

**DP02**

# **Law on Banking and Finance**

**10 APRIL 2007**

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) Briefly describe the statutory regulation of Islamic banking in Malaysia. [5]
- (b) In relation to the law relating to banker-customer relationships, answer all of the following:
- (i) Is a holder of a cash cheque who encashes the cheque over a bank's counter considered a customer of that bank? Briefly explain your answer. [5]
- (ii) Can a bank be another bank's customer? Briefly explain your answer. [5]
- (iii) State and explain **two** statutory provisions, in respect of which verification of a customer's identity when opening accounts and establishing a banker-customer relationship is legally required, or would be necessary in order for the bank to avail itself to the statutory protection so provided. [10]
- (Total:25 marks)
2. (a) Mr Yue Hu Tang incurred a credit card debt of RM15,000 when he failed to pay his credit card issuer, FastGo Credit Card Centre Bhd ("FastGo"). FastGo obtained judgement for the sum of RM15,000. FastGo knows that Mr Yue Hu Tang maintains a fixed deposit account with Bank Bagus Bhd with a credit balance of at least RM20,000.
- What legal proceedings should FastGo take if Mr Yue Hu Tang fails to pay the judgement debt? Your answer should include the description of the various steps or stages involved or taken in the legal proceedings. [10]
- (b) Describe what a promissory note is. [5]
- (c) (i) What is a special crossing on a cheque? [5]
- (ii) A cheque is discharged by payment in due course by or on behalf of a drawee.
- Explain the phrase "payment in due course". [5]
- (Total:25 marks)
3. (a) In relation to the law relating to cheques, answer all of the following:
- (i) Name and describe **three** main parties to a cheque. [5]
- (ii) Explain the following terminologies:
- (aa) Negotiation of cheques [5]
- (bb) Issue of cheques [5]
- (b) Explain the legal issue of corporate benefit that may be raised when taking security from a company to secure a third-party debt. [10]
- (Total:25 marks)
4. (a) ABC Sdn Bhd ("ABC") owned a piece of unencumbered land in Kajang, Selangor whereby a factory was built. In 2004, ABC obtained a hire-purchase facility from U-O Finance Bhd to finance the purchase of a state-of-the-art printing machine worth RM1million which was permanently bolted and fastened onto the floor of the factory.
- Unknown to U-O Finance Bhd, ABC was granted an overdraft facility of RM800,000 by Bank Money Bhd in 2006. The overdraft facility was secured by a first-party charge over the said piece of land in Kajang together with the factory built thereon.
- Recently, the value of the land depreciated greatly as not only was there a huge infrastructure of highways built next to the factory blocking its access and frontage, but a huge graveyard and crematorium were also constructed near the factory.

When ABC defaulted on the repayment of the overdraft facility, Bank Money Bhd subsequently recalled the facility.

Comment whether Bank Money Bhd can have a claim to the machinery in priority to the claim by U-O Finance Bhd, and whether U-O Finance Bhd ought to have taken any further step(s) to protect its interest over the machinery. [10]

- (b) Describe the types and forms of liens which may be taken as security for credit facilities. [5]
- (c) In relation to accepting assignment of contractual rights as security, such as assignment of contract proceeds, answer all of the following:
- (i) Describe how the above type of security works. [5]
- (ii) What are the key principles to be considered by bankers and financiers when accepting the above type of security? [5]

(Total:25 marks)

5. (a) Briefly explain the legal effects of an alteration made to a guarantee. [5]

- (b) Bank SS Bhd granted an unsecured credit card facility to Mr D and he defaulted on repayment. Bank SS Bhd proceeded to sue Mr D. In the midst of the proceedings, Mr D dies.

Can Bank SS Bhd continue the suit in relation to Mr D's debt? Briefly explain your answer. [5]

- (c) In relation to civil procedure, briefly explain what a summary judgement is. [5]

- (d) Mr P works as a chief cashier in Bank Busy Bhd. As Mr P is usually stressed and faces time constraints in his work, he finds it convenient to share his password (which was assigned to him by Bank Busy Bhd to gain access to the bank's computer system) with Ms A who works as a teller in Bank Busy Bhd. The sharing of password is against Bank Busy Bhd's standard procedures and practices.

State the legal (statutory) contravention and consequences of such act provided by the statute. [5]

- (e) Mr Q wanted to deposit RM2,000 cash into his account bearing account number 888366, using the cash deposit machine located at the lobby of Bank Hi-Tech Bhd. One late night, as Mr Q was depositing the money, he was distracted by his young son who accompanied him at that time. Due to the distraction, Mr Q carelessly deposited the RM2,000 into account number 883666 which belonged to Ms B instead. Mr Q only realised his mistake shortly after that.

The next morning, Mr Q approached Bank Hi-Tech Bhd with the receipt to recover his money. When Bank Hi-Tech Bhd contacted Ms B, she refused to cooperate. Mr Q requested Bank Hi-Tech Bhd for Ms B's name, address and contact number so that he can attempt to recover the money himself.

- (i) Can Bank Hi-Tech Bhd help Mr Q by providing him with the required information? Briefly explain your answer. [3]

- (ii) What are the legal contravention and consequences, if any, in relation to (e) (i) above? [2]

(Total:25 marks)

**– END OF QUESTION PAPER –**

## 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

- Most candidates knew the statutory regulations of Islamic banking and the basic law on the banker-customer relationship.
- Candidates not able to cite Section 85 of the Bills of Exchange Act 1949 on the statutory protection for the collecting banker.
- Candidates need to cite the relevant cases and statutory provisions.

1. (a) The statutory regulation of Islamic banking in Malaysia is as follows:

The provisions of the Banking and Financial Institutions Act 1989 (BAFIA) do not apply to Islamic banks. Islamic banks are regulated by the Islamic Banking Act 1983. This act which came into force in April 1983 was enacted to provide for the licensing and regulation of Islamic banking business. Under section 2 of the Islamic Banking Act 1983, “Islamic banking business” means “banking business whose aims and operations do not include any element which is not approved by the religion of Islam”. However, commercial banks which provide Islamic banking and finance products and services remain regulated under section 124, BAFIA.

- (b) (i) A holder of a cash cheque who encashes the cheque over a bank’s counter, is not a customer of that bank as, generally, that person does not have some sort of account with that bank. In *Great Western Railway Co v London and County Banking Co Ltd*, it was held that a person for whom the bank performs a casual service like cashing a cheque is not a customer of the bank. The main criterion was the possession of an account through which the transactions could pass. Further, a person encashing a cash cheque has not entered into any contractual relationship with the bank; the contract being between the drawer and drawee bank.
- (ii) Yes, a bank can be another bank’s customer. In *Importers Company Ltd v Westminster Bank Ltd*, it was argued that the term “customer” does not refer to another bank. However, Atkin LJ said that if a non-clearing bank regularly sends cheques to a clearing bank for clearing, the former is a customer of the latter.
- (iii) The two statutory provisions which require the verification of a customer’s identity when opening accounts and establishing the banker-customer relationship are section 16, Anti-Money Laundering Act 2001 (AMLA) and section 85, Bills of Exchange Act 1949.

Section 16 of the AMLA provides that a Reporting Institution (which includes banks as listed in the First Schedule, AMLA) is to maintain accounts in the account-holder’s name and cannot open, operate or maintain anonymous account/s in fictitious, false or incorrect names. The Reporting Institution is to verify (by reliable means) and record the identity, representative capacity, domicile, legal capacity, occupation, business purpose of any person, and other identifying information by using the IC, passport, birth certificate, driver’s licence, constituent document or any other official or private document when establishing or conducting business relations especially when opening new accounts.

If a banker opens an account for an incorrect person when it fails to verify the identity of the account-holder properly, then, all cheques collected into that account would be collected for the wrong ‘payee’. The banker then can be sued for damages for conversion and negligence. Thus, to gain the statutory protection under section

85, Bills of Exchange Act, the bank needs to collect “in good faith and without negligence” – *Rubber Industry Replanting Board v HSBC*.

### **Question 2**

- Most candidates could describe what a promissory note was and cite the relevant statutory provisions.
- Candidates wrote on *Mareva* injunction, instead of garnishee order which is in relation to interference by third parties on banker-customer relationship.
- This type of question is basically factual or narrative in concept. Thus, a brief explanation and description supported by statutory provisions would suffice.

2. (a) The legal proceedings that FastGo Credit Card Centre Bhd (“FastGo”) should take if Mr Yue Hu Tang fails to pay the judgement debt are that, FastGo should apply for a garnishee order. A garnishee order is a court order, obtained by a judgement creditor, attaching funds in the hands of a third party (the garnishee) who owes money to the judgement debtor. The steps for taking out a garnishee order are contained in Order 49 of the Rules of the High Court.

The first step is that the court makes a garnishee order *nisi*. As soon as the order is served, the bank should freeze the balance standing to the credit of the customer’s account, unless the court directs otherwise. The bank would normally request its lawyers to attend the hearing and the order is then discharged or made absolute. If the order is made absolute then the bank will pay the sum stated in the order to either the judgement creditor or the court.

- (b) A promissory note is an “unconditional promise in writing made by one person to another signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money, to, or to the order of, a specified person or to bearer” – section 88(1), Bills of Exchange Act 1949. Promissory notes are negotiable instruments. Unlike a bill of exchange, it is not drawn on a third party. It is a promise made by the maker of the note to pay the specified sum of money at the specified time.

- (c) (i) A special crossing on a cheque 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, Bills of Exchange Act 1949. Once a cheque is specially crossed, it may be paid only through that specified banker only.

(ii) The term “payment in due course” means payment made at or after the maturity of the cheque to the holder, in good faith and without notice that the holder’s title is defective. A cheque is thus discharged by payment in due course by or on behalf of the drawee bank – section 59(1), Bills of Exchange Act 1949. Therefore, the drawee bank will not be held liable to the drawer.

### **Question 3**

- Candidates had good knowledge on cheques.
- Candidates had poor knowledge on corporate issues in the context of security-taking and credit.

3. (a) (i) The three parties to a cheque are the drawer, drawee and payee. The person who draws a cheque is called the drawer. The banker on whom the cheque is drawn is called the drawee or the paying banker. The person to whom the cheque is drawn payable to is called the payee.

(ii) (aa) The term “negotiation” of cheques, means a cheque is negotiated when it is transferred from one person to another in such a manner as to constitute the transferee the holder of the cheque – section 31(1), Bills of Exchange Act 1949. A bearer cheque is negotiated by delivery alone; whereas an order cheque is negotiated by indorsement and delivery.

- (bb) A cheque is not valid until it is issued. Section 2, Bills of Exchange Act 1949 states that “issue” means the first delivery of a cheque complete in form to a person who takes it as a holder of the cheque. “Holder” refers to the payee or indorsee of a cheque who is in possession of it, or the bearer thereof. And “delivery” means the transfer of possession, actual or constructive from one person to another.
- (b) The issue of corporate benefit that may be raised when taking security from a company to secure a third-party debt is explained as follows:

As a general rule, the directors of a company are under a duty to act *bona fide* for the benefit of the company. In *Rolled Steel Products (Holdings) Ltd v British Steel Corp.*, it was held that the directors of a company will not have actual authority from the company to exercise any express or implied powers other than for the purposes of the company as set out in its memorandum of association. So if the directors enter into a transaction that does not benefit their company, they may be exercising their powers for an improper purpose. The transaction is voidable at the option of the person to whom the duty is owed, namely, the company.

Thus, one of the issues lays in the test to be used in determining whether the giving of security to secure another company’s indebtedness benefits the company. In *Charterbridge Corporation Ltd v Lloyds Bank Ltd*, the test adopted was “whether an intelligent and honest person in the position of a director of a company concerned, could, in the whole of the existing circumstances have reasonably believed that the transactions were for the benefit of the company.”

#### **Question 4**

- Answers given by candidates were not substantiated with relevant cases and statutory provisions.
- Candidates should address the relevant issues supported by cases and statutory provisions.

4. (a) In my opinion, Bank Money Bhd can have a successful claim to the machinery in priority to the claim, if any, by U-O Finance Bhd. This is because the term “land” is widely defined in section 5 of the National Land Code 1965 and includes “all things attached to the earth or permanently fastened to anything attached to the earth, whether on or below the surface.”

Thus, when ABC charged its land (which included the land, factory and fixtures – such as the printing machine) to Bank Money Bhd, the machinery became part of the charged property.

In *Wiggins Teape (M) Sdn Bhd v Bahagia Trading Sdn Bhd, The East Asiatic Co Ltd & Ors as Objectors*, it was held that machinery which were fixtures formed part of the land. Since the land was charged to the chargee, the machinery accordingly passed as security to the chargee along with the charged land. Thus, the chargee had a prior claim over the owner (under the hire-purchase) to the machinery.

Thus, as U-O Finance Bhd did not obtain a waiver from the chargee, Bank Money Bhd, their interests over the machinery are not protected or secured.

- (b) The “lien” which may be taken as security for credit facilities can be created over realty or personality. Realty refers to real property like land, while personality refers to personal property like movable goods and chattels. The statutory lien is the only recognised form of lien over realty in Malaysia. The National Land Code lien is a method of taking security over land often resorted to for short-term borrowings, or where the amount of the advance is small, or for taking additional security. Whereas, liens over personality would take the form of possessory liens.
- (c) (i) In relation to accepting assignment of contractual rights as security such as assignment of contract proceeds, this type of security can be in the form of assignment of debt owed by third parties, assignment of proceeds of contract; and can

be legal assignments or equitable assignments. It is possible for a customer to assign a debt owed by a third party to the bank as security for an advance. The assignee has the right to take legal action to recover any moneys due under an assignment – *Bank Bumiputra Malaysia Bhd v Syarikat Kejuruteraan Hong Huat Sdn Bhd & Ors*. The banker also can accept the assignment of the proceeds of a contract as security. However, such a security depends on the ability of the debtor to pay as well as the ability of the contractor to perform, the contract and the payment in respect thereof.

- (ii) The key principles to be considered by bankers and financiers when accepting this type of security include the following:
- it must be in writing and signed by the assignor (borrower)
  - it must be absolute; that is, the whole debt must be assigned and free from any conditions
  - express notice should be given to the debtor; and
  - the debtor should be requested to acknowledge the notice, confirm the debt and the existence of any right of set-off or counter-claim, and also advise of any prior assignments.

#### Question 5

- Candidates had good knowledge on banking secrecy.
- Candidates had poor knowledge on summary judgement.
- They were unable to distinguish between breaching confidentiality with committing an offence under Section 6 of the Computer Crimes Act 1997.

5. (a) The legal effects of an alteration made to a guarantee are as follows. Any alteration to a guarantee must be assented and signed by all parties to the guarantee. Any substantial variation made without the guarantor's consent may result in the guarantor avoiding the guarantee – section 86, Contracts Act 1950. In *Bank Bumiputra Malaysia Bhd v Fu Lee Development Sdn Bhd & Ors*, when construing the meaning of “unsubstantial variation”, the Court held that to constitute unsubstantial variation, the variation should not prejudice a party to it; be to the advantage of the guarantor and not to the guarantor's disadvantage; and it must be self-evident.
- (b) Yes, Bank SS Bhd can continue the suit in relation to Mr D's debt even though Mr D, the defendant died. As Mr D is the sole defendant and assuming that the cause of action is one that survives (as reflected in the usual standardised credit card-holder's agreement), Bank SS Bhd as plaintiffs may apply for an order to continue the proceedings against the executor or administrator of the deceased defendant. Alternatively, the executor or administrator may apply to be substituted for the defendant. Until and unless such executor or administrator is added or substituted, the action cannot be continued.
- (c) Summary judgement, as provided in Order 14, Rules of the High Court 1980, is the procedure for obtaining judgement without trial. The hearing is in Chambers, usually before the Registrar of the High Court. The defendant may wish to resist the application for summary judgement and ask that the claim be tried in Court. In order to do so he must file a counter-affidavit and claim that there is an issue to be tried. This triable issue is generally “on the merits”. A summary judgement is generally given in cases where there is no reasonable doubt that the plaintiff entitled to judgement and where it is inexpedient to allow a defendant to defend for mere purposes of delay. Where all the issues are clear and the matter or substance can be decided once and for all, leave to sign judgement may be given – *Citibank NA v Ooi Boon Leong & Ors*.
- (d) The legal (statutory) contravention and consequences of such act are provided in section 6 of the Computer Crimes Act 1997 which makes it an offence to communicate directly or indirectly a number, code, password or other means of access to a computer system to any

unauthorised person. Here, where Mr P communicated his password to Ms A, a teller, this access to the bank's computer system is made to an unauthorised person.

A person guilty of this offence shall on conviction be liable to a maximum fine of RM25,000 or to imprisonment for a term of up to 3 years or to both such imprisonment and fine.

- (e) (i) Bank Hi-Tech Bhd cannot help Mr Q by providing him the required information as this would be a breach of banking secrecy under section 97, Banking and Financial Institutions Act 1989 (BAFIA). Under this section, the employees of Bank Hi-Tech Bhd cannot produce, divulge, reveal, publish or otherwise disclose to any person (Mr Q) or make a record for any person, of any information or document whatsoever relating to the affairs or account of such customer, Ms B.
- (ii) A person guilty of this offence shall on conviction be liable to a maximum fine of RM3million or to imprisonment for a term of up to 3 years or to both such imprisonment and fine.