

CF02

Operations of Financial Institutions

7 MAY 2002

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) What is customer service? [2]
- (ii) Why do organisations, nowadays, pay greater attention to customer service? [6]
- (b) As the central bank of Malaysia, what are Bank Negara Malaysia's **four** main functions? [8]
- (c) Puan Norliah has a fixed deposit of RM120,000, which she placed on 4 July 2001 for **12** months at 4% per annum. The fixed deposit will mature on 4 July 2002.
- (i) Calculate the interest Puan Norliah will receive on 4 July 2002. [2]
- (ii) If 4 July 2002 is declared a public holiday, Puan Norliah would not be able to present her fixed deposit for payment until the next day, 5 July 2002.
- Explain to Puan Norliah what would happen to the interest of her fixed deposit if the above happens. Your answer should also include any calculation made. [4]
- (d) (i) What are the **three** types of indorsements that can be made on a cheque? [3]
- (ii) What are the effects of each type of indorsement? [6]
- (e) Under Islamic Banking, a bank can issue letters of credit under the Al-Wakalah principle.
- Outline the mechanism of letters of credit under the Al-Wakalah principle. [9]

(Total:40 marks)

PART B

ANSWER THREE (3) QUESTIONS ONLY

2. (a) What is a standby letter of credit? [5]
- (b) The following is a standby letter of credit:

To	: Bank Sekali Berhad No 98 Jalan Hang Tuah 56900 Kuala Lumpur
Attention	: Encik Kamaruddin Harith
Date:	: 1 June 2002
From:	: Bank Kinabatangan Berhad 32 Pesiaran Kota Belud 76340 Kota Kinabalu
<p>We hereby issue in your favour our irrevocable letter of credit No 2-001-005774 up to the maximum aggregate of Ringgit: Eight hundred thousand only (RM800,000.00) plus accrued interest at 2.5% per annum above the Base Lending Rate of Bank Sekali Berhad for the account of Consolidated Millers Sdn Bhd.</p>	
<p>Funds under this letter of credit shall be available to you upon presentation of your sight draft drawn on us accompanied by the following:</p> <p>Your signed statement certifying that an amount of principal and accrued interest has become due and payable and remains unpaid.</p> <p>Drafts drawn under this credit must be presented during our business hours on a business day at our office at 32 Pesiaran Kota Belud, 76340 Kota Kinabalu for negotiation on or before 31 May 2003 and marked "DRAWN UNDER LETTER OF CREDIT OF BANK KINABATANGAN BERHAD, IRREVOCABLE STANDBY LETTER OF CREDIT NO 2-001-005774.</p> <p>If demand for payment is made by you hereunder at or prior to 12.00noon on a business day at our office, and provided that such demand for payment and the documents presented in connection therewith conform to the terms and conditions hereof, payment will be made to you of the amount demanded, in Ringgit Malaysia, at such account in Kuala Lumpur, Malaysia as you shall designate, on the second business day following such demand or such business day as you may specify.</p> <p>This letter of credit shall become valid and effective from the date hereof and shall expire on the earlier of (i) our close of business at our KL office on 31 May 2003 or (ii) the date upon which all obligations of Consolidated Millers Sdn Bhd covered by this letter of credit have been paid. This letter of credit will be promptly surrendered to us upon expiration.</p> <p>This credit is not transferable or assignable and is subject to the Uniform Customs and Practice for Documentary Credit (1994 Revision, International Chamber of Commerce Publication 500).</p>	

Answer the following questions with reference to the standby letter of credit (SBLC) provided on page 2:

- (i) Name the beneficiary. [1½]
- (ii) State the letter of credit number. [1½]

- (iii) What is the date of issue? [1½]
- (iv) When is the expiry date of the SBLC? [1½]
- (v) Name the applicant. [1½]
- (vi) Name the issuing bank. [1½]
- (vii) What is the amount of the SBLC? [1½]
- (viii) Name the **two** documents needed to negotiate the SBLC. [1½]
- (ix) Where would the payment be made? [1½]
- (x) If the commission is charged at 0.1% per month, calculate the amount of commission payable. [1½]
(Total:20 marks)
3. (a) What are the **three** main categories of conflict of interest? Give an example of each category. [9]
- (b) How do banks ensure that any of these **three** categories of conflict of interest mentioned in (a) above does not occur? [6]
- (c) As a staff in a bank, state **five** items that you should or should not do to prevent putting yourself in a conflict of interest situation. [5]
(Total:20 marks)
4. (a) Your customer, Alec Plywood Sdn Bhd, enjoys a leasing facility from your bank. Alec Plywood Sdn Bhd now wants to buy a machine costing RM240,000. The interest rate is 6.5% and the tenure is 5 years.
What is the monthly instalment if:
- (i) it is a full payout lease? [3]
- (ii) it is a residual value lease and the residual value is 20% of the cost price? [5]
- (b) (i) What are the **four** basic principles of insurance? [6]
- (ii) Name and briefly describe any **four** types of life assurances. [6]
(Total:20 marks)
5. As a credit officer in a bank, considering a loan application, briefly describe **ten** factors that must be satisfied with regard to the application.
(Total:20 marks)

- END OF QUESTION PAPER -

OUTLINE ANSWERS

PART A

Question 1

Most candidates thought that customer service is about handling complaints. Candidates understood BNM's role as the central bank and also the concept of time deposits. Most candidates knew the different types of indorsements but not many could explain the significance of each indorsement. Candidates had poor understanding of concepts within Islamic banking.

1. (a) (i) Customer service is defined as all activities that enhance or facilitate the sale or use of one's products or service.
- (ii) Organisations are paying greater attention to customer service because:
- Customer satisfaction is the key to profitable operations. Good customer service attracts new customers and retains old ones.
 - Satisfied customers are likely to share their experience with other people. This word of mouth promotion is powerful, paving the way to new business.
 - Many dissatisfied customers stop buying or using the services of companies where they were not well treated.
- (b) The main functions of BNM are to:
- Issue and manage the local currency to safeguard the value of the currency
 - Act as the Government's banker and advisor
 - Regulate the liquidity in the financial markets so as to promote a stable monetary and financial structure
 - Act as the banker to all banks
- (c) (i) Interest on the fixed deposit on July 4, 2002
- $$RM120,000 \times 4\% \times \frac{365}{365} = RM4,800.00$$
- (ii) Because of the "extra" holiday, interest would have to be paid one "extra" day.
- $$RM120,000 \times 4\% \times \frac{366}{365} = RM4813.15$$
- (d) (i) Blank indorsement, special indorsement and restrictive indorsement.
- (ii) Effect of blank indorsement: Anybody who presents this cheque to the bank can receive the amount stated on the cheque.
- Effect of special indorsement: The indorser specified the person to whom the cheque is being transferred.
- Effect of restrictive indorsement: This prevents the cheque from being paid to anybody else.
- (e)
- The customer requests the bank to establish a letter of credit.
 - The bank may require its customer to deposit the price of the good to be purchased, in full or part.
 - The bank establishes the letter of credit. When the letter of credit is negotiated, the bank pays the negotiating bank using the deposit paid earlier or funds from the customer. The documents are then released to the customer.
 - The bank charges the customer a fee and commission for its services.

PART B

Question 2

Many candidates could not define a standby letter of credit, but they were able to answer questions pertaining to the features of the given sample of a standby LC.

2. (a) The Standby LC is similar to a performance guarantee whereby the issuing bank guarantees the beneficiary the due performance of the applicant.

The Standby LC is based on an underlying contract that requires certain performance on the part of the applicant. The payment under the LC is triggered when the applicant fails to perform. If the applicant performs, the beneficiary will not draw on the LC and the credit expires on the specified expiry date.

The standby LC requires the beneficiary to present the documents stipulated in the LC to the issuing bank, accompanied by a certificate certifying that the beneficiary has defaulted.

The issuing bank must pay upon receipt of these documents whether or not the applicant has actually defaulted. The issuing bank then claims reimbursement from the applicant.

- (b)
- (i) Bank Sekali Berhad, 98 Jalan Hang Tuah, KL
 - (ii) 2-001-005774
 - (iii) June 1, 2002
 - (iv) May 31, 2003
 - (v) Consolidated Millers Sdn Bhd
 - (vi) Bank Kinabatangan Berhad, 32 Pesiaran Kota Belud, KK
 - (vii) RM800,000-00
 - (viii) Sight Draft and Signed Statement certifying amount of principal and accrued interest owing.
 - (ix) Kuala Lumpur
 - (x) RM9,600-00

Question 3

Few candidates answered this question. Many of those who did either were unable to identify the different categories of conflict of interest or provided the wrong examples to support their answers.

3. (a) Conflict of interest could arise:
- Between the bank and its staff
 - e.g. The bank has to foreclose a property belonging to a staff's relative or the staff has outside interests that make excessive demands on his time resulting in his not giving full commitment to his work.
 - Between the bank and its customer
 - e.g. A customer asks the bank to accept third party cheques into his account.
 - Between the bank's staff and customers
 - e.g. The customer's business may be in direct competition with the staff's family business.

- (b) The bank can ensure that conflicts of interest do not occur by:
- Establishing clear procedures and guidelines for staff to report and/or disclose possible conflict of interest situations.
 - Not assigning their staff duties which place them in situations where conflicts of interest could arise
 - Making it a prerequisite that staff must obtain the bank's senior management's approval before taking up any directorship, consultancy, agency or employment outside the bank.
- (c) As staff you should or should not do the following: (Pick any **five**.)
- Should not approve banking facilities to yourself, your family member/relatives or firms/corporations in which you or your family have an interest
 - Should report any financial interest you have in a customer and should not be directly involved in the customer's dealings with the bank.
 - Should not derive any improper benefits at the expense of the bank or its customer
 - Should not accept costly entertainment
 - Should not serve as director of another corporation without the approval of the bank.
 - Should not seek appointment as executor, administrator or trustee of a customer's estate.

Question 4

Part (a) on leasing facility was well answered. However, candidates lacked an understanding of the basic principles of insurance and could not answer the question on insurance well.

4. (a) (i) Monthly instalment for full payout lease:
- $$\frac{\text{RM}240,000 + (\text{RM}240,000 \times 6.5\% \times 5)}{60} = \text{RM}5,300.00$$
- (ii) Residual value = $\text{RM}240,000 \times 0.20 = \text{RM}48,000$.
- Monthly instalment for residual value lease:
- $$\frac{(\text{RM}192,000 + (\text{RM}192,000 \times 6.5\% \times 5)) + \text{RM}48,000 \times (6.5\% \times 5)}{60} = \frac{\text{RM}270,000}{60} = \text{RM}4,500.00$$
- (b) (i) The **four** principles of insurance are:
- Insurable interest
 - Utmost good faith
 - Indemnity
 - Proximate Cause
- (ii) Short description of any four of the following life assurances:
- Term Life
 - Whole Life
 - Endowment
 - Annuities
 - Juvenile
 - Mortgage Protection
 - Investment link

Question 5

Although candidates showed some understanding of the subject, they were not able to illustrate their answers clearly.

5. Factors to consider in a loan application:

- *Purpose of the loan*: consistent with present business activity; reflects government policy; loan for working capital or to purchase fixed assets
- *Amount of the loan*: adequate? is the basis of calculation correct?
- *Duration of loan*: commensurate with nature of the proposal; the longer the loan the greater the risk
- *Repayment*: able to determine the source of repayment whether from present income; future income; sale of assets?
- *Know-how*: possess the know-how? past performance; market reputation
- *Market stability*: demand for goods; sunset or sunrise industry
- *Financial position*: financially sound? short term/long term position of customer? fund flow position
- *Bank's position*: vis-à-vis borrower, other banks, industry
- *Security*: adequate, ease of liquidation?
- *Monitoring*: easy to monitor?