Question 1

L2FRA-PQ16011-1808

LOS: LOS-7136

Lesson Reference: Lesson 3: Analyzing an Insurance Company

Difficulty: medium

Bloom Code: 2

Which of the following ratios used to analyze the performance of a P&C insurer is likely to be the highest?

● Combined ratio.

○ Loss and loss adjustment expense ratio.

○ Dividends to shareholders ratio.

Rationale

✓ **Combined ratio.**

The combined ratio is the sum of the loss and loss adjustment expense ratio and the underwriting expense ratio.

Rationale

✗ **Loss and loss adjustment expense ratio.**

This answer is incorrect. This ratio is lower than the combined ratio.

Rationale

✗ **Dividends to shareholders ratio.**

This answer is incorrect. This ratio is typically lower than the combined ratio.

Question 2

L2FRA-PQ16001-1808
LOS: LOS-7131
Lesson Reference: Lesson 1: Introduction to Analysis of Financial Institutions
Difficulty: easy
Bloom Code: 2

The risk of disruption to financial services that is caused by an impairment of all or parts of the financial system and has the potential to cause financial contagion is best known as:

○ Market risk.
○ Liquidity risk.
● Systemic risk.

Rationale

✗ **Market risk.**

This answer is incorrect. Market risk refers to the risk of exposure to changes in interest rates, exchange rates, equity prices, or commodity prices.

Rationale

✗ **Liquidity risk.**

This answer is incorrect. Liquidity risk refers to the risk that a bank is unable to meet its near-term liabilities as they fall due.

Rationale

✓ **Systemic risk.**

Financial contagion refers to the situation in which a shock in the financial system spreads to other parts of the economy.

Question 3
L2FRA-PQ16012-1808
LOS: LOS-7136
Lesson Reference: Lesson 3: Analyzing an Insurance Company
Difficulty: medium
Bloom Code: 2

Which of the following statements in relation to the differences between a P&C insurer and an L&H insurer is/are correct?

Statement 1: A P&C insurer's claims are more predictable and shorter-term than those of an L&H insurer.

Statement 2: A P&C insurer usually has higher capital requirements compared to an L&H insurer.

○ Statement 1 only.
● Statement 2 only.
○ Both Statement 1 and Statement 2.

Rationale
✗ **Statement 1 only.**
This answer is incorrect. A P&C insurer's claims are less predictable than those of an L&H insurer.

Rationale
✓ **Statement 2 only.**
Due to the unpredictability of a P&C insurer's claims, it will typically have higher capital requirements compared to an L&H insurer.

Rationale
✗ **Both Statement 1 and Statement 2.**
This answer is incorrect. Only one of the statements is correct.

Question 4

L2FRA-PQ16002-1808

LOS: LOS-7131

Lesson Reference: Lesson 1: Introduction to Analysis of Financial Institutions

Difficulty: easy

Bloom Code: 2

A major difference between financial institutions and nonfinancial companies is that the assets of financial institutions are mainly:

● Financial assets.

○ Intangible assets.

○ Tangible assets.

Rationale

✓ **Financial assets.**

The assets of financial institutions are mainly financial assets, such as loans and securities.

Rationale

✗ **Intangible assets.**

This answer is incorrect. The assets of nonfinancial companies such as advertising and IT companies are mainly intangible assets.

Rationale

✗ **Tangible assets.**

This answer is incorrect. The assets of nonfinancial companies such as manufacturing and real estate companies are mainly tangible assets.

Question 5

L2FRA-PQ16008-1808

LOS: LOS-7134

Lesson Reference: Lesson 2: Analyzing a Bank

Difficulty: medium

Bloom Code: 2

Which of the following is *least likely* to be a banking-specific analytical consideration that is not addressed by the CAMELS bank rating approach?

○ Mission of a bank.

○ Management capabilities.

● Off-balance-sheet items.

Rationale

✗ **Mission of a bank.**

This answer is incorrect. A bank's mission is one of the banking-specific analytical considerations that is not addressed by the CAMELS approach.

Rationale

✗ **Management capabilities.**

This answer is incorrect. Management capabilities is one of the components of the CAMELS approach.

Rationale

✓ **Off-balance-sheet items.**

Analysis of off-balance-sheet items is relevant to both financial and nonfinancial institutions.

Question 6

L2FRA-PQ16007-1808
LOS: LOS-7134
Lesson Reference: Lesson 2: Analyzing a Bank
Difficulty: medium
Bloom Code: 2

Which of the following is a banking-specific analytical consideration that is *not* addressed by the CAMELS bank rating approach?

- ○ Capital adequacy.
- ● Government support.
- ○ Competitive environment.

Rationale

✗ **Capital adequacy.**

This answer is incorrect. Capital adequacy is one of the components of the CAMELS approach.

Rationale

✓ **Government support.**

Government support is one of the banking-specific analytical considerations that is not addressed by the CAMELS approach.

Rationale

✗ **Competitive environment.**

This answer is incorrect because analysis of a company's competitive environment, while not addressed by the CAMELS approach, is not a banking-specific analytical consideration.

Question 7

L2FRA-PQ16006-1808

LOS: LOS-7133

Lesson Reference: Lesson 2: Analyzing a Bank

Difficulty: easy

Bloom Code: 2

The CAMELS bank rating approach is *least likely* to analyze:

○ The asset quality of a bank.

○ The earnings quality of a bank.

● The corporate culture of a bank.

Rationale

✗ **The asset quality of a bank.**

This answer is incorrect. The CAMELS approach considers a bank's asset quality.

Rationale

✗ **The earnings quality of a bank.**

This answer is incorrect. The CAMELS approach considers a bank's earnings quality.

Rationale

✓ **The corporate culture of a bank.**

A bank's corporate culture is one of the banking-specific analytical considerations that is not addressed by the CAMELS approach.

Question 8

L2FRA-PQ16005-1808
LOS: LOS-7133
Lesson Reference: Lesson 2: Analyzing a Bank
Difficulty: easy
Bloom Code: 2

Which of the following ratios is an investor *most likely* to review when analyzing a bank's liquidity position under the CAMELS bank rating approach?

○ Interest margin.
● Net stable funding ratio.
○ Common equity Tier 1 ratio.

Rationale

✗ **Interest margin.**

This answer is incorrect. The interest margin is related to the earnings component of the CAMELS approach.

Rationale

✓ **Net stable funding ratio.**

The net stable funding ratio and the liquidity coverage ratio are minimum liquidity standards introduced by Basel III.

Rationale

✗ **Common equity Tier 1 ratio.**

This answer is incorrect. The common equity Tier 1 ratio is used to assess a bank's capital adequacy.

Question 9
L2FRA-PQ16003-1808
LOS: LOS-7132
Lesson Reference: Lesson 1: Introduction to Analysis of Financial Institutions
Difficulty: hard
Bloom Code: 2

Which of the following statements in relation to the Basel III regulatory framework for banks is/are correct?

Statement 1: The minimum liquidity requirement specifies that a bank must hold an adequate amount of high-quality liquid assets to cover its liquidity needs over 30 days in normal market conditions.

Statement 2: The stable funding requirement specifies that a bank must have a minimum amount of stable funding relative to the bank's liquidity needs over a one-year horizon, where stability of funding is based on the tenor of deposits and the type of depositor.

○ Statement 1 only.
● Statement 2 only.
○ Both Statement 1 and Statement 2.

Rationale
✗ **Statement 1 only.**
This answer is incorrect. The minimum liquidity requirement specifies that a bank must hold an adequate amount of high-quality liquid assets to cover its liquidity needs in a 30-day liquidity stress scenario.

Rationale
✓ **Statement 2 only.**

Tenor: Longer-term deposits are considered more stable than shorter-term deposits.

Type of depositor: Consumer deposits are considered more stable than funding from the interbank market.

Rationale
✗ **Both Statement 1 and Statement 2.**
This answer is incorrect. Only one of the statements is correct.

Question 10
L2FRA-PQ16010-1808
LOS: LOS-7135
Lesson Reference: Lesson 2: Analyzing a Bank
Difficulty: hard
Bloom Code: 4

An equity analyst has used the CAMELS approach to analyze ABC Bank, placing twice as much weighting on management capabilities and earnings compared to the other factors, as shown below.

	Rating	Weighting
Capital adequacy	1.0	1
Asset quality	1.5	1
Management capabilities	2.0	2
Earnings	2.5	2
Liquidity	1.0	1
Sensitivity to market risk	1.0	1

ABC's overall CAMELS score, based on the analyst's weightings, is closest to:

○ 1.5
● 1.7
○ 2.3

Rationale
✗ **1.5**
This answer is incorrect. The overall CAMELS score was incorrectly calculated as the arithmetic mean of the individual ratings (using an equal weighting for each CAMELS factor).

Rationale
✓ **1.7**

Sum of the weighted ratings = (1 + 1.5 + 4 + 5 + 1 + 1) = 13.5

Sum of the weights = (1 + 1 + 2 + 2 + 1 + 1) = 8

Overall CAMELS score = 13.5/8 = 1.69

Rationale
✗ **2.3**
This answer is incorrect. The weights were incorrectly applied when calculating the overall CAMELS score.