LAW RELATING TO MODES OF PAYMENTS IN THE BANKING SYSTEM OF PAKISTAN

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ABSTRACT

A Bank is a financial intermediary whose core activity is to provide loans to borrowers and to collect deposits from savers. In other words, Banks act as intermediaries between borrowers and savers. By carrying out the intermediation function, banks collect surplus funds from savers and allocate them to those (both people and companies) with a deficit of funds (borrowers). In doing so, they channel funds from savers to borrowers thereby increasing economic efficiency by promoting a better allocation of resources. Deposits typically have the characteristics of being small size, low risk and high liquidity. Banks bridge the gap between the needs of lenders and borrowers by performing a transformation function such as size transformation, maturity transformation and risks transformation.

Keywords: cheque; plastic cards; credit transfer; standing orders; payment

1. Introduction

Banks traditionally differ from other financial intermediaries for two main reasons: (i) banks liabilities (i.e., deposits) are accepted as a means of exchange; and (ii) banks are the only intermediaries that can vary the level of deposits and can create and destroy credit. Modern views on financial intermediation indicate as a crucial function of financial intermediaries the transformation of primary securities issued by firms (deficit units) into secondary securities that are more attractive to surplus units. Modern banks offer a wide range of financial services, including:

- Payment services
- Deposit and lending services
- Investment pension and insurance services
- E-banking.

An important services offer by banks is that they offer facilities that enable customers to make payments. A payment system can be defined as any organized arrangement for transforming value between its participants. The jurisprudence about the meaning of banking has arisen in three contexts. The first revolves around regulation. Secondly, some legislation confers a privilege or protection on " banks" without defining them, and the issue becomes whether a particular body can take advantage of it. Thirdly, those seeking to avoid a payment obligation have occasionally argued that it arose on an illegal contract, which is void or unenforceable because it is owed by or to an unlicensed bank.

Payment and banking go hand-in-hand. Except for small value transactions, where cash, credit cards, and e-money are used, payments are typically made through the banking system. The payment network may be bilateral or multilateral. Correspondent banks clearly enter bilateral contracts with each other. Three basic elements of banking payment through the banking system deserve to be highlighted. The first is the payment messages in this context are unconditional instructions to effect payment in favour of a payee. Traditionally payment messages were paper based, but outside the realm of cheques and payments card are now conveyed electronically. A second basic element of payment through banking system is that it simply involves movements on accounts. Obviously the customer's account is debited, and the payee credited. Payment through the banking system, whether by credit transfer, direct debit, cheque, or other means involves a movement on accounts affected, of course, following receipt of a payment message. A third basic element of payment through the banking system is settlement. By 'settlement' is meant payment between the banks themselves of their obligations inter se, arising out of a payment. Settlement may follow each payment or it may occur periodically through the netting of a series of payments either between two banks or among number of banks. Movement on accounts which both banks have with a third bank, but it typically affected that a bank by movement on the accounts can effect settlement which bank have with a central bank. So payment methods are the instruments, procedures, and institutions, which enable users to meet payment obligations. The payment methods are either paper based, electronic, or a combination of both.

At domestic level, the main types of payments for individual or personal customers are cheques, made by writing from their current accounts or via debit or credit card payments. In addition, various other payment services are provided including giro (or credit transfer) and automated payments such as direct debits and standing orders. Payments services can be either paper based or electronic and an efficient payments system forms the basis of a well-functioning financial system. In most countries the retail payments systems are owned and run by the main banks.

2. Formal Modes of Payment

i. Cheque

Cheques are widely used as a means of payment for goods and services. Cheque payment is known as debit transfers because they are written requests to debit the payee's account.

ii. Credit Transfer

Credit transfer (or Bank Giro Credits) is payment where the customer instructs their bank to transfer funds directly to the beneficiary's bank account. Consumers use bank giro transfer payments to pay invoices or to send payment in advance for products order.

iii. Standing Orders

Standing Orders are instructions from the customers (account holder) to the bank to pay a fixed amount at regular intervals into the account of another individual or company. The bank has the responsibility for remembering to make these payments. Only the account holder can change the standing orders instructions.

iv. Direct Debit or Plastic Cards

The supplier that supplied the goods/services originates direct debits and the customer has to sign the direct debit. The direct debit instructions are usually of a variable amount and the items at which debiting takes place can also be either fixed or variable. If a payment is missed, the supplier can request the missed payment on a number of occasions. If the payments continually missed over a period of time, the customer's bank will cancel the direct debit. Many retail customers pay utility bills in this way.
Plastic Cards include credit cards, debit cards, cheque guarantee cards, travel and entertainment cards, shop cards and 'smart or chip' cards. Technically, plastic cards do not act themselves as a payment mechanism, they help to identify the customers and assist in creating either a paper or electronic payment. All the main banks and building with branch networks issue their personal customers with plastic cards (cash cards) which can be used to withdraw cash from cash dispensing machine, or automated tell machine (ATMs) situated within or outside of bank branches and in public places. The amounts withdrawn from ATMs are debited automatically to the account of customers whose cash cards were used for the withdrawals.

v. Electronic Payment Transfer System

Other Electronic Payment Transfer Systems (EFT) also refers to electronic payment systems such as BACS, CHAPS, SWIFT and EFTPOS. Bankers Automated Clearing Services Limited (BACS) is a clearinghouse through which credit or debit payments may be made electronically. The Clearing House Automated Payment System (CHAPS) is operated by a company, which like the BACS COMPANY, is owned by the major clearing banks. CHAPS can only be used for 'irrevocable guaranteed unconditional sterling payment for same day settlement in amount of 1000 pounds or more. Electronic Funds Transfer at Point of Sale (EFTPOS) may be defined as a consumer payment system which enables a customer of a bank to pay for goods and services by direct and immediate transfer of bank account of the party supplying the goods or services (the retailer). The Society for Worldwide Inter bank Financial Telecommunication (SWIFT) is not a funds transfer system; it facilitates the international transfer of funds through the use of a secure and reliable international communications network. Credit transfers are a vital means of payment cross-border. At the retail level payment cards, which have just been considered, are also prominent in cross-border payment but apart from aforesaid payment methods the following modes of payment may also be used:

(a) The use of cheques and drafts;
(b) London Currency Clearing;
(c) Travelers' Cheques
(d) Letter of Credit.

3. Banking Laws

The State bank of Pakistan is a central bank, which was established under the State Bank of Pakistan Act, 1956. The other banking Companies in Pakistan were established under the Banking Companies Ordinance, 1962. The State Bank of Pakistan plays a pivotal role for the establishment and supervision of schedule banks. The Financial Institutions (Recovery of Finances) Ordinance, 2001 provides the legal structure and procedure for the recovery of finances. The legal structure about payment services methods in Pakistan is very complicated. The Negotiable Instrument Act, 1881 regulates the instruments regarding payments service and their formation. According to said Act, negotiable instruments mean promissory note, bill of exchange or cheque payable either to order of bearer. A bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay on demand or at a fixed or determinable future time a certain sum of money only to, or the order of certain person or to the bearer of the instrument. Section 6 of the Act defined that a cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand. In default of the payment of any negotiable instruments, the Order 37 of the Code of Civil Procedure, 1908 provides the summary procedure for the recovery of payment on negotiable instruments. In 2002, the legislature amended the Pakistan Penal Code and added the new Section 489-F, now dishonoring of cheque is a crime and accused may be punished to the extent of three years or fine or both.

The Electronic Transactions Ordinance, 2002 came into force in 2002, which provided the legal structure for the payments through electronic transactions. The electronic development brought the change in payment methods to banking services of Pakistan, then the Payment System and Electronic Funds Transfer Act, 2007 was implemented to regulate the modern mode of payment in Pakistan. The State Bank of Pakistan is playing a key role to supervise and control the advance payment transactions by Banking companies within or cross-border.

4. Review of Literature

According to Andrew Landlaw and Graham Roberts, negotiable instrument include bank notes (currency of the realm), promissory notes, bill of exchange, Cheque (except crossed that not negotiable), banker's draft, bearer bonds, certificate of deposits, commercial paper and eurobonds. Heffernan defines the payments system as by product of the intermediation process as it facilitates the transfer of ownership of claims in financial sector. These payments flows reflect a variety of transactions: for goods and services as well as financial assets. Some of these transactions involve high value transfers, typically between financial institutions. Lord Denning said that there are, therefore, two characteristics usually found in bankers today: (i) they accept money from, and collect cheques for, their customer and place them to heir customer; (ii) they honour cheques or order drawn on them by their customer accordingly; (iii) they keep current accounts or something of that nature in their books in which the credit and debits are entered.

Ross Cranston writes that payment through the banking system can be broadly categorized as in-house, domestic, correspondent, and complex. An in-house payment occurs when both payor and payee have accounts at the same bank. The payor's account is debited and the payee's account is credited. By domestic payments is meant payment in the local currency between banks in the same country and settlement can be across the books of that country's central bank.

Traditionally, correspondent payment occurred because of payment between those in different jurisdictions. With a credit transfer the payer's bank will send a payment message to its correspondent in the jurisdiction of payee's bank. The correspondent will, in turn, send a payment message to the payee's bank. In the realm of complex payment, where payment is in a foreign currency and there is a string of banks. An intermediaries bank may be needed where, for example, the payor's banks does not have a correspondent in the jurisdiction of the payment currency. Annu Arora said that the uses of plastic cards in payment process have revolutionized the payment industry. The first charge card was started in America and was designed for businessmen to charge meals to their expense account, although its use and function have been overshadowed by the credit card. Barclaycard was the first credit card to be launched in the UK, in 1996.

5. Conclusion and Recommendations

In Pakistan, the law relating to methods of payments is not always clear and even complicated. Nor does it always provide guidelines on how issues relating to be determined. There are some conflict and confusion between the lawyers and banking authorities about whether the resolution of dispute in this area is an issue of law or of banking practice. The laws relating to method of payment, the term of transfer, and the relationship between banks need clarity and reforms. At the International level the International Chamber of Commerce (ICC) has had uniforms rules for collections since 1956, designed to codify good banking practice in relation to documentary collection. At present with international credit transfers, different system of municipal law may govern different parts of transaction and they need reforms to provide consistency with international laws, for example, the law of payer bank, the law of any intermediate banks, the law of settlement systems and the law of payee. However, the highest number of transactions relate to transfers between individual and companies. If any of these circulation systems failed, the functioning of large and important parts of economy would be affected. The law, at present, provides no clear answer.

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