2016-FRR Q&As

Financial Risk and Regulation (FRR) Series

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QUESTION 1

According to Basel II what constitutes Tier 2 capital?

A. Debt that is not subordinated to equity and innovative capital products that would count as Tier 1 capital and excluding perpetual non-cumulative preference shares.

B. Debt that is subordinate to equity.

C. Equity capital and debt together.

D. Core capital excluding undisclosed reserves and general reserves that the bank may make against its expected loan losses.

Correct Answer: A

QUESTION 2

Which one of the following four model types would assign an obligor to an obligor class based on the risk characteristics of the borrower at the time the loan was originated and estimate the default probability based on the past default rate of the members of that particular class?

A. Dynamic models

B. Causal models

C. Historical frequency models

D. Credit rating models

Correct Answer: C

QUESTION 3

A corporate bond gives a yield of 6%. A same maturity government bond yields 2%. The probability of the corporate bond defaulting is 2.5%. In case of default, investors expect to lose 60% of their investment. The risk premium in the credit spread is:

A. 1.5%

B. 4.5%

C. 2.5%

D. 0.5%

Correct Answer: C

QUESTION 4

A customer asks a broker employed by AlphaBank to buy Eureka Corporation bonds for her account. While this trade was executed correctly and the bonds were bought, the trade was mistakenly accounted for as a sell order. If the price of Eureka Corporation bonds goes up, this trade would result in a significantly larger loss than if the market had remained stable. However, if the market drops, the customer will benefit from the incorrect accounting and gain from this trade. This trading scenario can serve as an example that

A. Market risk in this transaction can magnify operational risk.

B. Credit risk in this transaction can magnify operational risk.

C. Liquidity risk in this transaction can magnify operational risk.

D. Strategic risk in this transaction can magnify operational risk.

Correct Answer: A

QUESTION 5

Which one of the four following statements about back testing the VaR models is correct? Back testing requires

A. Plotting VaR forecasts against the proportion of daily losses exceeding the average loss.

B. Comparing the predictive ability of VaR on a daily basis to the realized daily profits and losses.

C. Plotting the daily profit and losses along with the ranges predicted by VaR models

D. Determining the proportion of daily profits exceeding those predicted by VaR.

Correct Answer: B