- A. To provide a forum for buying and selling stocks
- B. To set the prices of stocks
- C. To regulate the stock market
- D. All of the above

Answer: D

5. What is a primary market?
   - A. A market where new securities are sold for the first time
   - B. A market where existing securities are traded
   - C. A market where securities are traded over the counter
   - D. None of the above

Answer: A

Section B: Short Answer Questions (50 marks)

1. Explain the different types of financial markets.
2. Discuss the functions of financial markets.
3. Describe the different types of financial institutions.
4. Explain the role of financial intermediaries in the financial system.
5. Discuss the importance of financial markets and institutions in the economy.

Sample Answers

1. Explain the different types of financial markets.

There are two main types of financial markets: money markets and capital markets.

- Money markets: Money markets are for short-term securities, such as Treasury bills, commercial paper, and certificates of deposit. Money market securities are typically used by businesses and investors to meet their short-term liquidity needs.
- Capital markets: Capital markets are for long-term securities, such as stocks, bonds, and mutual funds. Capital market securities are typically used by

businesses to raise capital for investment and by investors to save for retirement or other long-term goals.

In addition to the two main types of financial markets, there are also a number of specialized financial markets, such as the foreign exchange market, the derivatives market, and the insurance market.

2. Discuss the functions of financial markets.

Financial markets perform a number of important functions in the economy. These functions include:

- Mobilizing savings and investment: Financial markets provide a way for businesses and investors to connect with each other. This allows businesses to raise capital for investment and investors to save for retirement or other long-term goals.
- Pricing financial assets: Financial markets provide a mechanism for setting the prices of financial assets. This helps to ensure that financial assets are traded at a fair price.
- Providing hedging and speculation opportunities: Financial markets allow businesses and investors to hedge against risk and speculate on future price movements. This can help businesses to reduce their risk and investors to generate higher returns.

3. Describe the different types of financial institutions.

There are two main types of financial institutions: depository institutions and non-depository institutions.

- Depository institutions: Depository institutions are financial institutions that accept deposits from the public. These institutions include commercial banks, savings banks, and credit unions. Depository institutions use these deposits to make loans to businesses and consumers.
- Non-depository institutions: Non-depository institutions are financial institutions that do not accept deposits from the public. These institutions include investment banks, insurance companies, and mutual fund companies. Non-depository institutions raise funds by issuing securities or borrowing from banks.

4. Explain the role of financial intermediaries in the financial system.

Financial markets perform a number of important functions, including:

- Providing a means for businesses to raise capital
- Facilitating the transfer of risk
- Providing information about the value of assets
- Determining the cost of capital

4. What are the different types of financial instruments?

Answer:

Financial instruments can be classified into two main types: debt and equity. Debt instruments, such as bonds, represent a loan to the issuer. Equity instruments, such as shares, represent ownership in the issuer.

5. What are the factors that affect the yield on a bond?

Answer:

The yield on a bond is affected by a number of factors, including:

- Term to maturity: Longer-term bonds generally have higher yields than shorter-term bonds.
- Credit risk: Bonds issued by riskier borrowers generally have higher yields than bonds issued by less risky borrowers.
- Liquidity: Bonds that are more liquid, meaning that they can be easily traded, generally have lower yields than bonds that are less liquid.

Section C: Essay (10 marks)

1. Discuss the role of financial markets and institutions in the economy.

Answer:

Financial markets and institutions play a vital role in the economy by providing a means for businesses to raise capital, facilitating the transfer of risk, providing information about the value of assets, and determining the cost of capital.

like open market operations and changes in the discount rate to influence the money supply and, in turn, the economy's performance.

8. Primary financial markets are where newly issued securities are bought and sold, often through an initial public offering (IPO). Examples include the issuance of shares by a company during its IPO. Secondary financial markets are where existing securities are traded, like the stock exchange where investors buy and sell shares of publicly traded companies.

9. Investment banks serve as intermediaries between companies and investors. They offer services such as underwriting securities, providing mergers and acquisitions advice, and facilitating the trading of financial instruments like stocks and bonds.

Section C:

10. The 2008 financial crisis was primarily caused by the bursting of the housing bubble, excessive risk-taking by financial institutions, and the proliferation of complex financial products. Consequences included a severe economic downturn and massive government bailouts. Regulatory changes included the Dodd-Frank Wall Street Reform and Consumer Protection Act, which aimed to strengthen financial regulations and consumer protection.

11. Risk management in financial institutions involves identifying, assessing, and mitigating various risks, including credit risk, market risk, and operational risk. Strategies for risk management can include diversifying investments, setting risk limits, and using derivatives to hedge against market fluctuations. For example, a bank might use credit risk models to assess the likelihood of borrower defaults and then make decisions on loan approvals based on those assessments.