

DPO2

# Law on Banking and Finance

12 OCTOBER 1999

1. Time allowed : Three (3) hours
2. Total number of questions : Five (5) questions on 2 pages
3. Number of questions to be answered : Four (4) questions [25 marks each]
4. Answers should be supported by reference 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) Is Bank Negara Malaysia (BNM) a “bank” as defined in Section 2 of the Banking and Financial Institutions Act 1989? Give reasons for your answer. Your answer should also include the definitions of “bank” and “banking business”, and a brief description of the roles or functions of BNM. [10]
- (b) Mr Yu maintains a current account with Bank Kaya Bhd. Mr Yu issued a RM100 cash cheque. Bank Kaya Bhd’s teller debited RM1,000 instead of RM100 from Mr Yu’s account. The error was not discovered because the same teller paid to the holder of the cheque RM1,000 instead of RM100. Mr Yu issued another cheque for RM500 for payment of home rental. Bank Kaya Bhd wrongfully dishonoured the RM500 cheque. If not for the wrong debit for the earlier cash cheque, Mr Yu’s cheque for RM500 would have been good for payment.

In relation to the dishonoured cheque, Bank Kaya Bhd may be sued for damages for breach of contract and libel.

Explain the legal basis for each of the following:

- (i) The reason why Bank Kaya Bhd may be sued for breach of contract when it wrongfully dishonoured Mr Yu’s cheque. [5]
- (ii) The Court’s assessment of the amount of damages for breach of contract. [5]
- (iii) The Court’s assessment of the amount of damages for libel. [5]

(Total:25 marks)

2. Minah and Kassim are getting married soon and are keen to purchase a condominium unit in Kuala Lumpur. However, Minah and Kassim learnt that the strata title for the unit has yet to be issued. They intend to apply for a housing loan from Bank Segar Bhd.

Explain the following:

- (a) The legal documentation and procedure required if they are offering the condominium unit itself as security for the loan. [15]
- (b) The legal documentation and procedure required if the strata title is issued **one** year after the housing loan has been released. [5]
- (c) The loan recovery process, in brief, if Minah and Kassim default in repayment of the loan prior to the issuance of the strata title. [5]

(Total:25 marks)

3. (a) Datuk Vincent Tan and Datin Molly recently opened a joint fixed deposit account with Kekal Finance Bhd. The mode of operation of the account is “either to sign” i.e. any **one** of them can operate the account.

A few days ago, Datuk Vincent Tan died in a freak helicopter accident. The accident was widely publicised by the local media and Kekal Finance Bhd’s branch manager attended Datuk Vincent Tan’s funeral.

Today, Datin Molly comes to Kekal Finance Bhd to withdraw the RM2,000,000 credit balance in the joint fixed deposit account.

You are the officer in charge of fixed deposits in Kekal Finance Bhd. Would you allow the withdrawal? Give reasons for your answer. [10]

- (b) Ali, Abu and Muthu are partners of AAM Enterprise which operates a motor-repair shop. Ali, Abu and Muthu want to open a current account with Bank Sedia Bhd. Assuming you are an officer in Bank Sedia Bhd, should you require that there should be an introducer and that certain searches be made before the account is opened? Give reasons for your answer. [15]

(Total:25 marks)

4. (a) Describe and explain the legal effects of the following types of crossings on a cheque:
- (i) a general crossing [5]
  - (ii) a special crossing [5]
- (b) Encik Mahmud issued a cheque for RM15,000 payable to “Ali bin Mat”. The cheque is crossed and contains the words “A/C Payee” without the word “Only”.
- Explain the legal effects of the inclusion of the words “A/C Payee” on the cheque. [10]
- (c) Encik Osman, a bank officer of Bank XY Bhd has just received a telephone call from En Wan Bee Soo (a current account holder) instructing him to stop payment of a cheque.
- Advise Encik Osman on the validity, or otherwise, of an oral countermand. [5]
- (Total:25 marks)
5. (a) XYZ Sdn Bhd wants to open a current account with Bank AB Bhd. Is it sufficient if a certified copy of a board resolution is obtained or does Bank AB Bhd need to investigate further to ensure that the resolution was in fact passed by XYZ Sdn Bhd’s board of directors in accordance with its Memorandum and Articles of Association? Give reasons for your answer. [5]
- (b) The shareholders of ABC Sdn Bhd are Encik Ali bin Mat, Mr Benny Tong and Century Sdn Bhd. Encik Ali bin Mat, the majority shareholder, wants to apply for an overdraft facility from Bank Besar Bhd for his personal use to be secured by a charge over land owned by ABC Sdn Bhd.
- Should Bank Besar Bhd proceed with the loan application and the taking of the security? Discuss. [10]
- (c) Once a charge is registered with the relevant Land Office or Registry, the charge is said to be “indefeasible”.
- In this context, explain the word “indefeasible”. [10]
- (Total:25 marks)

## OUTLINE ANSWERS

### Question 1

**Many candidates lost marks when they failed to answer the question “Is Bank Negara Malaysia (BNM) a bank as defined in Section 2 of the Banking and Financial Institutions Act 1989?” but instead gave lengthy narration on the roles and functions of BNM. Candidates should read the questions carefully before answering. Candidates showed a lack of understanding of breach of contract and libel as well as the wrongful dishonour of cheques. Candidates are advised to study well ahead of the examination dates and to avoid last-minute cramming.**

- (a) Bank Negara Malaysia (BNM) is not a “bank” as defined in Section 2 of the Banking and Financial Institutions Act 1989 (BAFIA). BNM is the Central Bank of Malaysia and is set up pursuant to and is governed by the Central Bank of Malaysia Act 1958 and not BAFIA.

Section 2(1) of BAFIA defines the word “bank” as “a person who carries on banking business” and it goes on to define “banking business” as:

- (i) the business of:
- receiving deposits on current accounts, deposit accounts, savings accounts or other similar accounts;
  - paying or collecting cheques drawn by or paid in by customers; and
  - provision of finance; or
- (ii) such other business as the Bank (ie. BNM) with the approval of the [Finance] Minister may prescribe.

BNM does not carry out such banking business and is therefore not a bank as described in *United Dominions Trust Ltd. v Kirkwood*. Local cases on the definition of ‘bank’ include *Bank of China v Lee Kee Pin*, *Koh Kim Chai v Asia Commercial Banking Corporation Limited*, *Vernes Asia Ltd. v Trendale Investment Pte. Ltd. & Anor* and *Sabah Development Bank Bhd. v SKBS (Sabah) Sdn. Bhd. & Ors*.

BNM is basically a regulatory authority and is the authority on banks, having been conferred many functions, powers and duties including the power to issue guidelines and regulations, issue licences to banks and financial institutions, make monetary policies and to control and supervise financial institutions, banks and other institutions and corporations under its purview.

- (b) (i) The legal basis why the bank may be sued for breach of contract is because the banker-customer relationship is contractual in nature and Bank Kaya Bhd had breached a term of the contract (i.e. the current account contract) entered between Bank Kaya Bhd and Mr Yu.

As stated by Atkin LJ. in *Joachimson v Swiss Bank Corporation*, the bank undertakes to receive money and to collect bills of exchange for its customers’ accounts. The proceeds so received are not to be held in trust for the customer, but the bank borrows the proceeds and undertakes to repay them.

This contractual relationship is usually that of debtor and creditor – *Foley v Hill*. A current account being a deposit account means that the bank is the debtor and the customer (Mr Yu) is the creditor. Thus, when Mr Yu issues a cheque, the bank is contractually bound to pay on a regularly drawn cheque provided there is sufficient funds. In this case, if not for the earlier wrongful debit, there would have been sufficient funds to meet the RM500 cheque. Bank Kaya Bhd has thus committed a breach of the contract.

- (ii) In the case of *Ng Cheng Kiat v Overseas Union Bank*, it was observed that where a customer brings an action against his bank for wrongfully refusing to pay a cheque which he has drawn, the amount of the damages for breach of contract depends on whether or not the customer is a trader.

In *Kphoraror v Woolwich Building Society*, however, it was suggested that the distinction between a trader and a non-trader in the context of such claims may no longer be relevant under modern conditions. The court held that the credit rating of individuals is now as important for their personal transactions including mortgages and hire purchase facilities as it is for those who are engaged in trade.

In an action for breach of contract for wrongfully dishonouring a trader's cheque, the plaintiff is entitled to recover substantial but reasonable damages for injury to his commercial credit, without the necessity of alleging and proving any actual damage. Customers who are not traders (or businessmen) need to allege and prove actual damage.

(iii) The rule for assessment of damages for libel is stated by Shorland J. in *Baker v Australia and New Zealand Bank* (and applied in *Ng Cheng Kiat v Overseas Union Bank*). The matters to be taken into consideration in assessing damages for libel are:

- the position and standing of the plaintiff,
- the nature of the libel,
- the mode and extent of the publication,
- the absence of any retraction or apology, and
- the whole conduct of the defendant from the time when the libel was published, down to the very moment of verdict.

## Question 2

**Many candidates were well-versed with security documentation in credit.**

- (a) The legal documentations required if Minah and Kassim are offering the condominium unit itself as security for the loan are a Loan Agreement and a Deed of Assignment. The Loan Agreement (sometimes called the Facility Agreement) contains all the terms and conditions of the loan facility. The Deed of Assignment assigns contractual rights of the purchasers (Minah and Kassim) absolutely to the financier (Bank Segar Bhd). The contractual rights are those contained in the Sale and Purchase Agreement entered into between Minah and Kassim (as purchasers) and the vendor (usually the developer of the condominium) as well as all rights and titles and interest in the property. Such absolute assignment has been held to be an equitable mortgage or charge – *Chuah Eng Khong v MBB* [1999] 2 MLJ 917 and *Phileo Allied Bank (M) Bhd v Bupinder Singh a/l Avatar Singh & Anor* [1999] 2 CLJ 1023.

In accepting the Assignment as security, it is imperative to ensure that there is a binding and valid Sale and Purchase Agreement entered into by the assignors (i.e Minah and Kassim) in respect of that condominium unit. It is also necessary to give notice of the assignment to the other party to the Sale and Purchase Agreement (in this case, the vendor or developer of the condominium) in order to constitute a legal assignment. In a normal Deed of Assignment, the vendor/developer would also consent to the assignment and undertake to transfer the unit sold into names of the purchasers and to submit the strata title to the financier (Bank Segar Bhd) within a specified period (usually 14 days) once the strata title is issued by the relevant authorities.

In addition, the financier is advised to lodge a private caveat against the land whereon the condominium is built, stating the interest affected – *Chor Phaik Har v Farlim Properties Sdn. Bhd.*

In the event the developer has charged the master title of the land, it is necessary to obtain the undertaking of the chargee to omit or exclude the unit in question from any foreclosure proceedings commenced by the chargee and to further undertake to discharge its charge affecting the unit upon the issue of the strata title.

The Loan Agreement will be stamped *ad valorem* and the Deed of Assignment would also be stamped. Alternatively, the assignment may be incorporated into the loan agreement as a single instrument. In such event, it is referred to as a Loan Agreement cum Assignment.

The documentation would also include a power of attorney clause and such power of attorney needs to be registered with the High Court. Upon completion of all these documents, the purchasers' Sale and Purchase Agreement (original copy) will be deposited with the financier for safe custody.

The legal effect of this form of security documentation is laid down in the Supreme Court Case of *Hipparion (M) Sdn. Bhd. v Chung Khiaw Bank Ltd.*

- (b) If the strata title is issued a year after the housing loan has been released, pursuant to their undertaking and consent in the Deed of Assignment, the vendor/developer would have to transfer the strata title to the purchasers (Minah and Kassim) and submit the strata title to Bank Segar Bhd.

Minah and Kassim will execute a charge over the strata title. As the Loan Agreement (or Facility Agreement) was already stamped *ad valorem*, the stamping of the charge will be at a nominal rate. The charge will then be presented for registration and once registered, the charge document and the title will be kept by Bank Segar Bhd.

- (c) Briefly, prior to the issuance of strata title and in event of default, the Bank will serve notices of demand on Minah and Kassim and also a notice to quit and deliver possession of the property.

Then, if there is still default and since the assignment of the property constituted an absolute assignment of rights of a borrower to a financier where there is no title issued, Bank Segar Bhd will commence proceedings under Order 31 of the Rules of the High Court 1980 to obtain a court order to sell the property by way of public auction – *Bupinder Singh a/l Avatar Singh & Anor v PhileoAllied Bank (M) Bhd.* However, recently, the Court of Appeal in *PhileoAllied Bank v Bupinder Singh* [1999] 2 CLJ 1023 had held that the enforcement of absolute assignment as an equitable charge must proceed by way of Order 83 of the rules of the High Court. This requirement cannot be contracted out and this was held to be the only way in which the rights of a chargor may be extinguished.

### Question 3

**Some candidates were confused with the effects of the “survivorship” clause and were not aware of what Grant of Probate and Letters of Administration are. Many candidates however, did not understand the importance of making preliminary enquiries before an account is opened.**

- (a) As an officer in charge of fixed deposits in Kekal Finance Bhd, I would not allow the withdrawal.

In *Hirschhorn v Evans*, it was stated that a joint account is no less a joint account where the mandate under which it is operated provides for the bank to act on the sole signature of either account holder. Moreover, the mandate is revoked by notice of death of Datuk Vincent Tan and the banker should therefore freeze the account as soon as he has notice of the death.

When a joint account is frozen because of the death of one of the joint account-holders, the question of survivorship comes into play. In practice, the fixed deposit contract (for joint accounts) may provide for survivorship i.e, that the balance in the account can be transferred to the surviving parties. The legal title or right at law to the remaining credit balance in respect of the deceased's share in a joint account generally vests in the survivor whereas the equitable and beneficial interest of the same may nevertheless vest in the estate of the deceased. However, if the monies have been deposited or paid in by all or both joint account holders, the monies may be considered as having accrued to the joint account holders and not the estate. The estate of the deceased will not be able then to establish that it was a beneficial interest in the monies. After the banker has been shown the death certificate of the deceased party, the banker may allow the money (usually of a small amount) to be paid out of the account provided he is authorised to do so by all the surviving parties and preferably, by the next-of-kin of the deceased. As additional caution, the banker normally requires a joint and several indemnity to be given by the surviving parties, and the deceased's next-of-kin where applicable, before allowing the money to be paid out.

In the instant case, as the amount is substantial i.e RM2,000,000 Kekal Finance Bhd is advised to freeze the account and wait for the Letters of Administration (if Datuk Vincent Tan died intestate i.e without a will) or the Grant of Probate (if Datuk Vincent Tan died testate, i.e with a will). This is because the

survivorship principle does not mean that the balance in the account belongs beneficially to the survivors. Beneficial ownership is a matter to be resolved between the survivors and the personal representatives of the deceased party and will depend upon the terms on which the account was held as between the deceased and the surviving parties.

For instance, if Datuk Vincent Tan has provided in a will that his brother Mr Bobby Tan be the executor of his estate, then Kekal Finance Bhd should pay out (after verifying the genuineness of the Grant of Probate) by way of a banker's cheque made payable to "Bobby Tan, executor of the estate of Datuk Vincent Tan deceased, and Datin Molly". Prior to the production and search done on the Grant of Probate, the account should be frozen.

- (b) If I am an officer in Bank Sedia Bhd, I would require that there should be an introducer and that searches be made at the Registry of Businesses and checks be made against the Biro Maklumat Cek (BMC) and bankruptcy searches be done.

First, I would enquire whether the partners of AAM Enterprise have entered into any partnership agreement. If not, then, provisions of the Partnership Act 1961 apply.

As a partnership has no legal entity nor personality of its own (*Wong Yoon Yar v Lin Yin Thai & Ors.*), I would make a check (an unofficial search suffices, as an official search at the Official Assignee's office may not be practical or necessary as this is only for opening a current account and not for the granting of credit facilities) whether the partners are bankrupt. This is because should the bank open a current account and collect the proceeds of a cheque for a bankrupt or accepts deposits of monies into the account and pay the same thereafter to the bankrupt rather than to the Official Assignee, the bank is liable to the Official Assignee should a demand be made by the Official Assignee. Secondly, I would also check whether AAM Enterprise, Ali, Abu and Muthu are bad cheque offenders under the BMC.

It is essential to require an introducer before I open this account. An introducer is basically a responsible person who knows the identity of the prospective customer and who has been maintaining a satisfactorily-conducted current account with the bank for a duration of time (eg. at least 6 months or a year).

A search at the Registry of Businesses is also essential to establish whether Ali, Abu and Muthu are indeed the parties of AAM Enterprise.

These checks and searches are important legally as, having done so, the bank has not been negligent in opening the current account – *The Rubber Industry (Replanting) Board v Hongkong and Shanghai Banking Corporation*. In this case, it was stressed that a banker has to make inquiries when opening accounts and a banker may be put on enquiry when collecting cheques in certain circumstances. For instance, a collecting banker who has not proven that he has acted without negligence may not avail himself to the statutory protection under Section 85 of the Bills of Exchange Act 1949, and he may be liable for damages for conversion of a cheque when he collects payment of a crossed cheque marked "Account Payee" for a customer and it later turns out that the customer is not the true owner of the cheque. The banker will be liable to the true owner unless he (the banker) collected the cheque for his customer in good faith and without negligence" – *Ladbroke & Co. v Todd and Hampstead Guardians v Barclays Bank*.

#### Question 4

**The question on special crossings on cheques was poorly answered by most candidates. Almost all the candidates gave wrong answers and did not understand the legal effects of the inclusion of "A/C Payee" crossed on cheques.**

- (a) (i) Section 76(1) of the Bills of Exchange Act 1949 defines a general crossing. Where a cheque bears across its face an addition of:
- the words "and company" or any abbreviation thereof between two parallel transverse lines, either with or without the words "not negotiable"; or

- two parallel transverse lines simply, either with or without the words “not negotiable”;

that addition constitutes a crossing, and the cheque is crossed generally.

The legal effect of a general crossing on a cheque is that the cheque cannot be encashed over the counter and the cheque must be banked into an account maintained with any banker.

- (ii) Section 76(2) of the Bills of Exchange Act 1949 describes a special crossing. The provision reads that where a cheque bears across its face an addition of the name of a banker, either with or without the words ‘not negotiable’, that addition constitutes a crossing, and the cheque is crossed specially and to that banker.

A cheque with a special crossing cannot be encashed over the counter but must be banked into an account maintained with the bank so specified on the cheque.

Under Section 80, Bills of Exchange Act 1949, the banker, in order to avail itself to this statutory protection, must pay in accordance with the crossing and in good faith and without negligence. Thus, the paying banker must pay to a banker if the cheque is crossed generally and to a specified banker only if the same is so crossed to that specific banker.

- (b) Section 81A of the Bills of Exchange Act 1949 provides that an “account payee” cheque shall not be transferable, but shall only be valid as between the parties thereto.

Thus, crossed cheques containing the words “A/C Payee” are to be credited into the account of the payee only. It does not make any difference, legally, whether the word “only” is there or not.

Thus, a crossed cheque with the words “A/C Payee” cannot be encashed over the counter and must be banked into the payee’s account only.

Failure to do so, and if the cheque is collected for a third party instead of the payee, the bank may be sued for conversion and negligence as in the case of *Kek Tek Huat, deceased v U.M.B.C.*

If the bank credits an “account payee” crossed cheque in favour of a third party, the bank is negligent and cannot plead the statutory provision of Section 85, Bills of Exchange Act, as collection of such cheque for a third party without explanation was negligent and therefore, the protection of Section 85 is forfeited.

Another legal effect of the crossing with “A/C Payee”, due to Section 81A of the Bills of Exchange Act is that a customer is no longer able to negotiate his “A/C Payee” cheque to his collecting bank for immediate advance of monies so that the collecting bank can in turn collect the cheque for itself as holder for value or holder in due course since all “A/C Payee” cheques are no longer transferable.

- (c) In *Chua Neoh Kow v Malayan Banking Bhd* it was held that a countermand may be given orally. As En Wan’s instructions countermanding payment of the cheque are received by telephone, En Wan’s written confirmation should be obtained. If the cheque is presented in the meantime, it should be returned with the answer “oral countermand pending written confirmation”.

En Wan must follow up with a written countermand instruction. Thus, Encik Osman is advised that he has to act on the oral countermand and that he has to be cautious and to follow up with ensuring that the written stop payment instruction is received and verified as soon as possible. The banker’s authority to pay on a cheque is determined upon countermand of payment – Section 75 Bills of Exchange Act 1949.

## Question 5

**Many candidates were also mixed-up with Section 67, Section 133 and Section 133A of the Companies Act and cited the incorrect provision. A large percentage of candidates could not explain what “indefeasible” (in relation to registered dealings such as the charge) means.**

- (a) It is sufficient if a certified true copy of a board resolution or a certified true copy of an extract thereof is produced and it is not necessary to investigate further to ensure that the resolution was in fact passed by the company’s board of directors. This is because of the rule in *Turquard’s* case which states that a third party dealing with a company is not bound to ensure that all the internal regulations of the company have in fact been complied with as regards to the exercise and delegation of authority. However, the bank must make a search with the Registry of Companies to verify the genuineness of Form 49 submitted by the company, i.e. to verify the identities of the directors concerned – *KL Engineering Sdn Bhd v Arab-Malaysian Finance Bhd*.

A third party (such as Bank AB Bhd) may rely or assume that a certain board resolution has been duly passed by the board of directors (of XYZ Sdn Bhd) so long as he is given a certified true copy thereof or a certified copy of an extract thereof if the same was certified by a duly authorised officer of the company. The bank need not bother itself with questions whether there was a quorum and whether other internal requirements of the company have been complied with.

- (b) Section 133 of the Companies Act 1965 prohibits a company (other than an exempt private company) from providing any security in connection with a loan made to a director by the bank.

Loan transactions may be avoided if they contravene Section 133 of the Companies Act and then the securities given (such as the charge) to secure such illegal loans will be illegal and void and therefore unenforceable – *Utama Wardley Bhd. & Anor v Lenggang Laut Development Sdn. Bhd. & Ors.* and *Chung Khiaw Bank v Hotel Rasa Sayang Sdn. Bhd. & Anor; Che Wan Development Sdn. Bhd. v Cooperative Central Bank Ltd*. The case, *Chung Khiaw Bank v Hotel Rasa Sayang* was recently overruled by the Federal Court in *Lori Malaysia Bhd v Arab-Malaysian Finance Bhd* [1999] 2 CLJ 997 which held that Section 67 (6) [prior to its amendment, being similar to Section 133 (5) Companies Act] is sufficiently wide to cover or protect the borrowing company as well as the lenders. Securities to lenders given in contravention of Section 133 may therefore still be valid.

Under Section 133 of the Companies Act, there is an exception if ABC Sdn Bhd is an exempt private company. However, in the instant case, ABC Sdn Bhd is not an exempt private company as it does not fall under the definition of such company (as defined in the Companies Act) as one of its shareholders, Century Sdn Bhd, is a company. An exempt private company is a private company with not more than twenty shareholders, none of whom is a corporation. Thus, where one of the shareholders of ABC Sdn Bhd is a company, ABC Sdn Bhd is not an exempt private company.

Thus, Bank Besar Bhd is advised not to proceed with the taking of the security as the security offered is unenforceable. Bank Besar Bhd should proceed with the loan application only if other security is offered instead of the said charge.

- (c) In the context of charge over land, the word “indefeasible” in relation to the charge refers to the quality of “indefeasibility” of the charge once the charge is registered. This means that the registered charge acquires a shield of protection against attacks – subject only to the limited exceptions in Section 340(2) of the National Land Code 1965 such as fraud, misrepresentation, forgery, void or insufficient instrument or unlawful acquisition.

This notion of “indefeasibility” of the registered charge sets out the position of the registered chargee as against all other persons with respect to such person’s entitlement to the interest registered. The expression means that a registered chargee enjoys immunity from attack by adverse claims to the interest in respect of which the charge is registered. This is provided for by Section 340(2) of the National Land Code.

Cases on point include *Tai Lee Finance Co. Sdn. Bhd. v Official Assignee & Ors., Public Finance Bhd. v Narayanasanary* and *BBMB v Kuching Plaza Sdn. Bhd.*

To illustrate, if X signs a charge in favour of Y in 1997 but this charge was never registered; and in 1998, X signs another charge over the same piece of land in favour of Z and Z registers this charge, then Z's interest as chargee is "indefeasible" i.e Z is protected against any adverse claims made by Y.