ACT EDUCATION

ACT EXAMINATION PAPER

Diploma in Treasury Management (AMCT)

Unit 2: Risk management for treasury

March 2026

This is a past paper for Unit 2 of the Diploma in Treasury Management (AMCT)

Based on the syllabus assessed from 1 August 2022.

INTRODUCTION

This past paper has been produced by the Awarding Body at the Association of Corporate Treasurers (ACT) to assist students in their preparation for the Diploma in Treasury Management assessments. It is important to highlight that the answers provided in this paper are not exhaustive and that any other reasonable answers would be awarded marks where necessary in a marked assessment. It contains a past exam for the specified unit as well as past answers. Ideally, students should have completed the majority of their Diploma in Treasury Management studies for Unit 2 before attempting this past paper.

Students should allow themselves 180 minutes to complete the exam plus an additional 25 minutes reading time. They should then review their performance to identify areas of weakness on which to concentrate the remainder of their study time. Although the past exam in this guide is typical of a Diploma in Treasury Management 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, students 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

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

The best way to approach written assessments is to work methodically through the questions. You 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 AND TEST SPECIFICATION

The Diploma in Treasury Management assessments for Units 1 and 2 each have 4 written questions, of which you must answer 3, and will involve a pre-seen case study workbook that is released no later than two weeks prior to the assessment date. The papers will be split into sections A and B and can be made up of either one case study or two case studies; each unit exam is worth a total of 100 marks.

For the purpose of this past paper the questions follow each case study. Diploma in Treasury Management assessment test specification:

Section	Amount of questions	Marks available
Section A	1 case study based question	50
Section B	3 shorter case study based questions, of which candidates choose to only answer two	25 marks each
Total	**3**	**100**

Under exam conditions, **3 hours** (180 minutes) is allowed for the Diploma in Treasury Management assessments plus an additional 25 minutes reading time.

When you take your actual exam, you will be sitting online using your own PC/Laptop. You have access to an online scientific calculator, but for the purpose of this past paper, you may use a non-programmable scientific calculator.

In order for you to determine how well you have performed, sample mark schemes are provided after each question. Please note that these are mark schemes only and not model answers. They provide lists of points that are expected to be covered within answers, although the content of your answers must be much more detailed (satisfying the command word used in the question, for example 'analyse'). As with all mark schemes, the content is indicative only, i.e. the lists of points featured are not exhaustive. It is highly likely that there are other perspectives and, provided these are valid and supported fully, marks would be awarded for these in a live exam. There are also references to the relevant Learning Outcomes if you need to revisit the associated material.

SECTION A

1 long form question worth 50 marks based on a pre-seen case study. This question should test knowledge, analysis, application insight, evaluation and justification as appropriate to level descriptors. This is a professional paper and application to practice should be at 'management' level.

Total available for Section A: 50 marks

QUESTION 1: CASE STUDY

Express Trade Logistics (ETL) is headquartered in the US and provides multiple supply chain management and logistics services. It operates a fleet of eight owned and six chartered vessels. ETL offers end to end logistics by transportation of finished goods, electronics, technical equipment and other consumer products. It also provides value added services including warehousing, inventory management and customs clearance.

The ETL network operates from the US to Europe, and onwards to the Middle East and South Asia, supported by its main warehouses in the United Kingdom, Kingdom of Saudia Arabia and United Arab Emirates. ETL has become a top choice of its customers for providing cost effective and fast services globally. Two shipping routes are used. The North Atlantic route is the primary shipping route between the USA and Europe while the Red Sea crossing is the shortest and a critical corridor connecting Europe to the Middle East and South Asia.

Marine fuel and insurance constitute ETL's largest variable costs, hence ETL prioritises fuel efficient routing to minimise the cost of the fuel as well as the delivery time.

USD' 000	2025	2024
Revenue		
Freight and logistics services	1,080	1,050
Warehousing and VAS	260	250
Total revenue	**1,340**	**1,300**
Operating costs		
Marine fuel	(385)	(360)
Insurance and claims	(120)	(110)
Crew and staff Costs	(190)	(180)
Depreciation	(95)	(90)
Other operating expenses (port delays, unrest and penalties)	(180)	(160)
Total operating costs	970	900
Operating profit (EBIT)	370	400
Finance costs		
Interest on RCF and CP	(75)	(65)
FX losses/derivative costs	(15)	(20)
Total finance costs	(90)	(85)
Profit before tax	280	315
Tax (25%)	(70)	(79)
Net profit after tax	210	236

Business continuity risk factors

In 2021, ETL faced a catastrophic loss when one of its vessels sank in the North Atlantic during a severe storm. The incident caused total vessel and container loss and crew member fatalities. Additionally, ETL faced financial losses not covered its by insurance (uninsured costs, customers claims and penalties and operational delays). This resulted in reputational damage as well.

In subsequent years, hurricane frequency in the North Atlantic increased especially in the period from October to February, escalating seasonal risks to operations.

Geopolitical instability has repeatedly forced ETL to suspend use of the Red Sea route. The alternative via the Cape of Good Hope (South Africa) adds nearly two weeks to the voyage. This results in increased fuel cost, additional insurance premiums and delayed deliveries. This then results in customer complaints and dissatisfaction as it has a direct impact on business which depends on timely delivery of these imports through ETL.

During the 2025 Middle East unrest situation, some of the ETL vessels were present in the Middle East during that time and experienced port closure, delays in anchoring, delays in operations and in revenue recoveries. It created not only operational risk but also exposed ETL to external and catastrophic risks.

ETL funding structure & other arrangements

ETL has a diversified source of funding. To manage its operations and fill in any gaps in its working capital, ETL has a revolving credit facility and commercial paper programme. To manage all its other operations and projects, ETL is funded by medium-term bank loans. All these facilities are at floating rates of interest (currently 4.0%). The economic situation is uncertain, and the future interest rate is also unpredictable. ETL wishes to manage the risk that interest cover falls below the covenanted level in its bank facility, while retaining the flexibility to gain from a fall in interest rates. It could enter into option contracts but is unwilling to pay significant fees in premiums. Its treasury department is considering a portfolio structure that is relatively cost effective.

ETL's branch office in the UK can issue USD bonds in the UK at a competitive price but requires GBP2m to fund its business. A cross-currency swap agreement is under consideration. In this regard, the treasury is in discussion with a major bank in the UK. ETL will have a liability in GBP while its counterparty, the bank, will have a liability in USD.

The terms of the agreements are set as below:

Party currency paid (notional principal)	**ETL (requires GBP2m)**	**Bank will lend GBP against (USD1.5m)**
Spot rate USD/GBP	0.75	
Start date	Today	
Maturity	5 years	
Fixed rate	4.00%	3.50%
Payments	Annually in arrears	

The operation and maintenance of ships are conducted in house by ETL while some core ship parts are imported from Spain. ETL has signed a bilateral agreement with a famous marine parts manufacturer Zylo (ZLO) in Spain. Under the contract, ZLO will supply the core parts which are essential to the ship under annual maintenance and needing upgrade or replacement depending on the life of the ship. To minimise the forex risk, ETL has transacted a call option with its bank to make payments to ZLO.

Accordingly, ETL requires EUR100,000 to make a payment to ZLO, which is expected to be due in three months' time. ETL will buy EUR in the call option.

Strike rate	EUR/USD1.15
Notional amount	EUR100,000
Premium (hedged & to be paid in USD):	USD0.04/EUR
Days to expiry	91 days

QUESTION 1

a.	Recommend a business continuity plan for ETL. You are also required to propose a structured response to natural disaster.	10 marks
b.	Recommend an approach ETL could use to hedge its interest rate risk using a portfolio hedging strategy and briefly discuss its key benefits.	7 marks
c.	i) Discuss the structure and mechanics of the cash flows of ETL's cross currency swap agreement with its bank. ii) Calculate the interest amount to be paid by each party on an annual basis. You are required to show your workings.	7 marks 4 marks
d.	i) Calculate the premium paid at the time of purchase of the call option contract. ii) Calculate the hedged cost to ETL each ease case if the actual spot exchange is (1) EUR/USD 1.0000; or (2) EUR/USD 1.1800 iii) Based on the calculations in part (ii) above, recommend the appropriate action of ETL for each exchange rate.	2 marks 5 marks 5 marks
e.	Evaluate the non-financial risks that might impact ETL's profitability.	10 marks
		Total: 50 marks

Mark scheme

Q1a

ETL's treasury must work closely with other departments to develop a business continuity plan as the business must deal with not only disturbed sea waves for a good five months, but the shipping routes are also exposed to multiple geopolitical situations which are beyond ETL's control and has a direct impact on its business. For ETL's treasury, it is important to safeguard the financial risks to ensure operational efficiencies and compliance to agreed covenants against its balance sheet loans. ETL's treasury response must have three key elements i.e. • **People:** Train treasury staff across regions (US, UK, UAE, KSA) to ensure continuity in case of local disruption, with clear succession planning. This is to resume treasury daily responsibilities with immediate effect in the event of any natural disaster or loss of key employees. • **Facilities & systems:** A TMS integrated solution should be adopted which can work from remote places in case the main offices are not accessible. A back up should also be maintained for example cloud-based treasury systems with remote access backup facilities outside high-risk geographies	3 marks for BCP plan

to secure payment processing and liquidity monitoring. Test and ensure back up plans are working perfectly.

- **Communication & relationships:** Establish crisis communication protocols with banks, insurers, and fuel suppliers, ensuring ETL can quickly access funding, invoke insurance, and preserve customer trust during disruptions. It should be tested from time to time.

Structured response to natural disaster

1. Initial assessment

- Identify critical treasury exposures: liquidity buffers, fuel cost sensitivity, insurance cover gaps, FX risk, and counterparty dependencies.
- Identify geographic sensitivity: (North Atlantic hurricane season, Red Sea instability, Middle East port disruptions).
- Quantify financial exposures arising from any potential event like vessel loss, route diversion, or port closure. This will help the treasury team to identify the impact on cashflows and any funding required.

2. Scenario planning

Develop different scenarios that are specific to ETL considering past or emerging trends. Some ETL scenarios are mentioned below.

- **Hurricane:** A hurricane can cause vessel loss as happened in the past, uninsured claims, and a sharp rise in insurance and fuel costs
- **Geopolitical:** Red Sea closure resulting in additional rerouting delays resulting in higher fuel consumption.
- **Natural disaster:** A regional port closure could hold up cargo and delay customer payments.

3. Business continuity plan (BCP)

Approved BCP: Develop a BCP plan specific to each scenario duly reviewed and approved by all stakeholders. Cost benefit must be explained in the plan. The BCP plan should include action plan of short term (0-72 hours), medium term (3-30 days) and long term (30+ days)

- **Hurricane:** Reschedule shipments where there are more chances of hurricanes to happen in specific days. Cost benefit of rescheduling should be closely evaluated.
- **Geopolitical:** What could be the alternate routes. Identify costs (fuel, insurance and others) which will be incurred to use an alternate route.
- **Natural Disaster:** Add clauses in terms and conditions of the business terms mentioning any natural disaster should not impose any penalties. For customer payments, more secure mode of payment can be adopted. Like electronic bank transfer to ensure continuity and reliability of payment channels of business operations during any natural disaster.

4. Test, refine, communicate

- All the plans must be tested on a regular basis and must be amended from time to time and per the test outcome and requirements.
- Feedback and outcome should be closely monitored and discussed to ensure success. Only positive outcome/feedback plan should be considered.

7 points max for structured response.

- Communicate continuity strategies to all stakeholders including internally to employees and externally to the banks, insurers, and key customers to reinforce confidence and transparency.

Total marks: 10

Q1b

ETL's loan is on floating rates and future uncertain economic situation can expose ETL to interest rate fluctuations. Accordingly, ETL treasury may consider portfolio hedging of the debt portfolio as below:

- **Fixed rate:** Fix 35-40% of the loan at 4% using swaps, making ETL funding cost more stable and predictable, leaving only 60-65% of the loan exposed to any changes in interest rates fluctuations.
- **Collar and cap:** Enter a mix of collar and cap arrangement with a floor of 3.5% and a cap at 5.5% to provide cost effective protection within defined interest rate range. An additional Cap for 20-25% offers supplementary protection against sharp movements in interest rate. This combination approach balances the premium cost as well.
- **Floating rate**: Leaving the rest of 30-35% at floating rate to benefit from any favourable movements.

Funding structure 4 marks

Benefits of portfolio hedging:

- **Risk diversification:** By combining swaps, caps, and collars, ETL avoids concentration in a single hedging instrument, creating a balanced debt profile.
- **Cost efficiency:** This type of structure is cost effective depending on the overall debt composition, tenor and pricing.
- **Flexibility:** Keeping part of the debt floating ensures ETL can still benefit if rates fall, rather than being fully locked into fixed costs.
- **Stability:** This layered approach protects ETL against both gradual increases and sudden increase in interest rates, strengthening overall financial flexibility.

Benefits 3 marks

Total marks: 7

Q1c

i)

- On the start date both parties i.e. ETL and its bank will exchange the principal amounts. ETL will pay USD1.5m to its bank in the UK in exchange for GBP2m that ETL requires to issue the bond and pay interest in the same currency.
- Both parties exchange periodic interest during the life of the swap agreement denominated in different currencies i.e. ETL makes interest payments in GBP.
- ETL pays interest in GBP on the GBP notional at the fixed rate of 4.00%.
- The bank pays interest in USD on the USD notional at the fixed rate of 3.50%.
- At maturity (after 5 years), the notional principals are re-exchanged at the original reference rate (USD/GBP0.75).
- This ensures ETL has access to GBP funding while hedging its USD exposure, and the bank benefits symmetrically.

7 marks

ii)

- ETL pays GBP80,000 (2m*4.00%) to its bank at the end of each year.
- ETL receives USD53,229 (1.5m*3.50%*365/360) from its bank on an annual basis. *(USD interest convention = 365 /360)*

4 marks

Total marks: 11

Q1d

i)

Premium * notional amount

USD .04 *EUR100,000 = USD4,000

This will be sunk cost. This must be paid at time of purchasing the option contract.

Any other valid points are accepted.

2 marks

ii)

- EUR/USD 1.0000

Spot price= 1.0000* 100,000 = USD100,000

Premium= USD 4,000

Total payable = USD104,000

5 marks

Spot rate= 104,000/100,000 =1.04

Strike Rate = 1.15 (1.15*100,000+4000 =119,000)

- EUR/USD 1.1800

Spot price= 1.1800* 100,000 = USD 118,000

Premium= USD 4,000

Total payable = USD 122,000

Spot rate= 122,000/100,000 =1.22

Strike Rate = 1.15 (1.15*100,000+4000 =119,000)

iii)

At a spot rate EUR/USD 1.000, the spot rate is lower than the strike price of 1.15. This makes the option out if the money hence ETL will not exercise the option and only pay the premium as it must be paid regardless of exercising the option. This results in the lowest effective cost for ETL.

5 marks

At a spot rate EUR/USD 1.1800, the spot rate is higher than the strike price of 1.15. The option in this case is in the money, making it financially advantageous. By exercising the option, ETL secures EUR at the strike rate rather than paying the higher market rate, resulting in cost savings.
Therefore, ETL should exercise the option and pay the strike rate plus the premium, as this produces a lower cost.

Any other valid points are accepted.

Total marks: 12

Q1e

1. **Operational risks**: ETL is exposed to several external risks which can impact its operations, causes delays for example if a ship has to take an extra two weeks due to a shift in the original route, the whole operations (ship reaching to destination and back to origin) will cause a delay in all operational activities.
2. **External events & catastrophic risks**: ETL has recently suffered loss and reputational damage due to storms at sea. The nature of its business cannot avoid such situations in the future hence the risk will remain.
3. **Reputational risk**: any incident like vessel sinking, delays in deliveries can put ETL's reputation at stake which can give its competitors an edge (the converse is also true of course).
4. **Legal and regulatory risks:** Since ETL has global networking and coverage, any violation to international laws or changes in regulations can challenge ETL. Any penalties, license permissions can be a hefty amount which can impact its revenues or profitability.
5. **Business continuity risk:** Imposition of tariffs, wars or climate change can result in business continuity issues.

Only case specific point will be awarded a mark

6. **Political risk:** due to ETL being USA-based, ETL may face operational restrictions or heightened scrutiny in certain regions due to evolving political relationships. Such risks may result in port access limitations, delays in customs clearance, or changes in trade policies and sanctions, potentially disrupting shipping schedules and increasing compliance costs.
7. **Supply chain disruption risk**: ETL relies on a single supplier for critical ship components required for maintenance and operations. Any deterioration in this relationship, production issues, or discontinuation of supply could lead to maintenance delays, operational disruptions, and increased costs, ultimately affecting service delivery and profitability.
8. **Cyber security risk**: ETL's global business can be at stake if its system is compromised due to any cyber-attack. It could compromise critical systems and sensitive data, leading to operational disruptions, data security breaches, and loss of customer trust, all of which could have significant financial and reputational consequences.
9. **Criminal activity and people risk:** e.g. ETL staff at a warehouse taking deliberate actions of fraud and theft, or making errors in processing payments and refunds.
10. **Processes and systems failure** Failures in critical operational processes or IT systems can disrupt logistics activities, delay deliveries and increase operational costs.

This mark scheme is not exhaustive – all valid points within answers will be awarded marks.

Syllabus refs: 2.5.1; 2.4.1; 2.4.1; 2.4.2; 2.1.1; 2.2.1; 2.4.4.

Total marks: 10

Total: 50 marks

SECTION B – 50 MARKS

Answer TWO of the following THREE questions. (2 x 25 marks).

Questions test knowledge, analysis, application, insight, evaluation and justification as appropriate to level descriptors. This is a professional paper and application to practice should be at 'management' level. Candidates are expected to be able to synthesise knowledge from different elements of the syllabus rather than be tested on discrete areas.

Total available for Section B: 50 marks

QUESTION 1: CASE STUDY

Bronze Airlines International (BAI) is a budget airline headquartered in Germany, launched in 2015. Within a decade, it has expanded its network to cover 29 European countries, with plans to connect eight more countries by 2027.

BAI has built a reputation for punctuality, customer service and budget friendly ticket pricing. However, the European budget airline sector is highly competitive, leaving operators with thin profit margins during peak summer seasons.

BAI kept its margin very low to maintain a strong presence and gain a broad customer base. During the summer seasons, it launches various deals to attract customers such as weekend special deals, last minute flight deals and student deals.

BAI's financial health has become weaker over the past year. Its cash reserves have dropped from EUR180m in 2024 to EUR100m in 2025. Lease obligations and loans have also increased from around EUR850m to EUR950m during the same period. Because of this, BAI's ability to cover its interest payments has become tight, with interest coverage now close to 1.1 times. As a result, financial partners are becoming more cautious when entering derivative contracts with BAI, especially those that require regular payments and settlements.

Fuel remains BAI's largest operating cost, accounting for nearly half of total expenses. Since the outbreak of the war in Ukraine, jet fuel prices have become increasingly volatile due to disruptions in global energy markets. To maintain its competitive positioning in the European budget airline sector, BAI deliberately kept ticket prices low and absorbed the additional fuel costs, rather than passing them on to customers.

However, this approach has come at a cost. With no hedging strategies in place, BAI was fully exposed to fluctuations in jet fuel and crude oil markets. As a result, profitability declined sharply in 2025, creating growing pressure on margins.

The situation has worsened further in 2025 amid broader economic uncertainty. While BAI operates primarily in EUR, its jet fuel purchases are priced in USD and linked to crude oil benchmarks. This creates a double exposure.

Management has now two options to consider, either:

- **increase ticket prices,** risking a loss of competitiveness in an already tight-margin industry, or
- **undertake hedging strategies,** considering partial or full hedging strategies after treasury approval.

Hedging consideration:

BAI consumes 1.2m barrels of jet fuel annually. Jet fuel is priced at USD95 per barrel today, but analysts forecast prices could range between USD90, USD105 and USD115 in the next 12 months. The spot EUR/USD exchange rate is currently 1.10.

The treasury team is evaluating three hedging alternatives for the next 12 months:

1. Jet fuel swap: Lock in at USD96 per barrel.
2. Jet fuel futures: Current futures price at USD97 per barrel (requires daily margin calls).
3. Jet fuel call option: Strike price USD100 per barrel, premium USD3 per barrel (paid upfront).

BAI operates within Europe and earns most of its revenues in EUR but purchases jet fuel in USD. Due to the volatile economic situation in 2025, there is high uncertainty about fuel cost. Disruptions in Russian oil supply to international markets, fluctuations in US shale oil production, OPEC and its action to control oil outputs, have contributed to high volatility in fuel prices.

BAI is already facing a decline in profit margins. The foreign exchange (forex) exposure can further impact its profit margins. As a result, the treasury team is considering forward contracts to minimise the forex exposure. For the next quarter, the treasury team estimates the following exposures:

- USD-denominated fuel purchases: USD180m
- EUR-denominated revenues: EUR200m.

Current market data:

- Spot EUR/USD = 1.10
- 3-month forward EUR/USD = 1.08
- BAI is considering hedging 100% of its USD fuel requirement using a forward contract.

BAI has maintained a 'BB' credit rating from Standard & Poor's for the past three years; consequently, derivative counterparties require collateral to mitigate credit risk. The proposed jet fuel swap would therefore need a committed bank facility to cover potential mark-to-market losses, estimated at USD10m (approximately the maximum potential loss). The facility carries an annual commitment cost of 1% p.a., adding to the effective cost of the swap.

Additionally, the chief executive officer (CEO) expects oil and jet fuel prices to decline over the coming year and is reluctant to fix prices through hedging, preferring to remain partially exposed to potential price decreases.

Funding considerations:

BAI is planning to diversify its funding sources, as rising aircraft lease instalments and escalating operating costs are becoming increasingly difficult to manage under the existing debt-heavy

structure. To strengthen its financial position and provide comfort to derivative counterparties of its credibility, BAI is exploring alternative funding options such as unsecured bond issuance, sale and leaseback of aircraft, and equity linked instruments. These measures would not only reduce reliance on traditional bank facilities but also improve counterparties' confidence in BAI's ability to meet margin calls and settlement obligations under derivative contracts.

QUESTION 1

a.	i) Calculate the net effective cost per barrel in USD if year-end jet fuel prices fluctuate to USD 90, USD 105 or USD 115, under each of the three hedging strategies provided. ii) Calculate the net effective cost of hedging strategies in EUR. You are required to show your workings. iii) Recommend and justify the most suitable hedging strategy for BAI, considering the factors provided in the scenario.	4 marks 4 marks 5 marks
b.	i) Calculate BAI's fuel cost in EUR with and without the forward hedge assuming the actual EUR/USD in three months is 1.05, 1.10 or 1.15. You are required to show your workings. ii) Discuss briefly the three key components of valuation of forward contracts.	3 marks 3 marks
c.	Assess the possible indicators that derivative counterparties could use to monitor BAI's creditworthiness.	6 marks
		Total: 25 marks

Mark Scheme

Q1a

i)

Net cost impact per barrel using Swap, Future and Call option — 4 marks

Spot at 12M (USD/bbl)	Swap (fixed at 96/bbl.)	Futures (fixed AT 97/bbl)	Call option (at 100/bbl + USD 3 Premium)
90	96.083	97	90 + 3 = 93 (don't exercise option, premium sunk cost)
105	96.083	97	100 + 3 = 103 (exercise option)
115	96.083	97	100 + 3 = 103 (exercise option)

ii) Net cost in Euro: — 4 marks
EUR/USD =1.10
Annual consumption= 1.2m bbl

Spot at 12M (USD/bbl)	Swap (96)	Futures (97)	Call Option
90	96.083 × 1,200,000 = -$115,299,600	97 × 1,200,000 = $116,400,000	93 × 1,200,000 = $111,600,000
105	$115,299,600	116,400,000.00	103 × 1,200,000 = $123,600,000
115	$115,299,600	116,400,000.00	123,600,000.00

EUR/USD1.10

90	EUR 104,817,818.20	EUR 105,818,181.82	EUR 101,454,545.45
105	EUR 104,817,818.20	EUR 105,818,181.82	EUR 112,363,636.36
115	EUR 104,817,818.20	EUR 105,818,181.82	EUR 112,363,636.36

Divide the cost mentioned in first table by 1.10 to calculate the cost in Euro.

iii)

- The jet fuel swap provides complete price certainty but now involves a collateralised bank facility costing 1% per annum (on max potential loss of USD10m exposure). This additional funding requirement reduces its cost advantage and restricts BAI's liquidity, which is significant given its BB credit rating.
- The futures contract offers similar protection but would require daily margin calls, creating cash flow volatility and additional operational demands/ restricting liquidity flexibility.
- In contrast, the call option, while involving an upfront premium of USD3 per barrel, requires no collateral and allows BAI to benefit if prices fall, consistent with the CEO's expectation. It provides downside protection if prices rise while maintaining flexibility in case prices decline.

Overall, the call option offers the most balanced approach between cost management, financial flexibility and aligns with the CEO's market judgment. However, it provides less cost certainty compared to the swap and involves a definite upfront cost/sunk cost.

5 marks

Total marks: 13

Q1b

i)

Fuel price = USD180m

Forward rate: 1.08

3 marks

Spot EUR/USD	Euro Cost unhedged	Hedged cost EUR/USD 1.08
1.05	180/1.05 =171.43	180/1.08 = 166.67
1.10	180/1.10=163.64	180/1.08 = 166.67
1.15	180/1.15=156.52	180/1.08 = 166.67

ii)

- By valuing the forward, BAI locks in predictable EUR outflows for its USD denominated fuel purchases eliminating the uncertainty caused by the changes in the market conditions The primary factors involve the spot rate, interest rate and time to maturity.
- For BAI, the fair value of an FX forward is determined by spot rate and interest rate difference in both currencies (USD and EUR) and comparing it with the agreed rates. Any differential can then be discounted by the present value. (The USD fuel payment to be converted into EUR).
- For BAI, the valuation approach will allow it to fix the EUR cost against fuel purchase in USD reducing the forex adverse movements. Without any hedging, the cost can volatile between €3-10 million depending on EUR/USD movements, which directly impacts margins (as seen in the above calculations).

3 marks

Total marks: 6

Q1c

1. **Credit Default swaps**:
   - CDS spreads on BAI's debt reflect the market's perception of default probability.
   - Greater spreads indicate higher expected credit risk, even before ratings change.
   - Derivative counterparties can use CDS prices as a forward looking, market driven credit risk indicator.

2. Credit Rating (S&P BB)

- Serves as a standardized, independent assessment of BAI's default risk.
- A downgrade below BB would signal worsening financial health, raising collateral or margin requirements.

- While the rating is stable, it still reflects weaker credit profile which can result in additional security/ collateral demand by the derivative counterparty.

3. Market price of debt and equity

- Falling bond prices (or rising yields) suggest investors view BAI's debt as riskier, indicating deteriorating credit quality.
- A significant drop in equity value signals declining confidence in BAI's future earnings and capital strength.

4. The VIX (Volatility Index)

- VIX provides a measure of average market expectations about the size but not the direction of future changes in stock prices.
- A spike in VIX indicates higher systemic volatility, which may increase counterparties' concerns about BAI's ability to manage liquidity under stress.
- Counterparties may link BAI's risk premium to movements in VIX.

This mark scheme is not exhaustive – all valid points within answers will be awarded marks.

Syllabus refs: 2.4.1; 2.4.2.; 2.3.4.

Total marks: 6

Total: 25 marks

QUESTION 2: CASE STUDY

TeleFin Lanka (TLK) is a fintech established in 2022 in Sri Lanka as a joint venture between the country's largest telecom operator, Lanka Telecom (LTC), and a regional private equity fund. TLK was created as a first digital fintech to support entrepreneurs in building their businesses by accessing TLK's financial services. It also offers to transfer money through mobile numbers unlike traditional banking channels. This makes its network more accessible and user friendly.

The equity is supported by its investor base which includes the parent telecom group parent, foreign institutional investors and a network of local entrepreneurs who also deposit funds into TLK's platform. TLK launched a mobile app offering digital wallets and micro to SME loans, positioning itself as a key enabler of the country's start-up and informal economy.

Business model and lending approach

TLK's primary market consists of small traders, micro-SMEs and fresh graduates launching start-ups. Eligibility requires applicants to be Sri Lankan citizens, with at least one year of customer history with LTC. Borrowers must also submit a two-year business plan, which TLK's business team evaluates before approving the borrower.

Upon registration in the app, users provide personal details (national identity card, bank account and mobile number). Approved applicants gain access to instant loans ranging from LKR50,000 to LRK500,000, disbursed with a 5% commission deducted upfront. Repayments are structured on a quarterly basis, linked to the three-month reference rate, with loan repayment tenors ranging from six to twelve months.

TLK relies on AI-driven models using LTC's customer data covering mobile usage, payment behaviour, and social patterns to assess creditworthiness. While innovative, this model has inherent weaknesses in validating repayment capacity, particularly during economic downturns.

Lack of risk management framework

As a young fintech in its growth phase, TLK faces multiple operational and treasury risks. A critical weakness lies in the absence of a formal enterprise risk management (ERM) framework. Currently:

- Customer data is split across departments.
- The business team evaluates loan requests, the IT team manages customer data and applications and treasury manages debt portfolios.
- No central data ownership or governance structure exists.

This lack of control has resulted in repeated data breaches. Sensitive customer information, including NIC details, mobile numbers and bank account data, was leaked twice within one quarter. These incidents triggered regulatory penalties, reputational damage and investor withdrawals. The sudden loss of funds created a liquidity crisis, undermining TLK's ability to meet its wholesale lender obligations. Despite the seriousness of these breaches, TLK failed to establish accountability or assign responsibility for cyber-risk management.

Commercial risk of counterparty non-repayment

In its first two years, TLK pursued an aggressive growth strategy, prioritising market share and customer acquisition over risk controls. Loan disbursements grew by an average of 32% annually, supported by TLK's strong brand recognition through its telecom parent.

However, repayment performance deteriorated sharply:

- Recoveries fell to 40% of outstanding loans, resulting in a surging non-performing loan (NPL) ratio.
- Delays in repayment created mismatches between inflows and outflows, as TLK struggled to service obligations to wholesale lenders.
- Capital buffers were eroded as provisions for loan losses increased.

The macroeconomic environment worsened the situation. The downturn left many entrepreneurs unable to service debts. As most borrowers were first-time credit users, they lacked financial discipline or collateral, heightening counterparty risk. Profitability declined as TLK was forced to absorb credit losses while maintaining operating costs and investor payouts.

Internal reporting and treasury oversight

TLK's current reporting approach is reactive. The treasury team is only notified once a loan has already defaulted, with no predictive monitoring in place. There are no key performance indicators (KPIs) or key risk indicators (KRIs) to anticipate credit deterioration.

Further, TLK does not benchmark itself against industry standards, despite operating in an emerging competitive fintech market. Management reviews performance only on an annual basis, which is insufficient in a rapidly changing macroeconomic environment. The lack of updated risk policies, accountability, and reporting discipline has resulted in an unclear direction for both the board and operational teams.

QUESTION 2

a.	Examine how a risk management framework, which includes clearly defined risk policies, can help TLK move to a more proactive stance in managing operational risks.	8 marks
b.	Discuss the role of corporate governance in embedding risk ownership and oversight across TLK.	4 marks
c.	Recommend and justify a structured action plan for TLK to strengthen the management of credit risk arising from commercial transactions.	8 marks
d.	Discuss the main benefits of establishing structured internal reporting in improving resilience.	5 marks
		Total: 25 marks

Mark Scheme

Q2a

• A risk management framework can help TLK to align its risk appetite and facilitates day to day operations in more structured way. • It will enable TLK to understand its business and financial risks in a more holistic way and take systematic steps to identify, assess, evaluate, respond to, and report these risks. • The framework will allow similar risks to be grouped into categories, making it easier to respond to and manage them in a structured and effective manner. • Currently TLK has a reactive approach to its risks. By implementing the framework, a more proactive approach can be taken which certainly reduces the probability of material risks. • Clearly there is no ownership of risk and data breaches. Implementing the framework will help define risk owners, who will be held accountable for their respective risk areas. • The risk framework will be monitored, reviewed and updated in a timely manner with agreed frequency. This will help TLK to control the risk better by prioritising the risk and their responses in a timely manner. • Accurate data supports better credit, funding, and operational strategies. Management will also be aware of important areas to be addressed. A risk framework will help in making informed decisions. • A framework will also enable transparency by having consistent reports, builds trust with investors, regulators and lenders. • By adopting proactive decision-making through a risk framework, TLK will be able to anticipate cash flow mismatches early and plan funding requirements effectively.	Each valid point will be awarded a mark **Total marks: 8**

Q2b

- **Adaptability**: Currently, TLK has no risk management framework. To integrate the concept of a framework into the business model and foster a culture of adaptability, corporate governance provides the necessary support to achieve this objective.
- **Board-level oversight:** The board and risk committee set the tone from the top, ensuring risk management is integrated into strategic decision-making. Through corporate governance, the board's message can be implemented in the culture.
- **Clear accountability:** Defining roles for management and functional heads ensures each operational risk cybersecurity, credit, treasury is owned and monitored by a responsible leader. For example, the fragmented roles performed by three different departments will make them responsible for the performance. If customer data is breached by the IT department, the head of IT will be responsible for the consequences.
- **Internal controls & escalation:** Governance frameworks ensure timely reporting of risk events and enforce corrective actions. It will also monitor the progress of various ongoing projects and will coordinate with internal departments for quick action. For example, if TLK faces any liquidity issue due to investors withdrawals, it will escalate to treasury who in turn will exercise the funding options to manage any liquidity gaps.
- **Ethical and compliance standards:** Corporate governance reinforces adherence to data protection, lending regulations, and investor reporting requirements.

The establishment of a risk management policy must ensure and support compliance with corporate governance requirements.

Total marks: 4

Q2c

- **Check creditworthiness:** While TLK currently uses an AI tool to analyse payment patterns, this should be supplemented with additional verification mechanisms to ensure a comprehensive assessment of customer creditworthiness. This can be done through reviewing utilities, rent or other payment records.
- **Approval limits**: Introduce tiered deal limits based on customer type and credit history. For first time customers, assign a conservative credit limit with strict repayment timelines. For repeat customers adjust borrowing limits based on previous repayment performance and updated credit assessments.

- **Score card**. TLK should develop and maintain a score card for its customers for future use and keep all customer transaction history and payment timeline data for future use.
- **Non repetition:** no customer should be paid twice unless the first loan is fully repaid.
- **Recovery and collections**: Establish policies including legal actions against non-payment. These terms should be signed by the borrowers at the time of signing the loan request. Stricter action should be taken as per policy against repayments.
- **Stress testing**: Stress testing should be conducted on liquidity buffers to avoid any repayments shocks. Stress testing should include economic downturns.

Total marks: 8

Q2d

Establishing structured, timely, and forward-looking internal reporting provides multiple benefits:

- **Early risk detection:** Regular reporting enables management to act on warning signals before they turn into losses.
- **Enhanced decision-making:** It supports treasury in making the board aware of relevant risks to make informed decisions that are aligned with TLK's strategies.
- **Transparency:** It ensures that the stakeholders have the information they require to continuously improve its risk responses. Consistent reports build trust with investors, regulators, and lenders.
- **Improved liquidity planning:** Timely information helps treasury to anticipate the cash flow shortfalls and plan funding proactively.
- **Strengthened resilience:** When risks are tracked systematically, TLK can respond swiftly to shocks, protecting profitability and reputation.
- **Cost benefit analysis:** It also help management to assess the effectiveness of risk mitigation strategies, leading to better risk management, enhanced resilience and boost investor confidence.
- **Benchmarking:** Internal reporting enables comparison of key risk and performance indicators with competitors within same industry. This will help TLK for better positioning by adapting best practices.

This mark scheme is not exhaustive – all valid points within answers will be awarded marks.

Syllabus refs: 2.1.1; 2.1.4; 2.1.3; 2.4.3; 2.5.3.

Total marks: 5

Total: 25 marks

QUESTION 3: CASE STUDY

Active Your Experience (AYX) is a premium activewear brand headquartered in Cambodia. It operates across both local and international markets.

AYX's product portfolio features a full performance driven range, including premium workout shirts, training trousers, functional gym accessories and athletic footwear. Each product is made with high quality materials and designed for inclusivity, ensuring accessibility and appeal to fitness enthusiasts of all levels and backgrounds. AYX has a range of advanced dry-fit fabrics engineered for extreme weather conditions and offers a range of modest wear, which has contributed to its growing recognition in multiple countries.

AYX currently serves customers in Malaysia, Thailand, Singapore and the United States. In 2025, AYX strategically expanded into the European market, launching its products by mid-2025. While Cambodia's official currency is the Riel (KHR), the US Dollar (USD) is predominantly used for larger transactions. AYX has adopted USD as its functional currency for all local and international operations, simplifying its treasury and FX management framework.

Pre-settlement risk

In mid-2025, AYX executed two significant international sales agreements:

1. Breath Fit Wear (BFW), Portugal, a new market entrant placing a first-time order valued at EUR2.5m, expected to settle in six months.
2. ZipZap (Zap), Spain, an established European brand, placing a substantial order in of EUR3m with payment expected in three months' time.

Given BFW's emerging business profile, AYX faces pre settlement FX and counterparty risk. To mitigate currency exposure, AYX entered into a forward hedge agreement with a leading bank, locking in the sale of EUR2.5m for USD2.9m, at a contractual USD/EUR exchange rate of 0.86.

Liquidity headroom

AYX is modernising and expanding its manufacturing operations by upgrading sewing, printing and stitching machinery to remain competitive globally. The treasury team has assessed that a robust liquidity position is critical to support not only current operational requirements but also to manage the uncertainty associated with tapping new countries and for capital expenditure. Treasury wants to ensure the headroom must be close to the forecast to avoid any added costs, while keeping the gearing (D/D=E) at 75%.

This project has two phases. The current headroom for the first phase is as below:

Liquidity buffer headroom (phase one)	**USD'000**
Fixed assets (capex investment)	100,000
Working capital	40,000
Total working assets	140,000
Initial assessment for core funding	140,000
Funding structure	
Equity	35,000
Debt (term loan for capex)	80,000
Working capital line / revolving credit facility	25,000

For phase two, an additional term loan of USD95m is required whereas the additional working capital facility requirement will increase from USD25m to USD55m by Q3, 2026.
The working capital (revolving credit) facility is an interest-bearing short-term loan; hence it is included in total debt for calculating the gearing ratio.

Internal vs external hedging:

The treasury function is actively engaged in evaluating hedging strategies to manage both commercial and financial risks. The team is evaluating a range of hedging solutions that are cost effective, operationally feasible and sustainable over the long term.

Key exposures under consideration include both internal and external risks, as outlined below:

Risk type	**Risk**	**Hedging action (under consideration)**
Internal – commercial	Potential inventory shortages	Under review
Internal – financial	Depreciation of foreign currency profits when converted to the functional currency	Under review
External – commercial	Increases in inventory prices	Under review
External – financial	Depreciation of foreign currency profits when converted to the functional currency	Under review

QUESTION 3

a.	i) Calculate the hedge impact for a EUR 2.5m receivable if the spot USD/EUR rate moves to 0.65 and 0.95, assuming BFW remains insolvent in both cases. ii) Recommend AYX's action to mitigate the counterparty risk.	6 marks 6 marks
b.	i) Recommend and justify a liquidity target headroom for the second phase with additional loan requirements of USD150m while maintaining the same leverage as phase one. ii) Discuss the key considerations in determining the value of the cash buffer as an optimal funding choice for AYX.	4 marks 5 marks
c.	Recommend and justify external and internal hedging actions from the exposures under consideration.	4 marks
		Total: 25 marks

Mark Scheme

Q3a

i) **At agreed Forward FX Hedge:** Receive EUR2.5m from BFW USD/EUR exchange rate of 0.86 AYX will receive USD2.9m (2.5/0.86). **Spot rate at USD/EUR 0.65 and bank is insolvent:** In this case AYX will receive USD3.8m (2.5/0.65). If bank becomes insolvent, AYX could go into the market and sell EUR2.5m for USD3.8m. This goes in AYX's favour however there is a risk that the bank administrator could attempt to claim the market value of the original deal of USD0.9m (3.8m-2.9m). In either case the deal would benefit AYX. **Spot rate at USD/EUR0.95 and bank is insolvent:** In this case AYX will receive USD2.6m (2.5/0.95), a less favourable rate. AYX could attempt to claim the market value of the original deal USD0.3m (2.9-2.6m) from its bank but AYX would be an unsecured creditor of the bank and can lose the pre-settlement risk differential value i.e. USD0.3m. **ii)** **Managing pre-settlement risk:** • Imposing deal limit: For new customers who are new entrants (BFW), impose a deal limit to minimise the extend of loss from such transactions.	6 marks

- Check creditworthiness: Before signing a credit term for new customers, due diligence should be conducted to check the creditworthiness. Credit should be awarded accordingly.
- Credit worthiness should be regularly monitored and limits amended from time to time.
- Negotiate stricter credit terms with a customer which has suffered deterioration in its credit standing.
- No new credit should be given before the first payment is fully paid off.
- Include clauses from ISDA agreement where applicable. AYX can implement netting settlements with its counterparty. This will reduce the overall net exposure at credit risk.

6 marks

Total marks: 12

Q3b

i)

Liquidity buffer headroom phase 2	**USD'000**
Fixed assets (capex investment)	100,000
Working capital	40,000
Working assets (Phase 1)	**140,000**
Working assets (Phase 2)	150,000
Total funding required	290,000
Funding Structure for phase 2	
Equity	72,500
Debt (Term loan for capex)	175,000
Working capital line	42,500

4 marks

ii)

1. Sources of liquidity need to be sufficient to meet the cash needs as well as ensures sufficient liquidity to support the ongoing capex on modern machinery without disrupting operations.
2. Cash buffer is a cushion against unforeseen risks, such as delayed receivables, FX fluctuations, or unexpected cost overruns in new markets.
3. It must align liquidity with forecasted working capital cycles and future expansion into Europe, mitigating reliance on costly short-term borrowing. The level of headroom needs to be carefully considered as any significant buffer (more than forecasted) can add material cost to AYX.
4. Maintaining headroom through cash balances provides AYX with greater strategic and operational flexibility in managing its funding structure.

5 marks

5. Covenants associated with the term loan or working capital must be carefully considered as it can restrict AYX flexibility specifically in adverse situations.

Total marks: 9

Q3c

Risk Type	Risk	Hedging Action (Under Consideration)
Internal – Commercial	Potential inventory shortages	Maintain a minimum one week's supply of inventory
Internal – Financial	Depreciation of foreign currency profits when converted to the functional currency	Match Sale and cost per currency. Natural hedging
External – Commercial	Increases in inventory prices	Agree Fixed price contract with inventory supplier
External – Financial	Depreciation of foreign currency profits when converted to the functional currency	Use forward foreign exchange transactions to fix the value of profits to the extent the profits will be paid to AYX in Cambodia.

This mark scheme is not exhaustive – all valid points within answers will be awarded marks.

Total marks: 4

Syllabus refs: 2.4.1; 2.4.3.

Total: 25 marks

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