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## GARP Financial Risk and Regulation (FRR) Series Sample Questions (Q273-Q278):

### NEW QUESTION # 273

John owns a bond portfolio worth \$2 million with duration of 10. What positions must he take to hedge this portfolio against a small parallel shifts in the term structure.

- A. Long position worth \$20 million with duration of 1.
- B. Short position worth \$20 million with duration of 1.
- C. Long position worth \$2 million with duration of 10.
- D. Short position worth \$2 million with duration of 10.

Answer: D

#### NEW QUESTION # 274

Bank Sigma takes a long position in the oil futures market that requires a 2% margin, i.e., the bank has to deposit 2% of the value of the contract with the broker. The futures contracts were priced at \$50 per barrel (bbl) at inception, and rose by \$5 to \$55. The VaR on the position is estimated to be \$10. What is the return on this transaction on a risk adjusted basis?

- A. 500%
- B. 10%
- C. 50%
- D. 20%

**Answer: C**

Explanation:

\* Initial Margin Calculation: The bank takes a long position requiring a 2% margin. For futures contracts priced at \$50 per barrel, the margin required per barrel is  $0.02 \times 50 = 1.02 \times 50 = 10.02$

$\times 50 = 1$  dollar.

\* Profit Calculation: The price rises from \$50 to \$55 per barrel, making a profit of  $55 - 50 = 5$  dollars per barrel.

\* Return Calculation:

\* Return on Investment (ROI) without considering risk:  $5 / 1 = 5$  or 500%.

\* Risk-Adjusted Return:

\* VaR (Value at Risk) on the position is estimated to be \$10.

\* Risk-adjusted return formula:  $\text{Profit} / \text{VaR} = 5 / 10 = 0.5$  or 50%.

References

Source: How Finance Works

#### NEW QUESTION # 275

The Sarbanes-Oxley Act includes one of the following four requirements for financial institutions in the United States:

- A. Risk and control requirements
- B. Regulatory response to systemic risk requirements
- C. Capital allocation requirements
- D. Market discipline requirements

**Answer: A**

#### NEW QUESTION # 276

A retail credit score of above 680 is generally considered to be "prime." The term "prime" means the borrower is what?

- A. High quality with high risk of default
- B. Low quality with low risk of default
- C. Low quality with high risk of default
- D. High quality with low risk of default

**Answer: D**

Explanation:

Comprehensive and Detailed In-Depth Explanation:

In credit risk assessment, a "prime" borrower is one with a high credit score (e.g., above 680 on the FICO scale), indicating high credit quality and a low probability of default (PD). This classification is widely used in retail lending (e.g., mortgages, auto loans) to denote borrowers who are less risky, justifying lower interest rates. The Basel II framework, under the Internal Ratings-Based (IRB) approach, links credit quality to PD, where "prime" aligns with lower PD bands. Option D correctly pairs high quality (strong creditworthiness) with low risk of default. Option A is contradictory (low quality implies higher risk), Option B reverses the risk profile, and Option C describes "subprime" borrowers (typically below 620).

Exact Extract from Official Source:

\* BCBS, "Basel II: International Convergence of Capital Measurement and Capital Standards," June

2006, para. 211: "Under the IRB approach, banks must categorize banking-book exposures into broad classes of assets with different underlying risk characteristics... For retail exposures, this includes distinguishing between high-quality (low PD) and lower-

quality (higher PD) borrowers."

\* GARP FRR Study Notes, Credit Risk Section: "Prime borrowers, typically with credit scores above 680, are considered high-quality obligors with a low likelihood of default, contrasting with subprime borrowers who exhibit higher risk profiles." Reference:BCBS, "Basel II," para.211-215; GARP FRR Study Notes, Credit Risk Section.

#### NEW QUESTION # 277

A credit analyst wants to determine if her bank is taking too much credit risk. Which one of the following four strategies will typically provide the most convenient approach to quantify the credit risk exposure for the bank?

- A. Using stress testing techniques to forecast underlying macroeconomic factors and bank's idiosyncratic risks
- **B. Assessing aggregate exposure at default at various time points and at various confidence levels**
- C. Simplifying individual credit exposures so that they can be combined into a simplified expression of portfolio risk for the bank
- D. Analyzing distribution of bank's credit losses and mapping credit risks at various statistical levels

**Answer: B**

#### NEW QUESTION # 278

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