

DP06

International Trade Finance

6 MAY 2002

1. Time allowed : Three (3) hours
2. Total number of questions : Seven (7) questions
3. Number of questions to be answered : Five (5) questions of which at least two (2) must be from Part A [20 marks each]
4. Candidates must obtain a minimum of 16 marks in Part A as well as pass the paper as a whole.
5. Begin each answer to a new question on a fresh page.
6. Answer **all** questions in **English**.
7. A blank page is provided at the end of the question paper for rough work.

PART A

ANSWER AT LEAST TWO (2) QUESTIONS

1. At the request of Pelita Sdn Bhd, Prima Bank Berhad issued an irrevocable letter of credit in favour of PT Mille Imports, Jakarta and advised it through PT Bank Soedarno. Among others, the letter of credit allows for partial shipment and requires a full set of clean on board ocean bill of lading.

After having effected two shipments under the letter of credit and obtaining payments thereunder, PT Mille Imports made a final shipment fully utilising the value of the credit. The documents were presented to PT Bank Soedarno for negotiation. After having examined and negotiated the documents, PT Bank Soedarno forwarded the documents to Prima Bank Berhad for reimbursement.

Prima Bank Berhad, upon receipt of the documents, determined that the documents were discrepant. The bill of lading presented was a "received for shipment" bill of lading with a superimposed clause reading "clean on board". The on board clause was typed on the bill of lading and was not dated. Prima Bank Berhad notified Pelita Sdn Bhd of the discrepant presentation and asked for a waiver of the discrepancy and authorisation to pay but was refused.

Prima Bank Berhad immediately notified PT Bank Soedarno of the rejection of the documents and requested instructions for disposal. PT Bank Soedarno, as instructed by PT Mille Imports, offered its indemnity against payment of discrepant documents but Prima Bank Berhad did not accept it as Pelita Sdn Bhd has already refused to authorise payment.

PT Mille Imports made a formal demand for payment stating that PT Bank Soedarno, Prima Bank Berhad and Pelita Sdn Bhd had previously accepted those bills of lading without any objection.

Required:

- (a) Was Prima Bank Berhad correct in rejecting the documents, as they were not in compliance with Uniform Customs and Practice (UCP) 500? [4]
- (b) Was Prima Bank Berhad correct in rejecting the offer of an "indemnity" to induce them to pay for the discrepant documents? [4]
- (c) Did Prima Bank Berhad act fully in accordance to UCP 500? [4]
- (d) Would the fact that Prima Bank Berhad had accepted a similar bill of lading in the previous shipments have any bearing on their rejection of the bill of lading and refusal to pay? [8]
(Total:20 marks)

2. KL Optic Sdn Bhd ("KL Optic") normally trades by using irrevocable letter of credit as its payment terms. En Hassan, the Managing Director of KL Optic, wishes to consider other ways of obtaining payment from his buyers in Taiwan. He recently learnt **two** ways to obtain payment from a trade finance seminar he attended, that is:

- (i) for KL Optic to draw a bill of exchange for 30 days sight and send the bill direct to the bank in Taiwan; and
- (ii) for the Taiwanese buyer to send to KL Optic a promissory note avalised by a leading Taiwanese bank prior to shipment and to collect the proceeds of the promissory note at maturity as an outward bill for collection.

Required:

- (a) List and explain the advantages and disadvantages to KL Optic Sdn Bhd of the above **two** options in comparison with its usual requirement of irrevocable letter of credit terms. [10]
- (b) What are the differences in the procedures to obtain payment after shipment in (i) and (ii) above? [5]
- (c) How can En Hassan reduce his risk under documentary collection? [5]
(Total:20 marks)

3. You were invited by the local chamber of commerce to present a lecture on the “Role of Banks in Financing International Trade”. After your presentation, you opened the floor for questions and you received the following queries. How would you answer them?
- (a) Briefly explain **four** of the services that can be provided by your bank to help customers who are engaged, or want to engage, in international trade. [8]
- (b) International traders face greater risk than those engaged in domestic trade.
Briefly explain **five** risks that are commonly faced by those engaged in international trade. [10]
- (c) What is an “Incoterm”? [2]
- (Total:20 marks)

PART B

4. En Sofi of AMTrade Sdn Bhd received a standby letter of credit from Aman Bank Corporation, advised through Jaya Bank Berhad. The standby letter of credit is available at sight with Aman Bank Corporation and shall expire at the counters of the issuing bank.

The standby letter of credit, which expires on 1 June 2001, requires:

- Sight draft to be drawn on Aman Bank Corporation.
- Beneficiary's statement to the effect that the amount of the draft drawn represents the unpaid balance due from the Accountee because of the non-payment on the maturity date or upon acceptance on one or more of the following promissory notes:

<u>Instalment No.</u>	<u>Note No.</u>	<u>Amount</u>	<u>Maturity Date</u>
1	AAA	USD150,000	1/1/2001
2	BBB	USD150,000	1/2/2001
3	CCC	USD150,000	1/3/2001
4	DDD	USD150,000	1/4/2001
5	EEE	USD150,000	1/5/2001
6	FFF	USD150,000	1/6/2001

- The original promissory note(s) past due to be marked “PAID”.

Prior to the due dates of the first **three** instalments, the applicant paid AMTrade Sdn Bhd directly and out of the standby letter of credit amount due. Therefore, there was no need for AMTrade Sdn Bhd to draw under the standby letter of credit.

On 2 April 2001, **one** day after instalment number **four** was due and not paid by the applicant, En Sofi presented the documents of default to Jaya Bank Berhad for remittance to Aman Bank Corporation.

Aman Bank Corporation examined the drawing and notified Jaya Bank Berhad that it refused to honour the drawing, and the documents were to be returned, for the following reasons:

- Promissory note not marked “PAID”
- Credit not available for drawings on instalment number four or any future instalment as per Uniform Customs and Practice (UCP) 500 Article 41.

Jaya Bank Berhad disagreed with the rejection stating that the promissory note could not have been marked “PAID” since neither the applicant nor Aman Bank Corporation has paid the promissory note. In addition, Article 41 of UCP 500 does not apply to standby letter of credit.

Required:

- (a) Explain the following issues that should have been corrected and noted by all parties prior to the issuance of the standby letter of credit:
- (i) Availability [3]

- (ii) Expiry place [3]
- (iii) Statement of default as required [3]
- (iv) Promissory note [3]
- (v) Expiry date [3]
- (b) Does UCP 500 Article 41 apply to standby letter of credit? [5]
(Total:20 marks)
5. (a) Briefly describe the following types of exchange rates commonly used by commercial banks:
- (i) Counter rate [3]
- (ii) Special counter rate [3]
- (iii) Spot rate [3]
- (iv) Forward rate [3]
- (b) Name and briefly explain **four** main factors that affect exchange rates. [8]
(Total:20 marks)
6. (a) A bank purchases a bill of exchange drawn in connection of a documentary collection.
- (i) When the presenting bank receives the collection, would that bank know of the purchasing aspect? [2]
- (ii) The exporter instructs the bank **not** to protest on the collection order. Can the remitting bank legally amend the collection order to indicate "**protest**"? [2]
- (b) Under the Export Credit Refinancing (ECR) Pre-shipment Scheme, there are **three** types of loans that may be drawdown by direct exporters.
- Name these **three** types of loans and briefly describe each of them. [6]
- (c) There are several features under the Banker's Acceptance scheme.
- List **five** of these features. [10]
(Total:20 marks)
7. (a) Briefly explain any **five** of the following terms and concepts used in Islamic banking:
- (i) Al-Wadiah Yad-Dhamanah [3]
- (ii) Al-Mudharabah [3]
- (iii) Al-Musyarakah [3]
- (iv) Al-Bai' Bithaman Ajil [3]
- (v) Al-Murabahah [3]
- (vi) Al-Qardh Ul-Hasan [3]
- (vii) Al-Ijarah [3]
- (viii) Al-Kafalah [3]
- (b) A letter of credit issued under the Islamic Banking concepts may take **one** of **three** different forms.
- Name and explain these **three** forms. [5]
(Total:20 marks)

OUTLINE ANSWERS

PART A

Question 1

Candidates did poorly in this question, as they were not familiar with the UCP500 and the modus operandi of handling discrepancy on letters of credit.

1. (a) Yes. The letter of credit required a full set of clean on board ocean bill of lading. UCP 500 Sub Article 23(a)(ii) requires that the bill of lading indicate that the goods have been loaded on board, or shipped on a named vessel. The sub-article further states that loading on board or shipment on a named vessel may be indicated by pre-printed wording on the bill of lading that the words have been loaded on board a named vessel or shipped on a named vessel, in which case the date of the issuance will be deemed to be the date of loading on board and the date of shipment.

Alternatively, the bill of lading must evidence that the goods are on board a named vessel, by a notation on the bill of lading that gives the date on which the goods have been loaded on board, in which case the date on board notation will be deemed to be the date of shipment.

In this particular case, the bill of lading did not bear notation that indicated the date of shipment.

- (b) Yes. Prima Bank Berhad has already contacted Pelita Sdn Bhd and determined that Pelita Sdn Bhd refused to accept the discrepant documents. UCP 500 sub-Article 14(f) places a certain responsibility on the Issuing Bank when payment has been made under reserve or against an indemnity in respect of discrepancies. This sub-Article requires the Issuing Bank to comply with all the provisions of Article 14. Therefore, the offer of the indemnity had no value.
- (c) In this particular case, Prima Bank Berhad acted in accordance with UCP 500 sub-Articles 14(c) and 14(d)(i) and (ii). Sub-Article 14(c) allows the issuing bank to approach the applicant for a waiver of the discrepancy, while sub-Article 14(d)(i) and (ii) demand that if the issuing bank decides to refuse the documents, it must give notice to that effect by telecommunication, without delay, but no later than the close of seventh banking day following the day of the receipt of the documents. Sub-Article 14(d)(ii) states that the notice of discrepancy must state all the discrepancies and must also state whether the documents are being held at the disposal of presenter or being returned to them.

In this case and for the presentation in question, Prima Bank Berhad adhered to the conditions of the letter of credit and UCP 500. However, the position may not be the same with regards to the two previous presentations.

- (d) Yes. In this case, Prima Bank Berhad had noted the same discrepancy on the two previous presentations. It had approached Pelita Sdn Bhd for waiver of the discrepancy and eventually paid the documents as presented. When effecting a credit to PT Bank Soedarno account, it failed to inform the presenter that payment has been effected despite the fact that the documents tendered were discrepant.

In certain court decisions, such inconsistent action by a bank prevented the said bank with full knowledge of the facts from acting or conducting itself in an inconsistent manner. The court have held that the bank cannot afterward assume a position which is inconsistent with its previous behaviors and which might prejudice the beneficiary who acted in reliance on such conduct.

Other courts have commented that where the bank is well acquainted with the legal and commercial practice applicable with Letter of Credit, it was entitled to demand strict compliance with the conditions stated in the documentary credit. The courts have also acted while the bank can impose conditions in the letter of credit and demand complete compliance with them, it cannot, in a series of dealings based upon other transactions related to the letter of credit, arbitrarily select those transaction that must conform to the requirements therein

stated and those which may be paid without complete compliance. If the bank chooses to demand complete compliance with the stated conditions at a later date, its future intent should and must be conveyed in time for the beneficiary to comply with.

Question 2

This was a popular question on collection bills but some candidates still failed to give satisfactory answers for the advantages and disadvantages of a bill of exchange and a promissory note. Some candidates also listed the advantages and disadvantages of letter of credit, which was not required in the question.

2. (a) Advantages and disadvantages to En. Hassan in remitting the bill directly to the Taiwanese collecting bank in comparison to use of irrevocable letter of credit:

Advantages

1. Documentary collections are more acceptable than letter of credit from buyer's (En. Hassan) point of view. He will save by:
 - Reduced cost
 - Less administration (no need to request for issue of letter of credit)
 - No effect on bank facilities whereas LCs will be treated on par with borrowing facilities.

This will make the deal more attractive.

2. En. Hassan will pay reduced bank charges because there is no need for his bank to make careful check on the documents.
3. En. Hassan can decide what documents to send without having to refer to the conditions in the letter of credit.
4. Time will be saved as documents can be remitted directly to the collecting bank without the need for his bank to be involved.

Disadvantages

1. Greater credit risk because there is no conditional bank guarantee of payment. The buyer may refuse to accept the bill of exchange or he may refuse to pay at maturity.
2. The direct collection method will mean that there is no check of the documents by his banker. Thus, any documents problems will only come to light once the documents has reached the Taiwanese bank.
3. All follow-up correspondence will have to be done by En. Hassan, as opposed to his bank.
4. It may not be possible to negotiate this collection, whereas letters of credit can usually be used to provide for post-shipment finance.

Advantages and disadvantages to En. Hassan as of avalised promissory note in comparison to use of irrevocable letter of credit:

Advantages

1. Since the notes are to be received prior to shipment, the notes could be discounted (forfeited) to raise pre-shipment finance. A documentary credit can normally only raise post-shipment finance, since the required documents are normally available on shipment, unless red-clause or assignment can be applied.
2. The aval to the Taiwanese bank means that payment is unconditionally guaranteed by that bank on the due date. Thus, provided that the bank is sound, En. Hassan can be sure of payment.

3. Bank collection charges will be lower than that for letter of credit because there is no need for careful examination of documents.

Disadvantages

This method is less acceptable than letter of credit from the buyer's point of view. There is no "documentary protection" to ensure receipt of the correct goods, the aval will tie-up his (buyer/importer) facilities with his Taiwanese bank and the commitment fee may be greater than that of a letter of credit.

Thus much depends on the relative bargaining power of the two parties.

- (b) Differences in procedures to obtain payment after shipment:

	Direct Collection	Avalised Promissory Notes
1	The Malaysian bank is not involved in handling the documents; i.e. once the shipping documents are collated, the collection is sent to the Taiwanese bank by En. Hassan.	The Malaysian bank could collect the proceeds of the avalised bill at maturity.
2	The Malaysian bank presents the bill for acceptance.	The acceptance and avalisation has already been achieved.
3	The Malaysian bank would hold the accepted bill until the maturity date and seek drawee's authority to make payment.	The promissory note would be held by En. Hassan and sent for collection in plenty of time before maturity.
4	The Malaysian bank is acting as En. Hassan's agent in collecting payment from the Taiwanese importer.	The Taiwanese bank has guaranteed payment and must pay at maturity whether it can recover the funds from the importer or not.
5	Subsequent correspondence on the collection including advice of payment would be sent to the En. Hassan direct.	There will be an advice of payment only and that would be sent to the Malaysian bank or En Hassan as appropriate.

- (c) En Hassan can reduce his risk under documentary collection by:

- By taking status inquiry on the buyer
- Ask for third party inspection certificate
- Insert protest instruction on the collection order. If not paid, it will cause severe damage to the credit of the Taiwanese buyer
- Take out insurance against non-payment from MECIB.
- See if arrangement can be agreed for acceptance of aval.
- By requesting for a bank guarantee or standby letter of credit to guarantee payment
- To request for a partial advance payment before shipment.

Question 3

Many were able to answer this straightforward question on the concept of international trade.

3. (a) **Four** of the common services provided by banks that are involved with customers who are engaged in international trade.

- by giving trade information and providing replies to inquiries

Banks can be used as what is called trade information. By this, we mean that if an importer wants to identify potential supplier of goods or suppliers of the service that he wants, his bank can assist him to establish the identity of the suppliers.

The reverse can also apply. When an exporter is looking for new markets and potential buyers for his manufactured products, his bank can normally assist him to identify suitable buyers.

Once the respective parties have been identified, it is then possible for one party to make an enquiry with the other party, using the banking system.

It should be noted that a bank that need to assist their customers in kind aspect of services will also require and extensive correspondent banking relationships (for a local bank) in order for them to build their own database of potential importer and exporter.

- by being document processor
Banks can be used as a media through which documents, representing the shipment of goods or provision of services, are passed between exporter and importer. For example, where goods are involved and the goods have been shipped, all the necessary documents can be put together and taken to the exporter's bank. The bank will use its international connection (i.e. network of correspondence banks) to get the documents through to the importer.
- by obtaining payment from the importer and remitting the sum obtained to the exporter.
Bank can be used to 'demand' payment from the importer. Once the importer has paid, the money will be remitted to the exporter. The bank acts as the transmitter of the money, while the final bank in the chain acts as the receiver.
- by providing finance
Business engaged in international trade may find that they do not have enough working capital to finance deals from their existing and future credit balances. Thus, they have to resort to external funding. For exporters, they need financing because of the delay in getting the money from the importers and also the transit time in getting as the payment from the importer. Some importers do not want to pay until they know that the goods have arrived in their respective countries. They also expect to be given the normal credit period to pay. For the importers, they also need financing for them to obtain the documents for the clearance of goods from the port. As these goods need to be sold and turned to cash, the period of financing allowed by their banks will ease their cash-flow problem,
- by giving advise about the type of risk involved.
Engaging in international trade has certain risks. Some might be common to the domestic trader, while some are unique to international trades. Banks can assist by identifying some of these risks for their customers, indicate the extent of the risk and provide some advice on how those risk can be mitigated.

When the bank is involved in financing the customer, banks have vested interest in seeing that customers' risks are minimised. By ensuring that the customers take some form of protection, both the customer and the bank are then in a more secure position.

- by supplying foreign currency
Bank change domestic currency into foreign currency and vice versa. The exchange process may be of benefit to either an exporter or importer, depending upon the type of currency that is specified for trade settlement. A bank is licensed and prepared to carry out either type of conversion.

(b) **Five** risks that are commonly faced by international traders.

- Credit Risk
With international trade, the need to access credit risk is more critical and, in the first instance, more problematic. Exporters would always need to access whether the importer will pay them in due course and what would the financial position of the importers be. At the very best, the exporter need to conduct bank status inquiry on the importer by getting the most recent audited account of their importer. This may not be completely protecting the exporter from credit risk. Circumstances may change the importer may get into financial difficulty even tough their previous year audited accounts are healthy. Thus, considering this, the exporter may need to insure himself by choosing the most suitable payment method.

- Performance Risk
Performance risk is the type of risk that a buyer faces. A buyer who has entered into a contract to purchase some goods will have to establish that the goods meet the provisions laid down in the contract and up to their expectation. As a protection against performance risk, it is advisable that the importer to ask the supplier to provide a performance bond or standby letter of credit.
- Documentary Risk
There is a possibility that the documents presented on a bank by the 'exporter' are forged. In such circumstances, a bank may have committed itself to pay or it may have paid out only to find at a later date that the documents are forged. This will have negative impact on the bank. Exporters may be facing the same problem too. They could have released their goods to some unscrupulous party who issued them with forged documents. Thus, it is advisable that exporters deal with a known party who has long history and good track records in handling international trade documents on their behalf.
- Foreign exchange risk
The currency exchange rate is never static. An international trader, who deals in foreign currency for his trade settlement, will have to face the uncertainty in the exchange rate fluctuation. A Malaysian exporter need to convert the foreign currency obtained from his export proceed into Ringgit Malaysia. When an exporter first quotes the price of his products, he will base it on the current exchange rate. However, due to time taken in producing and eventually exporting and receiving payment from the importer, the exporter will be exposing himself to the forex risk if he choose not to consider hedging himself. The exporter should always contact his bank to establish the best technique for hedging purposes. By doing so, his profit margin will be protected.
- Transit Risk
While goods are still in transit from the supplier's factory to the importer's warehouse, it could be damaged. This is a common problem, irrespective of whether the goods are being packed. There are other transit risks that can damage or reduce the value of the goods such as fire, flood, etc. By taking appropriate insurance cover the risk can be minimised. In this situation, international traders need to be fully conversant with the Incoterm they have agreed upon so as to ensure the extent of their risk.
- Transfer Risk
While settling of debt domestically may not be too risky, the transfer risk need to be seriously considered when the settlement of debt cross the international border. The buyer may be located in a country that has limited international currency reserves. Such country will place restriction on the outflow of currency and may require appropriate approval before the remittance is effected. The exporter taking an appropriate insurance cover from MECIB can mitigate this risk.
- Sovereign Risk
There are two instances where sovereign risk can happen. First, the importer's country may suddenly be at war and thus prohibits any outflow of currency from their country. Second. there are possibilities that the government of the buyer's country imposing exchange control regulation because of political reason.

(c) *Definition of Incoterm*

Incoterm, which were drawn up by the ICC, provide as internationally accepted set of standardised terms which set out where the exporter's responsibility ends as regards to insurance and transport of goods. It detailed the main obligations of the seller and the buyer in international contract of sales. The main elements are delivery, costs and transfer of risk. The main categories of costs are :

- Dispatch, carriage and delivery
- Customs clearance for export and import

- Service assistance rendered by one party to the other in addition to what the assisting party is required to do under the trade term
- Insurance.

PART B

Question 4

Many candidates showed poor understanding on the mechanics/concepts of the UCP500.

4. (a) (i) Availability
The beneficiary should be aware that the standby letter of credit as issued required drafts to be drawn at sight on the issuing bank and the credit did not permit negotiation.
- (ii) Expiry place
The beneficiary should be aware that the standby letter of credit as issued required that the document be presented at the counters of the issuing bank on or before the expiry date. In this case, the risk of forwarding the documents and eventual receipt by the issuing bank is on the beneficiary. The beneficiary or the remitting bank, on his behalf, cannot guarantee time receipt by the issuing bank of the documents remitted.
- (iii) Statement of default as required
The statement of default required in the credit is not specific as to its wording. The credit requires a statement to the effect that something has happened. Is it possible that the wording implies that the statement may substantially comply with the wording appearing in the credit or must it comply strictly with such wording? For this reason it is suggested that the wording to appear in the statement of default be clearly stated in the credit by requiring the specific declaration to be placed in quotes. By having the exact wording, all parties are aware that there must be strict compliance with the requirement.
- (iv) Promissory Notes
The credit required the Promissory Note to be marked "PAID" at the time it was presented for payment under the credit. It is NOT a prudent requirement. The issue that must be reviewed is what effect would that be if the beneficiary deeded note the Promissory Note as "PAID" and, when presented to the issuing bank, such bank failed to pay the drawing under the credit. Would the beneficiary in such event be able to take a note that has already been noted as "PAID" and claim that payment has not been effected? What if he wished to institute "protest" claims?
- Furthermore, the credit permits that the statement of default relates to the non-payment on the maturity date of upon acceleration. Yet the credit requires presentation of the original Promissory Note past due date. If the credit allows drawing on an accelerated basis, then the corresponding Promissory Note may not have matured or become past due.
- (v) Expiry date
The credit expired on 1 June 2001, and the promissory note number 6 mature on 1 June 2001. Therefore, the beneficiary must wait until the close of business on 1 June 2001, to determine whether payment was made by the Applicant directly or whether a default situation has occurred. If the Applicant defaulted in his direct payment, then the beneficiary must look to the credit as the secondary means of payment. The beneficiary must draw under the credit and must present his documents to the issuing bank on or before the expiry date.

In this case, the beneficiary does not have the necessary time to comply with such expiry date constraints. Therefore, the standby letter of credit should expire a few days after the maturity date of the last Promissory Note due. This action would

enable the beneficiary to prepare and present his documents to the issuing bank within the expiry date of the credit.

- (b) Article 41 states that “If drawings and/or shipments by installments within given periods are stipulated in the credit and any installment is not drawn and/or shipped within the period allowed for that installment, the credit ceases to be available for that and any subsequent installments, unless otherwise stipulated in the credit”.

There have been certain cases where bank have used the arguments that UCP 500 Article 41 applies to standby letter of credit requiring installment drawings. For this reason, it is prudent to ensure that if standby letter of credit are used, where installment drawings are required, a condition be stated that in such standby letter of credit that UCP 500 Article 41 does not apply.

Question 5

The answers for this question on the definition of different foreign exchange rates were average.

5. (a) (i) Counter rate
A rate that the bank will apply to all non-special over the counter transactions during a particular working day. A bank will have a counter rate that it will use to buy or sell low value transactions such as foreign currency traveller's cheque, drafts or telegraphic transfer.
- (ii) Special counter rate
Where the amount of a particular transaction is above a certain threshold level (i.e. where the ordinary counter rate cannot be used), the dealer will be contacted for a special rate to be quoted. This will ensure that the customer will be given a preferential rate whilst the dealer is also in a position to hedge himself against any unnecessary large exposure from the fluctuation of exchange rate.
- (iii) Spot rate
An exchange rate that is quoted for an immediate foreign currency transaction. The currency transfers takes place immediately and the appropriate accounting entries for the transactions are posted on the same day. In a bank-to-bank transaction, although the spot rate is the rate that is applied on the currency transaction date, the settlement between the banks can take place two working days in future.
- (iv) Forward rate
This is the exchange rate that the bank applies beyond the current day. It is a rate that is quoted for a future foreign exchange transaction; i.e. tomorrow and onwards. Depending on the demand of the currency, a heavy traded currency exchange rate can be quoted up to 12 months and less demanded can be obtained for a shorter period.
- (b) Four main factors that can affect the exchange rates are:
- Speculation
Speculation may have a dramatic effect on the value of a currency and may take various forms; e.g. speculators may sell a weakening currency and/or hold a strengthening currency awaiting market movements in their favour. Hot money may be moved from one currency to another looking for a future currency movements; or some commercial companies will ‘lead’ or ‘lag’, securing their exchange rate, anticipating a movement of rates in their favour.
 - Interest rates
A government or central bank may influence the value of its currency by raising or lowering interest rates. Investors may buy or sell currency to obtain the best return on their deposit, thus, creating the demand for the currency.

- Central Bank intervention
A central bank may on its own or in concert with other central banks buy or sell currencies to stabilise rates (and where appropriate replenish country's reserve for foreign currency). When supporting a fixed value of a currency, it may be necessary to realign a currency; i.e. devalue or revalue.
- Market news
World and home events, political or economics, positive or negative, will be analysed by the market makers, and future trends will be anticipated and reviewed as news comes in, particularly economic indicators.

Bad news may affect confidence and unsettle the market and dealers will adjust rates. Currencies may be bought and sold as funds moved to perceived safe haven.

Where markets are relatively quiet, supply and demand play an important part and large transactions may have an impact.

All things being equal, a country with current and continuing low inflation, economic and political stability, balance of trade surplus and high interest rates should have a strong currency that would be in demand.

Question 6

Many failed to provide accurate answers for this question.

6. (a) Purchase of bill of exchange in connection of a documentary collection.
- (i) The presenting bank will not know about the purchasing aspect. The remitting bank will submit the documents and will use the normal collection order.
 - (ii) The exporter would have signed a purchasing authority that will authorise the bank to amend his instruction on the collection order as he deems fit. In view that the bank has its financial interest in the documents, amending an instruction that would protect its interest.
- (b) Three types of loans under ECR Pre-shipment
- value added loan (VAL)
The proceeds of VAL have to be used to finance the exporters overhead expenses in relation to the products to be exported. The amount available should not exceed 30% of the 'eligible' amount whichever finance method – order-based or certificate of performance – is used. The amount differs depending upon the reasons why finance is needed. Agricultural products producers may draw down merely at his request. Trading companies are not permitted to draw down VAL.
 - Domestic input loan (DIL)
The proceeds of DIL have to be used to purchase input materials from domestic supplier. Again, the conditions that need to be satisfied for disbursement vary. IT may be drawn down either against the reimbursement of a ECR DLC, ECR DPO or under the Cash Reimbursement method.
 - Domestic output loan (DOL)
This type of loan is only available to trading companies. Such companies can raise finance in relation to their purchases of intermediate or final products from domestic supplier. As in the case of DIL, the draw down will be against an ECR DLC, ECR DPO or CRS.
- (c) Special features in Bankers Acceptances:
- The bill of exchange, which is to be used to obtain finance, is drawn payable on a specified future date and excludes days of grace.

- The maturity date of the BE is beyond the date when the importer is expected to pay. This, then, enables the accepting bank to be put 'in funds' to meet payment which will be demanded from it on the maturity day.
- The bills of exchange either drawn on the commercial or merchant bank must be payable on the head office, central office or main office of the bank.
- BE must be drawn payable to drawer.
- BE can only be drawn in multiples of RM1,000 and cannot be for amount of less than RM30,000. When it is not exactly in round RM1,000 figures, it should be rounded downwards.
- The BE can neither be drawn for a period of less than 21 days nor can it be for a period of more than 365 days from date of acceptance.
- The tenor should be reflective of the credit period that would normally be given by the business engaged in that particular trade. Hence, if normal credit period is 180 days, then the BE should not be drawn for a period longer than that. When the credit sales is made to anon-resident and the normal credit period is in excess of 6 months, prior approval of the Controller of Exchange is needed before the BE is drawn and accepted.
- BE should not mature either on Sunday or Public holiday. Should it the bill exceptionally matures on a public holiday, it will fall due for payment on the next working day.
- The bill of exchange must be drawn on a standard format and size and written on the face where finance is being drawn down in relation to a trade transaction

Question 7

Candidates' answers were average, as they are still confused with the terms and concepts used in Islamic banking.

7. (a) (i) Al-Wadiah Yad-Dhamanah
 In addition to that Al-Wadiah Yad-Amanah, where the bank service possesses certain features, the obligation of the bank becomes different. Thus, where one of the following is a feature:
- deposits are pooled together for lending purposes rather than kept separate.
 - deposits are invested or lent at the discretion of the Islamic bank; or
 - the Islamic bank imposes services charges in relation to the deposit of money,
- the governing concept becomes Al-Wadiah Yad-Dhamanah. This means that the bank's role change from that of a trustee to a guarantor and, thus, the obligation on the bank to return the deposits in accordance with the agreement between the bank and its customer.
- (ii) Al-Mudharabah
 This term relates to an agreement between an entrepreneur and an owner of capital. In this relationship, the customer who deposits the sum is the owner of the capital, while the bank takes on the role of the entrepreneur. The bank will take the money deposited for the specified period of the time and it will agree to pay the depositor his capital sum PLUS a pre-determined ratio of profit. The bank is able to use the money deposited in any way it sees as being appropriate and the depositor cannot provide instruction to the bank. Any profit made will be distributed between the two parties in accordance with the pre-determined ration as defined in their contractual agreement. In contrast, if losses occur, it will be for the account of the person depositing the money. There shall be no provision on the losses shall be shared.

- (iii) Al-Musarakah
This relates to what partnership is. The partnership is created in the sense that the entrepreneur and investors jointly manage and provide funds for the business venture. Where partnership operates in a profitable basis, the profits are shared between the two parties in accordance with the pre-agreed ratio. Where losses are incurred, it will be shared between the two parties in proportion to the contribution of capital.
- (iv) Al-Bai' Bithaman Ajil
This term relates to the sales of goods where payment for them is deferred. Thus, the bank can purchase the goods from the seller and await payments from its own customer at a later date. The price paid by the customer will be greater than the amount the bank paid to the seller.
- (v) Al-Murabahah
The term relates to "purchase and sale" transactions. To use it, an investor such as a bank, buys goods and sells them to the customer at a price that is above what he (the customer) paid. This mark-up represents the bank's income for providing finance to the customer. The techniques can also be called as "cost plus" because the bank sells the goods at the cost to it, plus some more.
- (vi) Al-Qardh ul-Hasan
This term relates to the provision of loan money that are repayable at the end of the agreed period. The borrower has no obligation imposed upon him other than to repay the amount that was advanced to him. This type of arrangement may also be called a "benevolent" arrangement. However, should he do so, he can make a payment of an amount over an above of what he borrowed.
- (vii) Al-Ijarah
One type of conventional financial product is a leasing arrangement. Al-Ijarah is the Islamic equivalent. Thus, a financial institution buys an asset and then leases it to the customer. The lease agreement will provide for regular rental payments to be made.
- (ix) Al-Kafalah
There may be occasions where someone deposits his goods with third party for the purpose of safekeeping. The depositor may wish to have the return of his goods guaranteed independently. A guarantor, such as a bank, can give such a guarantee.

(b) Three forms of letter of credit under Islamic concept:

- Al-Murabahah
The principles that relate to this type of letter of credit are of the 'cost-plus' nature. The importer will repay the bank with a lump sum on a deferred basis. With this arrangement, the bank provides 100% of the funds needed to purchase the goods. This will be apparent from the way that the negotiations progress between the customer and the bank.
- Al-Musharakah
The principles that relate to this type of credit focus on the concept of joint venture/partnership profit sharing basis. While the bank and the importing customer are in the process of negotiating the letter of credit, the nature and extent of the partnership between the two parties will have to be decided upon.

Once the details of the relationship have been decided, the amount the customer's cash contribution will be known and, hence, the balance that the bank has to provide will have to be determined. The importing customer will be expected to pay his agreed contribution by way of cash sum.

As the details of the letter of credit are sent to the negotiating bank, the amount claimable by the beneficiary under the letter of credit is remitted. The amount is partly made up by the importer's (customer) cash and partly by the bank's contribution. Once the goods have been received, the importer can attend to the disposal. Once payment has been received from the on-buyer, the resultant will be shared between the bank and the customer in accordance with their agreement.

- Al-Kafalah

With this type of arrangement, the bank is considered as the agent for the importing customer. Prior to the issuance of the letter of credit, it is a standard practice for the bank to ask for cash deposit. The money will be deposited under the Al-Wadiah Yad-Dhamanah principle.

Under this arrangement, the bank is not advancing any of its own money. The bank will merely generate a fee/commission income for the service it provides.