Subject: Basel

Chapter: Unit 3

Category: Practice questions

1. Blue Star Bank has a $100 million exposure to Monarch, Inc. The exposure is secured by $80 million of collateral consisting of AAA-rated bonds. Monarch has a credit rating of B. The collateral risk weight is 20% and the counterparty risk weight is 150%. Using the simple approach, calculate the risk-weighted assets.

2. A bank's assets consist only of $100 million BB-rated drawn loans with a remaining maturity of 3 years. PD is estimated to be 0.01, the LGD is 30 percent and DR is 0.14. Calculate the risk weighted assets under the IRB approach of Basel II.

3. Bank Macatawa has a $150 million exposure to Holland Metals Co. The exposure is secured by $125 million of collateral consisting of AA+-rated bonds. Holland Metals Co. is unrated. The collateral risk weight is 20%. Bank Macatawa assumes an adjustment to the exposure of +15% to allow for possible increases in the exposure and allows for a −25% change in the value of the collateral. Calculate the risk-weighted assets for the exposure.

4. State the three pillars under Basel II and explain each one of them in brief.

5. Choose the correct answer and state reasons for it.

1) Which of the following statements about a stressed value at risk (VaR), required under Basel 2.5, is correct?

A. Basel 2.5 has established the year 2008 as the "stress" period. All banks use data from 2008 to calculate the stressed VaR.
B. The stressed VaR replaces the "normal" VaR for the purpose of calculating capital for credit risks.
C. Market risk capital under Basel 2.5 should be at least double that of market risk capital under Basel II due to the addition of the stressed VaR.
D. The stressed VaR must be calculated using a 99.9% confidence interval.

2) Banks are required to rebalance their portfolios as the creditworthiness of bonds decline, leading to losses over time but generally not to outright default. This requirement to specify a liquidity horizon for each instrument in the portfolio and rebalance at the end of the liquidity horizon is part of:

A. the incremental risk charge calculation
B. the net stable funding charge formula
C. the countercyclical buffer estimation
D. the comprehensive risk charge calculation

3) For banks that use the advanced internal ratings based approach (advanced IRB) to credit risk the primary inputs to the capital calculations are:

A. mandated by bank supervisors
B. the bank's internal assessment of key risk drivers
C. interest rates
D. credit assessments of external rating agencies

4) Pillar III of the Basel II accord includes all of the following requirements for internationally active banks except:

A. there should be specific remedial actions in the event of non disclosure
B. financial statements that fairly reflect financial condition should be published regularly
C. a formal disclosure policy should be established, and supported by a bank's board of directors
D. banks should operate above minimum regulatory capital ratios

5) Under the Basel II Capital Accord, the standardized approach to credit risk requires that loans considered past due be risk weighted at:

A. 200%
B. 150%
C. 100%
D. 80%

6) Regulators have proposed several approaches to determining a bank's operational risk exposure. One approach which would allow bank each bank to use it's own internal loss data to calculate the capital charge is the:

A. Advanced measurement approach
B. Proprietary risk approach
C. Internal factor approach
D. Basic indicator approach