2024 FRM Part II Practice Exam #1 – Answer Key

1.	C	21.	B	41.	B	61.	D
2.	C	22.	B	42.	C	62.	C
3.	D	23.	A	43.	B	63.	A
4.	C	24.	A	44.	B	64.	D
5.	A	25.	C	45.	A	65.	B
6.	A	26.	C	46.	B	66.	D
7.	D	27.	C	47.	D	67.	C
8.	B	28.	A	48.	B	68.	B
9.	D	29.	B	49.	A	69.	C
10.	C	30.	A	50.	B	70.	C
11.	D	31.	B	51.	B	71.	B
12.	C	32.	A	52.	C	72.	C
13.	D	33.	C	53.	A	73.	B
14.	C	34.	A	54.	B	74.	A
15.	B	35.	B	55.	A	75.	C
16.	A	36.	C	56.	B	76.	D
17.	C	37.	B	57.	A	77.	B
18.	B	38.	C	58.	B	78.	A
19.	C	39.	B	59.	C	79.	D
20.	C	40.	C	60.	D	80.	B

1.	Question	A risk consultant has been tasked with assessing a small bank's liquidity risk profile. While reviewing a presentation produced by the bank, the consultant comes across a list of early warning indicators used to signal potentially heightened liquidity risk. Which of the following trends should the consultant consider as the strongest warning signal for potential liquidity risk at the bank?
	A	Decrease in stock price of the bank's peers but not in the stock price of the bank itself.
	B	Increase in credit lines received from other financial institutions.
	C	Widening spreads on the bank's issued debt and credit default swap.
	D	Significant asset growth funded by an increase in stable liabilities.
	Correct Answer	C
	Explanation	C is correct. Wider spreads indicate a loss of market confidence in the bank and a higher cost of funding. A is incorrect. A more bank-specific early-warning-indicator (EWI) would be a decrease in stock price of the bank relative to its peers. B is incorrect. A decrease, not an increase, in credit lines is problematic for liquidity. D is incorrect. Rapid asset growth funded by volatile liabilities would be more problematic.
	Section	Liquidity and Treasury Risk
	Learning Objective	Evaluate the characteristics of sound Early Warning Indicators (EWI) measures.
	Reference	Shyam Venkat, Stephen Baird, Liquidity Risk Management (John Wiley & Sons, 2016). Chapter 6 - Early Warning Indicators

2. Question

A risk manager is estimating the market risk of a portfolio using both the arithmetic returns with normal distribution assumptions and the geometric returns with lognormal distribution assumptions. The manager gathers the following data on the portfolio:

- Annualized average of arithmetic returns: 16%
- Annualized standard deviation of arithmetic returns: 27%
- Annualized average of geometric returns: 13%
- Annualized standard deviation of geometric returns: 29%
- Current portfolio value: EUR 5,200,000
- Trading days in a year: 252

Assuming both daily arithmetic returns and daily geometric returns are serially independent, which of the following statements is correct?

A The 1-day normal 95% VaR is equal to 1.63% and the 1-day lognormal 95% VaR is equal to 1.76%.

B The 1-day normal 95% VaR is equal to 2.69% and the 1-day lognormal 95% VaR is equal to 2.88%.

C The 1-day normal 95% VaR is equal to 2.74% and the 1-day lognormal 95% VaR is equal to 2.92%.

D The 1-day normal 95% VaR is equal to 3.26% and the 1-day lognormal 95% VaR is equal to 3.48%.

Correct Answer: C

Explanation: 1-day normal 95% VaR = -[(0.16/252)-1.645*0.27/sqrt(252)] = 2.74%
1-day lognormal 95% VaR = 1-exp[(0.13/252)-0.29*1.645/sqrt(252)] = 2.92%

Section: Market Risk Measurement and Management

Learning Objective: Estimate VaR using a parametric approach for both normal and lognormal return distributions.

Reference: Kevin Dowd, Measuring Market Risk, 2nd Edition (West Sussex, England: John Wiley & Sons, 2005). Chapter 3 - Estimating Market Risk Measures: An Introduction and Overview