

DP02

Law on Banking and Finance

9 MAY 2000

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**.

ANSWER FOUR (4) QUESTIONS ONLY

1. (a) Describe what an Islamic bank is and state whether the provisions of the Banking and Financial Institutions Act 1989 apply to Islamic banks. [5]
- (b) Mary Foo has recently attended a training programme conducted by Bank Sedia Bhd. During the programme, Mary Foo was trained on how excellent customer service could be provided to customers.

Assuming that you are Mary Foo's supervisor, advise her, by citing reasons for your answers, whether the following are Bank Sedia Bhd's customers:

- (i) Harris, who does not maintain any account with Bank Sedia Bhd, presented a "cash" cheque for encashment over the bank's counter. [2]
- (ii) Mr Ken Donald, who does not maintain any account with Bank Sedia Bhd, purchased foreign currencies from the bank. [2]
- (iii) Kewangan Kekal Bhd, a finance company, regularly deposited cheques for collection or clearing with Bank Sedia Bhd. [2]
- (c) From the stand point of the legal position or requirements relating to or expected of a bank, give any **two** reasons to explain why it is important for a bank to be able to ascertain whether any person dealing with the bank is or is not a customer of the bank. [4]
- (d) Samy is a current account customer of Bank AB Bhd. Samy is angry with Bank AB Bhd as he claimed that the bank had wrongfully returned his RM300 cheque with the reason "account closed" when there was a credit balance of RM350 in his account.

Bank AB Bhd alleged that Samy's account was closed based on his telephone conversation with the manager of the bank, instructing him to do the same. A cashier's order for RM350 made in Samy's favour was posted to him recently. Samy denied having had such conversation with the manager of Bank AB Bhd.

Samy threatens to sue Bank AB Bhd. Advise Bank AB Bhd as to their liabilities, if any. [10]
(Total:25 marks)

2. (a) Mr Wai, Mr Yu, Mr Tee and Ms Poo Mee are partners in a legal firm, M/s Wai, Yu, Tee, Poo Mee & Co. The legal firm is now claiming against Bank IDK Bhd as constructive trustee of monies misappropriated by **two** of their partners (Mr Tee and Ms Poo Mee) from the legal firm's clients' account. The **two** partners had used the misappropriated funds for speculation in the stock market and gambling.

The legal firm alleged that the branch manager of Bank IDK Bhd had reasonable grounds to suspect that the clients' account was operated fraudulently as there were numerous "cash" cheques drawn on that account encashed by Mr Tee and Ms Poo Mee themselves. The legal firm alleged that the branch manager of Bank IDK Bhd had never informed the other partners of the legal firm nor did he make any inquiries into the proprietary of the cash withdrawals. Mr Tee and Ms Poo Mee have since absconded.

Advise Bank IDK Bhd on their liability, if any, as constructive trustee. [10]

- (b) **One** of the duties of the paying banker is to honour its customer's payment orders or instructions. However, under certain circumstances, the paying banker is entitled to refuse making such payments.

State and explain **three** of the instances (citing examples) when a paying banker can refuse to obey its customer's payment orders or instructions. [15]

(Total:25 marks)

3. (a) In relation to company law, explain the rule in *Turquand's* case. [10]

(b) Mr X makes a cheque deposit into his current account maintained in Bank BC Bhd. The cheque deposited was drawn by Mrs F and the drawee bank was Bank DE Bhd.

State the main duties and liabilities of Bank BC Bhd as the collecting bank and discuss whether Bank BC Bhd is accorded any statutory protection in relation to such liabilities. [15]
(Total:25 marks)

4. (a) Give the meaning of the term "electronic fund transfer" as defined in the Banking and Financial Institutions Act 1989 (BAFIA), and write a brief note on other provisions of BAFIA relevant to electronic fund transfers. [15]

(b) Bank KB Bhd granted an overdraft facility of RM35,000 to Mr Soh on unsecured basis. Mr Soh's sister, Ms Eileen Soh, was to be the guarantor. As Mr Soh is well known to some officers of Bank KB Bhd, the credit officer trusted Mr Soh and gave him the Letter of Guarantee and the letter of waiver in respect of the "BNM Guideline for Lending Institutions Accepting Guarantee for a Credit Facility" for Ms Eileen Soh's signature.

Although Ms Eileen Soh is a millionaire, she is illiterate and cannot read and write. Mr Soh told her that the documents she is signing are documents for the Inland Revenue Department in relation to her appeal concerning tax assessment.

Bank KB Bhd disbursed the facility after the signed Guarantee documents were returned to them and were duly stamped. **Two** years later, Mr Soh went into financial difficulties and defaulted in repayment of the facility. Mr Soh is now a bankrupt. Ms Eileen Soh received a letter of demand from Bank KB Bhd but could not understand the contents.

Assuming you are Ms Eileen Soh's neighbour and she asked you for advice on whether she has any defence to Bank KB Bhd's claim, what would your advice be? [10]

(Total:25 marks)

5. (a) Bank WWW Bhd is the registered chargee of a piece of land in Kuala Lumpur owned by PPB Sdn Bhd. Under the National Land Code 1965, the charge in Bank WWW Bhd's favour is indefeasible.

What are the exceptions to this indefeasibility provided in the National Land Code 1965? Define and explain the meaning of each exception. [10]

(b) Companies sometimes agree to create debentures incorporating fixed and floating charges over their assets as a form of security. Explain the nature and the meaning of the terms "debenture" and "fixed and floating charges" as used in this context. [15]

(Total:25 marks)

OUTLINE ANSWERS

Question 1

Almost all the candidates performed well in this question, which required them to describe an Islamic bank. However, when they were asked to state whether the provisions of Banking and Financial Institutions Act 1989 apply to Islamic banks, many failed to support their answers with relevant statutory provisions.

1. (a) An Islamic bank is a person (a company) carrying on Islamic banking business, that is, “banking business whose aims and operations do not include any element which is not approved by the religion of Islam.” – section 2, Islamic Banking Act 1983. Islamic banks need to be licensed under the Islamic Banking Act and they conduct their banking business in line with Islamic principles.

The Banking and Financial Institutions Act 1989 (BAFIA) does not apply to Islamic banks. Islamic banks are regulated by the Islamic Banking Act 1983.

- (b) (i) Harris is not a customer of the Bank. As the Bank is merely rendering a casual service to Harris, that is, cashing a cheque, Harris is not the Bank’s customer – *Great Western Railway Co. v London and County Banking Co. Ltd.* Customers must have some sort of account with the Bank or at least enter into some contractual relationship with the Bank, for example, walk-in customers requesting the Bank to remit monies or exchange currencies, etc.
- (ii) It is submitted that Ken Donald is a customer of the Bank although he does not maintain an account with the Bank. He has entered into a banker-customer relationship by entering into the contract for the exchange of currencies. However, he is the Bank’s customer for the duration of that transaction only.

Duration of the relationship is not important – *Commissioners of Taxation v English, Scottish and Australian Bank Ltd.* and *Oriental Bank of Malaya v Rubber Industry (Replanting Board)*. In *Kehar Singh v Standard Chartered Bank*, a person entering into a contract for the purchase of a bank draft was treated by the Court as a customer and the Bank was held to owe a duty of care towards him.

- (iii) Kewangan Kekal Bhd is a customer of the Bank. A bank may be another bank’s customer. In *Importers Company Ltd. v Westminster Bank Ltd*, it was stated by Atkin LJ that if a non-clearing bank regularly sends cheques to a clearing bank for clearing, the former is a customer of the latter.
- (c) From the legal perspective, it is important to know who are the Bank’s customers and who are not. Firstly, the Bank owes various duties and legal obligations towards their customers, such as the duty of secrecy and confidentiality.

Banks also enjoy certain privileges such as statutory protection under the Bills of Exchange Act 1949 when collecting cheques on behalf of customers.

- (d) As a general rule, a customer is not obliged to give the bank any prior notice of his or her intention to close an account. In the case of a current account, the customer may close the account simply by demanding repayment of the credit balance. However, in practice, the current account agreement might have specified that notice is required.

If the bank manager had indeed closed the account based on a telephone conversation, it is submitted that it was inadvisable to do so. This is because the customer can dispute as to whether there was such an instruction – as, indeed, is happening now. It is advised that the Bank should have insisted for written instructions to close the account or at least, for the customer to indicate his intention in writing, such as issuing a cheque payable to “Self – to close account”. This will avoid loss to the bank in any event of dispute.

In *Wilson v Midland Bank Ltd*, where the facts are similar to this instant case, the Bank was ordered to pay damages to the customer for libel and breach of contract. This is because the words “no account” are defamatory and the Bank had breached a term in the contract with its customer, that is, that the Bank must honour cheques drawn on their customers’ accounts provided there are sufficient funds and the cheques are regularly drawn.

In *Ng Cheng Kiat v Overseas Union Bank* where the Bank did not give notice to its customer before closing his account and cheques drawn were returned “account closed”, the Bank was held liable for damages for libel and breach of contract. Reasonable notice must be given to the customer before closing a customer’s account which is in credit – *Prosperity Ltd v Lloyds Bank Ltd*.

Question 2

The first part of the question, on “constructive trustee”, was poorly attempted by most candidates. These candidates did not understand the term “constructive trustee”. Candidates however, performed better for the second part of the question. Here, candidates were required to explain instances when a paying banker can refuse to obey its customer’s payment orders or instructions.

2. (a) As the account is a clients’ account, the Bank knows that its customer, the legal firm, is holding the money in trust. Thus, the Bank should not part with the money for any purpose which is inconsistent with the trust, even on instructions of the customer. Otherwise, the Bank could be held by the Court to be a party to a breach of trust and be regarded as a constructive trustee.

There are four elements that must be proven before the Bank can be held liable as a trustee:

- (i) the existence of a trust or other fiduciary relationship;
- (ii) a breach of trust, even if innocent, by the trustee or the person under the fiduciary duty;
- (iii) assistance by the bank in the breach of trust; *and*
- (iv) dishonesty on the part of the bank.

The Privy Council case, *Royal Brunei Airlines v Philip Tan*, is the case on the above principles. This case replaced the principle of “knowing assistance” (as laid down in *Barnes v Addy* and followed by *Lipkin Gorman v Karpnale Ltd* and *Lloyds Bank plc.*) with “dishonest assistance”.

Applying the above, it appears that whether Bank IDK Bhd will be held liable as constructive trustee would depend on the facts. If the four elements stated above are proven, then the Bank will be held liable. Otherwise, the Bank will not be.

If it is found as a fact that the cheques drawn by the partners of the legal firm are drawn in suspicious circumstances or are out of the ordinary, it is likely that the Bank may be held liable. If not, the Bank owes no duty to the clients of the solicitors in relation to all drawings under the account.

- (b) Generally, a banker is obliged to honour its customer’s payment orders or instructions. However, this duty is imposed provided the following conditions are met:
- (i) The customer has sufficient available funds;
 - (ii) The cheque is in regular and unambiguous form; *and*
 - (iii) The banker’s authority to pay must not have been determined and there must be no legal bars to payment.

First, the balance in the customer’s account must be sufficient to meet any cheque drawn by the customer, or there are available funds to meet the cheque on the basis of an agreed overdraft granted by the bank. The funds in the customer’s account must be sufficient and

available. Available funds refer to cleared funds less funds earmarked for any specific purpose, for example, current account balances earmarked against letters of credit or banker's guarantees issued by the bank.

For example, if Mr X issues a cheque for RM1 000 when the available balance in his account is only RM60, his banker can dishonour the cheque if the overdrawing is not permitted by the banker.

Secondly, the cheque must be regular and unambiguous in form. The cheque must not only be signed by the customer in accordance with his or her signature, but the name of the payee, the date and amount of the cheque must be clearly written on it. Since the bank is not obliged to take any unusual risks, it can postpone payment if the cheque is not properly drawn.

For example, the paying banker may refuse to honour a cheque where the amount in words and figures differ.

Thirdly, the banker's authority to pay must not have been determined and there must be no legal bars to payment. The customer must not have countermanded payment, or the customer's mandate must not have been determined by events such as notice of death, bankruptcy or winding-up or mental incapacity of the customer. If the bank has notice of any Mareva injunction or garnishee order or any other court order restraining the customer from operating the account, the bank should refuse payment. The bank also may refuse payment of a cheque if it has knowledge of any defect in title of the person presenting it for payment, for example, when it is a stolen cheque.

An example would be that a banker could return the customer's cheque once it has notice that the customer has died. In such circumstance, even though the account has available funds, the bank may return the cheque as "Customer deceased." This is provided for under section 75 of the Bills of Exchange Act 1949.

Question 3

The explanation of the rule in *Turquand's* case was generally weak. Candidates, however, performed well when they were required to state the main duties and liabilities of a collecting bank. Some candidates, however, lost marks when they failed to discuss the statutory protection for the collecting banker.

3. (a) The rule in *Turquand's* case is also known as the 'indoor management rule'. This rule originated from the case, *Royal British Bank v Turquand*. In this case, the Articles of Association provided that the company may borrow such amounts of money as authorised by a resolution passed at a general meeting of the company. The company borrowed £2000 from the bank and gave the latter a bond, under seal, and signed by two directors. However, no resolution was passed to authorise the borrowing. Subsequently, the company went into liquidation and Turquand, the liquidator, argued that the loan contract was void as the directors had no authority to borrow. The Court held that the company was bound, as a third party was entitled to assume that the internal procedures prescribed by the articles had been properly carried out.

The rule in *Turquand's* case is that "Persons contracting with a company and dealing in good faith may assume that acts within its constitution and powers have been properly and duly performed, and are not bound to inquire whether acts of internal management have been regular." A third party is, therefore, able to make certain assumptions such as the directors were duly appointed and have the authority such persons normally have, or the document was properly sealed if it bears an impression of a seal and is attested by two directors. In other words, the effect of the rule is to prevent a company from pleading procedural irregularity as a ground for avoidance of an *intra vires* transaction.

- (b) The main duties of Bank BC Bhd as collecting bank are:

- (i) to use reasonable care and diligence when presenting and securing payment of cheques (for example, if the Bank fails to send the cheque collected for the next available clearing).
- (ii) to give prompt notice to its customers if the cheques that they have deposited are dishonoured.

The main liability of the collecting banker is that it may be liable to the true owner of the cheque if it opened an account negligently and collected the cheque negligently. The Bank may be sued for negligence, conversion, for money had received and/or breach of trust. Thus, if a person who is not entitled to a cheque presents it to the bank for collection and subsequently absconds with the proceeds, the true owner of the cheque may initiate a claim in conversion and negligence – *UMBC v Kek Tek Huat*.

Bank BC Bhd is entitled to the statutory defence under section 85 of the Bills of Exchange Act 1949. Where a banker, in good faith and without negligence, receives payment of a cheque for a customer with no title or a defective title, the banker will not incur any liability to the true owner. However, even if the Bank has acted in good faith, but has been negligent in opening the account (as in *Ladbroke v Todd* and *The Rubber Industry (Replanting Board) v Hongkong and Shanghai Banking Corporation*) or where it failed to make the necessary enquiries despite the existence of factors which should have aroused its suspicions (as in *Lloyds Bank Ltd. v EB Savory & Co.*), the Bank cannot avail itself to this statutory protection.

Question 4

The worst attempted question was a two-part question on “electronic fund transfer” and “defences for guarantors”. Only a few candidates had a sound knowledge on “electronic fund transfer”. The second part of the question, which focused on the “defences for guarantors” was also poorly attempted. Here, candidates were unable to advise the client accurately on this area.

4. (a) Section 2 of the Banking and Financial Institutions Act 1989 (BAFIA) defines “electronic fund transfer” as “any transfer of funds (other than a transaction originated by cheque, draft or other similar instrument) which is initiated, activated or commenced, regardless at which stage it was initiated, activated or commenced, through an electronic terminal, telephonic instrument or computer or magnetic tape or other storage device so as to order, instruct or authorise any person to debit or credit an amount, and includes point-of-sale transfers, direct deposits or withdrawals of funds, automated teller machine transactions, and transfers initiated, activated, commenced or transmitted by telephone.”

The main BAFIA provision is section 119(1) which prohibits the operation of any electronic fund transfer (EFT) system without the prior written approval of Bank Negara Malaysia (BNM). Persons wishing to operate an EFT system must submit details of the scheme, the customer contract, and other operational details to BNM for approval. BNM is also empowered to inspect the premises, equipment and books before and after giving such approval, and such approval may be revoked, suspended or amended by BNM. While an authorisation is in force, BNM may also inspect the premises, machinery, books or other documents, accounts or transactions relating to the system.

Any financial institution wishing to commence a new electronic banking service must obtain BNM approval. The main objective of section 119 BAFIA is to protect the interests of the public and safeguard the financial system. Any person authorised to operate an EFT system is required to comply with BNM Regulations, such as the Interbank Fund Transfers Regulations 1997. Pursuant to sections 119 and 126 BAFIA, BNM issued BNM/GP11, the Guidelines on Consumer Protection on Electronic Fund Transfers which provide a basic framework to establish the rights, liabilities and responsibilities of customers and financial institutions relating to electronic fund transfers.

- (b) Ms Eileen Soh is advised that she can use the common law defence of ‘*non est factum*’ to avoid liability. By using this defence, she would be asserting that the document was executed in ignorance of its character and therefore was not her deed.

The facts of this instant case are similar to the facts in *Carlisle and Cumberland and Banking Co. v Bragg* where the Court of Appeal held that the guarantor was not liable as he signed the guarantee in complete ignorance of the nature of the transaction.

The *Carlisle* case has since been overruled by the House of Lords in *Saunders (Executrix of the Estate of Rose Maud Gallie) v Anglia Building Society* and it now appears that only in exceptional circumstances can any person of full age and understanding successfully plead ‘*non est factum*’. Thus, for Ms Eileen’s defence to succeed, she must show that the guarantee is radically, fundamentally, basically, totally or essentially different from the contract intended and that she acted with reasonable care.

Ms Eileen may also allege that her brother Mr Soh exerted undue influence on her – section 16, Contracts Act 1950. And, since the Bank was the one who entrusted Mr Soh with the task of obtaining the guarantee from his sister, the Bank may be placed on enquiry or have constructive or actual notice of undue influence arising from the close relationship between Mr Soh and his sister. The Bank should have ensured that Eileen receive independent legal advice before executing the guarantee.

Question 5

Another poorly attempted question was on the exceptions to the “indefeasibility” provided in the National Land Code 1965. A large percentage of candidates gave answers, which stated the exceptions without defining or explaining the meaning of each exception, as required by the question.

5. (a) The general rule is that once a charge is registered it is indefeasible – section 340 National Land Code and *Teh Bee v K Maruthamuthu* and *Ong Chat Pang & Anor. v Valliappa Chettiar*

The National Land Code exceptions to the indefeasibility given in section 340(2) are:

- (i) in any case of fraud or misrepresentation to which the person or body, or any agent of the person or body, was a party or privy, *or*
- (ii) where registration was obtained by forgery, or by means of an insufficient or void instrument, *or*
- (iii) where the title or interest was unlawfully acquired by the person or body in the purported exercise of any power or authority conferred by any written law.

“Fraud” means actual fraud, dishonesty of some sort, not what is called constructive or equitable fraud – *Assets Co. Ltd. v Mere Roihi & Ors.*, *Tai Lee Finance Co. Sdn. Bhd. v Official Assignee & Ors.* and *BBMB v Kuching Plaza Sdn. Bhd. & 4 Ors.* Fraud is defined in *Waimiha Sawmilling Co. Ltd. v Waione Timber Co. Ltd.* as involving a willful and conscious disregard and violation of the right of other persons.

“Misrepresentation” in the context of section 340(2) means “fraudulent misrepresentation” and is a species of fraud and includes recklessness – *Loke Yew v Port Swettenham Rubber Co Ltd* and *Datuk Jagindar Singh & Ors. v Tara Rajaratnam.*

Where registration was obtained by forgery, the charge is defeasible – section 340(2)(b) NLC. Forgery may be defined as the dishonest misuse of the name of the registered proprietor (or of the party seeking without fault to take from the registered proprietor) or as involving factors relevant to the transaction where the name, details or other factors of the party are counterfeited by a rogue or someone intending to act dishonestly in so counterfeiting the signature.

Insufficient or void instruments are where, for example, the charge is signed by an attorney pursuant to an invalid or insufficient power of attorney – *Puran Singh v Kchar Singh & Anor*.

A void charge includes one which is forged or which is contrary to any restriction in interest to which the land is subject or to any prohibition imposed by the National Land Code or any written law – *Tan Hee Juan v Teh Boon Keat* and *Appoo s/o Krishnan v Ellamah d/o Ramasamy*.

The exception where interest or titles over land are unlawfully acquired apply where there is non-compliance with legislation such as the National Land Code, land acquisition laws or other statutes.

- (b) A debenture is an instrument, usually a deed, issued by a company, as acknowledgment 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.”

Thus, a debenture may not incorporate any charge, or it may incorporate a fixed or floating charge, or both, over the company’s assets.

A “fixed charge” may be created over assets of the company including land and machinery. The essential feature of a fixed charge is that it attaches to the property in question from the moment of creation and once registered, it gives the holder of the charge an immediate security over the property in priority to subsequent claimants.

A “floating charge” is a charge on a class of assets present and future. The class of assets may change from time to time in the ordinary course of the company’s business and the company may carry on its business and dispose of the assets in the course of business until the charge crystallises – *Re Yorkshire WoolCombers Association Ltd*.