



THE CATHOLIC UNIVERSITY OF EASTERN AFRICA

A. M. E. C. E. A

P.O. Box 62157
00200 Nairobi - KENYA
Telephone: 891601-6
Fax: 254-20-891084
E-mail: academics@cuea.edu

MAIN EXAMINATION

AUGUST - DECEMBER 2018 TRIMESTER

FACULTY OF COMMERCE

DEPARTMENT OF ACCOUNTING AND FINANCE

REGULAR / ODEL PROGRAMME

CFI 413: FINANCIAL RISK MANAGEMENT

Date: DECEMBER 2018

Duration: 2 Hours

INSTRUCTIONS: Answer Question ONE and ANY OTHER TWO Questions

Q1. a) As a Consultant in Enterprise Risk Management prepare a discussion paper for presentation to a board of directors on the objectives of financial risk management. **(20 marks)**

b) Chama self help has been offered different savings account by two banks. Bank X is offering 7% interest pa compounded daily while bank Y is also offering 7% pa compounded monthly (every 30 days) with 15% withholding tax deducted at source.

Required:

Evaluate the better investment option. **(10 marks)**

Q2. a) In the national budget of 2010/2011 the then minister of finance announced that a Financial Futures Exchange would be established in Kenya in 2012 (not yet in place).

Required:

Define a FFE contract and comment on how it works. **(5marks)**

b) Your company has a USD 100 million floating rate loan with a three month rollover next due in March 2016. You believe that interest rates will rise and wish to hedge interest cost until the next rollover. Today is 1 January 2016 and three months USD forward/forward rate in the money

Markets from 1/03/2016 is 7.9125% as compared to March futures contract which is 92.00(implied interest rate of 8%).

On 1st March 2016 the outturn rates are:

March futures contract is 89.95

Actual rate of interest in the money market is 10%.

(NB an initial margin of USD 2000 per contract is payable to the exchange).

Required:

Prepare (side by side) a cash flow statement for the hedged position as compared to NIL hedge position and explain why the hedge was not 100% effective. **(15 marks)**

Q3. i) Explain why Foreign Exchange (FX) risks are crucial to a business involved in exports and imports. **(4 marks)**

ii) You are given the following exchange rates by the bank.

GBP/USD spot 1.5440 - 1.5450

USD/FFR spot 5.1171- 5.1195

USD/ DM spot 1.4870- 1.4875

Required: Calculate the exchange rates for following:

a) GBP/ FFR and indicate the amount which a bank would buy 1,000 FFR spot **(8 marks)**

b) DM/ FFR At what amount would a customer sell DM 1,000 to a bank. **(8marks)**

Q4. a) There has been a raging debate on whether it is a good or bad thing to set a CAP and a FLOOR on interest rate charged by commercial banks.

Required:

Discuss the merits and demerits (if any) of the above legislation and indicating how the rates are set, how regularly, and the prevailing rates today. **(20 marks)**

END