



Subject: Basel

Chapter: Unit-4

Category: Practice questions
solutions

Answer 1:

$$1) \text{HQLA} = 1.0 \times (30) + (0.0 \times 165) = 30$$

$$\text{Net cash outflow in a 30-day period} = (100 \times 0.05) + (75 \times 0.2) + (20 \times 0.0) = 20$$

$$\text{LCR} = 30 / 20 = 1.50 = 150\%$$

$$2) \text{ASF} = (100 \times 0.9) + (75 \times 0.5) + (2 \times 1.0) + (18 \times 1.0) = \$147.50$$

$$\text{RSF} = (10 \times 0) + (10 \times 0) + (10 \times 0.05) + (30 \times 0.65) + (30 \times 0.85) + (90 \times 0.85) + (15 \times 1.0) = \$137.00$$

$$\text{NSFR} = 147.50 / 137.00 = 1.0766 = 107.66\%$$

With both the LCR and NSFR greater than 100%, Bank of the Bluegrass satisfies the new liquidity requirements.

Answer 2:

1) C

Reason – The capital conservation buffer is meant to protect banks in times of financial distress. Banks are required to build up a buffer of Tier 1 equity capital equal to 2.5% of risk-weighted assets in normal times, which will then be used to cover losses in stress periods. This means that in normal times, a bank should have a minimum 7% Tier 1 equity capital to risk-weighted assets ratio, an 8.5% total Tier 1 capital to risk weighted assets ratio, and a 10.5% Tier 1 plus Tier 2 capital to risk-weighted assets ratio. The capital conservation buffer is a requirement and is not left to the discretion of individual country regulators. It is not a requirement at all times but is built up to that level in normal economic periods and declines in stress periods.

2) C

Reason – The bank's understanding of inherent money laundering and the financing of terrorism (ML/FT) risks is based on both internal and external data sources including operational and transaction data (internal) and national risk assessments and country reports from international organizations (external).

3) A

Reason – To mitigate ML/FT risks, the first line of defense is the business units (e.g., the front office and customer facing activities). They identify, assess, and control ML/FT risks through policies and procedures that should be specified in writing and communicated to bank personnel. The second line of defense is the chief officer in charge of ML/FT. The third line of defense is internal and external audits.

Answer 3:

Basel III requires a minimum liquidity coverage ratio of 100%. The LCR focuses on the bank's ability to weather a 30-day period of reduced/disrupted liquidity.

The formula is computed as follows:

High – quality liquid assets / net cash outflows in a 30-day period

$$\text{LCR} = \$125 \text{ million} / \$137 \text{ million} = 0.912 \text{ or } 91.2\%$$

In this case, Highlands Bank does not meet the minimum 100% requirement and is in violation of the rule.

Answer 4:

B

Reason –

Correspondent banking relationships allow the respondent bank to provide services that it could not otherwise provide. A correspondent bank does not generally have a direct relationship with the respondent bank's customers. A correspondent bank is, in fact, a customer of the respondent bank and, thus, must conduct due diligence on the respondent bank but not on the respondent bank's customers. Cross-border correspondent banking involving the execution of third party payments is higher risk.

Answer 5:

C

Reason –

Tier 1 capital (or core capital) includes: common equity including retained earnings (called Tier 1 equity capital or Tier 1 common capital) and non-cumulative perpetual preferred stock (additional Tier 1 capital, part of total Tier 1 capital).

Answer 6:

D

Reason –

To mitigate ML/FT risks, the first line of defense is the business units (e.g., the front office and customer facing activities). They identify, assess and control money laundering and financing of terrorism (ML/FT) risks through policies and procedures which should be specified in writing and communicated to bank personnel. The second line of defense is the chief officer in charge of anti-money laundering and countering financing of terrorism (AML/CFT). The officer should engage in ongoing monitoring and the fulfillment of anti-money laundering and countering financing of terrorism AML/CFT duties. The third line of defense is internal audits. The bank should establish policies for conducting internal audits of the bank's AML/CFT policies.