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***Roll No.* ....** **OPEN BOOK EXAMINATION**

Time allowed : 3 hours ***Maximum marks : 100***

Total number of questions : 6 ***Total number of printed pages : 16***

NOTE : *Answer **ALL** Questions.*

PART–I

1. Risk Management in Banks

The Banking sector has a very important role in the development of an economy of any country. As one of the key drivers of economic growth of a country, banking sector plays a pivotal role in making use of idle funds for nation building. The foundation of a strong economy depends on how strong the Banking sector is and vice versa. Banking is always considered to be a very risky business. In the context of Banking, 'Risk' can be defined as the potential loss from a banking transaction in the form of a loan, or investment in securities or any other transaction that a bank undertakes for itself or for its customers. Banks are exposed to both, financial (e.g., monetary loss) as well as non-financial (e.g., reputation loss) risks. Basic function of any bank is to accept funds from public for the purpose of lending and investment. In case something goes wrong, banks can collapse and 'failure of one bank is sufficient to send shock waves right through the economy'. It is imperative that bank managements must be very careful in identifying the types as well as the degrees of risk exposure and mitigate them positively. Therefore, banks must recognize risk management as an ongoing and unavoidable activity with the active participation of the Board of Directors. In economic/financial/business activities risk is directly proportional to returns, higher the risk a bank takes, it can expect to gain more profits. However, greater risk also increases the danger that the bank may incur big losses and can be out of the business and perhaps out of existence. In fact, today, a bank must run its operations with twin objectives in mind-generate profit and stay in business. However, banks must ensure that their risk-taking decisions are measured, informed and prudent.

Pre-requisites for a Good Risk Management System in Banks :

The following are some of the salient requirements in respect of risk management in banks :

- A comprehensive Risk Management Policy approved by the Board of Directors should be in place. A Training/Learning set up to inculcate and sensitize the risk management culture in the organization on an ongoing basis.
- Information Technology department should be fully geared up for generating Management Information System ('MIS'). MIS plays a vital role in mitigation of risk. Strong internal control systems should be in place. Audit department of a Bank plays a significant role in this.

Stages of Risk Management

(1) *Risk Identification* : This is the first and the most important stage of risk management. The process starts with identifying the risks. Risk identification originates from where the problem starts. Risk identification can be objective based, scenario based, taxonomy based and common risk checking based. It will help the bank or any organization to take the corrective measures.

(2) *Risk Analysis (Risk Measurement or Quantification)* : It includes analyzing the risk and measuring its vulnerability and impact on the organization. Frequency and severity of the risk can be analyzed as well in this stage. Risk management can be both quantitative as well as qualitative. Numerically determining the probabilities of various adverse events and expected extent of losses if any unexpected event occurs, is termed as Quantitative Analysis whereas defining the various threats, devising counter-measures for mitigation and determining the extent of vulnerabilities is known as Qualitative Risk Analysis.

(3) *Risk Mitigation* : Only after properly analyzing the risk, a bank can decide as to how it can be controlled. If the risk can be controlled by in house efforts, it is well and good; it can also seek professional help from outside. Risk control is the entire process of procedures, systems, policies, an organization needs to manage prudently all risks which may arise.

(4) *Risk Transfer* : If the risk is not manageable, one cannot retain that risk; then we must transfer that risk to a third party. This is the stage where insurance comes into play. Insurance will be willing to take on those risks which the organization cannot handle. But it should also be understood that insurance alone is not a solution or a panacea for all risks.

(5) *Risk Monitoring* : Risk review is the last stage in which all the foregoing steps are evaluated. Review must be regular and on a continuous basis, as conditions and circumstances of the business as well as organizations are dynamic. It should be monitored to see that the desired results of risk management are achieved. If not, then identifying as to where the problem occurred and subsequently reviewing all stages and making changes in the management of risks according to the scenario.

Types of Risks :

Risks can be basically classified into two types, viz., Financial and Non-Financial Risks. Financial risks would involve all those aspects which deal mainly with financial aspects of the bank.

Credit Risk : It is also called as a default risk (borrower not meeting his obligations to pay instalments and or interest). It is prevalent in case of loans. A credit risk is the risk of default on a debt that may arise from inability of a borrower to make required payments as per commitments.

Market Risk : It is also called price risk. Market risk is the possibility of an investor experiencing losses due to external factors that affect the overall performance of financial markets. Sources of market risk include recessions, political turmoil, changes in interest rates, natural disasters, and terrorist attacks etc.

Interest Rate Risk : Interest Rate Risk arises when the Net Interest Margin of an institution is affected due to changes in the interest rates. IRR can be viewed in two ways—its impact is on the earnings of the bank or its impact on the economic value of the bank's assets, liabilities, and Off-Balance Sheet (OBS) positions.

Currency Risk : Currency risk is the risk where the fair value or future cash flows of a given financial instrument fluctuate as a result from changes in the currency exchange rates. Currency exchange rates can be subject to big and unexpected changes, and understanding and managing of the risk related to the currency exchange rates' volatility can be very complicated.

Operational Risk : This risk arises due to failed internal processes, people, system, or from external events. It includes number of risks such as—fraud, communication, documentation, competence, legal, compliance etc. However, it will not include strategic risk or reputational risk. Operational risk is "the risk of a change in value caused by the fact that actual losses, incurred for inadequate or failed internal processes, people and systems, or from external events (including legal risk), differ from the expected losses".

Strategic Risk : Strategic risks are those that arise from the fundamental/adverse decisions that directors take concerning an organization's objectives/improper implementation of decisions. Essentially, strategic risks are the risks of failing to achieve these business objectives.

Reputational Risk : It arises from negative public opinion about a bank/financial institution. It may lead to litigation, financial loss or decline in customer base.

Liquidity Risk : A Bank's inability to meet its payment obligations as and when they are demanded is known as Liquidity risk. Deposits of banks as liabilities and loans/advances as assets of the bank are the prominent items in a bank's balance sheet. Types of deposits held and the interest rates offered on them on the one hand and types of loans and advances sanctioned and interest rates charged on them on the other hand may not match. In view of this liquidity risk is encountered by the banks. It arises when bank funds long term assets by short term liabilities.

Political Risk : Political risk is the risk faced by investors, corporations, and governments due to political decisions of Governments, events, or conditions. This will significantly affect the profitability of a business or the expected value of an economic move. Political risk can be understood and managed with reasoned anticipation and investment.

 Contd. ....

Based on the above facts, answer the following questions :

(*a*) What is the role of 'Risk Management Committee' of the Board in a Bank ?

(*b*) How does Internal Audit help in managing risk in a Bank ?

(*c*) How does Reputation Risk affect Bank's business ?

(*d*) What is Capital to Risk Assets Ratio ? Does it affect Bank's stability ?

(*e*) Distinguish between Tier 1 and Tier 2 Capital.

(*f*) Do you think a stable Government is a positive factor in reducing Business Risks ?

(*g*) How can ALM Committee help in managing Risks in a Bank ?

(*h*) What is Risk Based Internal Audit ?

(*i*) Distinguish between Risk Transfer and Risk Mitigation

(*j*) How does RBI help Banks in managing Risks ?

(10×2=20 marks)

2. (*a*) Examine the origin and development of Small Industries Development Bank of India (SIDBI). Do you think SIDBI made radical changes in the growth and development of industries in India ?

(2+3=5 marks)

(*b*) "Reserve Bank of India (RBI) plays an important role for Issue and Management of Currency and Distribution of Coins in India". What is Currency Management ? Has the importance of RBI for managing currency has diminished with the advent of UPI and Digital Currencies ?

(3+3=6 marks)

(*c*) Maya Iyer is a Software Professional who availed a Term Loan of ₹ 50 lacs at an interest of 9% p.a. from Cosmos Bank, Cochin for buying a XYZ Brand Vehicle. The loan was taken on 15th February, 2020 repayable in 10 Years' EMIs and is against Hypothecation of the vehicle. She serviced the EMIs up to 15th June, 2022, promptly. However, she was laid off by the company in July, 2022 and lost her job. The EMIs could not be serviced thereafter. The loan became overdue.

Answer the following questions, with reference to the above situation, considering the Income Recognition & Asset Classification (IRAC) norms issued by RBI :

(*i*) When is the loan classified as Standard Asset ?

(*ii*) When will the loan be classified under SMA category ?

(*iii*) When will it fall under NPA category of Sub-standard Asset ?

(*iv*) Does it come under any other NPA category thereafter ?

(4×1=4 marks)

Attempt all parts of either Q. No. 3 or Q. No. 3A

3. (*a*) (*i*) RBI as the Central Bank of India, issues Licenses for Commercial Banks to open branches. Can Foreign Banks open branches in India ? If so, are there special conditions stipulated by RBI for licenses by a Foreign Bank ?

(2 marks)

(*ii*) ABC Ltd, an Indian company, applied to the Central Bank (RBI), for license to start banking operations in India. But RBI rejected the application. Can ABC Ltd appeal against this decision at a judicial forum ? Answer the question with reference to a decided case law.

(2 marks)

(*b*) Ashuthosh Mukherjee is a Civil contractor enjoying credit facilities at ABC Bank, Kolkata. He undertakes construction work on behalf of Central/State Governments, besides private projects. Bank sanctioned him the following limits as on 1st January, 2025.

Working Capital limits :

(1) Overdrafts (OD) of ₹ 100 Crores (Drawing Power-DP).

Primary Securities :

(I) Hypothecation of raw materials & work in progress, duly certified by civil engineers;

(II) Debtors (other than government departments).

Monthly Stock Statement is to be submitted by 7th of next month for calculating the Drawing Power. Mr. Ashuthosh follows FIFO method for stock consumption and old stocks of materials of more than 3 months are to be excluded from DP Calculation. Debtors Aged more than 90 days are also to be excluded for Drawing Power (DP) Calculation. Margin is 25%.

(2) Bill Discounting facility (BD) ₹ 50 crores (Against the bills drawn, on Government Departments)

(3) Term Loan (TL) ₹ 25 Crores for the Machineries, including Cranes/JCBs and other equipment purchased (Machineries are Hypothecated to the Bank)

In addition to the primary securities, Mr. Ashuthosh also furnished his landed properties worth ₹ 50 Crore as collateral securities to the Bank for the entire facility and his personal guarantee. As on 30th June, 2025, the balance outstanding on the above loan accounts at the Bank are as follows :

Overdraft—₹ 92 crores; Bills Discount—₹ 42 crores; Term Loan—₹ 23.75 crores.

Stock Statement as on 30th June shows the following particulars :

Value of Raw materials ₹ 100 crores, consisting of the following :

- Raw materials purchased on 20th January, 2025 was ₹ 4 crores and on 10th March, 2025 was ₹ 6 crores. Remaining Stocks were bought on different dates in May and June, 2025. Semi-finished work duly certified ₹ 20 crores. Creditors for materials outstanding is ₹ 10 crores.
- Work completed and certified by approved engineers ₹ 30 Crores (Work for Government Department worth ₹ 20 crores and Private Projects ₹ 10 crores) Bills raised on 30th June.

As the Stock Auditor appointed by the Bank, calculate the Drawing Power for Overdraft and Bills Discount Limits for July, 2025, available to Ashuthosh and ascertain whether the balance outstanding is within the eligible Drawing Power.

(2+2=4 marks)

(*c*) (*i*) How do Cyber Criminals use social network for committing online frauds ?

(1 mark)

(*ii*) Distinguish between :

(1) Hacker and Cracker

(2) Cyber-squatting and Cyber stalking.

(3) Phishing and Smishing.

(2×3=6 marks)

Or (Alternate Question to Q. No. 3)

3A. (*a*) Distinguish between Rural Banks and Co-operative Banks.

(*7 marks*)

(*b*) What are the documents required to open an account with Bank of Limited Liability Partnership ?

(*3 marks*)

(*c*) SWOC (Strength, Weakness, Opportunities, Challenges) analysis as perceived by the management while processing of Project Loans, banks have their own project parameters for long term funding. In the following cases, mention the parameters to be considered by bank :

(*i*) What percentage of total cost of project as Promoter's Contribution ?

(*ii*) What will be Debt Equity Ratio ?

(*iii*) What will be Fixed Asset Coverage Ratio ?

(*iv*) What will be Debt Service Coverage Ratio ?

(*v*) What is Internal Rate of Return ?

(*1×5=5 marks*)

PART–II

4. IRDAI Regulations on Investments

Insurance business is globally regulated for reasons of equity and efficiency. Insurance companies receive huge amounts of cash in the form of premiums. These premiums are again invested by Fund Managers as per the guidelines of the Insurance Regulatory and Development Authority of India (IRDAI). The investments are regulated as they are made from the money contributed by the policyholders.

Objectives of IRDAI Investment Regulations :

- Ensure prudential norms for investments
- Safeguard policyholders' funds
- Maintain solvency and financial discipline
- Promote diversification and reduce risk concentration

Major Provisions of IRDAI Investment Regulations :

(1) Investment Categories : IRDAI classifies investments into :

- Approved Investments—Safer instruments (e.g., govt. securities, AAA-rated bonds)
- Other Investments—Riskier investments (e.g., unlisted equity, lower-rated debt)

Minimum 75% of controlled funds must be in Approved Investments

(2) *Exposure Limits :* To avoid concentration risk :

- Max 10% of fund in a single company (Equity).
- Max 15% of fund in a single group (Equity + Debt).
- Sectoral limits also apply (e.g., Real Estate, Infrastructure)

(3) *Investment Pattern* : To spread the risk in investments there has to be a mixture of investments in government securities and other approved securities.

(4) *Derivative Instruments* : Permitted only for hedging purposes, not for speculation. IRDAI places strict controls on investments in derivatives.

(5) *Foreign Investments* : Insurers may invest in foreign assets, subject to a cap (e.g., 5% of controlled fund). Only in approved jurisdictions and instruments, investments were permitted and detailed disclosure and prior approval is mandatory.

(6) *Corporate Governance* : All insurers must have a Board-approved Investment Policy with a Chief Investment Officer (CIO) to monitor and for regular reporting to IRDAI on Monthly, Quarterly, and annual basis, the details of exposure, compliance, default, ratings. The Corporate governance involves the following in a well-managed Insurance Company :

(A) **Constitution of Investment Committee :** Every insurer shall constitute an Investment Committee which shall consist minimum of two non-executive directors of the Insurer, the Chief Executive Officer, Chief of Finance, Chief Risk Officer, Chief of Investment division, and the Appointed Actuary. The Board of the Insurer shall ensure that Chief of Finance, Chief of Investment and the Chief Risk Officer, shall fulfil the minimum qualification requirements specified in the regulations/guidelines issued by the Authority. The decisions taken by the Investment Committee shall be recorded and be open to inspection by the officers of the Authority.

(B) **Investment Operations :**

(*i*) The funds of the insurer shall be invested and continued to be invested in equity shares, equity related instruments and debt instruments rated by a credit rating agency, registered under SEBI (Credit Rating Agencies) Regulations, 1999. The Board shall lay down norms for investing in 'Other Investments' as specified in section 27A(2) of the Insurance Act, 1938 by the investment committee, considering the safety and liquidity of the policyholders' funds and protection of their interest.

(*ii*) To ensure proper internal control of investment functions and operations the insurer shall clearly segregate the functions and operations of front, mid and back office and no function falling under Front, Mid and Back Office Investment function(s), shall be outsourced. Also, the primary data server of the computer application used for investment management shall remain within the country.

(*iii*) The Board of the Insurer shall appoint a Custodian to carry out the custodial service for its Investments, who shall not be an entity under its promoter 'Group' unless permitted otherwise by the Competent Authority.

(C) **Risk Management Systems and Its Review :**

(*a*) The Board shall implement the Investment Risk Management Systems and Process, mandated by the Authority. The implementation shall be certified by a Chartered Accountant firm, as per the procedure laid down in the "Guidance note on Review and Certification of Investment Risk Management Systems and Process of Insurance Companies", issued by the Institute of Chartered Accountants of India, as amended from time to time.

(*b*) The Investment Risk Management Systems and Process shall be reviewed once in two financial years or such shorter frequency as decided by the Board of the Insurer (the gap between two such audits should not be more than two years), by a Chartered Accountant firm and file the certificate issued by such Chartered Accountant, with the Authority along with the first quarter returns.

(*c*) The appointment of Chartered Accountant firm to certify implementation and review of Investment Risk Management Systems and Process shall be as per the circular issued under these regulations.

(D) **Miscellaneous :**

The Board of the Authority may, by any general or special order, modify or change the policy subject only to the provisions of the governing regulations.

Based on the above passage, answer the following questions :

(*a*) It is said that insurance companies should make their investments very prudentially. Why ?

(*b*) Why are investments in derivative instruments risky ?

(*c*) What is the role of a Chief Investment Officer in an Insurance Company ?

(*d*) The Investment Committee must guard against insider trading. What are the harmful effects of insider trading ?

(*e*) Who shall review the investment risk management system of the insurance company ?

(*f*) What is liquidity risk in insurance business ?

(*g*) How can internal control of insurance investments be ensured ?

(*h*) Which are the rating agencies competent to rate the investments of insurance companies ?

(*i*) What are money market instruments suitable for investments by insurance companies ?

(*j*) Is periodical reporting to IRDA an important requirement to ensure investment discipline of the insurance company ?

(10×2=20 marks)

5. (*a*) There are some principles on which Insurance Act and Rules framed. What do you know about :

(I) Principle of 'Maxim of Causa Proxima'.

(4 marks)

(II) Principle of Subrogation.

(4 marks)

(*b*) Every Insurance company charge premium while issuing the Insurance Policy. In such a case it had been seen that they charged loading charges on premium. What do you mean by loading charges and what are the factors that can lead to loading charges ?

(7 marks)

Attempt all parts of either Q. No. 6 or Q. No. 6A

6. (*a*) Explain the provisions regarding prohibition of rebates in insurance as per Insurance Act, 1938.

(*4 marks*)

(*b*) Dileep Sharma has an insurance policy with Active Insurance Ltd. His car got damaged in an accident caused by another vehicle of Raja, whose vehicle is insured with Robust Insurance Co. Ltd. Dileep incurred an expenditure of ₹ 25,000 for repairs of his car, which he claims and receives from Active Insurance Ltd.

In this situation, answer the following :

(1) Under what legal principle does Active Insurance Ltd have the right to pursue Robust Insurance Co. Ltd or Raja for the cost of the repairs ?

(2) What are the key elements that must be present for this principle to apply in this situation ?

(3) What are the potential benefits of this principle for both the insurer and the insured ?

(4) Can this principle be waived by contract ? If so, how ?

(4 *marks*)

(*c*) "Insurance is a form of contract or an arrangement where one party agrees in return for a consideration to pay an agreed amount of money to another party to make good the loss, damage or injury to something of value in which the insured has an interest."

Do you think insurance has a role to play in nation's economic development ? Explain.

(4 marks)

(*d*) What is the role of an insurance broker ? Distinguish between Direct broker and Composite broker.

(1+2=3 marks)

OR (Alternate question to Q. No. 6)

6A. (*a*) As per the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, it is mandatory for the Listed Companies to undertake Directors and Officers Insurance for its Independent Directors. You are the Company Secretary of ABC Ltd. The MD&CEO of the company desires to know about the Directors and Officers Liability Policy.

Write a brief note about Directors and Officers Liability Policy.

(*3 marks*)

(*b*) You are an underwriter at a life insurance company. A proposal is received for a ₹ 50 lakh term life insurance policy, from a 35-year-old highly paid software engineer. He works with a leading software company. He is non-smoker, married with two children. He does not have any known bad habits. Medical exams and lab tests were completed as part of the underwriting process and shows the following details :

- BMI : 35 (obese)
- Blood pressure : Slightly elevated (150/90)
- Cholesterol : Within normal limits
- No known chronic illnesses.
- Family history : Father died of a heart attack at age 50; mother is alive and is of good health.
- Engages in trekking twice a year.

Based on the above situation :

(*i*) Identify *three* risk factors in this application that may affect the underwriting decision.

(*ii*) What will be a likely underwriting decision (e.g., standard, rated, postpone, decline) ? Justify your recommendation.

(*iii*) Suggest any additional information or medical tests you may request before making a final decision.

(*1+1+2=4 marks*)

(*c*) Trust Well Insurance Company, Mumbai entered a reinsurance contract with Maxwell Insurance, Dubai with the following details :

Quota of Insurance Business Share : 60%, Ceding Commission = 30% of Ceded Premium, Gross Premium = ₹ 2 crores and Gross Claims = ₹ 1.20 Crores.

Calculate :

(*i*) Ceded Premium and Claims.

(*ii*) Reinsurer Commission.

(*iii*) Net Underwriting result for the Insurer.

(*1+1+2=4 marks)*

(*d*) BISMI Electronics is a medium-sized business that sells electronic appliances and gadgets. They hold significant stock in their showroom and warehouse located in an urban commercial area of Delhi. On 10th June 2025, a burglary occurred at night at the godown. Thieves broke in after disabling the alarm system & CCTV and stole inventory worth ₹ 15,00,000.

The company has a Burglary Insurance Policy in place with XYZ Insurance Co., with the following terms :

Sum Insured : ₹ 20,00,000; Policy Type : Declaration Policy (Stock Value Declared Monthly); Monthly Declared Value for June 2025 : ₹ 12,00,000; Policy Excess (Deductible) : 5% of the Claim Amount

Exclusions *:* Loss due to Employee Involvement, Losses without forcible entry, and under-insurance clause applies.

Upon investigation, the insurer discovered the following :

(*a*) There were signs of forcible and violent entry.

(*b*) No evidence of employee involvement.

(*c*) The actual value of stock at risk on the date of the burglary was ₹ 15,00,000.

(*d*) The loss assessed and approved was ₹ 15,00,000.

In view of the above information answer the following questions :

(*i*) Calculate the claim payable by the insurer after applying all relevant policy terms.

(*ii*) Whether under-insurance applies in this case or not ?

(*iii*) What key documentation would be required to process this claim ?

(1+1+2=4 marks)

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