

# KASNEB

## CIFA PART I SECTION 2

### FINANCIAL INSTITUTIONS AND MARKETS

WEDNESDAY: 25 May 2016.

Time Allowed: 3 hours.

Answer any FIVE questions.

ALL questions carry equal marks.

#### QUESTION ONE

(a) Explain the following terms as used in financial markets:

- (i) Flight to quality. (2 marks)
- (ii) Financial contagion. (2 marks)
- (iii) Moral hazard. (2 marks)
- (iv) Competitive laxity. (2 marks)
- (v) Frontrunning. (2 marks)

(b) Explain three characteristics of a liquid market. (6 marks)

(c) Identify four financial market frictions that could make a market imperfect. (4 marks)

(Total: 20 marks)

#### QUESTION TWO

(a) Describe four methods that could be used by commercial banks to improve the stability of their liquidity. (8 marks)

(b) Highlight four features of Eurocurrency loans. (4 marks)

(c) Before the arrival of a large order, a market has the following limit orders standing on its book:

| Buyer | Bid size | Limit price (Sh.) | Offer size | Seller |
|-------|----------|-------------------|------------|--------|
| A     | 15       | 100.10            |            |        |
| B     | 8        | 100.20            |            |        |
| C     | 10       | 100.30            |            |        |
|       |          | 100.40            | 4          | D      |
|       |          | 100.50            | 6          | E      |
|       |          | 100.60            | 12         | F      |

Required:

The buyer average trade price. (4 marks)

(d) Describe two sub-systems in a relationship marketing process. (4 marks)

(Total: 20 marks)

#### QUESTION THREE

(a) Explain three features of Islamic finance and banking. (6 marks)

(b) Discuss three reasons for the existence of government safety net under financial market regulation. (6 marks)

(c) Describe four benefits of a modern financial markets regulatory structure. (8 marks)

(Total: 20 marks)

#### QUESTION FOUR

(a) Examine four challenges faced by small and medium sized enterprises in your country. (8 marks)

(b) Describe three advantages of high quality fund of funds. (6 marks)

(c) A price weighted index series is composed of the following three stocks:

| Stock | Number of shares outstanding before stock split | Market price before split (Sh.) Day 1 | Market price after split (Sh.) Day 3 |
|-------|---|---------------------------------------|--------------------------------------|
| X     | 1,000,000                                       | 10                                    | 12                                   |
| Y     | 5,000,000                                       | 20                                    | 19                                   |
| Z     | 4,000,000                                       | 60                                    | 22                                   |

Stock Z completes a three for one stock split at the end of Day 1.

**Required:**

The value of the index after the stock split.

(6 marks)

**(Total: 20 marks)**

**QUESTION FIVE**

(a) A financial analyst obtained the following information about a common stock investment:

|                        | Date            | Amount (Sh.) |
|------------------------|-----------------|--------------|
| Stock purchase         | 15 January 2016 | 48.00        |
| Cash dividend received | 14 May 2016     | 4.00         |
| Stock sale             | 15 May 2016     | 54.00        |

**Required:**

The holding period return on the common stock investment.

(4 marks)

(b) Describe three main characteristics of foreign exchange markets in developing countries.

(6 marks)

(c) Explain two main features of informal financial groups.

(4 marks)

(d) Discuss three challenges of rural finance intermediation.

(6 marks)

**(Total: 20 marks)**

**QUESTION SIX**

(a) Highlight five obstacles that could make it difficult for microfinance institutions to offer true securitisation transactions.

(5 marks)

(b) Describe two factors that could have immediate impact on exchange rates.

(4 marks)

(c) A company requires to issue a Sh.2,500,000 (face value) commercial paper for one month. The company has quoted a rate of 5.88% with a dealer's commission of  $\frac{1}{8}\%$  and a backup cost of  $\frac{1}{4}\%$  both of which will be assessed on the face value.

**Required:**

The effective cost of financing.

(5 marks)

(d) Discuss three categories of private equity investments.

(6 marks)

**(Total: 20 marks)**

**QUESTION SEVEN**

(a) Define the term "market beating return".

(2 marks)

(b) Describe three ways that companies repurchase shares.

(6 marks)

(c) Discuss three behavioural causes of market anomalies.

(6 marks)

(d) Explain three limitations of achieving full capital market efficiency.

(6 marks)

**(Total: 20 marks)**

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