PAN AFRICA CHRISTIAN UNIVERSITY

BACHELOR OF COMMERCE
BACHELOR OF BUSINESS LEADERSHIP

END OF TERM EXAMINATION

DEPARTMENT: BUSINESS

COURSE CODE: CFN 402

COURSE TITLE: FINANCIAL RISK MANAGEMENT

TIME:

INSTRUCTIONS

- This examination script consists of **SIX (6)** questions.
- Read all questions carefully before attempting.
- Question **One** is compulsory and Answer any **Four (4)** questions.
- Write your **student number** on the answer booklet provided.

SECTION A: COMPULSORY

QUESTION ONE

a) Explain how a financial institution can reduce capital management risk exposure. (4 Marks)

b) The probability distribution of the rate of return on a stock is given below:-

State of the Economy	Probability of Occurrence	Rate of Return
Boom	0.30	40%
Normal	0.60	20%
Recession	0.10	10%

Required

The standard deviation of return (6 Marks)

QUESTION TWO

a) Outline the limitations of the capital assets pricing model. (3 Marks)

b) Assume that the risk free rate of return is 8%, the market expected rate of return is 12%. The standard deviation of the market return is 2% while the covariance of return for security A and the market is 2%.

Required:

What is the required rate of return on Security A? (7 Marks)

QUESTION THREE

a) Discuss any five types of risks that face organizations today. (5 Marks)

b) Explain five reasons why organizations find the need to engage in risk management processes. (5 Marks)

QUESTION FOUR

a) Recommend five ways an organization can use to reduce exposure to operational risks. (5 Marks)

b) Discuss five principles of financial risk management. (5 Marks)

QUESTION FIVE

a) Define Capital Asset Pricing Model (CAPM) (2 Marks)

b) Discuss four assumptions upon which Capital Asset Pricing Model (CAPM) is anchored. (8 Marks)

QUESTION SIX

a) Explain three disadvantages of using derivatives in managing financial risks (3 Marks)

b) Consider two investments, A and B each having the following investment characteristics:

Investment	Expected Return(%)	Proportion
A	10	$\frac{2}{3}$
B	20	$\frac{1}{3}$

Required:-

Compute the expected return of a part folio of the two assets. (7 Marks)