



Department Finance and Investment Management

RISK IN FINANCIAL SERVICES 2A

RFS22A2

Final Assessment Opportunity

June Examination 2019

Time: 2 hours

Marks: 70

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Moderator: Mrs M. Lepheana (Internal)

INSTRUCTIONS:

- This paper consists of 10 pages (including the cover page).
- Start each question on a new page.
- Calculators are allowed

Question	Topic	Marks	Time
1	Multiple choice	35	45 minutes
2	Principles of Risk Management	8	18 minutes
3	International Risk Regulation	6	13 minutes
4	Operational Risk	12	24 Minutes
5	Credit Risk & Market Risk	9	20 Minutes
		70	120 minutes

QUESTION 1 - (35 marks)

1. If a significant change occurs in technological innovation and personal spending habits.
Which of these changes could affect business risk?
 - A. Only changes in personal spending habits
 - B. Only changes in technological innovation
 - C. Both of these changes
 - D. Neither of these changes
2. The need for greater levels of information security has arisen over the years in order to address which of the following risks?
 - A. Credit exposure
 - B. Poor corporate governance
 - C. Cyber theft
 - D. Misspelling
3. Stress tests used under the internal capital adequacy assessment process aid the assessment of capital adequacy mostly by:
 - A. Indicating the likelihood of a scenario occurring
 - B. Identifying the amount of maximum potential loss
 - C. Prioritising the control measures needed
 - D. Removing the impact of any economic downturn
4. Outsourcing as a risk mitigation strategy is:
 - A. Transferring an operation to a specialist third party for a fee
 - B. Insuring operations with a third party for a fee
 - C. Ensuring an alternative plan is operational if a major disruption occurs
 - D. Designed to reduce operational capital
5. In the sequential stages of the risk management process, what stage immediately follows risk measurement and assessment?
 - A. Identification
 - B. Mitigation
 - C. Monitoring
 - D. Reporting
6. Which of the following factors is most likely to help distinguish between risk and uncertainty? The
 - A. Methods needed to avoid a harmful situation arising

- B. Availability of historical data
 - C. Existence of external drives
 - D. Methods used to insure against an adverse event
7. A bank is checking for any common ownership links between two firms to which it is lending money. The main reason for doing this is to minimize the level of:
- A. Liquidity risk
 - B. Enterprise risk
 - C. Basis risk
 - D. Concentration risk
8. An international bank with headquarters in country A operates a subsidiary banking operation in country B. In accordance with the Basel Concordat on Cross-Border Banking Supervision,
- A. Bears sole supervisory responsibility for the subsidiary
 - B. Must refer the matter to the World Bank
 - C. Is obliged to appoint an independent supervisor
 - D. Should liaise with the regulator in country B
9. Following a review, a bank's risk management department has implemented a large number of risk mitigation activities. The effect of this is that the bank will now experience a new overall level of risk which is usually known as:
- A. equalised risk
 - B. residual risk
 - C. inherent risk
 - D. exposed risk
10. If a regulator moves from a statutory-based approach to regulation to a principles-based approach, it will normally:
- A. trigger a delay in the authorisation process
 - B. reduce the need for prescriptive rules
 - C. indicate a relaxation in enforcement activities
 - D. operate for a relatively short period only
11. What key factor can determine a firm's risk and control culture?
- A. Ongoing supervision by regulators
 - B. Shareholder approval

C. Communication and knowledge management

D. Recruitment policy

12. Which of the following risk assessment processes encompasses the likelihood of a risk being realised and the magnitude of the impact?

A. Benchmarking

B. Bottom-up approach

C. Ranking

D. Value-at-Risk models

13. What is the main reason why the government is more likely to intervene if a bank has a major liquidity problem?

A. To protect the level of taxation revenue

B. To minimise the associated enterprise risk

C. To prevent consumers losing confidence in the banking system

D. To ensure inflation targets are achieved

D. European Commission

14. What is the MAIN reason why internal and external drivers of a company's business risks are often BEST addressed simultaneously?

A. To benefit from economies of scale

B. To avoid compliance breaches

C. To reflect their inter-relationship

D. To minimise the scope for error

15. One of the key purposes of the Basel II accord was to achieve closer alignment between:

A. UK practice and US practice on risk management

B. regulatory capital and economic risks

C. credit risk assessment and market risk assessment

D. short term risk control measures and longer term ones

16. The Basel Committee's objective is to:

A. Enhance understanding of supervisory issues and improve the quality of banking supervision worldwide

B. Publish best practice standards on risk and banking

C. Serve as a bank for central banks, and foster international monetary and financial cooperation

D. Establish a worldwide legal framework to force countries to regulate their banks

17. An assessment of a firm's risk profile that excludes the beneficial effects of mitigating controls is called:

- A. Gross risk
- B. Net risk
- C. Target risk
- D. Residual risk

18. Which of the following areas forms a Pillar of the Basel Accord?

- A. Minimum capital requirements
- B. Reinsurance needs
- C. Conflicts of interest
- D. Credit risk quantification

19. When assessing the counterparty credit risks associated with a loan, the loss given default percentage is based on the recognition of what key underlying

- A. Losses can have repercussions on third parties
- B. There is a strong correlation between risk and loss
- C. Some money may be recoverable to offset a loss
- D. Most losses are due to unexpected market changes

20. Why should the measurement used to set a market risk limit be as accurate as possible?
To:

- A. Maximise the agreed level of risk specified
- B. Allow a significant margin for error
- C. Minimise the level of credit risk
- D. Maximise the potential for a higher profit margin

21. As part of its operational risk policy, a firm has decided to improve its processing training. Into which category of risk mitigation does this fall?

- A. Transfer risk
- B. Avoiding of risk
- C. Reducing the impact of risk event
- D. Reducing the likelihood of risk events

22. Which of the following statements regarding the various types of the market risk is TRUE? They:

- A. Primarily subdivide into macro and micro-economic issues

- B. Only arise for relatively large investment
 - C. Tend to have a strong inter-relationship between each other
 - D. Are only measurable over short period of time
- 23.** What method is typically used by banks to capture data when determining capital requirements using operational risk scenario modelling?
- A. workshops with senior personnel
 - B. probability theory based on in-house past performance statistics
 - C. expert views from external specialists
 - D. extrapolation of market movements
- 24.** One of the methods of identifying operational risk involves using the expertise of department managers and key staff to produce a checklist of risks. What is the method formally known?
- A. Internal reviewing
 - B. Self-assessment
 - C. Scenario analysis
 - D. Top-down measurement
- 25.** In order for a market risk management function to be considered to be effective, Value-at-Risk should be suitably combined with:
- A. Escalation procedures and scenario analysis
 - B. stress testing and scenario analysis
 - C. Independent daily monitoring of utilisation
 - D. stress testing and low market risk limits
- 26.** Which of the following is the BEST reason for using external detective controls?
- A. To reduce the likelihood of risk occurring
 - B. To prevent a risk occurring
 - C. To reduce the impact if a risk occurs
 - D. To provide feedback in the risk reporting process
- 27.** Operational risk is defined as the loss arising from four distinct causes. Which of the following is one of these causes?
- A. Systems issues
 - B. Market issues
 - C. Credit issues
 - D. Governance issues

28. Which of the following statements BEST describes hedging?

- A. It is a means of reducing market risk
- B. It is a means of reducing credit risk
- C. It limits operational risks
- D. It is a cost-free method of insurance

29. Which of the following is not a duty of the operational risk department?

- A. Benchmark best industry practice
- B. Provide risk oversight and monitoring
- C. Ensure issues are properly escalated and track the actions arising from operational risk incidents
- D. Own the firm's operational risks

30. Which of the following types of risk is excluded from the Basel Committee's definition of operational risk?

- A. Legal risk
- B. Process risk
- C. Reputation risk
- D. Systems risk

31. Which of the following statements is an advantage of credit derivatives?

- A. They help to reduce concentrations of credit risk
- B. They reduce market volatility
- C. They replace the need for diversification
- D. They allow credit risk to be monitored

32. A company has decided to purchase insurance. What method of reducing operational risk exposure are they using?

- A. Risk transfer
- B. Reducing the likelihood
- C. Risk avoidance
- D. Reducing the impact

33. Moody's have categorised an investment as Ba2. What is this a relative measurement of?

- A. Market risk

B. Systemic risk

C. Operational risk

D. Credit risk

34. Which of the following statistical methods is used when conducting operational risk scenario modelling?

A. Credit migration probabilities

B. Normal distribution

C. Lognormal distribution

D. Confidence level

35. If interest rates fall by 1%, the market value of corporate bonds is likely to:

A. rise

B. fall

C. become more stable

D. become more volatile

QUESTION 2 - (8 marks)

2.1 What are the three main ways in which political change can affect the financial services sector? (3)

2.2 Define the following terms as applied in risk management

2.2.1 Risk Appetite (1)

2.2.2 Conduct Risk (1)

2.2.3 Residual Risk (1)

2.2.4 Risk Profile (1)

2.3 Why might regulators strive to keep a troubled bank operating but allow an investment management firm to fail? (1)

QUESTION 3 - (6 marks)

3.1 Clearly distinguish between home and host state regulation. (2)

3.2 What does BIS stand for, serves and fosters? (3)

3.3 Which of the Basel pillars deals with the supervisory review process? (1)

QUESTION 4 - (12 marks)

4.1 What is the Basel definition of operational risk? (1)

4.2 Why is it difficult to measure operational risk quantitatively? (1)

4.3 Give examples of three possible defences against cyber theft. (3)

4.4 Match the following event type categories and examples. (7)

	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>6</u>	<u>7</u>
Event-type category	Employment practices and workplace safety	External fraud	Clients, products and business practices	Internal fraud	Damage to physical assets	Execution, delivery, and process management	Business disruption and systems failures

	Examples
<u>A</u>	Losses due to acts of a type intended to defraud, misappropriate property or circumvent regulations, the law or company policy, (excluding diversity/discrimination events), which involves at least one internal party
<u>B</u>	Losses from failed transaction processing or process management, from relations with trade counterparties and vendors
<u>C</u>	Losses due to acts of a type intended to defraud, misappropriate property or circumvent the law by a third party
<u>D</u>	Losses arising from disruption of business or system failures
<u>E</u>	Losses arising from acts inconsistent with employment, health or safety laws or agreements, from payment of personal injury claims or from diversity and discrimination events
<u>F</u>	Losses arising from loss or damage to physical assets from natural disaster or other events
<u>G</u>	Losses arising from an unintentional or negligent failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements), or from the nature or design of a product

QUESTION 5 - (9 marks)

5.1 Give three occurrences that could be counted as credit events. (3)

5.2 Define the following terms:

5.2.1 Non-performing assets (1)

5.2.2 basis risk (1)

5.2.3 Issuer risk (1)

5.3 What is the difference between stress test and scenario testing? (2)

5.4 What measures the volatility of an investment relative to the market or benchmark? (1)

