2016-FRR Q&As

Financial Risk and Regulation (FRR) Series

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QUESTION 1

What are some of the drawbacks of correlation estimates? Which of the following statements identifies major problems with correlation calculations?

I. Correlation estimates are not able to capture increases in factor co-movements in extreme market scenarios.

II. Correlation estimates tend to be unstable.

III. Historical correlations may not forecast future correlations correctly.

IV.

Correlation estimates assume normally distributed returns.

A.

I and II

B.

I and IV

C.

I, II and III

D.

II, III, and IV

Correct Answer: C

QUESTION 2

Which one of the following four metrics represents the difference between the expected loss and unexpected loss on a credit portfolio?

A. Credit VaR

B. Probability of default

C. Loss given default

D. Modified duration

Correct Answer: A

QUESTION 3

Which of the following are conclusions that could be drawn from the shape of the statistical distribution of losses that a

bank might incur over a future time period?

I. In most years a bank would look more profitable than it will be on average.

II. Most of the time a sufficiently well capitalized bank will appear over-capitalized.

III.

Bad years do not come along very often, but when they do they lead to enormous losses.

A.

I, II

B.

I, III

C.

II, III

D.

I, II, III

Correct Answer: D

QUESTION 4

Which one of the following four statements about the "market-maker" trading strategy is INCORRECT?

A. A market maker that attracts buy and sell orders can make a profit from the spread quoted between the buy and sell price.

B. A market maker can benefit from the market information she gets from the trades she is asked to execute.

C. This strategy is independent of market liquidity and number of other market makers.

D. This risk in this strategy is that traders have to take positions that may quickly incur a loss.

Correct Answer: C

QUESTION 5

John owns a bond portfolio worth $2 million with duration of 10. What positions must he take to hedge this portfolio against a small parallel shifts in the term structure.

A. Long position worth $2 million with duration of 10.

B. Long position worth $20 million with duration of 1.

C. Short position worth $2 million with duration of 10.

D. Short position worth $20 million with duration of 1.

Correct Answer: C

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