

DP02

Law on Banking and Finance

12 APRIL 2005

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) (i) Explain the following:
- (aa) Statutory provision relating to banking secrecy.
- Your answer should include the extent and scope of the duty of secrecy, people who are bound by the duty and the duration of the duty. [8]
- (bb) Statutory penalty if there is a breach of duty of secrecy. [2]
- (ii) Describe **five** permitted disclosures and the relevant sections under the Banking and Financial Institutions Act 1989 whereby the duty of secrecy is overridden. [10]
- (b) Mr X, bank manager of Bank AA Bhd, committed an act of criminal breach of trust in Bank AA Bhd involving RM21million. Bank AA Bhd knew that Mr X had deposited the proceeds of his crime in other financial institutions. Bank AA Bhd intends to apply for a *Mareva* injunction in respect of the RM21million.
- Explain what a *Mareva* injunction is and its uses. [5]
- (Total:25 marks)
2. In relation to cheques, answer the following:
- (a) State **two** main duties owed by a customer to his banker. [5]
- (b) (i) State the relevant sections of the Bills of Exchange Act 1949 which give statutory protection to paying banks. [3]
- (ii) Briefly describe the protection accorded by each of the sections identified in (b)(i) above. [7]
- (c) It is a general practice for banks to pre-print the general crossing on cheques with the words "A/c Payee Only" appearing on it between two parallel lines.
- What are the legal effects of this crossing – in particular, whether such a cheque can be transferred or negotiated? [5]
- (d) Briefly describe what a special crossing is. [5]
- (Total:25 marks)
3. Mr MC is an officer with Bank ZZ Bhd. Advise Mr MC on the following issues:
- (a) Would it be advisable for Mr MC to open a joint fixed deposit account for Mr and Mrs B if Mr B was recently adjudged a bankrupt? State the reasons for your answer. [5]
- (b) Would it be advisable for Mr MC to open a savings account for Mr G, a 16 year-old individual, who appears to be mentally unstable? State the reasons for your answer. [5]
- (c) At 1.00pm on 25 March 2005, Bank ZZ Bhd received a telegraphic transfer message from a bank in Germany instructing Bank ZZ Bhd to pay Ms DD a sum of USD1.3million. Ms DD does not maintain any account with Bank ZZ Bhd.
- At 2.45pm on the same day, Ms DD approached Bank ZZ Bhd for the money. Mr MC asked Ms DD for her identification but all that Ms DD could produce was her driving licence. Ms DD said that if she cannot take the cash, she does not mind if the money is deposited into a fixed deposit or a savings account to be opened under her name.
- (i) In attending to Ms DD, should Mr MC be concerned with the compliance of anti-money laundering laws? Give reasons for your answer. [4]

- (ii) State the statutory obligations or duties owed by Mr MC and the penalties for contravention (if any) if Mr MC fails to comply with the anti-money laundering laws. [6]
- (d) In relation to electronic banking, define and explain what a digital signature is. [5]
(Total:25 marks)
4. (a) State **one** main similarity and **one** main difference of a “contract of guarantee” and a “letter of comfort”. [10]
- (b) (i) Explain what a negative pledge is. [2]
(ii) What is the remedy available to a creditor in the event his borrower breaches the terms contained in the negative pledge? [3]
- (c) (i) Briefly explain what floating charges are. [3]
(ii) (aa) What are debentures? [2]
(bb) How are debentures normally enforced? [5]
(Total:25 marks)
5. (a) Explain the type of legal documentation and procedure involved in the creation of a lien over land in Peninsula Malaysia as security for the granting of credit facilities. [5]
- (b) What is the remedy available to a lien-holder (as provided under the National Land Code 1965) in the case of default in repayment of the loan? [5]
- (c) In relation to charges over land in Peninsula Malaysia, explain the following:
(i) Remedies of a chargee [5]
(ii) Discharge of charge [5]
(iii) Transfer subject to charge [5]
(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

- Candidates could not describe the permitted disclosures under the Banking and Financial Institutions Act 1989.
- Candidates were unable to describe the uses of *Mareva* injunction.

1. (a) (i) (aa) The statutory provision in Malaysia which imposes the duty of secrecy on bank officers concerning their customers' affairs is section 97 of the Banking and Financial Institutions Act 1989 (BAFIA). The duty is imposed on the directors and officers of all licensed institutions, which include merchant banks, finance companies and discount houses. The term "officer" is defined in section 2 of the BAFIA to include all employees.

This obligation is binding on the directors and officers even after they have left the employment of the licensed institution. This secrecy provision covers external bureaus and agents which are established or appointed by licensed institutions to undertake any part of their business. Section 97(1) also prohibits any person with any reason, by any means access to records, books, registers, correspondences or other documents or materials relating to the affairs or in particular, the account of bank customers, from divulging banking secrecy.

Section 97(3) BAFIA provides that a person who has any information or document, which to the person's knowledge has been disclosed in contravention of section 97(1) should not disclose it to any other person. However, according to section 97(2) BAFIA the duty of secrecy will not apply where the information was lawfully made available to the public from a source other than the licensed institution.

- (bb) The statutory penalty for breach of banking secrecy is a maximum penalty of three years' imprisonment or a RM3million fine or both.

- (ii) Five of the permitted disclosures under BAFIA are:

- disclosure to facilitate performance of Bank Negara Malaysia's (BNM) functions – section 98
- where the customer or the customer's personal representative has given permission in writing to disclose – section 99
- when the bank is served with a garnishee order – section 99
- in the course of any criminal or civil proceedings between the licensed institution and its customers or their guarantors or between the licensed institution and two or more parties making adverse claims to money in a customer's account – section 99
- when BNM gives written authorisation to disclose – section 99 (1)(i)

Note : Other permitted disclosures as listed in the study manual page 2-32 and 2-33 are also acceptable answers.

- (b) A *Mareva* injunction is an *ex parte* or interlocutory injunction granted by the court to restrain the defendant or third parties from removing assets from or within the jurisdiction pending trial or further orders.

The defendant might want to transfer the assets out of the jurisdiction so that they would not be available to the plaintiff if his or her claim succeeds. It may also be granted to prevent a defendant from dissipating his or her assets in order to defeat any judgment awarded against the defendant – *Mareva Compania Naviera SA v International Bulkcarriers SA* and *Aspatra Sdn Bhd & 21 others v Bank Bumiputra Malaysia Bhd & Anor*.

Question 2

Candidates could not state the relevant sections which gives statutory protection to paying bankers and also were unable to describe the protection accorded by each section.

2. (a) 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 customers 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*.

- (b) (i) - Section 60 of the Bills of Exchange Act 1949
- Section 80 of the Bills of Exchange Act 1949
- Section 82(2) of the Bills of Exchange Act 1949

(ii) - Section 60 of the Bills of Exchange Act, 1949
This section provides that “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 the banker 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 of the Bills of Exchange Act 1949
This section 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(2) of the Bills of Exchange Act 1949 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.”
- (c) Section 76 of the Bills of Exchange Act 1949 provides *inter alia* that a general crossing is constituted by “... two parallel transverse lines with or without the words ‘not negotiable’”. The legal effect of a generally crossed cheque is that it cannot be paid over the counter but must be banked into an account. Due to the addition of the words “account payee”, by virtue of section 81A of the Bills of Exchange Act 1949, the cheque shall not be transferable, but shall only be valid as between the parties thereto. Where a cheque is not transferable, it also is not capable to be negotiated.
- (d) A special crossing is constituted by the addition across the face of a cheque the name of a banker, either with or without the words “not negotiable”.
 - Section 76(2), Bills of Exchange Act 1949.

Question 3

- Candidates could not give the statutory obligations and the penalties for contravention in respect of the anti-money laundering laws.
- For “problem-type” questions, candidates have to identify the issues and support their answers with facts.

3. (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 1967 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 an undischarged bankrupt vest in the Official Assignee and bankers are required to pay the same to the Official Assignee.

Thus, Mr MC is advised not to open the joint account since Mr B is an undischarged bankrupt.

- (b) Although Mr G is a minor (below the age of 18 – section 2, Age of Majority Act 1971), banks do allow minors to open savings accounts for minors of the age of 12 and above (with an identification card). However, there is the problem of mental capacity of Mr G. 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 terminology “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 Mr MC to open the account for Mr G.

- (c) (i) Bank ZZ Bhd being a commercial bank licensed under BAFIA 1989 is one of the reporting institutions as defined in section 3 of the Anti-Money Laundering Act 2001 (AMLA). As the Ringgit, equivalent of USD1.3million, 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), Mr MC should insist on the proper identification documents before paying Ms DD.

Moreover, the bank has to avoid liability for money-laundering or abetting money laundering which are offences under section 4 of AMLA punishable with the maximum sentence (upon conviction) of five years’ imprisonment or a fine of RM5million or to both such fine and imprisonment. Section 5 of AMLA requires disclosure of section 4 contravention on Mr MC’s own initiative as soon as reasonably possible.

- (ii) Under section 13 of 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 of 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, the bank is to verify by reliable means and record identifying information by using the IC or passport, etc. as required under section 16, AMLA. Although a driving licence is stated as one of the identification documents, it was submitted that the production of a driving licence alone is insufficient.

According to section 86 of AMLA, there is a general penalty of a maximum fine of RM250,000. 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 RM1million or a jail term of one year or both.

- (d) 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, a pair of keys known as the private key and the public key are created. 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 is 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 the message 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.

Question 4

- Candidates were unable to state the main similarity and main difference of a letter of comfort.
- Candidates were unable to state the remedy available to a creditor if the borrower breaches the terms in a negative pledge.
- Candidates are advised to support their answers with statutory provisions and cases.

4. (a) Section 79 of the Contracts Act 1950 defines a contract of guarantee as “a contract to perform the promise, or discharge the liability, of a third person in case of his default” whereas, a letter of comfort (or letter of awareness, as they are sometimes called) are usually given when the company or entity is unable or unwilling to provide a guarantee, but is prepared to offer ‘comfort’ to a lender in the form of an assurance of its continuing interest in or commitment to the relevant debtor.

Guarantees are governed by the Contracts Act 1950. Both the guarantee and the letter of comfort are strictly speaking not securities. Practically, the guarantee is only as good as the person giving it.

Guarantees can be enforced by suing the guarantor upon default by the principal debtor. The enforceability of a letter of comfort depends very much on the facts of the case – in particular the wordings. In *Banque Brussels Lambert SA v Australian National Industries Ltd*, the court held that one of the letters of comfort given by the defendant was legally binding.

- (b) (i) A negative pledge is basically a legally binding promise by a borrower, such as a company, to a lender that it would not create any security over its assets in favour of another creditor or to incur additional indebtedness. The stringency of the terms of the negative pledge, which depends on the words used in the document, largely hinges on the bargaining powers of the parties.
- (ii) If the borrower breaches the “negative pledge”, the creditor can only enforce contractual rights (according to the wording of the document) against the borrower. The creditor can only sue for damages for breach of contract.

Usually, the loan documentation would have stipulated that breach of the negative pledge constitutes an event of default of the loan. The creditor can then recall the credit facility and demand for repayment. The creditor may also seek injunctive relief if there is a breach or a threatened breach of the debtor's covenant contained in the negative pledge.

- (c) (i) The essential characteristics of a floating charge were described in *Re Yorkshire Woolcombers Association Ltd*:
- It is a charge on a class of assets of a company present and future
 - The class is one which, in the ordinary course of the business of the company, would be changing from time to time
 - By the charge, it is contemplated that, until some future step is taken by or on behalf of those interested in the charge, the company may carry on its business in the ordinary way as far as concerns the particular class of assets.

The advantage of taking a floating charge is that the chargor can deal with the assets subject to the charge as long as the charge has not crystallised. Otherwise, it would be cumbersome if the chargor had to get the assets released as security whenever it wants to trade in them.

- (ii) (aa) 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.
- (bb) The enforcement of a debenture is by way of appointing a receiver and manager to manage the affairs of the company. 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. – *Kimlin Housing Development Bhd v Bank Bumiputra Malaysia Bhd*.

Additional point/issue:

The Court of Appeal in *Melantrans Sdn Bhd v Carah Enterprise Sdn Bhd* (2000) 3 MLJ 304 distinguished or qualified the *Kimlin*'s case by stating that before the company is wound up and prior to obtaining the order for sale of the charged property, the receiver or manager as agent of the company may sell the charged land by private treaty so long as the consent of the debenture holder is obtained.

Question 5

- Candidates showed poor understanding of lien and remedies for default of repayment of loan.
- Candidates could not explain the transfer subject to charge.

5. (a) A lien over land is a non-registrable interest in land – section 206(2)(b), National Land Code 1965 (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(1), NLC.

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 would 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.

- (b) The remedy given to the lien-holder under the NLC is that of judicial sale. Under section 281 of the NLC, after the lien-holder has obtained judgment, the lien-holder may apply to the court for an order of sale.

- (c) (i) The most commonly resorted to 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; and, in the case of land held under Land Office title, to the Collector of Land Revenue.

The other remedy is the right to possession. However, this right is expressly limited to charges over land 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.

- (ii) Discharge of charge is when a chargee, by an instrument in prescribed form, discharges the land or lease to which the charge relates. The discharge takes effect upon registration of the instrument. Upon full settlement, the chargor has the statutory right to apply to the Registrar to discharge the charge by way of cancellation of the charge. Once all charges are discharged, the land is unencumbered.

- (iii) A transfer is one of the types of dealings. According to the NLC, all transfers need to be registered in order to be accorded indefeasibility. Although the transfer is registered by registration of an instrument in prescribed form, it will be subjected to the prior registered interest of the existing chargee. Transfer subject to charge means that the chargee would have consented to the transfer but after the transfer, the transferee is also bound by the charge. Where there is a transfer subject to charge, only covenants running with the land (and not personal covenants) in the existing charge are binding as the transferee – section 216, NLC.