



Strathmore
UNIVERSITY

STRATHMORE BUSINESS SCHOOL
BACHELOR OF FINANCIAL SERVICES
END OF SEMESTER EXAMINATION

BFS 2101: FINANCIAL INSTITUTIONS AND MARKETS

DATE: Thurs, 1st Aug 2024

TIME: 15:30 – 17:30

INSTRUCTIONS

- 1) Answer question **one** and any **other two** questions
- 2) Question one is compulsory and carries **30 marks**
- 3) All other questions carry **20 marks each**

QUESTION ONE

- a) Distinguish between a financial system and financial markets **(2 marks)**
- b) Discuss **six** the important roles played by a financial system to meet the gaps in the economy. **(6 marks)**
- c) Define financial intermediation **(2 marks)**
- d) While commercial banks involve in the intermediation process they face a serious risk that threatens their very existence. Discuss the serious risk/problem they face as they engage in maturity intermediation. **(4 marks)**
- e) Discuss **four** types of financial intermediation **(8 marks)**
- f) Compare the intermediation process between the arbitragers and dealers **(4 marks)**
- g) A Company issues a 10-year bond that has a par value of Ksh 2500 issuing it at discount of ksh 12%. The coupon rate is 14.25%. Calculate
 - (i) Current yield of bond **(1 mark)**

- (ii) The yield to maturity of the bond (3 marks)

(TOTAL 30 MARKS)

QUESTION TWO

- a) Discuss **four** types of money market securities (4 marks)
- b) What are the distinct characteristics between capital markets and money markets? (4 marks)
- c) The government of Kenya is issuing a one-year treasury bill that has a par value of Kes 200,000 at an issue price of Kes 279,000. An investor is seeking your opinion whether to buy or not. The investors require a 17 % annualized return since the central bank has recently adjusted its CBR to 13%. Calculate the price that they are willing to pay and advise the investor. Advise the investor (4 marks)
- d) Explain the relationship between bond prices, yields and market interest rates (4 marks)
- e) Discuss **four** differences between futures and forwards (4 marks)

(TOTAL 20 MARKS)

QUESTION THREE

- a) Equities and bond trade in the capital markets. Compare the riskiness between bonds and equities, give reasons why one is riskier than the other. (4 marks)
- b) Define information asymmetry (2 marks)
- c) Differentiate between adverse selection and moral hazard (4 marks)
- f) Choose any **two** financial institutions and explain how they deal with information asymmetry problem. (4 marks)
- d) Company A issues a five years bond with par value of Ksh 1500. The coupon rate of the bond is 16.5%. What is the price of the bond if YTM of the bond is?
- (i) 12.5% (2 marks)
- (ii) 20% (2 marks)
- e) Explain the difference between a conversion ratio of a bond and conversion premium of a bond. (2 marks)

(TOTAL 20 MARKS)

QUESTION FOUR

- a) Differentiate between options and futures (2 marks)
- b) Inflation is a big issue in ensuring stability of the economy. Discuss **six** tools that the CBK uses to ensure stability of the financial system. (6 marks)
- f) Distinguish between competitive and non-competitive bidding. (2 marks)

- g) Explain why a puttable and callable preference share can be regarded as a derivative. **(4 marks)**
- h) Distinguish between arbitrage and brokerage **(2 marks)**
- i) Define **(i) Bond conversion parity **(2 marks)****
(ii) Bond conversion price **(2 marks)**
- j) A company current share price is kes 34, and the conversion ratio for a bond with a par value of ksh 1000, issued 5 years ago is 48:1, calculate the conversion value of the bond? **(2 marks)**
- k) In reference to the bond in part (e) above, if the bond has a par value of Ksh 1000, and has a current market price of ksh 1,250. Would you convert it if today was conversion date as per the bond agreement? Give a reason for your answer. **(2 marks)**

(TOTAL 20 MARKS)

QUESTION FIVE

- a) Explain the difference between a long and short positions under derivatives. **(2 marks)**
- b) Distinguish between Exchanges and OTC markets **(2 marks)**
- c) Discuss the advantages of derivatives **(5 marks)**
- d) If a company issues a callable bond that has a par value of 1,000 at an issue price of Ksh850. The bond has a maturity period of 8 years and coupon rate is 14%. The call is supposed happen at the end of year 3. Explain the circumstances that will motivate the company to exercise the call at the end of year three. **(3 marks)**
- e) The principal amount of a bond is kes 10,000, the maturity is 6years, the coupon rate is 18.5%, and interest payments are made annually. The market interest rate used to discount the bonds' expected cash flows until maturity is assumed to be constant at 18.5%. The bonds are issued and redeemed at par. For the partially amortized bond, the balloon payment is kes 4,500 at maturity.

Calculate the cash flows if:

- i. the bond is a bullet bond **(2 marks)**
- ii. the bond is fully amortized bond **(3 marks)**
- iii. the bond is partially amortized bond **(3 marks)**

(TOTAL 20 MARKS)