Examination Period 3: 2018/19

FINM04519N

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<th>Module Title</th>
<th>Risk Management in Financial Institutions</th>
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<tr>
<td>Level</td>
<td>Seven</td>
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<tr>
<td>Time Allowed</td>
<td>Two hours plus fifteen minutes reading time</td>
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Instructions to students:

- Enter your student number **not** your name on all answer books.
- Students are encouraged to use the **first fifteen minutes** of the exam to read the questions carefully and to plan answers.
- Answer **three** questions: **one compulsory** question from **Section A** and **two** from **Section B**.
- Begin each question in a separate answer book; label each answer book clearly with the number of the question you are answering.
- Neither books nor notes may be taken into the examination.
- The use of a calculator **is** permitted.

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Section A

Answer the compulsory question.

Question 1

a. As the main depository institutions in an economy, commercial banks perform a range of special functions. Take stock of the key functions performed by banks and explore different types of risks associated with those functions.

(15 marks)

b. Why is risk management important for financial institutions?

(15 marks)

c. "Financial innovation and integration have increased the speed and extent to which shocks are being transmitted across asset classes and countries, and have blurred boundaries, including between systemic and non-systemic institutions." (Virmani and Ray, 2010)¹.

Explain the role of systemic risk in Global Financial Crisis of 2008/09.

(10 marks)

Total: 40 marks

Section B

Answer two questions from this section.

Question 2

a. On a typical bank’s balance sheet loans are the most important asset and, amongst others, they pose credit risk to the bank. Define credit risk and discuss why it is important for banks to measure and manage credit risk emanating from a single loan and a portfolio of loans.

(15 marks)

b. Present an account of qualitative techniques of credit risk measurement by taking examples of the models in each type.

(15 marks)

Total: 30 marks

Question 3

‘The tools of the risk management organization have intrinsic limitations and their reliability is easily overstated’ (Rene Stulz, 2014).

a. In the light of the above statement, discuss the key limitations of risk management in banks.

(15 marks)

b. How do culture, organization and governance of risk result in increasing value of the banks by overcoming those limitations?

(15 marks)

Total: 30 marks

Question 4

a. Define market risk and explore different sources/types of market risks in financial institutions.

(15 marks)

b. Explain Historical Simulation approach and Variance-Covariance approach for measuring market risk.

(15 marks)

Total: 30 marks

Section B continues overleaf
Question 5

Standardisation of bank capital regulation came in the form of Basel Accord 1 in 1988. Basel Accord 2 was introduced in 2001 and the third version, Basel Accord 3, is in enforce from 2019. Looking at the motives and requirements of the three Basel Accords, answer the following questions:

a. Highlight the key limitations of Basel Accord 1 and explain how Basel Accord 2 was a major improvement over Basel Accord 1.  
   (15 marks)

b. Highlight the weakness in Basel Accord 2 and discuss the role of Basel Accord 2 in the Global Financial Crisis.  
   (15 marks)
   Total: 30 marks