MAASAI MARA UNIVERSITY

REGULAR UNIVERSITY EXAMINATIONS
2020/2021 ACADEMIC YEAR
FOURTH YEAR SECOND SEMESTER

SCHOOL OF BUSINESS AND ECONOMICS
BACHELOR OF BUSINESS MANAGEMENT

COURSE CODE: ECF 4203

COURSE TITLE: MANAGEMENT OF FINANCIAL INSTITUTIONS

DATE: 14^{TH} OCTOBER, 2021 TIME: 1100 – 1300HRS

INSTRUCTIONS TO CANDIDATES

Answer question **ONE** and any other **THREE** questions

QUESTION ONE [25 MARKS]

a) Briefly explain the three major functions of financial markets. [6 Marks]
b) Discuss three approaches to credit risk mitigation. [6 Marks]
c) Define a derivative and outline three types of derivatives that a financial institution can use to hedge against exposure to various risks. [4 Marks]
d) Clearly explain the difference between speculation, hedging and insurance in relation to management of financial risk in institutions [3 Marks]
e) Clearly explain the differences between marginal VaR, incremental VaR and Component VaRfor a portfolio consisting of a number of assets. [6 Marks]

QUESTION TWO[15 MARKS]

a) Discuss the measures that an investment firm can put in place to minimize their exposure to market risk [6 Marks]
b) Risk management affects the optimal capital structure of a firm. Discuss [4 Marks]
c) Define operational risk giving the different categories and 3 real life examples of operationalrisk and how to manage them [5 Marks]

QUESTION THREE [15 MARKS]

a) Describe the three pillars of the Basel II Accord and how they influence the banking regulations implemented in Kenya [7 Marks]
b) Explain the difference between credit risk and market risk in a financial contract [4 Marks]
c) A trader in a financial institution buys a corporate bond. The trader pays in USD for the bond,holds it for 2 weeks and then sells it again in USD, to a client. The bank accounts and funds in Kenya shilling. Outline all the operational and reputational risk one can think of in the transaction [4 marks]

QUESTION FOUR[15 MARKS]

a) Clearly explain each of the following terms, giving examples and two measures a financial risk manager would put in place to manage each of the risks for a financial institution.
   i) Interest rate risk [4 marks]
   ii) Liquidity risk [4 Marks]

b) Discuss the importance of financial risk management for banking institutions [7 Marks]

QUESTION FIVE [15 MARKS]

a) Explain using an example how a firm can hedge against losses arising as a result of commodity price fluctuations using derivatives [5 Marks]
b) Explain how risk management can add value to a financial institution. [5 Marks]
c) If financial markets are perfect, discuss how hedging affects the firm value. [5 marks]

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