FINAL EXAMINATION

December 2023

P-20B(RMBI)
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.
All working notes must form part of the answer.
Where necessary, candidates may make appropriate assumptions and clearly state them in the respective answer.

Section-A

Answer Question No. 1 which is compulsory.

1. Choose the correct answer from the given four alternatives: 2×15=30

(i) Which of the following is not a step in the Risk Management Process?

(A) Stabilize Risk

(B) Measure Risk

(C) Identify Risk

(D) Mitigate Risk

(ii) Which of the following is a limitation of the Value at Risk (VaR) approach, a widely used risk management tool to measuring risk?

(A) It fails to specify the probability that a loss could occur.

(B) It fails to specify a time frame for potential loss.

(C) It fails to specify the assumptions for estimation of loss.

(D) It fails to specify the maximum loss that could occur.

(iii) Risk faced by financial institutions in which advancement of technology does not produce savings in cost is known as ________.

(A) Savings Risk

(B) Advance Risk

(C) Cost Risk

(D) Technology Risk

(iv) Which of the following risk is made up of transaction risk, default risk and portfolio risk?

(A) Market Risk

(B) Liquidity Risk

(C) Credit Risk

(D) Country Risk

(v) __________ is the act of taking on a risk for a fee.

(A) Credit Appraisal

(B) Investment

(C) Underwriting

(D) Speculation

(vi) Which of the following is not a type of Market Risk?

(A) Commodity Risk

(B) Interest Rate Risk

(C) Forex Risk

(D) Loan default Risk

(vii) 'Risk-Tolerance' is best described by which of the following?

(A) It refers to the various types of risks one can take.

(B) It refers to the amount of risk one is willing to bear while investing.

(C) It refers to the passive instruments of risk management.

(D) It refers to the period for which one is willing to risk his/her investments.

(viii) When a bank sanctions a large loan to a borrower, which of the following risks it may not have?

(A) Liquidity Risk

(B) Market Risk

(C) Concentration Risk

(D) Operational Risk

(ix) Which of the following is not a Pillar of Basel II?

(A) Supervision

(B) Minimum Capital Requirement

(C) Credit Risk

(D) Market Discipline

(x) Which of the following is a contract between Two Insurers i.e., Original Insurer and another Insurer?

(A) Premium

(B) Co-Insurance

(C) Reinsurance

(D) Double Insurance

(xi) __________ can also be defined as Surrender of Rights by the Insured to an Insurance Company that has paid a Claim against the Third-Party.

(A) Subrogation

(B) Contract

(C) Nomination

(D) Underwriting

(xii) A Condition which increases the probability of a loss or its severity and affects the associated risk is known as ___________.

(A) Rider

(B) Hazard

(C) Speculation

(D) Mitigation

(xiii) For an Insurance Claim to be paid, the associated loss incurred due to the risk must be ___________ and ___________.

(A) definite, measurable

(B) static, speculative

(C) dynamic, critical

(D) pure, marginal

(xiv) Which product offered by insurance companies that, unlike a pure insurance policy, gives investors both insurance and investment under a single integrated plan?

(A) Money Back Plan

(B) Unit Linked Insurance Plan

(C) Endowment Plans

(D) Term Insurance Plans

(xv) ___________ are the agents, but they can sell policies of several life and non-life insurance companies at a time.

(A) Loss Assessors

(B) Brokers

(C) Insurer

(D) Surveyors

Section-B

(Answer *any five* Questions out of *seven* questions given. Each question carries 14 marks.)

2. (a) What is Risk? What are the major Risks in Banking Business? 7

(b) Differentiate between Gap or Mismatch Risk and Basis Risk under Interest Rate Risk of Banks. 7

3. (a) Why Banks in India are using 'Credit Risk Modelling' while appraising the Credit Proposals? Explain its importance to mitigate the Credit Risk that arises in Banks. 7

(b) What are the advantages and disadvantages of Sovereign Risk Rating? 7

4. (a) How does operational risk management in banking involve categorizing the activities of a bank into eight business lines specified in the New Capital Adequacy Framework? 7

(b) (i) An exposure of ₹ 200 lakhs is backed by financial collateral of A+ debt security of ₹ 60 lakhs issued by others. The tenor of the exposure is 3 years. The residual maturity of the financial collateral is 2 years. Calculate Net Exposure qualifying for Capital Adequacy.

(ii) Suppose Bank Z lends EUR 1 million to X and EUR 5 million to Y. Over the next year, the Probability of Default (PD) for X is 0.2 and for Y is 0.3. The PD of joint default is 0.1. The loss given default is 40% for X and 60% for Y. What is the expected loss of default in one year for the bank? 7

5. (a) "Insolvency Risk Analysis can be assessed through Capital Adequacy Ratios". Based on this statement, read the following case let and answer the questions.

International Bank has paid up capital of ₹ 200 Crores, Free Reserves of ₹ 600 Crores, Provisions and Contingencies Reserves ₹ 400 Crores, Revaluation Reserves 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 ₹ 8000 Crores. Based on the above information, calculate the following:

(i) The amount of Tier-1 Capital

(ii) The amount of Tier-2 Capital

(iii) The Capital Adequacy Ratio of the Bank

(iv) The amount of minimum capital to support credit and operational Risk

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(b) Discuss the role of insurance and reinsurance in risk management. 7

6. (a) What are the duties and responsibilities of a Surveyor and Loss Assessor? 7

(b) Explain the role, need and functions of Third-Party Administrators in Health Insurance. 7

7. (a) Differentiate between risk, peril and hazard. 7

(b) What are the components of Alternative Risk Transfer, specifically regarding alternative forms of risk carriers? What are the three key points related to risk pooling? 7

8. (a) Given the following Data, i.e., Assets and Capital of M/s. Small Finance Bank:

Type of Asset	**Exposure**	**Risk Weight**
Government Treasury Held as Asset	15,00,000	0%
Loans to Corporates	1,50,00,000	10%
Loans to Small Businesses	80,00,000	20%
Guarantees and other Non-Balance Sheet Exposures	60,00,000	10%

The bank's Tier I Capital and Tier II Capital is as follows:

Tier-I Capital : ₹ 2,00,000

Tier-II Capital : ₹ 3,00,000

Note: Guarantees and other non-balance sheet exposures are factored into the risk-weighted exposure calculation.

(i) Calculate the Capital Adequacy Ratio (CAR) of M/s. Small Finance Bank.

(ii) Explain the importance of CAR from the point of view of solvency of banks. 7

(b) Mr. R purchased a bus by taking a loan from M/s. ABC Limited. The bus was being used as private service vehicle and not as a public transport vehicle. It was insured under a comprehensive insurance policy issued by M/s. XYZ Insurance Limited. The bus met with an accident, for which insurance was claimed.

The insurance company appointed its surveyor, who assessed the loss at ₹ 1,26,500. However, the insurance company deducted ₹ 33,125 from the assessed amount on the ground that the driver did not have an endorsement on his licence to drive a transport vehicle. Even this amount was not paid to Mr. R, but was paid directly to the Finance Company.

Advise:

(i) Was the insurance company right in deducting the amount of ₹ 33,125 from the claim amount? Justify your answer. What is the course of action available to Mr. R?

(ii) Is it right on the part of the insurance company to pay the claim amount directly to the Finance Company and not to the insured? Justify your answer. 7

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