NATIONAL UNIVERSITY OF SCIENCE AND TECHNOLGY

FACULTY OF COMMERCE
DEPARTMENT OF BANKING

MASTER OF SCIENCE IN BANKING & FINANCIAL SERVICES AND MASTER SCIENCE IN FINANCE & INVESTMENTS

FINANCIAL MARKETS AND REGULATION (CBA 5101)

SUPPLEMENTARY EXAMINATION **MAY/JUNE 2008**

TIME ALLOTED: 3 HOURS

<u>INSTRUCTIONS TO CANDIDATES</u>

(i) Attempt <u>any</u> **FOUR (4)** questions.
(ii) Begin the answer to each question on a fresh page of the answer sheet.
(iii) Except where otherwise stated; where applicable, all numerical answers should be given to two decimal places

<u>INFORMATION TO CANDIDATES</u>

(i) This examination paper contains **SEVEN (7)** questions.
(ii) Questions may be answered in any order but must be correctly and legibly numbered.
(iii) Each question carries 25 marks.
(iv) Marks may be deducted for careless or untidy work.

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<u>QUESTION ONE</u>

(a)

(i) Define the term ‘deregulation of financial markets’ and identify the factors that have motivated this phenomenon. [3 marks]

(ii) Differentiate *market deregulation* from *institutional deregulation* by detailing what each involves. [10 marks]

(b) The category of *Banking* is one of several broad functional categories into which financial institutions can be grouped. Identify the financial institutions that can be grouped under this category and explain the functions of each of these financial institutions. [12 marks]

<u>QUESTION TWO</u>

Discuss the characteristics of financial assets that determine such assets’ attractiveness to different classes of investors [25 marks]

QUESTION THREE

(a)

(i) Why would an international bank fund itself by the issue of Eurodollar CD's rather than by non-negotiable time deposits? [3 marks]

(ii) A Negotiable Certificate of Deposit (NCD) has the following data:

Maturity Value	=	$2 121 917 808
Contract date	=	30 July
Maturity date	=	31 August
Interest Rate	=	430% p.a.

Calculate the Investment Proceeds or Consideration for the NCD [3 marks]

(b)

(i) With the aid of examples, distinguish between the following bond yields [8 marks]

- Interest yield (or current yield)
- Yield to Maturity (YTM)
- Yield to Redemption (YTR) and,
- Expected yield

(ii) Assume that a $1 000 par value bond with two years to maturity pays a coupon of 5% p.a. semi-annually and is currently selling for $900. Calculate the YTM using the Net Present Value interpolation method. [6 marks]

(c) Identify the main variables that affect the price for bonds [5 marks]

QUESTION FOUR

Are there perfectly efficient markets? Answer this question in the context of the problem of *insider dealing* and the practice of *confidential briefings;* both of which are seen by some analysts as giving an unfair advantage to a certain class of market participants. What can regulators do to 'level the playing field'? [25 marks]

QUESTION FIVE

Two companies face the following costs in the respective markets

	Fixed Rate	Floating Rate
Company A (AAA)	10.40	Six month LIBOR + 0.25
Company B (BBB)	11.50	Six month LIBOR + 0.**75**

(a)

(i) Which company has an absolute advantage? In which market segment does each company have a comparative advantage? [3 marks]

(ii) Explain the possible reasons for the comparative cost of borrowing advantages enjoyed by each company. [4 marks]

(b) If a Swap were arranged, what are the maximum savings that could be divided between the two parties? [3 marks]

(c) Structure a Swap transaction that would result in such savings being divided in the ratio 2:5:5 among an Intermediary, Company A and Company B respectively. Show all calculations and explain intermediate steps.

[15 marks]

QUESTION SIX

(a) "While *social efficiency* may be considered to be the overall objective of regulation given the general philosophy, three regulatory objectives are of particular relevance on a more practical level".

Identify and briefly explain these three objectives and explain why they are important.

[15 marks]

(b) Discuss the regulatory framework in Zimbabwe's financial markets and explain the extent to which it is adequate in protecting the interests of various participants in these markets. [10 marks]

QUESTION SEVEN

You are a currency arbitrager for your company.

The spot rate this morning is ZW$120.50/US$. The United States Federal Reserve Bank is worried about rising inflation and has finally decided to raise 90-day interest rates by 25 basis points from their current level of 4.1250% p.a. The 90-day forward exchange rates quoted to you by local banks are all about the same, at ZW$119.60/US$. The current 90-day ZW$ interest rate is 0.5000% p.a. You are allowed to borrow/lend a maximum of ZW$300 billion or its foreign currency equivalent

Required:

(a) How can you make a profit through covered interest arbitrage? Support your answer with calculations. [5 marks]

(b) How much profit in ZW$ can you hope to make in 90 days using the above strategy assuming you dealt at you maximum borrowing /lending limit? [12 marks]

(c) 'In essence, the FRA contract is simply a bet on the movement of interest rates' Do you agree with this statement? Explain with the use of examples.[8 marks]