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CHAPTER 53

INTRODUCTION TO RISK MANAGEMENT

1. (C) **interactions among different risks.**

   Explanation

   The various financial and non-financial risks interact in many ways. A risk management process should consider these interactions among risks rather than treating them each in isolation.

   (Study Session 18, Module 53.1, LOS 53.f)

   Related Material

   SchweserNotes - Book 5

2. (A) **beta.**

   Explanation

   Beta measures the market risk of an asset or portfolio. Duration measures the interest rate sensitivity of the value of a fixed-income security or portfolio. Rho measures the interest rate sensitivity of the value of a derivative.

   (Study Session 18, Module 53.1, LOS 53.g)

   Related Material

   SchweserNotes - Book 5

3. (C) **The financial strength of an organization is one of the factors it should consider when determining its risk tolerance.**

   Explanation

   Financial strength is an important factor in an organization's risk tolerance because it reflects the organization's ability to withstand losses. Even if its risk tolerance is low, an organization may choose to bear some risks that are consistent with achieving the organization's objectives. Risk tolerance includes risks that arise from within the organization as well as risks from outside.

   (Study Session 18, Module 53.1, LOS 53.d)

   Related Material

   SchweserNotes - Book 5

4. (A) **the organization's risk tolerance.**

Explanation

Risk governance begins with determining the organization's overall risk tolerance. (Study Session 18, Module 53.1, LOS 53.c)

Related Material

SchweserNotes - Book 5

5. (A) **credit risk, market risk, and liquidity risk.**

Explanation

Credit risk, market risk, and liquidity risk are examples of financial risk. Solvency risk and tax risk are classified as non-financial risks.

(Study Session 18, Module 53.1, LOS 53.0

Related Material

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6. (C) **human error or faulty processes will cause losses.**

Explanation

Operational risk arises from faulty processes or human error within the organization. Solvency risk is the risk that the organization will run out of cash and therefore be unable to continue operating. Tail risk is the risk that extreme events are more likely than the organization's managers have assumed.

(Study Session 18, Module 53.1, LOS 53.f)

Related Material

SchweserNotes - Book 5

7. (B) **disciplining managers who exceed their risk budgets.**

Explanation

Corrective actions against individuals are not specifically part of a risk management framework. Features of a risk management framework include establishing risk governance policies, determining risk tolerance, identifying and measuring risks, managing or mitigating risks, monitoring exposures to risks, performing strategic risk analysis, and communicating risk levels through the organization.

(Study Session 18, Module 53.1, LOS 53.b)

Related Material

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8. (B) **identify the risks faced by an organization.**

Explanation

The risk management process should identify an organization's risk tolerance, identify the risks it faces, and monitor or address these risks. The goal is not to minimize or eliminate risks.

(Study Session 18, Module 53.1, LOS 53.a)

Related Material

SchweserNotes - Book 5

9. (C) tail risk.

Explanation

VaR and Conditional VaR are measures of tail risk, the probability of or magnitude of extreme negative outcomes in the tail of a distribution.

(Study Session 18, Module 53.1, LOS 53.g)

Related Material

SchweserNotes - Book 5

10. (A) scenario analysis.

Explanation

Scenario analysis involves modeling the effects of changes in multiple inputs at the same time. Stress testing examines the effects of changes in a single input. Risk shifting refers to managing a risk by modifying the distribution of outcomes.

(Study Session 18, Module 53.1, LOS 53.g)

Related Material

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11. (C) transfer a risk.

Explanation

Buying insurance transfers a risk to the insurance company. Shifting a risk is changing the distribution of outcomes, typically with a derivatives contract. Preventing a risk refers to taking steps such as strengthening security procedures.

(Study Session 18, Module 53.1, LOS 53.g)

Related Material

SchweserNotes - Book 5

12. (B) Model risk.

Explanation

Model risk is an example of a non-financial risk. Other examples include operational risk, solvency risk, regulatory risk, governmental or political risk, legal risk, tail risk, and accounting risk. Financial risks include credit risk, liquidity risk, and market risk.

(Study Session 18, Module 53.1, LOS 53.f)

Related Material

SchweserNotes - Book 5