

Risk Management in Financial Institution (RMFI)

For AIBB

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Suggestion:

- *Read 4 star and 5 star marked chapter if you have time shortage to read all chapter.*
- *Must read short notes from all chapter.*
- *MetaMentor Center suggest to read whole note to find 100% common in exam. We cover everything in our note.*

Important	Details	Number of Question common in previous years
*****	Module-A: <i>Introduction: Risk Management</i>	19
*****	Module-B: <i>Risk Identification and Assessment</i>	17
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*****All short note from all chapter and end of note *****		

Syllabus

Module A: Introduction

Risk Management, Scope and concept of Risk Management and Enterprise Risk Management (ERM), Risk Culture, Risk Strategy, Risk Appetite and Tolerance, Risk Assessment and Treatment, Risk, Governance and Organization, Inherent Risk, Control, and Residual Risk.

Module B: Risk Identification and Assessment

Culture of Risk Identification, Process of Risk identification, Categorization of Risk, Financial Risks, Non-Financial Risks, Risk Assessment Techniques, Likelihood, Potential Impact, Selection of significant risks for the enterprise, Key Risk Indicators (KRI), Risk Register, Risk Rating.

Module C: Risk Management Responsibilities and Checklist

Elements of sound risk management system, Criteria for ensuring sound risk management. Role of Bank Supervisor and Regulator Board Oversight- Role of Board of Directors, Role of Board Risk Management Committee (BRMC). Senior Management Oversight- Role of Executive Risk Management Committee (ERMC) & its functions, Chief Risk Officer (CRO) - Appointment, Responsibilities & Functions, Risk Management Division (RMD) Roles & Functions. Role of other stakeholders for managing risks: Internal Stakeholders (like different risk committees, different units/cells), External Stakeholders (like regulatory authorities, statutory auditors, credit rating agencies, different development partners & lenders). Risk Management Checklist: Risk Architecture, Risk Strategy, Risk Protocol.

Module D: Operational risk Management

Operational Risk Management, its components & factors (People, Process, System etc.), Three (3) Lines of Defense (3LoDs), approach for managing operational risks, elements and parties of 3LoD, identification procedures, measurement, contingency planning etc.

Module E: Steps of ERM Implementation

Planning and Designing, Implementing and Benchmarking, Measuring and Monitoring, Learning and Reporting. Conducting stress testing - communicate its impact to Board & Senior management.

Module F: Policy initiatives for development of risk management in FIs

Core risk management initiated by Bangladesh Bank: Credit Risk Management (CRM), Asset-Liability Risk management (ALM), Foreign Exchange Risk Management (FX), Anti-Money Laundering Risk Management (AML), Internal Control & Compliance Risk Management (ICC), Information Communication & Technology Risk Management (ICT); Environmental & Social Risk Management (E&S risk Management).

Module G: Implementation of Basel Capital Framework/Accord

Basel Capital Framework issued by Bangladesh Bank: Components of capital (CET1, Tier 1, Tier 2), its importance for FIs, Limits-Maxima & Minima of capital ratios, Board and Senior Management oversight for managing sustainability of Capital, Capital Planning and dividend policy, relation between risk management and capital. Measurement of Risk Weighted Assets (RWA) under Pillar 1 for Credit risk, Market risk and Operational risk, Strategies for managing RWA of each segment. Measurement & Managing capital requirement for Pillar 2 – Supervisory Review Process, Preparation of ICAAP Documents for determination of capital requirement against different risks under Pillar 2. Pillar 3-Market Discipline: its importance for different stakeholders. Liquidity Ratios under Basel Capital Framework- Liquidity Coverage Ratio (LCR), Net Stable Funding Ratio (NSFR), Leverage Ratio-calculation procedures and importance for banks and NBFIs.

Module A:

Introduction: Risk Management

Q-01. What do you understand by risk? BPE-99th. BPE-5th.

Or, Explain the 'Risk' considering the activities of a financial institution. BPE-98th.

Risk refers to the possibility of uncertain outcomes or negative events that could impact the success or stability of a bank or financial institution. It involves the potential for financial losses, reputation damage, or operational disruptions. For example, a bank may face the risk of default on loans if borrowers fail to repay their debts. This could result in financial losses for the bank and affect its ability to meet its obligations. Managing risk involves implementing strategies and safeguards to mitigate potential negative impacts and protect the institution's assets and reputation.

Q-02. What is the relationship between risk and returns? BPE-97th.

Risk and return are closely related in finance. Generally, higher-risk investments offer the potential for higher returns, while lower-risk investments typically yield lower returns. This relationship is based on the principle that investors need to be compensated for taking on additional risk. For example, a government bond, considered low risk, usually offers a modest return. In contrast, stocks, that are riskier due to market volatility and uncertainty, often provide the chance for higher returns. Investors balance these elements to align with their risk tolerance and investment goals. In summary, the risk-return tradeoff is a fundamental concept, where higher risk is associated with the potential for higher rewards, and vice versa.

Q-03. What do you understand by risk management? BPE-97th. BPE-99th.

Risk management involves identifying, assessing, and prioritizing risks followed by coordinated and economical application of resources to minimize, monitor, and control the probability or impact of unfortunate events. It's a strategy to manage uncertainty in investment decisions, ensuring potential threats are understood and mitigated while opportunities are maximized. This process is crucial in business and investing, as it helps organizations and investors avoid or reduce losses. Effective risk management strategies include diversification, hedging, insurance, and setting aside emergency funds. By systematically managing risks, individuals and organizations can protect their assets, ensure stability, and achieve their objectives more reliably. It's about making informed decisions to navigate uncertainties in any endeavor.

Q-04. Briefly describe the risks involved in banking book, trading book and off-balance sheet exposure.

Or, Business Line from Risk Management Perspective.

In a bank, different types of activities carry different risks:

- 1. Banking Book:** This is where the bank keeps track of long-term stuff like loans and mortgages. The main risk here is credit risk—people not paying back their loans. Interest rate changes can also be a risk, affecting how much the bank earns from these loans.
- 2. Trading Book:** This is the bank's short-term financial activities, like buying and selling stocks or bonds. Market risk is the big concern here. If market prices move the wrong way, the bank could lose money quickly.
- 3. Off-Balance Sheet Exposure:** These are deals the bank makes that don't show up on the main financial statements, like guarantees or derivatives. Risks here are often hidden and can include both credit risk and market risk. Plus, these are hard to keep track of, so there's a risk of surprise losses.
- 4. Each area needs careful management to keep the bank stable and profitable.**

Understanding and managing these risks are essential for banks to ensure financial stability and resilience.

Q-05. What is the difference between risk management and risk assessment?

Criteria	Risk Management	Risk Assessment
1.Definition	Risk Management is the systematic process of identifying, analyzing, and mitigating risks to achieve objectives.	Risk Assessment is the process of identifying and evaluating risks to understand their potential impact.
2.Objective	To provide a structured approach for managing uncertainties, reducing risks, and seizing opportunities.	To create a detailed understanding of risks, their likelihood, and their potential impact.
3.Scope	Broader, includes risk identification, assessment, prioritization, and treatment (mitigation or acceptance).	Narrower, focuses solely on identifying and evaluating risks. It is a part of risk management.
4.Outcome	Action plans, risk mitigation strategies, and monitoring systems to control and reduce risks.	A list or matrix of identified risks, their likelihood, and potential impact.
5.Decision-making	Involves decision-making to implement risk treatment options and allocate resources.	Informs decision-making by providing data on potential risks but does not decide on actions.

Q-06. What kind of change do you think is required in the current risk management system in your organization? BPE-96th.

For the banking industry in Bangladesh to enhance its risk management system, several changes are crucial:

- 1. Technology Upgrade:** Implementing advanced technology for real-time risk monitoring and analytics can significantly improve risk detection and management capabilities.
- 2. Regulatory Compliance:** Strengthening compliance with international banking standards (like Basel III) to ensure robust capital adequacy, stress testing, and liquidity management.
- 3. Risk Culture:** Cultivating a strong risk culture across all levels of the organization, where risk awareness and management are integral to daily operations.
- 4. Training and Development:** Investing in regular training programs to equip staff with the latest risk management techniques and practices.
- 5. Integrated Risk Management:** Adopting a holistic approach to risk management that encompasses credit, market, operational, and other risks in a unified framework.
- 6. Cybersecurity Measures:** Enhancing cybersecurity protocols to protect against increasing digital threats and ensuring data integrity and security.
- These changes can help mitigate risks more effectively, ensuring the banking sector's stability and growth.

Q-07. Discuss your role in risk management considering the risks of your bank. BPE-98th.

- In the role of an official in the credit department, managing risks effectively involves:
- 2. Credit Risk Management:** Assessing borrowers' creditworthiness, ensuring compliance with lending policies, and maintaining portfolio quality to minimize defaults.
- 3. Monitoring and Reporting:** Regularly reviewing loan performance and promptly reporting potential risks to senior management.
- 4. Risk Mitigation Strategies:** Applying safeguards such as collateralization, guarantees, or credit derivatives to reduce exposure to credit risks.
- 5. Policy Adherence:** Implementing the bank's risk management framework and adhering to regulatory guidelines to align with risk appetite.
- 6. Proactive Assessment:** Identifying emerging risks and adapting strategies to mitigate potential impacts.

Q-08. Do you think that supervisors and regulators proper initiatives are the only way to ensure sound risk management systems in an organization? BPE-96th.

1. While supervisors and regulators play a crucial role in establishing guidelines and standards for risk management, they are not the sole factor ensuring sound risk management systems in an organization. Effective risk management also depends on:
2. **Regulatory Role:** Supervisors and regulators establish guidelines and compliance standards for risk management.
3. **Not the Sole Solution:** Effective risk management requires more than just regulatory compliance.
4. **Organizational Culture:** A risk-aware culture encourages all employees to participate in identifying and mitigating risks.
5. **Leadership Commitment:** Leadership must prioritize risk management and allocate resources appropriately.
6. **Employee Training:** Ongoing training ensures employees understand risk management practices and their roles.
7. **Internal Controls:** Strong internal controls are essential for monitoring and managing risks effectively.
8. **Continuous Monitoring:** Regular assessments help in adapting to new risks and improving risk management strategies.
9. **Proactive Measures:** Organizations should take proactive steps beyond regulatory requirements to manage risks.
10. Effective risk management combines regulatory guidance with an organization's internal efforts to create a comprehensive approach.

Q-09. How does the active participation of the board of directors and senior management contribute effectively to the sound risk management of a financial institution? Explain. BPE-97th.

1. The active participation of the board of directors and senior management is paramount in fostering effective risk management within a financial institution.
2. **Strategic Alignment:** Board and senior management involvement ensures that risk management strategies align with the institution's overall objectives, preventing conflicts between risk-taking and organizational goals.
3. **Risk Culture:** Leadership sets the tone for a risk-aware culture. Their commitment to ethical practices and risk consciousness permeates throughout the organization, promoting a robust risk management environment.
4. **Decision-Making Oversight:** Boards and senior management provide oversight on major decisions, ensuring that risks are adequately considered and that risk-taking activities are within acceptable limits.
5. **Resource Allocation:** Effective risk management requires resource allocation. Board and senior management involvement ensures the allocation of adequate resources for risk identification, assessment, and mitigation.
6. **Compliance and Governance:** Leadership's active role ensures compliance with regulations and governance standards, mitigating legal and regulatory risks.

In summary, the engagement of the board and senior management establishes a risk-aware culture, aligns strategies with objectives, and provides the necessary oversight and resources for sound risk management in financial institutions.

Q-10. Discuss the scope of Risk Management.

The scope of risk management is about what areas you're going to focus on to keep things running smoothly. For a bank, this can include:

1. **Credit Risk:** Making sure people who borrow money can pay it back.
2. **Market Risk:** Watching how changes in interest rates or stock prices could affect the bank.

3. **Operational Risk:** Making sure the bank's systems, like computers and customer service, work well.
 4. **Compliance Risk:** Following all the laws and rules that banks have to obey.
 5. **Strategic Risk:** Planning for the long-term, like what services to offer or markets to enter.
 6. **Reputation Risk:** Managing how people see the bank, so customers keep trusting it.
- So, the scope covers everything from daily operations to long-term planning, making sure the bank stays healthy, compliant, and trusted.

Q-11. Briefly discuss the Enterprise Risk Management (ERM).

Enterprise Risk Management (ERM) is a strategic framework that allows organizations to identify, assess, and prepare for potential risks affecting operations and objectives. Unlike traditional siloed approaches, ERM takes a holistic view, integrating risk management across all departments and business units.

Key aspects of ERM include:

1. **Holistic Approach:** Risks are evaluated collectively to ensure alignment with organizational goals.
2. **Integration:** Incorporates credit, market, operational, and liquidity risks under a single framework.
3. **Proactive Planning:** Identifies and mitigates risks before they materialize.
4. **Strategic Decision-Making:** Helps in balancing risk appetite with business opportunities.

For example, a bank using ERM might assess credit risks across branches and consolidate insights to manage its risk exposure more effectively, ensuring compliance with regulatory frameworks like Basel norms.

Q-12. Describe the benefits of maintaining effective Enterprise Risk Management (ERM)?

1. Maintaining effective Enterprise Risk Management (ERM) provides several benefits:
2. **Proactive Protection:** Identifying and mitigating risks in advance, protecting the organization from potential threats.
3. **Informed Decision-Making:** Providing data-driven insights to make well-informed and strategic decisions.
4. **Resilience:** Strengthening the organization's ability to adapt and recover from unexpected events and uncertainties.
5. **Resource Optimization:** Efficiently allocating resources to manage risks, maximizing effectiveness and cost-saving.
6. **Stakeholder Confidence:** Building trust and confidence among stakeholders by demonstrating responsible risk management practices.
7. **Sustainable Growth:** Supporting long-term success and sustainability by considering risks in strategic planning.
8. **Compliance:** Ensuring adherence to laws, regulations, and industry standards, reducing legal and reputational risks.
9. Effective ERM enhances organizational stability, performance, and the ability to capitalize on opportunities while minimizing potential negative impacts.

Q-13. Define risk culture? Why should risk culture be given due importance? BPE-99th.

Or, Discuss how important the risk culture is for effective bank management. BPE-97th.

Risk culture refers to the values, attitudes, and behaviors within an organization regarding risk awareness and management. It reflects how employees perceive and respond to risks, impacting their decisions and actions.

Importance: Risk culture should be given due importance because it directly influences an organization's ability to identify and handle risks effectively. A positive risk culture promotes transparency, open communication, and accountability, encouraging employees to be proactive in reporting and addressing risks. When risk culture is prioritized, it fosters a risk-aware environment, enabling better decision-making, early risk detection, and the

ability to adapt to uncertainties. By nurturing a strong risk culture, organizations can minimize potential negative impacts, enhance resilience, and achieve sustainable success in an ever-changing business landscape.

Q-14. Discuss the Process for Managing Risk Culture.

To manage risk culture effectively, organizations should follow a structured process that includes:

1. Define/Steer Target Risk Culture:

- a. Establish a clear view of the desired risk culture.
- b. Identify the specific attitudes and behaviors necessary to align with organizational goals.

2. Measure Current State:

- a. Assess the existing risk culture using surveys, audits, and employee feedback to determine strengths and weaknesses.

3. Gap Analysis:

- a. Compare the current state with the desired culture to identify gaps and areas for improvement.

4. Design Corrective Actions:

- a. Develop and implement targeted measures, such as training programs, communication plans, and revised policies, to bridge the identified gaps.

Example: A bank may measure its employees' understanding of risk policies and identify a gap in awareness. Corrective action might include specialized training sessions to improve compliance and risk awareness.

Q-15. Mention some areas where bank should have their own risk strategy.

- 1. Credit Risk:** Managing the risk of borrowers defaulting on loans or credit products.
- 2. Market Risk:** Addressing potential losses due to fluctuations in interest rates, foreign exchange rates, or market prices.
- 3. Operational Risk:** Mitigating risks arising from internal processes, systems, or human error.
- 4. Liquidity Risk:** Ensuring sufficient funds to meet financial obligations and handle unforeseen events.
- 5. Compliance Risk:** Adhering to regulatory requirements and avoiding penalties.
- 6. Reputational Risk:** Safeguarding the bank's image and brand reputation.
- 7. Cybersecurity Risk:** Protecting against cyber threats and data breaches.
- 8. Strategic Risk:** Evaluating potential risks associated with business strategies and decisions.

Q-16. What is risk appetite? Why is developing risk appetite statement help in mitigating the risk? BPE-96th. BPE-98th. BPE-99th.

Risk appetite is like how much spicy food you're willing to eat; it's the amount of risk a company is comfortable taking on to achieve its goals. In a business context, a Risk Appetite Statement is like saying, "We're okay with a little spice, but not too much."

Why is it helpful?

- 1. Clear Limits:** The statement sets clear boundaries on what kinds of risks are okay and how much risk are too much.
- 2. Informed Decisions:** Knowing the risk appetite helps managers make better choices that align with the company's comfort level for risk.
- 3. Team Alignment:** Everyone in the company understands what the acceptable level of risk is, making it easier to work together.
- 4. Risk Control:** By knowing your limits, you can avoid taking on too much risk that could harm the company.

5. Trust: Shareholders and customers feel more confident if they know the company has a well-defined approach to managing risks.

So, having a Risk Appetite Statement helps the company manage risks more effectively and keeps everyone on the same page.

Q-17. Discuss the relationship between risk appetite and risk response strategy of a bank. BPE-98th.

Think of risk appetite as a bank's hunger for risk and risk response strategy as its plan for dealing with that hunger. Here's how they're related:

- 1. Understanding Hunger:** Risk appetite helps a bank figure out how much risk it's willing to take to meet its goals. It's like deciding how spicy you want your food – some banks like it mild, while others prefer it hot.
- 2. Choosing the Menu:** Once the bank knows its appetite, it picks a risk response strategy. This is like choosing what dishes to order based on how much spice you can handle. If the bank has a low risk appetite, it might go for safer options, while a high-risk appetite might lead to more adventurous choices.
- 3. Balancing Flavors:** The risk response strategy should match the bank's risk appetite. It's like making sure the food matches your taste buds – too much spice can be uncomfortable, just like too much risk can be dangerous.

By aligning risk appetite with the risk response strategy, banks can ensure they're taking the right amount of risk to achieve their goals without getting burned.

Q-18. What the objectives of risk appetite? BPE-98th.

- 1.** The objectives of risk appetite are to:
- 2. Set Boundaries:** Clearly define the level of risk the organization is willing to accept to achieve its objectives.
- 3. Guide Decision-Making:** Provide a framework for making informed decisions about risk-taking and risk management.
- 4. Enhance Resilience:** Ensure the organization's ability to withstand adverse events within acceptable risk parameters.
- 5. Align with Strategy:** Ensure that risk-taking aligns with the organization's overall strategic goals and objectives.
- 6. Prioritize Risks:** Assist in prioritizing risks based on their significance and potential impact on the organization.
- 7. Optimize Risk Management:** Facilitate the allocation of resources to effectively manage and mitigate risks.

Overall, risk appetite ensures a balanced approach to risk-taking, promoting stability, and supporting the organization's long-term success.

Q-19. Discuss the elements/components of the risk appetite framework.

A bank's Risk Appetite Framework (RAF) should encompass several essential components:

- 1. Board Approval:** Reviewed and approved by the board of directors at least annually.
- 2. Alignment with Strategy:** Align with the organization's strategy, objectives, and stakeholders' demands.
- 3. Comprehensive Coverage:** Cover all key risks, including preferences for both desired and minimized risks.
- 4. Risk Documentation:** Clearly document risks in a risk register, including definitions, risk owners, measurement frequency, assumptions, severity, likelihood, and manifestation speed.
- 5. Loss Tolerances:** Recognize that losses are part of business and include tolerances reflecting overall business objectives.
- 6. Resource Allocation:** Reflect the human and technological resources needed to measure and manage risks timely.

Q-20. Discuss how to develop and adopt a risk appetite framework (RAF) in a bank.

To develop and adopt a Risk Appetite Framework (RAF) in a bank:

1. **Assess Current Risk Profile:** Evaluate existing risks, risk management practices, and risk tolerance levels.
2. **Define Risk Tolerance:** Establish clear risk tolerance thresholds for different risk categories.
3. **Involve Stakeholders:** Engage key stakeholders, including senior management and board members, to gain buy-in and input.
4. **Establish Risk Limits:** Set specific risk limits and key risk indicators to monitor risk exposures.
5. **Communication:** Effectively communicate the RAF throughout the organization to ensure understanding and alignment.
6. **Implement and Monitor:** Integrate the RAF into decision-making processes and regularly review its effectiveness.
7. **Continuous Improvement:** Adapt the RAF as the bank's risk profile and strategic objectives evolve.

Adopting an effective RAF empowers the bank to make informed decisions, enhance resilience, and achieve its business objectives while managing risks prudently.

Q-21. What do you mean by risk assessment? What are the most common risk assessment techniques used by banks? BPE-5th.

Risk assessment is the process of identifying, analyzing, and evaluating potential risks that could affect an individual, organization, or project. It involves understanding the likelihood of a risk occurring and the potential impact it may have. The goal of risk assessment is to assess the significance of risks to prioritize and plan appropriate risk management strategies. By conducting risk assessments, individuals and organizations can make informed decisions to mitigate, avoid, or prepare for potential negative consequences, enhancing their ability to navigate uncertainties and achieve their goals more effectively.

For instance, before opening a new restaurant, a risk assessment would involve identifying possible risks like food safety, customer satisfaction, and competition. The assessment would analyze the likelihood of these risks occurring and their potential consequences. Based on this information, the restaurant owner can develop strategies to address each risk, such as implementing rigorous food safety protocols, conducting customer surveys, and offering unique menu items to stand out from competitors. Risk assessment helps businesses anticipate challenges and plan for success while minimizing potential negative outcomes.

Banks use different techniques to find, measure, and understand risks in their operations. Common techniques are:

1. **Risk Control Self-Assessment (RCSA)** – Staff assess risks and controls within their own departments.
2. **Scorecards** – These rate risks using weighted scores to compare risk levels across departments.
3. **Quantitative Analysis** – Uses numbers, data, and models (like Monte Carlo simulation) to measure risk.
4. **Qualitative Analysis** – Relies on expert judgment and experience when data is not available.
5. **Risk Likelihood and Impact Matrix** – Shows how likely a risk is and how much damage it can cause.
6. **Key Risk Indicators (KRIs)** – Early warning signals that show rising or potential risks.

Q-22. What do you mean by risk treatment? Discuss different risk treatment options/strategies. BPE-98th.

1. **Risk treatment** refers to the process of selecting and implementing measures to manage or mitigate identified risks effectively. It aims to reduce the likelihood or impact of risks to an acceptable level. Different risk treatment options include:
2. **Avoidance:** Eliminating activities or exposures that pose high risks to prevent their occurrence.
3. **Reduction:** Implementing controls and preventive measures to minimize the likelihood or impact of risks.
4. **Transfer:** Shifting the responsibility for risk to another party, such as insurance or outsourcing.

5. **Acceptance:** Acknowledging and consciously deciding to bear the risk, often applicable to lower-level risks.
6. **Diversification:** Spreading investments or exposures across various areas to reduce concentrated risks.
7. **Contingency Planning:** Developing response plans to handle and recover from unexpected events.

Q-23. Considering the severity and probability of occurrence, how risk should be treated?

Considering the severity and probability of occurrence, risks should be treated in a way that aligns with the organization's risk appetite. Different risk treatment options based on risk severity and probability include:

1. **High Severity, High Probability:** Risks with severe consequences and high likelihood should be treated with priority. Measures like avoidance, reduction, or transfer may be appropriate.
2. **High Severity, Low Probability:** Risks with severe impacts but low chances of occurring may benefit from contingency planning or acceptance.
3. **Low Severity, High Probability:** Risks with minor consequences but high likelihood can be managed through reduction or acceptance.
4. **Low Severity, Low Probability:** Risks with minor impact and low chances of occurring may be accepted without additional treatment.

By tailoring risk treatment based on severity and probability, organizations can allocate resources efficiently, focusing efforts on managing significant risks while accepting lower-level risks that are manageable without excessive measures. This approach optimizes risk management efforts and supports the organization's overall objectives.

Q-24. Discuss the three lines of defense model in risk management.

The three lines of defense model in risk management is a framework that helps organizations effectively manage risks.

First Line of Defense: This involves the front-line operational staff responsible for daily activities. They identify and manage risks within their areas, ensuring proper controls and compliance.

Second Line of Defense: This comprises risk management, compliance, and internal control functions. They oversee and support the first line, ensuring risk frameworks are in place, and policies are followed.

Third Line of Defense: The internal audit function operates independently from the first and second lines. They assess risk management effectiveness and verify if controls are working as intended.

This model ensures a clear division of responsibilities and provides checks and balances to manage risks efficiently. It strengthens risk management practices, promotes accountability, and enhances the organization's overall risk management capabilities.

Q-25. What is a risk governance framework?

A risk governance framework outlines the structure and processes for managing risks within an organization. It defines the roles, responsibilities, and communication channels for effective risk management. Key roles and functions in a risk governance framework include:

1. **Board of Directors:** Setting risk appetite, overseeing risk management, and ensuring alignment with strategic goals.
2. **Risk Committee:** Assisting the board in risk oversight and providing expertise in risk assessment and mitigation.
3. **Chief Risk Officer (CRO):** Leading the risk management function and coordinating risk-related activities.
4. **Risk Owners:** Identifying and managing risks within their respective areas of responsibility.

- 5. Risk Management Function:** Developing risk policies, methodologies, and frameworks, and supporting risk analysis and treatment.

Q-26. How can effective corporate governance help to mitigate risk in a bank? BPE-98th.

Effective corporate governance is like having good captains on a ship, guiding it safely through rough waters. Here's how it helps banks manage risks:

- 1. Clear Direction:** Good governance sets out rules and guidelines for how the bank should operate, including managing risks.
- 2. Accountability:** It ensures that everyone in the bank, from top executives to employees, is responsible for their actions. This encourages careful decision-making and reduces the chances of risky behavior.
- 3. Transparency:** Banks with strong governance practices are open and honest about their operations and risks. This helps investors, regulators, and customers trust the bank more.
- 4. Risk Oversight:** Good governance involves regular monitoring and assessment of risks by the board of directors. They can identify potential problems early and take action to prevent them from getting worse.

Overall, effective corporate governance creates a culture of responsibility and transparency, making banks more resilient to risks.

Q-27. Discuss how to implement the three lines of defense model of a bank appropriately.

To implement the three lines of defense model in a bank effectively:

- 1. Clearly Define Roles:** Define the responsibilities of each line of defense, ensuring a clear division of tasks.
- 2. Establish Communication:** Promote open communication and collaboration between the three lines, fostering a culture of risk awareness.
- 3. Provide Training:** Offer training and support to employees in each line to enhance their understanding of risk management.
- 4. Develop Risk Framework:** Create a comprehensive risk framework with policies, procedures, and risk assessment methodologies.
- 5. Monitor and Review:** Regularly assess the effectiveness of the model, identifying areas for improvement and adjusting as needed.
- 6. Engage Leadership:** Gain support from senior management to endorse and champion the three lines of defense model.
- 7. Internal Audit Independence:** Ensure the internal audit function remains independent to provide unbiased evaluations.

By following these steps, the bank can successfully implement the three lines of defense model, strengthening risk management practices and promoting a resilient and compliant organization.

Q-28. What are the benefits of a bank three-line defense model?

Or, Discuss the importance of 'Three Lines of Defense (3LoD)' in operational risk management. BPE-98th.

- The three lines of defense model offers several benefits to banks:
- 2. Enhanced Risk Management:** Clearly defining roles and responsibilities ensures risks are identified, managed, and monitored effectively.
- 3. Improved Governance:** The model promotes accountability and transparency, enhancing corporate governance practices.
- 4. Strong Compliance:** It helps banks adhere to regulatory requirements and industry standards, reducing compliance-related risks.
- 5. Efficient Operations:** By having specialized teams, it ensures focus on their core functions, leading to efficient operations.

6. **Effective Internal Controls:** The model provides independent validation of controls, ensuring they work as intended.
7. **Stakeholder Confidence:** The model builds trust among stakeholders, demonstrating robust risk management practices.
8. **Early Risk Detection:** It allows for early identification of emerging risks, enabling timely risk mitigation.

The three lines of defense model ultimately supports the bank's stability, resilience, and ability to navigate challenges in an ever-changing financial landscape.

Q-29. What do you mean by Inherent Risk?

Or, Write Short note on: Inherent risk. BPE-5th.

Inherent Risk refers to the level of risk that exists naturally in a situation or activity before any measures are taken to mitigate it. It is the potential impact of an event multiplied by its likelihood of occurring.

For example:

1. **Cybersecurity Risk:** If an organization conducts online transactions without firewalls or antivirus software, the inherent risk of a cyberattack is extremely high.
2. **Employee Risk:** More employees can mean higher chances of errors or fraud. Without checks like vetting or monitoring, this risk remains high.
3. **Vendor Risk:** Allowing vendors access to sensitive systems can introduce risks. Without controls like vendor management, the institution faces significant inherent risk.

Inherent risk assessment helps organizations prioritize risks and plan safeguards effectively.

Q-30. What do you mean by Risk control?

Risk control refers to the measures and actions taken to minimize, mitigate, or manage risks effectively within an organization. It involves implementing policies, procedures, and tools to prevent potential losses or reduce their impact. For example, a bank may use firewalls and encryption software to safeguard its digital systems from cyberattacks. Similarly, ensuring proper segregation of duties in financial transactions helps prevent fraud. Regular monitoring and assessment of controls ensure they remain effective and relevant, adapting to new risks as they arise. Risk control is critical for maintaining operational efficiency, protecting assets, and achieving organizational goals.

Imagine a bank's credit department is assessing loans. To control the risk of default, the bank implements a policy that requires checking the borrower's credit history and financial stability before approving a loan. This control helps minimize the likelihood of lending to individuals who may not repay, thereby protecting the bank's assets.

Q-31. What do you mean by Residual risk?

Residual risk refers to the level of risk that remains after applying controls or mitigation strategies. It acknowledges that no control is entirely effective in eliminating risk. Residual risk can result from factors like partial control effectiveness, unforeseen events, or the nature of the risk itself.

The corrected formula based on your attached file is:

Residual Risk = Inherent Risk × Control Effectiveness

Where:

- **Inherent Risk** is the level of risk before any controls are applied.
- **Control Effectiveness** represents how well the controls reduce the risk.

Example: If the **Inherent Risk** is 100 and the **Control Effectiveness** is 0.8 (80%), the **Residual Risk** would be:

Residual Risk = $100 \times 0.8 = 80$

This highlights the importance of monitoring and managing the risk that remains even after applying controls.

Q-32. Outline effective strategies that a financial institution can implement to reinforce and enhance its risk culture. BPE-99th.

Effective strategies for financial institutions to reinforce and enhance risk culture include:

1. **Define Target Risk Culture:** Establish a clear understanding of the desired risk culture aligning with organizational objectives.
2. **Measure Current Culture:** Assess and identify gaps between the current and target risk culture.
3. **Design Corrective Actions:** Develop actionable strategies to bridge the identified gaps.
4. **Promote Open Communication:** Foster an environment where employees feel confident to report risks without fear.
5. **Integrate Risk into Decision-Making:** Embed risk awareness in everyday operations and strategic planning.
6. **Provide Training:** Educate employees about their roles and responsibilities in risk management.
7. **Align Incentives with Objectives:** Ensure rewards and penalties reflect adherence to risk management principles.

Example: A bank introduces a whistleblower policy encouraging staff to report unethical practices, enhancing accountability and trust

Q-33. Discuss the role of Internal Audit Department in risk management. BPE-97th.

The role of the Internal Audit Department in risk management includes:

- **Policy Compliance:** Ensures adherence to board-approved policies and procedures.
- **Control Assessment:** Evaluates the effectiveness of internal control and governance systems.
- **Risk Monitoring:** Tests and monitors risk measures for alignment with organizational goals.
- **Risk-Based Audits:** Conducts audits focusing on critical risk areas.
- **Regulatory Compliance:** Checks compliance with internal policies and external regulations.
- **Communication Enhancement:** Acts as a bridge between the board and management for risk-related issues.
- **Recommendations:** Provides actionable insights to improve risk management systems.

These functions enhance the organization's ability to identify, assess, and mitigate risks effectively

Q-34. A sound risk management policy will not work if the bank management does not recognize the policy in their day to day activities— please write your opinion on this statement. BPE-5th.

1. This statement is true. A bank may have a strong risk management policy, but it will fail if the management does not apply it daily.
2. A written risk policy is useless if not applied in day-to-day operations.
3. Bank management must **actively follow** and enforce the policy in all activities.
4. **Senior management and staff** should use the policy during lending, investing, and internal processes.
5. Without daily use, **risks remain unchecked**, which may lead to financial loss or non-compliance.
6. A **risk-aware culture** must be built through regular training and communication.
7. **Monitoring, reporting, and accountability** should be maintained to ensure proper policy use.
8. Board oversight and proper **governance structure** are key to linking policy with practice.

End of Module-A

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