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PASS PRO Questions

1.

According to FAS 133, assets with embedded derivatives should be split between the host contract and the embedded derivative if:

- I. the payoff of the derivative is not a function of the value of the host contract.
- II. the embedded derivative meets the definition of a derivative on a stand-alone basis.
- III. the fair market value for the hybrid contract would otherwise not be reported on the balance sheet.
- IV. the economic characteristics of the contract and embedded derivative are not "clearly and closely related".

- A. I and II
- B. II and III
- C. I, II and III
- D. II, III, and IV

2.

Which of the following is NOT a recommendation of G-30?

- A. An activity related to derivatives should not be outsourced, given the nature of the risks involved.
- B. Professionals with sufficient skills and appropriate experience should undertake derivatives activity.
- C. One should account for derivatives transactions used to manage risks so as to achieve consistent income recognition.
- D. None of the above.

3.

FAS133 requires all US listed firms to:

- A. mark to market all derivatives contracts.
- B. use a VaR model for market risk management.
- C. declare the mark to market value of all derivatives contracts in the footnotes to the balance sheet.
- D. apply accrual accounting only to the derivatives contracts that meet the hedge effectiveness criterion.

4.

Consider the retrospective assessment methodology for testing the effectiveness of the hedge. What is the maximum possible gap between the two tests for effectiveness?

- A. One month.
- B. One quarter.

- C. One year.
- D. Two years.

5.

Accounting discrepancies in a trading operation are generally:

- A. corrected within the day.
- B. transferred to a corrections book.
- C. corrected if they are large, else they are left in suspense accounts.
- D. accounted for by net additions/deductions from suspense accounts.

6.

If a hedge has passed the "highly effective test", the change in the fair value of the derivative is allocated, in accordance with the hedge documentation, in three possible components or portions. Which of the following is true of the effective portion of a cash flow hedge?

- A. It is charged to current earnings.
- B. Management must decide which method, based on whether it is a loss or profit.
- C. It is finally recorded in a retained earnings account called accumulated other comprehensive income.
- D. None of the above.

7.

If a hedge has passed the "highly effective test", the change in the fair value of the derivative is allocated, in accordance with the hedge documentation, in three possible components or portions. Some portions are always recognized immediately in earnings, regardless of the type of hedging relationship. This portion is:

- A. effective.
- B. ineffective.
- C. excluded.
- D. ineffective and excluded.

8.

Which of the following forms the basis for the most prudent mark-to-market valuation of OTC contracts?

- A. Broker quotes.
- B. Simulation results.
- C. Directly observable prices.
- D. Trader's end-of-the-day values.

9.

Consider the prospective assessment methodology for testing the effectiveness of the hedge.

Which one of the following is TRUE?

- A. The period of the expectation that the hedge will be highly effective can be less than the maturity of the hedged item.
- B. The period of the expectation that the hedge will be highly effective can be more than the maturity of the hedged item.
- C. The period of the expectation that the hedge will be highly effective must be equal to the maturity of the hedged item.
- D. Cannot comment.

10.

Derivatives contracts managed under hedge accounting need to be valued at:

- A. market cost.
- B. historical cost.
- C. market cost or historical cost depending on the asset being hedged.
- D. insufficient information.

11.

A swap contract produces a(n):

- A. liability position which is reflected in the balance sheet.
- B. asset position which is not reflected in the balance sheet.
- C. asset and a liability position that are reflected in the income statement.
- D. asset and a liability position which are not reflected in the balance sheet.

12.

Under hedge accounting, a derivatives position may be valued using:

- A. accrual method.
- B. mark-to-market.
- C. lower of cost or market.
- D. any of the above.

13.

Which of the following statements about SFAS 133 is FALSE?

- A. Fair value is the relevant measure for derivatives.
- B. Derivatives appear as assets and/or liabilities on the balance sheet.
- C. Derivatives are contingent assets and liabilities that should be recorded off the balance sheet.
- D. Special hedge accounting is limited to offsetting changes in fair value or cash flows for the positions being hedged.

14.

A bank has a long position on JGB futures in Singapore and a short position on the same futures in London. It can mark-to-market the combined position by using the:

- A. closing prices for both markets.
- B. opening prices for both markets.
- C. market prices recorded at one instant when both markets are open.
- D. lowest price for the day in Singapore and the highest price for the day in London.

15.

Which of the following statements about SFAS 133 is FALSE?

- A. Fair value is the relevant measure for derivatives.
- B. Derivatives appear as assets and/or liabilities on the balance sheet.
- C. Derivatives should be recorded using the firm's accounting principles.
- D. Special hedge accounting is limited to offsetting changes in fair value or cash flows for the positions being hedged.

16.

Accounting discrepancies in a trading operation are generally:

- A. corrected within the day.
- B. transferred to a corrections book.
- C. corrected if they are large, else they are left in suspense accounts.
- D. accounted for by net additions/deductions from suspense accounts.

17.

Which of the following are exceptions to a definition of "derivative", even though they meet the eligibility criteria of FAS 133?

- A. Certain insurance contracts.
- B. Certain financial guarantee contracts.
- C. Derivatives that serve as impediments to sale accounting.
- D. All of the above.

18.

Hedge funds generally are more risky than traditional funds because they:

- A. are small.
- B. do not diversify.
- C. are highly leveraged.
- D. do not actually hedge any of their risks.

19.

Which of the following forms the basis for the most prudent mark-to-market valuation of OTC contracts?

- A. Broker quotes.
- B. Simulation results.
- C. Directly observable prices.
- D. Trader's end-of-the-day values.

20.

Which of the following statements about SFAS 133 are TRUE?

- I. Fair value is the relevant measure for derivatives.
- II. Derivatives appear as assets and/or liabilities on the balance sheet.
- III. Special hedge accounting is limited to offsetting changes in fair value or cash flows for the positions being hedged.
- IV. The cash flows due to derivatives are contingent upon uncertain events, so their value should not be included with assets or liabilities.

- A. I and II.
- B. III and IV.
- C. I, II and III.
- D. II, III and IV.

21.

Under FAS 133, when is the change in the fair market value of an item, which is hedged with a net investment hedge, booked in the P&L?

- A. At the end of the year.
- B. At the end of the quarter.
- C. Only when the subsidiary is liquidated.
- D. Only when normal GAAP would require booking to the balance sheet.

22.

Which of the following is LEAST likely to be considered as a derivative under FAS 133?

- A. At-the-money option.
- B. At-the-money forward.
- C. Deeply in-the-money option.
- D. Deeply out-of-the-money option.

23.

Which of the following is NOT recommended for the revaluation of trading assets for the purpose of profit/loss reporting?

- A.

Revaluations should assume zero correlation between assets in the market.

- B. Revaluations should not depend on market data provided by the risk takers within the firm.
- C. Revaluations should be conducted at a frequency that matches the risk horizon of the operation.
- D. For structured products the end user must not rely on values provided by the dealer from whom the contract was purchased.

24.

Which of the following accounting methodologies is most susceptible to cherry picking?

- A. Hedge.
- B. Accrual.
- C. Mark-to-market.
- D. Lower of cost or market.

25.

Under FAS 133, when is the change in the fair market value of an item, which is hedged with a cash flow hedge, booked in the P&L?

- A. Immediately, every year.
- B. Immediately, every quarter.
- C. Only when the subsidiary is liquidated.
- D. Only when normal GAAP would require booking the hedged item to the P&L.

26. Which of the following statements are TRUE in the case of securitization?

- I. If the cash generated from securitization is used to buy risk-free assets or to reduce the on-balance-sheet debt, there is no effective change in the risk profile of the originator.
- II. If the proceeds are invested back into the generation of new assets with a risk profile similar to the assets securitized, there is no effective change in the risk profile of the originator.
- III. As long as the originator retains the equity tranche, the securitization should have a similar effect on the risk profile of the borrower as the on-the-balance sheet borrowing.

- A. I and II.
- B. I and III.
- C. II and III.
- D. I, II and III.

27. Which of the following statements are TRUE?

- I. Securitization reduces the effective (economic) leverage of the originator under all the circumstances.
- II. In securitization, most of the risks of the entire portfolio are concentrated in the equity tranche of the structure.
- III. As long as the originator retains the equity tranche, the securitization should have similar effect as the on-the-balance sheet borrowing, on the risk profile of the borrower.

- A. I and II.
- B.

- I and III.
- C. II and III.
- D. I, II and III.

28. Which of the following is FALSE in relation to the BIS II treatment (standardized approach) of the securitization?

- A. Banks will be required to deduct from Tier 1 capital any expected future margin income (FMI) (e.g. interest-only strips receivable) that has been capitalized and carried as an asset on the balance sheet and recognized in regulatory capital.
- B. When a banking organization provides implicit support to a securitization, it will NOT be required, to hold capital against all of the exposures associated with the securitization transaction as if they had not been securitized.
- C. It treats the equity tranche ownership as a direct substitute for equity capital.
- D. All of the above.

29. Most of the originators have funded the losses incurred (due to worse than expected performance of the portfolio) by the holders of senior tranche of the securitized debt. Which of the following is the correct description of the causes of this behavior?

- A. The originators fear penalties from the regulators for NOT supporting the structure and protecting the investors.
- B. These actions have been prompted by the desire of the issuers to purchase market goodwill.
- C. Both of the above.
- D. Neither of the above.

30. Which of the following statements are TRUE for securitization?

- I. If the proceeds are invested back into the generation of new assets with a risk profile similar to the assets securitized; then the originator has actually decreased its economic leverage.
- II. Most of the originators have funded the losses incurred (due to worse than expected performance of the portfolio) by the holders of senior tranche of the securitized debt.
- III. If the proceeds are invested back into the generation of new assets with a risk profile similar to the assets securitized, then the originator has actually increased its economic leverage.

- A. I and II.
- B. I and III.
- C. II and III.
- D. I, II and III.

31. Most of the originators have funded the losses incurred (due to worse than expected performance of the portfolio) by the holders of senior tranche of the securitized debt. Which of the following is the correct description of the view of the bank regulators to this behavior?

- A. Regulators appreciate the exemplary actions of the originators, encouraging investor protection.
- B. Regulators are constrained to ask for provision of more capital for the originators.
- C. Regulators have reduced the capital requirement for the holders of the structures, recognizing this safety valve.

D. All of the above.

32. Which of the following is TRUE in the case of securitization?

- A. The costs incurred can be measured in terms of the spreads paid.
- B. The benefits can be analyzed in terms of risk sharing with the investors into the securitized assets.
- C. Both of the above.
- D. Neither of the above.

33. Which of the following is TRUE for the BIS II treatment (standardized approach) of the securitization?

- A. Originating banks must deduct, from Tier I and II capital, all retained securitization exposures rated below investment grade (i.e. BBB-).
- B. Originators may recognize external credit assessments that are equivalent to BB+ to BB- for risk weighting purposes of securitization exposures.
- C. When a banking organization provides implicit support to a securitization, it will NOT be required to hold capital against all of the exposures associated with the securitization transaction as if they had not been securitized.
- D. All of the above.

34. Which one of the following is TRUE?

- A. BIS II norms give impression that the Committee recognizes the economic transfer of risks in all securitization deals.
- B. In most securitization, the originator keeps the equity tranche of the SPV with itself.
- C. Most of the risks of the entire portfolio are diffused in the senior tranche of the structure.
- D. All of the above.

35.

Under what circumstances can a bank remove assets from its balance sheet under the New Basel Accord?

- A. When it securitizes them.
- B. When it sells them to another bank with recourse.
- C. When it puts them in an SPV that is run independently.
- D. None of the above.

36. Most of the originators have funded the losses incurred (due to worse than expected performance of the portfolio) by the holders of senior tranche of the securitized debt. Which of the following statements is correct?

- A. It would be prudent to consider that there is no economic separation of the assets from the originator
- B. Even though the assets have been legally separated from the originator; the originator has de-facto ownership of full downside of the asset performance.
- C. Regulators are constrained to ask for provision of more capital for the originators.

D. All of the above.

37. Which of the following is FALSE in relation to the BIS II treatment (standardized approach) of the securitization?

- A. Originators may recognize external credit assessments that are equivalent to BB+ to BB- for risk weighting purposes of securitization exposures.
- B. For eligible liquidity facilities, the risk weight applied to the exposure's credit equivalent amount is equal to the highest risk weight assigned to any of the underlying individual exposures covered by the facility.
- C. The risk weight for BB+ to BB- ratings is 350%.
- D. All of the above.

38.

When a bank transfers assets to an SPV as a part of a securitization it is not allowed to remove the assets from its balance sheet unless the sale meets the clean break criteria laid out under the New Basel Accord. Which of the following is not one of the clean break criteria?

- A. Seller loses control over the assets.
- B. Legal separation of assets from the seller.
- C. Seller must continue to service the assets.
- D. Stockholders of the SPV have right to pledge or exchange the assets.

39. Which of the following statements are TRUE?

- A. The unsecured creditor is paid first, as the secured creditor already has security.
- B. The shareholders of a corporation with unlimited liability are safer than the shareholders of a corporation with limited liability.
- C. Both of the above.
- D. Neither of the above.

40.

In most tax jurisdictions capital gains due to an option contract can be set off against:

- A. losses on other option contracts only.
- B. net losses recorded in the previous years only.
- C. losses due to the decrease in market value of any asset.
- D. losses arising due to current unprofitable operations.

41.

The taxation of cash flows is influenced by their:

- I. character.
- II. timing.
- III. source.
- IV. classification in financial accounts.

- A. I and II.

- B. III and IV.
- C. I, II and III.
- D. I, II, III and IV.

42.

Under the US rules, hedging transactions are taxed as:

- A. capital gains.
- B. ordinary income.
- C. non-cash income.
- D. none of the above.

43.

Which of the two tax liabilities can be generated by derivatives contracts?

- A. Income tax.
- B. Capital gains tax.
- C. Both of the above.
- D. None of the above.

44. Which of the following statements are TRUE?

- A. The concept of limited liability means the bondholder's liability is limited to the face value of the bond.
- B. The concept of limited liability means the shareholder's liability is limited to the face value of the shares.
- C. Both of the above.
- D. Neither of the above.

45.

The taxation of cash flows is influenced by their:

- I. character.
- II. timing.
- III. source.
- IV. classification in financial accounts.

- A. I and II.
- B. III and IV.
- C. I, II and III.
- D. I, II, III and IV.

46. Which of the following statements are TRUE?

- I. The concept of netting potentially decreases the LGD of the creditors with netting agreements.

II. The concept of netting potentially increases the LGD of the creditors with netting agreements.

III. The concept of netting potentially increases the LGD of the creditors without netting agreements.

- A. I only.
- B. II only.
- C. I and III.
- D. II and III.

47. The principle of limited liability:

- A. reduces the LGD of the creditors.
- B. increases the LGD of the creditors.
- C. reduces the LGD of the shareholders.
- D. increases the LGD of the creditors and reduces the LGD of the shareholders.

48.

Hedging transactions are typically taxed as:

- A. capital gains.
- B. interest income.
- C. ordinary income.
- D. dividend income.

49.

Under the US tax rules, profits on foreign exchange transactions are taxed as:

- A. capital gains.
- B. ordinary income.
- C. non-cash income.
- D. none of the above.

50.

The Basel Accord "add on factor" for potential credit exposure for off-balance sheet derivatives with a maturity of less than one year is highest for:

- A. gold.
- B. equity.
- C. precious metals.
- D. other commodities than gold and precious metals.

51.

In the Internal Models Approach, banks:

- A. must forecast risk using inside information about the market.
- B. must adopt standardized models internally to calculate regulatory capital.
- C. can calculate regulatory capital using their own internal market risk model and data.
- D. none of the above.

52.

The BIS capital requirement for real estate investments is:

- A. 0%.
- B. 1.6%.
- C. 4%.
- D. 8%.

53.

Based on the BIS minimum capital requirements, what is the market risk capital requirement for a bank with a 99% 10-day VaR of \$42 million and a specific risk surcharge of \$9 million?

- A. \$126 million.
- B. \$135 million.
- C. \$398 million.
- D. \$407 million.

54.

Under original 1988 Basel Accord, which of the following off-balance sheet items attract a 0% credit conversion factor?

- A. Forward purchase of asset.
- B. Revolving underwriting facility.
- C. Short-term self-liquidating trade related contingencies.
- D. Commitments with the original maturity of less than one year.

55.

Tier 1 capital includes:

- I. common stock.
- II. disclosed reserves.
- III. asset revaluation reserves.
- IV. noncumulative preferred shares.

- A. I and II.
- B. II and III.
- C. I, II and IV.
- D. II, III and IV.

56.

Under the BIS 1988 Accord, which of the following on-balance sheet items carry a risk weight of 100%?

- A. Claims on OECD banks.
- B. OECD located real estate.
- C. Claims on OECD governments.
- D. Claims on OECD public sector entities.

57.

A bank subject to the Basel Accord makes a 5-year loan of \$50 million to a non-OECD bank. What is the basic credit risk charge that the bank giving the loan needs to take on its balance sheet?

- A. \$0.8 million.
- B. \$2 million.
- C. \$4 million.
- D. \$8 million.

58.

Tier 1 capital, as recognized in the Basel Accord, includes:

- I. Convertibles.
- II. Share premium.
- III. Common shares.
- IV. Cumulative preference shares.

- A. I and III.
- B. I and IV.
- C. II and III.
- D. II and IV.

59.

Over the years, the Basel Accord has been fine tuned to take advantage of newer, more sophisticated techniques. In which of the following risk categories has it made the least progress?

- A. Operational risk.
- B. Credit guarantees.
- C. Bond volatility risk.
- D. Foreign exchange volatility risk.

60.

A bank estimates its VaR internally using a 90% confidence level and a 5-day horizon. If its internal VaR currently stands at \$22 million, its Basel Committee VaR would be CLOSEST to:

- A. \$17.15 million.
- B. \$43.99 million.
- C. \$56.45 million.
- D. \$79.83 million.

61.

Tier 2 capital, as recognized in the Basel Accord, includes:

- I. Convertibles.
- II. Cumulative preference shares.
- III. Subordinated debt with a maturity of eight years.
- IV. Loan loss reserves held against unidentified losses.

- A. I and II.
- B. II and III.
- C. III and IV.
- D. I, II, III and IV.

62.

Given that the RiskMetrics VaR of a bank portfolio is \$6 million, its Basel Committee VaR will be CLOSEST to:

- A. \$1.3 million.
- B. \$13.4 million.
- C. \$26.8 million.
- D. \$84.7 million.

63.

Under the New BIS 2001 Accord, which of the following is NOT a feature of standardized approach to computing minimum capital requirements?

- A. It recognizes risk mitigation techniques.
- B. It accounts for portfolio diversification effect.
- C. It accounts for interest risk in the banking book.
- D. None of the above.

64.

Tier 1 capital, as recognized in the Basel Accord, includes:

- I. Retained profits.
- II. Disclosed reserves.
- III. Subordinated debt with a maturity of five years.
- IV. Loan loss reserves held against unidentified losses.

- A. I and II.
- B. III and IV.

- C. I, II and III.
- D. I, II, III and IV.

65.

A bank estimates its VaR internally using a 90% confidence level and a 2-day horizon. If its internal VaR currently stands at \$6 million, its Basel Committee VaR would be CLOSEST to:

- A. \$7.39 million.
- B. \$18.97 million.
- C. \$24.34 million.
- D. \$54.43 million.

66.

Consider a bank that funds itself in the wholesale market at LIBOR - 12.5 bps and lends money to its corporate clients at LIBOR + 22 bps. What is the annualized return on regulatory capital requirement that this bank can generate assuming minimum BIS capital requirements and zero operating costs?

- A. 1.2%.
- B. 3.0%.
- C. 4.3%.
- D. 8.0%.

67.

Based on the BIS minimum capital requirements, what is the market risk capital requirement for a bank with a 99% 10-day VaR of \$10 million and a specific risk surcharge of \$5 million?

- A. \$30 million.
- B. \$35 million.
- C. \$95 million.
- D. \$100 million.

68.

Under the New Basel Capital Accord (2001), which of the following is FALSE about IRB? No adjustment for will be made for:

- A. industry based credit risk concentration.
- B. geography based credit risk concentration.
- C. concentration of risks (or lack of it) in retail loans.
- D. groups of closely related borrowers credit risk concentration.

69.

The "green zone" in context of the Market Risk Amendment to the Capital Accord corresponds to:

- A. 0 to 4 exceptions out of 250 observations.
- B. 1 to 4 exceptions out of 250 observations.
- C. 5 to 9 exceptions out of 250 observations.
- D. greater than 10 exceptions out of 250 observations.

70.

A bank estimates its VaR internally using a 90% confidence level and a 5-day horizon. If its internal VaR currently stands at \$40 million, its Basel Committee VaR would be CLOSEST to:

- A. \$31.18 million.
- B. \$79.99 million.
- C. \$102.64 million.
- D. \$145.15 million.

71.

Given that the Basel Committee VaR of a bank portfolio is \$15 million, its RiskMetrics VaR will be CLOSEST to:

- A. \$3.4 million.
- B. \$6.7 million.
- C. \$33.6 million.
- D. \$67.0 million.

72.

Consider a bank that pays LIBOR - 1.25% on its deposits. Assuming zero operating costs, what spread over LIBOR does the bank need to charge to earn an annualized return of 25 percent on its BIS capital requirements?

- A. 0.75%.
- B. 1.25%.
- C. 1.75%.
- D. 2.25%.

73.

Using the Riskmetrics methodology (95%, 1-day) a fund manager determines that the VaR her portfolio relative to its expected return is -5%. What is the approximate value of this VaR be if she used Basle definition (99% 10-day) instead?

- A. -71%.
- B. -22%.
- C. -16%.
- D. -7%.

74.

Which of the following is NOT a criticism of the BIS 1988 Accord?

- A. It systematically reduces capital requirements for banks.
- B. It systematically ignores benefits of portfolio diversification.
- C. It improperly clubs AAA and BB-rated corporates into one class.
- D. All of the above are criticisms of the BIS 1988 Accord.

75.

Consider the standardized approach to specific market risk under the BIS-mandated market risk. What is the weighting factor for a trading book asset with 12 months to maturity, issued by a AAA US corporate, listed on recognized exchange?

- A. 0.25.
- B. 1.00.
- C. 1.60.
- D. 8.00.

76.

Which of the following statements is TRUE for BIS 1996 Amendment for market risk?

- A. The entire market risk can be covered from Tier III capital.
- B. Tier II capital can be at the most 100% of Tier III capital available (used + excess).
- C. Tier III capital can be used to cover capital requirement for market risk charge only.
- D. All of the above.

77.

Consider a bank with Tier I capital of 500, Tier II capital of zero, and Tier III capital of 300. Which of the following risk positions is the bank allowed to take under capital adequacy norms of BIS 1988 as amended in 1996?

- A. Risk weighted assets for credit risk: 7,000. Market Risk Capital Charge: 300.
- B. Risk weighted assets for credit risk: 4,000. Market Risk Capital Charge: 500.
- C. Risk weighted assets for credit risk: 6,000. Market Risk Capital Charge: 300.
- D. Risk weighted assets for credit risk: 4,000. Market Risk Capital Charge: 300.

78.

Tier 3 capital, as recognized in the Basel Accord, includes:

- A. Cumulative preference shares.
- B. Loan loss reserves held against unidentified losses.
- C. Short-term subordinated debt with a maturity of two years.
- D. None of the above.

79.

Your trading desk has been allocated \$4m of risk capital. In the context of the specific approach to market risk, which of the following options need to be ignored for lack of risk capital?

- A. \$150 million loan to a British Bank for 12 months.
- B. \$100 million loan to a French Bank for 36 months.
- C. \$100 million loan to an Emerging Market company.
- D. \$50 million loan to a non-investment grade US corporation.

80.

Which of the following statements is TRUE for BIS 1996 Amendment for market risk?

- A. The entire market risk can be covered from Tier III capital.
- B. At least 28.57% of market risk must be covered from Tier I.
- C. Unutilized Tier III capital can be used to cover credit risk.
- D. At least 50% of market risk must be covered from either Tier I or Tier II.

81.

Which of the following capital structures (available capital) is not allowed under BIS 1996 amendment?

- A. Tier I: 50 Tier II:25 Tier III:30.
- B. Tier I: 60 Tier II:20 Tier III:25.
- C. Tier I: 60 Tier II:15 Tier III:25.
- D. Tier I: 60 Tier II:15 Tier III:15.

82.

Under BIS 1996 market risk amendment, which of the following relationships can be derived between Tier II and Tier III capital.

- A. Tier II capital can be at the most 100% of Tier III capital available (used + excess).
- B. Tier II capital can be at the most 50% of Tier III capital available (used + excess).
- C. Tier II capital can be at the most 66% of Tier III capital available (used + excess).
- D. None of the above.

83.

Which of the following capital structures (available capital) is not allowed under BIS 1996 amendment?

- A. Tier I: 50 Tier II:25 Tier III:25.
- B. Tier I: 60 Tier II:40 Tier III:25.
- C. Tier I: 60 Tier II:15 Tier III:25.
- D. Tier I: 60 Tier II:15 Tier III:15.

84.

Tier 3 capital, as recognized in the Basel Accord, includes:

- A. Cumulative preference shares.
- B. Short-term subordinated debt of any maturity.
- C. Loan loss reserves held against unidentified losses.
- D. None of the above.

85.

Under the 1996 BIS Amendment, which of the following is TRUE with regard to banks following internal models?

- A. The banks needs to carry out systematic back testing and stress testing of their internal models.
- B. The model parameters must be certified by the dealing personnel, who are the risk takers, for correctness.
- C. The banks must use separate models for setting internal risk limits and for calculating regulatory risk capital.
- D. The bank can adopt internal models to calculate risk capital, after seeking the permission of their regulators. They can implement the best practice risk management system later.

86.

Under the 1996 BIS Amendment, what is the minimum regulatory capital charge for the most sophisticated banks following internal models?

- A. $3 \times (10 \text{ day market risk VAR})$.
- B. $3 \times (10 \text{ day market risk VAR}) + 4 \times (10 \text{ day specific risk VAR})$.
- C. $[3 \times (10 \text{ day market risk VAR}) + 4 \times (10 \text{ day specific risk VAR})] \times 25 / 8$.
- D. $[3 \times (10 \text{ day market risk VAR}) + 4 \times (10 \text{ day specific risk VAR})] \times \text{Trigger} / 8$.

87.

Tier 3 capital, as recognized in the Basel Accord, includes:

- A. Cumulative preference shares.
- B. Loan loss reserves held against unidentified losses.
- C. Non-redeemable non-cumulative preference shares.
- D. None of the above.

88.

Which of the following statements is TRUE?

- A. Under BIS 1988, at least 50 % of a bank's qualifying capital must be Tier I.
- B. Under BIS 1996 amendment, Tier iii capital cannot exceed 50% of Tier II capital.
- C. Under BIS 1996 amendment, at least 50 % of a bank's qualifying capital must be Tier I.
- D. All of the above.

89.

The BIS 1988 Accord, and BIS Market Risk Amendment of 1996, fails to account for which of the following risks?

- A. Credit risk in trading book.
- B. Credit risk in banking book.
- C. Interest rate risk in trading book.
- D. Interest rate risk in banking book.

90.

Which of the following is NOT a standard for the internal model approach?

- A. The internal model should be back tested.
- B. The trading units should be reviewed independently.
- C. An external consultant must certify the internal model.
- D. The bank's board or senior management must be involved in the approval of internal model.

91. Which of the following is NOT a recommendation of G30?

- A. All organizations participating in the derivatives market must have an independent risk management function.
- B. The netting arrangements should be considered while aggregating credit exposure on a regular basis.
- C. Credit risk management should be a part of the market risk management group.
- D. None of the above.

92.

The CRMPG issued a report on:

- A. LTCM
- B. Barings
- C. risk management principles
- D. none of the above

93. According to the G-30 report on derivatives, which of the following does NOT increase the systemic risk of the market?

- A. Increase in the derivatives market size as a proportion of the cash market size.
- B. Increase in the trading activity without a commensurate increase in internal controls.
- C. The regulatory structures encouraging irrational behavior.
- D. None of the above.

94. Which of the following statements is FALSE?

- A. All the 24 recommendations in the G-30 report are directed towards the regulators.

- B. Only four of the recommendations in the G-30 report are directed towards the regulators.
- C. Only 20 of the recommendations in the G-30 report are directed towards the market players.
- D. All of the above.

95. Which of the following is NOT part of the G-30 recommendations for regulators?

- A. Netting.
- B. Derivatives pricing.
- C. Derivatives accounting.
- D. Uncertainty caused by frequent legal changes.

96. Which of the following is NOT a recommendation of G-30?

- A. The market makers in complex derivatives can mark to market their portfolios on a quarterly basis.
- B. The stress testing of risk parameters is important.
- C. The derivative's credit risk needs to be analyzed for current and potential exposure.
- D. None of the above.

97. Which of the following is NOT a G-30 recommendation?

- A. Given the complex nature of derivatives, the disclosures on them should be brief, so as not to confuse the lay reader of the financial statements.
- B. The accounting policies, procedures should be commensurate with the level and frequency of risk taking and risk managing activity.
- C. The skill, experience and number of people should be commensurate with the level of activity.
- D. None of the above.

98.

The G-30 report recommends that dealers should market their derivatives positions to market:

- A. on a daily basis.
- B. as prices change.
- C. on a monthly basis.
- D. at a frequency determined by their risk management cycle.

99.

The G30 report recommends the use of master agreements to address:

- A. legal risk.
- B. credit risk.
- C. market risk.
- D. liquidity risk.

100. Which of the following is TRUE for the G-30 report on derivatives?

- A. The report was published in 1983.
- B. It found that derivatives, almost always, increase the systemic risk of the market.
- C. The aim of the report was to discover new and improved derivatives products.
- D. None of the above.

101.

The ISDA Master Agreement primarily addresses:

- I. legal risk.
- II. credit risk.
- III. market risk.
- IV. operations risk.

- A. I and II.
- B. III and IV.
- C. I, II and III.
- D. II, III and IV.

102.

Which of the following automatically lead to a default under credit provisions of the ISDA Master Agreement?

- I. breach of agreement.
- II. change of name and/or address.
- III. failure to provide collateral when due.
- IV. rise in credit risk above a threshold value.

- A. I and II.
- B. I and III.
- C. II and IV.
- D. III and IV.

103.

Which of the following best captures the meaning of pari passu?

- A. Treat all parties fairly.
- B. Treat all parties equally.
- C. Deal with all parties together.
- D. Deal with all parties individually.

104.

Netting enables a firm to:

- A. offset all its losses against its gains.

- B. pay the losses only if the counterpart defaults.
- C. pay only the losses due to unfavorable market prices.
- D. offset its transaction with a given counter-party against each other.

105.

Netting enables a firm to:

- A. offset all its losses against its gains.
- B. pay the losses only if the counterpart defaults.
- C. offset its transaction with all counter-party against each other in case the firm defaults.
- D. offset its transaction with a given counter-party against each other in case the counter-party defaults.

106.

Netting enables a firm to:

- A. offset all its losses against its gains.
- B. pay the losses only if the counterpart defaults.
- C. pay only the losses due to unfavorable market prices.
- D. offset its transaction with a given counter-party against each other.

107.

The 1992 ISDA Master Agreement mainly addresses:

- A. market and credit risk.
- B. market and liquidity risk.
- C. liquidity and operational risk.
- D. legal and credit risk.

108.

Legal risks can arise from:

- I. failure to perform in a contract.
- II. the use of single master agreements.
- III. future changes in laws and regulations.
- IV. failure of a counter-party to perform in a contract.

- A. I and IV.
- B. I, III and IV.
- C. II, III and IV.
- D. I, II, III and IV.

109.

A trader who enters into a swap with a counter-party for whom the contract is not appropriate

has:

- I. committed a criminal offence.
- II. exposed his firm to credit risk.
- III. exposed his firm to litigation risk.
- IV. put the reputation of his firm in jeopardy.

- A. I and II.
- B. III and IV.
- C. I, II and III.
- D. II, III and IV.

110.

Multi-branch netting agreements are:

- A. enforceable in all jurisdictions.
- B. enforceable in some jurisdictions.
- C. not enforceable unless they are enforceable in all jurisdictions.
- D. only enforceable in the jurisdiction that has adopted the ISDA master agreement.

111.

Which of the following automatically lead to a default under credit provisions of the ISDA Master Agreement?

- I. liquidation.
- II. cross default.
- III. failure to pay.
- IV. misrepresentation.

- A. I and II.
- B. III and IV.
- C. I, II and III.
- D. I, II, III and IV.

112.

Which of the following are contained in the standard ISDA Master Agreement?

- I. Schedules.
- II. Obligations.
- III. Credit provisions.
- IV. Boilerplate statements.

- A. I and II.
- B. III and IV.
- C. I, II and III.
- D. II, III and IV.

113.

Which of the following are contained in the standard ISDA Master Agreement?

- I. Schedules.
- II. Credit provisions.
- III. Trade confirmations.
- IV. Boilerplate statements.

- A. I and III.
- B. II and IV.
- C. I, II and III.
- D. II, III and IV.

114.

Which of the following would be regarded as a "credit event" under ISDA definitions?

- I. An issuer calls back a callable bond.
- II. The credit rating of a borrower is downgraded.
- III. A borrower fails to pay a coupon on another bond.
- IV. A counter-party announces that its projected earnings will be lower than expected.

- A. I and IV.
- B. II and III.
- C. I, II and III.
- D. II, III and IV.

115.

A walk-away clause in a derivatives contract can:

- A. result in a loss for the non-defaulting party.
- B. allow the defaulting party to avoid payments.
- C. allow the net debtor to make a windfall profit.
- D. result in cancellation of contract if it is annulled by law.

116.

The legal risk manager in a bank is responsible for:

- I. dealing with cases of default.
- II. enforceability of netting agreements.
- III. ensuring that proper Master Agreements are in place with OTC counter-parties.
- IV. verifying that the rates and prices stated in OTC contracts are stated at their fair market values.

- A. I and II.
- B. III and IV.
- C. I, II and III.
- D. I, II, III and IV.

117.

A typical ISDA Master Agreement contains a list of:

- I. obligations.
- II. credit provisions.
- III. historical market prices.
- IV. contractual boilerplate statements.

- A. I and II.
- B. III and IV.
- C. I, II and IV.
- D. II, III and IV.

118.

What is the order of precedence of the following parts of the ISDA agreement in case of a conflict?

- A. Confirmation, Schedule, Master agreement.
- B. Schedule, Master agreement, Confirmation.
- C. Schedule, Confirmation, Master agreement.
- D. Master agreement, Confirmation, Schedule.

119.

A typical swap executed under the 1992 ISDA Master Agreement would include:

- I. closeout netting.
- II. walk away netting.
- III. netting by novation.
- IV. netting of cash flows.

- A. I and IV.
- B. II and III.
- C. I, II and III.
- D. I, II, III and IV.

120.

Money laundering can be best defined as the process used to:

- A. finance the arms trade.
- B. conceal the origin of the proceeds from criminal activities.
- C. avoid double taxation on the returns from foreign investments.
- D. avoid withholding taxes on the investments in foreign debt instruments.

121.

Multi-branch netting agreements are:

- A. enforceable in all jurisdictions.
- B. enforceable in some jurisdictions.
- C. not enforceable unless they are enforceable in all jurisdictions.
- D. only enforceable in the jurisdiction that have adopted the ISDA master agreement.

122.

The principle that all parties within a group must be treated equally is called:

- A. ultra vires.
- B. actus reus.
- C. pari passu.
- D. caveat emptor.

123.

A typical ISDA Master Agreement contains a list of:

- I. obligations.
- II. credit provisions.
- III. historical market prices.
- IV. contractual boilerplate statements.

- A. I and II.
- B. III and IV.
- C. I, II and IV.
- D. II, III and IV.

124.

One of the earliest well-publicized disputes in derivatives involved Hammersmith local authority in the UK. Hammersmith council had entered into contracts that were declared null and void because it lacked the authority to execute them. This was an application of the principle of:

- A. ultra vires.
- B. actus reus.
- C. pari passu.
- D. caveat emptor.

125.

A typical ISDA Master Agreement contains a list of:

- I. obligations.
- II. credit provisions.
- III. historical market prices.
- IV. contractual boilerplate statements.

- A. I and II.
- B. III and IV.

- C. I, II and IV.
- D. II, III and IV.

126.

Which of the following is primarily responsible for regulating the exchange traded derivatives markets in the US?

- A. Fed.
- B. SEC
- C. OCC.
- D. CFTC.

127.

Which of the following countries has a single financial regulator?

- A. UK.
- B. US.
- C. Japan.
- D. France.

128.

Which of the following is not an objective of bank regulators?

- A. Protecting depositors.
- B. Minimizing systemic risk.
- C. Preventing money laundering.
- D. Protecting shareholder value.

129.

Bank of Japan has

- A. no responsibility to regulate financial institutions in Japan.
- B. sole responsibility to regulate financial institutions in Japan.
- C. joint responsibility to regulate financial institutions in Japan with the FSA.
- D. no responsibility to regulate financial institutions other than banks in Japan.

130.

The Capital Adequacy Directive would apply to a bank based in:

- I. UK
- II. US.
- III. Germany.
- IV. Switzerland.

- A. I and III.
- B. II and IV.
- C. I, II and III.
- D. II, III, and IV.

131.

The Capital Adequacy Directive applies to:

- A. all banks based in the European Union.
- B. all international banks except those in the US.
- C. all commercial banks based in the G-10 countries.
- D. none of the above.

132.

Which one of the following tools are appropriate for achieving a control over both systemic risk and customer protection.

- I. Disclosure rules.
- II. Asset restrictions.
- III. Capital adequacy rules.

- A. I only.
- B. I and II.
- C. I and III.
- D. II and III.

133.

Which country of the following countries is NOT a part of the OECD?

- A. Spain.
- B. Korea.
- C. Mexico.
- D. Argentina.

134.

In the context of financial regulation, the risk that is most difficult to measure and manage is:

- A. credit risk.
- B. operational risk.
- C. commodity risk.
- D. interest rate risk.

135.

The Capital Adequacy Directive applies to:

- A. all banks based in the European Union.
- B. all international banks except those in the US.
- C. all commercial banks based in the G-10 countries.
- D. none of the above.

136.

Commercial banks in the United Kingdom are regulated by:

- I. FSA.
- II. FDIC.
- III. Bank of England.

- A. I only.
- B. I and II.
- C. I and III.
- D. II and III.

137.

The Bank of Japan:

- A. has no supervisory authority.
- B. is the sole supervisor of banks in Japan.
- C. shares its supervisory role with the FSA.
- D. is the sole supervisor of brokers in Japan.

138.

Which of the following sets out risk guidelines for multinational banks?

- A. BIS.
- B. Plaza.
- C. Bretton-Woods.
- D. Garn-St Germaine.

139.

The appropriate tools for achieving customer protection are:

- I. conflict rules.
- II. disclosure rules.
- III. asset restrictions.
- IV. antitrust enforcements.

- A. I and II.
- B. I, II and III.

- C. I, II, and IV.
- D. II, III and IV.

140.

The Basel Accord applies to:

- A. only European banks.
- B. all internationally active commercial banks.
- C. all international banks except those in the US.
- D. all commercial banks based in the G-10 countries.

141.

Which of the following prevented commercial banks in the US from operating in the securities business?

- A. Plaza.
- B. Glass-Steagall.
- C. Bretton-Woods.
- D. Garn-St Germaine.

142.

The appropriate tools for achieving customer protection are:

- I. conflict rules.
- II. disclosure rules.
- III. asset restrictions.
- IV. antitrust enforcements.

- A. I and II.
- B. I, II and III.
- C. I, II, and IV.
- D. II, III and IV.

143.

The appropriate tools for achieving customer protection are:

- I. conflict rules.
- II. disclosure rules.
- III. asset restrictions.
- IV. antitrust enforcements.

- A. I and II.
- B. I, II and III.
- C. I, II, and IV.
- D. II, III and IV.

144.

The Basel Committee regulates:

- A. all internationally-active commercial banks.
- B. all commercial banks based in the G-10 countries.
- C. all banks with operations in more than one country.
- D. none of the above.

145.

Which of the following is not a prime reason for the regulation of commercial banks?

- I. To protect bank customers.
- II. To protect of bank shareholders.
- III. To protect deposit insurance fund.

- A. II only.
- B. I and II.
- C. II and III.
- D. I, II and III.

146.

The Basel Accord applies to:

- A. only US banks.
- B. all internationally active commercial banks.
- C. all international banks except those in the US.
- D. all commercial banks based in the G-10 countries.

147.

Which country of the following countries is NOT a part of the OECD?

- A. Spain.
- B. China.
- C. Korea.
- D. Mexico.

148.

Which of the following EU countries has not adopted the euro?

- A. Greece.
- B. Portugal.
- C. Denmark.
- D. Luxembourg.

149.

The Basel Committee regulates:

- A. all internationally active commercial banks.
- B. all international banks except those in the US.
- C. all commercial banks based in the G-10 countries.
- D. none of the above.

150.

Commercial banks in the United States are regulated by:

- A. OCC.
- B. FDIC.
- C. Federal Reserve.
- D. all of the above.

151.

Commercial banks in the United States are regulated by:

- A. OCC.
- B. FDIC.
- C. Federal Reserve.
- D. all of the above.

152.

The Basel Committee regulates:

- A. all internationally active commercial banks.
- B. all commercial banks based in the G-10 countries.
- C. all banks with operations in more than one country.
- D. none of the above.

153. Which of the following statements are FALSE in relation to SEC guidelines for derivatives disclosure?

- I. The SEC guidelines say nothing about the disclosure of accounting policy disclosures.
- II. SEC issued the guidelines for enhancing the disclosures for derivatives in January 1987.
- III. SEC believed that too much information was revealed in the financial statements about the derivatives positions, prior to formulation of the rules in this regard.

- A. I and II.
- B. I and III.
- C. II and III.
- D. I, II and III.

154. Which of the following information is mentioned in the SEC rules on disclosure for derivatives?

- I. Methodology used to account for derivatives.
- II. The types of derivatives accounted for under each method.
- III. The application of rules required for the use of each method, such as how portfolio risk reduction, correlation, designation, and effectiveness tests are applied.

- A. I and II.
- B. I and III.
- C. II and III.
- D. I, II and III.

155.

US firms can report market risk to SEC using the sensitivity of:

- I. fair values.
- II. cash flows.
- III. value at risk.
- IV. earnings volatility.

- A. I and II.
- B. II and III.
- C. I, II and III.
- D. II, III, and IV.

156. Under quantitative information about market risk, all the instruments (including derivatives) are required to be classified. Which of the following is TRUE in this regard?

- A. There are two classifications: instruments with the objective of trading and those with objectives other than trading.
- B. There are two classifications: hedged items and unhedged items.
- C. There are three classifications: effective hedges, other hedges and unhedged items.
- D. It depends on the circumstances.

157. Which of the following are TRUE in relation to SEC requirements on disclosures of corporate exposures to derivatives?

- I. Qualitative information about market risk include discussions on primary market risk exposures.
- II. Qualitative information about market risk includes discussions how the risk exposures are managed.
- III. Qualitative information about market risk shall be presented separately for market risk sensitive instruments entered into for trading purposes and those entered into for purposes other than trading.

- A. I and II.
- B. I and III.
- C. II and III.
- D. I, II and III.

158. Which of the following statements are TRUE in relation to the disclosure of quantitative information on derivatives?

- A. The reporting corporate has three alternative formats: VAR, sensitivity analysis or tabular format.
- B. The reporting corporate has to report in all the three formats: VAR, sensitivity analysis and tabular format.
- C. The reporting corporate has two alternative formats: VAR or tabular format.
- D. The reporting corporate has to report in both formats: VAR and tabular format.

159.

US firms can report market risk to SEC using the sensitivity of:

- I. earnings.
- II. cash flows.
- III. value at risk.
- IV. price earnings ratio.

- A. I and II.
- B. II and III.
- C. I, II and III.
- D. II, III, and IV.

160. Which of the following statements are TRUE?

- A. Market risk information is required to be disclosed as a part of the accounting statements.
- B. Accounting treatment for the termination of derivatives designated as hedges need not be disclosed.
- C. Information about when derivatives and related profits and losses are reported in the balance sheet, revenue statement, and cash flow statement need to be disclosed.
- D. All of the above.

161.

US firms can report market risk to SEC using the sensitivity of:

- I. earnings.
- II. fair values.
- III. earnings volatility.
- IV. price earnings ratio.

- A. I and II.
- B. II and III.
- C. I, II and III.
- D. II, III, and IV.

162. Which of the following are TRUE in relation to SEC requirements on disclosures of corporate exposures to derivatives?

- A. The corporate has the right to use different reporting choices for different risk categories, in

relation to the reporting of quantitative information.

- B. In sensitivity analysis, the hypothetical changes should not be normally less than 10 percent of the closing market prices.
- C. VAR numbers must be supported by the information about the parameters, assumptions and models used to arrive at the numbers.
- D. All of the above.

163.

Which of the following cannot be an objective of the Internal Control System of a manufacturing company? To ensure that:

- A. assets are safeguarded against improper use.
- B. company transactions are properly authorized.
- C. company transactions are properly recorded.
- D. money launderers are not able to purchase the securities issued by the firm in the secondary markets.

PASS PRO Solutions

1. Correct answer: D

According to FAS 133, assets with embedded derivatives should be split between the host contract and the embedded derivative if:

- the embedded derivative meets the definition of a derivative on a stand-alone basis, and
- the fair market value for the hybrid contract would otherwise not be reported on the balance sheet, and
- the economic characteristics of the contract and embedded derivative are not "clearly and closely related".

The payoff of the derivative is quite likely to be a function of the value of the host contract, and this is not a criteria in FAS 133.

Study Session: 5 - RA: 1

2. Correct answer: A

There is no recommendation against outsourcing activities related to derivatives.

Study Session: 5 - RA: 1

3. Correct answer: D

FAS133 requires all US listed firms to apply hedge accounting (which may be on an accrual basis) only where the contracts meet several criteria including hedge effectiveness.

Study Session: 5 - RA: 1

4. Correct answer: B

FAS 133 specifies that the effectiveness must be tested at least quarterly for the hedge to continue as effective.

Study Session: 5 - RA: 1

5. Correct answer: C

Accounting discrepancies in a trading operation are generally corrected if they are large, else they are left in suspense accounts.

Study Session: 5 - RA: 1

6. Correct answer: C

The effective portion of the "cash flow" hedge is first charged (recognized) in other comprehensive income and then recorded on an after-tax basis in AOCI (accumulated other comprehensive income). AOCI is transferred to earnings when the underlying hedged item's value impacts the P&L.

Study Session: 5 - RA: 1

7. Correct answer: D

The ineffective and excluded portions are charged immediately to the P&L irrespective of the type of the hedge.

Study Session: 5 - RA: 1

8. Correct answer: C

Directly observable prices in the market are least susceptible to manipulation.

Study Session: 5 - RA: 1

9. Correct answer: A

Under FAS 133, the period of the expectation for which the hedge will be highly effective can be less than the maturity of the hedged item.

Study Session: 5 - RA: 1

10. Correct answer: C

Hedge accounting requires derivatives contracts to be managed using same methodology as the assets being hedged. This may require mark-to-market or historical cost accounting depending on the treatment of the assets.

Study Session: 5 - RA: 1

11. Correct answer: D

A swap contract consists of streams of receipts and payments, which constitute asset/liability pairs. But these positions are not reflected in the balance sheet because future transactions are not traditionally included in accounts.

Study Session: 5 - RA: 1

12. Correct answer: D

In case of hedge accounting, when the derivative can be accounted for by any method that is being used for the underlying asset.

Study Session: 5 - RA: 1

13. Correct answer: C

SFAS 133 requires all derivatives to be included on the balance sheet at their fair values.

Study Session: 5 - RA: 1

14. Correct answer: C

Since these positions are highly correlated, the bank should mark-to-market the combined position by using the market prices recorded at the same time, which is not the case with other choices.

Study Session: 5 - RA: 1

15. Correct answer: C

SFAS 133 requires all derivatives to be included on the balance sheet at their fair values (the firm's accounting principles may dictate including them on a cost basis which would be wrong).

Study Session: 5 - RA: 1

16. Correct answer: C

Accounting discrepancies in a trading operation are generally corrected if they are large, else they are left in suspense accounts.

Study Session: 5 - RA: 1

17. Correct answer: D

All of the above are mentioned as an exception to the definition of "derivative" under FAS 133.

Study Session: 5 - RA: 1

18. Correct answer: C

Hedge funds do not indeed hedge large parts of their risk and tend to make very focused bets. What makes them risky is that huge amount of leverage that they take on their bets, which can magnify any adverse market movement.

Study Session: 5 - RA: 1

19. Correct answer: C

Directly observable prices in the market are least susceptible to manipulation.

Study Session: 5 - RA: 1

20. Correct answer: C

SFAS 133 requires all derivatives to be included on the balance sheet at their fair values.

Study Session: 5 - RA: 1

21. Correct answer: C

Under a "net investment hedge", P&L accounting of the hedged item is accounted for when the subsidiary is liquidated.

Study Session: 5 - RA: 1

22. Correct answer: C

The premium of a deeply in-the-money option is close to its intrinsic value, i.e. same as the cost of taking the equivalent delta position on the underlying. Thus it fails the second test for the definition of a derivative under FAS 133.

Note: FAS 133 poses the following three tests that must be met for a contract to be treated as a derivative:

- The contract must have one or more underlying prices, rates or indices, and one or more notional amounts.
- The initial investment in the contract must be zero or much less than the cost of taking the equivalent position in the cash market.
- The derivative must require or permit net settlement, or must be convertible into cash or another derivatives instrument (e.g. option on futures).

Study Session: 5 - RA: 1

23. Correct answer: A

Revaluations should use the prevailing correlation between assets in the market. The use of zero correlation can lead to under or over valuations.

Study Session: 5 - RA: 1

24. Correct answer: B

The accrual method does not reflect the value of derivatives contracts. This allows a manager to produce immediate profits by liquidating in-the-money contracts while allowing out-of-the-money contracts to produce a gradual loss over time.

Study Session: 5 - RA: 1

25. Correct answer: D

In the case of a cash flow hedge, the P&L effect for the hedged item is only booked when normal GAAP would require.

Study Session: 5 - RA: 1

26. Correct answer: B

If the proceeds are invested back into the generation of new assets with a risk profile similar to the assets securitized; then the originator has actually increased its economic leverage. Study Session: 5 - RA: 2

27. Correct answer: D

All the above statements are TRUE. Study Session: 5 - RA: 2

28. Correct answer: B

When a banking organization provides implicit support to a securitization, it will be required, at a minimum, to hold capital against all of the exposures associated with the securitization transaction as if they had not been securitized. Study Session: 5 - RA: 2

29. Correct answer: B

The regulators have no role in encouraging this action from the originators. Study Session: 5 - RA: 2

30. Correct answer: C

Only statements II and III are correct. Study Session: 5 - RA: 2

31. Correct answer: B

The regular occurrence of implicit support has increased the possibility that the economic risks might filter back to the originator. Study Session: 5 - RA: 2

32. Correct answer: C

The originator pays the costs by way of paying the spreads, in the hope that the risks will be shared with the investors. Study Session: 5 - RA: 2

33. Correct answer: A

When a banking organization provides implicit support to a securitization, it will be required, at a minimum, to hold capital against all of the exposures associated with the securitization transaction as if they had not been securitized.

Only third party investors, as opposed to banks that serve as originators in substance, may recognize external credit assessments that are equivalent to BB+ to BB- for risk. Study Session: 5 - RA: 2

34. Correct answer: B

The Basel committee is aware of the possibility that economic risks might filter back to the originator. In securitization, most of the risks of the entire portfolio are concentrated in the equity tranche of the structure. Study Session: 5 - RA: 2

35. Correct answer: D

The New Basel Accord only permits banks to remove assets only after a true sale, i.e. transfer of legal right and no recourse to the seller.

Study Session: 5 - RA: 2

36. Correct answer: D

All the above statements are TRUE.Study Session: 5 - RA: 2

37. Correct answer: A

Only third party investors, as opposed to banks that serve as originators in substance, may recognize external credit assessments that are equivalent to BB+ to BB- for risk.Study Session: 5 - RA: 2

38. Correct answer: C

Clean break criteria require a legal separation of assets from the seller and ability of the new owners to pledge or exchange the assets.

Study Session: 5 - RA: 2

39. Correct answer: D

The secured creditors are paid in priority over the unsecured creditors. The shareholders of a corporation with limited liability are safer than the shareholders of a corporation with unlimited liability.Study Session: 5 - RA: 3

40. Correct answer: C

Capital gains can typically be set off only against capital losses, i.e. decreases in market values of other assets.

Study Session: 5 - RA: 3

41. Correct answer: C

Depending on the jurisdiction, the taxation of cash flows depends on their character (capital gains or ordinary income), timing (inception, during the life of a contract, expiration) and source (domestic, foreign etc.)

Study Session: 5 - RA: 3

42. Correct answer: B

Under the US tax rules, gains and losses on derivatives are treated as of capital nature. The exception is foreign exchange transactions, which are treated as ordinary. Moreover, where the transaction qualifies as a hedge, the profits/losses are taxed as ordinary income.

Study Session: 5 - RA: 3

43. Correct answer: C

Derivatives contract can generate both capital gains and ordinary income depending on the jurisdiction and nature of use.

Study Session: 5 - RA: 3

44. Correct answer: B

Limited liability implies the shareholders are not required to contribute more than the amount they contractually agreed to contribute.Study Session: 5 - RA: 3

45. Correct answer: C

Depending on the jurisdiction, the taxation of cash flows depends on their character (capital gains or ordinary income), timing (inception, during the life of a contract, expiration) and source (domestic, foreign, etc.)

Study Session: 5 - RA: 3

46. Correct answer: C

Netting, in effect, gives the creditor a senior right over otherwise "senior secured" creditor. Thus, it reduces the LGD of the creditor with netting agreement, while increases the LGD of other creditors. Study Session: 5 - RA: 3

47. Correct answer: D

The principle of limited liability caps the liabilities of shareholders of a failed business. This, in turn, increases the potential losses for the creditors. Study Session: 5 - RA: 3

48. Correct answer: C

The gains and losses due to hedging transactions are taxed as ordinary income in most jurisdictions.

Study Session: 5 - RA: 3

49. Correct answer: B

Under the US tax rules, gains and losses on derivatives are treated as of capital nature. The exception is foreign exchange transactions, which are treated as ordinary. Moreover, where the transaction qualifies as a hedge, the profits/losses are taxed as ordinary income.

Study Session: 5 - RA: 3

50. Correct answer: D

The Basel Accord "add on factor" for potential credit exposure for off-balance sheet derivatives with a maturity of less than 1 year is 10% of notional for other commodities.

Add on factors for contracts with remaining maturities less than one year: interest rate - 0.0%, exchange rate and gold - 1%, equity - 6%, precious metals (without gold) - 7%, other commodities - 10%.

Add on factors for contracts with remaining maturity 1 - 5 years: interest rate - 0.5%, exchange rate and gold - 5%, equity - 8%, precious metals (without gold) - 7%, other commodities - 12%.

Add on factors for contracts with remaining maturity greater than five years: interest rate - 1.5%, exchange rate and gold - 7.5%, equity - 10%, precious metals (without gold) - 8%, other commodities - 15%.

Study Session: 5 - RA: 4

51. Correct answer: C

In the Internal Models Approach, banks can calculate regulatory capital using their own internal market risk model and data.

Study Session: 5 - RA: 4

52. Correct answer: D

The BIS capital requirement for various assets are equal to 8% of the notional exposure times the risk weights that are as follows:

0%: for cash, OECD government debt, and non-OECD government debt in local currency.

20%: for cash to be received, non-OECD government debt in foreign currency, OECD bank debt, non-OECD bank debt below one year, Multilateral bank debt.

50%: for residential mortgage loans

100%: for non-OECD bank debt above one year, Corporate debt (bonds, loans, etc), Plant, Property and Equipment.

Study Session: 5 - RA: 4

53. Correct answer: B

The market risk capital requirement = $3 \times (99\% \text{ 10-day VAR}) + \text{Specific risk surcharge} = 3 \times \$42 \text{ million} + \$9 \text{ million} = \$135 \text{ million}.$

Study Session: 5 - RA: 4

54. Correct answer: D

Under the original BIS (1988) accord, the commitments with an original maturity of less than one year attracted a zero credit conversion factor.

Study Session: 5 - RA: 4

55. Correct answer: C

Tier 1 capital does not include asset revaluation reserves.

Study Session: 5 - RA: 4

56. Correct answer: B

All real estate assets attract the full 100% risk weight.

Study Session: 5 - RA: 4

57. Correct answer: C

A loan greater than one year to a non-OECD bank carries a weighting of 100%. Therefore, the basic credit risk charge = $100\% \times \$50 \text{ million} \times 8\% = \$4 \text{ million}.$

Study Session: 5 - RA: 4

58. Correct answer: C

Under the Basel Accord, Tier 1 capital includes:

Equity capital: fully paid up common stock and non-redeemable non-cumulative preference shares.

Disclosed reserves: share premium, retained profits and other equity reserves.

Tier 2 capital includes:

Undisclosed reserves.

Asset revaluation reserves adjusted for deductions for price volatility and capital gains taxes.

General provisions and loan loss reserves held against unidentified losses.

Hybrid debt: convertibles, cumulative preference shares.

Subordinated debt with a minimum maturity of five years with a deduction of 20 percent during the final five years.

Tier 3 capital includes short-term subordinated debt with a maturity of at least two years.

Study Session: 5 - RA: 4

59. Correct answer: A

Operational risk is least understood and least well modeled. Therefore, it is the area of least progress in Basel.

Study Session: 5 - RA: 4

60. Correct answer: C

The VaR for any given definition is directly proportional to the square root of the time period and inversely proportional to the alpha (the quantile corresponding to the confidence level).

The bank calculates its VaR using 90% confidence (quantile = 1.282) and a 5-day horizon, while the Basel Committee VaR is calculated using 99% confidence (quantile = 2.326) and a 10-day horizon. proportion.

Therefore Basel Committee VAR = $22 \times 2.326 / 1.282 \times (10/5)^{0.5} = 56.45$ million.

Study Session: 5 - RA: 4

61. Correct answer: D

Under the Basel Accord, Tier 1 capital includes:

Equity capital: fully paid up common stock and non-redeemable non-cumulative preference shares.

Disclosed reserves: share premium, retained profits and other equity reserves.

Tier 2 capital includes:

Undisclosed reserves.

Asset revaluation reserves adjusted for deductions for price volatility and capital gains taxes.

General provisions and loan loss reserves held against unidentified losses.

Hybrid debt: convertibles, cumulative preference shares.

Subordinated debt with a minimum maturity of five years with a deduction of 20 percent during the final five years.

Tier 3 capital includes short-term subordinated debt with a maturity of at least two years.

Study Session: 5 - RA: 4

62. Correct answer: C

RiskMetrics estimates VaR using 95% confidence level and a time horizon of one day, while

Basel Committee uses 99% and 10 days.

Relative VaR = Alpha x Volatility x (Time period)^{0.5}. Therefore, Basle VaR
 = Riskmetrics VaR x (2.33 / 1.65) x (10 / 1)^{0.5}
 = \$6 million x 1.412 x 3.162 = \$26.8 million.

Note: the above calculation relies on the assumption of normally distributed returns.

Study Session: 5 - RA: 4

63. Correct answer: B

The standardized approach does not account for portfolio diversification effects.

Study Session: 5 - RA: 4

64. Correct answer: A

Under the Basel Accord, Tier 1 capital includes:

Equity capital: fully paid up common stock and non-redeemable non-cumulative preference shares.

Disclosed reserves: share premium, retained profits and other equity reserves.

Tier 2 capital includes:

Undisclosed reserves.

Asset revaluation reserves adjusted for deductions for price volatility and capital gains taxes.

General provisions and loan loss reserves held against unidentified losses.

Hybrid debt: convertibles, cumulative preference shares.

Subordinated debt with a minimum maturity of five years with a deduction of 20 percent during the final five years.

Tier 3 capital includes short-term subordinated debt with a maturity of at least two years.

Study Session: 5 - RA: 4

65. Correct answer: C

The VaR for any given definition is directly proportional to the square root of the time period and inversely proportional to the alpha (the quantile corresponding to the confidence level).

The bank calculates its VAR using 90% confidence (quantile = 1.282) and a 2-day horizon, while the Basel Committee VaR is calculated using 99% confidence (quantile = 2.326) and a 10-day horizon. proportion.

Therefore Basel Committee VaR = 6 x 2.326 / 1.282 x (10/2)^{0.5} = 24.34 million.

Study Session: 5 - RA: 4

66. Correct answer: C

For every dollar that this bank lends, it receives LIBOR + 22 bps and needs to pay LIBOR - 12.5 bps, leaving it with a net margin of 34.5 bps. However, BIS requires the bank to hold capital equal to 8% of the loan, therefore its return on BIS capital requirements = 0.00345 / 0.08 = 4.3%.

Study Session: 5 - RA: 4

67. Correct answer: B

The market risk capital requirement = $3 \times (99\% \text{ 10-day VaR}) + \text{Specific risk surcharge} = 3 \times \$10 \text{ million} + \$5 \text{ million} = \$35 \text{ million}.$

Study Session: 5 - RA: 4

68. Correct answer: D

The granularity adjustment conceived in the Accord will take care of the concentration risk of lending too much to single/groups of closely-related borrowers.

Study Session: 5 - RA: 4

69. Correct answer: A

In context of the Market Risk Amendment to the Capital Accord, up to 4 exceptions (incidences of the actual trading loss exceeding the VaR) out of 250 observations are acceptable, and this defines the "green zone".

Between 5 and 9 exceptions out of 250 observations incurs a penalty in the form of the multiplicative factor (Capital requirement = VaR x Multiplicative factor) rises from 3 to 4. This is classified as the "yellow zone".

If there are 10 or more exceptions out of 250 observations the integrity of the model falls into question and an automatic non-discretionary penalty is applied.

Study Session: 5 - RA: 4

70. Correct answer: C

The VaR for any given definition is directly proportional to the square root of the time period and inversely proportional to the alpha (the quantile corresponding to the confidence level).

The bank calculates its VaR using 90% confidence (quantile = 1.282) and a 5-day horizon, while the Basel Committee VaR is calculated using 99% confidence (quantile = 2.326) and a 10-day horizon.

Therefore Basel Committee VAR = $40 \times 2.326 / 1.282 \times (10/5)^{0.5} = 102.64 \text{ million}.$

Study Session: 5 - RA: 4

71. Correct answer: A

Basel Committee estimates VaR using 99% confidence level and a time horizon of 10 days, while RiskMetrics uses 95% and 1 day.

Relative VaR = Alpha x Volatility x (Time period)^{0.5}. Therefore, Basle VaR = Riskmetrics VaR x $(1.65 / 2.33) \times (1 / 10)^{0.5}$ = \$15 million x 0.708 x 0.316 = \$3.4 million.

Note: the above calculation relies on the assumption of normally distributed returns.

Study Session: 5 - RA: 4

72. Correct answer: A

BIS requires the bank to hold capital equal to 8% of the loan. Therefore, to earn a return of 25% on the regulatory capital, the bank needs to earn a net margin = $25\% \times 8\% = 2\%$. Therefore, on its loans it needs to charge $\text{LIBOR} - 1.25\% + 2\% = \text{LIBOR} + 0.75\%$.

Study Session: 5 - RA: 4

73. Correct answer: B

In the Riskmetrics definition the value of alpha is 1.65 and time period is 1. The same parameters in the Basle definition are 2.33 and 10 respectively. Therefore Basle VaR = Riskmetrics VaR $\times (2.33 / 1.65) \times (10 / 1)^{0.5} = -5\% \times 1.41 \times 3.16 = -22.32\%$.

Note: the above calculation relies on the assumption of normally distributed returns.

Study Session: 5 - RA: 4

74. Correct answer: A

There are many criticisms of the BIS 1988 (it does not account for differences in ratings and diversification), but inadequate capital requirements are not one of them.

Study Session: 5 - RA: 4

75. Correct answer: B

For a qualifying issuer the BIS market risk weights are: 0.25 for securities with less than six months of remaining maturity, 1.00 for securities with between 6 and 24 months remaining, and 1.60 for securities with over 24 months to remaining maturity. For other issuers the weight is 8.00.

Study Session: 5 - RA: 5

76. Correct answer: C

Tier III capital can only be used to cover the market risk capital charge.

Study Session: 5 - RA: 5

77. Correct answer: D

For Choice 4:

Condition I: Tier I capital $\geq 8\%$ of the Risk weighted assets.

Condition II: Tier I + Tier II + Tier III capital $> 8\%$ of the risk-weighted assets + $\min [(300 - 4,000 \times 8.00\%) \times 2.5, 300] + (300 - 4,000 \times 8\%) = 500 / 4,000 > 8.00\%$ is TRUE

Condition II: $= (4,000 \times 8\%) + \min((500 - 4000 \times 8.00\%) \times 2.5, 300) + (500 - 4,000 \times 8\%) = A$

$B = (4,000 + 12.5 \times 300)$

Condition A / B $> 8.00\%$ is TRUE.

One can verify that at least one of these conditions are false for other options

Study Session: 5 - RA: 5

78. Correct answer: C

Under the Basel Accord, Tier 1 capital includes:

Equity capital: fully paid up common stock and non-redeemable non-cumulative preference shares.

Disclosed reserves: share premium, retained profits and other equity reserves.

Tier 2 capital includes:

Undisclosed reserves.

Asset revaluation reserves adjusted for deductions for price volatility and capital gains taxes.

General provisions and loan loss reserves held against unidentified losses.

Hybrid debt: convertibles, cumulative preference shares.

Subordinated debt with a minimum maturity of five years with a deduction of 20 percent during the final five years.

Tier 3 capital includes short-term subordinated debt with a maturity of at least two years.

Study Session: 5 - RA: 5

79. Correct answer: C

The \$100m loan to an Emerging Market company would require capital of \$8 million.

Study Session: 5 - RA: 5

80. Correct answer: B

The sum of Tier II and Tier III capital allocated for market risk cannot exceed 250% of tier I capital allocated for the same. That is, $(100 / (100+250)) = 100 / 350 = 28.57\%$ of market risk must be covered from Tier I.

Study Session: 5 - RA: 5

81. Correct answer: A

Condition I: Tier I should be at the least 50% of (Tier I + Tier II + Tier III).

Condition II: Tier II cannot exceed 50% of Tier I.

Choice A does not satisfy condition I. All other choices satisfy both the conditions.

Study Session: 5 - RA: 5

82. Correct answer: D

Condition I: Tier I should be at the least 50% of (Tier I + Tier II + Tier III).

Condition II: Tier II cannot exceed 50% of Tier I.

Thus, no condition for interallocation between Tier II and Tier III can be derived. Either Tier II or Tier III or both can be zero.

Study Session: 5 - RA: 5

83. Correct answer: B

Condition I: Tier I should be at the least 50% of (Tier I + Tier II + Tier III).

Condition II: Tier II cannot exceed 50% of Tier I.

Choice B does not satisfy condition II. All other choices satisfy both the conditions

Study Session: 5 - RA: 5

84. Correct answer: D

Under the Basel Accord, Tier 1 capital includes:

Equity capital: fully paid up common stock and non-redeemable non-cumulative preference shares.

Disclosed reserves: share premium, retained profits and other equity reserves.

Tier 2 capital includes:

Undisclosed reserves.

Asset revaluation reserves adjusted for deductions for price volatility and capital gains taxes.

General provisions and loan loss reserves held against unidentified losses.

Hybrid debt: convertibles, cumulative preference shares.

Subordinated debt with a minimum maturity of five years with a deduction of 20 percent during the final five years.

Tier 3 capital includes short-term subordinated debt with a maturity of at least two years.

Study Session: 5 - RA: 5

85. Correct answer: A

The bank needs to have a sound risk management system in place, before embarking on internal model. The internal models must be widely used in business decision-making process and, as far as possible, all model parameters must be estimated independently of the dealing personnel. Banks are required to systematically back test the models over time.

Study Session: 5 - RA: 5

86. Correct answer: D

If the bank is following internal models for both market risk and specific risk, the market risk VAR is multiplied by a minimum of three, and the specific risk VAR is multiplied by minimum of four. This product is increased by a ratio of Trigger / 8.

Study Session: 5 - RA: 5

87. Correct answer: D

Under the Basel Accord, Tier 1 capital includes:

Equity capital: fully paid up common stock and non-redeemable non-cumulative preference shares.

Disclosed reserves: share premium, retained profits and other equity reserves.

Tier 2 capital includes:

Undisclosed reserves.

Asset revaluation reserves adjusted for deductions for price volatility and capital gains taxes.

General provisions and loan loss reserves held against unidentified losses.

Hybrid debt: convertibles, cumulative preference shares.

Subordinated debt with a minimum maturity of five years with a deduction of 20 percent during

the final five years.

Tier 3 capital includes short-term subordinated debt with a maturity of at least two years.

Study Session: 5 - RA: 5

88. Correct answer: C

Under 1996 Amendment, the Qualifying Capital (Tier I + II + III) can be at most 200% of Tier I capital. Under 1988 Accord (where there is no Tier III), Tier II capital can be at most 50% of Tier I capital, i.e. Tier I must be a minimum of 66.68% of total capital. There is no direct relationship prescribed between Tier II and Tier III.

Study Session: 5 - RA: 5

89. Correct answer: D

The original 1988 accord takes care of credit risk (although in an imperfect manner). The 1996 amendment takes care of interest rate risk in a trading book. Thus, interest rate risk in the banking book remains uncovered.

Study Session: 5 - RA: 5

90. Correct answer: C

It is not essential for an external consultant to certify the internal model.

Study Session: 5 - RA: 5

91. Correct answer: C

The credit risk management function should be separate. Study Session: 5 - RA: 6

92. Correct answer: A

The CRMPG (the Counterparty Risk Management Policy Group) issued a report analyzing the LTCM problems and providing a set of recommendations for the financial industry.

Study Session: 5 - RA: 6

93. Correct answer: A

The systemic risk does not depend on the relative size of the derivatives markets. Study Session: 5 - RA: 6

94. Correct answer: A

Only four of the recommendations in the G-30 report are directed towards the regulators. Study Session: 5 - RA: 6

95. Correct answer: A

The G-30 recommendations are silent on the pricing (they do have lots to say about how derivatives are valued for accounts but not how they should be priced in the market). Study Session: 5 - RA: 6

96. Correct answer: A

All institutions must have detailed guidelines for mark to market (MTM) processing on a daily (or higher frequency) basis. Study Session: 5 - RA: 6

97. Correct answer: A

The disclosures should enable the stakeholders to grasp the nature of risks and the nature of risk management followed by the organization, at appropriate level of detail. Study Session: 5 - RA: 6

98. Correct answer: A

According to the G-30 report dealers should market their derivatives positions to market on a daily basis.

Study Session: 5 - RA: 6

99. Correct answer: A

Master agreements standardize the terms and conditions that form the basis for transactions between counter-parties and hence reduce the legal risk arising from disputes over interpretation of contracts.

Study Session: 5 - RA: 6

100. Correct answer: D

This 1993 report, with the objective of "defining a set of sound risk management and control practices for those involved in financial derivatives activity" found that "the derivatives, by themselves do not increase the systemic risk of the market." Study Session: 5 - RA: 6

101. Correct answer: A

The ISDA Master Agreement is primarily concerned with terms, definitions and other legal provisions used in individual derivatives contracts between two parties. In addition, the parties may also add netting provisions aimed at reducing the credit risk due to the contracts.

Study Session: 5 - RA: 7

102. Correct answer: B

ISDA Master Agreement provides for the event of default in the case of:

- cross default,
- failure to pay.
- misrepresentation.
- breach of agreement.
- bankruptcy or liquidation.
- failure to provide collateral when due.

Study Session: 5 - RA: 7

103. Correct answer: B

The legal meaning of *pari passu* is to treat all parties equally. For example, in the event of a bankruptcy, all the senior lenders of the firm are classed as *pari passu* and are treated equally. However the subordinated debt holders are not *pari passu* and hence may not receive anything.

Study Session: 5 - RA: 7

104. Correct answer: D

Netting enables a firm to net all the outstanding transactions with a given counter-party in case of a default into one payment (to or from the counter-party).

Study Session: 5 - RA: 7

105. Correct answer: D

Netting enables a firm to net all the outstanding transactions with a given counter-party in case of a default into one payment (to or from the counter-party).

Study Session: 5 - RA: 7

106. Correct answer: D

Netting enables a firm to net all the outstanding transactions with a given counter-party in case of a default into one payment (to or from the counter-party).

Study Session: 5 - RA: 7

107. Correct answer: D

ISDA Master Agreement and other such agreements mainly deal with the legal terms that apply to derivatives transactions and the issues that emerge in the case of a default.

Study Session: 5 - RA: 7

108. Correct answer: B

Failure by us or our counterparty to perform in a contract and changes in laws and regulations are sources of credit risk. The use of single master agreements mitigates credit risk.

Study Session: 5 - RA: 7

109. Correct answer: D

The trader has not committed a criminal offence but has put the reputation his firm in jeopardy and exposed it to credit risk and litigation risk.

Study Session: 5 - RA: 7

110. Correct answer: B

Multi-branch netting agreements are only enforceable in some jurisdictions.

Study Session: 5 - RA: 7

111. Correct answer: D

ISDA Master Agreement provides for the event of default in the case of:

cross default,
failure to pay.
misrepresentation.
breach of agreement.
bankruptcy or liquidation.

failure to provide collateral when due.

Study Session: 5 - RA: 7

112. Correct answer: D

The schedules are actually not contained in the standard ISDA Master Agreement, but added to it as supplements by the counter-parties.

Study Session: 5 - RA: 7

113. Correct answer: B

The schedules are actually not contained in the standard ISDA Master Agreement, but added to it as supplements by the counter-parties. Trade confirmations are not a part of the Master Agreement, rather they are agreed upon on a case by case for each trade.

Study Session: 5 - RA: 7

114. Correct answer: B

Calling of the bond or an earnings announcement are not credit events.

Study Session: 5 - RA: 7

115. Correct answer: C

In case the net debtor is the non-defaulting party, it can walk-away from the contract if the counter-party defaults, thus making a windfall profit.

Study Session: 5 - RA: 7

116. Correct answer: C

The legal risk manager in a bank is responsible for putting the appropriate legal/documentation arrangements in place and dealing with credit events, but not for negotiating the specific economic details of individual transactions.

Study Session: 5 - RA: 7

117. Correct answer: C

ISDA master agreement defines the general terms for contracts. Specific prices and rates are agreed and confirmed on a trade-by-trade basis.

Study Session: 5 - RA: 7

118. Correct answer: A

Confirmation is specific provisions for a given transaction, which overrides the Schedule that consist of specific provisions agreed between the counter-parties, which override the general terms in the Master agreement.

Study Session: 5 - RA: 7

119. Correct answer: A

The 1992 ISDA Master Agreement only covers netting of cash flows and closeout. It does not permit the practice of walk away, in which a party that is out of the money simply walks away from the swap in case of default (by the counter-party that is actually in the money).

Study Session: 5 - RA: 7

120. Correct answer: B

Money laundering can be best defined as the process used to conceal the origin of the proceeds from criminal activities.

Study Session: 5 - RA: 7

121. Correct answer: B

Multi-branch netting agreements are only enforceable in some jurisdictions.

Study Session: 5 - RA: 7

122. Correct answer: C

The legal meaning of *pari passu* is to treat all parties equally. For example, in the event of a bankruptcy, all the senior lenders of the firm are classed as *pari passu* and are treated equally. However the subordinated debt holders are not *pari passu* and hence may not receive anything.

Study Session: 5 - RA: 7

123. Correct answer: C

ISDA master agreement defines the general terms for contracts. Specific prices and rates are agreed and confirmed on a trade-by-trade basis.

Study Session: 5 - RA: 7

124. Correct answer: A

Ultra vires can be used to annul a contract that is beyond the authority of a signatory to execute.

Study Session: 5 - RA: 7

125. Correct answer: C

ISDA master agreement defines the general terms for contracts. Specific prices and rates are agreed and confirmed on a trade-by-trade basis.

Study Session: 5 - RA: 7

126. Correct answer: D

Commodity Futures Trading Commission, or CFTC has primary responsibility for regulating futures and options markets in the US.

Study Session: 5 - RA: 8

127. Correct answer: A

UK is the only country that has a single financial regulator - the FSA. In all other countries the

job of financial regulation is split between the central bank and a securities regulator.

Study Session: 5 - RA: 8

128. Correct answer: D

Bank regulators are concerned with protecting depositors, minimizing systemic risk, and preventing money laundering. They are not concerned at all with the conserving the shareholder value of the banks.

Study Session: 5 - RA: 8

129. Correct answer: C

Bank of Japan shares the responsibility to regulate the financial markets in Japan with the FSA.

Study Session: 5 - RA: 8

130. Correct answer: A

The Capital Adequacy Directive applies only to banks based in the European Union. The Basel Accord applies to all internationally active commercial banks.

Study Session: 5 - RA: 8

131. Correct answer: A

The Capital Adequacy Directive applies only to banks based in the European Union. The Basel Accord applies to all internationally active commercial banks.

Study Session: 5 - RA: 9

132. Correct answer: C

Asset restrictions help towards achieving control of systemic risk only. Systemic risk control is achieved through: capital adequacy rules, disclosure rules, and asset restrictions.

The complete set of tools for customer protection includes: capital adequacy rules, disclosure rules, antitrust enforcement and conflict rules.

Study Session: 5 - RA: 9

133. Correct answer: D

OECD includes Spain, Korea, and Mexico but not Argentina.

Study Session: 5 - RA: 9

134. Correct answer: B

The methods of measuring and managing credit and various types of market risk are fairly well established relative to operational risk, which is far more difficult to quantify and impossible to hedge.

Study Session: 5 - RA: 9

135. Correct answer: A

The Capital Adequacy Directive applies only to banks based in the European Union. The Basel Accord applies to all internationally active commercial banks.

Study Session: 5 - RA: 9

136. Correct answer: A

Following the Financial Services and Markets Act 2000, the regulation of commercial banks in United Kingdom has been completely passed on from Bank of England to the FSA.

Study Session: 5 - RA: 9

137. Correct answer: C

The Bank of Japan shares its supervisory role in the banking sector in Japan with the Japanese FSA (Financial Services Authority).

Study Session: 5 - RA: 9

138. Correct answer: A

The BIS Accord (or the Basel Accord) and associated amendments set out the risk-based capital requirements for multinational banks.

Study Session: 5 - RA: 9

139. Correct answer: C

The complete set of tools for customer protection includes: capital adequacy rules, disclosure rules, antitrust enforcement and conflict rules.

Systemic risk control is achieved through: capital adequacy rules, disclosure rules, and asset restrictions.

Study Session: 5 - RA: 9

140. Correct answer: B

The Basel Accord applies to all internationally active commercial banks.

Study Session: 5 - RA: 9

141. Correct answer: B

Commercial banks in the US from operating in the securities business by the Glass-Steagall Act (1933). This Act was repealed in 1999 to allow commercial banks some degree of flexibility in this regard.

Study Session: 5 - RA: 9

142. Correct answer: C

The complete set of tools for customer protection includes: capital adequacy rules, disclosure rules, antitrust enforcement and conflict rules.

Systemic risk control is achieved through: capital adequacy rules, disclosure rules, and asset

restrictions.

Study Session: 5 - RA: 9

143. Correct answer: C

The complete set of tools for customer protection includes: capital adequacy rules, disclosure rules, antitrust enforcement and conflict rules.

Systemic risk control is achieved through: capital adequacy rules, disclosure rules, and asset restrictions.

Study Session: 5 - RA: 9

144. Correct answer: D

The Basel Committee does not itself regulate banks, although its rules regarding capital adequacy are enforced via the Basel Accord.

Study Session: 5 - RA: 9

145. Correct answer: B

The individual customers of commercial banks are given a degree of protection by the deposit insurance fund. Therefore, minimizing systemic risk and protecting the deposit insurance fund are the objectives of the regulation of commercial banks.

Study Session: 5 - RA: 9

146. Correct answer: B

The Basel Accord applies to all internationally active commercial banks.

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147. Correct answer: B

OECD includes Spain, Korea, and Mexico but not China.

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148. Correct answer: C

Denmark, Sweden and the UK are the only EU countries to have opted out of the euro for the time being.

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149. Correct answer: D

The Basel Committee does not itself regulate banks, although its rules regarding capital adequacy are enforced via the Basel Accord.

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150. Correct answer: D

Commercial banks in the United States are regulated by: The Federal Reserve, the OCC (the Office of the Comptroller of the Currency) and the FDIC (the Federal Deposit Insurance Corporation).

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151. Correct answer: D

Commercial banks in the United States are regulated by: The Federal Reserve, the OCC (the Office of the Comptroller of the Currency) and the FDIC (the Federal Deposit Insurance Corporation).

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152. Correct answer: D

The Basel Committee does not itself regulate banks, although its rules regarding capital adequacy are enforced via the Basel Accord.

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153. Correct answer: D

SEC issued the guidelines for enhancing the disclosures for derivatives in January 1997. These guidelines have detailed discussions for disclosures of accounting policy information. Study Session: 5 - RA: 10

154. Correct answer: D

All three statements are part of the information about accounting policy information required to be disclosed. Study Session: 5 - RA: 10

155. Correct answer: A

SEC allows market risk based on the sensitivity of fair values, cash flows, and reported earnings.

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156. Correct answer: A

All the instruments (including derivatives) are required to be classified in two categories: instruments with the objective of trading and those with objectives other than trading. Study Session: 5 - RA: 10

157. Correct answer: D

All the above statements are TRUE. Study Session: 5 - RA: 10

158. Correct answer: A

The types of formats are alternatives to each other. The reporting corporate has a choice to select any one of them. Study Session: 5 - RA: 10

159. Correct answer: A

SEC allows market risk based on the sensitivity of fair values, cash flows, and reported earnings.

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160. Correct answer: C

Market risk information can be disclosed outside of the accounting statements. Accounting treatment for termination of derivatives designated as hedges need to be disclosed. Study Session: 5 - RA: 10

161. Correct answer: A

SEC allows market risk based on the sensitivity of fair values, cash flows, and reported earnings.

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162. Correct answer: D

All the above statements are TRUE. Study Session: 5 - RA: 10

163. Correct answer: D

A manufacturing company cannot have means to achieve this objective. The other three objectives are listed in a recent SEC proposal as reported by PWC.

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