



GRETSA UNIVERSITY - THIKA

UNIVERSITY EXAMINATIONS JANUARY – APRIL 2025 SEMESTER

BACHELOR OF COMMERCE

COURSE CODE: BCFI 305

COURSE TITLE: FINANCIAL RISK MANAGEMENT

DATE: 2025

TIME: 11.30AM-2.30PM

INSTRUCTIONS TO CANDIDATES

- a) SECTION A IS **COMPULSORY**.
- b) SECTION B: ANSWER ANY OTHER **TWO** QUESTIONS.
- c) **DO NOT** WRITE ANYTHING ON THIS QUESTION PAPER AS IT WILL BE AN EXAM IRREGULARITY.
- d) ALL ROUGH WORK SHOULD BE AT THE BACK OF YOUR ANSWER BOOKLET AND CROSSED OUT.

CAUTION: *All exam rooms are under CCTV surveillance during the examination period.*

SECTION A: COMPULSORY

Question One

- a) Discuss four types of Market risks **[12 marks]**
- b) Explain two financial risks one faces when investing internationally in the offshore markets **[4 marks]**
- c) Explain two assumptions of portfolio theory **[2 marks]**
- d) Explain four ethical issues in financial risk management **[4 marks]**
- e) Explain the following terms
 - I. Risk (2 Marks)
 - II. Swaps. (2 Marks)
 - III. Systematic risk. (2 Marks)
 - IV. Securities trading (2 Marks)

SECTION B: ANSWER ANY TWO QUESTIONS

Question Two

- a) Discuss the five roles of financial markets **[10 marks]**
- b) Discuss the types of risks faced by commercial banks and possible risk management measures that can be adopted **[10marks]**

Question three

- i) Discuss any three theories that explain the shape and behaviour of term structures of interest rate **[12 marks]**
- ii) Explain four limitations of CAPM **[8 marks]**

Question Four

- a) ABC Ltd is considering three possible capital projects for next year. Each project has a 1 year life, and project returns depend on the next years state of the economy. The estimated rates of return are shown below.

STATE OF THE ECONOMY	PROBABILITY OF OCCURRENCE	RATE OF RETURN		
		A	B	C
Recession	0.25	10%	9%	14%
Average	0.50	14	13	12
BOOM	0.25	16	18	10

- I. Find each projects expected rate of return and standard deviation **[12 marks]**
 b) Explain the process involved in risk management **[8 marks]**

Question 5

In the year 2008, Howard Archer made the following statement;

The collapse of Lehman Brothers has sent a major jolt through financial markets as it is by far the biggest victim of the credit crisis that started in August 2007 and had been considered too big to fail.”| Howard Archer, Economist, Global Insight, 2008.

On September 15, 2008, US-based Lehman Brothers, one of the top five investment banks in the US, filled for chapter 11 bankruptcy sending shock waves to the financial sector of all over the world. As per the details filled by Lehman in its bankruptcy filing, it held assets worth US\$ 639 billion whereas its total liabilities stood at US \$ 613 billion. With this Lehman earned the dubious distinction of having filled the biggest bankruptcy ever in the world. The bank reported a loss of US\$ 2.8 billion in the second quarter of 2008 ending May 2008, its first loss since it went public in the year 1994. On September 10,2008, Lehman again reported a net loss of US\$ 3.9 billion for the third quarter ending August 2008. The Korea Development Bank (KDB), which had earlier evinced an interest in purchasing a 25% equity, announced that it had withdrawn this offer, stating that the price Lehman quoted was too high and hence not interested. Lehman’s shares plunged by almost 45% from US \$14.15 to US\$ 7.79 after KDB’s announcement. This made it file for Chapter 11 bankruptcy.

In reference to the above excerpt answer the following questions;

- a) In terms of risk assessment, what should have been considered in the Lehman Brothers and or actions that would have been put in place to minimize the effects of the looming financial crisis? **[4 marks]**
- b) What probable risk management strategies could have been employed once the financial crisis was noticed to be systemic with a reported loss later in the second quarter of 2008? **[8 marks]**
- c) The eventual collapse of Lehman Brothers is a severe lapse indicator of the board's poor risk management oversight role. Explain what could have prompted this board failure. **[6 marks]** |