

LECTURE No.9

INSTRUMENTS OF PAYMENT

Cash and cash instruments

The cashier's work consists in receiving cash and cash instruments such as cheques and other instruments ("documents of title to cash") in order to credit the customers' accounts.

Cash consists of:

Banknotes;

Coins;

Cash instruments such as cheques.

In modern banking practice, the name of the customer and his computer account number are pre-printed in the pay-in books to eliminate any error and to speed up transactions at the counter.

Procedure used by the Romanian banks:

- The cashier has to make sure that the name and account number of the customer is clearly indicated;
- Where counter pay-in slip is used by the customer (or non-customer), the cashier should check the correctness of the name and account number of the customer whose account is credited;
- The cashier must count the currency notes presented and sort them into different denominations;
- The cashier ticks against each item on the pay-in slip with a coloured pen or pencil and places the notes in his till.

Cash instruments ("documents of title to cash"):

Banker's drafts;

Conditional orders;

Dividend and interest warrants;

Bearer bonds;

Postal orders;

Unused traveller's cheques.

Cheque – definition, parties involved, endorsement, types of endorsement

A *cheque*¹ represents an unconditional order in writing addressed by one person to another who must be a banker, signed by the person giving the order, requiring the banker on whom it is drawn to pay on demand a certain sum in money to or to the order of a specified person or to the bearer.

More clarifications:

The person who draws the cheque is called the drawer;

The bank through the cheque is drawn is the drawee bank (paying bank);

The person to whom the cheque is drawn payable is called the payee or beneficiary;

When the drawer draws a cheque payable to himself, both the drawer and the payee are the same person.

The following items need to be verified by the receiving cashier:

If the Date is correct: Is the cheque post-dated or stale?

Post-dated: it means the cheque has been presented before the cheque date.

Stale: it means the cheque has been presented after six months of its date.

In both situations the cheque should not be cashed.

Payee (beneficiary):

When the cheque is crossed “A/C payee” or crossed to a particular account, such instructions must be implemented.

Content of the instruments:

When there are differences between the amount written in words and the amount written in figures, the amount payable is the one mentioned in words. Anyway, the bank is entitled to return the unpaid cheque marked “words and figures differ”. The paying bank has the right to ask its clients that their cheques are filled in clear and unambiguous terms.

Signature of the drawer:

The signature should be verified to ensure that it is complying with the copy of the signature card which is kept in the banker’s safe. The signature is a genuine one.

Endorsement³:

The endorsement of an instrument is the placing of a signature thereon by a person who thereby becomes a party to the instrument.

There are two types of endorsement:

1. *Blank endorsement:* no endorsee is indicated. Such blank endorsement converts the order cheque into a bearer cheque;

2. *Special endorsement:* the endorser specifies the person to whom the cheque is endorsed.

Usually, endorsements are written on the backside of the order cheque.

¹Kirițescu Costin - Relații valutare-financiare internaționale, Ed. Științifică și Enciclopedică, București, 1978,

Endorsement of part of the sum indicated on the cheque is irregular and invalid. An endorser can endorse the cheque payable to the order of more than one person.

The simplest and most obvious method is merely to send a cheque to the beneficiary in the other country. This has advantages for the drawer of the cheque who only incurs the postage costs and bank charges when the cheque is debited.

However, if the cheque is used in payment for goods, their delivery may be delayed while the payee of the cheque waits for it to be cleared. It is possible to issue a cheque in the relevant currency if the drawer maintains an account in that currency.

Now let's try to be in the position of the payee who suffers the following:

The cheque will often be drawn in the drawer's currency, thereby imposing an exchange risk on the payee;

The payee's bank may insist on collecting the proceeds of the cheque before crediting the bank account, thereby delaying the receipt of the funds by as much as a month. This delay, of course, favours the drawer;

The payee will also incur some, if not all, of the expenses of the collection process;

The cheque may not be paid.

In order to avoid some of these problems, beneficiaries can insist that:

- *Cheques are drawn in their own currency.* This transfers the exchange risk back to the drawer but does not really solve any of the other problems highlighted;
- *Payment is made by means of Banker's draft.*

This requires the remitter to give instructions to a bank to issue a draft, which is a type of cheque, drawn in the appropriate currency on a bank abroad. So, *a bank draft is in effect a cheque drawn by one bank on another.*

This may be one of its own subsidiaries or associates or a correspondent bank. For the payee this method solves the exchange risk problem, guarantees payment as the draft is drawn on a bank, and removes the delay in the collection process.

The process of the Romanian cheque under the Law no. 59/1934 concerning the cheque, with the subsequent amendments

Introduction

The cheque is an instrument of payment used by the banking accounts holder with available funds into these accounts. The available funds are a result of a bank deposit, collecting proceeds or a credit.

The cheque is an instrument of payment, which connects three persons:

- the drawer; It is the person who makes out the instrument, being the holder of the banking account.

- the drawee; It is always the bank where the drawer has an account opened with. It will pay the presented cheque only if the drawer has enough availability in his account.

- the beneficiary (payee). It is the person who will receive the money.

This person can be a third person or the drawer himself.

The instrument is made out by the drawer, who by virtue of a deposit in a bank, gives an unconditionally order to that bank (the drawee) to pay a determined sum of money to a third party (or to the drawer himself), who is the beneficiary.

In the process of the cheque the drawer issues the cheque, the legal owner cashes it and the drawee pays the cheque.

In order for the drawer to issue cheques, the bank must deliver to its client a blank passbook.

The owner of the cheques fills in the blank cheque, signs and delivers it to the beneficiary, who will present it to his bank for cashing it.

In order to be valid, the cheque has to contain the following compulsory mentions¹⁰:

the name "Cheque" written in the text of the instrument;

the unconditional order to pay a certain amount of money;

the name of the drawee, respectively the bank where the drawer has an account opened with;

the place of the payment, respectively the locality and the address of the bank where the payment is made;

the date and the place of the issue of the instrument, respectively the day, month, year, as well as the name of the locality;

the signature of the drawer.

The transmission of the cheque

The transmission of a cheque can be:

a) by *simple remittance*; it is the case of the cheque payable to the bearer, which in the moment of issue doesn't show exactly the beneficiary and bears the mention "cheque payable to bearer". This kind of cheque is payable to the beneficiary, or to the bearer of the cheque.

b) by *ordinary transfer of debts*; it is the case when the cheque is issued for a specified person and it has the mention "not to order"; only the authorised person can enact the cheque.

c) by *endorsement* - it is the operation by which all the rights of the cheque are sent with the remittance. It has a special mention on the backside of the cheque in the favour of somebody, including the drawer. The new beneficiary can, on his turn, endorse the cheque.

The payment of the cheque

The cheque is payable only at sight/at presentation.

In Romania, the cheques are issued and payable at the following terms:

- 8 days, for the cheque payable in the same place it was issued;
- 15 days, in any other cases.

These terms are calculated from the subsequent day of the issuing date of the cheque.

The presentation of the cheque after the expiring of the legal term will cause the loss of the right for a legal action against the previous endorsers if the cheque wouldn't be paid.

All the persons who obliged themselves in any way by the cheque (drawer, endorsers) are jointly and severally responsible for paying that cheque, although the obligations had been assumed at different moments.

Types of cheques

The main types of cheques used in Romania are:

- a) the *cheque payable to bearer*. It is the instrument, which has in the text the special mention "to bearer" or "payable to bearer" or is has no mentions.
- b) the *crossed cheque* - the drawer or the owner of a cheque can make a cross by drawing two horizontal or crossed parallel lines on the side of the cheque; meaning that the beneficiary has to ask for a bank's services in order to cash the sum written on the cheque.

The **cross** can be:

- **general** - there is no special mention between the two lines;
- **special** - between the two lines is specified the name of the bank.

The general cross can be transformed into a special cross.

c) *certificate cheque* - by this kind of cheque the bank (the drawee) confirms on the cheque the existence of the necessary fund for payment and the person who issued the cheque (the drawer) can not withdraw funds from his account until the end of the submitting period.

d) *Traveller's cheque* – in this case, the drawer can condition the payment of this cheque upon the identity between the signature of the person who got the cheque (the possessor) and the signature of the person who cashes it at submitting. In fact, the possessor puts his first signature on the cheque in the moment he buys it; the second time, he signs it in the moment of cashing the cheque, in the presence of the banking clerk, or in the moment of the payment in the presence of the beneficiary. This kind of cheque is an easy and safe mean of payment.

The role of the banks

When the clients of a bank (drawers) issue cheques, these have to be presented to the bank (the payee bank) to be paid. The bank has the obligation to pay the cheques in favour of its clients in the following conditions:

- the client has enough money in his account;
- the cheque was drawn correctly and signed by the client (the drawer);
- there is no any other legal reason for the bank not to pay.

The beneficiary bank has the obligation to collect the cheques from its own clients for encasement. The bank will remit the cheques to payment.

Financial documents

The **Bill of Exchange and the promissory note** are negotiable instruments; the cheque is an instrument of payment.

Parties to the transaction:

There are three parties involved: the drawer, the drawee and the payee/beneficiary.

The bill of exchange is made out by the drawer (creditor), who gives an order to his debtor called the drawee, to pay a certain amount of money, at a determinable future time either to a payee or to the order of this payee.

In Romania, the Bill of Exchange is regulated by the provisions of the *Law no 58/1934 concerning the Bill of Exchange and the Promissory Note*.

Under this law, there are some mandatory items of the Bill of Exchange:

- the denomination “bill of exchange” in the title of the text;
- an unconditional order to pay a certain amount of money;
- the drawee;
- the maturity date;
- the place where the payment will be made;
- the drawer;
- the date and place where the bill was issued;
- the signature of the drawer;

Under *the British law*³ *the Bill of Exchange or the Draft* (the two words are synonymous) is:

- an unconditional order in writing;
- addressed by one person (the drawer);
- to another (the drawee);
- signed by the person giving it, meaning the drawer;
- requiring the person to whom it is addressed (the drawer);
- to pay;

on demand or at a fixed or determinable future date;

a certain sum of money;

to, or to the order of, a specified person (the payee), or to Bearer.

The words “on demand” mean “at sight”, requiring the drawee to honour the bill when it falls due.

The bill could be payable on a fixed future date or a determinable future date.

For instance, a bill payable at “90 days sight” means that it is payable 90 days after presentation.

- The drawee “accepts” the bill by signing on its face, thus agreeing to pay at that future time.
- The bills can be transferred by endorsement. Endorsement is the signature of the person who transfers the bill. (It is written on the back of the bill).
- The Bill of Exchange drawn on the advising bank can be discounted.

The bank (exporter) can purchase the bill at less than its face value, giving the proceeds to the exporter. The bank can hold the bill until maturity, or rediscount it.

The Bill of Exchange is an instrument of credit and an instrument of payment; it is used under a L/C or bill of collection.

The Promissory Note

There are two parties involved: the issuer and the beneficiary/payee. The Promissory Note is created by the issuer as a debtor who is obliged to pay a certain amount in money at a certain time or at the presentation of the payee called creditor.

Under the provisions of the Law no 58/1934, the *Promissory Note includes the following elements*:

- The denomination promissory note in the title of the text;
- The unconditional promise to pay a fixed amount of money;
- The maturity;
- The place where the payment will be made;
- The name of the person who gives the order to pay;
- The date and place of the issuing of the Promissory Note;
- The issuer’s signature.

SWIFT

These initials stand for the *Society for Worldwide Interbank Financial Telecommunication*, which is an international organisation whose members consist of several hundred of the largest international banks. The society, which was created under Belgian Law and located in Brussels, was formed to accelerate the transfer of funds and other messages between the member banks.

The system works by means of a telecommunication link between the computer systems of the banks, which allows the rapid transmission of messages. The system is used to execute telegraphic

transfers previously sent by cable or telegraphs and may also be used for international payment orders/airmail transfers at the discretion of the bank, making for a much faster execution of a customer's instructions. When instructions are transmitted in this way the bank is said to be sending *a SWIFT message* and for telegraphic transfers the phrase used is *urgent SWIFT message*.

SWIFT processes information (i.e. data, text, or commands) in the form of messages. From the user's point of view, messages are sent either:

From one user to another (e.g. Normal banking messages such as a customer transfer); or

From a user to the system (e.g. Requests for information such as a retrieval request); or

From the system to a user (e.g. Responses to requests, such as a retrieved message).

A message can consist of one or more headers, which contain reference information for the message, a body which contains the text of the message, and one or more trailers, which are added for control purposes.

Messages are seen from the point of view of the SWIFT system. All messages introduced into the system by a user are referred to as input messages; all messages, which the system delivers, to a user are referred to as output messages. A three-digit number, e.g. MT 100 represents messages, where the first digit defines the message category, indicating the general usage of the message. There are nine categories of user-to-user messages, identified as categories 1-9, and a separate category for messages exchanged between a user and the system, identified as category 0.

Security at SWIFT meets four objectives:

Confidentiality – information is only disclosed to authorised persons at authorised locations;

Integrity – information can be relied upon to be complete, accurate and valid;

Availability – information and associated services are accessible and usable when needed;

Accountability – every individual authorised to use the system is accountable.

Confidentiality and integrity are ensured by means of security of transmission, delivery and message storage; by validation of messages; and by user-to-user authentication.

The various system functions of SWIFT are separated into a well-defined hierarchy, with each level of the hierarchy controlled by a particular computer. A global communications network links all of Swift's computers so that they are in constant communication with each other. All processors have at least one standby processor.

A unique ISO Bank Identifier Code (BIC) identifies financial institutions.

BIC's are published in the SWIFT BIC Directory. The first 8 characters of the BIC, when used for addressing purposes, are called the destination; it is made up as follows:

Bank (Financial Institution) Code 4 characters

Country Code 2 characters

Location Code 2 characters

The bank code, country code and location code are mandatory components of a BIC. In addition, an optional branch code of 3 characters can be used to identify any branch of a user institution. If no branch code is defined, the default of “XXX” is used for addressing purposes.

There are three main types of SWIFT message:

- **System Messages** (MT category 0) – which may relate to either the sending and receiving of messages (e.g. User-to-SWIFT message, Delivery Notification, Retrievals), or to some aspect of an user’s logical terminal (LT) or destination;
- **User-to-User Messages** (MT categories 1-9) – which enable users to perform financial transactions;
- **Service Messages** (or Control Messages) –, which relate either to system commands or to acknowledgements”.

The SWIFT system normally processes user-to-user messages on a First-In- First-Out basis.

User-to-user messages fall into distinct categories to be used for different types of financial transactions. A 3-digit number identifies individual types of messages (MTs). The first digit identifies the category of the message.

There are 9 categories of financial messages. Each category referring to a different general usage:

Category 1 Customer transfers

Cheques

Category 2 Financial institution transfers

Category 3 Treasury markets & Derivatives

Foreign exchange, Forward rate agreement etc

Category 4 Collections

Cash letters

Category 5 Securities

Category 6 Precious metals & Syndication’s

Category 7 Documentary credits

Guarantees

Category 8 Traveller’s cheques

Category 9 Statements, Reports etc.

All SWIFT messages conform to a defined block structure. Each block of messages contains data of a particular type and is used for a particular purpose.

SWIFT offers round the world, round the clock expert support to its customers, covering administrative, operational and technical matters.

Support is available 24 hours a day, seven days a week and in many languages.