

Finality Rules within the Law of Domestic Large Value Renminbi Electronic Funds Transfers (EFT) in China

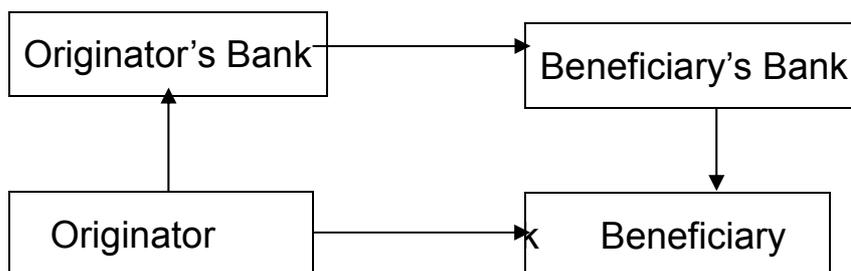
Wen Li

PhD candidate, Centre for Commercial Law Studies, Queen Mary University of London
liwen830409@hotmail.com, & wen.li@qmul.ac.uk

Explanation of the topic

Prof. Liu Ying (刘颖), Deputy Prof. Chen Jian(陈健), and Dr. Wang Shuqian(王蜀黔)¹, who are the three leading EFT law scholars, have explained or translated foreign EFT law (primarily Uniform Commercial Code Article 4A, Regulation E, Regulation J, Electronic Funds Transfer Act, and UNCITRAL Model Law on International Credit Transfers) into Chinese in great details, and described various electronic payment mechanisms precisely. Yet, they have not clearly proposed the EFT legal framework for China, which is something that the author plans to do in his thesis. In this paper, the author will focus on discussing finality rules within the law of domestic large value Renminbi (literally, People's Currency) electronic funds transfers in China. The reason why the topic is constrained to "domestic", "large value", and "Renminbi" EFT is because first, international EFT involves private international law issues that has been distributed in chapter 4 of the thesis which exclusively deals with cross-border issues. Second, small value EFT requires different rules from large value EFT, because, (1) both debit and credit transfers are needed to make a small value system fully effective; (2) that small value transfer systems need to be far less costly per transfer; and (3) because small value transfers do not necessarily need to provide immediate value (real-time) payment, there may be commercial justifications for building in some delay (this gives the banks use of the float, and profits from that use can in part fund the system)². Third, China's domestic payment system, which is like pretty much all domestic payment systems everywhere, can only settle Renminbi business other than any other foreign currencies at present.

1. Basic model of domestic large value Renminbi electronic funds transfers



This chart reflects the basic model of domestic large value Renminbi electronic funds transfers (inter-banks). The communication of information flow and funds flow is like this:

¹ Their representative publications in Chinese are "Legal issues research on electronic funds transfers", (Law Press China, 2001); "Research on the law of electronic payment", (China University of Political Science and Law Press, 2006); and "Legal issues research on electronic payment" (Wuhan University Press, 2005) respectively.

² This explanation was kindly suggested by the author's supervisor, Prof. Chris Reed, and the whole paper has been carefully commented by Prof. Reed. The author is expressing his appreciation here.

First, the originator initiates a payment instruction to the originator's bank;
Second, the originator's bank *receives* the payment instruction;
Third, the originator's bank *accepts* the payment instruction;
Fourth, the originator's bank *debits* the originator's bank account in accordance with the payment instruction;
Fifth, the originator's bank issues a payment instruction to the beneficiary's bank;
Sixth, the beneficiary's bank *receives* the payment instruction;
Seventh, the beneficiary's bank *accepts* the payment instruction;
Eighth, the China National Advanced Payment System (CNAPS)³ clears this transaction accordingly.
Ninth, the beneficiary's bank *credits* the beneficiary's account.

In the cases of intra-branch transfers and inter-branch transfers, no CNAPS involves in the payment process, but the procedural is the same as the inter-banks transfers.

After introducing the payment mechanism, it is time to turn to the legal analysis of the topic----"finality".

2. Deciphering the term "finality"

EFT law scholars frequently ask a question regarding finality in EFT like this: "when does a payment become final?" At first sight, it is a very good question, which conceals legal issues on the time of payment in EFT transaction; however, this question is imprecise. The precise enquiries in respect of finality in EFT law, suggested by the author, would be first, in respect of whom are we asking whether a payment becomes final? Second, at what stage does a payment *to that person* become final? Third, what are legal consequences arising from a finalized payment? Fourth, what the finality rule is or should be in China's EFT law? Those questions will be answered in the following analysis.

(1) To whom does a payment become final in law----the targeting parties

There are at least⁴ two targeting parties that have to be taken into account, which are the originator and the beneficiary. For the originator, a finalized payment means the originator (or the originator's bank and any intermediary banks, if any) is not entitled, in law, to revoke (the motion "revoke" here encompasses the meaning of "reverse", "cancel", "modify", and "change") the payment instruction which has been sent to his bank. In other words, when a payment for the originator reaches the final stage that the originator cannot revoke his payment instruction; we say that the payment is final for the originator. In this sense, a finalized payment for the originator is a synonym of irrevocability.

However, the irrevocability of payment instruction for the originator does not necessarily mean the payment process to the beneficiary is finalized as well. For the beneficiary, a finalized payment means the payment obligation⁵ owed by the originator to the beneficiary, in law, has been discharged.

Based on above analysis, we should be able to tell the meaning of distinguishing the targeting parties, namely, to whom a payment becomes final.

Furthermore, it can be observed that the point in time when a payment becomes final for the originator could be different from the point in time when a payment becomes final for the beneficiary. One thing for sure is that the point in time that a payment becomes final for the

³ China's payment systems consist of China National Advanced Payment Systems (CNAPS) (the most important system), regional (cities and counties) payment systems (LCHS), and commercial banks' intra-bank payment systems. CNAPS is the main body responsible for domestic large value Renminbi electronic funds transfers.

⁴ Apart from these two targeting parties, the originator's bank, beneficiary's bank and any intermediary banks (if any) are all capable to revoke payment instructions, and therefore, could be treated as the "targeting parties" as well.

⁵ The payment obligation should be distinguished from underlying obligation owed by the originator to the beneficiary.

beneficiary cannot be earlier than the point in time that a payment becomes final for the originator. Because, as long as the originator is in the position of being entitled to revoke his payment instruction, the beneficiary is constantly bearing the risk that the payment might be cancelled or subject to any changes, which means this payment *cannot* be final for the beneficiary.

(2) Distinction between payment finality and settlement finality

Following the last paragraph, it is also necessary to distinguish payment finality and settlement finality.

Payment finality occurs when the payment instruction given by the sender⁶ to the recipient⁷ becomes unconditional. When the payment instruction becomes unconditional it ceases to be revocable⁸.

However, payment finality does not conclude the relationship between the sender and recipient. The relationship comes to an end only when the payment has become settled, namely, the settlement finality.

In a domestic large value Renminbi EFT, settlement finality can either be concurrent or subsequent to payment finality. In the event that payment finality and settlement finality are not concurrent, the beneficiary may face uncertainty even if the payment has been finalized, because the account terms allow the beneficiary's bank to deduct unsettled payments from the beneficiary's account.

To some extent, "payment finality" focuses on the description of "payment instruction"; whilst "settlement finality" focuses on the description of "funds".

After explaining the complex meanings contained in the term "finality", the author is attempting to propose the finality rules for China from the perspective of law.

3. Proposed finality rules in law for China

(1) Time of finality

In the context of time of finality, at least two questions shall be examined, "until when does the sender lose the right to revoke their payment instructions? (in other words, when does a payment become final for the senders)" and "until when has the payment obligation owed by the originator to the beneficiary been discharged (in other words, when does a payment become final for the beneficiary)?"

The first question actually, has been referred in the "Measures on domestic large value payment system (trial)"⁹ This Measures, from the perspective of banking practice, stipulate when a payment becomes irrevocable for senders:

Article 23, a payment transaction, initiated by originator's bank or chartered participant, can be cancelled by sending cancellation request to the large value

⁶ Here, "sender" is a collective appellation, which could be any party who sends out his payment instructions.

⁷ Likewise, "recipient" is also a collective appellation, which could be any party who receives payment instructions from the sender.

⁸ Razeen Sappideen, "Cross-border electronic funds transfers through large value transfer systems, and the persistence of risk", *Journal of Business Law*, 2003, NOV, 584-602, p. 591. Available in Westlaw.

⁹ In 2002, People's bank of China (PBoC) issued "Measures on domestic large value payment system", On the purpose of bridging and giving attention to both the traditional paper-based payment mechanism and the emerging electronic-based payment mechanism, this Measures applies to both systems, rather than exclusively targeting the EFT side. This measures clarified that five categories of financial institutions are under regulation, namely, banks which are undertaking large value payment businesses within the territory of People's Republic of China, urban credit cooperatives, rural credit cooperatives (collectively called banks thereafter), chartered institutions and their system operators.

payment system. National Process Centre (NPC) bears the responsibility to cancel the payment immediately as long as the fund has not been cleared yet; once it has been cleared, no cancellation applies any more.

And:

Article 24, a payment withdrawal request has to be sent to the large value payment system. The receiving bank bears the responsibility to reverse the fund as long as the beneficiary's bank account has not been credited. If the beneficiary's bank account has been credited already, the originator's bank needs to inform both originator and beneficiary to negotiate and reach an agreement if the withdrawal request was initiated by the originator; on condition that the withdrawal request was initiated by the originator's bank, then such agreement shall be made between the originator's bank and receiving bank by negotiation.

Literally explaining, those two rules made a distinction between cancellation of payment and withdrawal of funds by establishing two demarcation points in time: namely the point in time that the National Processing Centre (NPC) has already cleared the payment instruction, and the point in time that the fund has been credited to the beneficiary's account. The first demarcation point in time is the finalized time for all payment instruction senders, and the second demarcation point in time is the time of settlement finality. Whether a payment can be cancelled (or in another word, revoked) or not, is solely based on whether the NPC has cleared the fund accordingly. Whether a finalized payment can be withdrawn or not, is partly based on whether the beneficiary's account has been credited, and also partly based on whether the two parties (either between originator and beneficiary, or between originator's bank and beneficiary's bank, depending on originally who initiated such a withdrawal instruction) could reach an agreement to withdraw such amount of fund.

Therefore, Article 23 has answered when a payment becomes final for senders, the criterion is whether the NPC has cleared the fund. Although it might be an experience summary from payment practice or merely out of banking convenience, it seems to be very much fit for China's current circumstance.

When it comes to the second question, when does the payment become final for the beneficiary, the author would suggest the future China's EFT law stipulates that:

“a domestic large value Renminbi EFT becomes final for the beneficiary after the time that the beneficiary's bank decides to accept the payment instruction for the benefit of the beneficiary¹⁰”;

also

“a domestic large value Renminbi EFT can still become final for the beneficiary notwithstanding that the amount of the payment instruction accepted by the beneficiary's bank is less than the amount of the originator's payment instruction because one or more intermediary banks have deducted charges or any other reasonable fees¹¹”.

The reason why the author chooses the time that “the beneficiary's bank decides to accept the payment instruction for the benefit of the beneficiary” is because, in most cases of large value credit transfer, the beneficiary's banks are chosen and appointed by the beneficiaries themselves. Therefore, it is reasonable for the law to allocate relevant risk to the beneficiary. Those risks encompass the risk that the beneficiary's bank fails to fulfill its obligation to credit

¹⁰ Scholars might suggest that this point in time is not decisive enough, which needs to be something objective or evidenced, for instance, maybe when it notifies NPC that it accepts; or if no notification in the system, a fixed period after NPC notifies B's bank that the payment is being made. The author would suggest that the EFT law leaves this detail out banking custom or practice, since the technology innovates with such a high speed, and banking custom never stops from changing, an over rigid stipulation might negatively affect the payment technology innovation.

¹¹ This article is similar to Art. 19 (2) of UNCITRAL Model Law on International Credit Transfer.

the fund to the beneficiary's account, the risk that the beneficiary's bank becomes insolvent, the risk that the beneficiary's bank accepts the funds contrary to the originator's instructions, and any other risk that could cause the result that the fund is unavailable to the beneficiary¹².

Such analysis reflects an important principle in law, which is "one should bear the risk that is caused by his own choice", or "who chooses it, who bears it".

The reader might be asking, could it be that the beneficiary is entitled to escape from such risk in case that the beneficiary's bank is not designated by the beneficiary himself. For instance, the beneficiary has to collect the fund in the beneficiary's bank which is appointed by a third party, and the beneficiary has no options at all. This scenario, however, would be very rare in modern commercial world, and the law should be emphasizing on regulating mainstream and representative circumstance, rather than paying attention to every extreme side of a matter. In the second article proposed by the author, deducted charges or any other reasonable¹³ fees will not prevent a payment from becoming final for the beneficiary, because some banks and financial institutions would charge administrative fee from the fund that they are undertaking to transfer, and the beneficiary may receive an amount of fund which is slight less than the amount initially sent by the originator. If the EFT law insists on the consistency of amount while cognizing finality, it will obviously discourage and obstruct transactions, which runs in the opposite direction of making EFT law—facilitating EFT transactions.

(2) Legal consequences of the finality of the whole payment process

What are the legal consequences when the whole payment process becomes final?

The author proposed two important legal consequences in two articles (although the second article should be deleted eventually, it is still useful for discussion):

"When a domestic large value Renminbi EFT becomes final, the beneficiary's bank becomes indebted to the beneficiary to the extent of the payment instruction accepted by it.

And:

"The finality of payment *discharges the underlying obligation* owed by the originator to the beneficiary".

The first article is easy to understand, as it is explained that the legal nature of fund transfer is not an assignment of debt¹⁴, but creation and extinguishment of debt, and therefore, the beneficiary's bank becomes indebted to the beneficiary to the extent of the payment instruction accepted by it, when the payment becomes final for the beneficiary.

The difficult part is the second article, should the EFT law stipulate the relationship between the originator and beneficiary? In the drafting process, UNCITRAL working group has also proposed a similar provision to discharge the underlying obligation of the originator owed to the beneficiary as a legal consequence of a finalized payment to the beneficiary:

Art. 11 (2) "The obligation of the debtor is discharged and the beneficiary's bank is indebted to the beneficiary to the extent of the payment order received by the

¹² This argument is suggested from "International Credit Transfers: major issues to be considered by the working group" UNCITRAL Doc. (A/CN. 9 /WG. IV/Wp. 42), para. 35. (not available on the UNCITRAL official website). Although it was argued in the context of international credit transfer, it applies to domestic credit transfer as well, simply because in most credit transfer, the beneficiary's bank is designated by the beneficiary other than a third party.

¹³ How to define and judge the reasonability of the deducted fees would be another interesting question to discuss. Apart from stipulating in hard law, an alternative option to resolve the problem of fee deduction is to allow the parties to allocate the risk. If they agree that the originator will bear the fees, the full amount has to arrive. If they agree that the beneficiary bears the fees, then beneficiary gets whatever arrives after charges.

¹⁴ See details in the crucial case, *R. v. Preddy* [1996] AC 815, which examines the legal nature of funds transfers.

beneficiary's bank when the payment order is accepted by the beneficiary's bank"¹⁵.

However, this provision has been strongly rejected by a considerable number of countries.

Canada believed that "this provision is an error to purport to discharge the obligation as soon as the beneficiary's bank accepts the payment order (this version of the draft of Model Law also proposed the payment becomes final for the beneficiary when the beneficiary's bank accepts the payment instruction), because acceptance may occur at a time significantly before the time that the beneficiary actually receives payment from the beneficiary's bank"¹⁶.

Even more sharply, Switzerland argued that "the Model Law must not intervene in the basic relationship between the originator and the beneficiary. The transfer is independent of the relationship with the basic transaction and all provisions of the Model Law which directly or indirectly refer to that transaction should be eliminated. For the sake of clarity, it could even be stated in the Model Law that the transfer is **abstract** and **independent** of the legal relationship underlying it"¹⁷.

In Swiss jurists' argument, they identified an important legal concept—abstraction. This legal concept, actually, was derived from the law of negotiable instruments¹⁸. On the purpose of facilitating the circulation of negotiable instruments, and enhancing the confidence of the negotiable instruments holders who receive the instruments from remitters or endorsers, the law in most countries stipulates that the relationship of negotiable instruments should be abstracted from the relationship of its underlying obligation (namely the premise reason why the relationship of negotiable instruments generated). This sort of characteristic of negotiable instruments is named Wu Yin Xing (无因性) in Chinese legal theory¹⁹.

Should China adopt such Wu Yin Xing in its EFT law? If yes, then above proposed article 2 in the legal consequences of payment finality should be deleted. The author tends to argue for its deletion for three reasons:

First, stipulating the underlying relationship between the originator (debtor) and the beneficiary (creditor) has overstepped the scope of what the EFT law should do (EFT law should focus on adjusting relationships arising from electronic funds transfers). Such underlying relationship is better resolved by the law of obligation, or the forthcoming Chinese Civil Code, or even criminal law if criminal issues involved, such as money laundering.

Second, if Wu Yin Xing has been dropped out by the EFT law, consequently, the payment system, CNAPS, will be asked to decide the payment dispute between the originator and the beneficiary, which is obviously unfair for CNAPS, since we cannot require CNAPS to be able to justify the underlying relationships of each transaction that it undertakes.

Third, such stipulation would be inconsistent with UNCITRAL's Model Law on International Credit Transfers, which left out the discharge provision of underlying obligation owed by the originator to the beneficiary. If China's rule of domestic large value Renminbi EFT is inconsistent with international prevailing rule on this matter, potential conflict may well come out. For instance, a finalized cross-border Renminbi EFT might argued by the originator, to have been discharged the underlying obligation between the originator and the beneficiary, however, argued counterwise, by the beneficiary, that such transaction has not discharged the

¹⁵ UNCITRAL working group on international payments, "Draft model rules on electronic funds transfers" (A/CN. 9/WG. IV/WP. 39), p. 88, @ <http://www.uncitral.org/pdf/english/yearbooks/yb-1989-e/vol20-p88-102-e.pdf> (27/03/2007).

¹⁶ UNCITRAL working group on international payments, compilation of comments by governments and international organizations (A/CN. 9/347 and Add. 1), p. 107, @ <http://www.uncitral.org/pdf/english/yearbooks/yb-1991-e/vol22-p102-144-e.pdf> (27/03/2007).

¹⁷ *Id.*, p. 125.

¹⁸ Modern China's law of negotiable instruments primarily covers three types of instruments, bills of exchange, promissory notes, and cheques.

¹⁹ However, current China's law of negotiable instruments has not adopted the concept of Wu Yin Xing due to several reasons, one of which is the prevention of fraud. See Prof. Liu Yin's EFT law book at p. 343.

originator's underlying indebtedness. Therefore, the article of discharging underlying obligation between the originator and beneficiary should be deleted.

In conclusion, above proposed five articles have covered the major issues of finality rules within China's domestic Renminbi credit transfer in the sense of law, and certainly, it can be refined in accordance with further understanding on this matter.