

# Guidance Notes – CBM Directive No. 19 on the use of cheques and bank drafts

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## 1. Introduction

The aim of this Directive is to introduce a set of rules and regulations on the use of paper-based instruments in Malta to regulate the use of such instruments due to their inefficient nature, high processing costs and Anti-Money Laundering (AML) risks. With the publication of this Directive, the Central Bank of Malta (Bank) aims to minimise the risks associated with such instruments, while shifting consumers' behaviours towards more efficient and traceable electronic payment instruments. This Directive forms part of other national legislative and operational actions aimed at achieving an efficient local payments market.

## 2. Subject Matter and Scope

This Directive regulates the use of cheques and bank drafts, excluding money orders given that these are governed by the Universal Postal Union, as well as the Postal Services (General) Regulations (S.L. 254.01). Furthermore, this Directive applies to all local credit and financial institutions which are licensed by the Malta Financial Services Authority (MFSA), institutions which exercise their passporting rights to provide their services in Malta, post office giro institutions and the Bank when acting as a payment service provider. The provisions of this Directive shall apply only when both the drawee institution and the payer institution are located in Malta.

This Directive applies also to natural and legal persons making use of cheques and bank drafts. Natural persons refer to individuals while legal persons refer to companies or other persons set up through legislative provisions.

## 3. General Rules

*Paragraph 8* outlines the details that should be present on paper-based instruments, including the sum to be paid, a specified payee and the authentication of the drawer. Furthermore, the drawer should ensure that the date on the paper-based instrument reflects the date when the instrument is made available to the beneficiary. Nevertheless, the drawee institution or payer institution shall still encash or deposit any post-dated paper-based instruments upon presentation. The instrument shall also bear on the face of it the word “Only”, meaning that the instrument is non-transferable and can only be negotiated by a payment service provider (PSP).

*Paragraph 9* requires payment service providers to encash or deposit a paper-based instrument only when this is presented by the named payee, i.e. the person to whom the instrument is addressed, even when the instrument bears on its face the word “Or Order”, as paper-based instruments are no longer transferable to third parties.

As from **1 January 2022**, institutions shall discontinue the issue of “Or Order” cheques. Holders of chequebooks with cheques marked “Or Order” can continue to use their chequebook, however, service providers will only honour these cheques by paying the beneficiary named by the drawer. Beneficiaries of cheques which have been negotiated by third parties and who therefore are not the named payee of the cheque, will need to encash or deposit the cheque until the **31 December 2021**, as from the next day, PSPs will not be able to pay them the value of the cheque.

*Paragraph 10(i)* outlines the duties of a drawer when issuing a cheque. The drawer should write in a clear manner on the face of the cheque: (a) the date when the cheque is issued; (b) the name of the payee who is to receive the funds; (c) the amount payable, in words and figures which should agree; and (d) the signature or any other means of authentication which would allow the drawee institution to verify that the cheque was issued by the account holder.

*Paragraph 10(ii)* stipulates that paper-based instruments of €20 or less dated prior to 1st January 2022 can still be honoured by PSPs if still valid, from 1st January 2022 till 30th June 2022. Paper based instruments issued on 1st January 2022 or after, should not be drawn for amounts of €20 or less, and PSPs should not honour these cheques if presented for negotiation.

*Paragraph 11* sets a maximum monetary limit of five thousand euro (€5,000) for which paper-based instruments payable to natural persons can be encashed. Paper-based instruments with a payable sum exceeding this amount shall be deposited in full in the payee’s account, which can also be a joint account where the named payee is one of the account holders. Should there be consecutive cheques issued by the drawer to the same payee over a short period of time, for amounts lower than or up to five thousand euro (€5,000), the drawee institution may refuse to pay such cheques in cash. It is at the Bank’s discretion to define “a very short period of time” based on what is generally understood as market practice for settling a single transaction.

In the event that the payee does not hold an account with the drawee institution, the latter is only obliged to encash paper-based instruments for which the payable sum is equal or less than five thousand euro (€5,000). However, PSPs may establish a lower limit based on their respective risk appetite.

**Paragraph 12** outlines that, where the payee is a natural person, the payee must endorse the paper-based instrument by signing at the back of the cheque and include the ID card number, or passport number, or the number of an officially issued identification document before presenting it to the drawee institution or payer institution for negotiation.

Furthermore, the drawee institution or the payer institution is required to authenticate the identity of the payee through:

- (a) a valid officially-issued identification document, when the payee presents a paper-based instrument for negotiation over the counter; or
- (b) a check with the related payee's account mandate personal information (such as: ID card number, or account holder signature), when the instrument is deposited through an ATM network or a drop-box in the branch.

Regarding point (b), if institutions have electronic means of authentication to ensure that a paper-based instrument payable to a named beneficiary was in fact deposited in the account of that same beneficiary, then this would be deemed as sufficient in meeting the provisions of Paragraph 12.

This, to ensure that the funds have been credited to the account of the named payee and the paper-based instrument was not transferred to another beneficiary. If a PSP opts to apply a risk-based approach to meet this requirement, should there be a case where the funds are not credited to the payee's account, the paying institution will retain liability for each instrument negotiated in breach of Paragraph 9.

Additionally, the drawee institution or the payer institution is also obliged to record the date of negotiation on the paper-based instrument. This can be done through an automated cheque clearing process.

Where the payee is a legal person, the payee must deposit all paper-based instruments in the account of the named payee meaning that instruments payable to legal persons cannot be encashed. The drawee institution or payer institution is also obliged to record the date on the paper-based instrument when the service is provided.

**Paragraph 13** obliges the drawee institution and the payer institution to ensure that the paper-based instrument is negotiated only for the named payee.

**Paragraph 14** allows a payer institution to refuse to pay in cash a paper-based instrument where the named payee does not hold an account with it.

**Paragraph 15** states that the drawee institution shall ensure the validity and authentication of the paper-based instrument before debiting the drawer's account with the payable amount. The bank servicing client's cheques needs to ensure that the required authority exists when debiting a client's account, and it is up to the PSPs to ensure this and assume the liability should it fail to do so. Furthermore, the PSP is to assess whether its practices are effective in managing the risks involved.

If a drawee institution opts to use a risk-based approach for authenticating paper-based instruments when these are presented, such institutions must ensure that the adopted techniques increase the efficiency and the quality of the authentication process. Nevertheless, the drawee institution will retain full liability in cases of fraud. To better manage the risk of fraud, drawee institutions who adopt this methodology will once a year report to the Competent Authority on the outcome of their approach.

**Paragraph 16** outlines that the validity period of paper-based instruments is six (6) calendar months. This is in line with the current market practice.

**Paragraph 17** requires institutions to retain physical or electronic copies of paper-based instruments for at least five (5) years from the date when such instrument has been encashed or deposited.

**Paragraph 18** obliges the drawee institution to discontinue the cheque issuance facilities to a drawer if, during the preceding twelve (12) calendar months, six (6) authenticated valid paper-based instruments presented for settlement could not be paid due to insufficient funds, or any other reason which by the drawer's action would have rendered the instrument as invalid. The term "during the preceding twelve (12) calendar months" indicates that this depends on when the first dishonoured cheque was presented. For example, if the first dishonoured cheque was presented on 6<sup>th</sup> February 2022, then the facility should be discontinued if there are other 5 dishonoured cheques by 6<sup>th</sup> February 2023. Cheque issuance facilities should remain unavailable for at least twenty-four (24) months from the date of suspension.

In case of natural persons, drawee institutions are obliged to stop the cheque issuance facility on all current/overdraft accounts and joint accounts which personal customers might have. However, personal and business activities should be considered separately. Thus, in a situation where a customer acts as a signatory for a legal entity and holds a personal payment account, any infringements on either of these accounts are to be considered separately.

#### **4. Penalties**

**Paragraph 19** stipulates that when a PSP fails to comply with the requirements set out in this Directive, the Bank may impose penalties in accordance with Article 56 of the Central Bank of Malta Act (Cap. 204 of the Laws of Malta) and CBM Directive No. 12 on Administrative Measures and Penalties for

Infringements under the Central Bank of Malta Act. In such case, the Bank may publish any administrative penalties imposed.

*Paragraph 20* deals with cases where the administrative penalty is imposed on a payment service user (PSU), where such penalty shall not exceed two hundred euro (€200). Such penalties may be imposed for each paper-based instrument issued which contravenes this Directive. If two or more payment service users are involved in a transaction that contravenes this Directive, the Bank may impose an administrative penalty on every party involved in the transaction.

The PSPs are to provide information on PSUs who contravene any of the rules outlined in the Directive through a specific reporting template that will be made available to PSPs. This template is to be submitted to the Central Bank of Malta via email to [directive19@centralbankmalta.org](mailto:directive19@centralbankmalta.org). However, the Directive is not mandating a compulsory reporting requirement on service providers.

## **5. Dispute Resolution**

*Paragraph 21* stipulates that a PSU who is considered an eligible customer under the Arbitration for Financial Services Act, may resort to the Office of the Arbitrator for any complaints and settlement of disputes with a payment service provider, concerning the requirements emanating from this Directive.

Furthermore, a PSU who is not considered an eligible customer and other interested parties, may direct any complaints concerning the requirements emanating from this Directive to the Bank.

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