GRETSA UNIVERSITY - THIKA

UNIVERSITY EXAMINATIONS

JANUARY-APRIL 2026 SEMESTER

BACHELOR OF COMMERCE

COURSE CODE: BCFI 305

COURSE TITLE: FINANCIAL RISK MANAGEMENT

DATE: 09 APRIL 2026 **TIME: 2 HOURS**

INSTRUCTIONS TO CANDIDATES

1. SECTION A IS **COMPULSORY.**
2. SECTION B: ANSWER ANY OTHER **TWO** QUESTIONS.
3. **DO NOT** WRITE ANYTHING ON THIS QUESTION PAPER AS IT WILL BE AN EXAM IRREGULARITY.
4. 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) Explain the five benefits that will accrue to a firm adopting an active risk management approach. **[10 Marks]**

b) Secondary capital markets deal in the second hand issued securities. Discuss any 4 segments of the Nairobi Securities exchange **[8 Marks]**

c) A portfolio consists of three securities A,B, and C with the following parameters

Security Weight	A (0.45)	B (0.35)	C (0.15)	Correlation Coefficient
$\epsilon(r)$	20%	12%	8%	
Individual σ	11%	8%	6%	
ρAB				-0.8
ρBC				-0.5
ρAC				0.2

i) Calculate the risk of the portfolio formed by the three securities combination **[6 Marks]**

ii) If the significance level at $\alpha_{0.05}$ is 1.645 and the portfolio value is Kes 10,000 calculate the VaR for Security A and B **[6 Marks]**

SECTION B: ANSWER ANY TWO QUESTIONS

Question Two

a) Explain any six strategies that could be used to manage operating exposure. **[12 Marks]**

b) Mr. John entered into a contract to supply Sh. 10 million worth of goods to Adam in the United States in a period of three months. The following information is provided.

Spot rate KSH/1 USD= 100

3 month rate 95

Forward exchange rate = 101

Advice on whether use of forward contract will be beneficial to Mr. John support your answer with calculations. **[4 Marks]**

c) Distinguish between European call and American call. **[4 Marks]**

Question three

(a) Using a well labelled diagram, to show the relationship between risk and return, explain the four benefits of diversification in the context of risk. **[8 Marks]**

(b) The goal of risk management is not to eliminate risk but to ensure that risk remains at a certain level of acceptability. Explain the various risk management approaches available to risk managers. **[12 Marks]**

Question Four

Explain the following terms using examples:

i) Bull investors **[4 Marks]**

ii) Swaption **[4 Marks]**

iii) Arbitrageur **[4 Marks]**

iv) Protracted default **[4 Marks]**

v) Inverse floaters **[4 Marks]**

Question five

a) The problem of credit risk in the management of financial institutions is compounded by the challenges of adverse selection and moral hazards. Explain the seven methods used by financial institutions to manage these challenges and by extension credit risk. **[14 Marks]**

b) Explain 3 ways of mitigating the liquidity risks. **[6 Marks]**