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BNK501 Quiz File

Chapter-wise Solved MCQs

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Chapter 1: Banks and Their Financial Statements

Q1. Which line item represents the largest asset on a commercial bank's balance sheet?

A) Cash and balances with central bank
B) Investments in government securities
C) Advances and loans
D) Fixed assets

Q2. How is Net Interest Margin (NIM) defined in bank financial statement analysis?

A) Net interest income divided by average total assets
B) Net interest income divided by average earning assets
C) Total interest income minus total interest expense
D) Average lending rate minus average funding rate

Q3. Commercial banks are characterized as highly leveraged financial institutions because:

A) Non-performing loans account for over 50% of advances
B) Equity typically constitutes only 8% to 12% of total assets
C) Interest income is lower than operating expenses
D) Deposits are classified as equity on the balance sheet

Q4. A non-performing loan (NPL) in commercial banking is typically defined as a loan that is overdue by at least:

A) 30 days
B) 60 days
C) 90 days
D) 180 days

Answer Key

Q1 Answer: C) Advances and loans. Explanation: Loans/advances constitute the largest asset line item on a commercial bank's balance sheet.

Q2 Answer: B) Net interest income divided by average earning assets. Explanation: Net Interest Margin (NIM) is calculated specifically as Net Interest Income (NII) divided by average earning assets.

Q3 Answer: B) Equity typically constitutes only 8% to 12% of total assets. Explanation: Banks operate with high financial leverage where equity typically represents only 8–12% of total assets.

Q4 Answer: C) 90 days. Explanation: Non-performing loans (NPLs) are defined as loans that are overdue by 90 days or more.

Chapter 2: Ratio Analysis for Banks

Q1. In the DuPont decomposition model adapted for commercial banks, Return on Equity (ROE) is expressed as:

A) Net Profit Margin × Asset Turnover × Current Ratio
B) Return on Assets (ROA) × Financial Leverage (Assets / Equity)
C) Net Interest Margin (NIM) × Cost-to-Income Ratio
D) Operating Cash Flow × Debt-Service Coverage Ratio

Q2. Which of the following ratios measures a bank's operational efficiency?

A) Advances-to-deposits ratio (ADR)
B) Provision coverage ratio

C) Cost-to-income ratio (Operating Expenses / Total Income)
D) CASA ratio

Q3. What does a high CASA (Current Account and Savings Account) ratio indicate for a commercial bank?

A) High proportion of expensive long-term borrowings
B) High proportion of low-cost, cheap deposit funding
C) High percentage of non-performing loans
D) Excessive reliance on interbank money market funding

Q4. Under Basel III liquidity standards, the Liquidity Coverage Ratio (LCR) requires banks to hold sufficient high-quality liquid assets to survive a stressed outflow scenario over:

A) 7 days
B) 14 days
C) 30 days
D) 90 days

Answer Key

Q1 Answer: B) Return on Assets (ROA) × Financial Leverage (Assets / Equity). Explanation: Bank DuPont analysis breaks ROE into ROA multiplied by equity leverage (assets/equity).

Q2 Answer: C) Cost-to-income ratio (Operating Expenses / Total Income). Explanation: The cost-to-income ratio gauges operational efficiency; lower ratios (~40–50%) indicate higher efficiency.

Q3 Answer: B) High proportion of low-cost, cheap deposit funding. Explanation: Current and savings accounts provide low-cost funding, making a high CASA ratio highly desirable.

Q4 Answer: C) 30 days. Explanation: LCR mandates holding enough unencumbered high-quality liquid assets to cover 30 days of severe liquidity stress.

Chapter 3: Credit Analysis and Lending Decisions

Q1. Among the classic 5 Cs of credit appraisal (Character, Capacity, Capital, Collateral, Conditions), which element is considered the primary source of debt repayment?

A) Collateral
B) Capacity (operating cash flows)
C) Capital
D) Conditions

Q2. Lenders generally prefer a borrower's Debt-Service Coverage Ratio (DSCR) to be at least:

A) 0.5x to 0.8x
B) 0.8x to 1.0x
C) 1.2x to 1.5x
D) 3.0x to 5.0x

Q3. Under risk-based pricing, the interest rate charged on a loan is constructed from funding costs, operating costs, profit margin, capital charge, and:

A) Historical dividend payout ratio
B) Expected loan loss
C) Total bank deposits
D) Non-interest fee income

Q4. Which of the following is identified as an early-warning signal of impending borrower credit distress?

A) Consistent increase in account turnover
B) Returned cheques and covenant breaches
C) Rapid rise in the borrower's DSCR above 2.0x
D) Timely submission of quarterly stock reports

Answer Key

Q1 Answer: B) Capacity (operating cash flows). Explanation: Cash flow (capacity) repays loans, while collateral is only the secondary backup.

Q2 Answer: C) 1.2x to 1.5x. Explanation: Banks target a DSCR of 1.2x to 1.5x or higher to ensure comfortable cash flow coverage of debt obligations.

Q3 Answer: B) Expected loan loss. Explanation: Risk-based pricing formula includes cost of funds + operating cost + expected loss + capital charge + margin.

Q4 Answer: B) Returned cheques and covenant breaches. Explanation: Cheque returns, falling turnover, and covenant breaches serve as classic early-warning signs of borrower stress.

Chapter 4: Risk Management in Banking

Q1. Statistical credit risk expected loss (EL) is calculated using which formula?

A) EL = Net Interest Margin × Total Advances
B) EL = Probability of Default (PD) × Loss Given Default (LGD) × Exposure at Default (EAD)
C) EL = Non-Performing Loans ÷ Provision Coverage
D) EL = Capital Adequacy Ratio × Risk-Weighted Assets

Q2. If a bank has a positive one-year repricing gap (rate-sensitive assets exceed rate-sensitive liabilities), what happens to its Net Interest Income (NII) when market interest rates rise?

A) NII decreases
B) NII increases
C) NII remains unchanged
D) NII drops to zero

Q3. Which metric measures the maximum expected trading loss at a specific confidence level over a given time horizon?

A) Debt-Service Coverage Ratio (DSCR)
B) Net Interest Margin (NIM)
C) Value at Risk (VaR)
D) Net Stable Funding Ratio (NSFR)

Q4. System failures, human errors, internal fraud, and IT disruptions are classified under which category of banking risk?

A) Credit risk
B) Market risk
C) Operational risk
D) Liquidity risk

Answer Key

Q1 Answer: B) EL = Probability of Default (PD) × Loss Given Default (LGD) × Exposure at Default (EAD). Explanation: Credit risk expected loss is the statistical product of PD, LGD, and EAD.

Q2 Answer: B) NII increases. Explanation: A positive repricing gap means more assets reprice than liabilities; hence higher rates increase NII.

Q3 Answer: C) Value at Risk (VaR). Explanation: VaR quantifies maximum expected portfolio loss at a given confidence level over a specific horizon.

Q4 Answer: C) Operational risk. Explanation: Operational risk stems from failed internal processes, people, IT systems, or external events.

Chapter 5: Basel Accords and Capital Adequacy

Q1. What is the primary regulatory purpose of requiring commercial banks to maintain minimum capital adequacy ratios?

A) To guarantee maximum annual dividend payouts to shareholders
B) To absorb unexpected losses and protect depositors and financial stability
C) To eliminate the need for liquid asset reserves
D) To convert all bank loans into government securities

Q2. Which Basel accord introduced the "Three Pillars" framework (Minimum Capital Requirements, Supervisory Review, and Market Discipline)?

A) Basel I
B) Basel II
C) Basel III
D) Basel IV

Q3. Under Basel III guidelines, which capital component represents the highest quality capital that absorbs losses first, with a minimum requirement of 4.5% of RWA?

A) Tier 2 Subordinated Debt
B) Additional Tier 1 Capital
C) Common Equity Tier 1 (CET1)
D) Revaluation Reserves

Q4. What consequence occurs if a bank's capital ratio falls into the 2.5% Capital Conservation Buffer zone under Basel III?

A) Immediate revoking of the banking license
B) Capital requirements are reduced to zero
C) Mandatory restrictions are imposed on dividend payouts and bonus distributions
D) All outstanding loans are automatically written off

Answer Key

Q1 Answer: B) To absorb unexpected losses and protect depositors and financial stability. Explanation: Bank capital acts as a cushion to absorb unexpected losses and safeguard depositor funds.

Q2 Answer: B) Basel II. Explanation: Basel II established Pillar 1 (minimum capital), Pillar 2 (supervisory review), and Pillar 3 (market discipline).

Q3 Answer: C) Common Equity Tier 1 (CET1). Explanation: CET1 (common equity and retained earnings) absorbs losses first and must be at least 4.5% of RWA.

Q4 Answer: C) Mandatory restrictions are imposed on dividend payouts and bonus distributions. Explanation: Breaching the 2.5% CET1 conservation buffer triggers automatic regulatory limits on dividends and bonuses.

Chapter 6: Bank Performance Analytics and CAMEL

Q1. In the regulatory CAMEL rating framework, what does the letter 'M' stand for?

A) Market risk
B) Management
C) Margin analysis
D) Maturity mismatch

Q2. Funds Transfer Pricing (FTP) is used internally by commercial banks to:

A) Calculate external tax liabilities on corporate loans
B) Price funds between treasury, deposit-gathering branches, and lending units to measure true unit profitability
C) Determine statutory cash reserve requirements with the central bank
D) Standardize retail bank branch architecture

Q3. What early-warning signal on an analyst's dashboard often precedes a major provisioning shock?

A) High CASA ratio combined with falling operating expenses
B) Rapid loan growth (e.g., 30%+ YoY) accompanied by flat or unrecognised NPLs
C) CAR exceeding 20% with high provision coverage
D) Declining cost-to-income ratio with rising NIM

Q4. Each component in the CAMEL supervisory rating system is assigned a score ranging from:

A) 1 (best) to 5 (worst)
B) 1 (worst) to 10 (best)
C) 0% to 100%
D) AAA to D

Answer Key

Q1 Answer: B) Management. Explanation: CAMEL stands for Capital, Asset quality, Management, Earnings, and Liquidity.

Q2 Answer: B) Price funds between treasury, deposit-gathering branches, and lending units to measure true unit profitability. Explanation: FTP assigns internal transfer rates to remove maturity mismatches and reveal true unit/product margins.

Q3 Answer: B) Rapid loan growth (e.g., 30%+ YoY) accompanied by flat or unrecognised NPLs. Explanation: Fast loan expansion alongside delayed NPL recognition signals potential loan evergreening and a future provisioning shock.

Q4 Answer: A) 1 (best) to 5 (worst). Explanation: Supervisory ratings grade each CAMEL category on a 1 to 5 scale, where 1 indicates top strength.

Chapter 7: Islamic Banking Analytics and Digital Banking

Q1. Islamic banking operates on principles that strictly prohibit interest, which is known in Sharia law as:

A) Mudaraba
B) Riba
C) Murabaha
D) Wadiah

Q2. Which Islamic financing contract is defined as a cost-plus sale where the bank purchases an asset and sells it to the client at an agreed markup?

A) Ijara
B) Murabaha
C) Musharaka
D) Salam

Q3. Which Islamic financing mode is specifically structured for advance payment for future delivery of goods, commonly used in agricultural financing?

A) Istisna
B) Salam
C) Ijara
D) Mudaraba

Q4. What key structural cost advantage do digital banking channels provide compared to traditional brick-and-mortar branches?

A) Total exemption from Basel III capital requirements
B) Dramatically lower cost per transaction (e.g., ~Rs 5 via app vs. ~Rs 150 at a branch)
C) Elimination of all operational and IT cyber risks
D) Fixed zero percent tax rate on net profit

Answer Key

Q1 Answer: B) Riba. Explanation: Riba represents interest, which is strictly prohibited under Islamic law.

Q2 Answer: B) Murabaha. Explanation: Murabaha is a cost-plus sale transaction where the cost and profit markup are agreed upfront.

Q3 Answer: B) Salam. Explanation: Salam involves advance payment for future delivery of specified goods, widely applied in agriculture.

Q4 Answer: B) Dramatically lower cost per transaction (e.g., ~Rs 5 via app vs. ~Rs 150 at a branch). Explanation: App-based digital transactions operate near zero incremental cost (~Rs 5) relative to physical branch visits (~Rs 150).

End of Quiz

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