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SUGGESTED SOLUTION

CA FINAL

SUBJECT- CAPITAL MARKET

Test Code –

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Solution to Case Study 1:

1.1 (A)
1.2 (C)
1.3 (C)
1.4 (D)
1.5 (A)

Ans. to 1.6 (A)
Answer:
The buyback is typically undertaken by the company after considering the strategic and operational cash requirements of the company in the medium term and for returning surplus funds to the members in an effective and efficient manner. Few key reasons for buyback are:

a. The buyback helps the company to return surplus cash to its members;
b. The buyback is generally expected to improve return on equity through distribution of cash and improve earnings per share by reduction in the equity base, thereby leading to long term increase in members' value; and
c. The buyback gives an option to the members of the company, either to sell their equity shares and receive cash or not to sell their equity shares and get a resultant increase in their percentage shareholding in the company post the buyback, without additional investment.

   Buy back is useful in case of a company in such situations, where it can utilize it's excess cash balance and save tax on dividend payment to shareholders.
   For shareholders, buyback is useful when it is offered to the shareholders at a price which is higher than the price at which it was purchased by them.

Ans. to 1.6 (B)

Shareholders	**Pre Buyback**		**Post Buyback**	
Promoters and / or persons who are in control and / or acting in concert (Promoter Group)	56,01,82,338	12.82	56,01,82,338	13.13
Indian Financial Institutions	31,73,073	0.07		
Banks	17,09,234	0.04		
Mutual Funds	58,46,44,086	13.38		
Indian Public & Corporate	95,54,85,110	21.87		
Foreign Institutional Investors	1,49,15,64,414	34.14		
NRIs	2,58,96,923	0.59		
Foreign Nationals and Overseas Corporate Bodies	21,618	0.00		
American Depository Shares (ADS)	74,62,54,648	17.08	3,70,54,99,106	86.87%
Total	**4,36,89,31,444**	**100**	**4,26,56,81,444**	**100**

Non-promoter holding pre-buyback is 3,80,87,49,106 shares.

Maximum no. of shares which will be bought back are 10,32,50,000 (Rs. 8,260 crore size @Rs. 800 price)

Hence, non-promoter holding post-buyback will be 3,70,54,99,106 shares

Promoters shall not participate in the buyback hence their holding in terms of no. of shares remain same post-buyback

Ans. to 1.6 (C)

Calculation of Financial Return for Mr. B

Acquisition Price = Rs. 580 x 5000 shares

= Rs. 29,00,000

Return = 2000 shares x Rs. 740 + 2500 shares x Rs. 760 + 500 shares x Rs. 790

= Rs. 14,80,000 + Rs. 19,00,000 + Rs. 3,95,000

= 37,75,000

Return % = 37,75,000 – 29,00,000/29,00,000 x 100

= 30.17%

Hence, financial returns over the period of holding are Rs. 8.75 lakhs.

Particulars	Pre-buyback	Post-buyback
Income for EPS (Rs. Crores)	15,570	15,570
No. of shares for EPS (Crores)	436.89	426.57
EPS (Rs.)	35.64	36.50
PE (Multiple)	21.24	21.24
Price (Rs.)	756.95	775.27

As per above calculation, the expected price post-buyback should have been Rs. 775 + and pre-buyback the price was – Rs. 755-756. Hence, Mr. should not have sold his shares below Rs. 755 and could have waited for price to cross Rs. 775. Had he sold his entire shares in the week 6, he could got better price. Additionally, the same can be corroborated with the price rise post completion of buyback to Rs. 840 suggesting that investors have found value in the buyback and overall ROE may improve.

Ans. to 1.7 (A)

The company shall, before opening of the offer, create an escrow account towards security for performance of its obligations and deposit in escrow account 25 percent of the amount earmarked for the buyback as specified in the Board/Special Resolution.

The escrow account may be in the form of:

a. Cash deposited with any scheduled commercial bank (SCB); or
b. Bank guarantee issued in favour of the merchant banker by any SCB

Where part of the escrow is in the form of a bank guarantee, the company shall deposit with a SCB, in cash, a sum of at least 2.5 percent of the total amount earmarked for buy-back as and by way of security for fulfillment of the obligations.

Hence, amount to be kept in Escrow Account shall be Rs. 2,065 i.e. 25% of Rs. 8,260 crores.

Out of above, 50% shall be in the form of cash deposited with schedule commercial bank i.e. Rs. 1,032.50 crores.

Another, 50% shall be in the form of bank guarantee in favour of merchant banker i.e. Rs. 1,032.50 crores. Out of which Rs. 206.50 crores, being 2.5% of the Maximum Buyback Size of Rs. 8,260 shall be in the form of deposit with SCB. Hence, amount of Bank Guarantee shall be reduced to this extent.

Hence, total Rs. 1,239 crores (Rs. 1,032.50 + Rs. 206.50 crores) shall be in the form of cash deposited with SCB and Rs. 826 crores shall be form of Bank Guarantee totaling to Rs. 2,065 crore of escrow account security.

Ans. to 1.7 (B)

Calculation of pay-out amount to investors if Maximum Buyback Size has been executed

Week No. (1)	No. of shares offered in each week (in crores) (2)	Volume weighted avg. price of shares (Rs.) (3)	(2) x (3) (Rs.) (4)
1	Nil	755	0
2	1.5	740	1110
3	2	760	1520
4	2.5	785	1962.5
5	3	775	2325
6	1.325	790	1046.75
	10.325		7964.25

Ans. to 1.8 (A)

As per Regulation 4 (i) of the said Buy Back Regulations, the maximum limit of any buy-back shall be twenty-five per cent or less of the aggregate of paid-up capital and free reserves of the company. Moreover, it is further explained in the regulations that in respect of the buy-back of equity shares in any financial year, the reference to twenty-five per cent in this regulation shall be construed with respect to its total paid-up equity capital in that financial year.
Further, Proviso to Regulation 4(iv) also provides that no offer of buy-back for fifteen per cent or more of the paid up capital and free reserves of the company shall be made from the open market.
In the present case, ABC Ltd. has offered a buyback of Rs. 8260 crores which is within the limit as mentioned above as it is evident as per the following calculations:

Maximum Buy Back limit

= 25% of Paid up Capital and Free Reserves

= 25% of Rs. 2184 crores + Rs. 54636 crores = 25% of 56,820 crores

= Rs. 14205.

And, Maximum Buy Back limit for open market

= 15% of Paid up Capital and Free Reserves

= 15% of Rs. 56,820 crores

= Rs. 8523 crores

So, Buy Back offer of buyback of Rs. 8260 crores is within limit
The minimum buyback size is 50% of the amount earmarked for buyback in the Board Resolution and accepted by special resolution. Hence, the minimum size shall be Rs. 4,130 crore.

Ans. to 1.8 (B)

As per Regulation 4(ii) of the Buy Back Regulations, the ratio of the aggregate of secured and unsecured debts owed by the company after buyback shall not be more than twice the paid-up capital and free reserves.
Now, Total Debt after buy back = Rs. 20,000 Crores

And, Total of Paid up Capital and Free Reserves after the buyback offer

= Rs. 56,820 crores – Rs. 8260 crores = Rs. 48,560 Crores

So, debt equity ratio after buy back = Debt/Equity

= Rs. 20,000 Crores/Rs. 48,560 Crores

= 0.41: 1

Hence, ABC Ltd. is in compliance with the Debt Equity Ratio as per the buyback regulations.

ANSWER TO CASE STUDY 2:

(A) **(i)** Recognized stock exchange is a stock exchange which operate under the rules, regulations and guidelines approved by the government. As per section 2(j) of the Securities Contract Regulation Act, 1956, "stock exchange" means any body of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities.

Further, no stock exchange is permitted to function as such to trade in the securities of a publicly held company without being recognized.

(ii) In Regulation 4 of SEBI (ICDR) Regulations 2009, the indication is given with regard to specified securities. Specified securities is defined under 2(zj) as equity shares and convertible securities. Also, 2(k) defines a convertible security as a security which is convertible into or exchangeable with equity shares of the issuer at a later date, with or without the option of the holder of the security and includes convertible debt instruments and convertible preference shares. Hence, the regulations apply to convertible preference shares.

However, this inclusion is superseded by a separate SEBI (ICDR) Regulation for redeemable, non-convertible preference shares and for perpetual non-cumulative preference shares.
Thus, the SEBI (ICDR) Regulations 2009 amended by the Finance Act, 2017 does not apply to preference shares that are non-convertible.

(iii) The various flaws of the proposal, there rectification along with relevant regulations is explained as below:

(a) **The company wants to keep the bid open from the 14th of May, 2018 upto 5th June, 2018.**
The proposal is wrong because **Regulation 46** of SEBI (ICDR), Regulations, 2009, clearly provides that an issue through book building system remains open for three to seven working days. In case of revision of price band, the issue period disclosed in the red herring prospectus shall be extended for a minimum period of three working days. However, the total bidding period shall not exceed ten working days.

(b) **The price band is to be fixed between** Rs. **30 to** Rs. **40 per share.**
As per regulation 30 (2) of SEBI (ICDR), Regulations, 2009, the issuer shall announce the floor price or price band at least five working days before the opening of the bid (in case of an initial public offer) in all the newspapers in which the pre issue advertisement was released. As no detail has been given about the price band or the floor price in the question, it seems that the efficacy of the rule that the spread of price between floor price and cap in the price band should not be more than 120% [(regulation 30(4)] is not satisfied by the company. Moreover, the difference between Rs. 30 to Rs. 40 per share seems to exceed the spread between 100% to 120%.

(c) **The promoter intends to contribute to 15% of the shares proposed to be offered at** Rs. **30 per share and hold the investment upto two years.**
The proposal is wrong. As per Regulation 32 (1) (a) of the said regulations, in a public issue by an unlisted issuer, the promoters shall contribute not less than 20% of the post issue capital. Further, as per Regulation 36, minimum promoters' contribution shall be locked-in for a period of three years from the date of commencement of commercial production or date of allotment in the public issue, whichever is later. And, promoters' holding in excess of minimum promoters' contribution shall be locked-in for a period of one year.

(d) **Support of anchor investors.**
Anchor investors cannot be used here. The anchor has to apply for at least Rs. 10 crore value in a public issue. Here, the total value itself is less than that of the minimum required for anchor investors. [Schedule XI of SEBI (ICDR), Regulations, 2009]

(iv) In case the promoter is an individual, his holding cannot be counted for the limit applicable for a retail individual investor. The reason is that in Regulation 32 of the said regulations, it has been clearly mentioned that minimum promoters' contribution shall be 20% of the post issue capital. And, in regulation 43 (2), it has been categorically mentioned that in the net offer to public category, not less than thirty five per cent shall be allocated to retail individual investors. Further, in regulation 43(4), in the net offer to public category, in an issue made other than through the book building process, minimum fifty per cent shall be allocated to retail individual investors. From the above discussion, it seems to be clear that promoter's holding cannot be counted towards the limit applicable for a retail individual investor.

Alternative Answer

Even if the promoter is an individual, his holding cannot be counted under "retail individual investor" since the definition of a retail individual investor or shareholder under Regulation 2(ze) and (zf) define him as one who applies for or bids for a value not more than Rs. 2 lacs. Hence, the promoter's holding cannot be reckoned under the retail individual investor or shareholder.

(v) According to Regulation [60(7)(h)] of the said regulations, no issue advertisement shall display models, celebrities, fictional characters, landmarks or caricatures or the likes. In view of the above, the soap manufacturing company will not be successful in getting SEBI's approval to use a popular actor to advertise for the proposed equity issue to public.
However, product advertisement is not covered under this regulation and hence that is alright.

(vi) The ASBA (Application Supported by Blocked Amount) has been made mandatory by SEBI not only for book built issue but to also any public issue of equity shares. Under this arrangement, the investor has to submit an application to the Self-certified Syndicate Bank (SCSB) with whom the bank account to be used for the application money is maintained. By virtue of this ASBA facility, the amount payable on application is merely blocked by the SCSB and released to the company only on allotment, thereby obviating the necessity for a refund on non-allotment and also enabling the investor to have his liquidity for immediate other use of his funds.

(vii) As per the SEBI circular dated October 6, 2017, large cap, mid cap and small cap has been defined as follows:
(a) Large Cap: 1st – 100th company in terms of full market capitalization.
(b) Mid Cap: 101st – 250th company in terms of full market capitalization.
(c) Small Cap: 251st company onwards in terms of full market capitalization.

Alternative Answer

Market Capitalization of a company means number of shares outstanding multiplied by market price per share. The market cap measures the market value of a company's share capital. Stocks traded on the stock exchange are categorized by market cap. Though there is no regulation to determine a cut off the classification, conventionally, top 50 stocks ranked according to market capitalization in a stock exchange are called large cap or blue chip stocks, the next 200 are mid cap and the next 500 are small cap. The large cap stocks represent liquidity and stability. Mid cap stocks provide momentum and opportunity, while small cap stocks do not enjoy much liquidity.

(viii) The numbers are leading market indices. A market index normally is computed by computing market capitalization of select number of shares chosen to represent market movement. The S & P BSE Sensex was set at 100 on April 1st, 1979 and consists of the market cap weighted index of 30 chosen stocks, whereas the Nifty 50 consists of 50 companies' stocks listed on the National Stock exchange. The base period is November 3rd 1995 and the base value has been set at 1000. Since the base values are very different, we have a big gap in the updated values on every trade day. However, daily % increases/decreases of the indices are almost the same, indicating the general market movement. Apart from these, there are sectoral indices to track specific sectors.

(ix) The prices will be almost the same. There could be minor differences. The prices displayed on the screen are the last traded prices. Hence, even if we want to buy at a lower price and sell it higher, by the time we order, that price will not be applicable.

Moreover, this guaranteed profit arising out of arbitrage cannot be attempted by an ordinary person, since there are software programs and specific algorithms that are continuously working on the trading platform set up by the bigger traders and the arbitrage mechanism is soon put out by equalization of prices. Then prices differ by a slim margin, that even if they are available at that margin, the cost of the transaction brokerage, STT, etc. will not justify it and will wipe out the potential profits.

(x)

Investment Objective	Instrument	Instrument
Growth and appreciation in value	Equity Shares	Equity based Mutual Fund
Regular Income	Debentures	Bonds
Liquidity	Liquid Funds	Money Market Mutual Funds
Capital Preservation	Government Securities	Debentures

Alternative Answer

Investment Objective	Instrument	Instrument
Growth and appreciation in value	Equity Shares, mutual funds in equity	Real Estate, gold
Regular Income	Deposits, debt instruments	Debt funds, Real estate
Liquidity	Bank Deposits	Mutual Funds – Short term, liquid funds
Capital Preservation	Bank Deposits	Ultra-short term funds

(B) (i) (A) Investment banking is entirely different from commercial banking which needs license from RBI. Further, permission is not automatic. Objections are raised, set right and then approved.

(ii) (B) Goods have to be durable to be traded on the exchange. Diamonds have been recently introduced for trading.

(iii) (C) The breaking up of an entire portfolio of loans into smaller marketable portions of negotiable instruments is called debt securitization.

(iv) (C) Margin trading is a facility given to the investors in which they can invest in shares by part financing from the bank. The shares purchased are themselves the collateral for the bank and variation in prices will easily be covered by the margin contributed by the borrower.

(v) (B) The number of persons beyond 200 will invoke public offering and therefore SEBI will come into picture. Hence, restricting the issue to 150 persons will be private placement and in order. Setting up a Mutual Fund will not be possible since the money cannot be invested in one company or even mainly in one company. Moreover, Mutual Fund should be an Indian entity. Also, banking and marketing cannot go together. In such cases, license will not be granted.

(C) (i) Credit Default Swap (CDS)
(ii) Secondary Market/Stock Exchange
(iii) Takeover/Strategic Acquisition

SOLUTION TO CASE STUDY : III

Solution to Question 1:

It is true that a factor not only finance trade debts but also performs various other functions. These functions include:

(i) Maintenance/administration of sales ledger: The factor maintains the clients' sales ledgers. On transacting a sales deal, an invoice is sent to the customer and a copy of the same is sent to the factor. The factor also gives periodic reports to the client.

(ii) Collection facility: The factor undertakes to collect the receivables on behalf of the client relieving him of the problems involved in collection, and enables him to concentrate on other important functional areas of the business. It also enables the client to reduce the cost of collection by way of savings in manpower, time and efforts.

(iii) Credit Control and Credit Protection: Assumptions of credit risk is one of the most important functions of the factor. This service is provided where debts are factored without recourse. The factor in consultation with the client fixes credit limits for approved customers.

(iv) Advisory Services: By virtue of their specialized knowledge and experience in finance and credit dealings and access to extensive credit information; factors can provide the following information services to the clients:

a. Customer's perception of the client's products, changing in marketing strategies, emerging trends etc.

b. Audit of the procedures followed for invoicing, delivery and dealing with sales returns.

c. Introduction to the credit department of bank/subsidiaries of banks engaged in leasing, hire-purchase, merchant banking.

Solution to Question 2:

We need to perform two distinct calculations - one which calculates the cost of factoring and one which calculates the cost without factoring. Then, the difference between the two calculations will be the cost /benefit of factoring.

A. Cost of factoring

Credit Sales for last year	6,40,00,000
Expected New credit sales level	7,68,00,000
Expected average collection period	30

Average level of receivables (7,68,00,000*30/360)	64,00,000
Receivables advanced by factor (80%)	51,20,000
Factoring Commission (64,00,000*2%)	1,28,000
Amount available for advance (51,20,000-1,28,000)	49,92,000
Factoring interest @12% (49,92,000*12%*30/360)	49,920
20% still financed by overdraft	12,80,000
Overdraft interest (12,80,000*11%*30/360)	11,733
Annual cost	
Factoring Commission (1,28,000*360/30)	15,36,000
Factoring Interest charges (49,920*360/30)	5,99,040
Overdraft charges (11,733*360/30)	1,40,800
Total (A)	**22,75,840**

B. Cost of not factoring

Credit Sales for last year	6,40,00,000
Expected New credit sales level	7,68,00,000
Expected average collection period	45
Average level of receivables (7,68,00,000*45/360)	96,00,000
Overdraft interest	10,56,000
Credit admin cost	13,00,000
Total (B)	23,56,000

Since the cost of factoring is less than cost of not factoring, it is financially beneficial to employ the services of a factor.

Solution to Question 3:

Summary of the distinct advantages of factoring over other methods of finance/facilities provided to an exporter:

(i) Immediate finance up to a certain percentage (say 75-80 percent) of the eligible export receivable. This pre-payment facility is available without a letter of credit – simply on the strength of the invoice(s) representing the shipment of goods.

(ii) Credit checking of all the prospective debtors in importing countries, through own databases of the export factor or by taking assistance from his counterpart(s) in importing countries known as import factor or established credit rating agencies.

(iii) Maintenance of entire sales ledger of the exporter including undertaking asset management functions. Constant liaison is maintained with the debtors in importing countries and collections are effected in a diplomatic but efficient manner, ensuring faster payment and safeguarding of financial costs.

(iv) (iv) Accordingly, bad debt protection up to full extent (100 percent) on all approved sales to agreed debtors ensuring total predictability of cash flows.

(v) (v) Efficient and fast communication system through letters, e-mail, and telephone or in person in the buyer's language and in line with the national business practices.

(vi) (vi) Consultancy services in areas relating to special conditions and regulations as applicable to the importing countries.

Solution to Question 4:

(i) d

A company's investment in total current assets signifies the Working Capital. So, Gross working capital is equal to total current assets. Gross Working Capital for Vrikshya is computed as follows:

Trade receivables	40,00,000
Cash and cash equivalents	5,00,000
Total current assets/Gross working Capital	45,00,000

Option a is incorrect as it reduces trade payables from total current assets. Option b is incorrect as it reduces trade payables and short term provisions from total current assets.

Option c is incorrect as it represents net working capital

(ii) d

financing upon the financing standing of the availing bank happens in forfaiting.

(iii) c

The calculation is as under:

Annual credit sales	1,20,00,000
Average collection period	50
Average level of receivables (1,20,00,000*50/365)	16,43,836
Receivables advanced by factor (80%) (A)	13,15,068
Factoring Commission @2% of 16,43,836 (B)	32,877
Amount available for advance (13,15,068-32,877)	12,82,191
Factoring interest @10% (12,82,192*10%*50/365)(C)	17,564
Amount remitted to Vrikshya (A-B-C)	12,64,627

(iv) b

The calculation is as under:

Amount remitted to Vrikshya as calculated above (X)	12,64,627
Factoring cost for 50 days:	
Factoring Commission	32,877
Factoring interest	17,564
Total	50,441
Factoring cost for the year (50,441*365/50)(A)	3,68,219
Less: Costs saved	
Bad debts (2% of 1,20,00,000) (B)	2,40,000
Administration costs (C)	50,000
Net factoring cost (A-B-C)	78,219
Net factoring cost (%)(78,219/12,64,627*100)	6.19

Option a is incorrect as it calculates net factoring cost on 80% of receivables and not the amount remitted to client.

Option c is incorrect as it nets annual costs of bad debts and administration against the factoring cost for 50 days.

Option d is incorrect as it nets bad debt cost for 50 days and annual administration costs against the factoring cost for 50 days.

SOLUTION TO CASE STUDY : V

Solution to Question 1:

It is true that just like other financial products, Collateralized Loan Obligations

(CLO) are also subject to various types of risk. These risks include:

1. *Default Risk:* Also called 'credit risk', it emanates from the default of underlying party to the instruments. The prime sufferers of these types of risks are equity or junior tranche.
2. Interest Rate Risk: Also called Basis risk and mainly arises due to different basis of interest rates. For example, asset may be based on floating interest rate but the liability may be based on fixed interest rates.
3. Liquidity Risk: Another major type of risk by which CDOs are affected is liquidity risks as there may be mismatch in coupon receipts and payments.
4. *Prepayment Risk*: This risk results from unscheduled or unexpected repayment of principal amount underlying the security. Generally, this risk arises in case assets are subject to fixed rate of interest and the debtors have a call option.
5. *Reinvestment Risk*: This risk is generic in nature as the CDO manager may not find adequate opportunity to reinvest the proceeds when allowed for substitutions.
6. *Foreign Exchange Ris*k: Sometimes CDOs are comprised of debts and loans from countries other than the country of issue. In such a case, in addition to above mentioned risks, CDOs are also subject to the foreign exchange rate risk.

Solution to Question 2:

A Credit default swap (CDS) can be structured as follows:

1. ABC Bank Limited buys Credit Default Swap (CDS) from MNC Bank for the 10 year, unsecured 8% corporate bond of DEF Limited amounting Rs 10 crores.
2. Here, ABC Bank Limited is the buyer of CDS as it needs protection against default by DEF Limited on its corporate bond. DEF Limited is the reference entity, the entity owing the bond obligation and MNC Bank is the writer or seller of the CDS.
3. ABC Bank Ltd will pay periodic premium to MNC Bank.
4. In case DEF Limited defaults on bond, ABC Bank Limited will receive one time payment and CDS contract is terminated

Solution to Question 3:

With respect to 10 year 8% corporate bond of DEF Limited, the three categories of credit risk can be explained as under:

1. Default Risk

Default risk is the risk that borrowers default, meaning that they fail to comply with their obligations to service debt. Default triggers a total or partial loss of any amount lent to the counter party. Default Risk can be measured by probability of default. It depends on credit worthiness of a borrower which in turn depends upon various factors such as management of organization, size of business, strength and reputation of promoters etc.

In case of 10 year 8% corporate bond of DEF Limited, the rating downgrade indicates greater probability of default by DEF in making the promised payments of interest or principal and hence subject to default risk.

2. Exposure Risk

Exposure risk arises from the fact that future exposures (the size of amount due) are subject to uncertainty. Since only future exposures will trigger losses in the event of default, and since future exposures are uncertain, there is exposure risk.

Bonds usually have a fixed maturity date and fixed interest payment schedules but they are subject to exposure risk since a bond issuer facing financial distress may seek to renegotiate or modify terms of the bond, as part of debt restructuring.

3. Recovery risk

Economically, the amount of recoveries is not known in advance. It depends on the quality of collateral or guarantees backing the instrument and economic conditions of borrowers. Recovery risk refers to such uncertainty that arises at the time of default.

Debt ranks ahead of all types of equity with respect to priority of payment within the debt component of the capital structure, there can be varying levels of seniority. Which bond will have priority of claim in the event of default depends upon the classification of bonds. Higher priority of claim implies higher recovery rate in the event of default.

With respect to priority of claims, secured bonds ranks ahead of unsecured bonds, and within unsecured bonds, senior bonds ranks ahead of subordinated bonds. In the typical case, all of an issuer's bonds have the same probability of default due to cross-default provisions in most indentures.

Since the DEF corporate bond is unsecured, it faces high recovery risk in the event of default.

Solution to Question 4:

(i) d

CAMEL stands for **C**apital, **A**ssets, **M**anagement, **E**arnings, **L**iquidity. Statement a is incorrect because ABC Bank scores highest in terms of Capital adequacy and not credit worthiness

Statement b is incorrect because JKL Bank scores lowest in Earnings and not employment Level

Statement c is incorrect because NGO Bank scores par with ABC in Liquidity and not Leverage.

(ii) b

Statement a is incorrect because fully funded synthetic CDO comprises of CLN only

Statement c is incorrect because partially funded synthetic CDO comprises of CLN and CDS.

(iii) c

The calculation is as under:

Loan outstanding	90,00,000
Amount of exposure (loan to be written off)	90,00,000
Current Home Value	84,00,000
Recovery amount (home to be sold)	84,00,000
Recovery rate (Amount recovered/Loan outstanding*100)	0.9333
Default Probability	0.50
Expected Loss (Default risk*Amount of Exposure*(1-Recovery Rate)	3,00,000

(iv) d

Statement a is incorrect. The cost of CDS that is the premium paid by the buyer has a positive relationship with risk attached with bonds. In case of DEF corporate bond, since the rating has been downgraded and the bond is unsecured, the credit risk is higher and hence, the premium for CDS providing protection against default on such bond will be higher.

Statement b is incorrect. If an investor buys a CDS without being exposed to credit risk of the underlying bond issuer, it is called "naked CDS". In this case, ABC is exposed to credit risk of DEF and hence the CDS purchased will not be a naked CDS.

Statement c is incorrect because by entering into CDS, credit risk is not eliminated but it transfers from bond holder (CDS buyer) to CDS Seller. Statement d is correct. MNC will receive periodic premium payments as long as DEF does not default during the period of swap contract. If it defaults, MNC will pay ABC the stipulated amount and contract will be terminated.

(v) b

Statement a is incorrect as failure by Nigerian Government to make timely payments on the bond issued or actually default on its bond obligations is not liquidity risk but sovereign risk.

Statement c is incorrect because repricing risk is not a country risk but a market risk.

Statement d is incorrect because the risk mentioned is political risk and not transfer risk.