



**Uva Wellassa University  
Faculty of Management**

**Degree of Bachelor of Business Management in Entrepreneurship and Management**  
**THIRD YEAR SECOND SEMESTER EXAMINATION – AUGUST/SEPTEMBER 2011**

**EMG 305 -2 Financial Risk Management**

**Instructions to candidates:**

No. of pages : Two (02)  
 No. of questions : Four (04) Essay  
 Time allocation : Two (02) Hours  
 Marks allocated : 100Marks

Index Number:

Question paper is not to be removed from examination hall.

Answer **all** questions.

01. As of December 31, 2003, an insurance company has a known obligation to pay \$1,000,000 on December 31, 2007. To find this liability, the company immediately purchases 4-year 5% annual coupon bonds totaling \$ 822,703 of face value. The company anticipates reinvestment interest rates to remain constant at 5% through December 31, 2007. The maturity value of the bond equals the face value.

- i) Why the purchase will cover the obligation of \$ 1,000,000 in four years if reinvestment rates remain at 5%?
- ii) What happens if reinvestment rates drop by 0.5% (effective January 1, 2004)?
- iii) By analyzing historical data, the company obtained the following information:

Table 1:

Probability	Interest rate drop by(effective January 1,2004)
0.05	1%
0.05	0.75%
0.1	0.5%
0.15	0.25%
0.5	remain constant
0.1	-0.25%
0.05	-0.5%

- a) By calculating expected income and standard deviation of it, discuss about the interest rate risk.
- b) Determine risk percentage.

**(25 Marks)**

02.

- i) Discuss about the valuation of Bonds and Stock. (It is expected to find out similarities as well as differences in these two valuation and also valuation risk too)
- ii) Assume a stock is expected to pay a dividend of \$10 per share next year and to increase the dividend payout by 3% per year every year thereafter. Assume investors require a 15% rate of return on this stock. Find the value of this stock.
- iii)
  - a) Define a Preferred stock.
  - b) What is the value of a preferred stock that pays a dividend of \$20 per share every year, assuming investors require a 15% rate of return?

(25 Marks)

03.

- i) What is risk management?
- ii) Who uses risk management?
- iii) How is risk management used?
- iv) Who does the risk assessment?
- v) How to rank risk?
- vi) Once you identify risk levels, discuss the risk management plan.

(25 Marks)

04.

- i) Why should we study financial risk management?
- ii) Write down four main financial risks.
- iii) What is credit risk?
  - a) Write down types of credit risk?
  - b) Why does credit risk happen?
  - c) How do we evaluate credit risk?
  - d) How do we mitigate credit risk?

(25 Marks)