ASSETS/LIABILITIES MANAGEMENT (ALM)

TI &RM Chapter 4 Part 1

Q: 1Which of the following statements correctly describe the objectives and nature of Asset/Liability Management (ALM)?

1. ALM helps in planning, organizing, and controlling asset and liability portfolios in terms of volumes, maturities, rates, and yields.
2. ALM aims to minimize interest rate risk and ensure an acceptable level of profitability.
3. ALM supports capital protection by managing risks from mismatches in cash flows.
4. ALM enables proactive decision-making to maintain stable liquidity under fluctuating market conditions.

a) Only 1 and 2 are correct
b) Only 3 and 4 are correct
c) Only 1, 2 and 3 are correct
d) All 4 statements are correct

Q: 2_____ is a portfolio of financial instruments that a bank actively trades in the financial markets for short-term gains.

a) Banking Book
b) Savings Portfolio

c) Trading Book

d) Investment Portfolio

Q: 3 Which of the following financial instruments are typically found in a bank's trading book?

a) Personal loans and mortgages

b) Fixed deposits and recurring deposits

c) Government bonds held to maturity

d) Stocks, bonds, currencies, and derivatives

Q: 4 The assets in the trading book are valued using which of the following methods?

a) Amortized cost

b) Historical cost

c) Mark-to-market

d) Net present value

Q: 5 What type of risk is the trading book primarily exposed to?

a) Demographic risk

b) Liquidity risk

c) Market risk

d) Operational risk

Q: 6 The banking book comprises financial instruments that a bank holds for the long term, these instruments include_____.

a) Equity shares, commodity futures, and currency swaps

b) Loans, mortgages, government bonds, and other fixed-income securities

c) Intraday derivatives, equities, and speculative instruments

d) Options, futures, and interest rate swaps for trading

Q: 7 The primary purpose of the banking book is to provide a stable source of income for the bank over the long term. Which types of risk are primarily associated with the banking book?

a) Market risk, operational risk, and legal risk

b) Credit risk, interest rate risk, and liquidity risk

c) Reputational risk, currency risk, and inflation risk

d) Strategic risk, compliance risk, and volatility risk

Q: 8 What does it mean when we say that the value of assets in the banking book is generally not marked-to-market?

a) The assets are valued based on their current market prices daily.

b) The assets are constantly traded to earn short-term profits.

c) The assets are valued at book or amortized cost and not frequently revalued with market fluctuations.

d) The assets are revalued only when there is a profit in the trading book.

Q: 9 When interest rates change, causing the present value and timing of future cash flows to change, which affects the value of a bank's assets, liabilities, off-balance sheet instruments, and overall economic value in the banking book, this risk is known as _____.

a) Credit risk due to borrower default

b) Liquidity risk from cash flow shortages

c) Interest rate risk in the banking book (IRRBB)

d) Market risk from price fluctuations

Q: 10 Interest rate risk in the banking book (IRRBB) is the current or prospective risk to the bank's capital and earnings arising from adverse movements in interest rates that affect the institution's banking book positions. Which of these is NOT a subtype of IRRBB?

a) Gap Risk

b) Non-parallel Gap Risk

c) Credit Risk

d) Optionality Risk

Q: 11 A bank is exposed to negative interest margins because interest on its liabilities increases before income on assets. What type of risk is this?

a) Credit Risk

b) Gap Risk

c) Market Risk

d) Currency Risk

Q: 12 Liquidity risk results from size and maturity mismatches of assets and liabilities. Liquidity risk is best described as the _____.

a) Risk of credit default by borrowers

b) Risk of fluctuations in foreign exchange rates

c) Risk of decline in stock market prices

d) Risk of not being able to raise required funds without excess costs

Q: 13 Liquidity gaps generate liquidity risk. Which of the following best defines liquidity gaps?

a) Differences in credit quality of assets

b) Differences in interest rates of loans and deposits

c) Differences in market capitalization

d) Differences between outstanding balances of assets and liabilities

Q: 14 A bank has liabilities of ₹100 crore maturing within one year but only ₹80 crore in assets maturing within the same period. This means the bank has ₹20 crore more liabilities than assets in that time frame.This situation where liabilities exceed assets within a specific period is known as what type of gap?

a) **Positive Liquidity Gap**
b) Negative Liquidity Gap
c) Static Liquidity Gap
d) Dynamic Liquidity Gap

Q: 15 A static liquidity gap is_____

a) Analyzing current liquidity position based on existing assets and liabilities only
b) Analyzing future projections of assets and liabilities
c) A gap caused by unexpected credit losses
d) The difference between market and book value of assets

Q: 16 _____ gap considers new assets and liabilities derived from commercial projections which cumulate with the existing assets and liabilities. Considers both existing and anticipated assets and liabilities, providing a more comprehensive view of the bank's liquidity position

a) Static liquidity gap

b) Dynamic liquidity gap

c) Positive liquidity gap

d) Negative liquidity gap

Q: 17 _____ is the difference between the amounts of interest-sensitive assets and interest-sensitive liabilities that reprice or mature within a specific period. This gap helps a bank understand how changes in interest rates can impact its earnings and economic value by highlighting potential mismatches between assets and liabilities in terms of their interest rate sensitivity and timing.

a) Liquidity Gap

b) Interest Rate Gap

c) Credit Risk Gap

d) Market Risk Gap

Q: 18 Fixed interest rate gap is calculated as_____

a) Fixed Rate Assets - Variable Rate Liabilities

b) Fixed Rate Assets - Fixed Rate Liabilities

c) Variable Rate Assets - Fixed Rate Liabilities

d) Total Assets - Total Liabilities

Q: 19 Variable interest rate gap is the difference between_____.

a) Fixed Rate Assets and Fixed Rate Liabilities

b) Interest sensitive assets and interest sensitive liabilities

c) Equity and Fixed Assets

d) Total Assets and Total Liabilities

Q: 20 Given Fixed Rate Assets of 80, Variable Rate Assets of 60, Fixed Rate Liabilities of 70, Variable Rate Liabilities of 50, Equity of 25, and Fixed Assets of 15, calculate the Liquidity Gap.

a) 10

b) 20

c) 30

d) 40

Solution

Liquidity Gap = Total Assets - Total Liabilities

Q: 21 If Fixed Rate Assets are 90 and Fixed Rate Liabilities are 100, calculate the Fixed Interest Rate Gap.

a) -10

b) 10

c) 190

d) -190

Fixed Interest Rate Gap
= (Fixed Rate Assets - Fixed Rate Liabilities)

Q: 22 Given Variable Rate Assets of 55 and Variable Rate Liabilities of 65, calculate the Variable Interest Rate Gap.

a) -10

b) 10

c) 120

d) -120

Solution

Variable Interest Rate Gap
= (Variable Rate Assets - Variable Rate Liability)

Q: 23 A bank has fixed rate assets of 120, variable rate assets of 80, fixed rate liabilities of 100, and variable rate liabilities of 90 for a specific period. What is the interest rate gap, calculated as the difference between total interest-sensitive assets and total interest-sensitive liabilities?

a) 10

b) 20

c) 30

d) 40

The Interest Rate Gap

Interest Rate Gap = (Fixed Rate Assets + Variable Rate Assets) - (Fixed Rate Liabilities + Variable Rate Liabilities

Q: 24 Which of the following best explains why Duration Gap Analysis is considered more effective than traditional gap analysis in managing interest rate risk?

a) It only considers short-term interest rate changes

b) It focuses on credit risk instead of market risk

c) It accounts for the timing and present value of future cash flows

d) It ignores changes in the yield curve

Q: 25 Duration analysis begins by computing the individual duration of each rate sensitive asset and liability and weighing the individual durations by the percentage of the asset or liability, in the balance sheet, to obtain the _____.

a) Net Interest Margin

b) Weighted Average Maturity

c) Interest Rate Gap

d) Combined Asset and Liability Duration

Q: 26 One key assumption in Duration Gap Analysis is that_____.

a) All interest rates remain constant over time

b) Credit ratings of all assets improve over time

c) Yield curve experiences parallel shifts

d) Duration of liabilities remains zero

Q: 27 What is the primary objective of using Duration Gap Analysis in banking?

a) To maximize short-term profits

b) To track daily market price fluctuations

c) To compute total non-performing assets

d) To protect the economic value of equity from interest rate risk