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**KARATINA UNIVERSITY**

**UNIVERSITY EXAMINATIONS**

**2021/2022 ACADEMIC YEAR**

**SECOND** YEAR **FIRST** SEMESTER EXAMINATION

**BACHELOR OF BUSINESS MANAGEMENT**

**&**

**BACHELOR OF EDUCATION (ARTS)**

**COURSE CODE: BBM 312**

**COURSE TITLE: FINANCIAL INSTITUTIONS & MARKETS**

**DATE: 18 FEBRUARY, 2022 TIME: 8AM-12PM**

**INSTRUCTIONS**

**ATTEMPT QUESTION 1 AND CHOOSE THREE OTHER QUESTIONS**

QUESTION ONE

* 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 (3 mks).

QUESTION TWO

a. 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).

b. 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).

c. Discuss the following terminology:

* + 1. The law of one price.
    2. Purchasing power parity.
    3. Local arbitrage.
    4. Triangular arbitrage (4 mks).

d. Short-term interest rates are 2% in UK and 4% in Kenya. The current exchange rate is Ksh. 150 per sterling pound. If you can enter into a forward exchange rate of Ksh. 135 per sterling pound, how can you arbitrage the situation? (3 mks).

QUESTION THREE

a. Discuss the pros and cons of the regulation of financial markets. (6 mks).

b. To what extent is self regulation applicable in the financial sector? (3 mks)

c. Under what circumstances might regulation decrease rather than increase the stability of an industry? (3 mks)

d. How important is moral hazard as a determinant of people’s behaviour? Provide examples of moral hazard related to the financial services industry. (3 mks).

QUESTION FOUR

a. 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)

b. Explain the term bond indenture. (2 mks)

c. What are the components of a bond indenture, and how do the components help investors manage risk. (4 mks).

d. What do you understand by the following terminology as used in financial markets?

* + 1. Junk Bonds.
    2. Inflation indexed bonds.
    3. Convertible Bonds. (3 mks).

QUESTION FIVE

Discuss the following derivative instruments, highlighting their distinguishing characteristics and application to risk management.

a. Forward contracts (4 mks).

b. Futures contracts (4 mks).

c. Options (4 mks).

d. Swaps. (3 mks)