# INTRODUCTION TO RISK MANAGEMENT

## TI &RM Chapter 1

**Q: 1Which of this statement is correct regrading Risk ?**

a) Risk refers to the potential for loss due to various uncertainties and unpredictable events.

b) Risk is an event or injury that can cause damage to an institution's income and/or reputation.

c) There is a direct relationship between risk and reward

**d) All of the above**

**Q: 2What is the difference between risk and loss in banking?**

a) Risk is a consequence of taking on loans, while loss is the financial interest charged on those loans.

**b) Risk is the future possibility of a negative outcome, while loss is the actual realization of that outcome.**

c) Risk is always quantifiable, while loss can be subjective and dependent on individual experiences.

d) There is no real difference between risk and loss, they are just different terms for the same thing.

**Q: 3 How does the risk-return relationship apply to banks?**

a) Lower risks always lead to higher returns, and higher risks always lead to lower returns.

b) There is no clear correlation between risk and return, and it depends solely on individual bank strategies.

**c) Taking higher risks generally gives banks the potential for higher returns, but also increases the possibility of greater losses.**

d) Banks should avoid all risks at all costs to ensure maximum profitability.

**Q: 4 Which statement best defines credit risk in banking?**

**a) The risk of borrowers not repaying loans and causing financial losses.**

b) The risk of interest rates fluctuating and impacting investment returns.

c) The risk of technological failures disrupting bank operations.

d) The risk of employees engaging in fraudulent activities.



**Q: 5 Which of the following is a sub-component of credit risk in banking?**

a) Individual loan characteristics, such as borrower creditworthiness and collateral.

b) Overall market conditions affecting the ability of borrowers to repay debts.

c) The concentration of loans within specific industries or geographic regions.

**d) All of the above**

**Q: 6In modern financial markets, credit risk extends beyond debt instrument non-performance to include________**

a) Hardware downtime and network failures.

**b) Non-performance by a counterparty in off-balance sheet contracts like forward and swap agreements.**

c) The impact of natural disasters on the entire financial system.

d) Disruptions due to poorly defined internal procedures.



**Q: 7Which of the following is listed as a mitigation strategy for credit risk?**

1. **Better Credit Appraisal:** Thoroughly analyzing a business's cash flows before investing.
2. **Investing Only in Rated Instruments:** Focusing on investments with reliable credit ratings.
3. **Risk Pricing:** Setting appropriate prices to compensate for potential risks.

4. **Adequate Security:** Requiring sufficient financial or physical assets as collateral.

a) Only 1, 2, and 3 are correct

b) Only 2, 3, and 4 are correct

c) Only 1 and 4 are correct

**d) 1, 2, 3, and 4 are correct**

**Q: 8_______________ is a risk of not having enough readily available cash or equivalent assets to cover payments due to depositors, creditors, and other counterparties.**

a) Credit Risk

b) Market Risk

**c) Liquidity Risk**

d) Operational Risk

**Q: 9Which of the following best describes Funding Risk under Liquidity Risk?**

a) Risk arising due to foreign exchange rate fluctuations

b) Risk from interest rate changes

c) Risk of loss from trading activities

**d) Risk arising from unanticipated withdrawals and non-renewal of deposits**

**Q: 10 Which dimension of Liquidity Risk arises when contingent liabilities become real and immediate liabilities?**

a) Funding Risk

b) Operational Risk

c) Time Risk

**d) Call Risk**

**Q: 11 Which of the following are causes of Liquidity Risk?**

1. **Maturity mismatch:** Funding long-term assets with short-term liabilities.
2. **Unstable funding:** Overreliance on **volatile sources** like wholesale funding or deposits.
3. **Inefficient cash flow management**: Poor planning and budgeting leading to cash shortages.
4. **External factors**: Economic downturns, regulatory changes, or market volatility.

a) 1 and 2 only

b) 1, 2, and 3 only

c) 2, 3, and 4 only

**d) All of the above**

**Q: 12 Which of the following are effective Strategies to Minimize Liquidity Risk?**

a) Maintain a diversified portfolio of readily available assets to meet short-term cash needs

b) Develop accurate cash flow forecasts to anticipate both regular and unexpected fluctuations

c) Secure various funding options beyond to avoid overreliance on any single source

**d) All of the above**

**Q: 13 A bank sets maximum exposure limits for individual counterparties across both fund and non-fund exposures. This action is a direct mitigation strategy for which type of risk.**

a) Liquidity risk

b) Market risk

**c) Credit risk**

d) Operational risk

**Q: 14 What is Interest Rate Risk?**

a) Risk of not receiving loan repayments on time

b) Risk of losing principal due to currency fluctuations

c) Risk of inflation exceeding returns on investment

**d) Risk of loss in the value of investments due to fluctuations in interest rates**

**Q: 15 Interest rate risk is the potential for losses in the value of an investment due to fluctuations in interest rates. This risk is most associated with__________.**

a) Equity shares

b) Real estate investments

**c) Fixed-income investments**

d) Commodities like gold and oil

**Q: 16 When interest rates fall, what typically happens to the prices of existing fixed rate bonds, especially those of long maturity?**

a) Their prices go down.

b) Their prices remain unaffected.

**c) Their prices go up.**

d) They become more liquid.

**Q: 17 Which of the following is NOT a component of Interest Rate Risk?**

a) Reinvestment Risk

b) Price Risk

**c) Credit Risk**

d) Gap Risk

**Q: 18 A bank holds more rate-sensitive assets than liabilities. Interest rates fall. What type of risk might it face?**

a) Basis Risk

b) Embedded Option Risk

**c) Gap Risk**

d) Credit Risk

**Q: 19 All of the following are true about Reinvestment Risk EXCEPT_____________.**

a) It occurs when interest earned is reinvested at lower rates

**b) It reduces future returns compared to original bond income**

c) It is irrelevant when market rates are rising

d) It affects the total yield of long-term fixed-income investments

**Q: 20 Which of the following instruments may carry Embedded Option Risk?**

a) Floating-rate notes

**b) Callable bonds**

c) Zero-coupon bonds

d) Treasury bills

**Q: 21 All of the following are strategies to minimize interest rate risk EXCEPT____________.**

a) Duration matching

b) Diversification by maturity

**c) Investing only in fixed-rate bonds**

d) Hedging with derivatives

**Q: 22 Foreign Exchange Risk primarily arises due to___________.**

a) Increase in local interest rates

b) Variations in stock prices

**c) Fluctuations in foreign currency exchange rates**

d) Reduction in credit rating of domestic companies

**Q: 23 Which of the following is NOT a strategy to manage foreign exchange risk?**

a) Open position management

b) Forward maturity monitoring

c) Exchange rate movement analysis

**d) Investing only in domestic equity**

**Q: 24 What is the main difference between interest rate risk and foreign exchange risk?**

a) Interest rate risk affects fixed-income investments, while foreign exchange risk affects all investments.

**b) Interest rate risk is driven by changes in domestic rates, while foreign exchange risk is driven by changes in international rates.**

c) Interest rate risk is always negative, while foreign exchange risk can be positive or negative.

d) There is no significant difference between these two risks.

**Q: 25 Market risk is a broad term describing the risk of financial losses due to__________.**

a) Errors in transaction processing.

**b) Changes in overall market conditions.**

c) The default of a single large borrower.

d) An inadequate legal framework for contracts.

**Causes of Market Risk**

**Economic events:** Recessions, **inflation, and unemployment** can lead to decreased investor confidence and a general sell-off in various asset classes.

**Geopolitical disruptions:** Wars, p**olitical instability, and international tensions** can impact global markets and send shockwaves through specific sectors.

**Monetary policy decisions**: Central bank actions like **interest rate adjustments or quantitative easing** can influence market liquidity and asset valuations.

**Unexpected events**: Black swan events like **natural disasters or pandemic**s can trigger sudden market crashes and widespread losses.

**Q: 26 Which of the following is a strategy used to mitigate market risk?**

1. Diversification
2. Hedging
3. Stress Testing for Resilience
4. Dynamic Rebalancing

a) 1 and 2 only

b) 1, 2, and 3 only

c) 2, 3, and 4 only

**d) All of the above**

**Q: 27 ___________ refers to the potential for loss arising from inadequacies or failures in internal processes, systems, people, or external events.**

a) Market Risk

b) Credit Risk

**c) Operational Risk**

d) Liquidity Risk

**Q: 28 Which of the following statements correctly describe the key components and causes of Operational Risk in treasury activities?**

1. **System deficiencies**, if not properly integrated with workflows and lacking proper authorization controls, can significantly disrupt transaction processing and affect timely payments and settlements.
2. **Non-compliance** with prescribed procedures and authorization protocols can lead to operational errors, processing delays, and financial losses.
3. **Fraud risks—**such as falsifying deals or misappropriating funds—can have a severe impact on both the financial position and reputation of the institution.

4. **Legal risks** may arise from inadequately defined contracts or agreements, leading to disputes, litigations, or regulatory penalties.

a) Only 1, 2, and 3 are correct

b) Only 2, 3, and 4 are correct

c) Only 1 and 4 are correct

**d) 1, 2, 3, and 4 are correct**

**Strategies for Mitigating Operational Risk**

**Supervision and control**: Strong oversight and robust controls ensure adherence to best practices, minimizing errors and fraudulent activities.

**Training of personnel:** Training on **operational risks, procedures, and risk management** empowers employees to identify and report threats.

**Internal and independent audits**: Regular **internal audits by independent teams** scrutinize processes and identify areas for improvement.

**Personnel policies with ethical codes:** stablished policies outline company **expectations, procedures, and acceptable behavior** for employees, reducing ambiguity and potential misconduct.

**Q: 29 A new government regulation increases capital requirements for banks. This is an example of what type of risk?**

a) Fiscal Risk

**b) Regulatory Risk**

c) Political Risk

d) Compliance Risk

Changes in regulations and policies directly impact how banks operate and manage their business.

**Q: 30 A competitor launches a new, innovative banking product that attracts significant market share. This is an example of what type of risk?**

**a) Competitive Risk**

b) Proposition Risk

c) Market Risk

d) Strategic Risk