THE CATHOLIC UNIVERSITY OF EASTERN AFRICA

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MAIN EXAMINATION

SEPTEMBER – DECEMBER 2019 TRIMESTER

SCHOOL OF BUSINESS

MBA – REGULAR/ODEL PROGRAMME

CFI 612: INTERNATIONAL FINANCE AND DERIVATIVE SECURITIES

Date: DECEMBER 2019	**Duration: 3 Hours**
INSTRUCTIONS: Answer ALL FIVE Questions	

Q1. ‘’ Treasurers need to have plans to help them to manage financial risks on behalf of the board of directors’

a) In any organization standpoint discuss who is responsible for enterprise risk management and why, indicating how it is implemented. **(6 marks)**
b) Discuss typical steps for effective hedging financial risk in an organization such as an airline with regard to jet fuel oil. **(14 marks)**

Q2. Your company has $ 100 million floating rate borrowing with a three month rollover next due on 1st March. As the treasurer you believe that interest rates will be on the rise and wish to hedge interest costs until the time of the next rollover. Today is 1st January and the forward –forward rate of interest from 1st March is 7.9125% while March Eurodollar contract price is 92.00 . On 1st March 3 month dollar actual rate is 10% and March Eurodollar Futures contract price is 89.95%.
Required:
i) Explain briefly the working of a futures market and highlight why it does not pose any counterparty risk. **(5marks)**
ii) Prepare a schedule to show (side by side) the cash flow results of a hedged versus a nil hedge positions and explain the effectiveness of the hedge (if at all) as well as the reason for the discrepancy of the results **(15 marks)**

Q3. Your company has a £ 10 million long term loan with interest rate set at 6 months LIBOR + 30 basis point (bp). You are considering FRAS to hedge interest cost due from

1st July to 31 December 2012.

Today is 1st February 2012 and your bank has displayed the following market rates for

FRAS (over the counter):

5v6	5.6% - 5.8%
5V 11	5.3%- 5.5%
6v 12	5.2%- 5.4%

Outturn six months LIBOR rates (the actual outturn) FRA rates are as follow:

1st February	5.8% - 6.0%
1st July	4.8%- 5.0%
1st October	4.60%- 4.62%
31st December	4.10%- 4.14%

Required:

i) As the Financial Risk Manager explain to the Board what action you should take and explain the term to " hedge interest risk" and its overall effect. **(4 marks)**

ii) Calculate the total cost of borrowing taking into the account an additional 30bp is added to the libor outturn rate as a premium. **(8 marks)**

iii) What is the effective cost of borrowing and show proof that it is equal to the hedged (lock in rate) **(4 marks)**

iv) Recalculate the above effective rate (under iii above) in a compounded annualized interest rate and explain the reason for the difference.

(4marks).

Q4. a) Currency forecasting is of crucial importance to multinational companies. Discuss the classes of foreign exchange risks faced by multinational companies indicating how to mitigate against the FX risk arising from each class of risk respectively. **(15 marks)**

c) Calculate how many HKD would a bank pay to a customer for CHF 1000 based on the following bank quote and indicate why:

USD/ CHF	1.4920/30
USD/HKD	8.0750/60

(5 marks)

Q5 An Interest Rate Swap (IRS) dates back to the 1980s and is now the most popular Financial Derivative.

a) Define an IRS and explain how it is operated ?

(3marks)

b) A Ltd is a high rated company at AAA and can borrow at a fixed rate of 10% or at a floating rate of LIBOR + 30 bp but would like to borrow at a floating rate . Conversely, B Ltd has a low credit rating at BBB and can borrow at a fixed rate of 11% or at a floating rate of LIBOR+ 50bp but would like to borrow at a fixed rate.

As an expert on IRS derivative set out cash flows illustrations on how the two Companies can enter into an IRS with a view to achieving savings on interest Costs and present the final results in a diagram.

(12 marks)

c) What are the pros and cons of arranging an IRS through an intermediary rather than a counter party directly?

(5 marks)

END