

DP02

Law on Banking and Finance

7 OCTOBER 2003

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. Ms BC is an officer with Bank XYZ Bhd in Kuala Lumpur. Advise Ms BC on all the following issues:
- (a) Would it be advisable for Ms BC to open a joint savings account for Mr and Mrs N if Mr N was recently adjudged a bankrupt? State the reason(s) for your answer. [8]
 - (b) Would it be advisable for Ms BC to open a savings account for Mr T, a 17 year-old person, who appears to be mentally unstable? State the reason(s) for your answer. [7]
 - (c) At 11.00am, Bank XYZ Bhd received a telegraphic transfer message from Bank ABC Bhd instructing Bank XYZ Bhd to pay Ms Richie a sum of RM900,000.

At 3.45pm, Ms Richie, a young woman, walked in and demanded for the money. Ms BC asked Ms Richie for her identification but Ms Richie said that her handbag, which contained all her identification documents, was just stolen. Ms Richie only produced her driving licence which she had kept in her car.
 - (i) With reference to Malaysian anti-money laundering legislation, is it advisable for Ms BC to pay Ms Richie without the identification documents that Ms Richie claims were stolen? Give reasons for your answer. [4]
 - (ii) State Ms BC's statutory duties or liabilities in (c)(i) above. [6]
- (Total:25 marks)
2. On 29 August 2003, Mr ZZ, an officer in Bank Besar Bhd closed Mr DK's current account without informing Mr DK. On 2 September 2003, Mr DK filled a cash deposit slip and handed over RM1,800 to Bank Besar Bhd's teller, Dolly. Dolly told Mr DK that the bank's computer system was down for the entire day and that the amount would only be credited "once the system goes online".
- Later in the afternoon, Mr DK issued a cheque for RM300 payable to Millionaires Club. Mr DK is the Treasurer of the Millionaires Club and this payment was the annual membership subscription.
- Later that day, due to malfunction of Bank Besar Bhd's computer system, the RM1,800 cash transaction was wrongly credited into another account belonging to Mr Lucky instead of Mr DK's account. As a result, the cheque for RM300 was dishonoured with the reason, "Account Closed".
- Mr Lucky, who was pleasantly surprised at this unexpected windfall, quickly withdrew the RM1,800 from his account.
- In relation to the above context, answer all of the following and give reasons to support your answer:
- (a) Legally, should the bank have closed Mr DK's accounts without informing him? [5]
 - (b) Is the bank liable to repay the RM1,800 to Mr DK? [5]
 - (c) Can the bank recover the RM1,800 that was wrongly paid to Mr Lucky? [5]
 - (d) Is the bank liable for the wrongful dishonour of the RM300 cheque? [10]
- (Total:25 marks)
3. (a) An existing current account holder (who was recently paralysed) cannot sign as usual on his cheques. As such, he thumbprints the cheque and this is witnessed by his banker.

Is the cheque valid? Give reasons to support your answer. [10]
- (b) Mr PW and his brother, Mr TW, opened a joint current account at Bank EC Bhd with the mandate of operation, "Both to sign/operate the account". This joint account has an average credit balance of RM200,000.
 - (i) Can Mrs PW (Mr PW's wife) enquire from Bank EC Bhd on the outstanding balance of that joint account? Give a reason for your answer and state the penalty for contravention of the law. [5]

- (ii) Bank EC Bhd paid a cheque on 13 April 2003 which was signed by Mr PW. It was unknown to the bank that Mr PW died on 12 April 2003. The bank was only informed of Mr PW's death on 15 April 2003.

What is the legal position of Bank EC Bhd?

[10]
(Total:25 marks)

4. Define and describe the following types of securities:

(a) Debenture [10]

(b) Lien [10]

(c) Pledge [5]

(Total:25 marks)

5. Ms EM and Mr JJ, directors of LIZZIE Productions Sdn Bhd, approached Bank PJ Bhd for the following credit facilities:

- A personal housing loan of RM2million to be granted to Ms EM – to finance the purchase of a piece of vacant titled land and to finance the construction of a 4-storey bungalow thereon.
- A term/fixed loan of RM10million to be granted to LIZZIE Productions Sdn Bhd – to part-finance the construction of an entertainment centre. The titled land, upon which the entertainment centre is to be built, belonging to Ms EM, is free from encumbrances.

(a) Explain how Bank PJ Bhd can obtain security for the above credit facilities. Support your answer by giving details of the required security documentation, including the steps and procedures for the perfection of the security documentation. [15]

(b) In the event of default, briefly describe the various legal remedies and loan recovery efforts which may be pursued by Bank PJ Bhd. [10]

(Total:25 marks)

OUTLINE ANSWERS

Question 1

- Most candidates answered parts (a) and (b) of the questions correctly, which tested on the types of customers. However, they failed to provide sufficient reasons (legal principles, statutory provisions or case-law) to support their answers.
- Candidates' answers relating on AMLA lacked in-depth knowledge of that topic.
- Candidates should note that if the question requires them to "reason your answer", this means that the answer should be supported by legal principles, statutory provisions or case-law, or simply the legal basis for the answer.

1. (a) In order to enter into a legal contract such as deposit account contracts, a customer has to have full legal capacity to do so. Generally, a person has to be of the age of majority, be of sound mind and not be disqualified by law from contracting – section 11, Contracts Act 1950.

Although provisions in the Bankruptcy Act do not specifically prevent an undischarged bankrupt from opening any banking account, the banking practice is that an undischarged bankrupt is not allowed to open or operate an account without the Official Assignee's permission. This is because, under the Bankruptcy Act provisions, all monies, properties and assets owned by the undischarged bankrupt vest in the Official Assignee and bankers are required to pay the same to the Official Assignee.

Thus, Ms BC is advised not to open the account for an undischarged bankrupt.

- (b) According to section 11, Contracts Act 1950, an insane person cannot enter into binding contracts (such as a savings account contract) as he lacks mental capacity. Moreover, section 12 of the said Act goes on to emphasise the importance of ascertaining whether, at the time of making the contract, the person concerned is capable of understanding the contract and of forming a rational judgement as to its effect upon his interest.

In *Chow Yee Wah & Anor. v Choo Ah Pat*, the Privy Council held that the term 'person of unsound mind' extends to a person who loses the use of his or her mental faculty as a result of an accident. This Privy Council case suggests that the mental capacity of a person is a question of fact and is independent of the physical health of a person.

Thus, it is not advisable for Ms BC to open the account for Mr T.

- (c) (i) Bank XYZ Bhd, being a commercial bank licensed under Banking and Financial Institutions Act 1989 (BAFIA) is one of the reporting institutions as defined in section 3 of the Anti-Money Laundering Act 2001 (AMLA). As RM900,000 is a substantial amount to be paid to a young lady who is not the bank's existing customer (so little is known about her), Ms BC was right to insist on the identification documents before paying Ms Richie.

Moreover, Ms BC has to avoid liability for money-laundering or abetting money laundering which are offences under section 4 of the said Act punishable with the maximum sentence (upon conviction) of five years imprisonment or fine of RM5million or to both such fine and imprisonment.

- (ii) Under section 13, AMLA the reporting institution must record transactions exceeding a specified amount. Such records are to include the identity and address of the beneficiary of the telegraphic transfer.

Under section 14, AMLA, the Bank also has to promptly report to the competent authority (Financial Intelligence Unit, Bank Negara Malaysia) any transaction exceeding the amount specified and where the identity of persons or transaction or circumstances raises suspicion that proceeds of unlawful activity is involved. Although the amount has yet to be specified, perhaps, the Bank can consider reporting this transaction as a suspicious transaction.

As this is a substantial cash transaction, Ms BC is to verify by reliable means and record identifying information by using the identification card or passport, etc. as required under section 16, AMLA. Although a driving licence is stated as one of the identification documents, it is submitted that the production of driving licence alone is insufficient.

Section 17 provides that the bank must maintain the record of such transaction for 6 years from the transaction date. The maximum penalty is a fine of RM1 million or a jail term of one year or both fine and imprisonment.

Question 2

- Most candidates lost marks because they failed to elaborate their answers. A “yes” or “no” answer is grossly inadequate.
- The candidates who answered well supported their answers with case laws.
- Candidates should use the marks allocated as a guide to determine how much to write for their answers.

2. (a) When a bank wishes to close a customer’s account, the bank must first give reasonable notice to the customer – *Joachimson v Swiss Bank Corporation, Prosperity Ltd v Lloyds Bank Ltd.* and *Ng Cheng Kiat v OUB*. Reasonable notice would mean the banks must give sufficient notice to their customers in order that they can make alternative arrangements and thus, the length of such notice depends on the facts and circumstances of each case. In deposit account contracts entered into between banks and their customers there are specific provisions as to the giving of notices; and these need to be complied with. In this instant case, Bank Besar Bhd failed to notify Mr DK of the closure.

(b) The mistake of crediting the wrong account (i.e. Mr Lucky’s account instead of Mr DK’s account) was due to computer error. As such an error in the system or equipment malfunction and such items are maintained by Bank Besar Bhd, the said bank is liable to make a loss of RM1,800. (BNM/GP 11, para.20) Thus, the bank is liable to repay the RM1,800 to Mr DK.

Alternatively, even though Mr DK’s account had been closed, the Bank has no basis to retain the RM1,800 and Mr DK can make his claim based on money had and received.

(c) The next issue is whether the bank can recover the RM1,800 wrongly paid to Mr Lucky. Section 73 of the Contracts Act 1950 provides that a person to whom money has been paid, or anything delivered, by mistake must repay or return it. However, the Bank may be prevented from correcting its mistake if the customer honestly believes that the entries are correct and alters his or her position in reliance upon them – *Lloyds Bank Ltd v Brooks*.

It is submitted that Mr Lucky would not fall under this exception and so Bank Besar Bhd is likely to succeed in recovering the RM1,800 from Mr Lucky. It is unlikely that the courts will allow a customer to take advantage of an incorrect credit entry – *British & North European Bank v Zalztein*.

(d) The dishonour of the cheque with the reason ‘Account closed’ is defamatory. Applying the case of *Ng Cheng Kiat v OUB*, it appears that the Bank may be sued for damages for breach of contract and libel. Tradesmen generally could recover substantial but reasonable damages whilst non-tradesmen could recover nominal damages unless special loss could be proven. However, courts may be prepared to award substantial damages if there is loss of credit or business reputation – *Kpohraror v Woolwich Building Society*. Here, since Mr DK is the treasurer of the Millionaires Club which is generally perceived by the public as constituting members of substantial means and standing in society. Thus, the bank will be liable for damages for the wrongful dishonour of the cheque.

Question 3

- Most candidates gave correct answers but failed to substantiate them with authorities.
- Part (a) of the question was not well answered by the candidates. Their answers lacked in-depth knowledge about the issues relating to thumbprints as signatures.
- Many candidates gave the wrong penalty for contravention of section 97 of the Banking and Financial Institutions Act 1989.

3. (a) Applying the case Privy Council case, *Chow Yee Wah & Anor v Choo Ah Pat.*, a thumb-printed cheque may be held to be valid so long as when the drawer affix his thumb-print thereon, he had the mental capacity to do so. The mental capacity of a person is a question of fact and is independent of the physical health of a person. Thus, if an existing account-holder, who was recently paralysed, cannot sign as usual on his cheques and thumbprints the cheque, witnessed by his banker who is satisfied as to his mental capacity, the cheque is valid.
- (b) (i) One of the duties of a banker is the duty of secrecy. Under section 97(1) BAFIA 1989, a banker is under a legal obligation to keep secret the affairs of its customers. Bank EC Bhd is bound by this statutory provision not to disclose about the joint account. Otherwise, the maximum penalty for contravention of section 97, BAFIA is 3 years imprisonment or RM3 million fine or both fine and imprisonment.
- (ii) Regarding the payment of a cheque on 13 April 2003, a day after Mr PW's death, section 75 of the Bills of Exchange Act 1949 provides that the bank's authority to pay is determined upon notice of death of the customer. In this instant case, the notice of death was only received by Bank EC Bhd on 15 April 2003, after the debiting of the account. Thus, Bank EC Bhd had rightfully debited the account and would not be liable thereon.

However, since notice of death was received on 15 April 2003, the account should be frozen because of the substantial amount involved. Notice of Mr PW's death has the effect of terminating the banker-customer relationship.

The mentioned account is to be frozen (no more withdrawals to be allowed) until it is operated by the executors (in case Mr PW died testate, i.e. with a will) or the administrators (in case Mr PW died intestate, i.e. without a will) jointly with Mr TW.

Question 4

Candidates managed to define the three types of securities. However, most of them lost marks due to failure in giving proper description of the securities.

4. (a) A debenture is an instrument, usually a deed, issued by a company, as acknowledgement of a debt. Under section 4(1) of the Companies Act 1965, 'debenture' includes "debenture stock, bonds, notes and any other securities of a corporation whether constituting a charge on the assets of the corporation or not".

It may incorporate either a fixed or floating charge, or both, over the company's assets. Fixed charges may cover plant and machinery, including its goodwill and its uncalled capital. In *Re Yorkshire Woolcombers Association Ltd.*, a floating charge is described as a class of assets of a company present and future, which would be changing from time to time and until crystallisation, the company is free to deal with such assets.

- (b) Liens can be created over realty (land) or personalty (e.g. movable goods and chattels). A lien over land is created when the registered owner or lessee, as security for a credit facility, deposits the issue document of title or duplicate lease with the lender who then applies for entry of a lien-holder's caveat. The deposit of the title or lease is usually accompanied by a Memorandum of Deposit of Title which sets out the terms and conditions under which the document is held by the lender.

A possessory lien is the right of a creditor to hold his or her debtor's property until the debt has been satisfied. Possessory liens can either be created by agreement or arise by operation of law. Possessory liens are either general liens (e.g. banker's lien) or particular liens. The essential element of the possessory lien is that the creditor has either physical or legal possession of the goods, and possession must have been lawfully acquired.

- (c) A pledge is a form of possessory security. A pledge involves the delivery of possession of goods by one person (pledgor) to another person (pledgee) as security for a debt or other obligations. Section 125 of the Contracts Act 1950 defines a pledge as "the bailment of goods as security for payment of a debt or performance of a promise."

Question 5

- Many candidates failed to mention the steps and procedures for the perfection of the security documentation. Some candidates could not even state the proper documentation needed or did not know that for titled land, Deed of Assignment is not the proper documentation required.
- Candidates' answers for part (b), which was tested on the legal remedies and loan recovery, were generally good.

5. (a) As security for the RM2 million housing loan, a first party first legal charge over that piece of land can be created. It must be registered (pursuant to the requirements of the National Land Code [NLC]) with the Land Registry or Land Office – section 243, NLC. The charge must be in the statutory prescribed form, together with a Charge Annexure, and has to be duly executed and stamped, and accompanied by the appropriate fees.

As for the term/fixed loan of RM20 million to be granted to LIZZIE Productions Sdn Bhd, the security documentation would be a debenture. The debenture (particulars of the charges) would incorporate fixed and floating charges. A fixed charge would cover the land, building and machinery, including its goodwill and machinery. Here, since the land is owned by Ms EM, the charge over the land would be a third party charge first legal charge since the borrower is LIZZIE Productions Sdn Bhd. The charge also has to be registered with the Registry or Land Office concerned.

Floating charges over the assets of LIZZIE Productions Sdn Bhd are also to be incorporated in the debenture. The debenture would be registered with the Registry of Companies pursuant to section 108, Companies Act.

Although guarantees are strictly speaking not securities, joint and several guarantees can be obtained from the directors of LIZZIE Productions Sdn Bhd. A guarantee is a "contract to perform the promise, or discharge the liability, of a third person in case of his default".

- (b) If there is default in repayment of the above facilities which are secured by charges over land, the Bank has the following remedies:
- right to possession
 - power of sale

The rights of the chargee to enter into possession are provided in sections 271 to 277 of the NLC. Section 253, NLC provides that the provisions of sections 253 to 269, NLC enables the chargee to obtain the sale of the land to which his charge relates in event of breach by the chargor. The application for an order for sale will be made in the High Court (in case of Registry title) or the Land Office (in case of Land Office title).

Enforcement of the debenture is by way of the appointment of a receiver to manage the affairs of the company. The floating charge also would crystallise and the chargor cannot deal with the company's assets anymore. The receiver would get in the assets charged, collect all receipts and to realise the security on behalf of the debenture-holder in discharge of its debt and must discharge the liabilities of the company in the proper order of priorities.

To recover the amounts guaranteed, the Bank can take legal action against the guarantors. A letter of demand will be sent to the guarantor's address given in the guarantee. If there is no response, the Bank can proceed to sue for and prove the debt. The process of enforcement ends with the High Court giving judgment on the liability of the guarantor, after which the Bank may proceed with enforcement via writ of seizure and sale, judgement debtor summons and bankruptcy proceedings.