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Exam : 8005

**Title : Associate PRM Exam
English**

Version : DEMO

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- 1.The steps which the US Treasury Department and the Federal Reserve took in July 2008 to boost confidence in both Fannie Mae and Freddie Mac did not include which one of the following:
- A. Access to the Federal Reserve discount window
 - B. Removing the prohibition on the Treasury Department to buy both companies stock
 - C. Restricting the sale of new Fannie Mae and Freddie Mac securities only to US citizens
 - D. Reiterating their belief that both companies played a central role in the US housing finance system

Answer: D

- 2.According to the Basel framework, reserves resulting from the upward revaluation of assets are considered a part of:

- A. Tier 3 capital
- B. Tier 2 capital
- C. Tier 1 capital
- D. All of the above

Answer: B

Explanation:

According to the Basel II framework, Tier 1 capital, also called core capital or basic equity, includes equity capital and disclosed reserves.

Tier 2 capital, also called supplementary capital, includes undisclosed reserves, revaluation reserves, general provisions/general loan-loss reserves, hybrid debt capital instruments and subordinated term debt.

Tier 3 capital, or short term subordinated debt, is intended only to cover market risk but only at the discretion of their national authority.

- 3.When compared to a high severity low frequency risk, the operational risk capital requirement for a low severity high frequency risk is likely to be:

- A. Higher
- B. Zero
- C. Lower
- D. Unaffected by differences in frequency or severity

Answer: C

Explanation:

High frequency and low severity risks, for example the risks of fraud losses for a credit card issuer, may have high expected losses, but low unexpected losses. In other words, we can generally expect these losses to stay within a small expected and known range. The capital requirement will be the worst case losses at a given confidence level less expected losses, and in such cases this can be expected to be low.

On the other hand, medium severity medium frequency risks, such as the risks of unexpected legal claims, 'fat-finger' trading errors, will have low expected losses but a high level of unexpected losses. Thus the capital requirement for such risks will be high.

It is also worthwhile mentioning high severity and low frequency risks - for example a rogue trader circumventing all controls and bringing the bank down, or a terrorist strike or natural disaster creating other losses - will probably have zero expected losses & high unexpected losses but only at very high levels of confidence. In other words, operational risk capital is unlikely to provide for such events and

these would lie in the part of the tail that is not covered by most levels of confidence when calculating operational risk capital.

Note that risk capital is required for only unexpected losses as expected losses are to be borne by P&L reserves. Therefore the operational risk capital requirements for a low severity high frequency risk is likely to be low when compared to other risks that are lower frequency but higher severity.

Thus Choice 'c' is the correct answer.

4. According to the PRMIA study guide for Exam 1, Simple Exotics and Convertible Bonds have been excluded from the syllabus. You may choose to ignore this question. It appears here solely because the Handbook continues to have these chapters.

Which of the following describes a 'quanto' instrument:

- A. options on options
- B. any two asset hybrid instrument
- C. correlation products
- D. any two asset instrument in which one asset is a foreign currency

Answer: D

Explanation:

A quanto is any instrument in which one asset is a foreign currency. Examples include any option on a foreign currency asset with the strike price in foreign currency, and an option on a foreign currency asset with the foreign currency risk hedged.

Correlation products refer to credit products on a basket of credits.

Options on options represent an option to buy or sell an option in the future, and they are not 'quintos'. Similarly, not every two asset instrument is a quanto unless one of the two assets is a foreign currency.

5. An Organization as a Whole must:

- I. Provide an environment in which an Escalation Policy can be effective
 - II. Commit itself to actual enforcement of corporate governance policies
 - III. Provide ongoing education and training to all employees on the role of risk management and corporate governance in the organization
 - IV. Publish an external auditor's opinion that the corporation is in compliance with the Board's publicly stated Standards of Corporate Governance
- A. I, II and III only
 - B. I, III and IV only
 - C. I, II and IV only
 - D. All of these are expectations of the Organization as a Whole

Answer: D