

CF03

Law and Practice of Banking

13 APRIL 2005

1. Time allowed : Three (3) hours
2. Total number of questions : Six (6) questions
3. Number of questions to be answered : Five (5) questions [20 marks each]
4. Answers should be supported by references to cases and/or statutes.
5. Begin each answer to a new question on a fresh page.
6. Answer **all** questions in **English**.

ANSWER FIVE (5) QUESTIONS ONLY

1. (a) For each of the following questions, choose the **correct** answer (A, B, C or D):
- (i) _____ is the body of principles recognised and applied by the State in the administration of justice.
- A. Equity
 - B. Parliament
 - C. Law
 - D. Government
- [1]
- (ii) Article 4(1) of the Federal Constitution declares that the Federal Constitution is the supreme law of Malaysia and any law passed, which is inconsistent with the Constitution, shall to the extent of the inconsistency, be:
- A. valid.
 - B. pertinent.
 - C. void.
 - D. infeasible.
- [1]
- (iii) Law may be classified into all of the following divisions **except**:
- A. public law.
 - B. international law.
 - C. government law.
 - D. private law.
- [1]
- (iv) Which of the following statements is **incorrect**?
- A. The law of tort is the branch of public law which determines when a promise or a set of promises are legally binding and who is liable.
 - B. The two main sources of banking law in Malaysia are written law and unwritten law.
 - C. Written law includes the Federal Constitution, the State Constitutions, legislation and subsidiary legislation.
 - D. A trust is an equitable obligation. It binds the trustee who deals with trust property for the benefit of the beneficiaries.
- [1]
- (v) One of the essential elements of a crime is _____, which is the intention to commit a crime.
- A. *actus reus*
 - B. *actus rea*
 - C. *actus mens*
 - D. *mens rea*
- [1]
- (vi) Which of the following statements is **correct**?
- A. Bank Negara Malaysia mainly forms legislation relevant to bankers.
 - B. The Federal Constitution, being the supreme law of Malaysia, lays down the powers of the Federal and State governments as well as the basic rights of an individual.
 - C. An example of a Malaysian statute relevant to bankers is the Secrecy Act 1989.
 - D. Subsidiary legislation are mainly made by Parliament.
- [1]
- (vii) The following are superior courts in the present judicial system in Malaysia **except** the:
- A. Federal Court.
 - B. Supreme Court.
 - C. High Court.
 - D. Court of Appeal.
- [1]

- (viii) The Bills of Exchange Act 1949, the Contracts Act 1950 and the Hire-Purchase Act 1967 are examples of:
- A. legislation.
 - B. subsidiary legislation.
 - C. judicial precedents.
 - D. common laws. [1]
- (ix) The main sources of law applicable to bankers are:
- A. guidelines issued by Bank Negara Malaysia.
 - B. English commercial laws.
 - C. banking practices.
 - D. legislation. [1]
- (x) In Malaysia, appeals from the Court of Appeal are heard by the:
- A. Federal Court.
 - B. Supreme Court.
 - C. Privy Council.
 - D. Yang Di-Pertuan Agong. [1]
- (b) In relation to the Anti-Money Laundering Act 2001, explain the terminology “money laundering”. [10]
(Total:20 marks)
2. (a) Answer “**True**” or “**False**” for each of the following statements:
- (i) Equity is based on legal obligations and it is the breach of contractual duties imposed by law. [1]
 - (ii) Under the Code of Good Banking Practice, customers should keep their cheque books locked and draw cheques carefully so as not to facilitate fraud or forgery on their accounts. [1]
 - (iii) Under the Banking and Financial Institutions Act 1989 (BAFIA), The Association of Banks in Malaysia is empowered to issue guidelines for bankers. [1]
 - (iv) The Sessions Court is a subordinate court in the Malaysian judicial system. [1]
 - (v) BAFIA has no relevance to merchant banks. [1]
- (b) In relation to banking law, define “customer”. Your answer should include the relevant case law. [5]
- (c) Kassim, a 17 year-old mechanic, wants to open a current account with Bank MM Bhd to enable him to pay his utility bills, rental and personal expenses. However, the bank officer informed Kassim that he would not be able to open a current account.
- (i) Based on the information given above, explain why Bank MM Bhd is unable to open a current account for Kassim. [7]
 - (ii) State **three** types of contracts that Kassim, being a minor, can legally enter into. [3]
(Total:20 marks)

3. (a) Fill in the blanks with the **correct** word(s) for each of the following:
- (i) The two parties to a hire-purchase agreement are called the owner and the _____ [1]
 - (ii) In an insurance contract, the insurer is the party who agrees to indemnify the _____ against a loss which may arise. [1]
 - (iii) The two parties to a contract of agency are the principal and the _____. [1]
 - (iv) Section 2(b) of the Contracts Act 1950 calls the person accepting the proposal to an agreement as the _____. [1]
 - (v) A contract of _____ of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price. [1]
- (b) Answer "**True**" or "**False**" for each of the following statements:
- (i) An "account payee" crossed cheque is not transferable. [1]
 - (ii) A traveller's cheque is a type of cheque. [1]
 - (iii) A cheque is not invalid by reason only if it is ante-dated. [1]
 - (iv) A cheque must always be payable on demand. [1]
 - (v) The drawee is the person to whom the cheque is addressed to. [1]
- (c) Describe the nature of a partnership. [5]
- (d) State **two** reasons why a banker has to be careful and needs to verify the true identity of his customer before opening an account for him. [5]
(Total:20 marks)
4. (a) Hamid and Bong entered into a contract where Bong is required to assist Hamid in supplying software products to Bank BB Bhd. Bong then committed a breach of contract. While Hamid seeks damages as a remedy, he is under a legal duty to mitigate the loss suffered by him because of the breach.
- Explain what the phrase "mitigate the loss" means. [5]
- (b) Answer "**True**" or "**False**" for each of the following statements:
- (i) Tortious liability arises from the breach of a duty primarily fixed by the terms in a contract. [1]
 - (ii) Negligence is a defamatory statement or representation in a permanent form. [1]
 - (iii) Professional negligence is judged by the test of the ordinary skilled man exercising and professing to have that special skill. [1]
 - (iv) Defences to an action for defamation include justification, fair comment and privilege. [1]
 - (v) Land in Peninsula Malaysia can be categorised as freehold and leasehold. [1]
- (c) In relation to the National Land Code 1965 (NLC), answer the following:
- (i) State **five** types of dealings (over land) which are capable of being effected under the NLC. [5]
 - (ii) (aa) Explain the terminology "indefeasible". [2]
 - (bb) What are **three** exceptions to indefeasibility? [3]
- (Total:20 marks)

5. (a) (i) Briefly describe the purpose, nature and the legal effects of a prohibitory order. [5]
- (ii) State the life span of a prohibitory order. [2]
- (iii) John defaulted in his credit card repayment and Bank AA Bhd obtained judgement against him for RM40,000. Bank AA Bhd knows that John owns a piece of unencumbered land in Johor Bahru. Bank AA Bhd intends to obtain a prohibitory order in respect of John's land.
- Can Bank AA Bhd lodge a private caveat over John's land? Give a reason for your answer. [3]
- (b) Answer "**True**" or "**False**" for each of the following statements:
- (i) A bill of exchange is negotiated when it is transferred from one person to another in such manner as to constitute the transferee the holder of the bill. [1]
- (ii) A banker's draft is a type of negotiable instrument. [1]
- (iii) The payee is the person to whom the bill of exchange is addressed. [1]
- (iv) The holder of a bill is the person who promises to pay the bill according to its tenor. [1]
- (v) A bill must be duly presented for payment or else the drawer and indorsers shall be discharged. [1]
- (c) In relation to negotiable instruments, fill in the blanks with the **correct** word(s) for each of the following:
- (i) An _____ party is a person who signs a bill as a drawer, acceptor or an indorser without receiving value for it. [1]
- (ii) _____ is the transfer of possession, actual or constructive, from one person to another. [1]
- (iii) _____ is the signification by the drawee of his assent to the order of the drawer. [1]
- (iv) _____ are promissory notes issued by the government to raise short-term loans. [1]
- (v) _____ is a form of transfer of property or ownership from one person to another in a document evidencing a contractual obligation to pay money. [1]
- (Total:20 marks)

6. (a) What is the legal effect if a cheque is crossed generally and bears across its face the words "account payee"? [5]
- (b) As stated in the Bills of Exchange Act 1949, describe the statutory protection available to a collecting banker. [5]
- (c) State **five** differences between a company and a partnership. [5]
- (d) Answer "**True**" or "**False**" for each of the following statements:
- (i) A "company limited by guarantee" means a company formed on the principle of having the liability of its members limited by the memorandum to the amount (if any) unpaid on the shares respectively held by them. [1]
- (ii) The statement "a company is a separate legal entity" means that the directors, shareholders and the company itself comprise one entity, separate and distinct from all other companies. [1]
- (iii) An "exempt private company" is a private company which shares all beneficial interests held directly or indirectly by a maximum of 20 corporations. [1]
- (iv) A public company can be defined as a company, other than a private company, which must be listed in the stock exchange and must have more than 50 shareholders. [1]
- (v) According to the rule in *Turquand's case*, a company is prohibited from dealing with its own shares. [1]
- (Total:20 marks)

- END OF QUESTION PAPER -

OUTLINE ANSWERS

The comments given in the boxes below indicate the areas of weaknesses the examiners have identified and their advice to future candidates.

Question 1

- Candidates were unable to define the term money laundering.

1. (a) (i) C
(ii) C
(iii) C
(iv) A
(v) D
(vi) B
(vii) B
(viii) A
(ix) D
(x) A

- (b) Section 3 of the Anti-Money Laundering Act 2001 defines the word “money laundering” as the act of a person who:

- engages, directly or indirectly, in a transaction that involves proceeds of any unlawful activity;
- acquires, receives, possesses, disguises, transfers, converts, exchanges, carries, disposes, uses, removes from or brings into Malaysia proceeds of any unlawful activity; or
- conceals, disguises or impedes the establishment of the true nature, origin, location, movement, disposition, title of, rights with respect to, or ownership of, proceeds of an unlawful activity;

where:

- as may be inferred from objective factual circumstance, the person knows or has reason to believe, that the property is proceeds from any unlawful activity; or
- in respect of the conduct of a natural person, the person without reasonable excuse fails to take reasonable steps to ascertain whether or not the property is proceeds from any unlawful activity.

Question 2

- Candidates explained the duties customers owed to the bank, instead of defining the term “customer”.

2. (a) (i) False
- (ii) False
- (iii) False
- (iv) True
- (v) False
- (b) There is no statutory definition for “customer”. According to *G.W. Railway Co v London and Country Banking Co*; a person is not a customer unless he has “some sort of an account, either a deposit or a current account or some similar relation” with a bank.
- A person might possibly be regarded as a customer even before he opens an account; but this applies if it was his intention to open an account and he did subsequently open one. *Woods v Martins Bank Ltd*.
- (c) (i) Bank MM Bhd is unable to open a current account for Kassim because he is a minor. Kassim, being 17 years old, is a minor. A minor is a person below the age of majority, that is 18 years of age -Age of Majority Act 1971.
- A current account is a contract between the bank and the account holder. Section 11 of the Contracts Act 1950 provides that every person is competent to contract who is of the age of majority according to the law to which he is subjected to, and who is of sound mind, and is not disqualified from contracting by any law to which he is subject. As a general rule, contracts made by minors are void - *Mohori Bibee v Dharmodas Ghose* and *Tan Hee Juan v Tan Boon Keat*
- (ii) Three types of contracts that Kassim may legally enter into are:
- contracts for necessities
 - contracts of scholarship
 - contracts of insurance

Question 3

- Candidates were unable to explain why verification of the customers’ true identity was important.

3. (a) (i) hirer
- (ii) insured
- (iii) agent
- (iv) promisee
- (v) sale
- (b) (i) True
- (ii) False

- (iii) True
 - (iv) True
 - (v) True
- (c) A partnership is a relation which subsists between persons carrying on business in common with a view of profit – section 3(1), Partnership Act 1961. Partnerships are formed by two or more persons for the purpose of making profit. Partnerships are registered under the Registration of Businesses Act 1956 and are not legal entities.
- (d) The legal reasons why a banker must open accounts carefully and verify the true identity of their customers are:

(Give any two of the following:)

- Section 85 of the Bills of Exchange Act 1949 – statutory protection for the collecting banker if the banker acts “in good faith and without negligence”. A case in point is *Rubber Industry Replanting Board v HSBC*.
- Section 16 of the Anti-Money Laundering Act 2001 (AMLA), requires bankers to verify the identity of the account-holder.
- Section of the 18 AMLA – bankers cannot open false or fictitious accounts.

Question 4

- Candidates wrote on the actual damages suffered by the plaintiff, instead of explaining the mitigation of damages.
- A caveat is a restraint on dealings. Some candidates gave wrong answers stating that a caveat is a form of dealing.

4. (a) The duty imposed on the party seeking damages due to breach of contract is the duty to mitigate the loss. This duty, as provided for in the explanation to section 74 of the Contracts Act 1950, was recognised by the Federal Court in *Kabatasan Timber Extracting Co. v Chong Fah Shing*.

The phrase “mitigate the loss” means that the party who suffered loss from a breach of contract must take the reasonable steps available to him to mitigate (or reduce) the extent of the damage caused by the breach. He cannot claim to be compensated by the party in default for loss, which is not really due to the breach but to his own failure to behave reasonably after the breach. If he does not mitigate the loss, his claim will be reduced accordingly.

- (b)
- (i) False
 - (ii) False
 - (iii) True
 - (iv) True
 - (v) True

- (c) (i) Types of dealings (over land) which are capable of being effected under the National Land Code 1965:

(Give any five of the following:)

- Transfers
- Leases
- Tenancies
- Charges
- Liens
- Easements

- (ii) (aa) That the registered charge is “indefeasible” means that the registered title or interest shall, subject to the limited exceptions provided in section 340(2) of the National Land Code 1965, not be defeated by any unregistered or subsequently registered title or interest.

(bb) Give any three of the following exceptions:

- Fraud,
- Misrepresentation, to which the person or body, or any agent of the person or body, was a party or privy,
- Registration was obtained by forgery,
- By means of an insufficient or void instrument, or
- Where the title or interest was unlawfully acquired by the person or body in the purported exercise of any power or authority conferred by any written law.

Question 5

- Candidates had poor knowledge of private caveats and negotiable instruments.

5. (a) (i) A “prohibitory order” is where “land or an interest in land held by a judgment-debtor is to be sold in execution proceedings, an order made pursuant to rules of court by a court of competent jurisdiction prohibiting the judgment-debtor from effecting any dealing therewith or from effecting such dealing therewith as may be specified in the order.” – section 334, National Land Code 1965. In other words, judgment creditors may obtain a prohibitory order for the purpose of imposing restraints on dealings over land owned by their judgement debtors.

Once the prohibitory order is registered or entered on the register document of title, the judgment creditor can then apply for the order for sale of the land. The legal effects of a prohibitory order are that it prohibits the registration, indorsement or entry thereon of any instrument of dealing (except certificates of sale) executed by or on behalf of the proprietor, any claim to the benefit of any tenancy exempt from registration, and any lien-holder’s caveat.

- (ii) The life span of a prohibitory order is six months from the date the order is granted by the Court – section 338(10), National Land Code 1965.

- (iii) Bank CC Bhd being a mere judgment creditor, cannot lodge a private caveat because the bank does not have any caveatable interest under section 323(1) of the National Land Code. The Bank is not “claiming title to the land in question or a registrable interest therein or a claim to such registrable interest”.
- (b)
 - (i) True
 - (ii) True
 - (iii) False
 - (iv) False
 - (v) True
- (c)
 - (i) accommodating
 - (ii) Delivery
 - (iii) Acceptance
 - (iv) Treasury bills
 - (v) Negotiability

Question 6

- Candidates could not state the legal effects of general crossed cheques that bear the words “account payee”. They also showed poor understanding of company law principles.

6. (a) The legal effect of the addition of the words “account payee” to a crossing on a cheque is that the cheque shall not be transferable, but shall only be valid as between the parties thereto – section 81A, Bills of Exchange Act 1949. Thus, normally, cheques crossed with the words “account payee” are banked into the payee’s account only and cannot be transferred nor negotiated.
- (b) The statutory protection accorded to the collecting banker is provided for in section 85 of the Bills of Exchange Act 1949. The essence of this protection is that where a banker, in good faith and without negligence, receives payment of a cheque for a customer with no title or a defective title, he is not liable to the true owner.

To be accorded this protection, the banker must have collected the cheque:

- for a customer – *Oriental Bank of Malaya v Rubber Industry (Replanting) Board*.
- in good faith – section 95, Bills of Exchange Act 1949.
- without negligence – *The Rubber Industry (Replanting) Board v Hong Kong and Shanghai Banking Corporation* and *The National City Bank of New York v Ho Hong Bank Ltd*.

(c) Differences between a company and a partnership:

(Give any five of the following:)

- A company is a legal entity separate and distinct from its members and directors whereas a partnership is not a separate legal entity.

A company is registered with the Registry of Companies whereas a partnership is registered with the Registry of Businesses (now centralised under the Companies Commission of Malaysia).
- Shares in a company are generally transferable although the right of transfer may be restricted. On the other hand, generally, a partner cannot transfer his status as partner to someone else without the consent of all the other partners.
- Members of a company may not necessarily be its managers, directors or agents. On the other hand, partners are agents of the firm for carrying on its business in the course of business and are generally entitled to manage the firm.
- Public companies have no maximum number of members (the maximum for private companies is 50) but partnerships (except professional firms which has no limit) can have a maximum of twenty partners.
- Companies must be constituted in writing (by Memorandum of Association) but a partnership may be formed orally or in writing.
- Companies can borrow for purposes covered by their objects as contained in the Memorandum of Association. Partners generally have unrestricted powers of borrowing.
- Companies can use current assets as security by creating floating charges. Partnerships cannot do so but can mortgage the firm's assets.
- Companies are subject to various statutory rules of procedure and are required to supply certain information to the public. On the other hand, partnerships are formed informally and need not supply information to the public.
- Companies are dissolved by winding up and liquidation, which is a formal procedure; whereas, partnerships are dissolved informally, for example, by the partners' agreement.

- (d)
- (i) False
 - (ii) False
 - (iii) False
 - (iv) False
 - (v) False