

CFL2

Offshore Legislation

6 OCTOBER 2004

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. Begin each answer to a new question on a fresh page.
5. Answer **all** questions in **English**.

ANSWER FIVE (5) QUESTIONS ONLY

1. (a) State **five** ways how an agency can be created. [5]
- (b) (i) Explain the doctrine of the undisclosed principal. [8]
- (ii) Name the Act and the sections that govern the doctrine of the undisclosed principal in offshore banking. [3]
- (c) What is the difference between an agent's actual authority and apparent authority? [4]
(Total:20 marks)
2. (a) (i) What are customary laws? [2]
- (ii) Which areas of law are customary laws applied to in Malaysia? [2]
- (b) Give **two** examples of unwritten law that are applicable to offshore bankers. [3]
- (c) What is the significance of the Constitution (Amendment) Act 1984 in relation to land law in Labuan? [5]
- (d) (i) Explain how the validity requirement of a power of attorney differs between Peninsula Malaysia and Labuan. [6]
- (ii) Explain the requirement to have a valid power of attorney relating to land in Labuan. [2]
(Total:20 marks)
3. (a) In relation to the Anti-Money Laundering Act 2001 (AMLA), answer "**True**" or "**False**" for each of the following statements:
- (i) AMLA came into force on 15 January 2001. [1]
- (ii) Section 2 of AMLA states that it is applicable to any serious foreign offence or unlawful activities whether committed in the past or even in the future. [1]
- (iii) AMLA provides for the forfeiture of any movable or immovable property or interest worldwide when it is derived from or involved in money-laundering. [1]
- (iv) The serious offence definition under AMLA does not include offences under the Penal code such as kidnapping and robbery. [1]
- (v) The provisions under section 20 of AMLA override the secrecy obligations imposed by any other written law. [1]
- (b) In relation to the Code of Good Banking Practice, answer the following:
- (i) Briefly explain **four** principal objectives of the Code. [8]
- (ii) Explain the application of the Code to offshore banks in Labuan. [7]
(Total:20 marks)

4. (a) In relation to the Labuan Offshore Limited Partnerships Act 1997 (LOLPA), answer the following questions:
- (i) Explain **one** main advantage of LOLPA. [2]
 - (ii) Who must be made as one of the partners in an offshore limited partnership? [3]
- (b) (i) What is contributory negligence? [2]
- (ii) Which party needs to prove contributory negligence and why is it important? [2]
 - (iii) Which Act governs contributory negligence in Malaysia? [1]
- (c) Describe **three** ways in which a contract may be discharged and state the effects (if any) of each. [10]
(Total:20 marks)

5. Mr Smith, an Australian, married Sheela, a Malaysian. Sheela is also a permanent resident of Australia and the couple lives in Australia. They came to visit their son Tom, who will turn 18 years old in four months' time and is about to finish his secondary school education in a boarding school in Malaysia. Although Tom is an Australian, he has obtained permanent resident status in Malaysia. Mr Smith also has two other children from his previous marriage, Joshua aged 26 and Sharon aged 22, who live in the United Kingdom with their mother.

Mr Smith wants to set up a trust fund that will look after the needs of all his children. He wishes to distribute all his property to his children upon his death.

Mr Smith and Sheela have invested in a large amount of immovable property in Australia and also own a beautiful bungalow in the prime area of Kuala Lumpur. Mr Smith and Sheela are not sure how to go about setting up a trust and have come to seek your advice on the following before they proceed with their plans:

- (a) Explain to Mr Smith and Sheela how they can create an offshore trust. [4]
- (b) Explain to them the criteria for the following:
 - (i) Settlor [2]
 - (ii) Trust property [2]
- (c) Based on your answer to (b)(i), can Mr Smith and Sheela be settlors? Give a reason for your answer. [1]
- (d) In your opinion, which type of trust would best meet their needs? Give reasons for your answer. [4]
- (e) (i) How many trustees must they appoint? [1½]
- (ii) How can they appoint a trustee? [1½]

The trust was successfully created one year ago. Mr Smith died in a plane crash last week. Sheela contacted you as she was worried about the status of the beneficiaries and their inheritance. She informed you that Sharon got married to a Malaysian six months ago and has moved to Malaysia where she is permanently residing. Meanwhile Tom, the youngest son who is now almost 19 years old, has returned to Australia to attend university and lives there permanently.

- (f) Sheela now wants to know if these developments in any way would affect the offshore trust or the beneficiaries' entitlement pursuant to the Labuan Offshore Trusts Act 1996.
- What would be your advice? [4]
(Total:20 marks)

6. (a) Explain **five** major differences between onshore banking business (governed by the Banking and Financial Institutions Act 1989) and offshore banking business in Labuan International Offshore Financial Centre. [10]
- (b) Describe the nature of a banker–customer relationship. [5]
- (c) In relation to agency, answer “**True**” or “**False**” for each of the following statements:
- (i) Y had acted on behalf of Z without Z’s authority or knowledge. Therefore, Z cannot elect to ratify Y’s acts. [1]
 - (ii) An agent has a right to compensation for injury caused by the principal’s negligence. [1]
 - (iii) A principal need not have contractual capacity at the time of ratification of a contract. [1]
 - (iv) A mandate holder must also hold a power of attorney. [1]
 - (v) Section 22 of the Offshore Banking Act 1990 provides the general rule for secrecy in offshore banking. [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

- No comments are provided for this question as none of the candidates attempted it.

1. (a) An agency can be created in any one of the following ways:

- Express appointment by the principal
 - express appointment may be in written or oral form.
- Implied appointment by the principal
 - Where the law can infer the creation of an agency by implication when a person by his words or conduct holds out another person as having authority to act for him.
- By ratification by the principal;
- By the doctrine of estoppel or holding out; or
- By necessity / by operation of law in certain circumstances.

(b) (i) The doctrine of the undisclosed principal applies where the principal of an agency is not disclosed. This occurs when the agency is not disclosed and the agent acts as if he is the principal.

If an agent makes a contract with a person who neither knows, nor has reason to suspect, that he is an agent, his principal may require the performance of the contract. But the contracting party has, as against the principal, the same rights as he would have had as against the agent if the agent had been the principal.

If the principal discloses himself before the contract is completed, the other contracting party may refuse to fulfil the contract, if he can show that he would not have entered into the contract, if he had known who was the principal in the contract, or if he had known that the agent was not a principal.

(ii) The doctrine of the undisclosed principal is provided for in Sections 183, 184 and 185 of the Contracts Act 1950.

(c) An agent's authority may be classified into actual and apparent authority. Actual authority is that which is expressly given by the principal to the agent, orally or in writing, or implied from the express authority given from the circumstances of the case, the custom or usage of trade or the situation and conduct of the parties.

On the other hand, apparent or ostensible authority is that which is not expressly given by the principal but which the law regards the agent as possessing although the principal has not consented to his exercising such authority.

Question 2

- Candidates could not explain the legal principles related to customary law.
- Instead of giving examples of unwritten law, candidates named the related statutes.
- Candidates were unable to state the significance of the Constitution (Amendment) Act 1984 in relation to land law in Labuan.

2. (a) (i) Customary laws or personal laws are laws that affect a particular ethnic group.
- (ii) In Malaysia, the application of customary laws is applied in family law and land ownership.

- (b) Unwritten laws applicable to offshore bankers.

(Give any two of the following:)

- English law
- Judicial decisions of the superior courts
- Customary Law

- (c) Section 6 of the Constitution (Amendment) Act 1984 provides for the continuation of existing laws to be in force and shall continue to have effect over Labuan until repealed, amended or replaced by laws passed by Parliament. As such, Labuan may dispose of or deal with land in accordance with the Sabah Land Ordinance (SLO) (Cap 68) because the SLO is still in force and has not been repealed, amended or replaced.

- (d) (i) In Peninsula Malaysia, the Powers of Attorney Act 1949 applies with regards to power of attorney. Section 4 of the Powers of Attorney Act requires all powers of attorney within Peninsula Malaysia to be deposited in the High Court.

In contrast, the Powers of Attorney Act does not apply to Labuan. Hence, Labuan does not have any specific legislation with regards to power of attorney. Therefore, the common law on power of attorney applies, subject to any written law on the subject.

As the Power of Attorney Act is not applicable in Labuan, there is no legal requirement for powers of attorney to be registered with the High Court. However, some magistrate courts do allow for the lodgement of powers of attorney.

- (ii) In the case of Labuan, Section 98 of the Sabah Land Ordinance (SLO) requires that all powers of attorney in relation to land must be properly attested and the power of attorney must then be filed in the Land Office concerned.

Question 3

- Instead of explaining the principal objectives and the application of the Code of Good Banking Practice to offshore banks in Labuan, candidates described the Code.

3. (a) (i) False
(ii) True
(iii) True
(iv) False
(v) True

- (b) (i) The principal objectives of the Code are to:
- establish minimum standards of good banking practice which customers are entitled to receive in their dealings with banking institutions
 - promote a more transparent and fair relationship between the institutions and their customers, including adequate disclosure of relevant contractual information
 - ensure that customers of banking institutions have an understanding of how their accounts operate as well as the banking services offered
 - maintain confidence in the security and integrity of banking.
- (ii) Offshore banks in Labuan are not bound by this Code as they are not members of the Association of Banks in Malaysia but it serves as a useful guide for offshore banks in their dealings with their customers. Furthermore, not all the practices enumerated in the code are relevant to offshore banks as some of these practices include those relating to cheques, credit cards and electronic banking cards which are services offshore banks are prohibited from providing. Finally, it should also be noted that LOFSA has not issued this Code to offshore banks in Labuan.

Question 4

- Candidates were unable to define the term “contributory negligence” and could not state the Act that governs it in Malaysia.
- Candidates failed to understand what a discharge of contract is and failed to use the proper terms to explain the answer.
- Candidates are advised to understand the question before writing their answers and to answer according to the marks allotted for each question.

4. (a) (i) The main advantage of the Labuan Offshore Limited Partnerships Act 1997 (LOLPA) is that it allows the partners/investors to have limited liabilities if they are not actively involved in the operation of partnerships. The LOLPA allows any person, even residents of Malaysia, to form an offshore partnership for any lawful purpose.
- (ii) At least one of the partners of the offshore limited partnership must be:
- a registered offshore company;
 - a trust company acting as trustee or nominee of a non-resident; or
 - a non-resident. The registered address of the partnership shall be the registered office of a trust company.
- (b) (i) Contributory negligence may be raised by the defendant if the plaintiff has, to an extent, contributed to the negligence of the defendant, thereby resulting in the damages suffered. It simply means that the plaintiff is partly to blame or is also at fault for whatever damage he/she has suffered.
- (ii) The defendant will need to raise the issue of contributory negligence. The importance of this lies in the fact that if the defendant is successful in proving contributory negligence, the damages awarded to the plaintiff will be apportioned and reduced accordingly.
- (iii) The Civil Law Act 1956 – [Section 12(1)]

(c) Contracts may be discharged by any one of the following ways:

- **Frustration**

A contract is frustrated when there is a change in the circumstances which renders a contract's performance legally or physically impossible.

Pursuant to Section 57(2) of the Contracts Act, there are clearly 2 instances of frustration:

- when a contract to do an act becomes impossible, or
- when a contract to do an act becomes unlawful.

However, the frustration should be supervening and subsequent to the formation of the contract. i.e. it should be some event which the promisor could not prevent. As such, "self-induced frustration" does not discharge a party of its contractual obligations.

Effects

When a contract is discharged by frustration, its effect is that it does not merely become voidable but is brought to an end forthwith and automatically.

- **Discharge by Performance**

As a general rule, performance of a contract must be exact and precise and should be in accordance with the terms of the contract – i.e. what the parties had promised.

Section 38(1) of the Contracts Act provides that parties to a contract must either perform or offer to perform their respective promises, unless such performance has been dispensed with by any law.

If the contract is performed in accordance with the terms of the contract, then the contract comes to an end.

- **Discharge by Breach**

Where one of the parties indicates to the other either by conduct or in clear terms an intention not to go on with the contract, the party is said to have repudiated or renounced the contract.

A refusal to perform the contract may occur before the time due for performance or during the time of performance itself. A refusal to perform when a contract is due will amount to a discharge.

As with refusal to perform, a party may put an end to the contract if the other party has disabled himself from performing either before the time due for performance or during the time of performance. A contract is discharged only if the disability to perform is brought about through the fault of the party concerned. If the disability is caused through the occurrence of some other events, beyond the control of the parties concerned, the contract may be discharged through frustration.

Effects

- On an innocent party

The innocent party must restore any benefits which he may have received from the other party – Section 65, Contracts Act.

- On a party in default

As a general rule, the party in default cannot terminate the contract, which he himself had broken.

Question 5

- Candidates' answers generally lacked elaboration and this contributed to the low marks received.
- Candidates are reminded that each piece of information given in the question is very important and should not be ignored when answering the question.

5. (a) The Labuan Offshore Trusts Act 1996 (LOTA) is the single law which governs the creation and recognition of offshore trusts in the Labuan International Offshore Financial Centre. Therefore, Mr Smith will need to fulfil the requirements therein.

Creation of an offshore trust

The creation of an offshore trust must be done by a will or other instruments (agreements) in writing, including a trust deed and unilateral declaration of trust. The settlor's name need not appear in the unilateral declaration provided there is certification from the trustee that the settlor is a qualified person – a non-resident of Malaysia.

Before a settlor entrusts his property, he enters into an agreement whereby he must set out the terms of the trust. This should include details as to how the assets are to be managed, who the beneficiaries are, when they will receive the benefits of the trust, how long the trust is to exist and ultimately who is to own the trust assets.

- (b) (i) **Settlor**

The LOTAs requires the settlor to be a non-resident of Malaysia. Pursuant to the definitions under the Exchange Control Act 1953, Mr. Smith does not fall under the resident category as he is an Australian citizen and does not reside in Malaysia. Thus he is deemed to be a non-resident. As for Sheela, even though she is a Malaysian citizen, she is also a permanent resident of Australia and is residing permanently outside Malaysia. Therefore she too is deemed a non-resident.

- (ii) **Trust property**

The immovable property Mr Smith acquired in Australia can be the trust property for an offshore trust. However, the bungalow in KL cannot be involved in the offshore trust unless Mr Smith obtains approval from the relevant authorities.

- (c) Both Mr Smith and Sheela fulfil the criteria and can be settlors in an offshore trust pursuant to the LOTAs.
- (d) As Mr Smith and Sheela want to distribute all their immovable property, they are advised that the best trust they could create would be a personal trust. This is a trust that is privately and traditionally used for the benefit of beneficiaries, where the settlor loses control of the property for the next generation's benefit. This would be an ideal trust for them as they have indicated their preference to distribute all their property.
- (e) (i) There are no restrictions imposed on the number of trustees that may be provided for in a trust instrument. However Mr Smith and Sheela must appoint a Labuan trust company to be at least one of the trustees.
- (ii) Mr Smith and Sheela can appoint a Labuan trust company, which may become the sole trustee. However, they must ensure that this must be a company that has been incorporated under the Companies Act 1965 and must be registered under the Labuan Trust Companies Act 1990.
- (f) Sheela is advised that the beneficiaries are still entitled to the inheritance despite the change in their residency status. This is because the requirements for the status of a beneficiary pursuant to the LOTAs are as follows:

- Sharon was a non-resident at the time of the trust's creation as she was living in the UK then. Even though she has now moved to Malaysia, and is a resident of Malaysia at the time of becoming a beneficiary, the trust remains an offshore trust.
- Although Tom was a resident at the time of the trust's creation, at the time he came of age and when he became a beneficiary of the trust, his status as a resident had been changed to that of a non-resident because he had returned to Australia for good.

Question 6

- Candidates confused the nature of the banker-customer relationship with the rights and duties of each party as their answers emphasised secrecy and confidentiality.

6. (a) The five major differences between onshore and offshore banking are as follows:

Item	Onshore	Offshore
Currency	Business transactions are conducted in ringgit	Business transactions are not allowed to be conducted in ringgit. (most transactions are conducted in US Dollars) <u>Exceptions:</u> <ul style="list-style-type: none"> • Defraying administrative costs; • Providing ringgit financial guarantees; and • Investment in ringgit assets
Dealings with residents of Malaysia	There are no restrictions on dealings with residents of Malaysia except for those provided pursuant to the Banking and Financial Institutions Act 1989.	Generally, offshore banks are not allowed to deal with residents of Malaysia unless the residents have obtained the permission of the Controller of Foreign Exchange. (The onus is on the residents to obtain permission before transacting with offshore banks.) Offshore banks are deemed to be non-residents under the Exchange Control Regulations.
Cash Deposits	Customers can transact in cash and deposit cash into their accounts.	Customers are not allowed to deposit cash into their accounts.
Checking Accounts	Bank can provide checking account services to their customers.	Section 15 of the Offshore Banking Act 1990 prohibits an offshore bank from providing the service of checking accounts.
Regulatory Framework	Governed by the Banking and Financial Institutions Act 1989 and taxed under the Income Tax Act 1967.	Governed by the Offshore Banking Act 1990 and taxed under the Labuan Offshore Business Activity Tax Act 1990 Offshore banks are deemed residents for tax purposes. Banks are taxed at the rate of 3% of chargeable profits or RM20,000 per annum at their election. This low tax regime and its flexibility are key advantages of the Labuan Offshore Financial Centre.

- (b) The nature of the banker–customer relationship is generally that of a debtor and creditor, or vice versa ,depending on the state of the account at any particular time. When a banker receives money he is said to be debtor to his customer. However when a banker advances credit facilities or a loan to his customer his position is that of creditor.

In circumstances in which bankers honour their customers' cheques, bankers become agents for their customers in the collection and payment of their customers' money or cheques. The banker is also an agent for his customer when the customer's valuables are kept in the bank's safe custody.

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