RSK2602

May/June 2013

FUNDAMENTALS OF OPERATIONAL & FINANCIAL RISK

Duration   2 Hours

70   Marks

EXAMINERS
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Use of a non-programmable pocket calculator is permissible

Closed book examination

This examination question paper remains the property of the University of South Africa and may not be removed from the examination venue

This examination paper consists of **14** pages including this page and 2 pages for rough work

This paper comprises **TWO SECTIONS**

Section A consists of twenty **Multiple-Choice** questions of 1 mark each **The answers to these questions must be indicated in the table at the end of the section.**

Section B consists of **Essay Type** questions Each question must be answered in the designated area below the question.

[TURN OVER]

SECTION A: MULTIPLE-CHOICE QUESTIONS   [Total 15 marks]

Indicate the **CORRECT** answer to each question in the table at the end of the section

Question 1

Risk factors that are related to operational risk are

a   internal fraud

b   movement in prices of commodities

c   inability to make loan payments

d   key person dependency

Choose the correct combination

1   a, b

2   b, c

3   c, d

4   d, a

Question 2

Corporate governance is defined as

1   a prescribed set of rules to define the relationships between an organisation's management, its board, its shareholders and stakeholders

2   the concern of holding a balance between economic and social goals and between individual and communal goals

3   the practice by which organisations are managed and controlled

4   the precise alignment of interests of individuals, corporations and the community

Question 3

The cost of risk can be described as the sum of

a   management time involved in risk identification and evaluation

b   opportunity cost by choosing between investment alternatives

c   risk training and seminars attended by risk and other staff

d   uninsurable losses

Choose the **most** correct option

1   a, b, c

2   b, c, d

3   d, a, b

4   a, c, d

[TURN OVER]

Question 4

People can use a number of different sources to identify risk The sources of risk can be classified as either internal or external sources Examples of external sources can be

a   Staff fraud
b   External audit reports
c   Changes in legislation
d   Financial statements

Choose the correct combination

1   a, b
2   b, c
3   c, d
4   a, d

The next 5 questions (questions 5 – 9) are based on the diagram below
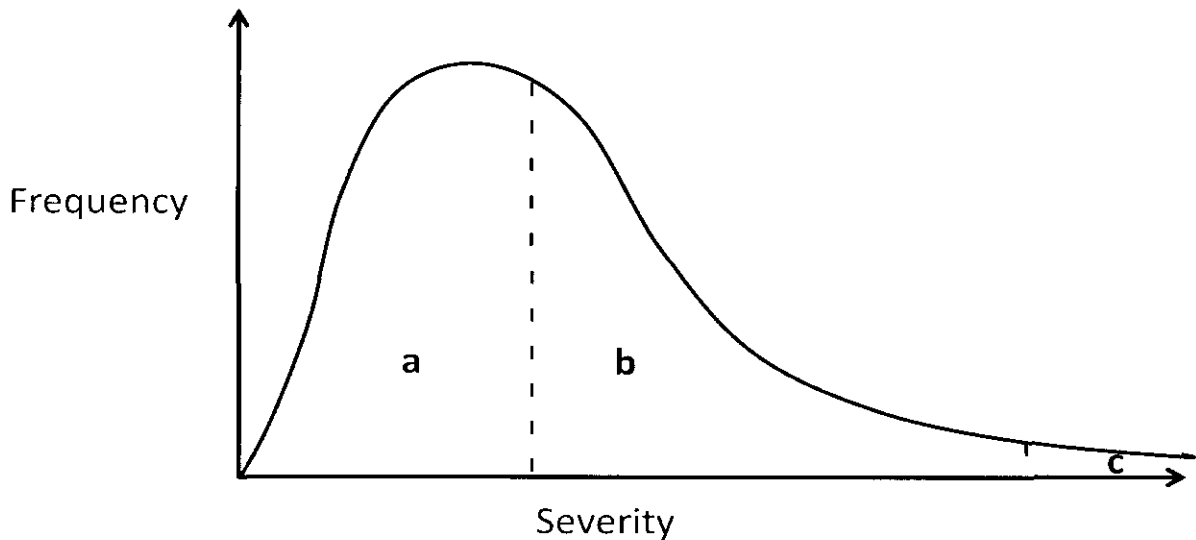
Question 5

The area in the diagram where the use of internal data for the modelling of operational risk is the most appropriate is best described by

1   a
2   b
3   c
4   all of the above

Question 6

Scenario analysis can be the best method to use to calculate operational risk capital, for the areas represented by

1   a and b
2   b and c
3   c and a
4   all of the above

Question 7

The most appropriate control strategy to implement for the area represented by "c" on the diagram will be

1   avoidance and/or transfer
2   more effective preventative and/or detective controls
3   improvement of corporate governance
4   Insurance and/or capital allocation

Question 8

Examples of the type of losses represented by "a" in the diagram are

a   Flood damage in Gauteng
b   Pilfering by staff in a retail outlet such as Checkers
c   Spillage in a manufacturing concern due to the incorrect calibration of the machinery
d   Incorrect calculation of the annual tax assessment

Choose the **correct** combination

1   a, b
2   b, c
3   c, d
4   a, d

Question 9

The area represented by "b" on the diagram is also known as

1   unexpected losses
2   grey swans
3   expected losses
4   external losses

The next six questions (questions 10 – 15) are based on the following information.

The Commercial Bank of Africa Ltd (CBA) is a registered credit provider and is incorporated in the Republic of South Africa The banking business of CBA consists of a retail banking and corporate division Both the divisions were able to achieve their annual profit targets, but experienced significant losses across the various risk types the bank is exposed to

The EXCO of the bank has invested a significant effort to cut operational cost One of the outcomes was to reduce the insurance premiums paid by the bank by improving the risk environment and to limit insurance cover to large amounts Although the Chief Risk Officer

was satisfied that risk management has improved across the board, areas for concern highlighted were the accuracy of the Loss Event Database with regard to the losses included and the classification of the risk

Below is an extract from the Loss Event Database of the most significant losses experienced over the last six months for CBA

DATE	DESCRIPTION	AMOUNT
2011/12/24	ATM robbery Robbers forced open an ATM at the Kliptown branch	R 500,000
2011/12/27	A counterparty did not settle an interest rate swap reset due to a crash of one of the servers in CBA's computer centres	R 125,000
2011/12/30	A staff member defrauded the bank with a fictitious loan	R 50,000
2012/01/05	The static data of a Greece Government Bond was captured incorrectly, which meant that the trader calculated and traded off the incorrect curve	R 2,185,670
2012/01/18	Internal Audit highlighted that incorrect assumptions were used to evaluate Credit Default Swaps (CDS)	R 150,432
2012/02/23	Greece defaulted on the government bond	R 50,000,000
2012/03/05	An uninsured pool vehicle was written of in an accident	R 270,000
2012/03/15	Teller differences for February	R 350,000
2012/04/17	Un-reconciled items on suspense accounts written off	R 1,354,678
2012/04/25	Upgrading of the bank's teller system	R 1,500,000

Question 10

The loss caused by the incorrect capturing of the static data of the Greece Bond is an example of
1   country risk
2   counterparty risk
3   operational risk
4   market risk

Question 11

The loss incurred with the implementation of the credit default swap evaluation model is an example of
1   model risk, which is a sub-component of market risk
2   model risk, which is a sub-component of operational risk
3   quantification of market risk
4   system risk, which is a sub-component of operational risk

[TURN OVER]

Question 12

The **most probable** cause of the loss experienced with the un-reconciled items is

1   bad system design
2   bad process design
3   weak supervision
4   untrained people

Question 13

The total amount that can be classified as operational losses is

1   R4 985 348
2   R6 335 348
3   R54 985 348
4   R56 485 348

Question 14

The loss incurred by not insuring the pool vehicle is an example of

1   management oversight
2   risk retention
3   low impact and low probability
4   captive insurance

Question 15

The total of losses that can be classified as internal events in terms of the operational risk definitions is

1   R54 065 348
2   R5 715 348
3   R4 215 348
4   R4 065 348

Answer sheet for Section A

1		**11**	
2		**12**	
3		**13**	
4		**14**	
5		**15**	
6			
7			
8			
9			
10			

[TURN OVER]

END OF SECTION A

SECTION B: ESSAY QUESTIONS [Total 55 Marks]

Answer **ALL** the questions in the space provided

Question 1 [10 Marks]

Discuss five core principles of the operational risk management function of an organisation

Question 2   **[25 Marks]**

Illustrate the business continuity process by means of a diagram and discuss the processes

Question 3   **[5 Marks]**

Highlight the items that can be classified as risk control and loss prevention expenditure

Question 4   **[5 Marks]**

Define risk monitoring and identify the items a risk monitoring programme would entail

Question 5   **[10 Marks]**

Discuss the concept of risk transfer

[TOTAL 70 MARKS]

END OF PAPER

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