Written Exam for the B.Sc. or M.Sc. in Economics summer 2013

Economics of Banking

Master's Course

3 June 2013

(3-hour open/closed book exam)

Please note that the language used in your exam paper must correspond to the language of the title for which you registered during exam registration. I.e. if you registered for the English title of the course, you must write your exam paper in English. Likewise, if you registered for the Danish title of the course or if you registered for the English title which was followed by "eksamen på dansk" in brackets, you must write your exam paper in Danish.

This exam question consists of 2 pages in total (including this page)

1. A country has a large number of small transportation firms, each having only a few vehicles. The industry is very competitive, so that profits are small on the average and subject to considerable variation over time.

The firms complain that they have problems in getting credits and that loan rates are high. Faced with such complaints, the banks point to a large number of cases where the borrowers default on their credits.

For purposes of income taxation, there is a system of registration installed which keeps track of the activity of each vehicle in the industry. The banks argue that if they were allowed access to these data, it improve the credit situation of the firms.

Give a theoretical explanation of why the banks might be right. Could there be other ways of improving the situation?

2. After a period of financial insecurity it has been decided that the deposit insurance of the country should be reorganized. As a main principle for the new arrangements, the deposit insurance should be self-financing, at least on average, but it has also been an important argument that the deposit insurance should reduce risk, not only for depositors but for the financial sector as a whole.

Give a brief survey of the alternative approaches towards financing a deposit insurance, with suggestions for the particular one described above.

In the final phase of negotiation, representatives of the large banks argue that the small banks have a higher risk of a bank run that a large bank, so that small banks should pay a higher premium relative to the size of their deposits than large banks. Can it be argued that size should matter when determining the premium ?

3. A bank has experienced some problems with their credits to a particular type of investment, where investors are subject to some risk, and where the way in which investor conducts business cannot be monitored with the bank, whereas final outcomes are publicly observable. Give a theoretical explanation of the problems that the bank will have in such a situation.

It is now suggested to introduce a new type of contract, where the fixed repayment is supplemented by a percentage of investor's gain. Will this solve the problems of the bank?