SOME RECENT DEVELOPMENTS IN THE LAW OF BANKING IN MALAYSIA

The Central Bank of Malaysia and Banking (Amendment) Act, 1982 introduced a new Section 26A into the Banking Act, 1973. Ever since its introduction into the Banking Act, Section 26A has been the subject of much criticism by bankers and other members of the public alike for its inherent "harshness". It is small wonder that the section had to be amended so soon after its birth.

Thus, on October 10, 1983, the Dewan Rakyat passed the Banking (Amendment) Bill, 1983, which sought to amend the Banking Act, 1973 by introducing a new section 24A and amending the existing section 26A.

In this paper, it is sought to discuss the amendment to Section 26A. Before that amendment is discussed, it is pertinent perhaps that a few words be said about the new arrival into the Banking Act, 1973 — Section 24A.

I. Section 24A

This new section attempts to cut across procedural hurdles normally involved when a company intends to restructure itself involving the whole or any part of its undertaking being transferred to another company.

The company involved in this case is a licensed bank. In the case of a restructure of a licensed bank, it would appear as if there are only two major hurdles to cross before the scheme for restructure is made effective.

First, the bank must have obtained the Minister's approval to the proposed scheme for reconstruction in accordance with section 24 of the Banking Act, 1973. A scheme which has been so approved may then be effected in accordance with the new provision. This is provided under subsection (1) of section 24A, to the following effect:

"24A(1) Any proposed scheme —

(a) for reconstruction of a licensed bank; or
(b) for amalgamation, merger, or otherwise between a licensed bank and another licensed bank,

Wherein the whole or any part of the undertaking or the property of a licensed bank (hereinafter referred to as "the transferor") is to be transferred to another licensed bank (hereinaftar referred to as "the transferee") and which has been approved by the Minister pursuant to subsection (2) of section 24, may be effected in accordance with this section."

The second hurdle consist of applying to the High Court for a *confirmation* of the scheme by way of *ex parte* originating summons, and the

High Court may, by order, confirm the scheme. Once the High Court has confirmed the scheme, the scheme shall take effect.[1]

This simplistic, two-hurdle process represents a major departure from existing provisions regarding requirements in cases of reconstruction or arrangement between companies as found in some Malaysian statutes. Under the Companies Act, 1965, for example, any scheme for reconstruction must be approved by a statutory majority (three-fourths) of the ordinary shareholders of the company, besides being approved by the High Court.[2]

The Insurance Act also contains a provision relating to the transfer of insurance business. While the Act does not provide that a scheme of transfer of insurance business be approved by all the members and policy owners, it does enact that *before* an application is made to the High Court for a confirmation of a scheme, notice of the intention to make the application containing such particulars as are prescribed shall be published in the Gazette and in not less than two newspapers. For a period of fifteen days after the publication of the notice, a copy of the scheme shall be kept at each office in Malaysia of every insurer concerned which shall be open to inspection by all members and policy owners.[3]

It should be noted that the new section 24A eliminates altogether participation by shareholders of a licensed bank and those who would be affected by any proposed scheme for reconstruction. Subsection (5) of section 24A states that the order of the High Court made under subsection (3) shall be published in not less than two newspapers as may be approved by the Central Bank. This would seem to be the first instance when the fact of the restructure is brought to the notice of the public. However, it should be noted that unlike the notice under the Insurance Act, the notice under the new provision in the Banking Act, 1973 is *after* the fact.

Another departure from existing statutory requirements on reconstruction which merits consideration is the requirement to furnish reports or statements together with the proposed scheme. Section 177 of the Companies Act, 1965, for example, provides that with every notice summoning a meeting of members or creditors there shall be sent a statement explaning the effect of the compromise or arrangement. The Insurance Act provides that before an application is made to the High Court, a copy of the scheme is to be lodged with the Director General, together with copies of actuarial and other reports (if any) upon which the scheme is founded.[4]

[1] "(2) A scheme under this section shall not have effect unless confirmed by the High Court and if so confirmed, the scheme shall have effect according to its tenor notwithstanding anything in any law and shall be binding on any person thereby affected."

(3) An application to the High Court for confirmation of a scheme under this section shall be made by the transferor by way of *ex-parte* originating summons, and the High court may by order confirm the scheme which may provide for all or any of the following."

[2] Section 176, Companies Act, 1965.

[3] Paragraphs (b) and (c) of Section 33(1), Insurance Act.

[4] Section 33(1)(a), Insurance Act.

When the Scheme is sent for the approval of the Minister under section 24 of the Banking Act, 1973, there is no provision for any accompanying report. The Minister may approve or refuse to allow the proposed arrangement or Scheme on the recommendation of the Central Bank. The decision of the Minister then would be based solely on the expertise of the Central Bank in its advisory function.

The Powers of the High Court under Section 24A

Once the Scheme of reconstruction has been approved by the Minister upon the recommendation of the Central Bank, are the hands of the High Court tied when it comes to confirmation of the Scheme under subsection (3) of section 24A? Subsection (3) provides that "the High Court *may* by order confirm the Scheme. . ." It would seem, from the foregoing, that the High Court is imbued with a discretion whether or not to confirm the Scheme as approved by the Minister.

In confirming the Scheme, does the High Court have the power to modify or alter the Scheme in any way?

Subsection (4) of section 176 of the Companies Act, 1965 provides that the Court may grant its approval to a compromise or arrangement "subject to such alterations or conditions as it thinks just". Subsection (5) of section 33 of the Insurance Act provides that the Court may confirm the Scheme "without modification or subject to modifications agreed to by the insurers concerned, or may refuse to confirm the Scheme". By enacting merely that the High Court "may by order confirm the Scheme" in subsection (3) of section 24A, it is very much in doubt whether the legislature intended the High Court to possess the power to vary or modify the Scheme. It appears as if the powers of the High Court in case of the reconstruction of a licensed bank is made very much more limited than in the case of reconstruction of other companies under the Companies Act or insurance companies under the Insurance Act.

Other Points of Interest

It is also interesting to note that the date on and from which the Scheme shall take effect may be "a date *earlier* or later than the date the order is made."[5]

It should also be noted that the order of the High Court under subsection (3) of section 24A may make provision for the "vesting" of any property formerly held by the tranferor in the transferee "on and from the date of the transfer".[6] Under the Companies Act, 1965, no vesting order

[5]Paragraph (a) of subsection (3) of section 24A, Banking (Amendment) Act, 1983.

[6]"(4) Where the order of the High Court made under subsection (3) provides for the transfer of any undertaking or property vested in or held by the transferor either alone or jointly with any other person, then, by virtue of the order, that undertaking or property shall, on and from the date of the transfer, become vested in or held by the transferee either alone or, as the case may be jointly with such other person."

shall have any effect or operation in transferring or otherwise vesting *land* until the appropriate entries are made with respect to the vesting of that land by the appropriate authority.[7] There is no similar provision in section 24A. Subsection (6) provides that the transferor shall lodge, within thirty days of the making of the order, a copy of the order of the High Court together with a copy of the scheme with the appropriate authority concerned with the registration or recording of dealings in that land or interest in that land. Although it is not expressly provided for under section 24A, it would appear that immovable property can only be effectively transferred upon registration of such transfers in accordance with the National Land Code. In the absence of provisions to the contrary, the effect of the vesting order of the High Court with respect to land should be read in the light of the National Land Code.

II. Section 26A, before the Amendment Act, 1983

Section 26A of the Banking Act, 1973 prohibits a licensed bank from granting advances, loans or credit facilities to any of its directors, officers or employees or their related concerns. The exceptions to the above strict prohibition are contained in the first two lines of the section itself, which reads "Except as provided under paragraph (c) of subsection (1) of section 26 and subsection (2). . .".

Paragraph (c) of subsection (1) of section 26 prohibits a licensed bank from granting advances, loans or credit facilities which are *unsecured* in excess of, or in the aggregate and outstanding at any one time, ten thousand ringgit to any of its related corporations except a related bank, a related finance company or any other related financial institution approved by the Central Bank.

It follows, therefore, that it would be allowable for a licensed bank to grant *unsecured* advances, loans or credit facilities of *ten thousand and below*, and *secured* advances, loans or credit facilities of any amount to any of its related corporations, and this a licensed bank may do even if such corporations are director, officer or employee-interested concerns by virtue of the exception under section 26A.

The other exception is contained in subsection (2) of section 26A which states that a licensed bank may grant to any of its officers or employees loans which are provided under its appropriate scheme of service and, where the bank is satisfied that special or compassionate circumstances exist, a loan not exceeding at any one time six months' remuneration of that officer or employee on such terms and conditions as the bank thinks fit.

Categories of Prohibition

The categories of prohibition under section 26A are divided into five

[7] Subsection (4) of section 178, Companies Act, 1965.

paragraphs, (a) to (e). A licensed bank shall not grant advances, loans or credit facilities to any of the following:

(a) its own directors, officers or employees or other persons receiving renumeration from it;
(b) any firm in which any of its directors, officers or employees is interested as partner, manager, agent or guarantor;
(c) any corporation in which any of its officers or employees is a director, manager, agent or guarantor, or any corporation in the shares of which any of its officers or employees has any material interest as determined by the Central Bank;
(d) any corporation in which any of its directors is a member, director, manager, agent or guarantor, or any corporation in the shares of which any such director has any interest whatsoever, directly or indirectly, or
(e) any individual for whom any of its directors, officers or employees is a guarantor.

Problems of interpretation may arise in case of paragraphs (c) and (d), especially when read together with subsection (4). Both paragraphs seem to consist of two parts:

i) any corporation in which any of the bank's officers or employees [or directors][8] is a director, manager, agent or guarantor [or member] *OR*
ii) any corporation *in the shares of which* any of the bank's officers or employees [or director] has any material interest [or any interest whatsoever directly or indirectly].

From the above, it would follow that if a bank grants a loan to a corporation wherein an officer of the bank is a director, that loan would be caught by *the first limb* of paragraph (c) of subsection (1) of section 26A. This would be true even if that director holds no shares whatsoever in the corporation concerned. There is an exception to this form of interpretation in the case of paragraph (d).

Subsection (4) of section 26A seeks to exempt a bank from the prohibition contained in paragraph (d) of subsection (1). Under subsection (4), a bank may grant loans, advances or credit facilities to a director interested corporation upon the following conditions:-

[8]In case of paragraph (d).

a) that the corporation be listed on a recognised stock exchange and that the director should not, whether directly or indirectly, have any material interest in that corporation, or

b) that the corporation be a public company where the director should not have any interest in his personal capacity.

Therefore, if a bank grants a loan to a corporation listed on the stock exchange wherein a director of the bank is a director, that loan would *not* be automatically caught within the first limb of paragraph (d) if the director's shareholding interest in that corporation does not exceed the limit as determined by the Central Bank under paragraph (a) of subsection (4). However, if the bank were to grant a loan to the same corporation wherein its *executive director* is a director that loan would be automatically caught by the first limb of paragraph (c).

Two questions spring to mind:—

1) Why is there only an exception for paragraph (d) and not paragraph (c)?

2) Why is paragraph (b) of subsection (4) made more "stringent" than paragraph (c)?

Directors v. Executive Directors

Paragraph (d) of subsection (1) applies only to directors, excluding executive directors who have been emplaced in paragraph (c) by virtue of subsection (3) which states that paragraph (c), and also subsection (2), shall apply to executive directors. To understand why directors and executive directors are treated differently, it would be pertinent to know the difference in their offices.

Executive directors, unlike ordinary directors, are involved in the day-to-day management of a bank on a full time basis. A possible rationale, therefore, for the difference in treatment could be to discourage executive directors from sitting on the boards of other corporations as this would impair their efficiency in the management of the bank.

A bank may grant loans to executive directors or their interested concerns only in two instances:

i) if the loan falls under the bank's scheme of service, or in special or compassionate circumstances;[9] and

ii) where the executive director is not a director, manager, agent or guarantor in the corporation concerned, if the executive director does not have a material interest in the corporation concerned.[10]

[9] Section 26A(2), Banking Act, 1973.

[10] Section 26A(1)(c), Banking Act, 1973.

A Listed Corporation v. A Public Company

While a rationale may be found in case of the difference in treatment between directors and executive directors, it is difficult to rationalise the differences between paragraphs (a) and (b) of subsection (4).

In case of a director sitting on the board of a listed corporation, in order for the bank to be able to grant loans to that corporation the director concerned should not have any material interest in the shares of that corporation. However, for purposes of lending to a public company the director should not hold any interest in his personal capacity in that company. This would mean that a director cannot even hold one share if that share is held in his personal capacity. He may only be a nominee director at best.

A public company is a company which is not a private company,[11] the shares of which may or may not be listed on the stock exchange. However, most public companies have their shares listed on the stock exchange, and the bulk of non-listed companies are private companies. To whom is paragraph (b) directed then, and if it is meant to cover an ordinary public company which is not listed on the stock exchange, why is there a need to impose different conditions with regard to shareholding interest for bank directors who sit on the boards of these companies?

Are the categories closed?

The prohibitions contained in paragraphs (a) to (e) are specific and they seem "complete". There is no general "catch-all" provision which would prohibit a bank from granting loans to any other persons or bodies not specified within paragraphs (a) to (e).

If a director of a bank owns a company in which he is also a director,the company would not be able to obtain loans from the bank, but there is nothing in the law to prevent it from obtaining loans from any of the bank's subsidiaries in which the director has no interest whatsoever. Even if he has an interest in the subsididary, there is nothing to prevent the subsidiary from granting that loan because the law is directed at a licensed bank, and not its subsidiary corporation which may be a finance company or leasing company. Similarly, could not the same company obtain the loan from the bank's branches abroad? "There is no obligation not to do what the legislature has not really prohibited nor to do what it has not really commanded. It is not evading an Act to keep outside it."[12]

A close inspection of the provision would reveal that there are many ways in which a director or his interested concern may be able to "get round" the provision.

[11]Section 4, Companies Act 1965.

[12]Maxwell on the Interpretation of Statutes, 12th edn., at p. 143.

III. Secton 26A, after the Amendment Bill, 1983

With a few simple sentences, section 26A of the banking Act 1973 was amended to read, in subsection (1), "Unless otherwise exempted by the Central Bank, with or without conditions, or except as provided under subsection (2) or (4). . .", a licensed bank shall not grant loans to those mentioned in paragraphs (a) to (e). No other amendments were made.

A glaring effect of this amendment is that loans that were previously allowed under section 26 (whether they were granted to director, officer or employee interested concerns or not) are now subject to section 26A. A licensed bank can no longer grant secured loans to its related, director-interested corporation, unless exempted by the Central Bank.

On the one hand, the amendment is beneficial in the sense that the initial "harshness" of the section is diluted by the new opening words of the section. A parent, spouse or child of a bank employee may now obtain loans from the same bank in which their child, spouse or parent is employed.[13]

On the other hand, the amendment fails to clarify any existing anomaly, and, most important of all, it fails to "mend" the section, making section 26A one of the most ineffective sections in the Banking Act, 1973.

Furthermore, categories of exemption are not specified. The Central Bank is given wide discretionary powers to "exempt, with or without conditions". One can only hope that the Central Bank would be in possession of well-defined guidelines on the matter and exempt or not exempt in accordance with those guidelines.

It should be obvious in this case that "speedy amendments" to an existing provision in a law is not necessarily effective in curing the defects of the provision. What is required is an "overhaul" of the provision. Perhaps, it is time that the Banking Act, 1973 be revised. When this is done, hopefully section 26A can be made more effective in achieving its objectives.

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[13]Before the amendment, the prohibition against lending to directors, officers or employees of a bank included their spouses, parents or children — section 26A(1) and section 26A(6), Banking Act, 1973.