2016-FRR Q&As

Financial Risk and Regulation (FRR) Series

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QUESTION 1

Which one of the following four parameters is NOT a required input in the Black-Scholes model to price a foreign exchange option?

A. Underlying exchange rates

B. Underlying interest rates

C. Discrete future stock prices

D. Option exercise price

Correct Answer: C

QUESTION 2

To hedge a foreign exchange exposure on behalf of a client, a small regional bank seeks to enter into an offsetting foreign exchange transaction. It cannot access the large and liquid interbank market open primarily to larger banks. At which one of the following exchanges can the smaller bank trade the currency futures contracts?

I. The Tokyo Futures Exchange

II. The Euronext-Liffe Exchange

III.

The Chicago Mercantile Exchange

A.

I

B.

III

C.

II, III

D.

I, II, III

Correct Answer: D

QUESTION 3

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 4

A risk associate responsible for the operational risk function wants to evaluate the upward reporting governance structure and to assess its critical features. Which one of the four attributes does not represent a critical feature of the upward reporting governance structure?

A. Independence

B. Importance

C. Relevance

D. Security

Correct Answer: D

QUESTION 5

A trader inadvertently booked a trade with incorrect information. A subsequent market move resulted in a gain to the bank. Should the bank include this amount of gain into its operational loss event data program?

I. The bank should include this gain in its operational loss event data program as a gain realized due to operational risk events.

II. The bank should include this gain in its operational loss event data program as it indicates that a control failed or a process is flawed.

III.

The bank should include this event in its operational loss event data program and record the gain as a loss resulting from operational risk.The bank should not include this event in its operational loss event data program as it is not a loss event, but a market risk event.

A.

I and II

B.

II and III

C.

I, II and III

D.

I and III

Correct Answer: A

QUESTION 6

Which one of the following four mathematical option pricing models is used most widely for pricing European options?

A. The Black model

B. The Black-Scholes model

C. The Garman-Kohlhagen model

D. The Heston model

Correct Answer: B

QUESTION 7

The Basel II Accord\\'s operational risk definition excludes all of the following items EXCEPT:

A. Legal risk

B. Strategic risk

C. Reputational risk

D. Geopolitical risk

Correct Answer: A

QUESTION 8

A hedge fund trader buys options to establish an exposure in the currency market, thereby effectively removing the risk of being able to participate in a gapping market. In this case the options premium represents the price paid for eliminating the execution risk of

A. The delta-hedging strategy.

B. The gamma-hedging strategy.

C. The vega-hedging strategy.

D. The theta-hedging strategy.

Correct Answer: A

QUESTION 9

To improve the culture and awareness of the operational risk, Gamma Bank\\'s CRO decides to promote three activities within her organization. Which one of the following four activities is NOT typically used to develop an operational risk framework?

A. Marketing

B. Planning

C. Training

D. Auditing

Correct Answer: D

QUESTION 10

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 11

An options trader is assessing the aggregate risk of her currency options exposures. As an options buyer, she can potentially ___ lose more than the premium originally paid. As an option seller, however, she has a ___ risk on the contract and always receives a premium.

A. Never, unlimited

B. Sometimes, unlimited

C. Never, limited

D. Sometimes, limited

Correct Answer: A

QUESTION 12

Sam has hedged a portfolio of bonds against a small parallel shift in the yield curve using the duration measure. What should Sam do to ensure that the portfolio is hedged against larger parallel shifts in the yield curve?

A. Take positions to reduce the duration

B. Take positions to increase the duration

C. Take positions to make the convexity zero

D. Since the portfolio is duration hedged Sam does not need to take additional positions.

Correct Answer: C

QUESTION 13

Which one of the following four statements describes the advantage of using delta-gamma method of mapping options positions over delta-normal method?

Delta-gamma method

A. Converts options into underlying factor risks according to their deltas and the gammas to those factors.

B. Fully captures option price risk, particularly for extreme price movements.

C. Overstates the risk of long option positions, but understate the risk of short option positions.

D. Approximates more accurately the non-linear relationship of option values and risk.

Correct Answer: D

QUESTION 14

When considering the advantages of operational risk function owned by the Chief Compliance Officer in a financial institution, an operational risk manager consultant suggests that this governance approach will have all of the following advantages except:

A. This governance structure maintains an independent operational risk function.

B. The operational risk function is closely linked in a partnership with the compliance function to leverage data and assessment activities.

C. The operational risk function quickly inherits an existing reporting structure, established meeting schedules and functional reporting cycles from the compliance function.

D. In accordance with Basel II Accord, the operational risk function should report directly into the audit function and strengthen that function.

Correct Answer: D

QUESTION 15

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