RISK MANAGEMENT AND FINANCIAL INSTITUTIONS

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Short Description

RISK MANAGEMENT AND FINANCIAL INSTITUTIONS case study

Description

Multiple Choices:

Q1. The options that come into existence or disappear when the price of the underlying asset reaches a certain barrier.

1. **Asian Options**
2. **Barrier options**
3. **Basket Options**
4. **Binary Options**

Q2. The volatility of this model is changes with the passage of time:

1. **EMWA Model**
2. **GAMMA Model**
3. **VEGA Model**
4. **GARCH Model**

Q3. The office which consists of risk managers who are monitoring the risks being is taken is called

1. **Front Office**
2. **Middle Office**
3. **Back Office**
4. **None of the above**

Q4. A separate issue from the number of exceptions is:

1. **Bunching**
2. **Grouping**
3. **Stress testing**
4. **None**

Q5. This simulation is a very popular approach for estimating VaR:

1. **Historical Simulation**
2. **Accuracy**
3. **Extensions**

4. **None of the above**

6. **Out of the following which rate is defined as the square of the volatility?**
7. **Standard Deviation**
8. **Variance**
9. **Mean**
10. **Median**

Q7. Risk measures satisfying all four conditions are referred to as:

1. **Time Horizon**
2. **Auto Correlation**
3. **Confidence level**
4. **Coherent**

Q8. Only bonds with ratings of Baa or above are considered to be:

1. **Investment grade**
2. **Internal Credit Ratings**
3. **Altman's Z- Score**
4. **None of the above**

Q9. The by- product of any program to measure & understand operational risk is likely to be the development of:

1. **Risk & Control self assessment**
2. **Key Risk Indicators**
3. **Operational risk Capital**
4. **Casual Relationship**

Q10. The Securities that are subject to a discount are known as a:

1. **Collateralization**
2. **Downgrade Trigger**
3. **Haircut**
4. **None of the above**

Part Two:

1. **Explain 'Collateralization'.**
2. **Briefly explain the 'Linear Model'.**
3. **Explain the 'GARCH-MODEL'.**
4. **Explain the Concept of 'Exchange-Traded Markets'.**
5. **Differentiate between the Systematic vs. Nonsystematic Risk.**

1. **In the 1980s, Bankers Trust developed index currency option notes (ICONs). These are bonds in which the amount received by the holder at maturity varies with a foreign exchange rate. One example was its trade at maturity varies with a foreign exchange rate. One example was its trade with the Long Term Credit Bank of Japan. The ICON specified that if the yen/US dollar exchange rate, ST , is greater than 169 yen per dollar at maturity (in 1995), the holder of the bond receives $1,000. If it is less than 169 yen per dollar, the**

amount received by the holder of the bond is 1,000- max [0, 1,000 (169 – 1) ST When the exchange rate is below 84.5, nothing is received by the holder at maturity. Show that this ICON is a combination of a regular bond and two options.

2. **Suppose that the risk-free zero curves is flat at 7% per annum with continuous compounding and that defaults can occur halfway through each year in a new 5- year credit default swap. Suppose that the recovery rate is 30% and the default probabilities each year conditional on no earlier default are 3%. Estimate the credit default swap spread. Assume payments are made annually.**

3. **Suppose that 6- month, 12-month, 18-month, 24-month, and 30-month zero rates are 4%, 4.2%, 4.4%, 4.6%, and 4.8% per annum, respectively, with continuous compounding. Estimate the cash price of a bond with a face value of 100 that will mature in 30 months and pays a coupon of 4% per annum semiannually.**

4. **Suppose that the economic capital estimates for two business units are as follows: Business Unit 1 2 Market risk 10 50 Credit risk 30 30 Operational risk 50 10 The correlation between market risk and credit risk in the same business unit is 0.3. the correlation between credit risk in one business unit and credit risk in another is 0.7. the correlation between market risk in one business unit and market risk in the other is 0.2. All other correlations are zero. Calculate the total economic capital. How much should be allocated to each business unit?**

1. **A Bank is considering expanding its asset management operations. The main risk is operational risk. It estimates that the expected operational risk loss from the new venture in one year is $2 million and the 99.97% worst-case**

loss (arising from a large investor law suit) is $40 million. The expected fees it will receive from investors for the funds under administration are $12 million per year and administrative costs are expected to be $5 million per year. Estimate the before-tax RAROC? Also explain the two different ways in which RAROC can be used?

2. **Why is there an add-on amount in Basel I for derivatives transactions? "Basel I could be improved if the add-on amount for a derivatives transaction depended on the value of the transaction." How would you argue this viewpoint?**

3. **"A long forward contract subject to credit risk is a combination of a short position in a no-default put and a long position in a call subject to credit risk." Explain this statement.**

Details

1. Case study solved answers

2. pdf/word

3. Fully Solved with answers