**Financial Institutions and Markets**

**NMIMS Centre for Distance and Online Education (NCDOE)**

**Internal Assignment Applicable for April 2025 Examination**

**Q1. Mr. Arjun is the Chief Financial Officer (CFO) of ABC Bank, a leading private sector bank. Recently, the banking sector has been grappling with increasing non-performing assets (NPAs) and financial instability. ABC Bank is also expected to release its quarterly financial results in the coming weeks, which indicate a significant rise in NPAs. Mr. Arjun, being privy to sensitive financial data, shares this information with a close associate, who then liquidates their significant holdings in the bank's stocks to avoid losses from the anticipated market reaction. Upon investigation, the Reserve Bank of India (RBI) uncovers the violation and penalizes both Mr. Arjun and his associate for breaching ethical and legal standards under banking regulations.**

**In light of the above case, explain the importance of the Reserve Bank of India (RBI) and discuss its key functions in regulating and supervising the banking and financial sectors.**

**Answer:**

**Introduction:**

The Reserve Bank of India (RBI) plays a crucial role in maintaining financial stability and ensuring ethical conduct in the banking sector. As the apex regulatory authority, the RBI oversees banking operations, formulates monetary policies, and enforces regulations to safeguard the economy from risks such as non-performing assets (NPAs) and financial misconduct. The case of Mr. Arjun highlights the significance of RBI’s supervision in preventing insider trading and unethical financial practices that could undermine market integrity. By imposing penalties and enforcing compliance, the RBI ensures transparency, trust, and accountability in the banking system. This regulatory framework is essential for protecting investor interests, maintaining public confidence, and fostering a resilient financial ecosystem. The following discussion explores the RBI’s key functions in regulating and supervising the banking and financial sectors.

**This is partially solved sample answer**

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**Q2. Mr. Ajay, a risk-averse investor, is considering Treasury Bills (T-bills) as a secure financial asset that offers guaranteed returns. However, he is unfamiliar with the details of this instrument. Could you explain Mr. Ajay about the Treasury Bills, Its features and functions in detail. Also, explain how T-bills contribute to economic stability.**

**Answer:**

**Introduction:**

Treasury Bills (T-bills) are short-term financial instruments issued by the government to meet its short-term borrowing needs. They are considered one of the safest investment options as they are backed by the government, making them ideal for risk-averse investors like Mr. Ajay. T-bills are issued at a discount to their face value and redeemed at maturity, ensuring assured returns. These instruments play a crucial role in financial markets by providing a risk-free avenue for investment, managing liquidity, and supporting monetary policy implementation. Additionally, T-bills contribute to economic stability by helping the government finance fiscal deficits without causing inflationary pressures. This discussion will explore the features and functions of Treasury Bills in detail and explain how they promote financial stability and economic growth.

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**Q3a. Mr. Ravi, working in the portfolio management department of Alpha Ltd., was tasked with training new recruits about the risks inherent in the financial market. Recognizing the importance of understanding both returns and risks, he decided to broadly classify risks into two categories and explain each type to the trainees. As part of the session, he focused on systematic risk and its various types. If you were Mr. Ravi, how would you explain the different types of risks associated with systematic risk?**

**Answer:**

**Introduction:**

In financial markets, risk is an inherent factor that influences investment decisions. Mr. Ravi, while training new recruits at Alpha Ltd., emphasized the importance of understanding both returns and risks. He categorized risks into two broad types: systematic and unsystematic risk. Systematic risk, also known as market risk, is unavoidable as it affects the entire market and cannot be eliminated through diversification. To provide a comprehensive understanding, he explained different types of systematic risks, including market risk, interest rate risk, inflation risk, currency risk, and political risk.

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**Q3b. Illustrate one real-world example of unsystematic risk, explaining its cause, impact on the company, and how it could have been mitigated through diversification.**

**Answer:**

**Introduction:**

Unsystematic risk, also known as specific or diversifiable risk, arises from factors unique to a particular company or industry. Unlike systematic risk, it can be mitigated through portfolio diversification. A real-world example is the Volkswagen emissions scandal in 2015. This incident was caused by the company’s fraudulent emissions testing practices, leading to massive fines, legal actions, and a sharp decline in stock value. Investors with concentrated holdings in Volkswagen faced significant losses. However, a well-diversified portfolio across industries and companies could have reduced the impact of this event.

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