Question 1
L2FI-PQ37013-1808
LOS: LOS-9770
Lesson Reference: Lesson 7: Credit Analysis for Securitized Debt
Difficulty: easy
Identify which of the following statements is untrue regarding the securitization of assets from the perspective of the lender.

- ○ Balance sheet risk goes down.
- ○ There is greater capital to originate loans.
- ◉ Issuing securitized debt is less complex than general obligation debt.

Rationale
✗ **Balance sheet risk goes down.**
True. Balance sheet risk goes down for lenders.

Rationale
✗ **There is greater capital to originate loans.**
True. There is greater capital to originate loans for lenders.

Rationale
✓ **Issuing securitized debt is less complex than general obligation debt.**
Untrue. Issuing securitized debt is more complex than issuing general obligation debt.

Question 2
L2FI-PQ37004-1808
LOS: LOS-9700
Lesson Reference: Lesson 2: Credit Scores and Credit Ratings
Difficulty: medium
Calculate the expected price change in a bond, assuming the risk-free rate is 4.0%, its modified duration is 7, and that it transitions from an A rating with a credit spread of 0.50% to a BBB rating with a credit spread of 2.50%.

- 7.00%
- –14.00%
- 14.00%

Rationale
7.00%

This answer assumes the calculation for the expected price change in a bond given a credit transition is modified duration × (risk-free rate – new spread – original spread):

7 × (4.0% – 2.50% – 0.50%) = 7.00%

Rationale
–14.00%

The correct calculation for the expected price change in a bond given a credit transition is – modified duration × (new spread – original spread):

–7 × (2.50% – 0.50%) = –14.00%

Rationale
14.00%

This answer assumes the calculation for the expected price change in a bond given a credit transition is – modified duration × (original spread – new spread):

–7 × (0.50% – 2.50%) = 14.00%

Question 3
L2FI-PQ37005-1808
LOS: LOS-9720
Lesson Reference: Lesson 3: Structural and Reduced-Form Models of Credit Risk
Difficulty: easy
Identify which of the following statements about structural debt models being interpreted as options contracts is correct.

- (●) Equity is a long call option on assets held by shareholders, with a strike price equal to the value of debt.
- ( ) Equity is a short call option on assets held by shareholders, with a strike price equal to the value of assets.
- ( ) Equity is a long put option on assets held by shareholders, with a strike price equal to the value of debt.

Rationale
✔ **Equity is a long call option on assets held by shareholders, with a strike price equal to the value of debt.**
Equity is a long call option on assets held by shareholders, with a strike price equal to the value of debt.

Rationale
✘ **Equity is a short call option on assets held by shareholders, with a strike price equal to the value of assets.**
Equity is not a short call option on assets held by shareholders, with a strike price equal to the value of assets.

Rationale
✘ **Equity is a long put option on assets held by shareholders, with a strike price equal to the value of debt.**
Equity is not a long put option on assets held by shareholders, with a strike price equal to the value of debt.

Question 4
L2FI-PQ37011-1808
LOS: LOS-9750
Lesson Reference: Lesson 6: The Term Structure of Credit Spreads
Difficulty: medium
Identify which of the following statements about the term structure of credit spreads is untrue.

- High-yield debt can have an inverted term structure of credit spreads during times of economic recession.
- Investment-grade debt usually has a flat term structure of credit spreads over the long term.
- High-yield debt can have a steep upward term structure of credit spreads during times of economic expansion.

Rationale
High-yield debt can have an inverted term structure of credit spreads during times of economic recession.
High-yield debt can have an inverted term structure of credit spreads during times of economic recession based on expectations of improving economic conditions.

Rationale
Investment-grade debt usually has a flat term structure of credit spreads over the long term.
Investment-grade debt usually has a flat term structure of credit spreads over the short term.

Rationale
High-yield debt can have a steep upward term structure of credit spreads during times of economic expansion.
High-yield debt can have an upward term structure of credit spreads during times of economic expansion based on expectations of declining economic conditions.

Question 5
L2FI-PQ37010-1808
LOS: LOS-9740
Lesson Reference: Lesson 5: Interpreting Changes in Credit Spreads
Difficulty: easy
Identify which of the following risk factors that contribute to bond yields are shared by government and corporate debt.

- ○ Expected losses and liquidity
- ○ Expected liquidity and inflation
- ◉ Expected inflation and real interest rates

Rationale
✗ **Expected losses and liquidity**
Expected losses and liquidity are risk factors only for corporate debt.

Rationale
✗ **Expected liquidity and inflation**
Expected liquidity is not a risk factor for government debt.

Rationale
✓ **Expected inflation and real interest rates**
Expected inflation and real interest rates are risk factors for both government and corporate debt.

Question 6
L2FI-PQ37006-1808
LOS: LOS-9720
Lesson Reference: Lesson 3: Structural and Reduced-Form Models of Credit Risk
Difficulty: easy
Identify which of the following statements regarding reduced-form credit models is incorrect.

- ○ Reduced-form models use regression analysis.
- ○ Reduced-form models rely on publicly available data.
- ◉ Reduced-form models explain the reasons for default.

Rationale
✗ **Reduced-form models use regression analysis.**
Reduced-form models use regression analysis.

Rationale
✗ **Reduced-form models rely on publicly available data.**
Reduced-form models rely on publicly available data.

Rationale
✓ **Reduced-form models explain the reasons for default.**
Reduced-form models do not explain the reasons for default and assume they occur randomly.

Question 7
L2FI-PQ37012-1808
LOS: LOS-9760
Lesson Reference: Lesson 6: The Term Structure of Credit Spreads
Difficulty: medium
Identify which of the following is likely to happen to a bond when it has an increasing POD.

- (●) Its CVA will increase and its credit spread will widen.
- ( ) Its CVA will decrease and its credit spread will tighten.
- ( ) Its CVA will decrease and its credit spread will widen.

Rationale
✔ **Its CVA will increase and its credit spread will widen.**
A higher POD will cause the CVA to increase and its credit spread to widen.

Rationale
✘ **Its CVA will decrease and its credit spread will tighten.**
A higher POD will cause the CVA to increase.

Rationale
✘ **Its CVA will decrease and its credit spread will widen.**
A higher POD will cause the CVA to increase.

Question 8
L2FI-PQ37008-1808
LOS: LOS-9730
Lesson Reference: Lesson 4: Bond Valuation and Credit Risk
Difficulty: medium
Assuming interest rate volatility changes and the bond value assuming no default (VND) for a bond remains unchanged, the risk-free rate remains unchanged, and the bond's credit valuation adjustment (CVA) increases, identify which of the following statements is correct regarding the bond's fair value, yield to maturity (YTM), and credit spread.

- Fair value goes up, YTM goes up, and the credit spread increases.
- Fair value goes down, YTM goes up, and the credit spread increases.
- Fair value goes down, YTM goes down, and the credit spread decreases.

Rationale
Fair value goes up, YTM goes up, and the credit spread increases.
The fair value of a bond will go down when its CVA increases.

Rationale
Fair value goes down, YTM goes up, and the credit spread increases.
The fair value of a bond will go down when its CVA increases, which increases the YTM and the credit spread.

Rationale
Fair value goes down, YTM goes down, and the credit spread decreases.
When the fair value of a bond decreases, the YTM and the credit spread increase.

Question 9
L2FI-PQ37002-1808
LOS: LOS-9690
Lesson Reference: Lesson 1: The Impact of Credit Exposure on Bond Valuation
Difficulty: medium
Calculate the probability of default (POD) for a bond, assuming the expected exposure is 100, the loss given default (LGD) is 65.00, and the expected loss is 4.00.

- 4.0000%
- 6.1538%
- 2.6000%

Rationale
4.0000%

This answer assumes the POD is expected loss/expected exposure:

4.00/100 = 4.0000%

Rationale
6.1538%

The POD for a bond is the expected loss/LGD:

4.00/65.00 = 6.1538%

Rationale
2.6000%

This answer assumes the POD is (LGD × expected loss)/100:

(65.00 × 4.00)/100 = 2.6000%

Question 10
L2FI-PQ37003-1808
LOS: LOS-9700
Lesson Reference: Lesson 2: Credit Scores and Credit Ratings
Difficulty: easy
Identify which of the following factors used in FICO scores is incorrectly weighted.

- (●) Debt burden = 35%
- ( ) Length of credit history = 15%
- ( ) Payment history = 35%

Rationale
✓ **Debt burden = 35%**
Debt burden has a 30% weighting in FICO scores.

Rationale
✗ **Length of credit history = 15%**
The length of credit history has a 15% weighting in FICO scores.

Rationale
✗ **Payment history = 35%**
Payment history has a 35% weighting in FICO scores.

Question 11
L2FI-PQ37009-1808
LOS: LOS-9740
Lesson Reference: Lesson 5: Interpreting Changes in Credit Spreads
Difficulty: medium
If a credit analyst knows a firm is BBB-rated based on its senior secured debt, and assumes a lower recovery rate for its subordinated debt, identify which of the following statements is correct.

- (●) It will increase the CVA for the subordinated bond, increase its YTM, increase its credit spread, and warrant a lower rating than BBB.
- ( ) It will decrease the CVA for the subordinated bond, decrease its YTM, decrease its credit spread, and warrant a higher rating than BBB.
- ( ) It will decrease the CVA for the subordinated bond, decrease its YTM, decrease its credit spread, and warrant a lower rating than BBB.

Rationale
✔ **It will increase the CVA for the subordinated bond, increase its YTM, increase its credit spread, and warrant a lower rating than BBB.**
Assuming a lower recovery rate will increase the CVA for the subordinated bond, increase its YTM, raise its credit spread, and warrant a lower rating than BBB.

Rationale
✘ **It will decrease the CVA for the subordinated bond, decrease its YTM, decrease its credit spread, and warrant a higher rating than BBB.**
Assuming a lower recovery rate will not decrease the CVA for the subordinated bond.

Rationale
✘ **It will decrease the CVA for the subordinated bond, decrease its YTM, decrease its credit spread, and warrant a lower rating than BBB.**
Assuming a lower recovery rate will not decrease the CVA for the subordinated bond.

Question 12
L2FI-PQ37014-1808
LOS: LOS-9770
Lesson Reference: Lesson 7: Credit Analysis for Securitized Debt
Difficulty: medium
If a securitized debt issue consists of thousands of auto loans made only to people with FICO scores of 700 or greater, identify which of the following best describes this debt.

- ○ Homogeneous and nongranular
- ○ Heterogeneous and nongranular
- ◉ Homogeneous and highly granular

Rationale
✗ **Homogeneous and nongranular**
A securitized debt issue with thousands of underlying loans is not considered nongranular.

Rationale
✗ **Heterogeneous and nongranular**
A securitized debt issue where borrowers are subject to common underwriting requirements is not considered heterogeneous.

Rationale
✓ **Homogeneous and highly granular**
A securitized debt issue with thousands of underlying loans where borrowers are subject to common underwriting requirements is considered homogeneous and highly granular.