

The
Management
University
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UNDERGRADUATE UNIVERSITY EXAMINATIONS

SCHOOL OF MANAGEMENT AND LEADERSHIP

DEGREE OF BACHELOR OF COMMERCE

FIN 421: SECURITY ANALYSIS AND SECURITIZATION

DATE: 9TH APRIL 2026

DURATION: 2 HOURS

MAXIMUM MARKS: 70

INSTRUCTIONS:

1. Write your registration number on the answer booklet.
2. **DO NOT** write on this question paper.
3. This paper contains **SIX (6)** questions.
4. Question **ONE** is compulsory.
5. Answer any other **THREE** questions.
6. Question **ONE** carries **25 MARKS** and the rest carry **15 MARKS** each.
7. **Write all your answers in the Examination answer booklet provided.**

QUESTION ONE

Read the Case Study below carefully and answer the questions that follow:

SECURITY AND SECURITIZATION AT ABC BANK LIMITED

ABC Bank, one of Kenya's leading financial institutions, recently faced a challenge related to loan defaults. As the economy slowed down due to external factors like the COVID-19 pandemic and fluctuating commodity prices, many borrowers, especially small and medium-sized enterprises (SMEs), struggled to repay their loans. The bank had granted a large number of unsecured loans, which increased the risk of bad debt. To mitigate this risk, ABC Bank turned to securitization, a financial practice that allows banks to transform these loans into tradeable securities, which can then be sold to investors.

The process began with ABC Bank identifying a pool of performing loans that could be securitized. These loans were bundled together to create a collateralized debt obligation (CDO). ABC Bank then sold the CDO to institutional investors, such as pension funds and insurance companies. By securitizing these loans, ABC Bank transferred the risk associated with the loans to the investors, while also receiving upfront cash that could be used to lend more money or invest in other ventures.

Kenya's legal framework for securitization is governed by the Capital Markets (Asset-Backed Securities) Regulations, which provide a legal foundation for banks and other financial institutions to engage in this process. ABC Bank had to comply with strict regulatory requirements to ensure that the securitization process was transparent and that the rights of investors were protected. These regulations require the bank to disclose detailed information about the underlying loans, the risks involved, and the expected returns.

Securitization has become an increasingly popular tool for banks in Kenya as they seek to manage risk and improve liquidity. However, it is not without challenges. ABC Bank had to carefully assess the creditworthiness

of the loans selected for securitization to minimize the risk of default. Additionally, there was the challenge of market acceptance, as some investors were hesitant to invest in securities backed by SME loans, which are considered riskier than corporate or government bonds.

In the end, the securitization allowed ABC Bank to reduce its exposure to non-performing loans while simultaneously generating funds for new lending. This case highlights the growing importance of securitization in Kenya's financial sector as a means of managing risk and supporting economic growth through the extension of credit.

Required:

- a) Discuss four ways that ABC Bank used securitization to manage its loan portfolio.

(5 Marks)

- b) Examine five roles of the Capital Markets (Asset-Backed Securities) Regulations in facilitating securitization in Kenya

(5 Marks)

- c) Discuss three challenges faced by ABC Bank in the process of securitization

(5 Marks)

- d) Evaluate five benefits of securitization to banks like ABC Bank and investors in the Kenyan financial sector

(5 Marks)

- e) Discuss five risks associated with investing in securities backed by SME loans, as seen in ABC Bank's case

(5 Marks)

QUESTION TWO

- a) Discuss five roles of capital markets in the financial system.

(8 Marks)

- b) Describe the implications of the Efficient Market Hypothesis (EMH) for financial decision-makers.

(7 Marks)

QUESTION THREE

- (a) Discuss how bond prices are affected by changes in interest rates, using examples to illustrate the relationship between bond prices and interest rate fluctuations.

(7 Marks)

- (b) Assume you purchased a bond with a face value of Ksh 1,000,000, a coupon rate of 8%, and a maturity of 10 years. Calculate the bond price if the market interest rate is currently 6%. Use the present value formula for bond pricing.

(8 Marks)

QUESTION FOUR

- a) Explain the relationship between dividends and common stock value, focusing on the Present Value of Perpetual Dividend Growth model.

(8 Marks)

- b) A company is expected to pay a dividend of Ksh 10 per share next year, with a dividend growth rate of 5% per year indefinitely. If the required rate of return is 12%, calculate the value of the stock using the Gordon Growth Model (Dividend Discount Model).

(7 Marks)

QUESTION FIVE

- a) Discuss five different types of risks that investors face when investing in financial markets.

(8 Marks)

- b) Examine three ways in which an investor can mitigate the effects of market risk and liquidity risk when building an investment portfolio.

(7 Marks)

QUESTION SIX

- a) Describe FOUR principles of security analysis and explain its role in the investment decision-making process.

(8 Marks)

- b) Elaborate three ways how industry analysis contributes to effective security analysis. **(7**

Marks)