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GARP Financial Risk and Regulation (FRR) Series Sample Questions (Q33-

Q38):

NEW QUESTION # 33

Which one of the following four statements about hedging is INCORRECT?

- A. For a fully hedged portfolio, any changes in markets prices will typically produce significant changes in the market value of the portfolio.
- B. Traders can hedge their portfolio risks by taking a position in a different instrument.
- C. Traders can hedge their risks by taking an appropriate position in the underlying instrument.
- D. A large number of hedge positions is generally required to match the underlying transaction completely.

Answer: A

Explanation:

A fully hedged portfolio is designed to minimize or eliminate the impact of market price changes on the portfolio's value. Here are the correct and incorrect statements about hedging:

* Correct Statements:

- * Traders can hedge their risks by taking an appropriate position in the underlying instrument.
- * Traders can hedge their portfolio risks by taking a position in a different instrument.
- * A large number of hedge positions is generally required to match the underlying transaction completely.

* Incorrect Statement:

- * For a fully hedged portfolio, any changes in market prices will typically produce significant changes in the market value of the portfolio.

This statement is incorrect because the purpose of hedging is to protect the portfolio from market price changes, hence reducing the impact of such changes on the portfolio's value.

ReferencesSource: How Finance Works

NEW QUESTION # 34

Which one of the four following statements about Basis point values is correct?

Basis point value:

- A. Refers to the change in the value of a fixed income position for a very small change yields.
- B. Is a widely used statistical tool used to measure market risk.
- C. Is a risk sensitivity measure used to measure the point spread risk in the banking book.
- D. Provides a quick estimate of the sensitivity of the bank's banking book, to increasing volatility in interest rates.

Answer: A

NEW QUESTION # 35

Beta Insurance Company is only allowed to invest in investment grade bonds. To maximize the interest income, Beta Insurance Company should invest in bonds with which of the following ratings?

- A. AA
- B. AAA
- C. B
- D. A

Answer: D

Explanation:

Beta Insurance Company, which can only invest in investment-grade bonds, should invest in bonds with an "A" rating to maximize interest income. Investment-grade bonds are rated from AAA to BBB. While AAA bonds offer the highest credit quality, they also offer the lowest yield. Bonds rated A offer a good balance between credit quality and higher interest income compared to AAA and AA bonds.

NEW QUESTION # 36

Which one of the following four statements correctly identifies disadvantages of using the economic capital?

- A. The economic capital models used by banks may be subject to significant model risk.
- B. Economic capital may do not take into consideration the regulatory requirements.
- C. Since banks are putting their money at risk they have an incentive to increase economic capital.
- D. Economic capital estimates the level of expected losses.

Answer: A

Explanation:

Economic capital models, while useful, have the following disadvantages:

- * Model Risk: These models may not accurately capture the complexities of financial systems, leading to significant model risk.
- * Estimation Errors: Potential errors in risk estimation can lead to either underestimation or overestimation of required capital.
- * Regulatory Differences: These models may not align with regulatory capital requirements, causing discrepancies.
- * Complexity: The complexity of these models makes them difficult to understand and manage.

References

Source: How Finance Works

NEW QUESTION # 37

Which of the following statements defines Value-at-risk (VaR)?

- A. VaR is the maximum likely loss on a financial instrument or a portfolio of financial instruments over a given time period with a given degree of probabilistic confidence.
- B. VaR is the minimum likely loss on a financial instrument or a portfolio of financial instruments with a given degree of probabilistic confidence.
- C. VaR is the maximum of past losses over a given period of time.
- D. VaR is the worst possible loss on a financial instrument or a portfolio of financial instruments over a given time period.

Answer: A

Explanation:

Value-at-Risk (VaR) is a statistical measure used to assess the risk of loss on a specific portfolio of financial assets. It estimates the maximum potential loss with a given confidence level over a defined period.

* Maximum Likely Loss: VaR calculates the worst expected loss under normal market conditions at a specific confidence level.

* Time Period: VaR is assessed over a specified time horizon, such as a day, week, or month.

* Confidence Level: VaR is defined at a certain confidence level, typically 95% or 99%. This means there is a 95% (or 99%) probability that the loss will not exceed the VaR estimate.

For instance, a daily VaR of \$1 million at a 99% confidence level implies that there is only a 1% chance that the portfolio will lose more than \$1 million in a day.

References

* How Finance Works.pdf, p. 201

NEW QUESTION # 38

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