

**INSTITUTE OF BANKERS IN MALAWI**

**ADVANCED DIPLOMA IN BANKING EXAMINATION**

**SUBJECT: RISK ANALYSIS AND MANAGEMENT (IOBM – AD305)**

**Date: Monday, 9th November 2015**

**Time Allocated: 3 hours (08:00 – 11:00 am)**

**INSTRUCTIONS TO CANDIDATES**

1 This paper consists of **TWO** Sections, A and B.

2 Section A consists of 4 questions, each question carries 15 marks.

Answer **ALL** questions.

3 Section B consists of 4 questions, each question carries 20 marks. Answer **ANY TWO** questions.

4 You will be allowed **10 minutes** to go through the paper before the start of the examination, you may write on this paper but not in the answer book.

5 Begin each answer on a new page.

6 **Please write your examination number on each answer book used. Answer sheets without examination numbers will not be marked.**

7 All persons writing examinations without payment will risk expulsion from the Institute.

8 If you are caught cheating, you will be automatically disqualified in all subjects seated this semester.

9 DO NOT open this question paper until instructed to do so.

**SECTION A (60 MARKS)**

Answer **ALL** questions from this section.

**QUESTION 1**

Bank’s are not charitable institutions and they strive to maximize profitability in order to satisfy their shareholders’ expectations. However, like any other business, banks face a multitude of risks and have to ensure that their revenues are greater than their costs in order to generate returns. Two of the major issues that banks’ have to deal with, in this regard, is the concept of liquidity management and cost of funds.

1. Explain the relationship between liquidity management and “Cost of Funds”.
2. *marks*
3. Give and explain **four** reasons for a bank to measure its cost of funds.

*(8 marks)*

1. Give **four** sources of funds for a bank. *(4 marks)*

**(Total 15 marks)**

**QUESTION 2**

1. What do you understand by the term “foreign exchange exposure?” *(2 marks)*
2. Describe the **three** main classifications of foreign exchange exposure.

*(3 marks)*

1. Give and briefly the **four** elements of transaction exposure?  *(8 marks)*
2. How would you describe a “partial hedge” in relation to transaction exposure?

*(2 marks)*

**(Total 15 marks)**

**QUESTION 3**

The Basel Committee recommendations are globally widely regarded as the standard for best practice in banking and the management of financial institutions.

1. What are the major basic differences between Basel I and Basel II requirements?

*(7 marks)*

1. Briefly discuss the importance of Basel 2 as an international benchmark. Your answer must include a criticism.  *(8 marks)*

**(Total 15 marks)**

**QUESTION 4**

Operational risk is another key risk management area. With the aid of a diagram, briefly explain the Viable Systems Model in relation to operational risk management. Your answer should state **three** lessons that banks can learn from this model.

**(Total 15 marks)**

**SECTION B (40 MARKS)**

Answer **ANY TWO** questions from this section

**QUESTION 5**

Countryside Bank Limited is a medium-sized retail bank that provides traditional loan and deposit services including generic current accounts, savings accounts, term deposits and fixed deposit account, short-term loans and overdraft facilities.

The bank set up a Risk Management function three years ago and this function has been busy writing policies and procedures, setting up a risk committee, and rolling out a new risk management process for the bank, which covers the identification, assessment, monitoring and control of its risks.

This risk management framework has been successfully implemented in most of the bank’s business areas. However, one area, the Credit Department, has refused to support the process. Anothersheep Kamanga, the department head, has argued that he and his team do not have time to ‘waste’ on risk management activities, as they are too busy generating sales/revenue for Countryside. In any case, Kamanga argued, the bank’s Audit Department have not identified any significant problems in their procedures and controls for the last three years. Anothersheep is a popular and successful department head, so Countryside’s directors have been reluctant to deal with the issue, arguing that his department is an important profit centre.

You are the Head of Risk Management and need to find a way to help Anothersheep and his team understand the benefits of effective risk management, whilst at the same time protecting the company from potentially damaging risk events. The work of the Credit Department was recently disrupted for two days due to a virus being introduced to its systems by a member of staff who had been dismissed for a previous episode of gross misconduct. In addition, the number of customer complaints has been steadily rising, due to repeated incidents of poor customer service and delays in credit processing and approvals.

You have decided that you must act to get Anothersheep’s support for the risk management process.

**REQUIRED:**

In order to convince Anothersheep of the need for a robust risk management framework across the bank and to avoid any further problems, write a memorandum to:

1. Explain to him, using a diagram, the main elements of a standard risk management program, as might be implemented by a bank like Countryside and summarise the objectives behind the **four** activities in the process. *(12 marks)*
2. Summarise **four** benefits of risk management for the bank as a whole and relate these to the Credit department in terms of cost reduction, business efficiency, regulatory compliance, and customer satisfaction in light of recent developments in the department.  *(8 marks)*

**NOTE:** Your answers must refer to the case study in support of your views to Anothersheep. **(Total 20 marks)**

**QUESTION 6**

Following recent cases in the media relating to alleged wrong-doing of company Directors, the Board wants to ensure that all of their officers are aware of how their corporate responsibilities relate to reputation. As the company risk professional, you have been asked to prepare a presentation to the Board as they are concerned about damage to the company’s reputation.

Explain the relevance of Corporate Governance in risk management. Your answer must demonstrate an understanding of corporate governance, the major objectives and the pillars that underpin this important aspect of business. **(Total 20 marks)**

**QUESTION 7**

The world at large generally maintains a misconception about risk that is not generally shared by savvy business professionals and entrepreneurs.

* 1. What **three** factors influence risk preferences. *(3 marks)*
  2. Briefly describe the **three** risk preference categories under which you would classify individuals.*(9 marks)*
  3. Give your opinion on the two statements below with practical examples from the business world.

1. Risk must be eradicated completely at all costs. *(4 marks)*
2. People who take risks are unsafe characters *(4 marks)*

**(Total 20 marks)**

**QUESTION 8**

Asset and Liability Management (ALM) considers Interest Rate Risk (IRR) as a major risk exposure that needs to be carefully understood and mitigated. This risk has always been central to the management of banking institutions.

1. Define IRR.  *(2 marks)*
2. Give **three** types of earnings risks that impact on bank earnings. *(3 marks)*
3. Discuss the **three** techniques or models for measuring and managing the asset-liability gap exposure of a bank. (*15 marks)*

**NOTE:** Your answer must show a full appreciation of the different techniques/ models, including a brief explanation of the weaknesses of using the repricing gap. **(Total 20 marks)**

**END OF THE EXAMINATION PAPER**