WAYS AND MEANS OF TAKING SECURITY OVER BANK DEPOSITS

Comment by

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The decision in Broad's case involved a customer of a bank executing a document which gave the bank the right to hold money deposited by the customer with that bank as security for advances made by the bank to the customer. The case involved the question of stamp duty, and in particular whether the document which the customer executed constituted a mortgage or a charge, within the meaning of section 3 of the New South Wales Stamp Duties Act.

The court held that the document did not constitute a charge or mortgage, because the deposit over which security was given, was no more than an indebtedness of the bank to the customer, and there could be no mortgage or charge in favour of one's self of one's own indebtedness to another. What the document did, according to Mr Justice Lee, was no more than to give the bank the right to set off against its own indebtedness to the customer the indebtedness of the customer to the bank at any given time.

Such contractual rights of set off, even if considered to be a "security" in a wide sense of that term, could not be regarded as a mortgage or charge. It is interesting to note, that Professor Goode has expressed a view which parallels the decision of Mr Justice Lee in Broad's case. There are a number of arguments and bases upon which I believe Professor Goode and the decision in Broad's case have separately relied, and these are as follows.

First, National Westminster Bank Limited v Halesowen Presswork & Assemblies Ltd [1972] AC 785 is said to be authority for the proposition that a bank cannot sensibly be said to have a lien over its own indebtedness to a customer. Professor Goode argues that this must equally be true of non-possessory forms of security.

The second rationale, in Professor Goode's view in any event, would be that the English equivalent to section 12 of the New South Wales Conveyancing Act becomes unworkable when there are only two parties involved. That section contemplates three parties, the assignor, the assignee and the debtor.

The third argument that Professor Goode, I believe, would put to support the Broad decision, is of the essence of assignment of a debt that the assignee becomes entitled to recover the debt. On that basis, where the debtor is the bank, the bank cannot legally sue itself. It follows according to Professor Goode that the customer's assignment to the bank of its own right of action against the bank is a nullity - for it transfers nothing.

I submit however, that there are a number of strong rejoinders to the arguments that I have just mentioned. First, simply because a bank does not possess anything over which it can exercise a lien that does not mean it has nothing to charge.

Further, I believe that the remarks made in the Halesowen case in relation to liens indicate that the expression "lien" is inappropriate to describe the rights that a bank has over its customer's credit balance.

As far as the argument concerning the equivalent of section 12 of the New South Wales Conveyancing Act is concerned, it may be said that this section contemplates three parties, but it is difficult to find the reason why one must infer from that, that a charge in a two party situation is legally impossible.

In any event, charges over deposits are nearly always in the form of an equitable, rather than a legal or statutory assignment, in which case section 12 would not apply.

The next point I would like to make is that it is true that a bank cannot sue itself to recover a debt assigned to it. However, this simply illustrates that this particular form of security is realised by the bank effecting a set-off, not by the institution of proceedings against a third party.

Further, it does not even necessarily follow that an assignment of the kind under discussion would operate as a release of the debt. It is true that if a debtor assigns the debt to his creditor the law of merger results in the debt evaporating. A contract may be discharged where the rights and liabilities under it become vested by assignment or otherwise in the same person, but only where the rights and liabilities are vested in the same person in the same right. When a chose in action is assigned by way of security however, the debt is vested in the assignee as chargee rather than as assignee.

The final point that I would like to make about the rationale underlying Broad's case, is that on one view the decision does not reflect the pre-existing decisions. The first decision to mention is the decision of the English Court of Appeal in Ex parte Caldicott [1884] 25 Ch D 716 in which the court upheld an agreement by which a bank took security over money deposited with it representing the proceeds of sale of property in substitution for security over the property itself. This substitution did not affect the bank's position as a secured creditor.

The only other case that I propose to refer is the decision in Swiss Bank Corp v Lloyds Bank Limited [1982] AC 584 in which the

House of Lords seems to have assumed that a charge over a deposit with the plaintiff bank which the borrower had agreed to make in support of the lending would have been valid (see 614C).

Be that as it may, although the arguments against the correctness of Broad's case are strong, until the matter is tested, the decision cannot prudently be ignored. In light of this, an alternative method of taking security over a deposit - commonly known a the "Flawed Asset Approach" - is worthy of mention.

Speaking generally, the essential requirement when a cash deposit is to be treated as a security is for the bank to be satisfied that it cannot be called upon to repay the deposit until the secured liabilities have been satisfied. This can be achieved by making it a term of the deposit that maturity is postponed until the secured liabilities are satisfied. The bank does not actually need set-off rights against the deposit, although the result may be that the deposit remains on its books indefinitely.

As the depositor is prevented by contract from withdrawing the money until the secured liabilities have been satisfied, the prime risks here are assignment, attachment and insolvency on the part of the depositor. This now raises directly the set-off implications and associated questions of insolvency, and I think it best then to hand over to Barry McWilliams on those aspects.