POSTAL TEST PAPER

FINAL SYLLABUS – 2022

PAPER – 20B

RISK MANAGEMENT IN BANKING AND INSURANCE

Time Allowed: 3 Hours **Full Marks: 100**

The figures in the margin on the right side indicate full marks.

SECTION – A : Risk Management in Banking

Answer Question No. 1 and 6 are compulsory; Answer any three fromQuestion No. 2, 3, 4 & 5.

1. Choose the correct alternative. Provide justification in each case. 1 mark isallotted for correct selection and 1 mark for the justification.: [8 × 2 = 16]

(i) Operational Risk is the Risk of _____________. Please justify your selection.
  a. When borrowers or counterparties fail to meet contractual obligations.
  b. The unpredictability of equity markets, commodity prices, interest rates, and credit spreads.
  c. Loss due to errors, interruptions, or damages caused by people, systems, or processes.
  d. The ability of a bank to access cash to meet funding obligations.

(ii) When the risk of losses in on- or off-balance sheet positions arise from movement in market prices, it is called as_____________. Briefly justify your selection.
  a. Credit Risk
  b. Operational Risk
  c. Market Risk
  d. Liquidity Risk

(iii) risk arises because of the fact that the financial system is oneintricate and connected network. Please justify your selection.
  a. Credit
  b. Operational
  c. Market Risk
  d. Systemic

(iv) The major component of Market risk is_________________. Please justify your selection.
  a. Interest Rate Risk
  b. Equity Risk
  c. Foreign Exchange Risk
  d. All of the above

(v) As per existing guidelines of RBI, the Co-operative Bank was required to disclose its exposure to Capital Market under the heading of _______________.

a. Segmental Reporting
b. Transaction with related parties
c. Exposure to sensitive sectors
d. Maturity pattern of assets and liabilities

(vi) Which of the following is known as the third pillar of Basel-II accord andwhy?

a. Minimum capital requirement.
b. Supervisory review process.
c. Standard approach.
d. Market Discipline

(vii) With reference to Basel III how much capital conservation buffer are bank required to maintain? Provide the reason.

a. 3.5%.
b. 2.5%.
c. 7.5%.
d. 1.5%.

(viii) If you sold a short futures contract, you will hope that interest rates will ___________.

a. rise
b. fall
c. remain stable
d. fluctuate

2. **(a)** Write a note on the benefits of Masala Bonds.

(b) (i) Explain the difference between a regular credit default swap and a binary credit default swap.

(ii) An exposure of ₹ 100 lakhs is backed by a lien on a fixed deposit of ₹ 30 lakhs. There is no maturity mismatch. Calculate the Credit Risk mitigant. **[6+3+3=12]**

3. **(a)** Analyze the steps to be followed by Banks for computation of the Risk Weighted Assets for Credit Risk under Standardized Approach method.

(b) Discuss the types of Market Risk. **[8+4=12]**

4. International Bank has following assets and liabilities in its balance-sheet as on March 31, 2023:

Capital	₹4,000 Crores
Reserves	₹ 24,000 Crores
Saving Bank Accounts	₹ 1,2,000 Crores
Term Deposits	₹ 1,20,000 Crores
Borrowing from RBI	₹ 12,000 Crores
Cash Balances	₹ 27,000 Crores
Balances with other Banks	₹ 60,000 Crores
Investment in Securities	₹ 60,000 Crores
Bills Payable	₹ 8,000 Crores
Cash Credit	₹ 80,000 Crores
Term Loan	₹ 80,000 Crores and
Fixed Assets	₹ 12,400 Crores
Total Assets and Total Liabilities	₹ 4,00,000 Crores.

The term loans have a fixed rate of interest. Based on this information, answer the following questions.

(i) What is the amount of interest rate sensitive assets?

(ii) What is the amount of interest rate sensitive liabilities?

(iii) In this case, how much and what type of gap in rate-sensitive assets and liabilities, the bank is having?

(iv) What is the amount of Tier-1 capital of the bank?

[3+3+3+3=12]

5. (a) Discuss any four types of Bank Risks.

(b) Why VaR is Useful? **[8+4=12]**

6. An exposure of ₹100 lakhs is backed by financial collateral in the form of NSCs of ₹ 30 lakhs and eligible A+ Debt Securities Issued by others of ₹ 50 lakhs. The residual tenor of the exposure is 3 years and the residual maturity of both the collaterals is 3 years. There is no maturity mismatch.

The weights of NSCs and A+ debt security in the basket of assets is 30% and 50% respectively. Based on residual maturity hair cut applicable to NSCs is 2% and that to A+ debt security is 6%.

Create the Net Exposure Ranking for Capital after showing the details of calculation you have resorted for creating such a rank. **[8]**

SECTION – B : Risk Management in Insurance

Answer Question No. 7 and 11 are compulsory; Answer any two from Question No. 8, 9 & 10.

7. Choose the correct alternative. Provide justification in each case. 1 mark is allottedfor correct selection and 1 mark for the justification.: [2×2=4]

(i) The following is the similarity between insurance and gambling __________________. Please justify your selection.

a. Promise to pay on the happening of an event.

b. The amount of loss to be paid is known beforehand.

c. Both the parties win on happening of an event.

d. Both are enforceable at law.

(ii) Subrogation in insurance means__________________. Please provide justification for yourselection

a. Losses must be reported in time to the insurance company

b. Losses must be considered legally binding

c. The insured must pay premiums before losses can be paid

d. One party is being substituted for another in terms of legal rights

8. **(a)** List any four powers of Tariff Advisory Committee (TAC).

(b) Discuss the types of re-insurance treaty. **[4+10=14]**

9. **(a)** What are the basic requirements of an Insurance Contract?

(b) Analyze the importance of insurable interest in every insurance contract. Elucidate your answer with suitable examples. **[6 + 8 = 14]**

10. **(a)** Discuss the benefits of Investing in Postal Life Insurance Policy.

(b) How Can Insurance Companies Benefit from Risk Management? **[7+7=14]**

11. Soham Rao, a dealer in timber, supplied timber to companies on a contract basis. He insured his business with Unity Insurance Company. Soham Rao had different payment arrangements with each of his clients. While some clients were asked to pay in cash, others were allowed credit.

GR Public Ltd was one of the companies that purchased timber from Soham Rao. Soham Rao received fully paid shares of the company as payment for the timber sold to it. By financing the company during its time of need, Soham Rao had also becomean unsecured creditor of the company.

On 10 April 2023, Soham Rao and GR Public Ltd signed a deal for 1000 teak wood logs. The delivery of the timber was to take place the next day. Unfortunately, that night therewas a short circuit at the godown where the timber was stored, and the entire consignment was destroyed in the fire. Soham Rao filed a claim with the insurance company for the loss he had incurred. Unity, however, rejected his claim and refused to pay for the loss, alleging that the timber which was destroyed was sold by the insured to GR Public Ltd and,therefore, Soham Rao no longer had any claim over it.

Critically analyse the facts of the case and answer the following:

a. Is Soham Rao entitled to receive compensation from the insurance company for the loss caused by the fire?

b. What is insurable interest in the above example? Advise Mr. Soham Rao whetherhe is entitled to recover the compensation for the loss due to fire. Formulate a set of justification in support of your answer. Do you think whether the insurance company can refuse to entertain the claim? **[4 + 4 = 8]**