QUESTION & ANSWERS

Question: 1

An asset manager for a large mutual fund is considering forward exchange positions traded in a clearinghouse system and needs to mitigate the risks created as a result of this operation. Which of the following risks will be created as a result of the forward exchange transaction?

A. Exchange rate risk

B. Exchange rate and interest rate risk

C. Credit risk

D. Exchange rate and credit risk

Answer: B

Question: 2

Which one of the following statements about futures contracts is correct?
I. Futures contracts are subject to the same risks as the underlying instruments.
II. Futures contracts have additional interest rate risk die to the future delivery date.
III. Futures contracts traded in a clearinghouse system are exposed to credit risk with numerous counterparties.

A. I

B. I, III

C. II, III

D. I, II, III

Answer: A

Question: 3

A credit risk analyst is evaluating factors that quantify credit risk exposures. The risk that the borrower would fail to make full and timely repayments of its financial obligations over a given time horizon typically refers to:

A. Duration of default.

B. Exposure at default

C. Loss given default.

D. Probability of default

Answer: D

Question: 4

Which one of the following four options does NOT represent a benefit of compensating balances to the bank?

A. Compensating balances allow the bank to net some of the exposure they may have in case of default, by taking funds from these specific deposit account one the borrower defaults.

B. Since the compensating balances cannot be withdrawn at short notice, if at all, they are not considered transaction accounts and are able to provide a stable funding to the bank, reducing its reliance on more volatile external inter-bank based funding sources.

C. Compensation balances influence the expected loss rate of the bank given the default obligor and improve capital structure by controlling obligor type and avoiding payment delays

D. Since the compensating balances reduce the next amount lent to the borrower, the earned return on the loan is increased, further widening the bank's interest rate margin and profitability

Answer: C

Question: 5

A risk manager has a long forward position of USD 1 million but the option portfolio decreases JPY 0.50 for every JPY 1 increase in his forward position. At first approximation, what is the overall result of the options positions?

A. The options positions hedge the forward position by 25%.

B. The option positions hedge the forward position by 50%.

C. The option positions hedge the forward position by 75%.

D. The option positions hedge the forward position by 100%.

Answer: B

Question: 6

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 expected loss be?

A. $500

B. $750

C. $1,000

D. $1,300

Answer: A

Question: 7

Which one of the following four statements correctly defines an option's delta?

A. Delta measures the expected decline in option with time and is usually expressed in years.

B. Delta measures the effect of 1 bp in interest rate change on the option price

C. Delta is the multiplier that best approximates the short-term change in the value of an option.

D. Delta measures the impact of volatility on the price of an option.

Answer: C

Question: 8

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. What may happen to the Delta's initial credit parameter and the value of its loan if the machinery industry experiences adverse structural changes?

A. Probability of default and loss at default may decrease simultaneously, while duration rises causing the loan value to decrease.

B. Probability of default and loss at default may decrease simultaneously, while duration falls causing the loan value to decrease.