2016-FRR Q&As

Financial Risk and Regulation (FRR) Series

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QUESTION 1

ThetaBank has extended substantial financing to two mortgage companies, which these mortgage lenders use to finance their own lending. Individually, each of the mortgage companies have an exposure at default (EAD) of $20 million, with a loss given default (LGD) of 100%, and a probability of default of 10%. ThetaBank\\'s risk department predicts the joint probability of default at 5%. If the default risk of these mortgage companies were modeled as independent risks, the actual probability would be underestimated by:

A. 1%

B. 2%

C. 3%

D. 4%

Correct Answer: D

QUESTION 2

Bank G has a 1-year VaR of USD 20 million at 99% confidence level while bank H has a 1-year VaR of USD 10 million at the same confidence level. Which bank is in a more risky position as measured by VaR?

A. Bank H is taking twice the risk of bank G as measured by VaR.

B. Bank G is taking twice the risk of bank H as measured by VaR.

C. Since the confidence levels are the same we cannot make any conclusions.

D. Both banks are equally risky since the measurements are with the same confidence level.

Correct Answer: B

QUESTION 3

By lowering the spread on lower credit quality borrowers, the bank will typically achieve all of the following outcomes EXCEPT:

A. Aggressively courting of new business

B. Lower probability of default

C. Rapid growth

D. Higher losses in case of default

Correct Answer: B

QUESTION 4

Of all the risk factors in loan pricing, which one of the following four choices is likely to be the least significant?

A. Probability of default

B. Duration of default

C. Loss given default

D. Exposure at default

Correct Answer: B

QUESTION 5

Which one of the following four statements regarding the basic Net Interest Income model is INCORRECT?

A. Assets and liabilities have the same interest rate sensitivities.

B. Effective repricing date can be different than contractual repricing.

C. The amount of intermediated funds can be a function of interest rate levels.

D. Net interest income risk does not address the impact of changing interest rates on bank equity value.

Correct Answer: A

QUESTION 6

Which one of the following four statements about regulatory capital for a bank is accurate?

A. Regulatory capital is determined by rules imposed by an outside authority, such as a supervisor or central bank.

B. Regulatory capital is the lowest level of economic capital the bank should have to meet regulatory requirement.

C. Regulatory capital reflects the economic tradeoffs of the bank as accurately as the bank can represent them.

D. Regulatory capital is less than the regulatory capital requirement.

Correct Answer: A

QUESTION 7

Which of the activities represent examples of market manipulation?

A. Market gap

B. Crowded trades

C. Short squeeze

D. Stop-loss order

Correct Answer: C

QUESTION 8

Changes to which one of the following four factors would typically not increase the cost of credit?

A. Increasing inflation rates in a country.

B. Increase in consumption of goods and services.

C. Higher risk premium on a fixed income instrument.

D. Higher return earned on alternative investments.

Correct Answer: C

QUESTION 9

SigmaBank has many branches that offer the same products and services. Which one of the four following statement presents an advantage of using RCSA questionnaire approach in the SigmaBank\\'s operational risk framework?

A. The questionnaires are usually sent to specific nominated parties for completion.

B. This approach ensures that there has been full participation in the scoring, rather than a single view.

C. It provides a forum for an in-depth discussion of the operational risks in the firm.

D. The results can be collected electronically and the responses compared to identify themes, trends and areas of potential control weakness or elevated risk.

Correct Answer: D

QUESTION 10

Which one of the following four statements regarding commodity derivative risks is INCORRECT?

A. Because of the different demand/supply balance in each region and the cost of transporting the oil between regions, a tanker of Brent crude oil in the UK will have a different value to a UK buyer than a tanker of Arab light crude oil in Singapore, which results in the basis risk.

B. Calendar spreads represent a special case of basis risk and occur when the relative prices of commodity futures do not come in alignment and the trader becomes exposed to the absolute price movements.

C. In most commodities, the longest term contracts are the most volatile, while the shortest term forward contract are the least volatile.

D. Some commodities can be both in backwardation and a have a strong seasonal element.

Correct Answer: C

QUESTION 11

Gamma Bank provides a $100,000 loan to Big Bath retail stores at 5% interest rate (paid annually). The loan is collateralized with $55,000. The loan also has an annual expected default rate of 2%, and loss given default at 50%. In this case, what will the bank\\'s exposure at default (EAD) be?

A. $25,000

B. $50,000

C. $75,000

D. $105,000

Correct Answer: B

QUESTION 12

A credit portfolio manager analyzes a large retail credit portfolio. Which of the following factors will represent typical disadvantages of market-linked credit risk drivers?

I. Need to supply a large number of input parameters to the model

II. Slow computation speed due to higher simulation complexity

III. Non-linear nature of the model applicable to a specific type of credit portfolios

IV.

Need to estimate a large number of unknown variable and use approximations

A.

I

B.

I, II

C.

II, III

D.

III, IV

Correct Answer: B

QUESTION 13

Banks duration match their assets and liabilities to manage their interest risk in their banking book. Currently, the bank\\'s assets and liabilities both have a duration of 10. To hedge against the risk of decreasing interest rates, the bank should:

I. Increase the duration of the liabilities

II. Increase the duration of the assets

III. Decrease the duration of the liabilities

IV.

Decrease the duration of the assets

A.

I only.

B.

I and II.

C.

II and III.

D.

I and IV

Correct Answer: D

QUESTION 14

Which one of the following statements accurately describes market risk tolerance?

A. Market risk tolerance is the maximum likely gain in the market value of portfolios over a given period of time.

B. Market risk tolerance is the maximum loss in the market value of financial instruments caused by the failure of the counterparty to meet its obligations.

C. Market risk tolerance is the maximum loss the bank is willing to bear due to fluctuations in market prices and rates.

D. Market risk tolerance is the minimum loss the bank is willing to bear due to fluctuations in market prices and rates.

Correct Answer: C

QUESTION 15

Alpha Bank determined that Delta Industrial Machinery Corporation has 2% change of default on a one-year no-payment of USD $1 million, including interest and principal repayment. The bank charges 3% interest rate spread to firms in the machinery industry, and the risk-free interest rate is 6%. Alpha Bank receives both interest and principal payments once at the end the year. Delta can only default at the end of the year. If Delta defaults, the bank expects to lose 50% of its promised payment. Hence, the loss rate in this case will be

A. 1%

B. 3%

C. 5%

D. 10%

Correct Answer: A