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CS/BIRM/SEM-6/BIRM-604/2010

2010

FINANCIAL & TREASURY RISK MANAGEMENT

Time Allotted : 3 Hours   Full Marks : 70

The figures in the margin indicate full marks.

Candidates are required to give their answers in their own words as far as practicable.

GROUP – A

(Multiple Choice Type Questions)

1. Choose the correct alternatives for the following : 10 × 1 = 10

   i) The major difference between exchange-traded and OTC derivatives is in respect to

      a) Replacement risk   b) Price risk

      c) Credit risk   d) Mark-to-market risk.

   ii) Which of the following statements is false ?

      a) Hedgers in derivatives market are exposed to risk due to their normal business operations

      b) Speculators try to make profit by going against the market

      c) Arbitrageurs help in enhancing liquidity in the market

      d) None of these.

iii) Which one of the following statements is not a feature of derivatives ?

a) It is easier to take short position in derivatives than in other assets

b) Exchange traded derivatives are less liquid, and have high transaction costs

c) It is possible to construct portfolio which is exactly needed, without having the underlying assets

d) There is a relation between the values of derivatives and their underlying assets.

iv) Which of the following derivatives are not available in India ?

a) Interest rate futures b) Stock index futures

c) Currency forwards d) Energy futures.

v) You purchased XYZ stock at $ 50 per share. The stock is currently selling at $ 65. Your gains may be protected by placing a

a) Stop-loss order
b) Limit-buy order
c) Market order
d) Limit-sell order.

vi) Your sold short 200 shares of common stock at $60 per share. The initial margin is 60%. Your initial investment was

a) $4,800
b) $12,000
c) $5,600
d) $7,200.

vii) An investor goes long on Nifty future contract at Rs. 1,225. Initial margin was Rs. 5,000 with maintenance margin of Rs. 4,500. If index closes at Rs. 1,125 and multiple associated with the contract is 100, calculate the call money.

a) Rs. 9,500
b) Rs. 10,000
c) Rs. 14,500
d) Rs. 15,500.

viii) Which of the following money market instruments has a maturity period varying from 2 to 15 days ?

a) Call money
b) Commercial paper
c) Notice money
d) Treasury bill.

ix) Who among the following categories of people try to obtain risk free profits by simultaneously buying and selling similar instruments in different markets ?

a) Arbitrageurs
b) Speculators
c) Factors
d) Brokers.

x) Which of the following is an example of a diversifiable risk ?

a) Ability of a company to obtain adequate supply of raw materials.
b) Changes in the tax structure
c) Reduction in the purchasing power of money
d) Recession in the economy.

GROUP – B

(Short Answer Type Questions)

Answer any *three* of the following. $3 \times 5 = 15$

2. A wheat farmer in order to protect himself from price fluctuations sells 15 future contracts of 5000 bushels each at the rate of Rs. 9·00 per bushel. At the time of harvest which is five months from now, the basis is –0·15 and the price of wheat per bushel is Rs. 9·50. Did the farmer gain or lose and by how much amount ?

3. Write done the steps to be followed in financial risk management.

4. Point out the needs and importance of financial risk management to an organisation.

5. Discuss about the various applications of weather derivatives in business.

6. Define the concept of value at risk.

GROUP – C

(Long Answer Type Questions)

Answer any *three* of the following. 3 × 15 = 45

7. What do you mean by a financial swap ? How do both the parties of a swap contract gain from a swap contract ? 5 + 10

8. "In the context of the present business environment financial risk management has become a critical activity for most of the firms ? Discuss the different approaches to manage risks.

9. The following information is taken from the books of a bank relating to an interest rate swap :

   Remaining term to maturity 3 years

   Fixed rate paid by bank 10%

   Floating rate received by bank 6 m Libor

   Current 6m Libor 9%

   Market quote for 3 year swap 10·5% semi-annual *vs*. Libor

   Find out the value of the swap, if the bank has received the latest interest payment.

10. You have a 12-month payable of AUD 1,00,000. The current Rs. /AUD spot rate is Rs. 20, rupee interest rate is 21% p.a. and AUD interest rate is 10% p.a. You are considering a forward hedge at the current forward rate of Rs. 22. A friend tells you that he recently bought a call on AUD 1,00,000 at a strike price of Rs. 20 and is willing to sell it to you at the historic premium of Re. 1 per AUD or Rs. 1,00,000 for the entire contract. The call matures at the same time as your payable and is a European call. What should you do ?

11. Define money market. State the major instruments that are traded through money market. Discuss in brief the recent trends in money market in India. 2 + 6 + 7