

DP08

Retail Financial Services

11 OCTOBER 2000

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**.

PART A

ANSWER ALL THREE (3) QUESTIONS

1. Mr William Gonzales, a businessman, comes to your bank to apply for a RM350,000 housing loan to buy a new double-storey terrace house in Bandar Utama costing RM450,000. Construction of the house will begin next month and is scheduled to be completed in **two** years' time.

Mr Gonzales is accompanied by his wife, a dentist. Mrs Gonzales plans to stay at home to look after their **two** children in **five** years' time.

Mr and Mrs Gonzales have a few questions regarding the loan, which they would like you to answer.

- (a) How much is the processing fee for the housing loan? [2]
- (b) What is the formula for calculating the interest on the housing loan? [6]
- (c) If part of the housing loan is in the form of an overdraft, what is the formula for calculating the interest on the overdraft portion? [3]
- (d) What is the advantage of an overdraft over a housing loan? [3]
- (e) What are "low-start" loans and "high-start" loans? Which of these **two** loans are more suitable for Mr and Mrs Gonzales? [4]
- (f) If Mrs Gonzales becomes the guarantor for the housing loan, would she be protected under Bank Negara Malaysia's Guidelines for Accepting Guarantee for a Credit Facility? [2]
- (Total:20 marks)

2. United Transport Sdn Bhd (UTSB) intends to enter into a hire-purchase agreement with your finance company to purchase **seven** buses for its transport business. The details of UTSB's loan proposal are as follows:

Cost of buses	RM560,000
Deposit paid	RM84,000
Loan amount	RM476,000
Interest rate	6% per annum flat
Repayment period	60 months

Required:

- (a) (i) Is this transaction covered by the Hire-Purchase Act 1967 as amended by the Hire-Purchase (Amendment) Act 1992? [1]
- (ii) The goods covered by the above Act are listed in which schedule? [1]
- (b) (i) Should both parts of the Second Schedule of the Hire-Purchase Act 1967 as amended by the Hire-Purchase (Amendment) Act 1992 be served on UTSB, if negotiations leading to the hire-purchase agreement is carried out by a dealer? [1]
- (ii) Explain what are Part 1 and Part 2 of the Second Schedule of the above Act. [4]
- (c) (i) Is UTSB obliged to enter into the hire-purchase agreement once the Second Schedule of the Hire-Purchase Act 1967 as amended by the Hire-Purchase (Amendment) Act 1992 has been served on it? [1]
- (ii) How much must UTSB pay for the preparation of the Second Schedule of the above Act? [1]

- (d) Calculate the term charges to be earned by your finance company. [4]
- (e) Calculate the monthly instalment payable by UTSB. [4]
- (f) Calculate the Annual Percentage Rate (APR) using the formula below:

$$\text{APR} = \frac{2NF(300C + NF)}{2N^2F + 300C(N + 1)}$$

$$\text{where } F = \frac{100C \times T}{N \times A}$$

[3]
(Total:20 marks)

- 3. (a) What are Registry titles and Land Office titles? [4]
- (b) Explain the difference between a private caveat and a lien-holder's caveat. [4]
- (c) (i) How does a chargee make the application for an order for sale, in respect to Registry titles and Land Office titles? [2]
- (ii) To whom must a chargee make the application for an order for sale, in respect to Registry titles and Land Office titles? [2]
- (d) State the difference between Form 16D and Form 16E under the National Land Code 1965. [4]
- (e) Describe **two** remedies available to a bank in respect to properties secured by way of an assignment if the assignor defaults in the loan repayment under a Deed of Assignment. [4]
(Total:20 marks)

PART B

ANSWER TWO (2) QUESTIONS ONLY

- 4. (a) Explain the differences between an operating lease and a financial lease. [5]
- (b) What is the effect of a Novation Agreement? Under what circumstances is a Novation Agreement used? [5]
- (c) What is the difference between a full pay-out lease and a non-full pay-out lease? [5]
- (d) Explain a "sale and lease-back" leasing activity. [2]
- (e) Leasing frauds usually happen in leasing companies with certain characteristics. Describe **three** of these characteristics. [3]
(Total:20 marks)
- 5. (a) State and explain **four** financial benefits of factoring. [8]
- (b) What is "confidential" factoring? [2]
- (c) List **three** areas of risk associated with block discounting and suggest ways to minimise these **three** risks. [6]
- (d) When a batch of hire-purchase agreements are discounted under a block discounting arrangement, the dealer will normally forward **four** documents to the finance company. What are these **four** documents? [4]
(Total:20 marks)
- 6. (a) List **three** advantages and **three** disadvantages of taking quoted shares as security for a loan. [6]
- (b) What are the **two** disadvantages of taking unquoted shares as security for a loan? [4]

- (c) Explain **four** precaution lenders must take when offered securities on properties without the issue/strata document of title. [8]
- (d) What is the difference between a Deed of Assignment and a Loan Agreement? [2]
- (Total:20 marks)

OUTLINE ANSWERS

Question 1

Only a small number of candidates passed this compulsory question which covered two major areas, housing loans and personal overdraft. Many candidates did not know how much is the processing fee for a housing loan. When asked to calculate the interest on the housing loan, most candidates gave only one formula, when there should be one formula each for progressive release and full release. Moreover, many of the formulas were incomplete.

1. (a) In accordance with the Rules of ABM and AFCM, the processing fee payable is RM200.00.
- (b) Interest from the first drawdown until the loan is fully released is calculated daily using the following formula:
Daily Interest = Principal (P) x Time (T) x Interest Rate (R)

where P = Balance of loan outstanding at the end of each day
T = 1/365
R = interest rate quoted for the loan

Upon full disbursement of the approved loan amount, interest is calculated monthly using the following formula:
Monthly Interest = Principal (P) x 1/12 x Interest Rate (R)

Where P = amount of loan outstanding at the end of the previous month
R = interest rate quoted for the loan
- (c) Interest on overdraft on the overdrawn daily balance of the current account using the following formula:
Overdraft Interest = Principal (P) x Time (T) x Interest Rate Quoted

Where P = overdrawn balance at the end of each day and T = 1/365
- (d) Overdraft is more flexible as the borrower may repay the outstanding debt at any time without notice to the bank, whereas one month notice is required for full or partial sum settlement of housing loan. Overdraft has a revolving line of credit.
- (e) Low start loan - the repayment amount is adjusted upwards at regular intervals.

High start loan - the repayment amount is adjusted downwards at regular intervals.

High start loan is more suitable as both husband and wife are currently working and can afford higher repayments. When Mrs Gonzales retires from her job, the instalment would have reduced to a lower, more manageable level.
- (f) No, Mrs Gonzales would not be protected by the guidelines as the guidelines do not apply to a credit facility granted to an individual whose spouse is the guarantor and not applicable for loans more than RM200,000.

Question 2

Candidates performed the best in another compulsory question, which covered two parts, the Hire-Purchase Act and service of the Second Schedule. A majority of the candidates secured a pass for this question. Most candidates wrongly thought that the list of goods is covered in the Second Schedule of the Hire-Purchase Act, instead of the First Schedule. Most candidates knew that both parts of the Second Schedule has to be served on the company but many thought that the customer has to pay stamp duty or deposit. However, many candidates managed to score when asked to calculate the term charges and the monthly instalment payable.

2. (a) (i) Yes, the transaction is covered by the Hire-Purchase Act, 1967 as amended by the Hire-Purchase (Amendment) Act 1992.
- (ii) The list of goods covered by the Act is the First Schedule.
- (b) (i) Yes, both parts of the Second Schedule have to be served on UTSB.
- (ii) Part 1 is the summary of the applicant's financial obligation under the proposed hire-purchase transaction. Part 2 is the consent of the prospective owner's consent to enter into the proposed hire-purchase transaction.
- (c) (i) No, UTSB is not obliged to enter into the Hire-Purchase agreement.
- (ii) There is no charge for the preparation of the Second Schedule.
- (d)
$$R = \frac{100 \times C}{T \times P}$$
- $$6 = \frac{100 \times C}{5 \times 476,000}$$
- $$C = \frac{6 \times 5 \times 476,000}{100}$$
- $$= \text{RM}142,800$$
- (e) Instalment
$$= \frac{\text{Loan Amount} + \text{Term Charges}}{\text{Repayment Period}}$$
- $$= \frac{\text{RM}476,000 + \text{RM}142,800}{60}$$
- $$= \text{RM}10,313.33$$
- (f)
$$\text{APR} = \frac{2NF(300C + NF)}{2N^2F + 300C(N+1)} \quad \text{where } F = \frac{100C \times T}{N \times A}$$
- $$= \frac{2(60 \times 6) [300(12) + 60(6)]}{2(60)^2(6) + 300(12)(60 + 1)} \quad = \frac{100(12) \times 142,800}{60 \times 476,000}$$
- $$= \frac{720 \times (3,600 + 360)}{43,200 + 219,600} \quad = 6$$
- $$= \frac{2,851,200}{262,800}$$
- $$= 10.85$$

Question 3

Only a few candidates passed this question on real estate financing. Many candidates lost marks when they could not give the complete names of the land registration bodies, i.e. Land Office and Registry of Land Titles. They were also confused about using Originating Summons and Form 16G for application of order for sale, as well as to whom the application should be directed to. However, those candidates who were knowledgeable in this area managed to score above 75% of the overall mark for this question.

3. (a) Registry Titles – These are divided into Grants (Geran) or State Leases (Pajakan Negeri). These titles can either be final or qualified. Normally, the following words are endorsed on Registry Titles: “Geran, Pajakan Negeri, Hakmilik Sementara Daerah [HS(D)]”.

Land Office Titles – These are divided into Mukim Grants (Geran Mukim) or Mukim Leases (Pajakan Mukim). These titles can either be final or qualified. The following words identify Land Office titles: “Geran Mukim, Pajakan Mukim, Hakmilik Sementara Mukim [HS(M)]”.

- (b) The effect of a private caveat is to prevent all dealings on the land. It prohibits the registration, endorsement or entry of any instrument and certificate of sale, claims or lien-holder’s caveat on the register document of title.

Lien-holder’s caveat has the same prohibitive effect as a private caveat. But unlike a private caveat, it operates as a form of security and renders a lien a secured debt.

- (c) (i) Registry titles – The chargee must make the application by way of an Originating Summons together with an Affidavit in support, at the appropriate High Court.

Land Office titles – The application should be made using Form 16G addressed to the appropriate Collector of Land Revenue of the Land Office of the District having jurisdiction over the charged land.

- (ii) Registry titles – High Court

Land Office titles – Collector of Land Revenue

- (d) Form 16D is used to demand payment of principal and interest or demand remedy of any breach of the covenants under a legal charge.

Form 16E is a demand for payment of the principal sum, which is repayable on demand.

- (e) The remedies are:

- (i) Issuance of Writ and Statement of Claim against the assignor to recover the outstanding loan.

- Once judgment has been obtained against the assignor, the assignee proceeds to apply to the Court to execute the judgment by way of a Writ and Sale of assigned property. The property is sold by public auction and the proceeds of sale is utilised to satisfy the judgement sum.

- (ii) Disposing the assigned property by way of private treaty with consent from the borrower.

- An assignment enables the assignor the right and power to sell and assign the subject property as the unencumbered owner at such price and in such manner as the assignee shall think fit, free from any interest of the assignor.

Question 4

The candidates who attempted this question generally knew that operational lease is short term, while financial lease is for most of the equipment’s useful life. However, many were unsure as to what a novation agreement is and as such could not describe its function in a leasing transaction. A majority of candidates thought that full pay-out lease means that the lessee finances the full value of equipment and that the contrary would apply for a non-full pay-out lease.

4. (a) **Operating Lease** – This is normally a short-term lease which can be terminated at the discretion of the lessee and the rentals do not provide the lessor a full recovery of its investment during the lease period e.g. car rental services.

Financial Lease – A financing device whereby a user can acquire use of an asset for most of its useful life. Payment is net to the lessor and the user is responsible for maintenance, taxes and insurance. Payments over the life of the lease are sufficient to enable the lessor to recover the cost of the equipment plus interest on its investment e.g. full pay-out lease (pure lease) and non-full pay-out lease (deposit lease).

- (b) **Novation Agreement** – The effect of this agreement is to cancel the existing lease contract between the lessee and the supplier and to substitute a new agreement between the lessor and the supplier. The lessee then drops out of the contract and is released from all liabilities to the supplier.

A novation agreement is used when the lessee placed an order for the equipment and made part payment towards the purchase price of the equipment prior to making leasing arrangement with the lessor. The novation agreement cancels the contract between the lessee and the supplier, substituting the lessee with the lessor as the purchaser of the equipment.

- (c) **Full pay-out lease** – The lessor receives capital cost of the equipment plus an amount equivalent to a financing charge during the primary lease period. During this period, the contract cannot be cancelled.

Non-full pay-out lease – The lessor does not recoup the total purchase price of the equipment. The period of the lease is always less than the useful economic life of the equipment, and part of the lessor's investment and income is obtained through the residual value of the leased equipment.

- (d) **Sale and Leaseback** – The user of an equipment sells to a leasing company the equipment to which the user already has title to, and leases the equipment back to the user under a lease agreement.

- (e) The characteristics of fraud prone leasing companies are: (*Select any three*)
- Poorly trained or inexperienced management or staff.
 - Excessively sales driven strategies where credit is subjugated to the pressure on the staff to achieve business targets.
 - Inadequate or poorly documented procedures for handling new business.
 - There is no effective supervision or audit team to ensure that the company's policies and procedures are followed.

Question 5

This two-part question on factoring and block discounting was a popular question among candidates. Most candidates were able to state the four financial benefits of factoring but only a handful were able to give complete description of these benefits.

5. (a) (i) Raising additional working capital easily and quickly
- Client can increase the velocity of its working capital, and hence, profitability through higher sales turnover.
 - The company can raise more funds based on its sales volume instead of networth (balance sheet strength) and collateral which banks will look at.
- (ii) Better cash flow planning
- In the event of delays in debt collection, the customer can draw on the factoring facility to meet contingencies or even purchase supplies on cash term to take advantage of discounts.
- (iii) Be more competitive
- If a company wants to penetrate a market or compete more effectively, it cannot insist on cash terms or uncompetitive payment terms, unless it is a sellers' market. Factoring allows a company to sell on more competitive terms.

- (iv) Increase return on capital
 - Receivables turn-over faster and hence, more frequently in a year with factoring. Profitability is increased through better return on capital either because of a greater volume of business on the same amount of capital, or the same amount of business on a smaller amount of capital.

- (b) **Confidential factoring** – An arrangement where the supplier enters into a factoring arrangement, normally on a with recourse basis, with the factor without the knowledge of the customer.

- (c)
 - (i) Fictitious agreements/papers
 - Verify existence of hirers through phone calls or visits
 - Inspect goods

 - (ii) Dealer absconded
 - Give notice of assignment to all hirers so that finance company can immediately notify all hirers to make all future payments directly to the finance company

 - (iii) Agreement not in compliance with statutory requirements
 - All papers submitted by dealers must be checked thoroughly. Papers with discrepancies or irregularities must be rejected.

- (d) The documents forwarded by the dealer are:
 - the original agreements
 - an offer for sale or request to purchase
 - a sales letter and declaration
 - a schedule or schedules listing the agreements and showing the balance outstanding under each agreement (known as “collection value” of the agreement) and the remaining unexpired period.

Question 6

This question tested candidates' knowledge on share margin financing and real estate financing. Many candidates managed to pass this question. Candidates generally knew that unquoted shares are difficult to sell, but they did not know that only equitable mortgage is possible as share transfers may be restricted by the company's Articles of Association. The majority of candidates could not explain the precautions that lenders must take when taking securities on properties without title.

6. (a) Advantages
- The value of the security can usually be ascertained without much difficulty.
 - There are few formalities to be observed when taking shares as security.
 - It is inexpensive as stamp duties on mortgage of shares are minimal.
- Disadvantages
- The value of the shares can change very quickly.
 - There is a possibility of theft by people who handle or deal with the security since shares are easily realised.
 - If partly paid shares are transferred into the name of the financier or its nominees, it would be liable for any calls made on the shares.
- (b) The disadvantages of unquoted shares are:
- Difficulty in finding a buyer. Although a lender may offer such shares to existing shareholders, they may offer unreasonable terms as they are the only possible purchasers.
 - Only equitable mortgage is possible. The right to transfer shares may be restricted by its Articles of Association.

- (c) The precautions are:
- Immediate sight and possession of the original Sales and Purchase Agreement between the purchaser/borrower and the vendor/seller.
 - A letter of confirmation from the vendor/developer that the purchaser/borrower is the current purchaser of the property in their records.
 - If there is a charge on the master title under which the property was built, a letter of disclaimer from the master chargee to disclaim all rights, interest and title to the property from any foreclosure proceedings that may be instituted against the land.
 - A written declaration from the purchaser/borrower to the lender that he/she has not executed any deed of assignment or any other documents parting with his/her legal interest under the Sale and Purchase Agreement.
- (d) **Deed of Assignment** – The instrument creating the assignment, where the borrower assigns his rights on the collateral, to the financier.

Loan Agreement – The terms and conditions of the loan and the assignor's obligations and covenants in respect of the loan are normally stipulated in this document.