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QUESTION 1

Satish Dhawan, a veteran fixed income trader is conducting interviews for the post of a junior fixed income trader. He interviewed four candidates Adam, Balkrishnan, Catherine and Deepak and following are the answers to his questions.
Q-1: Tell something about Option Adjusted Spread

Adam: OAS is applicable only to bond which do not have any options attached to it. It is for the plain bonds.

Balkishna: In bonds with embedded options, AS reflects not only the credit risk but also reflects prepayment risk over and above the benchmark.

Catherine: Sincespreads are calculated to know the level of credit risk in the bound, OAS is difference between in the Z spread and price of a call option for a callable bond.

Deepark: For callable bond OAS will be lower than Z Spread.

Q-2: This is a spread that must be added to the benchmark zero rate curve in a parallel shift so that the sum of the risky bond\\'s discounted cash flows equals its current market price. Which Spread I am talking about?

Adam: Z Spread

Balkrishna: Nominal Spread Catherine: Option Adjusted Spread Deepark: Asset Swap Spread

Q-3: What do you know about Interpolated spread and yield spread?

Adam: Yield spread is the difference between the YTM of a risky bond and the YTM of an on-the-run treasury benchmark bond whose maturity is closest, but not identical to that of risky bond. Interpolated spread is the spread between the YTM of risky bond and the YTM of same maturity treasury benchmark, which is interpolated from the two nearest on-the-run treasury securities.

Balkrishna: Interpolated spread is preferred to yield spread because the latter has the maturity mismatch, which leads to error if the yield curve is not flat and the benchmark security changes over time, leading to inconsistency.

Catherine: Interpolated spread takes account the shape of the benchmark yield curve and therefore better than yield spread.

Deepak: Both Interpolated Spread and Yield Spread rely on YTM which suffers from drawbacks and inconsistencies such as the assumption of flat yield curve and reinvestment at YTM itself.

Then Satish gave following information related to the benchmark YTMs:

Maturity(yrs)	1	2	3	4	5
YTM	8.22	8.52	8.88	8.98	9.02

There is a 10.25% risky bond with a maturity of 4.75 year(s). Its current price is INR105.31, which corresponds to YTM of 9.22%. Compute Interpolated Spread from the information provided in the vignette:

A. 0.20%

B. 0.21%

C. 0.24%

D. 0.22%

Correct Answer: C

QUESTION 2

Proportion of fee based income is examined as the same is an _____ efficient source of bank\\'s profitability.

A. Interest based

B. Capital

C. Current

D. Fee Based

Correct Answer: A

QUESTION 3

Provisioning Coverage Ratio (PCR) is essentially the ratio of provisioning to ______ and indicates the extent of funds a bank has kept aside to cover loan losses.

A. total loan portfolio

B. gross non-performing assets

C. total assets

Correct Answer: B

Reference: https://currentaffairs.gktoday.in/tags/provision-coverage-ratio

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QUESTION 4

If you yield curve is humped and the medium rates drop, what will happen to the yield curve?

A. It will move from negative to positive

B. It will shift up in a uniform fashion

C. It will become steeper

D. It will flatten

Correct Answer: C

QUESTION 5

The following information pertains to bonds: Further following information is available about a particular bond `Bond F\\'

Bond	Initial Maturity	Spread from G-Sec (bps)		
		January 2013	April 2013	July 2013
Bond A	10 Years	94	97	89
Bond B	10 Years	102	103	93
Bond C	10 Years	370	530	560
Bond D	10 Years	115	130	110
Bond E	10 Years	10	15	7

There is a 10.25% risky bond with a maturity of 2.25% year(s) its current price is INR105.31, which corresponds to YTM of 9.22%. The following are the benchmark YTMs.

Maturity(yrs)	1	2	3	4	5
YTM	8.22	8.52	8.88	8.98	9.02

Assuming the G-Sec has not changed from the time January 2013 to April 2013, what can you predict about the changes bond price and change in issues borrowing rates:

A. Decrease and Increase

B. Increase and Increase

C. Decrease and Decrease

D. Increase and Decrease

Correct Answer: D

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