THE CATHOLIC UNIVERSITY OF EASTERN AFRICA

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MAIN EXAMINATION

SEPTEMBER – DECEMBER 2019 TRIMESTER

SCHOOL OF BUSINESS

DEPARTMENT OF ACCOUNTING AND FINANCE

REGULAR/ODEL PROGRAMME

CFI 413: FINANCIAL RISK MANAGEMENT

Date: DECEMBER 2019	**Duration: 2 Hours**
INSTRUCTIONS: Answer Question ONE and any other TWO Questions	

Q1. a) In an organization who is responsible for overall risk management and why? **(4 marks)**

b) Describe the objectives of Financial Risk Management in details **(16 marks)**

c) Calculation of forward –forward rate related to yield curves is crucial in financial risk management. You are given the following:
If three months (90 days) interest rate is 3.82% and six months (183 days) interest rate is 4.0% calculate the 3x6 forward rate for an investor who chooses to invest for three months, immediately followed by another three months as opposed to making a direct investment for six months at once and show proof of the accuracy of your calculation (to 5 decimal points). **(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:

a) 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 1^{st} 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 contact 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.

(15marks).

Q3. Foreign Exchange (FX) risks are crucial to a business involved in exports of goods.

a) Describe associated currency risks and indicate the options available for hedging those risks of receivables **(10 marks)**

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:

b) GBP/ FFR and indicate the rate at which a bank would buy FFR spot. **(5 marks)**

c) DM/ FFR and indicate at what rate would a customer sell DM to a bank at spot. **(5 marks)**

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:

b) 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