GARP Financial Risk Manager (FRM) Part 1 Practice Exam (Sample)

Study Guide

Everything you need from our exam experts!

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Introduction

Preparing for a certification exam can feel overwhelming, but with the right tools, it becomes an opportunity to build confidence, sharpen your skills, and move one step closer to your goals. At Examzify, we believe that effective exam preparation isn't just about memorization, it's about understanding the material, identifying knowledge gaps, and building the test-taking strategies that lead to success.

This guide was designed to help you do exactly that.

Whether you're preparing for a licensing exam, professional certification, or entry-level qualification, this book offers structured practice to reinforce key concepts. You'll find a wide range of multiple-choice questions, each followed by clear explanations to help you understand not just the right answer, but why it's correct.

The content in this guide is based on real-world exam objectives and aligned with the types of questions and topics commonly found on official tests. It's ideal for learners who want to:

- **Practice answering questions under realistic conditions,**
- **Improve accuracy and speed,**
- **Review explanations to strengthen weak areas, and**
- **Approach the exam with greater confidence.**

We recommend using this book not as a stand-alone study tool, but alongside other resources like flashcards, textbooks, or hands-on training. For best results, we recommend working through each question, reflecting on the explanation provided, and revisiting the topics that challenge you most.

Remember: successful test preparation isn't about getting every question right the first time, it's about learning from your mistakes and improving over time. Stay focused, trust the process, and know that every page you turn brings you closer to success.

Let's begin.

How to Use This Guide

This guide is designed to help you study more effectively and approach your exam with confidence. Whether you're reviewing for the first time or doing a final refresh, here’s how to get the most out of your Examzify study guide:

1. Start with a Diagnostic Review

Skim through the questions to get a sense of what you know and what you need to focus on. Your goal is to identify knowledge gaps early.

2. Study in Short, Focused Sessions

Break your study time into manageable blocks (e.g. 30 – 45 minutes). Review a handful of questions, reflect on the explanations.

3. Learn from the Explanations

After answering a question, always read the explanation, even if you got it right. It reinforces key points, corrects misunderstandings, and teaches subtle distinctions between similar answers.

4. Track Your Progress

Use bookmarks or notes (if reading digitally) to mark difficult questions. Revisit these regularly and track improvements over time.

5. Simulate the Real Exam

Once you're comfortable, try taking a full set of questions without pausing. Set a timer and simulate test-day conditions to build confidence and time management skills.

6. Repeat and Review

Don’t just study once, repetition builds retention. Re-attempt questions after a few days and revisit explanations to reinforce learning. Pair this guide with other Examzify tools like flashcards, and digital practice tests to strengthen your preparation across formats.

There’s no single right way to study, but consistent, thoughtful effort always wins. Use this guide flexibly, adapt the tips above to fit your pace and learning style. You've got this!

Questions

1. Which segment accounts for 12% of revenue?

A. Agency Services

B. Retail Brokerage

C. Both Agency Services and Retail Brokerage

D. Corporate Finance

2. What is the formula for calculating the Sharpe Ratio?

A. [E(Rp) - Rf]/Portfolio Standard Deviation

B. [E(Rp) - Rf]/Portfolio Beta

C. Alpha = Rp - [Rf + Portfolio Beta*(Rm-Rf)]

D. E(Rp- Rb)/Tracking Error

3. What is the typical sign of Delta for call options?

A. Positive

B. Negative

C. Zero

D. Indeterminate

4. In duration-based hedging, how is the number of contracts calculated?

A. # of contracts = - (Portfolio value * Dp) / (futures value + Df)

B. # of contracts = - (Portfolio value * Dp) / (futures value * Df)

C. # of contracts = (Portfolio value / Dp) * (futures value * Df)

D. # of contracts = (Portfolio value + Dp) / (futures value * Df)

5. What is the objective of the GARP FRM certification?

A. To provide risk management professionals with specialized knowledge

B. To educate the public on financial risks

C. To prepare students for entry-level finance jobs

D. To create standard financial accounting practices

6. Which equation represents Recall in the context of a Confusion Matrix?

A. True Positive/Positive

B. True Positive/True

C. False/All

D. True/All

7. What does the term 'volatility' generally refer to in finance?

A. The average return on investments

B. The degree of price fluctuation

C. The total market capitalization

D. The number of investors in a market

8. How does qualitative risk analysis differ from quantitative risk analysis?

A. Qualitative uses mathematical models while quantitative uses subjective judgement

B. Qualitative focuses on financial metrics while quantitative focuses on risk sources

C. Qualitative is subjective while quantitative is data-driven

D. Qualitative involves simulations while quantitative involves real market scenarios

9. Which formula represents the BSM Call Pricing Model?

A. c = So*N(d1) - X*e^(-r*T)*N(d2)

B. Combined Ratio After Dividends - Investments/Premiums

C. True/All

D. Gamma = Change in Delta / Change in Asset Price

10. What does liability management refer to?

A. The management of equity to maximize shareholder return

B. The strategic planning of the liabilities of an organization to ensure adequate capital and liquidity while minimizing risk

C. The process of investing only in high-yield commodities

D. A method of managing income to maintain operations

Answers

1. C
2. A
3. A
4. B
5. A
6. B
7. B
8. C
9. A
10. B

Explanations

1. Which segment accounts for 12% of revenue?

A. Agency Services

B. Retail Brokerage

C. Both Agency Services and Retail Brokerage

D. Corporate Finance

The choice that indicates both Agency Services and Retail Brokerage collectively accounts for 12% of revenue is considered accurate because in financial services, it's common for various segments to contribute to overall revenue in significant but varying proportions. Agency Services typically includes services that facilitate transactions for clients, while Retail Brokerage involves the buying and selling of securities on behalf of retail clients. If the question specifies that together these segments make up 12% of revenue, it is plausible in a financial context, especially since both segments are essential components of a full-service investment firm or financial institution. The other segments, Corporate Finance for instance, may be crucial as well but could also likely contribute a different percentage to the overall revenue. In a scenario where both the highlighted segments combine to create a specific contribution to revenue, understanding the dynamics and operations of each segment allows one to appreciate how they complement each other within the firm's broader revenue-generating strategy. Each area engages different clientele and requires distinct business strategies, leading to their specific contributions to the overall financial performance.

2. What is the formula for calculating the Sharpe Ratio?

A. [E(Rp) - Rf]/Portfolio Standard Deviation

B. [E(Rp) - Rf]/Portfolio Beta

C. Alpha = Rp - [Rf + Portfolio Beta*(Rm-Rf)]

D. E(Rp- Rb)/Tracking Error

The Sharpe Ratio is a key measure used in finance to evaluate the risk-adjusted return of an investment or a portfolio. It quantifies how much excess return is received for the extra volatility that is endured by holding a riskier asset compared to a risk-free asset. The formula for the Sharpe Ratio is represented as: $$\text{Sharpe Ratio} = \frac{E(R_p) - R_f}{\sigma_p}$$ Where: - $E(R_p)$ is the expected return of the portfolio. - R_f is the risk-free rate. - σ_p is the standard deviation of the portfolio's excess return (which acts as a measure of risk). This formula highlights the relationship between the portfolio's return above the risk-free rate and the standard deviation of that return, providing insight into how well the portfolio compensates investors for the risk taken. The Sharpe Ratio increases with greater excess returns or less volatility, thus signaling a more attractive investment. The other choices presented do not accurately represent the Sharpe Ratio. For instance, using portfolio beta in a formula relates to the Capital Asset Pricing Model (CAPM) rather than risk-adjusted return via the Sharpe Ratio.

3. What is the typical sign of Delta for call options?

A. Positive

B. Negative

C. Zero

D. Indeterminate

The typical sign of Delta for call options is positive. Delta measures the sensitivity of an option's price to changes in the price of the underlying asset. For call options, a positive Delta indicates that as the price of the underlying asset increases, the price of the call option also tends to increase. This relationship exists because call options give the holder the right, but not the obligation, to purchase the underlying asset at a specified strike price, which becomes more valuable as the asset's price rises. A positive Delta usually ranges between 0 and 1 for call options, signifying that an increase in the underlying asset's price will lead to an increase in the option's price, reflecting the intrinsic value that the call option gains as it moves further "in-the-money." In contrast, put options typically have a negative Delta, indicating that their prices decrease as the price of the underlying asset rises. The sign of Delta provides critical insights into the behavior of options pricing and helps traders assess their positions effectively.

4. In duration-based hedging, how is the number of contracts calculated?

A. # of contracts = - (Portfolio value * Dp) / (futures value + Df)

B. # of contracts = - (Portfolio value * Dp) / (futures value * Df)

C. # of contracts = (Portfolio value / Dp) * (futures value * Df)

D. # of contracts = (Portfolio value + Dp) / (futures value * Df)

In duration-based hedging, the calculation of the number of contracts needed is grounded in the relationship between the duration of the portfolio and the duration of the hedging instrument, typically futures contracts. The correct formula is derived from the goal of matching the interest rate sensitivity of the portfolio with that of the futures contracts, thereby minimizing interest rate risk exposure. The formula involves several components: the value of the portfolio, the duration of the portfolio (often represented as Dp), the value of the futures contract, and the duration of the futures contract (Df). The negative sign in front of the formula reflects that a short position in futures is typically initiated to hedge against a decrease in interest rates, which would negatively impact the value of a bond portfolio. The correct choice shows the appropriate relationship between these elements: - The portfolio value is multiplied by the change in duration (Dp) to estimate the overall interest rate risk of the portfolio. - This value is then divided by the product of the futures value and its duration (Df), allowing for the value of the futures contracts to counterbalance the risk from the portfolio. This calculation effectively allows the hedger to determine the necessary number of futures contracts to maintain a neutral duration stance, ensuring that any adverse movement in interest rates

5. What is the objective of the GARP FRM certification?

A. To provide risk management professionals with specialized knowledge

B. To educate the public on financial risks

C. To prepare students for entry-level finance jobs

D. To create standard financial accounting practices

The objective of the GARP FRM certification is to provide risk management professionals with specialized knowledge. This certification focuses on equipping individuals with the expertise needed to understand and manage financial risks effectively. It covers a broad range of topics, including market risk, credit risk, operational risk, and investment management, which are essential for professionals working in various sectors of finance and risk management. The emphasis on specialized knowledge sets this certification apart, as it is designed for individuals who are already working in or aspiring to work in risk management roles. It helps enhance their skills and competencies, enabling them to tackle complex risk scenarios in financial institutions and corporations. The other choices, while addressing important aspects of the finance and risk management field, do not align with the primary aim of the GARP FRM certification. Educating the public on financial risks and preparing students for entry-level finance jobs are beneficial endeavors, but they are not the main focus of this certification. Similarly, creating standard financial accounting practices is more aligned with accounting certifications rather than a risk management framework like the FRM.

6. Which equation represents Recall in the context of a Confusion Matrix?

A. True Positive/Positive

B. True Positive/True

C. False/All

D. True/All

The concept of Recall in the context of a Confusion Matrix specifically measures the ability of a model to identify all relevant instances within a dataset, typically focusing on the positive instances. Recall is calculated as the ratio of True Positives to the total number of actual positives, which effectively captures how many of the positive cases were correctly identified by the model. In this case, the equation for Recall is represented as True Positives divided by the sum of True Positives and False Negatives. This measurement provides insights into the model's effectiveness at recognizing positive cases, revealing its capacity to avoid overlooking relevant instances. The correct choice underscores the importance of True Positives in the formula, emphasizing that Recall assesses the model's success specifically in capturing positive outcomes. This showcases Recall's role as a crucial metric, especially in scenarios where missing a positive instance carries significant consequences, such as in medical diagnoses where failing to detect a disease could lead to severe outcomes.

7. What does the term 'volatility' generally refer to in finance?

A. The average return on investments

B. The degree of price fluctuation

C. The total market capitalization

D. The number of investors in a market

In finance, the term 'volatility' specifically refers to the degree of price fluctuation of an asset or a market over time. This concept is crucial for assessing the risk associated with a particular investment; a higher volatility indicates that the price of the asset can change dramatically over a short period, which can lead to greater potential for profit but also increases the potential for loss. Volatility is commonly measured using statistical metrics such as standard deviation or beta, reflecting how much an asset's price varies compared to its average price over a specified time. Investors and risk managers pay close attention to volatility, as it provides insights into market conditions and helps in making informed decisions around hedging, investment strategies, and the overall risk profile of portfolio management. The other provided choices do not accurately capture the essence of volatility. The average return on investments focuses on performance rather than price fluctuations, total market capitalization refers to the overall value of a market and does not consider price movements, and the number of investors in a market is related to market participation rather than price volatility. Thus, the most accurate interpretation of 'volatility' in this context is indeed the degree of price fluctuation.

8. How does qualitative risk analysis differ from quantitative risk analysis?

A. Qualitative uses mathematical models while quantitative uses subjective judgement

B. Qualitative focuses on financial metrics while quantitative focuses on risk sources

C. Qualitative is subjective while quantitative is data-driven

D. Qualitative involves simulations while quantitative involves real market scenarios

Qualitative risk analysis is characterized by its subjective nature, relying on personal judgment and insights to assess risks and their potential impacts. This approach often involves the use of descriptive categories to evaluate the likelihood and consequences of risks, which may include expert opinions, stakeholder discussions, and brainstorming sessions. It allows for a comprehensive understanding of the situation, particularly in scenarios where data may be scarce or difficult to quantify. On the other hand, quantitative risk analysis is data-driven and employs mathematical and statistical methods to measure risk. This method utilizes numerical data and formulas to calculate probabilities, financial impacts, and other measurable factors, allowing for more precise risk assessments. It often involves simulations or modeling to predict the potential outcomes based on historical data and current trends. The other options, while discussing various characteristics, do not accurately capture the fundamental difference between the two methodologies. For instance, the focus on mathematical models and subjective judgment is reversed in the first option, while the second option inaccurately describes the focus areas of each type of analysis. The fourth option confuses the nature of simulations with market scenarios rather than clearly delineating between subjective and data-driven assessments. Thus, the distinction where qualitative is described as subjective and quantitative as data-driven is the most accurate characterization.

9. Which formula represents the BSM Call Pricing Model?

A. c = So*N(d1) - X*e^(-r*T)*N(d2)

B. Combined Ratio After Dividends - Investments/Premiums

C. True/All

D. Gamma = Change in Delta / Change in Asset Price

The Black-Scholes-Merton (BSM) Call Pricing Model is a fundamental formula used in financial derivatives to calculate the theoretical price of European call options. The correct formula captures the essence of option pricing by integrating key variables such as the current stock price, the strike price, time to expiration, risk-free interest rate, and the volatility of the underlying asset. The BSM Call Pricing Model is structured as follows: the price of a call option is derived by taking the present value of the expected payoff of the option at expiration. This is represented as the current stock price multiplied by the cumulative distribution function of the standard normal distribution at $d1$, minus the present value of the strike price adjusted by the risk-free rate, which is then multiplied by the cumulative distribution function at $d2$. The terms $N(d1)$ and $N(d2)$ reflect the probabilities of the option finishing in-the-money under the risk-neutral measure. This precise formulation allows traders and risk managers to estimate what the option should be worth based on various market conditions and assumptions, thereby helping in making informed decisions. In contrast, the other choices are unrelated to the BSM Call Pricing Model: the second choice refers to insurance ratios,

10. What does liability management refer to?

A. The management of equity to maximize shareholder return

B. The strategic planning of the liabilities of an organization to ensure adequate capital and liquidity while minimizing risk

C. The process of investing only in high-yield commodities

D. A method of managing income to maintain operations

Liability management is fundamentally about the strategic planning and oversight of a company's liabilities to ensure its financial health. This includes ensuring that the organization maintains adequate capital—enough resources to meet its obligations—and liquidity, which refers to the ability to quickly access cash or liquid assets when needed. By effectively managing liabilities, an organization can minimize financial risks that might arise from cash flow shortages or the inability to meet its debt obligations. The focus on balancing liabilities against assets and ensuring that obligations can be met during different conditions also plays a critical role in sustaining the operational capacity and financial stability of the organization. This strategic approach separates liability management from equity management or the mere pursuit of high-yield investments, which do not directly relate to managing company obligations. The skillful management of an entity's liabilities is key to safeguarding its overall financial health and risk profile.

Next Steps

Congratulations on reaching the final section of this guide. You've taken a meaningful step toward passing your certification exam and advancing your career.

As you continue preparing, remember that consistent practice, review, and self-reflection are key to success. Make time to revisit difficult topics, simulate exam conditions, and track your progress along the way.

If you need help, have suggestions, or want to share feedback, we'd love to hear from you. Reach out to our team at hello@examzify.com.

Or visit your dedicated course page for more study tools and resources:

https://garpfrm1.examzify.com

We wish you the very best on your exam journey. You've got this!