Roll No……..……..

Membership No……

The Institute of Chartered Accountants of India
Forex & Treasury Management Certificate Course
Evaluation Test Booklet

Paper 2

31st January, 2016

Duration- 3 Hours **Total Marks- 100**

INSTRUCTIONS:

1. Please read the instructions carefully given in the question paper and solve it in the space provided.
2. The candidates are not allowed to carry the evaluation test booklet with them. This should be tied up with sheets provided to answer the question Paper.
3. Use Blue/Black pen only.
4. Do not write your Roll No. or Name or other identification other than in the space (perforated) provided on this sheet.
5. Please show Identity Card to the invigilator for verification of your identity, when asked.
6. The candidates may use the simple calculator.
7. In order to get full credit on the problems, the candidates must show all their rough work/ other workings.

(Participant Signature) (Invigilator Signature)

PLEASE RETURN THIS BOOKLET BEFORE LEAVING THE EXAMINATION HALL

Date : 31st January, 2016
Centre : Delhi/ Mumbai /Chennai/Kolkata/Kanpur/Bangalore

(Do not write your Roll No. and Membership number anywhere in the answer sheet except as mentioned above)

Checked by **Verified by**

CERTIFICATION COURSE ON FOREX AND TREASURY MANAGEMENT

S. No.	Total Number of Questions	Questions to be answered	Total Marks	Marks Obtained
Multiple Choice - Section A	65	65	65	
Short Notes – Section B	7	5	25	
Case Study – Section C	2	1	10	
Total	**74**	**71**	**100**	

Section A

Number of questions: 65

Marks: 65

Multiple choices: Please [✔] mark for the correct answer.

Part A: Answer all questions. **1 mark each**

1. When using the Internet to access auction markets, companies may use certificate authorities to reduce their exposure to which of the following types of risk?
(A) Credit
(B) Valuation
(C) Counterparty
(D) Foreign exchange

2. A company can pay their supplier by check or by electronic transfer. If the difference between the value date of the payment methods is 4 days from the company's perspective, what discount should the supplier offer them to get the company to pay on the same day as they did when they paid by check (rounded to the nearest 100th percent)? Assume no difference in the cost of the payment method, an opportunity cost of 8%, and float neutrality.
(A) 2.00%
(B) 0.09%
(C) 0.87%
(D) 0.02%

3. An airline wants to lock in the price of the jet fuel it needs to purchase to satisfy the peak in-season demand for travel. The airline wants to manage its exposure to fluctuations in fuel prices. What type of exposure is this?
(A) Translation
(B) Delivery
(C) Commodity
(D) Speculative

4. After a recent review of its insurance policies, a petroleum products company determines it needs to re-evaluate its risk exposure to potentially reduce its insurance premiums. The company has operated in two locations for 20 years but only produces and stores petroleum at one location. In doing so, the risk manager determine the following exposures: The number of employee workers compensation claims due to injuries while loading trucks has increased 25% in the past 12 months.

The primary tank used for petroleum storage is 13 years old and standard life of tanks of this model is 20 years.
There is only one road into the current petroleum storage facility.
Given the above information, if the risk manager constructs a second road into the petroleum storage facility, what risk management strategy is being used?

(A) Risk avoidance
(B) Transference of risk
(C) Risk mitigation
(D) Keep the risk

5. The treasury manager of a privately held company is looking to finance new equipment that has a useful life of 5 years. What type of financing would the Treasury Manager MOST LIKELY employ to finance the equipment?
   (A) Equity shares
   (B) Long-term bond
   (C) High-yield bond
   (D) Instalment term loan

6. A company has decided to manage its short-term investment portfolio in-house. It is looking for enhanced capital gains as well as the ability to sell the instruments on the secondary market at a premium. The investment manager has forecasted the interest rates shown below:

Month	**Short-term rates**	**Long-term rates**
January	0.25%	0.27%
February	0.28%	0.30%
March	0.26%	0.29%
April	0.24%	0.27%
May	0.25%	0.28%
June	0.26%	0.29%

   Which investment strategy should be employed by the company?
   (A) Passive strategy
   (B) Matching strategy
   (C) Tax-based strategy
   (D) Total-return strategy

7. Brazilian corporation purchases finished products from a German subsidiary and sells raw materials to the subsidiary several times in one month. To minimize foreign exchange transaction costs, the Brazilian corporation's cash manager would MOST LIKELY use:
   (A) Bilateral netting.
   (B) Multilateral netting.
   (C) Forward options.

(D) Pooling

8. A manufacturing company is working to improve its cash conversion cycle. Factory production has increased over the last year to increase inventory levels. They have an inventory turnover of 3.1 and asset turnover of 5.0. The company has a days' payable of 30 and a days' receivable of 60. It has started enforcing its net 30 terms and placed customers with balances outstanding more than 45 days on credit hold. As a result, the company collected receivables quicker but it suffered a 10% loss in sales. What can the company do to reduce its cash conversion cycle?
   (A) Pay vendors in advance.
   (B) Decrease the days' payable.
   (C) Extend payables deferral period.
   (D) Revise credit policy to be more lenient.

9. The treasury manager of a chain of clothing stores wants to develop a medium-term forecast. Management plans to open two new stores, and anticipates same-store sales to increase by 15%. Which of the following items can be predicted with the highest degree of certainty?
   (A) Taxes on stock options
   (B) New product sales
   (C) Fixed bond interest payment
   (D) Refranchising proceeds

10. An Indian firm acquires a large U.K. manufacturer that generates high levels of cash flow in its local currency. The purchase is denominated in British pounds and is financed through the issuance of 10-year, 7.5% Indian Rupee bonds. The Indian firm will rely entirely on the U.K. manufacturer's cash flows to fund the interest payments on the bonds. What derivative instrument would help the India firm manage its FX exposure?
   (A) Currency forward
   (B) Currency swap
   (C) Interest-rate swap
   (D) Currency future

11. In evaluating alternative capital investments, a company should consider qualitative factors such as:
   (A) Projected cash flows.
   (B) estimated economic returns.
   (C) Corporate strategy.
   (D) Estimated costs

12. In an organization with personnel limitations, which of the following strategies should be considered to mitigate cash management system risk?
   (A) Outsourcing

(B) Verification
(C) Matching
(D) Hedging

13. As an internal control tool, what does the matching of an invoice to the original purchase confirm?
(A) The placement of the order
(B) The fulfilment of the order
(C) The execution of the order
(D) The payment of the order

14. Loss exposures related to treasury management may include which of the following?
(A) Excessive product recalls
(B) PBGC violations
(C) Deterioration of investment principal
(D) Bank consolidations

15. A put option on a company's stock has an exercise price of $20. On the delivery date, the stock is trading at $24 per share. What should the investor who has paid $2 for the option do?
(A) Not exercise the option and lose $2.
(B) Not exercise the option and lose $6.
(C) Exercise the option and gain $2.
(D) Exercise the option and gain $4.

16. Which of the following global cash concentration methods would be MOST appropriate for a single company with operations in the India, China, United States, Germany, Mexico, and Japan looking to minimize expenses?
(A) Multilateral netting
(B) Bank overlay structure
(C) Shared service center
(D) Physical pooling

17. Company ABC experienced a loss in the past when an employee in the treasury department was able to transfer $1.5 million to a personal account offshore. The company is working with a security agent to prevent this from happening in the future. ABC also accepts a large number of cheques as payment. The agent has suggested upgrades to ABC's payment process. What step should be taken to help mitigate this type of risk in the future?
(A) Periodically Treasury check.
(B) Set up international bank security.
(C) Implement dual approval.
(D) Implement data security standards

18. A company wants to gather daily balance reporting from its international subsidiaries' bank accounts. Which of the following systems would allow the company's bank to gather the balance positions from the local banks?
    (A) SWIFT
    (B) CHIPS
    (C) Giros
    (D) EDI

19. In a typical swap transaction, two parties agree to exchange?
    (A) Notional principal amounts.
    (B) Amortization schedules.
    (C) Maturity dates of obligations
    (D) Cash flows at future points in time

20. A company enters into a cash flow hedge to offset fluctuations in the value of foreign currency transactions occurring in two years. How should the company record the gains and/or losses on the cash flow hedge in the current year?
    (A) The hedged gains and losses are reported in comprehensive income.
    (B) The hedged gains and losses are reported in current period income.
    (C) The hedged gains and losses are reported in current period income together with the offsetting gains and losses of the foreign currency.
    (D) The hedged gains and losses are reported in comprehensive income together with the offsetting gains and losses of the foreign currency.

21. An internal auditor discovers that employees can enter and approve their own wire transfers. This practice violates what internal control?
    (A) Adequate segregation of duties
    (B) Accurate reporting of cash transactions
    (C) Appropriate monitoring of covenant compliance
    (D) Proper authorization of investment transactions

22. An arrangement in which a borrower makes periodic payments to a separate custodial account that is used to repay debt is known as a:
    (A) Balloon payment
    (B) Sinking fund
    (C) Mortgage.
    (D) Zero-coupon bond.

23. Today's modern cash management systems would include which of the following?
    (A) Full integration to ERP systems
    (B) Performance management systems and support
    (C) Remote check disbursement software
    (D) Full customer relationship management (CRM) capability

24. A treasurer has been advised that his privately held company has just lost its largest customer, which will have a significant impact on earnings. The treasurer applies an aggressive working capital strategy. Presently, the yield curve is upward sloping. Given this information, the treasurer should ensure that the company has:
(A) Short-term non-committed lines.
(B) Short-term committed lines.
(C) Long-term non-committed lines.
(D) Long-term committed lines.

25. Upon entering into an interest rate swap with a notional principal of Rs.10, 000,000, what is the initial amount of money the counterparties must exchange at the beginning of the swap?
(A) Rs. 0
(B) Rs. 5,000,000
(C) The future value of Rs.10, 000,000
(D) Rs. 10,000,000 discounted

26. Company XYZ is conservative when investing in their short-term portfolio. XYZ is looking to add the following money market instruments in their own country: a reverse re-purchase agreement, a floating-rate note, and a negotiable certificate of deposit. What types of investment risks are associated with these instruments?
(A) Credit and liquidity risk
(B) Liquidity and price risk
(C) Default and reinvestment risk
(D) Default and payment risk

27. A treasury professional is deciding between two investment opportunities. The first is a taxable security in the amount of Rs. 2,000,000 with a yield of 3.6%. The second is a tax-exempt security for the same amount with a yield of 2.85%. Both securities have the same maturity and a similar risk profile. The marginal income tax rate is 35%. What is the taxable equivalent yield for the tax exempt security?
(A) 5.54%
(B) 4.38%
(C) 1.15%
(D) 4.15%

28. Some treasury management systems are capable of initiating investment purchases and loan draw downs automatically. The automating of these transactions is related to which of the following treasury management functions?
(A) Payment management
(B) Liquidity management
(C) International trade management
(D) Capital budget management

29. XYZ Company is a U.S. based company that has just issued some euro-denominated bonds in London. The bonds have duration of 10 years at a rate of 3.5% with a par value of EUR 50 million. An FX swap contract was created on the date of the issuance in EUR/USD, with a spot rate of 1.2908 and a forward rate of 1.1102. This bond is subject to what type of risk?
(A) Interest rate
(B) Currency
(C) Floating rate
(D) Duration

30. In the context of financial futures, basis can be defined?
(A) As the spot price minus future price
(B) Future realization of foreign investments sold today
(C) As the future price minus spot price
(D) As the base rate unit used by the bank

31. In a Risk Management Policy, specific coverage should be given to?

(A) Maximum limits of currency hedge should be laid down
(B) Type of permitted Instruments to hedge
(C) Audit related issues on Treasury management
(D) All of the above

32. A short-term financial decision based on an MNC management's expectation that the local foreign currency will appreciate may be?
(A) Increasing local customers' accounts receivable and increasing local notes payable.
(B) Decreasing local notes receivable and decreasing accruals.
(C) Increasing local inventories and increasing local notes payable.
(D) Increasing local accounts receivable and decreasing local accounts payable

33. If the real exchange rate remained the same between two time periods, it means that the following theory (ies) held good for the relevant period?
(A) Purchase power parity
(B) Relative purchasing power parity
(C) Interest rate parity
(D) Both (a) and (b) above

34. In which of the system, the official exchange rates are set and maintained by the regulatory Central government/Central bank/other authority?
(A) Floating exchange rate system

(B) Pegged exchange Rate system
(C) Banking exchange rate system
(D) None of the above

35. When a dealer enters into a buy sell swap in foreign exchange with a counterparty bank, his banks?

(A) Position in that currency increases
(B) Position in that currency decreases
(C) Liquidity position worsens
(C) Liquidity in that currency increases

36. A reduction in repo rate _____ ?

(A) Makes it cheaper for scheduled banks to borrow from RBI
(B) Makes expensive for scheduled banks to borrow from RBI
(C) Helps RBI to get money from scheduled banks at cheaper rate
(D) Helps banks to get money from RBI at cheaper rate

37. Which of the following is/are **true** according to the International Fisher effect?
(A) Currencies with higher level of inflation will have higher level of interest rate
(B) Real returns are equalized across countries through arbitrage
(C) Until the expected real return in two countries are equalized the process of arbitrage continues
(D) Currencies with lower level of interest rate, will appreciate against currencies with higher level of interest rate

38. Credit default swaps are credit derivatives that?

(A) Should only be used by people seeking high returns from low risk
(B) Do not require collateral to be posted by either the buyer or the seller of the insurance
(C) Allow lenders to insure themselves against the risk that a borrower will default
(D) Present high levels of risk and should only be used by the wealthy

39. True commercial life refers to?
(A) Life period of an income generating asset
(B) Expected number of years an income producing asset can generate cash inflows
(C) Difference between the time of purchase of an asset and the time of final disposal of the asset
(D) It is also known as physical life of the asset.

40. Which of the following statement/s is/are false regarding internal auditing?

(A) Internal auditing of a company is done by an individual who is not an employee or partner of the company.
(B) The main objective of an internal audit is to ensure true and fair presentation of accounts.
(C) Internal audit is optional.
(D) Both (a) and (b) above.

41. Optimal dividend policy is one that does all of the following EXCEPT:
(A) Maintain adequate retained earnings for future growth.
(B) Maximize shareholder value.
(C) Balance tax shield benefits against agency costs
(D) Distribute corporate income to investors

42. According to the Monetary Approach of exchange rate forecasting, inflation is the outcome of?
(A) Increase in wages in the economy
(B) Increase in real output growth
(C) Increase in government spending
(D) Increase in money supply in excess of real output growth.

43. Bank of the Middle East, Dubai is maintaining an account with SBI Mumbai. SBI Mumbai calls this account as
(A) Nostro account
(B) Vostro account
(C) Loro account
(D) Mirror account

44. Which of the following statements is false?
(A) Authorized dealers are market makers in the foreign exchange market
(B) Foreign currency broker act as a middleman between two market makers
(C) The counterparty in the foreign exchange market is another bank
(D) Foreign exchange brokers buy or sell foreign currencies for their customers.

45. Which of the following intermediaries is/are not registered with SEBI?
(A) Portfolio Managers
(B) Brokers
(C) Foreign Institutional Investors
(D) All of the above intermediaries are required to be registered with SEBI.

46. Gap loan, a form of real estate loan is a?
(A) Loan extended during the gap the borrower is able to find out a suitable lender
(B) Loan extended to the developer to cover the difference between the bank construction loan and the total cost of the project.

(C) Loan extended on which additional payment is required to be made to cover the gap between market interest rate and the ceiling rate agreed upon.
(D) Loan on which the interest charged is generally lower than the prime lending rate.

47. The operating risk in the host country does not include the risk of?
(A) Change in government policies.
(B) Exchange control.
(C) Price controls.
(D) Sanctions.

48. Options have an advantage over futures because?

(A) They provide a more certain hedge
(B) They are less likely to require delivery of the underlying asset
(C) They are likely to be cheaper because all one is buying is the right to do something
(D) They provide a hedge without removing the opportunity to make a profit

49. An option whose intrinsic value is calculated by comparing the strike price with the average spot price over the period of the option is?

(A) A warrant
(B) A barrier option
(C) An Asian option
(D) A European option

50. Which of the following is most similar to a stock broker?

(A) Pit trader
(B) Floor broker
(C) Futures commission merchant
(D) Local

51. Which of the following is best described as selling a synthetic asset and simultaneously buying the actual asset?

(A) Speculating
(B) Arbitrage
(C) Diversifying
(D) Hedging

52. Which of the following investment strategies has unlimited profit potential?

(A) Protective put
(B) Covering call
(C) Writing call
(D) Bull Spread

53. Tingley's Chocolate must purchase coca to make its products. The company is concerned that prices may rise prior to building inventory for Diwali sales. Analysts project that price per ton could vary from Rs.65,000 to Rs. 90,000. A September futures contract can be obtained with a Rs. 78,000 purchase price. What is Tingley's risk in this situation?
(A) Coca prices will rise above Rs. 78,000 and Tingley will purchase its coca at a price of Rs. 78,000.
(**B) Coca prices will decline below Rs. 78,000 and Tingley will have to purchase coca at Rs. 78,000.**
(C) Coca prices will hit Rs. 78,000 and the contract was a waste of time.
(D) Tingley has no risk in this situation.

54. Which one of the following is not an approved manner of payment for exports as per FEMA 1999 on Exports?

(A) Bank Draft, pay order, bankers, cheque or personal cheques
(B) FC Notes/F. T/Cs from the buyer during his visit to India
(C) Payment out of funds held in the FCNR/NRE account maintained by the buyer
(D) Precious metals i.e. Gold/Silver/Platinum by Gems & Jewellery Units in SEZs and 100% EOUs in equivalent value of jewellery exported subject to fulfillment of certain conditions.

55. Which one of the following is not a source of fund available to banks Pre-shipment Credit in Foreign Currency (PCFC) Scheme?
(A) EEFC A/c.
(B) NRE A/c.
(C) RFC A/c.
(D) Escrow A/c.

56. The market forces influencing the exchange rate are not fully operational under?
(A) Floating exchange rate system.
(B) Speculative attack on the market.
(C) Fixed exchange rate system.
(D) Current regulations of IMF.

57. Regulatory documents for international trade include?
(A) Shipping bill.
(B) Bill of lading.
(C) Marine insurance policy.
(D) Proforma invoice

58. A unilateral move to reduce the value of one's own currency by changing a fixed or official exchange rate is known as

(A) Reduction.
(B) Devaluation.
(C) Revaluation.
(D) Restructuring

59. The number of nostro accounts that can be maintained by a bank in a particular currency is?

(A) One.
(B) Not exceeding three.
(C) Minimum two.
(D) No such limit.

60. To what extent is FDI permitted in the FTWZ (Free Trade and Warehousing Zone)?

(A) 50%
(B) 60%
(C) 75%
(D) 100%

61. RBI is coming up with the concept of_____to protect banks against possible harmful effects arising from the operations of their non-banking financial subsidiaries?

(A**) Financial Holding Company**
(B) Bank Holding Company
(C) Bureau of Credit Union
(D) Financial Institutions Audit Cell

62. RBI has introduced "Marginal Standing Facility" with the objective of?

(A) Controlling Inflation
(B) Containing instability in long term inter-bank rates
(C) **Containing instability in the overnight inter-bank rates**
(D) All of the above

63. The recommendations of which committee paved the way for establishment of IRDA as the regulator for Indian insurance sector?

(A) Goiporia Committee
(B) Malhotra Committee
(C) Vaghul Committee
(D) Jalan Committee

64. During July 2014 the FDI limit in insurance sector in India was raised from 26% to?

(A) 51%
(B) 46%
(C) 76%

(D) 49%

65. Which of the following statement/s is/are correct with regard to Chit Funds.?

1. Chit Funds are regulated by State Governments.
2. Chit Funds are ponzi schemes and are illegal in India.
3. SEBI is responsible to look after all issues related to Chit Funds.
4. Chit Funds are a type of Collective Investment Schemes but not covered under CIS, 1999.

(A) 1,2 & 3 Only
(B) 3 & 4 Only
(C) 1 & 4 Only
(D) 1 & 3 only

Section B

Number of questions: 7

Marks: 25

Note: Answer any five questions. Each answer will carries 5 marks

[Unrelated answers & answers exceeding the brief will attract negative marks]

1. Explain what is meant by NTP & NDD and establish the difference and relation between the two. Give example when it is applicable and when not applicable?
   Ans:

NTP & NDD to be explained as per study material given viz.: NTP is the average period for realization of an export bill and fixed as 25 days by FEDAI. NDD is the notional due date of a usance export bill taking into account the usance + NTP & grace period, if applicable. NTP gives a period for which concessional interest is applicable in case of sight bills, NDD is the due date up to which it is available in case of usance bills. NDD includes NTP [by adding usance & grace period, if applicable]. In case of fixed due date bills like due date from date of shipment, date of draft etc, NTP is not applicable. NDD not applicable if sight bill. Concept of NTP applicable only in case of FC bills drawn on buyer outside India. Not applicable where reimbursement is available in India.

2. Whether REIT is covered under Alternate Investment Fund? What are the differences between REIT and Real Estate Investment Fund?

Ans:

REIT is not covered under Alternate Investment Fund. REITs are governed by separate regulations. SEBI has made the investments in REITs much easier with the minimum investment amount of Rs 2 lakh. Besides that REITs has got lot of restriction on the investment part where as the Real Estate Investment Fund under AIM has lot of flexibility when it comes to investments. So Real Estate Investment Trust is less riskier investment compared to Real Estate Investment fund under AIM. Riskier real estate project would be funded by the Real Estate Investment Fund under AIM whereas the less riskier real estate project would be funded by REIT.The government has also framed a mechanism so that the units of REITs can be traded like units of mutual fund on recognised stock exchanges.
It's a new concept and will take time to get popularize.

3. What is 'Scheduled Offence' under PMLA, 2002?

Ans:
The offences listed in the Schedule to the Prevention of Money Laundering Act, 2002 are scheduled offences in terms of Section 2(1) (y) of the Act. The scheduled offences are divided into two parts - Part A & Part C.
In part A, offences to the Schedule have been listed in 28 paragraphs and it comprises of offences under Indian Penal Code, offences under Narcotic Drugs and Psychotropic Substances, offences under Explosive Substances Act, offences under Unlawful Activities (Prevention) Act, offences under Arms Act, offences under Wild Life (Protection) Act, offences under the Immoral Traffic (Prevention) Act, offences under the Prevention of Corruption Act, offences under the Explosives Act, offences under Antiquities & Arts Treasures Act etc.

Part 'C' deals with trans-border crimes, and is a vital step in tackling Money Laundering across International Boundaries.
Prior to 15February, 2013, i.e., the date of notification of the amendments carried out in PMLA, The Schedule also had Part B for scheduled offences where the monetary threshold of rupees thirty lakhs was relevant for initiating investigations for the offence of money laundering. However, all these scheduled offences, hitherto in Part B of the Schedule, have now been included in Part A of Schedule w.e.f 15.02.2013. Consequently, there is no monetary threshold to initiate investigations under PMLA.

4. What are the Basic objectives of internal audit of treasury?
Ans:
Internal audit of the treasury has become need of the hour because of two reasons; first it enhances the efficiency of the system and second to eliminate the probability of occurrence of fraud and to detect existing frauds if any .In internal audit a detailed review of treasury organisation, bank services, Cash flow forecasting & management, investing activities and risk management policy is carried out.

- Ensure that the entity frames policies and procedures relating to all treasury activities and review them for adequacy and coverage.
- Determine whether management has planned for liquidity needs for both normal operating conditions and emergency situations
- Ensure adequate physical and access control procedures are in place in the department.
- Verify existence of satisfactory controls exist in the processing of deals

- Ascertain that the entity receives favourable rates for all its deals.
- To check that there is accurate recording and accounting of positions
- Ensure that their there is proper documentation procedures and filing systems in place.
- Ensure that limits are set for different procedures and they are adhered to in a consistent manner.
- Verify that any violations are promptly reported and properly dealt with.
- Ensure that reconciliation is being made timely and accurately.

5. Suppose that we are on 16-02-15, and that your company expects the following cash-flows during the month of March:

Cash-INs:	DM 100,000	(16-03)
	DG 45,000 (Dutch Guilder)	(16-03)
	DM 125,000	(20-03)

Cash-Outs:	DM 140,000	(16-03)
	¥ 10,900,000	(20-03)

The exchange rates on 16-02 are as follows:

	Spot	**30-day forward**
DM:	1.66 DM/1$	1.64
DG:	1.5 DG/1$	1.48
¥:	120 ¥/1$	120

You are further told that a March DM futures contract on the same day costs $76,000, including all transactions costs. The third Wednesday of March is 16-03-15. Finally, you are told that over the past 2 years -- for each 1% appreciation of the $ against the DM, the $ has appreciated by 1% against the guilder and by .4% against the ¥.

Suppose that your company wants you to hedge as much as possible of its end-of-March transaction exposure, yet wants to minimize hedging costs. What would you recommend? Explain thoroughly, and state your assumptions?

Ans:
First, to reduce costs, you can assume away the credit risk, i.e., you can assume that the amounts receivable (the "cash-ins") will be paid to your company on the due date. This enables you to net out the cash-ins and cash-outs, per currency per date. In the case at hands, this enables you to net out 100,000 DM on 16-03, which leaves you with the following amounts to worry about:

Cash-INs:	DG 45,000(Dutch Guilder)	(16-03)
	DM 125,000	(20-03)

Cash-Outs:	DM 40,000	(16-03)
	¥ 10,900,000	(20-03)

Second, notice that the DG (Dutch Guilder) and the DM have, in the last 8 or 9 years, moved almost perfectly together against other currencies. This is due not only to the fact that the two

currencies belong to the ERM, , but also to the fact that, within the ERM, the Dutch government has made a point of avoiding any devaluation of the DG against the DM. As a result, it is a safe bet to consider DG and DM
Cash-flows as very close substitutes (the DG is almost perfectly pegged to the DM). Since the DG 45,000 cash-in and DM 40,000 netted cash-out are taking place on the same day, it is reason able to net them out. At the current exchange rates, the Dutch cash-in is worth 45,000/1.5=$30,000, whereas the German cash-out is worth 40,000/1.66=$24,000. This leaves you with netted-out cash in on 15-03 that amounts to:

(30,000-24,000) x1.5 = DG 9,000.
After this first round of netting across currencies, you are left with the following amounts to worry about:

Cash-INs:	DG 9,000(Dutch Guilder)	(16-03)
	DM 125,000	(20-03)
Cash Out:	¥ 10,900,000 (20-03)	

At this point, you could recommend to the company to sell DG 9,000 30-day forward, short 125,000 DM 35-day forward and buy ¥ 10,900,000 35-day forward, both of which require a customized contract at a bank. This would leave the company with little exchange risk, and would contain hedging costs.

If the company prefers cutting costs to the complete elimination of risk, however, you could recommend that it short 1 DM March futures contract at the IMM (125,000 DM). Notice that, since March futures Contracts next year require delivery on 15-03; the company would bear some basis risk between 15-03 and 20-03 on its DM 125,000 exposure.

6. Briefly explain the grievance redressal mechanism of IRDA for Protection of policyholders' Interests and addressing investors' grievances?

Ans.
Besides the regulation for safeguarding interests of policy holders, an Insurance Ombudsman is Appointed to redress investor grievances. Every insurer shall have in place proper procedures and Effective mechanism to address complaints and grievances of policyholders efficiently and with Speed and the same along-with the information in respect of Insurance Ombudsman shall be communicated to the policyholder along-with the policy document and as maybe found necessary.
Insurance Ombudsman has two types of functions to perform (1) conciliation, (2) Award making. The insurance Ombudsman is empowered to receive and consider complaints in respect of personal lines of insurance from any person who has any grievance against an insurer. The complaint may relate to any grievance against the insurer i.e. (a) any partial or total repudiation of claims by the insurance companies, (b) dispute with regard to premium paid or payable in terms of the policy, (c) dispute on the legal construction of the policy wordings in case such Dispute relates to claims; (d) delay in settlement of claims and (e) non-issuance of any insurance

Document to customers after receipt of premium. Ombudsman's powers are restricted to Insurance contracts of value not exceeding Rs. 20 lakhs. The insurance companies are required to Honour the awards passed by an Insurance Ombudsman within three months.

Therefore to sum up, it can be noted that if the said insurance company does not resolve a complaint to the complainant's satisfaction it can be escalated to IRDA. If the complaint is Suitable for taking to the Insurance Ombudsman IRDA will help you resolve it by taking it up With the insurance company. Further for disputes where enquiry or adjudication is required for its disposal, Consumer Forum or Courts would be a likely resort.

7. Write a short note on FDI in Multi Brand Retailing (As per FDI Policy, 2013)?

Answer:

This Topic has been in discussion for quite long time now and it's the main issue of concern for lawmakers, investors and the common public. Since the policy has become liberal and ease doing business has also increased this may prove to be game changer in case of foreign direct investments in India.

FDI in multi brand retailing was allowed in all sectors, they were however subject to specifications which inter alia are as follows:

- Is subject to minimum capitalization norm of USD 100 Million.
- At least 50% of the foreign investment shall be invested in certain specified activities defined as backend infra structure within 3 years from the date of first tranche of investments coming in. Further at least 30% of the value of procure of manufactured/processed products purchased shall be sourced from Indian small industries.
- Self-certification by the company, to ensure compliance of the all the above conditions which could be cross-checked, as and when required. Accordingly, the investors shall maintain accounts, duly certified by statutory auditors.
- Most importantly, a right to every State Government/ Union Territory is given, to use or not to use such retailing. The above policy is only an enabling policy only and the State Governments/Union Territories would be free to take their own decisions in regard to implementation of the policy. Therefore, retail sales outlets may be set up in those States/Union Territories which have agreed, or agree in future, to allow FDI in MBRT under this policy.

Section C

Number of questions: 2

Marks: 10

Note : Case Studies. Answer any one. Max 10 marks

1. **A**BC Limited has 4 divisions A, B , C and D. At present, the company is charging uniform return on equity and uniform cost of debt across all divisions. However the company wants to shift to modern treasury management and it wants to charge Risk Adjusted Transfer Pricing. The following are the information given :

	Total	A	B	C	D
Capital	100	20	30	15	35
Debt	400	75	125	110	90
Industry leverage		1.5	3.5	8	3
Marginal Tax Rate		30%	30%	30%	30%
Unlevered Beta		0.30	0.45	0.6	0.4
Default Spread		2%	3.10%	3.25%	3.10%

Risk Free Rate = 8.50% p.a.

Equity Risk Premium = 7% p.a.
How much treasury should charge to each division based Risk Adjusted Weighted Average Cost of Capital

Ans :

	A	B	C	D
Capital	20	30	15	35
Debt	75	125	110	90
Industry Leverage	1.5	3.5	8	3
Leverage	3.75	4.16667	7.33333	2.57143
Marginal Tax Rate	30%	30%	30%	30%
Unlevered Beta	0.3	0.45	0.6	0.4
Levered Beta	1.0875	1.7625	3.68	1.12
Risk Free Rate	8.50%	8.50%	8.50%	8.50%
ERP	7%	7%	7%	7%
Cost of Equity	16%	21%	34%	16%
Default Spread	2%	3.10%	3.25%	3.10%
Cost of Debt	10.50%	11.60%	11.75%	11.60%
WACC	9.19%	10.58%	11.35%	10.42%

2. Your employer, Volkswagen Motors Corp., plans to import 500 Opel Insignias from its plant in Berlin, Germany, rebadge them as "Polo" and sell them in the U.S. via Smart Car dealerships. The German subsidiary of the company has agreed to sell them for a total of 10 million Euros, which will be payable on April 9th, 2015. We are on February 1st, 2015.

(a) Explain how VW can use currency futures to hedge the exchange-rate risk stemming from this account payable. Should VW go long or short? Approximately how many futures contracts Will VW need? Each Euro futures is for delivery of Euro 125,000?
(b) Is VW completely hedged? Would VW's hedge be better with a customized forward contract?

Ans:
To hedge its foreign-exchange risk, VW needs to lock in *today* the $ price that it will pay for the 10m Euros on April 09. Buying an appropriate number of Euro futures contracts with a delivery date close to April 09 is one attempt to do that.
The IMM division of the CME offers March and June futures contracts in the amount of 125,000 Euro per contract. In each case, VW should therefore go long approximately 80 futures contracts (covering the underlying short exposure of 10,000,000 Euro divided by the contract size of 125,000 Euro).
The last day of trading for March and June contracts is the Monday before the third Wednesday of March and June, respectively, i.e., March 15 and June 14, 2015. The corresponding delivery dates are March 17 and June 16.

<u>Possibility 1</u>: **VW could go long 80 March Euro futures on February 1st. In this case, VW would have to make one of two choices on March 15th:**

1. Either VW decides that it will take delivery of the Euros, in which case VW is, as of February 1st, exposed to foreign *interest rate* risk. Put differently, VW would hold Euro 10m from March 17th till April 9th but cannot know, as of February 1st, the interest rate that will prevail on Euro deposits during this period. Since VW takes delivery of Euro 10m at a price (the March futures price) that is known by February 1st, however, it faces no exchange-rate risk.
Note that, while VW could use a forward rate agreement (FRA) to hedge that interest-rate risk, There is a further problem with this approach: VW would need to come up with the cash (i.e., the US dollars to get the Euros) three weeks ahead of the April 9th deadline, which defeats the (credit) purpose of using account payable in the first place.

2. Alternatively, on March 15th – the last day of trading for 2015 March futures -- VW could reverse its trade on the CME by shorting the same number (80) of Euro March futures. By doing so, VW would pocket the gain or pay the loss from having gone long March Euro futures on February 1st, 2015. The flip side, of course, is that VW would still need to purchase 10m Euro on the spot market on April 9th, at a rate that cannot be known for sure (neither on February 1st nor on March 15th). In this case, then, VW would be exposed to foreign *exchange* risk from March 15th (after it exits its futures hedge) to April 7th (when it must buy the Euros spot to ensure payment two days later, on April 9th). While this is a shorter period than from February 1st till April 9th, the amount of forex risk would remain high.
The **bottom line** is that, by using the March Euro futures, VW is arguably exposed to quite a bit of risk. Whether VW would choose, on March 15th, to take delivery of the Euro 10m or to offset its futures hedge, would depend on its estimate of exchange rate movements from 15-03 to 07-04 (remember that spot deliveries take 2 days) and of interest rate movements between 17-03 and 09-04 the time interval between the decision and the delivery of the Euro 10m.

<u>Possibility 2</u>: **VW could go long 80 June Euro futures on February 1st. In this case, VW would face two choices on March 15:**
A 2015 June futures requires delivery on June 16th. VW, however, needs the dollars on April 9th. hence, if VW used a June 2015 Euro futures hedge, it would have to liquidate its long Euro June futures position two days before April 9th, and buy 10m Euros on the spot market that day. As of February 1st, of course, VW knows neither the Euro spot price nor the June Euro futures Price that will clear the markets *on April 9th.* All VW knows is that changes in the price of a June
Euro futures is positively correlated changes in the spot USD/EUR exchange rate, so that VW Can hope to offset any loss (resp. *gain*) on its underlying short Euro position with the gain (resp. *Loss*) on its June futures hedge.

(b) As argued in part a., if VW uses futures (whether March futures or June contracts) then it Will face some risk and will not be perfectly hedged.
The only way for VW to completely hedge its foreign exchange risk would be to enter into a forward contract with a bank, whereby VW would agree to take delivery on April 9th of 10m Euros at a price fixed as of today, February 1st.