CANDIDATE DETAILS

Access Number	Roll Number	For Official Use Only	Serial Number

Subject **FINANCIAL DERIVATIVES**	
Candidate's Name	
Father's Name	
CNIC Number	
Cell Number	E-mail
I verify that my particulars given above are correct and I declare that I have read the INSTRUCTIONS printed in the examination booklet, and/ or given in the ISQ Examination Guidelines, violation of which would mean cancellation of my paper and debarment from appearing in future examinations.	
Candidate's Signature	Invigilator's Signature

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The Institute of Bankers Pakistan

ISQ Examinations
Winter - 2018
AIBP
Financial Derivatives

SEAL
BOOK
HERE

Section 2
Subjective Questions

Number of Questions: 5
Marks: 40

Allotted time (Objective and Subjective): 3 hours

INSTRUCTIONS FOR THE CANDIDATE

1. The candidate must abide by the ISQ Examination Guidelines sent along with the admit card.
2. The candidate must sign the booklet after verifying the particulars and should **NOT** write his/ her name or roll number etc. on any other page of the examination booklet.
3. The candidate is advised **NOT** to approach the invigilators for seeking any explanation related to the questions in the examination paper.
4. Laptops, mobile phones or any other gadgets are **NOT** permitted in the examination hall. **ONLY** non-programmable scientific calculator is allowed. If any candidate is found in possession of any restricted gadgets or items, his/ her examination paper will be cancelled immediately.
5. The candidate must ensure that the examination booklet has all the pages duly numbered. If any page is missing, damaged or not numbered, then return the booklet to the superintendent/ invigilator and obtain another booklet.
6. Write your answer **ONLY** in the given space for each question. Anything written outside the given space will not be considered for marking.
7. **ONLY** blue or black ball points are to be used.
8. The candidate must attempt **ALL** questions in the paper.

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Marks Obtained	Q.1	Q.2	Q.3	Q.4	Q.5	Total Marks	Total in words
Marker - I							
Q.C							
Scrutiny							
Re-Scrutiny							
Marker– II							

Signatures:

1. Marker - I   2. QC   3. Scrutinizer   4. Re-Scrutinizer   5. Marker - II

Q 1.

A. Differentiate between Options and Futures Contracts. (5 Marks)

B. A Pakistan based company is engaged in import and export business. It is expected to settle following foreign currency transactions: (5 Marks)

Payment to US supplier in three months' time	=	USD 2,500,000
Receipts from German customer in six months' time	=	Euro 2,000,000
Receipts from Turkish customer in three months' time	=	USD 1,500,000

The bank is offering following rates:

	USD to PKR		Euro to PKR		Turkish Lira to PKR	
	Bid	Offer	Bid	Offer	Bid	Offer
Spot rate	125.00	127.00	150.00	152.50	26.00	27.00
One month forward rate	125.50	128.00	151.00	153.00	26.25	27.50
Three months' forward rate	126.50	128.50	152.50	154.00	26.75	28.00
Six months' forward rate	127.00	129.50	153.00	155.00	27.50	29.00

Required:
Suggest how hedging could be done by means of a forward contract.

Q 2. Q Limited (QL), a listed company, had recently issued debt finance for acquiring plant and machinery to increase its activity levels. The debt finance is a floating rate bond, with a face value of Rs. 320 million redeemable in four years. The mark-up on bond is payable annually, and is based on Karachi Interbank Offer Rate (KIBOR) plus 60 basis points. The next annual payment is due at the end of year one.

QL is concerned that the expected rise in KIBOR rates over the coming few years would make it increasingly difficult to pay the mark-up due. It is therefore proposing to swap the floating rate interest payment to a fixed rate payment.

Y Bank (YB) has offered QL a swap agreement, whereby QL would pay YB mark-up based on equivalent mark-up based on fixed annual rate of 10.7625% in exchange for receiving a variable amount based on current KIBOR rates. Payment and receipts will be made at the end of each year, for the next four years. YB will charge an annual fee of 20 basis points if the swap is agreed and will also guarantee the swap. The current KIBOR rates are as follows:

Year	One	Two	Three	Four
Rate	9.5%	10.1%	10.5%	10.8%

The current annual forward rates for years two, three and four are as follows:

Year	Two	Three	Four
Rate	10.7%	11.3%	11.7%

Required:

A. Based on the above information, calculate the amounts QL expects to pay or receive every year on the swap (excluding the fee of 20 basis points). Explain why the fixed annual profit rate of 10.7625% is less than the four year KIBOR of 10.8%. (5 marks)

B. Demonstrate that QL's mark-up payment liability does not change, after it had undertaken the swap, whether the mark-up rates increase or decrease. (5 marks)

Q 3. Arbitrage opportunity exists when future price of commodity is greater than the spot price during the delivery period. Discuss, whether it is possible to get arbitrage opportunity if future prices are less than spot prices? (5 Marks)

Q 4. Explain the difference between Credit Risk and Market Risk.

(5 Marks)

Q 5.

A. Explain two various types of derivative instruments traded on stock exchange.

(5 Marks)

B. Discuss the risks associated with trading in derivatives. (5 Marks)

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