25/01 560 FINANCIAL MARKETS

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FM Graded Quiz M5

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QUESTIONS

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Question 1

Which of the following is NOT typically used as an indicator of liquidity?

- (●) The bond's coupon rate
- ( ) Trading volume
- ( ) Bid-ask spread
- ( ) Time to execute a trade

Question 2

How does a high Loan-to-Value (LTV) ratio typically affect the probability of default?

- ( ) It only affects the loss given default
- ( ) It decreases the probability of default
- (●) It increases the probability of default
- ( ) It has no effect on the probability of default

Question 3

Accoring to "Do House Prices Influence Stock Prices? Empirical Investigation from the Panel of Selected European Union Countries.", what did the Pedroni panel cointegration test results indicate about the long-run relationship between house prices and stock prices?

- ( ) There is no cointegration relationship between the variables
- (●) There is a strong cointegration relationship between the variables
- ( ) There is a weak cointegration relationship between the variables
- ( ) The test was inconclusive about the cointegration relationship

Question 4

If a loan has an Exposure at Default (EAD) of $500,000 and a Loss Given Default (LGD) of 40%, what is the potential loss amount?

- ( ) $150,000
- ( ) $300,000
- (●) $200,000
- ( ) $250,000

Question 5

In a securitization structure with three tranches (Senior, Mezzanine, Equity) each with $100 million per value if there are $150 million in losses how much will Mezzanine tranch lose?

- ( ) $0 million
- ( ) $100 million
- ( ) $150 million
- (●) $50 million

Question 6

What potential impact could widespread mortgage refinancing have on MBS investors?

- (●) It could lead to reinvestment risk as principal is returned earlier than expected

- ◯ It would automatically trigger defaults on all MBS tranches
- ◯ It would have no effect on MBS cash flows
- ◯ It would always result in higher returns for all investors

Question 7

If you believe a bond has a probability of default of 15% and a recovery rate of 70% what credit spread should you require?

- ◯ 15%
- ◉ 4.50%
- ◯ 10.50%
- ◯ 21%

Question 8

What potential problem arises from the rear-view mirror approach of credit rating agencies?

- ◉ Ratings may not reflect current market conditions accurately
- ◯ Ratings focus too much on future predictions
- ◯ Ratings change too frequently
- ◯ Ratings become too optimistic

Question 9

According to "Determination of Default Probability By Loss Given Default", which of the following best describes a limitation of the Market LGD approach?

- ◉ It cannot be used for instruments without a liquid market
- ◯ It overestimates losses due to including a risk premium
- ◯ It requires a long time period to calculate accurate results
- ◯ It does not account for the time value of money

Question 10

How might one critically assess the argument that increased regulation is necessary to prevent financial crises?

- ◯ By disregarding the historical context of past financial crises
- ◯ By focusing solely on the costs of implementing new regulations
- ◉ By weighing the potential benefits against the risks of unintended consequences
- ◯ By assuming that all regulation is inherently detrimentalBy weighing the potential benefits against the risks of unintended consequences

Question 11

If a bank has a loan with an EAD of $1,000,000, a PD of 3%, and an LGD of 45%, what is the expected loss?

- ◯ $30,000
- ◉ $13,500
- ◯ $11,000
- ◯ $45,000

Question 12

An MBS pool has $500 million in mortgages. If the average LTV ratio is 80% what is the total value of the properties backing these mortgages?

- ◯ $400 million
- ◉ $625 million
- ◯ $550 million

$550 million

$700 million

Question 13

What is the primary difference between subprime and prime conventional mortgages?

- ( ) Subprime mortgages have lower interest rates
- (•) Subprime mortgages are typically given to borrowers with lower credit ratings
- ( ) Prime mortgages are only available for commercial properties
- ( ) Prime mortgages cannot be securitized

Question 14

According to "Introduction to Credit Risk Management", a 5-year CDS has a notional principal of €200 million and a spread of 120 basis points per year. If no default occurs what is the total amount the buyer will pay over the life of the contract?

- (•) €12 million
- ( ) €2.4 million
- ( ) €10 million
- ( ) €14 million

Question 15

How might the relationship between credit spread and probability of default change in extreme market conditions?

- ( ) The relationship always remains perfectly linear
- ( ) The probability of default becomes fixed regardless of credit spread
- ( ) The credit spread becomes independent of probability of default
- (•) The relationship may become non-linear

Question 16

If you were designing a new credit risk model, which of the following factors would be LEAST important to include?

- ( ) Debt-to-Income ratio
- ( ) Borrower's credit score
- (•) Borrower's favorite watch value
- ( ) Loan-to-Value ratio

SUBMIT