



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 × 2=30]

- (i) The risk that arises from the possibility of non-payment of loans by the borrowers is known as-
- a) Credit Risks
 - b) Market Risks
 - c) Moral Hazard
 - d) Business Risk
- (ii) A Safe Haven for Investors Money is:
- a) Debt Market
 - b) Equity Market
 - c) Speculative Market
 - d) All of the above
- (iii) Which of the following is the correct definition of Exposure at Default (EAD)?
- a) It measures the remaining economic maturity of the exposure
 - b) It is estimated amount outstanding in a loan commitment if default occurs
 - c) It measures the proportion of the exposure that will be lost if Default occurs
 - d) It measures the likelihood that the borrower will default over a given time horizon
- (iv) _____ risk is the potential loss due to changes in the value of a bank's assets or liabilities resulting from exchange rate fluctuations.
- a) Interest rate.
 - b) Equity.
 - c) Foreign exchange.
 - d) Commodity.
- (v) 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



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(vi) Risk retention means-----

- a) Saving money to pay for the losses
- b) Accepting and agreeing to finance the loss oneself
- c) Not taking up any activity which is risky
- d) Insuring the risk

(vii) Under Section 42 of the Insurance Act, 1938, who may appoint a person to act as an insurance agent?

- a) The Insurance Regulatory and Development Authority (IRDAI)
- b) The Central Government
- c) The insured
- d) The insurer

(viii) What does the solvency margin of an insurance company indicate?

- a) The total premium income earned by the insurer
- b) The extent to which liabilities exceed assets
- c) How solvent and prepared the company is to meet unforeseen exigencies
- d) The number of claims settled in a financial year

(ix) Which of the following method reduces the chance of loss to zero?

- a) Risk Transferring
- b) Risk avoidance
- c) Risk retention
- d) Risk reduction

(x) _____ risks happen within a stable environment and are constant over an observed period of time.

- a) Speculative
- b) Pure
- c) Dynamic
- d) Static

(b) International Bank has a Paid-up Capital of ₹ 100 Crores, Free Reserves of ₹ 300 Crores, Provisions and Contingencies Reserves of ₹ 200 Crores, Revaluation Reserve of ₹ 300 Crores, Perpetual Non-cumulative Preference Shares of ₹ 400 Crores, and Subordinated Debt of ₹ 300 Crores. The Risk-Weighted Assets for Credit and Operational Risk are ₹ 10,000 Crores and for Market Risk ₹ 4,000 Crores. Based on the above information, answer the following question:

(xi) What is the amount of Tier-1 Capital?

- a) ₹ 900 Crores.
- b) ₹ 800 Crores.
- c) ₹ 750 Crores.

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d) ₹ 610 Crores.

(xii) Calculate the amount of Tier-2 capital:

a) ₹ 900 Crores.

b) ₹ 800 Crores.

c) ₹ 750 Crores.

d) ₹ 610 Crores.

(xiii) What is the capital adequacy ratio of the bank?

a) 9%.

b) 9.65%.

c) 10.05%.

d) 10.07%.

(xiv) What is the amount of minimum capital to support credit and operational risk?

a) ₹ 900 Crores.

b) ₹ 950 Crores.

c) ₹ 1,000 Crores.

d) ₹ 1,250 Crores.

(xv) What is the amount of minimum Tier 1 and Tier 2 to support the Credit and Operational Risk?

a) ₹ 900 Crores, ₹ 900 Crores

b) ₹ 600 Crores, ₹ 900 Crores

c) ₹ 450 Crores, ₹ 450 Crores

d) ₹ 300 Crores, ₹ 450 Crores

Answer:

(i)	(ii)	(iii)	(iv)	(v)	(vi)	(vii)	(viii)	(ix)	(x)	(xi)	(xii)	(xiii)	(xiv)	(xv)
a	a	b	c	a	b	d	c	b	d	b	d	d	a	c

SECTION – B

Answer any 5 questions out of 7 questions given. Each question carries 14 marks. [5 × 14 = 70]

2) (a) Explain the common types of risks faced by banks. [7]

(b) A bank has computed its Tier I capital: ₹ 1,400 Crores (inclusive of CET1 + AT1)

Tier-II Capital – ₹ 1,200 Crores.

RWAs for Credit Risk: ₹ 10,000 Crores

The capital charge for Market Risk: ₹ 500 Crores

The capital charge for Operational Risk: ₹ 300 Crores.

Calculate the Bank's Tier-I CRAR and Total CRAR?

[7]

**RISK MANAGEMENT IN BANKING AND INSURANCE****Answer:****(a) Banks face a significant amount of risk; these are the seven most common types:**

- **Operational Risk:** This refers to any risk incurred as a result of failure in people, internal processes and policies, and systems. Common examples of operational risk in banks include service interruptions and security breaches.
- **Market Risk:** Also known as systematic risk, market risk refers to any losses resulting from changes in the global financial market. Sources of market loss include economic recessions, natural disasters, political unrest, and changes in interest.
- **Liquidity Risk:** This refers to a bank's inability to meet its obligations, thereby jeopardizing its financial standing or even its very existence. Liquidity risks effectively prevent a bank from being able to convert its assets into cash without sacrificing capital due to insufficient interest.
- **Compliance Risk:** Any risk incurred as a result of failure to comply with federal laws or industry regulations. Compliance risk can lead to financial forfeiture, reputational damage, and legal penalties.
- **Reputational Risk:** As its name implies, reputational risk refers to any potential damage to a bank's brand or reputation. Banks can incur reputational risk for any number of reasons, from the actions of a single employee to the actions of the entire institution.
- **Credit Risk:** Retail banks take a credit risk any time they lend money to a borrower without a guarantee that the borrower will be able to repay their loan. The risk itself is that the bank might incur debt as a result of such an agreement.
- **Business Risk:** This refers to any risk that stems from a bank's long-term business strategy and affects the bank's profitability. Common sources of business risk to banks include closures and acquisitions, loss of market share, and inability to keep up with competitors.

(b) RWAs for Credit Risk = ₹ 10,000 Crores

RWAs for Market Risk = ₹ 500 Crores / .09 = ₹ 5,556 Crores

RWAs for Operational Risk = ₹ 300 Crores / .09 = ₹ 3,333 Crores

Total RWAs = ₹ 18,889 Crores

Tier I Capital = ₹ 1400 Crores

Tier II Capital = ₹ 1,200 Crores

Total Capital = ₹ 2,600 Crores

Tier-I CRAR = (Eligible Tier I Capital Funds) ÷ (Total RWAs)

= ₹ 1,400 Crores / ₹ 18,889 Crores

= 7.41%

Total CRAR = (Eligible Total Capital Funds) ÷ (Total RWAs)

= ₹ 2,600 Crores / ₹ 18,889 Crores

= 13.76%.

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- 3) (a) Explain the concept of Credit Risk Exposures and discuss the main types of credit risks faced by financial Institutions. [7]
- (b) Differentiate between Debt Repudiation and Debt Rescheduling in the context of international lending. Discuss why debt rescheduling is generally easier to implement for bank loans compared to bond issues, citing suitable reasons. [7]

Answer:

- (a) Financial institutions used credit risk analysis models to determine the probability of default of a potential borrower. The models provide information on the level of a borrower's credit risk at any particular time. If the lender fails to detect the credit risk in advance, it exposes them to the risk of default and loss of funds. Lenders rely on the validation provided by credit risk analysis models to make key lending decisions on whether or not to extend credit to the borrower and the credit to be charged.

With the continuous evolution of technology, banks are continually researching and developing effective ways of modelling credit risk. A growing number of financial institutions are investing in new technologies and human resources to make it possible to create credit risk models using machine learning languages, such as Python and other analytics-friendly languages. It ensures that the models created produce data that are both accurate and scientific.

Credit risk arises when a corporate or individual borrower fails to meet their debt obligations. It is the probability that the lender will not receive the principal and interest payments of a debt required to service the debt extended to a borrower.

On the side of the lender, credit risk will disrupt its cash flows and also increase collection costs, since the lender

may be forced to hire a debt collection agency to enforce the collection.

The loss may be partial or complete, where the lender incurs a loss of part of the loan or the entire loan extended to the borrower.

The interest rate charged on a loan serves as the lender's reward for accepting to bear credit risk. In an efficient market system, banks charge a high interest rate for high-risk loans as a way of compensating for the high risk of default. For example, a corporate borrower with a steady income and a good credit history can get credit at a lower interest rate than what high-risk borrowers would be charged.

Conversely, when transacting with a corporate borrower with a poor credit history, the lender can decide to charge a high interest rate for the loan or reject the loan application altogether. Lenders can use different methods to assess the level of credit risk of a potential borrower in order to mitigate losses and avoid delayed payments.

The following are the main types of credit risks:

1. Credit default risk:

Credit default risk occurs when the borrower is unable to pay the loan obligation in full or when the borrower is already 90 days past the due date of the loan repayment. The credit default risk may affect all credit-sensitive financial transactions such as loans, bonds, securities, and derivatives.

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The level of default risk can change due to a broader economic change. It can also be due because of a change in a borrower's economic situation, such as increased competition or recession, which can affect the company's ability to set aside principal and interest payments on the loan.

2. Concentration risk:

Concentration risk is the level of risk that arises from exposure to a single counterparty or sector, and it offers the potential to produce large amounts of losses that may threaten the lender's core operations. The risk results from the observation that more concentrated portfolios lack diversification, and therefore, the returns on the underlying assets are more correlated.

For example, a corporate borrower who relies on one major buyer for its main products has a high level of concentration risk and has the potential to incur a large amount of losses if the main buyer stops buying their products.

3. Country risk:

Country risk is the risk that occurs when a country freezes foreign currency payments obligations, resulting in a default on its obligations. The risk is associated with the country's political instability and macroeconomic performance, which may adversely affect the value of its assets or operating profits. The changes in the business environment will affect all companies operating within a particular country.

- (b) When making loans to borrowers in foreign countries, two risks need to be considered. First, the credit risk of the project needs to be examined to determine the ability of the borrower to repay the money. This analysis is based strictly on the economic viability of the project and is similar in all countries. Second, unlike domestic loans, creditors are exposed to sovereign risk.

Sovereign risk is defined as the uncertainty associated with the likelihood that the host government may not make foreign exchange available to the borrowing firm to fulfill its payment obligations. Thus, even though the borrowing firm has the resources to repay, it may not be able to do so because of actions beyond its control. Thus, creditors need to account for sovereign risk in their decision process when choosing to invest abroad.

Loan repudiation refers to a situation of outright default where the borrower refuses to make any further payments of interest and principal. In contrast, loan rescheduling refers to a temporary postponement of payments during which time new terms and conditions are agreed upon between the borrower and lenders. In most cases, these new terms are structured to make it easier for the borrower to repay.

The reasons why it is easier to reschedule debt in the form of bank loans than bonds, especially in the context of post-war lending in international financial markets, include:

- Loans usually are made by a small group (syndicate) of banks as opposed to bonds that are held by individuals and institutions that are geographically dispersed. Even though bondholders usually appoint trustees to look after their interests, it has proven to be much more difficult to approve renegotiation agreements with bondholders in contrast to bank syndicates.
- The group of banks that dominate lending in international markets is limited and hence able to form a cohesive group. This enables them to act in a unified manner against potential defaults by countries.
- Many international loans, especially those made in the post-war period, contain cross-default clauses, which make the cost of default very expensive to borrowers. Defaulting on a loan would trigger default clauses on all loans with such clauses, preventing borrowers from selectively defaulting on a few loans.
- In the case of post-war loans, governments were reluctant to allow banks to fail. This meant that they

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would also be actively involved in the rescheduling process by either directly providing subsidies to prevent repudiations or providing incentives to international agencies like the IMF and World Bank to provide other forms of grants and aid.

- 4) (a) **Explain the concept of a Commercial Letter of Credit and discuss how it provides protection to both buyers and sellers in international trade. Also, describe the different types of letters of credit commonly used in business transactions.** [7]

- (b) **International Banks provided following information about its-NPA account as on Mar 31, 2022.**

Total loans ₹ 40,000 Crores.

Standard Accounts ₹ 38,000 Crores including Direct Agriculture and SME loans of ₹10,000 Crores.

Sub-standard ₹ 800 Crores and out of which unsecured Sub-standard ₹ 200 Crores..

Doubtful up to 1 Year ₹ 800 Crores and Doubtful above 1 year up to 3 years ₹ 200 Crores and Doubtful above 3 Years ₹ 120 Crores and Loss Accounts ₹ 80 Crores.

All doubtful loans are fully secured.

Based on the above information, Calculate the following:

- (i) **Provision on standard accounts**
- (ii) **Amount of provision on sub-standard loan accounts**
- (iii) **Amount of provision on doubtful loan accounts**
- (iv) **Total provision on NPA loan**
- (v) **If security value in Doubtful Category-1 accounts is 600 Crores what will be amount of provision for Doubtful Category-1 accounts**
- (vi) **If security value is 3,150 Crores in Doubtful Category-2 accounts, then what will be the provision.**
- (vii) **Percentage of Net NPA?** [7]

Answer:

- (a) A commercial letter of credit is a contractual agreement between the banks issuing the credit that authorizes another bank to make payments to the beneficiary on behalf of the customer.

A commercial letter of credit is written on behalf of the customer and allows a different bank than the one issuing credit to make a payment to the beneficiary. In the letter, the issuing bank promises to allow draws made on the credit. The idea behind a letter of credit is similar to escrow. A bank acts as a neutral party and only releases funds after the parties meet certain requirements. In most situations, the beneficiary provides the products or services. Under a letter of credit, the issuing bank takes over from the bank's customer as the payee.

Commercial letters of credit have a longstanding history in international trade. For international matters, the letters are overseen by the International Chamber of Commerce Uniform Customs and Practice for Documentary Credits.

Protection Offered by a Commercial Letter of Credit:

A commercial letter of credit offers protection to both parties. The seller is protected because if they don't receive payment from the buyer, the bank that issued the letter of credit is then responsible for paying the

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seller. That means that the seller knows they will always receive some kind of payment. This is especially helpful for international deals where the buyer and seller are in different countries.

Buyers are protected because if they pay for a product or service that they don't receive, the buyer may be able to get some money back through a standby letter of credit. The payment is similar to a refund and allows the buyer to then find another company to buy the product or service from.

Types of Letters of Credit:

There are multiple kinds of letters of credit, each of which is best used in certain situations.

- A commercial letter of credit offers direct payment from the bank to the beneficiaries receiving payments.
- A revolving letter of credit lets the customer pull money from the bank in an unlimited number of transactions within a specific time frame.
- A traveller's letter of credit promises that the bank will accept drafts through accepted foreign banks.
- A confirmed letter of credit includes a second bank that guarantees the letter of credit. This bank is usually the seller's bank and is known as the confirming bank. In the case that both the issuing bank and the customer can't make payments, the confirming bank will step in to make payments. This type of arrangement is usually requested by the issuing bank in international deals.
- A standby letter of credit works as a secondary payment tool. A bank issues a standby letter of credit to show that a customer can make payments under the terms of the agreement. Both parties expect to never have to draw on this type of letter of credit; the letter is simply there to provide additional support for the customer's financial standing. However, if the customer doesn't meet their obligation, the beneficiary can provide evidence and draw on the credit.
- Standby letters of credit come with expiration dates and are used to back up monetary obligations, ensure that an advanced payment is refunded, and assure that a sales contract is completed. These types of letters are typically used to strengthen the creditworthiness of a customer. In most cases, a standby letter of credit is never actually used, especially if the customer makes payments according to the terms set by the seller.

However, if the seller wants to be paid directly and the customer can't pay, the seller can provide evidence and draw on the credit. In domestic situations, the Uniform Commercial Code states that banks have three business days to accept the evidence that payment hasn't been made to then honour the seller's draw on the credit.

(b)

- (i) Provision on General accounts = ₹ 28000 × 0.4% = ₹ 112 Crores + Provision on direct agriculture and SME accounts = ₹ 10000 × 0.25% = 25 Crores.
Total provision = ₹ 112 + ₹ 25 = ₹ 137 Crores.
- (ii) Secured Sub-standard accounts = ₹ 600 × 15% = ₹ 90 Crores + Unsecured Sub standard ₹ 200 × 25% = ₹ 50 Crores.
Total Provision = ₹ 140 Crores
- (iii) Doubtful Category-1 = ₹ 800 × 25% = ₹ 200 Crores + Doubtful Category -2 = ₹ 200 × 40% = ₹ 80 Crores + Doubtful Category -3 = ₹ 120 × 100 = ₹ 120 Crores
Total provision = ₹ 200 + 80 + ₹ 120 = 400 Crores
- (iv) Sub-standard = ₹ 140 + (Doubtful Category = ₹ 400) + (Loss accounts = ₹ 80 Crores)
Total = ₹ 140 + ₹ 400 + ₹ 80 = ₹ 620 Crores.
- (v) Provision on secured portion 25% and on unsecured portion 100%.

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Hence provision shall be as under:

Secured Accounts = ₹ 600 × 25% = ₹ 150 Crores. Unsecured ₹ 200 × 100% = ₹ 200.

Total Provision = ₹ 150 + ₹ 200 = ₹ 350 Crores.

(vi) Secured = 40% and Unsecured = 100%

Secured Account = ₹ 150 Crores × 40 = ₹ 60 Crores

Unsecured = ₹ 50 Crores × 100 = 50 Crores,

Total = ₹ 60 + ₹ 50 = ₹ 110 Crores.

(vii) Net Advances = ₹ 40,000 - ₹ 620 = ₹ 39,380.

Net NPA = ₹ 1380 Crores

NPA % = ₹ 1,380 Crores / 39,380 Crores = 3.5%.

5. (a) Aspire Bank has paid up capital of ₹300 Crores, free reserves of ₹800 Crores, provisions and contingencies reserves ₹500 Crores, Revaluation Reserve of ₹700 Crores, Perpetual non-cumulative preference shares of ₹900 Crores, and Subordinated Debt of ₹700 Crores. The Risk Weighted Assets for Credit and Operational Risk are ₹25,000 Crores and for-Market Risk ₹10,000 Crores.

Based on the above information, calculate the following:

- The amount of Tier-1 capital.
- The amount of Tier-2 capital.
- The amount of Fund
- The capital adequacy ratio of the bank
- The amount of minimum capital to support Credit and Operational Risk.
- What is the amount of minimum Tier 1 and Tier 2 to support the credit and operational risk?
- What is the amount of Tier-1 capital fund, to support Market Risk?
- What is the amount of Tier-2 capital fund, to support Market Risk?

[7]

- (b) Explain the fundamental principles of insurance that ensure fair and efficient functioning of insurance contracts.

[7]

Answer:

(a)

- Tier-1 = Capital + Free Reserves + Perpetual non-Cumulative preference shares
= ₹300 Crores + ₹800 Crores + ₹900 Crores = ₹2,000 Crores.
- Tier II = (Provisions and Contingencies Reserves Maximum 1.25% of Risk Weighted Assets) + (Revaluation Reserve at 55% Discount) + (Subordinated Debts)
= ₹437.5 Crores + ₹315 Crores (₹700 Crores × 45%, at 55% discount) + ₹700 Crores
= ₹1,452.5 Crores
- Total Capital Fund = Tier - 1 capital + Tier - 2 capital
= ₹2000 Crores + ₹1452.5 Crores
= ₹3452.5 Crores
- ₹3452.5 Crores / ₹35000 Crores = 9.86%
- ₹25,000 Crores × 9% = ₹2,250 Crores
- Tier 1 = ₹25,000 Crores × 4.5% = ₹1,125 Crores

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Tier-2 = ₹25,000 Crores x 4.5% = ₹1,125 Crores.

vii. Total Tier-1 Minus Min Tier 1 for Credit and Operational risk

= ₹2,000 Crores – ₹1,125 Crores = ₹875 Crores.

viii. Total Tier-2 Minus Min Tier 2 for Credit and Operational risk

= ₹1,452.50 Crores – ₹1,125 Crores = ₹327.50 Crores.

(b) The concept of insurance is risk distribution among a group of people. Hence, cooperation becomes the basic principle of insurance.

To ensure the proper functioning of an insurance contract, the insurer and the insured have to uphold the 7 principles of Insurance mentioned below:

1. Utmost Good Faith.
2. Proximate Cause.
3. Insurable Interest.
4. Indemnity.
5. Subrogation.
6. Contribution.
7. Loss Minimization.

Principle of Utmost Good Faith:

The fundamental principle is that both the parties in an insurance contract should act in good faith towards each other, i.e., they must provide clear and concise information related to the terms and conditions of the contract.

The Insured should provide all the information related to the subject matter, and the insurer must give precise details regarding the contract.

Principle of Proximate Cause:

This is also called the principle of 'Causa Proxima' or the nearest cause. This principle applies when the loss is the result of two or more causes. The insurance company will find the nearest cause of loss to the property. If the proximate cause is the one in which the property is insured, then the company must pay compensation. If it is not a cause the property is insured against, then no payment will be made by the insured.

Principle of Insurable interest:

This principle says that the individual (insured) must have an insurable interest in the subject matter. Insurable interest means that the subject matter for which the individual enters the insurance contract must provide some financial gain to the insured and also lead to a financial loss if there is any damage, destruction, or loss.

Principle of Indemnity:

This principle says that insurance is done only for the coverage of the loss; hence insured should not make any profit from the insurance contract. In other words, the insured should be compensated the amount equal to the actual loss and not the amount exceeding the loss. The purpose of the indemnity principle is to set

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back the insured in the same financial position as he was before the loss occurred. The principle of indemnity is observed strictly for property insurance and does not apply to the life insurance contract.

Principle of Subrogation:

Subrogation means one party stands in for another. As per this principle, after the insured, i.e., the individual has been compensated for the incurred loss to him on the subject matter that was insured, the rights of the ownership of that property go to the insurer, i.e., the company.

Subrogation gives the right to the insurance company to claim the amount of loss from the third party responsible for the same.

Principle of Contribution:

The contribution principle applies when the insured takes more than one insurance policy for the same subject matter. It states the same thing as in the principle of indemnity, i.e. the insured cannot make a profit by claiming the loss of one subject matter from different policies or companies.

Principle of Loss Minimisation :

This principle says that as an owner, it is obligatory on the part of the insurer to take necessary steps to minimize the loss to the insured property. The principle does not allow the owner to be irresponsible or negligent just because the subject matter is insured.

6. (a) **Discuss the concept of Individual Agents in the insurance sector. Also analyse the conditions under which a person can act as an insurance agent and the circumstances that lead to disqualification under Section 42 of the Insurance Act, 1938.** [7]

- (b) **Discuss the key features and benefits offered under the Postal Life Insurance (PLI) scheme. How do these features make PLI a preferred life insurance option for government and postal employees?** [7]

Answer:**(a) Individual Agents:**

These are individuals who can be appointed by an insurance company to sell insurance policies on their behalf. As per Section 42 of the Insurance Act, 1938, an insurer may appoint any person to act as insurance agent for the purpose of soliciting and procuring insurance business.

No person shall act as an insurance agent for more than one life insurer, one general insurer, one health insurer at a time.

Provided that the Authority shall, while framing regulations, ensure that no conflict of interest is allowed to arise for any agent in representing two or more insurers for whom he may be an agent.

Following are the disqualifications of an Insurance Agent:

- that the person is a minor;
- that he is found to be of unsound mind by a court of competent jurisdiction;

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- that he has been found guilty of criminal misappropriation or criminal breach of trust or cheating or forgery or an abetment of or attempt to commit any such offence by a court of competent jurisdiction; Provided that where at least five years have elapsed since the completion of the sentence imposed on any person in respect of any such offence, the Authority shall ordinarily declare in respect of such person that his conviction shall cease to operate as a disqualification under this clause;
- that in the course of any judicial proceeding relating to any policy of insurance or the winding up of an insurer or in the course of an investigation of the affairs of an insurer it has been found that he has been guilty of or has knowingly participated in or connived at any fraud, dishonesty or misrepresentation against an insurer or insured;
- that he does not possess the requisite qualifications or practical training or passed the examination, as may be specified by the regulations;
- that he has not passed such examination as may be specified by the regulations;
- that he has not violated the code of conduct as may be specified by the regulations.

(b) Features of Postal Life Insurance Policy:

A policyholder can avail the following benefits:

- Nomination facility: The policyholder can nominate his/her beneficiary, and can also make changes to the nomination.
- Loan facility: Loan facility is available against this policy. The policyholder can pledge his/her policy as a collateral to the Heads of the Region/ Circle on behalf of the President of India, once the policy has attained three years maturity in case of an Endowment Assurance policy and four years policy period has been completed in the case of a Whole Life Insurance policy. Assignment facilities are also available under this scheme.
- Policy Revival: A policyholder can revive a lapsed policy. The policy can be revived when policy has lapsed under the following conditions -
 - Policy has lapsed after six successive non-payments of premium with the policy being in effect for less than three years.
 - Policy has lapsed after 12 successive non-payments of premium where policy has been in effect for more than three years.
 - Duplicate Policy Document: A duplicate policy document will be issued to the policyholder if he/she has lost the original document. This also applies to the case where the original policy document is mutilated, burned or torn and the insured wants a duplicate of the same.
 - Conversion of Policy: This policy can be converted from a Whole Life Assurance policy to an Endowment Assurance Policy. An Endowment Assurance Policy can be converted to another Endowment Assurance plan as per the regulations and guidelines laid down by the insurer.

Benefits of Investing in PLI:

Some of the other benefits and discounts offered under the Postal Life Insurance scheme are as follows:

- The insured can avail income tax exemption as provided under Sec. 88 of the Income Tax Act.
- Additional facilities offered under this policy are Assignment, Loan, Conversion, Surrender and Paid-Up Value options.

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- The policy can be transferred to any Circle within India, at no additional charges.
- Passbook facility is available to track the payment of premium and in case of loan transactions, etc.
- Premium can be paid on an annual, half-yearly and monthly basis. When the payment is due, the policyholder can make a payment on any working day.
- If paid an advance premium payment for a policy period of six months, then avail a discount on premium worth 1% of the value.
- If an advance premium payment for a policy period of 12 months, they can avail a discount on premium worth 2% of the value.
- Nomination facility is available.
- Since this scheme has a centralized accounting facility, claims process is quick and easy.

7. (a) Define Marketing Risk and discuss the steps involved in Marketing Risk Management.

[7]

(b) Apply the concept of risk avoidance to real-life business scenarios. Demonstrate how organizations can minimize exposure to high-severity risks through avoidance strategies, with at least two suitable examples

[7]

Answers:

(a) Marketing risk is an unavoidable element of marketing activities. However, with the proper marketing risk management techniques, many risks can be mitigated and addressed. Marketing risk management can also ensure that the marketing department has substantial backup plans that will keep financial loss at bay. Marketing risk management is the process of identifying potential risks in marketing activities and laying out steps to neutralize those risks where possible.

It's worth backing up for a minute to establish a clear marketing risk definition. Marketing Risk is the potential for failures or losses during any marketing activity, from production to promotion. Marketing risks could include any of the following examples:

- Pricing a product incorrectly.
- Choosing the wrong channel to advertise to a target audience.
- Distribution delays.
- Negative feedback via social media or review sites.
- Employee turnover.
- Business operations changes.

There are many more examples, but this list should give the sense that at any given time, marketing departments are at risk for any of these types of problems, which can lead to financial losses and can harm a company's brand. Marketing risk management seeks to identify and mitigate the potential for these risks.

Marketing risk management works to neutralize the potential for marketing risk by identifying, assessing, and addressing marketing risk before it happens. Marketing departments often focus their energy on the planning and execution phases for marketing activities, but they would be remiss to stop there. Successful marketing departments need to go a step further and engage in marketing risk management in order to ensure that the marketing activities aren't impacted by events or circumstances that could have been planned for in advance.

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Marketing risk management involves several steps that can help teams avoid some of these risks from the start or be ready to respond when they do arise.

Assessment: Throughout the planning process, marketers should conduct a marketing risk assessment to identify potential risks that could impact activities and campaigns. These could be as simple as identifying the inclement weather trends that might impact production, from hurricane season in coastal areas or snowstorms in cold weather locations. The team might also brainstorm issues that might arise with competitor pricing based on past data.

Analysis: Analysis is the next step and involves considering how likely these events are to occur, how often they have happened in the past, and any data we have that will help us determine which risks are most likely to play out.

Planning: Next, the marketing team will adjust marketing plans based on the identified risks and the marketing risk analysis that determined their likelihood. Alternative plans should be included where possible, so marketing teams know how to adjust their activities should one of the risks turn into reality. For instance, a marketing plan could include an alternative plan should a production or distribution system encounter inclement weather.

Monitoring: Finally, the marketing team needs to continually monitor marketing activities for risk throughout the planning phases as well as execution. Continual assessment of marketing risk can help marketing teams stay ahead of potential problems and employ alternative plans when necessary.

While everyone on the team should be mindful of potential risks, it can be a smart strategy to designate a single team member to assess risk regularly throughout the planning process. Having alternate plans in place ahead of time can significantly improve marketing performance by enabling teams to pivot to a pre-planned alternative without missing a beat. This will help to cut down on any losses the company might have otherwise incurred.

- (b) This is the simplest of the risk control techniques. Do not get into something which has a risk. It is possible to avoid certain types of risk altogether. That is, remove the possibility of losses associated with a given risk by not exposing to that risk. In generally, this strategy is appropriate for certain risks that are of both high frequency and high severity. For example, if someone is engaged in the sports of hang-gliding for adventure sports, the frequency and severity of accidents that occur are high. Thus, the best course of action to ensure that one does not die or suffer injury while hang gliding is to avoid hang gliding completely. Though it is simplest form of risk control, it is not an appropriate strategy for dealing with most of the risks that an individual face. For example, if an individual wants to ensure that he will never suffer financial loss from a car accident. He can avoid the risk by never driving a Car. While this certainly would eliminate the possibility of a loss, it is clearly not a viable option for those who must drive in order to function on a daily basis. That is why most of us take a Motor insurance to combat the financial risks associated with driving rather than leaving driving.

Risk avoidance is not performing any activity that may carry risk. A risk avoidance methodology attempts to minimize vulnerabilities that can pose a threat. Risk avoidance and mitigation can be achieved through policy and procedure, training and education, and technology implementations.

For example, suppose an investor wants to buy stock in an oil company, but oil prices have been falling significantly over the past few months. There is political risk associated with the production of oil and credit risk associated with the oil company. If an investor assesses the risks associated with the oil industry and decides to avoid taking a stake in the company, this is known as risk avoidance.

There are different examples of practices that managers adopt to avoid risk. Such measures may include;

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- A company may realize that sending workers to conduct research in a hostile area may result in bodily harm to employees, which may expose the company to endangerment claims. Therefore, management may forgo such research, which may have presented enormous profit opportunities by improving efficiency.
- A trader may realize that trading with a specific supplier exposes them to exchange rate volatility, usually seen in international business. The trader, therefore, chooses to change their supplier to one who trades using the currency the trader uses.
- A company may choose not to invest in a war-torn country because it may cause a loss of the capital invested.

8. (a) As per RBI guidelines on ALM, Capital and Reserves are to be placed in over 5 Years' Bucket, Savings Bank and Current Deposits may be classified into volatile and core portions. Savings Bank (10%) and Current (15%). Deposits are generally withdrawable on demand. This portion may be treated as volatile. While the volatile portion can be placed in the time bucket for 14 days, the Core portion may be placed in over 1-3 Years bucket. The term deposits are to be placed in respective maturity buckets.

Capital	₹1,180 Crores.
Reserves	₹12,000 Crores.
Current account	₹1,000 Crores.
Savings Bank	₹4,000 Crores.
Term deposits 1-month maturity bucket	₹400 Crores.
1 to less than 3 months maturity bucket	₹800 Crores.
3 months to less than 6 months maturity bucket	₹1,200 Crores.
6 months to less than 12 months maturity bucket	₹2,000 Crores.
1 year to less than 3 years maturity bucket	₹1,200 Crores.
3 years to less than 5 years maturity bucket	₹600 Crores. and
Above 5 years maturity bucket.	
Borrowing from RBI	₹400 Crores.

Based on the given information, answer the following questions:

- Calculate the amount of current account deposit that can be placed in 14 days bucket?
- Calculate the amount of saving bank deposit that can be placed in 14 days bucket?
- Calculate the amount of current account deposit that can be placed in a 1-3 years bucket?
- Calculate the amount of saving bank deposit that can be placed in a 1-3 years bucket?
- Calculate the total amount of term deposit that will be placed in various maturity buckets up to less than 12 months?

[7]

- (b) The Term, whole life, endowment, annuity policies or the combination of policies are available in the market. The best policy is the one that best meets your financial needs. You have to select the policy according to your needs.

Suggest suitable life insurance policies for the given situations:

- You are at the age of 25. You just joined an organization. You are recently married. Now you

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- cannot spend more on life insurance.
- ii. You are the only earning member in your family. You purchased a flat by taking a loan from housing finance. As long as you are there you can pay EMIs regularly. You want to retain the house for your family members even in your absence.
 - iii. You are at the beginning of career; you want to combine both insurance and saving. But the combination of this saving and insurance is costly. Right now, you cannot invest much, having dependents and you want to invest later after settling in the career.
 - iv. You want to leave an estate to your family after you. But you cannot pay the premiums after retirement. You are undisciplined in your saving habits and you are not financially savvy.
 - v. You want to set up a saving stream, beyond term plans. [7]

Answer:

(a)

- i. Volatile portion of 15% to be placed in this bucket.
Hence = ₹1,000 Crores x 15% = ₹150 Crores.
- ii. Volatile portion of 10% to be placed in this bucket.
Hence = ₹4,000 Crores x 10% = ₹400 Crores.
- iii. Non-volatile portion of 90% to be placed in this bucket.
Hence = ₹1,000 Crores × 90% = ₹900 Crores.
- iv. Non-volatile portion of 90% to be placed in this bucket.
Hence = ₹4,000 Crores × 90% = ₹3,600 Crores.
- v. ₹400 Crores + ₹800 Crores + ₹1,200 Crores + ₹2,000 Crores
= ₹4,400 Crores.

(b)

- i. For these situations, the suggested best policy is Term Insurance Policy. These plans offer life insurance cover for the specific number of years, at least cost. The premium of Term Insurance is comparatively low at the age of 25. Since the entire premium goes towards the cost of insurance, there is only risk cover and no saving element is involved.
- ii. The best policy for this situation is the Mortgage Redemption Insurance policy. These plans offer life insurance cover for the specific number of years like till the loan is cleared (or on death, an outstanding loan is covered) at the least cost.
- iii. The best policy for this situation is the Convertible Term insurance policy. This plan offers life insurance cover for the specific number of years, and at the same time it also facilitates to convert this policy into endowment policy (when your income increases) which includes saving element.
- iv. The best policy for this situation is Limited Payment Whole Life insurance policy. In this plan, the policy remains in full force for the whole of life, but premiums are payable for a limited number of years only, after which the policy becomes paid up for its full-face amount. The premium - paying period may be expressed as a set number of years or to a specified age.
- v. The best plan for this situation is Endowment plans or money - back plans. These policies promise not only the policy face amount on the death of the insured during a fixed term of years but also the full-face amount at the end of the term if the insured survives the term.