



**STRATHMORE BUSINESS SCHOOL
BACHELOR OF FINANCIAL SERVICES
END OF SEMESTER EXAMINATION
BFS 4101: FINANCIAL RISK MANAGEMENT**

Date: Tuesday, 25th July, 2023

Time: 2 Hours

Instructions

1. This examination consists of **FIVE** questions.
2. Answer **Question ONE (COMPULSORY)** and any other **TWO** questions.

QUESTION ONE

(TOTAL 30 MARKS)

- a) You have a discussion on financial disasters with a friend, who is not attending the Financial Risk Management. In the course of your discussion, you mention the following terms: economic bubble, *contagion effect*, *moral hazard*, *lender of last resort*. Your friend is perplexed about the terms and inquires for more information

Required

- i. Explain to your friend, how the above processes (in italics) may contribute to systemic crisis/ disaster **(6 Marks)**
- ii. Describe to him/her how an economic bubble happens. **(4 Marks)**

- b) 'Debt financing is considered a cheaper source of finance though some financial institutions may not utilize it for fear of default risk'. Assume you have been employed recently as a risk officer in a reputable financial institution. Your boss requests you to present to your colleagues a session on financing decisions and financial risk management.

Required

In your presentation,

- i. Evaluate the importance of financial risk management in relation to Capital Structure of the Financial Institutions **(5 Marks)**
- ii. Differentiate between risk capacity, risk appetite and risk tolerance as applied in the management of risk **(5 Marks)**

- c) An increase in the probability of default risk can have a dramatic impact on the business of a Financial Institution (FI). The FI must control its risks with extreme care. It must make sure there is little probability that it will lose customers because of credit risk. In such circumstances, the FI may find Value at Risk (VaR) as a better measure of risk.

Required

- i. Illustrate Value at Risk as a measure of risk in financial institutions **(3 Marks)**
- ii. Explain the advantages of VaR as a measure of risk **(4 Marks)**
- iii. Differentiate stress testing and reverse stress testing **(3 Marks)**

QUESTION TWO**(TOTAL 20 MARKS)**

Risk management can be an influential process driving strategic planning and resource allocation as opposed to a mere compliance exercise. As a chief risk officer of Kenya Bank (KB), one of your tasks is to implement an Enterprise Risk Management (ERM) process. The BOD asks you to write a brief

Required**In the brief**

- a) Justify the implementation of ERM process at KB (6 Marks)
- b) Explain how you would conduct risk identification, analysis and evaluation at KB (6 Marks)
- c) Evaluate four different risk management response strategies that you may apply at KB (8 Marks)

QUESTION THREE**(TOTAL 20 MARKS)**

Innovations in risk management take place every day and regulations that affect risk management change over time in financial institutions. However, bank failures continue to happen in different parts of the world. The most recent one being Silicon Valley Bank in the US.

Required

- a) Critically evaluate, citing specific examples, the genesis of financial crisis in institutions that offer financial services (8 Marks)
- b) Examine the implications (lessons learned) of financial crisis to risk management (6 Marks)
- c) Briefly explain the role played by any three regulators of financial institutions in Kenya (6 Marks)

QUESTION FOUR**(TOTAL 20 MARKS)**

To manage the price risk-market risk-of a portfolio of derivatives, the portfolio must be structured so that the value is not be affected by changes in the underlying prices

Required

- a) Critically evaluate how as a risk officer the Greeks-Delta, Gamma and Vega will assist you to assess option risks and manage risks in portfolio (10 Marks)
- b) Assess the advantages and disadvantages of Monte Carlo Simulations (8 Marks)

QUESTION FIVE**(TOTAL 20 MARKS)**

There is a universal agreement that the role of the board of directors in financial risk management is crucial. Likewise, there is essentially universal agreement that it is not necessary for the board members to be rocket scientists; instead the members of the board of directors need to know the right questions to ask.

Required

- a) Critically, evaluate the role of the Board of Directors in the Risk Management of a financial institution of your choice (10 Marks)
- b) Draft a risk appetite statement for a financial institution of your **choice** (10 Marks)