

Information Note for
Legislative Council Panel on Financial Affairs

Bills of Exchange (Amendment) Bill

Summary

1 With the support of the Hong Kong Monetary Authority (HKMA), the Hong Kong Association of Banks (HKAB) has commissioned Hong Kong Interbank Clearing Limited (HKICL) to implement a cheque imaging and truncation project to be launched in mid-2003. This would obviate the need for banks to make physical presentation of low-value cheques (i.e. below HK\$20,000 in value) for clearing, and would both improve cheque clearing efficiency and security, and lower the cost of cheque clearing and settlement. The clearing would in future be on the basis of electronic presentation of the cheque images and relevant data of the cheque. In future the cheques images and data will be presented to the paying bank instead of the physical cheque for the low value items. The data and images taken from the cheque are much less expensive to handle and store than physical cheques (on average about 500,000 cheques processed a day) and can be retrieved from the image database almost instantaneously through PC workstations. It is however necessary to amend the Bills of Exchange Ordinance to enable non-physical presentment of cheques. HKMA is working closely with the Financial Services and the Treasury Bureau (FSTB) to seek passage of the amendment bill in early 2003.

Current cheque processing arrangement in Hong Kong

2 Cheques are widely used as a means of payment in Hong Kong. Currently cheques are submitted in physical form for clearing through a cheque clearing system operated by HKICL for all licensed banks. Collecting banks, which receive cheques paid in by their customers, are required to deliver the physical cheques to HKICL for processing in the evening of the day they are paid in (“Day D”). A total of about 500,000 cheques are physically transported to HKICL each day. HKICL processes the cheques and the paying banks then collect the cheques from HKICL around midnight of Day D or in the morning of Day D+1. The paying banks check the availability of funds in the cheque drawers’ accounts and verify the signatures on the cheques. The paying banks return any unpaid cheques (for example cheques for which there are insufficient funds or which bear incorrect signatures or have other technical errors) by physical delivery to HKICL at around noon on Day D+1 for return to the relevant collecting banks. Around 1% or 5,000 cheques are returned each day. The collecting banks collect returned cheques from HKICL in the afternoon of Day D+1. After arranging to exclude such returned cheques from processing, HKICL runs the cheque settlement at 3 p.m. on Day D+1 to post the clearing results to the banks’ settlement accounts with the HKMA.

New processing approach

3 Whilst this paper-based system is cumbersome and relatively expensive, requiring over ten million cheques to be delivered to, and collected from, HKICL each month, physical cheque processing has until recently been the only viable option. However, banking

technology has now advanced to a level which can support paperless cheque clearing, obviating the need for the bulk shipment of physical cheques around Hong Kong. Cheques can now be cleared through the transfer of “electronic information” by means of cheque imaging and cheque truncation. Cheque imaging involves the scanning of a cheque to create a digital image which can be transferred through a data link, CD-ROM or cartridge. Cheque truncation is the electronic presentation of the essential details of a cheque without the cheque itself having to be physically presented. With cheque imaging and truncation, the physical cheques remain with the collecting bank, or with HKICL if the collecting bank commissioned HKICL to do the imaging on its behalf.

4 In designing the new system, we had full regard to the question of reliability of the cheque images as evidence in court. Electronic Transactions Ordinance, Cap. 553 provides that without prejudice to any rules of evidence, an electronic record shall not be denied admissibility in evidence in any proceedings on the sole ground that it is an electronic record. Besides, Evidence Ordinance, Cap. 8 provides that statements contained in a document produced by a computer shall be admissible as prima facie evidence in civil and criminal proceedings provided that certain conditions (e.g. conditions as to the supply and retrieval of the information to and from the computer) as set out in the Evidence Ordinance are satisfied. To maintain integrity of the system, the banking industry has agreed on a common set of control policies and procedures for the imaging process and operations. To ensure compliance by the banks and the HKICL, it has been agreed that they have to go through a Compliance Assessment Programme performed by qualified external auditors or internal auditors. On successful assessment, the chief executives of the banks and HKICL are required to issue a letter stating their full compliance with the requirements of the Programme.

5 As regards the retention period for low-value physical cheques, it may be noted that the current practice varies considerably among banks. For example, a major bank keeps cheques under HKD500,000 for 15 days, whereas another major bank keeps all cheques for an indefinite holding period. In all, the bulk of the cheques processed today are kept for less than say three months. Under the new cheque imaging and truncation system, the settled low-value cheques will be retained for six months by all banks. This was a period arrived at after consultation with the HKAB, the Commissioner of Police, the Commissioner of ICAC, the Securities and Futures Commission and the Director of Public Prosecutions. As can be seen from above, this is already longer than the average retention period for many settled cheques under the existing system.

6 As regards the choice of HK\$20,000 as the threshold value, this is a value set by the HKAB and may be reviewed periodically. For instance, after some experience with the processing by the new system, if the fraud rate does not increase, there may be scope to increase the threshold in order to capture more benefits of the imaging and truncation project. The HKMA and the HKAB consider HK\$20,000 to be an appropriate level for the time being. The HKMA will need to be consulted for any change to the threshold value.

7 In examining international experience in implementing cheque-imaging systems, the HKMA found that in those countries like the UK, Belgium, Denmark and Germany, they have adopted a system of cheque truncation but without cheque imaging. In other words, in these countries certain cheques are cleared by the transmission of “electronic data” from the collecting bank to the paying bank without the processing and presentment of physical cheques and without the paying bank receiving either the cheque in its physical form or in its image form for record purposes. This wholesale cheque truncation approach, i.e.

without any imaging at all, is not favoured in Hong Kong. The HKMA and HKAB are both of the view that a system of imaging and truncation is more secure than a system of truncation alone.

Security measures

8 The industry will adopt a set of control policies and procedures relating to the cheque imaging and truncation system. Full compliance with these will ensure that cheque images are generated from a reliable and secure imaging process so that “images” can be used as substitutes of physical cheques for reliance by drawee banks, and admissible in court as evidence of receipt of payment, if necessary. Images produced will be transmitted by encrypted leased line or delivered by sealed security bags if the images are stored in CD-ROM or tapes.

Benefits

9 The establishment of a paperless cheque clearing system yields a variety of advantages. First, the electronic processing and storage of cheque images is expected to result in improved efficiency of cheque clearing and in cost savings. Secondly, imaged cheques are easy to process, transfer and retrieve. Remote access to the image database through PC workstations allows instantaneous information retrieval to facilitate checking and investigation of cheque images. Thirdly, the adoption of cheque imaging and truncation system in Hong Kong could provide a technology that facilitates Hong Kong’s efforts to broaden its current work on promoting cross-border joint cheque clearing, which relies on the transport of physical cheques back to Hong Kong for clearing, whereas imaging could

conceivably allow joint cheque clearing to be done over longer distance and not be confined to neighbouring regions of Hong Kong.

Progress on legislative work

10 We are making good progress in preparing the Bills of Exchange (Amendment) Bill. Our target is to introduce the Bill into LegCo in Q1 2003.

Hong Kong Monetary Authority

Financial Services and the Treasury Bureau

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