2016-FRR[Q&As]

Financial Risk and Regulation (FRR) Series

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QUESTION 1

A customer asks a broker employed by AlphaBank to buy Eureka Corporation bonds for her account. While this trade was executed correctly and the bonds were bought, the trade was mistakenly accounted for as a sell order. If the price of Eureka Corporation bonds goes up, this trade would result in a significantly larger loss than if the market had remained stable. However, if the market drops, the customer will benefit from the incorrect accounting and gain from this trade. This trading scenario can serve as an example that

A. Market risk in this transaction can magnify operational risk.

B. Credit risk in this transaction can magnify operational risk.

C. Liquidity risk in this transaction can magnify operational risk.

D. Strategic risk in this transaction can magnify operational risk.

Correct Answer: A

QUESTION 2

According to Basel II what constitutes Tier 3 capital?

A. Subordinated debt issues that pay interest.

B. Debt capital that can only be used to support market risk in the trading book of the bank.

C. Preference shares that confer on issuers the right to defer payment of a fixed dividend.

D. Hybrid debt capital instruments that are similar to equity.

Correct Answer: B

QUESTION 3

Except for the credit quality of the Credit Default Swap protection seller, the following relationship correctly approximates the yield on a risk-free instrument:

A. Bond + CDS

B. Bond + CDS + Market Spread

C. Bond - CDS

D. Bond - CDS - Market spread

Correct Answer: A

QUESTION 4

Using a forward transaction, Omega Bank buys 100 metric tones of aluminum for delivery in six-months\\' time. However, after two months, the bank becomes concerned with the potential fluctuations in aluminum prices and wants to hedge its potential exposure against a possible decline in aluminum prices. Which one of the following four strategies could the bank use to offset the risk from its current exposure to aluminum as it sets the price for selling the commodity in four-months\\' time?

A. Sell an aluminum futures contract

B. Buy an aluminum futures contract

C. Sell an aluminum forward contract

D. Buy an aluminum forward contract

Correct Answer: A

QUESTION 5

A bank customer expecting to pay its Brazilian supplier BRL 100 million asks Alpha Bank to buy Australian dollars and sell Brazilian reals. Alpha bank does not hold Brazilian reals so it asks for a quote to buy Brazilian reals in the market. The market rate is 100. The bank quotes a selling rate of 101 to its customer, sells the reals, and receives AUD 1,010,000. To perform foreign exchange matched position trading, the banks should

A. Immediately buy the real at the market rate of 100 and pay AUD 1,000,000.

B. Immediately buy the real above the market rate of 105 and pay AUD 1,050,050.

C. Immediately sell the real at the market rate of 100 and receive AUD 1,000,000.

D. Immediately sell the real above the market rate of 105 and receive AUD 1,050,050.

Correct Answer: A