

FRM Part I Exam

By AnalystPrep

Questions - Foundations of Risk Management

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Reading 1: The Building Blocks of Risk Management

Q.1 In the context of financial markets, liquidity can be categorized into different types, each with its unique characteristics and implications. Market liquidity, in particular, is a critical aspect that investors and financial institutions often consider. Given the following definitions, which one is most likely to be associated with the concept of market liquidity?

- A. The risk that a bank will not be able to roll over a repo to finance their short-term cash flow needs.
 - B. The risk that depositors will flock into banks and withdraw their funds or that shareholders will redeem their shares en masse.
 - C. The risk that the collateral value of an asset will decline after a derivative position is established, resulting in an increase in the margin requirement.
 - D. The risk that an investor who lends out an asset will be forced to sell at a lower price once the asset is returned.
-

Q.3 In 2016, the United Kingdom made a historic decision to exit the European Union, a move commonly referred to as 'Brexit'. Following this decision, the value of the British pound depreciated against other major global currencies such as the U.S. dollar and the Chinese Yuan. Which one of the following risks best explains this observation?

- A. Interest rate risk
 - B. Foreign exchange risk
 - C. Reputation risk
 - D. Equity risk
-

Q.4 Market risk, also known as systematic risk, is a type of risk that is inherent to the entire market or market segment. Which of the following scenarios would be considered an example of market risk?

- A. Inadequate/malfunctioning computer systems
 - B. Circumvention of issued regulations and guidelines
 - C. Occurrence of a natural disaster, such as a tornado
 - D. An increase in the price of gas
-

Q.5 In the context of business operations, risk management plays a crucial role in ensuring the stability and sustainability of an organization. One approach to risk management is the enterprise-wide risk management. This approach is characterized by certain features that distinguish it from other risk management strategies. Based on your understanding of enterprise-wide risk management, which of the following best describes enterprise-wide risk management?

- A. Applying risk management within individual departments on a piecemeal basis.
 - B. Risk management that includes all major departments in a company.
 - C. A structured and consistent set of principles or risk management that are applied across the whole of a company.
 - D. Risk management that encompasses all business units.
-

Q.6 In financial markets, risk management plays a pivotal role in safeguarding investments and financial activities from potential losses. It involves a series of activities that aim to create economic value. Among the following options, which one best encapsulates the definition of risk management in the context of financial markets?

- A. The practice of creating economic value by identifying and investing in risky projects that could earn a profit.
 - B. The practice of avoiding an extremely risky financial undertaking to prevent a loss.
 - C. The practice of creating economic value by identifying and measuring risks, and formulating robust plans to address and manage these risks.
 - D. Setting risk limits beyond which an entity should not operate.
-

Q.7 Tohoday, a motor vehicle production company, has historically channeled most of its earnings and spare cash into short-term government bonds maturing in less than a year. The board wishes to change its investment policy substantially and intends to tap the riskier but more profitable long-term bond market. Assuming you're the risk manager for the company, which of the following risks would be of utmost (immediate) concern from an operational point of view?

- A. Trading liquidity risk
- B. Funding liquidity risk
- C. Interest rate risk
- D. Market risk

Q.8 In financial risk management, particularly in relation to credit risk, two key concepts are 'expected loss' and 'unexpected loss'. These terms are used to estimate potential credit losses and are integral to the risk management strategies of financial institutions. Which of the following accurately differentiates between expected loss and unexpected loss?

- A. Expected loss is the average credit loss we expect from an exposure while unexpected loss is the loss that occurs over and above the expected loss.
 - B. Unexpected loss is the average credit loss we expect from an exposure while expected loss is the loss that occurs over and above the unexpected loss.
 - C. Expected loss is the average credit loss that we would expect from an exposure while unexpected loss is the loss that would occur without a quantitative expression.
 - D. Expected loss is the average credit loss that we would expect from an exposure while unexpected loss is the sum of expected losses from several time periods.
-

Q.9 The concept of risk and reward is a fundamental principle that governs investment decisions. This principle suggests a certain relationship between the level of risk an investor is willing to take and the potential reward they might receive. Which of the following statements accurately describes this relationship between investment risk and potential reward?

- A. As the investment risk increases, the reward decreases.
 - B. As the investment risk decreases, the reward increases.
 - C. As the investment risk increases, the potential for reward increases.
 - D. The relation between investment risk and reward depends on the financial product.
-

Q.10 Credit risk is a primary category that encompasses several sub-types of risk. Among the following options, which one would most likely be classified as credit risk?

- A. Commodity price risk
 - B. Currency exchange risk
 - C. Interest rate risk
 - D. Default risk
-

Q.11 In risk management, risks are often categorized as either quantifiable or non-quantifiable. Quantifiable risks can be measured in numerical terms and are often associated with financial or market risks. Non-quantifiable risks, on the other hand, are difficult to measure numerically and are often associated with event or operational risks. Given this context, which of the following pairs correctly associates a quantifiable risk with a non-quantifiable risk?

- A. Quantifiable: Interest rate risk; Non-quantifiable: Default risk
 - B. Quantifiable: Civil war; Non-quantifiable: Liquidity risk
 - C. Quantifiable: Equity price risk; Non-quantifiable: Risk of terrorist attack
 - D. Quantifiable: Civil war; Non-quantifiable: Settlement risk
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Q.13 A public company is evaluating several projects for potential implementation. The risk manager, during his appraisal, identifies that some of these projects may lead to conflicts with the Food and Drug Administration due to potential ethical issues and violations of human safety standards. Which type of risk is the company primarily exposed to in this situation?

- A. Operational risk
 - B. Credit risk
 - C. Market risk
 - D. Liquidity risk
-

Q.14 In finance and investment, risks are often categorized into different types based on their nature and impact. Two such categories are systemic risks and specific risks. These two types of risks differ in terms of their scope and the entities they affect. The difference between systemic and specific risks is that:

- A. Systemic risk refers to the risks that affect the entire economy, while specific risks are risks that affect only a particular company or line of business.
 - B. Systemic risks are risks borne by a single entity while specific risks are borne by the economy as a whole.
 - C. Systemic risks are quantifiable while specific risks are non-quantifiable.
 - D. Systemic risk is diversifiable while specific risk is non-diversifiable.
-

Q.15 Financial institutions are constantly striving to maintain and enhance the trust and confidence of their stakeholders, which include customers, lenders, shareholders, among others. This trust is crucial as it ensures that each party feels secure about their interests. What type of risk is most relevant that companies need to manage to ensure the confidence of all stakeholders is not compromised?

- A. Legal and regulatory risk
 - B. Reputation risk
 - C. Specific risk
 - D. Operational risk
-

Q.33 In the context of financial risk management, the purpose of economic capital is to absorb:

- A. economic losses
 - B. expected loss
 - C. unexpected loss
 - D. tail loss
-

Q.35 The relationship between risk and return is simple for some assets and complex for others. The public perception of risk and return trade-off is that higher risk will lead to higher returns. However, in some asset classes like fixed-income securities, a large number of factors such as market risk, inflation, interest rate risk, and risk tolerance are considered. Which of the following options is most appropriate for a market with investors having a high risk tolerance?

- A. As the risk tolerance of investors is high, more investors will choose corporate bonds over government bonds
 - B. As the risk tolerance of investors is high, more investors will choose government bonds over corporate bonds
 - C. As the risk tolerance of investors is high, all investors will choose a good mix of corporate and government bonds
 - D. As the risk tolerance of investors is high, all investors will choose not to buy corporate bonds
-

Q.36 Equity price risk is the type of market risk that refers to the variability in the prices of equity or stocks. Equity price risk is further subdivided into specific risk and systematic risk. Which of the following is most likely a type of specific risk?

- A. The risk of changes in the consumer price index (CPI).
 - B. The risk of change in the aggregate demand of a specific sector.
 - C. The risk of strategic weaknesses in a business.
 - D. The risk of changes in tax rates.
-

Q.37 BT Motors and New Atlas bank are two parties of a derivative contract to hedge exchange rate risk. At the end of the contract, BT Motors has a net loss position of \$6.9 million but refused to pay the entire amount. Which of the following sub-types of credit risk best describes this situation?

- A. Bankruptcy risk.
 - B. General market Risk.
 - C. Settlement risk.
 - D. Default risk.
-

Q.5298 Which of the following definitions of bankruptcy risk is correct?

- A. The potential risk of harm to a company's brand or reputation resulting from negative public perception or publicity.
 - B. The potential risk of financial, operational, or reputational harm to a company resulting from cyber threats or attacks.
 - C. The likelihood that a company will become insolvent and unable to meet its financial obligations to creditors and investors.
 - D. The likelihood that a borrower will default on their debt obligations, resulting in financial losses for the lender.
-

Q.5299 A financial analyst is analyzing a bank's financial health and is particularly worried about the potential increase in the bank's cost of debt due to a possible decline in its credit rating. This concern is associated with which type of risk among the following options?

- A. Interest Rate Risk
 - B. Equity Price Risk
 - C. Bankruptcy Risk
 - D. Downgrade Risk
-

Q.5300 Which of the following risks is associated with uncertainties in demands, the cost of production, and the cost of delivery of products?

- A. Operational Risk
 - B. Business Risk
 - C. Strategic Risk
 - D. Liquidity Risk
-

Q.5303 Which statement best describes a benefit of using the Risk-Adjusted Return on Capital (RAROC)?

- A. It considers systemic risk.
 - B. It helps financial institutions allocate their capital effectively.
 - C. It considers non-financial risks, such as operational risk.
 - D. It is simple to calculate.
-

Q.5304 Which of the following methods of risk management involves derivative products where a company pays a premium to a party to accept a certain level of risk?

- A. Avoiding the risk.
- B. Retaining the risk.
- C. Transferring the risk.
- D. Mitigating the risk.

Q.5306 An analyst is calculating the expected loss using the following information.

Probability of default	2%
Loss given default	50%
Z-Score	1.645
Standard deviation	2.59
Exposure at default	\$1,000,000

The expected loss is closest to?

- A. \$20,000
- B. \$500,000
- C. \$10,000
- D. \$51,800

Reading 2: How Do Firms Manage Financial Risk?

Q.17 A Canadian company harbors an ambitious plan to launch a project in the U.S. in twelve months. The company uses the Canadian dollar as the functional currency, and the project would most likely be executed in U.S. dollars. However, the company's top management is worried that the CAD will weaken against the USD in the months leading up to the beginning of the project, which might, in turn, increase the amount the company will have to pay for the project. As the company's risk manager, which of the following business strategies would work best regarding the foreign exchange risk?

- A. Launching the project earlier than planned.
 - B. Take a hedging position in the form of a currency futures contract.
 - C. Advise the company to purchase stock index futures.
 - D. Immediately pay for some upfront costs of the project.
-

Q.18 In risk management, the term 'hedging' is often used to describe a specific strategy aimed at protecting the value of an asset or portfolio against potential losses due to market fluctuations. Which of the following options most accurately captures the essence of this concept?

- A. Buying an asset to offset a decline in value of another asset.
 - B. Holding an asset that appreciates in value to offset the decrease in the value of another asset.
 - C. Selling a loss-making asset and replacing it with a profitable one.
 - D. Holding an offsetting position in an asset or portfolio whose value we expect to move in line with market changes.
-

Q.19 An international construction company places a bid for a major construction project. Top management is convinced the company will secure the contract but are also wary of currency fluctuations during the bids evaluation process, which would make the project more costly and reduce the profit margin. Which of the following actions do you think can reduce this risk?

- A. Negotiating the price of construction materials with sellers in advance
 - B. Purchasing construction materials in advance with the option to sell them if the bid turns out unsuccessful
 - C. Getting into a currency futures contract
 - D. Adding a risk premium to the bid amount
-

Q.20 In a company's risk management strategy, the risk appetite statement plays a crucial role. It outlines the types of risks the company is willing to take, the risk management tools it prefers to use, and the maximum loss it is prepared to bear within a certain confidence limit and timeframe. Given these elements, which of the following is most likely to be excluded from a company's risk appetite statement?

- A. The types of risks the firm is willing to tolerate, specifying the risks to hedge and the ones to assume
 - B. The preferred risk management tools e.g, insurance, derivatives, etc.
 - C. The maximum loss the firm is willing to incur at a given confidence limit and time
 - D. The timings of cash flows from the firm's projects
-

Q.23 Distinguish between exchange-traded and over-the-counter risk management instruments.

- A. Exchange-traded instruments are standardized and exchange-tradable while over-the-counter instruments are non-standardized, privately negotiated financial contracts that cannot be traded on an exchange.
- B. Over-the-counter instruments are standardized and exchange-tradable while exchange-traded instruments non-standardized, privately negotiated financial contracts that cannot be traded on an exchange.
- C. Exchange-traded instruments are those instruments that only deal with intangible financial assets while over-the-counter instruments only deal with commodities such as coffee.
- D. Exchange-traded instruments have time to maturity of less than one year while over-the-counter instruments have longer maturity periods.

Q.25 A firm borrows funds at a variable interest rate. Buying which of the following instruments would help the firm protect itself against increases in the market rate of interest?

- A. Currency forward contracts
 - B. Options on interest rate futures
 - C. Currency swaps
 - D. Currency futures contracts
-

Q.41 The board of directors of BRT Inc. is determining the risk appetite of the firm. It believes increasing the firm's risk appetite will introduce BRT to new potential business opportunities and increase the rewards to stakeholders. However, changing the risk appetite of a firm can be a cause of conflict between parties. Determining the risk appetite of a firm can cause the greatest conflict between:

- A. Management and debtholders.
 - B. Management and shareholders.
 - C. Shareholders and the board of directors.
 - D. Shareholders and debtholders.
-

Q.42 Anadolu Tire Company is the market leader in the tires manufacturing sector in Turkey. It acquires its raw material from its neighbor, Iran, on fixed trade terms and pays the supplier in the local Turkish currency. Anadolu also sells its tires to some eastern European countries and accepts payments in Euro. Based on the business perspective of Anadolu, determine which of the following risk it should hedge.

- A. Pricing risk.
 - B. Foreign currency risk.
 - C. Interest rate risk.
 - D. Market risk.
-

Q.5036 A firm has a total risk capacity of \$600 million. Senior managers have set a risk appetite at \$300 million. Which of the following would most likely be within the acceptable risk profile for the firm?

- A. \$400 million
 - B. \$250 million
 - C. \$900 million
 - D. \$450 million
-

Q.5307 ABC Bank's chief risk officer is trying to reduce the bank's exposure to foreign exchange fluctuations. He has suggested using an agreement where the bank gets the right without any obligation to exchange a given amount of currency at a predetermined price in the future. Which of the following derivatives is the chief risk officer suggesting?

- A. Forwards
 - B. Futures
 - C. Options
 - D. Swap
-

Reading 3: The Governance of Risk Management

Q.21 In risk management within an organization, the board plays a crucial role. This role involves various responsibilities and tasks that contribute to the overall risk management strategy of the organization. Which of the following options best describes the primary role of the board in the risk management process?

- A. Issuing guidelines on how to manage risks
 - B. Developing the risk appetite statement
 - C. Regularly reviewing decisions made by managers regarding risk exposures
 - D. Choosing the risk exposures to hedge, the risks to mitigate, and those to avoid altogether
-

Q.45 Which of the following statements best describes corporate governance in today's business world?

- A. The process by which the board of directors delegates duties to hired professionals who oversee the day-to-day running of the company.
 - B. The system of rules, practices, processes, and regulations guiding risk managers when determining a company's risk appetite.
 - C. The system of rules, regulations, and processes by which a company's board of directors looks after the needs of various stakeholders within the broader agenda of meeting business objectives.
 - D. The tools used by the board of directors to drive business strategy, corporate responsibility, and streamline the interests of the company's shareholders.
-

Q.48 A multinational corporation, GlobalTech, operates in the rapidly evolving technology sector. The company's business strategy emphasizes aggressive growth through innovation and market expansion, often involving significant investments in research and development and entry into new, untested markets. The company's executive compensation structure includes substantial bonuses tied to short-term revenue growth and market share gains. Considering the relationship between GlobalTech's risk appetite and its business strategy, which of the following statements is most likely correct?

- A. The company's risk appetite is well-aligned with its business strategy.
 - B. The company's focus creates an environment where managers are incentivized to take on excessive risks.
 - C. The company's risk appetite is too conservative for its business strategy.
 - D. The company's business strategy is too aggressive for its risk appetite.
-

Q.52 Corporate governance plays a critical role in the success and sustainability of companies, influencing relationships with key stakeholders. Understanding how suppliers and customers can reward good corporate governance is essential for enhancing business operations and fostering long-term partnerships. In which way can suppliers and customers reward good corporate governance?

- A. Purchase from a competitor offering lower prices
 - B. Demanding a higher rate of return on their investment.
 - C. Actively doing business with the company in favorable terms.
 - D. Giving extra benefits to company executives.
-

Q.55 Explain the meaning of a 'fiduciary duty' within the bounds of corporate governance.

- A. A duty that arises out of a contractual agreement.
 - B. A duty that is not stipulated in a company's constitution, but nonetheless expected to be performed by management.
 - C. A duty imposed on a person because of the position of trust and confidence in which they stand in relation to another.
 - D. The duty to prioritize the interests of the government over those of one's clients
-

Q.57

Most companies now have several subsets of the board called 'board committees'.

Why are such committees formed?

- A. To directly report to shareholders on specific issues.
 - B. To enable the directors to reduce their individual liability and therefore serve more confidently.
 - C. To enhance the overall effectiveness of the board.
 - D. To introduce independence, thereby enabling verification of decisions/materials brought to the attention of the entire board.
-

Q.59 The remuneration of the board of directors is a critical aspect of corporate governance, influencing the board's ability to effectively oversee and guide the company. Which of the following statements about the board of directors' remuneration is correct?

- A. Directors may award themselves such salary payments as they think fit
 - B. Directors must receive a salary, just like other junior employees of the company
 - C. Directors only receive a salary if the constitution of the company explicitly allows it
 - D. Directors salaries are set by the HR department of the firm
-

Q.60 Muhammad Ismail, a research analyst, has recently learned in a seminar on the quality of research report writing that the firm's corporate governance is as important as the valuation of the firm's assets. He has noted the following points regarding the implication of good corporate governance. Which of them are not considered best practices of corporate governance?

- A. The board of director should be comprised of a majority of independent members.
 - B. A director from outside of the industry should be provided training before joining the board.
 - C. The board will consider the interests of stakeholders, including debtholders, while taking decisions.
 - D. The CEO of the firm must also be the chairman of the board of directors in order to bring consistency in the board decisions.
-

Q.61 Board independence is fundamental to effective corporate governance, as it ensures objective oversight and decision-making free from conflicts of interest. Identifying factors that may compromise this independence is crucial for maintaining the integrity and accountability of the board. Which of the following combinations is most likely to affect the independence of the board?

- A. Chief Executive Officer as a member of the board of directors.
 - B. Chairman of the board as a member of the remuneration committee.
 - C. Chief Executive Officer as the Chairman of the remuneration committee.
 - D. Chairman of the board as the Chairman of the ethics committee.
-

Q.64 Due to the presence of agency risk in the majority of organizations, it is necessary for the board to form a compensation committee to ensure appropriate risk is taken in relation to the long-term risk objectives. Its principal role is to design and approve the remuneration plans of management. Which of the following remuneration structures can be a potential cause of agency risk?

- A. Compensation with bonuses based on long-term revenues and objectives.
 - B. Compensation with no guaranteed bonuses.
 - C. Compensation with the clawback clause on previous bonuses if the long-term goals are unachieved.
 - D. Compensation with the bonuses based on share prices.
-

Q.5308 Simon Harvey has recently assumed the role of chairman for the audit committee at his bank. In their initial meeting, a member highlights the committee's responsibilities. Which of the following statements accurately reflects their role?

- A. Identifying and assessing the organization's risks, including operational, financial, strategic, reputational, and compliance risks.
 - B. Reviewing and approving risk management strategies and plans to mitigate and manage risks.
 - C. Overseeing the financial reporting process to ensure accuracy, completeness, and transparency of financial statements and disclosures.
 - D. Communicating executive compensation decisions to shareholders and other stakeholders in the organization.
-

Q.5309 Jane Doe has just been promoted to the position of Chief Risk Officer. At the beginning of her tenure, she is handed her job description by the board of directors and Chief Executive. Which of the following statements gives a correct description of her new role?

- A. Verify the activities of the firm to see if the reports outline the same
 - B. Define the level of risk the organization is willing to accept.
 - C. Review and approve the organization's policies.
 - D. Ensure compliance with regulations and standards related to risk management.
-

Reading 4: Credit Risk Transfer Mechanisms

Q.3718 Credit default swaps (CDS) are financial derivatives used to hedge or speculate on the credit risk of a borrower. Understanding the contractual specifications for the protection seller is crucial for evaluating the obligations and benefits involved in these transactions. What are the contractual specifications for the protection seller of a credit default swap?

- A. The protection buyer pays a premium to the protection seller at regular time intervals until a credit event occurs, in which case the protection seller pays the protection buyer compensation for the credit event.
 - B. If a credit event occurs, the protection seller is obliged to exchange contractually specified assets for government bonds.
 - C. The protection seller pays a premium to the protection buyer at regular time intervals until a credit event occurs, in which case the protection buyer pays the protection seller compensation for the credit event.
 - D. If the underlying of the credit default swap is a bond issued by a specific corporation, only this corporation can act as a protection seller.
-

Q.3719 The practice of approving mortgages in order to sell them as mortgage-backed securities is known as:

- A. Originate-to-distribute
 - B. Originate-to-keep
 - C. Principal-agent engineering
 - D. A credit default swap
-

Q.3721 Global Tech has declared its intention to bring to the market a 10-year senior bond issue at par with a coupon rate of 23%, offering a spread of 1200 basis points over the corresponding 10-year Treasury issue. An investor is keen to enter into a total return swap that matures in one year with the senior bonds that are about to be issued as the reference obligation. Under the terms of the contract, payments will be exchanged semiannually, where the total return receiver will pay the six-month Treasury rate plus 328 basis points. What is the 10-year Treasury rate at the time the bonds are issued?

- A. 10%
 - B. 12%
 - C. 11%
 - D. 13%
-

Q.3722 Credit derivatives played a significant role in the 2007/2009 financial crisis. Which of the following statements is correct regarding credit derivatives in the context of 2007/2009 financial crisis?

- A. Credit derivatives were solely responsible for causing the financial crisis.
 - B. Credit derivatives were completely withdrawn from the market after the crisis.
 - C. The blame for the crisis was solely on the use of credit derivatives and not the instruments themselves.
 - D. Complex credit derivatives like CDOs-squared and single-tranche CDOs were revived after the crisis.
-

Q.3723 Which of the following statements are correct? Credit default swaps:

- A. Present high levels of risk and are only be used by the wealthy
 - B. Allow lenders to insure themselves against the risk that a borrower will default.
 - C. It should only be used by people seeking high returns from low risk.
 - D. Do not require collateral to be posted by either the buyer or the seller of the insurance.
-

Q.3724 Credit derivatives play a crucial role in modern financial markets. The purpose of credit derivatives is to:

- A. Transfer the risk from one party to another.
 - B. Increase the risk, so that the return is larger.
 - C. Postpone the risk for both parties in the transaction.
 - D. Eliminate risk for both parties in the transaction.
-

Q.3727 Understanding the mechanics of credit default swap transactions is fundamental to comprehending the intricacies of financial risk management and derivatives trading. In a credit default swap transaction:

- A. The protection buyer is long on risk.
 - B. The protection seller is short on risk.
 - C. The protection seller makes periodic payments.
 - D. The protection buyer makes periodic payments.
-

Q.3729 An investor wishes to purchase a 5-year BBB-rated bond issued by BAC Corporation but does not want to bear the out-of-pocket costs and the inconvenience associated with long-term financing arrangements, actually going long the bond, and taking delivery. Suppose also that a bank owns the same bond and would like to extend a loan to BAC Corporation but its loans to BAC and investments in BAC debt instruments have fully exhausted its capacity to lend to BAC. Which of the following instruments would best suit the two parties in these circumstances?

- A. Credit spread swap option
 - B. Total return swap
 - C. Credit default swap
 - D. Collateralized loan obligation
-

Q.3730 Two parties decide to engage in a 2-year credit default swap. Assume that the reference entity is BAC Corporation. The notional amount of the contract is \$10 million, and the contract is cash-settled.

After one year, a default event occurs, and the bonds are valued at \$8.5 million at the time of default. Which of the following is most likely correct?

- A. The protection buyer receives \$1.5 million in compensation.
 - B. The protection buyer continues to pay premiums for one more year.
 - C. The protection buyer delivers the bond to the protection seller .
 - D. There is no compensation paid to the protection buyer.
-

Q.3731 An investor approaches a swap dealer wishing to engage in a total return swap. The underlying asset is \$10 million principal amount of a 9% BB-rated 5-year corporate bond that has semiannual interest payments. The swap dealer agrees to pay the total return on this bond for the coming 6 months in return for payments based on (1) an interest rate of 6-month LIBOR plus a spread of 30 basis points and (2) a notional principal amount equal to the face value of the underlying asset, \$10 million.

At the swap date, the bond is worth par, and the 6-month LIBOR is 6%. Suppose that at the termination date, the value of the bond has still not changed. Determine the net payment and the party that is owed. (Use discrete compounding.)

- A. Net payment = \$315,000 ; owed party is the investor
 - B. Net payment = \$450,000; owed party is the swap dealer
 - C. Net payment = \$0; no owed party
 - D. Net payment = \$135,000; owed party is the investor
-

Q.5310 ABC Bank has one of the best credit risk management strategies in the country. One way it does this is by having a rigorous screening process at the application stage. Of the four ways that banks deal with credit exposure, which one does the above strategy fall under?

- A. Retain
 - B. Avoid
 - C. Mitigate
 - D. Transfer
-

Q.5311 John Thomas has recently learned about different derivative instruments he can use in his stock trading business. He is particularly interested in an instrument that would give him the right but not the obligation to buy the underlying stock at an agreed-upon strike price at the maturity date. Which of the following derivative instruments is John Thomas referring to?

- A. American call option
 - B. European put option
 - C. American put option
 - D. European call option
-

Q.5312 Coin Bank would like to decrease its credit risk by using credit derivatives. Which of the following credit derivatives would the bank use to pool together multiple mortgage and bond loans, package them into different tranches and sell them to investors?

- A. Credit default swaps
 - B. Collateralized loan obligations
 - C. Collateralized debt obligations
 - D. Mortgage-backed security
-

Reading 5: Modern Portfolio Theory (MPT) and the Capital Asset Pricing Model (CAPM)

Q.181 Consider a graph with expected return on the vertical axis and standard deviation on the horizontal axis. What's the name of the line that connects the risk-free rate and the optimal risky portfolio?

- A. The efficient frontier
 - B. The characteristic line
 - C. The indifference curve
 - D. The capital market line
-

Q.182 The difference between the capital market line (CML) and the efficient frontier (EF) is that:

- A. The CML represents possible combinations of portfolios consisting of all possible proportions between the market portfolio and a risk-free asset while the EF represents all possible combinations of efficient portfolios, taking into account only risky assets in varying proportions.
 - B. The EF represents possible combinations of portfolios consisting of all possible proportions between the market portfolio and a risk-free asset while the CML represents all possible combinations of efficient portfolios, taking into account only risky assets in varying proportions.
 - C. The CML represents a few possible combinations of portfolios consisting of various proportions between the market portfolio and a risk-free asset while the EF represents all possible combinations of efficient portfolios, taking into account only risk-free assets in varying proportions.
 - D. The EF represents possible combinations of portfolios consisting of all possible proportions between the market portfolio and a risk-free asset while the CML represents all possible combinations of efficient portfolios, taking into account only risky assets in fixed proportions.
-