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**CIFA PART I SECTION 2**

**FINANCIAL INSTITUTIONS AND MARKETS**

**WEDNESDAY: 25 November 2020.**

**Time Allowed: 3 hours.**

**Answer any FIVE questions. ALL questions carry equal marks. Show ALL your workings.**

**QUESTION ONE**

(a) Distinguish between the following financial markets terms:

- (i) “Automated trading system” and “central depository system”. (4 marks)
- (ii) “Sell-side analyst” and “buy-side analyst”. (4 marks)
- (iii) “Hedger” and “speculator”. (4 marks)

(b) Financial assets have various characteristics that influence investors to invest in them.

Examine four characteristics that could influence an investor’s choice of financial asset to invest in. (8 marks)

**(Total: 20 marks)**

**QUESTION TWO**

(a) Explain two challenges that could be faced by financial analysts when constructing fixed income indices. (4 marks)

(b) Analyse six benefits of mobile banking to consumers. (6 marks)

(c) Evaluate four methods that might be used by investors to invest in foreign stocks. (8 marks)

(d) Kwetu Ltd.’s share is priced at Sh.40 and pays an annual dividend of Sh.1 per share. An investor purchases the share on margin paying Sh.20 per share and borrowing the remainder from the brokerage firm at 10% annual interest. After one year, the share is sold at a price of Sh.60 per share.

**Required:**

Calculate the return on the company’s share.

(2 marks)

**(Total: 20 marks)**

**QUESTION THREE**

(a) QS Ltd. has decided to undertake an initial public offer (IPO). QS Ltd. has appointed Tama Ltd. as its lead underwriter.

**Required:**

(i) Analyse three roles of Tama Ltd. in the initial public offer (IPO) of QS Ltd. (6 marks)

(ii) Describe six benefits that might accrue to QS Ltd. from raising funds through the IPO. (6 marks)

(b) Evaluate four risks that could be associated with trading derivative contracts. (8 marks)

**(Total: 20 marks)**

**QUESTION FOUR**

(a) In relation to the mortgage market, describe three criteria used to measure a borrower’s creditworthiness. (6 marks)

(b) Outline four benefits that could accrue to an investor from the use of online trading of securities. (4 marks)

(c) Jane Mzalendo opened a margin account at the Hisa Securities Exchange. She deposited Sh.200,000 into the account. The prevailing margin requirement is 30%. The shares of BMZ Ltd. are trading at Sh.45 per share on the Securities Exchange. No commission is charged on any transaction.



**Required:**

- (i) The number of BMZ Ltd.'s shares that Jane Mzalendo could purchase using the maximum allowable margin. (2 marks)
- (ii) The profit or loss that Jane might make if the share price of BMZ Ltd. rose to Sh.60 per share. (2 marks)
- (iii) The profit or loss that Jane might make if the share price of BMZ Ltd. fell to Sh.35 per share. (2 marks)
- (iv) If the maintenance margin dropped to 20%, determine the price that BMZ Ltd.'s shares should fall to ensure that Jane receives a margin call. (4 marks)

**(Total: 20 marks)****QUESTION FIVE**

- (a) Explain three reasons why regulatory agencies are involved in regulation of advertisements on financial products and services. (6 marks)
- (b) Discuss five features of Islamic banking and finance. (10 marks)
- (c) A share index is composed of the following shares:

**Market price per share (MPS) as at 1 January**

Share	Number of shares (millions)	2018	2019	2020
		Sh.	Sh.	Sh.
Alpha	300	120	150	120
Beta	1500	40	50	80
Gama	600	80	70	70

**Required:**

The total return on the share index over the two year period using:

- (i) A value weighted index. (2 marks)
- (ii) A price weighted index. (2 marks)

**(Total: 20 marks)****QUESTION SIX**

- (a) Explain four reasons that could have caused slow development of financial markets in some countries. (4 marks)
- (b) Distinguish between the following financial markets terms:
- (i) "Bitcoin" and "blockchain". (4 marks)
- (ii) "Bank runs" and "bank panics". (4 marks)
- (iii) "Money market securities" and "capital market securities". (4 marks)
- (c) Examine four reasons that could cause price of a bond quoted in the Securities Exchange to fluctuate. (4 marks)

**(Total: 20 marks)****QUESTION SEVEN**

- (a) Assess two challenges that might be faced by the Unclaimed Financial Assets Authority (UFAA) in carrying out their duties. (4 marks)
- (b) Describe five challenges that informal finance groups face. (5 marks)
- (c) Explain five roles of financial depository institutions in your country. (5 marks)
- (d) Discuss three types of anomalies in the financial markets. (6 marks)

**(Total: 20 marks)**





**CIFA PART I SECTION 2**

**FINANCIAL INSTITUTIONS AND MARKETS**

**THURSDAY: 28 November 2019.**

**Time Allowed: 3 hours.**

**Answer any FIVE questions. ALL questions carry equal marks. Show ALL your workings.**

**QUESTION ONE**

- (a) The primary mandate of the Unclaimed Financial Assets Authority (UFAA) is to receive unclaimed financial assets from the holders of such assets, safeguard and re-unite the assets with their rightful owners.
- With reference to the above statement, highlight four examples of unclaimed financial assets. (4 marks)
- (b) Explain the following terms with reference to financial market regulations:
- (i) Financial liberalisation. (2 marks)
  - (ii) Financial stratification. (2 marks)
  - (iii) Financial rationalisation. (2 marks)
- (c) (i) Analyse three functions of a foreign exchange market. (6 marks)
- (ii) List four participants of the foreign exchange market in your country. (4 marks)
- (Total: 20 marks)**

**QUESTION TWO**

- (a) Analyse four categories of financial markets. (8 marks)
- (b) (i) Explain the term “customer based brand equity”. (2 marks)
- (ii) Outline three key ingredients of customer-based brand equity. (3 marks)
- (c) The current price per share is Sh.25. An investor has Sh.10,000 to invest. The investor can borrow an additional Sh.10,000 from the broker and invest Sh.20,000 in the stock.
- The maintenance margin is 30%.
- Required:**
- Determine the price at which a margin call first occurs. (2 marks)
- (d) (i) Explain the term “investment company”. (1 mark)
- (ii) Describe four functions performed by investment companies on behalf of investors. (4 marks)
- (Total: 20 marks)**

**QUESTION THREE**

- (a) Explain four tools that are used to solve the adverse selection problem in the financial markets. (8 marks)
- (b) Describe six constraints that are faced by small and medium-sized enterprises (SMEs) in obtaining finance. (6 marks)
- (c) Explain three responsibilities of a portfolio manager. (6 marks)
- (Total: 20 marks)**

#### QUESTION FOUR

- (a) Differentiate between “hybrid securities” and “derivative securities”. (4 marks)
- (b) Highlight two types of bond market indices. (2 marks)
- (c) An analyst has gathered the following data:

	As of 1 January 2018		As of 31 December 2018	
	Share price (Sh.)	Number of shares outstanding	Share price (Sh.)	Number of shares outstanding
Stock K	22	1,500	28	1,500
Stock L	40	10,000	50	10,000
Stock M	34	3,000	30	3,000

**Required:**

Calculate the following returns for the above three stocks:

- (i) 1 year return on a price weighted index. (2 marks)
- (ii) 1 year return on an equal-weighted index. (2 marks)
- (iii) 1 year return on a market capitalisation weighted index. (2 marks)
- (d) Discuss four money market instruments. (8 marks)

**(Total: 20 marks)**

#### QUESTION FIVE

- (a) In relation to foreign exchange markets, explain the following terms:
- (i) Roll over interest. (2 marks)
- (ii) Leverage. (2 marks)
- (iii) Technical analysis. (2 marks)
- (iv) Bid-ask spread. (2 marks)
- (v) Over the counter market. (2 marks)
- (b) List four functions of a stock broker. (4 marks)
- (c) Highlight three disadvantages to shareholders of private placement of shares. (3 marks)
- (d) Enumerate three roles of ethics in financial markets. (3 marks)

**(Total: 20 marks)**

#### QUESTION SIX

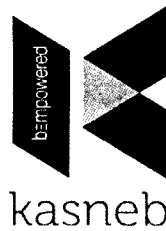
- (a) Argue two cases in favour of offshore banking and two cases against offshore banking. (8 marks)
- (b) Distinguish between the following terms as used in securities markets:
- (i) “Long position” and “short position”. (2 marks)
- (ii) “Spot rates” and “forward rates”. (2 marks)
- (c) Describe two participants in the forward market. (4 marks)
- (d) Outline two types of alternative investment indices. (4 marks)

**(Total: 20 marks)**

#### QUESTION SEVEN

- (a) Discuss three classifications of mutual funds. (6 marks)
- (b) Explain four factors that could trigger a financial crisis in your country. (8 marks)
- (c) Describe three common types of orders that are used to buy and sell stocks. (6 marks)

**(Total: 20 marks)**



**CIFA PART I SECTION 2**

**FINANCIAL INSTITUTIONS AND MARKETS**

**WEDNESDAY: 22 May 2019.**

**Time Allowed: 3 hours.**

**Answer any FIVE questions. ALL questions carry equal marks. Show ALL your workings.**

**QUESTION ONE**

- (a) (i) Describe six strategies of pricing financial services. (6 marks)
- (ii) Summarise eight challenges encountered when pricing financial services. (8 marks)
- (b) Outline six advantages of a demutualised securities exchange. (6 marks)
- (Total: 20 marks)**

**QUESTION TWO**

- (a) (i) Highlight three strategies that could be adopted by a financial services company to enhance customer loyalty. (3 marks)
- (ii) Explain five reasons why financial institutions undertake promotional activities. (5 marks)
- (b) Enumerate five advantages of using options in a derivatives market. (5 marks)
- (c) Examine five roles of the capital markets regulator in your country. (5 marks)
- (d) An investor at a certain securities market, made the following transactions in the market:
- Purchased a share for Sh.40 per share with an initial margin requirement of 50 per cent.
  - The maintenance requirement at the market was 25 per cent.

**Required:**

The share price at which the investor will receive a margin call.

(2 marks)

**(Total: 20 marks)**

**QUESTION THREE**

- (a) With reference to the Unclaimed Financial Assets Authority (UFAA):
- (i) Outline three requirements that must be met before an asset is declared unclaimed. (3 marks)
- (ii) Describe three duties of holders of unclaimed assets. (3 marks)
- (b) Summarise six characteristics of an efficient market. (6 marks)
- (c) Discuss eight factors that have contributed to globalisation of financial markets. (8 marks)
- (Total: 20 marks)**

**QUESTION FOUR**

- (a) "The liquidity of a financial market can be measured in terms of its depth, breadth or resilience".

In relation to the above statement, explain the following terms:

- (i) Depth. (1 mark)
- (ii) Breadth. (1 mark)
- (iii) Resilience. (1 mark)

- (b) (i) Distinguish between “information intermediation” and “risk intermediation”. (2 marks)
- (ii) Assess five roles of financial intermediaries in your country. (5 marks)
- (c) The following information relates to Faidika Securities Exchange:
- Number of shares purchased - 1,000 shares.
  - Current market price per share - Sh.100.
  - Annual dividend per share - Sh. 2.
  - Initial margin requirement - 40%.
  - Call money rate - 4%.
  - Commission per share - Sh. 0.05.
  - Future share price (1 year later) - Sh.110.

**Required:**

- (i) The leverage ratio. (2 marks)
- (ii) The investor’s return on the margin transaction (return on equity) if the share is sold at the end of the first year. (8 marks)

**(Total: 20 marks)**

**QUESTION FIVE**

- (a) Examine five benefits of using derivative instruments over cash market instruments. (5 marks)
- (b) (i) Discuss five differences between “formal financial sector” and “informal financial sector”. (10 marks)
- (ii) With reference to informal finance, describe five conditions necessary to ensure the success of credit guarantee schemes. (5 marks)

**(Total: 20 marks)**

**QUESTION SIX**

- (a) Highlight three challenges encountered in the construction of fixed income indices. (3 marks)
- (b) Suggest eight factors that might have contributed to limited access to financial market services in developing countries. (8 marks)
- (c) A mortgage is a form of debt created to finance investment in real estate.

In relation to the above statement, discuss nine types of residential mortgages. (9 marks)

**(Total: 20 marks)**

**QUESTION SEVEN**

- (a) Describe three key players in a derivatives market. (3 marks)
- (b) Examine ten benefits that could accrue to a country upon adoption of financial inclusion. (10 marks)
- (c) A financial analyst gathered the following information relating to a market capitalisation weighted index comprising three shares; A, B and C:

Share	Beginning of period Share price (Sh.)	End of period Share price (Sh.)	Dividends per share (Sh.)	Number of shares outstanding
A	2,500	2,700	100	5,000
B	3,500	2,500	150	7,500
C	1,500	1,600	100	10,000

**Required:**

The total return on the index. (4 marks)

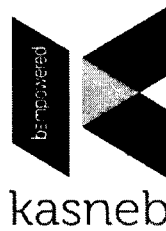
- (d) A trader gathered the following information relating to an equally weighted index. The amount invested in each of the securities; K, L and M is Sh.1,000:

	Beginning of period		End of period	
	Share price (Sh.)	Number of shares	Share price (Sh.)	Number of shares
K	20	300	22	300
L	50	300	48	300
M	26	2,000	30	2,000

**Required:**

The return on the index over the period. (3 marks)

**(Total: 20 marks)**



**CIFA PART I SECTION 2**

**FINANCIAL INSTITUTIONS AND MARKETS**

**WEDNESDAY: 28 November 2018.**

**Time Allowed: 3 hours.**

**Answer any FIVE questions. ALL questions carry equal marks. Show ALL your workings.**

**QUESTION ONE**

- (a) Distinguish between “bank runs” and “bank panics”. (2 marks)
- (b) Highlight two causes of:
- (i) Bank runs. (2 marks)
- (ii) Bank panics. (2 marks)
- (c) In financial markets, moral hazard refers to a situation in which one party gets involved in a risky event having the knowledge that it is protected against the risk and the other party will incur the cost.
- In relation to the above statement, outline two causes of moral hazard based on each of the following perspectives:
- (i) Market perspective. (2 marks)
- (ii) Company perspective. (2 marks)
- (d) Examine ten benefits of syndicated loans to commercial banks. (10 marks)
- (Total: 20 marks)**

**QUESTION TWO**

- (a) In relation to marketing of financial services:
- (i) Summarise nine benefits of adopting the e-banking system. (9 marks)
- (ii) Explain five challenges encountered in marketing of financial services. (5 marks)
- (b) With reference to market efficiency, discuss three implications of the efficient market hypothesis. (6 marks)
- (Total: 20 marks)**

**QUESTION THREE**

- (a) Explain the term “informal finance” as used in financial institutions and markets. (1 mark)
- (b) Differentiate between “margin purchases” and “short selling”. (2 marks)
- (c) Describe four characteristics of securities traded in equity markets. (8 marks)
- (d) An investor opened a margin account at Faida Financial Securities Limited. The investor began trading in securities by purchasing 400 shares of XYZ Ltd. on margin at Sh.80 per share. In order to complete this purchase, the investor borrowed Sh.6,000 from the broker.
- Required:**
- (i) The actual margin in the investor’s account at the time of the purchase. (3 marks)
- (ii) The actual margin in the investor’s account if the share price increases to Sh.120 per share. (2 marks)
- (iii) The actual margin in the investor’s account if the share price decreases to Sh.70 per share. (2 marks)
- (iv) Using the results obtained in (d) (i) above and a maintenance margin of 50%, determine the share price required for the investor to receive a margin call. (2 marks)

**(Total: 20 marks)**

#### QUESTION FOUR

- (a) Explain the difference between a “financial intermediary” and an “investment banking house”. (2 marks)
- (b) Analyse six factors that might have hampered the enhancement of financial deepening in your country. (6 marks)
- (c) Discuss six differences between “private equity funds” and “quoted equity funds”. (12 marks)
- (Total: 20 marks)**

#### QUESTION FIVE

- (a) Enumerate three uses of financial instruments in your country. (3 marks)
- (b) Describe four roles played by derivatives in the operations of the spot market. (8 marks)
- (c) Examine nine functions of the Unclaimed Financial Assets Authority. (9 marks)
- (Total: 20 marks)**

#### QUESTION SIX

- (a) Highlight five advantages of convertible preference shares. (5 marks)
- (b) Describe five market anomalies associated with the efficient market hypothesis. (5 marks)
- (c) A financial analyst gathered the following information relating to three shares, A, B and C:

Share	Share price (Sh.)		Number of outstanding shares	
	31 December	31 December	31 December	31 December
	2016	2017	2016	2017
A	30	25	1,000,000	1,000,000
B	25	30	8,000,000	8,000,000
C	20	20	5,000,000	5,000,000

#### Required:

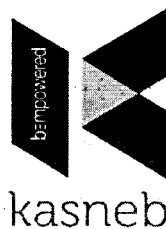
- (i) Price weighted average as at 31 December 2016. (1 mark)
- (ii) Value weighted average as at 31 December 2016. (3 marks)
- (iii) Geometric average as at 31 December 2016. (1 mark)
- (iv) Value weighted average as at 31 December 2017. (3 marks)
- (v) Geometric average as at 31 December 2017. (1 mark)
- (vi) Using the results obtained in (c) (ii) to (c) (v) above, explain why the values of the weighted average and the geometric average are different. (1 mark)

**(Total: 20 marks)**

#### QUESTION SEVEN

- (a) (i) Explain the term “money laundering”. (2 marks)
- (ii) Summarise five forms of money laundering activities. (5 marks)
- (iii) Suggest five measures that could be adopted to combat money laundering. (5 marks)
- (b) Discuss eight roles that the Institute of Certified Investment and Financial Analysts (ICIFA) plays in the regulation of financial markets in your country. (8 marks)
- (Total: 20 marks)**
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## CIFA PART I SECTION 2

### FINANCIAL INSTITUTIONS AND MARKETS

WEDNESDAY: 23 May 2018.

Time Allowed: 3 hours.

Answer any FIVE questions. ALL questions carry equal marks. Show ALL your workings.

#### QUESTION ONE

- Discuss four ways used by financial institutions to segment their business markets. (4 marks)
- In relation to marketing financial services, explain five components of marketing mix decisions. (5 marks)
- Discuss three types of fixed income indices available in the global financial markets. (6 marks)
- Jackson Kyalo heard about an initial public offer (IPO) underpricing. He gave an order to his broker for 1000 ordinary shares of every IPO that the broker could get. After three months, Kyalo's investment record was as follows:

IPO	Shares allocated to investor	Price per share (Sh.)	Initial Return (%)
A	500	10	7
B	200	20	12
C	1000	8	-2
D	0	12	23

#### Required:

- The average underpricing of this sample of IPOs. (1 mark)
  - The average initial return on the investor's portfolio of shares purchased from the four IPOs. (4 marks)
- (Total: 20 marks)

#### QUESTION TWO

- Analyse four roles played by private equity fund managers. (8 marks)
- In relation to marketing financial services, explain three stages of microfinance market development that impact client characteristics. (6 marks)
- The following table shows quarterly stock prices on the Spatan Stock Exchange for 2017-2018. Quarterly prices for the six stocks trading on the Spatan Stock Exchange are as follows:

	Kanga Ltd. 236 million*	TOL Ltd. 32 million*	Mamba Ltd. 14 million*	Tanga Ltd. 100 million*	Simba Ltd. 64 million*	Dahalo Ltd. 36 million*
June 2017	1,575	265	600	1,775	700	500
September 2017	1,525	265	500	1,700	690	520
December 2017	1,500	260	580	1,720	700	570
March 2018	1,300	260	570	1,720	830	580

\* Number of shares outstanding

#### Required:

Construct stock market indices using:

- Equal weights. (3 marks)
  - Market value weights. (3 marks)
- (Total: 20 marks)

### QUESTION THREE

- (a) Describe four types of bonds that could be issued by a corporation in your country. (4 marks)
- (b) Explain four roles of an investment bank during the issue of a security. (4 marks)
- (c) Highlight five measures which might have been taken by the market participants to contain the global financial crisis of 2008-2009. (5 marks)
- (d) (i) In relation to mortgage market, differentiate between "conforming loans" and "jumbo loans". (4 marks)
- (ii) Musa Kiteme takes a mortgage of Sh.5 million which has annual interest rate of 9% and intends to clear the mortgage in a period of 16 years.

**Required:**

Calculate Musa's monthly mortgage repayment.

(3 marks)

**(Total: 20 marks)**

### QUESTION FOUR

- (a) Every investment advisor and fund manager that manages discretionary funds has to appoint a custodian for the assets of the funds. The same requirement applies to investment banks when they undertake similar authorised functions.

**Required:**

In relation to the above statement, summarise five duties of a custodian.

(5 marks)

- (b) Your country is in the process of establishing a derivatives exchange. As a financial analyst, you have been appointed to the committee advising on its establishment.

Highlight five requirements necessary for proper establishment of a derivatives exchange.

(5 marks)

- (c) A securities exchange or a central securities depository is required to operate as a self-regulatory organisation (SRO).

**Required:**

In context of the above statement, examine five roles that a securities exchange or a central securities depository should exercise to ensure effective self regulation.

(5 marks)

- (d) Describe five duties of a fund manager in a unit trust.

(5 marks)

**(Total: 20 marks)**

### QUESTION FIVE

- (a) Outline four characteristics of a well functioning securities market. (4 marks)

- (b) (i) Explain three weighting schemes used in creating stock market indices. (3 marks)

(ii) Describe three biases introduced by each of the three weighting schemes in (b) (i) above. (3 marks)

- (c) Outline four assumptions behind efficient capital markets hypothesis. (4 marks)

- (d) In each case, highlight two sets of tests used to examine the following:

(i) Weak form of efficient market hypothesis. (2 marks)

(ii) Semi-strong form of efficient market hypothesis. (2 marks)

(iii) Strong form of efficient market hypothesis. (2 marks)

**(Total: 20 marks)**

### QUESTION SIX

- (a) (i) In relation to equity markets, explain the term "reverse takeover". (2 marks)

(ii) Discuss three advantages of reverse takeover in comparison to an initial public offer (IPO). (6 marks)

- (b) (i) List four providers of informal finance in your country. (4 marks)

(ii) Describe five characteristics of the informal financial sector in your country. (5 marks)

- (c) The current market price per share (MPS) of share X is Sh.25. Tom Kazungu, an investor, has Sh.10,000 to invest. He is able to borrow an additional Sh.10,000 from his broker, thereby investing Sh.20,000 in the share. The maintenance margin for the share is 30%.

**Required:**

The price at which a margin call will first occur.

(3 marks)

**(Total: 20 marks)**



### QUESTION SEVEN

- (a) Describe four uses of financial instruments traded in the derivatives markets. (4 marks)
- (b) Assess six objectives of financial market regulation. (6 marks)
- (c) (i) Explain the term "mutual fund". (2 marks)
- (ii) Summarise three types of costs incurred by investors in a mutual fund. (3 marks)
- (iii) Outline five measures undertaken by depository institutions to ensure availability of funds to cater for withdrawals and loan demands. (5 marks)

**(Total: 20 marks)**

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**CIFA PART I SECTION 2**

**FINANCIAL INSTITUTIONS AND MARKETS**

**WEDNESDAY: 29 November 2017.**

**Time Allowed: 3 hours.**

**Answer any FIVE questions. ALL questions carry equal marks. Show ALL your workings.**

**QUESTION ONE**

(a) In the context of financial markets, explain the following terms:

(i) Hedge funds. (2 marks)

(ii) Financial liberalisation. (2 marks)

(b) (i) Define the term “financial system”. (2 marks)

(ii) Describe four purposes of financial systems. (4 marks)

(c) (i) Summarise five uses of security market indices. (5 marks)

(ii) The following information relates to market price per share (MPS) and the number of outstanding shares for three companies for the financial years ended 31 December 2015 and 31 December 2016:

Company	MPS (Sh.)		Number of outstanding shares (millions)	
	31 December 2015	31 December 2016	31 December 2015	31 December 2016
Ishiara Ltd.	10	15	100	100
Ciakago Ltd.	20	15	150	150
Tunyai Ltd.	30	18	200	400

Tunyai Ltd. shares had a split of 2:1 within the year ended 31 December 2016.

**Required:**

The unweighted value index if the value of the index was 1,000 on 31 December 2015. (5 marks)

**(Total: 20 marks)**

**QUESTION TWO**

(a) Discuss four functions of investment banks. (8 marks)

(b) Assess three roles played by a portfolio manager in an efficient market. (6 marks)

(c) Mobile payments as a financial transaction medium emerged around a decade ago. Adoption was slow due to the nature of the mobile technology supporting the concept. However, recent significant advances in technology have increased the growth of mobile payments in the financial services sector.

**Required:**

In the context of the above statement, evaluate six benefits of mobile payments from both business and consumer perspectives. (6 marks)

**(Total: 20 marks)**



### QUESTION THREE

- (a) Examine six attributes of informal finance. (6 marks)
- (b) Describe three challenges that might be faced by the mortgage industry in your country. (6 marks)
- (c) Classify four types of traders based on their motivation to trade. (8 marks)
- (Total: 20 marks)**

### QUESTION FOUR

- (a) In relation to marketing of financial services:
- (i) Explain five needs of a financial service consumer. (5 marks)
- (ii) Outline three measures of effective market segmentation. (3 marks)
- (iii) Highlight four bases for market segmentation. (4 marks)
- (b) The weighting decision determines how much of each security to include in the index and has a substantial impact on an index's value.
- In relation to the above statement, evaluate the following weighting methods:
- (i) Price weighting. (2 marks)
- (ii) Equal weighting. (2 marks)
- (iii) Market-capitalisation weighting. (2 marks)
- (iv) Fundamental weighting. (2 marks)
- (Total: 20 marks)**

### QUESTION FIVE

- (a) Outline five objectives of financial markets regulation. (5 marks)
- (b) Discuss two types of each of the following forms of market pricing anomalies:
- (i) Time-series anomalies. (4 marks)
- (ii) Cross-sectional anomalies. (4 marks)
- (c) Anthony Maina, an investor, purchased 500 shares of Mkomani Ltd. at Sh.32 per share. The shares were purchased at a margin of 75%. One month later, Maina had to pay interest on the amount borrowed at a rate of 2% per month. At that time, Maina received a dividend of Sh.0.50 per share. Immediately after that, he sold the shares at Sh.28 per share. He paid a commission of Sh.10 on the purchase of the shares and Sh.10 on the sale of the shares.

#### Required:

The rate of return on Anthony Maina's investment for the one month period. (7 marks)

**(Total: 20 marks)**

### QUESTION SIX

- (a) Discuss three features of exchange-traded futures markets. (6 marks)
- (b) Describe four benefits that attract investors to mutual funds. (8 marks)
- (c) Consider an order-driven system that allows hidden orders. The following four sell orders on Oldonyiro Ltd. shares are currently in the automated trading system's (ATS's) limit order section.

Order	Time the order was placed	Limit price of the order (Sh.)	Special Instructions (if any)
I	9:52:01 am	20.33	
II	9:52:08 am	20.29	
III	9:53:04 am	20.29	
IV	9:53:49 am	20.29	Hidden order

#### Required:

Based on the order precedence hierarchy, illustrate the precedence in which the four orders were executed. (6 marks)

**(Total: 20 marks)**

#### QUESTION SEVEN

- (a) Describe four types of life assurance products. (4 marks)
- (b) Discuss four participants in the money markets. (8 marks)
- (c) Summarise four factors that would motivate a non-listed company to go public. (4 marks)
- (d) Highlight four consequences of failure to comply with regulations and corporate policies and procedures. (4 marks)
- (Total: 20 marks)**

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# KASNEB

## CIFA PART I SECTION 2

### FINANCIAL INSTITUTIONS AND MARKETS

WEDNESDAY: 24 May 2017.

Time Allowed: 3 hours.

Answer any FIVE questions. ALL questions carry equal marks. Show ALL your workings.

#### QUESTION ONE

- (a) Highlight four types of incentives provided by the Capital Markets Authority in your country in order to encourage investors. (4 marks)
  - (b) Outline four factors that could be considered when pricing financial services. (4 marks)
  - (c) In relation to the 4Ps of marketing, summarise four strategies for marketing bank services. (4 marks)
  - (d) Explain four challenges that might be faced by the informal sector in the provision of finance. (8 marks)
- (Total: 20 marks)

#### QUESTION TWO

- (a) Discuss four functions of a derivative securities market. (8 marks)
- (b) Explain three factors that might prevent international capital flows from taking advantage of a relative mispricing among countries. (6 marks)
- (c) A stock index is composed of the following stocks:

Stock	Shares (million)	Share price 1 January 2015 (Sh.)	Share price 1 January 2016 (Sh.)	Share price 1 January 2017 (Sh.)
	Quantity			
Alpha	450	120	150	120
Beta	2,250	40	50	40
Theta	900	80	70	35
	<u>3,600</u>	<u>240</u>	<u>270</u>	<u>195</u>

#### Required:

The total return on the stock index over the two year period using:

- (i) Value weighted index. (3 marks)
  - (ii) Price weighted index. (3 marks)
- (Total: 20 marks)

#### QUESTION THREE

- (a) Examine four reasons that would make the price of a bond quoted in a securities exchange to fluctuate. (8 marks)
- (b) The current financial institutions and markets are quite different from those of the past as financial systems continue to transform themselves.

In light of the above statement, describe four forces that might transform the current financial system in your country. (8 marks)

- (c) The following information relate to the performance of portfolio X, Y and Z for the year ended 30 March 2017 with assumed risk free rate of 15%.

	Portfolio		
	X	Y	Z
Net asset value per share as at 30 March 2017 (Sh.)	220	230	240
Total distributable income and capital gain per share (Sh.)	20	10	30
Average return (%)	40	42	44
Standard deviation (%)	2	3	3.5
Net asset value per share as at 30 March 2016 (Sh.)	200	200	220

**Required:**

Portfolio return for X, Y and Z using Sharpe Index.

(4 marks)

**(Total: 20 marks)****QUESTION FOUR**

- (a) (i) Distinguish between a "closed-end mutual fund" and a "closed-end country fund". (4 marks)
- (ii) Explain two reasons why closed-end country funds often trade at a premium to their net asset value. (4 marks)
- (b) Explain how mortgage securitisation could be used to contribute towards funding housing projects in developing countries. (4 marks)
- (c) Discuss two advantages and two disadvantages of real estate investment trusts (REITs). (8 marks)

**(Total: 20 marks)****QUESTION FIVE**

- (a) A mutual fund has the following assets and liabilities:

	Sh."000"
Stock (at current market value)	20,000
Bonds (at current market value)	10,000
Cash	500
Liabilities	300

After one year, the value of the stock portfolio held by the mutual fund rises by 10% and the value of the bond portfolio falls by 2%. The cash and liabilities remain unchanged. The shares outstanding are 10 million.

**Required:**

The yield on the investment on the mutual fund.

(5 marks)

- (b) Discuss four measures implemented by the market regulators in your country to ensure safety of funds invested under mutual funds. (8 marks)
- (c) In relation to foreign exchange market:
- (i) Explain two factors that could have contributed to the rapid growth of the global foreign exchange market. (4 marks)
- (ii) Identify three activities that take place in the foreign exchange market. (3 marks)

**(Total: 20 marks)****QUESTION SIX**

- (a) Explain four approaches to financial market supervision and regulation. (8 marks)
- (b) In relation to financial markets, discuss two ways of solving the "adverse selection problem". (6 marks)
- (c) Describe three benefits of automated trading systems on the financial market. (6 marks)

**(Total: 20 marks)****QUESTION SEVEN**

- (a) One role of the monetary policy committee under the umbrella of central bank is to provide a mechanism for regulation of banks and financial institutions' interest rates. This could be done through the introduction of a ceiling, that is, to put a cap on the rate of interest charged for loans and fix the minimum rate of interest that such institutions must pay on deposits held.

With reference to the above statement, discuss three advantages and three disadvantages of interest rate capping.

(12 marks)

- (b) Describe four ways in which deposit insurance might lead to moral hazard. (8 marks)

**(Total: 20 marks)**

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# KASNEB

## CIFA PART I SECTION 2

### FINANCIAL INSTITUTIONS AND MARKETS

WEDNESDAY: 23 November 2016.

Time Allowed: 3 hours.

Answer any FIVE questions. ALL questions carry equal marks. Show ALL your workings.

#### QUESTION ONE

- (a) Explain four benefits of credit reference bureaus (CRB) to an economy. (8 marks)
- (b) Discuss three sources of private equity investments. (6 marks)
- (c) Bond portfolio managers of financial institutions commonly follow a specific strategy for investing in bonds.

In the context of the above statement, explain the following strategies:

- (i) Matching strategy. (2 marks)
- (ii) Laddered strategy. (2 marks)
- (iii) Barbell strategy. (2 marks)

(Total: 20 marks)

#### QUESTION TWO

- (a) Define the term “moral hazard” as used in financial institutions. (2 marks)
- (b) Explain the effect of moral hazard on:
  - (i) Credit rationing. (4 marks)
  - (ii) Adverse selection. (4 marks)
- (c) An investor buys stock on margin and holds the position for exactly one year.

Shares purchased	700
Purchase price	Sh.22 per share
Call money rate	4%
Dividend paid	Sh.0.60 per share
Leverage ratio	1.6
Total return on the investment	12%

The interest on the loan and the dividends are both paid at the end of the year.

#### Required:

The price at which the investor sold the stock. (6 marks)

- (d) A banker's acceptance has an all-inclusive annual rate of 5.25% for a one month loan of Sh.2 million.

#### Required:

The effective annualised cost. (4 marks)

(Total: 20 marks)

#### QUESTION THREE

- (a) Distinguish between the following set of terms:
  - (i) “Sell-side analyst” and “buy-side analyst”. (4 marks)
  - (ii) “Principal trade” and “portfolio trade”. (4 marks)
- (b) Discuss three attributes of a well constructed security market index. (6 marks)

- (c) The following information relates to two stocks, A and B:

Average return for stock A	20%
Average return for stock B	16%
Average risk-free rate	8%
Standard deviation of stock A	14%
Standard deviation of stock B	6%
Stock beta for stock A	1.8
Stock beta for stock B	0.9

**Required:**

- (i) Treynor's index for each of the stocks. (4 marks)
- (ii) Based on the result in (c) (i) above, advise a prospective investor on which stock to invest in. (2 marks)
- (Total: 20 marks)**

**QUESTION FOUR**

- (a) In relation to financial markets, distinguish between the following set of terms:

- (i) "Eurobond" and "junkbond". (4 marks)
- (ii) "Mutual fund" and "hedge fund". (4 marks)

- (b) Describe three ways in which operators in the informal finance sector select their clients. (6 marks)

- (c) Four companies which are listed in a stock exchange belong to a group. The cross holding of these companies are as follows:

1. Company A owns 20% of company B and 10% of company C.
2. Company B owns 15% of company C.
3. Company C owns 10% of company A, 10% of company B and 5% of company D.
4. Company D has no ownership in any of the other three companies.
5. Each company has a market capitalisation of Sh.50 million.

**Required:**

The market capitalisation after adjusting for free float.

(6 marks)

**(Total: 20 marks)**

**QUESTION FIVE**

- (a) An asset management firm wants to purchase 500,000 shares of a company. It decides to shop the order from various broker/dealer firms to identify which firm can offer the best service at lowest cost.

**Required:**

Discuss two potential negatives of shopping the order.

(4 marks)

- (b) An investor decides to sell short 10,000 shares of XYZ Ltd. when it is selling at its yearly high of Sh.56. The broker has a margin requirement of 45% and the commission on the purchase is Sh.15,500. While holding the position, XYZ Ltd. pays a dividend of Sh.2.50 per share. One year later, the investor purchases 10,000 shares at Sh.45 to close out the position and the broker charges a commission of Sh.14,500 and 8% interest on the money borrowed.

**Required:**

The rate of return on the investment.

(6 marks)

- (c) (i) Differentiate between "electronic communication networks" and "electronic crossing networks". (4 marks)
- (ii) Highlight two disadvantages of electronic crossing networks. (2 marks)

- (d) Explain four challenges of bank marketing. (4 marks)

**(Total: 20 marks)**

### QUESTION SIX

- (a) Discuss five instruments traded in the secondary mortgage market. (10 marks)
- (b) A futures contract on a treasury bill expires in 60 days. The treasury bill matures in 140 days and the discount rates on the treasury bills are as follows:

Treasury bills	Discount rates
60-day treasury bill	10 %
140-day treasury bill	8%

Use 365 days in a year.

**Required:**

- (i) The appropriate futures price using the prices of the 60-day and 140-day treasury bills. (4 marks)
- (ii) The futures price of the underlying spot price compounded at the appropriate risk free rate. (4 marks)
- (iii) Convert the futures price to the implied discount rate on the futures. (2 marks)

**(Total: 20 marks)**

### QUESTION SEVEN

- (a) Describe three reasons for buying and selling foreign exchange. (6 marks)
- (b) Discuss three reasons why investors prefer futures market over the cash market trading vehicles. (6 marks)
- (c) Richard Kiti opened a margin account at Maximin Securities Ltd. Kiti started trading in securities by purchasing 400 Green Tea Ltd's shares on margin at Sh.80. In order to complete this purchase, Kiti borrowed Sh.6,000 from the broker.

**Required:**

- (i) Actual margin in Kiti's account at the time of purchase. (2 marks)
- (ii) Actual margin in Kiti's account, if the share price rises to Sh.120. (2 marks)
- (iii) Actual margin in Kiti's account, if the share price drops to Sh.70. (2 marks)
- (iv) Using the results obtained in (c) (i) above and a maintenance margin of 50%, compute the price that the share should drop to in order for Kiti to receive a margin call. (2 marks)

**(Total: 20 marks)**

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# 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)**

# KASNEB

## CIFA PART I SECTION 2

### FINANCIAL INSTITUTIONS AND MARKETS

#### PILOT PAPER

September 2015.

Time Allowed: 3 hours.

Answer any FIVE questions.

ALL questions carry equal marks.

#### QUESTION ONE

- (a) Discuss four evidence against market efficiency that exist in securities market. (8 marks)
- (b) (i) Summarise three attributes of a good capital market. (3 marks)
- (ii) Highlight five limitations facing capital formation in emerging economies. (5 marks)
- (iii) Define the term "Demutualisation". (1 mark)
- (iv) Highlight three objectives of demutualising the securities exchange market. (3 marks)

(Total: 20 marks)

#### QUESTION TWO

- (a) Highlight six roles played by the Capital Markets Regulator in your country in the development of financial markets. (6 marks)
- (b) In relation to foreign markets, describe four limitations of high frequency trading. (4 marks)
- (c) Define the term "margin trading" as used in secondary equity markets. (2 marks)
- (d) Explain four principles of financial sector regulations in your country. (8 marks)

(Total: 20 marks)

#### QUESTION THREE

- (a) Explain five roles of an Investment and Financial Analysts Institute in financial markets. (5 marks)
- (b) (i) Highlight six attributes of an ideal securities market index. (6 marks)
- (ii) A securities market is comprised of the following:

Security	Shares (millions)	Share prices		
		1 July 2013	1 July 2014	1 July 2015
		Sh.	Sh.	Sh.
W	180	80	100	80
X	890	30	40	60
Y	500	60	70	75
Z	200	25	15	15

#### Required:

Compute the total return on the stock index over the two year period using:

- (i) A price weighted index. (5 marks)
- (ii) A value weighted index. (4 marks)

(Total: 20 marks)



#### QUESTION FOUR

- (a) Evaluate five differences between a financial forward contract and a financial future contract. (10 marks)
- (b) Following the economic conditions in your country, insurance companies have revised their yearly premiums charged for the policy holders as shown in the table below:

Company	Market Shares	Premium last year Sh.	Revised premium Sh.
A	3%	1019	1019
J	7%	861	?
B	21%	852	795
K	47%	938	887
C	5%	731	731

Company B intends to revise its premium charged to customers due to the competition in the industry.

#### Required:

- (i) Determine the key competitor company in the insurance industry, citing your reasons. (2 marks)
- (ii) Using the parity based pricing principle, compute the revised price that company B should charge as premium to its policy holders. (4 marks)
- (iii) Explain four advantages of using the parity pricing approach in pricing financial services. (4 marks)
- (Total: 20 marks)**

#### QUESTION FIVE

- (a) Outline four functions of financial markets in the economy of your country. (4 marks)
- (b) (i) Describe six factors that have contributed to the slow growth and development of capital market in many developing countries. (6 marks)
- (ii) Name two reasons why channeling the capital from savers to spenders is important to the economy. (2 marks)
- (iii) Explain four main challenges facing financial intermediaries in an emerging economy. (8 marks)
- (Total: 20 marks)**

#### QUESTION SIX

- (a) Discuss the factors that have slowed down the growth of financial markets in developing countries. (10 marks)
- (b) Analyse the principles of fundamental analysis as applied in financial markets. (10 marks)
- (Total: 20 marks)**

#### QUESTION SEVEN

- (a) Describe five risks prevalent in foreign exchange markets. (10 marks)
- (b) Summarise five factors that attract investors to unit trusts. (10 marks)
- (Total: 20 marks)**
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# KASNEB

## FINANCIAL INSTITUTIONS AND MARKETS

## CSIA PART I SECTION 1 C112

FRIDAY: 23 May 2014.

Time Allowed: 3 hours.

Answer any FIVE questions.

ALL questions carry equal marks.

### QUESTION ONE

(a) Distinguish between the following sets of terms as used in financial markets:

(i) "Automated trading system (ATS)" and "central depository system (CDS)". (4 marks)

(ii) "Market based financial system" and "bank based financial system". (4 marks)

(b) (i) Explain the term "customer relationship management (CRM)". (2 marks)

(ii) Explain three benefits that could accrue to customers of financial institutions that implement electronic customer relationship management (e-CRM). (6 marks)

(c) Summarise four types of derivative products. (4 marks)

(Total: 20 marks)

### QUESTION TWO

(a) (i) Explain the term "clearing house". (2 marks)

(ii) Outline five ways in which a clearing house could assist to reduce settlement risk. (5 marks)

(b) You are a senior investment and securities analyst at an investment management firm that deals with individual and institutional investors. You are in the process of revising the firm's standards of professional conduct.

Required:

Recommend procedures for compliance with regard to the following duties:

(i) Duty of loyalty, care and prudence owed to your clients. (3 marks)

(ii) Duty of diligence and reasonable basis in the investment decision. (3 marks)

(c) A stock index is composed of the following stocks:

Stock	Shares (million)	Share price		
		1 January 2012 Sh.	1 January 2013 Sh.	1 January 2014 Sh.
A	150	60	75	60
B	750	20	25	40
C	300	40	35	35

Required:

Determine the total return on the stock index over the two year period using:

(i) A value weighted index. (3 marks)

(ii) A price weighted index. (4 marks)

(Total: 20 marks)

### QUESTION THREE

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

(i) Market order. (1 mark)

(ii) Limit order. (1 mark)

(iii) Short sale. (1 mark)

(iv) Stop loss order. (1 mark)

(v) Margin trading. (1 mark)

(vi) Matched funding. (1 mark)

(b) Lydiah Waruguru operates a margin account at the securities exchange. She has deposited Sh.50,000 into the account. The prevailing margin requirement is 40%. Assume that the shares of XYZ Ltd. are selling at Sh.35 per share. Ignore commission.

Required:

(i) The number of XYZ Ltd.'s shares that Lydiah Waruguru could purchase using the maximum allowable margin. (3 marks)

(ii) The profit (loss) to Lydiah Waruguru if the price of shares of XYZ Ltd. rose to Sh.45 per share. (2 marks)

(iii) The profit (loss) to Lydiah Waruguru if the price of shares of XYZ Ltd. fell to Sh.25 per share. (2 marks)

(iv) If the maintenance margin is 30%, determine the price that XYZ Ltd.'s shares should fall to before Lydiah Waruguru receives a margin call. (3 marks)

(c) Examine four types of central bank interventions in financial institutions and markets. (4 marks)

(Total: 20 marks)

### QUESTION FOUR

(a) (i) Explain the term "private equity firm". (2 marks)

(ii) Discuss three exit routes available to private equity investors to access their investments. (6 marks)

(b) Sema Telecommunications Ltd. is currently undertaking an initial public offering (IPO). The company has received a subscription for 80 million shares against 100 million shares that were offered and underwritten. The underwriting commitment of four underwriters; M Bank, C Bank, P Bank and S Bank were as follows: 40 million, 30 million, 20 million and 10 million shares respectively. The subscriptions for 80 million shares which carried the underwriters stamp were procured by M Bank, C Bank, P Bank and S Bank as follows: 20 million, 20 million, 15 million and 25 million shillings respectively.

Required:

The liability of each underwriter. (6 marks)

(c) Outline six roles played by insurance companies in your country. (6 marks)

(Total: 20 marks)

### QUESTION FIVE

(a) Identify six reasons which could trigger building societies to convert to commercial banks. (6 marks)

(b) Summarise six types of informal financial institutions in your country. (6 marks)

(c) Explain four reasons why moral hazard might arise within a financial market. (8 marks)

(Total: 20 marks)

### QUESTION SIX

(a) Distinguish between the following terms:

(i) "Open-end funds" and "closed-end funds". (2 marks)

(ii) "Call markets" and "continuous markets". (2 marks)

(iii) "Commingled funds" and "hedge funds". (2 marks)

(b) Describe five functions of financial intermediaries in an emerging economy. (8 marks)

(c) Suggest three effects of money laundering on the economy of your country. (6 marks)

(Total: 20 marks)

### QUESTION SEVEN

(a) The money and capital markets that we see today will soon be very different as the financial system continues to transform itself.

With reference to the above statement, describe five forces that are reshaping the current and the future of the financial system in your country. (10 marks)

- (b) Briefly explain three ways of promoting public confidence in a financial system. (6 marks)
- (c) Consider the following two bond issues:
- Bond A: 5% 15 year bond.  
Bond B: 5% 30 year bond.
- Neither bond has an embedded option.  
Both bonds are trading in the market at the same yield.
- Required:  
The bond whose price fluctuates more when interest rates change. Comment on your answer. (2 marks)
- (d) The bid ask prices of five dealers for issue 5XYZIOT are provided below:
- |                | Dealer  |         |         |         |         |
|----------------|---------|---------|---------|---------|---------|
|                | 1       | 2       | 3       | 4       | 5       |
| Bid price (\$) | 96.4375 | 96.4375 | 96.4685 | 96.4685 | 96.4065 |
| Ask price (\$) | 96.5625 | 96.5315 | 96.5625 | 96.6250 | 96.5940 |
- Required:  
The market bid-ask spread for the issue 5XYZIOT. (2 marks)
- (Total: 20 marks)

### FINANCIAL INSTITUTIONS AND MARKETS

FRIDAY: 29 November 2013.

Time Allowed: 3 hours.

Answer any FIVE questions.

ALL questions carry equal mark.

#### QUESTION ONE

- (a) Explain the meaning of the following terms as used in the financial markets:
- Financial deepening. (2 marks)
  - Financial liberalisation. (2 marks)
  - Bank panic. (2 marks)
- (b) Outline three objectives of a deposit protection fund. (6 marks)
- (c) Liquidity is critical to the growth of financial markets.

In light of the above statement, discuss four ways that a government might use to stabilise liquidity in the financial markets. (8 marks)

(Total: 20 marks)

#### QUESTION TWO

- (a) Explain three differences between formal financial markets and informal financial markets. (6 marks)
- (b) Discuss four barriers to the growth of informal financial markets. (8 marks)
- (c) Explain three categories of membership at the securities exchange. (6 marks)
- (Total: 20 marks)

#### QUESTION THREE

- (a) Describe three broad components that make up the financial system. (9 marks)
- (b) Highlight three goals of maintaining a global investable market index. (3 marks)
- (c) (i) Explain the term "demutualisation of the securities exchange". (2 marks)
- (ii) Discuss three challenges to the process of demutualisation of the securities exchange in emerging markets. (6 marks)
- (Total: 20 marks)

#### QUESTION FOUR

- (a) Explain the following types of bond securities:
- Zero coupon bond. (2 marks)
  - Callable bond. (2 marks)

- Convertible bond. (2 marks)
- Eurobond. (2 marks)
- Municipal bond. (2 marks)
- Private placement bond. (2 marks)

- (b) Describe four benefits of international financial integration. (8 marks)

#### QUESTION FIVE

(Total: 20 marks)

- (a) Explain four types of implicit costs associated with order placement in the securities market. (8 marks)
- (b) In relation to foreign markets:
- Define the term "high frequency trading". (2 marks)
  - Highlight four benefits of high frequency trading. (4 marks)
- (c) Efficiency of capital markets is important in an economy. Discuss. (6 marks)
- (Total: 20 marks)

#### QUESTION SIX

- (a) Analyse six determinants of interest rates in financial markets. (12 marks)
- (b) Explain four factors that have hindered cross border listing of securities by quoted companies. (8 marks)
- (Total: 20 marks)

#### QUESTION SEVEN

- (a) Outline the features of each of the following:
- Bond market index. (2 marks)
  - High yield bonds. (2 marks)
- (b) Differentiate between a "value weighted index" and a "style index". (4 marks)
- (c) Summarise two advantages and two disadvantages of each of the following market indices:
- Value weighted index. (4 marks)
  - Market capitalisation weighted index. (4 marks)
- (d) Citing two reasons, highlight the need for a code of ethics for players in the financial markets. (4 marks)
- (Total: 20 marks)



FRIDAY: 31 May 2013.

Time Allowed: 3 hours.

Answer any FIVE questions.

ALL questions carry equal marks.

**QUESTION ONE**

- (a) Explain each of the following terms as used in financial markets:
- (i) Defaultable debt. (2 marks)
  - (ii) Inflation - indexed bonds. (2 marks)
  - (iii) Market liquidity. (2 marks)
  - (iv) Watered capital. (2 marks)
- (b) Describe four benefits that might accrue to a firm that undertakes cross boarder listing of its shares. (8 marks)
- (c) In relation to secondary market indices, discuss the following terms:
- (i) Domestic stock indices. (2 marks)
  - (ii) Global stock indices. (2 marks)
- (Total: 20 marks)

**QUESTION TWO**

- (a) Summarise four advantages of specialised financial institutions to developing economies. (8 marks)
- (b) Explain six functions of a central depository system (CDS). (12 marks)
- (Total: 20 marks)

**QUESTION THREE**

- (a) (i) Define the term "bank run". (2 marks)
- (ii) Summarise four measures that might be used to stop bank runs in financial institutions. (8 marks)
- (b) Describe five ethical duties that an investment and securities analyst owes to the client. (10 marks)
- (Total: 20 marks)

**QUESTION FOUR**

- (a) Describe two types of municipal bonds. (4 marks)
- (b) (i) Explain three factors that have contributed to the growth of informal financial institutions. (6 marks)
- (ii) A trader buys a stock on margin and holds the position for exactly one year, during which time the stock pays a dividend. The following information relates to the stock:
- Purchase price Sh.20 per share.
  - Selling price Sh.15 per share.
  - Number of shares purchased 1,000.
  - Leverage ratio 2.5.
  - Market interest rate 5%.
  - Dividend paid Sh.0.10 per share.
  - Commission charged Sh.0.01 per share.

Required:

The return on the initial investment.

(10 marks)

(Total: 20 marks)

**QUESTION FIVE**

- (a) The financial services sector has experienced tremendous growth in the recent past.

Required:

In relation to the above statement, explain five factors that might have contributed to such growth.

(10 marks)

- (b) The Institute of Certified Securities and Investment Analysts (ICSIA) is a not for profit organisation that is heavily dependent on the expertise and intellectual contributions of its members (graduates of the CSIA examination) who devote their time as they share a mutual interest in the organisation's mission to promote and achieve ethical practice in the investment profession. High ethical standards are critical to maintaining the public's trust in the investment profession.

Required:

As a member of the Institute of Certified Securities and Investment Analysts (ICSIA), explain five fundamental principles of a code of conduct that you should always practise.

(10 marks)

(Total: 20 marks)

**QUESTION SIX**

- (a) Highlight four factors that could cause liquidity crises in a country. (8 marks)
- (b) A central bank acts as the "lender of the last resort".
- In relation to the above statement, discuss four ways in which it performs this function. (8 marks)
- (c) Outline two ways of mitigating market crash in an economy. (4 marks)
- (Total: 20 marks)

**QUESTION SEVEN**

- (a) Explain four characteristics of futures. (8 marks)
- (b) Examine six advantages associated with offshore banking. (12 marks)
- (Total: 20 marks)

**FINANCIAL INSTITUTIONS AND MARKETS**

FRIDAY: 30 November 2012.

Time Allowed: 3 hours.

Answer any FIVE questions.

ALL questions carry equal marks.

**QUESTION ONE**

- (a) Explain three determinants of the bid-ask spread in a foreign exchange market. (6 marks)
- (b) Describe four techniques that could be used to forecast future exchange rates. (8 marks)
- (c) Highlight three uses of the foreign exchange market by the following financial institutions:
- (i) Commercial banks. (3 marks)
  - (ii) Insurance companies. (3 marks)
- (Total: 20 marks)

**QUESTION TWO**

- (a) (i) Explain the term "shadow banking system". (2 marks)
- (ii) List two benefits that the traditional banking system has over the shadow banking system. (2 marks)
- (b) A mutual fund has invested in shares of X Ltd., Y Ltd., and Z Ltd. As at 31 July 2012, the market prices of the shares were quoted as follows:

Company	Number of shares	Market price Sh.
X Ltd.	1,000	56.00
Y Ltd.	2,000	70.25
Z Ltd.	1,500	120.50

The fund has 15,000 outstanding shares held by investors.

Required:

The fund's net asset value (NAV) as at 31 July 2012.

(2 marks)

- (c) Describe seven types of insurance and investment-oriented products offered by insurance companies. (14 marks)
- (Total: 20 marks)

**QUESTION THREE**

- (a) In the context of behavioural finance, explain the following types of investors:
- (i) Methodical investors. (2 marks)
  - (ii) Spontaneous investors. (2 marks)
  - (iii) Individualist investors. (2 marks)
- (b) In relation to the concept of efficient market hypothesis, analyse seven principles of technical analysis. (14 marks)
- (Total: 20 marks)

#### QUESTION FOUR

(a) Identify two limitations of the following stock market indices:

- (i) Value-weighted index. (2 marks)
- (ii) Equal-weighted index. (2 marks)

(b) (i) Explain the term "gilt-edged securities". (2 marks)

(ii) Summarise four factors that influence the yield on long-term gilt-edged securities. (8 marks)

(c) Initial public offerings (IPOs) have received negative publicity in the recent past because of several market abuses.

Describe three IPO market abuses.

(6 marks)

(Total: 20 marks)

#### QUESTION FIVE

(a) Enumerate three factors that have led to the increased integration of financial markets. (3 marks)

(b) (i) Outline three reasons why individuals join informal investment organisations. (3 marks)

(ii) Summarise four disadvantages of informal finance. (4 marks)

(c) (i) Describe three categories of financial innovation. (6 marks)

(ii) Highlight four causes of financial innovation. (4 marks)

(Total: 20 marks)

#### QUESTION SIX

(a) (i) Describe the term "margin call". (2 marks)

(ii) Mary Muli has a margin account with a margin requirement of 25 per cent. On 1 January 2012, she deposited Sh.200,000 in the account and purchased 8,000 shares of Faidika Limited.

Required:

The share price of Faidika Limited that will result in Mary Muli's account receiving a margin call. (2 marks)

(b) Mark Kirui is considering investing a large sum of money in foreign stocks.

Advise Mark Kirui on three ways in which he could invest in stocks of foreign companies. (6 marks)

(c) Suggest five measures that could be adopted by the government of your country to encourage the growth of financial futures and options market. (10 marks)

(Total: 20 marks)

#### QUESTION SEVEN

(a) Outline eight benefits of effective financial services marketing planning to an organisation. (8 marks)

(b) Certified Securities and Investment Analysts are at times required to undertake research and prepare research reports. In preparing the reports, the Certified Securities and Investment Analysts might refer to publications from other financial analysts.

Analyse three measures that a Certified Securities and Investment Analyst could adopt in order to avoid being accused of plagiarism. (6 marks)

(c) You have recently been appointed the Legal and Compliance Officer of a leading stockbrokerage firm in your country.

Suggest three measures that you would put in place to prevent general employee misconduct in your firm. (6 marks)

(Total: 20 marks)

#### FINANCIAL INSTITUTIONS AND MARKETS

CSA

FRIDAY: 25 May 2012.

Time Allowed: 3 hours.

Answer any FIVE questions.

ALL questions carry equal marks.

#### QUESTION ONE

(a) Describe four benefits of an efficient money market. (8 marks)

(b) Explain three properties of an effective derivatives market. (6 marks)

(c) Highlight six functions of the capital market regulator in your country. (6 marks)

(Total: 20 marks)

#### QUESTION TWO

(a) Differentiate between the following pairs of terms:

(i) Allocation efficiency and information efficiency. (4 marks)

(ii) Naive hypothesis and intrinsic value hypothesis. (4 marks)

(b) Explain four difficulties of stock index construction. (8 marks)

(c) Outline four features of over the counter (OTC) markets. (4 marks)

(Total: 20 marks)

#### QUESTION THREE

(a) Distinguish between "financial engineering" and "financial innovation". (4 marks)

(b) Explain five kinds of market imperfections that provide impetus for innovation. (10 marks)

(c) Describe the three main classifications of financial markets. (6 marks)

(Total: 20 marks)

#### QUESTION FOUR

(a) Describe five factors that are taken into account when under pricing initial public offerings (IPOs). (10 marks)

(b) Explain two major risks in the foreign exchange market. (6 marks)

(c) Outline four characteristics of a "frontier market". (4 marks)

(Total: 20 marks)

#### QUESTION FIVE

(a) Distinguish between the following terms:

(i) American options and European options. (4 marks)

(ii) Covered options and Naked options. (4 marks)

(b) Explain the following types of investment vehicles:

(i) Commingled funds. (3 marks)

(ii) Hedge funds. (3 marks)

(iii) Open-end funds. (3 marks)

(iv) Unit investment trusts. (3 marks)

(Total: 20 marks)

#### QUESTION SIX

(i) Explain the term "golden share". (2 marks)

(ii) Summarise two purposes of a golden share. (4 marks)

Define the term "market capitalisation". (2 marks)

Describe four areas of conflict of interest that a financial analyst should make full and fair disclosure to various stakeholders. (12 marks)

(Total: 20 marks)

#### QUESTION SEVEN

Define the term "financial assets". (2 marks)

(i) Explain three economic functions of financial assets. (6 marks)

(ii) State six properties of financial assets. (6 marks)

Explain three factors that affect the volatility of prices of fixed interest rate assets. (6 marks)

(Total: 20 marks)

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