

DP08

Retail Financial Services

5 SEPTEMBER 2007

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) Jim pledged his shophouse, valued at RM1.5million, to Bank Ace for an overdraft facility to increase his business working capital requirement.

Bank Ace provided an overdraft facility of RM1million. The interest rate was Base Lending Rate (BLR) + 1.5% per annum.

The overdraft account of Jim recorded the following transactions:

Date	Transaction Details	Amount (RM)
1 June 2007	Balance brought down	500,000
15 June 2007	Withdrawal	250,000
30 June 2007	Balance brought forward	750,000
20 July 2007	Deposit	200,000
31 July 2007	Balance brought forward	550,000

- (i) Calculate the interest on the overdraft facility for the month of June if the BLR was 6.5% per annum. [2]
- (ii) Assuming that the BLR increased from 6.5% per annum to 7.0% per annum on 1 July, determine the interest payable on the overdraft facility for the month of July. [2]
- (iii) Calculate the commitment fee for the month of July, assuming that the commitment fee charged on the unutilised portion of the overdraft facility was 1% per annum. [2]
- (iv) Identify **four** advantages of an overdraft facility over a term loan. [5]
- (b) John opened a share margin trading account with Bank One. The share margin account position as at 31 December 2006 showed the following details:

Market value securities	RM300,000
Agreed margin of financing	70%
Margin of finance	2 times
Pre-set line of credit	RM410,000

- (i) Determine the maximum value of shares that John can purchase from his stockbroker, based on the agreed margin of financing. [2]
- (ii) Assuming that the market value of the securities pledged and purchased rose to RM640,000 and the outstanding loan amount remained at RM350,000, determine the maximum value of shares that John can purchase from his stockbroker. [2]
- (iii) Assuming that the market value of the securities pledged and purchased fell, resulting in Bank One making a margin call, what are the **three** options available to John? [3]
- (iv) What would happen if John does not respond to the margin call within the stipulated period required by Bank One? [2]

(Total:20 marks)

2. (a) Amtel intends to acquire a high-speed precision cutting machine costing RM2million that will double Amtel's production capability.

Bank First is willing to provide Amtel a hire-purchase (HP) finance of either a 3-year or 5-year tenure based on the following terms and conditions:

HP tenure (years)	3	5
Margin of finance	90%	80%
Interest rate (flat per annum)	4.5%	5.0%

- (i) Calculate and compare the monthly instalment for both the 3-year and 5-year tenure. [3]
- (ii) Discuss **three** advantages of purchasing the precision cutting machine under HP finance by the hirer. [3]
- (b) Complete the following regarding HP finance:
- (i) The **two** types of goods that can be financed under the HP finance as listed in the First Schedule of the HP Act 1967 are _____ and _____. [2]
- (ii) The maximum term charges stipulated in the HP (term charges) Regulations 1968 is _____ and the maximum interest on overdue instalment under the HP Act 1967 is _____. [2]
- (c) Section 12(4) of the HP Act imposes three conditions for voluntary assignment of the HP Agreement.
State the **three** conditions. [6]
- (d) According to Section 19 of the HP Act 1967, the hirer may regain possession of the goods (repossessed from the owner) within 21 days after giving notice to the owner pursuant to Section 18(1)(a) which requires the hirer to fulfil three conditions.
State **two** of these conditions. [4]
- (Total:20 marks)

3. (a) Top Gloves, a rubber glove manufacturer, intends to purchase heavy duty cutters costing RM1million.

Bank First agrees to finance the purchase of the cutters using either hire-purchase or leasing based on the following terms and conditions:

Item	Hire-purchase	Leasing
Tenure (years)	5	5
Margin of finance	80%	80%
Interest rate	4.5%	4.5%
Stamp duty	RM10	RM2,000
Advance payment	-	1 month

- (i) Compute the cashflow for both the facilities for the first year and recommend which facility is better for Top Gloves. [3]
- (ii) Describe any **two** non-quantitative factors that Top Gloves should consider if Top Gloves decides to opt for the leasing facility. [4]
- (iii) State the **main** difference between a pure lease and a deposit lease. [3]

- (b) From the view point of retail investors, what are **three** advantages of investing in a unit trust fund over direct purchase of shares from the stock market? [6]
- (c) Describe **two** specific risks that need to be taken into consideration by bankers when expanding their housing loan portfolio. [4]
- (Total:20 marks)

PART B

ANSWER TWO (2) QUESTIONS ONLY

4. (a) Identify **five** elements that are required for the establishment of a comprehensive IT security system. [5]
- (b) (i) Determine **four** major types of risks faced by financial institutions in respect of providing Internet banking services. [4]
- (ii) Identify **four** factors that are accounted for the quantum growth in Internet banking transactions over the past few years. [5]
- (c) Describe **four** main objectives for the introduction and provision of Automated Teller Machines by financial institutions. [6]
- (Total:20 marks)
5. (a) Determine and provide the formula for **eight** key financial ratios that are commonly used by bankers in the analysis of financial statements. [8]
- (b) Explain the importance and the implications of liquidity and profitability ratios in the analysis of financial statements. [2]
- (c) Describe **five** general characteristics of Small- and Medium-sized Enterprises operating in Malaysia. [5]
- (d) Describe **five** methods a credit officer may undertake when performing a credit assessment of a borrower's character. [5]
- (Total:20 marks)
6. (a) Describe **six** major aspects of an agricultural project that need to be evaluated by a credit officer to determine the creditworthiness of the project. [6]
- (b) Describe the purpose, eligibility and other lending guidelines of **one** financing scheme launched either by Bank Negara Malaysia (BNM) or the Credit Guarantee Corporation Malaysia Berhad. [4]
- (c) Describe **two** differences between a private caveat and a lien-holder's caveat under the National Land Code 1965. [4]
- (d) BNM had drawn up a guideline for accepting guarantee for a credit facility. Based on the guideline, the lender, after obtaining judgment against the guarantor, may only execute the judgment against the guarantor under three circumstances.
- Describe these **three** circumstances. [6]

- END OF QUESTION PAPER -

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

- Most candidates were able to differentiate between overdrafts and term loans, and identify the advantages of overdrafts over term loans.
- Most candidates were not familiar with the computation of interest of a housing loan and the commitment fee for overdrafts.
- Candidates were not well-versed with share margin trading.
- Candidates need to prepare well for housing loan interest computation under progressive release and completed homes as well as the mechanics of share margin trading which are core topics in personal financing.

1. (a) (i) Interest (June) $= 500,000 \times \frac{14}{365} \times 8.00\% + 750,000 \times \frac{16}{365} \times 8.00\%$
 $= 1534.25 + 2,630.14$
 $= 4,164.39$
- (ii) Interest (July) $= 750,000 \times \frac{19}{365} \times 8.50\% + 550,000 \times \frac{12}{365} \times 8.50\%$
 $= 3,318.49 + 1,536.99$
 $= 4,855.48$
- (iii) Commitment fee (July) $= \left[\frac{(1,000,000 \times \frac{31}{365} \times 8.50\%) - 4,855.48}{8.50\%} \right] \times 1.00\%$
 $= \frac{7,219.18 - 4,855.48}{8.5}$
 $= 278.08$
- (iv) Advantages of an overdraft facility over a term loan:
- Borrower can repay outstanding debt at any time without notice to bank (flexible debt finance).
 - It is cheaper than a term loan as surplus cashflow can be used to reduce the overdraft outstanding and as interest payment is computed daily, this results in lower interest payable.
 - Suitable to increase working capital over seasonal peaks and troughs, especially for the short- and medium-term. Amount repaid can be reutilised up to the maximum credit limit.
 - Can operate update through a current account with convenient cheque payment.

- (b) (i) Maximum value of shares purchased
= 70% x RM300,000
= RM210,000
- (ii) Maximum amount of advance
= 70% x 640,000 = 448,000
But limited to pre-set limit = 410,000
Loan outstanding = 350,000
Maximum value of shares that
can be purchased = 60,000
- (iii) **Three** options available to John (margin call):
- Top up the shortfall in cash,
 - Put in additional shares acceptable to banks, or
 - Sell part of the share holdings to reduce the excess to its limit.
- (iv) The bank will execute a sale order to bring the margin down to 70% of the share value.

Question 2

- Candidates had a good grasp of the computational aspects of hire-purchase (HP) finance.
- Most candidates were unable to provide clear answers for assignment and repossession under HP finance.
- Candidates need to cover the more difficult areas in HP finance when preparing for the examination.

2. (a) (i) Hire-purchase monthly instalments:
- $$3 \text{ years} = \frac{(2,000,000 \times 90\%) [1 + 3 (0.045)]}{3 \times 12} = 56,750$$
- $$5 \text{ years} = \frac{(2,000,000 \times 80\%) [1 + 5 (0.05)]}{5 \times 12} = 33,333$$
- (ii) Advantages of HP:
(Choose any **three** of the following)
- Interest rate and monthly repayment fixed over HP tenure thus improving cashflow management and forecasting.
 - Standard HP agreement. No need to redraft documentation agreement with lawyers which results in savings in legal costs. Simple, fast and easy to execute with borrower.
 - Low stamp duty at RM10 compared with term loan based on *ad valorem* rate.
 - Easy and fast recovery as the goods belong to the bank (owner). Goods can be repossessed immediately upon default after four months without resorting to lengthy and expensive legal action.
- (b) (i) Consumer goods and motor vehicles
- (ii) 10% and 8%

- (c) **Three** conditions for voluntary assignments:
- All defaults must be updated.
 - Hirer and assignee to execute and deliver to the owner an assignment in a form approved by the owner to assume liability on the instalments remaining and perform all the hirer's obligations.
 - Pay reasonable costs incurred in stamping and registering the assignment.
- (d) Conditions to regain possession:
(Choose any two of the following)
- Pay or tender to the owner any amount due and outstanding.
 - Remedy any breach of the HP agreement or to pay or tender to the owner, the cost and expenses reasonably incurred by the owner in remedying the breach.
 - Pay or tender to the owner the reasonable actual cost and expenses incurred by taking possession of the goods and returning them to the hirer.

Question 3

- Candidates were able to provide good answers on the advantages of unit trust investments and specific risks in housing loans.
- Candidates were not familiar with leasing and were unable to give its difference from HP using a cashflow illustration.
- Candidates need to know the differences between HP and leasing faculties and be able to compare their differences.

3. (a) (i) Cashflow

Hire Purchase	RM	Leasing	RM
Deposit	200,000	Deposit	200,000
Stamp duty	10	Stamp duty	2,500
Instalment	196,000	Prepayment	16,333
		Advance rental	16,333
		Instalment	196,000
Total	396,010	Total	431,166

Hire Purchase is better.

- (ii) Advantages of leasing:
(Choose any **two** of the following)
- 100% financing possible and can be negotiated; better cashflow advantage and capital conservation as no capital outlay required
 - Off-balance financing preserves creditworthiness
 - Eliminates risk of obsolescence (technology)

- (iii) Difference between a deposit lease and a pure lease
- Deposit lease - leasee pays a deposit known as a security deposit at lease's inception
 - Pure lease - fully 100% finance; no deposit by the leasee as lessor pays the full funding

(b) Advantages of unit trust investment:
(Choose any **three** of the following)

- Diversification: enables investors with small available capital exposure to a basket of shares (diversification in asset classes – better spreading of risk)
- Professional: management by professional specialists with managers possessing knowledge and experience
- Liquidity: ready market for disposal
- Flexible and affordable: small initial investment from as low as RM100 per unit

(c) Specific risks facing housing loan financier:
(Choose any **two** of the following)

- Default risk: failure to repay due to changes in personal conditions
- Interest rate risk: rising interest rate due to market volatility
- Liquidity risk: funding long term assets with short-term liabilities

PART B

Question 4

- Candidates displayed good knowledge of the growth of internet banking and the risks involved.
- Candidates had difficulty in comprehending the control features of a comprehensive IT security system.
- Candidates need to do more in-depth study on the difficult areas in internet banking, especially IT.

4. (a) **Five** elements of a comprehensive IT Security system:

- Authentication: to identify user accurately.
- Confidentiality: all customer data remains confidential and not available for other authorised user viewing.
- Integrity: information cannot be modified without the bank's or customer's knowledge.
- Non-repudiation: neither bank nor the customer can deny any transaction done.
- Access control: the system's (bank or customer) users have access only to the information and processes designated for their use.

- (b) (i) Risks in Internet banking:
- Transaction risk: need to provide end-to-end security and prevent security breaches e.g. unauthorised access, disclosure of confidential information, denial of services and repudiation of transactions.
 - Legal risk: legal infrastructure concerning internet transactions, legality and enforceability of contracts and compliance with local and foreign laws. Possible legal action customers may take.
 - Reputation risk: level of customer trust and public perception important and must be managed carefully.
 - Strategic risk: substantial capital expenditure and skilled HR needed together with determining the appropriate market position in line with the overall business strategy.
- (ii) Growth in Internet banking:
- Internet is everywhere, all the time (24 hours x 7 days)
 - Low cost entry for customers as they only need a PC with a telephone/lease dataline and a subscription with local ISP
 - Easy to use through the www with a web browser application
 - A new field/space, where real world constraints are irrelevant, needing only a website instead of brick and mortar.
- (c) **Four** objectives of introduction/provision of ATM services:
- Additional convenient channels for customer to perform certain banking activities outside of business hours (24 hours x 7 days).
 - Lower transaction costs for low value simple and labour intensive transaction activities (handling and risk).
 - Higher consistency and lower error rates for the delivery of high volume and simple transactions e.g. deposits and withdrawals. Speedy and more accurate execution of transactions.
 - Availability of selected banking services globally in a relatively cost efficient manner.

- Check with competitors
- Interview borrower

Question 6

- Candidates were unable to provide correct answers for any of the areas tested in this question.
- Candidates need to study the entire syllabus, including the technical topics, as “spotting” certain topics is not sufficient.

6. (a) **Six major aspects for appraising agricultural projects:**

- Technical viability,
- Financial viability,
- Commercial viability,
- Sociological/environmental viability,
- Economic viability, and
- Managerial competency.

(b) **Financing schemes launched by BNM or the CGC:**
(Choose **one** only)

- Fund for Small and Medium Industries 2 (FSMI 2)
- New Entrepreneurs Fund (NEF)
- Fund For Food (3F)
- Flexi Guarantee Scheme (FGS)
- New Principle Guarantee Scheme (NPGS)
- Small Entrepreneur Guarantee Scheme (SEGS)

Refer to the DP08 Retail Financial Services study manual, pages 134-140, for a description of the purpose, eligibility and other lending guidelines for these financing schemes.

(c) **Two differences between a private caveat and a lien-holder’s caveat:**

Private caveat

- Protects the interest of any person who claims to have any title or registrable interest in the registered proprietor’s or the caveatee’s land.
- Prevents any further dealing on the land and is designed to freeze any claim/right during the interim period until the person claiming a right under an unregistered instrument regularises the position by registering the instrument.

Lien-holder’s caveat

- Protects the proprietor’s creditor’s interest with whom the issue document of title has been deposited as security for a loan granted to the proprietor.
- Is equitable in nature and is, therefore, an equitable charge or charge by way of deposit. The main effect is to render the lien a secured debt.

(d) **Three circumstances where the lender can execute judgment against the guarantors:**

- Lender has taken reasonable action (such as writ of seizure and sales, garnishee order or bankruptcy proceedings) to recover the sum in default from the borrower with the borrower being unable to repay the sum in default.
- Where any legal action against the guarantors would be time-barred, if not taken.
- Where the lender cannot recover the amount from the borrower e.g. the borrower cannot be found, has passed away or has been adjudged a bankrupt.