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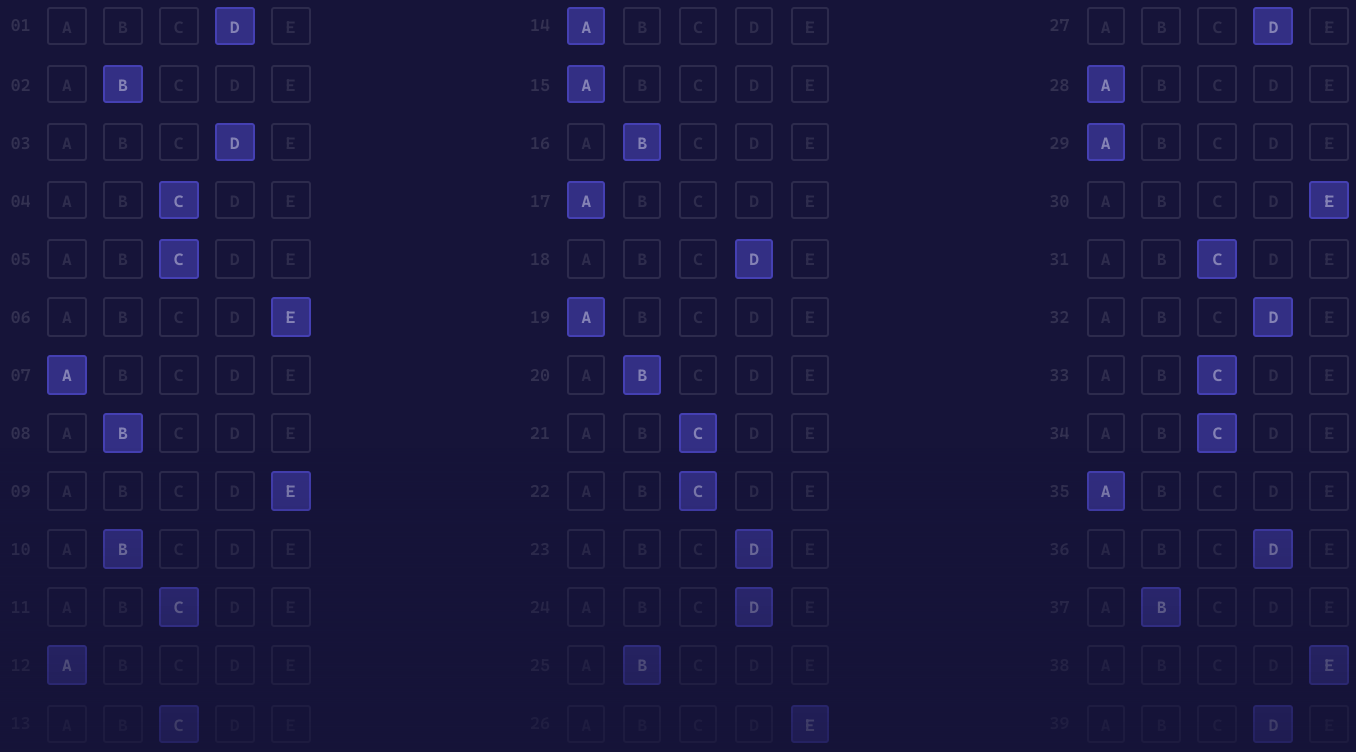


PRACTICE QUESTIONS

## Chartered Insurance Institute (CII)

# DLPT26R7

R02 - Investment principles and risk

| EDITION | QUESTIONS | FORMAT |
|---|---|---|
| Demo | 9 | Limited Edition PDF |

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# Before you begin

## What this is

9 practice questions for Chartered Insurance Institute (CII) `DLPT26R7`, each with its answer key and an explanation. Answer a question before you read its key — the explanation is worth more once you have committed.

## If something looks wrong

Send us three things and we will check it:

- the exam code, `DLPT26R7`
- the question number
- the email address on your order

Write to **support@mometrix.net**. We reply within one business day.

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**QUESTION 1** MULTIPLE CHOICE

Which TWO of the following are primary functions of a stock exchange? (Choose two.)

**A** **Providing a regulated secondary market where existing securities can be traded between investors**

B Acting as the issuer of new shares to the public on behalf of companies

**C** **Providing a central marketplace that facilitates price discovery through continuous trading**

D Guaranteeing the dividends paid by listed companies to their shareholders

ANSWER **A · C**

WHY Stock exchanges provide a regulated secondary market (A) and enable price discovery (C). Issuing new shares is the role of the company (often via an investment bank acting as underwriter), not the exchange itself (B), and exchanges do not guarantee dividends (D) – dividends are at the discretion of the issuing company's board.

**QUESTION 2** MULTIPLE CHOICE

Which TWO of the following statements about bond prices and yields are correct? (Choose two.)

**A** **When market interest rates rise, the price of an existing fixed-coupon bond falls**

**B** **A bond trading at a discount to par has a yield to maturity greater than its coupon rate**

C Long-dated bonds generally have lower interest rate (duration) risk than short-dated bonds

D Zero-coupon bonds make periodic coupon payments but no principal repayment at maturity

ANSWER **A · B**

WHY Bond prices and yields move inversely: rising market rates push existing fixed-coupon bond prices down (A). A bond priced below par (discount) must offer a yield higher than its coupon to compensate (B). Long-dated bonds have higher duration/interest rate risk than short-dated bonds, so C is wrong. Zero-coupon bonds pay no periodic coupons – they are issued at a discount and redeemed at par, so D is wrong.

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**QUESTION 3** TRUE FALSE

Diversification can eliminate systematic (market) risk from an investment portfolio.

A True

**B False**

**ANSWER B**

**WHY** This statement is False. Diversification reduces unsystematic (specific) risk associated with individual securities, but systematic (market) risk – arising from macroeconomic factors affecting all securities – cannot be eliminated through diversification.

**QUESTION 4** SINGLE CHOICE

If a country's central bank raises interest rates in response to rising inflation, what is the most likely effect on the price of existing government bonds?

A Bond prices will rise because higher coupons become more attractive

**B Bond prices will fall as new bonds are issued at higher yields**

C Bond prices will be unaffected because government bonds are risk-free

D Bond prices will rise as inflation expectations are anchored

**ANSWER B**

**WHY** Bond prices and yields move inversely. When the central bank raises interest rates to combat inflation, new bonds are issued at higher yields, making existing lower-coupon bonds less attractive. Their market prices therefore fall to align their yields with prevailing market rates.

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**QUESTION 5** SINGLE CHOICE

An ordinary share gives the holder which of the following rights?

A A fixed contractual obligation for the company to repay the original investment on a set date

B A right to a predetermined dividend that must be paid before any other class of shareholder

**C A residual claim on the company's assets and earnings after all creditors and prior claims have been met**

D A guarantee that the share price will not fall below its issue price

**ANSWER C**

**WHY** Ordinary shares represent equity ownership with a residual claim – shareholders are last in line after creditors and preference shareholders in both dividends and on winding up. Ordinary dividends are discretionary, not fixed (A is wrong; A describes debt). Preference shareholders typically rank ahead of ordinary shareholders for dividends (B is wrong). Share prices can fall below issue price (D is wrong).

**QUESTION 6** SINGLE CHOICE

In Modern Portfolio Theory, the efficient frontier represents the set of portfolios that:

**A Offer the highest expected return for any given level of risk**

B Have the lowest possible risk regardless of expected return

C Consist only of risk-free government bonds

D Combine assets in equal proportions regardless of correlation

**ANSWER A**

**WHY** The efficient frontier, as defined by Markowitz's Modern Portfolio Theory, is the locus of portfolios that provide the maximum expected return for a given level of risk (or, equivalently, the minimum risk for a given level of expected return). Portfolios below the frontier are sub-optimal because better risk/return combinations exist.

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**QUESTION 7** SINGLE CHOICE

Which of the following best describes an open-ended investment company (OEIC)?

A A fund with a fixed number of shares that trades on a stock exchange like a share

**B A pooled fund where shares can be created or cancelled by the manager to match investor demand, priced at the net asset value**

C A fund that can only invest in government bonds issued by OECD countries

D A unit trust that is exclusively available to institutional investors

**ANSWER B**

**WHY** An OEIC is an open-ended investment fund – a single-priced pooled vehicle in which shares are created or cancelled to meet investor demand, with the price set by the NAV. Option A describes a closed-ended investment trust. Options C and D are incorrect restrictions not implied by OEIC status.

**QUESTION 8** SINGLE CHOICE

An investor holds shares in a UK company that exports most of its products to the United States. Which type of risk is most directly increased by a fall in the value of sterling against the US dollar?

**A Currency risk**

B Credit risk

C Liquidity risk

D Business (operational) risk

**ANSWER A**

**WHY** The investor is exposed to currency (exchange rate) risk: a fall in sterling against the dollar increases the sterling value of the company's US dollar revenues, benefitting the company. The risk arises from the movement in the GBP/USD exchange rate. The other risks listed relate to borrower default, ease of selling assets, and operating performance respectively.

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**QUESTION 9** SINGLE CHOICE

Under the Financial Conduct Authority's 'knowing your customer' approach, which of the following is most important in establishing a client's suitability for a particular investment?

A The client's tax identification number only

**B The client's attitude to risk, investment objectives, capacity for loss and knowledge and experience**

C The marketing literature the client has previously requested

D The historical performance of the recommended fund over the last ten years

**ANSWER** **B**

**WHY** FCA suitability requirements (COBS 9) require advisers to obtain sufficient information about a client's investment objectives, attitude to risk, capacity for loss, and knowledge and experience to enable the adviser to recommend a suitable investment. Tax identification alone (A), marketing preferences (C) or past performance (D) do not on their own establish suitability.

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