Stockholm University

Department of Economics

Course name:	**Financial Development and Crises**
Course code:	**EC7213**
Examiner:	**Jonas Vlachos**
Number of credits:	**7,5 credits**
Date of exam:	**Sunday 13 December 2015**
Examination time:	**3 hours [09:00-12:00]**

Write your identification number on each paper and cover sheet (the number stated in the upper right hand corner on your exam cover).

Use one cover sheet per question. Explain notions/concepts and symbols. If you think that a question is vaguely formulated, specify the conditions used for solving it. Only legible exams will be marked. **No aids are allowed.**

The exam consists of 4 questions. There are 70 points in total and a maximum of 30 points have been awarded for the term paper. For the grade E 45 points are required, for D 50 points, C 60 points, B 75 points and A 90 points.

Your results will be made available on your "My Studies" account **(**www.mitt.su.se) three weeks after the exam, at the latest.

Good luck!

Question 1 (10 points).

a) What are the main similarities and differences between shadow banking and conventional banks?

b) Explain what securitization is and what useful purposes it fulfils.

c) Discuss the different problem that securitization creates?

Question 2 (20 points).

a) Discuss why information can be lost when banks go into bankruptcy and what the implications are for the real economy.
b) If you were to pick one indicator to keep your eyes on when watching for future financial crisis, which would it be? Explain why!
c) Why may the deposit insurance scheme of a small country with an internationally active banking sector not be credible?
d) Explain why a bank in a crisis situation can have the incentive to take unlimited risks.

Question 3 (20 points).

a) Firm raise very little capital through stock markets but much attention is still given to stock market developments. Why can it be useful for management to have shares traded at the stock market even though no, or very little, money is raised that way?
b) What further service does the secondary market provide and why is this useful?
c) Assume that there are two assets, A and B, in the market. What happens to the price of asset A if asset B becomes more liquid while nothing happens to asset A?
d) Explain briefly what the main insight from the weak version of the efficient market hypothesis is.
e) Explain briefly the concept of “Private benefits of control”.

Question 4 (20 points).

The Basel II and III agreements impose so called “capital requirements” on banks

a) Explain what capital requirements are in the context of the banks’ balance sheets.
b) Explain the similarities and differences between imposing capital requirements and imposing a so called “leverage ratio” on banks.
c) What is the main problem that the regulators are trying to handle by imposing capital requirements and leverage ratios? What are the main problems preventing this type of regulation from being successful? Briefly discuss whether or not capital requirements seem to have been effective tools of regulation during the last crisis.
d) What – if anything – do you expect happens to the required rate of return on bank equity capital when capital requirements are increased?