2016-FRR Q&As

Financial Risk and Regulation (FRR) Series

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QUESTION 1

Which one of the four following statements about drawdowns is correct?

A. Drawdown calculates significant losses in a particular business or a book.

B. Drawdown estimates the effect on bank\\'s liabilities when the bank\\'s credit rating is cut.

C. Drawdown quantifies the peak-to-trough decline of an investment over a known time period.

D. Drawdown measures the aggregate decline in market values of assets and positions due to a shock.

Correct Answer: C

QUESTION 2

Which of the following assets on the bank\\'s balance sheet has greatest endogenous liquidity risk?

A. A 2-year U.S treasury bond

B. A 1-week corporate loan with a AAA rated company

C. A 10-year U.S treasury bond

D. A 3-year subprime mortgage

Correct Answer: D

QUESTION 3

The pricing of credit default swaps is a function of all of the following EXCEPT:

A. Probability of default

B. Duration

C. Loss given default

D. Market spreads

Correct Answer: B

QUESTION 4

James Arthur is a customer of a bank who has taken a floating rate loan from the bank. He is concerned that the rates may rise in the future increasing his payment amount. Which of the following instruments should he buy to hedge against the rise in interest rates?

A. Interest rate floor

B. Interest rate cap

C. Index amortizing swap

D. Interest rate swap that receives fixed and pays floating

Correct Answer: B

QUESTION 5

A risk associate is trying to determine the required risk-adjusted rate of return on a stock using the Capital Asset Pricing Model. Which of the following equations should she use to calculate the required return?

A. Required return = risk-free return + beta x market risk

B. Required return = (1-risk free return) + beta x market risk

C. Required return = risk-free return + beta x (1 ?market risk)

D. Required return = risk-free return + 1/beta x market risk

Correct Answer: A

QUESTION 6

An associate from the finance group has been identified as an operational risk coordinator (ORC) for her department. To fulfill her ORC responsibilities the associate will need to:

I. Provide main communication contact with operational risk department

II. Provide main reporting contact with audit department

III. Coordinate collection of key risk indicators in her area

IV.

Coordinate training and awareness activities in her area

A.

I, II

B.

II, III, IV

C.

I, II, III

D.

I, III, IV

Correct Answer: D

QUESTION 7

In its VaR calculations, JPMorgan Chase uses an expected tail-loss methodology which approximates losses at the 99% confidence level. This methodology consists of two subsequent steps to estimate the VaR. Which of the following explains this two-step methodology?

A. After VaR is computed at the 97% confidence level, the expected tail loss in excess of that confidence level is determined, which is then compared with the VaR estimate at the 99% confidence level.

B. After VaR is computed at the 99% confidence level, the expected tail loss in excess of that confidence level is determined, which is then compared with the VaR estimate at the 98% confidence level.

C. After VaR is computed at the 99% confidence level, the expected tail loss in excess of that confidence level is determined, which is then compared with the VaR estimate at the 99% confidence level.

D. After VaR is computed at the 1% confidence level, the expected tail loss in excess of that confidence level is determined, which and is then compared with the VaR estimate at the 98% confidence level.

Correct Answer: A

QUESTION 8

Which one of the following four statements represents a possible disadvantage of using total return swap to manage equity portfolio risks?

A. Similar to the formal portfolio rebalancing strategy, the total return receiver needs to modify the size of the trading position.

B. The total return receiver needs to incur the transaction costs of establishing an equity position.

C. Similar to an equity forward position, the total return receiver does not get paid the dividend.

D. The total return receiver does not have any voting rights.

Correct Answer: D

QUESTION 9

To estimate the price of gold forwards, an investment analyst focuses on the cost of holding physical gold (bullion) and the cost of shorting the same. Given that physical gold spot price is $1,000, the annual risk-free rate is 5%, and the gold lease rate equals 2% annually, the analyst\\'s best estimate of the gold forward price to equal

A. $950

B. $1030

C. $1070

D. $1100

Correct Answer: B

QUESTION 10

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. Six months after Alpha Bank provides USD $1 million loan to the Delta Industrial Machinery Corporation, a new competitor enters the machinery industry, causing Delta to adjust its prices and mark down the value of its inventory. Hence, the probability of default increases from 2% to 10% and the loss given default increases from 50% to 75%. If Alpha Bank can reprice the loan, what should the new rate be?

A. 10%

B. 13%

C. 16.5%

D. 20.5%

Correct Answer: D

QUESTION 11

An options trader for a large institutional investor takes a long equity option position. Which of the following risks need to be considered when taking this position?

I. All the risks of underlying equities

II. Perceived volatility changes

III. Future dividends yields

IV.

Risk-free interest rates

A.

I, II

B.

II, III

C.

III, IV

D.

I, II, III, IV

Correct Answer: D

QUESTION 12

The Sarbanes-Oxley Act includes one of the following four requirements for financial institutions in the United States:

A. Risk and control requirements

B. Market discipline requirements

C. Capital allocation requirements

D. Regulatory response to systemic risk requirements

Correct Answer: A

QUESTION 13

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 95% confidence level. Which bank is in a more risky position as measured by VaR?

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

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

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

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

Correct Answer: C

QUESTION 14

The risk management department of VegaBank wants to set guidelines on commodity carry trades. Which of the following strategies should she pursue to achieve a profitable commodity carry?

I. Buy short-term commodity futures and sell longer-dated position when the curve is in contango.

II. Buy short-term commodity futures and sell longer-dated position when the curve is in backwardation.

III. Buy long-term commodity futures and sell shorter-dated positions when the curve is in contango.

IV.

Buy long-term commodity futures and sell shorter-dated positions when the curve is in backwardation.

A.

I, II

B.

I, III

C.

II, IV

D.

I, IV

Correct Answer: D

QUESTION 15

Rising TED spread is typically a sign of increase in what type of risk among large banks?

I. Credit risk

II. Market risk

III. Liquidity risk

IV.

Operational risk

A.

I only

B.

II only

C.

I and IV

D.

I, II, and III

Correct Answer: A