Chapter 3

Multiple-Choice Questions

1. **C**
2. **D**
3. **A**
4. **C**
5. **C**
6. **B**
7. **A**
8. **A**
9. **C**
10. **D**

Short-Answer Questions

Question 1
Suggested answers include:

- What is the purpose of the loan – is it to finance a productive or unproductive asset?
- Is the item we intend to purchase a need or a want? If it is a need, are there any viable alternatives that cost less? If it is a want, is it within our budget? If it is not, we should consider delaying the purchase.
- Make sure that we can afford to pay the monthly instalments, that is, ensure that our net debt to income ratio is not more than 40% based on AKPK's recommendation.
- Any other relevant answers

Question 2
Suggested answers include:
- Licensed financial institutions
- Cooperatives regulated by the Ministry of Domestic Trade
- Licensed moneylenders regulated by the Ministry of Urban Wellbeing, Housing and Local Government
- Borrowing from friends and family
- Home equity loans
- Any other relevant answers

Question 3

$$\text{Effective rate} = \left(1 + \frac{0.15}{365}\right)^{365} - 1 = 0.1618 \text{ or } 16.18\%$$

Question 4

	RM
The total loan instalments that Yesmin would have had to pay = 24 × 107 =	2,568
The total savings in the savings account after 24 months:	
Future value of an ordinary annuity = PMT $\left[\frac{(1+i)^n - 1}{i}\right]$	
Substitute: n = 24, i = 0.02/12, PMT = 100	2,447
Cost of similar phone in the next 24 months	2,400

Students' answers may consider some of the following issues:
- Yesmin had to forgo the use of the Model X smartphone for two years which she might consider

unfavourable

- After two years, she was not able to get a phone with the exact features as Model X but presumably Model X1 with similar and enhanced features, which she can now afford, is a better purchase. In addition, the cost of Model X1 is less than the total sum she would have had to pay had she chosen to purchase Model X on credit
- After two years, she could pay cash for Model X1. If Yesmin feels strongly about being debt-free, delaying the purchase would definitely have been a better decision
- Any other relevant answer

Question 5

- Cash advances from credit cards are charged between 3% to 5% immediately upon withdrawal
- If the cardholder cannot pay this in full by the end of the month, a finance charge of up to 18% p.a. will be levied. This will add to the credit card debt
- Both of the above points make cash advances an expensive source of credit

Discussion Questions

Question 1

(a) Khairul's monthly debt obligations = 871 + 1,560 = RM2,431
Net debt to income ratio = 2,431/6,589 = 37%

(b) Total number of months in original loan = 9 years × 12 = 108 months
January 2019 to June 2021 = 12 +12 + 6 = 30 months
Remaining number of months = 108 – 30 = 78 months

	RM
Amount of remaining instalments before rebate = 871 × 78 =	67,938
Applying the rule of 78:	
The amount of interest to be refunded = [78 x (78 +1)/(108 x 109) x 24,912] =	(13,040)
Balance on full settlement	54,898
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The implicit "penalty" would be:	
Interest portion for the remaining number of months = 78/108 x 24,912=	17,992
Less: Interest refund under Rule of 78	(13,040)
Implicit penalty on early settlement	4,952

(c) Increasing the tenure of a car loan would make the monthly instalments lower and more affordable to the buyer. However, the accumulation of interest would be a larger percentage of the overall loan. In the calculations for part (a), even though a 20% down payment was made, the total interest was a substantial amount of 36% (24,912/69,200 x 100) of the total loan taken. Also, if the owner wishes to replace the car, the selling price of the car may be less than the balance on full settlement due to depreciation. The balance of the loan needs to be settled by the buyer. For all these reasons, it is not wise for car buyers to take the maximum loan tenure. AKPK recommends not more than five years.

Question 2

(a) If only minimum payments are made on credit cards, Thamayanthee would have to bear the finance charge of up to 18% per annum depending on how often she has been carrying out this practice. This charge is calculated on a daily rest basis. Besides this, Thamayanthee will not get to enjoy the interest-free period on her outstanding balance on all the purchases she makes in a given month. The compounding daily interest will cause her debt to accumulate and it will take her a longer time to settle her debt.

(b) No, it is not advisable to use cash advances to pay credit card balances. Cash advances from credit cards are charged between 3% to 5% immediately upon withdrawal. If Thamayanthee cannot pay this in full by the end of the month, she will be levied a finance charge of up to 18% p.a. This will add to her credit card debt.

(c)

- Limit the number of credit cards you own based on your needs.
- You may request for the bank to reduce your credit limit if you do not require that high an amount to avoid unnecessary temptation to spend.
- Pay before the due date to avoid late payment and penalty charges.
- Pay the outstanding payments in full to avoid finance charges. If you have a cash flow problem, pay as much as possible more than the minimum payment first, and strive to pay the full amount as soon as possible. Avoid using your credit card if you cannot make the monthly payments.
- Check your credit card monthly statements properly to ensure accuracy of transactions and charges. Inform the card issuer if there are any discrepancies.
- If you cannot control your spending, leave your credit card at home or use a debit card.
- Before spending, ask yourself whether the item you plan to buy is a need or a want.
- Any other relevant answers.

Question 3

(a) Ah Ming's debts are very far above the net debt-to-income ratio of 40%. If he does nothing, the finance charges, especially those on his credit card debts, will continue to accumulate and he may also be unable to settle his car loan. This could result in legal action being pursued by the bank against him and his vehicle being repossessed. In the worst-case scenario, the bank could initiate bankruptcy proceedings against him.

(b) Ah Ming is already in dire straits. The monthly payments on the car loan and credit card debt are far above what he can afford (net debt to income ratio = (RM25,000 + RM500)/RM2,800 x 100% = 911%). He should not be taking any additional loans. Besides, moneylenders usually charge interest at rates higher than what banks offer. In addition, it is not clear whether the moneylender that Ah Kau recommended is legal or otherwise. Illegal moneylenders, better known as 'Ah Longs' or loan sharks in Malaysia, charge exorbitant interest which would be far beyond Ah Ming's ability to repay. They have also been known to resort to rogue tactics of debt collection which may endanger Ah Ming and his family.

(c) Ah Ming needs to accept that he has a debt problem and that this problem will not affect him alone but will also affect his family. Ah Ming may want to discuss his financial problems with his wife, Sim Ling. After all, it may be difficult to hide such a huge problem due to the constant reminders and actions from the bank. He should have an honest discussion with his wife about how much they could contribute to settling the outstanding credit card debts while continuing to service the car loan. Sim Ling could use her fixed deposit to pay the credit card debt, with the balance to be settled gradually.

Since Ah Ming's debts are less than RM2 million and so far, no legal action or bankruptcy notice has been filed against him, he could enroll in AKPK's Debt Management Programme. AKPK could help Ah Ming to negotiate and restructure his credit card debt to one that is more manageable for him and Sim Ling.

Case Study

<u>Question 1</u>

Couples such as Bobby and Charmaine need to have a frank discussion at some time about each other's financial goals and financial problems, if any, that they will be bringing into the marriage, including the following issues:

- How much each of the partners earn and whether they have any outstanding debts. Are they relying on any form of financial support from others (for example, parents, etc.)?
- What is their attitude towards money and debt?
- How would they share the responsibilities of paying the household bills?
- Would they want to maintain separate bank accounts, joint accounts, or both types of accounts, and how would these be managed in a marriage setting?
- What are their financial goals and priorities?
- How many children would they like to have and how would the cost of raising children be shared?
- Is a pre-nuptial agreement necessary?
- Any other relevant answers

Question 2

Charmaine's net debt to income ratio = $\dfrac{17{,}689+1{,}500}{6{,}567+3{,}500}\times 100\% = 190.6\%$

Bobby's net debt to income ratio = $\dfrac{2{,}570+3{,}253+25{,}788}{13{,}500}\times 100\% = 234.2\%$

Based on the calculations above, both of them have serious credit card debt issues. They should consider using some of their fixed deposits and savings to settle their credit card debts. They should not take on any more debt until they have settled their current credit card outstanding balances in full. Note that EPF balances cannot be withdrawn to settle debts.

While Bobby has sufficient cash resources to settle his credit card debts, he may have to help Charmaine settle her debts (to a certain extent, he may even be expected to do so if they marry). Besides, Charmaine's part-time income may be uncertain. Going forward, they really need to monitor their credit card spending on luxury items before their financial situation becomes out of control. In this case, Bobby and Charmaine need to have a frank talk about expectations on financial commitment and what each of them can contribute. It may be unrealistic for Charmaine to expect Bobby to unconditionally settle her debts and pay for all her wants since he will now be expected to be financially independent.

Question 3

The average cost of a wedding in Malaysia is about RM50,000. However, if it is held in a five-star hotel, it could be much more, such as in Bobby and Charmaine's case.

As Charmaine and Bobby will have to use a significant amount of their savings, fixed deposits and investments to settle their credit card debts, and Bobby's family will not be covering the wedding costs, they cannot afford a lavish wedding at the moment.

An alternative they could consider would be to register the marriage and have a simple ceremony with family and close friends first. This would probably be more meaningful. They could renew their wedding vows in a more elaborate ceremony later on when they are in a better financial position. They should start saving towards this goal by cutting down on their wants in their lifestyle (e.g., fashion trends, diamond rings, etc.)

Any other relevant and reasonable answers are acceptable.