Students may answer any three questions of their choice.

1. The role of the financial system in a market economy, is to effectively and efficiently move funds from surplus budget units to deficit budget units.” “However, in absence of well functioning financial intermediaries small players are likely to be adversely affected.” Discuss. (20 marks)

2. Discuss the major factors influencing the development of retail financial services in the United States and the likely implications for retail financial services in a Caribbean country of your choice. (20 marks)

3. Critically evaluate the role of Credit Rating Agencies such Standard and Poor’s and Moody’s in promoting well functioning capital markets. (20 marks)

4. a) Explain clearly, the role of the yield curve in pricing financial assets. (10 marks)

   b) Outline and briefly evaluate the various theories explaining the shape of the yield curve at any point in time. (10 marks)
5. Describe the following options strategies, draw a payoff diagram for each strategy and identify when an investor would likely use such a strategy:

a) Buy a Call;  
   3 marks
b) Write a Call  
   3 marks
c) Buy a Put  
   3 marks
d) Covered call;  
   4 marks
e) Protective put;  
   4 marks
f) Covered put;  
   4 marks

6. Explain clearly why interest rates differ across various borrowers, across different countries and over time.  
   20 marks

7. a) Briefly explain the concept of the efficient market hypothesis and each of its three forms and briefly discuss the degree to which existing empirical evidence supports each of the three forms of the efficient market hypothesis.  
   12 marks

   b) Briefly discuss the implications of the efficient market hypothesis for investment policy as it applies to technical analysis in the form of charting, and fundamental analysis.  
   8 marks

8. a) Suppose that Ayana has arranged to borrow $200 ml at LIBOR plus 10 basis points, while Ayeshia has a three year loan of $200 ml at a fixed rate of 5.2%. Illustrate how the two firms can arrange a swap that transforms Ayana’s loan into a fixed rate loan and Ayeshia’s loan into a floating rate loan.  
   5 marks

   b) Suppose Rojan owns $300 ml in bonds that will provide interest at 4.7% per annum over the next three years. Mona Inc has an investment of $300 ml that yields LIBOR minus 20 basis points. Illustrate how a financial institution can arrange a swap that transforms Rojan’s bonds into a floating rate investment and Mona Inc’s investment into a fixed rate one.  
   5 marks

TURN OVER
c) Alicia Ltd wants to borrow in Australian dollars, while Ayaneisha Inc wants to borrow in US dollars. Both firms are faced with the following quotations:

<table>
<thead>
<tr>
<th></th>
<th>US Dollars</th>
<th>Australian Dollars</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alicia Ltd</td>
<td>5.0%</td>
<td>12.6%</td>
</tr>
<tr>
<td>Ayaneisha Inc</td>
<td>7.0%</td>
<td>13.0%</td>
</tr>
</tbody>
</table>

Illustrate how a financial institution can arrange a swap that allows each firm to have loan repayments in its preferred currency, while minimising the interest rate paid on each loan. Explain clearly, why the eventual interest rate paid is lower than if each firm had borrowed directly in its preferred currency.  

(10 marks)