Chapter 11 – Securities

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Learning Objectives

What you should achieve after completing this chapter:

- Distinguish between types and forms of security;
- Understand the advantages and disadvantages of the various types of security;
- Distinguish between secured and unsecured lending;
- Appreciate the attributes of a good security;
- Understand the various forms of taking security; and
- Appreciate the credit considerations and control required for each form of security.

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1. Introduction

Collateral provides a lender with a secondary repayment source – a source of fund to help recover its investment should the borrower be unable to repay the loan for any reason. Therefore, the lender must perfect his interest in the collateral. Otherwise its position becomes subordinated to the security interest of others who have properly filed their interest. Consequently, the lender may lose his right in selling that collateral.

Therefore, we will examine various collateral types by lenders take and different security forms that must be perfected to enable lenders to successfully enforce their rights in the collateral, should the need arise.

(**Note**: The word collateral and security can be used interchangeably.)

2. Types and Forms of Securities

It is important to distinguish between securities and forms of security. For example, land is a security but the form of security can be either a charge or an assignment. Likewise, shares are another type of security but the form can be either a charge or a pledge.

2.1 Land

Land is the most common security taken by a lender. The National Land Code 1965 defines land to include anything that is permanently affixed on to the land, e.g. a building.

Notwithstanding the definition of land under the National Land Code 1965, we are referring to empty land only. The usage of land could be for agricultural, residential or industrial.

Advantages

- Value of land is relatively stable.
- Over time value appreciates, subject to right conditions.
- Depending on location and market conditions, it can easily be sold.
- It is easy to identify the existence of the security.
- Registration of interest in the title can be done easily.
- As loans are amortised with repayments, the equity in land will increase.

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Disadvantages

- During recessions, it may be difficult to sell.
- Valuation can be very subjective, thus leading to difficulty in obtaining a true value of the property.
- Leasehold land amortises in value will decline in remaining years of lease.
- Leasehold renewal premiums can be costly.
- Documentation cost can be high.
- Legal proceedings can be lengthy and costly.

2.2 Land and building

Definition of land, as per the National Land Code 1965, includes all that are permanently affixed on the land. This mainly includes building.

While land values may appreciate, values of buildings by nature will depreciate. But it is possible for replacement values of building to go up due to inflationary pressures on building materials and labour.

The type of building that can be erected on the land depends entirely on the land usage, i.e. agricultural, residential or industrial. On an agricultural land, only one building construction is permitted. On a residential land, houses for dwelling can be constructed. Factory buildings can be constructed on industrial land.

The advantages and disadvantages are similar to that of land as stated above. But for completed buildings on land, construction risk is non-existent. Therefore, a premium is attached to the gross development value (i.e. value of land + construction cost) due to its completed status.

2.3 Fixed deposit (FDR)

Fixed deposits, also called time deposits, are by far the best form of collateral due to their liquid form.

Advantages

- Easily realisable.
- Documentation is simple and easy to take.
- Interest compounded upon renewal will increase the principal amount.

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Disadvantage

- For corporate fixed deposits, the documentation is more elaborate as they are required to be registered with the Companies Commission of Malaysia.

Whilst it is a good form of security, not all borrowers can offer this as collateral on a one-to-one basis. It is common among customers to take loans against their fixed deposits that have not matured. This is to avoid losing interest due to the premature upliftment of the fixed deposits. Some customers pledge their fixed deposits and arrange for a standby facility to cater for contingency needs. Others may provide this as part of a comprehensive security arrangement to secure higher credit facilities.

2.4 Stocks and shares

Stocks and shares together with other related investment instruments are a commonly accepted lending security.

Advantages

- Market values of listed shares are easily available.
- Listed shares can easily be realised.
- Documentation procedures are simple.

Disadvantages

- Unlisted shares are difficult to value and sell as there is no ready market. For shares of private limited companies, there could be restrictions on the sale as incorporated in the Memorandum and Articles of Association (M&A) under the Companies Act 1965.
- Market prices on the stock exchange are subjected to numerous factors, thus leading to price fluctuations.
- Stock market crash is possible.
- Bonus and rights issue can lead to a reduction in the value of existing shares but the security value should not be adversely affected. To achieve this, proper control must be in place to ensure that the bonus shares are credited into the Central Depository System (CDS) account that is tagged to the lender’s name and rights issues are promptly advised to borrower and appropriate actions are taken.
- Shares which are thinly traded may be difficult to sell at a short notice.

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2.5 Unit trust

Unit trusts are similar to shares in that they, too, are investment instruments. Prices are less volatile as compared to stocks and shares as professional managers usually invest funds in a diversified portfolio. The prices can be determined at all times as the fund manager is required to provide a two-way quote of buy and sell prices. Units provided as collateral can always be sold as the fund manager is obliged to buy.

2.6 Vehicles

Vehicles are financed through hire-purchase or leasing facilities. The lender would automatically become the owner of the vehicles although the hirer or lessee will have possession.

Advantages

- Vehicles can easily be identified.
- As ownership is in the name of the financier, upon default, repossession can be effected.
- Vehicles serve a basic need for transportation, so there is a strong demand for new and used vehicles.
- There is an established secondary market for used vehicles.
- Second-hand values can be ascertained.

Disadvantages

- Vehicles are a depreciating asset.
- Repossession process is lengthy and difficult to carry out in practice.
- Vehicles involved in accidents can lead to total write-offs and need to rely on insurance claims.
- Vehicles can be stolen and also need to rely on insurance claims.

2.7 Machinery

Machinery financing is done either in the form of term-loan, hire-purchase or leasing.

There are some things which are distinct from machinery as compared to vehicles. Firstly, machinery do not have a strong secondary market. Specialised machinery cannot be resold and if the particular business that used it fails, then the machine will only be good for scrap value. Second, the depreciation rate is more rapid by nature. For these reasons and the

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inability to value machinery, generally no value is assigned to this collateral. Further, the process of repossession is generally tedious.

In joint ventures, one party may inject capital in the form of machinery. There is an inherent risk here. Inability to value machinery accurately coupled with the danger of bringing in reconditioned machinery as new, can lead to complications in assessing accurately the value of capital that was injected.

3. Secured and Unsecured Lending

3.1 Secured lending

Collateral is often required to reduce the level of risk. If the borrower encounters problems and is unable to repay a secured loan, the lender may take steps to realise the collateral, subject to the provisions in the loan contract and security agreement under the contractual terms.

Lenders can be secured under two common circumstances, namely:

- Nature of financing, i.e. asset-based financing where the lender is financing the acquisition of the asset; or
- Security is offered as a result of negotiation between the lender and borrower for the purpose of risk mitigation, and the security is not the subject of financing.

3.1.1 Categories of collateral

Secured loans are grouped into four categories according to the behaviour of the collateral's value over time. They are:

- Depreciating value – such as vehicles, machinery, boats, airplanes, etc.
- Fluctuating value – such as stocks and shares, etc.
- Stable value – such as fixed deposits, etc.
- Appreciating value – such as freehold properties, etc.

When securing a loan with a depreciating value collateral, it is important to determine the item's value at the time the loan is made. The method of determining collateral value should be part of the policy guidelines for each type of loans. A valuation guidebook to determine values should be made available as a guide.

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The values of some forms of collateral rise and fall over time. These fluctuations may increase the collateral risk and make risk management difficult. Collateral here includes stocks, bonds and other types of marketable securities. The value of securities changes constantly, making careful analysis and control essential. Some securities are riskier than others. A well-established company's shares with solid earnings, for example, is generally more predictable than that of a company experiencing significant problems or a new company without an established earnings record provided there is sufficient liquidity in the market. As the saying goes in the world of investment, 'A good company is not necessarily a good investment'. Similarly, in taking stocks and shares as collateral, shares in good companies need not necessarily be a good collateral unless it is marketable. It is important therefore, for each lender to establish clear guidelines about what it will and will not accept as collateral.

Many lenders only accept securities as collateral for on demand loans, which allows them to call the balance due in full at any time. To avoid collateral risk if the value of the shares or bonds deteriorates during the term of the loan, a well-run lender would include a provision allowing it to require additional collateral if the value of the original collateral decreases below the security margin in loan documents.

While newspapers publish the value of traded stocks and shares, the value of privately held securities not traded in public is more difficult to determine. Accepting these securities as collateral is riskier because it is difficult to predict their values and the demand is lower.

3.1.2 Stable value collateral

Stable value collateral carries less risk than the previous categories. This category of collateral includes fixed deposits, cash margins and surrender values of life insurance policies. These collaterals generally are loss free in terms of their values. However, losses sometimes do occur due to operational errors, legal disputes, and arrears in interest as well as some loans may be partially secured. For example, if a fixed deposit held under lien serving as collateral is accidentally released, the customer may take advantage of the opportunity to remove all the funds from the account, leaving the bank in an unsecured position.

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Barring operational errors, these loans have very low risks, which help to explain why they generally carry the lowest interest rates of all loan types.

3.1.3 Appreciating value collateral

Some collateral appreciate in value over time. This category is usually limited to loans secured by freehold properties such as residential, commercial or industrial properties. Although properties normally increase in value, this is not always the case. Property market corrections during recessions and properties in the wrong locations can be affected. Prudent practices are required to manage portfolios secured by properties.

The growth of equity from rising property values, the source of most of the increases in net worth, is reflected on borrowers' balance as asset revaluation. This equity is increasingly used to give customers access to enhancements in credit limits and to provide lenders with security for loans.

Property value is usually obtained from a professional valuer in the lender's panel. Some lenders value properties below certain amounts by themselves without engaging the services of a professional valuer particularly if there are recent cases involving properties from the same project where the valuation was still fresh.

As already noted, there is no guarantee that all real estate will appreciate in value. Properties depreciate due to neglect, a decline in the surrounding community, natural or man-made disasters, or the general state of the economy. Properties and other collateral sold under force sale situations (auctions and foreclosures) rarely bring full value. Thus, loans secured by appreciating value collateral are not completely risk free. This is also the reason why the first way out in the form of profits/cash flow must be analysed thoroughly.

3.2 Unsecured loans

Unsecured loans are loans made to customers who offer no collateral for the credit extension. Some lenders follow conservative practices regarding unsecured loans. Personal clean loans are restricted only to high net worth individuals. For corporations, they must have a good name in the market with strong cash flows and meaningful unencumbered assets.

Some banks take a more aggressive stance. They are comfortable extending unsecured loans to a broader range of customers, especially

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those with good earnings record and a clear purpose, and impose the relevant covenants to control them.

The key to success is learning how to effectively balance a customer's creditworthiness with reasonable risk taking and profit potential. Unsecured loans are based on trust in the customer's honesty, integrity and character, and the lender's ability to properly evaluate the credit risk associated with the loan request. The borrower covenants to repay the loan under the terms set forth in the loan agreement. If the borrower cannot make payments when due, then a default arises and the bank must work with the customer to resolve the problem rather then rely on legal recourse for debt repayment. As these loans have the highest degree of risk, they normally have the highest interest rates and shorter maturities.

3.3 Co-borrower / guarantor loans

These loans may be either unsecured or secured. They are different from other types of loans because someone else will sign the loan documents together with the applicant. This strengthens the loan request and helps induce the bank to make the loan. The **co-applicant** is fully liable for repayment if the primary borrower is unable or unwilling to repay the loan.

A guarantor signs to guarantee a loan to another person and is liable with the maker for repayment of the loan. A guarantor makes a guarantee defined as "the undertaking of responsibility by one party for another party's debt or obligation to perform some specific act or duty". Although the original debtor is responsible for the debt, the guarantor is liable in the event of default.

As direct liability is accorded to the co-applicant or joint borrower/s, it can and should be reflected in their financial statements and credit reports. The co-applicant is jointly and severally responsible for each and every payment, whereas a guarantor has a contingent liability that is generally shown off the balance sheet and will be notified in case of default.

4. Features and Attributes of a Good Security

In credit, there is a difference in being well secured vis-à-vis being secured by a good security. For instance, if a borrower wants to borrow RM1.2 million and offers the lender either a fixed deposit of RM1.2 million or properties in a decent location valued at RM2 million as security, it is likely that the lender would prefer the fixed deposit. It is obvious that the fixed deposit is a much better security than the properties. What makes the fixed deposit a far superior security? What are the attributes of a fixed deposit that distinguish it as a better security?

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The attributes of a good security include:

(a) Marketability (Liquidity)

The more marketable the security, the more liquid it is. As an example, quoted investments are marketable but if the volume of transaction and turnover on the stock exchange is low, the shares are considered illiquid. Such shares are not considered as good security.

(b) Assessability (Measurability)

Generally, all tangible assets have value. However, this value must be quantifiable or measurable. Less subjective elements present in the valuation process will enhance the value certainty. The final or realisable value will however be determined by the economics of demand and supply.
Examples of situations where the security's value may be difficult to determine objectively are as follows:

- Debentures on a company's assets especially when the main assets are plant and machinery, stocks and accounts receivable;
- Shares of an unlisted company;
- Works of art; and
- Guarantees.

(c) Stability

The value of the security should be stable. Fluctuations in value due to its nature will lower its quality. Speculative share counters tend to be relatively more volatile than blue-chip shares and bonds. Deposits in foreign currencies have different degrees of fluctuation depending on the volatility or stability of the foreign exchange markets for the respective currencies.

Stability of a security's value also depends on its 'life'. For example, the following are some factors that may affect stability of security value:

- Perishability of stocks;
- Leasehold versus freehold properties, and
- Electronic goods subject to technological changes, etc.

(d) Transferability

There are three aspects of transferability that can affect the quality of a security, namely:

- Ownership;

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- Physical transferability; and
- Usage.

Some forms of security may have restrictions in ownership transferability. This may affect either the enforcement of the security or its marketability. Examples include land subject to Malay Reservation Titles and Sdn Bhd shares, the sales of which are subject to several restrictions.

Physical transferability problems are largely restricted to plant and machinery. Some of which are very bulky, specifically assembled or even fixed to the ground. If the security is enforced in the future, there may be a problem in delivering it to the buyer.

As for transferability of usage, the more specialised an asset's function, the less transferable it is likely to be. Examples are niche industry's customised equipment or machinery or an industry comprising only a few players.

(e) Speed of realising collateral value

For collateral such as fixed deposits and public quoted shares that are not suspended, the lender can receive face or market value immediately by uplifting the fixed deposit or selling the shares on the stock exchange. In the case of properties, the process can take some time as legal action has to be taken against the borrower and judgment obtained before the property charged as security can be auctioned.

(f) Enforceability

The rights on the security must be legally enforceable. An asset protected by government laws or prohibited by a company's constitution is as good as having no security.

(g) Absence of encumbrances

Any prior ranking claims such as preferred creditors' claims and prior charges could affect a security's value. An obvious example is a debenture over a company's assets where the preferred creditors have priority over the lender. In addition, the security must be one that derives a good title.

5. Forms of Taking Securities

It is important for lenders to understand that the same security can be taken in different forms. As an example, shares can be taken as a security by way of a charge or pledge or hypothecation. The form of security lenders take depends on the nature of loan extended and degree of control they require. For instance, if a

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lender is financing a parent company on their strategic shareholdings in a listed company, then taking a charge over the shares is appropriate. However, if a borrower is extended share margin financing then it would be more appropriate to take the shares as security by way of pledge to facilitate selling the existing shares and offering new shares as security.

5.1 Basic steps for taking a security

Before delving into the various forms of taking securities, let us examine the basic steps for taking a security by the lender. The steps are:

(a) Creating the security interest

To create a security interest, a security agreement must first be obtained. A security agreement is a contract between the security provider and the lender, in which it is acknowledged that the security is provided in consideration of the loan or facility extended to the borrower.

A lender must first create a security interest following the requirements of country's laws and regulations for a security agreement to create a valid security interest and to ensure that the lender's rights to the security will not be jeopardised. The security agreement must be in writing and contain a description of the security concerned, and duly signed by the borrower.

(b) Perfecting the security interest

A security interest by itself is of limited value if it is not enforceable against third parties in establishing priority, such as over other secured creditors, unsecured creditors, or a trustee in the case of bankruptcy. To be valid against such third party claims, a security interest must be perfected, i.e. other parties must be notified of the security interest. Procedures for perfecting a security interest naturally differ for each type and form of security.

5.2 Types and forms of security

Security can be taken on a first or third party basis as follows:

- **First Party** – provided or owned by the borrower (i.e. customer).
- **Third Party** – provided or owned by a party other than the borrower.

Security can be obtained through various forms. These are:

(a) Charge;

(b) Assignment;

(c) Pledge;

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(d) Lien, and

(e) Hypothecation.

6. Security Instruments

6.1 Charge

A legal expression signifying that an asset or a property is encumbered. It can also be referred to as a “Mortgage” which usually relates to land or immovable property. In a charge, legal interest is conveyed to the party granting advance subject to it reverting to the chargor or mortgagor on the advance repayment. This means that the chargor has an equity of redemption and the chargee must allow redemption. It is an interest in a property that passes conditionally to a chargee, normally without physical possession.

A charge is probably the most common form of security particularly when properties are frequently taken as security. It is related to many different types of lending such as overdrafts, factory loans, commercial property loans, housing loans and revolving credit facilities.

A charge or mortgage may be either legal (created by deed) which gives a legal interest in the property, or equitable (created by deposit of title deeds with or without memorandum of deposit) which gives only an equitable interest in the property. Lenders would normally prefer a legal charge rather than an equitable charge as it is a perfected charge and can be enforced immediately whereas for an equitable charge, lenders may need to get a court order to enforce it. Lenders may not mind taking an equitable charge under the following circumstances:

- it is taken as additional comfort as the lender may be well secured by other security; and/or
- there is only short-term exposure such as for a temporary overdraft.

A charge or mortgage can be created on a priority basis (e.g. first and second charge). Each subsequent charge will require the prior chargee(s)’s consent. It is not normal for a prior chargee(s) to give consent unless it is to him or herself or a related financial institution such as the finance arm of a banking group. Subsequent charges created are normally related to additional borrowings extended to the chargor. Such priority charges may not be necessary if the charge was originally created as an “all monies owing” or “open ended” charge. This may facilitate future restructuring or extending incremental lines without having to create any new charge.

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Examples of assets that can be taken as security in the form of a charge include properties, shares, stocks, cash deposits, ships, plant and machinery.

Charges can be either fixed or floating:

- A **fixed charge** can be a charge over the chargor's overall fixed assets. It can be included in a debenture incorporating both first fixed and floating charges. It prevents the directors from dealing with such assets by way of sale or charge without the debenture holder's consent. Fixed charges can also be created over specific machinery, property and shares.
- A **floating charge**, however, can be regarded as a charge coupled with permission to the company to continue to deal with its assets until the charge crystallises upon the appointment of a receiver, or by the company ceasing to carry on business. An important point to remember is that preferential creditors have priority over the debenture holder with regard to assets covered by a floating charge.

There is also a distinction between a legal charge under the National Land Code 1965 in respect of properties (registered with the Land Office) and a debenture creating a charge on fixed and/or floating assets under the Companies Act 1965 (registered with the Registrar of the Companies Commission of Malaysia). A charge on property is not valid and cannot be enforced if it is not registered with the Land Office. If a property belongs to an incorporated company, the charge also has to be registered with the Registrar of the Companies Commission of Malaysia in order to be perfected.

6.2 Assignment

An assignment involves a transfer of the rights under a contract by an assignor (borrower) to an assignee (lender). An assignment is usually taken when there is no title involved or where the security consists of money under the contract such as book debts and life policies. Generally, assignment by an assignor does not require the consent of the other party with whom the contract was originally entered into, unless specifically stated in the said contract that consent is required. The other party needs only to be served notice of the assignment. Such notice is to be acknowledged either through registered mail, local courier or signing on a duplicate copy of the notification.

An assignment can be either legal or equitable:

- A <u>legal assignment</u> is established when the assignor offers the rights to be assigned and the assignee formally accepts the assignment in a

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document. That document is then stamp dutiable. However, this would provide the lender the absolute right over rights assigned.

- An equitable assignment can be established by implied conduct. For instance, it can be pre-agreed that upon the offer for assignment by the assignor, if the lender (the assignee) does not reply within 7 days, he is deemed to have agreed to the assignment. Stamp duty payment can be avoided in an equitable assignment, as there is no offer and acceptance in a formal document. In an equitable assignment, the assignee will only be able to take legal action to enforce his or her rights with the help of the assignor. Hence, the assignor normally provides the assignee with a power of attorney to enable the latter to perfect the legal assignment should the need arise.

Common examples of lenders taking assignment are:

- **Assignment of a sale and purchase agreement** entered into between a developer and an end purchaser. The lender is financing the end-purchaser of a property that does not yet have an individual title. Consent for the assignment is required from the developer as it is stipulated in the prescribed format of the sale and purchase agreement. In the event of default, it enables the lender to step into the shoes of the end-purchaser.
- **Assignment of tenancy agreements** for tenanted properties financed by the lender. Normally, the assignment does not need consent as the assignor is normally the landlord. Tenants are not normally required to pay the rental to the lender. However, if the borrower (landlord) were to default then lenders may exercise their rights under the tenancy agreements to serve notice of the assignment to the tenants requiring them to effect payment directly to the lenders.
- **Assignment of rights under insurance policies** such as mortgage reducing term assurances. This will enable lenders to claim against the payment of the benefits should the borrower either die or suffer permanent disabilities. Consent is not required for the assignment. However, the insurance companies will have to be notified of the assignment.
- **Assignment of book debts** debtors owe a creditor who is the assignor. If the debtor has given notice in writing, the assignment passes the legal right to the debt together with all legal remedies for non-payments to the assignee, which is an effective transfer of ownership. Consent is not required unless there is a prohibition against the assignment stipulated in the original contract entered into between the creditor and the debtor. If that is the case, then lenders must ensure that consent is obtained from the potential debtors in the form of a “condition precedent”. Otherwise, the assignment can be

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invalid. Hence, it is critical for lenders to carefully read the contract that they are financing to look out for any prohibition against assignment.

In some cases, an assignment may be incorporated into a loan agreement particularly for housing loans where land or strata titles are not issued yet. The loan agreement effectively spells out how a loan is to be regulated with covenants. Conditions precedent and antecedent will be stated. Remedies available to the lender, in the event of default, will be incorporated. What the events of default are will also be stated with other terms and conditions. Hence, loan agreement is not a security by itself but is used in conjunction with other forms of security, like assignment.

6.3 Pledge

In law, a pledge means the transfer of chattel, or a movable asset. It involves either actual or constructive delivery of goods to be held as security for a debt. It must arise by express agreement. Possession of the asset is passed to the pledgee, but the legal ownership remains with the pledgor who has an equity of redemption for the physical possession.

This usually applies to cash deposits, shares, stocks and accounts receivables. The pledgee has the right to sell if the pledgor does not redeem the security by a pre-agreed date or according to pre-agreed conditions.

This is a common form of security taken when lenders are extending overdrafts, share margin financing, and facilities against the pledge of cash deposits.

6.4 Lien

A lien can be taken on personalty or on realty. When the term is applied to personalty, a lien is understood to be the right of a bailee to retain possession of a chattel entrusted to him until the debt due is paid. For example, a banker’s lien conveys a general right over documents of title subject to pledge (such as negotiable instruments) that pass through the banker’s hands while a debt is owing to him. This is subject to the condition that the negotiable instrument is not in the lender’s hands for a special purpose that is inconsistent with such a right, such as safe custody. No lien exists where a property does not belong to the customer (except for negotiable instruments). Unlike an ordinary lien, a banker’s lien gives a power of sale and is therefore an implied pledge.

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6.5 Hypothecation

This is a security whereby a debt is acknowledged and the particular goods or things are not in the lender's possession. It is similar to the concept of pledge except that physical possession of the security is not with the lender. The letter of hypothecation may define how the lender may deal with the goods or things on default of debt repayment, and generally conveys a power of sale. The borrower may undertake to give possession of the goods or things hypothecated when called upon to do so. The goods or things hypothecated must be identified in the letter of hypothecation.

This form of security is used when lenders lend to stock-broking companies where the physical shares are hypothecated. With the introduction of scripless trading, the shares cannot be physically hypothecated. Lenders should rightfully take hypothecation of goods only where they do not assume a title when they finance the borrower on purchases. Where the lender have ownership in financing such as in hire-purchase and trust receipts, then there is no necessity for a hypothecation.

7. Power of Attorney

A power of attorney is a formal document created by a principal called the donor for the appointment of an agent, called the attorney or the donee.

Like a loan agreement, a power of attorney is not a form of security. It is to facilitate the execution of documents and enforcement of collaterals.

It falls under two categories namely general and specific. A general power is one in which the attorney is authorised to do virtually all acts and things which the principal could do in person. A specific power, on the other hand, limits the attorney's authority to the acts specified in the power. An example of a specific power of attorney is the power of attorney clause incorporated in a Loan Agreement cum Assignment whereby the customer/borrower authorises the bank as his attorney to sell property and do other acts but only in respect of the property assigned to the bank.

A power of attorney is addressed to the whole world and not confined to only the lender. It must be stamped.

To be valid, the power of attorney must be:

- Attested by any of the persons authorised under the Powers of Attorney Ordinance 1949, which includes lawyers, magistrates, and commissioners for oaths and
- Registered at the Registry of the High Court.

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In accepting a power of attorney from a customer, the lender should take the following precautions:

- Ensure that the legal formalities such as stamping, attestation and registration are duly complied with.
- Request for sight of a sealed copy of the power of attorney. The imprint of the official seal of the High Court, usually found on the last page of the document, together with the particulars of the registration and the signature of the senior assistant registrar will help determine the authenticity of the instrument.
- Examine the contents of the power of attorney to determine the extent of the agent's authority, to fully familiarise itself on what the attorney can do or cannot do. Any limitation on the agent's authority or departure from the lender's printed mandate form should be carefully noted and highlighted. This will help to alert lending officers handling the account that different rules exist for the operation of such an account and will minimise the risk of the lender being sued for breach of contract. If the power does not cover all the transactions normally encountered in operating an account, the lender should request that the customer sign its printed mandate form.

It is often difficult to verify whether a power of attorney has already been revoked, especially in cases where the principal is not available for confirmation or verification. In such cases, lenders frequently adopt the practice of requiring the attorney to make a Statutory Declaration to the effect that to the best of the attorney's knowledge, the power of attorney is still valid as at the date of the declaration. Under section 8 of the Power of Attorney Ordinance 1949, if any person makes a payment or does any other act in good faith not knowing that the power of attorney has been revoked, that person will not be liable in respect of that payment or act. Thus, even in a situation where the power of attorney has been revoked, the lender will be protected from liability if it acted in good faith in reliance on the statutory declaration.

7.1 Revocation of power

A power of attorney may be revoked if:

(a) The donor or principal gives written notice of its revocation and deposits a copy of such revocation, called the Deed of Revocation, with the Registry of the High Court at which the power was originally registered (section 5 of the Power of Attorney Ordinance 1949);

(b) The donee or attorney renounces his appointment in writing and registers a copy of the renunciation with the Registry of the High Court at which the power was originally registered (section 5 of the Power of Attorney Ordinance 1949);

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(c) There is death or unsoundness of mind of either the donor or the donee (section 5 of the Power of Attorney Ordinance 1949); or

(d) The donor is bankrupt (section 5 of the Power of Attorney Ordinance 1949).

As a general rule, a donor may revoke a power of attorney expressly stated to be "irrevocable" unless that power of attorney is intended to secure an interest of the attorney. This is because under section 6 of the Power of Attorney Ordinance 1949 it is provided that a power which is:

(i) Given for valuable consideration; and

(ii) Expressly stated in the power to be irrevocable cannot be revoked unilaterally by the donor without the consent of the attorney and will not be revoked by the death, mental incapacity or bankruptcy of the donor.

8. Principal and Subsidiary Instruments

Instruments under the Stamp Act 1949, include every written document. A principal instrument is a document where an *ad valorem* stamp duty is payable while a subsidiary instrument is a document where nominal stamp duty is payable.

9. Stamping

Under section 52 of the Stamp Act 1949, instruments not duly stamped are inadmissible in evidence. Section 52 (1) of the same Act, states, *"no instrument chargeable with duty shall be admitted in evidence for any purpose by any person having by law or consent of parties authority to receive evidence, or shall be acted upon, registered or authenticated by any such person or by any public officer, unless such instrument is duly stamped"*.

Duly stamped, as applied to an instrument, means that the instrument bears an adhesive or impressed stamp of not less than the proper amount and that such a stamp has been affixed or used in accordance with the law in force for the time being in Malaysia.

In the case of Sabah and Sarawak, an official receipt for the proper amount may be affixed to any instrument in lieu of the stamp, and the instrument shall be deemed to be duly stamped

Duty means any stamp duty for the time being chargeable under this Act or any written law.

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9.1 Stamp Act 1949

Section 3A(4)

Section 3A(4) – For the purpose only of ascertaining the market value of any property, the Collector may in writing authorise any valuer employed by the Government, whether he be a public officer or a person privately practicing as a valuer, to exercise any of the powers conferred upon the Collector by this section.

Section 4

Section 4 – Instruments chargeable with duty are those specified in the First Schedule of this Act.

Valuation for duty

Section 12A

Section 12A – assessment of the value of property under transfer or settlement. Where an instrument is chargeable with duty under the First Schedule, the date for determining the market value of any property being transferred, settled or gifted shall be the instrument of transfer's execution date. Following this, if a property without individual title is purchased and five years later the title is issued, the stamp duty payable on transfer will be based on the original sale and purchase agreement price.

Section 14A – Principal securities in Syariah financing

Where it is shown that a principal or primary security secures the repayment of moneys provided under a scheme of financing made according to the Syariah, duty chargeable thereon shall be calculated on the principal amount provided by the financier or financing body.

Section 40 – Time of stamping after adjudication

When the opinion of the Collector with respect to the amount of duty with which an instrument is chargeable has been required, the instrument shall be stamped in accordance with the assessment of the Collector within 14 days after notice of assessment, and in the case of an application to the High Court under section 39 within fourteen days after Court's issue of the order, or within such period, in either case as the Collector when giving notice of assessment or the court when making the order, may specify.

Provided that the said period of 14 days or any further period specified by the Collector or the Court may, on application made before the period or further period expires, be extended or further extended by the Collector or the Court, as the case may be.

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Section 47 – Stamping of instrument after execution

Save where other express provision is made by this or any other Act, any unstamped or insufficiently stamped instrument not being a cheque or promissory note drawn or made within Malaysia may be stamped after execution on payment of the unpaid duty if after execution, the instrument is presented for stamping within 30 days of its execution within Malaysia, or within 30 days after it has been received in Malaysia but executed out of Malaysia

Section 47A – Penalty for late stamping

An instrument, which is not stamped within the period specified in or under section 40 or 47, may be stamped on payment in addition to the unpaid duty of a penalty of

- RM25 or 5% of the amount of the deficient duty, whichever sum is greater, if stamped within 3 months after the time for stamping
- RM50 or 10% of the amount of the deficient duty, whichever sum is greater, if stamped within 6 months after the time for stamping
- RM100 or 20% of the amount of the deficient duty, whichever sum is greater, if stamped after 6 months from the time for stamping.

Section 74 – Fraud in relation to duty

Any person who practices or is concerned in any fraudulent act, contrivance or device not specially provided for by law, with intent to defraud the Government of any duty, shall be liable to a fine of five thousand Ringgit.

9.2 *Ad Valorem* and Nominal Charges

Instruments chargeable with stamp duty are enumerated under the First Schedule of the Stamp Act 1949.

Ad valorem means – according to value. Principal instruments are stamped for RM5 per thousand Ringgit.

Nominal charges are not according to value. It is stamped at RM10.

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10. Summary and Conclusion

Accepting various types of security should be perfected with the correct form. Stamping them to have the desired legal effect is important. Undertaking stamping only when there is a need to enforce a collateral is not good lending practice. Timely periodic valuation of collateral should be done without sparing effort.

Accuracy and completeness in the security documentation process should be maintained at all times.

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Practice Questions

1. Distinguish between type of security and form of security.

2. What is the distinct advantage of taking land and building as security against land?

3. List the advantages and disadvantages of taking stocks and shares as security.

4. Name the four categories of security according to their behaviour over time.

5. Distinguish between "being well secured" and "being secured by a good security". Give examples to illustrate.

6. Marketability is an important attribute of a good security. Explain marketability and give examples of securities that you consider marketable.

7. A good security must be transferable. Explain the three aspects of transferability.

8. Identify an asset where different forms of security can be established and explain the respective circumstances under which they are taken.

9. When a lender takes on a security, there are two basic steps to ensure that the lender's rights are absolute. What are the key aspects of these two steps?

10. Distinguish between a first party and a third party security.

11. Explain the difference between fixed charge and floating charge.

12. Under what circumstances is a lender prepared to take an equitable charge rather than a legal charge?

13. What is hypothecation? Give examples of lending propositions where hypothecation can be used.

14. Give examples of three different types of assignment.

15. Is a power of attorney a type of security?

16. What conditions must be present for a power of attorney to be valid?

17. What is the difference between principal and subsidiary instruments?

18. What is the penalty for late stamping?

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