



CIFA PART I SECTION 2

FINANCIAL INSTITUTIONS AND MARKETS

WEDNESDAY: 1 September 2021.

Time Allowed: 3 hours.

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

QUESTION ONE

- (a) (i) Explain the term “financial innovation”. (2 marks)
- (ii) Describe three categories of financial innovation. (6 marks)
- (b) Anne Mena, an investor at the securities exchange, buys XYZ Ltd.’s shares on margin and holds the position for exactly one year, during which time the company pays a dividend. Interest rate on the loan and the dividend are both paid at the end of the year. The following additional information is provided:
- | | |
|------------------------------|---------|
| • Purchase price per share | Sh.20 |
| • Sale price per share | Sh.18 |
| • Number of shares purchased | 1,000 |
| • Leverage ratio | 3.5 |
| • Interest rate per annum | 10% |
| • Dividend per share | Sh.0.10 |
| • Commission per share | Sh.0.01 |
- Required:**
The total return on Anne Mena’s investment. (4 marks)
- (c) Discuss four characteristics of a well-functioning financial market. (8 marks)
- (Total: 20 marks)**

QUESTION TWO

- (a) Explain the following terms as used in financial markets:
- (i) Index-arbitrage trading. (2 marks)
- (ii) Credit derivatives. (2 marks)
- (iii) Reinsurance. (2 marks)
- (iv) Financial crisis. (2 marks)
- (v) Securitisation. (2 marks)
- (b) Analyse five pricing strategies for financial services. (10 marks)
- (Total: 20 marks)**

QUESTION THREE

- (a) Describe three market execution mechanisms for trading shares. (6 marks)
- (b) Discuss four challenges that might be faced by investors in developing a vibrant mortgage market. (8 marks)
- (c) Distinguish between the following sets of terms as used in financial markets:
- (i) “Continuous market” and “call market”. (4 marks)
- (ii) “Long position” and “short position”. (2 marks)
- (Total: 20 marks)**

QUESTION FOUR

- (a) Explain five objectives of the anti-money laundering regulations in your country. (5 marks)
 - (b) Highlight seven functions of the Institute of Certified Investment and Financial Analysts (ICIFA). (7 marks)
 - (c) Discuss four functions of financial intermediaries in an emerging economy. (8 marks)
- (Total: 20 marks)**

QUESTION FIVE

- (a) Outline five factors that one could consider when pricing financial services. (5 marks)
 - (b) Highlight five types of incentives which might be provided by the Capital Markets Authority (CMA) to encourage potential and existing investors in the securities market. (5 marks)
 - (c) Evaluate five methods that banks might use to manage credit risk. (10 marks)
- (Total: 20 marks)**

QUESTION SIX

- (a) Describe three factors that might contribute to the degree of efficiency in a financial market. (6 marks)
 - (b) Analyse three ways in which moral hazard might lead to adverse selection. (6 marks)
 - (c) Summarise four types of derivatives traded in the derivatives security market. (8 marks)
- (Total: 20 marks)**

QUESTION SEVEN

- (a) Explain five uses of securities market indexes. (5 marks)
- (b) An analyst gathers the following information for a market capitalisation weighted index comprising securities 1, 2 and 3:

Security	Beginning of period price (Sh.)	End of period price (Sh.)	Dividend per share (Sh.)	Shares outstanding
1	25	27	2	5,000
2	35	25	1.50	7,500
3	15	16	2	10,000

Required:

- (a) The total return of the index. (3 marks)
- (c) An analyst gathers the following information for an equally weighted index:

Security	Beginning of period		End of period	
	price (Sh.)	Number of shares	price (Sh.)	Number of shares
A	20	300	22	300
B	50	300	48	300
C	26	2000	30	2000

Required:

- (a) Assuming Sh.1,000 is invested in each of the shares, calculate the return of the index over the period. (2 marks)
 - (d) Analyse five benefits of informal loans. (10 marks)
- (Total: 20 marks)**