

CF02

# Operations of Financial Institutions

4 APRIL 2006

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) In relation to banker's rights and duties, briefly elaborate on each of the following:
- (i) To charge commission for services rendered [3]
  - (ii) To charge interest on loans [3]
  - (iii) To receive money for crediting to a customer's account [3]
- (b) (i) What are **three** items that a bank should look for in a partnership registration certificate? [3]
- (ii) What is the risk implication if an account is opened for a company that has yet to be incorporated? [2]
- (c) (i) (aa) Name **four** types of Negotiable Instruments of Deposits (NIDs) in the Malaysian money market. [4]
- (bb) Calculate the redemption value of the NID with the following terms:
- |               |   |                                  |     |
|---------------|---|----------------------------------|-----|
| Issue date    | : | May 21, 2005                     |     |
| Maturity date | : | May 20, 2006 (based on 365 days) |     |
| Nominal value | : | RM100,000                        |     |
| Coupon rate   | : | 4.75% per annum                  | [2] |
- (ii) Name **four** types of regular payments where the mode of payment through standing instruction is very convenient for customers. [4]
- (d) State **five** advantages of using travellers cheques. [5]
- (e) (i) A banker's acceptance may be drawn to finance multiple trade transactions subject to certain conditions.
- State **four** of these conditions. [8]
- (ii) State **three** advantages of an endowment insurance policy. [3]
- (Total:40 marks)

## PART B

### ANSWER THREE (3) QUESTIONS ONLY

2. (a) (i) State **one** main facility provided by commercial banks. [2]  
(ii) What are **six** other facilities provided by commercial banks apart from the one mentioned in (i) above? [6]
- (b) In relation to banker's rights, give an example of how a bank can exercise its right "to set-off". [8]
- (c) (i) What is a sole proprietorship? [1]  
(ii) What is the legal liability of a sole-proprietor? [3]  
(Total:20 marks)
3. (a) State **four** basic factors of good customer service. [4]  
(b) Give **four** examples of ethical behaviours. [6]  
(c) Explain briefly the global closure of the following blacklisted account:  
(i) An individual account [3]  
(ii) A joint personal account [3]  
(d) State **four** types of identification papers that a bank may require when opening an individual account. [4]  
(Total:20 marks)
4. (a) Name **five** documents that are generally required in a letter of credit. [5]  
(b) State **four** advantages of options in the money market operations. [4]  
(c) What are **seven** advantages of leasing to a lessee? [7]  
(d) State the mechanism for financing purchases under the Al-Murabahah principle. [4]  
(Total:20 marks)
5. (a) State **six** services that are provided by Sistem Penjelasan Imej Cek Kebangsaan (SPICK). [6]  
(b) In relation to cheques, explain the following terminologies:  
(i) Local clearing [2]  
(ii) Outstation clearing [2]  
(c) Briefly describe the following:  
(i) Credit card [3]  
(ii) Charge card [2]  
(d) Why is "capital" an important consideration when assessing a loan application? [5]  
(Total:20 marks)

- 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**

- Candidates were not able to elaborate on the banker's rights and duties. They showed poor understanding of the concept of partnership. They were also unable to state the risk implications as required by the question.
- Candidates did not add the principal to the interest in calculating the redemption value of the Negotiable Instruments of Deposits. Candidates thus gave only the interest earned in their answer.
- Candidates were unable to state the advantages of using travellers cheques. They also showed poor understanding of the concept of banker's acceptance. Candidates wrote on the benefits of term life policies, instead of stating the advantages of an endowment insurance policy.
- Application of the correct concepts, reading carefully and understanding what was required of the questions would have improved the score of a number of candidates.

**1. (a) (i) To charge commission**

This right is derived from everyone's general right to charge a reasonable sum of money for services rendered. The amount charged is normally agreed upon between the banker and his customer, before the services is provided. In certain cases, The Association of Banks in Malaysia (ABM) Rules govern the amount charged, for eg., the commitment fee on the unutilised portion of overdraft facilities.

**(ii) To charge interest**

When a banker grants a loan to his customer, the interest to be charged will be agreed upon by both parties. However, when a customer draws a cheque, which takes his account into an overdraft, the banker will be entitled to charge interest on the overdrawn account. Nevertheless, the banker can only charge interest from the date the account is overdrawn and not from the date the cheque was drawn.

**(iii) To receive money for the customer's account**

It is the banker's duty to receive money for crediting to the customer's account. The bank also receives cheques and collects bills for crediting to the customer's account. The bank usually will credit uncleared cheques to the customer's account, although the amount may not be available to the customer until it is cleared. Should any of the uncleared cheques or bills be returned, the bank has the right to debit the account.

**(b) (i) The items are:**

- the name of the partnership,
- the names of the partners, and
- the share of each partner in the partnership.

**(ii) The company has no legal standing and therefore cannot sue or be sued.**

- (c) (i) (aa) The four types of Negotiable Instruments of Deposits are as follows:
- Short-term Negotiable Certificate of Deposits
  - Long-term Negotiable Certificate of Deposits
  - Zero-coupon Negotiable Certificate of Deposits
  - Floating Rate Negotiable Certificate of Deposits
- (bb) The redemption proceeds on May 20, 2006
- $$= \text{RM}100,000 \times \left\{ 1 + \frac{(4.75 \times 364)}{365 \times 100} \right\}$$
- $$= \text{RM}100,000 \times \left\{ 1 + \frac{1729}{36500} \right\}$$
- $$= \text{RM}100,000 \times 1.0473698$$
- $$= \text{RM}104,736.98$$
- (ii) The four types of regular payments where the mode of payment through standing instruction is very convenient for customers are as follows:
- Insurance premiums,
  - Money to children studying overseas/outstation,
  - Maintenance payments to ex-wives, and
  - Loan instalments.
- (d) The advantages of using travelers cheques are as follows:
- They are issued in various denominations and currencies.
  - They are drawn on the bank's head office and countersigned by the customer to whom they are issued at the time of issue.
  - They can be cashed at other banks, hotels or on ships throughout the world. When presented for payment, they are examined to see if they are in order and the customer is asked to countersign (sign again). After comparison of both signatures, cash payment will be made.
  - The customer will receive a refund if the travellers cheques are stolen or lost.
  - They do not have a date and as such can be encashed at any time.
- (e) (i) A banker's acceptance (BA) may be drawn to finance multiple trade transactions, subject to the following conditions:
- All transactions must be of the same class. That is, all the transactions must be sales to residents or sales to non-residents or purchases from residents or purchases from non-residents. A sale to a resident and a sale to a non-resident cannot be combined together to draw a BA.
  - The trade transactions may be with different persons, of different values or for different goods.
  - The aggregate financial value of all the trade transactions is at least RM50,000.

- The tenor of the BA shall not exceed:
    - for purchases – 365 days less the period between the date of the earliest supporting document and the date of acceptance and the documents are not more than 180 days before acceptance date.
    - for sales – the shortest remaining credit period extended by the drawer to his purchasers.
- (ii) Give any three of the following advantages:
- It provides protection against premature death
  - It is an effective and systematic way to save
  - It is a convenient way to save and provide for old age
  - It is a convenient way to save for a specific purpose such as children's university education

## PART B

### Question 2

- Candidates were not aware of the difference between the facilities offered by a commercial bank and other banks such as merchant banks and finance companies. They could not elaborate on the operations of a current account.
- Candidates wrote on banking business, instead of facilities provided by commercial bank.
- Candidates failed to mention that set-off can take place even if the account is maintained at different branches of the same bank or that it cannot be set-off if the accounts are not held in the same rights.
- Candidates wrote that the sole-proprietor is only liable for the debts of the firm and did not state the other liabilities.
- Most candidates attempted this question but they were unable to differentiate the principles/concepts to be used for each question. They were also not able to answer the questions satisfactorily.
- Some candidates did not give sufficient elaboration in their answers and therefore were not able to score higher marks.

2. (a) (i) One main service provided by commercial banks is the provision of current account facilities where payments can be made through issuing cheques.
- (ii) The other six facilities provided by commercial banks are:
- accept savings account deposits
  - accept fixed deposits
  - accept negotiable instruments of deposits
  - offer credit facilities like granting loans
  - remittances
  - letters of credit
- (b) Mr A maintains two accounts (Account 1 and Account 2) with a bank. Account 1 is overdrawn by RM1,500. Account 2 has a credit balance of RM2,800. If Mr A demands for the money owing to him in Account 2, the bank can deduct RM1,500 from Account 2, to settle the amount owing in Account 1. The bank only need to pay Mr A RM1,300, being the net balance due to him.

In the above example, Account 1 and Account 2 may be with the same branch of a bank or with different branches.

However, the bank can exercise the right of set-off only when the relevant accounts are held in the same right. If the rights to the account are different, the bank cannot exercise the right of set-off.

- (c) (i) A sole-proprietorship is a business owned by a single person.
- (ii) The legal liabilities of a sole-proprietor are as follows:
- The sole proprietor is fully liable for the debts of the sole proprietorship,
  - The sole proprietorship can sue or be sued in its name or in the name of the sole proprietor, and
  - The law applied to the individual is also applicable to the sole-proprietorship.

### Question 3

- Candidates stated the sub-factors, instead of the basic factors of good customer service.
- They also wrote on unethical behaviours and Code of Good Banking Practices, instead of giving examples of ethical behaviours.
- Candidates could not state the types of identification papers needed to open an individual account.
- Candidates are advised to read the questions carefully and answer according to the question's requirement.

3. (a) The four basic factors of good customer service are as follows:
- Project a positive sales image,
  - Know your company and your competitors,
  - Know your products, and
  - Understand your customer.
- (b) Give any four of the following examples of ethical behaviour:
- Errors in statements are corrected immediately
  - Customers are notified of changes in products and services that reduce their value, and also the recommended alternatives
  - The longest possible warning of adverse changes is given to those affected
  - A fair opportunity is given to defaulters to make good their payments within a reasonable period of time. For example, in the repayment of housing loans, a 14-day grace period is given before penalty is charged
  - Avoid words that are likely to confuse the customer
  - "Small print" is kept to a minimal level
  - Release of loans is made without delay so that customers do not have to pay any penalty
- (c) (i) An individual account
- All accounts in his own name will be closed. His joint accounts with others will be allowed to continue. He will not be allowed to open any new account in his own name or a joint account with others during the prohibition period.
- (ii) A joint personal account
- A blacklisted joint account will affect all the individual accounts of the joint holders. Their individual accounts will be closed. However, their joint accounts with other individuals will not be closed.

(d) Give any four of the following types of identification papers that banks require when opening an individual account:

- Malaysian driving license
- Royal Malaysian Police Warrant / Police Warrant Card
- Army identification card
- Passport
- Identity card

**Question 4**

- Candidates were unable to name the documents required in a letter of credit.
- They could not state the advantages of options in money market operations.
- They also confused the Al-Murabahah principle with other Islamic banking principles.

4. (a) Give any five of the following documents:

- Bill of exchange
- Commercial invoices
- Certificate of origin
- Packing list and weight note
- Insurance
- Transport documents – any of the following:
  - Parcel post receipt or courier service
  - Rail and road consignment notes
  - Air waybill
  - Marine bill of lading

(b) The four advantages of options in the money market operations are as follows:

- The owner/holder does not need to know exactly when he needs to make his payment or when his payment will be received. All he needs to know is the approximate time within which he needs to make his payment or will receive his payment.
- By buying a call option, he is able to buy his currency/commodity at the lower of market price or at the strike price.
- By buying a put option, he is able to sell his currency/commodity at the higher of market price or strike price.
- The option right can be sold to third parties.

(c) Give any seven of the following advantages of leasing to a lessee:

- Rental payments to the lessor are fully deductible as expenses. Leasing often offers a more rapid tax deduction (by way of lease rental) than depreciation.
- Lessee may only need to use a minimum amount of his own capital or none of his own capital as some leases are 100% financing. Capital is conserved and can be used for other purposes.
- As the lease is not included as a liability in the balance sheet, it does not affect the balance sheet ratios. The chattel leased is not included in the balance sheet as an asset. It, therefore, indirectly improves the return on asset ratio.
- Leasing eliminates the possibility of owning obsolete equipment.
- Compared to cash purchases, leasing offers a cash flow advantage as no cash (or very little cash) needs to be expended initially.
- In terms of cost, it is less than hire-purchase.

- In the case of chattels that wear out, the lease can be tailor-made to expire at the end of the economic life of the chattels. Thereafter, a new lease can be taken out to replace the worn out equipment.
  - As the lease term is shorter than the allowed depreciation, leasing can act as a hedge against inflation.
  - As lease rentals are fixed and regular, they aid corporates in their planning.
- (d) The mechanism for financing purchases under the Al-Murabahah principle are as follows:
- Bank appoints the customer as an agent to purchase on its behalf.
  - Customer acts as agent to purchase the goods.
  - Bank effects payment to the supplier or reimburses the customer.
  - Bank then sells the goods to the customer at an agreed price. This price includes the cost plus an agreed profit. The price is to be paid at an agreed later date.

**Question 5**

- Candidates showed poor understanding of Sistem Penjelasan Imej Cek Kebangsaan. They were unable to elaborate on the local and outstation clearing zones.
- Candidates confused charge cards with debit cards.
- They were also not able to state why capital is an important consideration when assessing a loan application.
- Generally, failure to understand the concepts and principles, and how they worked, were the major factors that prevented from performing satisfactorily.

5. (a) Give any six of the following services that are provided by Sistem Penjelasan Imej Cek Kebangsaan (SPICK):
- Receiving cheques in batches from banks
  - Sorting of cheques
  - Provide lists of inward clearing cheques in the form of reports with the cheques
  - Providing banks with reports showing their net clearing position
  - Sorting cheques into branch and account number order
  - Providing microfilm copies of the bank's inward clearing cheques
  - Providing a computer readable record of inward clearing cheques on a magnetic tape or diskette with printed listings
  - Accepting a computer readable record of outward clearing cheques on a magnetic tape or diskette together with the bank's outward cheques
- (b) (i) Local clearing
- Clearing within a clearing zone
- Cheques issued by other customers and drawn at other banks in the same locality or town, and
  - Cheques issued by other customers and drawn at the same bank but in different branches in the same locality or town. The hold day period is two days.

(ii) Outstation clearing

Clearing of cheques outside a clearing zone

- Cheques issued by other customers and drawn on the same bank but in different branches in other localities or towns, and
- Cheques issued by other customers and drawn on other banks located in other localities or towns. The hold day varies.

(c) (i) A credit card is one in which a cardholder is given a limit on the amount usable. The credit limit is revolving which means that when the cardholder pays part or full amount of the limit, he can reutilise the amount of credit he has repaid.

(ii) A charge card is one in which a cardholder must clear his balance fully every month. There is no credit period after a specified date.

(d) “Capital” is an important consideration when assessing a loan application because:

- it represents the borrower’s money that he puts into a project.
- the amount of capital that he puts in reflects his commitment to the project.
- it provides the borrower with the ability to absorb a certain amount of loss.
- a borrower who has not put any of his money into the project can just walk away from the project when things are not going well.
- if the borrower is convinced of the viability of his project, he should not hesitate to put his own money to invest in the project.