Chapter 6 : Credit Risk

Multiple Choice Questions

Question 1.

Capital allocation under RAROC system   takes place for two basics reasons:

A. Risk evaluation &. risk management .
B. Risk management & performance evaluation
C. Economic value added & capital management
D. Increase returns & performance evaluation

Question 2.

In case of........................, repayment tenor is greater than equal to 15 years or more?

A. Real estate construction loans
B. Cash credit
C. Demand loans
D. Term loans

Question 3.

One of the following models shall be useful for new customers. Which one is it?

A. EQUIFAX
B. FICO score
C. VANTAGE score
D. FAKO

Question 4.

Which of the following are not covered under the wholesale segment of the bank?

A. Investment banking
B. Corporate lending

C. Sales & trading
D. Mergers & acquisitions
E. Personal loan
F. None of the above

Question 5.

Which type of facility/assistance is provided by banks to enable a company to buy the goods to be exported

A. Packing credit
B. Letter of undertaking
C. Leasing
D. Forfaiting

Question 6.

Among the following, common variable/s used to estimate the PD of corporate obligors?

A. Owner data
B. The industry of the company
C. Type of loan
D. All of the above

Question 7.

.......................are the small tickets retail loans where the underlying asset is hypothecated to the lender with a tenor of 4-5 years that matches the life of underlying assets?

A. Housing loan
B. Agriculture & allied service loans
C. Credit Card loans
D. Student's education loan

Question 8.

Which of the following are not the external factors affecting the credit of a bank?

A. Ignoring the purpose for which the customer sought a loan.
B. Poor Quality or Liberal Credit Appraisal while granting the loan.
C. Excessive lending to a particular industry is subject to cyclical fluctuations.
D. Absence of effective recovery mechanism.
E. All of the above

Question 9.

Compute expected loss from the following

Default- 5%

Amount of Exposure -200 lakhs

Recovery rate- 40%

Options are:

A. 6 lakh
B. 4.8 lakh
C. 8 lakh
D. 4 lakh

Question 10.

What is the name given to technique wherein a large loan is underwritten by a single lender and then down sold to other investors/banks FIs for a fixed fee/income.

A. Sell down
B. Down-selling
C. Securitization
D. Diversification

Question 11.

Which of the following is/are the segments that are being catered by the bank?

A. Wealth management
B. Wholesale segment
C. Retail segment
D. All of the above

Question 12.

Which is the most critical of all risk for bank/financial institutions & whose management is most crucial for the survival of any bank/FI.

A. Third-party risk
B. Collateral risk
C. Counterparty risk
D. None of the above

Question 13.

Exposure at default(Exposure uncertainty) refers to:

A. The risk of a borrower defaulting on the payment
B. The loss likely to be suffered
C. The amount that is exposed
D. None of the above

Question 14.

Which of the following are not the decisions for a trade-off between risk & return in credit risk?

A. Acceptance or rejection of the customer's request.
B. How much compensation should be added while pricing the product?
C. How much should Credit Risk be accepted in return for an increase in sales or business in case of banking?
D. How will the bank advertise its products?

E. None of the above
F. All of the above.

Question 15.

What is Economic capital in relation to a firm ?

A. The amount of capital needed to ensure the solvency for a given risk profile
B. Net worth as per balance sheet
C. The amount of capital required by regulators
D. Capital required for economic development

Question 16.

Mutual fund A gives a 15% return over the past year & had a standard deviation of 10%. The risk-free return over the period was 6%. The Sharpe ratio for mutual fund A is:

A. 1
B. 0.8
C. 0.9
D. 0.7

Question 17.

Which of the following statements is false?

A. The historical method of risk identification involves identifying types of risk credit, market, operational, and liquidity.
B. Basel II was a pillar model that provided ,guidance and recommendations on the banking rule and the regulations.
C. Credit risk management, for retail financing is done on-a case to case basis with greater emphasis on each of the 5 C's of credit and in-depth due diligence on account of large amounts and complexities.
D. One should not hesitate to, ask for the nature of the business the borrower is dealing with
E. None of the above.

Question 18.

In quantitative techniques of credit risk measurement, Beta is a measure of:

A. The active return on an investment's
B. The volatility
C. An investment's excess return
D. None of the above

Question 19.

Which of the following represent external factor in credit risk evaluation?

A. The concentration of credit in particular geographical locations or business segments
B. Ignoring the purpose for which the customer sought a loan.
C. Excessive lending to a particular industry is subject to cyclical fluctuations.
D. Fluctuations in interest rate

Question 20.

Financial Swap is used for managing -

A. Interest rate risk
B. Exchange rate risk
C. Credit risk
D. Both A & B

Question 21.

Which component of credit risk is measured by the internal rating assigned to the Borrower and assesses the likelihood that the Borrower will default on its debt obligations.

A. Probability of default
B. Loss Given default
C. Expected loss
D. Exposure at default

Question 22.

Calculate expected loss:

Default intensity = 20%

EAD = Rs.50000

Recovery rate = 40%

A. 19,000
B. 6,000
C. 25,000
D. 4,000

Question 23.

Which one of the following is not a way to calculate the credit risk component prescribed by BASEL II?

A. Internal rating-based approach
B. Standardized approach
C. Credit risk mitigation
D. Basic indicator approach

Question 24.

What is the most crucial advice that RBI gives to banks to prevent bank frauds?

A. Conducting investor awareness programs regularly to inform & train customers to apprehend fraud
B. Through performance evaluation of bank employees
C. Proactive fraud control initiatives
D. All of the above

Question 25.

...........is that way of risk mitigation where a bank has recourse to cash or buyers' assets in order to recover money owing to it.

A. Non-funded credit risk mitigation

B. Funded credit risk mitigation
C. Diversification
D. Third party guarantee

Question 26.

Which among the following are not the eligible user entities in the CDS markets to buy credit protection against the hedged item?

A. NBFC
B. Insurance companies
C. Listed corporates
D. Housing finance companies
E. AMC's
F. None of the above

Question 27.

Which among the following CDS need to be considered as more likely to have defaulted, if the maturity of the two or more CDS is the same?

A. The CDS with stable credit risk & higher spread
B. The CDS with higher credit risk & higher spread
C. The CDS with lower credit risk & higher spread
D. The CDS based on LIFO basis

Question 28.

Identify the incorrect one?

A. RBI has not stipulated any minimum cover for security except for listed shares where the cover should be a minimum of 3x
B. Banks structure large ticket / complex transactions in such a way that full recourse is available to the lender in case of default by the borrower.
C. Risk identification, risk allocation & risk mitigation are the aspects covered under wholesale Financing.

D. Long-run LGD represents the average long-term LCD, corresponding to a non-cyclical scenario that is not dependent on the time the LGD is calculated.
E. A, C & D
F. All of the above

Question 29.

It is important to formulate suitable assumptions for projections basis i.e., historical experience/ business model/industry while conducting......................

A. Credit loss estimation
B. Credit risk rating
C. Credit risk Quantification
D. Credit risk due diligence of a borrower

Question 30.

...............can be calculated for a single obligor or group of an obligor with similar credit risk features

A. Credit insurance
B. PD
C. EAD
D. LGD

Question 31.

Which of the following are advantages of Equifax?

A. Establishes and presents the consumer's borrowing pattern.
B. Detailed Reported as compared to other reports.
C. The borrower needs an excellent credit history to ensure the line of credit is being extended appropriately.
D. All of the above

Question 32.

Within what time, market makers have to report their CDS trades with both users and other market makers on the reporting platform of CDS trade repository as per RBI guidelines?

A. 6 hours
B. 5 working days
C. 1 hour
D. 30 minutes

Question 33.

As per RBI framework, SMA (Special mention account) with subcategory 1 (SMA-1) denotes:

A. Principle or interest payment not overdue for more than 30 days
B. Principle or interest payment overdue between 31-60 days
C. Principle or interest payment overdue between 61-180 days
D. None of the above

Question 34.

Loss given default (LGD) refers to

A. The proportion of EAD that would be lost if default occurs
B. 1 - recovery rate
C. The loss likely to be suffered in the event of a default occurring in the exposure
D. All of the above

Question 35.

Which of the following Instruments considered to have a moderate risk of default regarding timely payment of a financial obligation?

A. AA
B. BB
C. A3
D. B

Question 36.

If the long-term instrument is rated as 'BBB.' this means that the instrument carries:

A. Moderate risk
B. High risk
C. Highest safety
D. Moderate safety

Question 37.

Which of the following is not a component of credit risk?

A. Exposure risk
B. Collateral risk
C. Maturity risk
D. Default risk

Question 38.

What is the primary source of worry for banks regarding their customers?

A. Non-banks are getting access to their customer information through third-party applications.
B. Deficiencies in the sale of the third-party investment products by the lenders
C. Cashback facilities offered by the e-wallet companies
D. Non-adherence to the RBI instructions about mobile or electronic banking services

Question 39.

When borrowers deposit collateral in the form of an asset against the loans, advances, debt, or credit lines, banks face the following issues?

A. Liquidity issue
B. Distress sale
C. Legal issues
D. All of the above

Question 40.

What is the reason for restricting the CDS to listed corporate bonds?

A. Restriction on the-entry of FPI to invests into this domain
B. Against the rules & regulation framed by RBI
C. Not a big market of pass through securities in India
D. None of the above

Question 41.

Which of the following is the most important common point of difference among the user and market makers?

A. User entities are permitted to take a long position in CDS without the underlying hedged item & hold them longer than the tenor of corporate bonds held by them
B. User entities are permitted to buy credit protection with the underlying hedged item & allowed to buy CDS higher than the face value of corporate bonds
C. User entities are permitted to buy credit protection Without having underlying hedged items & allowed to buy CDS higher than the face of corporate bonds
D. User entities are permitted to buy credit protection with the underlying hedged item & not allowed to buy CDS higher than the face value of corporate bonds

Question 42

The structural method is generally applicable for................ wherein structural models are used to calculate the probability of default for a corporate based on the value of its assets and liabilities.

A. Listed corporate entities
B. Sole proprietorship
C. Hindu undivided family
D. Partnership firm

Question 43.

Before extending the credit to the borrower, which of the following factors must be communicated to the borrower so that he knows all details of credit lines?

A. Implicit & non-implicit cost
B. Lenders solvency positions
C. Terms of loan agreements
D. Lenders credit history
E. Both A & C
F. Both B & D

Question 44.

Consider the following data for XYZ Ltd. which has approached SBI for working capital financing. you are required to compute maximum permissible bank finance as per the third method of Tandon committee.

Current asset = 500 crores, out of which core current asset = 60 crores

Current liability (including bank borrowings = 20 crores) = 50 crores

A. 345 crores
B. 280 crores
C. 245 crores
D. 180 crores
E. None of the above

Question 45.

As per the latest vantage score model, the credit scores are being rated between

A. 330-850
B. 330-850
C. 670-639
D. 300-850

Question 46.

Altman Z score uses how many ratios?

A. Three or four
B. Three or two
C. Four or Five
D. Five or six

Question 47.

The following association devices master agreements with contracting parties under CDS across the globe?

A. ISDA
B. FIMMDA
C. CRICIL
D. MOODY'S

Question 48.

Identify the correct one from the following?

A. Covenants are most often represented in terms of financial ratios such as a maximum debt-equity ratio, debt to EBITDA, minimum debt service coverage ratio, etc.
B. The economic capital is the amount of money needed to secure survival in a worst-case scenario. It is a buffer against unexpected shocks in market values.
C. Credit scoring models, which are alternatively called scorecards, are primarily used to inform management for decision-making and provide predictive analysis or the information on the potential delinquency of the loan approved or credit line extended.
D. All of the above.

Question 49.

Which of the following Instruments considered to have a adequate degree of safety regarding timely servicing of financial obligations. Such instruments carry low credit risk.?

A. BBB
B. AA
C. A
D. BB

Question 50.

Credit insurance is an investment policy offered for sale to a person in the market & is a type of

A. Reinsurance
B. Property & casualty insurance
C. Life insurance
D. Health insurance

Question 51.

Credit scoring models are mainly used by the credit rating agency to determine the creditworthiness of an individual. Which of the following is not a credit scoring model?

A. FICO score
B. CICRO score
C. VANTAGE score
D. PLUS score

Question 52.

For calculating "the cash flow available to pay current debt obligations," the bank would most likely use which of the following calculations?

A. (NOPAT + Interest + depreciation) / (Current portion of long term debt + Interest)
B. (PAT + DEP) / (Current portion of long term debt + dep)

C. (PAT + DEP + Interest) / (Current portion of long term debt + Interest)
D. (PAT + DEP + Interest) / (Current portion of long term debt + dep + Interest)

Question 53.

A person's credit score lies between.................

A. 300-550
B. 200-450
C. 300-720
D. 300-850

Question 54.

Which of the following is not true?

A. Credit Risk analysis from bond holders point of view will be an umbrella covering credit risk of other financial institutions.
B. Recovery risk is one of the components of credit risk.
C. Wholesale financing is one of the types of credit facilities.
D. None of the above

Question 55.

Following are traded on over the counter market except:

A. Securities
B. Closed ended mutual funds
C. CDS
D. Futures
E. Currency
F. All except C and E
G. None of the above

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Question 56.

Which of the following are not parameters in wholesale financing to limit the loss caused by the default of the borrowers?

A. Security margin cover
B. Covenant Monitoring
C. Scorecard parameter reviews
D. Site visits
E. Stress assets
F. None of the above

Question 57.

Which of the following Instruments with this rating are considered to have very strong degree of safety regarding timely payment of financial obligations. Such instruments carry low credit risk

A. AA
B. A1
C. A2
D. A3

Question 58.

Which among the following are rating outlooks assigned by the various credit rating agencies?

A. Stable
B. Positive
C. Negative
D. All of the above

Question 59.

which of the following statements is true?

A. Banks structure small ticket /simple transactions so that partial recourse is available to the lender in case of default by the borrower.
B. The rating agencies may apply ''+'' (plus) or ''-''(minus) signs for ratings from AA to D to reflect the company's comparative standing.
C. Data on characteristics of retailers and corporate obligors can be used to estimate their respective probability of defaults.
D. None of the above

Question 60.

The following essential elements are to be kept in mind after the loan is approved & disbursed as per the credit criteria of borrowers?

A. Cover
B. Repayment track
C. Sector updates
D. All of the above

Question 61.

Calculate expected loss if -

PD = 2%, EAD = 300 lakhs & recovery rate = 80%

A. 4.8 lakhs
B. 1.2 lakhs
C. 1.74 lakhs
D. Cannot be computed

Question 62.

Which of the following Instruments with this rating are considered to have very strong degree of safety regarding timely payment of financial obligations. Such instruments carry lowest credit risk?

A. AA
B. A1
C. A2
D. A3

Question 63.

Under .... method, lender may tighten the norms of lending including the amount to be lend.

A. Credit insurance
B. Tightening
C. Diversification
D. Risk-based pricing

Question 64.

............is the credit score which depends upon consumer behavior.

A. VANTAGE score
B. PLUS score
C. Altman Z score
D. FAKO score

Question 65.

Identify the working capital loans from the following?

A. Bank Overdraft
B. Term loan
C. Demand loan
D. None of the above

Question 66.

Identify the asset utilization ratio from the following?

A. Return on equity
B. Current ratio
C. Fixed asset turnover ratio
D. Debt equity ratio

Question 67.

Which metric is most commonly used by investment and commercial banks to determine the extent and occurrence ratio of potential losses in their institutional portfolios.

A. Economic capital
B. Standard deviation
C. Stress testing
D. VAR

Question 68.

The excess return of a portfolio relative to the return of a benchmark index is the fund's

A. Sharpe Ratio
B. Alpha
C. Beta
D. R squared

Question 69.

A FICO score of 800 means:

A. 61% chance of default
B. 3% of chance of default
C. 1% of chance of default
D. 2% of chance of default

Question 70.

RAROC is

A. Return on risk adjusted capital
B. Risk-based profitability measurement framework
C. Return on capital
D. Risk adjusted return on capital
E. A and B
F. A and C
G. B and C
H. B and D