Question #1 of 11

When using the fair value hierarchy as defined by IFRS and US GAAP, a financial asset valuation performed by discounting future cash-flows at a discount rate would *most likely* be classified as a:

A) level 2 valuation

B) level 1 valuation

C) level 3 valuation

Explanation

Neither the future cash flows or the discount rate in a PV calculation are directly observable, hence the valuation is level 3. Level 1 valuations are based on observed quoted prices for identical assets. Level 2 valuations are observable but are not quoted prices for identical assets, they may be prices for similar assets.

(Study Session 5, Module 17.3, LOS 17.c)

Related Material

SchweserNotes - Book 2
SchweserNotes - Book 3

Question #2 of 11

When assessing capital adequacy using risk-weighted assets, cash will *most likely*:

A) be weighted at 100%.

B) be weighted over 100%.

C) not be included in risk-weighted assets.

Explanation

Cash has zero risk and hence is not included in risk-weighted assets (i.e. is weighted at zero).

(Study Session 5, Module 17.2, LOS 17.c)

Related Material

SchweserNotes - Book 2
SchweserNotes - Book 3

Question #3 of 11

The following extract shows data prepared by OWB, a financial institution conducting a review of its BASEL III compliance from 2016 to 2018. All data has been prepared in accordance with BASEL III requirements.

	2016 $m	2017 $m	2018 $m
Net Outflows (30 days of stress level cash flows)	70,363	79,454	111,547
Available Stable Funding	337,964	347,945	298,045
Required Stable Funding	327,043	287,953	247,876
High Quality Liquid Assets	82,334	87,677	109,654

Using the data extracted from OWB, which of the following statements is *most likely* correct?

A) The number of days of stress level cash flows that OWB can withstand has steadily increased over the period

B) The net stable funding ratio was highest in 2017

C) The liquidity coverage ratio meets the standard BASEL III requirements in each of the three years

Explanation

		2016 $m	2017 $m	2018 $m
Net Outflows		70,363	79,454	111,547
Available Stable Funding		337,964	347,945	298,045
Required Stable Funding		327,043	287,953	247,876
High Quality Liquid Assets		82,334	87,677	109,654
Liquidity Coverage Ratio	High Quality Liquid Assets Net Outflows	**117%**	**110%**	**98%**
Number of days of stress		30 x 1.17	30 x 1.10	30 x 0.98
level volume of cash outflows OWB can withstand		**35.1**	**33.1**	**29.5**
Net Stable Funding Ratio	Available Stable Funding Required Stable Funding	**103%**	**121%**	**120%**

The answer "The net stable funding ratio was highest in 2017" is correct, the net stable funding ratio was highest in 2017. The number of days of stress level cash flows OWB can withstand has decreased over the period and is below the BASEL III requirement in 2018.

(Study Session 5, Module 17.5, LOS 17.e)

Related Material

SchweserNotes - Book 2

SchweserNotes - Book 3

Question #4 of 11

Which of the following statements comparing Property and Casualty insurers to Life and Health insurers is *least likely* correct?

A) Property and Casualty insurers typically require a higher equity cushion and hence can have higher capital requirements

B) Life and Health insurers typically face more predictable claims than Property and Casualty insurers

C) The calculation of Property and Casualty insurers minimum capital requirements is more likely to factor in exposure to interest rate risk

Explanation

Property and Casualty insurers typically face more unpredictable claims and hence have higher capital requirements.

Life and Health insurers are more likely to sell products with material exposures to interest rate risk and hence they, not Property and Casualty insurers, are more likely to factor that risk into capital requirements.

(Study Session 5, Module 17.6, LOS 17.f)

Related Material

SchweserNotes - Book 2
SchweserNotes - Book 3

Question #5 of 11

Which of the following statements is *least likely* correct? Financial institutions differ from other companies:

A) due to their assets being predominantly tangible.

B) due to their activities giving rise to systemic risk.

C) due to their balance sheet containing assets that are often measured at fair value.

Explanation

Lots of companies have predominantly tangible assets. Financial institutions differ in that their assets are predominantly financial assets. These are often measured at fair value, and financial institutions do give rise to systemic risk.

(Study Session 5, Module 17.1, LOS 17.a)

Related Material

SchweserNotes - Book 2
SchweserNotes - Book 3

Question #6 of 11

Basel III regulation that aims to prevent banks from assuming so much leverage that they are unable to withstand loan losses is *most correctly* described as the:

A) minimum capital requirement. ✔

B) minimum liquidity requirement. ✘

C) stable funding requirement. ✘

Explanation

The minimum capital requirement specifies a ratio of assets to risk-weighted assets to ensure the balance sheet is robust enough to cope with loan losses. Stable funding requirements specify the amount of stable funding relative to liquidity needs over a one-year horizon. The minimum liquidity requirement specifies a minimum level of liquidity to cover a partial loss of funding sources or outflow due to off balance sheet commitments.

(Study Session 5, Module 17.1, LOS 17.b)

Related Material

SchweserNotes - Book 2
SchweserNotes - Book 3

Question #7 of 11

Which of the following is *least likely* a reason for the establishment of global and regional regulatory bodies?

A) To increase harmonization or regulatory rules. ✘

B) To increase global opportunities for regulatory arbitrage. ✔

C) To minimize systemic risk. ✘

Explanation

One aim of establishing global regulatory bodies is to reduce, not increase, opportunities for regulatory arbitrage (multinational companies exploiting differences in regional regulations to avoid unfavorable rules).

(Study Session 5, Module 17.1, LOS 17.b)

Related Material

SchweserNotes - Book 2
SchweserNotes - Book 3

Question #8 of 11

Gert Fonn, CFA, extracted the following information on the regulatory capital and total assets for JJK inc, a U.S. commercial bank he is considering as an investment. Fonn weights cash at 0%, performing loans at 100% and non-performing loans at 150% when calculating risk-weighted assets, and only considers investing in institutions with a tier 1 capital ratio over 15%. However, he is concerned that JJK has classified $85m of non-performing loans as performing loans.

	2018		**2018**
Regulatory Capital	**$m**		**$m**
Common Equity Tier 1 Capital	80,438	**Cash**	165,754
Additional Tier 1 Capital	14,294	**Performing loans**	235,631
Tier 2 Capital	22,395	**Non-performing loans**	158,654

Using the information in the table, which of the following conclusions is Fonn *most likely* to make?

A) JJK's current tier 1 capital ratio meets Fonn's criteria, but would not if the $85m of non-performing loans were reclassified

B) JJK's current tier 1 capital ratio meets Fonn's criteria even if the $85m of non-performing loans were reclassified

C) JJK's current tier 1 capital ratio does not meet Fonn's criteria

Explanation

Common Equity Tier 1 Capital	80,438				
Additional Tier 1 Capital	14,294				
Tier 1 Capital	**94,732**				
Pre Adjustment					
Cash	165,754	0%	0		
Performing loans	235,631	100%	235,631		
Non-performing loans	158,654	150%	237,981		
TotalTotal			**473,612**	**Tier 1 Ratio**	**94,732**
					473,612
Post Adjustment					
Cash	165,754	0%	0		**20.0%**
Performing loans	150,631	100%	150,631		
Non-performing loans	243,654	150%	365,481		
Total			**516,112**	**Tier 1 Ratio**	**94,732**
					516,112
					18.4%

JJK's tier 1 ratio is 20% pre-adjustment and 18.4% post adjustment, both above 15%.

(Study Session 5, Module 17.5, LOS 17.e)

Related Material

SchweserNotes - Book 2

SchweserNotes - Book 3

Question #9 of 11

Which of the following statements regarding Property and Casualty insurance institutions is *most likely* correct?

A) The suitability of assets held can be analyzed by observing the status of the assets in the fair value hierarchy. A majority of level 3 reported values indicates an

B) The priority in the selection of assets should be liquidity

C) Due to the uncertainty of payout timings and levels, the institution will usually invest in high-risk, longer term assets

Explanation

Due to the uncertain nature of required payouts, liquidity is the key concern. High-risk, long term assets are therefore not appropriate. Level 1 valuations would suggest liquid assets, as they are priced using identical trading (and hence liquid) assets.

(Study Session 5, Module 17.6, LOS 17.f)

Related Material

SchweserNotes - Book 2
SchweserNotes - Book 3

Question #10 of 11

Which of the following factors is *least likely* to be considered during a CAMELS analysis of a financial institution?

A) Estimation methods used for the fair value of assets

B) Levels of government support

C) Accuracy of accounting estimates

Explanation

The level of government support or ownership is not part of the CAMELS process. The accuracy of accounting estimates and the valuation process used (level 1,2,3) would be considered within the earnings category.

(Study Session 5, Module 17.5, LOS 17.d)

Related Material

SchweserNotes - Book 2
SchweserNotes - Book 3

Question #11 of 11

John Gittens is reviewing his firm's guidance for the application of the CAMELS framework and notices the following two statements:

Statement 1:	"The mission of a banking entity will affect the way its assets and liabilities are managed, and hence this qualitative impact is usually addressed within the management capabilities section of the CAMELS approach."
Statement 2:	"The corporate culture may lead to excessive risk taking, or even a high level of risk aversion, and this aspect is not covered in a typical CAMELS analysis."

Regarding the two statements made by Gittens, statement 1 is *most likely*:

A) incorrect, and statement 2 is most likely correct

B) incorrect and statement 2 is most likely incorrect

C) correct and statement 2 is most likely correct

Explanation

Neither the mission nor the corporate culture are addressed in a typical CAMELS analysis, hence statement 1 is incorrect (stating that the mission is included) but statement 2 is correct (in stating that the corporate culture is not included).

(Study Session 5, Module 17.5, LOS 17.d)

Related Material

SchweserNotes - Book 2

SchweserNotes - Book 3