

DP02

Law on Banking and Finance

4 APRIL 2006

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 supervisory and regulatory framework in Malaysia that facilitates the enforcement of the Anti-Money Laundering Act 2001.

(Your answer should include the names of the various supervisory and regulatory bodies, institutions and agencies and their various functions, powers and/or duties.) [15]

- (b) Mr OK is an officer with Bank Kaya Bhd (“BKB”) in Kuala Lumpur. On 30 March 2006 at 12 noon, BKB received a remittance message from a bank in Indonesia instructing BKB to pay Mr Kool (who does not maintain any account with BKB) a sum of RM800,000.

At 3.00 pm on the same day, Mr Kool, a young man in his 20s, walked in and demanded for the money. Mr OK asked Mr Kool for his identification but Mr Kool said that all he brought with him was his driving licence. Mr OK asked Mr Kool on the source of the fund and Mr Kool replied that it was a gift from his rich aunty.

Can Mr OK proceed to pay Mr Kool the RM800,000? State BKB’s statutory duties or liabilities, if any. [10]

(Total:25 marks)

2. (a) Mr KS is a new officer with Bank VV Bhd in Kuala Lumpur. Advise Mr KS on all of the following issues:

(i) Would it be advisable for Mr KS to open a joint current account for Mr Wang and his daughter, Ms Juenta Wang, who is 17 years old? State the reason(s) for your answer. [5]

(ii) Would it be advisable for Mr KS to open a fixed or time deposit account for Mr Ree, a 57 year-old man who was recently adjudged a bankrupt? State the reason(s) for your answer. [5]

- (b) On 27 March 2006, Mr YY instructed Bank Best Bhd to close his current account immediately. Instead of closing Mr YY’s account, Mr Tidoor, an officer of Bank Best Bhd, accidentally closed Mr AB’s account and paid the credit balance sum of RM4,444 maintained under Mr AB’s account mistakenly to Mr YY. Subsequently, a cheque drawn by Mr AB for RM3,000 was presented to Bank Best Bhd for payment and this cheque was dishonoured and returned to the holder with a remark “Account Closed”. When Mr AB complained the above matter, Bank Best Bhd investigated and discovered that at the time when the request was made by Mr YY to close his account, there was only a credit balance of RM444 maintained under Mr YY’s account.

In relation to the above context, answer all of the following:

(i) Legally, what are Bank Best Bhd’s liabilities towards Mr AB? [10]

(ii) Can Bank Best Bhd recover the RM4,000 that was wrongly paid to Mr YY? Give reason(s) for your answer. [5]

(Total:25 marks)

3. (a) (i) Describe a special crossing which may be found on the face of a cheque and state its legal effects. [5]

(ii) What are the legal implications if a paying banker ignores the special crossing? [5]

- (b) In relation to the law relating to negotiable instruments, distinguish between the concept of “negotiability” and “transferability”. [5]

- (c) Unknown to Bank DD Bhd, Mr Mattee died at 4.44am on 28 March 2006. On 30 March 2006, Bank DD Bhd paid a RM2,000 cheque which was signed by Mr Mattee and dated 23 March 2006. Bank DD Bhd was later informed of Mr Mattee’s death on 31 March 2006.

In relation to the above context, answer all of the following:

- (i) Did Bank DD Bhd incur any liability for the payment of the RM2,000 cheque which was paid after Mr Mattee's death? Give reason(s) for your answer. [5]
- (ii) A RM4,000 cheque also dated 23 March 2006 and signed by Mr Mattee was presented for payment on 3 April 2006. Should Bank DD Bhd pay this cheque? Give reason(s) for your answer. [5]

(Total:25 marks)

4. (a) Mr Monee is a famous singer in Malaysia. Mr and Mrs Monee are joint account holders of fixed deposits totalling RM1million maintained with Bank Teguh Bhd. The mode of operation of this account is "both to sign".

Mr and Mrs Monee went through a divorce recently. Yesterday, while performing at a concert, Mr Monee suffered a heart attack and died. Today, Mrs Monee wants to withdraw the RM1million deposit from Bank Teguh Bhd.

In relation to the above context, answer all of the following:

- (i) Should Bank Teguh Bhd allow this withdrawal? Give reason(s) for your answer. [5]
 - (ii) Would it matter if Mr Monee left a will or if he did not? Give reason(s) for your answer. [5]
- (b) Mr BM is the hirer of a car financed by Bank WW Bhd under hire-purchase. Mr BM has not paid the instalments for the car for the last two months.

Should the officer in the Loan Recovery Department of Bank WW Bhd request Mr BM's wife to persuade Mr BM to pay the instalments? Give reason(s) for your answer. [5]

- (c) Compare and contrast between a letter of guarantee and a letter of comfort. [10]

(Total:25 marks)

5. (a) Mr JC, a regular customer of Bank MM Bhd, instructs Bank MM Bhd to remit by telegraphic (electronic) transfer £2,000 to his daughter who is residing in Manchester, England.

Explain the main laws and the Bank Negara Malaysia guidelines that apply to this remittance. [10]

- (b) Mr H has recently got married and bought an apartment for his wife. No strata title was issued for the apartment. Bank GG Bhd intends to finance this purchase:

- (i) Describe how Bank GG Bhd can take the property as security as no strata title was issued for that apartment. [5]
- (ii) Will your answer in (b)(i) be different if the strata title has already been issued for the apartment? [5]

- (c) Bank SS Bhd granted an unsecured credit facility amounting to RM40,000 to Mr NN. Mr NN defaulted in his repayment.

Briefly describe the procedure, including the various modes of execution of judgement, for the recovery of this debt that may be taken by Bank SS Bhd. [5]

(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

- Candidates showed poor knowledge of the concepts tested.
- They were unable to cite the relevant statutory provisions related to this question. Candidates are advised to cite the relevant statutory provisions whenever applicable in the question.

1. (a) The supervisory and regulatory framework in Malaysia that facilitates the enforcement of the Anti-Money Laundering Act 2001 (hereinafter referred to as AMLA) may be described as follows:

AMLA empowers the Minister of Finance to appoint a Competent Authority which is empowered to act in accordance with this Act. Thus, Bank Negara Malaysia was appointed as the Competent Authority and the Financial Intelligence Unit (FIU) was set up.

The functions of the FIU include:

- receiving and analysing information and reports from any person;
- sending reports and information to enforcement agencies;
- sending information derived from an examination to an enforcement agencies;
- compiling statistics and records;
- instructing reporting institutions on reports or information received under section 14;
- making recommendations to the relevant supervisory authority, enforcement agencies and reporting institutions;
- creating training requirements and training reporting institutions on transactions, reporting and record-keeping obligations as outlined in Part IV (Reporting Obligations – Sections 13 to 28) of the AMLA; and
- communicating relevant information to a corresponding authority of a foreign State.

Reporting institutions are legally obligated (under section 14(b) AMLA) to report suspicious transactions to the FIU which will then make recommendations to the relevant supervisory authority, enforcement agency and reporting institutions. Section 3 of AMLA defines “reporting institutions” to mean:

“any person, including its branches and subsidiaries outside Malaysia who carries on any activity listed in the First Schedule”. Examples include:

- banking business, finance company business, merchant banking business, discount house business and money-broking business and electronic fund transfer (EFT) as defined in the Banking and Financial Institutions Act 1989 (BAFIA);
- Islamic banking business;
- building credit business, credit token business, development finance business, factoring business and leasing;
- insurance business, insurance broking business and adjusting business;
- takaful business;
- dealing in securities (excluding providing investment advice);
- money-changing business;
- futures broking business and futures fund management business; and
- offshore financial services.

Section 3 of AMLA defines “enforcement agency” as including a body or agency that is for the time being responsible in Malaysia for the enforcement of laws relating to the prevention, detection and investigation of any serious offence. Examples of enforcement agencies include the police, customs, Bank Negara Malaysia, Securities Commission, Anti-Corruption Agency, Labuan Offshore Financial Services Authority and the Registrar of Companies (now known as Companies Commission of Malaysia).

The competent authority and enforcement agencies are accorded powers to undertake investigation, search and seizure upon having reason to suspect an offence under AMLA that has been committed.

These include the powers to:

- enter and search the premises for any property, record, report or document;
- make copies of, take extracts from, take possession of or remove from the premises, any of the records, reports or documents that were seized; and
- search and detain any person.

The enforcement agencies may issue an order to freeze any property and seize any movable property suspected to be the subject matter of an offence or evidence relating to such an offence, except those in the possession, custody or control of a financial institution. Where the movable property seized comprising money, shares, securities, stocks, debentures, etc., belonging to a person other than the person being prosecuted, the seizure shall prohibit using, transferring or dealing with such property; or require the surrender of the property.

- (b) Bank Kaya Bhd, being a commercial bank licensed under BAFIA is one of the reporting institutions as defined in section 3 of AMLA. As RM800,000 is a substantial amount to be paid to a young man who is not Bank Kaya Bhd's existing customer and nothing is known about him, Mr OK should insist on the identification documents such as the identity card or passport before paying Mr Kool as required under section 16 of AMLA.

Moreover, Bank Kaya Bhd's has to avoid liability for money-laundering or abetting money laundering which are offences under section 4 of the said Act punishable with the maximum sentence (upon conviction) of five years' imprisonment or a fine of RM5million or to both such fine and imprisonment. Under section 13 of AMLA, the reporting institution must record transactions exceeding a specified amount. Such records are to include the identity and address of the beneficiary of the telegraphic transfer.

Under section 14(b) of AMLA, the bank also has to promptly report to the competent authority (Financial Intelligence Unit, Bank Negara Malaysia) any transaction exceeding the amount specified and where the identity of persons or transaction or circumstances raise suspicion that proceeds of unlawful activity is involved. Although the amount has yet to be specified, perhaps, Bank Kaya Bhd can consider reporting this transaction as a suspicious transaction as it is doubtful that Mr Kool was telling the truth about his rich "aunty".

As this is a substantial cash transaction, Bank Kaya Bhd is to verify by reliable means and record identifying information by using the identity card or passport, etc. as required under section 16 of AMLA. Although a driving licence is stated as one of the identification documents, it is submitted that the production of a driving licence alone is insufficient.

Section 17 provides that the bank must maintain the record of such transaction for 6 years from the transaction date. The maximum penalty is a fine of RM1 million or a jail term of one year or both.

Question 2

Candidates were unable to cite the relevant case law and statutory provision in relation to the recovery of money paid by mistake. Mentioned the Bills of Exchange Act 1949 instead of Section 73, Contracts Act 1950.

2. (a) (i) In order to enter into a legal contract, such as deposit account contracts, a customer has to have full legal capacity to do so. Generally, a person has to be of the age of majority, be of sound mind and not be disqualified by law from contracting – section 11, Contracts Act 1950. Section 10(1) of the Contracts Act provides that "All agreements are contracts if there are made by the free consent of parties competent to contract, for a lawful object, and are not hereby expressly declared to be void". Section 2(h) of the Act further provides that an agreement enforceable by law is a contract. In other words, parties entering into a contract must have the legal capacity to do so. A person who is not of the age of majority cannot enter into binding

contracts such as a current account contract as she lacks mental capacity. According to the Age of Majority Act 1971, the age of majority is 18 years. Moreover, section 12 of the said Act goes on to emphasise the importance of ascertaining whether, at the time of making the contract, the person concerned is capable of understanding the contract and of forming a rational judgement as to its effect upon his interest. Ms Juenta Wang will not be liable on the cheques drawn on the current account due to her age.

Thus, it is not advisable for Mr KS to open a joint account for Mr Wang and Ms Juenta Wang. Mr KS can instead open the account in the sole name of Mr Wang.

- (ii) Although provisions in the Bankruptcy Act 1967 do not specifically prevent an undischarged bankrupt from opening any banking account, the banking practice is that an undischarged bankrupt is not allowed to open or operate an account without the Director General of Insolvency's (DGI) (formerly known as the Official Assignee) permission. This is because, under the Bankruptcy Act 1967 provisions, all monies, properties and assets owned by the undischarged bankrupt vest in the DGI and bankers are required to pay the same to the DGI.

Thus, Mr KS is advised not to open the account for Mr Ree, an undischarged bankrupt.

- (b) (i) When a bank wishes to close a customer's account, the bank must first give reasonable notice to the customer – *Joachimson v Swiss Bank Corporation, Prosperity Ltd v Lloyds Bank Ltd* and *Ng Cheng Kiat v OUB*. Reasonable notice would mean the banks must give sufficient notice to their customers in order that they can make alternative arrangements and thus, the length of such notice depends on the facts and circumstances of each case. In deposit account contracts entered into between banks and their customers, there are specific provisions as to the giving of notices; and these need to be complied with. In this instant case, Bank Best Bhd, because of their mistake, obviously did not notify Mr AB of the closure.

Therefore, Bank Best Bhd is liable for the wrongful dishonour of the RM3,000 cheque. One of the principal duties of a bank is to honour cheques drawn upon it by its customers.

Moreover, the dishonour of the cheque with the reason "account closed" is defamatory. Applying the case of *Ng Cheng Kiat v OUB*, it appears that Bank Best Bhd may be sued for damages for breach of contract and libel. Tradesmen, generally, could recover substantial but reasonable damages whilst non-tradesmen could recover nominal damages unless special loss could be proved. However, courts may be prepared to award substantial damages if there is loss of credit or business reputation – *Kpohraror v Woolwich Building Society*. Bank Best Bhd may be held liable to pay damages to Mr AB for breach of contract and libel.

- (ii) The issue is whether Bank Best Bhd can recover the RM4,000 wrongly paid to Mr YY. The mistake of paying Mr YY RM4,000 extra was Bank Best Bhd's mistake.

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. Therefore, legally, Bank Best Bhd can recover the RM4,000 from Mr YY.

However, Bank Best Bhd may be prevented from correcting its mistake if the customer honestly believes that the entries are correct and alters his or her position in reliance upon them – *Lloyds Bank Ltd v Brooks*.

It is submitted that if Mr YY does not fall under this exception, Bank Best Bhd is likely to succeed in recovering the RM4,000 from Mr YY. It is unlikely that the courts will allow a customer to take advantage of an incorrect credit entry – *British & North European Bank v Zalzein*.

Question 3

- Candidates had poor knowledge on special crossing on cheques.
- They were unable to support answers with relevant reasons in relation to payment of cheques and liability as a paying banker.
- Candidates are advised to read the questions carefully and answer according to the question's requirement.

3. (a) (i) Section 76(2) of the Bills of Exchange Act 1949 states that where a cheque bears across its face an addition of the name of a banker, either with or without the words “not negotiable”, the cheque is crossed specially and to that banker.

The legal effects of a special crossing is that the paying banker must pay the amount of the cheque only to the (collecting) banker named in the crossing. The banker on whom a crossed cheque is drawn must pay it strictly in accordance with the crossing. As the specially crossed cheque is crossed to a particular banker, it must be paid to that banker.

Also, the collecting banker must collect the specially crossed cheque into the account of the named payee/s maintained with it as the collecting banker must collect cheques “in good faith and without negligence” – section 85, Bills of Exchange Act 1949. Moreover, Section 81A of the Bills of Exchange Act 1949, provides that cheques which are crossed and bear the words “account payee”, such cheques are not transferable.

- (ii) The legal implications if the paying banker ignores the special crossing is that the paying banker will be liable for breach of contract, conversion and negligence as the paying banker will lose its statutory protection under section 80 of the Bills of Exchange Act 1949.

A special crossing instructs the paying banker to pay to the other banker to whom the cheque is crossed. If the paying banker does not act in accordance with the instruction, he will be liable to the true owner of the cheque for any loss he may sustain as a consequence of the cheque being so paid. And if the drawer of the cheque suffers loss, the drawee banker will be liable for breach of contract and will not be entitled to debit the cheque to the drawer's account.

A banker who pays a crossed cheque contrary to the crossing, does so at his peril and will be liable to the true owner for any loss sustained – section 79(2).

Section 80 protects the paying banker who although he complies with the crossing on the cheque, the true owner does not receive payment. However, to be so protected, the banker must prove that he has done so:

- in good faith;
- without negligence; and
- in accordance with its crossing.

If these three requirements are fulfilled, the paying banker is entitled to the same rights and to be placed in the same position as if, in paying the collecting banker (as required by the crossing), he had actually paid the true owner. In other words, he does not have to bother with the title of the person on whose behalf the cheque is being collected or the authority of the banker to collect it.

- (b) Although the terms “negotiability” and “transferability” are sometimes used interchangeably, they are distinct concepts. Transferability refers to the ability to assign whatever title one possesses in an instrument to another. Whilst, on the other hand, negotiability refers to the ability of the bona fide purchaser to acquire a better title than that enjoyed by the vendor.

In other words, transferability relates to the process of passing title in an instrument, whereas negotiability usually relates to the quality of the title. So while all negotiable instruments must be transferable, not all transferable instruments are negotiable.

- (c) (i) No, Bank DD Bhd would not incur any liability for the payment of the RM2,000 cheque which was paid after Mr Mattee's death. Section 75(b) of the Bills of Exchange Act 1949 states to the effect that the banker's authority to pay on a cheque is determined upon notice of death. Notice here means actual knowledge. Thus, if a banker is unaware of his customer's death and he honours a cheque drawn by the customer which is presented for payment after his death, the paying banker has the right to debit the deceased's account.

As notice of death was only received by the Bank on 31 March 2006, Bank DD Bhd would not be liable when it paid the cheque before the notice was received even though Mr Mattee was already deceased.

Thus, Bank DD Bhd had rightfully debited the account and would not be liable thereon.

- (ii) If a cheque is dated 23 March 2006 and signed by Mr Mattee is presented for payment on 3 April 2006, Bank Best Bhd should not pay this cheque as notice of death was already received by the bank – section 75(b) Bills of Exchange Act 1949.

A banker's duty and authority to pay his customer's cheques are determined by notice of the customer's death - section 75(b), Bills of Exchange Act 1949.

Once a banker has notice of the death, cheques signed by the deceased should be returned unpaid with the answer "drawer deceased". Since notice of death was received on 31 March 2006, the account should be frozen. Notice of Mr Mattee's death has the effect of terminating the banker-customer relationship.

The above-mentioned account is to be frozen (i.e. no more withdrawals to be allowed) until it is operated by the executors (in case Mr Mattee died testate, i.e. with a will) or the administrators (in case Mr Mattee died intestate, i.e. without a will).

If the account is overdrawn, the banker, on receiving notice of the death, and if he intends to preserve the liability of the deceased's estate for the debt, the banker has to rule off the account. This is in order to prevent the operation of the rule in *Clayton's Case* and to preserve the liability of the estate of the deceased party for the amount owing on the account.

Question 4

- Candidates had poor knowledge on banking secrecy. They were unable to support answers with relevant reasons.
- Candidates stated the nature of the letter of guarantee and letter of comfort but did not state the differences between them.
- Candidates are advised to support their answers with reasons whenever necessary.

4. (a) (i) As the amount of the deposit is substantial, RM1million, Bank Teguh Bhd should not allow this withdrawal. Generally when a customer dies, any credit balance in the customer's account vests in his personal representatives. As the amount involved is substantial, and Mr and Mrs Monee were recently divorced, Bank Teguh Bhd may not pay to Mrs Monee (being the survivor) the balance. Bank Teguh Bhd should be advised to freeze the account and the matter would have to be resolved in court between the surviving parties and the personal representatives.

- (j) Yes, it would matter if Mr Monee left a will or if he did not. Notice of Mr Monee's death has the effect of terminating the banker-customer relationship.

The above-mentioned account is to be frozen (i.e. no more withdrawals to be allowed) until it is operated by the executors (in case Mr Monee died testate, i.e. with a will) or the administrators (in case Mr Monee died intestate, i.e. without a will).

- (b) No, the officer in the Loan Recovery Department of Bank WW Bhd should not request Mr BM's wife to remind Mr BM and persuade him to pay the instalments. One of the duties of a banker is the duty of secrecy. Under section 97(1), Banking and Financial Institutions Act 1989 (BAFIA) bank employees are under a legal obligation to keep secret the affairs of its customers. Bank WW Bhd is bound by this statutory provision not to disclose about the account. Otherwise, if convicted of breach of banking secrecy, the maximum penalty for contravention of section 97 of BAFIA is 3 years imprisonment or RM3million fine or both.
- (c) Both the letter of guarantee and letter of comfort are strictly speaks on non-securities. They are not assets which may be used to secure credit facilities. A letter of comfort is usually given when the company or entity is unable or unwilling to provide a guarantee, but is prepared to offer 'comfort' to a lender in the form of an assurance of its continuing interest in, or commitment to the relevant debtor.

A guarantee is a promise by the guarantor to pay the creditor if the principal debtor does not do so. Section 79 of Contracts Act 1950 defines a guarantee as a contract to perform the promise, or discharge the liability, of a third person in case of his default. Whilst there is secondary liability in the case of the guarantee, the enforceability of a letter of comfort depends very much on its wording. Whilst a guarantee is enforceable as a contract, whether or not the letter of comfort is binding or not depends on the facts of each case – *Banque Brussels Lambert SA v Australian National Industries Ltd.*

Question 5

- Candidates wrote on types of electronic fund transfers and products of e-banking, instead of writing on the applicable laws and Bank Negara Malaysia guidelines.
- They had poor knowledge on the legal documentation and the differences between the use of charges and assignments in relation to property as security.
- Candidates are advised to read the questions carefully and answer according to the question's requirement.

5. (a) The main laws that apply to this remittance is the law of contract and agency. A whole series of contracts exist between Bank MM Bhd and Mr JC, Bank MM Bhd and the Electronic Fund Transfer (EFT) system provider (e.g. SWIFT), and the banks themselves (Bank MM Bhd and the bank in Manchester and the correspondent bank, if any).

The other laws relevant to this remittance include the Banking and Financial Institutions Act 1989 (BAFIA) [now, section 119 of BAFIA is repealed and replaced by the Payment Systems Act 2003 which now is the main legislation governing EFT] Digital Signatures Act 1997, Computer Crimes Act 1997, and where foreign currency is involved, the Exchange Control Act and the relevant ECM notices and Bank Negara Malaysia Guidelines also govern this remittance, in particular, BNM/GP11.

- (b) (i) As there is no strata title issued, Bank GG Bhd can take the property as security by way of Deed of Assignment. This is the assignment of the purchaser's rights in the Sale and Purchase Agreement. The Deed of Assignment may be a separate document by itself or it can be incorporated into the Loan Agreement (referred to as 'Loan Agreement cum Assignment). In *Hipparion (M) Sdn Bhd v Chung Khiaw Bank Ltd*, the Supreme Court held that the legal effect of such a Deed of Assignment is that the assignee has all the rights, title and interest of the assignor. There is a Power of Attorney given to the Bank, a notice of assignment to the vendor/developer, the

lodgement of a private caveat and also, where the master title is charged, the chargee's undertaking to omit the property from foreclosure proceedings and discharge of charge upon issue of separate title.

- (ii) Yes, my answer would be different if title has already been issued. Once title is issued, a first party first legal charge over that strata title can be created. It must be registered (pursuant to the requirements of the National Land Code 1965) with the Land Registry or Land Office – section 243, NLC. The charge must be in the statutory prescribed form, together with a Charge Annexure, and has to be duly executed and stamped, and accompanied by the appropriate fees.
- (c) To recover the unsecured debt, Bank SS Bhd can take legal action against Mr NN. A letter of demand will be sent to the Mr NN's address given in the facility agreement. If there is no response, Bank SS Bhd can proceed to sue for and prove the debt. The process of recovery ends with the court giving judgement on the liability of the guarantor, after which Bank SS Bhd may proceed with enforcement via writ of seizure and sale, judgement debtor summons and bankruptcy proceedings.