



# **MURANGA UNIVERSITY COLLEGE**

(A constituent College of Jomo Kenyatta University of Agriculture & Technology)

## **TOWN LEARNING CENTRE**

### **ORDINARY UNIVERSITY EXAMINATIONS**

**2015/2016 ACADEMIC YEAR**

### **THIRD YEAR FIRST SEMESTER EXAMINATIONS**

#### **FOR THE DEGREE OF BACHELOR OF COMMERCE**

**COURSE CODE: HBF 230 1**

**COURSE TITLE: FINANCIAL INSTITUTIONS AND MARKETS**

**DATE: 18<sup>TH</sup> April, 2016      TIME: 9.00-11.00AM      DURATION: 2 HOURS**

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#### **INSTRUCTIONS TO CANDIDATES**

- Question ONE (1) is compulsory
- Answer ANY OTHER TWO questions

MRUC observes ZERO tolerance to examination irregularities

This Paper Consists of 3 Printed Pages. Please Turn Over. ►

**QUESTION ONE (COMPULSORY)**

Read the following extract and answer the questions that follow

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**CBK SEEKS TO REASSURE INVESTORS OF BANKING SECTOR STABILITY**

The Central Bank of Kenya has come out to assure investors of stability in the banking sector after local banks took a hit from Tuesday's Imperial Bank closure. Shares of most Nairobi-listed lenders closed lower on Tuesday with the entire banking sector recording declines except for I&M Bank-which did not trade. NIC Bank, Standard Chartered and Housing Finance declined the most; falling 6.7 per cent, 5.5 per cent and 4.4 per cent respectively. Kenya Commercial Bank weakened towards close of the session and touched a 52 week low of Sh40.50 as local investors picked up the stock as it fell, Standard Investment Bank said in a note to clients.

According to *Bloomberg* the decline continued for a second day running (Wednesday) with the biggest lender, Equity Group seeing stocks tumble 6.3 per cent to 40.75 shillings by 10:14am heading for its biggest drop since September 2014. Co-Operative Bank has slid 3.9 percent, Barclays Bank of Kenya Ltd is down 2.4 per cent and Kenya Commercial Bank has fallen 3 per cent in today's trading. CBK released a

second statement jointly with Capital Markets Authority (CMA), clarifying the problems at Imperial Banks had been brought to its attention by the bank's board of directors. The statement signed by CBK Governor Patrick Njoroge and CMA CEO Paul Muthaura, further clarified that the action was meant to stop the listing of the Sh2 billion bond that was meant to start trading on Tuesday.

CMA directed the Nairobi Securities Exchange to suspend the introduction to listing and trading of the Corporate Bond issued by Imperial Bank which closed on September 17, 'in the Public interest and to protect interests of investors'. "The board of directors of Imperial Bank Limited brought to the attention of the CBK inappropriate banking practices that warranted remedial action in order to safeguard the interest of both depositors and creditors," the statement read. CBK sought to assure members of the public that 'Kenya's banking sector remains safe and robust'.

*Otiato Guguyu; Business Daily, 14<sup>th</sup> October, 2015*

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- a. As stated in the extract, CMA directed the suspension of listing and trading of Imperial Bank bond in the 'in the public interest and to protect interests of investors'.
    - i. Do you agree with this argument? (2 marks)
    - ii. What other role does CMA play in the financial markets (12 marks)

- b. It can be argued that the Kenyan financial market is efficient since the 'listed lenders took a hit' from closure of imperial bank and subsequent suspension of its securities from the market
- i. In view of this, what is meant by "an efficient market"? (2 marks)
  - ii. Why should financial markets be efficient? (9 marks)
  - iii. Explain the various types of efficiency to be found in any financial market (9 marks)
- c. Why should financial systems be regulated (3 marks)
- d. Apart from the regulators mentioned in the extract, mention any other three regulators in the Kenyan financial system and the market segment they regulate (3 marks)

### **QUESTION TWO**

- a. Differentiate between organized and over-the-counter exchanges (3 marks)
- b. Explain the role of organized stock exchanges in the financial systems (12 marks)

### **QUESTION THREE**

- a. Explain the operation of the following financial institutions
  - i. Mutual funds (3 marks)
  - ii. Pension funds (3 marks)
- b. According to the classical theorists, interest rate is a real phenomena determined by real factors. Discuss (9 marks)

### **QUESTION FOUR**

- a. An investor requires a liquidity premium of 1.5 percent for every investment period beyond the current holding period in order to take up long term investments. The current short term rate in the market is 8 percent and the market expects future short term rates of 10%; 12%; 11%; 10% and 6% in the next five years. Calculate the current long-term rate on a four year security in this market (5 marks)
- b. What is the role of depository financial institutions in the financial systems (10 marks)