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

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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