



**BACHELOR OF FINANCIAL SERVICES**  
**END OF SEMESTER EXAMINATION**  
**BFS 1101: INTRODUCTION TO FINANCIAL SERVICES**

**DATE:** Friday, 29<sup>th</sup> October 2021

**Time:** 2 Hours

**Instructions:**

1. This examination consists of **FIVE** questions.
2. Answer **Question ONE (COMPULSORY)** and any other **TWO** questions.

**Question 1**

**30 Marks**

- a. Insurance companies are faced by two types of risks, that is, Moral hazard and adverse selection. Using the aid of an example, differentiate the two types of risks (4 Marks)
- b. With the aid of an example differentiate between reinvestment risk and refinancing risk (4 Marks)
- c. Explain the meaning of the term too big to fail as used in the financial services industry (2 Marks)

Some authors argue that the government should not intervene for the firms that are considered too big to fail while others argue that the government should intervene.

**Required:**

- i. Present an argument why the government should intervene for the firms that are considered to be too big to fail (2 Marks)
- ii. Present an argument why the government should not intervene for the firms that are considered to be too big to fail (2 Marks)
- d. Explain how the following institutions help in financial intermediation:
  1. Commercial banks (2 Marks)
  2. Investment banks (2 Marks)
- e. James has been in employment for the last eight months. He has realized that he consumes less than he earns. He is torn between keeping the extra income in the bank or a financial cooperative. Explain to James some of benefits of putting his money in any of the two financial institutions (4 Marks).
- f. Explain three strategies that can be employed by hedge fund managers to earn return for their funds (4 Marks)
- g. Differentiate between the following terms
  1. Capital market and money market (2 Marks)
  2. Primary market and secondary market (2 Marks)

**Question 2****20 Marks**

- a. Mr. Daudi has witnessed the suffering that the children of his late friend are experiencing after his death. He therefore wants to take an insurance policy that will safeguard the interest of his own family in the unfortunate case that he dies. Explain to Mr. Daudi any three types of insurance policy that he can take to safeguard the interest of his family (6 Marks)
- b. Explain the following terms as used in a balance sheet of an insurance company:
  - i. Policy reserves (2 Marks)
  - ii. Capital reserves (2 Marks)
- c. What is a black swan in relation to the insurance company? Further explain whether it is possible to insure against black swan (2 Marks)
- d. Explain two types of home insurance (4 Marks)
- e. Discuss two challenges facing the insurance industry (4 Marks)

**Question 3****20 Marks**

- a. The government of any country has the responsibility of balancing the level of inflation and the level of unemployment in the country. Explain two measures that the central bank of country can use through commercial banks to influence level inflation and unemployment in a country (6 Marks)
- b. Uzuri Bank is a commercial bank in Kenya. It has deposits from its customers amounting to Sh. 30 billion. It has given out Sh. 25 billion as loans to its customers. Out of the Sh. 25 billion that it has lend, Sh. 5 billion is to a client in Uganda. The loan to the Ugandan customer was dispersed in Ugandan Shillings. Analyze and give a detailed explanation of three types of risks that the bank is exposed to (6 Marks)
- c. Ms. Cheruto has recently won amount of Sh. 2,000,000 after finishing as runners up in a marathon race held in Germany. She currently does not want to use the money rather she wants to invest the money in the short-term. She can therefore put the money in bank deposit account or in short-term money market fund.  
**Required:**  
Explain to Ms. Cheruto the difference between the two types of investment and the risk exposure for the two types of investment (2 Marks)
- d. Mr. Kimani imports electronics products from China which he then sells to his customers on credit basis. The credit period varies from 30 days to 90 days. This poses cash flow challenges to his business as he sometimes does not have cash to pay for the imports. Explain to Mr. Kimani two services that are offered by the bank that he can take advantage of and how they can help him (4 Marks)
- e. Explain two ways that financial cooperatives make money (2 Marks)

**Question 4****20 Marks**

- a. Funguo ltd is a Kenyan company that wants to expand its operations. It plans to do this by acquiring a new manufacturing facility. The company intends to raise the

funds required for the manufacturing facility by issuing shares. The company has therefore approached an investment banker to help it raise the funds. The investment banker has agreed to underwrite the issue on a **best of effort** basis. The investment banker can sell 40 million shares for Sh. 45 per share and charges the company Sh. 2 per share sold.

**Required:**

- i. How much money does the company receive? (2 Marks)
- ii. What is the profit to the investment banker? (1 Mark)
- iii. If the investment banker can sell the shares for only Sh. 43 per share, how much money does the company receive? (2 Marks)
- iv. What is the profit of the investment banker? (1 Mark)

Assume that instead the investment banker has agreed to underwrite the issue on a commitment basis. The investment bank pays the company Sh. 47 per share for 50 million shares. The investment banker then sells the shares to the public for Sh. 44 per share. You are required to answer the following questions:

- i. How much does the company receive? What is the price of the share? (2 Marks)
  - ii. What is the profit/loss to the investment banker? (1 Mark)
  - iii. If the investment bank can sell the shares for Sh. 50, how much money does the company receive? (2 Marks)
- iii b. What is the profit of the investment banker? (1 Mark)
- b. Differentiate between the following terms with the use of an example:
- i. Taking a long position and taking a short position (4 Marks)
  - ii. Bearish market and bullish market (4 Marks)

**Question 5**

**20 Marks**

- a. Jim wants to buy shares of an open-end mutual fund. The mutual fund currently has 400,000 shares outstanding. The mutual fund has invested in the following shares, 90,000 shares of Britam whose current market price is Sh. 8 per share; 70,000 shares of NCBA whose market price Sh. 27 and 20,000 shares of Orchards whose market price is Sh. 240.

**Required:**

- i. Calculate the price that the investor will pay to acquire one share of the mutual fund. (3 marks)
- ii. If Jim wants to buy 1000 shares of the mutual fund, how much will pay? (2 Marks)
- iii. If the additional money paid in part (ii) is used to acquire shares of NCBA, calculate the additional number of NCBA shares that would be acquired. (1 Mark)
- iv. Using the information in part (iii), calculate the Net Asset Value (NAV) after the investor acquires the shares of the mutual fund (3 Marks)

- b. A close-end mutual fund has 1,500,000 outstanding shares which are trading at a price of Sh. 60 per share. The mutual fund has the following shares, 15,000,000 shares of Sameer ltd at a price of Sh. 3; and 1000,000 shares of Centum at a price of Sh. 25 per share and 2000,000 shares of cooperative banks at a price of Sh. 7.5.

**Required:**

- i. Calculate the NAV of the mutual fund (3 marks)
  - ii. Establish whether the shares are trading at a premium or discount and by how much. (2 Marks)
  - iii. Determine the discount or premium per share (1 Mark)
- c. A hedge fund manager is managing a fund whose value is Sh. 500 million. The fund has generated a return of 11% for the year 2020. The fund uses a fee structure of 2 and 20 compensation structure. Calculate the total fees for this fund (that is, what the fund manager will get) (3 Marks)
- d. Explain why the expense ratio fees is criticized (2 Marks)