

**DP08**

# **Retail Financial Services**

**8 MAY 2002**

1. Time allowed : Three (3) hours
2. Total number of questions : Six (6) questions
3. Number of questions to be answered : Five (5) questions  
Part A : Three (3) questions [20 marks each]  
Part B : Two (2) questions [20 marks each]
4. Show details of workings, where appropriate. Silent, non-programmable calculators may be used.
5. Begin each answer to a new question on a fresh page.
6. Answer **all** questions in **English**.
7. Blank pages are provided at the end of the question paper for rough work.

## PART A

### ANSWER ALL THREE (3) QUESTIONS

1. Mr Saw applied for hire-purchase financing from Simple Finance Bhd to purchase a reconditioned tractor. As Mr Swindle, the heavy machinery dealer from whom Mr Saw bought the tractor was well known to the finance company, the finance company did not inspect the tractor.

In order to expedite the transaction, Mr Swindle asked Mr Saw to sign **one** of the blank Scheduled Goods hire-purchase agreements, which he keeps in his office. Simple Finance Bhd used the agreement and imposed the following financing terms:

Term charges	12% per annum
Margin of finance	95% of the cash price of the goods
Financing period	60 months
Interest on overdue instalments	10% per annum

You have been asked to handle this case for the finance company. Among the points you need to consider are:

- (a) Does the Hire-Purchase Act 1967 govern the above hire-purchase transaction? Explain your answer. [4]
- (b) Assuming that this transaction is governed by the Hire-Purchase Act 1967, are the terms of financing acceptable? Elaborate on your answers. [8]
- (c) What are the problems and risks associated with financing reconditioned equipment and how can these problems and risks be mitigated? [8]
- (Total:20 marks)
2. Your bank offers **three** types of share financing facilities; that is, new public issue, purchase of quoted shares on the stock exchange, and margin account. You have been asked to draft the answers for the following frequently asked questions:

#### New public issue

- (a) Up to what amount of financing will the bank provide for application of new public issue shares? [2]
- (b) Will the financing amount cover the commission for the cashier's order or draft? [1]
- (c) What is the security required for new public issue share financing? [2]
- (d) If the borrower fails to sell the shares within the period stipulated by the bank, what will the bank do with these shares? [2]
- (e) What is the procedure if the share application is unsuccessful? [2]
- (f) How is interest charged for new public issue share financing? [2]

#### Purchase of quoted shares on the stock exchange

- (g) Up to an agreed percentage of what value will the bank provide funds for the purchase of quoted shares on the stock exchange? [2]
- (h) Can unquoted shares be pledged as security for share financing? [1]

#### Margin account

- (i) Name **three** of the securities that can be offered for margin account. [3]

- (j) What are the borrower's options when the bank makes a margin call? [3]  
(Total:20 marks)

3. Small- and medium-sized entrepreneurs (SMEs) in Malaysia face many problems in their day-to-day operations. As these problems increase the risks of lending to SMEs, your bank's Risk Management Committee has asked you to investigate these problems.

State the problems faced by the SMEs, and explain where necessary, in your report to the Committee.  
(Total:20 marks)

## PART B

### ANSWER TWO (2) QUESTIONS ONLY

4. Kak Pah intends to seek financing to buy furniture and electrical items for her new house. She is undecided whether to apply for an overdraft facility or a hire-purchase facility. Hence, she has come to you with a list of questions on these **two** facilities.

- (a) How does she use an overdraft facility to pay for her purchases of furniture and electrical items? [2]
- (b) How is the overdraft interest calculated and charged to the account? Show the formula. [6]
- (c) Kak Pah heard that other than the interest, the bank would impose a commitment fee for an overdraft facility. How is the commitment fee calculated and charged? Is Kak Pah liable to pay the commitment fee? [5]
- (d) If Kak Pah opts for a hire-purchase facility, when would she obtain the ownership of the goods? [2]
- (e) Under hire-purchase, can Kak Pah obtain 100% financing for the goods? Explain your answer. [2]
- (f) Can all the furniture and electrical items be included in **one** hire-purchase agreement? [3]  
(Total:20 marks)

5. (a) (i) What is an operating lease? [4]
- (ii) What types of equipment are confined to operating lease? [2]
- (iii) How does an operating lease protect the lessee from the risk of early obsolescence of the equipment? [2]
- (b) (i) What are the roles of payment organisations like Visa and MasterCard in the credit card industry? [4]
- (ii) Other than the payment organisations, credit card transactions involve acquirers and issuers.  
What are their roles? [8]  
(Total:20 marks)

5. Agri Venture Sdn Bhd ("Agri Venture") has been involved in the planting of organic vegetables for the past **five** years. Agri Venture is planning to export their vegetables overseas. In order to do so, Agri Venture is increasing their production capacity by adding a few more greenhouses in their farm. Agri Venture has approached you for trade services, trade financing and additional capital.

- (a) Recommend to Agri Venture the suitable trade services and explain their purposes. [6]
- (b) The company would like to apply for a bill of exchange discounted/purchased facility.  
What is the purpose and benefit of this facility? [4]
- (c) Agri Venture has some heavy machinery that the company bought two years ago. It would like to use the equipment to raise capital via sale and leaseback.  
What types of equipment are suitable for sale and leaseback facility and how does this facility work? [4]
- (d) What are the factors to be considered when appraising Agri Venture's agricultural project? [6]  
(Total:20 marks)

## **OUTLINE ANSWERS**

### **Question 1**

- This question was poorly attempted – only a few realised that the goods were covered by the Hire-Purchase Act since the scheduled goods were signed, i.e. both parties agreed to be bound by the Act.
- Candidates were also not familiar with the problems and risks involved in financing reconditioned equipment.

1. (a) Although tractors are not listed in the First Schedule of the Hire Purchase Act, 1967, the parties can agree to be bound by those provisions of the Act (*Kesang Leasing Sdn.Bhd v Mohd Yusof b Ismail & Anor*). In this case, the parties agreed to be bound by the provisions of the Act as the hire purchase agreement was designed for use in respect of goods listed in the First Schedule of the Act.
- (b) Term charges: Not acceptable as the maximum term charges under the Act is 10% per annum.
- Margin of finance: Not acceptable as the current maximum margin of finance is 90% of the cash price of the goods.
- Financing period: Acceptable as the Act has no restriction on financing period.
- Interest on overdue instalments: Not acceptable as the maximum rate is 8% per annum.
- (c) Problems: When financing reconditioned equipment, there may be difficulty in determining the equipment's year of manufacture and it's conditions, especially reconditioned specialised equipment.
- Risks: The equipment may be detained or confiscated by the relevant authorities during the hiring period due to lack of proper documentation or non-compliance with import conditions or failure to pay the appropriate duties associated with the import of such goods.
- Mitigation: Financier must have the necessary knowledge and experience in dealing with such goods. The original documents such as certificate of registration in the country of origin must be obtained. Where in doubt, request for a valuation and inspection report.

### **Question 2**

This question was well answered.

2. (a) The bank will provide funds up to the full value of the cost of the issued price of the shares applied for.
- (b) No.
- (c) In the event that the share application is successful, the shares are to be pledged with the bank as security.
- (d) The shares will be registered in the name of the bank's nominees and will be sold by the bank provided the shares are deposited with the bank's authorised depository and the customer has pre-signed the necessary transfer forms, etc.
- (e) The cashier's order or the draft will be returned to the financier for cancellation and credited to the borrower's account.
- (f) Interest will be charged on the number of days the amount of funds was actually utilised.
- (g) Market value of the shares.

- (h) No.
- (i) Securities that can be offered for margin account (any **three**):
- landed properties
  - fixed deposit
  - unit trust
  - quoted shares
  - combination of the above
- (j) Borrower's options when the bank makes a margin call:
- top up the shortfall (put in cash)
  - put in additional securities acceptable to the bank
  - sell some of this share holding to reduce the excess to its limit

### Question 3

This was another poorly answered question although the answer can be obtained directly from the study manual.

3. Problems faced by SMEs in Malaysia (any **10** of the following):
- Small size and informal business management
  - Poor accounting record
  - High cost of raw materials
  - Lack skills and technical knowledge to add value to their existing products
  - Use of out-of-date machinery
  - Lack technological and managerial skills and information
  - Operate under conditions not conducive to optimal efficiency (factories not located in proper industrial parks)
  - Shortage of skilled labour and technicians
  - Lack capacity and capability to undertake organised marketing
  - Lack knowledge in export procedures and overseas market opportunities
  - Most multinational corporations bring their own SMEs to support them.

### Question 4

- Many candidates were familiar with the features and operations of an overdraft facility.
- The part on hire-purchase requirement for minimum deposit and separate agreement for each item of goods was also generally well answered.

4. (a) She can run her current account into debt up to an agreed limit.
- (b) Interest is calculated on the overdrawn daily balance of the current account and debited to the account once a month. The formula is:
- $$\text{Overdraft Interest} = \text{Principal (P)} \times \text{Time (T)} \times \text{Interest Rate (R)}$$
- (where P = overdrawn balance at the end of each day; T = 1/365)
- (c) 1% per annum is charged on the unutilised portion of the overdraft facility, usually at the end of each month. The unutilised portion is calculated by subtracting the average utilisation for the month from the approved limit. Kak Pah does not have to pay commitment fee as it is not applicable to personal overdraft with limit up to RM250,000.
- (d) When she exercises the option to purchase the goods from the owner.
- (e) No. Under the Hire-Purchase Act 1967, the buyer has to pay a minimum deposit of 10% of the purchase price.

- (f) There shall be a separate hire purchase agreement for every item of goods. Any goods, which are essentially similar or complementary to each other and sold as a set, are regarded as one item.

#### **Question 5**

- Most candidates were able to answer the question on operating lease.
- On credit cards, they were confused with the roles of payment organisations, acquirers and issuers. Many mistook payment organisations as card issuing banks and acquirers as cardholders.

5. (a) (i) The cost of the equipment under lease is not wholly recovered by the lessor out of the rental receivable during the non-cancellable period, which is normally significantly shorter than the estimated useful life of the equipment. The lessor relies on the residual value of the equipment to recover the balance net investment and to earn a profit.
- (ii) Equipment with an established second-hand market and hence value.
- (iii) The lessee may cancel the lease agreement as soon as the equipment become outdated and take on lease the updated model.
- (b) (i) They manage their respective brands by advertising and promotion programmes, developing new products, conducting clearing and settlement processing of transactions, and setting and enforcing rules and regulations governing their cards.
- (ii) The acquirer contracts with merchants to accept merchant sales slips, provide authorisation terminals, instructions and support, and handle the processing of credit card transactions. The acquirer usually charges a fee or discount rate for handling the transactions.

The issuer is responsible for the cardholder account programme, which include all aspects of cardholder activities ranging from acquiring new customers to billing current ones. The issuer is the party that performs the necessary credit checks and provides the card.

#### **Question 6**

- Candidates need to work on their knowledge and understanding of trade services and trade financing. Many answers were vague.
- Most candidates were familiar with the concept of sale and leaseback.
- Factors to consider when appraising agricultural projects can be found in the study manual, yet many candidates were not able to answer this part of the question well.

6. (a) The trade services are:
- Export letters of credit advising/confirmation – secure the company’s receivables on trade transactions.
  - Outward bills for collection (clean/documentary) – assist the company collect their bills drawn on the overseas buyers.
  - Shipping guarantee – issued to the owner or agents of the vessel for delivery of goods prior to the receipt of the bill of lading.

The bank can advance payments to exporters who want to receive immediate funds for their goods shipped under letters of credit or collection. This helps exporters avoid delays associated with cross border presentation. It also reduces the length of time exporters must wait to receive payment for goods shipped internationally.

- (c) An equipment users sells to a leasing company equipment to which it already has title and which has a reasonable remaining useful life. The leasing company then leases the same equipment back to the user under a lease agreement. The equipment can be either new or second-hand.
- (d) Factors to consider:
- Technical viability
  - Financial viability
  - Commercial viability
  - Sociological/environmental viability
  - Economic viability
  - Managerial competency.