10.04 Introduction to Risk Management

Question 1
An entertainment company is planning a large outdoor concert and is concerned about weather negatively affecting the event. If the company decides to modify the risk using a risk transfer method, it will *most likely*:
A. decide not to hold the event.
B. purchase insurance for the event.
C. set aside reserves to cover the event cost.

Question 2
Within a risk management framework, the role of a company's risk infrastructure is *best* described as:
A. defining risk tolerance.
B. tracking risk exposure.
C. developing risk strategies.

Question 3
A bank relocates its back-office functions to a property located in a flood plain. It establishes a reserve fund to cover damage that may occur if the property is flooded. This risk modification is *most likely* an example of:
A. risk shifting.
B. risk prevention.
C. risk acceptance.

Question 4
Which of the following activities is *most likely* an example of financial risk?
A. Arbitration of a commercial dispute
B. Embezzlement of funds by an employee
C. Company selling a large stock position quickly

Question 5
Which of the following is *most* consistent with a risk budgeting approach to portfolio management?
A. Allocating additional funds to managers with the highest risk-adjusted returns
B. Requiring that a certain percentage of each portfolio be dedicated to hedging strategies
C. Setting a firm-wide standard deviation target and managing investments toward that goal

Question 6
Which of the following risk metrics is *most appropriate* for measuring a bond's interest rate sensitivity?
A. Rho
B. Beta
C. Duration

Question 7
Which of the following statements is *least likely* a description of a nonfinancial risk?
A. The risk resulting primarily from payment and delivery of goods
B. The risk that extreme events are more likely than estimated by the chosen model
C. The risk that a customer with significant outstanding receivables will declare bankruptcy

Question 8
Which of the following is *mostly likely* categorized as a financial risk?
A. Model risk
B. Liquidity risk
C. Solvency risk

Question 9
When determining a company's risk tolerance, its leadership should *most appropriately* consider which of the following?
A. Alignment with leadership compensation
B. Government and regulatory environment
C. The company's short-term financial challenges

Question 10
If a company uses a surety bond, it is *most likely*:
A. self-insuring.
B. transferring risk.
C. pledging collateral for a debt obligation.

Question 11
A bank's risk management team estimates a one-day 1% value-at-risk (VaR) of $7 million. Of the following choices, the *best* interpretation of this analysis is:
A. 1 out of each 100 days, the bank expects to lose a maximum of $7 million.
B. 1% of the time, the bank expects to lose a minimum of $7 million in one day.
C. 99% of the time, the bank expects to lose a maximum of $7 million in one day.

Question 12
For a company that seeks to manage risk but prefers to avoid an upfront cash outlay, which of the following is *least appropriate*?
A. Contingent claim
B. Forward contract
C. Interest rate swap

Question 13
A company decides to shift price risk by entering into an options contract to buy a commodity. As a consequence, the company *most likely*:

A. pays a premium at contract initiation.
B. is obligated to purchase the commodity in the future.
C. will exercise the option and purchase the underlying if prices decline.

Question 14
The purpose of the risk budgeting process is *most likely*:
A. applying an appropriate beta.
B. eliminating the need for hedging.
C. setting a target return percentage.

Question 15
Which of the following statements about elements of the risk management framework is *most accurate*?
A. The company determines how frequently it monitors risk positions.
B. The risk infrastructure team is responsible for determining the risk budget.
C. The identification phase includes the assessment of whether risk positions align with the desired risk tolerance.

Question 16
Which of the following is the *most appropriate* risk management measure for an equity option contract?
A. Beta
B. Delta
C. Value-at-risk

Question 17
If a company shifts the price risk of a commodity by purchasing a futures contract, then the company *most likely*:
A. locks in a future price.
B. pays an initial premium.
C. has no future obligations.

Question 18
A trader at an investment management firm mistakenly buys 10,000 shares of stock instead of the intended 1,000 shares. The types of risks that interact as a result are *best* categorized as:
A. operational and market.
B. compliance, legal, and liquidity.
C. operational, settlement, and credit.

Question 19
Risk governance is *most* effective:
A. when applied to both core and non-core business units.
B. after a significant unexpected event when actual data become available.
C. when mainly focusing on mitigating risks that threaten the company's viability.

Question 20
Using derivatives to modify a company's currency risk is *best* described as which of the following types of risk modification?
A. Risk shifting
B. Risk transfer
C. Risk prevention