FINAL EXAMINATION | SET - 1

MODEL QUESTION PAPER | TERM – JUNE 2024

PAPER – 20B | SYLLABUS - 2022

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 (Compulsory)

1. Choose the correct option: **[15 x 2 = 30]**

(i) Legal Risk is known as ________________.
- a. When the actions can lead to the entire financial system coming to a standstill.
- b. When there is a financial loss to the bank arising from legal suits filed against the bank or by a bank for applying a law wrongly.
- c. When a bank chooses the wrong strategy or follows a long-term business strategy which might lead to its failure.
- d. All of the above

(ii) If the 1- day VaR of a portfolio is ₹ 50,000 with a 97% confidence level. In a period of 1 year of 300 trading days, in how many days the loss on the portfolio may exceed ₹50,000?
- a. 9 days
- b. 3 days
- c. 100 days
- d. None of the above

(iii) When did India started implementing BASEL-I guidelines?
- a. 1988
- b. 1990
- c. 1991
- d. 1992

(iv) Bankruptcy reorganizations are used by management to ________________.
- a. Forestall the inevitable liquidation in all cases.
- b. Provide time to turn the business around.
- c. Allow the courts time to set up an administrative structure.
- d. All of the above.

(v) ____________________ is a voluntary termination of the contract by the policy holders.
- a. Report
- b. Surrender
- c. Prospectus
- d. Cover note

(vi) ____________ Policy matures on the assured death or on his attainment of a particular age whichever occurs earlier.
- a. Endowment

b. Money back
c. Joint life
d. Single premium

(vii) The duty of disclosure of material facts arises in life insurance ___________________.
a. only during the proposal stage
b. only during the policy period if there is a change in risk
c. only at the time of renewal
d. All of the above

(viii) ____________ is the most famous tool of risk management.
a. Certainty risk
b. Insurance
c. Loss prevention
d. Uncertainty risk

(ix) _____ risks happen within a stable environment and are constant over an observed period of time.
a. Speculative
b. Pure
c. Dynamic
d. Static

(x) Insurance companies manage risks by________________.
a. Diversification
b. Reinsurance
c. Matching and hedging of assets
d. All of the above

(b) Based on the following case study, you are required to answer the questions no. (i) to (v)

The Bangalore branch of South Indian Bank granted a loan of Rs.25 Crore to Excel Manufacturers Ltd. The term of the loan was 10 years with applicable interest rate of 3% over the base rate. At present the base rate is 9% p.a. The loan is repayable in 40 quarterly instalments with a moratorium of two quarters. The bank funded the loan entirely out of fixed deposit issued at 8% p.a. The fixed deposit, however, had a tenure of 6 years only. Based on the given information, answer the following questions. Ignore impact on CRR and SLR.

(i) In the given situation, the loan carries a floating rate based on base rate while the deposit carries a fixed rate. Now, if the base rate declines over the first 6 years resulting into a reduction in the interest rate, what type of risk, the bank is exposed to____________.
a. Funding Risk
b. Embedded Options Risk
c. Basis Risk
d. Gap or Mismatch

(ii) The bank apprehends that the rate of interest at the end of 6 years on a loan and the fresh deposit to be raised for funding this loan will be different. This risk is termed as____________________.
a. Reinvestment Risk
b. Embedded Option Risk
c. Basis Risk
d. Gap or Mismatch

(iii) The bank apprehends that the quarterly collection of the instalments on loan may have to be deployed into fresh loans at a lower rate than the existing one. Due to this, the bank is exposed to ______________.
a. Reinvestment Risk
b. Embedded Option Risk
c. Basis Risk
d. Gap or Mismatch

(iv) South Indian Bank also has an apprehension that Excel Manufacturers Ltd. may prepay the loan at the end of 5th year and may not continue the same till the maturity. Due to this, the bank is exposed to ______________.
a. Reinvestment Risk
b. Embedded Option Risk
c. Basis Risk
d. Gap or Mismatch

(v) Which of the following risks is not associated with this loan issued to Excel Manufacturer?
a. Liquidity Risk
b. Equity Risk
c. Credit Risk
d. Operational Risk

SECTION-B

(Answer any 5 questions out of 7 questions given. Each question carries 14 marks.)

[5 x 14 = 70]

2. (a) List the broad parameters of risk management function. [7]

(b) Demonstrate the Principles for banks and supervisors on interest rate risk. [7]

3. (a) Discuss the internal and external factors in banks that may potentially lead to liquidity risk problems in Banks. [7]

(b) Debt Repudiation vs. Debt Rescheduling – discuss. **[7]**

4. (a) Discuss the types of loan commitments, its advantages and disadvantages. **[7]**

(b) International Bank has provided the following information relating to its advance portfolio as of Mar 31, 2023:

Total advances of ₹ 40,000 Crores. Gross NPA 9% and Net NPA 2%. Based on this information, answer the following questions:

(i) Considering that all the standard loan accounts represent general advances, what is the amount of provision for standard loan accounts?

(ii) What is the provision on NPA accounts?

(iii) What is the total amount of provisions on total advances, including the standard accounts? **[7]**

5. (a) International Bank has paid up capital of ₹200 Crores, free reserves of ₹600 Crores, provisions and contingencies reserves ₹400 Crores, Revaluation Reserve of ₹600 Crores, Perpetual non-Cumulative Preference Shares of ₹800 Crores, and Subordinated Debt of ₹600 Crores. The Risk Weighted Assets for Credit and Operational Risk are ₹20,000 Crores and for-Market Risk ₹8,000 Crores. Based on the above information, determine the following:

(i) The amount of Tier-1 capital.

(ii) The amount of Tier-2 capital.

(iii) The capital adequacy ratio of the bank. **[7]**

(b) List the features of Insurance. **[7]**

6. (a) Discuss the records to be maintained by a Corporate Agent. **[7]**

(b) The Government of India has taken number of initiatives to boost the insurance industry. Discuss any seven of such initiatives. **[7]**

7. (a) Demonstrate the underwriting risks faced by the insurance companies. **[7]**

(b) Enumerate the information which a product proposal includes to assist the Board or senior management in making informed decisions, in relation to Risk Reduction. **[7]**

8. (a) A Gujarat-based Cooperative bank permitted loans amounting to ₹1,500 Crores to the Group Companies of M/s Patel and Shah Limited, against overpriced shares of Group Companies. The following modus operandi was followed by the bank in disbursing these loans:

The bank will issue pay orders to the borrower without having any real cash balance in their account or without ensuring funding requirements as necessary in case of pre-paid instruments.

M/s Patel and Shah Limited was having an account with bank B at a branch in Ahmedabad. Bank B discounted the pay order issued by the Co-operative Bank amounting to ₹112 Crores and presented these through a clearing house. But the Co-operative Bank failed to honour the pay order due to a lack of funds. Resultantly, the pay orders were dishonoured. The clearing house regulator put an embargo on the Co-operative Bank.
Bank B is still to recover ₹90 Crores from M/s Patel and Shah Limited out of a total of ₹112 Crores. Later on, the investigations revealed that on the day of failure to make payment by the cooperative Bank, 65% of the pay orders discounted by Bank B belonged to the cooperative Bank.
Bank B now holds its manager responsible for inadequate management control.
It is also found that around 65% of total loans given by the said Co-operative Bank were restricted to 12 entities.

(i) Bank B's loss of ₹90 Crores in discounting the pay orders falls under which category of risk?
(ii) Cooperative Bank's outstanding loans to M/s Patel and Shah Limited group were more than 38% of their Capital Funds. Such high exposure to a single group by a bank is against the regulatory guidelines to avoid which kind of risk?
(iii) RBI is hesitant, for the time being, to put an embargo or ordered the liquidation of the said Co-operative Bank, as it could lead to a possible risk. Which kind of risk it would be?
(iv) As per existing guidelines of RBI, the Co-operative Bank was required to disclose its exposure to Capital Market under which heading? **[7]**

(b) True Ltd. is engaged in the business of manufacturing garments and has an office in New Delhi. The company is operating from rented premises. Management of the company decided to have its building/premises considering the requirement of more space and also to reduce the fixed expenses in the future.
Accordingly, the plan was made and fund arranging exercise begun. The funds available with the company were enough considering the current cost of construction. But management fears that construction costs will rise in the times to come and then the company may face a financial crunch. Management of the company seeks your guidance as to whether there is any way out that the risk of future price rise in construction costs can be handled/mitigated. Guide them suitably. **[7]**