

GARP 2016-FRR

Financial Risk and Regulation (FRR) Series Exam

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Topic 1, Volume A

Question: 1

Which one of the following four statements correctly defines credit risk?

- A. Credit risk is the risk that complements market and liquidity risks.
- B. Credit risk is a form of performance risk in contractual relationship.
- C. Credit risk is the risk arising from execution of a company's strategy.
- D. Credit risk is the risk that summarizes the exposures a company or firm assumes when it attempts to operate within a given field or industry.

Answer: B

Question: 2

A credit analyst wants to determine a good pricing strategy to compensate for credit decisions that might have been made incorrectly. When analyzing her credit portfolio, the analyst focuses on the spreads in each loan to determine if they are sufficient to compensate the bank for all of the following costs and risks EXCEPT.

- A. The marginal cost of funds provided.
- B. The overhead cost of maintaining the loan and the account.
- C. The inherent risk of lending to this borrower while providing a return on the risk capital used to the support the loan.
- D. The opportunity cost of risk-adjusted marginal cost of capital.

Answer: D

Question: 3

To estimate the interest charges on the loan, an analyst should use one of the following four formulas:

- A. $\text{Loan interest} = \text{Risk-free rate} - \text{Probability of default} \times \text{Loss given default} + \text{Spread}$
- B. $\text{Loan interest} = \text{Risk-free rate} + \text{Probability of default} \times \text{Loss given default} + \text{Spread}$
- C. $\text{Loan interest} = \text{Risk-free rate} - \text{Probability of default} \times \text{Loss given default} - \text{Spread}$
- D. $\text{Loan interest} = \text{Risk-free rate} + \text{Probability of default} \times \text{Loss given default} - \text{Spread}$

Answer: B

Question: 4

Alpha Bank determined that Delta Industrial Machinery Corporation has 2% change of default on a oneyear no-payment of USD \$1 million, including interest and principal repayment. The bank charges 3% interest rate spread to firms in the machinery industry, and the risk-free interest rate is 6%. Alpha Bank

receives both interest and principal payments once at the end the year. Delta can only default at the end of the year. If Delta defaults, the bank expects to lose 50% of its promised payment. Hence, the loss rate in this case will be

- A. 1%
- B. 3%
- C. 5%
- D. 10%

Answer: C

Question: 5

Alpha Bank determined that Delta Industrial Machinery Corporation has 2% change of default on a oneyear no-payment of USD \$1 million, including interest and principal repayment. The bank charges 3% interest rate spread to firms in the machinery industry, and the risk-free interest rate is 6%. Alpha Bank receives both interest and principal payments once at the end the year. Delta can only default at the end of the year. If Delta defaults, the bank expects to lose 50% of its promised payment. What interest rate should Alpha Bank charge on the no-payment loan to Delta Industrial Machinery Corporation?

- A. 8%
- B. 9%
- C. 10%
- D. 12%

Answer: C

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