GARP

Exam ICBRR

International Certificate in Banking Risk and Regulation (ICBRR)

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[Total Questions: 342]

Topic 1, Volume A

Question No : 1 - (Topic 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 No : 2 - (Topic 1)

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 No : 3 - (Topic 1)

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

A. Loan interest = Risk-free rate - Probability of default x Loss given default + Spread
B. Loan interest = Risk-free rate + Probability of default x Loss given default + Spread
C. Loan interest = Risk-free rate - Probability of default x Loss given default - Spread
D. Loan interest = Risk-free rate + Probability of default x Loss given default - Spread

Answer: B

Question No : 4 - (Topic 1)

Alpha Bank determined that Delta Industrial Machinery Corporation has 2% change of default on a one-year 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: A

Question No : 5 - (Topic 1)

Alpha Bank determined that Delta Industrial Machinery Corporation has 2% change of default on a one-year 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

Question No : 6 - (Topic 1)

Alpha Bank determined that Delta Industrial Machinery Corporation has 2% change of default on a one-year 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 may happen to the Delta's initial credit parameter and the value of its loan if the machinery industry experiences adverse structural changes?

A. Probability of default and loss at default may decrease simultaneously, while duration rises causing the loan value to decrease.
B. Probability of default and loss at default may decrease simultaneously, while duration falls causing the loan value to decrease.
C. Probability of default and loss at default may increase simultaneously, while duration rises causing the loan value to decrease.
D. Probability of default and loss at default may increase simultaneously, while duration falls causing the loan value to decrease.

Answer: D

Question No : 7 - (Topic 1)

Alpha Bank determined that Delta Industrial Machinery Corporation has 2% change of default on a one-year 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. Six months after Alpha Bank provides USD $1 million loan to the Delta Industrial Machinery Corporation, a new competitor enters the machinery industry, causing Delta to adjust its prices and mark down the value of its inventory. Hence, the probability of default increases from 2% to 10% and the loss given default increases from 50% to 75%. If Alpha Bank can reprice the loan, what should the new rate be?

A. 10%
B. 13%
C. 16.5%
D. 20.5%

Answer: D

Question No : 8 - (Topic 1)

Which one of the following four model types would assign an obligor to an obligor class based on the risk characteristics of the borrower at the time the loan was originated and estimate the default probability based on the past default rate of the members of that particular class?

A. Dynamic models
B. Causal models
C. Historical frequency models
D. Credit rating models

Answer: C

Question No : 9 - (Topic 1)

Which one of the following four models is typically used to grade the obligations of small- and medium-size enterprises?

A. Causal models
B. Historical frequency models
C. Credit scoring models
D. Credit rating models

Answer: C

Question No : 10 - (Topic 1)

A credit associate extending a loan to an obligor suspects that the obligor may change his behavior after the loan has been originated. The obligor in this case may use the loan proceeds for purposes not sanctioned by the lender, thereby increasing the risk of default. Hence, the credit associate must estimate the probability of default based on the assumptions about the applicability of the following tendency to this lending situation:

A. Speculation
B. Short bias
C. Moral hazard
D. Adverse selection

Answer: C

Question No : 11 - (Topic 1)

A bank customer chooses a mortgage with low initial payments and payments that increase over time because the customer knows that she will have trouble making payments in the early years of the loan. The bank makes this type of mortgage with the same default assumptions uses for ordinary mortgages, thus underestimating the risk of default and becoming exposed to:

A. Moral hazard
B. Adverse selection
C. Banking speculation
D. Sampling bias

Answer: B

Question No : 12 - (Topic 1)

The potential failure of a manufacturer to honor a warranty might be called _____, whereas the potential failure of a borrower to fulfill its payment requirements, which include both the repayment of the amount borrowed, the principal and the contractual interest payments, would be called ____.

A. Credit risk; market risk
B. Market risk; credit risk
C. Credit risk; performance risk
D. Performance risk; credit risk

Answer: D

Question No : 13 - (Topic 1)

Which one of the following four options does NOT represent a benefit of compensating balances to the bank?

A. Compensating balances allow the bank to net some of the exposure they may have in

case of default, by taking funds from these specific deposit account one the borrower defaults.

B. Since the compensating balances cannot be withdrawn at short notice, if at all, they are not considered transaction accounts and are able to provide a stable funding to the bank, reducing its reliance on more volatile external inter-bank based funding sources.

C. Compensation balances influence the expected loss rate of the bank given the default obligor and improve capital structure by controlling obligor type and avoiding payment delays.

D. Since the compensating balances reduce the next amount lent to the borrower, the earned return on the loan is increased, further widening the bank's interest rate margin and profitability.

Answer: C

Question No : 14 - (Topic 1)

According to a Moody's study, the most important drivers of the loss given default historically have been all of the following EXCEPT:

I. Debt type and seniority

II. Macroeconomic environment

III. Obligor asset type

IV. Recourse

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

Answer: D

Question No : 15 - (Topic 1)

A credit rating analyst wants to determine the expected duration of the default time for a new three-year loan, which has a 2% likelihood of defaulting in the first year, a 3% likelihood of defaulting in the second year, and a 5% likelihood of defaulting the third year. What is the expected duration for this three-year loan?

A. 1.5 years
B. 2.1 years
C. 2.3 years
D. 3.7 years

Answer: C

Question No : 16 - (Topic 1)

Of all the risk factors in loan pricing, which one of the following four choices is likely to be the least significant?

A. Probability of default
B. Duration of default
C. Loss given default
D. Exposure at default

Answer: B

Question No : 17 - (Topic 1)

By lowering the spread on lower credit quality borrowers, the bank will typically achieve all of the following outcomes EXCEPT:

A. Aggressively courting of new business
B. Lower probability of default
C. Rapid growth
D. Higher losses in case of default

Answer: B

Question No : 18 - (Topic 1)

In the United States, Which one of the following four options represents the largest component of securitized debt?

A. Education loans

B. Credit card loans
C. Real estate loans
D. Lines of credit

Answer: C

Question No : 19 - (Topic 1)

From the bank's point of view, repricing the retail debt portfolio will introduce risks of fluctuations in:

I. Duration

II. Loss given default

III. Interest rates

IV. Bank spreads

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

Answer: D

Question No : 20 - (Topic 1)

Altman's Z-score incorporates all the following variables that are predictive of bankruptcy EXCEPT:

A. Return on total assets
B. Sales to total assets
C. Equity to debt
D. Return on equity

Answer: D

Question No : 21 - (Topic 1)

Counterparty credit risk assessment differs from traditional credit risk assessment in all of the following features EXCEPT:

A. Exposures can often be netted
B. Exposure at default may be negatively correlated to the probability of default
C. Counterparty risk creates a two-way credit exposure
D. Collateral arrangements are typically static in nature

Answer: D

Question No : 22 - (Topic 1)

All of the following performance statistics typically benefit country's creditworthiness EXCEPT:

A. Low unemployment
B. Low inflation
C. High degrees of investment
D. Low degrees of savings

Answer: D

Question No : 23 - (Topic 1)

A financial analyst is trying to distinguish credit risk from market risk. A $100 loan collateralized with $200 in stock has limited ___, but an uncollateralized obligation issued by a large bank to pay an amount linked to the long-term performance of the Nikkei 225 Index that measures the performance of the leading Japanese stocks on the Tokyo Stock Exchange likely has more ___ than ___.

A. Legal risk; market risk; credit risk
B. Market risk; market risk; credit risk
C. Market risk; credit risk; market risk
D. Credit risk, legal risk; market risk

Answer: B

Question No : 24 - (Topic 1)