Question #1 of 20

Question ID: 1552772

When an investor makes a charitable gift of appreciated securities, in most instances the investor is:

A) not able to take a deduction.

B) able to take a deduction in the amount of the capital gain.

C) able to take a deduction in the amount of the current fair market value of the gift.

Explanation

When an investor makes a gift of appreciated securities to a charitable organization, in most countries the investor is able to take a deduction in the amount of the current fair market value of the gift.

(Module 20.4, LOS 20.j)

Question #2 of 20

Question ID: 1552740

The main benefit of tax-loss harvesting is:

A) saving on current taxes.

B) reducing both current and future taxes.

C) saving on future taxes.

Explanation

Although tax loss harvesting saves on current taxes, the apparent tax savings in a given year are misleading. This is because when the security is sold and the proceeds are reinvested, the cost basis of the new, replacement security is the low sales price of the old security. In other words, when the old security is sold, the cost basis for future taxes is reduced, thereby resulting in higher taxes in the future.

(Module 20.2, LOS 20.e)

Question #3 of 20

Question ID: 1552694

The behavioral bias reflected in retirees' preference to meet spending needs from investment income rather than liquidating securities *most likely* refers to:

A) framing.

B) self-control.

C) loss aversion.

Explanation

Spending investment income instead of liquidating shares to meet spending needs is an example of a self-control issue. Specifically, a lack of self-control when there is an overemphasis on income producing assets to meet shorter-term spending needs instead of viewing the portfolio from a total return perspective and selling shares to meet a portion of the spending needs. This is a lack of self-control if retirees are spending too much now for short-term gratification instead of saving assets for longer-term retirement needs. Framing bias relates to decision-making contingent on the way information is presented. Loss aversion refers to the desire to avoid losing money even at the expense of financial gain.

(Module 19.5, LOS 19.h)

Question #4 of 20

Question ID: 1552806

Financial wealth and the demand for life insurance have:

A) a negative relationship.

B) either a positive or a negative relationship depending upon the individual’s level of wealth.

C) a positive relationship.

Explanation

Financial wealth and the demand for life insurance have a negative relationship which means if a person has a lot of financial wealth their need for life insurance is small and vice versa.

(Module 21.2, LOS 21.d)

Question #5 of 20

Question ID: 1552748

Marcy invested $500,000 in a mutual fund at the beginning of the year. At the end of the year, if her investment value remained $500,000, she:

A) would only have to pay taxes if she had dispositions from the mutual fund.

B) could be required to pay income taxes.

C) would not have to pay income taxes.

Explanation

Although Marcy's investment value has not appreciated, she would be required to pay taxes if the fund manager sold some of the underlying holdings and realized capital gains, which would be distributed to all shareholders. Marcy would not necessarily have to pay taxes if she had dispositions from the mutual fund because those dispositions could have occurred at a loss, the latter of which would not require an income tax payment.

(Module 20.3, LOS 20.f)

Question #6 of 20

Question ID: 1552752

By using an exchange fund it is *most accurate* to expect an investor can:

A) monetize the asset and then obtain a loan.

B) pay more taxes now and then minimize future taxes.

C) avoid future taxes.

Explanation

The exchange fund simply exchanges an undiversified single asset holding for a share in a somewhat more diversified portfolio. The tax basis in the new fund is the same as before the exchange with no tax due currently and the unrealized tax liability is unchanged. With the increase in diversification the investor could seek a loan to monetize the exchange fund holding and use the funds for even further diversification. How much a lender will loan against a relatively illiquid exchange fund is unclear but this is the best answer choice offered.

(Module 20.3, LOS 20.g)

Question #7 of 20

Question ID: 1552859

The liquidity requirement of a pension plan is *directly* related to and *increased* by a:

A) high proportion of active lives.

B) low proportion of retired lives.

C) high proportion of retired lives.

Explanation

Pension plan liquidity requirements are increased by the proportion of participants currently receiving benefits. Hence, a high proportion of retired lives, those currently receiving benefits, indicates a larger liquidity requirement.

(Module 22.2, LOS 22.e)

Question #8 of 20

Question ID: 1552879

Which of the following would be included in an investment policy statement (IPS) for a defined contribution plan?

A) Time horizon.

B) Risk objectives.

C) A description of the investment alternatives available to plan participants.

Explanation

In a defined contribution plan, the plan sponsor does not establish objectives and constraints but rather the plan participants set their own risk and return objectives.

(Module 22.1, LOS 22.f)

Question #9 of 20

Question ID: 1552805

Life insurance is *most* commonly used to hedge against:

A) longevity risk.

B) mortality risk.

C) earnings risk.

Explanation

Life insurance is the most commonly employed hedge against mortality risk.

(Module 21.2, LOS 21.d)

Question #10 of 20

Question ID: 1552917

One difference between the asset liability management techniques between a life and property and casualty insurance company is liability:

A) payment amounts are known for the property and casualty insurer.

B) payment amounts are not known for the life insurance company.

C) payment amounts are known for the life insurance company.

Explanation

The liability payment amounts for the life insurance company are known, whereas they are not known for the property and casualty insurer.

(Module 22.5, LOS 22.c)

Question #11 of 20

Question ID: 1552768

Which of the following equations represents the relative value of a gift *when the gift taxes are paid by the receiver*?

A) $\dfrac{\left[1+\mathrm{r_g}\left(1-\mathrm{t_{ig}}\right)\right]^{\mathrm{n}}}{\left[1+\mathrm{r_e}\left(1-\mathrm{t_{ie}}\right)\right]^{\mathrm{n}}\left(1-\mathrm{T_e}\right)}$

B) $\dfrac{\left[\left(1-\mathrm{T_g}\right)\right]\left[1+\mathrm{r_g}\left(1-\mathrm{t_{ig}}\right)\right]^{\mathrm{n}}}{\left[1+\mathrm{r_e}\left(1-\mathrm{t_{ie}}\right)\right]^{\mathrm{n}}\left(1-\mathrm{T_e}\right)}$

C) $\dfrac{\left[1+\mathrm{r_e}\left(1-\mathrm{t_{ie}}\right)\right]^{\mathrm{n}}\left(1-\mathrm{T_e}\right)}{\left[\left(1-\mathrm{T_g}\right)\right]\left[1+\mathrm{r_g}\left(1-\mathrm{t_{ig}}\right)\right]^{\mathrm{n}}}$

Explanation

Equation #1 below shows the relative value of a *taxable* gift (numerator) when the *gift is subject to gift taxes* paid by the receiver compared to if it is gifted as part of an estate (denominator).

$$1.\ \mathrm{RV}_{\text{taxable gift}} = \frac{\mathrm{FV}_{\text{taxable gift}}}{\mathrm{FV}_{\text{bequest}}} = \frac{\left[\left(1 - \mathrm{T_g}\right)\right]\left[1 + \mathrm{r_g}\left(1 - \mathrm{t_{ig}}\right)\right]^{\mathrm{n}}}{\left[1 + \mathrm{r_e}(1 - \mathrm{t_{ie}})\right]^{\mathrm{n}}(1 - \mathrm{T_e})}$$

Equation #2 below shows the relative value of a *tax free* gift if it is gifted today (numerator) compared to if it is gifted as part of an estate (denominator).

$$2.\ \mathrm{RV}_{\text{tax-free gift}} = \frac{\mathrm{FV}_{\text{tax-free gift}}}{\mathrm{FV}_{\text{bequest}}} = \frac{\left[1 + \mathrm{r_g}\left(1 - \mathrm{t_{ig}}\right)\right]^{\mathrm{n}}}{\left[1 + \mathrm{r_e}(1 - \mathrm{t_{ie}})\right]^{\mathrm{n}}(1 - \mathrm{T_e})}$$

Equation #3 is Equation #1, but it incorrectly reverses the numerator and denominator.

(Module 20.4, LOS 20.j)

Question #12 of 20

Question ID: 1552716

Which of the following *most likely* is a valid framework to assess the portfolio performance of a client's investments?

A) Analysis of investment returns relative to benchmark.

B) Assessment of wealth management fees.

C) Incorporation of a tax-efficient investment strategy.

Explanation

Measuring portfolio performance specifically refers to a client's investment returns that can be quoted in absolute terms, relative terms, or in terms of risk-adjusted performance. Comparing a portfolio to a benchmark is a relative measure of portfolio performance. Minimizing wealth management fees and maximizing tax efficiency are appropriate markers of success for other aspects of a client's overall investment program.

(Module 19.8, LOS 19.n)

Question #13 of 20

Question ID: 1552706

Which of the following statements distinguishes the ability to take risk from the willingness to take risk? The:

A) ability to take risk is more amenable to quantitative measures whereas the willingness to take risk is more qualitative in nature.

B) willingness to take risk is connected with primary goals and objectives.

C) ability to take risk is more qualitative in nature whereas the willingness to take risk can be measured in a quantitative nature.

Explanation

The ability to take risk is usually associated with specific goals and time horizons and is more quantitative than willingness to take risk. Willingness to take risk is more subjective from the investor's perspective and is therefore more qualitative in nature.

(Module 19.6, LOS 19.j)

Question #14 of 20

Question ID: 1552683

Which measure of risk is determined in the *most* objective manner?

A) Willingness to take risk.

B) Tolerance for risk.

C) Ability to take risk.

Explanation

Ability to take risk is determined objectively, while willingness to take risk is a far more subjective, emotional matter. Risk tolerance is a combination of ability and willingness so it is not as objective as ability alone.

(Module 19.3, LOS 19.e)

Question #15 of 20

Question ID: 1552729

Amy Kobayashi is an Australian investor who purchased shares of an Australian corporation several years ago, which began paying dividends to shareholders this year. Kobayashi is concerned about her tax liability, but her tax advisor noted that she will earn franking credits. The *most likely* conclusion is that:

A) the corporate tax rate is lower than Kobayashi's personal tax rate.

B) the dividends are not taxed at the corporate level.

C) the corporate tax rate is higher than Kobayashi’s personal tax rate.

Explanation

Franking credits are designed to avoid double taxation, which occurs when dividends are paid out of after-tax profits at the company level, and then the dividends are taxed at the shareholder level. Franking credits can be used by shareholders to offset part of their tax liability and only pay the difference between the personal and corporate tax rates. That occurs when a shareholder's personal tax rate is higher than the corporate tax rate.

(Module 20.1, LOS 20.b)

A local bank, Renno Community Bank (Renno), is seeking help managing its financing and investments. Renno has access to all capital markets for funding and has an appropriate mix of assets and liabilities on its balance sheet, including loans and debt securities.

In the current market, credit spreads on loans have narrowed, and many economists are forecasting a recession soon. Renno's chairman, Geoffrey Scully, believes that Renno has positioned itself for many years of future success through the following actions:

Action 1:	Increasing asset allocations to longer-maturity securities
Action 2:	Decreasing leverage through fewer large retail time deposits

Scully is evaluating the role of Renno's asset and liability management committee (ALMCo). Renno has an investment team in place that operates separately from the ALMCo. Current responsibilities of the ALMCo include the following:

- Setting the investment policy statement (IPS)
- Monitoring investment performance on an ongoing basis
- Establishing investment policy benchmarks

Renno currently has an equity capital ratio for financial assets of 8%. The modified durations of its assets and liabilities are 2.5 and 1.5, respectively. For small changes in interest rates, the yield on liabilities is expected to move by 90 bps for every 1% change in yield of the assets. Scully would like to further understand how that would affect the value of shareholder equity.

Question #16 - 19 of 20

Question ID: 1552930

Which items on Renno's balance sheet would be classified as assets?

A) Loans only.

B) Debt securities only.

C) Both loans and debt securities.

Explanation

The largest component of bank assets is loans, typically comprising 50% or more of the total assets. The next-largest component of assets is debt securities, typically accounting for 25% or more of total assets.

(Module 22.1, LOS 22.c)

Question #17 - 19 of 20

Question ID: 1552931

Which of Scully's actions would *most likely* position Renno for many years of future success?

A) Action 2 only.

B) Actions 1 and 2.

C) Action 1 only.

Explanation

Only Action 2 would position Renno for many years of future success. Action 1 is incorrect because the allocation should be to short-maturity, not long-maturity, securities (see #3 in the following list).

The long-term horizon of the bank is evidenced by it (1) cutting back new lending, (2) selling part of its existing loan portfolio, (3) increasing allocations to short-maturity, liquid securities, and (4) decreasing leverage through fewer large wholesale time deposits.

(Module 22.1, LOS 22.c)

Question #18 - 19 of 20

Question ID: 1552932

Which of the responsibilities of the ALMCo is *most appropriate* to transfer to the investment team?

A) Setting the IPS.

B) Establishing benchmarks.

C) Monitoring performance.

Explanation

Establishing benchmarks is generally the responsibility of the investment team, not the ALMCo.

Banks establish an ALMCo that provides direction and oversight of the investment portfolio. The ALMCo has significant visibility with the bank's management and board of directors, as well as with external regulators. The ALMCo sets the investment policy statement (IPS), monitors performance on an ongoing basis, and has the ability to mandate adjustments on the asset and liability sides of the balance sheet. The ALMCo also ensures that market (interest rate and FX), credit, liquidity, and solvency (capital adequacy) risk positions are within the limits of the bank's specified risk tolerances.

Once the overall investment objectives and risk levels are set, the investment team establishes policy benchmarks.

Module 22.5 LO

(Module 22.1, LOS 22.f)

Question #19 - 19 of 20

Question ID: 1552933

Given the information regarding Renno's assets and liabilities, what would be the impact on the value of shareholder capital if there were a 75-basis-point rise in the level of yields on its asset portfolio?

A) Decrease by 10.78%.

B) Decrease by 15.73%.

C) Decrease by 11.79%.

Explanation

The modified duration of equity capital is calculated as follows:

$$D_E^* = \left(\frac{A}{E}\right)D_A^* - \left(\frac{A}{E} - 1\right)D_L^* \left(\frac{\Delta i}{\Delta y}\right)$$

Because the yields on liabilities are assumed to move only 90% as much as the yields on portfolio assets:

$$\frac{di}{dy} = \frac{\Delta i}{\Delta y} = 0.90$$

From the information provided, we calculate that if equity to assets is 8%, then the leverage multiplier M = 1 / 0.08 = 12.5x. Per the information in the question, D_A = 2.5, D_L = 1.5, and Δi / Δy = 0.90:

D_E^* = (2.5 × 12.5) − (1.5 × 11.5 × 0.90) = 15.725

Using this information, we calculate the change in equity capitalization value as follows:

0.75% × −15.725 = −11.79%.

The answer "decrease by 10.78%" is incorrect because it uses M (and not M minus 1) when multiplying D_L^* by in the second term of the equation.

The answer "decrease by 15.73%" is incorrect because it is the modified duration of equity multiplied by 1%, not 0.75%.

(Module 22.6, LOS 22.h)

Question #20 of 20

Question ID: 1552728

In an effort to maximize world-wide taxation on its residents and citizens, the United States demands a list of U.S. security owners from:

A) international governmental agencies. ✗

B) international companies. ✗

C) global banks. ✓

Explanation

The U.S. requires that global banks disclose the names of U. S. security owners in order to make sure that those individuals' incomes are fully taxed.

(Module 20.1, LOS 20.b)