



ZIMBABWE

MINISTRY OF HIGHER AND TERTIARY EDUCATION

**HIGHER EDUCATION EXAMINATIONS COUNCIL
(HEXCO)**

HIGHER NATIONAL DIPLOMA

IN

BANKING AND FINANCE

SUBJECT: Risk Management

PAPER NO: 737/S01

OCTOBER/NOVEMBER 2012 EXAMINATION

REQUIREMENTS

INSTRUCTIONS TO CANDIDATE

- 1. Answer ANY FIVE (5) questions.**
- 2. Each question carries 20 marks.**

This paper consists of 4 printed pages.

QUESTION 1

a) Discuss the following concepts:

- i) VAR (2 marks)
- ii) CAR (2 marks)
- iii) Mean-Variance (2 marks)
- iv) Risk based pricing (2 marks)
- v) SVA (2 marks)

b) Given the following information, calculate standard deviation of a portfolio and its coefficient of variation.

Probability	Return in theta (%)	Return in eta (%)
0.20	40	40
0.30	20	60
0.50	-10	30

(10 marks)

QUESTION 2

- a) Distinguish between moral hazard and adverse selection. (10 marks)
- b) How would rising interest rates affect a bank if the maturity of its assets is longer than the average maturity of its liabilities? (5 marks)
- c) How does price risk impact on the short and long positions of a bank? (5 marks)

QUESTION 3

A firm is considering two mutually exclusive projects A and B, the initial outlays of which would be \$130 000 and \$85 000 respectively. The firm's cost of capital is 12% and the estimated cash flows of the two projects are as follows:

Year	Project A (\$)	Project B (\$)
1	25000	40000
2	35000	35000
3	45000	30000
4	50000	10000
5	55000	5000

Required:

- a) Determine the NPV for each project. (10 marks)
- b) Compute the IRR for each project. (10 marks)

QUESTION 4

- a) Distinguish between forward contracts and futures contracts. (10 marks)
- b) Describe swaps and explain their attractiveness to the parties involved. (10 marks)

QUESTION 5

- a) Explain the following concepts as they are used in risk management.
- i) People risk (2 marks)
 - ii) Process risk (2 marks)
 - iii) Technological risk (1 mark)
 - iv) IT risk (1 mark)
 - v) Asymmetric information (4 marks)
- b) Examine any five (5) sources of information that can be used in credit granting decisions. (10 marks)

QUESTION 6

- a) Assume a forward contract on a non-dividend paying stock that matures in 3 months. Suppose the current stock price is \$40 and the 3 months risk free interest rate with continuous compounding is 5% per annum. Calculate the forward price. (5 marks)
- b) Consider a futures contract on gold. It costs \$2 per ounce per year to store gold with the payments being made at the end of the year. The price of gold today is \$450 per ounce and the risk-free rate of interest with continuous compounding is 7% per annum, for all maturities. Calculate the futures price of the contract. (5 marks)
- c) Explain five ways of financing a deficit on a current account of the balance of payments. (10 marks)

QUESTION 7

Analyse the five (5) basic canons used in credit assessment for borrowers in bank lending. (20 marks)

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