Banking law reforms: changes to cheques law and repeal of the Banking Act

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This article describes the changes to banking law which were introduced through the recent enactment of the Banking Law Reform Bill.

I Introduction

On 30 June 1995 the Banking Law Reform Bill received Royal Assent.¹ The enactment of this legislation implements some important changes to banking law, particularly in relation to cheques law. These changes were recommended by the Reserve Bank.

The new legislation makes three principal changes to the law:

• First, it provides for a non-transferable cheque through amendments to the Cheques Act 1960. A non-transferable cheque is one which can only be paid into the account of the named payee. It cannot be endorsed to a third party.

• Second, it permits “truncation” of cheque processing also through amendments to the Cheques Act. This means that banks are able to pay cheques on the basis of information received electronically and can therefore avoid having to transport cheques physically from the collecting bank to the paying bank to facilitate payment.

• Third, it frees banks from a range of administrative requirements by repealing the Banking Act 1982.

These reforms have considerable practical importance for the banking industry and the general public because of the prevalent use of cheques. Although the usage of cheques is declining, they remain the most popular payment method in New Zealand.²

II Background

Banking Law Working Group

The banking industry was closely involved in the development of the reforms. The proposals were developed through the Reserve Bank’s Banking Law Working Group. This Group is convened by the Reserve Bank and made up of representatives from the Bank, New Zealand Bankers’ Association, their respective legal advisers and the Justice Department.

The Working Group was formed in 1992 to review aspects of banking law to make the law consistent with modern banking practices, more understandable to users of the banking system, and better meet the needs of bank customers. It was recognised that the legal framework applying to the banking system was, in some respects, outdated and not conducive to the efficient operation of the system.

Cheques law review

The introduction of non-transferable cheques and truncation represents the completion of the first stage of a two-stage cheques law review process. In August 1993, the Working Group released a discussion paper³ outlining the Group’s preliminary thinking on the broader issues involved in reviewing cheques law and the nature of the potential changes which could be made. The purpose of the paper was to seek the views of a wide range of interested parties on the broader issues and possible directions for reform.

The responses to the paper revealed that many regarded the creation of a non-transferable cheque and truncation as being the immediate priorities for reform. The Working Group, therefore, decided that non-transferability and truncation were of sufficient practical importance to pro-

¹ The Bill was enacted as the Bills of Exchange Amendment Act 1995, Banking Act Repeal Act 1995, Evidence Amendment Act (No 2) 1995, and the Reserve Bank of New Zealand Amendment Act (No 2) 1995.
² Around 370 million cheques were processed by banks in New Zealand last year. See: New Zealand Bankers’ Association (1994).
ceed with immediately as a first stage, ahead of a broader review of cheques law.

The Working Group then released its second discussion paper on cheques law in August 1994. The paper set out detailed proposals on amending the Cheques Act to provide for a non-transferable cheque and to facilitate truncation. Overall, the submissions received on the paper indicated strong support for the proposals.

**Banking Act review**

The review of the Banking Act 1982 stemmed from the view that banks should, to the extent appropriate, be subject to the same legal framework as that which applies to other commercial enterprises. The review also recognised that the Banking Act was creating inefficiencies in the operation of the banking sector. The Working Group released a discussion paper in June 1993 which set out its preliminary recommendations in relation to the Act. The submissions on the paper strongly supported the Working Group’s view that the Act was largely redundant and should be repealed.

### III Non-transferable cheques

New provisions, sections 7B and 7C, have been introduced into the Cheques Act 1960 to provide for a non-transferable cheque. Under the new section 7B, where a cheque is crossed and bears across its face the words “not transferable” or “non-transferable”, or “account payee” or “a/c payee” either with or without the word “only”, it is recognised as being non-transferable. This will mean that the cheque is valid only as between the parties to it and cannot be transferred by the payee to any other person. In short, only the named payee can be credited with the funds represented by the cheque.

#### Delayed commencement

These new sections do not come into force until 1 January 1996. The delay is to allow time for the banking industry and the Reserve Bank to promote awareness and understanding of the new crossings. It is important for banks and cheque users to come to terms with the new crossings so that they are utilised effectively.

### Reasons for the change

One reason behind the change is to avoid the current confusion surrounding cheque crossings. It is widely believed that the crossings which are currently used prevent the transfer (ie endorsement) of a cheque. In fact this is not the case, and the law therefore provides less protection against fraud than cheque users expect.

The effect of crossing a cheque “not negotiable”, under section 81 of the Bills of Exchange Act 1908, is simply that no person to whom the cheque is endorsed has any better title to the cheque than the person transferring it. The addition of the words “account payee” or “account payee only” does not provide complete protection either. Although those words have gained some acceptance at common law, as constituting a valid direction to a bank to collect the proceeds of the cheque only for the payee’s account, they do not conclusively prevent a cheque from being transferred and are not recognised in the Bills of Exchange Act.

The new provisions will bring the law more into line with public expectations by providing unambiguous statutory recognition of a non-transferable cheque. However, the crossings currently recognised in the Bills of Exchange Act will not be abolished and cheque users will, therefore, retain the ability to write transferable cheques where this is desired.

Another reason for the reform is to prevent cheque fraud by making it more difficult to misappropriate cheques. Where a non-transferable cheque is stolen, a thief would not be able to obtain payment merely by forging an endorsement on the cheque to him or herself. Similarly, a third party, to whom the thief had fraudulently endorsed the cheque, would also be unable to obtain payment under it.

### Exception to non-transferability

The new provisions provide for one narrowly confined exception to non-transferability. It will be permissible to transfer a non-transferable cheque where

- it has been presented for payment and dishonoured by non-payment, and
- the transfer is for the purpose of recovering payment of the amount of the cheque.

This exception was considered to be justified to enable debt collecting operations to continue to operate effectively. Many retailers and other businesses rely on these services to enforce payments owing under dishonoured cheques.

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5 Banking Law Working Group (June 1993).
In these situations, payment is usually enforced by the debt collector taking a transfer of the dishonoured cheques and then re-presenting them or taking legal actions on them in their own name. These measures cannot be efficiently utilised unless the legal ownership in a cheque is effectively transferred to the debt collector.

It should be noted that there is no exemption in the legislation to allow lawyers, accountants, and other trust account operators to pay cheques made out to their clients into their trust accounts. Such an exemption was rejected largely because of the concern that it would unduly weaken the protection which non-transferability will give. For lawyers and other trust account operators, this will mean that they need to put in place arrangements which enable them to receive payments on behalf of clients where this is desired.

**Attempted endorsements**

The new provisions clearly set out the legal position where there is an attempted endorsement of a non-transferable cheque. If a bank ignores the endorsement and pays or collects the cheque into the payee’s account, the bank can, to that extent, successfully claim one of the statutory defences against liability contained in the Bills of Exchange Act. But if a bank pays or collects such a cheque in accordance with the endorsement, it is precluded from claiming a statutory defence.

In this respect the new provisions are more specific than the United Kingdom legislation on non-transferable cheques, the Cheques Act 1992 (UK), which is silent on the effect of an endorsement purporting to transfer a non-transferable cheque. The reason for the departure is that the UK legislation was thought to leave the position undesirably uncertain because it gives no guidance to banks on how to deal with a non-transferable cheque which has been endorsed. It was thought better for the legislation to state clearly that an endorsement is not effective to transfer a non-transferable cheque, thereby providing certainty for banks and also ensuring that there is no room for non-transferability to be undermined.

**Potential difficulties**

There may be initial teething problems with non-transferable cheques - for example, where the name of the payee is misspelt or a cheque is made out to the wrong payee. In some cases, the bank will be able to solve the problem by making inquiries of the drawer as to the correct payee. In other cases, it may be necessary for the drawer to write a new cheque. However, most of these problems can be avoided if cheque-users are properly informed of the new cheque crossings. In any case, the advantages of having a safer payment instrument should far outweigh any problems which do arise.

**IV Cheque truncation**

New provisions, sections 7D and 7E, have also been introduced into the Cheques Act to provide for the truncation of cheque clearing procedures. These sections came into force immediately upon enactment.

**Reasons for the change**

This change is designed to reduce the costs incurred by the banking industry and increase the efficiency of cheque processing. Banks have for many years undertaken the inefficient and costly exercise of transporting vast numbers of cheques to the bank branches on which they are drawn in order to make proper presentment of the cheques for payment. This was done because section 45 of the Bills of Exchange Act was regarded as imposing an obligation on the collecting bank to present the cheque physically to the paying bank for payment.

Under the new provisions there is no longer any need for physical presentment. Cheques may be presented by the collecting bank delivering the particulars of a cheque by electronic or other means to the paying bank. This will lead to significant cost savings and efficiency gains for the banking industry and should also benefit customers through shorter clearance times for cheques.

**Requirements for truncation**

Truncation is permitted between branches of the same bank as well as between banks. The main requirement is for truncation to take place through an inter-bank clearing system which is governed by written agreement between the relevant banks. Beyond that, the legislation is essentially permissive. There is no requirement to truncate. Accordingly, the details of how a system should operate, and how the risks and responsibilities should be allocated between the paying and collecting banks, have not been specified in the provisions. In order to provide flexibility these have been left for the industry to formulate.

**Duties and obligations preserved**

The new provisions make it clear that truncation does not alter the duties and obligations of the paying bank. There are three aspects to this. First, section 7E states that a paying bank will not be relieved of any liability, in respect of the payment of a cheque, merely because that cheque was cleared in truncation mode.
Second, the paying bank is under the same obligations, in terms of scrutinising the cheque and making inquiries, that it would have been under if the cheque had been presented physically. This means that, where a cheque has been presented in truncation mode, the bank will be treated, for the purpose of determining its liability, as if the cheque had been physically presented even though the bank has not actually sighted the cheque.

The third aspect is that section 7E makes it clear that the paying bank is not precluded from claiming one of the statutory defences to liability merely because of having agreed to a cheque being presented in truncation mode. The section states that the paying bank is not negligent and does not act otherwise than in the ordinary course of business by reason only of having determined that a cheque or a certain class of cheques be presented in truncation mode.

Right to request further information

In order to balance this preservation of liability, the paying bank is entitled to obtain further information about a cheque that has been presented electronically. The paying bank can require the collecting bank to provide it with the cheque itself or with further particulars about the cheque.

The effect of this is not to delay presentment of the cheque. Presentment will have already occurred when the particulars of the cheque were initially delivered through the inter-bank clearing system. However, where a request has been made the bank will have a reasonable amount of time to examine the cheque and make reasonable inquiries to determine whether it should be paid.

V Repeal of the Banking Act

Reasons for its repeal

The Banking Act 1982 was repealed on 30 June 1995. The Act imposed certain administrative requirements which were inconsistent with the open and competitive modern banking environment. While the requirements would have been necessary at the time the legislation was originally passed in 1908, when there were far fewer banks operating in New Zealand, most of the requirements no longer served any useful purpose. For the most part, the matters dealt with in the Banking Act are now adequately covered in other legislation, which is not specific to banks, such as the Companies Acts 1955 and 1993.

Requirements removed

The repeal of the Banking Act frees banks from unnecessary regulation and allows for more operational flexibilit-
oured. Consideration is being given to whether stage two should lead to the drafting of a comprehensive new Cheques Act, separate from the Bills of Exchange Act, rather than the necessary changes being implemented by way of amendments to the existing statutory framework. The Reserve Bank plans to undertake this second stage of the review in 1996.

Netting and statutory management

Prior to stage two of the cheques law review, the Bank intends to review the law affecting the legal enforceability of certain netting arrangements involving banks and other counterparties in the face of statutory management or liquidation. The Bank also intends to review its statutory management powers under Part V of the Reserve Bank of New Zealand Act 1989. It is expected that a discussion paper in relation to both these reviews will be released towards the end of 1995.

VII Conclusions

The enactment of the Banking Law Reform Bill was a significant contribution towards promoting a legal framework which is consistent with the sound and efficient operation of the banking system. The changes which have been introduced hold considerable benefits for banks, and for users of the banking system. For banks, the changes allow for cost savings, efficiency gains, and increased operational flexibility. For users of the banking system, the changes provide greater security against cheque fraud and the prospect of receiving quicker and more efficient banking services.

References


