

DP02

Law on Banking and Finance

7 MAY 2002

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) With reference to the Banking and Financial Institutions Act 1989, compare and contrast between a “bank” and a “finance company”.

[Your answer should include the definitions of “bank” and “finance company” and the meaning of “banking business” and “finance company business”]. [10]

- (b) Can a bank be another bank’s customer? Give reasons for your answer. [5]

- (c) Does section 97 of the Banking and Financial Institutions Act 1989 on banking secrecy have extra-territorial effect (that is, does it apply outside Malaysia)? [5]

- (d) If a bank wishes to close a customer’s account that is in credit, the bank must give reasonable notice to the customer.

In the context of this statement, briefly explain the meaning of the word “reasonable”. [5]
(Total:25 marks)

2. (a) In the year 2000, Bank Gabung Bhd granted Encik Osman, a partially secured overdraft facility of RM100,000. Encik Osman’s account was in frequent excesses and Bank Gabung Bhd’s officers are in the midst of reviewing the account with a view to recall the facility.

Bank Gabung Bhd then received a written request from Bank Baru Bhd for their opinion on the creditworthiness of Encik Osman.

Mr Tee Poo Yu, a credit officer in Bank Gabung Bhd, who is in charge of giving replies to such credit requests, intends to give a favourable reply – “Satisfactorily Conducted” – hoping that Bank Baru Bhd may eventually refinance the facility. Mr Tee Poo Yu thinks that after all, he and Bank Gabung Bhd are adequately protected by the disclaimer contained in the reply – “For your private use only. This opinion is given without any responsibility or liability on the part of the bank or any of its officers.”

Is Mr Tee Poo Yu legally correct? Advise him. [10]

- (b) Mrs Tan does not maintain any account with Bank Antarabangsa Bhd. One day Mrs Tan goes to the remittance counter of Bank Antarabangsa Bhd and instructs Bank Antarabangsa Bhd to remit £5,000.00 by telegraphic transfer to her son’s account maintained in Bank Antarabangsa Bhd’s branch in Liverpool, England.

Write a detailed explanation on the laws and regulations governing this telegraphic transfer transaction. [15]

(Total:25 marks)

3. (a) Ms Mary Sumary was given a RM2,000.00 cheque drawn on Bank STY Bhd made payable to “Mary Sumary” but the words “or bearer” were crossed out. There was no other writing on the cheque except for the date, the amount in words and figures and the drawer’s signature. The drawer was Mr Ben Umar, her best friend, who gave her the cheque as a gift for her birthday.

In the above context, answer the following, giving your reasons:

- (i) Can Ms Mary Sumary obtain cash over the counter at Bank STY Bhd or must she deposit the cheque through an account? [5]

- (ii) Assuming that the cheque is dishonoured with the reason “Refer to Drawer”, can Ms Mary Sumary sue anybody? [5]

- (b) Briefly describe what “negotiable instruments” are by stating their main characteristics and give **four** examples of negotiable instruments. [5]

- (c) In relation to cheques, define or explain the meaning of the following terms which are highlighted in bold:

- (i) **issue** of cheques [2]
- (ii) **holder** of a cheque [2]
- (iii) **holder for value** [2]
- (iv) **holder in due course** [2]
- (v) **delivery** of cheques [2]

(Total:25 marks)

4. (a) En Ismail is a newly recruited credit officer. Just yesterday when he was at a meeting he heard that the security to be created for a particular loan proposition was a “**third party first legal charge** over land and building ...”. Today when he read another credit file the security created was “**first party third legal charge** over land and building ...” .

Give a brief explanation of the meaning and differences of the **two** terms highlighted in bold. [5]

- (b) In consideration of credit facilities granted to it, XX Sdn Bhd executed a debenture incorporating fixed and floating charges over its assets in favour of the lender. The charges (both fixed and floating) over land were registered at the relevant Land Office/Registry but were not registered with the Registry of Companies.

State the legal implications by explaining whether the said failure to register the charges at the Registry of Companies within any prescribed time:

- (i) is capable of rectification; and [5]

- (ii) whether it would prejudice the lender from demanding repayment of the credit facilities from XX Sdn Bhd? [5]

- (c) Mr Kong Sie owns 500 lots of shares (500,000 shares) in AAA Holdings Bhd, which in turn owns 80% of the shares in Bank AAA Bhd. Mr Kong Sie approaches Bank AAA Bhd for a personal loan to be secured by the 500 lots of shares in AAA Holdings Bhd.

Briefly comment on the validity, or otherwise, of the creation of this security. [5]

- (d) Explain the main difference between the concept of a “mortgage” and a “charge”. [5]

(Total:25 marks)

5. Mr David Yew charged his land in Ipoh, Perak held under a Land Office title, to secure a housing loan granted to him by Bank HomeLoans Bhd. The charge was duly registered in favour of Bank HomeLoans Bhd. In this context, answer the following:

- (a) Why is it important for Bank HomeLoans Bhd to ensure that the charge is registered? [5]

- (b) In practice, would Bank HomeLoans Bhd have disbursed the loan prior to the registration of the charge? Give reasons for your answer. [5]

- (c) What are the duties (implied by the National Land Code) of Mr David Yew as a chargor? [5]

- (d) In event Mr David Yew defaults in repayment of the loan, what are the remedies available to Bank HomeLoans Bhd? [10]

(Total:25 marks)

OUTLINE ANSWERS

Question 1

- Candidates answered this question satisfactorily, apart from the question on section 97 of the BAFIA on the banker's duty of secrecy. Most candidates only described the section briefly but did not answer the question asked, i.e. whether it has "extra-territorial" effect.
- Candidates who scored high marks cited cases and statutory provisions to support their answers.

1. (a) Both banks and finance companies are licensed under the Banking and Financial Institutions Act 1989 ("BAFIA") and are termed as "financial institutions".

Section 2(1) of BAFIA provides the definitions of "bank" and "banking business". A "bank" is defined as a person that carries on banking business. And, "banking business" is defined as 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 such other business as the [Central] Bank, with the approval of the [Finance] Minister, may prescribe.

On the other hand, section 2(1) defines "finance company" as a person who carries on finance company business. And, "finance company business" is defined as the business of receiving deposits on deposit accounts, savings accounts or other similar accounts; and giving of credit facilities, leasing business, business of hire-purchase; or business of acquiring rights and interests in a hire-purchase, leasing or similar transactions; and such other business as the [Central] Bank, with the approval of the [Finance] Minister may prescribe.

Thus, the other similarity is that both "banks" and "finance companies" receive deposits, except that finance companies (unlike banks) do not receive deposits on current accounts and so cannot offer overdraft facilities.

Whilst both institutions offer credit facilities, the scope and range of facilities offered by banks are much wider compared with those offered by finance companies. Banks offer trade financing facilities and overdrafts, remittances etc. but finance companies do not offer trade financing facilities nor remittance facilities. However, finance companies offer other types of facilities such as hire-purchase and leasing facilities.

[Alternative answer: One major difference in respect of credit facilities granted by banks compared to those granted by finance companies is that banks (except for loans granted to related companies) may grant "clean" or unsecured credit facilities to its customers; whereas finance companies generally cannot do so except for certain facilities sanctioned or within certain specified limits – section 60, BAFIA.]

- (b) Yes, a bank can be another bank's customer. Banks often open accounts in other banks. Applying the case of *Great Western Railway Co. v London and County Banking Co Ltd.*, account-holders are customers.

Moreover, even if a non-clearing bank regularly sends cheques to a clearing bank for clearing (collection), the former is a customer of the latter – *Importers Company Ltd. v Westminster Bank Ltd.*

- (c) No, section 97 of BAFIA does not have extra-territorial effect; that is, it does not apply outside Malaysia. The Court of Appeal in *Attorney-General of Hong Kong v Zauyah Wan Chik & Ors* observed that since BAFIA had no extra-territorial effect, a disclosure made in contravention of s.97 BAFIA in Hong Kong would not affect criminal liability in Malaysia.

- (d) As a general rule, if a bank wishes to close a customer's account, reasonable notice must be given to the customer – *Ng Cheng Kiat v Overseas Union Bank*.

It was held in the case of *Prosperity Ltd. v Lloyds Bank Ltd* that a bank could not close an account in credit without reasonable notice and what was reasonable depended on the special facts and circumstances of the case. To illustrate what is meant by “facts and circumstances of the case”, in practice, some banks generally give 14 days’ notice for most customers (such as individuals and small businesses and companies) which may be sufficient notice. However, if the customer happens to be a corporate body with international dealings and overseas clients, 14 days’ notice may be insufficient.

Question 2

- Part (a) on banker’s liabilities when giving replies to credit request of another bank was answered moderately well.
- Part (b) was very poorly answered as most candidates displayed little knowledge on the law and regulations governing telegraphic transfers (a form of electronic funds transfer).

2. (a) Mr Tee Poo Yu is advised that before disclosing the requisite information to Bank Baru Berhad, he must ensure that the case fits or comes within the permitted disclosure as specified in section 99(1)(c) of the Banking and Financial Institutions Act 1989 (“BAFIA”). That is, the information must be in relation to a bona fide commercial transaction or a prospective bona fide commercial transaction, and the customer must be a party of the said transaction.

Even though he may give the opinion which is of a general nature on the creditworthiness of En Osman – as implied under section 99(1)(c) BAFIA, he must be careful when doing so because if he does so negligently, the Bank may be sued – *Hedley Byrne & Co Ltd v Heller & Partners Ltd*. In the Hedley Byrne case, the House of Lords held that the defendant bank was not liable because they included a disclaimer clause in the opinion.

However, in *Commercial Banking Co of Sydney Ltd v RH Brown and Co.* the Court held that a disclaimer in a banker’s opinion did not provide protection against fraud. It is submitted that since Mr Tee Poo Yu knew that Encik Osman’s account was not satisfactorily conducted, and he gave a favourable reply to get rid of the bad account, Mr Tee Poo Yu and his Bank may not be protected by the disclaimer.

- (b) Besides SWIFT, an alternative method of electronic transfer of funds is by means of telegraphic transfers. In operations of this type, the transferring bank communicates to the recipient bank, either directly or through an intermediary, details of the account to be credited with the amount involved and the method by which the recipient bank is to reimburse itself.

The laws and regulations governing telegraphic transfers are as follows:

Although principles of tort, restitution, property law, equity, and even criminal law, may be relevant when considering a problem thrown up by the electronic transfer of funds, the primary source of EFT law – the law governing telegraphic transfers – is the law of contract and agency.

A whole series of contracts exist between banks and their customers, banks and the EFT system provider, and the banks themselves.

The contractual relationship between the banks that participate in the EFT system is also important. Systems such as RENTAS and SWIFT depend upon multilateral contracts whereby each member bank is bound by the system rules. Multilateral contracts may arise where each member contracts with the EFT system provider to conform to the system rules; the members are then deemed to have contracted between themselves on the terms of their individual understandings. Alternatively, the members of the system may agree together to abide by the system rules. However, the end users, the payer and the payee, will not be privy to these contractual arrangements.

Section 119 of the Banking and Financial Institutions Act 1989 is also relevant here. This section merely provides for the necessity of written authorisation from and control by BNM before any system of EFT can be operated and afterwards.

Section 116(2)(e) provides that BNM may make regulations to provide for the imposition of duties, liabilities, responsibilities, restrictions, limitations, prohibitions or sanctions, or the conferment of rights, privileges, benefits or indemnities on the parties to any EFT system set up, or operating, in Malaysia. Section 116(2)(f) in turn provides for the power for BNM to make regulations to provide for the setting-up, operation, or administration of, or any other matter whatsoever relating to, EFT systems.

Part IV of BNM/GP 11 (para. 13) makes provisions on telegraphic transfers. It reads:

“Duties of financial institution

- 13(1) A financial institution shall transmit a telegraphic transfer within the same working day the customer makes the request or application for the telegraphic transfer.
- 13(2) A financial institution shall not be liable for the failure to carry out its obligations under subparagraph (1) if the customer has insufficient funds in his account to effect the transfer.
- 13(3) A financial institution has a duty to execute a payment order on the same working day that the payment order is received from another financial institution.
- 13(4) The beneficiary bank shall notify the beneficiary as soon as possible provided the customer has given sufficient information.
- 13(5) A beneficiary bank shall not impose any charges for expenses incurred in notifying the beneficiary of a payment order.”

Question 3

- Answers to parts (a) and (b) on concepts relating to cheques and the characteristics of negotiable instruments were of average level.
- Many candidates were not able to answer part (c) that required them to define some terms associated with cheques (e.g. holder, holder for value and holder in due course, etc.).

3. (a) (i) The cheque is an order cheque. Cheques are either made payable to bearer or to order or to a specified person – s.3(1) read with s.73(1) Bills of Exchange. When the words “or bearer” are crossed out, the cheque becomes an order cheque. Mary Sumary can take cash over the drawee bank’s (Bank STY Bhd) counter. She can also choose to deposit it through her account maintained in any financial institution if she so wishes.
- (ii) No, Mary Sumary cannot sue anybody. The party normally liable for a dishonoured cheque is the drawer. Here, the drawer is Ben Umar. Ben Umar has a defence against Mary’s claim because there is an absence of consideration since this cheque was a gift.
- (b) Negotiable instruments are formal legal documents each of which usually contains a legal obligation to pay money and possesses the attributes of negotiability. The main characteristics are that the:
- transferee can sue in his own name,
 - instrument may be transferred by delivery or delivery and indorsement, and
 - transferee taking the instrument in good faith and for value without actual notice of any defect in title or where there is no title obtains good title despite any defect in title or the absence of title of the transferor.

Examples of negotiable instruments include bills of exchange, cheques, promissory notes and bank drafts.

- (c)
- (i) Section 2 of the Bills of Exchange Act 1949 defines “issue” as “the first delivery of a cheque complete in form to a person who takes it as a holder”.
 - (ii) Section 2 of the Bills of Exchange Act 1949 defines the word “holder” as the payee or indorsee of a cheque who is in possession of it, or the bearer.
 - (iii) A holder for value is the holder of a cheque who has given value for the cheque. “Value” means for valuable consideration though there is no requirement that full value must be given.
 - (iv) A holder in due course is a holder who has taken a cheque complete and regular on the face of it, before it is overdue, without notice of previous dishonour, in good faith and for value with no notice of any defect in title of the person negotiating it.
 - (v) Section 2 of the Bills of Exchange Act 1949 defines the term “delivery” to mean the transfer of possession, actual or constructive from one person to another.

Question 4

- Candidates did not do well in parts (a) and (b) as they did not understand the law and principles governing debentures.
- Almost all candidates did not know the answer to part (c) relating to the security of shares in a holding company under BAFIA 1989.
- Candidates could not explain the difference between the concept of mortgage and of a charge.

4. (a) A “third party first legal charge” means that the security is not offered by the borrower but by a third party. The word “first” here refers to priority, meaning that this charge is not subject to any prior priority or encumbrance. The word “legal” means that the charge must be registered in the relevant Land Office/Registry and must comply with the National Land Code requirements. Legal charges would confer upon the parties to the charge statutory rights and obligations (such as the right given to the chargee to apply for order for sale). It is not merely an equitable charge – e.g. where the document of title and the relevant charge form/document has been delivered and executed respectively by the proprietor chargor – but not registered however in favour of the chargee.

On the other hand, “first party third legal charge” means that the security is provided by the borrower but the charge is third in priority. Third in priority means that there are two prior registered charges, which are ranking in priority to the third, unless they are stated to rank *pari passu*.

- (b)
- (i) Section 108(1) of the Companies Act provides that where a charge is created by a company, a statement of the prescribed particulars (Form 34), should be lodged with the Registrar of Companies for registration within 30 days after creation of the charge. Failure to comply with the requirements of section 108(1) would render the charge void against the liquidator and any creditor of the company – *Zeno Ltd v Prefabricated Construction Co (Malaya) Ltd & Anor*.
 - (ii) The repayment of monies secured by XX Sdn Bhd secured by a charge rendered void by non-registration as against the liquidator and creditor of the company, is not prejudiced and the debt becomes immediately repayable. Section 114 provides that failure to register within 30 days can be rectified through an application to the court. The court’s power to grant extension of time is discretionary, and unless there are good reasons it would not do so.

- (c) Mr Kong Sie is advised that the security is not acceptable by Bank AAA Bhd. As AAA Holdings Bhd owns 80% of the shares in Bank AAA Bhd, the former is the holding company of the latter as it owns more than 50% of the shares in the latter. – section 6, Companies Act. Section 59 of the Banking and Financial Institutions Act 1989 prohibits a licensed institution from entering into any transaction against the security of the shares of its holding company.
- (d) A mortgage is the transfer of ownership of property to the creditor to secure repayment of a debt, subject to the debtor's right of redemption. On the other hand, a charge does not involve any ownership change but gives the creditor (chargee) certain rights over the property, such as the right to be repaid out of the sale proceeds of the property.

Question 5

- Many candidates could provide answers to most concepts in the question, but some failed to support their answers with the relevant cases and statutory provisions.
- Many candidates failed to identify the duties of a chargor as implied by the National Land Code.

5. (a) It is extremely important for Bank HomeLoans Bhd to ensure that the charge is registered. This is because any charge created, under the National Land Code, must be registered with the appropriate Land Registry or Land Office to be effective as a security. – s.243, National Land Code. Under the Torrens system, all dealings (which include charges) in land must be registered. Once registered, the chargee's interest in the land is indefeasible – *Tai Lee Finance Co Sdn Bhd v Official Assignee & Ors*.
- (b) Yes, in practice Bank HomeLoans Bhd would have disbursed the loan prior to the registration of the charge. This is because of the time factor. The lender normally disburses the loan upon the confirmation from its solicitors that the charge documents have been presented for registration and that having conducted the necessary searches, there are no encumbrances on the title, which would prevent the charge from being registered in due course. The lender may also insist on obtaining the solicitor's undertaking to refund monies disbursed in event the charge cannot be registered. Solicitors often qualify their undertakings, if given, that they are not liable if the non-registration is not attributable to their acts or omissions.
- (c) The duties of Mr David Yew as chargor implied by the National Land Code include (sections 249-250 National Land Code) to:
- pay all rents falling due to the State authority
 - pay all rates, taxes and other outgoing
 - keep in repair all buildings on the land charged; and
 - insure the buildings to their full insurable value.
- (d) In event Mr David Yew defaults in repayment of the loan, the remedies available to Bank HomeLoans Bhd are:
- right to possession
The Bank, as first chargee, has the right to possession when the chargor is in breach of an agreement, expressed or implied – s.271(1), National Land Code. This right is expressly limited to charges over land held under a Land Office title, or in the case of any other town or village land, if the land is not occupied by the chargor. – s.270(1), National Land Code.

This remedy of taking possession may either take the form of going into physical possession, or where the property is subject to a lease or tenancy, by taking the rent. – s.271(1), National Land Code.
 - power of sale
The more widely used remedy is the exercise of the chargee's power of sale. The power of sale arises pursuant to express terms and conditions contained in the Facilities Agreement and the charge annexure and terms of conditions implied in the National Land

Code (“NLC”). Section 253(1) of the NLC provides that the right to sell arises when the chargor has defaulted in payment of interest and principal, and when the chargor has breached the agreement.

In the case of land held under Registry title the chargee may apply to the Court for an order for sale of the charged land. In this instant case, the land is held under Land Office title; and so the Bank has to apply to the Collector of Land Revenue for an order for sale. Sale is by public auction.