Higher National Unit Specification

General information

Unit title: Financial Services: Risk Management (SCQF level 8)

Unit code: J7Y7 35

Superclass:	AL
Publication date:	October 2023
Source:	Scottish Qualifications Authority
Version:	01

Unit purpose

This unit is designed to introduce and develop learners' knowledge of the concept and existence of risk in the Financial Services sector and to further equip them to identify and take actions to mitigate or prevent risk. It prepares learners for careers in investment, retail and digital banking, risk analysis and a range of financial services which are all impacted by decisions on risk.

Outcomes

On successful completion of the unit the learner will be able to:

1   Explain and calculate financial risk.
2   Explain, calculate, and analyse the relationship between financial risk and return.
3   Explain and calculate the mitigation and management of financial risk.
4   Explain and evaluate investor risk profiling.

Credit points and level

2 Higher National Unit credits at Scottish Credit and Qualifications Framework (SCQF) level 8: (16 SCQF credit points at SCQF level 8).

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Recommended entry to the unit

Access to this unit is at the discretion of the centre. However, it is recommended that candidates have good written communication and numerical skills. These may be demonstrated by the achievement of the Core Skill of Communication at SCQF level 5 or by possession of Standard Grade English or a suitable NC Unit, and Core Skill Numeracy at SCQF level 5 or by possession of a relevant NC Unit.

Core Skills

Opportunities to develop aspects of Core Skills are highlighted in the support notes for this unit specification.

There is no automatic certification of Core Skills or Core Skill components in this unit.

Context for delivery

If this unit is delivered as part of a group award, it is recommended that it should be taught and assessed within the subject area of the group award to which it contributes.

The Assessment Support Pack (ASP) for this unit provides assessment and marking guidelines that exemplify the national standard for achievement. It is a valid, reliable and practicable assessment. Centres wishing to develop their own assessments should refer to the ASP to ensure a comparable standard. A list of existing ASPs is available to download from SQA's website **(http://www.sqa.org.uk/sqa/46233.2769.html)**.

Equality and inclusion

This unit specification has been designed to ensure that there are no unnecessary barriers to learning or assessment. The individual needs of learners should be taken into account when planning learning experiences, selecting assessment methods or considering alternative evidence.

Further advice can be found on our website **www.sqa.org.uk/assessmentarrangements**.

Higher National Unit Specification: Statement of standards

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Acceptable performance in this unit will be the satisfactory achievement of the standards set out in this part of the unit specification. All sections of the statement of standards are mandatory and cannot be altered without reference to SQA.

Where evidence for outcomes is assessed on a sample basis, the whole of the content listed in the knowledge and/or skills section must be taught and available for assessment. Learners should not know in advance the items on which they will be assessed and different items should be sampled on each assessment occasion.

Outcome 1

Explain and calculate financial risk.

Knowledge and/or skills

♦   Portfolio risk in financial services.
♦   Inflation risk in financial services.
♦   Exchange rate risk in financial services.
♦   Contagion risk.
♦   Liquidity risk in financial services.
♦   Capital risk in financial services.
♦   Legal and regulatory changes in financial services.

Outcome 2

Explain, calculate and analyse the relationship between financial risk and return.

Knowledge and/or skills

♦   Theory of risk and return.
♦   Risk and returns for single investments using historical data.
♦   Risk and returns for single investments using a probability distribution.
♦   Beta for financial assets.

Higher National Unit Specification: Statement of standards (continued)

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Outcome 3

Explain and calculate the mitigation and management of financial risk.

Knowledge and/or skills

♦   Theory of asset diversification.
♦   Portfolio risk and expected return from historical data.
♦   Asset diversification from historical data.
♦   Theory of the Efficient Frontier.
♦   Risk modelling.

Outcome 4

Explain and evaluate investor risk profiling.

Knowledge and/or skills

♦   UK financial services Client Suitability Regulations.
♦   Process of investor risk profiling.
♦   Investor risk profiling factors.
♦   Limitations of investor risk profiling.

Evidence requirements for this unit

All evidence should demonstrate the knowledge and skills in the current context of Risk Management in Financial Services

Learners will need to provide evidence to demonstrate their knowledge and/or skills across all outcomes.

Outcome 1

Each knowledge and skill is matched by a corresponding evidence requirement.

Evidence for the knowledge and skills in the outcome will be provided on a sample basis. This evidence may be presented as part of a written report or in response to a specific question or questions. Each learner will need evidence to show that they can provide an accurate and clear explanation of the theoretical aspects of the outcome.

The sample must comprise **three** of the knowledge and skills with a different sample of knowledge and skills being used each time the outcome is assessed. **It is a requirement that at least one of the items sampled requires the learner to complete calculations.**

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Where an item is sampled, a learner's response can be judged to be satisfactory where the evidence provided is sufficient to meet the requirements for each sampled item by showing that the learner is able to:

♦   Explain portfolio risk in financial services.
♦   Calculate and explain the impact of inflation risk on an asset within financial services.
♦   Calculate and explain the impact of exchange risk on an asset within financial services.
♦   Explain the impact of contagion risk within financial services.
♦   Explain liquidity risk in financial services using relevant calculations.
♦   Explain capital risk in financial services.
♦   Explain legal changes that pose risks that impact on firms in financial services.

Calculations must be accurate within a tolerance of one arithmetic or computational error. One error of principle is permitted.

Outcome 2

Each knowledge and skill is matched by a corresponding evidence requirement.

Evidence for the knowledge and skills in the outcome will be provided on a sample basis. This evidence may be presented as part of a written report or in response to a specific question or questions. Each learner will need evidence to show that they can provide an accurate and clear explanation of the theoretical aspects of the outcome.

The sample must comprise of **two** of the knowledge and skills with a different sample of knowledge and skills being used each time the outcome is assessed. **It is a requirement that at least one of the items sampled requires the learner to complete calculations**.

Where an item is sampled, a learner's response can be judged to be satisfactory where the evidence provided is sufficient to meet the requirements for each sampled item by showing that the learner is able to:

♦   Explain the relationship between levels of risk undertaken and the levels of return expected.
♦   Calculate and comparatively analyse the risk and returns for investments using historical data.
♦   Calculate and comparatively analyse the risk and returns for investments using a probability distribution.
♦   Explain beta, calculate and comparatively analyse betas for financial assets.

Calculations must be accurate within a tolerance of one arithmetic or computational error. One error of principle is permitted.

Higher National Unit Specification: Statement of standards (continued)

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Outcome 3

Each knowledge and skill is matched by a corresponding evidence requirement.

Evidence for the knowledge and skills in the outcome will be provided on a sample basis. This evidence may be presented as part of a written report or in response to a specific question or questions. Each learner will need evidence to show that they can provide an accurate and clear explanation of the theoretical aspects of the outcome.

The sample must comprise of **two** of the knowledge and skills with a different sample of knowledge and skills being used each time the outcome is assessed .**It is a requirement that at least one of the items sampled requires the learner to complete calculations.**

Where an item is sampled, a learner's response can be judged to be satisfactory where the evidence provided is sufficient to meet the requirements for each sampled item by showing that the learner is able to:

♦ Explain the theory of asset diversification.
♦ Explain and calculate the expected return and risk of a portfolio.
♦ Explain and calculate portfolio asset covariance and correlation and select asset combinations offering diversification opportunities.
♦ Explain the theory of the Efficient Frontier.
♦ Perform risk modelling and analyse the outputs.

Calculations must be accurate within a tolerance of one arithmetic or computational error. One error of principle is permitted.

Outcome 4

Each knowledge and skill is matched by a corresponding evidence requirement.

Evidence for the knowledge and skills in the outcome will be provided on a sample basis. This evidence may be presented as part of a written report or in response to a specific question or questions. Each learner will need evidence to show that they can provide an accurate and clear explanation of the theoretical aspects of the outcome.

The sample must comprise of **two** of the knowledge and skills with a different sample of knowledge and skills being used each time the outcome is assessed.

Where an item is sampled, a learner's response can be judged to be satisfactory where the evidence provided is sufficient to meet the requirements for each sampled item by showing that the learner is able to:

♦ Explain the regulatory requirements relating to the risk profiling of investors.
♦ Explain the process of investor risk profiling.
♦ Apply the key factors in the investor risk profiling process and evaluate the outputs of a profile.
♦ Identify and explain limitations of Investor Risk Profiling.

Higher National Unit Support Notes

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Unit support notes are offered as guidance and are not mandatory.

While the exact time allocated to this unit is at the discretion of the centre, the notional design length is 80 hours.

Guidance on the content and context for this unit

The unit should be delivered within the context of Financial Services. The following guidance was prepared in September 2023 based on then, current regulations. Centres should ensure that learners have used current information in their learning and that assessment content and assessment checklists reflect the current situation, which may, as a result, differ from the guidance below in terms of the regulations listed.

Outcome 1 introduces and examines how various risk types manifest and impact. In addition to examining these risk types, there is an emphasis on quantifying, where possible, the impact of some of these risks.

Learners should become familiar with relevant terminology and should make use of this.

It is expected that centres will cover the following topics:

- ◆ Introduction to financial risk and its management
- ◆ Real and nominal inflation
- ◆ Elements of portfolio risk — asset types in the portfolio, the amount of money invested and, level of diversification.
- ◆ Calculation of inflation impact upon dividend, coupon payments, and/or asset sale proceeds.
- ◆ Floating exchange rates; appreciation/depreciation, impact of depreciation/appreciation on repatriation of dividends, coupon payments, and/or asset sale proceeds.
- ◆ History of financial crises and their impact on financial risk management.
- ◆ Measures of liquidity such as acid test ratio, liquidity test, and cash ratio, used to show changes historically (two calculations — before and after).
- ◆ Factors that affect the level of capital risk across shares, bonds and other relevant assets found within Financial Services.
- ◆ The historical impact on perceived financial risk levels from political changes in the UK and/or other relevant countries.
- ◆ Recent, current and potential regulatory changes which may impact and cause the vary, the level of financial risk faced by investors.

Higher National Unit Support Notes (continued)

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Outcome 2 introduces and examines the relationship between financial-risk and return. Measures of both metrics are explained, calculated within basic probability and historic scenarios. Further measures of risk are presented and calculated to demonstrate asset volatility in comparison to an overall market.

Learners should become familiar with relevant terminology and should make use of this.

It is expected that centres will cover the following topics:

♦ Investor assumptions — risk minimisers, return maximisers, return maximisation for stated level of financial risk.
♦ Locating and preparing data to be used in the calculation of returns and financial risk.
♦ How to generate data to use in calculations for financial risk and returns.
♦ Normal and Student's T distribution assumptions.
♦ Calculate % stock returns using historical data using the arithmetical mean.
♦ Calculating % returns for stocks using a basic probability distribution.
♦ Calculating and analysing the output of standard deviation, variance and co-efficient of variation as measure of risk for stock data using historic data.
♦ Calculating and analysing the output of standard deviation, variance and co-efficient of variation as measure of risk for stock data using a probability distribution.
♦ Analysing the returns of stock data.
♦ Beta — measure of volatility using covariance.
♦ Performing covariance analysis to then interpret the output in the context of beta, using market return and share price data.

Outcome 3 introduces and examines financial risk management within a portfolio context, borrowing from Portfolio Theory, with emphasis largely on diversification. Learners will perform calculations to measure the extent of diversification amongst assets alongside the creation and use of a model to reconcile risk tolerances with returns.

Learners should become familiar with relevant terminology and should make use of this.

It is expected that centres will cover the following topics:

♦ Diversification — across asset classes, asset location, correlation, risk tolerance review and hedging.
♦ Expected return of a portfolio using historical data to calculate percent returns, weight these, and subsequently calculate the average return.
♦ Covariance of multiple assets — portfolio weights and associated calculations, using historical data to understand the extent of asset diversification within a portfolio.
♦ Creation of a matrix of portfolio asset correlation coefficients and covariances to understand the extent of asset diversification. Learners should be making recommendations to investors about which assets are likely to match their risk appetites (risk minimisation/max return or max return).

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♦ Use of appropriate data analysis software and/or formula to create matrix for multiple stock correlation coefficients, covariances and interpretation of outputs.
♦ Theory of the Efficient Frontier — explain theory with particular focus on demonstrating how the model can be used to reconcile risk tolerances and expected returns of assets within a given context.
♦ Creating Efficient Frontier from a given data set (historic returns and risk (standard deviation) data) and using model outputs to reconcile with investor preferences — scatterplots showing relationships between risk and return.

Outcome 4 introduces and examines the process of investor risk profiling (IRP) – part of the 'Suitability' criteria of the FCA. Currently (2023), the Financial Conduct Authority (FCA) is the main regulator monitoring client suitability criteria. It is advised that centres review that the FCA remains as the main regulator for client suitability and keep abreast of any changes made to the criteria and risk profiling process.

Learners should become familiar with relevant terminology and should make use of this.

It is expected that centres will cover the following topics:

♦ Regulatory conduct of business rules relating to investor suitability.
♦ IRP process consists of five stages — defining goals, collect data from client for risk profile, score data, allocate assets based on risk score and then implement plan.
♦ Goal setting in the IRP process — single or multiple investment goals.
♦ Risk profiling — data collection techniques used to collect this information; questionnaires/interviews.
♦ Data collected:
  — Risk capacity — methods used by advisor in assessing an investor's ability to withstand losses and factors impacting risk capacity.
  — Risk aversion — methods used by advisor to gather personal and other characteristics that impact client risk aversion.
  — Risk tolerance — measuring the client's willingness to take risk and factors that lead to how risk tolerance varies across clients.
  — Client financial knowledge — ascertaining a client's education, training and experience within investment and measuring this.
  — Macro-economic risk — the influence of economic growth, inflation, performance of assets markets on advisors' asset recommendations to clients.
  — Client Investment experience — identifying the client's level of investment experience.
♦ Matching and purchase of assets commensurate with client tolerances.
♦ Limitations of the IRP process — ineffectiveness of 'one-size fits all' approach to gathering data regards risk tolerances, advisor influence on client in the IRP process, weighting of questions equally when some are more important than others in the process.

Higher National Unit Support Notes (continued)

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Guidance on approaches to delivery of this unit

This unit is likely to form part of a group award designed to provide learners with technical or professional knowledge and skills for the financial sector. The unit is primarily intended to contribute to the provision of introductory risk management knowledge and skills by employees working in the financial services industry as advisers.

During the delivery of this unit, in outcomes where it is required (outcomes 1 and 4), learners should be made aware of the latest developments in regulations and risk management in UK financial services .Learners are required to apply current legislation in any answers they give in assessments that require this focus.

Learners should be taught the unit in the order that the knowledge and/or skills are specified.

The focus of delivery should be on the application of the learner's knowledge and skills by reviewing risk-based scenarios and applying knowledge, performing relevant calculations associated with the scenarios, analysing calculation outputs and making recommendations.

The unit is not a substitute for and does not provide exemption from professional examinations associated with risk management.

Guidance on approaches to assessment of this unit

Evidence can be generated using different types of assessment formats. The following are suggestions only. There may be other methods that would be more suitable to learners.

The evidence for outcome 1 could be assessed using an open-book, unsupervised assessment.

The assessment of outcomes 2, 3 and 4 could be completed holistically also using an open-book, unsupervised assessment.

It is recommended that this unit be assessed by instruments of assessment that require learners to answer questions based on case studies relating to risk-based scenarios that are supported by relevant stimulus material.

Centres are reminded that prior verification of centre-devised assessments would help to ensure that the national standard is being met. Where learners experience a range of assessment methods, this helps them to develop different skills that should be transferable to work or further and higher education.

Higher National Unit Support Notes (continued)

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Opportunities for e-assessment

E-assessment may be appropriate for some assessments in this unit. By e-assessment we mean assessment which is supported by Information and Communication Technology (ICT), such as e-testing or the use of e-portfolios or social software. Centres which wish to use e-assessment must ensure that the national standard is applied to all learner evidence and that conditions of assessment as specified in the evidence requirements are met, regardless of the mode of gathering evidence. The most up-to-date guidance on the use of e-assessment to support SQA's qualifications is available at **www.sqa.org.uk/e-assessment**.

Opportunities for developing Core and other essential skills

Core Skills

Learners will have opportunities to develop the Core Skill of Communication at SCQF level 5 in this unit as they will have to read, understand and evaluate complex written communication.

Learners will also have the opportunity to develop numeracy and analytical skills within a risk-based scenario and the management of the risks. They will be presented with risk and return data within customer/advisor scenarios where they will have to apply the outputs of calculations, carried out by the learner, to make recommendations to customers about which financial products may suit the customer. The calculation and analysis of risk and return data will present opportunities in outcomes 2 and 3 for learners to develop skills in the Using Number component of the Core Skill Numeracy at SCQF level 5.

Other Essential Skills

Learners may be given opportunities to develop key employability skills, as well as develop an awareness and understanding of citizenship and sustainability. These include the skills of:

♦ Teamwork/group work.
♦ Positive attitude to work.
♦ Using initiative/being proactive.
♦ Analysing and evaluating.
♦ Problem solving.
♦ Planning and organising.
♦ Paying attention to detail.
♦ Time management research and investigation.
♦ Adopting professional working standards and practices.
♦ Applying numeracy skills.
♦ Setting goals and making action plans.

History of changes to unit

Version	Description of change	Date

General information for learners

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This section will help you decide whether this is the unit for you by explaining what the unit is about, what you should know or be able to do before you start, what you will need to do during the unit and opportunities for further learning and employment.

The unit introduces the learner to knowledge and skills associated with the subject of risk within the financial services sector. You will be given the opportunity to learn about some of the major risk types that exist within the financial services environment, in particular, those that impact within the area of investment. Given that risk exists and impacts on the expected return from investments, learners will have the opportunity to learn about the relationship between risk and returns as well as quantifying levels of risk and return for investment opportunities. When facing levels of risk, investors adopt strategies to lessen its impact by employing techniques to do so. As such, you will learn about techniques that allow for the management and mitigation of risk. This will involve assessing the relative risk and returns between assets and selecting assets for investor preferences. As part of the process of risk management, prior to offering investment products, firms are legally required to perform an analysis of investor knowledge, risk preferences, risk tolerances alongside a variety of other legally required activities. Learners will have the opportunity to learn about this process.

When undertaking this unit Learners will have opportunities to develop the Core Skill of Communication at SCQF level 5 in this unit as they will have to read, understand and evaluate complex written communication.

Learners will also have the opportunity to develop numeracy and analytical skills within a risk-based scenario and the management of the risks. They will be presented with risk and return data within customer/advisor scenarios where they will have to apply the outputs of calculations, carried out by the learner, to make recommendations to customers about which financial products may suit the customer. The calculation and analysis of risk and return data will present opportunities in outcomes 2 and 3 for learners to develop skills in the Using Number component of the Core Skill Numeracy at SCQF level 5.

On completion of the unit, the learner should be able to:

1   Explain and calculate financial risk.
2   Explain, calculate and analyse the relationship between financial risk and return.
3   Explain and calculate the mitigation and management of financial risk.
4   Explain and evaluate investor risk profiling.

In outcome 1, you will learn about the key financial risk types that have the potential to impact on the Financial Services sector.

In outcome 2, you will learn about the relationship between financial risk and return. This relationship of risk and return is central to all organisations operating within Financial Services. This outcome introduces the learner to the topic by explaining this relationship with scope for performing calculations using software packages of commonly used metrics within the area of investment. Learners will also perform an analysis of financial risk and return outputs from calculations.

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In outcome 3, you will apply knowledge gained in outcome 2 to build on skills and knowledge developed in this outcome. You will learn about processes that allow for the management and mitigation of financial risk, specifically within a portfolio of assets. Using software packages as part of the delivery of the outcome, learners will learn to quantify (partially through risk modelling) and analyse commonly used metrics to assess the level of returns for associated levels of risk.

In outcome 4, you will learn about the process of Investor Risk Profiling (IRP).IRP is legal requirement for firms that offer financial products to consumers. Learners will develop an understanding of the process — as well as locating up-to-date sources of the legal requirements of IRP, how it is performed and will develop an understanding of the limitations of IRP.

The unit could be assessed using two assessments. The first assessment could cover outcome 1 and the second assessment could cover the remaining outcomes, 2 to 4. The assessments could be open-book and unsupervised.