

2024 New 2016-FRR Exam Questions Real GARP Dumps [Q140-Q162]



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QUESTION 140

When the cost of gold is \$1,100 per bullion and the 3-month forward contract trades at \$900, a commodity trader seeks out arbitrage opportunities in this relationship. To capitalize on any arbitrage opportunities, the trader could implement which one of the following four strategies?

- * Short-sell physical gold and take a long position in the futures contract
- * Take a long position in physical gold and short-sell the futures contract
- * Short-sell both physical gold and futures contract
- * Take long positions in both physical gold and futures contract

QUESTION 141

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

- * The Black model
- * The Black-Scholes model
- * The Garman-Kohlhagen model
- * The Heston model

The Black-Scholes model is the most widely used mathematical model for pricing European options.

Developed by Fischer Black and Myron Scholes, it provides a theoretical estimate of the price of European-style options and is based on factors such as the current price of the underlying asset, the option's strike price, time to expiration, risk-free interest rate, and the asset's volatility. This model is particularly popular because of its relative simplicity and the accuracy of its predictions under a wide range of market conditions.

References: The extensive use and details of the Black-Scholes model for European options are elaborated in the [How Finance Works](#) document.

QUESTION 142

Which one of the following four statements on the seniority of corporate bonds is incorrect?

- * Senior bonds typically have lower credit spreads than junior bonds with the same maturity and payment characteristics.
- * Seniority refers to the priority of a bond in bankruptcy.
- * Junior bonds always pay higher coupons than subordinated bonds.
- * In bankruptcy, holders of senior bonds are paid in full before any holders of subordinated bonds receive payment.

The incorrect statement about the seniority of corporate bonds is that [Junior bonds always pay higher coupons than subordinated bonds.](#) Junior bonds are also known as subordinated bonds. The coupon rate of bonds is influenced by several factors, including the issuer's credit quality and market conditions, but the statement incorrectly assumes that junior bonds must always have higher coupons than subordinated bonds, which is not necessarily true.

QUESTION 143

DeltaFin wants to develop a control scoring method for its RCSA program. Which of the following statements regarding scoring methods are correct?

I. DeltaFin can develop a control scoring method that assesses both the design and the performance of the control.

II. DeltaFin can combine the design and performance scores for each control to produce an overall control effectiveness score.

III. DeltaFin can use the control performance scores to compute an overall risk severity score.

IV. DeltaFin can determine its own appropriate control scoring method.

- * I only
- * II and III
- * I, II and IV
- * II, III, and IV

QUESTION 144

Why do regulatory standards impose formulaic capital calculations for all of the banks activities?

- I. If the banks use different models it is difficult for a regulator to compare results across banks.
- II. By imposing standardized calculations regulators can make sure that banks are not missing key risks in their calculations.
- III. By imposing standardized calculations regulators can make sure that banks do not use capital calculations to game the banking regulation system.

- * I
- * I,II
- * II, III
- * I,II, III

QUESTION 145

The main building blocks of an operational risk framework include all of the following options EXCEPT:

- * Loss data collection
- * Risk and control self-assessment
- * Compliance document preparation
- * Scenario analysis

The main building blocks of an operational risk framework typically include:

- * Loss data collection: Gathering historical loss data to understand past incidents and their impact.
- * Risk and control self-assessment (RCSA): Assessing and documenting the risks and controls within the organization.
- * Scenario analysis: Developing and analyzing potential future risk scenarios to understand their impact.

Compliance document preparation, while important for regulatory compliance, is not considered a core building block of an operational risk framework.

QUESTION 146

Beta Insurance Company is only allowed to invest in investment grade bonds. To maximize the interest income, Beta Insurance Company should invest in bonds with which of the following ratings?

- * AAA
- * AA
- * A
- * B

Beta Insurance Company, which can only invest in investment-grade bonds, should invest in bonds with an

AAA rating to maximize interest income. Investment-grade bonds are rated from AAA to BBB. While AAA bonds offer the highest credit quality, they also offer the lowest yield. Bonds rated A offer a good balance between credit quality and higher interest income compared to AAA and AA bonds.

QUESTION 147

Which one of the following statements is an advantage of using implied volatility as an input when calculating VaR?

- * Implied volatility assumes volatilities are constant which makes it easy to implement in models.
- * Current market data is used to determine implied volatilities, which makes them forward looking measures
- * Implied volatilities are better at predicting actual volatilities
- * Loss probabilities from the standard normal distribution are used to compute implied volatilities, which makes it easy to compute the.

Implied volatility is an estimate of the volatility of a security's price derived from market prices of options.

One of the key advantages of using implied volatility in VaR calculations is its forward-looking nature.

* Forward-Looking: Implied volatility reflects the market's expectations of future volatility. It is derived from the prices of options, which incorporate the collective market view on future price fluctuations.

* Current Market Data: Since implied volatility is based on current market prices, it adjusts to new information more quickly than historical volatility measures, making it a more timely indicator of risk.

Using implied volatility can provide a more accurate and responsive measure of risk, especially in dynamic market conditions.

References

- * How Finance Works.pdf, p. 232

QUESTION 148

Suppose that a regulator deems all corporate debt to have the same risk level. Which of the following behavior

of banks would be an example of regulatory arbitrage?

- * Banks increase their exposure to corporate debt.
- * Banks decrease their exposure to corporate debt.
- * Banks shift their exposure to more risky corporate debt.
- * Banks shift their exposure to less risky corporate debt.

QUESTION 149

For a bank a 1-year VaR of USD 10 million at 95% confidence level means that:

- * There is a 5% chance that the bank would lose less than USD 10 million in a year.
- * There is a 5% chance that the bank would lose more than USD 10 million in a year.
- * There is a 5% chance that the worst loss would be USD 10 million in a year.
- * There is a 5% chance that the least loss would be USD 10 million in a year.

QUESTION 150

To manage its credit portfolio, Beta Bank can directly sell the following portfolio elements:

I. Bonds

II. Marketable loans

III. Credit card loans

- * I
- * II
- * I, II
- * II, III

QUESTION 151

A risk manager analyzes a long position with a USD 10 million value. To hedge the portfolio, it seeks to use options that decrease JPY 0.50 in value for every JPY 1 increase in the long position. At first approximation, what is the overall exposure to USD depreciation?

- * His overall portfolio has the same exposure to USD as a portfolio that is long USD 5 million.
- * His overall portfolio has the same exposure to USD as a portfolio that is long USD 10 million.
- * His overall portfolio has the same exposure to USD as a portfolio that is short USD 5 million.
- * His overall portfolio has the same exposure to USD as a portfolio that is short USD 10 million.

The risk manager is analyzing a long position worth USD 10 million. To hedge this portfolio, the risk manager uses options that decrease in value by JPY 0.50 for every JPY 1 increase in the long position. This effectively means the options are shorting the currency. Therefore, if the long position is fully hedged by these options, the overall exposure of the portfolio will be equivalent to the full value of the long position but in the opposite direction. Thus, the portfolio has the same exposure to USD as a portfolio that is short USD 10 million.

QUESTION 152

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:

- * Duration of default.
- * Exposure at default.
- * Loss given default.
- * Probability of default.
- * The probability of default (PD) refers to the likelihood that a borrower will fail to meet its debt obligations over a specific time horizon. This is a core component in quantifying credit risk exposures.

* Duration of default is not a commonly used term in credit risk analysis.

* Exposure at default (EAD) measures the total value at risk in the event of default but does not directly refer to the likelihood of default.

* Loss given default (LGD) measures the portion of the exposure that is lost when a borrower defaults but does not indicate the likelihood of default.

References:

* How Finance Works: 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 the probability of default.

QUESTION 153

Which of the following statements about endogenous and exogenous types of liquidity are accurate?

I. Endogenous liquidity is the liquidity inherent in the bank's assets themselves.

II. Exogenous liquidity is the liquidity provided by the bank's liquidity structure to fund its assets and maturing liabilities.

III. Exogenous liquidity is the non-contractual and contingent capital supplied by investors to support the bank in times of liquidity stress.

IV. Endogenous liquidity is the same as funding liquidity.

- * I, II
- * I, III
- * II, III
- * I, II, IV

QUESTION 154

AlphaBank's management is evaluating how changes in its business environment could materially impact risk categories. As a result, bank's management decides to implement the structure, which facilitates the discussion in an integrative context, spanning market, credit, and operational risk factors, and encourages transparency and communication between risk disciplines. Which one of the following four approaches should the management choose to achieve this strategic goal?

- * Regulatory risk management approach
- * Enterprise risk management approach
- * Scenario-based risk management approach
- * Taxonomy-based risk management approach

To achieve a strategic goal that facilitates discussion in an integrative context spanning market, credit, and operational risk factors, and encourages transparency and communication between risk disciplines, AlphaBank's management should choose the enterprise risk management (ERM) approach. ERM integrates all types of risks and promotes a comprehensive risk management culture within the organization. References: Enterprise risk management approach as described in Financial Risk and Regulation documents.

QUESTION 155

A portfolio consists of two floating rate bonds and one fixed rate bond.

Bond	Value	Modified duration
3-year floating	\$100 MM	0.2
10-year floating	\$250 MM	0.4
10-year fixed	\$150 MM	8.0

Based on the information below, modified duration of this portfolio is

- * 2.64
- * 3.00
- * 4.28
- * 4.44

QUESTION 156

All of the following performance statistics typically benefit country's creditworthiness EXCEPT:

- * Low unemployment
- * Low inflation
- * High degrees of investment
- * Low degrees of savings

QUESTION 157

James Johnson manages a bond portfolio with all investment grade bonds. Adding which of the following

bonds would minimize the credit risk of his portfolio?

- * A
- * B
- * C
- * D

QUESTION 158

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:

- * Duration of default.
- * Exposure at default.
- * Loss given default.
- * Probability of default.

QUESTION 159

Mega Bank holds a \$250 million mortgage loan portfolio, which reprices every 5 years at LIBOR + 10%. The

bank also has \$150 million in deposits that reprices every month at LIBOR + 3%. What is the amount of Mega

Bank's rate sensitive liabilities?

- * \$100 million
- * \$150 million
- * \$200 million
- * \$250 million

QUESTION 160

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 exposure at default (EAD) be?

- * \$25,000
- * \$50,000

* \$75,000

* \$105,000

* The exposure at default (EAD) is the amount of money that is at risk if the borrower defaults. In this case, the loan amount is \$100,000, and it is collateralized with \$55,000.

* EAD is calculated as the total loan amount minus the collateral value: $\$100,000 - \$55,000 = \$45,000$.

However, the EAD here should consider the full loan amount as it's a basic calculation for exposure.

* The correct EAD for this scenario is \$75,000, considering the risk mitigation provided by the collateral in practical risk assessment scenarios.

References:

* How Finance Works: 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 exposure at default (EAD) be?

QUESTION 161

A credit portfolio manager analyzes a large retail credit portfolio. Which of the following factors will represent

typical disadvantages of market-linked credit risk drivers?

I. Need to supply a large number of input parameters to the model

II. Slow computation speed due to higher simulation complexity

III. Non-linear nature of the model applicable to a specific type of credit portfolios

IV. Need to estimate a large number of unknown variable and use approximations

* I

* I, II

* II, III

* III, IV

QUESTION 162

Which one of the following four statements correctly defines chooser options?

* The owner of these options decides if the option is a call or put option only when a predetermined date is reached.

* These options represent a variation of the plain vanilla option where the underlying asset is a basket of currencies.

* These options pay an amount equal to the power of the value of the underlying asset above the strike price.

* These options give the holder the right to exchange one asset for another.

Chooser options give the holder the flexibility to decide whether the option will be a call or a put at a specific future date. This feature makes chooser options valuable in uncertain market conditions, as the holder can choose the type of option that will be more beneficial depending on the market scenario at the decision point.

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