

Review of cheques law in New Zealand

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This article is based on a recently released discussion paper on cheques law.¹

Background

In 1992, the Reserve Bank formed a working group (the Banking Law Working Group) to review aspects of banking law in New Zealand. The Working Group was formed in recognition that, in some respects, the law affecting the operation of the banking system was outdated and was impeding the efficient operation of the system.

The Group's objectives were to review aspects of banking law, with a view to promoting changes which would:

- facilitate efficiencies in the operation of the banking system;
- enable banks to better meet the needs of their customers;
- make the law more certain and understandable to users of the banking system.

The Group is convened by the Reserve Bank and comprises representatives from the Bank, the Bankers' Association and their respective legal advisers. The Department of Justice is also informally represented on the Working Group.

The Working Group's work programme has included a review of the law relating to cheques - principally the Bills of Exchange Act 1908 and Cheques Act 1960. The review was conducted in recognition that the law governing cheques had not been reviewed for many years, despite continuing advances in the technology used by banks to process cheques.

In August 1993, the Working Group released a paper outlining the Group's preliminary thinking in relation to the cheques law review. The paper was released to a wide range of interested parties in order to seek comments on the Group's thinking and to assist in advancing the review. The paper drew the following principal, but preliminary, conclusions:

- **Cheques should remain subject to statute law.** The paper preliminarily concluded that cheques should remain subject to statute law, as opposed to being principally governed by contract between the respective parties to a cheque. The Group took this view in recognition that:
 - Statute offers efficiencies relative to contract law, by effectively serving as a standardised contract.
 - It would be difficult to provide for the rights and obligations of all parties to a cheque, using contract law.
- **Separate Cheques Act** The paper indicated that the Group saw some merit in creating a new, stand alone Cheques Act, separate from the Bills of Exchange Act. This view acknowledged that cheques are the most commonly used bill of exchange and that there might therefore be merit in creating a separate Act to address the particular requirements of cheques. It was also considered that a separate and comprehensive Cheques Act would make it easier to locate and understand the law relating to cheques, compared to the existing approach, in which cheques law is principally subsumed within the Bills of Exchange Act.
- **Non-transferability** The paper observed that the existing law did not readily provide for a non-transferable cheque, despite the apparent demand for such an instrument. (A non-transferable cheque is a cheque which is payable only to the person named on the cheque as payee. Such a cheque cannot be negotiated to be payable to third parties.) It hypothesised that many users of cheques misunderstood the "not negotiable" designation within a cheque crossing to mean "not transferable". The paper argued that there would be merit in changing the law to provide for a non-transferable cheque.
- **Truncation** The paper noted that the existing law requires the physical presentation of a cheque at the paying branch of the paying bank before payment or dishonour of a cheque can occur. It was noted that this requirement imposes substantial compliance costs on the banking system, by necessitating the movement of large quantities of cheques from the receiving bank

¹ Discussion paper: "Proposed changes to cheques law," RBNZ Banking Law Working Group, August 1994.

to the appropriate branch of the paying bank. The paper advocated a change in the law to facilitate the truncation of cheques - ie the electronic presentment of a cheque, thereby obviating the need for the physical movement of cheques from the receiving bank to the paying bank.

- **Other matters** The Discussion Paper summarised the Working Group's preliminary thinking on a range of other matters, including the rules governing stale cheques and post-dated cheques, whether the law should be amended to provide for the grounds on which bank cheques may be dishonoured, and whether law was required to provide for a maximum time period for the obtaining of cleared funds on a cheque.

The Working Group's paper attracted a wide cross section of interest and elicited a number of submissions. In general, the submissions were broadly supportive of the Working Group's thinking. There appeared to be widespread support for the retention of statutory based cheques law. There was also general support for the creation of a new, stand alone Cheques Act.

The submissions also confirmed the Group's view that the immediate priorities for cheques law reform are the adoption of truncation and the creation of an unambiguously non-transferable cheque.

New proposals

With the benefit of the feedback which the Group had received from submissions on the August 1993 discussion paper, the Group has advanced its review of cheques law. In August of this year, the Group released a second discussion paper, which advocated a two stage process to cheques law reform. The two stage process involved:

- recommending to the Government that the existing law be amended as soon as practicable to facilitate truncation and non-transferability. Attached to the discussion paper was a proposed draft bill, which, on enactment, would give effect to these two measures.
- the conducting of a broad based review of cheques law, with a view to enacting a new Cheques Act in 1996 if possible.

These matters are considered below.

First stage of the review - the enactment of provisions relating to non-transferability and truncation

Non-Transferability

A common theme of many of the submissions sent to the Working Group in response to the August 1993 paper was that there is a widespread misunderstanding of the meaning of existing cheque designations. In particular, it was considered that the "not negotiable" designation is widely misunderstood to confer the status of non-transferability. It was also generally agreed that there is a widespread belief that the words "account payee" or "account payee only", written on a cheque, denote that the cheque is non-transferable. In fact, these words have no recognised meaning in the Bills of Exchange Act or Cheques Act, although they may have gained some meaning in common law.

The submissions also generally concurred with the view reached by the Working Group that there is a strong demand for an unambiguously non-transferable cheque. Such a cheque offers benefits in terms of providing banks and cheque users with greater scope for protecting themselves from cheque fraud.

Provision for non-transferability

The proposed bill prepared by the Working Group makes provision for a non-transferable cheque. The Working Group drafted two alternative versions of the proposed non-transferability provision. The first version provides for three types of designation to denote non-transferability:

- "non-transferable";
- "account payee", or "a/c payee", in either case, with or without the word "only"; and
- "pay payee only", in the case of an uncrossed cheque.

The first two designations are intended for use on crossed cheques (i.e. cheques which must be paid into a bank account). The third designation is intended for use on an uncrossed cheque (i.e. a cheque which could be cashed, rather than being paid into the payee's bank account, but which is nonetheless non-transferable).

Uncrossed non-transferable cheque

The "pay payee only" designation in the first version of the proposed non-transferability provision was drafted in recognition that some payees will not have bank accounts. A cheque so marked would enable a payee without a bank account to access the proceeds of the cheque by presenting the cheque to the paying bank and by proving his or her identity as the correct payee.

A non-transferable uncrossed cheque could place potentially substantial compliance burdens on banks by requiring them to be satisfied as to the identity of the payee. In addition, a requirement for banks to make two types of non-transferable cheques available to customers might impose significant costs on banks. It was also considered that the availability of an uncrossed non-transferable cheque might increase the potential for cheque fraud. Against those concerns, the creation of an uncrossed non-transferable cheque would assist those persons who do not have bank accounts.

In recognition of the potential difficulties associated with providing for an uncrossed non-transferable cheque, the Working Group set out a second version of the non-transferability provision. The second version only makes provision for crossed non-transferable cheques.

Cash cheques

The Group also gave thought to how cheques drawn for cash could operate in a situation where it is likely that most banks would issue pre-printed non-transferable cheques. It was concluded that the creation of such cheques should not impede the ability of the drawer to draw cheques for cash. In this context, it is understood that the introduction of pre-printed crossed, non-transferable cheques in the United Kingdom has not impeded the ability of customers to cash their cheques at their bank. The practice for cashing cheques in the United Kingdom apparently simply involves the drawer striking out the crossing in the presence of the teller. An alternative approach to obtaining cash from a pre-printed non-transferable cheque would involve making the cheque payable to the paying bank.

Truncation

Under the Bills of Exchange Act, presentment of a cheque can only occur by the physical presenting of a cheque to the paying bank branch at which the drawer's account is held. This rule of presentment requires the cheque clear-

ing process to include the physical movement of cheques from the collecting bank to the paying bank, at considerable expense. The cost of moving large quantities of paper from the collecting bank to the cheque processing centre and then to the paying bank branch adds significantly to the overall cost of cheque clearing. The requirement to physically present the cheque also reduces the efficiency of the cheque clearing process, by potentially extending the period within which cleared funds can be obtained.

Truncation of cheques

In recognition of these costs and inefficiencies, the banking industry has been reviewing its cheque clearing procedures, with a view to introducing a system of truncation, subject to changes being made to the law relating to presentment. Truncation is the process by which presentment occurs electronically, rather than through the physical presentment of the cheque at the paying bank branch. It would enable banks to pay a cheque (or to dishonour a cheque where there are insufficient funds in the drawer's account) on the basis of information transmitted electronically from the collecting bank to the paying bank. Physical presentation of the cheque would no longer be a necessary feature of the cheque clearing process.

General truncation provision

In recognition of these benefits, the Working Group considers that a strong case exists for an amendment to the existing law to facilitate truncation. The proposed bill provides for truncation by enabling the presentment of a cheque to occur in a manner agreed to between banks. The proposed bill does not specify the requirements for alternative means of presentment. The Group considers that it would be inappropriate to specify such matters in a statute, given that truncation technology may evolve over time. It is therefore considered that the law should facilitate truncation, but leave the mechanics of truncation to be determined by the banking industry.

Intra-bank truncation

The proposed bill does not specifically deal with the situation where the paying and collecting banks to a cheque are the same, and the cheque is cleared through the bank's internal processes. The intention would be to ensure that cheques presented in this way should also benefit from the truncation process. The Working Group will be considering what further changes might need to be made to the proposed bill in order to address this matter.

Scope for physical presentment

The proposed bill enables a paying bank to require the collecting bank to send the physical cheque to the paying bank. This provision recognises that in some circumstances a paying bank may wish to sight the actual cheque before determining whether the cheque will be paid or dishonoured, given the liability to which the paying bank may be exposed - for example, when paying out on a fraudulently drawn cheque. Where a bank elects to use this section, the cheque is deemed to be presented physically, rather than being truncated.

The proposed bill enables a paying bank to obtain a cheque from a collecting bank on such conditions as may be specified in the rules of the relevant inter-bank clearing system, after payment of the cheque is made.

Rights and obligations unchanged

The proposed bill makes it clear that the adoption of an alternative means of presentment would not affect the rights and obligations of the parties to a cheque. For example, any obligations to which a paying bank was subject under a system of physical presentment would not be lessened or increased as a result of adopting some form of truncation. Accordingly, the adoption of a system of truncation would not increase the risks to the users of cheques.

Implementation of non-transferability and truncation

Provided that submissions on the proposals are supportive of the policies on non-transferability and truncation, the Reserve Bank intends to recommend to the Government later this year that legislation be introduced at the earliest practicable opportunity to give effect to the policies.

Second stage of the Review - comprehensive cheques law reform

The second stage of the law reform process would be a comprehensive review of cheques law, which would probably result in the creation of a new stand alone Cheques Act. The drafting of such an Act would appropriately have close regard to relevant developments overseas, most notably in Australia. The Group sees merit in harmonising cheques law in New Zealand and Australia, in the context of CER, by modelling a new Cheques Act on the Australian Cheques and Payment Orders Act 1986. How-

ever, such harmonisation would appropriately be subsidiary to achieving an appropriate legislative framework for cheques in New Zealand.

The Working Group considers that a comprehensive review of cheques law, including the drafting of what would probably amount to a new Cheques Act, should await the outcome of a review being conducted by the Australian Attorney-General's Department of the Australian Cheques and Payment Orders Act. The final outcome of that review is not expected to be known until late 1995. On that basis, the Group aims to have concluded a comprehensive review of cheques law by about the end of 1995, with a view to releasing a paper for discussion in early 1996. That paper would be accompanied by a proposed Cheques Bill which would probably be modelled fairly closely on the revised Australian Cheques and Payment Orders Act. The proposed bill would incorporate such modifications as appropriate to meet the needs of cheque issuers and users in New Zealand.

It is proposed that the comprehensive review of cheques law would address a wide range of issues relating to cheques, including the following:

- the rules relating to crossings;
- negotiability, including the rules relating to endorsements;
- bank cheques;
- the rules relating to stale cheques;
- the treatment of post-dated cheques;
- time allowed for dishonour/finality of payment.

The second stage of the review would also present a useful opportunity to assess the adequacy of the provisions in relation to truncation and non-transferability, on the assumption that these proposals meet with support from respondents, are approved by government and are enacted in 1995. ■