Question #1 of 19

Question ID: 1209115

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 16.5, LOS 16.d)

Related Material

SchweserNotes - Book 2

Question #2 of 19

Question ID: 1209109

It would be *least* accurate to state that the Basel Committee:

A) monitors adoption and implementation of standards in member jurisdictions. ✗

B) develops international regulatory framework for banks. ✗

C) has legal authority to enforce compliance with supervision and accountability standards. ✓

Explanation

The Basel Committee develops international regulatory framework for banks, and monitors adoption and implementation in member jurisdictions. However, the Basel Committee does not have legal authority (i.e., jurisdiction) to enforce compliance.

(Study Session 5, Module 16.1, LOS 16.b)

Related Material

SchweserNotes - Book 2

Question #3 of 19

Question ID: 1209113

Important attributes that the CAMELS approach to assessing bank soundness does not address are *most likely* to include:

A) competitive environment, mission, and support by government. ✓

B) earnings, liquidity, and sensitivity to market risk. ✗

C) management capabilities, asset quality, and capital adequacy. ✗

Explanation

In addition to the CAMELS components, important attributes deserving analysts' attention include government support, the bank's mission, corporate culture and competitive environment, off-balance-sheet items, segment information, currency exposure, and risk disclosures. CAMELS itself focuses on a bank's: capital adequacy, asset quality, management capabilities, earnings sufficiency, liquidity position, and sensitivity to market risk.

(Study Session 5, Module 16.3, LOS 16.d)

Related Material

SchweserNotes - Book 2

Question #4 of 19

Question ID: 1209118

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

C) The net stable funding ratio was highest in 2017

Explanation

		2016	2017	2018
		$m	**$m**	**$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	**117%**	**110%**	**98%**
	Net Outflows			
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	**103%**	**121%**	**120%**
	Required Stable Funding			

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 16.5, LOS 16.e)

Related Material

SchweserNotes - Book 2

Question #5 of 19

Question ID: 1209120

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 16.6, LOS 16.f)

Related Material

SchweserNotes - Book 2

Question #6 of 19

Question ID: 1209110

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

A) be weighted over 100%.

B) be weighted at 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 16.2, LOS 16.c)

Related Material

SchweserNotes - Book 2

Question #7 of 19

Question ID: 1209121

When analyzing insurance companies, the combined ratio is *most likely* to:

A) suggest a soft market when it is low.

B) indicate an underwriting loss when it is higher than 100%.

C) equal net premiums earned divided by total insurance expenses.

Explanation

An underwriting loss is indicated by a combined ratio higher than 100% for a single insurance company. Low prices for premiums leads to a high combined ratio, indicating a soft market. The combined ratio equals the *total insurance expenses* divided by the *net premiums earned*.

(Study Session 5, Module 16.6, LOS 16.f)

Related Material

SchweserNotes - Book 2

Question #8 of 19

Question ID: 1209106

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 liquidity requirement.

B) stable funding requirement.

C) minimum capital 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 16.1, LOS 16.b)

Related Material

SchweserNotes - Book 2

Question #9 of 19

Question ID: 1209122

Compared to a life and health (L&H) insurance company, it is *most likely* that a property and casualty (P&C) insurer's:

A) policies will be longer term.

B) claims will be more predictable.

C) policies' final cost will typically be known within a year of an insured event.

Explanation

P&C insurers' final cost will usually be known within a year of an insured event occurring. P&C insurers' policies are usually short term, and P&C claims are more variable and "lumpier" because they stem from unpredictable events such as accidents.

(Study Session 5, Module 16.6, LOS 16.f)

Related Material

SchweserNotes - Book 2

Question #10 of 19

Question ID: 1209119

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

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

B) 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

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

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 16.6, LOS 16.f)

Related Material

SchweserNotes - Book 2

Question #11 of 19

Question ID: 1209116

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.

Regulatory Capital	**2018 $('000)**		**2018 $('000)**
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 16.5, LOS 16.e)

Related Material

SchweserNotes - Book 2

Question #12 of 19

Question ID: 1209114

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 16.5, LOS 16.d)

Related Material

SchweserNotes - Book 2

Question #13 of 19

Question ID: 1209111

The CAMELS approach to analyzing a bank considers:

A) capacity, appetite for risk, monetary assets, evidence, legislative factors, and structure.

B) character, ability to pay, market exposure, efficiency, liabilities, and stability.

C) capital adequacy, asset quality, management, earnings, liquidity, and sensitivity.

Explanation

The CAMELS approach to analyzing a bank stands for: capital adequacy, asset quality, management, earnings, liquidity, and sensitivity.

(Study Session 5, Module 16.2, LOS 16.c)

Related Material

SchweserNotes - Book 2

Question #14 of 19

Question ID: 1209105

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

A) To increase global opportunities for regulatory arbitrage.

B) To increase harmonization or regulatory rules.

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 16.1, LOS 16.b)

Related Material

SchweserNotes - Book 2

Question #15 of 19

Question ID: 1209117

When analyzing a bank, important attributes that the CAMELS approach to assessing bank soundness does *not* address are *most* likely to include:

A) capital adequacy, asset quality, management capabilities. ✗

B) corporate culture, exposure to currencies, and segment information. ✓

C) sensitivity to market risk, liquidity, and earnings. ✗

Explanation

In addition to the CAMELS components, important attributes deserving analysts' attention include government support, the bank's mission, corporate culture and competitive environment, off-balance-sheet items, segment information, currency exposure, and risk disclosures. CAMELS itself focuses on a bank's: capital adequacy, asset quality, management capabilities, earnings sufficiency, liquidity position, and sensitivity to market risk.

(Study Session 5, Module 16.5, LOS 16.d)

Related Material

SchweserNotes - Book 2

Question #16 of 19

Question ID: 1209112

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 3 valuation ✓

B) level 1 valuation ✗

C) level 2 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 16.3, LOS 16.c)

Related Material

SchweserNotes - Book 2

Question #17 of 19

Question ID: 1209104

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

A) due to their activities giving rise to systemic risk. ✗

B) due to their assets being predominantly tangible. ✓

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 16.1, LOS 16.a)

Related Material

SchweserNotes - Book 2

Question #18 of 19

Question ID: 1209108

Compared to manufacturing or merchandising companies, financial institutions are *most* likely to have higher direct exposures to:

A) operational risk, process risk, political risk, and compliance risk. ✗

B) market risk, credit risk, liquidity risk, and interest rate risk. ✓

C) inflationary risk, business risk, exchange rate risk, and legal risk. ✗

Explanation

Because the productive assets of financial institutions are primarily financial assets such as securities and loans, financial institutions are likely to have significant direct exposures to risks such as credit risk, liquidity risk, market risk, and interest rate risk.

(Study Session 5, Module 16.1, LOS 16.a)

Related Material

SchweserNotes - Book 2

Question #19 of 19

Question ID: 1209107

Systemic risk in financial services is *least* likely to:

A) concern the co-movement of an institution's asset values with the overall market.

B) be caused by interdependencies in the financial system.

C) have consequences for the economy as a whole.

Explanation

Systemic risk refers to the risk that impairment in one part of the financial system could spread throughout other parts of the financial system, and then negatively affect the entire economy. Note that systemic risk is distinct from systematic (beta) risk.

(Study Session 5, Module 16.1, LOS 16.a)

Related Material

SchweserNotes - Book 2