

CF02

Operations of Financial Institutions

9 OCTOBER 2001

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) Banking secrecy is very important to maintain public confidence in the banking system. However, Section 99 of the Banking and Financial Institutions Act 1989 permits bankers to disclose information regarding their customers.
- State the circumstances under which such disclosures are permitted. [8]
- (b) (i) What is a “shipping guarantee”? [2]
- (ii) What are the salient features of a shipping guarantee? [4]
- (c) Name the **four** types of Negotiable Instrument of Deposits in the Malaysian money market. [8]
- (d) In an effort to reduce the long queues in the banking halls, banks are encouraging their customers to make cash withdrawals through the Automated Teller Machines (ATMs).
- Apart from cash withdrawal, list **four** other functions that can be performed using the ATMs in Malaysia. [6]
- (e) (i) Name the **three** types of indorsement on a cheque. [3]
- (ii) State the effect of each type of indorsement mentioned in (i) above. [5]
- (f) Briefly describe how project financing under the *Al-Mudharabah* principle works. [4]
- (Total:40 marks)

PART B

ANSWER THREE (3) QUESTIONS ONLY

2. The Biro Maklumat Cek (BMC) was set up in order to curb the high incidences of “bad” cheques.
- Explain and illustrate each of the following in respect of BMC’s definitions and rules regarding “bad” cheques:
- (a) Twelve months roll-over time frame [8]
- (b) Prohibition period [6]
- (c) Probation period [6]
- (Total:20 marks)
3. (a) Describe the advantages and disadvantages of leasing to:
- (i) a lessee [5½]
- (ii) a lessor [4½]
- (b) Baram Microchips Sdn Bhd enjoys a pure leasing facility from your finance company. Assuming Baram Microchips Sdn Bhd now plans to lease an equipment costing RM250,000 from your finance company, calculate the following:
- (i) The monthly rental if the lease is for **three** years at the interest rate of 8.0% per annum. [4½]

- (ii) The monthly rental if the above lease is a residual value lease with the residual value being 20.0% of the cost price and the interest rates on capital repayment and residual value are 8.0% per annum and 10.0% per annum respectively. [5½]~
(Total:20 marks)

4. Samarahan Plantations produces desiccated coconut for export purposes. Their overseas trade dealings are mostly conducted through Letters of Credit (LCs) established by their customers.

Puan Rosita, who recently joined Samarahan Plantations, has come to seek your advice on documentary credits. Explain to Puan Rosita, the advantages of documentary credits to the:

(a) exporter [14]

(b) importer [6]
(Total:20 marks)

5. As a credit officer considering a loan application from a customer, what are the questions that must be satisfactorily answered before you recommend the approval of the loan?
(Total:20 marks)

- END OF QUESTION PAPER -

OUTLINE ANSWERS

PART A

Question 1

The answers given were of average level.

1. (a) Instances under which bankers may disclose information:
 - The customer or his personal representation has given permission in writing.
 - The customer is declared a bankrupt or if a corporation, if it is being wound up.
 - A party to a bona fide commercial transaction requires information.
 - In the course of civil proceeding between:
 - the bank and its customers or their guarantors
 - the bank and two or more parties making adverse claims to moneys in the customer's account.
 - Where the bank has been served a garnishee order.
 - Where the information is required by the Head Office.
 - Where disclosure is authorised by BNM.

- (b) (i) A shipping guarantee is an indemnity given by the consignee to a shipping company or its agent, so that the shipping company may release the merchandise to the consignee named in the shipping guarantee without the presentation of the relevant bills of lading.

- (ii) The salient features of a shipping guarantee:
 - It does not specify the total liability of the bank – it does not have an amount stated in the guarantee.
 - It does not specify an expiry date.

- (c) The four types of NIDs are:
 - Short term Negotiable Certificate of Deposit (NCD)
 - Long term NCD
 - Zero coupon NCD
 - Floating rate NCD

- (d) Any **four** of the following:
 - (i) Balance Inquiry
 - (ii) Request for bank statements
 - (iii) Deposit of cash/cheques
 - (iv) Request for cheque books
 - (v) Payment of utilities bills
 - (vi) Subscription of IPO
 - (vii) Transfer of funds

Note: Answers may include any other functions that are currently performed using ATMs.

- (e) (i) Blank indorsement – indorser signs behind the cheque.
Effect: Any one who presents the cheque to the bank can receive payment.
- (ii) Special indorsement – indorser specifies the person to whom the cheque is being transferred.
Effect: A can transfer the cheque to B by adding the words “pay to the order of B” in addition to his signature.
- (iii) Restrictive indorsement – indorser specifies the person to whom the cheque is being transferred by using the word “only”. E.g., “Pay to B only”.
Effect: This prevents the cheque from being paid to anyone else.
- (f) (i) Bank undertakes to provide the financing for the project.
(i) Bank becomes the provider of capital.
(ii) The initiator of the project becomes the entrepreneur. He manages the project without the interference of the bank.
(iv) Bank has the right to follow-up and supervise the project.
(v) The bank and the initiator will negotiate and agree on the distribution of profits.
(vi) Any loss will be borne by the bank.

PART B

Question 2

Although there were some good answers, many of the candidates failed to provide examples to illustrate their answers, indicating they did not have a full understanding of the Biro Maklumat Cek.

2. (i) Twelve months roll over time frame – three bad cheques incidents within a 12-month period.
- | | | | | |
|------|--------------------------|---------|---|---|
| e.g. | 1 st incident | 10/2/96 | } | all 3 incidents within 12 months |
| | 2 nd incident | 15/4/96 | | |
| | 3 rd incident | 16/1/97 | | |
| | 1 st incident | 10/2/96 | } | 3 rd incident outside the 12 month period |
| | 2 nd incident | 15/4/96 | | |
| | 3 rd incident | 2/3/97 | | |
| | 1 st incident | 10/2/96 | } | 4 th incident within the 12 month period of the 2 nd incident |
| | 2 nd incident | 15/4/96 | | |
| | 3 rd incident | 2/3/97 | | |
| | 4 th incident | 28/3/97 | | |
- (ii) During this period, offender will not be allowed to open a current account. The prohibition period depends on the number of times the offender is black listed.
- | | |
|--------------------------------|-----------|
| 1 st time | 6 months |
| 2 nd time | 12 months |
| 3 rd time | 12 months |
| 4 th time & onwards | 24 months |

- (iii) After the prohibition period, the offender may be allowed to open a current account. However, he is still under probation. If he does not commit another bad cheque offence, he will be given a clear record upon the end of the probation period.

The probation period is:

1 st offence	2 years
2 nd offence	2 years
3 rd offence	3 years
4 th offence & onwards	3 years

Question 3

Some candidates were confused the terms “lessee” and “lessor”. Candidates did well in the section, which required them to calculate the monthly lease rental.

3. (a) (i) Advantages and disadvantages of leasing to the lessee:

Advantages:

- Rental payments are fully deductible as expenses.
- Capital is conserved. Only need to use minimum capital or none at all if 100% lease.
- Lease is not included as a liability in the balance sheet.
- Eliminates the possibility of owning obsolete equipment.
- Cash flow advantage – no cash or little is expended initially.
- Hedge against inflation – as lease is shorter than allowed depreciation.
- Lease tailored to suit the life of equipment. New lease taken out to replace worn out equipment.
- Fixed and regular Rental – cash flow planning easier.

Disadvantages:

- Lease cannot be cancelled.
- Cannot enjoy special privileges like pioneer status, etc.
- No provision for grace period – must meet rental commitment.

- (ii) Advantages and disadvantages of leasing to the lessor:

Advantages:

- Ownership of the asset rests with lessor.
- Better returns than traditional lending.
- Leasing is asset based and therefore secured.
- Diversify services and retain customers' loyalty.

Disadvantages:

- Asset leased may be obsolete at the end of the lease.
- Equipment may be specialised and lessor may not be able to dispose off the equipment at the end of the lease.
- Risk of lessee defaulting.
- Lessee may not look after equipment properly.
- May be liable to third party claim arising out of the use of the equipment.

- (b) (i) Cost = RM250,000
Interest = 8 % p.a.
Period = three years

$$\frac{RM250,000 + (RM250,000 \times 8\% \times 3)}{36}$$

$$= RM8611.11 \text{ per month}$$

- (ii) Residual value at 20% (RM250,000 x 20%) = RM50,000

$$\frac{RM200,000 + (RM200,000 \times 8\% \times 3) + (RM50,000 \times 10\% \times 3)}{36}$$

$$= RM7305.56 \text{ per month}$$

Question 4

This was the most unpopular question in this examination. Nevertheless, the candidates who answered this question showed a satisfactory understanding of the topic examined.

4. Advantages of documentary credit:

- (i) To the exporter:

- Does not have to worry about the credit standing of his buyer.
- If he has doubts about the credit standing of the issuing bank, he can request for the LC to be confirmed.
- Irrevocable LC cannot be cancelled unless he gives his consent.
- Does not have to worry about the customs requirement of the buyer's country.
- Can use LC as security for advance from his bank.
- If he requests for a transferable LC, he can transfer the whole or part of the LC to his suppliers.
- In the case of a sight LC, he can receive payment almost immediately.

- (ii) To the importer (buyer):
- Payment will only be made if all the terms of the LC are complied with.
 - Can stipulate the time by which the goods must be delivered to him.
 - If he wants the goods to be send regularly, he can arrange for a revolving LC.
 - If he needs financing, he can arrange for a deferred LC or he can arrange for his banker to grant him a credit line.

Question 5

Many candidates misread the question and gave only the 5Cs as their answer.

5. (i) Purpose of loan:
- must reflect government policy
 - be consistent with present business activities
 - for working capital, purchase of fixed assets or speculative?
- (ii) Amount:
- must be adequate
 - is the basis of calculation correct?
- (iii) Duration of loan:
- does it commensurate with nature of proposal?
- (iv) Repayment
- is the present income adequate?
 - future income – is the revenue to be generated from proposal realistic?
 - will the sale of assets be sufficient?
- (v) Know-how
- does customer have the technical know-how?
 - market reputation of the borrower?
 - past performance – any indication/ability to carry out proposed project?
- (vi) Market stability
- how stable is the market for the demand of the products?
 - existence of substitutes?
 - is product “recession” proof – basic necessity or luxury goods?
- (vii) Financial
- is the borrower financial sound?
 - fund flow position of borrower
 - long term financial position
- (viii) Bank’s position
- bank’s exposure to borrower
 - other banks’ exposure to borrower
 - bank’s exposure to the industry
- (ix) Security
- what are the securities available?
 - ease of disposal
 - value of security in the event of auction?
- (x) Monitoring
- does the loan require close monitoring?
 - does the bank have the means to closely track the performance of the loan?