

DP02

Law on Banking and Finance

11 OCTOBER 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) Describe the main components of the Malaysian financial system and state the types of businesses they do. Your answer should also include the various statutes which directly regulate them and the financial services they provide. [10]
- (b) (i) One of the duties owed by bank employees is the duty of secrecy. Bank employees are legally bound to keep their customers' affairs and accounts secret.
State the exceptions/permitted disclosures to this duty of secrecy. [10]
- (ii) Sally is a teller employed by Bank Tahu Bhd.
(aa) Is Sally bound by the duty of secrecy with regard to the affairs and accounts of Bank Tahu Bhd's customers? Give a reason for your answer. [3]
(bb) Would your answer to (ii)(aa) above be different if Sally has already resigned or retired from Bank Tahu Bhd? Give a reason for your answer. [2]
(Total:25 marks)
2. (a) On 14 April 2005, Annie issued an "account payee" crossed cheque for a sum of RM8,000 payable to Kamarudin. The cheque was dated 14 May 2005. On 7 May 2005, Annie countermanded the said cheque by giving a written "payment stop" instruction to Bank ISO Bhd (the drawee bank).
On 10 May 2005, Kamarudin banked in the cheque for the credit of his account at Bank BC Bhd and Bank BC Bhd sent the cheque for clearing. Bank ISO Bhd paid the cheque on 12 May 2005 as there was sufficient funds in Annie's account. Bank BC Bhd duly credited Kamarudin's account. On 13 May 2005, Kamarudin withdrew RM8,000 from his account.
Discuss the liabilities of Bank ISO Bhd and state whether Bank ISO Bhd can recover the RM8,000 from Kamarudin. [15]
- (b) In relation to electronic banking, define and explain the following:
(i) Electronic funds transfers [5]
(ii) Digital signature [5]
(Total:25 marks)
3. (a) In the case of death of a customer, banks sometimes deal with the customer's personal representatives.
(i) Explain who "personal representatives" are. [5]
(ii) What does the bank require when opening an account for personal representatives? [10]
- (b) Your financial institution in which you work as an officer was served with a garnishee order affecting Datuk Kacak's accounts maintained in your financial institution.
(i) What is a garnishee order and what is it used for? [5]
(ii) Briefly explain what your financial institution should do when served with the garnishee order. [5]
(Total:25 marks)

4. (a) Jamal is the payee of a crossed cheque which had the preprinted words "A/c Payee" appearing on it between two parallel lines.
- What are the legal effects of this crossing – in particular, whether such a cheque can be transferred? [10]
- (b) In relation to charges over land in Peninsula Malaysia, explain the following:
- (i) Indefeasibility of interest of the chargee [5]
 - (ii) Discharge of charge [5]
 - (iii) Transfer subject to charge [5]
- (Total:25 marks)
5. (a) (i) What are debentures? [5]
- (ii) How are debentures normally enforced? [5]
- (iii) State the factors a lender would take into account when taking debentures as security. [5]
- (b) Bank Pinjam Bhd granted an overdraft facility of RM100,000 to Mr P. The facility is secured by a charge over a landed property to Bank Pinjam Bhd. Bank Pinjam Bhd came to know that Mr P was just adjudicated a bankrupt and the bank recalled the overdraft facility.
- (i) State the options or courses of action available to Bank Pinjam Bhd with regard to recovery of the security and the debt. [8]
 - (ii) Which of these options in (b)(i) above should Bank Pinjam Bhd take? [2]
- (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

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.

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.

The various statutes which directly regulate them and the financial services they provide include:

Any three of the following:

- Central Bank of Malaysia Act 1958 (Revised 1994).
- Banking and Financial Institutions Act 1989.
- Islamic Banking Act 1983.
- Offshore Banking Act 1990, Offshore Companies Act 1990, Offshore Insurance Act 1990, Labuan Trust Companies Act 1990, Labuan Offshore Business Tax Act 1990 and Income Tax (Amendment) Act 1990.
- Exchange Control Act 1953.
- Insurance Act 1996.

(this list is not exhaustive)

- (b) (i) The exceptions/permitted disclosures to this duty of secrecy are as follows:
Section 98 permits disclosure for facilitating performance of the functions of BNM, so that any information or document may be disclosed to the following:
- BNM.
 - Any director or employee of BNM.
 - BNM's appointee.
 - The Advisory Panel.
 - Professionals (such as lawyers, accountants and valuers) authorised in writing by BNM to obtain such information.

Section 99(1) provides for other permitted disclosures such as:

- where written permission to disclose is given by the customer or his personal representative.
- where the customer is declared bankrupt, or if the customer is a corporation and the corporation is being or has been wound up within or outside Malaysia.

- where the information is required by a party to a *bona fide* commercial transaction, or to a prospective *bona fide* commercial transaction, to which the customer is also a party, to assess the creditworthiness of the customer relating to such transaction, provided that the information required is of a general nature and does not enable the details of the customer's account or affairs to be ascertained.
 - for the purposes of any criminal proceedings or in respect of any civil proceedings
 - between a licensed institution and its customer or his guarantor relating to the customer's transaction with the institution; or
 - between the licensed institution and two or more parties making adverse claims to money in a customer's account where the licensed institution seeks relief by way of interpleader;
 - where the licensed institution has been served a garnishee order attaching monies in the account of the customer.
 - to an external bureau established, or to an agent appointed, by the licensed institution with the prior written consent of BNM.
 - where such disclosure is required or authorised under the BAFIA.
 - where such disclosure is authorised under any Federal law to be made to a police officer investigating into any offence under such law, such disclosure to the police officer being, in any case, limited to the account and affairs of the suspect.
 - where such disclosure is authorised in writing by BNM.
- (ii) (aa) Yes. Section 97 of the Banking and Financial Institutions Act 1989 (BAFIA) imposes the duty of secrecy on bank officers concerning their customers' affairs. 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 BAFIA to include all employees. Therefore, this obligation binds Sally as a teller in Bank Tahu Bhd.
- (bb) My answer would still be the same even if Sally has already resigned or retired from her job at Bank Tahu Bhd as she is bound during her employment "or thereafter".

Question 2

- Candidate were unable to cite the relevant statutory provisions and case in relation to recovery of money paid by mistake.
- Candidates should answer the question according to marks allocated.

2. (a) The cheque concerned is a post-dated cheque and therefore, the drawee bank (Bank ISO Bhd) should not have paid the cheque. Section 13(2) of the Bills of Exchange Act 1949 provides *inter alia* that a cheque is not invalid merely because it is post-dated.

Annie had countermanded the payment before the stated date of the cheque. Here again, Bank ISO Bhd had no authority to pay the cheque. Section 75 of the Bills of Exchange Act 1949 provides that a banker's authority to pay on a cheque is determined upon countermand.

Bank ISO Bhd is, therefore, liable to credit back the amount of RM8,000 which was wrongfully debited from Annie's account. Bank ISO Bhd has thus paid the cheque by mistake.

Bank ISO Bhd is entitled to recover the money (RM8,000) from the payee (Kamarrudin). 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.

A case on point is *Bank Bumiputra (M) Berhad v Hashbuddin Hashim* where the Bank overlooked an oral countermand and paid a cheque. The Bank succeeded in recovering from the payee under section 73 of the Contracts Act 1950 and under "money had and received".

Additional issues which may be argued in the answer:

- *However, the payer (Bank ISO Bhd) may not be able to recover such money paid by mistake if it is estopped from doing so. For example, if or where the payee was misled and had acted upon the misrepresentation of the payer and had changed its position in good faith – section 115, Evidence Act. Based on the facts of this instant case, it does not appear that this issue of estoppel had arisen.*
- *Effective 2 January 2001, The Association of Banks in Malaysia (ABM) has implemented certain rules including the rule on post-dated cheques. Whilst it is questionable whether Bank BC Bhd could be asked to contribute towards the liabilities of Bank ISO Bhd, the ABM rules require Bank BC Bhd to charge the payee of the cheque a RM10 charge.*

(b) (i) The four main areas of electronic funds transfers are:

- Consumer Electronic Banking:
 - ATM.
 - EFTPOS.
 - Telephone/screenphone banking.
 - Internet banking.
 - Home/office banking.
- Corporate Electronic Banking:
 - Financial EDI.
 - Netting arrangements.
- Interbank Electronic Banking:
 - RENTAS.
 - SWIFT.
- Products (plastic cards):
 - SMART cards.
 - Debit cards.
 - Credit cards.
 - Charge cards.

For purposes of BNM/GP 11, electronic fund transfer means fund transfers carried out through or by means of:

- telegraphic transfer.
- point-of-sale terminal.
- stored value card terminal.
- cash dispensing machine.
- cash deposit machine.
- telephonic instruments.
- debit card.

However, the term “electronic fund transfer” (for purposes of BNM/GP11) does not include:

- any cheque or authorisation service which does not directly result in a debit or credit to a customer’s account; or
- any automatic transfer from a savings account to a current account and vice-versa pursuant to an agreement between a customer and a financial institution.

- (ii) 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 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.

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.

Question 3

- Candidates were not able to state the bank’s requirement for opening an account for personal representatives.
- Candidates were unable to state the application of the relevant legal principles. They should know the legal principles as well as how to apply these principles in practise.

3. (a) (i) Personal representatives are usually the next-of-kin of a deceased customer and they comprise both executors and administrators. Executors are normally appointed by will and administrators are appointed by the court in cases of intestacy. On notice of death, the banker normally freezes the deceased customer’s account. If the deceased died without a will there will be an application for Letters of Administration. Where there is a will, a Grant of Probate will be applied for.

- (ii) When opening an account for personal representatives, the banker must insist on the production of the original Letters of Administration or Grant of Probate. The banker then should instruct its lawyers to make a search to ascertain that the documents are genuine. Only after confirmation should the banker proceed to open an account for them and allow them to operate the account of the deceased customer.

However, banks are permitted to make disclosures on the account of the deceased to personal representatives prior to them obtaining Grant of Probate or Letters of Administration – section 99(1)(a), Banking and Financial Institutions Act 1989.

In the absence of any express provision (in the Letters of Administration or Grant of Probate) any one executor or administrator can operate the executorship or administration account. Thus, the banker has to scrutinise the Letters of Administration or Grant of Probate accordingly.

Although one executor or administrator may act to bind the estate, in respect of opening of accounts by joint executors or administrators, banks usually require both or all (if more than two) to sign or operate the account so as to ensure that, should there be any overdrawing, all the joint executors or administrators can be held personally liable.

- (b) (i) A garnishee order is a court order obtained by a judgement creditor attaching funds in the hands of a third party who owes money to the judgement debtor. Garnishee order is a post judgement order and is one of the modes of execution of judgements as provided under Order 49 of the Rules of the High Court 1980. – *Choice Investments Ltd v Jeromnimon; Midland Bank Ltd (garnishee)*.
- (ii) As soon as a garnishee order is served, the financial institution should freeze the entire balance standing to the credit of the customer's account unless the order directs otherwise. The financial institution would then instruct its lawyers to attend the hearing relating to the garnishment. At the hearing, the court would either direct that the garnishee order be discharged (where there are reasons why the money should not be paid to the judgement creditor) or be made absolute. If the order is made absolute, the bank would then proceed to pay the sum stated in the order to either the judgement creditor or the court.

Question 4

- Candidates did not cite section 81A, Bills of Exchange Act 1949 in their answers.
- They could not explain the transfer subject to charge.

4. (a) The type of crossing is a general crossing with the words “account payee”. Section 76 of the Bills of Exchange Act 1949 provides 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.

Because of 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.

- (b) (i) Indefeasibility of interest of the chargee means that subject to limited exceptions (such as fraud, forgery or misrepresentation, etc. provided in section 340(2) National Land Code), the registered chargee is shielded from attacks against his or her interest in land – section 340, National Land Code. Cases on point include *Development & Commercial Bank v Che Wan Development Sdn Bhd & Ors.* and *Tai Lee Finance Co Sdn Bhd v Official Assignee & Ors.*
- (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) 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. A transfer is

one of the types of dealings. According to the National Land Code 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 subject to the prior registered interest of the existing chargee.

Question 5

Candidates were not able to state the options or courses of action available to a banker in relation to recovery of security and debt.

5. (a) (i) Debentures are instruments, usually deeds, issued by a company, as acknowledgment of a debt. Debentures include “debenture stock, bonds, notes and any other securities of a corporation whether constituting a charge on the assets of the corporation or not. – section 4(1), Companies Act 1965.

It may incorporate either a fixed charge or a floating charge or both.

- (ii) The enforcement of debentures are by way of appointing a receiver and a 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 done 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 Berhad*.

Additional points/issues:

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. This was followed by a ruling by the Federal Court, (2003) 2 MLJ 193.

- (iii) The factors that a lender takes into account include:
- whether the company has the legal capacity to issue debentures.
 - whether there are any limits imposed by the articles of association.
 - whether there are any other debentures that have been issued and registered
 - the nature of the assets charged and their respective values.

- (b) (i) The options available to Bank Pinjam Bhd are:
- rely on the security and not prove for the debt. Proof of debt is a formal procedure to establish that a debt is due from the bankrupt’s estate.
 - rely on the security and prove for the balance not realised under the security.
 - surrender the security and prove for the whole debt.
 - estimate the value of the security and prove for the balance.
- (ii) Under normal circumstances, Bank Pinjam Bhd is expected to take the second option; that is, rely on the security and prove for the balance not realised under the security.