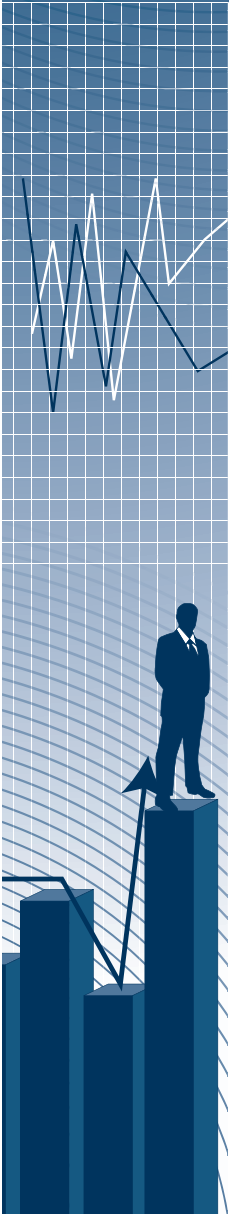




PART 1

1

BANK-CUSTOMER RELATIONSHIP AND ACCOUNT OPENING



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Contractual Relationships in Law and Practice

Learning objectives

After studying this chapter, you should be able to:

- 1** Describe the nature of the relationship between banker and customer and the key legal and regulatory issues relating to the terms of the contract between them
- 2** Understand the legal issues around the operation of bank accounts, including mandates, power of attorney, limitation of actions, appropriation of payments, set-off, and banker's lien
- 3** Explain the concept of banker's duty of secrecy and how it relates to the provisions of the Personal Data (Privacy) Ordinance, including the six principles of data protection
- 4** Discuss recommended bank practices related to a statement of account or passbook, wrongful dishonour of cheques, and exemption clauses

Introduction

Many legal issues arise in the course of day-to-day banking operations. Bankers, therefore, need to learn about these issues and be guided by them in order to protect their companies and themselves from liability. In this chapter, we provide an overview of the relationship between a bank and its customers from a legal and regulatory perspective. We discuss the implied terms of the banker and customer relationship relating to a banker's duty of secrecy, and explain specific legal issues relating to the terms of the contract and the respective rights and duties of the bank and the customer.

References are made to common law, legislation in Hong Kong, guidelines of the Hong Kong Monetary Authority and the Code of Banking Practice. We also discuss the relevance of the Personal Data (Privacy) Ordinance and the six data protection principles in protecting, and providing for the proper use of, the personal data of customers in the course of day-to-day banking operations. We conclude the discussion with an analysis of a number of issues commonly affecting the operation of bank accounts.

Definition of 'Customer'

There is actually no statutory definition in Hong Kong of who a customer of a bank is, so we have to refer to the decisions of the courts in order to discover the principles which determine whether or not a person is a customer.

In common law, which is a body of law developed through court decisions rather than bills passed by the legislature, a customer is a person who maintains an account with the bank. "There must be some sort of account, either a deposit or a current account or similar relation, to make a man a customer of a banker," a British court held in the case of *Great Western Railway Co. v. London & Country Banking Co.* The judge ruled that though a person may habitually deal with a bank, for example, to buy gift cheques, this does not make the person a customer of that bank.

Common law also holds that a relationship between a banker and customer does not come into existence unless and until both parties intend to enter into it. However, the relationship can be deemed to have started even before an account has been actually opened. In *Ladbroke & Co. v. Todd*, the court held that it was not necessary that a person "should have drawn any money or even that he should be in position to draw money" before he could become a customer. A banker-customer relationship is immediately established upon the bank's acceptance of a person's offer to open an account in that bank.

Why does a banking professional need to know who is a customer and who is not, legally speaking? One reason is to avoid contractual liability, which can arise when giving off-the-cuff investment advice, for example, in the belief that no contractual relationship exists. If there is an intention on both sides to enter into a relationship, that person can be

considered already a customer and therefore could theoretically sue the banker for giving negligent advice.

Another reason is to be protected by Section 86 of the Bills of Exchange Ordinance, which provides that bankers who receive a payment for a customer or credit a customer account will not be treated as having been negligent if the customer turns out to have no title or a defective title to that payment. If the banker receives a payment or performs a remittance funded by a cheque, to give two examples, for someone who is, legally speaking, not a customer, then he is not protected by Section 86.

Nature of the Banker-Customer Relationship

In legal terms, the relationship between banker and customer is essentially a contractual one, meaning that each side has explicit and implicit obligations. Breaching those obligations could be grounds for litigation. The nature of the relationship can take several forms, arising from the types of services rendered by the bank:

- Banker and customer;
- Debtor and creditor;
- Principal and agent;
- Bailor and bailee.

Banker and Customer

In recent years, many banks have tried to set out the terms of the contract between banker and customer as comprehensively as possible in written form. Customers are provided with a set of standalone consolidated terms and conditions and are asked to sign an application for account opening, which includes a reference to the terms and conditions and an acknowledgment of acceptance. The application normally takes the form of the customer's mandate to the bank and the terms and conditions are incorporated by reference in the application.

However, in most cases, there is no formal agreement which provides that a banker must maintain strict secrecy concerning his customers' accounts or that the customer must exercise care when drawing cheques to prevent the amounts from being fraudulently altered.

Of course, when most accounts are opened, such as current and savings accounts, a mandate is executed, which gives the bank express instructions and/or authorities concerning the operation of the account. However, even in those cases, no attempt is made to prepare a comprehensive list of the respective rights and duties of banker and customer.

This may be because it is impossible to list all the terms contemplated and banks also consider the impact on bank marketing.

The contractual relationship between banker and customer is founded on the customs and trade usages of bankers. To the extent that the customs and trade usages have been recognised by the courts of Hong Kong, they must be regarded as implied terms of contract between banker and customer. Therefore, the implied terms are of vital importance in banking law and practice.

The Code of Banking Practice requires banks to make readily available to customers, or prospective customers, written terms and conditions of each banking product or banking service and to advise customers to read and understand them. The terms and conditions should meet the following criteria:

- Provide a fair and balanced description of the relationship between bank and customer;
- Generally available in both Chinese and English;
- Use plain language and avoid legal and technical language unless it is necessary;
- Highlight any fees, charges, penalties, and the relevant interest rates (or the basis for determining the interest rates), and the customer's liabilities and obligations in using the service;
- Consistency with the provisions of the Code, and be kept under review to ensure such consistency;
- Have due regard to applicable laws in Hong Kong, in particular prevailing consumer protection legislation.

Debtor and Creditor

The deposit of money into a bank renders the bank a debtor and the depositor a creditor. The bank is therefore obliged to repay any sum deposited to the depositor (except in certain defined circumstances such as banker's right and set-off). These roles are reversed when a bank lends money to a customer.

It was settled in *Foley v. Hill* that the established debtor and creditor relationship excludes any element or suggestion of trusteeship or fiduciary relation with the banker with regard to a current account. The House of Lords held that the relation between a banker and his customer, who pays money into the bank, is the ordinary relation of debtor and creditor, with an additional obligation arising out of the custom of bankers to honour the customer's cheques.

Principal and Agent

When a banker is performing certain duties, he frequently acts as an agent. For example, the banker often collects the proceeds of cheques as an agent for his customers. In drawing and paying cheques, the relationship between customer and banker is that of principal

and agent. Further, the banker acts as an agent when accepting customers' instructions in regards to the purchase and sale of the stocks and shares.

However, when a banker is instructed by the customer to place an order with a broker for the purchase of shares on the customer's behalf, the relationship of principal and agent arises between the customer and the broker when the broker accepts the order; no such relationship arises between the customer and the banker.

Bailor and Bailee

When articles are delivered to a bank for safe custody, the contract between the bank (as bailee) and the customer (as bailor) is one of bailment, which involves the transfer of possession, not ownership. The bank is not entitled to use the articles whilst they are in its possession. The customer can demand the return of the articles at any reasonable time.

Safekeeping of title deeds after the mortgage loan of a customer is paid off is an example of custody service.

Laws and Practice

In Hong Kong, the sources of the laws and practice that govern the bank-customer relationship include the following:

- Common law
- Legislative sources
- Non-statutory rules
- Code of Banking Practice

Common Law

Although China has resumed sovereignty, Hong Kong still follows the English legal system of Common law. As laid down by the Basic Law of the Hong Kong Special Administrative Region, laws previously in force in Hong Kong (Common law), rules of equity, ordinance, subordinate legislation, and customary law shall be maintained except for any that contravenes the Basic Law. However, Common law is subject to amendment by the Hong Kong legislature, which has begun passing measures that diverge from it.

The doctrine of legal precedent has also been preserved in Hong Kong, although the court of final adjudication is the Court of Final Appeal in Hong Kong instead of the Privy Council in England. All decided cases in Commonwealth countries would be considered in equal standing by the court of Hong Kong, which may also refer to precedents of other common law jurisdictions. The same is applicable to Banking Law.

Legislative Sources

The two most important legislative sources in Hong Kong are the Banking Ordinance (Cap. 155) and the Bills of Exchange Ordinance (Cap. 19).

The Banking Ordinance is a statute providing for the regulation of banking business and the business of taking deposits in Hong Kong. It defines the term “banking business” and refers to the three-tier financial system in which licensed banks, restricted licence banks, and deposit-taking companies are collectively referred to as “authorised institutions.” The Bills of Exchange Ordinance, on the other hand, deals with the law relating to negotiable instruments, including bills of exchange, cheques, and promissory notes.

The Hong Kong Association of Banks Ordinance (Cap. 364), the Exchange Fund Ordinance (Cap. 66) and the Protection of Investors Ordinance (Cap. 335) are other important sources of banking law. The Companies Ordinance (Cap. 32), the Partnership Ordinance (Cap. 38), the Bankruptcy Ordinance (Cap. 6) and the Conveyancing and Property Ordinance (Cap. 219) have a bearing on banking as well.

Subsidiary legislation made by virtue of the Banking Ordinance and the above-mentioned ordinances are also important and bankers must take note of such legislation.

Given the growing significance of securities related services among banks’ core business, the Securities and Futures Ordinance (Cap. 571) is also an important legislative source.

The Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615), which codifies customer due diligence and record-keeping requirements for financial institutions and provides for supervisory and criminal sanctions for contravention of the statutory requirements, was enacted in June 2011 with effect from 1 April 2012.

Statutory and Non-statutory Guidelines

The Banking Ordinance empowers the Hong Kong Monetary Authority (HKMA) to issue guidelines relating to the internal workings of authorised institutions to ensure that proper banking standards are maintained. There are two broad categories of guidelines: statutory and non-statutory.

The HKMA’s statutory guidelines are issued under the Banking Ordinance, which set out the minimum standards with which authorized institutions are expected to comply to satisfy the requirements of the Banking Ordinance. Statutory guidelines do not have the force of law. Non-statutory guidelines are typically issued to set out the HKMA’s recommendations to AIs in respect of the standards they should aim to achieve, or for the purpose of clarifying the HKMA’s interpretation of regulatory and reporting matters. Any failure to adhere to any of these guidelines, whether statutory or non-statutory, may call into question whether the AI concerned continues to satisfy the minimum criteria for authorization under the Banking Ordinance. In addition, where such failure is in respect

of any of the statutory guidelines, it may constitute a contravention of the relevant provisions or requirements of the Banking Ordinance.

Code of Banking Practice

The Code of Banking Practice is issued jointly by the Hong Kong Association of Banks (HKAB) and the DTC Association (the industry group for restricted licence banks and deposit-taking companies), and is endorsed by the HKMA. Whilst it specifically covers banking services such as current accounts, savings and other deposit accounts, loans and overdrafts, and card services, its principles apply to the overall relationship between institutions and their customers. The Code does not apply retrospectively to transactions completed before its issuance.

The recommendations do not supplant any relevant legislation, codes, guidelines, or rules applicable to institutions authorised under the Banking Ordinance. However, the HKMA expects all authorised institutions to comply with the Code and will monitor compliance as part of its regular supervision. Authorised institutions may be challenged for any non-adherence to the Code.

The Code applies to cases where an institution is dealing with a personal customer. A personal customer is defined as a private individual who (i) maintains an account in Hong Kong with or receives services from an institution; or (ii) acts as guarantor or provider of third party security for a borrower (who may or may not be an individual).

Mandates

A mandate is a written instruction from a customer to a bank to do certain acts on the customer's behalf. In practice, it is a standard printed form drafted by the bank for customers' use on the opening of new accounts or when customers change the ways accounts are to be operated. The printed forms typically refer to a booklet that includes the terms and conditions of the mandate.

Through these documents the customer typically declares that, until he gives written notice to the contrary, a named person (whose signature appears on the mandate) is authorised to draw and endorse cheques on his behalf, notwithstanding that the debiting of any such instruments to his account may cause the account to be overdrawn. This latter provision is important because, in common law, the authority to draw cheques does not necessarily confer power to overdraw the account.

In a mandate, most terms are compulsory, that is, customers must accept them if they wish to open and maintain an account with a bank. However, there may be a number of optional clauses, one or more of which may be deleted in order to meet the wishes of the customer.

Most banks have two types of mandates:

- **Mandates for opening new accounts**, which are individual, joint, sole proprietorship, partnership, limited companies, clubs, unincorporated associations, and society; and
- **Mandates allowing third parties to operate the account**, which would confer power upon the agent:
 - i. to receive cheques, statements, and other vouchers relating to the account;
 - ii. to draw, accept, make, and endorse bills of exchange and promissory notes on behalf of the customer;
 - iii. to withdraw from the bank securities or other property belonging to the customer;
 - iv. to negotiate advances whether by way of loan, overdraft, discount, or otherwise; and
 - v. to pledge or deposit with the bank types of security for repayment for such advances.

These types of authority will not enable any agent to execute a deed on behalf of the customer, and the agent will not be able to create a legal charge by way of security.

In a strict legal sense, mandates are only instructions from customers to banks and not an agreement made between bankers and customers. In practice, however, most banks have incorporated many contractual clauses into a mandate. In other words, a mandate has become in practice a binding contract between the bankers and customers in most aspects of the terms of contract between them. For instance, the mandates of the banks would stipulate that both joint account holders would accept and limit the joint and several liabilities in respect of or arising out of the operation of the joint account maintained with the banks.

A bank should exercise reasonable care and skill when considering which clauses should be incorporated into a mandate. The clauses may not be enforceable if they are not in accordance with usual banking practice in Hong Kong.

Furthermore, any exemption clauses in a mandate, if any, are subject to the test of reasonableness under the Control of Exemption Clauses Ordinance (Cap. 71). Whether the clauses are reasonable will be determined in accordance with usual normal banking practice.

Because a mandate in practice has become a contract between bankers and customers, banks should not accept a mandate drafted by the customer, except for an account opened only for very special purposes and for a very valuable customer. In this special case, the bank must seek legal opinion on the contents of such special mandates, which should be approved by top executives.

In practice, banks would not open an account for any customer, including a valuable customer, if the customer requests to amend or vary the terms stated in the mandate. Only in a very special case would the bank allow any amendment or variation to the mandate. In those cases, the bank must seek legal opinion on any proposed amendment or variation.

Power of Attorney

Sometimes a customer may wish to authorise a third party to operate his account. He may do so by signing the bank's third-party mandate or executing a power of attorney. In this connection, it is important to distinguish between a mandate and a power of attorney.

A power of attorney is a document, usually executed under seal, which authorises one person (called the attorney, donee, or grantee) to act on behalf of another person (called donor, principal, or grantor).

The following differences between the two types of documents should be noted:

- A power of attorney is usually addressed to the world at large. A customer who wants the appointment of an attorney to be known to several parties could just execute one document instead of several. A mandate is usually addressed to one particular person, for example, a particular bank.
- In general, the donor of a power of attorney cannot notify his decision to revoke the power of attorney to everyone who might rely on it. The law makes special provision in favour of persons who rely upon a power in the honest belief that it has not been revoked. By contrast, a person who has signed a form of mandate may easily inform the person to whom it was addressed (the bank) that the authority of the agent has been cancelled.
- The general rule of law is that where an agent is authorised to execute a deed on behalf of his principal, his authority must be given by an instrument under seal. Therefore, an attorney under a power may be empowered to execute deeds, for example, legal charge. In contrast, an agent whose appointment is set out in a mandate cannot do so.

Types of Power of Attorney

There are two main types of powers of attorney: special/specific and general. A **special power** is one given for a specific purpose, for example, the attorney may be empowered to execute a legal charge only or to operate the accounts. An example would be an attorney being empowered to execute a mortgage.

A **general power** usually confers very extensive powers upon the donee. Both types (special and general) are usually executed under seal (signed, sealed, and delivered), thus enabling the donee to execute deeds on behalf of the donor.

Regardless of type, the power is revoked upon the death, winding up, bankruptcy, mental incapacity of, or expressed revocation by the donor. If a person without knowledge of the revocation deals with the donee, the transaction between them will be as valid as if the power is in existence.

Rules in the Use of Power of Attorney

The general rules in the use of the power of attorney include the following:

- Any person having power to contract may appoint an attorney.
- A corporation may appoint an attorney to complete *intra vires* (within the authority) acts.
- The attorney need not have contractual powers.
- The attorney cannot delegate his powers except under clear authority.
- A power given to two or more trustees jointly may be exercised by the survivors of those trustees.

The banker should make sure that:

- The power is operated exactly within the specific objects laid down.
- The power is still in force.
- The identity of the attorney is verified.
- The power is under seal.
- A certified copy of the power of attorney is obtained.

Revocable and Irrevocable

The banker may regard all powers of attorney as revocable, meaning that they can be revoked any time, even if expressly stated otherwise.

The only exception is under Section 4 of the Powers of Attorney Ordinance, which provides that the power of attorney is irrevocable if the power is expressed to be irrevocable and is given to secure a proprietary interest of the donee of the power or the performance of an obligation owed to the donee.

So long as the donee has that interest or the obligation remains undischarged, the power will not be revoked unless consented to by the donee or upon the death, bankruptcy, liquidation, and so on of the donor. As an example, the banker as mortgagee is always granted an irrevocable power of sale of the mortgaged property as an attorney of the mortgagor.

Enduring Power of Attorney

The Enduring Powers of Attorney Ordinance enacted in 1997 established a procedure for appointing an attorney who can manage a person's affairs after that person has become mentally incapable.

Practical Considerations for Banks

When a banker is given a general power of attorney under the Powers of Attorney Ordinance, there will be no problem ascertaining the scope of the attorney's power or authority. He will have power to do anything on behalf of the customer which the customer can lawfully do. But when a banker is given a special power of attorney, he would face the onerous task of finding out exactly what power has been conferred.

To operate an account under a power of attorney, the bank will need the original sealed power of attorney. If a bank is furnished with a power of attorney which is not in a form set out under Section 7 of the Powers of Attorney Ordinance, the banker has to ascertain the nature and extent of the power. Reading the document as a whole is a must.

Any exercise of the power by the attorney must be in accordance with the purpose for which the power was given. If the purpose of the power is unclear to the banker or the banker is not sure whether the actions of the donee will benefit the donor, a prudent banker should ask the donor of the power directly so as to confirm the actions of his attorney. In such cases, the banker should seek legal opinions from the bank's legal advisers.

When a power of attorney or a certified true copy (certified by the donor or a solicitor) executed by a customer is exhibited to the customer's bankers, the bankers must satisfy themselves that the following requirements have been complied with:

- The power must appear to have been validly executed. In some cases, difficulties arise if the customer is verging on senility, for example. In practice, it is prudent to have the power witnessed by the customer's doctor (a registered medical practitioner), who should certify that the said customer understands the nature and effect of the document being executed. However, the power may be revoked by the subsequent mental incapacity of the customer. The Enduring Powers of Attorney Ordinance establishes a procedure for appointing an attorney who can manage a person's affairs after that person has become mentally incapable.
- A true copy of the instrument creating the power of attorney must be supplied to the bank, preferably supplied directly from the donor (the customer) or his solicitors.
- The person claiming to be the attorney or donor must in fact be the person named in the power. In practice, the banker has to check and/or verify the identity of such person.
- The powers conferred upon the attorney must cover the transaction(s) which the donor wishes to enter into. This occasionally gives rise to difficulty because powers are strictly construed by the courts. The banker should request the customer to execute the bank's standard mandate, which is specially adapted to banking transactions. Alternatively, the customer may execute a general power of attorney. The signing of a

third-party mandate is a must whenever a bank is asked to operate an account by an appointed attorney.

Limitation of Actions

Lapse of time does not generally put an end to a contract or other liability, although it has been part of the public policy of Hong Kong law to prevent enforcement by legal action of long-dormant claims. The legislature has laid down certain periods of limitation after the expiry of which no action can be maintained. The statute of such law is the Limitation Ordinance (Cap. 347).

Two-year Limit

A two-year time limit applies in respect of actions to recover a penalty or forfeiture recoverable under any ordinance and to actions to recover a contribution pursuant to the Civil Liability (Contribution) Ordinance (Cap. 377). However, this does not apply to any action or arbitration for which a period of limitation is prescribed by another enactment.

Three-year Limit

The three-year time limit applies in actions for negligence, nuisance, or breach of duty, where the damages claimed by the plaintiff include damages in respect of personal injuries and to actions under the Fatal Accidents Ordinance (Cap. 22).

Six-year Limit

The six-year time limit applies to:

- Actions in respect of or arising out of simple contract or tort;
- Actions to enforce a recognizance;
- An award (where the submission is not by an instrument under seal);
- Actions to recover any sums recoverable under any ordinance;
- Actions for an account;
- Actions in respect of successive conversion of chattels;
- Actions to recover rent;
- Actions to recover arrears of interest payable in respect of money secured by a mortgage; or charge or in respect of a legacy;
- Certain actions by beneficiaries against trustees.

Twelve-year Limit

The 12-year time limit applies to:

- Actions upon specialities;
- Actions upon any judgement (save and except in respect of arrears in interest in respect of any judgement debt for which the period of limitation is six years);
- Actions to recover land, including foreclosure actions;
- Actions to redeem land;
- Actions to recover the principal monies secured by a mortgage or to foreclose a mortgage of personality;
- Actions claiming the personal estate of deceased persons.

No Limit

There is no period of limitation applicable to an action by a beneficiary, against a trustee, in respect of the trustee's fraud or fraudulent breach of trust or to recover trust property in the possession of the trustee or converted by him.

Extension of Period of Limitation

Part II of the Limitation Ordinance provides for the extension of the period of limitation as follows:

- In cases where the plaintiff was under a disability at the time when the cause of action accrued;
- In cases of an acknowledgement of the cause of action in writing or part payment by the defendant or his predecessor or agent;
- In cases where the action is based on fraud, the right of action was fraudulently concealed, or where the action is for relief from the consequences of a mistake.

The court also has the discretion to override the time limit for actions in respect of personal injuries, where the court considers that it would be equitable to allow the action to proceed.

Appropriation of Payments

Appropriation of payments is the right of a customer or a bank to apply a specified deposit to meet a specified debt. If the right of appropriation devolves on the creditor, the creditor may appropriate to a debt which is statute-barred, although such appropriation will not revive or acknowledge the debt. However, he may not appropriate to an illegal debt.

In *Canton Trust and Commercial Bank Ltd. v. Ho Pui Shue*, it was held that, in the absence of any instructions from the customer, the bank was entitled to appropriate any account. In this Hong Kong case, the court ruled that the bank acted properly in applying the payments to the current account and not to the trust account.

The creditor need not exercise his right of appropriation at the time of payment. It was held in *Seymour v. Pickett* that the creditor may make an appropriation when he is being examined as a witness in a legal action by him against the debtor. However, once a creditor has made an appropriation, “it is made once and for all, and it does not lie in the mouth of the creditor afterwards to seek to vary that appropriation.”

The common law principles regarding the appropriation of payments are as follows:

- The party who makes a payment has the right to apply that payment in whichever way he deems fit. For example, if the payer owes more than one debt, he is entitled to specify which debt is to be discharged by his payment. The payer’s intention may be inferred from the course of dealings or other circumstances. Money deposited into a bank account to pay a bill or cheque cannot be applied in any other way.
- If the payer does not specify the manner of application of funds at the time of payment, the right to apply the funds will generally pass to the recipient of the payment.
- If there is no specific appropriation by the parties in relation to current accounts where payments into and out of the account continue to be made, it is presumed that the first sum paid in is first drawn out, and the first debit item is discharged or reduced by the first sum paid. This is the rule established in *Devaynes v Noble, Clayton’s Case* (commonly referred to as the rule in Clayton’s Case). However, Clayton’s rule is a presumption in law only and may be rebutted by evidence indicating it was not the intention of the parties to apply the rule.

Rule in Clayton’s Case

The rule may operate against a bank in certain circumstances where the current account is overdrawn and subsequent payments into the account operate to reduce the overdraft, to the prejudice of the bank’s interests. The following are two examples:

- The bank extends an overdraft facility to the customer, which is secured by a mortgage. Clayton’s rule would operate such that any payments into the account will reduce overdrawn amounts which are secured, whilst payments out will constitute fresh advances, which are not covered by the security. To overcome this, bank security documents typically contain a clause providing that the security shall be a continuing security that extends to cover any sums constituting the balance due for the time being.
- Where an overdraft is guaranteed by a third party and the guarantee is for any reason terminated, the rule in Clayton’s case would operate such that payments into the account after termination will reduce or even discharge the principal debtor’s liability, whilst payments out will constitute fresh advances made after termination for which the guarantor will not be liable.

- To overcome this, guarantees now typically provide that in case of termination, the bank may continue the account with the principal debtor, and the guarantor's liability for the debtor's debt as at the date of termination will remain intact, notwithstanding any subsequent payments into or out of the debtor's account.

Appropriation of payments is very important in banking practice. Apart from the rule in Clayton's case, the following illustrations are given in order to show how the rules relating to appropriation of payments affect the banks, their customers, and third parties in modern banking practice.

- If a customer who maintains two or more accounts at the same bank makes a payment to credit, he has the right to appropriate the money to whichever account he may choose. If he fails to choose, then in theory the bank may appropriate, but in practice the bank would inquire which account is to be credited.
- A customer does not have any available credit balance in his current account. He informs the bank that he has issued two cheques, each for HK\$1,000, in favour of, let us say, Chan and Lee, respectively. But the customer pays in only HK\$1,000, and instructs the bank that only the cheque in favour of Chan should be paid.

If the bank wrongfully pays the cheque in favour of Lee and returns the cheque in favour of Chan, the customer will be entitled to sue the bank for damages for wrongful dishonour. Chan cannot sue the bank in this regard because there is no contract between him and the bank. However, if the bank had received notice of a specific appropriation and of an equitable assignment of the proceeds, the bank may be sued by the third party.

Set-off

Set-off arises when a debtor or his creditor wishes to arrive at the net figure owing between them when separate accounts or debts are involved. For example, if Peter owes his friend Thomas HK\$20,000 for monies lent, and then later Thomas buys Peter's car for HK\$10,000, Thomas could refuse to pay Peter the HK\$10,000. He can set off this sum against the loan due and simply settle the net figure of HK\$10,000.

Set-off is also referred to as 'consolidation' or 'combination' of accounts. It is a general principle of dealing between debtor and creditor, and therefore applicable to the relationship between banker and customer.

There are three requirements before a right of set-off can be exercised, although these can be varied by special agreement between the parties. The three requirements are:

- The sum involved must be certain and clearly ascertained;
- They must be due between the same parties; and
- They must be due in the same right.

In the context of banker and customer, if a customer has more than one account at a bank, the bank has the right to set off the customer's credit balance on one account against the same customer's debit balance on another account in order to ascertain the net amount owing to or by the customer. Such right may be exercised if both credit and debit balances are:

- Of ascertained amounts, and not mere claims of uncertain amounts;
- Owed between the same parties in the same capacity, meaning that a bank may not set off a customer's debts against monies in an account held by the customer as trustee, for example; and
- Already due, meaning that a bank may not set off its immediate liabilities to the customer (for example, deposits in a savings account) against sums which are to become due from the customer at a future time (known as unmatured or contingent liabilities, an example being future instalments of a mortgage loan).

The exceptions to this rule are:

- Where there is express agreement between the bank and the customer allowing set-off for unmatured or contingent liabilities; and
- Where the customer becomes insolvent, in which case the legislation allows all debts and liabilities, whether present or future, actual or contingent, to be the subject of set-off.

The banker's right of set-off is automatically exercisable in situations such as the customer's death, mental incapacity or insolvency, when accounts are normally estopped and a prudent banker would attempt to consolidate the position of the bank. In the case of insolvency (i.e., the bankruptcy of an individual, or winding-up of a company), the Bankruptcy Ordinance (Cap. 6) expressly provides for a right of set-off for creditors of a bankrupt individual.

The same rule applies to companies in a winding up under the Companies Ordinance (Cap. 32). This statutory right overrides any agreement between the parties to the contrary, which means that any agreement between banker and customer to exclude or restrict the bank's right of set-off is invalid in an insolvency situation.

If a customer has more than one account maintained with the same bank in Hong Kong (irrespective of the branches where the accounts are kept), the question may arise whether the bank has the right to set off what is due to the customer on one account against what is due from him on another account, and to have regard only to the ultimate or net balance when deciding what sum is available to the customer for drawing purposes.

One basic principle supporting the doctrine that in certain situations the bank is entitled to set-off or to combine the accounts of one customer, is that the customer's underlying contractual relationship is with the bank, and not with the branch at which the account is maintained. Further, the basic relationship of a banker and customer governs all the accounts of a customer regardless of their type. As there is only one contract between

banker and customer, there is room for the argument that when the bank becomes the customer's creditor, it can exercise a right of set-off regarding mutual dealings with him.

No Right of Set-off

In general, a bank is not entitled to right of set-off in the following cases.

- **Express or implied agreement.** Both banker and customer are free to agree that there is no right of set-off at all. For example, a customer has a loan account and a current account and the agreement is that the customer is to be allowed to draw upon his credit balance on a current account without reference to his loan account. It is clear that, in such a case, there will be no right of set-off. However, in practice, most banks are reluctant to agree to such express terms, except when the particular customer has strong bargaining power.

It is recognised by the court that it is an implied term in the contract between the bank and its customer that the right of set-off is not available to a bank if the customer maintains a loan account and current account in credit with a bank.

- **Contingent liabilities.** In *Jeffryes v. Agra and Masterman's Bank Ltd.*, the court observed that "you cannot retain a sum of money which is actually due against a sum of money which is only to become due at a future time." For example, a bank accepts a foreign currency deposit from another bank for a fixed period, and subsequently makes a loan in the same currency and to the same bank, but for a different period. If the deposit is due to be repaid on say, 15 January, the bank holding the deposit is not entitled to retain it against a loan which is due to be repaid on, say, 31 January.

Likewise, in the absence of some special arrangement, a bank is not entitled to retain its customer's credit balance to secure the bank's interest against a contingent liability on bills which it has discounted for the customer. However, if the customer is bankrupt the position is different. The rule in bankruptcy is that all debts and liabilities, present or future, certain or contingent, may be the subject of set-off.

- **Account contains trust funds.** In some cases, the title of an account indicates that it contains money belonging to other people, for example, Charles Chan, 'AA Football Club Account,' or Chan & Partners, 'Clients' Account.' A bank is not entitled to set-off a credit balance on such accounts against a debit balance on the customer's private account.

Similarly, professionals often maintain separate banking accounts for clients' moneys. Where it is known to a bank that a particular account is used for this purpose, no right of set-off can arise. There are statutory provisions that compel a solicitor to keep a separate banking account for the money of his clients and the word 'client' must appear in the title of the account. A bank cannot have any recourse or right, whether by way of set-off or otherwise, against moneys standing to the credit of such accounts.

- **Accounts of different customers.** In *Uttamchandami v. Central Bank of India*, the defendant bank sought to set-off accounts held in different names on the grounds that in each case the accounts were 'nominee' accounts, and that in each case the customer was in reality a Mr. Vaswani. The English Court of Appeal held that the bank had no such right.

Code of Banking Practice

For personal customers, Section 17 and 18 of the Code provides that:

- Institutions should make readily available to customers general descriptive information about the operation of their accounts, including any rights of set-off claimed by the institution. Such information should include clear and prominent notice of any rights of set-off claimed by the institution over credit and debit balances in different accounts of the customer.
- In particular, it should be made clear to customers of a joint account whether the institution claims the right to set off the credit balance in that account against the debit balance in other accounts, which may be held by one or more of the holders of the joint account.
- Institutions should set out the terms and conditions and the circumstances under which they will exercise their right of set-off.
- Institutions should inform the customer promptly after exercising any rights of set-off.

Banker's Lien

A lien is a right to retain possession of a debtor's goods until the debt is paid. In addition to any security it may have taken and to its right to combine or consolidate its customers' accounts, a bank in general law has a lien over securities deposited by the customer with the bank to the extent of the customer's indebtedness to the bank.

The banker's lien (or bank's lien) extends to cheques and bills collected by the bank on behalf of the customer. The Bills of Exchange Ordinance (Cap. 19) provides that where the holder of a bill has a lien on it, arising from either contract or by implication of law, he is deemed to be a holder of value to the extent of the sum for which he has a lien.

In practice, if the banker allows a customer to withdraw funds exceeding the credit limit of overdraft facilities temporarily or allows his account to be overdrawn temporarily, then the banker may hold the funds of his savings or time deposit account(s) as the banker's lien.

Rights of Bank Asserting lien

The bank has an implied power to sell the asset subject to the lien if the debtor defaults in repayment, after giving notice to the debtor of its intention to sell. Where the lien is asserted on instruments deposited with the bank for collection or presentment, the bank

is not relieved of its duty to collect or make presentment, hence there is no need for the bank to rely on a power of sale. The bank cannot use the asset under lien unless the debtor has defaulted and the bank seeks to enforce its lien.

However, a banker's lien can only be exercised in relation to an actual liability. It is doubtful whether a mere contingent liability can support a banker's lien.

It is now the practice of banks to either obtain a letter of lien from customers that expressly sets out the rights of the bank in relation to assets subject to the lien, or to incorporate a provision to such effect in its general agreement for lending customers. A genuine lien coupled with a contractual power of sale is not a charge.

The following are the types of assets that may be subject to a banker's lien:

- Share certificates;
- Negotiable instruments;
- Insurance policies;
- Credit balances in bank accounts (which strictly should be subject to the banker's right of set-off);
- Other documents such as bonds, coupons, deposit receipts, etc.

Matters Excluding Lien

Banker's lien is subject to the following limitations:

- It does not attach to assets deposited for safe custody only.
- It does not attach to securities known by the bank not to be the property of the customer at the date when they are first received by the bank.
- It is displaced by any contrary agreement between the parties. The bankers should not enter into such agreement.
- It does not attach to securities deposited by the customer which the bank knows to be subject to a trust in favour of a third party.

The lien is also excluded if, at the time the assets are deposited with the bank, the bank is aware that they belong to a third party, for example, if they are held by the customer on trust for a third party. However, if the bank receives the assets in good faith and without notice that they belong to a third party, the lien is not excluded.

Banker's Duty of Secrecy

Whilst the main relationship between a bank and its customer is that of debtor and creditor, there are other relationships and duties which do not normally exist between such parties. The most important of these is the duty of secrecy and it is one which every customer expects his bank to maintain at all times.

Under common law, this duty is implied when the account is opened and extends not only to the account itself and the information that could be gained from it, but also to any other particulars of the customer's affairs which come to the bank's knowledge from conducting the account or in carrying out any other transactions or financial dealings on behalf of the customer. The duty must be maintained both whilst the account is open and even subsequently after it has been closed. Most banks ask their employees to sign a declaration that they will not disclose any matters concerning the customers' affairs to any outside party.

In practice, it would be impossible to conduct the bank's business unless some disclosure was made to outside parties, and whilst one may start with the basic concept it will soon be realised that this duty of secrecy is a qualified duty and not an absolute one.

Common Law Principle

It is a long established general principle of common law that a bank is under a legal obligation to keep its customer's affairs secret. In the leading case of *Tournier v. National Provincial and Union Bank of England*, the English Court of Appeals held that:

- A bank owes an implied duty of secrecy to its customers.
- The duty not only covers knowledge derived by the bank whilst it maintains a contractual relationship with the customer, but also extends to:
 - i. Knowledge acquired by the bank before the relationship was in contemplation, or after its termination; and
 - ii. Knowledge derived by the bank from sources other than the customer's accounts but still in relation to its dealings with the customer, for example, information obtained from a third party that would help the bank decide how it should treat the customer.

Exceptions to Duty of Secrecy

The *Tournier* case also established four exceptions to the banker's duty of secrecy:

- Disclosure under compulsion by law;
- Disclosure as a duty to the public;
- Disclosure in the bank's interest;
- Disclosure by express or implied consent of the customer.

Disclosure Under Compulsion by Law

There are two main scenarios where this exception may be invoked: obligation to make disclosure under legislation and obligation to make disclosure under court order.

- **Obligation to make disclosure under legislation.** The following are among those most commonly encountered by authorised institutions:
 - i. The Inland Revenue Ordinance (Cap. 112) empowers the Inland Revenue Department to require any person in possession of information or documents relevant to any matter affecting a taxpayer's liability to furnish or produce such information or documents within a reasonable period. A bank may be obliged to provide copies of statements of accounts in a customer's name.
 - ii. The Prevention of Bribery Ordinance (Cap. 201) empowers the Commissioner for the Independent Commission Against Corruption to require a bank to produce for inspection, and provide copies of, statements and other records of a customer's account that are likely to be relevant to an ICAC investigation.
 - iii. The Police Force Ordinance (Cap. 232) specifically empowers the Commissioner of Police to require information from banks and deposit-taking companies for investigation of an indictable offence or apprehension of an offender. Such information includes whether a named individual has an account with a bank or deposit-taking company, and whether a bank provides a safe deposit box or holds property in its custody for the individual.
 - iv. The Drug Trafficking (Recovery of Proceeds) Ordinance (Cap. 405), the Organized and Serious Crimes Ordinance (Cap. 455), and the United Nations (Anti-Terrorism) Measures Ordinance (Cap. 575) oblige banks to report suspicious transactions or activities of customers to the authorities for investigation of suspected money laundering or terrorist activities or commission of serious crimes.

Failure to comply with the authorities' request is a criminal offence. However, care should be taken where the authorities in a foreign country (for example, the U.S. Inland Revenue Service) request disclosure of information of a customer from a bank located in Hong Kong. Such requests have no legal basis under the laws of Hong Kong and a bank would breach its duty of secrecy if it complied with such a request.

- **Obligation to make disclosure under court order.** A bank may be compelled by an order of the court to disclose information relating to a customer's affairs. Non-compliance constitutes contempt of court, which is a criminal offence. Some common examples are the following:
 - i. Subpoena: A bank employee may be served with a writ of subpoena (being a summons issued by the court) ordering him to attend court and to bring records and documents relating to a customer's affairs in the bank's possession. This may occur, for example, where the customer's affairs with the bank are relevant to the subject of litigation involving the customer.
 - ii. Order for discovery or disclosure: In *Norwich Pharmacal Co. v. Customs & Excise Commissioners*, the English House of Lords held that if an innocent person becomes caught up in another's wrongful acts through no fault of his own and thus inadvertently facilitated the wrongdoing, he does not incur personal liability, but the court

may order him to assist the victim by disclosing the identity of the wrongdoers and providing full information. In *Bankers Trust Co. v. Shapira*, it was established that not only could the court order disclosure of the fraudster's identity, but discovery could also be ordered of a bank's books and records in aid of a tracing claim.

- iii. Garnishee order: The bank is normally requested by the creditor of a customer to disclose the amount of credit balances held available for attachment. If the garnishee order does not also compel disclosure of information by the bank, the bank should take care not to reveal any information until the order is made absolute. In practice, banks normally will only disclose to the creditor the availability of credit balances for attachment. It is normal practice for banks to inform customers of the service of a garnishee order and its effect on the operation of the customer's accounts.

Care should be taken where a court order granted by a foreign court is served on a bank's offices in Hong Kong, or in that foreign jurisdiction requiring production of confidential information relating to a customer's accounts maintained with the Hong Kong branch of the bank. The foreign court order has no effect in Hong Kong. If the Hong Kong branch of the bank were to produce the information to the foreign court directly or through the bank's offices in the foreign jurisdiction, it would be in breach of its duty of secrecy.

Duty to the Public to Disclose

The majority of the scenarios in which this duty would have arisen are already provided for by legislation empowering authorities to compel disclosure of otherwise confidential information by banks. However, problems occasionally arise where there is yet insufficient grounds to invoke the statutory powers of ordering disclosure unless confidential information is first obtained.

For example, the police may be in the early stages of investigating a suspected crime and merely suspect, but do not yet have proof, that a customer of the bank is implicated in the crime. If the police make an informal request to the bank for information relating to the customer's affairs to assist in its investigation, the bank may find it difficult to decide whether its duty to the public overrides its duty to the customer.

In practice, banks will insist on the police certifying that the information is necessary for the prevention or detection of crime before agreeing to release the data, pursuant to an exception under the Personal Data (Privacy) Ordinance (Cap. 486) that applies to personal customers. For non-personal customers such as corporates, banks will normally resist such informal requests and insist that the police invoke their statutory powers.

Disclosure in the Bank's Interest

There are a number of obvious instances where the bank's interests will require disclosure.

- Where there is litigation between the bank and the customer. For example, where the bank sues the customer for recovery of debt due, the court papers must set out the amount claimed and particulars of the underlying transaction giving rise to the debt.

- Where there is litigation between the bank and a third party in relation to matters arising from the bank's dealings with the customer. For example, if the bank sues a guarantor of the customer's liabilities, the court papers must set out the relevant information.

Disclosure with Customer's Consent

The customer's consent to make a disclosure may be express or implied:

- **Express consent.** A customer may expressly authorise his banker to make disclosure to a third party. For example, a customer may specifically request the bank to provide a banker's reference on the customer's relationship with the bank to a third party.

The Personal Data (Privacy) Ordinance obliges banks, as a data user in relation to personal customers, to inform customers of the classes of persons to whom the customer's personal data may be transferred. The Code of Banking Practice further requires banks to be as specific as possible in their notification to customers of these classes of persons, which include debt collection agencies, computer firms to which processing of personal data may be outsourced, credit reference agencies, and related companies of the bank within the same group to whom customers' names and addresses may be disclosed for marketing purposes.

Whilst the Ordinance and the Code contemplate the giving of a notice to customers in respect of disclosure of personal data to the above classes of persons, it is the practice of most banks to either incorporate this part of the notice by reference, or duplicate it in their account terms and conditions such that the customer expressly consents to disclosure to the named classes of persons.

The Code also requires banks to obtain customers' express consent for giving bankers' references to another financial institution in respect of a customer, and for disclosure of customers' names and addresses to unrelated companies for marketing purposes. Although it is not a statutory or regulatory requirement, most banks now extend the practice of including an express disclosure clause to non-personal customers.

- **Implied consent.** In the case of *Sunderland v. Barclays Bank Limited*, the court accepted that the customer, by drawing a third party into her conversation with the bank, had given implied consent for the bank to reveal her affairs with the bank to that third party. However, it is never easy for a bank to ascertain in the first place, or establish when challenged, a customer's intentions.

In the modern era, in particular with the enactment of data protection legislation, it is no longer prudent for a bank to rely on implied consent in disclosing customers' information to third parties other than under compulsion of law or for the protection of the bank's interest.

For example, with regard to the provision of bankers' references or status opinions about a customer by one bank to another, banks had previously relied on customers' implied consent to what they contended was an established practice. However,

the English court rejected this argument in the case of *Turner v. Royal Bank of Scotland plc* and held that the provision of bank references cannot be based on implied consent as the practice is not sufficiently notorious to constitute an implied contractual term. In Hong Kong, it is now a requirement of the Code of Banking Practice that banks obtain customers' express consent to the provision of bankers' references.

Banker's Opinion

Whilst a banker has a duty to keep his customers' affairs secret, one of the exceptions is where the customer has given his consent. In the case of a banker replying to a status enquiry, the practice is so well established that the customer is presumed to have given his implied consent when he opened the account. If he expressly told the bank not to answer any status enquiries made about him, the implied consent would be revoked. However, the circumstances would be very unusual, and the bank might wonder about the advisability of conducting the account at all.

Businessmen and others value the status enquiry system, which is usually a free service, and there is no doubt that it is of considerable help in day-to-day commerce when dealing with an unknown or even a regular customer. The enquirer must approach his own branch as bankers will only give opinions to other bankers, and opinions will not be given directly to an individual. An exception to the latter rule, however, would be where the customer making the enquiry banks with the same bank and branch as the subject of the research, in which event the banker has in effect two roles.

The enquiries made should always be for genuine trade or financial transactions, and the answer is usually given also in brief terms. Over the years, certain phrases have come into general use between banks and their meaning is usually clear to the recipient banker or to an experienced trader.

Thus, in response to an enquiry as to whether a customer is good for \$100,000 trade credit, an answer might be given to the effect that he is considered "Undoubted" or "A respectable customer who maintains a satisfactory account. We regret however that we have insufficient knowledge of his affairs to speak for your figure (\$100,000 trade credit)."

It is usual for the bank to keep a record of all opinions given. This helps ensure that a consistent view is taken. Also, when a customer's financial position changes, it is then easier for the bank to decide how it should shade or improve its answer as against former expressions of opinion. A record will also help the account-holding bank to see if a customer is apparently attempting to raise too much by way of credit finance.

Disclaimer

In practice, banker's opinions are not signed and the standard printing form used by the bank will bear a disclaimer clause which might read "Confidential, and for your private use and without responsibility on the part of the bank or its officials."

However, since the Control of Exemption Clauses Ordinance (Cap. 71) came into force, it has been felt that such a disclaimer clause would not protect the bank if the recipient relied on the answer and suffered loss, where the answer would not meet the test of “reasonableness” as described in the Ordinance.

When preparing his answer, the banker should give consideration to all matters relating to the customer’s financial and business affairs that are known to him. There is no onus on the banker to make outside enquiries as to the customer’s solvency or otherwise. All that is required is an honest opinion, which should give no details of the actual bank account or the security lodged. Where the bank holds a debenture from a limited-company customer, it is invariably the practice to disclose that fact, the nature of the security being so all-embracing that the bank’s special position is perhaps material to the enquirer.

Duty to Enquirer

The bank might have a duty to the enquirer because he might suffer a loss in acting on the opinion given. The drafting of a suitable reply can be particularly difficult where the customer is known to have financial problems. Clearly, in such circumstances, a favourable reply cannot be given but, equally, to infer that the customer’s business is about to collapse could cause that very event. The bank must be neither too optimistic nor too pessimistic in its reply.

The leading case which examined these matters is *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd.* Hedley Byrne enquired to the respectability and standing of Easipower, whose account was with Heller & Partners to the extent of £100,000 per annum. The answer given was that Easipower was “considered good for its ordinary business engagements.” Relying on the banker’s opinion, Hedley Byrne entered into a contract with Easipower, but lost £17,000 when that company went into liquidation. They then sued Heller & Partners on the grounds that the opinion had been given negligently and in breach of a duty owed to them to exercise care.

The judge held that there was no contract between Heller & Partners and Hedley Byrne, and thus there could be no duty of care and therefore no breach. Moreover, there was no fiduciary relationship between the enquirer and the bank giving the opinion. The plaintiffs appealed, but the judgment was affirmed. Hedley Byrne went to the House of Lords, where the decision was still in favour of the bankers, although for different reasons. Here, it was felt that if it could be shown that the circumstances whereby information and/or opinions were given established a form of relationship, which was equivalent to, but did not actually constitute a contract, then a banker’s opinion could well fall in that category.

However, the decision in favour of the bank was made because the bank had included a disclaimer clause in its answer, declining at the outset to accept any responsibility and, therefore, had never established such a special relationship. It can be seen from this decision that the use of standard forms, with the disclaimer clause, is most important. Where opinions are given orally (a practice which is unusual and which requires special care), the giver of the opinion should always preface his remarks with the disclaimer.

As we have noted, however, the passing of the Control of Exemption Clauses Ordinance has thrown some doubt upon the worth of this practice in Hong Kong. It may be that a court in the future will take a different view. Bankers should continue to maintain the disclaimer clause in their answers to status opinions, but it is now necessary to exercise even greater care in framing the answer.

Personal Data and Consumer Credit Data

Since the Personal Data (Privacy) Ordinance (Cap. 486) came into force in Hong Kong in 1996, no consideration of the banker's duty of secrecy would now be complete without an understanding of this legislation and its implications for bankers. The Ordinance is an additional requirement to the banker's duty of secrecy.

The Ordinance aims to protect the privacy of living individuals in relation to their personal data. It aims to regulate the activities of all data users, such as banks, including the collection, holding, processing or use of personal data. It also contributes to Hong Kong's continued economic well-being by safeguarding the free flow of personal data to Hong Kong from restrictions imposed by countries that already have data protection laws.

What is Personal Data?

The Personal Data (Privacy) Ordinance defines 'personal data' as information that is recorded in a document in writing and stored on paper or electronically, or stored in a disc, film, tape, or other devices on which data (including visual images) are stored in such a way that they can be reproduced. This means that a tape recording of a telephone conversation between a bank employee and a customer of the bank is personal data and covered by the ordinance.

However, information transmitted verbally does not constitute personal data, unless it is recorded in writing. Data relating to deceased persons are also not covered by the ordinance; only personal data relating to living individuals are covered, and only those from which it is reasonably practicable to identify the individual.

Personal data thus includes any representation of information, opinion, and "personal identifier," including date of birth, personal or banking reference from other sources, family or education background information, account statements or deposit ticket and so on. A "personal identifier" means any numbers or documents that can identify an individual, such as a bank account number, ATM personal identification number, and copies of identity documents.

Collection of Data

When a bank first collects personal data from its customer, it has to give that customer a copy of its data policy. The customer must agree to accept the bank's data policy before or at the same time as data is first collected. A data policy clause is therefore usually incorporated into the bank's account opening or service application forms.

The purpose and manner of data collection must comply with the following requirements:

- **Data can only be collected for a lawful purpose.** For example, data should not be collected to facilitate criminal activities. Only data necessary for or directly related to the purpose should be collected; the volume of data should be adequate, not excessive.
- **Data should be collected by fair and lawful means.** In assessing fairness, consideration should be given as to whether less intrusive means will achieve the same result. An example is the tape recording of clients' instructions by banks or securities firms. This is justified by the need to obtain a record of the instructions for use in case a dispute arises. Any alternative means of obtaining such record before execution of the instructions, for example, by obtaining each client's signature to a written record of the instructions, is impractical.
- **Certain information should be provided to the data subject.** He or she must be told at the time of data collection:
 - i. Whether it is compulsory that he or she supply the data, and if so, what are the consequences of failure to do so;
 - ii. The purpose for which the data is to be used
 - iii. The classes of persons to whom the data may be transferred
 - iv. The data subject's right to request access to or correction of the data, and the name and address of the individual to whom such request may be made.

The Privacy Commissioner has recommended that data users prepare and make available to data subjects a Personal Information Collection Statement (PICS). Most banks have adopted a PICS form, developed by the Hong Kong Association of Banks, as a notice to customers and other individuals relating to the Personal Data (Privacy) Ordinance's requirement on the use of a Data Privacy Notice.

Data Protection Principles

The Ordinance establishes six data protection principles, with which all data users must comply.

- **Data Protection Principle 1: Purpose and manner of collection of personal data.** This provides for the lawful and fair collection of personal data, and sets out the information a data user must give to a data subject when collecting personal data from that

subject. The banks' use of a Data Privacy Notice complies with this principle, but it is impractical to give customers a copy of the notice every time new data is collected because, for a bank, every new instruction from and transaction with a customer constitutes the collection of new data.

The Ordinance provides for this situation by allowing data users to give a Data Privacy Notice once every 12 months, in cases where personal data is repeatedly collected under the same circumstances, such that there is no material difference in the notification. Typically, banks mail a copy of the Data Privacy Notice annually to customers along with the monthly statement of accounts or promotional materials, or include a reminder in the monthly statements of the availability of the Data Privacy Notice at the bank's branches or on its website.

- **Data Protection Principle 2: Accuracy and duration of retention of personal data.** This provides that personal data should be accurate, up-to-date, and kept no longer than necessary. Data users are obliged to take all practicable steps to ensure that inaccurate data is not used until its accuracy is validated or rectified. Wrong data should be erased.

Banks should establish procedures for updating customers' personal data to ensure their accuracy, including internal procedures for the prompt processing of customers' notification of personal data changes.

Banks are required under the Inland Revenue Ordinance to retain business records for a minimum of seven years. Since the Personal Data (Privacy) Ordinance does not have the effect of overriding other legislation, seven years is a valid period for which a bank may retain records of its dealings with customers, including the personal data of those who have terminated their relationship with the bank.

Where an individual applies for facilities with a bank but is rejected or withdraws the application, the question arises as to whether the bank is entitled to retain the applicant's personal data and, if so, for how long. It seems justifiable for banks to retain the data collected in such circumstances for a short period, so they can answer any subsequent queries from the applicant.

Some banks have argued for a longer retention period in case the bank decides to consider the applicant for another type of facility in respect of which he or she is likely to meet the approval criteria. To comply with Data Protection Principle 2, it is important that banks establish a clear policy covering this type of situation and make it known to applicants for their services.

- **Data Protection Principle 3: Use of personal data.** This provides that unless the data subject agrees otherwise, personal data should only be used for the purposes for which they were collected or for another but directly related purpose. If a bank wishes to use customers' data for a purpose not specified in the Data Privacy Notice, it will not be practicable to obtain express consent from all customers. Banks normally would notify customers of the intended use and rely on the customer's acceptance by his or her conduct of continuing to use the bank's services after the effective date of the change in data usage.

However, if a bank intends to transfer customers' data to an unrelated company for marketing purposes, for example, in a joint promotion scheme, the Code of Banking Practice specifically obliges banks to obtain customers' express consent. It should be noted that the code prohibits banks from terminating the basic banking relationship with a customer who objects such data transfer.

- **Data Protection Principle 4: Security of personal data.** This requires the application of appropriate security measures to personal data (including data in a form in which access to or processing of is not practicable). A data user should take all practicable steps to ensure that personal data held are protected against unauthorised or accidental access, processing, erasure, or other use. The greater the sensitivity of the data and the harm likely to be caused by unauthorised access or leakage, the higher the level of security should be.

Data users should take the following into account:

- i. location of the data, for example, in a restricted area
- ii. security measures incorporated into equipment storing the data, for example, computer passwords
- iii. measures for ensuring the integrity, prudence, and competence of persons having access to the data
- iv. measures for ensuring secure transmission of the data.

Banks should have tight procedures to safeguard its systems and records containing customers' personal data, restrict access only to authorised staff who need to access the data in order to perform their duties, and establish adequate guidelines for staff in handling personal data.

Where banks transfer personal data to a third party service provider, for example, as part of an outsourcing arrangement, the Code of Banking Practice requires them to take steps to ensure that the personal data will be treated as confidential and adequately safeguarded by the service provider.

Normally, the service contract between the bank and the service provider will include the service provider's confidentiality undertaken and obligation to establish and abide by adequate procedures for safeguarding the personal data, and the right of the bank to conduct audits on the service provider's observance of its secrecy obligations. The Code also requires banks to remain accountable to customers for any complaints arising from the service providers' handling of personal data. Banks should not disclaim responsibility to customers for breach of customer confidentiality by service providers.

- **Data Protection Principle 5: Information to be generally available.** This provides for openness by data users about the kinds of personal data they hold and the main purposes for which personal data is used. A data user must take all practicable steps to ensure that a data subject can ascertain the data user's policies and practices in relation to its collection, holding, and use of personal data.

In addition to the use of PICS, as previously mentioned, the Privacy Commissioner recommends that data users prepare and make available to data subjects

a Privacy Policy Statement (PPS) to explain the data user's policies and practices. The statement should be given to data subjects at the time of data collection, together with the Data Privacy Notice.

The Privacy Commissioner has also published guidelines on "Preparing Online PPS and PICS." These are meant to provide guidance to data users that collect personal data online from individuals, for example, in an online application or registration form or without the individuals being aware of the data collection through, for example, the use of 'cookies.' It is recommended that a data user provide prominent links to their PPS from its homepage as well as from each website form used to collect personal data.

- **Data Protection Principle 6: Access to personal data.** This provides for data subjects to have rights of access to and correction of their personal data. The Ordinance requires data users to comply with a request from a data subject for access to, or correction of, personal data within 40 days, and to give reasons if this cannot be complied with. Data users may charge a fee, which must not be excessive, for processing a data access request.

Use of Personal Data in Direct Marketing

The Personal Data (Privacy) Ordinance defines "direct marketing" as an offer or advertising of goods, services, or facilities by means of information or goods sent by mail, fax, e-mail, or similar means of communication, with the communication addressed to a specific person or persons by name.

Where personal data is used for direct marketing for the first time, the data user must inform the data subject that if the data subject so requests, the data user will, without any charge, cease to use his/her personal data for direct marketing. This is commonly called an 'opt-out clause.' The Code of Banking Practice requires banks to remind customers of their opt-out right at least once every year, or to do so by including a standard opt-out clause in all marketing and promotion materials.

For data users like banks that regularly engage in direct marketing, it is important to maintain a list of all individuals who have notified it that they wish to opt out from receiving further direct marketing, keep that list regularly updated, and ensure the list is promptly distributed among marketing staff as and when updated. The opt-out clause included in the account opening form or direct marketing materials should allow customers to choose which channel(s), such as direct mail, telephone, fax or email, they may or may not want to receive direct marketing information from.

Code of Practice on Consumer Credit Data

In the area of consumer credit, where credit is provided by a credit provider to and for the use of an individual, or to and for the use of another person for whom an individual acts as mortgagor or guarantor, the Privacy Commissioner issued a Code of Practice on

Consumer Credit Data (last updated in 2011), which requires credit providers such as banks to notify an applicant for credit facilities that his or her personal data may be supplied to a credit reference agency and, in case of loan default, to a debt collection agency.

The notification should also state that the applicant has the right to request the credit provider to inform him or her which items of data are routinely disclosed to the agency and to be provided with information (such as contact details of the agency) to enable the making of a data access or correction request to the agency.

For its part, the Hong Kong Monetary Authority has published a Supervisory Policy Manual on the sharing and use of consumer credit data through a credit reference agency. The guideline requires bank policies and procedures to be designed to ensure the security, confidentiality, and integrity of consumer credit data and to guard against unauthorised access to, or use of, such data that could result in a breach of the Code of Practice on Consumer Credit Data and the data protection principles and relevant provisions of the Personal Data (Privacy) Ordinance.

Statement of Account or Passbook

The modern practice is to issue computerised statements for current accounts and other tailored accounts, and passbooks for savings accounts and, occasionally, time deposit accounts. For a savings account, it is usual for the customer to retain the passbook and produce it during a withdrawal or deposit. Specimen signature(s) and other brief personal details usually will be encoded in the passbook. For time deposit accounts, the banks usually generate a receipt or advice to the customers as the evidence of such deposits.

Problems arise when errors occur in passbooks or statements which show the customer's account being either over-credited or over-debited. To address this and other areas of concern, the Code of Banking Practice requires banks:

- To provide customers with monthly statements of account, unless a passbook or other transaction records are provided, or there has been no transaction on the account since the last statement, or the bank has agreed otherwise with the customer;
- To advise customers to examine their statements of account and allow at least 90 days for customers to report unauthorised transactions;
- To warn customers that if they fail to report unauthorised transactions within the specified period, the bank reserves the right to regard the statement as conclusive. But banks should not exercise their reserved right to deny a customer's claim if the unauthorised transaction arises from a third-party fraud or forgery in relation to which the bank has failed to exercise reasonable care and skill; or arises from forgery or fraud by the bank's employee, or default or negligence of the bank or its employee.

The importance of complying with the Code's provision to advise customers to examine their statements is underlined by the ruling in *Tai Hing Cotton Mill Ltd. v. Liu Chong Hing Bank Ltd. and others*. In this case, the bank had paid out money on a cheque

that was later discovered to be forged. It then moved to debit the customer's account to cover the amount of the cheque. The court held that the bank was not entitled to do so.

The reason was, firstly, that unless it was otherwise agreed between the banker and the customer, the duty of care owed by a customer to the bank in the operation of his current account is limited to (a) a duty to refrain from drawing a cheque in such a way as to mislead the bank or facilitate fraud or forgery, and (b) a duty to inform the bank of a forgery as soon as it is discovered. This means that unless the terms of the contract seek to impose an express obligation on the customer to examine monthly statements and make the statements unchallengeable after a specified period, the customer has no duty to examine the bank statements.

Secondly, with regard to such a provision in the contract, the court held that the burden of the obligation imposed on the customer and of the sanction imposed must be clearly brought home to the customer. The clause must be clear and unambiguous and satisfy the 'undoubtedly rigorous' test. In that particular case, the court held that the bank had failed to meet the test.

Wrongful Dishonour of Cheques

Article II

A bank must pay cheques drawn by the customer on presentation, so long as there are sufficient funds in the account or the cheques are within the limit of an agreed overdraft, and the bank is not legally restrained from making payment. If a bank wrongfully dishonours a cheque drawn by the customer, the customer may claim damages from the bank based on either breach of contract or libel.

Thus, before the bank dishonours a customer's cheque for shortage of funds, it should be absolutely sure that it is in order to do so. Substantial damages might be awarded against the bank if it wrongfully dishonours a cheque and thereby injures the customer's credit. Before actually returning a cheque, banks should also ensure as far as possible that a credit has not been misapplied to another account or that other cheques have not been paid which have been stopped or which are post-dated.

Practical Considerations for Banks

In computing the balance available in a customer's account, the bank need not take into consideration cheques paid that are still in the course of clearing (uncleared effects), unless in the past the bank has agreed specifically or by implication through its conduct to pay cheques so drawn. This implication could arise where previous cheques drawn against uncleared effects have always been paid and there has been no warning to the customer that he must in the future ensure that cleared covering funds are available.

If a bank has wrongly returned a cheque with the answer “Refer to drawer” and the mistake is then discovered, the banker should at once take all possible steps to correct matters. This practice is due to business considerations and also because, in so doing, the bank will help alleviate the extent of damages which might be awarded in any subsequent court action brought by the drawer. Steps to remedy the situation should include contacting the payee and the presenting banker as soon as possible, by phone initially, and then by letter in confirmation.

The message should state that the cheque should have been paid and that the fault lies wholly with the bank and that neither party should construe the events as being any reflection upon the creditworthiness of the drawer. The bank may prefer to obtain the customer’s authority to disclose any details which are relevant and should, of course, remember that, in admitting the error, it will be unable to defend an action brought by the customer against it later. However, the court will take the bank’s conduct into account in assessing the actual loss to the customer and so this action may limit any damages awarded.

Breach of Contract and Libel

The general rule is that the party which is in breach must pay the amount of damage, which flows directly and naturally from his failure to keep his contract, provided that such would reasonably have been within the contemplation of the parties at the time when they made contract. It is difficult to apply this rule to a contract to honour a customer’s cheques. This is because it would only be on very rare occasions that a bank has any knowledge as to the circumstances under which the customer came to be drawing his cheque.

For instance, an importer lost a valuable contract through the wrongful dishonour of its cheques. Would the bank be liable for the loss of profits that would be earned under that contract? Substantial damages would be awarded in that case because the importer was a trader. In the case of a non-trader customer, the court may rule that only the nominal damages would be awarded, unless special damages were proved. The banker should note that the smaller the cheque, the greater might be the damage to the customer’s credit.

As stated above, the customer may claim against the bank for breach of contract and libel in case of wrongful dishonour. In some suits, the two claims have been dealt with without differentiation, whilst in others, there have been different decisions. In *Flack v. London and South Western Bank Ltd.*, the court ruled that the words “Refer to drawer” amounted merely to a statement by the bank: “We are not paying; go back to the drawer and ask why,” or else “Go back to the drawer and ask him to pay.” The judge felt it was not possible to extract a libellous meaning from the words “Refer to drawer.”

However, there is a tendency in more recent cases to regard the words “Refer to drawer” as being capable of a defamatory meaning. In one such case, the plaintiff carried on business as a manufacturer and retailer in ladies’ clothes. She claimed damages from the

bank for alleged breach of contract and for libel, after her bank wrongfully dishonoured two cheques drawn by her. The cheques bore the notation “Refer to drawer,” which the plaintiff claimed lowered her reputation.

In defence, the bank maintained that its obligation to pay the cheques was only on condition that the limit of £500 was not exceeded and this would have been the case if the cheques in question had been paid. The plaintiff’s case was that the bank had agreed to meet the two cheques against her undertaking that she would pay in £100 in the following week. In an action heard before the jury, the bank agreed in response to a specific question that the words “Refer to drawer” did lower the plaintiff’s reputation in the minds of right-thinking people. However, when the words were written on the cheques, she would have exceeded her agreed limit of £500.

The claim against the bank therefore failed and the bank successfully defended itself when an appeal to the English Court of Appeal was made. However, the jury’s view that the words “Refer to drawer” could be libellous or defamatory was important, as the words have come to be regarded by the ordinary person as meaning “no funds.”

Exemption Clauses

In the section on “Banker’s Lien,” we discussed the disclaimer clause in a trade enquiry reply. This is an example of an exemption clause, which frequently appears on standard bank forms such as account opening forms and third-party mandates. Exemption clauses are often meant to serve as an outright exclusion of banks’ liability, but they can also be couched in such a way that they impose obligations on customers.

For example, in order to exclude liabilities to customers for wrongful debits due to forged signatures on cheques, banks may include the following clause on their account opening forms:

“The account holder agrees that the statement of account shall, as between the Bank and the account-holder, be conclusive evidence as to the balance shown therein and that the statement of account shall be binding upon the account-holder, who shall be deemed to have agreed to waive any rights to raise objections or pursue any remedies against the Bank in respect thereof unless the account-holder notifies the Bank in writing of any such errors within 90 days after posted ... such statement of account.”

The above clause, whose wording is suggested by the Hong Kong Association of Banks, imposes an obligation on account holders. However, in essence, it is an exemption clause which excludes banks’ liabilities for wrongful debits. Bank exemption clauses, whether they are written in a negative way of excluding liabilities or in a positive way of imposing an obligation, are subject to the Control of Exemption Clauses Ordinance (Cap. 71).

Control of Exemption Clauses Ordinance

In order to claim protection under the Control of Exemption Clauses Ordinance, one party must have been dealing with the other as a consumer or using the bank's standard form. Article 4 of the Ordinance defines "dealing as a consumer" as someone who neither makes the contract in the course of a business nor holds himself out as doing so, whilst the other party does make the contract in the course of a business. An incorporated customer can also be dealing with a bank as a consumer.

Both private customers and incorporated customers are dealing with banks as consumers when the contracts are prepared by banks or a banks' standard forms are used. However, in special dealings when banks' special forms are not used *and* that contract is prepared jointly, such as in loan syndication, the Ordinance will not apply and the exemption clauses in the documentations are not controlled.

Furthermore, any exemption clauses in a mandate, if any, are subject to the test of reasonableness. If the clause cannot pass the said test, then it is not enforceable. Whether the clauses are reasonable will be determined in accordance with usual and normal banking practice. The Code of Banking Practice is one of the important references for such determination.

The "reasonableness" test is highly subjective. However, the Ordinance, having regard to the difficulties in applying the test, provides to the court or arbitrator some guidelines. In arriving to a decision that a clause is reasonable, and therefore should be upheld (or vice versa), the court or arbitrator should consider:

- The bargaining strength of both parties, taking into account alternative means by which the customer's requirements could have been met
- The inducement offered by the bank to the customer to agree to the term
- Customer's knowledge of the existence and extent of the term (having regard to the trade custom or previous dealings)
- Whether it was reasonable and practicable at the time

When an exemption clause fails the "reasonableness" test, it will be omitted from the bank-customer contract and the bank will be liable to the customer as though the term has never been inserted.

Summary

- Bankers need to understand the many legal issues that can arise in the course of day-to-day banking operations in order to protect their organisations and themselves from liability. One issue is the relationship between banker and customer, which can take several forms, such as banker and customer, debtor and creditor, principal and agent, and bailor and bailee.

- A mandate is a written instruction from a customer to a bank to do certain acts on the customer's behalf. In a strict legal sense, mandates are only instructions from customers to banks, but many banks have incorporated contractual clauses into a mandate. Some of those clauses may not be enforceable if they are not in accordance with usual banking practice.
- A power of attorney is a document that grants a third party the authority to operate a customer's account. A special/specific power of attorney gives the third party power for a specific purpose; a general power of attorney confers very extensive powers.
- Appropriation of payments is the right of a customer or a bank to apply a specified deposit to meet a specified debt. Set-off arises when a debtor or his creditor wishes to arrive at the net figure owing between them. If a customer has more than one account at a bank, the bank has the right to set off the customer's credit balance on one account against the same customer's debit balance.
- A lien is a right to retain possession of a debtor's goods until the debt is paid. In addition to any security it may have taken and to its right to combine or consolidate its customers' accounts, a bank in general law has a banker's lien over securities deposited by the customer to the extent of the customer's indebtedness to the bank.
- The banker's duty of secrecy is implied when the account is opened and extends not only to the account itself and the information that could be gained from it, but also to any other particulars of the customer's affairs, which come to the bank's knowledge from conducting the account or in carrying out any other transactions or financial dealings on behalf of the customer.
- The banker's duty of secrecy extends to the customer's personal data and consumer data. Banks must comply with the provisions of the Personal Data (Privacy) Ordinance and Code of Practice on Consumer Credit Data, respectively.
- The Code of Banking Practice requires banks to provide customers with monthly statements of account, advises them to examine them and allow at least 90 days to report unauthorised transactions, and compels them not to exercise their reserved right to deny a customer's claim if the unauthorised transaction arises from a third-party or bank employee fraud, forgery, or negligence.
- Substantial damages might be awarded against the bank if it wrongfully dishonours a cheque and thereby injures the customer's credit. The customer may claim damages from the bank based on either breach of contract or libel.

Key Terms

agent

bailee

bailor

banker's lien

breach of contract

Code of Banking Practice

Code of Practice on Consumer
Credit Data

common law

consumer credit data

Control of Exemption Clauses Ordinance	mandates
creditor	personal data
customer	Personal Data (Privacy) Ordinance
debtor	power of attorney
enduring power of attorney	principal
exemption clauses	set-off
general power of attorney	special/specific power of attorney
libel	wrongful dishonour of cheques

Study Guide

1. Mr. A has opened two accounts in two different branches of the same bank. He is frequently overdrawn on one account and fails to correct the overdraft. However, his other account holds sufficient credit to cover his overdraft. Under these circumstances, what are the bank's legal options?
2. Investigators suspect Mr. M of certain financial irregularities and apply to his bank to look into his personal finances. Can they compel the bank to disclose such information? Under what circumstances can they compel the bank to disclose?
3. Mrs. M neglected to put sufficient funds in her current account to pay off her bills. She has sufficient funds in her personal account, but most of the funds are tied up in a time deposit. Can the bank use the funds in the time deposit account to offset the overdraft? Why or why not?
4. Explain when and how a banker and customer relationship begins.
5. Mr. A lost his high-salaried job and, as a consequence, has not been servicing a large overdraft with his bank. His bank plans to place a banker's lien on Mr. A's assets with it, which includes a time deposit that will mature in three months' time and a safe deposit box. Draft a plan of action for the execution of the lien, including an assessment of what assets can and cannot be included.

Further Reading

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