# Topic 52 to 53

**Test ID: 8451116**

## Question #1 of 23

Question ID: 439601

Which of the following is **NOT** a use of stress testing?

**A)** Stress testing complements value at risk (VAR).

**B)** It can highlight weaknesses in contingency planning and assumptions.

**C)** It can be used for capital allocation across business units.

**D)** It enables the risk manager to eliminate all risk from a portfolio.

## Question #2 of 23

Question ID: 439598

Stress testing is considered an intuitive risk management tool because:

**A)** scenarios are drawn from factors that would likely impact portfolio value.

**B)** recent historical data greatly aids in the scenario selection.

**C)** major structural shifts can be anticipated by business line managers.

**D)** correlation between underlying exposures is ignored.

## Question #3 of 23

Question ID: 439594

Which of the following statements *best* describes the uses of stress analysis?

**A)** Scenario analysis, which is a special case of stress analysis, suffers from limitations on implementing a consistent and manageable approach.

**B)** Stress analysis can be used to enhance VAR analysis by focusing on the extent of loss in an extreme event.

**C)** Stress analysis has several advantages over a value at risk (VAR) only approach that includes: highlighting inappropriate assumptions, hidden vulnerabilities, and the ability to be able to forecast probability of rare but damaging events.

**D)** Scenario analysis can be used to model one-off hypothetical events but not actual events since their probability of occurrence is very miniscule and, as they have already occurred, they are not likely to recur.

## Question #4 of 23

Question ID: 439606

Greg Beck is using the conditional scenario method while conducting multidimensional scenario analysis. Which of the following statements are NOT characteristics of his correlation estimates?

I. The correlations are calculated from stressed time periods only.

II. All risk factor correlations are weighted equally.

III. Stressed correlations are estimated as three times the value as those in a normal market.

**A)** II and III.

**B)** I and III.

**C)** I, II and III.

**D)** I and II.

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## Question #5 of 23

Question ID: 439613

Which of the following statements is (are) CORRECT regarding stress testing methodologies?

I. Prior to the recent crisis, stress testing methodology was based on an underlying assumption that risk is generated by unknown and non-stochastic processes.

II. The process of reverse testing involves a scenario of known outcome, identification of likely events producing the outcome and evaluation of effectiveness of risk mitigating strategies to deal with the risk outcome.

III. Basis risk is the difference in the prices (or interest rates) between the cash market and the futures market.

IV. Contingent risk arises due to contractual agreements only.

**A)** I, II and III.

**B)** III only.

**C)** II only.

**D)** I only.

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## Question #6 of 23

Question ID: 439605

Unidimensional scenario analysis:

**A)** creates an array of portfolio gains/losses for all possible scenarios.

**B)** can easily handle multiple factors.

**C)** none of these answer choices are correct.

**D)** incorporates the correlation across multiple risk factors.

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## Question #7 of 23

Question ID: 439597

Which of the following would **NOT** be considered stress testing?

**A)** Exchange rate depreciation of 10% between $US relative to Japanese Yen.

**B)** Yield curve twist of 50 basis points.

**C)** S&P 500 index drop of 1%.

**D)** Treasury yield curve shift of 100 basis points.

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## Question #8 of 23

Question ID: 439608

Which of the following would *least likely* be associated with conducting a stress test?

**A)** Market values and relationships observed during the Crash of 1987.

**B)** Using one-percentile values of factors in an estimated factor analysis equation.

**C)** Modified VaR where kurtosis and skewness are zero.

**D)** Monte Carlo simulations that generate extreme values.

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## Question #9 of 23

Question ID: 439607

Which of the following stress testing approaches have the *disadvantage* of historical data limitations?

I. Use of historical events approach.
II. Historical simulation approach.
III. Stress scenarios approach.

**A)** I and II.

**B)** I, II, and III.

**C)** I only.

**D)** II only.

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## Question #10 of 23

Question ID: 439610

Factor push testing on interest rates is **NOT** appropriate for which of the following circumstances?

**A)** Fixed income and equities in bull market conditions.

**B)** Fixed income and equities in inflationary market conditions.

**C)** Fixed income and equities in normal conditions.

**D)** Fixed income and equities in bear market conditions.

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## Question #11 of 23

Question ID: 439604

Timothy Stratton is performing a scenario analysis for 3 interest rate scenarios and 2 equity scenarios for 4 assets. He has constructed the following partial table below.

| Interest Rate | Equity | Asset A | Asset B | Asset C | Asset D | Portfolio value |
|---|---|---|---|---|---|---|
| High | Bull | 6% | 3% | 12% | 7% | ?? |
| Normal | Bull | 10% | 2% | 2% | 5% | ?? |
| Low | Bull | -5% | 8% | -4% | 4% | ?? |
| High | Bear | 4% | 4% | 8% | 2% | ?? |

| | | | | | | |
|---|---|---|---|---|---|---|
| Normal | Bear | 6% | 0% | -4% | 1% | ?? |
| Low | Bear | -12% | -3% | -20% | 0% | ?? |

Suppose Timothy is considering a third risk factor based on economic growth (high, moderate, below average, low). How many more rows must he add to his previously constructed table if he wants to include the additional risk factor?

**A)** 18.

**B)** 24.

**C)** 12.

**D)** 6.

## Question #12 of 23

Question ID: 439612

Which of the following is not a step in the reverse stress testing methodology?

**A)** hedging.

**B)** outcome.

**C)** cause.

**D)** events.

## Question #13 of 23

Question ID: 439592

Which of the following statements highlights an issue with conducting stress tests?

I. Identifying key input variables.
II. Predicting regime shifts or structural changes.
III. Predicting how a change in one variable will impact others during a financial crisis.

**A)** I, II and III.

**B)** I and III.

**C)** II and III.

**D)** I and II.

## Question #14 of 23

Question ID: 439611

In response to an extremely large computed stress test, managers can:

I. sell insurance.
II. restructure business lines.
III. secure a line of credit.

**A)** I and II only.

**B)** II and III only.

**C)** III only.

**D)** I, II, and III.

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## Question #15 of 23

Question ID: 439595

Assume that the value at risk (VAR) over a 1-day time horizon for an $80 million equity portfolio at the 95 percent confidence level is calculated to be $792,000. Which of the following is a *drawback* to this VAR calculation?

**A)** The measure is backward looking.

**B)** The interpretation of the VAR measure would be different for a fixed-income portfolio.

**C)** The actual loss in a time of extreme market stress could be much greater than $792,000.

**D)** Increasing the time period used in the calculation will increase the VAR.

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## Question #16 of 23

Question ID: 439602

Which of the following is **NOT** a disadvantage of using stress testing? Stress testing:

**A)** fails to include the simultaneous adverse movements of risk factors.

**B)** reflects only normal circumstances.

**C)** reflects the analyst's intentional and unintentional misspecification of the model.

**D)** fails to measure the by-products of major factor movements.

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## Question #17 of 23

Question ID: 439609

Which of the following describes the form of stress testing referred to as factor push analysis?

**A)** The effect on the portfolio from simultaneous changes in several factors is examined.

**B)** The risk factors that have the greatest potential impact on the portfolio are examined.

**C)** The impact on the portfolio is measured by examining an input at an extreme level.

**D)** All factors are examined at levels that inflict the most damage on the portfolio.

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## Question #18 of 23

Question ID: 439599

Stress testing is a non-statistical risk management tool because:

**A)** non-parametric analysis is used.

**B)** losses are computed based on anticipated movements in key variables without specific probabilistic statements.

**C)** it is objective in its determination of scenarios to evaluate.

**D)** it specifies the minimum loss that will occur for a given significance level.

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## Question #19 of 23

Question ID: 439596

Which of the following is **NOT** an objective of stress testing? Simulate:

**A)** permanent structural shifts.

**B)** temporary changes in key variables.

**C)** shocks that do not appear in historical data.

**D)** shocks that are less likely to appear than historical evidence indicates.

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## Question #20 of 23

Question ID: 439614

Which of the following statement is (are) CORRECT? Stress testing plans should take into consideration inter-correlations between:

I. reputational and liquidity risks.
II. funding and market risks.
III. market and pipeline risks.
IV. basis and liquidity risks.

**A)** I only.

**B)** I, II and III.

**C)** I and II.

**D)** I, II, III and IV.

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## Question #21 of 23

Question ID: 439600

Which of the following would *least likely* be a part of a stress test?

**A)** Choosing the time period over which the stress will take place.

**B)** Computing market value at risk.

**C)** Adjusting the correlations of risk factors.

**D)** Choosing the market factors.

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## Question #22 of 23

Question ID: 439593

Which of the following *most accurately* describes the relationship between computing internal capital requirements using a stress testing approach versus a value at risk (VAR) capital strength approach? Stress testing approaches:

**A)** should never be used since they are based entirely on subjective inputs.

**B)** complement VAR approaches since they account for scenarios that may not be properly considered in VAR approaches.

**C)** are substitutes for VAR approaches since they better measure the entire spectrum of potential outcomes.

**D)** can never be combined with VAR approaches because they are based on different probability distributions.

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## Question #23 of 23

Question ID: 439603

Which of the following is **NOT** a drawback to stress testing?

**A)** Historical correlations mix normal and hectic periods.

**B)** Calculated losses may be extremely high relative to the 99% VAR significance level.

**C)** It identifies important factors not observed in historical data.

**D)** The number of scenarios increases greatly with additional risk factors.