



**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**

- (a) Discuss four ways used by financial institutions to segment their business markets. (4 marks)
- (b) In relation to marketing financial services, explain five components of marketing mix decisions. (5 marks)
- (c) Discuss three types of fixed income indices available in the global financial markets. (6 marks)
- (d) 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:**

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

**QUESTION TWO**

- (a) Analyse four roles played by private equity fund managers. (8 marks)
- (b) In relation to marketing financial services, explain three stages of microfinance market development that impact client characteristics. (6 marks)
- (c) 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:

- (i) Equal weights. (3 marks)
  - (ii) 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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