KABARAK UNIVERSITY

UNIVERSITY EXAMINATIONS
2009/2010 ACADEMIC YEAR

FOR THE DEGREE OF BACHELOR OF COMMERCE

COURSE CODE: FNCE 414

COURSE TITLE: MANAGEMENT OF FININCIAL INSTITUTIONS

STREAM: Y4S1

DAY: WEDNESDAY

TIME: 4:00 – 6:00 P.M.

DATE: 14/04/2010

INSTRUCTIONS:

i. The paper contains **FOUR** questions
ii. Answer **ALL** the questions
iii. Marks are allocated at the end of each question
iv. All Workings Leading to Answers **MUST** Be Clearly Shown
v. Any irregularity will be punished severely.

PLEASE TURNOVER

QUESTION ONE:

(a) The main market intermediaries in the Kenyan capital markets include: Stockbrokers, Stock Dealers, Investment Advisers, Fund Managers, Authorized Securities Dealers, Credit Rating Agencies, Collective Investment Schemes, Custodians and Venture Capital Funds.

Required:

Describe the roles for ANY FOUR of these market intermediaries **(8 marks)**

(b)

We study financial markets and institutions because they are dynamic and evolving markets. DJIA rose from 2800 in 1990 to more than 11,000 by 2000 (25% annual returns in the 90s), then the stock market declined for three consecutive years (2000, 2001 and 2002), the first time since 1930s. Financial institutions (FI) have made a full historical circle. Banking industry operated as a full service industry ("universal banking") until the 1930s, when commercial and investment banking were separated by regulation. In 1970s and 1980s, lots of innovation took place in the unregulated financial services industry (investment banking side) like mutual funds, money market accounts, commercial paper, junk bonds, mortgage securitization resulting in financial disintermediation. We are now moving again towards full service (universal) banking due to deregulation, technology and financial innovation, e.g. Citigroup. Also, global competition is increasing in the banking industry. Risk becomes increasing important in this evolving, dynamic, competitive global market for financial markets. The more frequent and the more unpredictable the changes are, the greater the risk.

Required:

i Distinguish between financial intermediation and financial disintermediation **(2 marks)**

ii Discuss the roles of financial intermediaries. **(15 marks)**

(Total: 25 marks)

QUESTION TWO:

(a) Rather than a traditional comprehensive exam, assume you are only given one question in this course. You have only 30 minutes to complete your answer. You are given the financial statements of a financial institution over a five year period and asked to evaluate the performance of this financial institution. Because of time limit, you must choose the most important management areas for which to analyze the performance.

Required:

i What general financial management areas would you choose to emphasize? Why? **(10 marks)**

ii For each area, identify a financial ratio that would be especially useful in analysis **(10 marks)**

iii What other information besides the published financial statements would you like to have? Why? **(5 marks)**

(Total: 25 marks)

QUESTION THREE:

(a) Why are financial institutions advised not to lend money on the strength of collateral alone? **(13 marks)**

(b) A bank with mismatched assets and liabilities can be badly hurt by unexpected interest rate changes. In the 80's, many Savings & Loan associations went bankrupt owing to rates increases: since they had borrowed short and lent long, both their income and their net worth had become negative. Banks use the gap and the duration analyses to respectively evaluate (not necessarily to eliminate) their exposure to income and to capital risks.

Required:

i Describe the practical implications of a negative GAP ratio, positive GAP ratio and unit GAP ratio. **(4 marks)**

ii What are the benefits of Gap Management to a financial manager **(4 marks)**

iii Explain how a depository institution could become insolvent even with perfectly matched assets and liability maturities **(4 marks)**

(Total: 25 marks)

QUESTION FOUR:

(a) The Basel Capital Accord (Accord or Basel I) is a fairly complex quantitative driven method for determining regulatory capital. The current state of the Accord has followed a long and tortuous path since January 16, 2001, when the Basel Committee on Banking Supervision released its second consultative document on the New Basel Capital Accord (New Accord or Basel II). This followed the initial indication in June 1999 that a new risk sensitive capital accord was necessary, supplanting Basel I which has been in place since 1988.

Required:

What limitations and benefits do the (Basle Accord) risk based capital Requirements have?

(14 marks)

(b) Since the late 1980s, many national financial markets got aboard the liberalization process to enhance global integration of all financial markets.

Required:

i Explain the justification of attempts to achieve global integration of all financial markets. **(3 marks)**

ii Despite efforts towards global financial market integration, there are many national financial markets that have remained largely segmented.

1. What have been the major causes of such segmentations? **(3 marks)**
2. Discuss the major effects of financial markets segmentation? **(5 marks)**

(Total: 25 marks)