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DRAFT LEGAL GUIDE ON ELECTRONIC FUNDS TRANSFER

CHAPTER ON LEGAL ISSUES RAISED BY ELECTRONIC FUNDS TRANSFERS

Report of the Secretary-General

(continued)

CONTENTS

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INTRODUCTION

1. The previous chapters in this legal guide have described the relationship between developments in electronic funds transfers and the paper-based funds transfer system in the context of the legal regime governing funds transfers. In this chapter a number of legal issues arising out of these developments are set forth as questions to be considered in the preparation of new rules necessitated by the introduction of electronic funds transfers. Most of these issues raise specific questions as to the appropriate legal rule and are based on the discussion in the previous chapters. Several of the issues raise questions of general policy. Following each question is a short comment indicating several factors which may influence the decision to be made in respect of the question posed.

2. The comments contain references to those portions of the previous chapters that are particularly relevant to the question posed as well as to certain material outside the legal guide. The references to the chapters have been abbreviated as follows:

Terminology, A/CN.9/250/Add.1	Terminology
Electronic funds transfer system in general, A/CN.9/250/Add.2	EFT in general
Agreements to transfer funds and funds transfer instructions, A/CN.9/250/Add.3	Agreements
Fraud, errors, improper handling of transfer instruction and related liability, A/CN.9/250/Add.4	Liability
Finality of funds transfers, A/CN.9/266/Add.1	Finality

Issue No. 1

Are major changes in the law required by the development of electronic funds transfers?

Comment

1. Since the underlying funds transfer procedures remain the same whether the medium of communication is paper-based or electronic, it could be expected that the law governing paper-based funds transfers would remain fundamentally appropriate for electronic funds transfers. However, since electronic funds transfers are not carried out in a manner identical to paper-based funds transfers, changes in the law to adjust to the new procedures should be expected. The following paragraphs suggest some of the major elements that would affect the extent to which the law written for paper-based funds transfers might need to be adapted to make it appropriate for electronic funds transfers.

2. Since most electronic funds transfers are made by credit transfer, countries where funds transfers have been largely made by cheque may have few legal rules which are directly applicable. Although this legal guide has frequently pointed out the identity or comparability of the rules governing debit transfers and credit transfers, rules drafted for the issue, collection and payment of cheques, with their elements of negotiability, are not applicable to credit transfers without significant modification.

3. The elimination of all elements of negotiability from electronic debit transfers, except for those transfers involving the truncation of cheques, bills of exchange or other negotiable debit transfer instructions, presents the opportunity for unifying or harmonizing the law of debit transfers with the law of credit transfers. Some degree of harmonization may already be present in the rules governing electronic funds transfer networks handling both types of funds transfers. A more substantial opportunity for harmonizing the law may be present when the statutory law governing funds transfers is reviewed for its applicability to electronic funds transfers.

4. Even in countries with a satisfactory legal structure for paper-based credit transfers the new technology requires an adjustment of the law in regard to such matters as the periods of time within which various actions are to be taken, the presence or absence of liability arising out of computer failure at one of the banks, clearing-houses or communication networks, the time when a funds transfer becomes final and the consequences of finality. Modifications of this nature to the existing legal rules do not affect their structure, but they may modify their content to an important degree.

5. Although the absence of negotiability in electronic funds transfers presents the opportunity to simplify the law by harmonizing the law of debit transfers and credit transfers, the technical development of several alternative ways of making funds transfers, and the continual change in the technology, may lead to new subdivisions in the law. It may be useful to distinguish between batch-processed funds transfers and individual funds transfers sent by telecommunications, between transactions using debit cards and those using credit cards, between those initiated on customer-activated terminals and those where the electronic communication is initiated at a bank. To some extent these distinctions may be satisfactorily expressed in

bank-customer contracts and in inter-bank rules governing different types of funds transfer networks. However, in some cases these distinctions may need to be expressed in the statutory law governing funds transfers. If the number of special rules which are the result of these distinctions is small, they can be handled within the general law of funds transfers. If the number of special rules is too large, it may be preferable for special laws to be adopted, as there currently are for debit transfers and credit transfers. In any case, there will continue to be a need for rules governing paper-based funds transfers, and in particular to cover cheques and bills of exchange.

6. Some questions arising in the context of electronic funds transfers are common to all forms of automatic data processing and the legal rules may also be common to all such transactions. Prominent among these questions is the evidential value of the computer records of funds transfer instructions sent and received in computer-readable form and of account records stored in that manner. Of particular concern is the acceptability of the authentication used in electronic funds transfers. In some cases, the rules in respect of these matters may be found in the law governing funds transfers rather than in laws of general application.

7. The concurrent growth of electronic funds transfers and of international large-value and small-value funds transfers is leading to the international standardization of funds transfers procedures and a growing interest in the international unification and harmonization of the governing law. This legal guide is one important step in that direction. A further step would be the preparation of rules governing aspects of international funds transfers in some appropriate manner. Yet a further step would lead to the unification or harmonization of some aspects of domestic law, especially in respect of those aspects of funds transfers which are the domestic extension of an international funds transfer.

Issue No. 2

To what types of financial transactions should the law of funds transfers apply?

References

Finality, paragraphs 44-47
Issue No. 4, paragraph 5

Comment

1. In a number of countries deposit taking institutions which previously were not permitted to make funds transfers on behalf of their customers are now permitted to do so. However, in some countries the law of funds transfers has been applied only to transfers made by debit and credit to current accounts in a bank, as the term "bank" is narrowly defined by the relevant law. Funds transfers made by debit to a current account in other types of deposit taking institutions, including funds transfers made by debit to accounts with the postal system, have often been governed by a distinct set of rules, even though the rules were often the same or similar in substantive content to the rules governing funds transfers made through banks. There

would be no technical difficulties for funds transfers made through the efforts of all deposit taking institutions to be governed by the same set of legal rules, if this was considered desirable.

2. In addition to accounts at deposit taking institutions, customers may hold credit balances at many other types of financial institutions, such as stock or commodity brokers or insurance companies. In some countries it has become possible for customers to transfer those credit balances in whole or in part to accounts of other parties held with the same institution, at a different institution of the same type or at a bank. This developing practice raises important monetary and regulatory questions in regard to the banking and funds transfer systems in general. It also raises the question as to whether these transfers of account balances, if they are permitted at all, should be governed by the law of funds transfers or whether a different legal regime should be applied. If a different legal regime is applied, many of the same or similar legal problems as those covered by the law of funds transfers will need to be considered.

3. A credit card transaction may be considered not to be a funds transfer for the purpose of applying the relevant law of funds transfers, e.g. consequences of a fraudulent transaction or finality of the debit, since the debit is usually considered to be an extension of credit to which certain rules of consumer credit may apply and which must subsequently be reimbursed by a credit from another account of the customer. The law of funds transfers may be considered to apply only to the customer's reimbursement of the debit and, perhaps, to the reimbursement of the merchant or other card acceptor.

4. Nevertheless, when the account is held with a bank or other deposit taking institution, it may be considered appropriate to include such transactions within the category of funds transfers, particularly since debit card transactions on accounts held by banks would clearly fall within the category of funds transfers. If credit card transactions on accounts held with banks are considered to be funds transfers, the question arises whether credit card transactions leading to a debit to an account held with an institution which is neither a bank nor other type of deposit taking institution should also be subject to the law of funds transfers. The decision may be affected by whether the credit card paper or electronic vouchers (debit transfer instructions) clear through or outside banking channels. This basis for a decision, however, might be upset by subsequent changes in clearing procedures.

5. A somewhat similar problem may be posed by the use of a microcircuit card which has been charged with value by the bank before its issue to the customer. The issue of the charged card to the customer and the debit to his account may be considered to be a completed funds transfer equivalent to the sale of traveller cheques. Use of the card would set in motion a procedure for reimbursement of the merchant by the bank which might be considered to be a form of electronic debit transfer similar to the collection of the traveller cheque. However, if the charged card were considered to be a special form of account with the bank, the issue of the charged card to the customer would merely furnish the customer with a means of accessing that account. Nevertheless, the consequences to the bank and the customer arising out of the issue of the charged card to the customer might be appropriately covered in the law of funds transfers in the same way that the consequences to the bank and customer arising out of the issue of cheques, debit cards or other devices to access the account is also covered in the law of funds transfers.

Issue No. 3

Should the law governing funds transfers recognize the increased role of the funds transfer system in individual inter-bank funds transfers?

References

Terminology, paragraphs 1-7
EFT in general, paragraphs 1-5
Liability, paragraphs 56-60
Issues No. 13, 16, 18, 22, 23

Comment

1. Until recently in most countries the funds transfer system in place did not restrict significantly the judgement of banks as to the methods by which funds transfers were made. The smaller volume of funds transfers allowed each funds transfer instruction to be considered as an individual item calling for the specific judgement of each bank in the chain as to how it should be handled.

2. Recent technological developments have led to the creation of specialized communications and funds transfer networks and a consequent standardization of many aspects of funds transfer procedures. Funds transfers are processed through these networks in large quantities and the design of the total funds transfer system determines whether funds transfers can be made promptly, accurately and safely.

3. Among the factors influencing the extent to which the increased role of the system might be consciously taken into consideration in the law governing funds transfers is the extent of fragmentation of the banking system. Where there are only a few banks with many branches, each bank represents a major portion of the funds transfer system as a whole. The bank would necessarily be responsible for the design of both the computer facilities at a specific branch and for the transmission system between branches. Since it would often be both transferor bank and transferee bank, most of the legal problems arising out of the transmission of funds transfer instructions from one bank to another would be eliminated. Therefore, there may be no significant distinction between rules based upon the bank as an individual entity and the bank as a participant in the larger framework of the funds transfer system.

4. Where the banking system is fragmented and there are a large number of banks engaging in funds transfers, the distinction between the bank as an individual entity and the bank as a participant in the funds transfer system is naturally greater. This fact may lead in two different directions. On the one hand it may be more important for the law to recognize overtly that the bank is operating in the context of the funds transfer system. On the other hand there may be more resistance on the part of the banks to losing whatever degree of independence may be involved in such a recognition.

5. The fragmentation of the banking system is of particular importance in respect of international funds transfers. Not only do many banks from all countries participate in making funds transfers, but the different banking practices and different legal rules have tended to isolate the banks from one

another. However, it may be thought that it is precisely in the field of international funds transfers that the practices of individual banks are changing most significantly in order to conform to the technological requirements of particular funds transfer networks and of the funds transfer system as a whole.

6. The important role the system plays in funds transfers may be recognized in the law in many ways. Inter-bank agreements, including clearing-house rules, may be accepted as a principal means of providing rules for the system. Those rules, or the law itself, may fix a single party responsible to the customer for errors or fraud which occur at any place in the system. Banks may be required to apply standardized procedures in order to participate in certain funds transfer networks. If they suffer loss as a result of failure of design of the system or of its implementation, they may have a right of reimbursement from the system as a whole or from other participant banks.

Issue No. 4

Should funds transfers between the transferor and transferee and the funds transfer transactions implementing the funds transfer be governed by the same rules? If some of the rules might be different, should the differences be reflected in the law or by inter-bank agreements?

References

Finality, paragraphs 23-30
Issue No. 2, paragraphs 3-4
Issue No. 5

Comment

1. Funds transfer transactions between banks implementing an inter-bank funds transfer between a transferor and transferee can be viewed in two ways. The traditional view in most countries is that the funds transfer transactions are subsidiary to the funds transfer. Inter-bank agreements in respect of funds transfers serve primarily to govern the technical relations between the banks and do not, or should not, affect the legal rights of the transferor and transferee. A second point of view, seen most clearly in regard to credit transfers transmitted individually by telecommunications, is that the primary activity taking place is the funds transfer transaction between the sending and receiving banks. Credit transfers between banks serve a number of purposes, only one of which is to implement a customer's instruction. The fact that a particular funds transfer transaction was made pursuant to a customer's instruction would be of operational interest to the transferor bank, since it would have to debit the appropriate customer account. However, it would be of no operational interest to intermediary banks except to the extent that a particular message type would be used and certain data fields in the funds transfer instruction would contain information to be passed on to the next bank.

2. Since each funds transfer transaction is treated by the banks as a separate and complete banking transaction, it could be expected that legal problems, such as the time of finality of the transaction or liability for errors, would arise just as they do in respect of the funds transfer itself. In the absence of any other rules, it could be expected that the rules otherwise applicable to funds transfers would apply. It may be thought, however, that appropriate rules for a funds transfer transaction between two banks might be somewhat different from appropriate rules for a funds transfer between two non-bank customers, even if the funds transfer transaction is implementing a customer transfer.

3. If it was desired to have rules for funds transfer transactions that were somewhat different from those governing funds transfers between bank customers, consideration might be given as to whether it would be preferable for those rules to be part of the general law of funds transfers, to be in a special section of the law governing inter-bank relations, or to be the subject of inter-bank agreements. In favour of the rules being adopted in the form of law is that, since the rules governing funds transfer transactions could be expected to have an effect upon the customer transfer, they should be prepared in such a way as not to interfere with the customer's legal rights. Therefore, it would be preferable if they were subjected to the public review normally available to proposed laws. In favour of the rules being adopted by inter-bank agreement is that different rules might be appropriate for different funds transfer networks. Furthermore, the technical nature of many of the rules and the need to amend them as the relevant technology and banking practices evolve, might make it better for them to be in a more flexible form. It might be thought that any effect they would have on bank customers would be no more significant than the current rules or banking practices governing the technical aspects of the funds transfer transaction.

4. Special attention might be given to the desirability for agreed rules governing aspects of international large-value funds transfer transactions. Since the domestic rules governing inter-bank transfers, which might otherwise apply in large measure to international transfers as well, differ in important respects from one another, unification or harmonization of these rules to the extent possible might be expected to have important beneficial results.

5. The situation would seem to be somewhat different in respect of international credit card and debit card transactions. Before cards issued in one country are accepted in a second country, inter-bank agreements are always concluded governing both technical and legal concerns. These agreements are specific to each network. Therefore, several inter-bank agreements governing the international use of credit cards and debit cards are already in force in most countries. Since credit card and debit card funds transfer instructions are currently cleared through special channels for technical reasons, there is little conflict with other forms of international funds transfers. However, if this form of international funds transfer continues to grow in volume, consideration might to be given to its relationship to the legal regime governing other forms of international funds tranfers.

Issue No. 5

Should internationally agreed rules be prepared to govern international electronic funds transfers?

References

Draft Convention on International Bills of Exchange and International Promissory Notes, A/CN.9/211
Issue No. 4
Issue No. 6

Comment

1. Once the transferor instructs his bank to transfer funds to the transferee at a bank in a foreign country, an international funds transfer has begun. As a result there is a high degree of inter-mixture of domestic and international concerns in an international funds transfer. The funds transfer itself between transferor and transferee is international. The very first and last actions, the issue of the funds transfer instruction by the transferor, the debit of his account by the transferor bank and the credit to the account of the transferee, are in themselves domestic acts identical to those made in a domestic funds transfer. One or more funds transfer transactions are required between banks in different countries as well as the possibility of one or more of funds transfer transactions in the country of the transferor and in the country of the transferee.

2. The situation has some similarity to the shipment of goods from an inland point in one country to an inland point in another country in that the single economic activity of the shipper may be carried out by domestic carriers in the two countries as well as by one or more international carriers. There is a tension between the need or desire for separate legal regimes to govern each of the domestic and international segments of the shipment and the need or desire for a single legal regime to govern the entire shipment. In the context of the shipment of goods the desire for a single legal regime to cover the entire shipment has led to the adoption of the United Nations Convention on International Multimodal Transport of Goods. This Convention does not, however, replace the legal regimes governing the individual segments so much as it co-ordinates some of their legal effects.

3. Since there are at present no rules governing international funds transfers, with the exception of the S.W.I.F.T. rules covering aspects of the transmission of a funds transfer instruction over that network and the network rules for credit cards and debit cards used internationally, the consequence of a funds transfer being international or of one or more of the implementing funds transfer transactions being international, is that the rules of conflict of laws would refer to the substantive law of one of the countries concerned. That law may or may not have special rules governing international funds transfers or, without having specially articulated rules, may recognize the differences inherent in an international funds transfer. Among those important differences is that some part of the funds transfer is carried out in a foreign country in conformity with the local banking laws and practice.

4. The basic approach followed in the draft Convention on International Bills of Exchange and International Promissory Notes, prepared by the United Nations Commission on International Trade Law, has been that the draft Convention should govern the funds transfer instruction issued by the transferor and all of the funds transfer transactions necessary to implement that instruction. However, it may be noted that the draft Convention specifies that certain legal problems concerning the bill are not governed by it. Of particular interest is the fact that the rights and obligations of an intermediary bank that becomes an endorser of the bill would be governed by the Convention, even if the bill of exchange were to come to it from another bank in its own country. This is consistent with the traditional view noted in Issue No. 4 that the inter-bank transactions implementing a non-bank customer's funds transfer instruction are subsidiary to the funds transfer. In the context of electronic funds transfers the same approach would subject the funds transfer transaction between the domestic transferor bank and domestic intermediary bank to the international rules. This would be of particular significance to domestic electronic funds transfer networks which handle the domestic link in international funds transfers.

5. The potential impact of the draft Convention is limited by its article 1 on the scope of application which provides that the draft Convention applies only if the parties have chosen it as the governing law by use of a bill of exchange which contains the words "international bill of exchange (Convention of ...)". It would not, therefore, apply to all bills of exchange used in international transactions between parties in contracting States. A similar restriction could be introduced into rules governing international electronic funds transfers, in which case the funds transfer instruction sent by the transferor bank and by every intermediary bank would have to contain that information.

6. A less radical approach than that taken in the draft Convention would be that the relations between on the one hand the transferor and transferee and on the other hand all banks in the funds transfer chain would be governed by the internationally agreed rules, but that the inter-bank funds transfer transactions would be governed by the relevant domestic law, supplemented by any applicable inter-bank agreements. If this approach was taken, a decision would have to be made as to which text controlled where the international rules gave the tranferor or transferee rights as against one of the banks but the relevant law or inter-bank agreement had conflicting provisions in respect of an implementing funds transfer transaction. For example, the international rules might give a right to withdraw a funds transfer instruction until the transferee's account had been irrevocably credited, but the rules governing a funds transfer network through which the funds transfer passed might limit the extent to which a funds transfer instruction could be withdrawn by a sending bank (see Issue No. 33).

Issue No. 6

Should internationally agreed rules on conflict of laws be prepared for international electronic funds transfers?

Reference

Issue No. 5

Comment

1. In the absence of a generally accepted legal regime governing international electronic funds transfers, internationally accepted rules on conflict of laws might be considered.

2. The aspect of the law of funds transfers which might most benefit from internationally agreed rules of law is the relationship of the transferor and transferee between themselves and their relationship to the banks implementing the funds transfer. The difficulties may be particularly acute when the funds transfer is in the currency of a third country and banks in that country become involved either as intermediary banks or as reimbursement banks. The most evident substantive difficulty which could be ameliorated by internationally agreed rules on conflict of laws is the lack of agreement whether an intermediary bank owes any duties directly to the transferor (perhaps as the transferor's agent as nominated by the sending bank) or whether the intermediary bank's obligations are limited to the sending bank with which it is in privity of contract. Although this issue may arise most often in regard to liability for errors or delay, it may also arise in connection with such matters as whether the transferor or transferor bank could directly instruct an intermediary bank with which it was not in privity of contract to refrain from processing further a funds transfer instruction that the intermediary bank had received from another intermediary bank.

3. The conflict of laws problems in regard to the funds transfer transactions are perhaps easier to resolve, since each funds transfer transaction is a simple bilateral arrangement. Only the electronic funds transfer instruction which is sent from one country to another would probably be in question, while the domestic funds transfer transactions before and following the international transaction would presumably be governed by domestic law.

4. If rules on conflict of laws were to be prepared, it would seem that they could not be done effectively by the banking community. The courts could be expected to enforce inter-bank agreements containing substantive rules governing the relationship between the banks as well as a choice of law clause governing the bilateral relationship of the two banks in a funds transfer transaction. However, it is less likely that they would enforce choice of law provisions in an inter-bank agreement prepared for adoption by the banking community as a whole that was intended to provide rules for all of the possible conflicts that might arise in the various funds transfer transactions. It is also unlikely that they would enforce rules on conflict of laws prepared by the banking community governing the relations of the transferor and transferee with the banks implementing the transfer.

5. Therefore, if it was felt desirable for internationally agreed rules on conflict of laws in regard to international electronic funds transfers to be adopted by States, it would seem best if they were prepared by an appropriate international body.

Issue No. 7

Do the rules of evidence give records of funds transfers kept in computer-readable form the same legal value as records kept in paper-based form?

Reference

Legal value of computer records, Report of the Secretary-General, A/CN.9/265
Issues No. 21, 22

Comment

1. Although the rules of evidence do not form a part of the law of electronic funds transfers, in order for domestic or international electronic funds transfers to be made with legal security, the rules of evidence must give bank records kept in computer-readable form or produced from computer-based entries the same legal value as are records kept or produced in paper-based form. Therefore, an important part of many national studies of the legal aspects of electronic funds transfers has been devoted to the question of evidence.

2. According to the results of a survey conducted by the Secretariat of the United Nations Commission on International Trade Law, it appears that in most countries records kept in computers can be used as evidence in case of litigation. In common law countries it is the usual rule that computer records can be admitted as evidence only if the proponent of the record establishes certain facts about the record and the computer system. The most important is that the system has been properly designed and sufficiently well-managed so that the possibility that the data stored in the record is incorrect is reduced to a minimum. In some common law countries records of financial institutions are admitted with less formality. In countries with other legal systems it is not necessary to establish that the system is properly designed and well-managed for a computer record to be admitted as evidence. However, in all legal systems, it is possible to challenge the accuracy of a computer record on the grounds, inter alia, that the computer system was not properly designed or well-managed.

3. In several countries with an exhaustive list of types of admissible evidence, computer records are admissible in commercial disputes but may not be admissible in non-commercial disputes. Since the latter category may include most transactions made through automated cash dispensers, automated teller machines and point-of-sale terminals, the potential problems for electronic funds transfers may be significant in those countries. In particular, when a non-commercial customer denies having used a customer-activated terminal, it may be difficult or impossible for a bank to prove that he did so on the basis of the computer record of the transaction

alone (see Issue No. 21). In a few countries with statutory requirements as to the supporting information to be furnished to a court to enable the court to determine whether a computer record should be admitted as evidence, the statutory requirements have been drafted in terms of data processing in batch-mode and there may be difficulties in using computer records in which a funds transfer instruction was created in one computer and transmitted to a second computer by handing over a computer memory device or by telecommunications.

4. There does not as yet appear to be any experience whether computer records created in one country will be usable as evidence in the courts of another country on the same conditions as computer records created in the second country. Any difficulties in this regard would be of serious concern for international electronic funds transfers.

5. Truncation of paper-based debit or credit transfer instructions and the forwarding of the essential data by electronic means may raise questions as to the evidential value of the computer record in the truncating bank or in a receiving bank in comparison with the paper-based instruction. Many countries may require a permanent hard copy of the original paper-based instructions, but may allow that hard copy to be retained in microfilm form.

Issue No. 8

Are changes in the law required in order to permit the truncation of cheques, bills of exchange and other debit transfer instructions at the bank of deposit?

References

Agreements, paragraphs 13-18
Convention providing a Uniform Law for Bills of Exchange and Promissory Notes (Geneva, 7 June 1930)
Convention providing a Uniform Law for Cheques (Geneva, 19 March 1931)

Comment

1. It appears that in those countries in which banks truncate cheques or other debit transfer instructions they have done so without legislative changes in the governing law. The banks seem to have determined that the savings from truncation are greater than the anticipated losses they would on occasion suffer because they could not conform to the statutory requirements adopted before truncation was possible. In a number of other countries it appears that concern over the potential losses arising out of truncating cheques without changes in the statutory requirements has been a significant factor in slowing this development. Therefore, in all countries in which cheque truncation is seriously being considered, thought should also be given to amending the law on cheques and bills of exchange to eliminate any losses to banks which might occur and which are not justified by public policy.

2. The most important risk which occurs as a result of cheque truncation is that the authenticity of the drawer's signature cannot be verified by the drawee bank before the cheque is honoured. That would not constitute a major change from the current situation in many countries where banks do not compare signatures on the vast majority of cheques. Furthermore, a drawer of large numbers of cheques may give the drawee bank a list on paper or on magnetic

tape of the cheque numbers and amounts of all cheques drawn, permitting substantial verification by the drawee of the authenticity of the cheques which have been truncated. Therefore, it may seem reasonable for the drawee bank to continue to bear the risk that a truncated cheque might not be genuine. As an alternative, the statute might be changed to provide, for example, that the drawee bank could debit the drawer's account even though the drawer's signature was not genuine if the cheque was drawn on a numbered cheque furnished to the drawer by his bank and the drawer had not notified the bank that the numbered cheque was missing. This would in essence reproduce the rule generally followed in respect of debit cards and credit cards.

3. In most countries where the law seems to provide that a cheque can be honoured only if it is physically presented to the drawee bank, the provisions can often be interpreted to mean that it is the data on the cheque which must be presented and not the physical cheque as a carrier of the data. Where this interpretation is not possible or is not acceptable, the law might be changed to so permit. This question may also arise in respect of whether the cheque has been presented within any applicable periods of time and the time allowable after dishonour for notice of dishonour or protest to be made.

4. In a few countries the drawee bank is obligated to verify that the cheque has not been presented before the date on the cheque and conversely that the cheque is not so old as to have lost its validity. These verifications can be performed as easily by the truncating bank and it would seem that the most reasonable action would be for banks to agree that any loss borne by the drawee bank in its relations with the drawer would be reimbursed by the truncating bank. Similarly, the truncating bank is in as good a position as the drawee bank to determine whether the cheque has been materially altered and to mark the cheque so that it cannot be presented a second time.

5. Where protest is required on a dishonoured cheque itself, it would seem reasonable to modify the law so that protest or its equivalent could be made in some other appropriate way. Similarly, where cancelled cheques must be returned to the drawer before time-limits begin to run within which the drawer can notify the bank of improper debits to his account, the law might be modified to eliminate this rule.

6. States which are parties to the Geneva Conventions on Bills of Exchange and on Cheques would be in violation of their treaty obligations if they were to modify their domestic laws so as to facilitate truncation.

Issue No. 9

Does the development of electronic funds transfer techniques require changes in the law governing bank secrecy?

References

Convention for the Protection of Individuals with Regard to Automatic Processing of Personal Data (Strasbourg, 28 January 1981).

Guidelines Governing the Protection of Privacy and Transborder Flows of Personal Data (Organization for Economic Co-operation and Development, Paris, 23 September 1980).

Comment

1. Bank secrecy is one of the more important aspects of the continuing public debate over invasions of privacy that are facilitated by the storage of data in computers, the linking of the computers by telecommunications and the availability of remote access to them. An important additional concern is that data regarding banking transactions may reveal underlying patterns of economic activity. Therefore, some States wish to limit the transborder data flows by which this information is transmitted to other States for processing or for use.

2. In many countries banks have a professional obligation to keep secret the affairs of their customers, except to the extent that disclosure of information is authorized by the customer or is required by the State in accordance with the relevant provisions of law. Violation of their professional obligation may lead to criminal penalties or to liability to their customer for the resulting harm. In the past an unauthorized disclosure was usually the deliberate act of the bank or of one of its employees. Now that unauthorized disclosure can result from access to the bank's computer by an unauthorized person or by the interception of teletransmitted funds transfer instructions, consideration may perhaps be given as to whether banks have a broader duty to establish a security system for the transmission of funds transfer instructions and their storage which limits the possibility of such access.

3. The ease of making international transfers of funds by telecommunications facilitates the hiding of funds transfers made for such reasons as payment for illegal transactions, the avoidance of taxes or the avoidance of exchange controls by shifting the funds rapidly through a series of accounts in different places. The public authorities in a number of countries have attempted to counter these activities by more thoroughly investigating bank records of funds transfers, including in some cases account records of banks or branches in foreign countries. In some instances requests for information in account records of foreign banks or branches directed either to the banks or to the foreign Governments have been resisted on the grounds of bank secrecy, or on the grounds that to make available the information would be an act of economic espionage.

4. The arguments in favour of strengthening bank secrecy in the face of the additional threats posed by the use of computers as well as the arguments in favour of increased access to bank records in criminal investigations, and increased international co-operation in this regard, are of great current importance. The resolution of the debate over these and related issues may, however, be expected to occur in a broader forum than one devoted to electronic funds transfers, or even to banking in general.

Issue No. 10

Should banks have written contracts with their customers covering rights and duties of the customers and the banks in respect of electronic funds transfers?

References

Agreements, paragraphs 1-11

Comment

1. Traditions vary in different countries as to the need for written contracts. In those countries where written contracts are not common, banking tradition and practice are usually called on to provide the content of the agreement between the parties.

2. It may be thought, however, that in respect of new funds transfer techniques, and especially electronic funds transfers, banking tradition and practice may not be able to provide the necessary content for many of the questions that may arise. It appears that banks always require written agreements before they issue credit cards or debit cards. Written contracts seem not to be always required before customers are allowed to participate in cash management programmes and other large-value funds transfers, although they may be particularly useful in this regard since some aspects of the bank-customer arrangement may differ from customer to customer.

3. Except for some aspects of the contracts negotiated for large-value funds transfers, bank-customer agreements are drafted by the banks and presented to their customers as a condition for opening an account. The techniques available for limiting the potential abuses of such contracts of adhesion differ in various countries.

Issue No. 11

Should there be any restrictions placed on standing authorizations to debit?

References

Agreements, paragraphs 21-23

Comment

1. Although a standing authorization to debit is analytically the same as an authorization to a bank to honour designated bills of exchange drawn on the transferor and domiciled at the bank, there are functional differences which may raise concerns. The most important is that the collection of bills of exchange is used only to secure payment from a commercial party, whereas the most extensive use of standing authorizations to debit is to collect amounts due on a regular basis from consumers. A second important difference is that the authorization to honour a bill of exchange can be lodged only with the transferor bank whereas in some countries a standing authorization to debit may also be lodged with the transferee bank or even with the transferee.

2. It may be thought that a standing authorization to debit should be lodged with the transferor bank since this would permit the transferor bank to verify the existence of the authorization before acting on the debit transfer instruction received from the transferee bank or from the transferee (in a one-bank transfer). However, even if the standing authorization to debit is lodged with the transferor bank, there is no assurance that the debit transfer instruction prepared by the transferee properly reflects the obligation due on the underlying transaction. Therefore, it may be thought that in all cases the transferor should have an unqualified right for a specified period of time to require reversal of the debit if he claims that it was improper. Reversal of the debit would, of course, revive the transferor's obligation to pay the underlying obligation. Consideration might be given to exacting a penalty against a transferor who claims reversal of the debit when a valid authorization was in existence and the transferor had no substantial reason to believe the amount of the debit was incorrect.

3. The inter-bank agreements covering standing authorization to debit should provide a warranty on the part of the transferee bank that it will reimburse the transferor bank for any debits it has been required to reverse on the demand of the transferor. The transferee bank should have a similar warranty from the transferee.

4. Where the debit transfer is submitted at a frequent and regular interval for a constant amount, the transferor can easily plan his cash flow. When the transfer is irregular, infrequent or for a fluctuating amount, the transferor, especially a non-commercial transferor, may not be able to plan his cash flow properly. The significance of this concern depends in large part on the extent to which transferors, especially non-commercial transferors, are permitted to carry debit balances in their accounts at reasonable rates of interest. Where this concern is significant, consideration may be given to requiring the transferee, transferee bank or transferor bank to notify the transferor of the date and amount of the forthcoming debit in sufficient time for him to adjust his cash flow. Consideration may also be given to permitting the transferor to withdraw his authorization before the debit is entered.

Issue No. 12

Should there be a legal requirement as to the form of authentication necessary in an electronic funds transfer?

References

Agreements, paragraphs 26-39
Issue No. 21

Comment

1. It appears that no country requires a funds transfer instruction to be in written form. It is for this reason that banks have been able to use various forms of electronic funds transfer techniques, including telex, computer-to-computer telecommunications, handing over of computer memory devices, and in some countries, oral instructions by telephone, without the need for express authorization by statute. In the absence of legislation

authorizing funds transfers to be made electronically, there seems to be no general requirement that a funds transfer instruction must be authenticated.

2. It may be thought to be desirable to require by law that all funds transfer instructions, including those in electronic form, must be authenticated. However, it may also be thought to be unnecessary since a bank could not substantiate a debit to an account unless it had a funds transfer instruction in a form on which it could rely in case of later dispute. This should be sufficient incentive for banks to be careful in their use of funds transfer techniques where the authentication is weak or non-existent. Furthermore, in many countries banking supervisors would consider it to be an unsound banking practice for banks to transfer funds on instructions that were not adequately authenticated.

3. If it was thought desirable to require by law that electronic funds transfer instructions must be authenticated, it may also be thought desirable to indicate the type of authentication which would be legally acceptable. Not only would this limit authentications to the types which the legislator deemed sufficiently secure, it would also assure that an authentication of the required type could be relied on to authorize a debit to the transferor's account, if there was otherwise doubt on this point.

4. However, it may be thought to be impracticable to specify by law in any meaningful way the manner in which an electronic funds transfer instruction should be authenticated. In contrast to authentication of a paper-based document, where a reasonably exhaustive list of means of authentication, including signature, could be given if desired, there are innumerable ways to authenticate a message sent by telecommunications. With the rapid development of technology, some current methods of authentication can be expected to become weaker while new and more secure forms of authentication can be anticipated.

5. As a result, it might be thought that any statutory provision concerning the authentication of an electronic funds transfer instruction should do little more than to authorize the use of means appropriate to the type of instruction involved. Questions as to the liability for loss caused by fraudulent or erroneous authentication might be dealt with separately, as might questions as to the party who bears the burden of proof as to whether the authentication was genuine or not.

Issue No. 13

Should sending banks be required to adhere to standard formats when sending funds transfer instructions?

References

Agreements, paragraphs 47-54
ISO/DIS 7746/1.2, Banking-Standard telex formats for inter-bank payment messages - Part 1: Transfers

Comment

1. A sending bank can fail to adhere to a standard format in two ways. It can fail to use the proper message type when more than one message type is

available and it can fail to include all of the information necessary for automated processing, including using improper abbreviations or other standard designations, placing the information in the improper field or placing it in the field for additional information when it should go into a specific data field. It is not a violation of the format rules to include incorrect information, such as the incorrect amount of the transfer, when the incorrect information is in the correct data field.

2. The rules of S.W.I.F.T. and similar networks specify the format which is to be followed for each message type. The only question remaining is the consequence to the sending bank for failing to adhere to the format. In contrast, even when the format rules for funds transfer instructions sent by telex, which are currently in an advanced stage of preparation and are closely modeled on the S.W.I.F.T. format rules, have become an international standard, they will not thereby acquire any legal force. Unless these format rules take on the character of norms of good banking practice, they could acquire legal force only by statutory or regulatory requirements that they be followed or by agreement of the parties.

3. The legal consequences to a sending bank from failing to follow the proper format rules could be twofold. The bank could be responsible for all errors on the part of subsequent banks that could be traced to the failure to adhere to the format. Exoneration on the grounds that a subsequent bank was itself negligent in that it should have understood the message correctly might be permitted, but it may be thought that exoneration on this ground should be rare. The second consequence for failing to follow the format rules could be the levy of a standard charge on the sending bank to be paid to the receiving bank for its effort in correcting the error of the sending bank. If receiving banks regularly claimed the charge, such a rule might have the beneficial consequence of making sending banks more conscientious in adhering to the format rules, to the benefit of all concerned.

Issue No. 14

Should a single electronic funds transfer format be required for all debit and credit cards in use in a country?

Reference

Agreements, paragraph 54

Comment

1. The use of a single format increases the possibility of interchanging funds transfer instructions and clearing them through a single clearing channel. It also permits the shared use of terminals by cards issued by different banks and other card issuers, although agreement on a common format does not necessarily imply shared use. If a single format is required or encouraged by the State, it is usually in order to bring about shared use.

2. The interest of the State in shared use may be to create a nation-wide system of electronic debit or credit cards. In some countries proposed point-of-sale networks have been delayed awaiting a decision on a single format and shared facilities because retail interests wish to have only one

terminal at each cash register. Both retail interests and the State may wish to assure that one card issuer is not able to establish a dominant position in point-of-sale systems by virtue of a format which does not permit the use of cards from other card issuers.

Issue No. 15

Where should customer accounts be considered to be located for the purposes of the legal rules governing funds transfers?

References

Agreements, paragraphs 79-81
Finality, paragraphs 62-68

Comment

1. So long as customer account records were maintained exclusively on paper, the usual rule was that the customer account was considered to be located for legal purposes at the place where it was maintained for bookkeeping purposes. When a bank had multiple branches, customer accounts were usually maintained at each branch, and therefore were located at the branch for legal purposes.

2. When a bank has a centralized data processing centre to which funds transfer instructions must be brought for processing, it may be thought that the basis for the old rule is eroded and that, at least for some purposes, the centralized data processing centre might be considered to be the location of the customer accounts. When a bank has remote access to the processing unit from terminals at some or all of its branches within the same legal jurisidiction so that relevant information can be entered to the account from these remote terminals, it may no longer be relevant to ask where the customer account is maintained since any or all of these locations may serve equally well. However, where paper-based funds transfer instructions are sent to the branch at which the account was opened for purposes of comparing signatures before the funds transfer becomes final, it may be thought that the account should remain localized at the branch even if the funds transfer data can be entered to the account from one or more other locations.

3. The question as to the localization of the account records may be relevant for knowing the place where a debit transfer instruction must be presented for honour, the place where a credit must be sent, the place where the transferor of a debit transfer instruction can notify his bank of the withdrawal of the instruction and the place to which legal notices and attachments of an account can be delivered. In the case of legal notices and attachments of accounts, the relevant statute may specify a place where the notice or legal process must be delivered or the person to whom it must be delivered, which need not be connected to the place where the account is maintained.

Issue No. 16

Should the duty of a transferor bank in a credit transfer be limited to sending a proper credit transfer instruction to a proper receiving bank or should the transferor bank's duty be to see that the transferor's instruction is carried out?

References

Liability, paragraphs 56-60, 100
Issues No. 3, 22, 30

Comment

1. This issue goes only to the question of the party responsible for the fulfilment of the funds transfer instruction. It deals neither with the standard of conduct to which any given bank or the banking system as a whole should be held responsible nor with the damages the transferor should be able to collect for improper performance. The extent of the duty of the transferor bank is of particular importance in international credit transfers and in domestic credit transfers in fragmented banking systems where a credit transfer may pass through several banks, communications systems or clearing-houses between the transferor bank and the transferee bank.

2. It may be thought that, since the transferor deals only with the transferor bank, has few independent means of identifying why a funds transfer was not carried out properly and can put little pressure on a distant or foreign bank to settle with it for the losses, the transferor bank should be responsible to the transferor for the proper performance of the funds transfer. This conclusion might be supported by the fact that banks participate in the design of the funds transfer system as a whole and the transferor bank normally decides which intermediary banks to use. Where the transferor bank itself was not at fault, it should normally be reimbursed for the loss, thereby eventually placing the loss on the individual bank at fault or on the system as a whole. It might be expected that one result of such a rule would be that banks might increase the pressure on other banks that consistently make loss-causing errors to improve their procedures. Further unification of banking standards and practice for international transfers might also be encouraged as an additional means of reducing loss causing errors and delays.

3. However, it might also be thought that it would not be reasonable to hold the transferor bank responsible for errors occurring at other banks. This is particularly true of errors caused by the transferee bank, since the transferor bank seldom has any choice as to the identity of the transferee bank. Even if the transferor bank had a right of reimbursement, it may not always recover from the bank at fault in another country because of exchange control regulations or the like and it could be thought that the transferor bank should not be required to carry such risks of non-reimbursement. Furthermore, the transferor bank might be held liable to the transferor under the banking and legal standards of its country whereas the bank in the country where the problem occurred may have been following different banking practices of its country. This raises the question whether the transferor bank's obligation should be limited to a duty to the transferor to warn him of the different banking practices of which it knew or should have known.

4. The alternative approach to liability is that each bank is directly responsible to the transferor for carrying out its obligations in respect of the funds transfer instruction. These two approaches are often determined by, or expressed by, the concepts of agency or of privity of contract. It may be thought that the consistent application of either of these concepts within a domestic legal system provides the transferor with a legal basis to hold responsible either the transferor bank or the bank at fault. However, it may be noted that in international transfers it is possible for the transferor not to be able to hold the intermediary bank responsible because of lack of privity of contract. It may, therefore, be thought desirable for a clear and consistent rule to be available, especially in international funds transfers.

5. Consideration might be given to the imposition of a higher funds transfer fee in exchange for which the transferor bank would take on a heavier burden of responsibility for losses caused by errors or delays of other parties in the funds transfer system as well as for its own errors or delays.

Issue No. 17

Is the transferee bank responsible to the transferor, to the sending bank or to the transferee for the proper fulfilment of its obligations in regard to a credit transfer?

References

Liability, paragraph 93
Finality, paragraphs 5-20

Comment

1. The transferee bank in a credit transfer may be regarded as being in a legally ambiguous position. On the one hand, its contract with its customer calls on it to receive transfers for credit to the account. In this respect the transferee bank would seem to be contractually responsible to the transferee for the proper fulfilment of its obligations as soon as it has received the credit transfer instruction from the sending bank. Any delays on its part in processing the instruction should be consistent with that contractual obligation. On the other hand, since the funds transfer does not become final and the transferor has not completed his obligations to the transferee until the transferee bank performs the requisite act bringing about finality, the transferee bank might have an obligation to the transferor (or to the sending bank) to act promptly and accurately to perform that act.

2. One approach to determining the party to whom the transferee bank should be liable for failure to carry out the funds transfer instruction properly would be to fix a point of time before which the transferee bank acts on behalf of the transferor (or the sending bank) and after which it acts for the transferee. This point of time might be the moment when the funds transfer becomes final. Alternatively, it may seem reasonable for the transferee bank to be responsible both to the transferor (or to the sending bank) and to the transferee.

Issue No. 18

Should public telecommunications carriers, private data communications services, electronic funds transfer networks and electronic clearing-houses be responsible for losses arising out of errors or fraud in connection with a funds transfer instruction?

References

Liability, paragraphs 23, 24, 68-73, 78-81
Issue No. 16

Comment

1. The question whether public telecommunications carriers should continue to be exonerated from all liability for losses arising out of a lost or delayed message or from changes in the content of the message has been re-opened because of changes in the nature of the services offered and as a result of the deregulation or privatization of the service in some countries. However, in the absence of such liability, consideration might be given as to whether the transferor or one of the banks should bear the loss. In favour of the transferor bearing the loss is that the funds transfer is undertaken on his benefit and the loss occurs through no fault of any party who could be held liable. In favour of the loss being borne by one of the banks is that the banks are in the best position to design a funds transfer system using the public carriers where delays or errors would be brought to the attention of the sending or receiving bank, thereby permitting prompt correction. Amongst the banks which might be selected to bear the loss are the transferor bank, especially if the transferor bank is responsible for the proper performance of the entire funds transfer, and the sending bank of the instruction that was lost, delayed or whose content was altered.

2. Private data communications services, electronic funds transfer networks and electronic clearing-houses may contract with the participating banks to limit or exclude their liability for lost, delayed or altered funds transfer instructions. It may be thought that contractual allocation of loss between these entities and the participating banks should not violate public policy. However, consideration should be given as to whether the effect of these contractual provisions is to place the loss on the transferor. It might be thought that there is less reason for the transferor to bear this loss than when the loss occurred with the public carrier, since the networks and clearing-houses are an integral part of the banking industry and the banks have a choice as to whether to use the private data communications services for sending funds transfer instructions.

3. It might be thought that the telecommunications carrier, data communication service, electronic funds transfer network or electronic clearing-house should be liable for loss caused by the fraud of its employees. However, it may also be thought that there are limits to the extent to which an employer should be responsible for the acts of its employees, especially when those acts are illegal. A distinction might be drawn between losses from fraud made possible by access to account records or to equipment as part of the employment relationship, for which the employer would be responsible, and losses from fraud made possible by knowledge

acquired by the employee in the course of his employment, for which the employer would not be responsible.

Issue No. 19

Should a bank be free from responsibility for errors or delayed funds transfers caused by failures in computer hardware or software?

References

Liability, paragraphs 64-67

Comment

1. Although bank computer hardware and software have reached high degrees of reliability compared to only a few years ago, on occasion errors occur and funds transfers are lost, delayed or altered because of computer failure. On the one hand it may be thought that technical problems of this nature are beyond the control of a bank and that the bank should be free from responsibility for any losses caused to customers as a result. If free to do so, banks often include a provision to this effect in the contracts they have with their customers.

2. On the other hand it may be thought that the degree of computer reliability is such that they should be treated the same as any other type of equipment used by banks. Computer failure may be the result of improper equipment or software or inadequate maintenance, and the consequences of computer failure can be reduced by advance planning, which may include the availability of redundant equipment, back-up power supplies, plans for using alternative means of effecting funds transfers and, in general, prompt action by the bank. As a result, a generalized exoneration from liability may be thought not to be justified but that exemption from liability for computer failure might be justified when the bank could not be expected to have prevented the failure or reduced its consequences.

Issue No. 20

Should a bank be liable to its customer for having entered a debit or credit to the account according to the account number indicated on the funds transfer instruction it has received if the name on that account does not correspond to the name given on the funds transfer instruction?

References

Agreements, paragraphs 44-46

Comment

1. The accounts to be debited and credited may be indicated on the funds transfer instruction by name, by account number, or by both name and account number. Banks which keep customer account records using automatic data processing normally rely upon the account number alone for processing. This

may be the only possible means when the instructions are batch-processed. However, it should be possible to compare the account name when the instruction has been transmitted individually by telecommunications.

2. It is unlikely that entering debits and credits by account number alone needs legislative authorization under the law of any country. However, it may be thought that it would be useful to indicate whether the bank should be liable for any loss which might occur if the name of the party to be debited or credited according to the funds transfer instruction did not correspond to the name on the account. The name on the instruction and the name on the account may fail to correspond because of fraud, error, including error by the transferor, or because the transferor did not know the correct name of the account.

3. A rule fully supportive of the increased use of automatic data processing might be that a bank that entered a debit or credit according to the account number on a funds transfer instruction it received would not be liable even though the entry was made to an account bearing a different name from that on the instruction. Any loss would be borne by the transferor or the bank at which the incorrect account number was first entered on a funds transfer instruction. This might be expressed as a rule that in case of conflict between the account number and the account name, the account number prevailed.

4. It may also be thought that the bank could be expected to compare the account number and the account name and discover any discrepancy between them. In particular, this might be done with high-value funds transfers received by telecommunications. If it chooses to enter debits and credits on the basis of account numbers alone, it is for the benefit of the bank and the customers should not suffer as a result. If this position is taken, consideration might be given as to whether the transferee bank or the transferor should suffer the loss where the discrepancy was caused through the error of the transferor or the fraud of one of his employees. The normal rule in such cases would probably be that the transferor bore the risk of such loss. If loss were attributed to the transferee bank, it would be a recognition that the loss could have been prevented by the subsequent actions of the transferee bank.

Issue No. 21

Should the bank or the bank customer carry the burden of proof whether a debit to the transferor's account was authorized by him or occurred through his fault?

References

Liability, paragraphs 13-21
Issue No. 7

Comment

1. The issue of the burden of proof involves litigation. If the customer has the burden of proving that a debit to his account was unauthorized and can neither meet that burden nor shift to the bank the burden of proving that the

debit was authorized, the customer will fail in his claim. If the bank has the burden of proving that the debit was authorized, the likelihood that the customer will succeed in his claim are increased.

2. In Issue No. 7 it was noted that in almost all countries computer records are accepted as evidence of the transactions they record. Although all legal systems that accept computer records as evidence permit a party to raise doubts as to the correctness of the record by showing that the computer system was improperly designed, insufficiently maintained or that improper procedures were used to enter the data so that accuracy of the data entries was not assured, in most disputes as to whether a funds transfer instruction had been properly authorized electronically, it would be a pratical impossibility for the customer to raise such doubts about the bank's computer system or procedures. This is particularly true of small-value funds transfers, but it would also be true of most large-value funds transfers.

3. In many cases when a customer claims that the funds transfer which was initiated through a customer-activated terminal was not authorized, the surrounding circumstances may either substantiate his claim or lead to strong doubts of its validity. However, when the surrounding circumstances neither substantiate nor raise serious doubts about his claim, a decision as to whether the customer's account may be debited often rests on whether the customer or the bank bears the burden of proof. The most frequent current example is the withdrawal of cash from an automatic cash dispenser, but the issue can be expected to arise frequently in point-of-sale transactions as well. In both cases the party who issues the funds transfer instruction departs with the cash or the goods leaving no audit trail other than the funds transfer instruction itself. A less frequent, but individually more important, case involves fraudulent large-value transfers where knowledge as to the identity of the fraudulent party might be relevant to the allocation of loss to the bank or to its customer.

4. It may be thought that it is so unlikely that the record of the account to be debited could be in error as a result of undetected computer error or that a third person could fraudulently access the computer without the aid or the negligence of the customer that the burden of proof should properly rest upon the customer to show that the entry at the customer-activated terminal was made without his aid and was not the result of his negligence. It is this argument that supports the provisions found in many bank-customer contracts that the customer is responsible for all transactions initiated by use of his debit card or other access device unless he has reported that the card was lost or that the means of access was compromised in some other way.

5. It may, however, be thought that fraudulent access to customer-activated terminals is a known and serious problem for which the banking industry should be responsible to its customers. It might even be thought that it is the duty of the banking industry to devise means of access to the computer through customer-activated terminals that are so secure that ordinary negligence on the part of the customer would not be sufficient to compromise them. It could also be thought that, unless such secure means of access are available, the banking industry should install customer-activated terminals only with great caution. This might lead to a conclusion that the bank in question should not be allowed to debit the customer's account unless the bank could show that the means of access to the computer was so secure that it was impossible, or that

it was highly unlikely, for the entry to have been made unless the means of access had been compromised in the hands of the customer. At present this would probably lead to the result that the bank could not debit its customer's account unless surrounding circumstances indicated that the fraud could be attributable to him. However, as more secure forms of authentication at customer-activated terminals become available, it could be expected that banks would be able to sustain this burden of proof with greater success.

Issue No. 22

Should the customer or the relevant banks carry the burden of proof as to the source of error or fraud causing loss in effectuating a funds transfer?

References

Liability, paragraph 59
Issues No. 7, 16, 21

Comment

1. This issue can arise in two principal ways. The first is that the customer claims to have initiated a funds transfer instruction but the bank has no record of it. Although the most frequent cases involving loss will undoubtedly arise from instructions alleged to have been sent from a customer-activated terminal at the customer's place of business, once funds transfers from automated teller machines or home banking terminals become common, cases involving such matters as lapsed insurance contracts for failure to pay the premium which was due are bound to arise. It could be expected that in most cases when the instruction was sent from a terminal at a place of business, the customer's computer would retain a record of the transmission. The issue may then focus on which party bears the risk of loss of the message, the customer or the bank. In the case of an automated teller machine or a home banking terminal, there will often be no paper receipt or computer record available to the customer to prove the transmission. Without such a receipt or record and in the absence of regular business routines by the non-commercial customer that would lend credence to his claim, it may be thought that the customer should carry the burden of proof.

2. The second way in which the issue can arise is that the funds transfer instruction was lost or delayed or contained an error when it arrived at the transferee bank but the source of the problem is unclear. When the rule selected imposes responsibility on the transferor bank for the proper performance of the entire funds transfer, it can be expected to carry the burden of proof that the loss, delay or error occurred in a manner which exonerates the bank from liability (see Issue No. 16). When the rule selected does not impose such a responsibility on the transferor bank, the transferor could be expected to carry the burden of proof of showing which bank is liable for the loss, delay or error. Normally, the audit trail should be sufficiently clear to show the bank where the problem occurred. However, the records establishing the audit trail would be in the complete control of the banks, and in the case of an international funds transfer, some of those banks may be foreign banks with the consequent increased difficulty of securing

information. If the records of the banks disagreed, the transferor would have no independent means of carrying this burden of proof. In addition, the transferor may be required to show that the loss, delay or error occurred through the negligence or other fault of the bank in question, in which case he could be expected to carry the burden of proof as to the cause of the problem.

Issue No. 23

Should the funds be required to be made available to the transferee within specific periods of time after the transferor bank receives a credit transfer instruction? If it should, how should the period of time be determined?

References

Agreements, paragraphs 55-78
Issues No. 16, 27-29
ISO/DIS 7746/1.2, Banking-Standard telex formats for inter-bank payment messages - Part 1: Transfers
ISO/DIS 7982/1, Bank telecommunication - Funds transfer messages - Vocabulary and data elements (as revised on 14 November 1984)

Comment

1. This issue is concerned only with the question whether a time-limit should exist within which credit transfers should be completed and, if so, what the source of that time-limit should be and which banks should be liable for failure to meet it. It is not concerned with the period of float that might be created in credit transfers, since the period of float can be made longer or shorter than the period of time which is required to effect the credit transfer by establishing an interest date earlier or later than the entry date.

2. In order for a transferor to initiate credit transfer instructions in time to meet payment deadlines, the time necessary before the transferee will have available funds must be known. Banks are increasingly able to give precise estimates of the time necessary for inter-bank credit transfers to be completed, since electronic fund transfer techniques are more reliable in this regard than are paper-based credit transfers. This is true for both domestic and international credit transfers.

3. It may be thought that, if transferor banks offer a service which contemplates that funds will be available to the transferee on a specified pay date, transferors will tend to rely on that fact in planning their transactions. In such a case, the transferor may well have a basis for claiming for losses that might have occurred because of unexcused delay.

4. It may be thought that the transferor bank should be required to act upon a credit transfer instruction it has received within a limited period of time appropriate to the type of funds transfer involved. If it was felt necessary, it should be possible to agree on standard time-limits for all types of credit transfer instructions in use in a country. These time-limits should, of

course, take into consideration the normal causes of delay which prevent all funds transfers from being completed within the optimal period of time. Where the credit transfer is a one-bank transfer, the bank might be held responsible for completing the transfer within the appropriate period of time. A different period of time might apply when the transferee's account was at another branch within or outside the country where the transferor held his account and the data processing of the transferee's account was performed at a different location from that servicing the transferor's account.

5. In a funds transfer involving two or more banks, each of the banks receiving the instruction would seem also to have an obligation to act within a limited period of time. Where the receiving bank received the funds transfer instruction through a network, the period of time might be established by network rules. In other cases, it may be established by banking custom, by inter-bank agreement, or by law. This obligation of the receiving bank might be considered to run either to the transferor or to the sending bank. In either case, there would be an increased likelihood that the estimated time for the entire funds transfer would be accurate.

6. Since the transferor must rely upon the transferor bank to furnish the estimate of time necessary for the funds transfer and to serve as the entry point to the entire funds transfer system, it seems appropriate to consider whether that bank should be legally responsible for the funds transfer being carried out on schedule. On the other hand the transferor bank cannot control the actions of the other banks in the chain, and can rarely even select the transferee bank (see Issue No. 16).

7. When the transferor specifies a pay date, i.e. the date on which the funds are to be made available to the transferee, the generalized obligation of the transferor bank or other banks in the chain becomes more specific. The acceptance of a funds transfer instruction with an indicated pay date might be understood to create a contractual obligation on the part of the transferor bank that the funds would be available to the transferee by that date. At a minimum it might be thought that the transferor bank would be obligated to include the pay date in its funds transfer instruction to the next bank in the chain. However, since standard message formats for telex and computer-to-computer funds transfer instructions do not contain a field for the pay date, that information would have to be included in the field for receiver information. It may also be noted that the term "pay date", which had been in earlier drafts of the proposed vocabulary for use in banking telecommunications, has been eliminated from the most recent version.

8. It might be thought that, when the transferor had provided insufficient time to be certain of meeting the pay date, the transferor bank would also be obligated to inform the transferor of that fact. Furthermore, if a receiving bank is not obligated to credit its credit party until it has received value, the transferor bank as sending bank would be obligated to provide its receiving bank with value in time for that bank to act within the necessary period of time.

Issue No. 24

How often should a bank be required to send its customers a statement of account activity?

References

Liability, paragraphs 47-50

Comment

1. A bank and its customer could agree that a statement of account activity would be given more often than might be required by law. This would be particularly true of business accounts where daily statements of account activity are often given. Therefore, this issue relates only to the minimum requirements that might be imposed by law.

2. In those banking systems where a notice is given whenever a debit or a credit is entered to an account, that notice serves as a statement of account activity. In other banking systems where a notice of debit or credit is not given automatically, periodic statements might normally be expected. However, an appropriate minimum requirement might vary for different types of account and different levels of account activity. In some cases, such as where the account is secret and designated only by number, it might be considered inappropriate for any periodic statement of account activity to be sent in the mail to the customer. Therefore, it might be thought that the frequency of statements of account activity is a matter which could be left to the agreement of banks and their customers.

3. It may, however, also be thought that for at least certain types of accounts minimum requirements established by law would be appropriate. This would most likely occur with regard to non-commercial accounts in countries where a notice of debit or credit was not necessary for the debit or credit to become final. This may be thought to be of increasing importance as larger numbers of individuals than in the past use bank accounts for funds transfers. It may be thought that these individuals are less likely to keep adequate records of their funds transfers. Where the transferor has an unqualified right for a period of time to demand reversal of a debit transfer made pursuant to a standing authorization to debit, the transferee would have an interest in knowing that the transferor had received notice of the debit and that the time for reversal had begun to run. Furthermore, the increased amount of fraud that has been reported as a result of the use of customer-activated terminals may be thought to call for relatively frequent statements of account activity as an aid in discovering the fraud.

4. If a statement of account activity is required by law, some consideration might be given as to whether the statement must be on paper and be sent to the customer or whether the requirement is satisfied when the statement is made available at the bank. In particular, the statement might be made available through the use of a customer-activated terminal that the customer has in his home or place of business or through an automated teller machine.

Issue No. 25

How much time should a bank customer have to notify his bank of improper entries to his account?

References

Liability, paragraphs 51-54

Comment

1. In some countries the period of time during which a bank customer should notify his bank of improper entries to an account is a part of the law concerning funds transfers. In other countries the period of time is determined by general rules of law. In either case the period of time should be relevant to current banking procedures.

2. The total period of time available to a bank customer to notify the bank of improper entries to his account, starting from the time when the entry is made to the customer's account, is determined both by the event which causes the period to commence to run and the duration of the period. The period could commence when the entry was made. In some countries in accordance with general rules of law the period commences when a formal balance of the account is stated by the bank, which may be semi-annually or annually. It may be thought, however, that it is more relevant for the period to commence when the bank gives the customer a statement of account activity showing the entry, since that is the event that brings its existence to the attention of the customer. If a statement of account activity is available to the customer through a customer-activated terminal, it might be thought that the period of time should commence to run as soon as the entry could show on the terminal on a request by the customer. If no statement of account activity is sent to the customer or available through a customer-activated terminal, the period might commence when information that the entry has been made is available to the customer at the bank on request.

3. When the period of time for the customer to notify his bank of an improper entry is limited only by the statute of limitations or period of prescription, i.e. the limitation period for commencing legal action, the period is often several years long, and may be considerably longer. It may be thought, however, that a shorter period of time, which might be measured by months rather than years, would be appropriate for giving notice. Especially where the improper entry appears to have arisen out of fraud or where the entry was made to an incorrect account, prompt notice to the bank may permit the bank to pursue the fraudulent party or correct its error by entering the amount to the correct account.

4. Consideration might be given as to whether there should be different periods of time for different types of account or for different types of customers. It might be thought, for example, that commercial customers should have a shorter period during which to notify the bank of an improper entry than would most non-commercial customers, since it can be assumed that commercial customers reconcile their statements of account activity sooner and with more care. Furthermore, the average size of individual commercial funds transfers is larger than non-commercial funds transfers, making it of greater importance that individual errors or fraud be found promptly.

5. It may be thought that the period of time available to a bank customer to give notice of an improper entry should be a matter of mandatory law not subject to being reduced by agreement between banks and their customers. However, it may also be thought that, particularly in the context of commercial accounts or of large-value funds transfer networks, it would be desirable for the parties to be able to adjust the legally prescribed period of time to the circumstances of the account and its activity.

Issue No. 26

Should there be a clearly articulated error resolution procedure?

Reference

Liability, paragraph 55

Comment

1. Since bank customers may question a certain number of entries to their account which may have been made in error or may be a result of fraud, every bank will of necessity have a procedure for investigating and resolving those errors. In some banks the procedure may be unwritten and informal. In many banks, and particularly banks with a large number of accounts and entries, the procedure tends to be written and formal.

2. It may be thought that every bank should have a written error resolution procedure. Such a procedure might be expected to contain certain minimum requirements in regard to the time the bank has to respond to the enquiring customer and the information that must be contained in the response. It may also be thought that the error resolution procedures of the bank should be made known to the bank's customers in an appropriate form.

3. Since error or fraud in a funds transfer often involves actions of banks other than that of the enquiring customer, any such procedure adopted by only one bank would of necessity be limited in its scope. Particular difficulties might be encountered where the other banks involved were in other countries and those banks had different standards in regard to investigating and correcting errors or reporting on apparent fraud.

4. It may be thought, therefore, that inter-bank agreements might be developed regarding error resolution procedures. These agreements might be incorporated into the rules of funds transfer networks, adopted by banking associations or by bilateral agreements between correspondent banks. It could be expected that the provisions of any such agreements relating to small-value funds transfers might be significantly different from those in agreements relating to large-value transfers.

5. In some countries it may be thought useful to prescribe by law the required error resolution procedures. It may be thought that, especially in regard to non-commercial accounts, mandatory error resolution procedures are an important measure of protection to bank customers who are otherwise in a weak position to argue with their bank about an alleged error on the part of the bank. However, it may also be thought that any error resolution procedure prescribed by law would be apt to be either too general to be of much

protection to bank customers or so detailed as to generate unnecessary expense. It may also be thought that in most countries experience does not necessitate legislation on this point.

Issue No. 27

Should either the transferor or the transferee recover interest for a delay of a funds transfer?

References

Agreements, paragraphs 55-78
Liability, paragraphs 92-95
Issues No. 23, 30

Comment

1. Issue No. 23 discussed whether the banking system should be required to make a credit transfer available to the transferee within specific periods of time after the transferor bank receives a funds transfer instruction. Implicit in that question was the question of the nature of damages that might result from a failure of the banking system to meet the time schedule. The most natural element of damages for delay in paying a sum of money on time is interest.

2. It should be noted here, as was alluded to in Issue No. 23, paragraph 1, that in some banking systems an implicit interest charge is built into the funds transfer schedule by debiting the transferor with an interest date of day 1 and crediting the transferee with an interest date of day 3. This implicit interest charge is not present in other banking systems where both the debit and the credit have the same interest date, e.g. day 3. However, in either case if the transfer is delayed and the credit is entered with an interest date of day 5, there has been a two day loss of interest to the transferee.

3. When a large-value funds transfer is delayed, the transferee's interest loss may be significant. However, in some banking systems it may be as difficult to determine which of several rates of interest is the appropriate rate of interest to compensate the transferee as it is to determine the appropriate rate of interest to compensate the transferee bank in case of delay (see Issue No. 30). One solution would be to give the transferee the rate of interest he would have received in the account. This is the solution implicit in the procedure of back-dating the credit mentioned in paragraph 4, below. Another solution would be to tie the interest rate used in calculating compensation to the transferee to the interest rate used for inter-bank compensation as described in Issue No. 30.

4. Although it is the transferee who has suffered the lost interest, it is not clear from whom the transferee should be able to recover. It could be thought that the transferee should be able to recover from the transferor if the delayed entry of the credit constituted breach of the underlying contract. If this were to happen and if the delay did not occur at the transferor bank, the question would arise as to whether the transferor could

seek reimbursement, and from which bank. If the delay occurred at the transferee bank, the transferee should probably be able to recover from it on the grounds of the pre-existing contract of account. However, if the delay appeared to have occurred at any other point in the funds transfer chain, including at the transferor bank, the transferee may not have a direct claim against that party. A practice which reduces the theoretical problems is that the interest date of the credit in the transferor's account may be back-dated to the appropriate date, with interest and fees adjusted to what they would have been if the transfer had not been delayed. In most cases this procedure would compensate the transferee adequately for the delay.

5. In the vast majority of delayed small-value transfers no claim for compensation for lost interest could be expected. The size of the individual claim would be small and transferees receiving small-value transfers often are not aware of the appropriate interest date for the funds transfer. If delay in completing small-value transfers beyond the established time-limits is a serious problem in a banking system, consideration could be given to administrative solutions that would eliminate this effect of delay on the transferee. One such solution might be to provide that the interest date of the debit to the transferor and the interest date of the credit to the transferee must be the same or separated by a specific number of days.

Issue No. 28

Should either the transferor or the transferee recover exchange losses for delay of a funds transfer?

References

Agreements, paragraphs 55-78
Liability, paragraphs 96-97
Issues No. 23, 27

Comment

1. As is true of a claim for lost interest, a claim for exchange loss can be made only if the time schedule for the funds transfer is so precise that the time when the exchange should have been made is clearly determined or determinable. In a period of floating rates with daily movements of several per cent between major trading currencies not unknown, the precise determination of the hour or even the minute when the exchange should have been made could be relevant in particular cases.

2. Putting aside the influence of hedging operations by the parties, the transferor may suffer exchange loss if his obligation to pay is denominated in a foreign currency and his currency of account devalues against the currency of payment between the time when the exchange should have been made and the time when it was made. Similarly, the transferee may suffer exchange loss if the currency of payment is a foreign currency which devalues against his currency of account between the time when the exchange should have been made and the time when it was made. The fact that there was an exchange loss, and the amount of that loss, might be established by a subsequent cover purchase of the foreign currency by the transferor or transferee, as the case may be.

The transferee suffers no exchange loss during the transfer itself if the currency of the account to which the transfer is credited is the same as the foreign currency of payment. However, consideration might be given as to whether a claim for exchange loss should be allowed when the transferee intended, or was required by currency control regulations, to sell the foreign currency promptly after receipt and the transferor knew of this intention or requirement.

3. Where the exchange loss occurred because of delays at a bank prior to the transferee bank, the same difficulties exist in determining from whom, and in what manner, the transferee could recover his loss as there are in regard to recovering lost interest arising out of delay (see Issue No. 27).

4. If no recovery for exchange loss is permitted, the transferor and transferee are required to accept the rate of exchange prevailing when the exchange was made in fact. If recovery of exchange loss is permitted, consideration might be given as to whether the customer, i.e. transferor or transferee, as the case may be, should have the choice between the rate of exchange prevailing when the exchange should have been made and the rate of exchange prevailing when it was made in fact. Alternatively, the governing rate could be deemed to be the rate of exchange prevailing when the exchange should have been made. In this latter case the banks would have the right to apply that exchange rate to the transaction even though the rate had moved in favour of the customer before the exchange occurred. As noted in the Chapter on Liability, paragraph 97, in the draft Convention on International Bills of Exchange and International Promissory Notes, the holder of the instrument is given the choice of dates "in order to protect him against any loss he may suffer because of speculation by the party liable."

Issue No. 29

Under what circumstances should the bank be liable for consequential damages?

References

Liability, paragraphs 98-100
Issues No. 16, 23

Comment

1. Although delay or error in the processing of a funds transfer instruction can usually be fully compensated by payment of interest, or exchange loss and the making of similar financial adjustments, in a few cases the failure to complete the funds transfer by the anticipated date may cause consequential damages to the transferor arising out of the cancellation of a contract, incurring of a penalty or forfeiture of rights with damages far exceeding compensation measured as interest.

2. It may be thought that, in accordance with the general rule, the bank should not be liable for consequences it did not foresee and could not reasonably have foreseen. Since a delay in executing a funds transfer only rarely causes such loss, even where the amount transferred is large, liability

for consequential damages would be correspondingly rare. This might be thought to be in accordance with the fee schedule for funds transfers since that schedule is usually too low to support even occasional claims for the large damages which might result.

3. However, there are occasions when the transferor bank knows the purpose of the transfer and the consequences that would follow from delay or error in its transmission. It might be thought that in such cases the normal rules of liability should follow. If this approach was taken, the transferor bank would be liable for the consequential damages arising out of its own errors or delays in processing the funds transfer. On the other hand banks often know a considerable amount about the affairs of their customers without that knowledge being available to the funds transfer department. It could be questioned who within the bank should have the requisite knowledge for the bank to be responsible for consequential damages.

4. If the transferor bank was responsible for the entire funds transfer, including the actions taken by other banks (see Issue No. 16), it would be responsible for consequential damages arising out of any delay or error in the funds transfer. However, if the transferor bank was responsible only for its own actions and the delay or error occured at a subsequent bank in the transmission chain, the question would arise whether the subsequent bank should be bound by the knowledge of the transferor bank or whether it could defend on the grounds of unforseeability.

5. It should be noted that under current banking practice it would be unusual for the transferor bank to explain to its receiving bank the potential consequences if the funds transfer instruction was delayed. However, there is no intrinsic reason that it should not have such a duty. At a minimum it might be thought that the transferor bank should include the pay date in the funds transfer instruction (see Issue No. 23). It might also be thought that inclusion of such a pay date would give the banks in the transmission chain the knowledge that some business consequences might occur if the funds were not available to the transferee by that date, even if they did not know the exact nature of those consequences.

6. It may be thought that there should be a standard procedure available whereby a transferor could notify the transferor bank that it was of particular importance that the funds transfer be completed on time. An additional fee might be charged based on a special priority procedure required for handling the funds transfer. Such a procedure would seem to have its greatest utility in international funds transfers where the possibilities of delay or error are the most significant and the difficulties of recovering substantial damages from an intermediary bank at fault are the greatest, although it might also be instituted for domestic funds transfers.

Issue No. 30

Should there be special rules governing the inter-bank liability for late reimbursement or for erroneous funds transfers?

References

Issue No. 16

Comment

1. In addition to any loss to the bank customers (transferor and transferee) that may be caused by an error on the part of the sending bank, the receiving bank may also suffer a loss. Although general rules of law would furnish a basis for determining when liability exists and for calculating the loss, they may not be completely satisfactory when applied to banking situations without interpretation. Furthermore, the general rules of law differ from one country to another and the use of conflict of laws to determine the appropriate compensation may be thought not to be satisfactory for the routine calculation of compensation. Therefore, it may be thought desirable for inter-bank rules to be prepared, especially for international funds transfers.

2. If the receiving bank should be required to pay damages to its credit party for losses arising out of errors or delay experienced prior to receipt of the funds transfer instruction by the receiving bank, that bank could be expected to receive reimbursement for the loss from the sending bank. An inter-bank agreement might be prepared to govern that reimbursement. A threshold question would be whether any such agreement should cover matters that would otherwise be governed by general rules of law. Other issues might include: Would the receiving bank receive reimbursement from the sending bank if the error was caused by yet an earlier bank in the chain? Could the receiving bank receive full reimbursement from the sending bank for all damages it has paid or would it have to justify the damages by showing a court order or arbitral decision? If the damages paid to the transferee consisted of interest only, should the transferee bank recover that interest as reimbursement in addition to the inter-bank interest discussed in the following paragraph? Similar questions are faced and might be settled by an inter-bank agreement if, as suggested in Issue No. 16, the transferor bank in a credit transfer is responsible to the transferor for the proper performance of the entire credit transfer.

3. When the receiving bank has credited its credit party as requested but has not received reimbursement on the date indicated, there is no loss to the credit party but there is a loss of interest to the receiving bank. Similarly, when a sending bank requests a receiving bank to correct an error of the sending bank by entering a credit to the account of the credit party as of a date earlier than the date of receipt of the instruction, the receiving bank has lost the opportunity to invest the funds it should have received at that earlier date. A contrary situation occurs when a bank sends a credit transfer instruction to the wrong receiving bank and that bank, at the request of the sending bank, subsequently reverses the credit entered to the account of its credit party and returns the funds to the sending bank. The receiving bank has had the use of funds to which it should not have been entitled. In some legal systems the receiving bank may be obligated to reimburse the

sending bank under a theory of unjust enrichment or the like even though the error was that of the sending bank.

4. In many banking systems there may be more than one interest rate that might appropriately apply to the inter-bank compensation. For international funds transfers there would certainly be more than one applicable rate. It may, therefore, be thought to be useful for inter-bank rules to specify the conditions under which interest would be given by one bank to the other as compensation and to give appropriate formulas for calculating the amount of interest. Furthermore, errors are time-consuming to rectify. Therefore, it might be thought appropriate for inter-bank rules to specify an amount of compensation to be paid by a sending bank to the receiving bank for the inconvenience and time spent in rectifying the error.

Issue No. 31

What should be the consequences of a funds transfer or funds transfer transaction becoming final?

References

Finality, paragraphs 49-96

Comment

1. The consequences of finality of a funds transfer are not the same in all countries. Legal results which are the consequences of finality in some countries may arise before or after finality as viewed in other countries, or in the same country may arise at different times depending on the type of funds transfer involved. Therefore, there could be no universal list of consequences which should be described as the result of finality; there can be only a list of consequences often associated with finality of a funds transfer. The exact time when each consequence occurs must be determined separately for each type of fund transfer in each country.

2. The consequences most often associated with finality are that:

(a) The balance in the transferor's account is reduced and the funds transfer can no longer be stopped by the death of the transferor, the commencement of insolvency proceedings against him, his supervening legal incapacity, attachment of his account, set-off by his bank or withdrawal of the funds transfer instruction by him;

(b) The credit balance in the transferee's account is increased and is subject to action by his creditors;

(c) The transferee has a right to withdraw the funds and might earn interest on the new credit balance (or cease paying interest on the previous debit balance);

(d) The transferee bank may be precluded from debiting the transferee's account to correct alleged erroneous credits to that account without the permission of the transferee;

(e) An underlying obligation between the transferor and transferee may be discharged.

3. Essentially the same consequences in respect of the accounts of one bank with another seem to occur as the result of finality of a funds transfer transaction between two banks. However, finality of the funds transfer transaction may also bring with it the obligation of the receiving bank to credit the account of its credit party, to pay interest on the new balance in the account of the credit party, to send a credit advice to the transferee or new funds transfer instruction to the next bank in the transmission chain and to make the funds available to the credit party.

Issue No. 32

Should funds transfers be final for any or all purposes on the happening of a specific event or at a particular point of time in the day?

References

Finality, paragraphs 4-48

Comment

1. A funds transfer may be final either on the happening of a specific event, e.g. the entry of the debit or the credit to the relevant account, on the happening of an event which is common to a large number of funds transfers, e.g. the placing of a computer memory device containing funds transfer instructions into the computer for processing, or at a specific time of the day, e.g. midnight of the day on which the funds transfer instruction was received or on which the debit or credit was entered. If the funds transfer becomes final upon the happening of a specific event, the rule treats each funds transfer as a unique transaction. If the funds transfer becomes final on the happening of an event common to a large number of funds transfers or at a particular time of the day, the rule places each funds transfer within the normal data processing cycle for the type of funds transfer in question.

2. Although some countries may find it desirable to establish a relevant event or point of time as the moment of finality for all types of funds transfers and for all consequences, other countries may find it preferable that certain funds transfers become final for some or all purposes on the happening of events while other funds transfers become final at a particular time of the day.

3. The one event which is likely to make all types of funds transfers final in all countries and in regard to all consequences is the handing over of cash by the transferor bank (debit transfer) or the transferee bank (credit transfer) pursuant to the funds transfer instruction. However, when the cash is handed over by a third bank, with or without recourse, the funds transfer is not considered to be final until the funds transfer instruction has been honoured by the transferor bank or transferee bank as the case may be. In the light of these prior rules, consideration may be given as to whether a funds transfer is final when the transferee withdraws cash from a cash dispenser in

an off-line shared system where the bank maintaining the cash dispenser is not reimbursed and the debit is not entered to the customer's account until a later time.

4. Some types of funds transfer seem to call for fixing different events or points of time for the various consequences flowing from the funds transfer. For example, the transferor loses the right to withdraw a funds transfer instruction when it is issued if the instruction is of a type which the transferor bank guarantees to honour. Because of the general desirability of certainty and of early finality in high-value electronic funds transfers, network rules often provide that the funds transfer instruction is not subject to reversal by the sending bank (or its instructing party) once it is sent. In the case of a net, or net-net, settlement network, the funds transfer may become final at the time when settlement occurs in the sense that there is then no longer the possibility that the funds transfer instruction may be returned to the sending bank because of a failure to settle, although other network rules may require immediate irrevocable credit to the account of the credit party.

5. Where the funds transfer instructions are processed in batch, it may be considered desirable for the rules on finality to fix a specific time of the day when the funds transfers become final, since batch processing of funds transfer instructions does not lend itself as well as does individual processing to fixing a single event during the processing period as the relevant event for finality. However, if a single event is desired, it has been suggested that it be an event which is easy to identify, such as the insertion of the computer memory device containing the batch of funds transfer instructions into the computer.

6. Furthermore, it may be considered desirable, as it is in some countries, to permit the data processing to take place in any order convenient to the bank. If this is to be permitted, it may be considered desirable to permit a bank to enter all debits and credits without regard to account balances or other reasons for refusing to honour the funds transfer instruction and to reverse the entries that the bank later determines it should not honour. If this is considered desirable, it may also be considered desirable to fix a maximum period of time during which the bank could reverse the entries, which would probably be best measured as terminating at a particular time of the day.

Issue No. 33

What should be the effect on a credit transfer between two customers that a funds transfer transaction between two banks has become final?

References

EFT in general, paragraphs 26-28
Finality, paragraphs 23-30, 58, 61, Annex
Issue No. 4

Comment

1. The relationship between the finality of a funds transfer transaction between two banks and a credit transfer between the transferor and transferee

is emerging as one of the more important legal issues to be faced in the design of high-value funds transfer networks and in the potential preparation of rules to govern international funds transfers.

2. The issue seems not to have raised concerns so long as high-value electronic funds transfers were made only by telegraph or telex between a relatively small number of large banks with well-established correspondent relationships. In many countries the inter-bank transfers were regarded only as acts implementing the instructions of the transferor. Therefore, when the transferee bank acted upon the funds transfer instruction, it was natural to conceive that the transferee bank was honouring the instruction of the transferor, even though the telegram or telex had been sent by the transferor bank or an intermediary bank.

3. The network rules of the various high-value electronic funds transfer networks that have been organized to take advantage of computer-to-computer technology include rules as to when funds transfer transactions made through that network are final. These rules seem to have two main purposes. The first is to protect the settlement. Although this purpose may seem to be of particular significance in regard to net or net-net settlement networks where the unraveling of a settlement would cause immense difficulties, it may in fact be of more importance to a network operated by a correspondent bank, including a central bank. It may be obvious that a net settlement must be irreversible as to all of the participating banks. However, in the absence of rules in the general law of funds transfers as to when a funds transfer transaction becomes irreversible, the transaction might be reversed on the instruction of the transferor. As a result, the correspondent bank might have to reverse the credit to the account of its receiving bank. This could leave the account with a debit balance that would be unacceptable to the correspondent bank.

4. The second reason for adopting network finality rules is to assure the receiving bank that the credit it has received is irreversible. With that assurance the receiving bank can also give irrevocable credit to its credit party, who may be either the transferee or another bank.

5. The first consequence of the network finality rule is that the sending bank in the fund transfer transaction can not withdraw its instruction once it is sent through the network. Therefore, the transferor also loses his right to have the instruction withdrawn from the network. However, if the funds transfer has not yet become final in respect of the transferee, the transferor may still have the right to withdraw his instruction in regard to the entire funds transfer. It may therefore be questioned whether the receiving bank in the funds transfer transaction would have an obligation to pass on the notice of withdrawal of the funds transfer instruction. If the receiving bank does not have such an obligation, consideration should be given whether the transferor or transferor bank should have the right to by-pass the intermediary banks involved and instruct the transferee bank directly. The question is of particular delicacy because it may arise most often in international funds transfers where the substantive and procedural law of several countries may be involved.

6. Although the problem may arise most often in respect of the withdrawal of a funds transfer instruction on the instruction of the transferor, the same question can arise in respect of notice of the death of the transferor, commencement of insolvency proceedings against him, attachment of his account or other legal proceedings that would interfere with the completion of the funds transfer.

7. If the funds transfer can be stopped by by-passing the receiving bank in the funds transfer transaction and by giving the requisite notice to a later bank in the chain, or directly to the transferee bank, it would seem that a procedure for reimbursing the various banks may need to be established that would also by-pass the receiving bank in the funds transfer transaction. If the receiving bank were required to reimburse the sending banks, the funds transfer transaction would not have been final. In this respect a network finality rule is different from some clearing-house rules that provide that a dishonoured cheque may be returned through the clearing-house for a certain period of time after which it can be returned only outside the clearing-house.

8. On the other hand each funds transfer network must necessarily have a procedure for the return of credit transfer instructions on the request of the transferor bank because of an error it has made or on the initiative of the transferee bank because it cannot execute the instruction, for example, because there is no such account. Since these returns do not seem to disturb the principle of finality of the original funds transfer transaction, perhaps returns arising out of notices of the type under discussion should also not be considered to disturb the principle of finality of the funds transfer transaction.

9. If the conclusion is reached that finality of a funds transfer transaction between intermediary banks has the effect of blocking notice of these various causes for terminating the funds transfer before the transfer becomes final, the effective result is that in respect of these matters the funds transfer becomes final at the same time the funds transfer transaction becomes final.

<u>Issue No. 34</u>

Should the time of finality of a funds transfer be affected by a guarantee of honour of the funds transfer instruction by the transferor bank?

<u>References</u>

Finality, paragraphs 41-43

<u>Comment</u>

1. Although guarantee of honour by the transferor bank is usually associated with paper-based debit transfers, such as guaranteed cheques and credit cards, it can also be associated with electronic debit or credit transfers. In particular, any point-of-sale system with delayed debit is likely to guarantee the credit to the transferee (merchant) once the authorization to enter into the transaction has been given to the merchant.

2. One of the immediate consequences of guarantee of honour is to terminate the right of the transferor to withdraw the funds transfer instruction. If the guarantee is considered to be the equivalent of acceptance of a bill of exchange (or certification of a cheque where that is permitted), other consequences associated with finality might also be thought to occur. The subsequent debiting of the transferor's account would not be impeded by the supervening death of the transferor, the commencement of insolvency proceedings, attachment of the transferor's account, set-off by the bank or the transferor's legal incapacity. The underlying obligation might be thought to be discharged upon issue of the guaranteed instruction. It is evident, however, that the transferee would not have a right to availability of the funds until the instruction had been presented for honour or until the time the funds were to be available as provided in the point-of-sale system agreement.

Issue No. 35

Should there be a specific rule as to whether a transferee bank to which funds have been sent for delivery to the transferee upon identification holds the funds for the transferor or for the transferee?

Reference

Agreements, paragraph 4

Comment

1. This issue differs from the general issue of finality of a funds transfer since the funds transfer cannot be completed by crediting the transferee's account. Furthermore, in the majority of cases there is no pre-existing contractual relationship between the transferee and transferee bank directing the bank to hold funds received for the future disposition of the transferee.

2. Although the practice of sending instructions to a bank to pay a sum of money in cash to a specific person upon identification constitutes an extremely small percentage of all funds transfers, it may be worthy of a specific rule. Such transfers are most often sent for small sums through the postal funds transfer system, but bank transfers for significant amounts of money are not infrequent. It is common for the transferee not to present himself over a period of time. This increases the possibility that the transferor may wish to withdraw the funds transfer instruction or that some event such as the transferor's insolvency or legal process against his account may occur before the transferee identifies himself.

3. It may be thought the funds transfer does not become final until the transferee presents himself and claims the cash. In that case the transferee bank would hold the funds at the direction of the transferor and subject to any claims made against assets of the transferor.

4. It may, however, also be thought that once the transeree bank notified the transferee of the availability of the funds, the transferor would have discharged his obligation to the transferee. Since the transferor would have

lost all control over those funds, they would remain at the risk of the transferee. The funds would be treated the same as if they had been deposited to an account of the transferee at that bank.

Issue No. 36

Should the time when an underlying obligation is discharged by means of a funds transfer be dependent upon the means used by the banks to effect the funds transfer? Should the time of discharge be the same as the time when the funds transfer becomes final?

References

Finality, paragraphs 41-43, 92-96.
Issue No. 35

Comment

1. Especially in large-value transactions, the time when an underlying obligation is discharged by means of a funds transfer may be established by the parties in the underlying agreement. When it is not established by the parties, the relevant legal rules usually establish the time of discharge in relation to the type of funds transfer and the procedures followed by the banks. For this reason, the legal rules on discharge of the underlying obligation may be found in the law governing funds transfers, although they may equally well be found in the law governing the underlying obligation.

2. It may be thought that, as the banking practices relevant to funds transfers change, consideration should be given whether the current rules as to when the underlying obligation is discharged continue to be appropriate. The question may be most pertinent in countries where funds transfers have usually been made by cheques and the rules in regard to discharge of an obligation by credit transfer may not be clear. Furthermore, the rules applicable to cheques may not be completely applicable to electronic forms of debit transfer, such as ones made pursuant to a standing authorization to debit.

3. In countries where funds transfers have usually been made by credit transfer, it may be thought that the traditional rules might serve well in the new context. This might particularly be thought to be the case where the underlying obligation is discharged when the funds transfer becomes final, at least if the time of finality of the funds transfer is clear under the relevant law and the current means of making funds transfers. However, where the rules on discharge of the obligation are dependent on a specific action by the bank, perhaps because it is that action which has marked the finality of the funds transfer, it may be thought appropriate to review those rules to determine whether banks continue to take that action or whether some other action by the bank would be more appropriate. Where, for example, the underlying obligation has been discharged when the credit has been entered to the account of the transferee, thought might be given as to when the credit is considered to be entered in the context of batch-processing.

4. There has been a considerable growth in the types of funds transfers where the transferor bank guarantees honour of the instruction. Even though the instruction itself has not as yet been honoured, the addition of the bank's guarantee to the obligation of the transferor may be thought to be sufficient reason to consider the underlying obligation discharged.

Issue No. 37

Should the rules governing funds transfers take into consideration the possibility that a bank may fail to settle?

References

Finality, paragraphs 97-99, Annex

Comment

1. In countries where there is a distinct possibility that a domestic bank may fail to settle for funds transfers, the legal rules anticipate the need to distribute the loss which arises from such failure. The discussion of system risk indicates that the creation of high-value on-line funds transfer networks has increased that risk in some countries to the point that new measures have been taken or contemplated.

2. In countries where failure of a domestic bank to settle is considered to be unlikely and where current or future domestic high-value on-line funds transfer networks would not increase the risk, the rules need not necessarily take such possibilities into account. The unexpected occurence of such an event would have to be handled under rules designed for other purposes, as would the failure of a foreign bank to settle for an international funds transfer.

3. The allocation of the loss between banks arising out of a failure of a bank to settle an international funds transfer might depend upon the law of either of the countries involved. When the failure to settle is of a funds transfer transaction made through an electronic funds transfer network, there may be specific provisions in the network rules to allocate the loss. The loss may also be allocated by application of the rules on finality. These rules may be found either in the law governing funds transfers or in inter-bank agreements.

4. Although inter-bank agreements may affect the rights of the non-bank transferor or transferee by determining the allocation of loss between the banks, those agreements would not be the source for rules determining whether a bank could pass on to its non-bank customer the loss arising out of a failure to settle. However, it is to be expected that if the transferee bank bears the risk that its sending bank will fail to settle, and if this risk is significant, means will be found by the transferee bank not to enter an irrevocable credit to the account of the transferee before settlement is final.

Issue No. 38

Can a funds transfer become final outside the normal working hours?

References

Finality, paragraphs 13-14, 32

Comment

1. The banking industry is moving towards a twenty-four hour day for many of its functions and this may affect the time of day when a funds transfer becomes final. In respect of paper-based funds transfer instructions it has been common for the data processing flow to be completed after the bank was closed to the public but before personnel went home in the evening. Items received after some cut-off point late in the day have often been considered as having been received the following day and have been processed with that day's activity. Whatever may have been the specific rule on finality, it took effect during normal working hours for the bank's personnel. The practice of completing the act of finality during the normal working hours may have had the character of being a rule of law in some countries.

2. At present the data processing flow in many banks goes on through the night. In many cases the acts that constitute finality take place outside normal working hours. With customer-activated terminals available in many places on a twenty-four hour basis, funds transfer instructions can be entered at night as well as during the day and, if the system is fully on-line, many of those transactions can be completed immediately. As a result international funds transfers initiated during the day from a bank in one time zone may be completed during the night in another time zone. This result may also occur in domestic funds transfers made in countries which cross several time zones. It could be expected that the normal operation of the finality rules would lead to the conclusion that these funds transfers had become final at that time. Although this would be a normal result from one point of view, it disturbs the commonly expected pattern that funds transfers are processed and become final during normal working hours.

3. It should also be noted that in those countries where reversal of the debit or credit entries is permitted for a limited period of time, that period for reversal may end outside normal working hours, e.g. at midnight, and the funds transfer would become final at that time.

4. Special problems may arise when an on-line computer-to-computer funds transfer becomes final on one day at the sending bank, but because of the difference in time zones, it becomes final on the previous or following day at the transferee bank.

Issue No. 39

When should a debit or credit be considered to be entered to an account?

References

Finality, paragraphs 8, 33, 36

Comment

1. Rules on finality are often based upon the time of entry of the debit or credit to the relevant account, since this was an objective act which seemed to indicate that a decision had been made to honour the instruction and seemed to symbolize the transfer of the claim against the bank from the transferor to the transferee.

2. Modern data processing techniques have reduced the clarity of the act as well as its value as a symbol. Banks often enter the data into the accounts as soon as possible after the funds transfer instructions are received, subject to reversal for a period of time during which the banks can decide whether they wish to honour the instruction. If reversal of an accounting entry is not allowed by law, the entries may be made to a provisional account and only at a later time are the entries in the provisional account merged with the real account. When the instructions are lodged with the bank for action one, two or more days later, they may also be entered immediately into the provisional account, with indication of their effective date, at which time they are also merged with the real account. These operations were not technically feasible prior to the use of computers.

3. The time of entry of the debit or credit to the account could be considered to be either the time it was entered to the provisional account or the time it was merged with the real account. It may be thought, however, that considering the entry to have been made when it was entered to the provisional account would give that entry a legal value that was specifically intended to be avoided. Furthermore, it seems obvious that the use of a provisional account was intended to give the bank the same opportunity to reverse the entry as is given to banks in countries where the entry is specifically understood to be reversible for a period of time.

4. It may be noted, however, that the two approaches do not give the same result as to the point of time when the debit or credit is entered to the account, or to be more precise, when it becomes final. In legal systems where the entry is reversible for a period of time, it automatically becomes irreversible at the end of that period of time, and the moment is a fixed one. Where the entry of the debit or credit depends on the merger of the provisional account with the real account, entry - and finality - depend upon the act of merging the account. This act can be assumed to consist of a human act to put in motion the computer file up-date. Although this act could be expected to occur at approximately the same time each day, the time might vary for a number of reasons. Of course, the merger could also be notional or, if a file up-date is necessary, it could be set in motion automatically by a clocking mechanism, unless there had been human intervention to delay the merger. All of these possiblities reduce the clarity of the concept of entering the debit or credit to the account.

5. Furthermore, there are difficulties in knowing when batch entries from a computer memory device have been entered to an account. To the extent that entry symbolized a decision to honour the instruction, the entry could better be deemed to have been entered at the time the computer memory device was placed in the machine for processing - or even when it was prepared and ready to be further processed. The point of time when the computer reached a particular item in the batch, even if that moment is recorded by the computer, would seem to have little relevance to the rights of various parties to the instruction or the account.

Issue No. 40

In what order of priority should the various entries to an account be considered to have been made?

References

Finality, paragraphs 32-37
Issues No. 38-39

Comment

1. When all entries to an account were made by a single individual by hand, the order in which they had been entered was evident and it was rational to base various rules of priority on that order. At present debit and credit entries arrive from a number of different sources and can be entered to the accounts in different ways. Paper-based items received over the counter or through the mail may be sent to the data processing centre either for entry directly to the account or for entry to a computer memory device that will later be used to enter the items to the accounts. Alternatively, the clerk who receives the item over the counter or opens the mail may key-in the data from a terminal at his work station. Instructions may arrive from automated teller machines either on-line or off-line. Although the bank may treat them as identical for the purposes of the interest date, the actual entry to the account may vary by one or more days. Paper-based instructions and electronic instructions that arrive in batches from other banks or clearing-houses may have processing schedules that are independent from the other items processed by the bank. Individual high-value items that arrive by telecommunications may be entered directly to the accounts. Items that are received for processing on a later day may be entered to provisional accounts and those provisional accounts may be merged with the real accounts at any point of time convenient to the data processing centre.

2. Although it is always possible to establish priorities on the basis of the order in which the debits and credits from the various instructions were entered to the account in question, it may be thought that in the current situation this does not necessarily lead to satisfactory results. It is difficult to know, however, what basis for ranking priority would be better. At least three possibilities which emerge are that the smallest items might be considered to be processed first so that as many as possible can be satisfied, all items might be considered to have the same priority, so that they would share pro-rata, or the bank may be permitted to decide the order in which to enter the items.

3. A network may have a rule that if a bank fails in the settlement, all credits to that bank remain valid but that the debits to that bank, i.e. credit transfer instructions sent by that bank or debit transfer instructions received by it, are satisfied in the order in which they passed through the clearing-house. This rule causes no difficulties based on the current discussion if the items pass through the clearing-house as individual items. In fact, it has the advantage of enouraging banks to rely on credit transfer instructions received early in the day, and to pass on the credit to their customers, since those instructions will have a high priority in case of the sending bank's failure to settle. However, if settlement is by entry of debits and credits in accounts held with the central bank, or with any other single settlement bank, and items other than those received through the network were submitted to the central bank for debit to the account of the failing bank on the day in question, a decision, similar to that described in paragraph 2, would have to be made on the priority of the items received through the network for debit to the account of the failing bank as against other items received for debit to that account.

Issue No. 41

Should a bank have a right to recover an erroneous credit by reversing an entry to the account of the credit party?

References

Finality, paragraphs 79-80

Comment

1. The most efficient way for a bank to recover an erroneous credit entered to the account of its credit party is to reverse the entry by debiting the account. This method is particularly efficient if the account is that of the non-bank transferee with the transferee bank or the loro account of the receiving bank held with the sending bank.

2. Reversal of the credit is permissible without question if the credit has not as yet become irrevocable, either because in that country credits may be revoked for a period of time after they are entered to the account or because the credit was entered to a provisional account that has not yet been merged into the real account. However, once the credit has become irrevocable under the relevant law, it may be thought that reversal of an erroneous credit by debit to the account without the prior permission of the credit party should be permitted only with caution. In some countries a transferee bank is permitted to reverse a credit arising out of its own error but not one arising out of an error of the transferor or of the transferor bank.