ISQ Examination (Winter-2012) Advance Risk Management - Associateship

- StudentBounty.com Q. The State Bank of Pakistan has reduced its discount rate by 150 basis points. Discuss the factors which prompted this long awaited decision and how it is going to impact on the economic activities in the country and profitability of the banks in general.
- Q. Contingent liabilities some time lead to a wrong perception as low risk a. business activity. To avert this mindset banks/DFIs are required to follow the well defined guideline incorporated in the Prudential Regulations, discuss the parameters specified in that guideline.
 - b. SBP has recently revised the existing limit for bank guarantees from US\$250,000 to US\$500,000 which are issued against back to back guarantees/counter-guarantee of banks/DFIs, not subject to normal How will this relaxation affect the banking credit rating criteria. institution, domestic economy in particular?
- Q. Discuss the risk base internal-audit system and elaborate how it differs a. from traditional audit system.
 - Banks/DFIs generally develop a policy and procedural guideline to b. address credit risk management. List the important issues that must be covered in this policy document.
- Q. Define Liquidity risk and types of liquidity risk. How would a banking institution be exposed to Liquidity risk? What are the tools that can be used to monitor and manage liquidity risk in a bank's balance sheet?
- Q. What are the key risk factors for the successful implementation of an enterprise wide risk management system? Identify any FIVE risk factors that the success of a risk management systems implementation would depend on.
- Q. Yuan (renminbi) is emerging as a regional 'anchor' currency. Whether utilizing bilateral currency swaps can serve as a part of solution to diversify foreign exchange reserves and reduce Pakistan's dependence on US banking system, comment.

Q. Yasuo Hamanaka, the lead copper trader for Sumitomo, attempted to control the copper market in a classic market manipulation strategy. Since the copper market was relatively small, Hamanaka had the potential to control and corner it.

He took a dominant long position in copper future contracts and at the same time purchased large quantities of physical copper. As the delivery would approach for the future contracts, the party with the short position would find little physical copper available for delivery and would be forced to either pay a large premium for physical copper or unwind its short position by taking and offsetting long position in futures contract. Either ways, the price of physical copper or/and copper future prices would rise and create handsome profits for Hamanaka and Sumitomo.

There was a risk of severe losses if copper prices fell. Subjecting the firm to enormous market risk to help finance his long copper positions, Hamanaka sold put options which exposed the firm even more to falling copper prices.

Hamanaka's unusually low degree of supervision and broad powers allowed him to implement this fraudulent trading strategy without detection until the Commodity Futures Trading Commission (CFTC) began an investigation of market manipulation in December 1995. CFTC felt that there was a possibility that Sumitomo had purposely influenced the price of copper with positions that were unrelated to legitimate commercial needs.

In May 1996, Hamanaka was reassigned to another position, sparking suspicion amongst other copper traders who began to sell their copper holdings in anticipation of Sumitomo doing the same. A continuation of plummeting copper prices resulted in a \$2.6 billion trading loss and a \$150 million fine from CFTC. Hamanaka was fired, prosecuted and jailed. The size of Sumitomo's copper positions in relation to the market exacerbated the drop in copper prices.

Sumitomo's lack of supervision on Hamanaka was a clear sign of weak internal controls. Because Hamanaka had total autonomy, he was able to give power of attorney to brokerage firms to execute highly leveraged transactions in a scheme to help finance his accumulation of copper. In addition the lack of supervision allowed him to keep two sets of trading books, one of which recorded large profits. The other set recorded large losses and was a secret, which allowed illegal activities to go undetected.

Large transactions should have required multiple approvals by senior management, who would have an understanding of the trading strategy. In Sumitomo's case however, non approvals were necessary and the senior management was unequipped to understand the complex transaction. Required:

- StudentBounty.com What are the two major kinds of risk most evident in the Sumiton a. case? Support your answer with at least two observations in each case.
- What kind of trading controls would have helped avoid or control the b. size of losses suffered by Sumitomo?
- List at least FIVE operational controls that would have prevented the C. Sumitomo failure.
- Q. Use the following table to answer the question below:

Default Probabilities		
Rating	3 year	5 year
AAA	0.05%	0.15%
AA	0.22%	0.48%
А	0.30%	0.72%
BBB	0.92%	1.98%
BB	6.91%	11.83%
В	20.37%	28.00%
CCC	31.63%	40.15%

Which loan below has the highest expected credit loss? (Assume that all of the loans are due at maturity without amortization)

- A 3-year loan of \$50,000,000 to a counterparty with a credit rating of "A". •
- A 5-year loan of \$1,500,000 to a counterparty with a credit rating of "BB".
- A 5-year loan of \$40,000,000 to a counterparty with a credit rating of "AA".
- A 3-year loan of \$20,000,000 to a counterparty with a credit rating of "BBB".

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