

Credit Risk Management

Sample Exam Questions

- 1. Which one of the following four statements correctly defines credit risk?**
 - a. Credit risk is the risk that complements market and liquidity risks
 - b. Credit risk is a form of performance risk in contractual relationship
 - c. Credit risk is the risk arising from execution of a company's strategy
 - d. Credit risk is the risk that summarizes the exposures a company or firm assumes when it attempts to operate within a given field or industry.

- 2. The potential failure of a manufacturer to honor a warranty might be called ____, whereas the potential failure of a borrower to fulfill its payment requirements, which include both the repayment of the amount borrowed, the principal and the contractual interest payments, would be called ____**
 - a. Credit risk; market risk
 - b. Market risk; credit risk
 - c. Credit risk; performance risk
 - d. Performance risk; credit risk

- 3. A financial analyst is trying to distinguish credit risk from market risk. A USD 100 loan collateralized with USD 200 in stock has limited ____, but an uncollateralized obligation issued by a large bank to pay an amount linked to the long-term performance of the Nikkei 225 Index that measures the performance of the leading Japanese stocks on the Tokyo Stock Exchange likely has more ____ than ____.**
 - a. Legal risk; market risk; credit risk
 - b. Market risk; market risk; credit risk
 - c. Market risk; credit risk; market risk
 - d. Credit risk, legal risk; market risk

See page 2 for answers and explanations

Credit Risk Management

Sample Exam Answers/Explanations

1. Which one of the following four statements correctly defines credit risk?

- a. Credit risk is the risk that complements market and liquidity risks
- b. Credit risk is a form of performance risk in contractual relationship
- c. Credit risk is the risk arising from execution of a company's strategy
- d. Credit risk is the risk that summarizes the exposures a company or firm assumes when it attempts to operate within a given field or industry.

Correct answer: b

Explanation: Credit risk is a form of performance risk in contractual relationship. In any contractual situation, performance risk refers to the possibility that one party in the contract will not honor its obligations to the other.

2. The potential failure of a manufacturer to honor a warranty might be called ____, whereas the potential failure of a borrower to fulfill its payment requirements, which include both the repayment of the amount borrowed, the principal and the contractual interest payments, would be called ____

- a. Credit risk; market risk
- b. Market risk; credit risk
- c. Credit risk; performance risk
- d. Performance risk; credit risk

Correct answer: d

Explanation: Credit risk is usually defined as the performance risk associated with a financial contract—e.g. a loan, bond, or derivative contract. Hence, the potential failure of a manufacturer to honor a warranty might be called performance risk, whereas the potential failure of a borrower to make good on its payment requirements, which include both the repayment of the amount borrowed, the principal, and the contractual interest payments, would be called credit risk.

3. A financial analyst is trying to distinguish credit risk from market risk. A USD 100 loan collateralized with USD 200 in stock has limited ____, but an uncollateralized obligation issued by a large bank to pay an amount linked to the long-term performance of the Nikkei 225 Index that measures the performance of the leading Japanese stocks on the Tokyo Stock Exchange likely has more ____ than ____.

- a. Legal risk; market risk; credit risk
- b. Market risk; market risk; credit risk
- c. Market risk; credit risk; market risk
- d. Credit risk, legal risk; market risk

Correct answer: b

Explanation: A USD 100 loan collateralized with USD 200 in stock has limited market risk, but an uncollateralized obligation to pay an amount linked to the long-term performance of the Nikkei 225 Index that measures the performance of the leading Japanese stocks on the Tokyo Stock Exchange likely has more market risk than credit risk.

Integrated Bank Risk Management

Sample Exam Questions

- 1. Which of the following statements depicts a difference between funding liquidity risks and trading liquidity risks?**
- a. Funding liquidity risks are associated with how fast prices move in the market while trading liquidity risks originate out of bank trades.
 - b. Funding liquidity risks are concerned with the ability of the bank to fund deposits withdrawals while trading liquidity risks are concerned with the change in bid-offer spreads of asset values.
 - c. Funding liquidity risks are short term risks while trading liquidity risks are longer term risks.
 - d. Funding liquidity risks are associated only with the bank assets while trading liquidity risks are associated with both assets and liabilities of the bank.
- 2. Which of the following bank events could stress the bank's liquidity position?**
- i. Maturing of bank debt
 - ii. Repurchase agreements
 - iii. Futures margins
 - iv. Staff turnover
- a. i, ii
 - b. iv
 - c. iii, iv
 - d. i, ii and iii
- 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

See page 4 for answers and explanations

Integrated Bank Risk Management

Sample Exam Answers/Explanations

1. Which of the following statements depicts a difference between funding liquidity risks and trading liquidity risks?

- a. Funding liquidity risks are associated with how fast prices move in the market while trading liquidity risks originate out of bank trades.
- b. Funding liquidity risks are concerned with the ability of the bank to fund deposits withdrawals while trading liquidity risks are concerned with the change in bid-offer spreads of asset values.
- c. Funding liquidity risks are short term risks while trading liquidity risks are longer term risks.
- d. Funding liquidity risks are associated only with the bank assets while trading liquidity risks are associated with both assets and liabilities of the bank.

Correct answer: b

Explanation: Funding liquidity risks are concerned with the ability of the bank to fund deposits withdrawals while trading liquidity risks are concerned with the change in bid-offer spreads of asset values.

2. Which of the following bank events could stress the bank's liquidity position?

- i. Maturing of bank debt
 - ii. Repurchase agreements
 - iii. Futures margins
 - iv. Staff turnover
-
- a. i, ii
 - b. iv
 - c. iii, iv
 - d. i, ii and iii

Correct answer: d

Explanation: Maturing of bank debt, repurchase agreements and futures margins could put stress on the bank's liquidity position. Staff turnover does not put stress on the liquidity position of the bank.

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

Market Risk Management

Sample Exam Questions

- 1. Most loans and deposits in the interbank market have a maturity of:**
 - a. More than 10 years
 - b. More than 5 years but less than 10 years
 - c. More than 3 years but less than 5 years
 - d. Less than one year

- 2. If the yield on the 3-month risk free bonds issued by the U.S government is 0.5%, and the 3-month LIBOR rate is 2.5%, what is the TED spread?**
 - a. 0.5%
 - b. -2.0%
 - c. 2.0%
 - d. 3.0%

- 3. Which If the yield on the 3-month risk free bonds issued by the U.S government is 0.5%, and the TED spread is 2.0%, what is the 3-month LIBOR rate?**
 - a. 0.5%
 - b. 2.0%
 - c. 1.5%
 - d. 2.5%

See page 6 for answers and explanations

Market Risk Management

Sample Exam Answers/Explanations

1. Most loans and deposits in the interbank market have a maturity of:

- a. More than 10 years
- b. More than 5 years but less than 10 years
- c. More than 3 years but less than 5 years
- d. Less than one year

Correct answer: d

Explanation: Most loans and deposits in the interbank market are of maturity less than one year.

2. If the yield on the 3-month risk free bonds issued by the U.S government is 0.5%, and the 3-month LIBOR rate is 2.5%, what is the TED spread?

- a. 0.5%
- b. -2.0%
- c. 2.0%
- d. 3.0%

Correct answer: c

Explanation: The TED spread is calculated as 3-month LIBOR rate - 3-month risk free rate.

Thus the TED spread is $2.5\% - 0.5\% = 2.0\%$.

3. Which If the yield on the 3-month risk free bonds issued by the U.S government is 0.5%, and the TED spread is 2.0%, what is the 3-month LIBOR rate?

- a. 0.5%
- b. 2.0%
- c. 1.5%
- d. 2.5%

Correct answer: d

Explanation: The TED spread is calculated as 3-month LIBOR rate - 3-month risk free rate.

Thus the LIBOR rate is $0.5\% + 2.0\% = 2.5\%$.

Operational Risk Management

Sample Exam Questions

1. Which one of the following four statements correctly identifies the Basel II Accord's definition of operational risk?

- a. Operational risk is all the risk that is not captured by market and credit risks.
- b. Operational risk is the risk of loss resulting from inadequate or failed processes, people and systems or from external events.
- c. Operational risk is a risk arising from execution of a company's business functions.
- d. Operational risk is a form of risk that summarizes the risks a company or firm undertakes when it attempts to operate within a given field or industry.

2. Which of the following factors are typically included in standard operational risk definitions?

- i. Human errors
- ii. Process failure
- iii. Systems failure
- iv. Unexpected events

- a. i, ii
- b. i, iv
- c. ii, iii
- d. i, ii, iii

3. 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

See page 8 for answers and explanations

Operational Risk Management

Sample Exam Answers/Explanations

1. Which one of the following four statements correctly identifies the Basel II Accord's definition of operational risk?

- a. Operational risk is all the risk that is not captured by market and credit risks.
- b. Operational risk is the risk of loss resulting from inadequate or failed processes, people and systems or from external events.
- c. Operational risk is a risk arising from execution of a company's business functions.
- d. Operational risk is a form of risk that summarizes the risks a company or firm undertakes when it attempts to operate within a given field or industry.

Correct answer: b

2. Which of the following factors are typically included in standard operational risk definitions?

- i. Human errors
- ii. Process failure
- iii. Systems failure
- iv. Unexpected events

- a. i, ii
- b. i, iv
- c. ii, iii
- d. i, ii, iii

Correct answer: d

Explanation: There are four main causes of operational risk that are identified in standard operational risk definitions. Operational risk event can occur when there are inadequacies or failures due to people (human factors), processes, systems, or external events. Unexpected events are not one of the causes identified in standard operational risk definitions.

3. 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

Explanation: The Basel II definition of operational risk includes legal risk, but excludes strategic and reputational risk. Geopolitical risk is not included in the definition of operational risk either.