LEGAL ASPECTS OF ELECTRONIC CLEARING AND SETTLEMENT

QUESTIONS AND ANSWERS

Question - George Weaver (Henry Davis York, Sydney):

I would just like to ask Alan a question about his perception of truncated internal presentment. I think you said, Alan, that as you understand it, it would be available, and I think you implied only where a cheque drawn on say Westpac is deposited by a customer of Westpac. I just wonder whether it does not have a bit more scope than that. As I recall the section says: truncated internal presentment occurs when a bank presents a cheque to itself either on its own behalf, on behalf of another financial institution or otherwise. And I just wonder, assuming Westpac receives a heap of cheques at the clearing house, whether it cannot then indulge in truncated internal presentment of those cheques to itself on the basis of *Barclays Bank v The Bank of England* saying that what the collecting bank does when it receives cheques at the clearing house and proceeds to take them to all the branches of domicile it is acting as agent for the collecting banks. Now that seems to me to be presenting them to itself on behalf of another financial institution. So I wonder whether truncated internal presentment cannot take place not only of cheques drawn on Westpac and deposited by a customer of Westpac, but also cheques drawn on Westpac, deposited with other banks and handed to Westpac at the clearing house?

Response - Alan Tyree (Speaker):

As usual, George, I think you are 100% right. But It is not so much the truncation provisions that do that, as the sections that allow you to specify the place where you can exhibit a cheque. And so Westpac, for example, can say for all of our branches the designated exhibition place is this room. And so, it is quite right, that would be due presentment under the Act.

Question - George Weaver (Henry Davis York, Sydney):

It has always seemed to me that truncated external presentment is where the collecting bank whizzes the signal direct to the drawee bank, but there would be considerable scope for truncation which I see to be of the internal variety even if you receive a heap of paper at the clearing house but take it no further then, than the drawee bank's own clearing office, which can then do truncated internal presentments for all that paper to all its branches, even though it began its journey as paper and got to the other side of the clearing house, and then truncation takes over to save the drawee bank having to then proceed to cart it all round Australia to the branch's domicile. If you agree that that is some scope for truncated internal presentment.

Response - Alan Tyree (Speaker):

I do agree with that. I think maybe we are using internal and external in ways that are slightly different from what the Act says though, because the Act is talking about internal presentment as a bank making a demand on itself. The sections are so roughly drafted, aren't they. It talks about a bank making a demand on itself, and it can make a demand on itself, and then it can require itself to send additional information, and so on. So that would seem again - I think you are right, but because of the definition of "proper place".

Response - Peter Smith (Speaker):

Without wanting to get into the legal discussion, most banks do in fact truncate paper that they receive at the clearing house. A few banks return their paper to the branch on which it is drawn, but most handle it at some central point, so that is in fact what happens now. They can do that quite legally.

Response - Alan Tyree (Speaker):

Before the new amendments that we were discussing, they may technically have been not presenting the cheque for payment. But there is no doubt that under the new amendments that it is presentment.

Question - Mark Sneddon (Monash University, Melbourne):

A couple of speculative questions on which I would be appreciative of some comments from both members. First of all, high value funds transfer has been legislated on in the United States to deal with problems not such as you have addressed, but the problems of possible consequential loss exposure of a bank to a third party because they did not make a payment on time and a contract has gone off and there are millions of dollars of consequential damages being claimed, and also to deal with the problem of interloper fraud where someone comes in and impersonates a customer and sends an electronic payment order to a bank, which the bank then acts on, and there are questions of mandate, and agency, and so on. Do we need legislation like that, in your opinion, to clarify those issues in Australia, given that the common law on those points is as yet untested and unclear? That is question number one.

The second question is, since there seems to be a policy of liberalising access to exchange settlement accounts by giving them now to non bank financial institutions outside the Reserve Bank umbrella. Can we think a little further into the future where say Telstra starts issuing stored value cards or various stored card issuers start issuing wider-ranging credits cards and so on, is it possible we might see exchange settlement accounts and direct clearing arrangements being opened up to non financial institutions altogether?

Response - Alan Tyree (Speaker):

In my opinion the first question of consequential damage - it probably would be wise to have some legislation. An American case held that a bank could not be responsible - *Evra v Swiss Bank* I believe. But to my way of thinking the reasoning in that case was seriously flawed at least in the common law context and I think there is a good argument that an institution could be liable for consequential damages and I think pretty clearly you do not want that to happen. There is a great benefit to be had in making the transaction costs as low as possible, I think, in the payment system which is one of the reasons why the new Internet payment methods are exciting, because you are talking about such very low transaction costs. So you do not want to expose the payment system to the risk of consequential damage I think. And you probably do need legislation.

Response - Peter Smith (Speaker):

It is difficult to talk about the provision of settlement accounts at the Reserve Bank. Clearly it is a matter for the Reserve Bank. But of course you have to jump a lot of prudential hurdles before the Reserve Bank is willing to provide an exchange settlement account, and usually the Bank would look to the institutions concerned being supervised in a particular way, and having stringent requirements in terms of capitalisation and in terms of their exposures. It seems most unlikely, in my view, that the Reserve Bank here, within the time period that we can think of, would be issuing exchange settlement accounts other than to financial institutions.

I suppose you could look at it a different way. It might be conceivable that somebody like Telecom would be allowed to establish a bank, for example. The Bank Shareholding Act, although I am not absolutely familiar with it - I think restricts ownership of a bank to 10% for any shareholder. Though I suppose you could, if you thought far enough into the future, imagine that there would be changes there which would allow major telecommunications companies to perhaps have a banking subsidiary which would then be separately supervised. I do not know, but I would not have thought that the option simply of an organisation like Telecom being issued with an ESA account is tenable.

Comment - David Clifford (Chairman):

Perhaps I can make one comment coming out of Alan Tyree's paper. He made reference in his presentation to section 16 of the Banking Act and the issues that arise from that provision - section 16(1) concerning pure set off issues where the section says that assets of a bank are available first to meet its deposit liabilities in Australia. The question is in a pure set off context does that mean that the amounts that are owed to the bank, being its assets, by an entity are free in an insolvency context of the requirement of the bank to perform under any obligations it might owe to the other entity as part of those assets? Alan in his paper makes reference to this difficulty and I would just like to take it up in this context. Firstly, to illustrate the importance of the general issue, similar kinds of issues arise for example in the Life Insurance Act. Yesterday Richard Coleman in his paper referred to the regulatory environment facing financial conglomerates. Well the Life Insurance Act contains a similar issue, because many of the provisions of the Life Insurance Act refer to assets of statutory funds that are set up. If there are policy holders under that legislation, insurance companies' assets are first available to meet liabilities to policy holders. So the same set off issue arises in that context as to what is the meaning of assets. Is it the assets free of the obligations to perform to the counterparty or is it the net assets, after applying the insolvency set off rules that Alan referred to. And it is quite an important issue which in a pure set off context, as I say, is not entirely clear. And there is another interesting element to it all and that is that section 553C of the Corporations Law dealing with insolvency set-off, is a piece of State legislation although it is in the Corporations Law because of the High Court view on the corporations power. Both the Banking Act and the Insurance Act are Commonwealth legislation. And also the Banking Act provisions were passed before the Corporations Law was passed and the Life Insurance Act 1995 was passed after the Corporations Law was passed, and it may give rise to Commonwealth power, State Power issues under presumably section 109 of the Corporations Law. So if it is not fixed up by legislation there could be some interesting issues in the future.

Despite the modest comments of our speakers, I think this session certainly for me has been an interesting one in dealing with difficult and important issues. So please thank our speakers.