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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<br>Share price (Sh.) | End of period<br>Share price (Sh.) | Dividends per share<br>(Sh.) | Number of shares<br>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)**