FINANCIAL INSTITUTIONS AND MARKETS

Attempt QUESTION ONE and any other THREE questions.

**QUESTION ONE**

Briefly discuss the following financial institutions found in Kenya, highlighting their FUNCTIONS.

* 1. Commercial banks and mortgage finance institutions (4 marks).
  2. Credit reference bureaus (4 marks).
  3. Investment banks (4 marks).
  4. Development Banks (4 marks).
  5. The Stock market (7.5 mks).

“The existing regulatory framework for the financial sector in Kenya consists of a number of

independent regulators each charged with the supervision of their particular sub sectors”.

**QUESTION TWO**

Discuss the structure of financial sector regulation in Kenya and highlight 4 GAPs and 2 OVERLAPS (Use diagrams where appropriate) (23.5 marks)

**QUESTION THREE**

Briefly discuss the following terms, highlighting their relevance in the stock markets

* 1. The theory of rational expectations (6 mks)
  2. The strong form market efficiency (6 mks).
  3. The weak form market efficiency (6 mks).
  4. The random walk hypothesis. (5.5 mks)

**QUESTION FOUR**

‘In addition to common stock investments, it is also possible to invest in derivative securities, which are securities that have a claim on the common stock of a firm’. In light of the above, discuss the following.

* 1. Call options (6 mks)
  2. Put Options (6 mks)
  3. Warrants (6 mks)
  4. Futures (5.5 mks)
  5. "A country is always worse off when its currency is weak (falls in value)." Is this statement true, false, or uncertain? Explain your answer (4 mks).
  6. Short-term interest rates are 2% in Kenya and 4% in the United States. The current exchange rate is 102 shillings per dollar. What is the expected forward exchange rate? (4 mks).
  7. Discuss the following terminology:
     1. The law of one price.
     2. Purchasing power parity.
     3. Local arbitrage.
     4. Triangular arbitrage (8 mks).

**QUESTION FIVE**

1. You are interested in buying a Ksh. 1000 par bond with 10 years to maturity and 8% coupon rate that is payable semi-annually. How much would you pay for the bond if your required return is 12%? (6 mks)
2. Explain the term bond indenture. (2 mks)
3. What are the components of a bond indenture, and how do the components help investors manage risk. (6 mks).
4. What do you understand by the following terminology as used in financial markets?
   * 1. Junk Bonds.
     2. Inflation indexed bonds.
     3. Convertible Bonds. (6 mks).

**QUESTION SIX**

* 1. Distinguish between defined contribution and defined benefits pension plans? (2 mks).
  2. Give three reasons that make financial markets important to the health of the economy (6 mks).
  3. Distinguish between exchange and over the counter (OTC) markets (2 mks).
  4. "In a world without information and transaction costs, financial intermediaries would not exist." Is this statement true, false? Explain your answer (3 mks).
  5. "If stock prices did not follow a random walk, there would be unexploited profit opportunities in the market." Is this statement true, false? Explain your answer (6 mks).
  6. A 5 year zero coupon bond has a par value of Ksh. 1000 is selling for Ksh. 1150. Compute its Yield to Maturity (YTM) (3 mks).
  7. Discuss the functions of the Central Bank of Kenya (8 mks).