



PAYMENT SYSTEMS OF THE FINANCIAL HUB: CURRENT LEGAL AND REGULATORY FRAMEWORK

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Imagine you live in the financial hub of South Asia.

You are stuck in traffic in the morning on your way to a meeting; you receive a sms from the utility company reminding you to pay the bill. You have the cheque book, enough cash, and your bank cards: in fact enough liquidity to settle the bill. But you realize that you are already late and there is no room in your schedule for you to go to the bank or other payment outlets and you are wondering whether you have time to pay the bill online from your PC.

However you have subscribed to mobile banking, the bill can be paid by pressing a few buttons on your mobile phone and by the time you reach the office, you can freely focus on your official meetings.

Later in the night you shop online on EBay¹ looking for a better mobile phone. You find what you have been looking for and use your credit card to pay for it.

Are you sure your mobile instructions have been properly carried out? Are you sure the goods you ordered will be delivered? Have you just violated the exchange control regulations of the country?

It is clear that you have taken a few risks merely in exchange for the convenience.

Historically man bartered goods and services. Then exchange of money, firstly through natural objects and later through coins became the payment method for commerce. Then the currency notes, cheques and the other forms of negotiable instruments were introduced. Legal concepts were evolved, enacted and tested by the states to support the new methods forms of payment.

¹ An online auctioning site



But with the advent of the electronic age the rapid acceleration of the trade activities, new methods of payment systems were created. e-commerce demanded solutions in the nature of electronic banking and mobile banking.

Increasingly unorthodox and novel methods of payment have been crept into the “national payment system” that was once dominated by traditional scrip based payment methods. But the question arises as to whether the legal concepts were able to evolve at the same pace.

What is a payment system?

It is a system in economy that provides the transfer mechanism through which the settlement of transactions between banks as major players and between their clients - buyers and sellers of goods and services - takes place.

An efficient and smoothly operating payment system is important for the growth of the economy. Safety, integrity, efficiency and reliability of both domestic and international payments are vital factors for the safety and stability of the financial system and the markets.

National Payment System

The National Payment System refers to institutions, instruments and processes that are used to effect payments in a specific country. National Payment System is the infrastructure that provides the economy with the channels for processing payments that result from the activities of economic agents.

The main elements of a national payment system include:

- payment infrastructures for transacting and clearing payment instruments, processing and communicating payment information, and transferring the funds between the paying and receiving institutions;
- financial institutions that provide payment accounts, instruments and services to consumers, and businesses and organisations that operate payment transactions, clearing and settlement service networks for those financial institutions;
- market arrangements such as conventions, regulations and contracts for producing, pricing, delivering and acquiring the various payment instruments and services;
- laws, standards, rules and procedures set by legislators, courts and regulators that define and govern the mechanics of the payment transfer process and the conduct of payment service markets.²

² Page 2 Committee on Payment and Settlement Systems-General guidance for national payment system development January 2006
<http://www.bis.org/publ/cps70.pdf?noframes=1>



However, few of the most common problems for effective development of the national payment system are legal, regulatory, and public policy barriers.³

To address these issues BIS Committee on Payment and Settlement Systems in 2006 issued General guidelines for payment system development.⁴

These guidelines were divided into four main components:

A. Banking system

Guideline 1. Keep the central bank at the centre: *due to its overall responsibility for a sound currency, the central bank has a central role in the development of the use of money as an effective means of payment.*

Guideline 2. Promote the role of a sound banking system: *payment accounts, instruments and services available to end users are provided by banks and other similar financial institutions, which compete individually but often, need to act cooperatively as a system.*

B. Planning

Guideline 3. Recognise complexity: *planning should be based on a comprehensive understanding of all the core elements of the national payment system and the principal factors influencing its development.*

Guideline 4. Focus on needs: *identify, and be guided by, the payment needs of all users in the national payment system and by the capabilities of the economy.*

Guideline 5. Set clear priorities: *plan and prioritise development of the national payment system strategically.*

Guideline 6. Implementation is key: *ensure effective implementation of the strategic plan.*

C. Institutional framework

Guideline 7. Promote market development: *the expansion and strengthening of market arrangements for payment services are key aspects of the evolution of the national payment system.*

³ *Ibid.* Page 3

⁴ *Ibid.* 3-6



Guideline 8. Involve relevant stakeholders: *encourage the development of effective consultation among relevant stakeholders in the national payment system.*

Guideline 9. Collaborate for effective oversight: *effective payment system oversight by the central bank often requires collaborative arrangements with other authorities.*

Guideline 10. Promote legal certainty: *develop a transparent, comprehensive and sound legal framework for the national payment system.*

D. Infrastructures

Guideline 11. Expand availability of retail payment services: *extend availability and choice of efficient and secure non-cash payment instruments and services to consumers, businesses and governments by expanding and improving retail payment infrastructures.*

Guideline 12. Let the business case guide the large-value payment system: *develop a large value payment system based primarily on the needs of financial markets and the growth in time-critical interbank payments.*

Guideline 13. Align development of payment and securities systems: *coordinate the development of securities and large-value payment systems for safety and efficiency in the financial system.*

Guideline 14. Coordinate settlement of retail, large-value and securities systems: *the settlement processes for the core systems should be operationally coordinated to efficiently manage the interrelated liquidity needs and settlement risks among them.*

In all countries, there is always some process of reform or modification of the National Payment System. In recent years, there has been an acceleration in fundamental reforms in national payment systems worldwide.

Sri Lankan Payment System

The payment systems reforms in Sri Lanka have been praiseworthy. Sri Lanka is the 16th country in the world, which has received BIS-Red Book status for modernized payments systems. It occupies the third place in Asia in terms of payment reforms and has been the first country to operate RTGS/SSS system with SWIFT link in the SAARC region.⁵

⁵ Modernization of the National Payment System *Dr Raneer Jayamaha, former Senior Deputy Governor Central Bank of Sri Lanka*
http://www.cbsl.gov.lk/pics_n_docs/05_fss/_docs/article1.pdf

The Central Bank of Sri Lanka publication “Lanka Settle” defines the national payment system as “..an arrangement which helps individuals, corporates including financial institutions and other organizations to transfer money efficiently from one to another to settle their financial obligations.

It also defines a payment as “a transfer of value from one party to another to settle a financial obligation incurred on purchase of goods or services, including financial instruments. Individuals, corporate and other organizations make payments either in the form of currency or by non-cash payment means such as cheques, money orders, postal orders, wire transfers and electronic fund transfers etc.⁶

Dr Raneey Jayamaha, former Senior Deputy Governor of Central bank of Sri Lanka identifies three systemically important payment systems in Sri Lanka. They are,

- (i) the high value and time critical payments and settlement system used by banks, primary dealers, the Central Bank for inter-bank and inter-market transactions; ie The RTGS and SSS systems.
- (ii) the cheque-based retail payment system used by all segments of the population ; and
- (iii) the Automated Trading System operated by the Colombo Stock Exchange (CSE) which settles stocks and shares, i.e. private equities.⁷

It is stated that any disruptions to these three payment systems can result in financial system-wide impacts leading to financial system instability.

These critical payment, clearing and settlement systems that are in operation today are backed by a strong institutional, legal and regulatory framework. The key elements include:

- (i) the payment and settlement services
- (ii) legal and regulatory framework
- (iii) mechanisms for consultation with stakeholders; and
- (iv) catalyst and oversight roles of the payment system.⁸

Thus it is evident that the Sri Lankan regulators have given the due importance to the 10th guideline issued by the Bank of International Settlements Committee on Payment and Settlement Systems.

⁶ “Lanka Settle” CBSL Publication

⁷ Modernization of the National Payment System *Dr Raneey Jayamaha former Senior Deputy Governor Central Bank of Sri Lanka*

⁸ *Ibid.*

http://www.cbsl.gov.lk/pics_n_docs/05_fss/_docs/article1.pdf



Guideline 10. Promote legal certainty: *develop a transparent, comprehensive and sound legal framework for the national payment system.*

The legal framework for a national payment system is the body of law which determines the rights and obligations of parties in the system. It can be established by legislation or other statutory instruments. Also the common law, administrative law, contracts (including system rules), or international treaties and regulations could be parts of the infrastructure. These rules also deals with the transfer procedures and resolution of disputes regarding instruments, services, organisational arrangements and governance procedures for transferring and settling obligations with finality. A sound legal framework for the national payment system reduces the legal uncertainty and risk for the participants in payment infrastructures.

The legal framework involves general laws such as property, contract, corporate and insolvency laws that affect the payment system. Also there are laws that are specific such as payment legislation, netting laws and clearing house rules.

In addition, it includes the legislative and judicial arrangements for establishing, interpreting, adjudicating and enforcing those laws.⁹

Text Boxes outline a basic legal framework for the national payment system.¹⁰

A basic legal framework

Laws of general application which support a payment system:

- Property and contract laws - established through common law (jurisprudence) or applicable legislation (including a civil code) that create legally enforceable rights and obligations to make and receive payment.
- Banking and finance laws - establishing the rights and obligations of financial institutions to take deposits, make loans, grant and take collateral security, and hold and deal in securities.
- Insolvency laws - establishing the rights and obligations of creditors of an insolvent entity.
- Laws on the use of credit and collateral - including credit terms (interest rates, duration, rights on default), debtor's rights, and the creation, realisation and priority ranking of rights in collateral.
- Laws for determining which jurisdiction's laws apply - including contractual choice of law clauses and conflict of laws rules.
- Laws on electronic documents and digital signatures.

⁹ 38 Committee on Payment and Settlement Systems-General guidance for national payment system development January 2006 <http://www.bis.org/publ/cpss70.pdf?noframes=1>

¹⁰ Committee on Payment and Settlement Systems-General guidance for national payment system development January 2006 <http://www.bis.org/publ/cpss70.pdf?noframes=1>

Laws specific to payment systems:

- Laws specific to payment instruments - including currency laws, bill of exchange and cheque laws, electronic payments laws, regulations against unfair payment instruments and services, and rules establishing instrument standards (size, configuration, coding).
- Laws relating to the calculation and discharge of payment obligations - including netting, novation, finality of payment and settlement.
- Laws on default proceedings and disputes in payments - priority ranking of payment settlement claims, settlement guarantees and loss allocation agreements, priority rights to collateral for settlement credit, evidence laws regarding electronic payments, and dispute resolution mechanisms such as arbitration clauses.
- Laws related to central bank roles, responsibilities and authority in the national payment system.
- Laws relating to the formation and conduct of infrastructure service providers and markets - formation and operation of clearing and settlement arrangements, access and participation in infrastructure systems, pricing of infrastructure services, rules on the issuance and redemption of e-money, and protection of central counterparties from risk.
- Laws governing securities infrastructure services - addressing dematerialisation and immobilisation of securities, book-entry holding and transfer of securities, delivery versus payment, finality of transfer and settlement.

The Legal Framework in Sri Lanka

Sri Lanka has been proactive in law reforms in order to suit the changing commerce of the electronic age. As examples enactment of following legislation can be given.

- **The Evidence (Special Provisions) Act no 14 of 1995,**

This was one of the first initiatives taken by the legislature in legalizing the admissibility of the evidence contained in or produced by computers.¹¹

- **The Payment and Settlement Systems Act no 28 of 2005,**

This act provides for the regulation of payment, clearing and settlement systems; for the Disposition of securities on the books of the central bank; for the regulation of providers of Money services; for the electronic presentment of cheques; and to provide for matters connected therewith and incidental thereto.¹²

(This act will be discussed and analyzed in detail since it the most relevant piece of legislation as far as the topic is concerned.)

¹¹ Evidence (Special Provisions) Act (No. 14 of 1995) - Sect 5

¹² Long Title payment and settlement systems act, no. 28 of 2005



- **The Electronic Transactions Act no 19 of 2006**

This is an act to recognize and facilitate the formation of contracts, the creation and exchange of data messages, electronic documents, electronic records and other communications in electronic form in Sri Lanka ; and to provide for the appointment of a certification authority and accreditation of certification service providers ; and to provide for matters connected therewith or incidental thereto.¹³

The objectives of the act are as follows

- (a) to facilitate domestic and international electronic commerce by eliminating legal barriers and establishing legal certainty ;
- (b) to encourage the use of reliable forms of electronic commerce ;
- (c) to facilitate electronic filling of documents with Government and to promote efficient delivery of Government services by means of reliable forms of electronic communications ; and
- (d) to promote public confidence in the authenticity, integrity and reliability of data messages, electronic documents, electronic records or other communications.¹⁴

Also this act provide some radical provisions presumably adopted from the United Nations Commission on International Trade Law (UNCITRAL) model law, which equates the information contained in a data message, electronic document, electronic record or other communication to an instrument reduced into writing, if the information contained therein is:

- (a) rendered or made available in an *electronic form*; and
- (b) *accessible* so as to be usable for a subsequent reference.¹⁵

Also the section 11 of the Act states that “...unless otherwise agreed by the parties, an offer and the acceptance of an offer may be expressed in electronic form. A contract shall not be denied legal validity or enforceability on the sole ground that it is in electronic form” thus dispensing with the strict requirement of traditional pen and paper contracts used in commerce.

However the provisions of this act will not apply to

- (a) The creation or execution of a will, or any other testamentary disposition by whatever name called ;
- (b) A license for a Telecommunication system issued under subsection (6) of section 17 of the Telecommunications Act, No. 25 of 1991 ;
- (c) A bill of exchange as defined in subsection (1) of section 3 of the Bills of Exchange Ordinance (Chapter 82)¹⁶

¹³ Long title - The Electronic Transactions Act, No. 19 of 2006

¹⁴ Section 2 The Electronic Transactions Act, No. 19 of 2006

¹⁵ E-COMMERCE, E-TRANSACTIONS, DATA PROTECTION AND PRIVACY ISSUES JUSTICE SALEEM MARSOOF, P.C

¹⁶ However the payment and settlement systems act, no. 28 of 2005 revised this proviso

- (d) A Power-of-Attorney as defined in section 2 of the Power of Attorney Ordinance (Chapter 122) ;
- (e) A Trust as defined in the Trusts Ordinance (Chapter 87) excluding a constructive, implied and resulting trust
- (f) A contract for sale or conveyance of immovable property or any interest in such property;
- (g) or any other document act or transaction specified by the Minister by regulations made under section 24.¹⁷

It can be said that these restrictions will not unduly restrain the e-commerce activities facilitated by the act.

● **The Payment Devices Frauds Act no 30 of 2006**

This is an act to prevent the possession and use of unauthorised or Counterfeit payment devices ; to create offences connected with the possession or use of unauthorised payment devices ; To protect persons lawfully issuing and using such payment Devices ; to make provision for the investigation, prosecution and punishment of offenders ; and to provide for matters connected therewith or incidental thereto¹⁸

This act defines the “payment device” as a

- (a) a credit card and includes any card, plate, code, account number, microchip, optical instrument or document wherein magnetized encoding has taken place; or
- (b) a device in which account numbers and mandatory or discretionary data or information relating to the holder of such device is recorded and stored by mechanical, electronic, electromagnetic, optical or other means, and which card or device is recognized by the Issuer thereof, and which facilitates—
 - (i) the extension of credit for obtaining goods or services; or
 - (ii) the making of cash withdrawals and doing other acts in relation to a bank account, to or by the holder to whom such card or device has been lawfully issued by an Issuer;

It can be stated that this is an act that complements and facilitate the existing criminal laws of the country i.e. the Penal Code and the Criminal Procedure Code. There is cross reference made to the Criminal Procedure Code ¹⁹ where the procedure is concerned. Also all offences committed under this act are cognizable (An offence where the arrest can be made without a warrant).²⁰

¹⁷ Section 23 The Electronic Transactions Act, No. 19 of 2006

¹⁸ Long title -The Payment Devices Frauds Act, No. 30 of 2006

¹⁹ Section 7 The Payment Devices Frauds Act, No. 30 of 2006

²⁰ Section 20 The Payment Devices Frauds Act, No. 30 of 2006



Another interesting feature is that this act has made it mandatory to obtain the service of the Experts in conducting the investigations. Also the section 10 subsection (2) provides that

“ No police officer shall access any payment device, computer or acquirer’s point of sales network or automated teller machine network for the purpose of an investigation under this Act unless the Inspector-General of Police has certified in writing that such police officer possesses adequate knowledge and skill in the field of information, communication, technology or electronic or software engineering and is possessed of the required expertise to perform such a function.”

Also the section 16 of the act supersedes the evidence ordinance by providing that: (for the purpose of understanding this provision one may interpret that *Issuer* is the cardholders’ bank and the *Acquirer* is the merchant’s bank.)

- (1) A certified copy of an entry relating to a payment device located in Sri Lanka or outside Sri Lanka, kept by an Issuer or Acquirer in the ordinary course of business of such Issuer or Acquirer, whether kept in written form or stored by electronic, magnetic, optical or any other means in an information system or computer or payment device shall be admissible in evidence in relation to a prosecution in respect of an offence under section 3 of this Act, and shall be *prima facie* evidence of the facts stated therein.
- (2) Every document, certificate, record, register or extract thereof, if duly signed and issued by an expert either in Sri Lanka or abroad, and duly authenticated by a senior executive of an Issuer or Acquirer to whose transactions, or to whose interests such document, certificate record or register or extract thereof relates, shall be *prima facie* proof of the facts stated therein.
- (3) In subsection (1) “a certified copy” means a copy of the entry with a certificate written at the foot of that copy by the Chief Executive Officer of the Issuer or Acquirer or any of its authorized representatives certifying it as a true copy, and where such an entry is stored in an information system or computer, a print out of such entry certified as a true copy by an officer holding a responsible position in relation to the operation of the relevant information system or computer.
- (4) Notwithstanding anything to the contrary in the Evidence Ordinance or any other law the provisions of this section shall have effect and apply to the prosecution of offences under section 3.

These provisions have made it convenient for leading of evidence on behalf of the prosecution.

There is a presumption under the section 18 of the act that any person who fails to settle the due amount to the issuing bank and who changes the place of residence of the place of employment has willfully committed an offence of fraud under this act.



“A holder of a credit card or other payment device—

- (a) who has failed to pay the total sum due to the Issuer of such credit card or payment device within period allowed therefore by the Issuer ; and
- (b) who changes his residence or place of employment as stated in the application for such payment device without informing the Issuer of such change, shall be presumed to have done so with intent to willfully defraud the Issuer of such sum.”

Also this act contains provisions relating to jurisdiction, extradition of offenders thereby overcoming the legal barriers posed in procedural laws and ensuring the smooth functioning of the payments systems.

- **The Computer Crimes Act of 2007**

This is an act to provide for the identification of computer crime and to provide the procedure for the investigation and prevention of such crimes; and to provide for matters connected therewith and incidental thereto.²¹

The act contains definitions for the computer crime, offences, investigations evidence and other relevant provisions to complement the Penal code and the Code of Criminal Procedure.²²

Also other legislative amendments made to The Local Treasury Bills Ordinance, The Registered Stock and Securities Ordinance and The Monetary Law Act, are significant laws reforms done to facilitate the new age commercial and banking developments.

Payment and Settlement Systems Act of 2005. (PSA)

The Act empowers the Central Bank to be the authority responsible for the national payment system, which requires oversight and continuous surveillance of all payment systems to ensure its efficiency and effectiveness. The systemically important payment systems will be reviewed periodically to ensure that the design and operation meet with international standards and best practice.²³

²¹ Long title: Computer Crimes Act No. 24 of 2007

²² Also other legislative amendments made to The Local Treasury Bills Ordinance, The Registered Stock and Securities Ordinance and The Monetary Law Act, are significant laws reforms done to facilitate the new age commercial and banking developments.

²³ Modernization of the National Payment System *Dr Ranee Jayamaha former Senior Deputy Governor Central Bank of Sri Lanka* http://www.cbsl.gov.lk/pics_n_docs/05_fss/_docs/article1.pdf



Section 2 lays down the objectives of the Act, that are;

- (a) to provide for the regulation, supervision and monitoring of payment, clearing and settlement systems ;
- (b) to provide for the disposition of securities in securities accounts maintained at the Central Bank ;
- (c) to provide for the regulation, supervision and monitoring of providers of money services; and
- (d) to facilitate the electronic presentment of cheques.

Section 3 of the act lays down the following hierarchy of laws

- (1) The obligations, requirements, powers and regulatory schemes established under the provisions of this Act, shall be in addition to the obligations, requirements, powers and regulatory regimes under any other written law, and the powers conferred on the Central Bank by this Act shall be in addition to those conferred on it by the Monetary Law Act (Chapter 422), the Banking Act, No. 30 of 1988 or any other written law for the time being in force.
- (2) The provisions of the Act shall be read and construed in conformity with the Monetary Law Act (Chapter 422) and the Banking Act, No. 30 of 1988.

Thus the provisions in the PSA shall be in addition to any other written laws.

Part 2 and chapter 1 of the act appoints the Central Bank of Sri Lanka as the authority responsible for planning, providing guidance and leadership for the establishment and development of payment, clearing and settlement system in Sri Lanka²⁴.

Also this chapter provides the Central Bank with far reaching powers exceeding any other laws regarding the regulation and supervision of payment systems and securities settlement systems.²⁵

Securities that are subjected to the provisions of the act are defined and restricted to²⁶

- (a) treasury bills issued in a scripless form in accordance with the provisions of the Local Treasury Bills Ordinance (Chapter 417) ;
- (b) treasury bonds issued in a scripless form in accordance with the provisions of the Registered Stocks and Securities Ordinance (Chapter 420) ;
- (c) securities issued in a scripless form by the Central Bank in accordance with the provisions of the Monetary Law Act (Chapter 422) ;

²⁴ Section 4 (1) Payment & Settlement Systems Act, No. 28 of 2005

²⁵ Section 4 (3) Payment & Settlement Systems Act, No. 28 of 2005

²⁶ Section 10 (1) Payment & Settlement Systems Act, No. 28 of 2005

It should be noted that the private equities traded at Stock Exchange has not been included in the definitions. However the section 19 of the PSA empowers the Central Bank to designate a clearing and settlement system as a systemically important clearing and settlement system which is subject to the provisions of this Act if the Central Bank is of the opinion that a clearing and settlement system may be operated in such a manner as to pose a risk to the financial system of Sri Lanka.

Question arises as to whether one day the Central Depository Systems operated by the Colombo Stock Exchange and regulated by the Securities and Exchange Commission in fact could fall within the ambit of the PSA?

Chapter 2 of PSA further provides for the electronic settlement of securities. It also contains provisions for the protection of the dealer direct participants (currently banks and primary dealers) in case of a dispute between the security holders, by laying down the provisions that are similar to those of the Bills of Exchange Ordinance.

The section 7 of the PSA provides that

- (1) A disposition of a security is carried out by means of debit and credit posted to the transferror's and transferee's respective securities account.
- (2) Upon a disposition, the transferee acquires rights to the extent of the interest transferred in the security that the transferror had or had the power to transfer. Where the credit for the interest acquired was posted to the transferee's securities accounts, and the transferee gave value without notice of any adverse claim, the transferee also acquires the transferror's interest in the security, free of any adverse claims.

For the purposes of this sub-section,

- (a) notice to the dealer direct participant authorized to act in the securities account of the transferee customers is not to be attributed to the customer ; and
- (b) notice only that the transferror acts as a trustee, an agent or in a representative capacity, or that the transfer is out of a designated securities account, is not notice of breach of trust or authority and does not amount to notice of an adverse claim.

Adverse claim is defined as

“Adverse claim” means a claim to a property interest in a security credited to the securities account of a person other than that of the claimant, including the right of redemption of a debt, under a mortgage, pledge or charge, or any other transaction intended to secure the payment of a debt and a beneficial interest under a trust ;²⁷

²⁷ Section 10 (1) Payment & Settlement Systems Act, No. 28 of 2005



Thus it can be said that the rights of any bona fide “outright” purchaser of a security is protected by these provisions. However the rights of a purchaser of a security under a repurchase agreement may not be fully protected by this provision. In the event of a repurchase agreement²⁸ the security buyer or the cash payer is aware of the claim on the security. Also a security so purchased into a “tradable repo account”²⁹ could be used to leverage and generate more trades. In such a situation the parties to the transaction may have to resort to remedies under the common contract law.

The PSA does not rule out the application of the law of contracts and the contractual remedies.

6. (2) A securities account holder may exercise all the rights that comprise the security credited to his or her securities account, or designated securities account, subject to any applicable adverse claim :

Provided however, a customer securities account holder may deal with his or her securities account as provided in this section only through a dealer direct participant authorized to act in that customer’s securities account :

Provided further that, no remedy against the account holder will be prejudiced where the exercise of rights under this section is in breach of a contract or is otherwise in violation of the rights of any other person.

The Act further provides that,

A dealer direct participant who deals with a security under the authority of a customer, is not liable to a person who has an adverse claim to the security, unless the dealer direct participant

(a) acted in collusion with any person who violated the rights of the adverse claimant ; or

(b) acted, after having been served with an injunction, restraining order or other creditor process issued by a Court of competent jurisdiction enjoining the dealer direct participant from so dealing, and the dealer direct participant has had an opportunity to act on the injunction, restraining order, or other creditor process as the case may be.³⁰

Chapter III of the PSA addresses the “Money services and payment systems” and Chapter IV addresses the issues relating to “Clearing and settlement systems”. Although these are addressed in two separate chapters it is interesting to analyse their definitions alongside each other.

²⁸ A form of collateralized borrowing: by way of a contract of sale with agreement to purchase of a security.

²⁹ A designated account in the Central Depository

³⁰ Section 7 (3) Payment & Settlement Systems Act, No. 28 of 2005

“money services” means any services relating to money, including safekeeping, money transmission, cheque encashment, or currency exchange, and other similar services ;³¹

“payment system” means a system or arrangement for the communication, processing, exchange, clearance or settlement of payment orders and other messages effecting, ordering, enabling, or facilitating the making of payments money transmission, money withdrawals, or transfers of monetary value ;³²

“clearing and settlement system” means a system or arrangement for the clearing or settlement of payment obligations in the financial system, in any currency, and in which there is a minimum of three participants, at least one of whom is a financial institution; and includes a system or arrangement for the clearing or settlement in the official currency of Sri Lanka, or for securities transactions, foreign exchange transactions or other transactions or financial contracts where the system or arrangement also clears or settles payment obligations arising from those transactions and contracts;³³

Thus it appears that the money services and payment systems refers to those systems that merely act as a conduit between the participants for the settlement of their payment obligations and the clearing and settlement systems includes “Central Participant” through which all rights and the obligations of the participant are settled.

These two chapters provide for the Central Bank and the relevant Minister’s supervision and control of the formulation of the system rules (effectively the terms of contract between the participants), inspection and auditing of the systems.

Globally the Mobile Banking involves two methods.

A Bank centered mobile banking option where the payment obligations are routed through the banking system where the system shall be subjected to the ambit of the PSA, and a Mobile operator centered mobile banking system, such as ones used by some of the African countries where the Geography demands it.

If a Sri Lankan mobile operator decides to expand its “mobile reload” concept in order to settle payment obligations between the subscribers it could be classified as a Payment System.

In that event would the mobile operator come under the supervision of the Central Bank instead of the Telecommunication Regulatory commission?

³¹ Section 18 Payment & Settlement Systems Act, No. 28 of 2005

³² Section 18 Payment & Settlement Systems Act, No. 28 of 2005

³³ Section 32 Payment & Settlement Systems Act, No. 28 of 2005



Interestingly the “clearing and the settlement systems” are subject to additional regulations.

Section 20 (1). of the PSA authorizes the Central Bank to issue rules, instructions and directions and also to enter into any agreement with a clearing house or a participant of a designated clearing and settlement system, or both, in respect of the following matters :

- (a) netting arrangements;
- (b) risk sharing and risk control mechanisms ;
- (c) certainty of settlement and finality of payment;
- (d) the nature of financial arrangements among participants ;
- (e) the operational systems and financial soundness of the clearing house; and
- (f) such other matters that in the view of the Monetary Board pertain to a risk to the financial system.

However the Section 21 (3) restricts the Central bank to issue directives under the PSA in the following matters.

A directive under this section may not be made in respect of—

- (i) the capital adequacy of a participant;
- (ii) the management of its investments;
- (iii) its corporate governance;
- (iv) its relations with customers who are not themselves participants in the designated clearing and settlement system; or
- (v) its ownership structure.

In Sri Lanka there was a lacuna in the law regarding the concepts of Netting and Close-out. Close-out and Netting consist of two separate but related rights, often combined into a single contract.

- Close-out: The right of a counter party to unilaterally terminate contracts under certain specified conditions.
- Netting: The right to offset amounts due at termination of individual contracts between the same counterparties when determining the final obligation.

In an important legislative step the concept of Netting & Close out is incorporated into the act under the section 28:

“Where a financial institution or the Central Bank is a party to a netting agreement, then notwithstanding anything in any other law relating to bankruptcy or insolvency, or any order of court made pursuant to an administration or re-organization arrangement, or receivership involving insolvency, the financial institution or the Central Bank may enforce the agreement, terminate the contract giving rise to any obligation governed by it, and determine a net termination value or net settlement amount in accordance with the provisions of the agreement, in which case, the



party entitled to the net termination value or settlement amount is to be a creditor of the party owing the net termination value or net settlement amount for that value or amount as the case may be.”³⁴

Additionally the section 33 of PSA provides for the electronic presentment of cheques. This law reform was required under the developments that took place with the cheque imaging and truncation project.

The image clearing as opposed to the scrip clearing is a global development. Some countries including India have amended their existing laws regarding the Bills of Exchange in order to address the issues of these new developments. However Sri Lankan legislature has enacted the additional provisions superseding the existing Bills of Exchange Ordinance.

33. (1) A banker may instead of presenting the cheque itself for payment, present a cheque by electronic means for payment to the banker on whom it is drawn, by transmitting an image thereof along with the stipulated electronic payment information of the cheque.

34.(1) Where a cheque presented for payment in accordance with subsection (1) of section 33 is dishonoured by non-payment, the banker to whom the holder delivered the cheque for collection shall either return the cheque to the holder or shall issue to the holder an image return document conforming to all requirements set out by the Central bank.

(2) An image return document shall be deemed to be the cheque to which it relates.

36.(1) The provisions of subsection (4) of section 52 of the Bills of Exchange Ordinance (Chapter 82)³⁵ shall not apply—

- (a) to the presentment of a cheque for payment under subsection (1) of section 33;
- (b) to a cheque which is paid following presentment under subsection (1) of section 33.

(2) Where a cheque is presented for payment by a banker under subsection (1) of section 33, the provisions of section 45³⁶ of the Bills of Exchange Ordinance (Chapter 82) shall not be construed as being applicable and requiring the presentment to be made at the proper place or at a reasonable hour on a business day.

(3) The provisions of this Part of this Act shall, in so far as it is possible be read and construed as one with the Bills of Exchange Ordinance (Chapter 82).

Also, It is interesting to note the enforcement provisions of the Payment & Settlement Systems Act, No. 28 of 2005.

³⁴ Section 28 Payment & Settlement Systems Act No. 28 of 2005

³⁵ Section 52 (4) Bills of Exchange Ordinance – requires the physical delivery of the Bill

³⁶ Section 45 (4) Bills of Exchange Ordinance – Presentment for payment



- 38.** Where any person fails to comply with any provision of this Act or any regulation made thereunder or a directive, direction, instruction, or rule issued by the Central Bank in connection with any matter as relates to the foregoing provisions, or a lawful request for information, records or documents directed under this Act, the Central Bank may make an application to a Court of competent jurisdiction for an order directing compliance with the provisions of this Act, regulation, rule, instruction, directive or request, as the case may be.
- 39.(1)** Every person who contravenes or fails to comply with any provision of this Act or any regulations made thereunder, or directive, direction, instruction or rule issued by the Central Bank in connection with any matter under those provisions, or a lawful request for information, records or documents, directed under this Act, shall be guilty of an offence, and—
- (i) in the case of a natural person, be liable on conviction after summary trial to a fine not exceeding one million rupees or to imprisonment of either description for a term not less than one year and not more than three years, or to both such fine and imprisonment; or
 - (ii) in the case of any other entity, be liable on conviction after summary trial to a fine not exceeding seven hundred and fifty thousand rupees.

As such, an offence is committed even if the person fails to comply with a directive, direction instruction or a rule issued by the Central Bank.

Please note that there is a minimum prison sentence of one year specified in the event of a natural person committing an offence under this act. However in the event of a juristic person the prison sentence is absent and the fine is also reduced.

Also the legislative framework is supported by a set of system rules and end user agreements. These agreements carry contractual obligations between the participants and the rules are subject to the supervision of the Central Bank of Sri Lanka.

However it should be noted that all of these novel legal concepts, have so far not been the subject of a proper inquiry conducted by the Sri Lankan courts. As such, some of the provisions of these acts are yet to be interpreted by the courts.



Conclusion

The classic legal texts of the Bills of Exchange ordinance & Evidence ordinance have been adaptable for the ever-changing commerce for more than a century.

However these times tested legal provisions have not been able to adapt to the changes that took place within the last decade. It is apparent that the legislators could not cope up with the rapid pace of IT development and the demand for new laws. They have hurriedly laid down many legal enactments sometimes with overlapping scope and that sometimes are inconsistent with each other.

Law reforms could be based on relevant “model” laws developed by international legal organizations such as UNCITRAL³⁷. The slow process of law reforms should not delay the innovative commercial practices. But somehow the business confidence must be ensured through proper legal reforms. The reformed laws should be flexible enough to be able to address the new commercial developments without frequent and major amendments.

Thus current laws regarding the payment and settlement systems could be classified as evolving laws or adapting to a more unified form of laws that will facilitate the revolutionary commercial patterns developed by Information Technology.

³⁷ United Nations Commission on International Trade Law