UNIVERSITY OF JOHANNESBURG

FACULTY OF MANAGEMENT
DEPARTMENT OF BUSINESS MANAGEMENT
FINAL WRITTEN ASSESSMENT

SUBJECT:	RISK FINANCING
CODE:	AC1RFIN
DATE:	13 November 2019
TIME ALLOWED:	120 minutes
TOTAL MARKS:	100

ASSESSOR:	Mrs I O’Leary-Govender
MODERATOR:	Mr Yatish Singh
NUMBER OF PAGES:	12

INSTRUCTIONS:

- This is a closed-book assessment.
- Question papers must be handed in together with your answer books.
- Read the questions carefully and answer only what is asked.
- Answer all the questions:
    - Answer **Section A** in the back of the answer book on the answer sheet provided. Indicate the correct answer as per the instructions.
    - Answer **Section B** in the answer book.
- Number your answers clearly.
- Write neatly and legibly on both sides of the paper in the answer book, starting
- on the first page.
- Structure your answers by using appropriate headings and subheadings.
- The general University of Johannesburg policies, procedures and rules pertaining to written assessments apply to this assessment.

SECTION A [40 MARKS]

QUESTION 1

To be insurable, a risk must have potential losses that are:
A. under the control of the insured
B. centrally located
C. predictable
D. unmeasurable

QUESTION 2

Uncertainty about outcomes that can be either positive or negative is known as:
A. Hazard
B. Risk
C. Speculation
D. Peril

QUESTION 3

Which type of risk presents only the chance of loss or no loss?
A. Pure risk
B. Speculative risk
C. Financial risk
D. Strategic risk

QUESTION 4

A systemic risk involves:
A. A risk that loss in one area of an organization may cause loss in another area of the organization
B. A risk that all of the current suppliers of an organization’s inputs will be unable to produce the inputs
C. A risk that an event will cause multiple key people in an organization to leave at once
D. A potential major disruption in the function of an entire market or financial system

QUESTION 5

What is the difference between risk and uncertainty?
A. Under risk, information is reliable; under uncertainty, it is not.
B. Under risk, choices are clear and the chances of different outcomes can be measured; under uncertainty, neither applies.
C. Under risk, probabilities can be measured; under uncertainty, they cannot.
D. Under risk, there is a well-defined problem; under uncertainty, the definition is unclear.

QUESTION 6

Which of the following are risks faced by banks?
A. Investment
B. Credit
C. Capital
D. All of the above

QUESTION 7

Financial markets have the basic function of:
A. Bringing together people with funds to lend and people who need funds.
B. Assuring that the swings in the business cycle are less pronounced.
C. Assuring that governments need never resort to printing money.
D. Both A and B of the above

QUESTION 8

Which of the following can be described as involving indirect finance?
A. A corporation’s shares are traded in an over-the-counter market.
B. People buy shares in a mutual fund.
C. A pension fund manager buys commercial paper in the secondary market.
D. All of the above.

QUESTION 9

The capital markets consist of the primary market and secondary market. Which of the following statements is *true* regarding the differences between the two markets?
A. New issues are distributed to investors in the primary market while existing securities are traded in the secondary market.
B. Existing securities are traded in the primary market while new issues are distributed to investors in the secondary market.
C. New issues are traded in the primary market while existing securities are distributed in the secondary market.
D. Existing securities are distributed to investors in the primary market while new issues are traded in the secondary market.

QUESTION 10

Which of the following is/are characteristic(s) of money market instruments?
A. Liquidity
B. Marketability
C. Low risk
D. All of the above

QUESTION 11

Which of the following are money market instruments?
A. A negotiable certificate of deposit
B. A banker's acceptance
C. A government Treasury Bond
D Both A and B of the above

QUESTION 12

Which of the following statements about the characteristics of debt and equity are true?
A. They can both be long-term financial instruments.
B. They both involve a claim on the issuer's income.
C. They both enable a corporation to raise funds.
D. All of the above

QUESTION 13

The interest rate charged by banks with excess reserves at a Reserve Bank to banks needing overnight loans to meet reserve requirements is the:
A. prime rate
B. discount rate
C. repo rate
D. call money rate

QUESTION 14

What does the term "negotiable" mean with regard to negotiable certificates of deposit?
A. The CD can be sold to another investor if the owner needs to cash it in before its maturity date.
B. The rate of interest on the CD is subject to negotiation.
C. The CD is automatically reinvested at its maturity date.
D. The interest rate paid on the CD will vary with a designated market rate.

QUESTION 15

Which of the following statements is true?
I. The coupon rate is the rate of interest that the issuer of the bond must pay.
II. The coupon rate is usually fixed for the duration of the bond and does not fluctuate with market interest rates.
A. I only
B. II only
C. I and II
D. Neither I or II

QUESTION 16

Sipho makes the following statements:
I. A common share in a firm represents an ownership interest in that firm.
II. A preferred share is as much like a bond as it is like a common share.
A. I is true, II is false
B. I is false, II is true
C. Both are true
D. Both are false

QUESTION 17

Which index represents the performance of the U.K. stock market?
A. DAX
B. FTSE
C. Nikkei
D. Hang Seng

QUESTION 18

The exchange rate is:
A. The rate at which goods are sold in a country
B. The interest rate differential between two countries
C. The value of one currency in terms of another
D. The growth rate differential between two countries

QUESTION 19

When the value of the US dollar changes from R14.50 to R14.25, then the rand has _________ and the dollar has ________.
A. appreciated; depreciated
B. depreciated; appreciated
C. appreciated; appreciated
D. depreciated; depreciated

QUESTION 20

MNC Company had a dividend payout ratio of 40% in 2018. The retention rate in 2018 was?
A. 40%
B. 50%
C. 60%
D. 0%

QUESTION 21

The market price of a bond and the level of interest rates are
A. Positively related
B. Negatively related
C. Unrelated
D. Indirectly related

QUESTION 22

The annual interest paid on a bond relative to its prevailing market price is called its
A. Promised yield
B. Yield to maturity
C. Coupon rate
D. Current yield

QUESTION 23

Financial Risk is defined as:
A. uncertainties resulting in adverse variation of profitability or outright losses
B. uncertainties that result in outright losses
C. uncertainties in cash flow
D. variations in net cash flows

QUESTION 24

A transaction where financial securities are issued against the cash flow generated from a pool of assets is called:
A. Securitization
B. Derivatives
C. Bonds
D. Shares

QUESTION 25

An option which gives the holder the right to sell a share at a specified price at some time in the future is called a:
A. Call option
B. Put option
C. Future
D. Forward

QUESTION 26

Which of the following is false?
A. Futures contracts trade on a financial exchange.
B. Futures contracts are more liquid than forward contracts.
C. Futures contracts allow fewer delivery options than forward contracts.
D. Futures contracts are marked to market.

QUESTION 27

If the exercise price of a put option is less than the spot price of the asset, the put option is:
A. In the money
B. At the money
C. Out of the money
D. Near the money

QUESTION 28

Options have:
A. Intrinsic Value
B. Time value
C. Premiums
D. All of the above

QUESTION 29

All of the following derivatives have no upfront cost *except*?
A. Futures
B. Forwards
C. Swaps
D. Options

QUESTION 30

Which of the following is potentially obligated to sell an asset at a predetermined price?
A. The buyer of a call option
B. The seller of a call option
C. The buyer of a put option
D. The seller of a put option

QUESTION 31

Present value is based on the concept of:
A. Compounding
B. Standard deviation
C. Variance
D. Discounting

QUESTION 32

According to the dividend growth model, the value of company's share would be based on:
A. Earnings
B. Dividends
C. Profit
D. Net Income

SECTION B [60 MARKS]

QUESTION 1 [10]

1.1. Define economic risks and pure risks. (4)

1.2. Distinguish between perils and hazards. (2)

1.3. Identify and briefly describe two types of hazards with examples. (4)

QUESTION 2 [10]

2.1. Distinguish between the two components of the financial market in which assets trade. (4)

2.2. Discuss the importance of an active secondary market? (6)

QUESTION 3 [8]

3.1. Assume that accrued interest on corporate bonds is calculated on a (30/360) day basis, i.e., each month has 30 days and the year has 360 days. You bought a 6% corporate bond on Friday, 21 October 2018. The face value of the bond is R1 000. Coupon payments are made on 1 January and 1 July each. Calculate the accrued interest for this bond. (4)

3.2. ABC Corporation had earnings of R5 million and R2 million for year ending 2018 and 2017 and shareholders equity of R25million. ABC has, in the past, paid out 60% of its earnings as dividends. What is ABC's sustainable growth rate for 2018? (4)

QUESTION 4 [12]

4.1. Discuss reinvestment risk, counterparty risk and liquidity risk as they relate to money market funds. (6)

4.2. Define a government bond and discuss the impact of inflation risk and currency risk when investing in government bonds. (6)

QUESTION 5 **[20]**

5.1. Briefly explain exchange rates and distinguish between bid and ask prices and the bid/ask spread. (4)

5.2. Briefly discuss foreign exchange risk exposure. (2)

5.3. Discuss and compare the costs of hedging via the forward contract and the options contract. (2)

5.4. Discuss how options contracts can be used to: (6)

5.4.1. Hedge import payments

5.4.2. Hedge against currency risks between the submission and awarding of tender contracts

5.4.3. Hedge against uncertain future payments

5.5. Consider the following to options on a share from ABC Corporation: (6)

Option	**Exercise Price**	**Spot Price**
Call May	R95	R 1.50
Put May	R95	R 3.50

As an investor, you buy the call and put options listed above. Determine the total cost of your position and explain the circumstances under which the call and put options will be exercised, identifying your breakeven point and the maximum profit for the call and put options.