RBI Grade B Phase 2 Official Handout (F&M) Solved Paper

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Directions for Questions 1 to 3: The Indian financial system has undergone a significant transformation in 1990s. The deregulation of lending rate and free pricing of equity issues etc., have changed the financial market scenario. Investors have shied away from equity market in last few year due to capital market scams and low return. A comparative analysis of all emerging economies confirms that most of the emerging economies have a corporate bond market. However, the Bonds/debts market in India has not yet fully developed and turnover is very low. The most popular Bonds include partly convertible debentures (PCDs), fully convertible debentures (FCDs), deep discount bonds (DDBs), zero coupon bonds (ZCBs), bonds with warrants, floating rate notes (FRNs) / bonds and secured premium notes (SPNs). Of these instruments, fixed rate bonds emerge as the dominant option with maximum volume transacted.

1. Mrs. Laxmi bought 10% p.a. Bonds of ABC Limited for Rs.105/- each, the face value being Rs.100/- each, with maturity date being exactly 3 years after the date of acquisition. Assuming market rate of return being 12% p.a., the per bond present value of the inflow will be:
   (1) Rs. 130.00
   (2) Rs. 95.30
   (3) Rs. 102.70
   (4) Rs. 87.90
   (5) Rs. 114.40

2. Vatsal Limited is operating at an EBIT of Rs.9 lacs, depreciation already charged being Rs.2.00 lacs and Tax rate being 35%. The present borrowing is Rs.30 lacs by way of Term loan at a cost of 12% p.a. and working capital limit fully utilized being Rs.10 lacs at a cost of 10% p.a. What is the interest Coverage Ratio:
   (1) 1.54
   (2) 2.50
   (3) 1.67
   (4) 0.97
   (5) 1.36

3. Mr. Mohan bought bonds of the face value of Rs.1000/- each at a discount of 10% on face value, bearing coupon@ 10% p.a., residual tenure for redemption at par being exactly 2 years from the date of acquisition. What is the IRR?
   (1) 11.11%
   (2) 18.12%
   (3) 12.12%
   (4) 16.18%
   (5) 15.25%

4. Which of the following is not the object of Corporate Governance?
   (1) Non-acceptance of Management's own role as trustees on behalf of the shareholders
   (2) Acceptance by management of the inalienable rights of shareholders as the true owners of the corporation
   (3) It is about commitment to values
   (4) It is about ethical business conduct
   (5) It is about making a distinction between personal & corporate funds in the management of a company

5. The halo error that tend to distort appraisals, refers to _____
   (1) The tendency to mark high on all factors due to a high impression on some specific factor
   (2) The tendency to mark everyone high
   (3) The tendency to give excellent ranking to those appraisee who very often wishes halo to the appraiser
   (4) The tendency to rate people higher than they deserve in order to see that poor ratings do not harm the individual
   (5) The tendency of the evaluator to rate high those employees who exhibit qualities which they themselves possess

6. Which of the following is System for participating approach of leadership?
   (1) Under this system managers have complete trust in their subordinates and always get ideas from them and use those ideas constructively
   (2) Under this system managers have a patronizing trust in their subordinates and motivate their people with rewards and some fear and punishment
   (3) Under this system, managers concern themselves neither with people nor production
   (4) Under this system managers have a substantial but not complete trust in their subordinates, use rewards for motivation and use punishment only occasionally
   (5) Under this system managers are highly autocratic and motivate people through fear and Punishment

7. Which of the following is/ are functions of financial markets?
   (1) Facilitate price discovery
   (2) Provide liquidity to financial assets
   (3) Reduce search costs
   (4) Reduce information costs
   (5) All of the above

8. Which one of the following is not a function of the Reserve Bank of India?
   (1) It provides currency and operates the clearing system for the banks
   (2) It formulates and implements monetary and credit policies
   (3) It supervises the operations of Commercial Banks
   (4) It regulates foreign exchange transactions
   (5) Register and regulate the working of mutual funds

9. The financial development of a country is commonly assessed in terms of all but one of the following ratios
   (1) Finance ratio
   (2) Cash ratio
   (3) Financial interrelations ratio
   (4) New issue ratio
   (5) Intermediation ratio

Directions for Questions 10 to 11: At first, money was thought to be the only incentive and then a little later it was thought that incentives include working conditions, security and perhaps a demographic style of supervision. Subsequently the content of motivation was deemed to be the so-called higher level needs or motives such as esteem and self actualization; responsibility, recognition, achievement and advancement and finally including in its purview growth and personal development.

10. Achievement factor of motivating an individual is the contribution of which theory and what other factor was considered along with it?
    (1) Maslow's theory and supervision factor
    (2) Alderfer's theory and recognition factor
    (3) Vroom's theory and responsibility factor
    (4) Herzberg's theory and advancement factor
    (5) Equity theory and salary factor

11. In which of the following models, the relationships are expressed diametrically rather than mathematically, there are more variables and the cognitive process of perception plays a central role and that motivation doesn't equal satisfaction or performance?
    (1) Vroom's model
    (2) Equity model
    (3) Porter Lawler model
    (4) Scientific model
    (5) ERG model

12. Four major theories on motivation are: (a) Maslow's Hierarchy of Needs; (b) Herzberg's Motivation/Hygiene (two factor) Theory; (c) McGregor's X Y Theories; and (d) McClelland's Need for Assessment Theory. The study of these theories generally validate that –
    (1) McGregor's Theory Y matches much of Maslow's self-actualization level.
    (2) Reward systems must not correspond to intrinsic factors, if employees are to be motivated.
    (3) Satisfying extrinsic factors is not commonly attempted method for motivating workers.
    (4) Motivation is irrelevant in management
    (5) There is nothing common in these theories

13. Financial Statements are analyzed and appraised with help of –
    (1) Balance Sheet
    (2) Profit and loss statements
    (3) Ratio analysis of Balance sheet and profit and loss statements
    (4) All of the given options
    (5) None of the given options

14. DSCR (Debt Service Coverage Ratio) and the Debt Equity ratio respectively are based on the logic of having adequate earning to cover debt servicing that shall neither be in excess nor too meager and the leverage is in proportion, are considered to be thumb rule for the financial projection analysis. You are advised to select the optimal ratios norms for the same from the following:
    (1) Range of 2 to 3 and 1:2 respectively
    (2) 2.5 and 3 respectively
    (3) 1.5 to 2 and 2:1 respectively
    (4) 1.5 and 1:1.5 respectively
    (5) None of the given options

15. The accounts of Government are kept in three parts viz. Consolidated Funds of India, Contingency Funds of India and Public Account. The transactions in the Public Account relate to debt other than those included in the Consolidated Fund of India and the receipts under Public Account do not constitute normal receipts of Government. Hence,
(1) Parliamentary authorisation for payments from the Public Account is, therefore, not required
(2) Parliamentary authorisation for payments from the Public Account is, therefore, required.
(3) Parliamentary authorisation to receipts from the Public Account is, therefore, not required.
(4) Parliamentary authorisation to receipts from the Public Account is, therefore, required.
(5) Parliamentary authorisation for payments and to receipts from the Public Account is, therefore, required.

16. There is enough anxiety over the fast eroding capital of public sector banks in India, especially that of loss-making lenders. As the rising pile of toxic assets eat away their capital, banks are struggling to do business. What could make the mess messier? Banks are mandated to keep 9% of minimum capital adequacy ratio, out of which Basel-III rules mandate a Tier-I capital ratio of 7%. A part of this Tier-I capital of lenders consists of additional Tier-1 bonds. Called AT-1 bonds in market parlance,What may be the biggest risk to the Public Sector Banks with AT-1 bonds:
(1) These are innovative debt instruments that have equity-like perpetuity and may dilute the Government ownership in these banks.
(2) Given the massive losses that public sector lenders have piled up in 2015-16, some banks are fast running out of distributable reserves to service these regular coupon payments on their AT-1 bonds.
(3) May be callable at the initiative of the issuer only after a minimum of five years. To exercise a call option a bank has to receive prior supervisory approval.
(4) Banks may find it difficult to repay these bonds (principal plus interest) at the time of maturity, owing to dearer coupon on these bonds.
(5) Is neither secured nor covered by a guarantee of the issuer or related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis bank creditors.

17. Bond valuations are generally done in terms of valuing the cash flows:
(i) coupon payment (interest payment) = (coupon rate * principal) usually paid every 6 months and / or (ii) maturity
value = principal or par value = Rs. 1000. The '9 ⅞ % ABC Ltd 2020' bond pays interest annually. The face value of the bond is Rs. 1,000. 'ABC Ltd' bond as of today, if the required rate of return is seven (7) per cent, is –
(1) Rs. 1,950.40
(2) Rs. 1,117.88
(3) Rs. 999.98
(4) Rs. 1,755.44
(5) None among the given options

18. Consider the current government budget where —
T is today's net taxes
D is government debt at the start of today
G is today's government spending
r is the real interest rate on govenment debt.
All variable are positive. The Government is running a deficit today if —
(1) $(G - T) > 0$
(2) $D(1 + r) > (T - G)$
(3) $r D > (T - G)$
(4) $((G + D) r - T) > 0.$
(5) $(T-G-rD) >0$

19. The banking sector in India is fully regulated sector. The Reserve Bank of India (RBI), established under the RBI Act, 1934 plays the role as central bank of the country and performs the function of regulating, supervising and controlling banking in India. The RBI is constituted and managed by a central board appointed by Government of India. The Reserve Bank of India derives powers from various acts/laws enacted for regulating banking in India and ensures that the banks function within the permitted frame work of laws, the main being Banking Regulation Act, 1949.
Can a commercial bank in India involve itself in a business to acquire, construct and maintain building for indefinite period?
(1) No, it is not permitted as per Section 6(1) or any other section of the B.R. Act.
(2) Yes, it is possible as it is not prohibited u/s 8 of B.R. Act.
(3) Yes, this is permitted u/s 6(1) of B.R. Act
(4) Yes, this is permitted u/s 5 of B.R. Act
(5) Yes, it can be done with the approval of the Board of Directors of the Bank concerned.fault , while repaying loan for 90 days, his account will be classified as NPA.

Answer keys:

1) 2	2) 2	3) 4	4) 1	5) 1
6) 1	7) 5	8) 5	9) 2	10) 4
11) 2	12) 1	13) 4	14) 3	15) 1
16) 2	17) 5	18) 3	19) 3	

Solutions:

Solutions for Questions 1 to 3:

1. 2

   In the question it is given that Lakshmi bought the bonds at Rs. 105/- each, and the face value being 100/- each that means the bond price is not 105/-. It is given only to confuse and the bond price is calculated always using the face value and coupon rate which is 10% here.
   We know that the price of a bond can be given as

   $P = [C \times \{1 - 1/ (1+i)^n\}/ i] + M / (1+i)^n$

   When no information is given about the type of payment whether annual/semi-annual or quarterly we have to take annual payment always.
   Here C = Coupon Value = 100 x 10% = Rs. 10/-
   i = market rate of return or yield or IRR = 12%
   n = 3 years
   M = Maturity value = Rs. 100/-
   Hence putting all these in the above formula we get,
   $P = [10 \times \{1 - 1/ \{1+0.12)^3\}/0.12] + 100/(1+0.12)^3$
   $P = [10 \times \{1 - 1/1.404928\}/0.12] + 71.1780$
   $P = [\{10 \times .2882\}/0.12] + 71.1780$
   $P = (2.882/0.12) + 71.1780$
   P = Rs 95.30 approx (Option 2)

2. 2

   Interest Coverage Ratio = EBIT/Interest Expenses = Rs. 9 Lakhs / Rs. 3.6 Lakhs = 2.5
   All the other figures do not play any role in calculation of Interest Coverage Ratio. (Option 2)

3. 4

   We know that the price of a bond can be given as
   $P = [C \times \{1 - 1/ (1+i)^n\}/ i] + M / (1+i)^n$
   So IRR is nothing but yield which is i in the above equation.
   So, we have to calculate the value of i
   Since nothing is mentioned again the payments are taken annually.
   C = Coupon Value = 1000 x 10% = 100
   M = Maturity Value = 1000
   n = No of years/period = 2 years
   Bond Price, P = 10% discount on the face value = 1000 – (1000 x 10%) = 900
   As calculator is allowed in the exam we can find out the value of i by using trial and error from the options and then checking it with our bond price which is 900.
   So when i = 11.11% we get, P = 981/-
   i = 12.12, we get P = 964
   Similarly when we check with other options we will get i value as 16.18% which is option (4)

4. 1

   Corporate governance ensures acceptance of Management's role (as well as employees) towards the organization. Hence option 1 is not the objective of the Corporate Governance. All the other options are inline with the objectives of the Corporate Governance. (Option 1)

5. 1

   Halo error refers to mark an individual high overall on the basis of one or a few particular areas, hence (Option 1)

6. 1
As the name means, participating approach is closest to democratic approach of leadership in which employees who are most affected by the decisions are allowed to take part in the decision making. Hence we can straightaway rule out options 3 and 5. Democratic and patronizing do not go together, as it is transparent and communication is both ways. Option 2 is also ruled out. The decision making stems from the employees themselves, and hence option 1 comes closest to the participating approach of leadership. (Option 1)

7. 5
The financial markets facilitate price discovery by means of reducing efficiencies, information inefficienes are reduced, search costs which are facets of transaction costs are reduced as operational inefficiencies come down and liquidity obviously increases because of more players. Therefore, all of the above are the functions. (5)

8. 5
Registration and regulation of the working of mutual funds is the function of SEBI, except that all other are functions of RBI (Option 5)

9. 2
Cash ratio is actually used for companies, it is the cash and cash equivalents to the liabilities of the company, the growth of the country cannot be measured by the cash and cash equivalent possessed by the govt., it has to take into account broader factors. Finance ratio measures the total analysis of primary and secondary claims of national income. Financial Interrelations ratio reveals about relationship between financial assets and physical assets, therefore it measures the ratio between the financial structure and real assets structure of the economy. New issue ratios indicates the relationship between the primary issues and physical capital formation in the country. Intermediation ratio indicates the ratio between the secondary to the primary issues in the country. Hence Cash ratio is not used for measuring the financial development of the country. (Option 2)

Solutions for Questions 10 to 11:

10. 4
Achievement factor of motivation definitely overrules salary as a motivation factor, and though Maslow's theory does have achievement in the esteem needs, supervision is not the associated factor there as supervision has to do more with power and not necessarily achievement. Alderfer's theory focusses on Maslow's theory itself – existence, relatedness and growth, again growth may be related to achievement but it focusses on more intrinsic desire of development. Vroom's theory is about motivation being a product of expectations,performance and rewards and does not bring much about achievement. Equity theory focusses efforts in comparison with the efforts of the others. Hence Options 1,2,3 and 5 can be ruled out. Option 4 which is Herzberg theory focusses on two kinds of factors – hygiene and motivation. It is in the motivation factor that achievement (growth opportunities) and advancement(which is more of intrinsic and not related to comparison with others) comes along. (Option 4)

11. 2
Amongst the above models which take into account perception are first two – Vroom's model and Equity Model. However, Vroom's theory is a mathematical relationship and assumes that efforts and performance have positive correlation and that employee desires to satisfy and important need. But equity theory is more about fairness, the motivation here would be the equality in rewards for equal efforts. Therefore Option 2 is a strong contender. We can rule out option 4 because scientific management does not take into account perception. ERG model also believes that motivation and satisfaction are closely related and does not take into account perception. Thus (option 2)

12. 1

Option 4 can be easily ruled out as motivation is very much relevant, Herzberg's theory of two factor motivation does take into account intrinsic factors so option 2 can be ruled out. Option 3 is actually the commonly attempted method for motivating workers, and the listed theories do not validate the actual scenario. Option 5 is wrong, as lot is common between the theories, for example both Herzberg's hygiene factor and Maslow's hierarchy lower levels stress upon some basic needs. Option 1 is correct, Mc Gregor's theory states that managers assume that people are internally motivated and therefore they try to create an environment where workers achieve higher levels of self-esteem and self-actualization. (Option 1)

13. 4

All of Balance Sheet, P&L and ratios are used to analyze financial statements of a firm. (Option 4)

14. 3

Though the acceptable norms vary from industry to industry, it is not advisable to have Debt-to-equity above 2, and DSCR should be between 1.5 to 2. (Option 3)

15. 1

Consolidated funds are for normal receipts (tax and non-tax revenues) and normal payments (loan repayments) and hence require parliamentary authorization. Public account on the other hand do not constitute normal payments or receipts (they are funds where govt. act merely as bankers like small savings, provident funds etc.), hence parliamentary authorization is not required for the payments from these account (Option 1)

16. 2

Option 1 is not a risk to the public sector banks as such, even if the ownership is being diluted, it does not contribute to any sort of risk. Option 5 is a risk to the buyers of the bonds, and not to the issuer of the bonds (banks) themselves. Option 3 actually gives more flexibility to the banks, and hence that can be ruled out. It is to be noted that AT-1 bonds have no maturity dates as such, they are perpetual bonds, so option 4 is theoretically wrong, hence option 2 is the actual risk which the banks have, as because of the redistributable reserves being reduced, the coupons may have to be paid using the capital which is nothing but erosion of capital as what the fear is stated in the question. (Option 2)

17. 5

We know that the price of a bond can be given as

$P = [C \times \{1 - 1/ (1+i)^n\}/ i] + M / (1+i)^n$

Again as nothing is mentioned in the questions coupons are paid annually.

In this question again lot of data is given which is not needed at all to solve.

So face value = Rs. 1000/-

Coupon Value = $9\ ^7/8\%$ = $1000 \times 9\ ^7/8\%$ = 1000 x 79/8% = 1000 x 9.875% = 98.75/-

Rate of return, i = 7%

M = maturity value = 1000/-

N= no of years = 3 (2020 – 2017 = 3)

Hence by substituting the values we get

P = 1075.44/- (Option 5)

18. 3

Govt is running a deficit if its net income is less than its expenses

Net Income = Taxes = T

Net expenses = G + rD

Therefore when (G+rD) > T or rD> T-G ie option (3), the Govt is running a deficit today. (Option 3)

19. 3

Under Section 6, it is permitted that Banks can acquire, construct and maintain buildings for the purpose of the company. This is self-understandable, as the banks would require to possess assets for its own premises and so it is a part of business to acquire, maintain and construct at cost which are profitable for the bank in the long-run. Though option 2 is also true, as Section 8 prohibits trading and not acquiring and maintaining buildings, but section 6(1) clearly states that banks are permitted to do so, the most relevant option is (Option 3)

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