UNIVERSITY OF JOHANNESBURG

FACULTY OF MANAGEMENT
DEPARTMENT OF BUSINESS MANAGEMENT
SUPPLEMENTARY FINAL WRITTEN ASSESSMENT

SUBJECT:	RISK FINANCING
CODE:	AC1RFIN
DATE:	7 January 2020
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

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

QUESTION 2

The cause of loss or the contingency that may cause a loss is referred to as:
A. Risk
B. Peril
C. Danger
D. Hazards

QUESTION 3

The determination of whether a specific risk is tolerable will involve consideration of
  I. the size of the residual risk
  II. history of losses
  III. risk appetite for that risk
  IV. the cost of insurance
A. I and II
B. I, II and III
C. II and IV
D. II, III and IV

QUESTION 4

A potential major disruption in the function of an entire market or financial system is referred to as:
A. systemic risk
B. economic risk
C. financial risk
D. pure risk

QUESTION 5

Which of the following statements relating to risk and uncertainty is *true*?
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

All of the following are risks faced by banks *except*?
A. Investment
B. Credit
C. Capital
D. None of the above

QUESTION 7

Which of the following statements is *correct*?
A. The basic function of financial markets is to bring together people with funds to lend and people who need funds.
B. The basic function of financial markets is to ensure that the swings in the business cycle are less pronounced.
C. The basic function of financial markets is to ensure that governments need never resort to printing money.
D. Both A and B of the above

QUESTION 8

All of the following can be described as involving indirect finance *except*?
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. None of the above.

QUESTION 9

Which markets facilitate the trading of long term and short term instruments?
A. money and secondary markets
B. primary and secondary markets
C. capital and money markets
D. capital and secondary markets

QUESTION 10

All of the following are characteristics of money market instruments *except*?
A. Liquidity
B. Marketability
C. High risk
D. None of the above

QUESTION 11

Which of the following is not *a* money market instrument?
A. A negotiable certificate of deposit
B. A banker's acceptance
C. A government Treasury Bond
D. None of the above

QUESTION 12

Which of the following statements about the characteristics of debt and equity is incorrect?
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. None 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

Which of the following is used by the government to finance deficits?
A. NCD’s
B. T-Bills
C. Corporate Bonds
D. Public provident fund

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

Equity securities include:
I. Preference Shares
II. Bonds
III. Treasury bills
IV. Common shares
A. IV only
B. III and IV
C. I, II and IV
D. I and IV

QUESTION 17

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

QUESTION 18

Exchange rates are determined in the:
A. money market
B. foreign exchange market
C. stock market
D. capital market

QUESTION 19

When the value of the US dollar changes from R14.25 to R14.50, 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 retention ratio of 60% in 2018. The payout rate in 2018 was?
A. 40%
B. 50%
C. 60%
D. 0%

QUESTION 21

Bonds issued by corporations and exposed to default risk are classified as?
A. Corporate Bonds
B. Mortgages
C. Government bonds
D. None of the above

QUESTION 22

A coupon bond is a bond that:
A. pays interest on a regular basis (typically every six months)
B. does not pay interest on a regular basis but pays a lump sum at maturity
C. can always be converted into a specific number of shares of common stock in the issuing company
D. always sells at par

QUESTION 23

The current yield on a bond is equal to?
A. annual interest payment divided by the current market price
B. the yield to maturity
C. annual interest divided by the par value
D. the internal rate of return

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 buy 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 true?
I. Futures contracts trade on a financial exchange.
II. Futures contracts are more liquid than forward contracts.
III. Futures contracts allow fewer delivery options than forward contracts.
IV. Futures contracts are marked to market.
A. I and II
B. I, II and III
C. I, II and IV
D. I, II, III and IV

QUESTION 27

If the exercise price of a put option is greater 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

Futures have:
A. Counterparty risk
B. Time value
C. Margin requirements
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 buy 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 risk and uncertainty. (4)

1.2. Define pure risks. (2)

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

QUESTION 2 **[10]**

2.1. Distinguish between the primary and secondary markets in which assets trade. (4)

2.2. Discuss the different types of assets that trade in the financial markets? (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, 15 May 2019. 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. XYX Inc. had earnings of R15 million and R20 million for year ending 2017 and 2018 and shareholders' equity of R100million. XYZ has, in the past, paid out 50% of its earnings as dividends. What is XYZ'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 treasury securities and monetary policy and explain how SARB uses treasury securities to implement monetary policy? (6)

QUESTION 5 **[20]**

5.1. Briefly explain the difference between the following pairs of terms. (6)

5.1.1. Spot market and Forward market
5.1.2. Interest rate arbitrage and Covered interest arbitrage
5.1.3. Real exchange rate and Nominal exchange rate

5.2. Discuss the implications of the deviations from the purchasing power parity (PPP) for countries' competitive positions in the world market. (2)

5.3. Define the term hedging (2)

5.4. Define the term basis and explain why a short hedger's position improves when the basis strengthens unexpectedly. (6)

5.5. Consider the following to options on a share from ABC Corporation: (4)

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. Graph the profit potential of this spread position. Be sure to include labels on the y-axis and the values of where the combined position crosses the x-axis.