CHARTERED INSTITUTE FOR
SECURITIES & INVESTMENT

RISK IN FINANCIAL SERVICES

TIME ALLOWED: 2 HOURS

How to use this sample paper

These 100 questions should be answered in two hours in the real exam, so make sure you time yourself accurately.

Record your answer for each question by circling your selected answer.

When you have finished the test, you may check your answers against the **Answer Sheet** at the back of this paper.

The exam is scored as follows:

70-100	Pass
0-69	Fail

For those questions you answered incorrectly, the answer sheet will show you the corresponding syllabus element, sub element and learning objective against which the questions were written, so you can identify any syllabus areas where you may need to revise further.

1 Which of the following is within the remit of the credit risk management function? To:

A monitor country exposure

B follow adverse movements in market prices

C assess breaches in dealing limits

D chase overdue payments

2 Party A, a subsidiary company of Party B, bought corporate bonds issued by Party C and, to protect itself, Party A entered into a credit default swap deal with Party D. Who will normally be classed as the reference entity in respect of this arrangement?

A Party A

B Party B

C Party C

D Party D

3 What key factor can determine a firm's risk and control culture?

A Ongoing supervision by regulators

B Shareholder approval

C Communication and knowledge management

D Recruitment policy

4 One of the MAIN reasons why credit rating agencies often appear to be relatively slow in downgrading companies is because:

A ratings are based on historical data resulting in a time lag

B board approval is required to take such action

C there is a desire to avoid volatile ratings

D lower grades automatically trigger less fee income

5 Which of the following describes the Monte Carlo Simulation approach to Value-at-Risk? It involves:

A assuming that the distribution of possible returns can be plotted, based on a small number of factors and the confidence level can be 'read off' the graph

B looking back at what actually happened in the past and basing the view of the future on that analysis

C generating a random set of results based on the actual underlying risk factors and 'reading off' the graph

D subjecting a portfolio to 'extreme' market event scenarios, in order to bring out particular risks not previously captured

6 Which ONE of the following is an example of market risk?

A The inability to trade a security due to the market being closed

B A delay in the opening of bank accounts for a firm

C The price of a security falling to lower than the price paid

D A counterparty not honouring its obligations to its clients

7 The head of IT at a large unit trust company has recently been recruited from a rival firm. It is a highly complex and crucial role which was difficult to fill. If the company fails to establish a succession plan for this position, this would represent what type of risk?

A System risk

B People risk

C Process risk

D External event risk

8 One of the key reasons why regulators treat banks in a fundamentally different way from other types of financial institutions is because:

A EU directives demand a lighter touch

B operational risk issues are less transparent

C systemic failure can have a broader impact

D supervision is significantly cheaper

9 Fund A has a return of 6%. This value represents a difference from the mean of 2%. What is the mean return for this fund?

A 2%

B 4%

C 8%

D 16%

10 Which of the following types of market risk is MOST likely to directly affect fixed income securities?

A Basis risk

B Currency risk

C Interest rate risk

D Price level risk

11 What is the main reason why the government is more likely to intervene if a bank has a major liquidity problem? To:

A protect the level of taxation revenue

B minimise the associated enterprise risk

C prevent consumers losing confidence in the banking system

D ensure inflation targets are achieved

12 Moody's have categorised an investment as Ba2. What is this a relative measurement of?

A Market risk

B Systemic risk

C Operational risk

D Credit risk

13 Where the interest rate under an investment arrangement is 8% but the 'annual equivalent rate' is slightly higher than 8%, this means that the:

A interest rate is variable rather than fixed

B interest is payable at least twice a year

C investment period is less than one year

D investment earns simple, not compound, interest

14 'Understanding the likelihood of risks occurring and their impact on the business in terms of direct or indirect loss' is a description of:

A risk control

B risk management

C risk mitigation

D risk measurement

15 If the Credit VaR of a portfolio over a one-year time horizon is £10 million at the 90% confidence level, this effectively means that in one year's timethere is a:

A 90% probability that the value will be exactly £10 million

B 90% probability that the value will be below £10 million

C 10% probability that the value will be less than £10 million

D 10% probability that the value will be above £10 million

16 Companies often struggle during periods of market dislocation because:

A export restrictions operate

B corporate taxation rises

C borrowing becomes more difficult

D consumer demand plummets

17 An operational risk report completed on a fund management subsidiary of a large bank contains full discussion of risk policies, identifies risk and measures their potential impact and controls that mitigate the risks. The report is long, all manner of risks are discussed, each risk has one page of text devoted to it. In what way does the report appear to be both deficient and inefficient?

A There is no discussion of the impact on the operational risk requirement and no calculations of the quantum

B The report should discuss the likelihood of occurrence of the risks and tailor its discussions accordingly

C Only the 'top 10' risks based on the potential impact by quantum of loss should be discussed at all

D The report should have been completed by 'internal audit' who would be more efficient and include details of substantive testing

18 When managing an investment portfolio, what is the main purpose of 'performance attribution reporting'? To:

A ensure compliance with the investment mandate

B identify the strong and weak components

C benchmark performance against the market in general

D quantify the degree of volatility

19 Which of the following factors is MOST likely to cause a bank's liquidity limits to regularly change during the course of each day? The bank:

A started operations nine months ago

B operates on a global basis

C has a relatively short maturity ladder

D has identified significant market depth

20 A chief executive personally oversees the writing of the company's operational risk policy which is strongly supported by ex colleagues in finance. However, the marketing department disagrees about the implementation as it had not been consulted during policy formation. This failure was due to a lack of each of the following EXCEPT:

A sponsorship

B cross divisional involvement

C consistency

D roles and responsibilities

21 If the nominal return under an investment is 11% and inflation is running at 2.5%, then 8.5% is normally described as the investment's:

A gross yield

B net yield

C real return

D invisible return

22 Deflation is MOST likely to occur when:

A the market is considered to be excessively liquid

B the market is considered to be dislocated

C there is a loose fiscal policy in place

D there is a loose monetary policy in place

23 A company has decided to purchase insurance. What method of reducing operational risk exposure are they using?

A Risk transfer

B Reducing the likelihood

C Risk avoidance

D Reducing the impact

24 What do the defined escalation procedures deal with in an effective market risk management function?

A Increasing trading losses

B Incorrect market pricing

C Inaccurate measurement of risk limits

D Inadequate scenario analysis

25 A bank has exposure of $30m to a hedge fund, comprising assets of $80m and liabilities of $50m to the counterparty. There is a netting agreement in place and the hedge fund subsequently crashes. If unsecured creditors receive 40c on the dollar, then ABC's assets will become a cash inflow of:

A $6m

B $12m

C $18m

D $20m

26 The 'capital divided by risk' calculation under Basel, used for basic capital requirement purposes, must generate what MINIMUM percentage?

A 6%

B 8%

C 10%

D 12%

27 If a regulator moves from a statutory-based approach to regulation to a principles-based approach, it will normally:

A trigger a delay in the authorisation process

B reduce the need for prescriptive rules

C indicate a relaxation in enforcement activities

D operate for a relatively short period only

28 The market risk appetite within an investment management firm is MOST likely to be defined:

A across the board

B per fund

C per fund manager

D per territory

29 Consistent confidence levels and time-levels are fundamental to which of the following challenges to establishing an enterprise risk management programme?

A Aggregation

B Cultural

C Measurement

D Timescale

30 A firm is designing an operational risk management framework. What is a common problem when using existing indicators? They:

A focus on short term risk only

B cover market risk rather than credit risk

C cover market risk rather than credit risk

D tend to monitor performance rather than risk

31 Where an asset has a negative beta, the asset can be expected to:

- **A** have no price correlation with the market
- **B** offer a risk-free return
- **C** increase in value as the market falls
- **D** always fall below benchmark values

32 If interest rates fall by 1%, the market value of corporate bonds is likely to:

- **A** rise
- **B** fall
- **C** become more stable
- **D** become more volatile

33 Where the individual assets within a fund are negatively correlated, this should normally:

- **A** increase the degree of investment risk
- **B** reduce the degree of investment risk
- **C** increase the degree of liquidity risk
- **D** reduce the degree of liquidity risk

34 How does an enterprise risk management approach help those with corporate governance responsibilities?

A Compares risk profiles for similar organisations

B Enables regulations to be modified

C Gives a single view of the firm's risk profile

D Quantifies risk using a diversification scale

35 A firm has decided to launch a type of product it has never sold before. Consequently, it should:

A reappraise the risk mitigation measures for all its other products

B conduct a risk assessment exercise immediately after the launch

C amend its corporate governance guidelines

D give particular attention to any regulatory issues

36 What is the significance to an investor where the probability distribution curve of an investment has a 'fat tail'?

A The investment is classed as low risk

B Performance is highly sensitive to interest rate movements

C There are likely to be large deviations from normal anticipated returns

D General market movements will be closely matched

37 An improved risk awareness within an organisation can MOST effectively be achieved by linking:

A risk culture and competitive activities

B risk rankings and product range

C cash flow and risk categorisation

D employee pay and risk indicators

38 Why do boards of directors generally delegate the management and responsibility for maintenance and execution of the firm's risk management framework to senior management? Because:

A senior management are responsible for ensuring that the level of model risk is within the firm's model risk appetite

B many boards fail to understand it is their duty to oversee risk model development and implementation

C senior management are best placed to establish risk controls, evaluate results and take prompt remedial action where necessary

D it is the role of senior management to set the tone for the whole organisation in relation to the importance of model risk and its active management

39 Which of the following is NOT a common measurement assumption that can produce inaccurate credit risk calculations?

A Credit risk is significantly reduced by diversification

B Simplification of potential exposure calculations

C Default risk increases as the time of exposure increases

D Some exposures have equal credit risk

40 The relationship between credit rating agencies and the management of various companies means that the:

A companies must provide regular due diligence reports to the regulator

B companies are deemed to be both clients and suppliers of the agencies

C agencies are vulnerable to conflict of interest accusations

D agencies share a significant element of credit risk with the companies

41 What is the main reason for a bank's risk management staff to be involved in product development projects from a very early stage? To:

A keep the terms as competitive as possible

B enable mitigation measures to be identified

C prevent a breach of the compliance rules

D help co-ordinate the interests of all relevant stakeholders

42 Direct investment in which one of the following asset classes is likely to present the greatest liquidity risk?

A Property

B Overseas equities

C UK equities

D Gilts

43 International co-operation on banking regulations has been addressed by central banks coming together under the auspices of the:

A International Monetary Fund

B World Bank

C G20

D Basel Committee

44 The Basel Accords prescribe the minimum capital ratios for banks in relation to operational risk, credit risk and which other specified risk?

A Market risk

B Interest rate risk

C Non-systematic risk

D Regulatory risk

45 In relation to VaR, what is the main purpose of back testing? To:

A prove the reliability of historical data

B compare predicted values to actual results

C establish the liquidity risk

D confirm the relevance of the sample trading period

46 How does the Internal Capital Adequacy Assessment Process deal with the subject of risk appetite? By:

A setting a published minimum and maximum risk level

B ensuring this is audited by an independent risk assessment firm

C solely recognising market risk and credit risk

D requiring separate consideration for each identified risk category

47 Which type of risk is defined as 'the risk of loss arising from processes, people, systems or external events'?

A Operational risk

B Strategic risk

C Systematic risk

D Financial risk

48 The ability to quantify the probability of a harmful event occurring is usually the main criterion used to distinguish between:

A risk and uncertainty

B risk and probability

C market risk and operational risk

D investment risk and operational risk

49 When short selling takes place, the investor undertaking the activity is NORMALLY looking to profit as a result of the market:

A rising

B falling

C increasing in volatility

D decreasing in volatility

50 Industry best practice benchmarking is being carried out in order to assess the main internal drivers of a bank's business risks. Who is MOST likely to be carrying out this analysis?

A The participants of a risk assessment workshop

B Members of the board

C External consultants

D A SWOT team from the bank's compliance department

51 One of the key problems of systemic risk within the financial services industry is that it can:

A have an inverse relationship with an individual firm's measured risks

B manifest itself in middle management and gradually move upwards

C become triggered by an excessive and complex level of regulation

D give rise to a general feeling of undue complacency

52 The ratio of the bid/offer spread to an asset's mid price can be used to compare different assets. What does it mean if asset A has a higher ratio than asset B?

A A is more liquid than B

B B is more liquid than A

C A is more volatile than B

D B is more volatile than A

53 Which scenario constitutes a combined credit and operational risk?

A Mismatched settlement instructions

B Release of collateral before loan is repaid

C Fraud on a client's account

D Sudden resignation of a director

54 Which two criteria are MOST likely to be used for scoring each individual risk where the internal drivers of business risk for a life insurance firm's underwriting department are being risk assessed using a ranking method?

A Complexity and impact

B Impact and likelihood

C Likelihood and benefits

D Benefits and complexity

55 Which of the following business functions, participating in an enterprise risk management programme, would be MOST likely to introduce initiatives to directly address the risks from external threats and opportunities?

A Finance department

B Market risk department

C Operational risk team

D Strategy team

56 Using the ranking basis, risk A has a PESTLE risk score of 14 and risk B has a PESTLE risk score of 16. This means that risk A:

A is considered less severe in terms of the combined issues of probability and impact

B has triggered more losses in the historical period reviewed

C is more likely to change in nature over the coming 12 months

D has been more effectively mitigated through the use of an oversight control

57 Following a review, a bank's risk management department has implemented a large number of risk mitigation activities. The effect of this is that the bank will now experience a new overall level of risk which is usually known as:

A equalised risk

B residual risk

C inherent risk

D exposed risk

58 For which of the following types of financial institution is the Capital Requirements Directive MOST likely to yield an overall net benefit, in terms of a reduction in credit risk outweighing an increase in operational risk?

A Trading firms

B Building societies

C Asset managers

D Brokers

59 Which of the following column headings should normally be included in a typical risk register?

A Sources of assurance

B Method of assessment

C List of affected stakeholders

D Level of required approval

60 Market depth is a measurement which indicates:

A the volume of transactions necessary to influence an asset's price

B how deeply prices need to fall in the market

C the number of market makers for a particular stock

D how much stock is available in the market

61 How does good succession planning help to maintain effective risk governance? It:

A prevents reward for failure

B encourages staff authority

C offsets the impact of change

D ensures the delegation of responsibility

62 The standard deviations of a fund's returns enable the fund manager to estimate the likelihood of:

A future returns falling within a specific range

B maintaining a specific competitive position

C outperforming the stock market in general

D being adversely affected by short-term liquidity risks

63 When using the self-certification method of identifying operational risks, the issues relating to consistency are likely to be greater for:

A larger firms

B newer firms

C firms which transact business purely online

D firms which have weak capital reserves

64 Which ONE of the following operational risk issues is classed under Basel II as an event type as opposed to a sub-type?

A Safe environment

B Systems security

C Vendors and suppliers

D Execution, delivery and process management

65 An investment return has a relatively large standard deviation. This implies that the investment may be suitable for an investor with a:

A high risk strategy

B low risk strategy

C short-term requirement

D medium-term requirement

66 The risk that Firm A may fail to meet its contractual obligations towards Firm B in relation to a particular transaction, is BEST described as:

A market risk

B counterparty risk

C issuer risk

D business risk

67 What is the fundamental principle behind hedging?

A An investor can offset the risks of a falling market by purchasing assets at a reduced price

B An investor can buy products in one market at a better rate than the domestic market

C The risk exposure of one instrument offsets the risk exposure of another instrument

D The risk exposure of two instruments moves with the market

68 If the banking regulator in France wants to study research material on banking regulatory matters, which body is MOST likely to be able to help?

A International Monetary Fund

B European Central Bank

C Bank for International Settlements

D European Commission

69 When assessing the cost/benefits argument of a process enhancement to address an operational risk, what aspect of the risk management process is MOST likely to support the 'benefits' element of the case? The:

A choice of risk control method

B extent of risk awareness

C results of the risk measurement

D degree of risk transfer

70 Which type of market risk is MOST likely to be caused as a secondary effect of a lack of supply or demand?

A Currency risk

B Interest rate risk

C Liquidity risk

D Volatility risk

71 How has Basel II influenced the issue of enterprise risk management (ERM)? By:

A encouraging firms to adopt an ERM approach

B banning ERM other than in exceptional circumstances

C making it more complicated to achieve an ERM approach

D linking ERM to profitability

72 Credit limits are designed to help ensure that a bank's credit-granting activities are:

A mathematically hedged

B sufficiently diversified

C driven primarily by interest rate levels

D driven primarily by liquidity needs

73 A bank has a number of risk sub-committees which report into a crucially important central risk committee. In accordance with best practice, each member of this central risk committee:

A should be insured on a keyperson basis

B must be the subject of a succession plan

C should be a member of the board of directors

D must be professionally qualified in a relevant subject

74 Which of the following underlying assets of a managed fund is MOST likely to cause the fund to be exposed to issuer risk?

A Futures

B Commercial property

C Corporate bonds

D Treasury bills

75 As part of its credit risk modelling program, which of the following would benefit most from the stress testing method?

A Administrative problems

B Liquidity problems

C Internal fraud

D External fraud

76 What is the purpose of reporting tools in credit risk management?

A Verifying credit ratings from external rating agencies

B Providing information on credit exposure to management

C Reporting on market activity in trading areas

D Evaluating credit derivatives' model risk

77 A company decided to focus on a market sector which turned out to be unprofitable due to intense competition. What was the key driver of business risk?

A Operational

B Strategic

C Financial

D Compliance

78 A liquidity gap analysis which shows a net positive figure for a particular month indicates that:

A anticipated cash inflows exceed anticipated cash outflows

B anticipated cash outflows exceed anticipated cash inflows

C projected income exceeds projected expenditure

D projected expenditure exceeds projected income

79 A member of a company's IT department has been careless in his programming work as he knows that it will not be checked by a supervisor. This type of problem is normally described as:

A a moral hazard

B a physical hazard

C an institutional risk

D a strategic risk

80 A typical asset distribution change for an individual pensions portfolio where the intended retirement date is five years away would be a switch of:

A 10% of the fund from cash to bonds

B 20% of the fund from cash to equities

C 30% of the fund from equities to bonds

D 40% of the fund from bonds to equities

81 Which of the following statistical methods is used when conducting operational risk scenario modelling?

A Credit migration probabilities

B Normal distribution

C Lognormal distribution

D Confidence level

82 What is the main reason why banks include escalation tools within their credit risk management policy? To:

A help minimise the potential for losses

B satisfy Basel II developments

C facilitate insurance cover

D avoid any conflicts of interest

83 A firm borrows £10 million of stock to take a short position. The lender requires collateral equal to the value of the lent stock. If the 'haircut' is 5% and the stock's standard deviation of annual returns over 5 years is 4%, then how much stock value must be lodged?

A £10.40m

B £10.50m

C £10.90m

D £10.92m

84 A firm should categorise all types of information that it processes or receives because:

A different information requires different levels of care and protection

B paper information is safer

C all electronic information requires password protection

D all electronic information can be corrupted

85 What is the main method used to control the problems associated with 'single-name concentration risk'?

A An adjustment to the insurance cover

B A restriction on credit limits

C An increase in collateral requirements

D A request for guarantors

86 A bank is conducting stress testing as part of its liquidity risk analysis. What factors being stressed MUST be based on historical data?

A None

B Internal

C External

D All

87 One of the key weaknesses of using standard deviation as a measure of investment risk is that it:

A ignores dividend reinvestment

B ignores short-term volatility

C assumes past experiences will tend to continue

D assumes a lack of any form of competitor activity

88 The ultimate effect of the realisation of a firm's liquidity risk is:

A frozen dividends

B profit stagnation

C competitor disadvantage

D corporate insolvency

89 Which ONE of the following is a recognised driver of international business risk in the financial services market?

A Technological

B Geopolitical

C Compliance

D Managerial

90 Which of the following risk assessment processes encompasses the likelihood of a risk being realised and the magnitude of the impact?

A Benchmarking

B Bottom-up approach

C Ranking

D Value-at-Risk models

91 Enterprise risk is BEST defined as:

A all the risks faced by a firm

B the appreciation of the credit risk associated with a firm acquiring new business

C the impact of a firm's risk profile on its available risk capital

D the process of applying the discipline of risk management to a firm's operations

92 What is the MAIN reason why internal and external drivers of a company's business risks are often BEST addressed simultaneously? To:

A benefit from economies of scale

B avoid compliance breaches

C reflect their inter-relationship

D minimise the scope for error

93 Which of the following details is typically contained in a fund's investment mandate document?

A A list of its top five holdings

B A table of annual returns for the last three years

C The extent of any gearing which can apply

D The level of charges which can be levied

94 The key approach taken when using extreme event testing is to:

- **A** measure the earnings at risk
- **B** eliminate existing risk factors
- **C** highlight particular market risks
- **D** spread risks across a portfolio

95 Which ONE of the following is an important tool in the process of risk identification?

- **A** Risk categorisation
- **B** Risk measurement
- **C** Risk ranking
- **D** Value-at-Risk models

96 Which ONE of the following is a technique for mitigating market risk at portfolio level?

- **A** Asset securitisation
- **B** Credit limits
- **C** Risk premiums
- **D** Stop-loss limits

97 What operational risk is controlled by the segregation of duties?

A Modelling errors

B Discrimination

C Fraud

D Software failure

98 What would a bank's credit risk management function normally take ownership of the?

A credit risks themselves

B credit policy

C individual credit decision

D administration of credit events

99 What is the main reason why it is against best practice for a risk manager to authorise risks on the firm's behalf? It would:

A require additional auditing

B compromise the role

C duplicate the process

D circumvent the compliance stage

100 Which situation would be an operational risk as defined by the Basel Committee on Banking Supervision?

A Change in market value of an asset

B Sovereign debt rescheduling

C Data centre disruption

D Failure of a counterparty

Risk in Financial Services

Question Number	Answer	Syllabus Reference
1	A	4.3.4
2	C	4.3.1
3	C	9.2.1
4	C	4.2.3
5	C	5.2.8
6	C	5.1.3
7	B	3.4.3
8	C	1.2.2
9	B	5.2.3
10	C	5.1.1
11	C	7.1.2
12	D	4.2.2
13	B	6.1.2
14	D	3.5.2
15	C	4.3.8
16	C	7.3.3
17	B	3.3.1
18	B	6.2.9
19	B	7.3.1
20	A	3.2.1
21	C	6.1.1
22	B	7.3.3
23	A	3.6.2
24	A	5.2.2
25	B	7.3.2
26	B	2.2.1
27	B	2.3.1
28	B	5.2.2
29	C	10.1.4
30	D	3.5.6
31	C	5.2.6
32	A	6.2.1
33	B	6.2.5
34	C	10.1.2
35	D	2.4.1
36	C	5.2.5
37	D	3.5.4
38	C	8.1.3
39	D	4.2.6
40	C	4.2.3
41	B	1.1.9
42	A	6.2.4
43	D	2.1.2
44	A	2.1.2
45	B	5.2.7
46	D	2.2.1

47	A	1.1.5
48	A	1.1.2
49	B	6.2.8
50	C	1.1.6
51	A	1.2.2
52	B	7.2.2
53	B	4.1.3
54	B	1.1.6
55	D	10.1.5
56	A	1.1.4
57	B	1.1.8
58	B	2.2.2
59	A	3.6.1
60	A	7.2.2
61	C	9.2.1
62	A	5.2.5
63	A	3.4.2
64	D	3.1.2
65	A	5.2.4
66	B	4.1.1
67	C	5.2.1
68	C	2.1.1
69	C	3.5.1
70	C	5.1.2
71	A	10.1.3
72	B	4.2.5
73	B	9.1.1
74	C	4.1.2
75	B	4.3.6
76	B	4.3.5
77	B	1.1.7
78	A	7.2.1
79	A	9.2.2
80	C	6.1.3
81	C	8.1.2
82	A	4.3.5
83	B	4.3.2
84	A	3.6.3
85	B	4.3.7
86	A	7.2.1
87	C	6.2.2
88	D	7.1.2
89	C	1.1.7
90	C	3.5.3
91	A	10.1.1
92	C	1.1.7
93	C	6.2.7
94	C	5.2.9
95	A	3.4.1
96	D	5.2.1

97	**C**	**3.6.3**
98	**B**	**4.3.3**
99	**B**	**9.2.1**
100	**C**	**3.1.1**