange risk**
 - X Ltd is using 'leads and lags' to protect the exchange risk
 - The WOS has an exchange risk against INR
51. Within a bank, managing the following risk is the primary responsibility of treasury department
- Credit risk
 - Operational risk
 - Market risk**
 - All types of financial risk
52. Checking of all treasury transactions through the audit trail is done by
- External auditor, if appointed by the bank to do this work
 - Back office of the treasury department
 - Mid office, at its sole discretion on test or complete basis
 - Mid office in conjunction with back office**
53. The concept of country risk
- Is applicable to only foreign banks in India
 - Is a sub concept under credit risk**
 - Does not arise in treasury transactions, if there is ECGC cover
 - Is hardly relevant in this globalized world
54. In the derivatives market, following description is correct
- Hedgers are those who take view on future direction of the market
 - Speculators are those who take view on future direction of the market**
 - Arbitrageurs take positions in financial markets to earn profits with risk
 - Hedgers are those who do not have a present or anticipated exposure
55. T & L Ltd has submitted its bid along with bid bond guarantee of its bank for Green-house gas construction project in Australia with expected cash flows spread over next 3 years. Though its pricing is very competitive, it is not sure of securing it due to other factors. But if secured, it has a huge exchange risk in the invoicing currency viz.: AUD. It can opt for the following derivative product to protect itself.
- Forward contract
 - Futures contract
 - Option contract**
 - Swaps
56. Forward contract with a bank abroad faces
- Counter party risk**
 - Operational risk
 - Currency risk

- d. Market risk
57. Following is not a method of valuation of stock index used as the underlying for a stock index futures
- a. Market capitalization method
 - b. Market value method
 - c. Equal weightage method
 - d. Value at risk method**
58. What is the information gathered from market participants in the poll to determine NSE MIBOR?
- a. The rate at which they would be able to lend and borrow in the markets
 - b. The rate at which they are willing to lend and borrow amongst one another
 - c. Their view of the market rates for lending and borrowing**
 - d. Their view of the lending and borrowing rates of specific market participants
59. If you are the auditor of a treasury, you are likely to see records indicating the following
- a. Deals recorded by the trader are confirmed independently by the back-office**
 - b. Deals recorded by the back-office are confirmed independently by the mid-office
 - c. Deals recorded by the back-office are confirmed independently by the trader
 - d. Deals recorded by the trader are confirmed independently by the mid-office
60. What is basis risk in the context of interest rate risk?
- a. The risk of interest rate of different assets & liabilities changing in different magnitude
 - b. The risk of interest rate of the assets & liabilities moving in different magnitude in opposite direction with a net loss possibility
 - c. The risk of interest rate of different assets, liabilities and off-balance sheet items changing in different magnitude**
 - d. The risk of reference interest rate used for valuation of different assets, liabilities and off-balance sheet items changing
61. Which of the following statements, in the context of risks relating to forex deals by bank dealers, is more accurate?
- a. Pre settlement risk is likely to cause lesser loss than settlement risk
 - b. Settlement risk is also called as Herstatt risk**
 - c. Pre settlement risk is also called as Herstatt risk
 - d. Post settlement risk causes the highest loss
62. The concept of sectoral cap arises
- a. In case of foreign direct investments**
 - b. In case of foreign portfolio investments
 - c. Both in case of foreign direct & portfolio investments
 - d. There is no concept of sectoral cap in view of liberalization
63. Under FEMA, there is a clause called sunset clause which means
- a. Any contravention under the earlier FERA can be taken notice within 1 year of FEMA coming into force
 - b. Any contravention under the earlier FERA can be taken notice within 5 years of FEMA coming into force

- c. **Any contravention under the earlier FERA can be taken notice within 2 years of FEMA coming into force**
 - d. Any contravention under the earlier FERA can be taken notice only if it continues to be a contravention under FEMA
64. Indian Rupee became convertible on current account transactions
- a. After FEMA came into force i.e. from 1st June 2000
 - b. Much before FEMA i.e. during FERA regime itself**
 - c. By India subscribing to the relevant provisions of BIS
 - d. Along with its convertibility on capital account also
65. You were auditing the nostro account reconciliation records of a bank treasury. Which is *not* likely to be your conclusion?
- a. An old outstanding credit entry in mirror account could be a cause for a fraud**
 - b. An old outstanding credit entry in nostro account could be a cause for a customer complaint
 - c. An old outstanding debit entry in nostro account could result in loss to the bank
 - d. An old outstanding credit entry in mirror account could mean a free float
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Section B

Number of questions: 7

Marks: 25

Note: Answer any five questions. Each answer will carries 5 marks

[Unrelated answers & answers exceeding the brief will attract negative marks]

1. What is the purpose of Repo transaction?
2. What are the benefits of commodity market?
3. Discuss the scope of Securities Transaction Tax
4. What are the RBI guidelines on the Electronic Data Processing [EDP] i.e. the information system used in bank treasuries?
5. Describe briefly the four 'Greeks' used in the context of derivatives
6. Describe the main objectives of portfolio management
7. Explain buying & selling rates used by banks in customer transactions with examples of types of transactions to which they are applied.

Good answer should cover the following points:

Q1:

- It helps banks to invest surplus cash
- It helps investor achieve money market returns with sovereign risk.
- It helps borrower to raise funds at better rates
- An SLR surplus and CRR deficit bank can use the Repo deals as a convenient way of adjusting SLR/CRR positions simultaneously.
- RBI uses Repo and Reverse repo as instruments for liquidity adjustment in the system.

Q2:

- Price Discovery – Assessment of fair value
- Price Risk Management – hedging the commonest method
- Import- Export competitiveness – hedging and committing
- Predictable Pricing – due to futures market
- Benefits for farmers/Agriculturalists – but only small percentage

- Credit accessibility – due to proper risk management
- Improved product quality – The existence of warehouses

Q3: [Page 93 of the text book – standard text bookish question]

Scope of STT: According to the Securities Contracts (Regulation) Act, 1956, STT would be applicable on the following securities.

- Shares, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate
- Derivatives
- Units or any other instrument issued by any collective investment scheme to the investors in such schemes
- Security receipt as defined in section 2(zg) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002
- Government securities of equity nature
- Rights or interest in securities
- Equity-oriented mutual funds
- STT is not applicable on any off-market transaction.

Q4:

- Ensure functional separation.
- Access rules for performing distinct functions should be defined in detail and drawn up by persons unconnected with the dealing activity.
- Confidentiality of the data in the systems may be ensured in the case of outsourcing of IT services to external agencies.
- Ensure that dealers are enabled to enter transactions solely through identification.
- The trading date, time and transaction serial number must be entered automatically by the system, which must be made impossible for the dealer to alter without proper authorisation.
- If the dealer deviates from the specified norms while entering transaction data, this must be approved in each case by an official not connected with the dealing office.
- Deals concluded after the Back Office has closed recording for the day (late deals) are to be marked as such and included in that day's position.
- A late deal slip must be passed immediately to an official unconnected with the dealer.
- Back up of crucial information and data should be done and preserved according to the IT policy of the bank.

Q5:

- Delta: An options delta is used to measure the anticipated percentage of change in the premium in relation to a change in the price of the underlying security. If a particular call option had a delta of 60%, we would expect the option premium to vary by 60% of the change in the underlying stock. If that stock rose 1 point, the option premium should rise approximately $\frac{6}{10}$ (60%) of 1 point.
- Gamma: Gamma measures the expected change in the delta factor of an option when the value of the price of the underlying security rises. If a particular option had a delta of

60% and a gamma of 5%, an increase of 1 point in the value of the stock would increase the delta factor by 5% from 60% to 65%.

- Theta: The theta derivative attempts to measure the erosion of an option's premium caused by the passage of time. We know that at expiration an option will have no time value and will be worth only the intrinsic value if, in fact, it has any. Theta is designed to predict the daily rate of erosion of the premium. Naturally other factors, such as changes in the value of the underlying stock will alter the premium.
- Vega: The fourth derivative, Vega is concerned with the volatility factor of the underlying stock. Volatility varies among different securities. Vega measures the amount by which the premium will rise when the volatility factor of the stock increase. Vega measures the sensitivity of the premium to these changes in volatility.

Delta, gamma, theta and vega are very sophisticated tools for predicting changes in an option's premium. They merely take the three factors which determine a premium (price of the stock, passage of time, and volatility), and measure each in an exacting manner.

Q6: The main objectives of portfolio management are as follows: [Standard text book question: Details are available at page 207 of the text book. Answer should be more than the following bullet points with descriptions as in the text book]

- Security of Principal Investment
- Consistency of Returns
- Capital Growth
- Marketability
- Liquidity
- Diversification of Portfolio
- Favorable Tax Status

Q7:

The answer should clearly indicate the understanding by the candidate viz.: buying & selling are used from the bank's angle. E.g. if the customer wants to sell FC notes to the bank, bank will apply buying rate. Buying rates are applied for encashing currency notes, TCs, inward remittances, purchase of export bills, reversal of a sale transaction etc. Selling rates are applied for issuing FC notes, TCs, outward remittances, import bill retirement, reversal of purchase transaction etc. If examples of actual rates are mentioned, if selling rate is always costlier than buying rate from customer angle is mentioned, additional marks.

Section C

Number of questions: 2

Marks: 10

Note : Case Studies. Answer any one. Max 10 marks

1. You have been provisionally appointed as the head of treasury of a software giant Exfosys Ltd having long forex exposure in major currencies, with cash surplus of over Rs 15000 crores and operations in several countries. Your first test-assignment is to independently draft a treasury policy to replace the existing document, to which you do not have access yet. Indicate ten salient points which you will highlight in your document and articulate why.
2. Recently RBI has permitted a new category of banks called payment banks. Such bank can accept demand deposits [with end of day balance not to exceed Rs 1 lac in the account], handle remittances & other ancillary services and deploy its funds minimum 75% in Government securities with max maturity of one year and max 25% in deposits with banks. Discuss the ALM issues for such a bank.

Answers:

1. There is no 'right' answer. Any logically articulated answer deserves marks. It should include many of the following ideas. Logic and reasons to be highlighted.
 - a. The advantageous position of the company and hence the bargaining power with banks
 - b. It has long position i.e. always overbought in currencies. One sided. View on currency accordingly
 - c. The need to go for hedging. fully, partly... why
 - d. Choice of instruments for hedging
 - e. No matching natural hedging
 - f. View on currency and that on invoicing currency
 - g. Need for balanced investment policy for the surplus matching the risk & yield
 - h. Counterparty limits for deployment of such surplus
 - i. Deployment of surplus, currency wise choices available [@overseas, EEFC...], for what tenure, with or without hedging & why
 - j. Dealing room policies, all the guidelines of risk management of RBI, documentation, resolutions, authorizations, limits with banks...
 - k. Audit and review, frequency, guidelines, why,
 - l. How much to be active in Indian market, securities, credit risk control...

2. The answer should discuss the following:
 - a. The nature of deposits [CASA] with small balances, small core balance...
 - b. Deployment – no credit risk except relating to G Sec, duration of FDs with banks, how to manage maturity matching
 - c. Interest rate risk on liabilities only on SA balance but that is likely to be the major component – generally fixed and not moving with market interest rates movement. Deployment is interest rate sensitive.
 - d. Construct an example of 80% in SA and 20% in CA and G Sec yield at say 6% and FD yield at 8%. Work out average cost of deposits and yield on deployment.
 - e. Generally easier ALM in view of restricted business model. Liquidity risk is controlled by design [G Sec max one year and term deposits] and interest rate risk has only upside. The G Sec and FD yield is likely to be always more than that of SB interest.