



**UNITED NATIONS  
GENERAL  
ASSEMBLY**



Distr.  
GENERAL

A/CN.9/250/Add.1  
18 April 1984

ORIGINAL: ENGLISH

28289

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UNITED NATIONS COMMISSION ON  
INTERNATIONAL TRADE LAW  
Seventeenth session  
New York, 25 June - 11 July 1984

**DRAFT LEGAL GUIDE ON ELECTRONIC FUNDS TRANSFERS**

**Report of the Secretary-General**

(continued)

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## PREFACE

1. This legal guide has been prepared to aid legislators and lawyers considering the rules for particular networks. Since the guide is intended to be of practical value in a number of countries, there has been a conscious effort not to rely upon or to discuss legal theories or to consider problems which arise only in a small number of countries. On the contrary, there has been a deliberate effort to find the common elements in the law and the banking practice of funds transfers so as to ease the process of adapting the law governing paper-based transfers to the requirements of electronic funds transfer techniques. Although the greatest use of electronic funds transfer techniques is to be found at present in the economically developed countries, this guide may be of most value in the developing countries where the need is being felt to modernize their funds transfer system for both domestic and international purposes.

2. Computers first entered the back-rooms of banks as a means of handling more efficiently the increasing volume of paper-based funds transfers. The introduction of magnetic ink character recognition (MICR), and later optical character recognition (OCR), on both debit and credit transfer instructions permitted the automated processing of standardized paper documents. This development increased the efficiency with which clearing-houses and individual banks were able to cope with the increased number of funds transfers, and often caused a wholesale reorganization of the clerical operations of the banks. The creation of computer centres by banks led some of them to centralize the record keeping of customer accounts at the computer centre rather than to continue the previous decentralized record keeping of accounts by each branch.

3. Once many banks were equipped with computers to handle paper-based funds transfer instructions, it was possible to devise means to exchange funds transfer instructions in electronic form, either by the physical exchange of computer memory devices or by telecommunications. In some countries it has been possible to take this step with no fundamental change in the established institutional structure. In other countries new institutions have been created to operate inter-bank telecommunications facilities, message switches and electronic clearing-houses. Computer memory devices can be submitted by banks to automated clearing-houses for sorting the funds transfer instructions contained on those devices and redispaching to the receiving banks.

4. Funds transfer instructions have long been sent by telegram and telex. The international teletransmission of computer-to-computer funds transfer instructions is now available through connection to the Society for Worldwide Interbank Financial Telecommunications (S.W.I.F.T.) as well as through the internal telecommunications systems of banks with multi-national branches. Several of the consumer oriented debit card and credit card networks are developing international telecommunications systems for purposes of authorization of transactions, transmission of funds transfer data and the linking of automated cash dispensers and automated teller machines.

International point-of-sale systems are expected to soon follow. In a related development Eurocheque is moving towards truncation in the country of deposit with electronic presentment to the transferor (drawee) bank in its country.

5. Several international organizations have undertaken projects to explore the significance of these developments. The Bank for International Settlements (BIS) published in 1980 a monograph entitled "Payment Systems in Eleven Developed Countries", which looks into the payment systems in operation in those countries and the possible changes these systems may undergo with the increased use of automated data processing techniques. A new edition is to be published in 1984 with statistical data to the end of 1983. The Organization for Economic Co-operation and Development (OECD) published in 1983 a monograph by J.R.S. Revell entitled "Banking and Electronic Funds Transfers". The monograph describes the nature of electronic funds transfer systems which have been introduced into OECD member States and the impact that those systems have on banking and on monetary policy, although legal factors are not considered in depth. BIS has also published a monograph entitled "Security and Reliability in Electronic Systems for Payments" (2nd rev. ed., Sept. 1982).

6. In a broader context of automated data processing, several other organizations are active in the field. For example, the Working Party on Facilitation of International Trade Procedures, a subsidiary organ of the Economic Commission for Europe which works closely with UNCTAD's Special Programme on Trade Facilitation (UNCTAD/FALPRO), is responsible for facilitating international trade and transport by promoting rationalization of trade procedures and the effective use for this purpose of electronic and other forms of automated data processing and the teletransmission of trade data. Among the recent activities of the Working Party has been the identification of legal issues arising out of the use of these new procedures.

7. The Council of Europe adopted in 1981 the Convention for the Protection of Individuals with Regard to Automatic Processing of Personal Data. The Convention will come into force three months after five member States of the Council of Europe have expressed their consent to be bound. The OECD in 1980 also adopted "Guidelines Governing the Protection of Privacy and Transborder Flows of Personal Data". The Council of Europe adopted in 1981 a recommendation to its member States concerning the conditions under which computer records would be admissible as evidence in a court or arbitral tribunal.

8. Work is progressing in other international organizations such as the Customs Co-operation Council, International Maritime Organization and the International Civil Aviation Organization on legal aspects of automatic data processing arising out of the special concerns of those organizations. Although of no direct relevance to electronic funds transfers, the solutions adopted in one context are apt to be of significance in other contexts. The United Nations Commission on International Trade Law, as the core legal body in the field of international trade law, serves as the central forum for co-ordination of these various efforts.

## TERMINOLOGY USED IN THIS GUIDE

### Introduction

1. With the exception of negotiable instruments, where the three parties on the face of a bill of exchange or a cheque are consistently referred to as the drawer, drawee and payee, there is no generally accepted terminology in use to describe the parties or the activities involved in a funds transfer. In each country terms have developed which have reflected the realities of the funds transfer system in use in that country. It has also been true within many countries that bankers and lawyers have used different terms to describe the same party or the same activity, or that the same term had different meanings depending on the circumstances.
2. The problems arising out of inconsistent terminology in funds transfers have become serious only in recent years. The rapid switch to electronic means of data transmission between banks, coupled with the use of computers for processing funds transfer messages, has called for the standardization of the content of the messages and their formats. This in turn has required standardization of the terms used to describe the data elements in each type of funds transfer message.
3. To remedy this situation the Banking Committee of the International Organization for Standardization (ISO, TC 68) is developing international standards for various aspects of automated banking operations and has prepared a Draft International Standard (DIS 7982) in English and French for data elements and terms used in describing, processing and formatting messages relating to credit transfers transmitted over computer-to-computer telecommunications networks. The terminology in DIS 7982 has been followed closely in the preparation of DIS 7746 on telex formats for inter-bank funds transfer messages. The development of these international standards and general adherence to them by banks making international funds transfers should have the effect of reducing the number of errors and loss suffered. However, the terminology used in other international standards which have been adopted or are in preparation by the ISO Banking Committee and by the other ISO committees whose work is relevant to electronic funds transfers have defined some terms inconsistently with the definitions in DIS 7982. Therefore, the Banking Committee is compiling a list of all such terms defined by ISO committees in published documents. The compilation, which will also contain terms defined by other organizations interested in electronic funds transfers and will include the terms defined in this legal guide, is expected to serve as the basis for a consistent definition of terms used in international electronic funds transfers.
4. The terminology in DIS 7982 has generally been established from the viewpoint of the bank which receives a funds transfer message, "[s]ince it is incumbent upon the receiver of a funds transfer message to interpret and understand the full intent and meaning of funds transfer messages received through a variety of services or systems". This reflects the purpose of DIS 7982, which is to aid in formatting individual funds transfer messages.

5. However, the decision to identify and define terms and data elements used in individual credit transfer instructions sent by computer-to-computer telecommunications in order eventually to establish an international standard for the format of such instructions and to establish mapping conventions to help translate funds transfer instructions from one network to another makes it inevitable that the terminology chosen for that purpose will be oriented towards the message passing between any given pair of banks. Such a terminology emphasizes the instruction for a funds transfer as the central element at the expense of the entire funds transfer. Therefore given the purpose of the terminology, it is unlikely to be appropriate for other kinds of funds transfers for which it was not intended, such as batch mode credit transfer by means of exchange of computer memory devices or debit transfers of all types.

6. The terminology as used in this guide starts from that in DIS 7982. However, in spite of the general desirability of international agreement on terminology for use in all contexts to describe the parties and the activities involved in an electronic funds transfer, the terminology used in this legal guide sometimes deviates substantially from that found in DIS 7982, since the primary orientation of this legal guide is to describe parties and actions in relation to the funds transfer rather than to the funds transfer instruction.

7. In this orientation the principal parties are the "transferor" of the funds, his bank the "transferor bank", the "transferee" of the funds, and his bank the "transferee bank". If there are any banks between the transferor bank and the transferee bank, they are "intermediary banks". The transfer may be either a "debit transfer" or a "credit transfer", and the "funds transfer instruction" may be further described as either a "debit transfer instruction" or a "credit transfer instruction". The principal terms used in this guide are defined in the Glossary which follows.

### Glossary

**Authentication:** The identification of a message in a physical, electronic or other manner which permits the receiver to determine that the message comes from the source indicated. For the purposes of this guide it is immaterial whether authentication may also permit the receiver to determine that the message has not been deliberately or inadvertently altered. The authentication of a message does not necessarily indicate that the message as received was authorized or that the person sending the message had authority to do so. (Compare the definition of "authentication" given by the subcommittee on test-keys of the ISO Banking Committee: "The process of determining that a message comes from a source authorized to originate messages of that type." ISO document 68/2 N 80 or 68 N 118. Compare also the definition of "authenticator result" in DIS 7982, "A code in a message between the sender and the receiver used to validate the source and the full text of the message.")

**Automated clearing-house:** (See electronic clearing-house.)

**Bank:** A financial institution which as an ordinary part of its business engages in funds transfers for itself or other parties, whether or not it is recognized as a bank under the relevant law.

**Clearing-house:** An institution which effects the exchange of funds transfer instructions between participating banks and performs the accounting to enable settlement. (See also electronic clearing-house.)

**Closed-user network (for funds transfers):** A paper-based or electronic clearing-house, a communications service or a switch which is restricted to the banks or their customers who agree to adhere to particular technical standards and banking procedures.

**Communications service:** A service that moves messages, including funds transfer instructions, among subscribers but which does not perform the accounting to enable settlement. (Similar to definition of "communication service" in DIS 7982.)

**Computer memory device:** An external support on which data in computer-readable form can be stored.

**Credit transfer:** A funds transfer where the account of the originating bank or its customer is to be debited and the account of the destination bank or its customer is to be credited.

**Debit transfer:** A funds transfer where the account of the originating bank or its customer is to be credited and the account of the destination bank or its customer is to be debited. (Compare to definition of "debit transfer" in DIS 7982.)

**Destination bank:** The bank to which the chain of funds transfer instructions is ultimately addressed. In a credit transfer the transferee bank is the destination bank. In a debit transfer the transferor bank is the destination bank.

**Destination party:** The customer of the destination bank.

**Electronic clearing-house:** A clearing-house for funds transfer instructions in electronic form. An electronic clearing-house may be either on-line or off-line. An electronic clearing-house operating in batch mode is also referred to as an automated clearing-house.

**Entry date:** Date on which entries are made in the records of an account. (Identical to DIS 7982.)

**Funds transfer:** Movement of funds between the transferor and the transferee. (Almost identical to first sentence of DIS 7982. Compare definitions of "funds transfer transaction" and of "payment" in DIS 7982.)

**Funds transfer instruction:** A message or that part of a message that contains the instruction and required details for a funds transfer. A funds transfer instruction may be further indicated to be a debit transfer instruction or a credit transfer instruction. (First sentence almost identical to definition of instruction in DIS 7982. Second sentence is new. Compare definition of "payment order" in DIS 7982. This term is not used both because it seems to duplicate "instruction" and in order to avoid use of the word "payment" in regard to the inter-bank funds transfer.)

**Interest date:** Date as of which funds credited to an account begin to earn interest or funds debited to an account cease to earn interest.

**Intermediary bank(s):** Bank(s) between the originating bank and the destination bank through which a funds transfer passes. (Compare to definition in DIS 7982.)

**Originating bank:** The bank which transmits the first of a chain of funds transfer instructions to another bank. In a credit transfer the transferor bank is the originating bank. In a debit transfer the transferee bank is the originating bank.

**Originating party:** The customer of the originating bank.

**Pay date:** Date on which the funds are to be freely available to the transferee for withdrawal in cash. (Almost identical to DIS 7982.)

**Personal identification number (PIN):** The secret code used to authenticate funds transfer instructions initiated through a customer-activated terminal. (Based on definition in ISO 4909 "Bank cards - Magnetic stripe data content for track 3".)

**Receiving bank:** The bank to which a message, including a funds transfer instruction, is delivered. (Almost identical to DIS 7982.)

**Sending bank:** The bank which sends a message, including a funds transfer instruction, to a receiving bank. (Based upon DIS 7982. Has been modified so that a bank sending a funds transfer instruction by exchange of computer memory device or by sending a paper-based funds transfer instruction is also a sending bank.)

**Settlement:** A transfer of funds from a bank with a debit position to a bank with a credit position or an agreed accounting entry between them to cover one or more prior funds transfer transactions. (Based on DIS 7982.)

**Standing authorization to debit:** Authorization given by transferor to the transferor bank, the transferee bank or the transferee authorizing the transferor bank to honour debit transfer instructions presented in accordance with the terms of the authorization.

**Standing instruction to credit:** Funds transfer instruction given by transferor to transferor bank to transfer a specified sum to the account of a specified transferee at regular intervals.

**Switch:** A mechanism which receives, sorts and directs messages, including funds transfer instructions.

**Transferee:** The customer of the transferee bank. (Compare to definition of "beneficiary" in DIS 7982.)

**Transferee bank:** The bank which credits the transferee's account as a result of a funds transfer. (Compare to definition of "beneficiary bank" in DIS 7982.)

**Transferor:** The customer of the transferor bank. (Compare to definition of "originator" in DIS 7982.)

**Transferor bank:** The bank which debits the transferor's account as a result of a funds transfer. (Compare to definition of "originator's bank" in DIS 7982.)