



UNIVERSITI KUALA LUMPUR
BUSINESS SCHOOL

FINAL EXAMINATION
OCTOBER 2025 SEMESTER

COURSE CODE : EGB20403
COURSE TITLE : CAPITAL MARKET AND FINANCIAL INSTITUTIONS
PROGRAMME NAME : BACHELOR OF SCIENCE (HONS) IN ANALYTICAL ECONOMICS
DATE : 27 JANUARY 2026
TIME : 9:00AM - 12:00PM
DURATION : 3 HOURS

INSTRUCTIONS TO CANDIDATES

1. Please read the instructions given in the question paper CAREFULLY.
2. This question paper is printed on both sides of the paper.
3. This question paper consist of ONE sections.
4. Section A consist of five questions. Answer FOUR (4) questions only.
5. Please write your answer on the answer booklet provided.
6. Please answer all questions in English only.
7. Refer to the attached Formula/ Appendies. Tick if applicable

THERE ARE 6 PAGES OF QUESTIONS INCLUDING THIS PAGE

SECTION A (Total: 100 marks)

Answer FOUR (4) questions.

Please use the answer booklet provided.

Question 1

Answer the following questions.

- (a) Explain the main economic functions of derivative markets in the financial system. Discuss at least three (3) of the following aspects, using clear examples where appropriate:
- (i) Risk transfer and hedging.
 - (ii) Price discovery.
 - (iii) Market completeness and arbitrage.
 - (iv) Liquidity and cost of trading.

(9 marks)

- (b) A flour mill expects to purchase 50,000 bushels of wheat in three months' time. The current spot price of wheat is RM4.00 per bushel, and the 3-month wheat futures price is RM4.10 per bushel. Each wheat futures contract is for 5,000 bushels.

- i. Specify an appropriate hedging strategy using wheat futures: state clearly whether the mill should go long or short, and the number of contracts required.

(3 marks)

- ii. Assuming basis remains constant, calculate the mill's effective purchase price per bushel in each of the following scenarios at maturity:

Scenario 1: Spot price at maturity, $S_T = \text{RM}3.60$; futures price at maturity, $F_T = \text{RM}3.70$

Scenario 2: Spot price at maturity, $S_T = \text{RM}4.40$; futures price at maturity, $F_T = \text{RM}4.50$

Comment briefly on how effective the hedge is in stabilising the mill's wheat purchase cost.

(7 marks)

- (c) Derivatives are widely used in risk management, but they also introduce additional risks to financial institutions. Identify and briefly explain three (3) major types of risk associated with derivative positions and describe one risk-management practice or mechanism for each type of risk that can be used to mitigate it.

(6 marks)

Question 2

Answer the following questions.

- (a) Classify derivative instruments by underlying asset (commodity vs financial) and by payoff structure (linear vs nonlinear), giving one relevant example for each category.
- (b) Using a crude oil producer–consumer scenario, explain how a linear derivative creates a risk-sharing arrangement, while a nonlinear derivative creates an insurance type arrangement.
- (c) Define a swap contract and explain why it is classified as a linear payoff derivative used for risk management.
- (d) Choose any three (3) swap types and outline the cash flows exchanged between counterparties and the risk exposure each swap is designed to manage.

(10 marks)

(5 marks)

(4 marks)

(6 marks)

Question 3

Answer the following questions.

- (a) Define the debt market (2 marks)
- (b) Distinguish money market from bond market instruments. (6 marks)
- (c) State the main features of a bond. (8 marks)
- (d) Identify government bonds, corporate bonds, and one other bond sector, and for each state who issues them, why funds are raised, and one key risk or feature investors should consider. (9 marks)

Question 4

Answer the following questions.

- (a) Explain how the required yield on a bond is determined in the market. (5 marks)
- (b) Discuss any four (4) factors that influence a bond's required yield, (10 marks)
- (c) Define the term structure of interest rates. (2 marks)
- (d) Use the expectations, liquidity preference, and preferred habitat/market segmentation theories to interpret three main shapes of yield curve. (8 marks)

Question 5

Answer the following question.

- (a) Explain how the foreign exchange (FX) market works, how exchange rates are quoted, and the difference between spot and forward FX transactions.

(9 marks)

- (b) A Malaysian company expects USD receipts and EUR payments over the next year. Explain its main FX exposures and how FX forwards, futures, swaps, and options can be used to hedge them.

(10 marks)

- (c) Discuss three (3) key considerations or limitations a firm should consider before using derivatives to hedge its FX exposure, focusing on when hedging may be costly, ineffective, or create new risks.

(6 marks)

END OF EXAMINATION PAPER