

**DP08**

# **Retail Financial Services**

**12 OCTOBER 2005**

1. Time allowed : Three (3) hours
2. Total number of questions : Six (6) questions
3. Number of questions to be answered : Five (5) questions  
Part A : Three (3) questions [20 marks each]  
Part B : Two (2) 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**.
7. Blank pages are provided at the end of the question paper for rough work.

## PART A

### ANSWER ALL THREE (3) QUESTIONS

1. (a) (i) On 1 July 2005, Ali's fixed loan facility of RM100,000 was fully drawn down.  
Compute the interest payable for the month of July 2005, assuming that no repayment was made during the month and the interest rate charged for that month was 8.0%. [2]
- (ii) Ali also has an overdraft facility with a credit limit of RM50,000 that has not been utilised at all. On 30 July 2005, Ali decided to withdraw all the funds available (RM50,000) to pay his building contractor for the renovation of his house.  
Calculate the overdraft interest payable for the month of July 2005, assuming that the interest rate charged was 8.5%. [2]
- (b) A housing loan is long-term in nature. As a result, banks face significant risks due to the many unforeseen circumstances during the long loan tenure.
- (i) Briefly explain **three** specific risks faced by banks in managing their housing loan portfolio. [3]
- (ii) Name **two** measures that can be taken to mitigate the risks identified in (b)(i) above. [2]
- (c) It is increasingly common for an individual to finance the purchase of a house with a personal overdraft.  
State **four** advantages of using a personal overdraft to finance the purchase of a house. [4]
- (d) (i) From an individual investor's viewpoint, list **four** factors why a unit trust investment is preferred over a share investment. [4]
- (ii) The Securities Commission has set guidelines for the financing of unit trust investments to protect the interest of borrowers.  
State **three** guidelines that banks must comply with when they provide financing for unit trust investments. [3]  
(Total:20 marks)
2. (a) The following questions relate to the Hire-Purchase Act 1967. Fill in the blanks with the appropriate figures:
- (i) The Hire-Purchase (Terms Charges) Regulations 1968 provides that the maximum rate of term charges is \_\_\_\_% per annum. [1]
- (ii) Under Section 31(1), the hirer is required to pay a minimum deposit of \_\_\_\_% of the cash purchase price of the goods, and the maximum margin allowable is \_\_\_\_%. [2]
- (iii) Under Section 34, the maximum interest on any overdue instalments to be charged should not exceed \_\_\_\_% per annum based on simple interest calculated on a daily basis. [1]
- (iv) The stamp duty payable for a hire-purchase agreement is RM\_\_\_\_ for the original copy and every copy thereof, and should it incorporate a guarantee, an additional stamp duty of RM\_\_\_\_ is payable. [2]
- (v) Under Section 5(1), an owner must serve a copy of the hire-purchase agreement on the hirer and the guarantor within \_\_\_\_ days. [1]
- (b) In relation to hire-purchase, illustrate with a diagram the repossession procedure from the point of default until the disposal of the repossessed goods. [5]
- (c) Briefly explain **eight** major risks faced by banks when providing commercial and industrial hire-purchase finance. [8]  
(Total:20 marks)

3. ACE Sdn Bhd (ACE) is a trading company. ACE enjoys a RM4million term loan facility and a RM3million overdraft facility from Bank One.

You are the account manager of Bank One and you are in the process of reviewing ACE's application for an increase of RM2million in the overdraft facility to RM5million to meet its business needs.

The following is the summary of ACE's key financial ratios for the past three years, based on the latest audited financial statement (for the financial year ended June 30):

Item	2002	2003	2004
Gross profit margin	26%	28%	30%
Net profit margin	2.5%	2.7%	3.0%
Current ratio	4.5	4.0	3.5
Quick ratio	2.4	2.2	2.0
Stock turnover days	44	63	75
Debtors' days	31	42	65
Creditors' days	15	28	35
Gearing ratio	0.3	0.4	0.5

- (a) Determine ACE's financing gap (in days) for 2003 and 2004. [4]
- (b) Based on the financial ratios for 2004, would you recommend to your Credit Committee to approve ACE's application to increase the overdraft facility from RM3million to RM5million? Explain your answer. [8]
- (c) ACE also applied for a new RM2million overdraft facility from Bank First.

If you were the account manager of Bank First, what other factors apart from ACE's financial performance would you consider when reviewing ACE's application? [8]

(Total:20 marks)

## PART B

### ANSWER TWO (2) QUESTIONS ONLY

4. (a) XPod Sdn Bhd (XPod) is a leading Small- and Medium-sized Enterprise manufacturing iPod parts in the Bayan Lepas Free Trade Zone. XPod intends to purchase a robotic equipment at a cost of RM1.5million.

XPod has three options to acquire the equipment:

- Option 1 : Buy  
 Option 2 : Lease  
 Option 3 : Hire-purchase

Bersatu Finance has offered the following financing proposal to XPod:

Item	Lease	Hire-Purchase
Deposit	RM150,000	RM150,000
Interest rate	4.5%	4.5%
Term instalment	3 years with one advanced instalment payment	3 years
Stamp duty	RM750	RM10

- (i) Which of the three options is preferred if XPod's priority is to conserve its cash flow? Show your workings. [3]
- (ii) If XPod was awarded a pioneer status, which facility is preferred from the tax point of view? Explain your answer. [2]
- (iii) Assuming that XPod would enjoy an initial allowance of 20% and an annual allowance of 12% for the purchase of the robotic equipment, calculate the tax write down value in the fourth year. [3]
- (iv) What is the difference between hire-purchase and leasing with regard to instalment repayment? [2]
- (b) Using diagrams, illustrate the following:
- (i) A credit card transaction process flow involving a cardholder, an acquirer, an issuer and a merchant. [5]
- (ii) A clearing and settlement process flow involving a cardholder, an acquirer, an issuer and a payment organisation. [5]
- (Total:20 marks)
5. (a) Today, banks offer innovative financing packages to Small- and Medium-sized Enterprises (SMEs) featuring a flexible combination of term loans, overdrafts and trade lines.
- (i) State the main purpose of the following:
- (aa) A term loan [1]
- (bb) An overdraft [1]
- (ii) What are **four** differences between a term loan and an overdraft? [4]
- (iii) Give **five** reasons why SMEs face difficulties in obtaining financing from banks. [5]
- (b) Agricultural projects are considered high-risk ventures by banks.
- State **nine** factors that contribute to the risks in agriculture financing. [9]
- (Total:20 marks)
6. (a) (i) Using a diagram, illustrate an Electronic Funds Transfer at Point of Sale (EFTPOS) transaction process involving a merchant, a customer and a bank. [7]
- (ii) State **four** major benefits of EFTPOS to a bank and its customers. [4]
- (b) Explain the rights of a guarantor under the Hire-Purchase Act 1967. [6]
- (c) What are **three** differences between a legal charge and a lien-holder's caveat? [3]
- (Total:20 marks)

## OUTLINE ANSWERS

The comments given in the boxes below indicate the areas of weaknesses the examiners have identified and their advice to future candidates.

### Part A

#### Question 1

Candidates did not know the risk mitigating measures required in managing a housing loan portfolio and the Securities Commission's guidelines for unit trust investments.

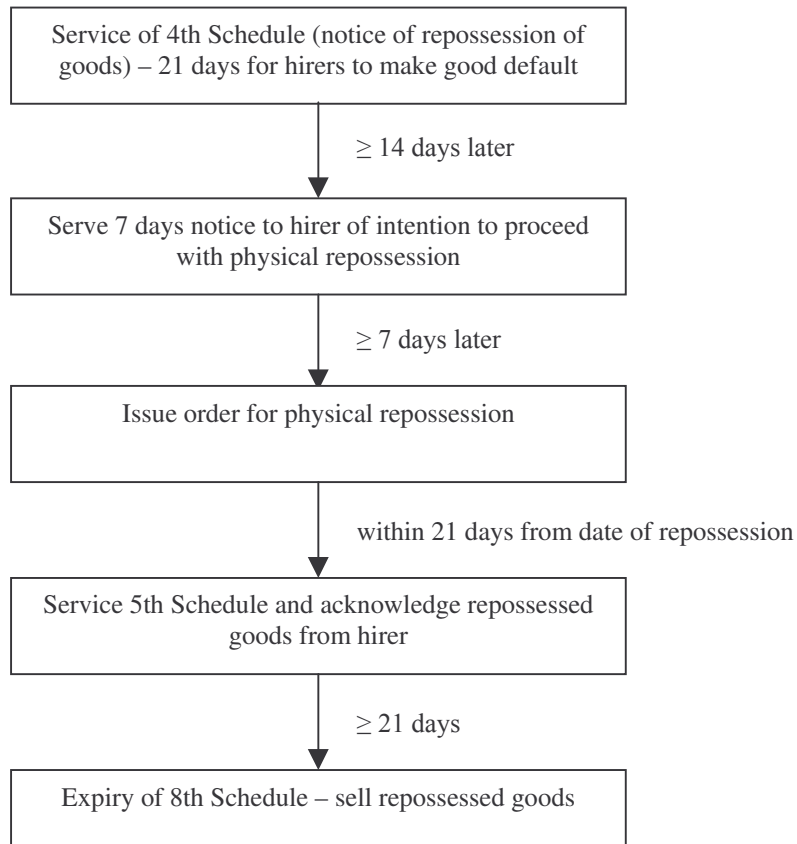
1. (a) (i) Interest payable  
=  $P \times T \times I$   
=  $100,000 \times 31/365 \times 8.0\%$   
= RM679.45  
or  
=  $100,000 \times 1/12 \times 8.0\%$   
= RM666.67
- (ii) Overdraft interest  
=  $P \times T \times I$   
=  $50,000 \times 2/365 \times 8.5\%$   
= RM23.29
- (b) (i) Risks in housing loan financing
- Default risk – failure to repay loan due to unforeseen factors.
  - Interest rate risk – due to volatile interest rate movement.
  - Liquidity risk – funding long term assets with short-term liabilities.
- (ii) Risk mitigating factors
- Requirement for personal guarantors.
  - Periodic review.
- (c) Advantages of using an overdraft for mortgage (any **four**):
- Cheap and flexible debt finance through current account within credit limit.
  - Flexible repayment anytime without notice, savings on interest.
  - Standby credit line with utilisation of amount repaid in the event of contingencies.
  - Non-charging of interest on unutilised portion.
  - No commitment fee payable (<RM250K)
- (d) (i) Advantages of unit trust investment
- Professional management – specialist fund managers.
  - Diversification for investors to spread risk in asset classes (not to put all eggs in one basket).
  - Liquidity – ready market.
  - Flexibility and affordable – low and affordable with initial investment as low as RM10.
- (ii) Securities Commission's guidelines for units trust financing:
- The maximum margin of financing is 67% (i.e. loan up to 2 times the investment value).
  - Investor has to sign a Risk Disclosure Statement.
  - Loan plan sales materials must be disassociated from the sale of unit trusts, e.g. promotion materials involving projections of returns based on a loan scheme is disallowed.

**Question 2**

Candidates were unfamiliar with the HP repossession procedure and the risks involved in HP financing.

2. (a) (i) 10%  
(ii) 10%, 90%  
(iii) 8%  
(iv) RM10, RM10  
(v) 14 days

(b) Repossession procedures



(c) Risks in hire-purchase financing

- Fictitious hirers/goods.
- Fixtures attached to land considered part of land.
- Used/reconditioned equipment – value doubtful and not in demand.
- Stolen goods – unable to transfer clean title and possible claims by hirer.
- Locked premises – unable to enter premises without authorisation.
- Insurance – in subsequent years and incomplete coverage.
- Repossessors – used of excessive and high-handed method.
- Syndicated workshop – exorbitant repair and storage cost.

### Question 3

- Candidates could not determine the financing gap of the given company.
- Candidates could not interpret the financial ratios to make decision on extending the additional credit to the company.
- Candidates did not go beyond the 5Cs of credit into the purpose of the loan, the relevant management experience and sources of repayment, when undertaking a credit evaluation.

3. (a) Financing gap = Stock turnover days + Debtors days – Creditors days

For 2003: 63 and 42 – 28 = 77

For 2004: 75 and 65 – 35 = 105

The financing gap has increase from 77 days to 105 days.

(b) Yes, I propose to increase the overdraft limit from RM3million to RM5million. This is because the financial ratios indicate the following:

- Increasing profitability from the higher gross and net profit margins.
- Declining liquidity ratios (current and quick ratios), due to high stock turnover day which indicate a high stock level.
- Longer debtor days and delays in creditors' payment also indicate higher financing needs.
- Gearing ratio increased slightly due to higher borrowing.

(c) Factors to consider in reviewing a new credit application:

- Nature and purpose of loan.
- Relevant management experience and reputation.
- Financial records and source of repayment.
- 5Cs – character, capital, capacity, conditions and collateral.

## Part B

### Question 4

- Candidates could not evaluate the options available to cater for the need of the different scenarios.
- Candidates could not illustrate a credit card transaction process flow and a clearing and settlement process flow.

4. (a) (i) [Best option: To finance acquisition by hire-purchase]

	Buy	Lease	Hire-purchase
Deposit		150,000	150,000
Stamp duty		750	10
Advanced rental		42,563	
Cash	1,500,000		
	1,500,000	193,313	150,010

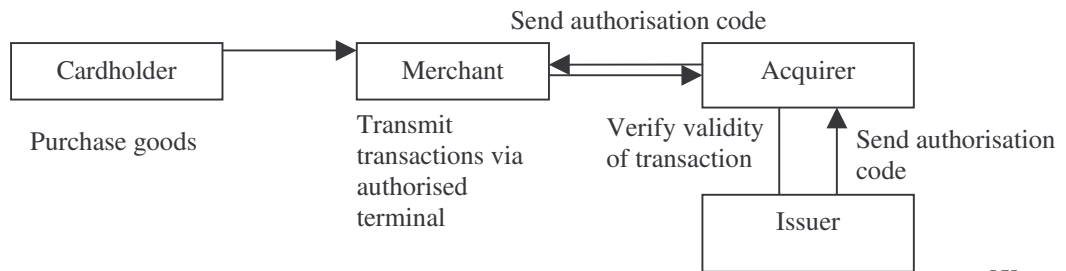
(ii) Hire-purchase is preferred to maximise profit, as the company's profit is not taxable with during the pioneer status period. Better to charge-out HP interest expense which is lower than lease payment during initial years.

(iii)

Year	Equipment cost	Initial allowance (20%)	Annual allowance (12%)	Total	Tax write down value
1	1,500,000	300,000	180,000	480,000	1,020.00
2			122,400	122,400	897,600
3			107,712	107,712	789,888
4			94,278	94,287	695.101

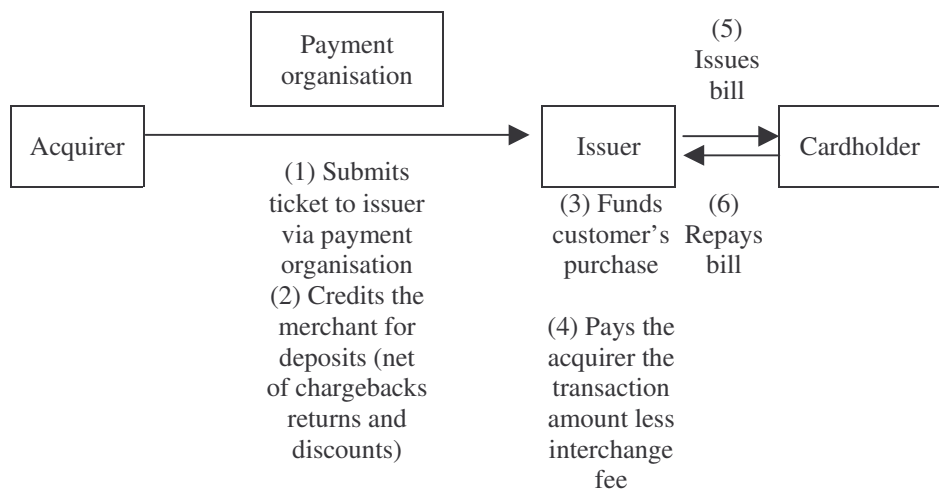
(iv) Hire-purchase instalment is paid in arrears while leasing instalment paid in advance.

(b) (i) Credit card purchase: transaction flow and approval of transaction



[5]

(ii) Credit card payment flow (clearing and settlement)



### Question 5

- Candidates were unable to identify the difficulties faced by SMEs in obtaining financing from banks. Instead, the general problems faced by SMEs were listed, which was not the question requirement.
- Candidates could not determine the factors contributing to the risks in agricultural financing but outlined the types of risks faced by the agricultural sector.

5. (a) (i) (aa) Term loan – granted for the purchase of commercial properties/ fixed assets (other than residential properties) or for working capital.
- (bb) Overdraft – granted for working capital purposes to augment seasonal peaks and trough in business

(ii)

	<b>Term loan</b>	<b>Overdraft</b>
Loan tenor	Long-term	Short-term
Loan period	Fixed term/tenor	Renewed annually (one year) and repayable on demand
Repayment	Fixed instalment schedule, prepayment possible with advance notice	Anytime without notice
Utilisation	Up to approved limit with fixed instalment. Amount repaid cannot be re-utilised.	Up to approved limit Through current account withdrawal permitted up to approved limit

(iii)

Difficulties for SMEs to obtaining financing:

- Absence of satisfactory track records.
- Limited collateral offered to secure loan.
- No proper accounting records – audited account often unreliable.
- Minimal information available for credit processing – unable to provide information required to banks.
- Lack of support from bankers due to high historical default rates.

(b)

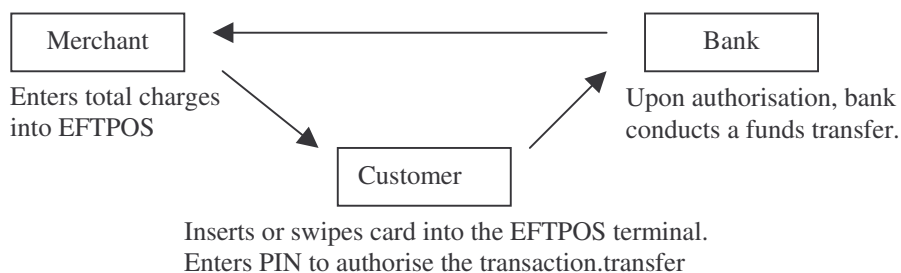
Risk agriculture (any **nine** factors):

- Dependent on external natural elements such as weather, soil, pollution, pest/disease.
- Long gestation period: 3-7 years.
- Price variability.
- Inelastic demand and supply.
- Comparative cost advantages.
- Perishability.
- Imperfect market structure.
- Low investment.
- Poor distribution network.
- High wastage.
- High import contents and imports.
- Low mechanisation and modernisation.
- Labour intensive.
- High competitive for land resources.

### **Question 6**

- Candidates could not illustrate an EFTPOS transaction process flow.
- Candidates could not explain the rights of a guarantor under the HPA.
- Candidates could not state the difference between a legal charge and a lien-holder's caveat.

6. (a) (i) EFTPOS transaction flow



(ii) Benefits of EFTPOS

- Convenience and security-reduce need to carry cash and its inherent risks.
- No requirement for credit processing/checking process like credit card as it is withdrawal from pre-existing deposits/funds.
- Reduce need for ATM for dispensing of cash. Purchase can be made at merchant by debiting the account.
- Increase revenue for acquirer in terms of discount for purchases.

(b) Rights of a guarantor in a hire-purchase (HP) agreement

The guarantor's obligation in an HP agreement is discharged upon payment of the amount due from the hirer to the owner [Section 23(1)]. The guarantor is then entitled to:

- sue the hirer in the name of the owner for any breach of the hirer's obligation under HP agreement by providing the owner with a suitable indemnity for costs
- sue the hirer in his own name if he takes legal assignment of the HP debt.
- insist upon the transfer of all securities taken by the owner from the hirer to himself to secure the performance of the hirer's obligation.
- avail himself of any set-off or counter-claim for any claims made by the owner against the guarantor which the hirer has against the owner [Section 23(3)].
- be indemnified by the hirer against any claim by the owner [Section 24(1)].
- apply to Magistrate Court for an order compelling the hirer to pay instalments to the owner as and when the instalments fall due.

However, the guarantor has no right to seize goods from the hirer in the name of the owner unless provided expressly in the HP agreement Section 25.

(c) Comparison between a legal charge and a lien-holder's caveat:

	<b>Legal charge</b>	<b>Lien-holder's caveat</b>
Purpose of creation	To secure the repayment of any debt or payment if any sum other than a debt or the payment of an annuity or other periodic payment	For the security of the loan
Default	Chargee may apply to court for an order for the sale of the charged land immediately	Need to obtain judgement before applying for an order for sale
Stamp duty	<i>Ad valorem</i> stamp duty	No stamp duty