The hire purchase conundrum explained

BY **ADELINE PAUL RAJ**

The reason hire purchase (HP) loans have come into focus of late is that banks were in a conundrum over how to account for such loans, following their offer of a six-month moratorium on repayments to borrowers.

HP loans are unique in that they are governed by the Hire-Purchase Act 1967. Under the Act, the tenure of the HP scheme and the amount of interest charged cannot be altered by the banks unilaterally.

"Hence, banks cannot just vary the tenure and amount of the interest or instalment at their own discretion to recover some of the losses. If banks are not allowed to vary the tenure and amount of interest to be charged, they will suffer a sizeable modification Day One accounting loss [at the start of the moratorium]," says Ong Ching Chuan, a partner and financial services leader at PwC Malaysia.

As such, over the last few weeks, banks had been exploring various options with Bank Negara Malaysia to overcome this challenge, he says.

Separately, fixed-rate Islamic financing had also been an issue for banks. "For fixed-rate financing under Islamic banks, in most cases, there is a ceiling rate for the pricing of such products. Islamic banks may not be able to have sufficient Ibra — or rebate — to offset the losses for the extended period," Ong explains.

Addressing these issues, Bank Negara, in an April 30 press release, announced that from May 1, banks would be contacting customers with HP or fixed-rate Islamic financing agreements on what to do to complete the process of the six-month payment deferment — should they opt for it — and on any changes to the terms of their agreement.

Bank Negara deputy governor Jessica Chew had also indicated in an interview with *The Edge* earlier last week that banks can restructure an HP agreement, upon first engaging with the borrower.

"The HP Act prescribes the way in which any changes to the terms of the HP can be made. For example, if you sign up for an HP, the number of instalments, the amount [for] every instalment, the period, schedule [are] all prescribed in the agreement and [are] mandated by the HP Act. So, that means when the moratorium is offered, that will require a change to the HP agreement," she said.

> There is no 'free lunch' ... one should not expect that interest will not be charged on deferred loans/financing. – Ong

She said the banks will have to take the extra step of notifying the borrowers about any changes.

"They will need to engage with the borrowers to send them details of any changes on the instalments, pursuant to the HP Act. There are banks that will continue to accrue interest [over the six months], but, if they want to do that, it has to be in accordance [with the HP Act]. The Act does not prohibit the accrual of interest, but it just states that if you want to change anything, it has to meet certain requirements spelt out in the Act."

Local lenders with a higher proportion of HP loans include Public Bank Bhd, whose HP loans accounted for 15% of total loans as at end-2019, Malayan Banking Bhd (14%) and AMMB Holdings Bhd (14%).

No U-turn, no free lunch

Contrary to a widely held perception, expressed particularly over social media, Bank Negara did not do an about-turn on the six-month moratorium for HP loans or fixed-rate Islamic financing. The word "U-turn" has been trending on Twitter ever since the central bank put out its press release on April 30.

Industry sources tell *The Edge* the misconception may have come about because some people think the six-month moratorium is a payment holiday in every sense of the word. This is not the case, however, as there is interest accrued over the period that borrowers will have to address later.

It would be painful and makes no sense for banks to give borrowers a "free pass", so to speak, for those six months, as the banks would have to absorb the holding cost of the money owed and this would result in their incurring losses, one source says. "Someone has to absorb the cost."

Ong says, "The original intent of the loan moratorium was to ease cash flow for borrowers during the six-month period, and that has remained unchanged. There is no 'free lunch' ... one should not expect that interest will not be charged on deferred loans/financing. Bank Negara has already clarified this in its latest FAQ [Frequently Asked Questions] on its website."

Bank Negara put out the FAQ on May 1 to make things clearer for borrowers. An older version of the FAQ, which provided an illustration, may have contributed to some of the misperception out there, industry sources say.

According to Bernama, in a media briefing last Friday, Bank Negara officials said they regretted any confusion that may have arose and were doing their best to clear it up. They said Bank Negara had always made it known that interest/profit will accrue on all products during the moratorium period; hence there is no such thing as making a U-turn.

"We sincerely regret the confusion. We try to explain; there is no inconsistency on the explanation to the public. There was great excitement when the moratorium was first announced. We took pains even then to point out to borrowers that they need to be aware that interest will accrue on this deferred payment," Chew was reported to have said.

In the FAQ, the central bank made clear that that payment deferment is still automatic for HP and fixed rate Islamic financing. "What is required now is an additional step (of informing the borrower) to comply with procedural requirements under the Hire-Purchase Act 1967 and Shariah. This additional step is unavoidable, and is required to incorporate the changes to the payment schedule and/or amounts as a result of the six-month payment deferment in loan/financing agreement," it says.

The Association of Banks in Malaysia says HP customers who choose to take up the moratorium, which runs from April to September, will have the option to pay the accumulated six months' deferred instalments - meaning, principal and interest - together with their October instalment without being charged any additional interest. Industry sources say not many borrowers would opt for this as they are unlikely to immediately have surplus cash to do so.

Borrowers also have the option to continue the repayment of these instalments after October through an extension of six months in the repayment period after the original maturity date. In this case, interest based on the contractual rate will be charged on the amount of deferred instalments that remains outstanding until the instalments are fully repaid, which should be by the end of the extended six-month tenure.

Bank Negara gave a new illustration in its latest FAQ. For a RM50,000 HP loan with a remaining tenure of five years and a fixed interest of 2.71% (or an effective rate of 5.36%) per annum, the monthly instalment was RM712 before the deferment.

The instalment will increase to RM731 after the deferment, meaning an increment of RM19. The increase in total interest will be RM1,130. In this example the instalment amount increases by 2%, or RM19 a month.

Bank Negara advises borrowers to weigh for themselves the pros and cons of deferring the payment, and pay particular attention to their ability to meet these payments after the moratorium. ■