

CF02

# Operations of Financial Institutions

8 APRIL 2003

1. Time allowed : Three (3) hours
2. Total number of questions : Five (5) questions
3. Number of questions to be answered : Four (4) questions  
Part A : Compulsory questions [40 marks]  
Part B : Three (3) questions [20 marks each]
4. Show details of workings, where appropriate. Silent, non-programmable calculators may be used.
5. Begin each answer to a new question on a fresh page.
6. Answer **all** questions in **English**.

## PART A

### COMPULSORY QUESTION

1. (a) (i) The Banking and Financial Institutions Act 1989 does not provide any definition for the word "customer". However case law has laid down various "qualities" that a person must have before he is considered a customer of a bank.
- What are these "qualities"? [4]
- (ii) What are **two** rights and **two** duties of a customer in a banker-customer relationship? [4]
- (b) Mr Nirmal Singh, a valued customer of your bank, is studying the possibility of exporting to African countries. He has learnt that the Government has Bilateral Payments Arrangements/Agreements with various other developing countries and has asked you what this means.
- Explain to Mr Nirmal how Bilateral Payments Arrangements/Agreements work. [9]
- (c) A currency option gives its holder the right but not the obligation to buy or sell the currency at a specified price over a period of time. In order to obtain this option, the holder must pay a premium.
- What are **four** factors that determine the premium? [8]
- (d) Under Islamic banking, a bank accepts deposits from its customers who are looking for investment opportunities under the Al-Mudharabah principle.
- Briefly explain how the Al-Mudharabah principle works for deposits. [5]
- (e) From a customer's perspective, you represent the company you work for. Therefore, it is important that you know your company well.
- What are **two** benefits of knowing your company? [4]
- (f) Conflict of interest may occasionally arise when an individual works in a financial institution.
- What are the **three** different scenarios under which conflict of interest may arise? Give an example for each of these scenarios. [6]
- (Total:40 marks)

## PART B

### ANSWER THREE (3) QUESTIONS ONLY

2. (a) What are the requisites which must be fulfilled for a document to be rightfully called a "cheque"? [7]
- (b) Who are the persons authorised to cross a cheque? [6]
- (c) What are considered as material alterations of a cheque? [7]
- (Total:20 marks)

3. (a) Before granting a hire-purchase facility, most financial institutions require the hirer to provide a guarantor.

What are **three** obligations and **five** rights of a guarantor in a hire-purchase agreement? [12]

- (b) You are an Account Relationship Officer in a bank and one of your customers enjoys a hire-purchase facility with the following terms:

Interest rate	6.25% per annum
Hiring period	3 to 5 years
Margin of advance	Up to 85% of cost
Rental period	Monthly

The customer wants to buy a medical equipment costing RM650,000. Calculate the following:

- (i) The maximum loan amount [2]
- (ii) Based on the maximum loan amount in (b)(i) above, what is the monthly rental if the hiring period is
- (aa) 3 years? [2]
- (bb) 4 years? [2]
- (cc) 5 years? [2]
- (Total:20 marks)

4. (a) "Capability" and "condition" are two of the Cs in credit.
- What are the factors to consider when evaluating these two Cs? [14]
- (b) Financial ratios are used to determine the financial health of a borrower. However, financial ratios have their limitations.
- What are **five** limitations in using financial ratios? [6]
- (Total:20 marks)

5. (a) What are **six** risks of investing in a unit trust? [12]
- (b) What are **five** factors to consider when choosing the right unit trust investment? [8]
- (Total:20 marks)

**- END OF QUESTION PAPER -**

## **OUTLINE ANSWERS**

### **PART A**

#### **Question 1**

Many candidates failed to distinguish between a customer and a “casual relationship”, and also the rights and duties of a customer.

There was an apparent lack of knowledge on what Bilateral Payment Arrangements/Agreements (BPAs) are or how the Al-Mudharabah principle works.

Candidates were able to list the factors that determine the premium of an option and also the benefits of knowing their own companies (i.e. basic information, policies and procedures, products and services, etc.)

While candidates were able to give the different scenarios under which conflict of interest may arise; they failed to support their answers with examples, which was required by the question.

1. (a) (i) The qualities are:
- Must have an account (deposit or current)
  - Bank accepts his instruction to act on his behalf
  - Duration of relationship is not important
  - Casual relationship does not make a person a customer
- (ii) Customer's rights:
- Repayment
  - To draw cheques
- Customer's duties:
- To exercise reasonable care in drawing cheques
  - To disclose forgery
- (b) Bilateral Payment Arrangements/Agreements
- Bank Negara Malaysia (Central Bank of Malaysia) enters into bilateral and reciprocal banking arrangements with the central bank of a developing country.
  - The central banks of both countries will effect and guarantee settlements of financial claims arising from the export/import of goods between the 2 countries.
  - The central bank of exporting country will pay exporters the domestic equivalent of export proceeds through designated banks. Central bank of importing country undertakes to discharge the obligations of importer by reimbursing central bank of exporting country via inter-central bank accounts established for this purpose. Central bank of importing country will claim from the importer.
  - Settlement of financial claims between 2 countries rest on capacities of the 2 central banks. Exporters do not worry about the commercial risk of doing business with trading partners.
  - Commercial risk is now converted into sovereign (country) risk.
  - Savings on foreign exchange as settlement among central banks conducted on net basis.
- (c) Factors determining premium:
- Duration of option
  - Volatility of currency
  - Relationship between strike price and current forward price
  - Interest rate of currency

- (d) The Al-Mudharabah principle:
- Bank provides entrepreneurship
  - Depositor provides capital
  - Both parties agree on the distribution of profits
  - Depositor does not participate in management of investment
  - Depositor bears all losses
- (e) Benefits of knowing your company:
- Can answer wide range of questions about company to favourably impress customer. Viewed as well prepared, informed and knowledgeable.
  - As you learn more about the company, you gain sense of loyalty to the company. Should you meet with criticism, you will be able to put up a strong defence.
  - If you are familiar with company policies and procedures, you will be able to handle customers' queries and complaints.
- (f) Conflict of interest can arise between:
- Bank and its staff e.g. bank foreclosing property belonging to staff's family
  - Bank and its customers e.g. customer asking bank to accept third party cheques
  - Bank's staff and bank's customers e.g. customer's business and staff's family business are in direct competition

## PART B

### Question 2

Although candidates were able to list the requisites of a cheque, they were confused between the "crossing" and "indorsement" of a cheque.

Candidates were also under the incorrect impression that "material alterations" were the same as fraud.

2. (a) Requisites of a cheque:
- Must be an unconditional order to pay
  - Order must be in writing
  - Addressed by one person to another who must be a banker
  - Signed by the person giving the order
  - Requiring banker to pay on demand
  - A sum certain in money
  - To the order of a specified person or bearer
- (b) Persons authorised to cross cheque:
- Drawer of cheque
  - Holder of cheque
  - Banker
  - If cheque is generally crossed, banker may cross it specifically
- (c) Material alterations to a cheque:
- Date
  - The amount payable in words
  - Crossing
  - Alterations from order to bearer
  - Payee's name

### Question 3

Candidates were not able to list the obligations and rights of a guarantor in a hire purchase agreement. However, they performed well in calculating the monthly rental under hire purchase.

3. (a) Obligations and rights of a guarantor in a hire-purchase agreement:

**Obligations:**

- Equivalent to that of the hirer.
- Obligation subsists even after goods have been repossessed.
- Where the guarantor has paid the owner the amount due from the hirer, his obligation is discharged.

**Rights:**

- Guarantor may indemnify himself by suing hirer in the name of the owner.
- Guarantor may insist on the transfer to himself of any security that the owner had taken from the hirer.
- He is entitled to avail himself of any set-off or counter claim that the hirer has against the owner.
- He may sue in his own name for any claims made by the owner on the guarantee.
- He can apply to the magistrate court for an order compelling the hirer to pay the instalments to the owner as and when the instalments fall due.

- (b) (i) Maximum loan amount:

$$= \text{RM}650,000 \times 85\% = \text{RM}552,500$$

- (ii) (aa) Rental for 3 years tenor:

$$= \frac{\text{RM}552,500 + (552,500 \times 6.25\% \times 3)}{3 \times 12}$$

$$= \text{RM}18,224.83$$

- (bb) Rental for 4 years tenor:

$$= \frac{\text{RM}552,500 + (552,500 \times 6.25\% \times 4)}{4 \times 12}$$

$$= \text{RM}14,388.02$$

- (cc) Rental for 5 years tenor:

$$= \frac{\text{RM}552,500 + (552,500 \times 6.25\% \times 5)}{5 \times 12}$$

$$= \text{RM}12,085.94$$

#### Question 4

Although the 5Cs of credit and the limitations of financial ratios are frequently examined, candidates still have a very poor understanding of these concepts, as reflected in their answers.

4. (a) Factors to consider when evaluating:

**Capability:**

For individuals

- Salary/income
- Wealth
- Qualification
- Business acumen
- Health
- Industriousness

For businesses

- Technical skills
- Raw materials availability
- Business acumen
- Aggressiveness
- Judgement

**Condition:**

- Economic condition
- Industry outlook
- Government policy

- (b) Limitations of financial ratios:

- Ratios reflect relationship between 2 items. Sometimes it is important to examine the two items individually.
- The 2 items must be related.
- One ratio does not tell the whole picture. Sometimes, several ratios have to be considered to get a better picture.
- Ratios tell the relationship at a point in time. The trend of a ratio is important.
- Ratios depend on the figures used to compute them. The accuracy of the figures is important.

#### Question 5

Only a few candidates were able to list the risks of investing in a unit trust and the factors to consider when choosing the right unit trust investment.

5. (a) Risks of investing in unit trust:

- Market risk
- Stock risk
- Currency risk
- Country risk
- Manager's risk
- Dividend risk

- (b) Factors to consider when choosing right investment:

- What stage in life is the investor?
- What is investor's goal?
- What is the time horizon for the investment?
- What kind of returns is investor looking for?
- What level of risk is acceptable to the investor?