PAN AFRICA CHRISTIAN UNIVERSITY

BACHELOR OF COMMERCE BACHELOR OF BUSINESS LEADERSHIP

END OF TERM EXAMINATION -JANUARY-APRIL 2026

DEPARTMENT: BUSINESS

COURSE CODE: CFN 402

COURSE TITLE: FINANCIAL RISK MANAGEMENT TIME:

INSTRUCTIONS

- This examination script consists of **FIVE (5)** questions.
- Read all questions carefully before attempting.
- Question **One** is compulsory and Answer any **three (3)** questions.
- Write your **student number** on the answer booklet provided.

QUESTION ONE (TOTAL 30 MARKS)

a) You have a discussion on financial disasters with a friend, who is not attending the Financial Risk Management. In the course of your discussion, you mention the following terms: economic bubble, *contagion effect, moral hazard, lender of last resort.* Your friend is perplexed about the terms and inquires for more information

Required

i. Explain to your friend, how the above processes (in italics) may contribute to systemic crisis/ disaster **(6 Marks)**

ii. Describe to him/her how an economic bubble happens. **(4 Marks)**

b) 'Debt financing is considered a cheaper source of finance though some financial institutions may not utilize it for fear of default risk'. Assume you have been employed recently as a risk officer in a reputable financial institution. Your boss requests you to present to your colleagues a session on financing decisions and financial risk management.

Required
In your presentation,
i. Evaluate the importance of financial risk management in relation to Capital Structure of the Financial Institutions **(5 Marks)**

ii. Differentiate between risk capacity, risk appetite and risk tolerance as applied in the management of risk **(5 Marks)**

c) An increase in the probability of default risk can have a dramatic impact on the business of a Financial Institution (FI). The FI must control its risks with extreme care. It must make sure there is little probability that it will lose customers because of credit risk. In such circumstances, the FI may find Value at Risk (VaR) as a better measure of risk.
Required
i. Illustrate Value at Risk as a measure of risk in financial institutions **(3 Marks)**
ii. Explain the advantages of VaR as a measure of risk **(4 Marks)**

iii. Differentiate stress testing and reverse stress testing **(3 Marks)**

QUESTION TWO (TOTAL (MARKS 10)
a) Describe the various types of risk faced by an organization (5 Marks)
b) Discuss the factors that have encouraged the development of risk management (5Marks

QUESTION THREE (TOTAL MARKS 10)
Derivative contracts also have the ability to create artificial wealth and this creates additional risk. The artificial wealth skews the values of underlying assets considerably.
Using suitable examples, discuss any **five** types of derivative risks. (10 Marks)

QUESTION FOUR (TOTAL MARKS 10)
(a) Risk management process is a detailed plan that if well adhered to saves the organizations many losses. Discuss a typical risk management process for a manufacturing firm. (5 marks)

(b) Describe the contents of a good risk management manual. (5 marks)

QUESTION FIVE (TOTAL MARKS 10)

a) A firm fears a rise in interest rates and enters into an **interest rate swap**. Explain how the swap helps in managing risk with suitable assumptions. (4 Marks)

b) Discuss the following using suitable examples:
   i. Hedgers (2 marks)
   ii. Speculators (2 marks)
   iii. Arbitraguers (2 marks)