THE CATHOLIC UNIVERSITY OF EASTERN AFRICA

A. M. E. C. E. A

MAIN EXAMINATION

JANUARY – APRIL 2017 TRIMESTER

FACULTY OF COMMERCE

DEPARTMENT OF ACCOUNTING AND FINANCE

EVENING / REGULAR PROGRAMME

CFI 312: RISK MANAGEMENT

Date: April 2017	Duration: 2 Hours

INSTRUCTIONS: Answer Question ONE and any other TWO Questions

Q1. Jumbo Airlines was recently incorporated in Kenya to offer low cost air travel within the East African Region. You have been appointed the risk manager of the airline.
Required:

a) Explain to the management what your role is as the risk manager.

(6 marks)

b) Explain the steps you will go through in the risk management process.

(6 marks)

c) Identify the specific business risks facing the airline. **(12 marks)**

d) Recommend risk controls for the risks. **(6 marks)**

Q2. a) The three major risk management methods include loss control, loss financing and internal risk reduction. Discuss. **(12 marks)**

b) Explain how risk creates an economic burden. **(8 marks)**

Q3. Write notes on the following
a) Levels of risk **(5 marks)**
b) Moral hazard and Morale hazard **(5marks)**
c) Credit risk **(5 marks)**
d) Longevity risk **(5 marks)**

ISO 9001:2008 Certified by the Kenya Bureau of Standards

Q4. The following are probability distributions for two companies, Alpha and Beta. Jackie has an opportunity to invest $40,000 in either company or invest in a portfolio of the two companies (60% in Alpha and 40% in Beta). Alpha performs best in wet and cold weather while Beta performs best in dry and moderate weather conditions.

Weather Condition	Probability	Return - Alpha	Return- Beta
Wet	0.25	35%	-8%
Cold	0.25	15%	5%
Moderate	0.25	6%	12%
Dry	0.25	-10%	30%

Required:
a) Explain the process of distributing your funds among different investments. **(2marks)**

b) Identify the relationship between Alpha and Beta and give two examples of companies familiar to you. **(4 marks)**

c) Show through calculations which investment is more risky, Alpha or Beta. **(7 marks)**

d) Calculate the standard deviation of the portfolio and interpret your answer. **(7 marks)**

Variance = $\sum_{i=1}^{n} p_i (x_i - \mu)^2$

Standard Deviation = $\sqrt{\sum_{i=1}^{n} p_i (x_i - \mu)^2}$

Cov $(R_A, R_B) = \sum_{i=1}^{n} (R_A - \bar{R}_A)(R_B - \bar{R}_B) p_i$

$\sigma_p = \sqrt{a^2 \sigma_A^2 + (1-a)^2 \sigma_B^2 + 2a(1-a)Cov(R_A, R_B)}$

END