

DP02

Law on Banking and Finance

5 OCTOBER 2004

1. Time allowed : Three (3) hours
2. Total number of questions : Five (5) questions
3. Number of questions to be answered : Four (4) questions [25 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**.
7. Blank pages are provided at the end of the question paper for rough work.

ANSWER FOUR (4) QUESTIONS ONLY

1. (a) Describe the composition (structure) of the Malaysian financial system. [10]
- (b) Annie, Badariah and Chong have just registered a partnership, Syarikat ABC. They wish to open a current account with Bank XYZ Bhd.
- Describe the documents and procedures required for the opening of Syarikat ABC's current account. [10]
- (c) What is "money laundering" as defined in the Anti-Money Laundering Act 2001? [5]
(Total:25 marks)
2. (a) Muthu is a clerk in the call centre department of Bank JB Bhd and his duties at work are to provide clerical and other office support services. Muthu has no direct dealings or contact with Bank JB Bhd's customers.
- Is Muthu bound by the duty of secrecy with regard to the affairs and accounts of Bank JB Bhd's customers? Give reasons for your answer. [5]
- (b) Inspector Abu is investigating a crime involving counterfeit notes which were circulated and used by one of the customers who maintains an account in Bank BB Bhd. The Inspector approaches the officer-in-charge for some personal details such as the residential address of the customer.
- Can Bank BB Bhd's officer-in-charge disclose information about the customer to Inspector Abu? Give a reason for your answer. [5]
- (c) Describe the nature of a banker-customer relationship. [15]
(Total:25 marks)
3. (a) Datuk A and his wife, Datin A, respectively owns 70% and 30% of the issued and paid-up share capital of JJ Sdn Bhd. Datuk A is also JJ Sdn Bhd's managing director. JJ Sdn Bhd maintains a current account with Bank Maju Bhd. According to JJ Sdn Bhd's board resolution, both Datuk A's and Datin A's signatures are required on all cheques of JJ Sdn Bhd.
- KK Enterprise, of which both Datuk A and Datin A are partners, also maintains a current account with Bank Maju Bhd.
- Recently, Datin A orally informed Bank Maju Bhd that Datuk A has passed away in Indonesia.
- In relation to the above scenario, answer the following and give reasons to support your answer:
- (i) Should Bank Maju Bhd freeze JJ Sdn Bhd's current account? [5]
- (ii) Should Bank Maju Bhd freeze KK Enterprise's current account? [5]
- (b) Bank ABC Bhd, as a paying banker, pays cheques each day on behalf of its customers by debiting its customers' accounts.
- (i) State **two** main duties owed by a customer to his banker in relation to cheques. [5]
- (ii) Describe the protection and requirements given in the Bills of Exchange Act 1949 to Bank ABC Bhd as a paying banker. [10]
(Total:25 marks)

4. (a) Kassim is the payee of a general-crossed cheque which has the words "A/c Payee Only" appearing on it.
- (i) What are the legal effects of this crossing? [2]
 - (ii) Can this cheque be transferred or negotiated? Give a reason for your answer. [3]
- (b) In relation to electronic banking, answer the following:
- (i) What is a digital signature? [5]
 - (ii) State the legal effects of a digital signature by stating the applicable or governing statutory provisions. [5]
- (c) In relation to a debenture (which may be created as a form of security by a company), answer the following:
- (i) State what a debenture is. [2½]
 - (ii) Explain **one** advantage of taking a floating charge as security under a debenture created by a company. [2½]
 - (iii) How is a debenture normally enforced? [5]
- (Total:25 marks)

5. (a) Mr Kaya requires a short-term loan of RM200,000 for two months only. He owns an unencumbered piece of land in Ipoh upon which a three-storey building, called Kaya Centre, was built. Mr Kaya wants to use that land as security for the loan but he does not want to create a charge over that land.

Advise Mr Kaya on the following matters:

- (i) The type of security that Mr Kaya can create by using the land title without creating a charge. [5]
 - (ii) The type of legal documentation and procedure involved in creating the security identified in (a)(i) above. [5]
 - (iii) The remedies available to the lender (as provided under the National Land Code 1965) in case of default in repayment of the loan. [5]
- (b) Bank HH Bhd granted an overdraft facility to Mr SW and his wife. The facility is secured by a charge over a piece of land to Bank HH Bhd.

Describe the nature of the **two** main remedies provided under the National Land Code 1965 which are available to Bank HH Bhd, as the chargee, in the event Mr SW defaults in the repayment of the overdraft. [10]

(Total:25 marks)

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

- Instead of writing on documents and procedures for opening current account for a partnership, candidates wrote on opening current account for a company.
- Candidates wrote irrelevant issues on money laundering instead of defining what money laundering is.

1. (a) The Malaysian financial system comprises:
- banking institutions
 - non-bank financial intermediaries
 - financial markets

Banking institutions include Islamic banks, commercial banks, finance companies, merchant banks, discount houses and foreign banks' representative offices.

All banking institutions, except for Islamic banks, are required to be licensed under section 6(4) of the Banking and Financial Institutions Act 1989. Commercial banks represent the largest group of banking institutions in Malaysia. Offshore banks offer offshore banking services. Islamic banks conduct their banking business strictly in line with Islamic principles. Finance companies accept deposits (except current accounts) and provide credit facilities such as hire-purchase financing, lease financing, housing loans, block discounting and revolving credit. Merchant banks provide specialist finance services such as loan syndication, share underwriting, project finance and corporate advisory services. Discount houses specialise in short-term money market operations. They garner funds mainly from banks and the corporate sector, and invest such funds in Government securities and Treasury bills. Money brokers are involved in brokerage activities in the money and foreign exchange markets.

Non-bank financial intermediaries comprise leasing companies, factoring companies, venture capital companies, development finance institutions, savings banks, insurance companies, provident and pension funds, unit trusts, property trusts, housing credit institutions, government housing loan divisions, Cagamas Berhad, pilgrim fund boards, Credit Guarantee Corporation, Malaysian Export Credit Insurance Berhad and Rating Agency Malaysia.

Financial markets include the Labuan International Offshore Financial Centre, money and foreign exchange, private debt securities, options and financial futures exchange, stock exchange and commodity futures exchange.

- (b) The documents and procedure required are:

The bank should carry out an investigation (for example, searching with CTOS or any other negative file search and the Registry of Businesses under the Companies Commission of Malaysia) to verify the existence of the firm, identity of the partners (the identity cards of each partner) and the other particulars of the firm (registration certificate).

If the partnership was formed with a written partnership agreement, a copy of such agreement needs to be obtained and studied. The bank also should obtain a specimen of the firm's rubber stamp and an account mandate containing account operation details, signed by all the partners. As the account to be opened is a current account, an introducer is necessary.

- (c) The Anti-Money Laundering Act 2001 defines "money laundering" to mean the act of a person who:
- engages, directly or indirectly, in a transaction that involves proceeds of an 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

- Instead of describing the nature of the banker-customer relationship, candidates wrote on rights and duties of bankers and customers.
- Candidates are advised to understand and answer according to the requirement of the question.

2. (a) Section 97(1) of the Banking and Financial Institutions Act 1989 (BAFIA) provides that all officers of licensed institutions (which includes banks such as Bank JB Bhd.) are under a legal obligation to keep secret the affairs of its customers. The word 'officer' is defined in section 2 of BAFIA as including all employees. Therefore, Muthu is bound by the duty of secrecy even though he is only a clerk in the call centre department as he is an employee of the Bank.
- (b) The officer of Bank BB Bhd cannot disclose information about the customer to Inspector Abu. The officer can only do so with prior authorisation by Bank Negara Malaysia – section 99(1) (i), BAFIA. As this was a counterfeit notes case, it involves a crime under the Penal Code and the Penal Code is not one of the Federal laws which authorises disclosure to a police officer investigating into an offence.
- (c) Due to the range of services offered by banks to their customers, the nature of the bank's relationship with the customers may take various forms:

The general character of the relationship between banker and customer is a contractual one, which developed out of the customs and usage of bankers. Contractual terms may be expressed (written or oral) or implied terms.

Apart from this ordinary relationship, there are a number of special relationships that the banker and customer may enter into during the course of their dealings. For example, under certain circumstances, the banker may find itself in a fiduciary relationship with its customer.

The bank may also find itself in the position of a constructive trustee. A banker who acts on payment instructions given by the holder of a trust account knowing that those instructions involve a misapplication of trust money will be liable as a constructive trustee.

When the customer borrows money from the bank, the relationship is that of debtor and creditor. *Carr v Carr*. However, where the customer deposits money with the bank, the bank is the debtor and the customer the creditor. – *Foley v Hill*.

The rights and obligations of the bank and its customer depend on the nature of the relationship. For example, if the bank is acting as a bailee, it must take care of the goods bailed, or it will be liable for negligence. Additionally, a bailee has to return the specific item bailed in accordance with the instructions of the bailor.

Question 3

Candidates wrote on the statutory protection available to “collecting” bankers instead of writing in relation to “paying” banker.

3. (a) (i) Upon the death of a director, the banker does not freeze the company’s account because the company is a separate legal entity, separate and distinct from its shareholders and directors – *Salomon v Salomon & Co. Ltd.* Thus, the JJ Sdn Bhd’s account is unaffected by the death of the managing director, Datuk A. However, a new director may have to be appointed and a fresh resolution be given to Bank Maju Bhd as JJ Sdn Bhd is required to have a minimum of two directors under company law.

(ii) The banker reacts differently as a partnership, unlike a company registered in the Registry of Companies, is not a legal entity – *Wong Yoon Yar v Lin Yin Thai & Ors.* A partnership does not enjoy perpetual succession.

In the absence of any agreement to the contrary, a partnership is dissolved on the death of a partner. After dissolution, the authority of the partners continues so far as it is necessary to wind up the affairs of the partnership and to complete transactions unfinished at the time of dissolution – section 40, Partnership Act 1961.

On the death of a partner, his or her estate is jointly and severally liable for debts and obligations of the partnership incurred prior to the death of the partner. Thus, after verification of Datuk A’s death, KK Enterprise’s account should be frozen.

(b) (i) The two main duties of the customers in relation to cheques are the Macmillan duty and the Greenwood duty. The first duty is laid down by the decision of the House of Lords in *London Joint Stock Bank Ltd v. Macmillan* (the Macmillan duty).

The first duty is to refrain from drawing a cheque in such a manner as may facilitate fraud or forgery. The second was laid down by the decision in *Greenwood v. Martins Bank Ltd* (the Greenwood duty). The second duty is a duty to inform the bank of any forgery of a cheque purportedly drawn on the account as soon as the customer becomes aware of it. – *UAB v Tai Soon Heng Construction Sdn Bhd.* and *Syarikat Islamiyah v. Bank Bumiputra Malaysia Bhd.*

(ii) The protection and requirements given in the Bills of Exchange Act 1949 to Bank ABC Bhd as paying banker are:

Section 60 of the Bills of Exchange Act, 1949 provides:

“When a bill payable to order on demand is drawn on a banker, and the banker on whom it is drawn pays the bills in good faith and in the ordinary course of business, it is not incumbent on the banker to show that the indorsement of the payee or any subsequent indorsement was made by or under the authority of the person whose indorsement it purports to be, and the banker is deemed to have paid the bill in due course, although such indorsement has been forged or made without authority.”

The section requires that, to entitle him to its protection, the banker must pay the cheque ‘in good faith and in the ordinary course of business’.

In *Syarikat Islamiyah v. Bank Bumiputra Malaysia Bhd*, it was held that section 60 protects the paying bank against forged or unauthorised indorsements, but it does not cover forged or unauthorised signatures that are governed under section 24.

Section 80, Bills of Exchange Act, 1949 provides:

“...where the banker, on whom a crossed cheque (including a cheque which under section 81A or otherwise is not transferable) is drawn, in good faith and without negligence pays it, if crossed generally, to a banker, and if crossed specially, to the banker to whom it is crossed, or his agent for collection, being a banker, the banker paying the cheque, and if the cheque has come into the hands of the payee, the drawer, shall respectively be entitled to the same rights and be placed in the same position as if payment of the cheque has been made to the true owner thereof.”

Section 82 which provides protection to the paying banker in respect of the payment of certain instruments analogous to cheques, reads:

“... where a banker in good faith and in the ordinary course of business pays any such instrument as the following, namely:

- a document issued by a customer of his which, though not a bill of exchange, is intended to enable a person to obtain payment from him of the sum mentioned in the document;
- a draft payable on demand drawn by him upon himself, whether payable at the head office or some other office of his bank; he does not, in doing so, incur any liability by reason only of the absence of, or irregularity in, indorsement, and the payment discharges the instrument.”

Question 4

- In relation to crossing of cheques, candidates did not relate the answers to section 81A, Bills of Exchange Act 1949.
- Candidates showed shallow understanding of digital signature and its legal effects.

4. (a) (i) The legal effect of a generally crossed cheque is that it cannot be paid over the counter but must be banked into an account.
- (ii) In Malaysia, cheques are often crossed as “A/c Payee” instead of “Not Negotiable”. Due to the addition of the words “A/c Payee Only”, by virtue of section 81A of the Bills of Exchange Act 1949, the cheque shall not be transferable nor negotiated, but shall only be valid as in between the two parties thereto.
- (b) (i) A digital signature is not a handwritten signature. It is also not merely an electronic signature that is the application of an electronic substitute for a handwritten signature. A digital signature is a technique that can include more possibilities than just an electronic substitute for a handwritten signature. A digital signature can also be used to establish the origin and integrity of electronic data.

A digital signature may be described as a string of data generated by a cryptographic method that is attached to a message to ensure its authenticity as well as to protect the recipient against repudiation by the sender. In order for digital signatures to work, there is the need to create a pair of keys known as the private key and the public key. (Public key cryptography is a technique whereby a public key cryptosystem environment exists in which users of the system each have a pair of public key and private key. The public key is freely distributed to others while the private key is kept secret.) The creation of the pair of keys may be by the user or a certification authority. The private key (which is retained and kept secret) is the most important item as it enables the authentication of the sender of the message. The private key also assures the recipient that the user is who he claims to be. Thus if a person sends

a message and encrypts it with his private key, there is little or no chance of the user or sender being able to deny that he did not send the message. This is because the system would have authenticated the sender's identity when the message was decrypted using the sender's public key.

- (ii) The Digital Signature Act 1997 sets out a regulatory structure in respect of entities involved in the creation of digital signatures and legalises private key – public key cryptography.

Under section 62 of the Digital Signature Act 1997, a digital signature is recognised as an authentic signature.

- (c) (i) A debenture is an instrument, usually a deed, issued by a company, as acknowledgment of a debt. It may incorporate either a fixed charge or a floating charge or both.– section 4(1), Companies Act 1965. The essential characteristics of a floating charge were described in *Re Yorkshire Woolcombers Association Ltd*.
- (ii) The advantage of taking a floating charge is that the charger can deal with the assets subject to the charge as long as the charge has not crystallised. Otherwise, it would be cumbersome if the charger had to get the assets released as security whenever it wants to trade in them.
- (iii) The enforcement of a debenture is by way of appointing a receiver and manager to manage the company's affairs. The debenture-holder is normally given express power to appoint receivers and managers if the company defaults in repayment. The appointment can also be by the court.

The receivers would then get in the assets charged, collect all receipts, and realise the security on behalf of the debenture-holder.

However, in enforcing the debenture incorporated with charges over land, the debenture-holder (chargee) needs to apply for order for sale before foreclosing under the provisions of the National Land Code 1965. – *Kimlin Housing Development Bhd. v Bank Bumiputra Malaysia Berhad*.

Question 5

Candidates showed poor understanding of documentation and procedure in creating a lien and also the loan recovery aspects.

- 5. (a) (i) The type of security Mr Kaya can create is a lien over the land. A lien is a non-registrable interest in land – section 206, National Land Code (NLC). It is created when the registered owner or lessee, as security for a loan or advance, deposits the issue document of title or duplicate lease with the lender who then applies for entry of a lien-holder's caveat – section 281, NLC.
- (ii) The type of legal documentation and procedure which is involved in the creation of such security is the deposit of the issue document of title or duplicate lease, and the entry of a lien-holder's caveat. There must also be an intention to create a lien and this will be clearly expressed in the Memorandum of Deposit of Title. The Memorandum of Deposit of Title sets out the terms and conditions under which the security is held.
- (iii) The remedy given to the lien-holder under the NLC is that of judicial sale. Under section 281(2) of the said Code, after the lien-holder has obtained judgment, the lien-holder may apply to the court for an order of sale.

- (b) The two main remedies provided under the National Land Code 1965 (NLC) which are available to Bank HH Bhd, as chargee are:

The most common remedy is the right to sell the charged land by applying for an order of sale by public auction. In the case of land held under Registry title, the chargee may apply to the court (section 256, NLC); and, in the case of land held under Land Office title to the Collector of Land Revenue section 260, NLC).

The other remedy is the right to possession (section 271, NLC). However this right is expressly limited to charges over land not held under a Land Office title, or in the case of any other town or village land, if the land is not occupied by the chargor. This remedy is not usually resorted to.