ALMA

ASSET & LIABILITY MANAGEMENT ASSOCIATION

Practice Paper

Certificate of Banking Asset & Liability Management (CertBALM®)

Units 2-3 Practice Paper

For ACT Surpass System

produced October 2020 from past exam

Practice Paper for Units 2-3 of the Certificate of Banking Asset & Liability Management (CertBALM®)

Available on the ACT Surpass System to practice use of the System

Introduction

This practice paper has been produced by the Education Board of the Asset & Liability Management Association (ALMA), in partnership with the Professional Standards team the Association of Corporate Treasurers (ACT), to assist students in their preparation for the CertBALM® assessments. It contains a practice exam for the specified units as well as specimen answers.

Ideally, students should have completed the majority of their CertBALM® studies for Units 2 and 3 before attempting this practice paper. Students should allow themselves 180 minutes to complete the exam. They should then review their performance to identify areas of weakness on which to concentrate the remainder of their study time.

Although the practice exam in this guide is typical of a CertBALM® assessment, it should be noted that it is not possible to test every single aspect of the syllabus in any one particular exam. To prepare properly for the examination, candidates should make full use of the tuition options where available and read as widely as possible to ensure that the whole syllabus has been covered.

Assessment technique: CertBALM®

This paper is a professional paper that, as well as testing theory, expects application to practice at an operational level.

The best way to approach written assessments is to work methodically through the questions.
Candidates should not spend too much time on any one question if you are struggling to think of an adequate answer. Remember, you can flag any question to come back to later should you want to continue your way through the exam.

When all of the questions have been answered, it is prudent to use any remaining time to go through each question again, carefully, to double-check that nothing has been missed. Altering just one response could make the difference between passing and failing.

Please ensure you show your workings within your answer when prompted as this means there are marks available for the workings out. You will be able to make rough workings on a piece of paper during the exam and on screen should you wish to, however these will not count towards your final mark.

Assessment information

The CertBALM® assessments for both Units 2 & 3 as well as 4 & 5 each consist of 15 written questions, split into sections A, B and C; each assessment is worth a total of 100 marks.

CertBALM® assessment test specification:

Section	Amount of questions	Marks available	Question format
Section A	5 short form questions	10	This section will test a cross-section of knowledge to achieve breadth of syllabus coverage.
Section B	6 longer form questions	30	This section will test knowledge, analysis, application and justification as appropriate.
Section C	4 longer form questions	60	This section will be based on mini-scenarios common to practice. Questions will test knowledge, analysis, application and justification as appropriate
Total	**15**	**100**	

Under exam conditions, **3 hours** (180 minutes) is allowed for the CertBALM® assessments as well as 15 minutes reading time.

When you take your actual exam, you will be sitting online using your own PC/Laptop.

In order for you to determine as to how well you have performed, exemplar answers are listed at the end of this paper. There are also references to the relevant Learning Outcomes if you need to revisit the associated material.

Section A – 10 marks

This section consists of 5 short form questions

1. Define the meaning of the term "gearing" in the context of capital structures.

(2 marks)

2. In the context of credit risk, define 'expected loss'. Include in your answer the 3 components of the expected loss formula.

(2 marks)

3. Identify FOUR components of an effective ICAAP document.

(2 marks)

4. Describe the term 'liquidity maturity mismatch' within a bank and provide an example of how it might arise.

(2 marks)

5. Outline TWO characteristics of liquid assets.

(2 marks)

Section B – 30 marks

This section consists of 6 longer form questions

6. Explain the main techniques for managing short-term liquidity risk within a major global bank.

(5 marks)

7. Explain FIVE quantitative regulatory drivers of liquidity risk.

(5 marks)

8. Major banks use behavioural methodologies to manage their contractual liquidity and funding mis-match. Explain FIVE drivers that might impact the behaviour in either wholesale markets or by individuals.

(5 marks)

9. Explain the purpose and requirements of the '3 pillars' in capital management.

(5 marks)

10. Recovery planning is a vital part of bank asset and liability management. What is the minimum number of scenarios, and outline those scenarios, that should be included within the recovery plan? In addition outline FOUR Early Warning Indicator sections of a recovery plan. For each of those FOUR sections chosen, discuss, briefly, a quantitative early warning indicator.

(5 marks)

11.

a) Discuss the difficulty in calculating exposure at default (EAD) for an interest rate swap portfolio (where the bank is predominantly in a Pay Fix/Receive Float position).

(3 marks)

b) Explain TWO ways of mitigating this risk without unwinding the swaps.

(2 marks)

(Total 5 marks)

Section C – 60 marks

This section consists of 4 longer form questions

12. You have been asked to calculate the Common Equity Tier 1 capital ratio and Total Capital Ratio for your EU-based bank. The Total Capital Ratio is defined as:

(CET1 + AT1 + T2) / RWA

where: CET1 = Common Equity Tier 1 capital, AT1 = Additional Tier 1 capital, T2 = Tier 2 Capital and RWA = Risk Weighted Assets

You have been provided with the necessary information for these ratio calculations, which has been included in the two tables below:

Table 1 – Credit Risk

Exposure Type	RWA assessment approach	Exposure at Default** €m	Risk Weight %	Risk Weighted Assets €m	Expected Loss *** €m	Provisions * €m
Sovereign	Standardised	12,632	3%	379	-	0
Corporate	Standardised	13,553	80%	10,842	-	197
Financial Institutions	Standardised	1,053	50%	527	-	2
Retail Residential Mortgages	Internal Ratings Based	44,079	14%	6,171	237	203
Other Retail	Internal Ratings Based	6,974	65%	4,533	145	59
Other Assets	Standardised	1,842	75%	1,382	-	0
Total		80,133		23,834	382	461

Notes
* Provisions are classified as Specific Provisions (also known as Specific Credit Risk Adjustments)
** Exposure At Default values shown in the table include adjustments for Standardised exposures from Provisions (Specific Credit Risk Adjustments)
*** For defaulted assets Expected Loss values are greater than Provisions (Specific Credit Risk Adjustments) for all exposure types

Table 2 – Other RWA and Capital Resources

Capital Resources	**€m**
CET 1 Capital Instruments and related share premium accounts	2,477
Retained Earnings	772
Accumulated other comprehensive income and other reserves (including unrealised gains and losses)	1,172
Foreseeable Ordinary share dividend	-210
Common Equity Tier 1 regulatory Adjustments, excluding Negative amounts resulting from the calculation of expected loss amounts - adverse impact to CET	-1,335
Additional Tier 1 capital	730
Tier 2 Capital	954
RWA	**€m**
Market Risk and Counterparty Risk RWA	393
Operational Risk RWA	3,162
CVA RWA	119
Other Items	**€m**
Cap on inclusion of Provisions (Specific Credit Risk Adjustments) in Tier 2 capital under internal ratings-based approach	64

Table 1, containing the information necessary to calculate Credit Risk RWA, and the impact to CET1 for Internal Rating Based (IRB) modelled exposures of Expected losses and Provisions. All Provisions are classified as CRD IV Specific Credit Risk Adjustments.

Table 2, containing the RWA levels for all other risk types and capital resources information.

a) Using the information provided in Table 1, and showing your workings, calculate the CET1 negative amounts resulting from the calculation of expected loss amounts, which is equal to the value of Expected Loss minus Provisions for IRB exposures.

(1 mark)

b) Using your answer from part (a), Credit Risk RWA from Table 1 and the information in Table 2 calculate the CET1 ratio and Total Capital Ratio. You are required to show all workings.

(3 marks)

c) Your manager is interested in the potential impact of provision increases on capital ratios, as the implementation of expected loss-based provisioning under the IFRS 9 accounting standard is expected to have an adverse effect. She has provided the following guidance on how the provision increases will impact elements of capital ratio calculations:

- The tax effects of any provision increases will reduce the overall corporate tax payable in the current year, and consequently when provisions are raised the corresponding reduction in reserves will be on a net of tax basis. The reduction in reserves will diminish the bank's CET1 capital.

- For exposures using the Standardised approach, the increase in provisions will reduce the Exposure at Default by a corresponding amount.
- For exposures using the IRB approach, any excess of provisions above expected loss for the bank is treated as Tier 2 capital. There is however a cap on the amount of contribution of these excess provisions to Tier 2 capital, and this value is included under 'Other Items' in Table 2.

i) Estimate the reductions to the CET1 Ratio and Total Capital Ratio assuming the level of provisions for every exposure type in Table 1 is increased by 100% (i.e. provisions double in size). Use a tax rate of 25% when assessing the impact of provision rises on reserves. You are required to show all workings.

(8 marks)

ii) Outline 3 reasons why a bank's CET1 ratio is likely to decrease as a consequence of the increase in level of provisions resulting from the implementation of the IFRS 9 accounting standard.

(3 marks)

(Total 15 marks)

13. You have recently joined a newly established UK bank and have been asked to establish an ICAAP process for your bank.

The CFO of the bank has asked you to provide her with information about the ICAAP process, so she can prepare a presentation for the Board on the ICAAP. She has asked a set of questions and would like an answer to each of these.

a) Discuss the main objectives of a bank's ICAAP.

(4 marks)

b) Describe the key elements of the Capital Plan, which is included in an ICAAP.

(4 marks)

c) Identify TWO differences between sensitivity analysis to a Capital Plan and stress testing of a Capital Plan.

(2 marks)

d) Explain THREE Pillar 2A risk types which are not covered by Pillar 1 that need to be considered for an ICAAP.

(3 marks)

e) Discuss what is meant by a Pillar 2B Risk.

(2 marks)

(Total 15 marks)

14. Mette is a treasury analyst working at Overseas Bank. Mette has been provided with transactional information about recent funding trades. The head of ALM of Overseas Bank has asked Mette to bucket these data using the Excel cash ladder provided. The head of ALM has noted the large amount of short-term funding and has asked Mette to comment.

The following data were provided to Mette by the regulatory reporting team as at 1 November 2016. The team has reminded her that settlement date accounting is used for all transactions provided:

Item	**Amount (EUR, millions)**	**Trade Date**	**Settlement Date**	**Maturity Date**
Corporate term deposit (credit)	-129	31/08/2016	31/08/2016	30/11/2016
Corporate current account (credit)	-190	01/11/2016	01/11/2016	None
Repurchase agreement with bank	-210	11/08/2016	15/08/2016	11/04/2017
Tier 2 perpetual subordinated debt	-250	01/09/2016	05/09/2016	None
TLAC-eligible 5yr Note	-250	01/09/2016	05/09/2016	01/09/2021
Repurchase agreement with NBFI	-275	01/11/2016	04/11/2016	05/12/2016
Repurchase agreement with bank	-425	30/08/2016	01/09/2016	None
Deposit from bank	-1100	01/11/2016	01/11/2016	02/11/2016

a) Construct a cash flow report from the data above, using the Excel workbook provided.

FOR STUDENT_Live Assessment Unit 3 S

(Note: Liabilities should be presented as negative numbers)

(10 marks)

b) Discuss how operational complexity might make contractually short-term funding less likely to be withdrawn in practice.

(5 marks)

(Total 15 marks)

15. You have just started working at Challenger Bank, a recently incorporated low-risk retail bank with a BBB rating, focused primarily on providing residential mortgages, savings and credit cards to its customers in the UK.

Previously you worked for a large universal bank, where you were the head of the Individual Liquidity Adequacy Assessment Process (ILAAP). You have been hired as the Treasurer. Challenger Bank has been informed by the regulator that its current liquidity and funding framework is not fit for purpose. The regulator has reminded Challenger Bank of the Overall Liquidity Adequacy Rule that underpins its prudential regulation of liquidity and funding within the banking industry, i.e. that *'a bank must, at all times, maintain liquidity resources which are adequate, both as to amount, and quality, to ensure there is no significant risk that its liabilities cannot be met as they fall due.'*

a) Recommend a basic governance arrangement for the bank including,
   - a risk appetite statement;
   - an outline of what this looks to achieve; and
   - what/whom influences that statement.

(5 marks)

b) Recommend both a basic liquidity and funding metric (other than LCR and NSFR) that the Board could use within the risk appetite that best reflects the nature and risks within the balance sheet. Include within your answer an outline of FIVE key roles of such metrics.

(7 marks)

c) Given your previous knowledge of the ILAAP advise Challenger Bank of a number of other areas of the liquidity and funding framework that you consider should be designed and documented and outline why these are important for the bank.

(3 marks)

(Total 15 marks)

Specimen guide: Answers and references to relevant unit and learning outcome

Question No.	Syllabus ref:	Exemplar answers
1	Unit 2 LO3	Answers could refer to the following: - • Use of lower quality capital (non CET1) in the capital structure • More AT1 or T2 in capital structure • Designed to improve Return on Equity • Can add to volatility of returns The list is not exhaustive, i.e. other points might also be valid and would be rewarded. One mark per point made, maximum two marks.
2	Unit 2 LO5	• Expected loss = the loss a bank expects to happen. Primarily applies to credit risk, factored in to loan pricing so no capital required. • The formula is EL= PD X LGD X EAD (PD = probability of default; LGD = loss given default; EAD= exposure at default). One mark for definition and one mark for the formula.
3	Unit 2 LO22	Any of the following could be included within an ICAAP (Internal Capital Adequacy Assessment Process): • Business Model Description and Strategy • Governance Framework • Risk Appetite Framework (RAF) • Risk Data Aggregation Data Quality, IT issues and concerns • Material Integrated Risk Assessment (MIRA) or describe as Risk Measurement, Assessment and Aggregation • Capital Plan • Stress Test • Disclosure description The list is not exhaustive, i.e. other points might also be valid and would be rewarded. • Half a mark for each component identified, maximum two marks.
4	Unit 3 LO1	Definition terms include: • Lending Long/Borrowing Short • Long term assets funded by shorter term borrowing • Contractual maturity difference between assets and liabilities The list is not exhaustive, i.e. other points might also be valid and would be rewarded. Example: -

		• Giving a mortgage for 25 years (or any other long term asset) to a customer and funding this with a retail/corporate/wholesale liability that has a contractual maturity shorter than the assets they are funding. One mark for the description and one mark for a suitable example.
5	Unit 3 LO2	There are a wide range of points which could be used to describe the characteristics, including: - • "flight to quality" • Assets that maintain their price under a general market disequilibrium/stress • High quality rating/Credit quality step (CQS) • Ease & certainty of valuation • Low correlation with risky assets • Low price volatility • Low bid/offer spread • Large/varied number of participants in market • Can be used at a central bank • Many market makers The list is not exhaustive, i.e. other points might also be valid and would be rewarded. One mark per point described, maximum two marks.
6	Unit 3 LO9	Answers are likely to address some of the following: • Having a liquid asset buffer manages the liquidity risk • Terming out liabilities to longer dated • "Ring fencing the buffer" which would be managed by Treasury, or letting every different trading desk have assets and then having service level agreements between them and Treasury • Students might talk about a shorter maturity term of assets in the liquidity buffer being better • Students might talk about higher quality deposits being better, so moving from a wholesale short dated funded liability base to a retail funded liability base • Getting better relationships with your liability providers • If students talk about cash placed at a central banks being better than other liquid assets then • If students mention managing concentration risk in their short dated liability base then The list is not exhaustive, i.e. other points might also be valid and would be rewarded. One mark per point explained, maximum five marks

7	Unit 3 LO19	Any five of the following: • Retail - Outflows of deposits under stress. Causes of which are: size of deposit, channel, guarantee size, maturity, product type, customer type, level versus deposit guarantee scheme • Wholesale secured - increased margin for collateral price movements or counterparty risk • Wholesale unsecured - risk or deposit being removed, not rolled over of required to be collateralised. Stickiness caused by deep relationships, location (on-shore is better), term of deposit with longer being better • Concentration - metrics assume portfolio effects, so if concentration this invalidates the metric. Concentrations should be considered in markets, currency, instrument type and currencies • Off-balance sheet - increased risk of additional assets/outflows caused by. Derivatives, contingent liabilities, commitments (liquidity and funding), facilities to vehicles. • Funding tenors - This is the risk that the legal maturity of a liability will move because of a market index or an option built into the contract • Credit rating - This is both risks from clients removing their deposit from the bank and also connected to derivatives on downgrade (AIG risk) • Cross-currency - The risk that the FX swap market does not work, so one currency is not able to be swapped for another, you would then require to have capacity to lend and borrow in those respective currencies • Transferability - it may not be possible to move cash fluently around a group because of regulatory or legal constraints • Funding risks from asset growth - this is the risk that there are plans to increase assets in excess of the ability to the appropriate liabilities to back those assets • Franchise risk - Ensuring that under stress you do not just survive, but survive in a state which means you can recover • Marketable asset risk - Ability to sell, repo or place with a central bank. Points to consider are haircuts, operational capacity and time to monetise • Non-marketable asset risk - The risk that these methods or monetisation are not reliable, these methods being securitisation, covered bond monetisation. The other is natural inflows, which may need to be rolled over, delayed or default • Internalisation - is within prime broker units. It is the funding of one client's long with another client's short, there is efficiencies here that can be lost under stress • Intraday - This is the amount of cash/collateral that banks need to run the payments system. Mentioning of timed payments One mark for each driver explained, maximum five marks.
8	Unit 3 LO12	Drivers include: • Concern over the solvency of an institution (lack of capital and risk of losses to the depositor, both wholesale and retail), but more likely wholesale • Concern over the liquidity of an institution • Changes to the solvency of the government, so if retail depositors do not believe the compensation scheme provided by the government has any worth then they will migrate to the nearest flight to quality asset • A change in the credit rating of the bank e.g. downgrade • Any references to "time subordination" and the fact that it can be entirely rational to join the queue when a bank run is happening

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Concerns caused by “social media”, possibly by payments problems at the bank
Reputational risk- clients may change banks if they perceive their bank to be untrustworthy (rigging markets, ripping off customers, money laundering etc.), possibly indicated by the regulator
Changes to taxes (e.g. if ISA tax rules were changed, so people would change account)
Changes to interest rates (clients move to different accounts)
Changes to product offerings (new better types of accounts)
Changes in Capital controls (redenomination risk, e.g. as seen in Cyprus, Greece and Argentina)

The list is not exhaustive, i.e. other points might also be valid and would be rewarded.
One mark per point explained, maximum five marks.
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<tr><td>9</td><td>Unit 2
LO10</td><td>

Pillar 1 = Minimum Capital Requirements set by regulations (or can specify CRR/CRD IV)
Pillar 1 Three Risks

Credit Risk
Market Risk
Operational Risk

Regulatory Minimum levels: -4.5% CET1, 6% Tier 1 and 8% Total Capital before buffers
Pillar 2 = Supervisory Assessment

Must refer to ICAAP for any marks to be awarded
Must include 1 of the following also
Pillar 2 Assessment
SREP
Risk not adequately captured under Pillar 1
“Other Risk” types not covered at all by Pillar 1

Pillar 3 = Market Discipline

Qualitative and Quantitative Disclosure of how a bank measures and manages risk (should mention market disclosure)

The list is not exhaustive, i.e. other points might also be valid and would be rewarded.
One mark per point explained, maximum five marks.
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<tr><td>10</td><td>Unit 2
LO27,
LO28</td><td>

A Recovery plan must be tested against a minimum of 3 scenarios – name/institution specific, market-wide stress, combined name and market stress
Any four of the following with a suggested indicator for each

Capital- CET1%, Total Capital%, Leverage Ratio%
Liquidity- LCR, NSFR, LT Funding target, Liquidity Surplus under stress scenarios, Survival horizons, funding mix measures
Asset Quality- Non Performing Loans, Days Past Due % of book, Impairment levels, Provision coverage
Profitability- ROE%, PBT target, NII growth
External Market Indicators- Share Price, CDS Spreads, Ratings (downgrades or watch)

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Macroeconomic Indicators- GNP/GDP, House Price Indices, Inflation, Government finances e.g. indebtedness
One mark for scenarios and one each for the indicators, maximum five marks.
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<td>11</td>
<td>Unit 2
LO18</td>
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a) Answers are likely to include:

Variability of the exposure over time; and
Include reference to Mark to Market/Replacement Cost and Potential Future Exposure
A swap book where the Pay Fixed Rate Of Portfolio > Current market Fixed Rates will cause a negative mark to market/Replacement cost. Vice Versa means have credit risk on other counterparty i.e. that your Fixed Rates < Current Fixed Rates
A single swap where Fixed Rate = Floating Rate at start and then as rates rise, my pay fix position becomes more valuable to me and I have credit risk.

The list is not exhaustive, i.e. other points might also be valid and would be rewarded.
One mark per point outlined, maximum three marks.
b) The options to reduce the risk are: -

Netting- Bank A and Bank B enter a netting agreement so that payments reduced to the net settlement between the two.
Margining- posting collateral by a bank for the change in MTM between the two banks.
Moving to a Central Counterparty (CCP)

One mark for each method, maximum two marks
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<tr>
<td>12</td>
<td>a) Unit 2
LO5, LO4

b) Unit 2
LO18

c) Unit 2
LO5
L026</td>
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a)
<table>
<tr><td>CET1 Negative amounts resulting from the calculation of expected loss amounts</td><td></td><td></td></tr>
<tr><td>Expected Loss</td><td>382</td><td></td></tr>
<tr><td>Provisions - IRB portfolios only</td><td>262</td><td></td></tr>
<tr><td>Expected Loss Less Provisions</td><td>120</td><td>1 mark</td></tr>
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b) Capital Ratios

CET1 - sum of capital and reserves elements for CET1 as provided in Table 2	2,876	
EL-P -from Part a)	-120	
Total CET1	2,756	1 mark
Total Capital - CET1 plus provided results for AT1 and T2	4,440	½ mark
Total RWA - add Credit Risk RWA from part a) to Table 2 RWA results	27,508	½ mark
Ratios		
CET1 - CET1/ RWA	10.02%	½ mark
TC - Total Capital / RWA	16.14%	½ mark

c)

i) impact of Increase in Provisions

Calculation elements

Calculate Revised EL-P, and set T2 for excess of P		
IRB EL (from Table 1)	382	
IRB revised P	524	
EL-P	-142	½ mark
EL-P = Treat as Zero as P > EL	0	½ mark
Excess P over EL treated as Tier 2 capital		
Excess P over EL treated T2 addback	142	½ mark
Cap on inclusion of credit risk adjustments in T2 under internal ratings-based approach - from Table 2	64	
Final addback	64	½ mark
Revise Ratio calculation		
CET1 (before EL-P) from Table 2	2,876	
less net of tax provision rise	-346	½ mark
EL-P from EL-P calculation above	0	
Revised CET1	2,530	½ mark
AT1 - per table 2	730	
Tier 2- per Table 2	954	

T2 P>EL from above	64	
Revised Total Capital	4,278	1 mark
Reduce RWA for Standardised exposures provision increases - reduce EAD by provision increase and multiply by risk weight		
STD RWA decrease	159	1 mark
Calculate Revised RWA, reflecting lower Standardised Exposures RWA from provision increase		
RWA from part b)	27,508	
Less STD RWA increase from directly above	-159	
Revised RWA	27,349	½ mark
Revised Ratios		
CET1	9.25%	½ mark
TC	15.64%	½ mark
Movements in Capital Ratio from Provision Increase		
CET1	-0.77%	½ mark
TC	-0.50%	½ mark

c

ii) reasons for CET1 ratio decreases include:

- Decrease in CET1 reserves from Provision rises
- RWA reduction for Standardised exposures from provision rises is not sufficient to offset the decrease in CET1 capital (reduction in reserves)
- If Provision is classified as a General Provision, for Standardised exposures the provision has no beneficial impact on the CET1 ratio (as counts as Tier 2 capital only)
- For IRB exposures, provision rises are only beneficial to CET1 capital until they fully offset Expected Loss. Further rises have no CET1 beneficial impact from offsetting expected loss (only are included as Tier 2 capital) but will have adverse impact to CET1 from the reduction in reserves

This list is not exhaustive, i.e. other points might also be valid and would be rewarded.

One mark per point, maximum three marks.

Total 15 marks

13	a) Unit 2 LO5	a) Objectives of an ICAAP – answers should consider • To formalise / outline the banks approach to understanding its risk profile • To outline the banks processes and systems to identify, quantify and control risks • Allows the Bank to determine the amount of capital it needs to cover the risk to which it is exposed • To ensure a bank is sufficiently capitalised to survive a period of significant stress • To meet regulatory requirements, including the 'use test' requirement • To inform a Banks Internal Capital Guidance / Pillar 2 requirements • To inform the setting of Pillar 2A and 2B capital by the regulator (PRA) This list is not exhaustive, i.e. other points might also be valid and would be rewarded. One Mark for a relevant point which is explained, maximum four marks b) Key elements of the Capital Plan – answers should consider • Forward-looking assessments of risk on a regulatory and / or internal view • Consider future projection of material risk types and associated parameters (such as PD or LGD for credit risk) • Forward-looking projection of RWA and Capital Resources (CET1, T1, T2) • Forecast of Capital accretion (retained profits, new issuance etc.) and Capital Outflows (dividends, capital instrument maturities) • Impact of changes to regulations • Forward looking view covering a minimum of 3 years • Key assumptions for forecasts – including economic assumption, business assumptions, and assumptions for projections of capital requirements / available capital • Sensitivity analysis, to determine impact if key assumptions do not hold true This list is not exhaustive, i.e. other points might also be valid and would be rewarded. One Mark for a relevant point which is explained, maximum four marks c) Sensitivity Analysis / Stress Test differences – answers should consider • Sensitivity Analysis normally considers narrower range of factors / single factors • Stress Testing requires economic paths to be determined, Sensitivity analysis tends to cover instantaneous impacts • Stress Testing tends to cover more extreme events, (such as 1 in 100 year scenarios) • Key vulnerabilities should be identified in advance for establishing Stress Tests, so that such Stresses can be focussed on such vulnerabilities. This is not necessary for Sensitivity analysis

This list is not exhaustive, i.e. other points might also be valid and would be rewarded.

One Mark for a relevant point which is explained, maximum two marks

d) Pillar 2 Risk Types- answers should consider

- Credit Concentration Risk – covers risk posed by a bank's portfolio having concentrations of credit exposure in individual names, sectors or geographies
- Operational Risk – to address risk not covered by simple Pillar 1 approach
- IRRBB – to cover interest rate risk on Banking Book exposures impacting Banks earnings, and can include credit spread risk on such exposures
- Pension Obligation Risk – to address risk from the funding of defined benefit pension fund liabilities, or risk from variability in the valuation and CET1 capital impacts of defined benefit Pension schemes
- Credit Risk – to address capital requirements for certain asset classes (such as Sovereigns) where Pillar 1 capital under the Standardised approach underestimates risk
- Market Risk – to address risk not captured in VaR models or Pillar 1 requirements
- Counterparty credit risk – to address risk not captured or controlled for banks, particularly those banks using simpler or standardised approaches

This list is not exhaustive, i.e. other points might also be valid and would be rewarded.

One Mark for a relevant point which is explained, maximum three marks

e) Pillar 2B Risk or – answers should consider

- Risk to which a bank my become exposed over a forward looking planning horizon
- Risks to capital position from Stress Testing
- Risk from inadequate Risk Management and Governance processes
- Risks from bank specific vulnerabilities – including leverage, systemic importance, group risk

This list is not exhaustive, i.e. other points might also be valid and would be rewarded.

One Mark for a relevant point, maximum two marks

Total 15 marks

14	Unit 3 LO13 LO14	a) See workbook (10 marks) FOR EXAMINER_Live Assessment Unit 3 S b) • Operational complexity is likely to make the customer reliant on the bank for “clearing, custody, and cash management”: • Cash management services provided by the bank allow the firm to use it for working capital management e.g. receivables, salaries, meaning that the firm is reliant on the bank for at least the short term • Operational complexity makes these deposits more stable – classed as “operational deposits” under Basel III • These operational deposits themselves are simply by-products of the services the firm is utilising the bank for, meaning that an amount will remain as long as those services are used • Due to the operational nature of the accounts, the deposit will not be sensitive to movements in interest rates ONE mark per bullet / argument above. Max 5 marks. Maximum 15 marks total

15	a) Unit 3
	LO20,
	LO21,
	LO23
	
	b) Unit 3
	LO22
	
	c) Unit 3
	LO20
		a)Answers should consider: -
		• The Risk Appetite/Policy Statement is an outline of the quantitative and qualitative principles for liquidity and funding that the Bank wants to conform to given its business model and strategy
		• The Risk appetite is owned by the Board
		• It outlines the management’s “culture” towards risk
		• The Risk appetite should outline metrics for liquidity and funding at the highest level
		• The Risk appetite should include, at a high level, the models and methodologies, so that the board really understands the quantitative risk appetite that is being set
		• The Risk appetite can be both an External and Internal Risk Appetite (both quantitative and qualitative) and a technical statement of models and methodologies
		• Points could also include the setting up ALCO’s and Risk Committee’s 3 lines of defence mechanism to manage the bank.
		• Influences on the risk appetite statement- “what/whom”
		    • Rating agencies
		    • Economic environment
		    • Shareholders
		    • Regulator
		    • Jurisdiction
		    • Company strategy
		
		The list is not exhaustive, i.e. other points might also be valid and would be rewarded.
		
		One mark per point, maximum five marks.

		b)Any reasonable metric is sufficient, for example: • Loan to Deposit (L/D) • Loan to Stable Deposit (L/SD) • Loan to Stable Funding (L/SF) • Mismatch gap • Liquid Asset/Total Asset • Survival period The list is not exhaustive, i.e. other points might also be valid and would be rewarded. One mark per metric, maximum two marks. Such metrics are used for: - • Monitoring • Control • Early warning indicators • Comparability • Identification • Confidence • Clarity • Planning and Forecasting • Aggregation The list is not exhaustive, i.e. other points might also be valid and would be rewarded. One mark per point, maximum five marks. c) Other potential areas for ILAAP include: • Stress Testing- to understand what are the effects of changes to your balance sheet • Funds Transfer pricing- to incentivise and manage the balance sheet • Intraday- probably not captured in many metrics • Contingency Funding Plan- if things go wrong a framework as an aide memoir to make changes under a crystallised stress • Finally, any reasonable discussion around risk identification, measurement, management, reporting, monitoring and control. The list is not exhaustive, i.e. other points might also be valid and would be rewarded. One mark per point, maximum three marks.

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