



Palestine Economic Policy Research Institute (MAS)

Background Paper

Roundtable (2)

**Rejected Cheques on the Rise in Palestine: Causes and
Implications**

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Background and Rationale

Cheques were introduced long time ago to regulate, expedite and facilitate commercial transactions¹. Over the years, the number and diversity of financial and commercial transactions increased and led to wider use of cheques. Since it became possible to replace cash money with non-cash documents (such as commercial bills known as bills of exchange, bills to order/promissory notes, and cheques), the use of cash has declined in many countries.

Cheques are the most commonly used instruments among other non-cash instruments, as they save time and effort and can be used as a substitute for money, while the bill of exchange and the promissory note are used as loan guarantees. However, usage of cheques as a means of obligation to pay or instruments for paying money on a specific date, may not always be accepted by payees for fear that cheques may be rejected, mainly due to insufficient funds of the account holder. In such cases, cheques fail in their function as collection instrument for post-dated or delayed payments and turn into a means of fraud and deception.

Under law, such acts fall within the sphere of economic crimes, entailing criminal and civil penalties as well as civil fines, mainly because of: causing harm to others; shaking confidence in commercial transactions; violating public and private laws; which all in all adversely affect financial and commercial transactions and all spheres of life. Regardless whether the cheque drawer had criminal intent (*mala fide*) or not (i.e. returning the cheque unpaid as a result of the default of its drawer), legislation considers issuing a cheque without securing sufficient funds as a crime. Most of the applicable laws do not stipulate that the *mala fide* of the cheque drawer is necessary for a rejected cheque to be considered as crime. The payee trusts that this cheque guarantees his rights. According to the law, any breach of this trust, regardless of the causes, is a punishable crime. The Palestinian legislation considers writing a cheque, while knowing that there are insufficient funds to honor it, as an intentional crime, regardless of the causes of why the cheque is returned (Jarada, 2012).

The phenomenon of returned cheques has been witnessed in many countries around the world. However, the magnitude of this negative phenomenon differs from one economy to another, as it does not exceed 1% of the total value of cheques in circulation in some economies, while it reaches up to 7% in others. For example, in Jordan the percentage of rejected cheques of the total cheques presented for clearance was 3.5% on average during the last five years, compared with less than 1% in Abu Dhabi, which still shows that this percentage is on the decline in both countries² In Palestine this percentage reaches 7.7% (in the Gaza Strip the value of rejected cheques amounts to USD 145 million, representing 14% of the total of rejected cheques in Palestine). This percentage is continuously rising in value and has grown from US\$ 667 million in 2014 to US\$ 1154 million in 2017, whereas in the first quarter of 2018 it was US\$ 287 million.³

The table below shows that over the last five years, the value of rejected cheques of total cheques (presented for clearance) ranged from 6% to 7.7%, indicating that this ratio increased in 2017 following its decline in previous years. Both the value and the volume of rejected cheques increased, reaching over 735,000 cheques in 2017, an increase of 127,000 compared with 2016. The increase in the number of cheques means an increase in the number of persons writing rejected cheques (because of insufficient funds in the account). This also contributes to the expansion of this phenomenon in terms of volume and value, as the value of rejected cheques was US\$ 323 million higher compared with 2016, reaching US\$ 1154 million in 2017. This figure is high when evaluated against other banking indicators. For example, the value of rejected cheques constituted about 10% of total bank deposits, 16% of total direct credit facilities, and 27% of total current deposits (Association of Banks in Palestine Magazine, Banking Studies 2016). Assuming that the problem of rejected cheques was resolved and its incidence is significantly less, these banking indicators would themselves have different values, especially the value of direct facilities.

¹ Cheques have been used since the 19th century in England. However, it spread in Europe and the rest of the world later. In 1931 the Geneva Convention on the Unification of the Law relating to Cheques was concluded. (Abdelqader Jarada, Cheque Crimes in the Palestinian Legislation, 2012) ...

² The Jordanian Alghad newspaper: www.alightsadi.ps <http://www.alghad.com/articles/1923752-> Jordan Central Bank .

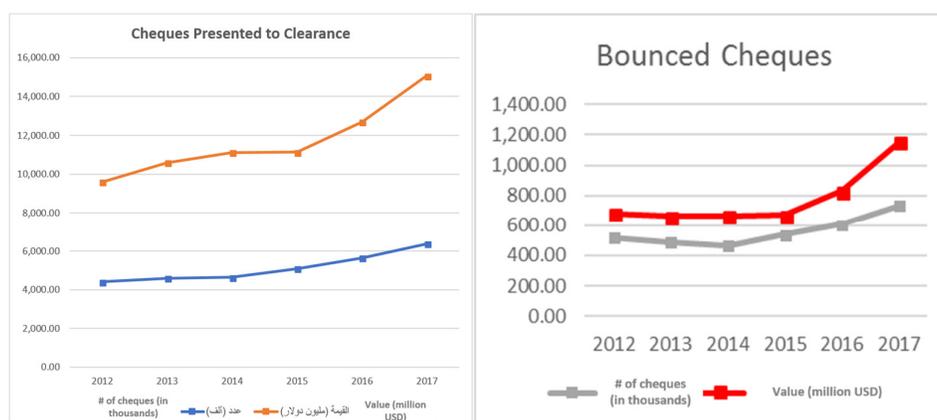
³ PMA data

Table 1: Value and Volume of Cheques Presented for Clearance, Rejected Cheques and its Ratio to Total Cheques Presented to Clearance

	Cheques Presented for Clearance		Rejected Cheques		Ratio of Rejected Cheques to Total Cheques Presented for Clearance
	Volume (thousand)	Value (million US\$)	Volume (thousand)	Value (million US\$)	
2012	4,400.00	9,600.00	520.00	680.00	7.1
2013	4,600.00	10,600.00	490.00	660.00	6.2
2014	4,637.77	11,117.80	467.44	664.78	6.0
2015	5,096.40	11,131.40	538.05	670.31	6.0
2016	5,644.74	12,691.53	608.60	831.54	6.6
2017	6,375.86	15,072.77	735.75	1,154.19	7.7

Source: PMA data.

Figure 1 and 2: Evolution of Cheques Presented to Clearing and Rejected Cheques, 2012-2017



It is widely agreed that this phenomenon is adverse and, as some describe it, reflects an economic and social malady with economic and social consequences that are negatively affecting the investment cycle. This phenomenon was addressed and highlighted in different media channels and specialized workshops⁴. Some economists contend that the phenomenon slows down the economy and distorts liquidity. Others see it as an indicator of economic collapse and decline in the purchasing power of individuals. Furthermore, the phenomenon erodes confidence in the banking and the judicial system, both of which have failed to curb this phenomenon in the view of the private sector. This highlights the need for priority interventions to be taken by both the Palestine Monetary Authority (PMA) and the judicial system.

To build on the background and rationale presented above, the following sections assesses risks associated with this phenomenon, its causes, relevant legal and executive procedures, PMA's measures and instructions, and whether the current countermeasures are adequate for curbing the phenomenon. Through this Roundtable session, Palestine Economic Policy Research Institute (MAS) aims to shed light on this phenomenon in order to formulate appropriate policies and interventions for curbing it. First, the paper reviews the legal and regulatory framework, then moves on to discuss the main determinants exacerbating this problem. The paper concludes with a number of questions for addressing this phenomenon in the future.

⁴ A specialized workshop in Ramallah and Al Bireh Chamber of Commerce on 24/3/2018, a series of news articles and releases published in local newspapers and economic journals, and a number of press reports published by Maan News Agency.

The Legal Framework

When the Palestinian National Authority was established in 1994, it reinstated the laws that were in force before 1967, based on Decision No. 1 of 1994, issued by Palestinian President Yasser Arafat at the time. This means that cheque cases are governed by the general provisions of Chapter Three in the Jordanian Commercial Law No. (12) of 1966, and the Jordanian Penal Code No. (16) of 1960, which provides for punitive actions on cheque crimes.⁵ In the Gaza Strip the Egyptian Law No. (7) of 1964 issued during the Egyptian administration of the Strip, is still in force⁶.

The Penal Code stipulates that any person, who contravenes the Law on Issuing Cheques, will be imprisoned for a period between two months to two years, in addition to incurring a fine of up to JOD 50. Effecting these penalties entails a series of procedures, starting with investigating the attendant circumstances of the case, then transferring the filed complaint to the Public Prosecutor. The Prosecutor in turn examines the file and summons (arrests) the accused cheque drawer to complete the investigations before preparing the indictment to be submitted to the Magistrates Court or the Court of First Instance. The Public Prosecution is the competent authority that brings the file to court if sufficient evidence was presented by those involved in the dispute (Jarada, 2012).

Executive Procedures for Penalties

The laws applied in Palestine stipulate clearly the executive procedures for penalties. Specifically, there are two paths that may be followed: First, under article 421 of the Jordanian Penalties Law of 1966, the Penal Code procedures stipulate that issuing a cheque without having sufficient funds in the account is a crime, punished by imprisonment from 90 days to three years. If the drawer seeks reconciliation and pays the amount of the cheque, such reconciliation shall be registered in court and the prison sentence shall be commuted to a fine ranging between half a dinar and five dinars instead of each day of imprisonment. The second path is to follow the civil procedures through the Execution Department.⁷ In this case, the filed complain is not regarded as a crime, but rather a case of debt collection, which is referred to the court's Execution Department (i.e. there is a court ruling to arrest the cheque drawer in accordance with Military Order no. (890) of 1982),⁸ in accordance with the Execution Law No. (23) of 2005. In the event the drawer defaults on paying the cheque, he shall be imprisoned for 21 days if the cheque is less than JOD 500 or 91 days if it exceeds JOD 500 or its equivalent in the currency in circulation. In addition, in this case no fine is incurred. In case reconciliation has been made, and the cheque is paid, the drawer is released from jail.

The penal path through Public Prosecution is the most common path, because of its efficiency and the deterrent measures it imposes, like imprisonment and fines. However, judges in Palestine tend to impose minimal penalties, often three months imprisonment which can be commuted to a fine in case of reconciliation. Penalties for military personnel are much tougher; if a military officer issues a cheque without securing sufficient funds, he is brought to a military trial and sentenced to imprisonment for a minimum of seven months.⁹

There are some shortcomings in the judicial system, which undermine the efficiency of handling these cases, namely; lengthy litigation process, the time lag between the hearing sessions of up to two months or more; the judges' lenient sentences and minimal fines. Judges avoid applying the existing Military Order, according to which the source (drawer) of a cheque, having insufficient funds in his or her account, should be sanctioned a heavy fine reaching up to four times the value of the drawn cheque. Commuting the penalty of prison to a small amount of money is a mitigation of the sentence and may

⁵ The Jordanian Commercial Law of 1966, Article 122, defines the cheque as follows "a cheque is written and drawn in accordance with the law terms and conditions. It contains an order from a person (the drawer) to another identified person/entity on which the cheque is drawn (usually a bank), to pay to a third person or to the order of the cheque bearer (the beneficiary) a certain amount of money when the cheque is presented".

⁶ Following the 2007 political divide, Hamas issued the Palestinian Commercial Law No. (2) of 2014, which included provisions and penalties for returned cheques.

⁷ According to the Execution Law No. (23) of 2005 Articles (1 &2), an execution department shall be established and affiliated with the court.

⁸ It should be differentiated between jail and prison. Prison can be commuted to a fine, while jail can't. The jailed person is released immediately if the value of the cheque was paid to the payee.

⁹ Interview with lawyer Abdullah Al Slaybi

trivialize the crime of a rejected cheque, which could encourage cheque issuers to continue their practices. All of these issues come under the penal procedures path.

As for civil procedures, procrastination and delays are possible throughout the process: First, there may be more than one lodging of appeal rounds, which are usually admitted at Palestinian courts. However, many appeals will be found inadmissible if Article 221- paragraph (3)¹⁰ was applied at courts, and it would also lessen the number of cases brought to the Execution Departments. Second, verdict may be appealed through a “writ petition”, lodging different appeals against the execution procedures (i.e. the convicted person challenges the execution procedures of the sentence, and not the validity of the ruling under Articles 420-423, which is done according to specific terms, as it is a preliminary ruling as Article 254 states.¹¹ In addition, the backlog of cases in the Execution Departments, concurrent with the shortage of Palestinian judges, adversely affects the efficiency of execution.¹²

Some lawyers consider that applying the penal procedures in full or at least partially, is a sufficient and effective deterrence (for example, imposing the penalty of six months’ imprisonment that can be commuted to a fine of three dinars for each day of imprisonment instead of half a dinar or one dinar). They also confirmed how procrastination in judicial proceedings weakens the system. Others considered that civil procedures are equally important if all the executive procedures have been fully implemented and deliberate malicious acts of procrastination have been limited.

Hence, while legal and executive procedures for cheque crimes are clearly stated in laws, the questions that remain are whether penalties are sufficiently dissuasive or not? Is the application of minimal penalties sufficient? Does the shortage of Execution Judges affect expediting the proceedings? These aspects should be reassessed and reconsidered by the competent judicial authorities and legal experts.

PMA Instructions and Procedures at Banks

Since 2010 the PMA has given greater attention to the rejected cheques phenomenon. It has issued a package of instructions and restrictions on the issuers of rejected cheques, and instructions for banks on dealing with rejected cheques under the provisions of the Banking Law No. (9) of 2010. Because the volume of rejected cheques has not diminished, it has issued another package of instructions in 2011 (under Presidential Decree No. 132 of 2011 on Licensing and Supervision on Microfinance Institutions). However, these instructions did not curb this phenomenon by and large, which spurred the PMA to issue stricter instructions in lieu of the previous ones early in 2017 (Instruction No. (2) of 2017 regarding rejected cheques, settlements and outstanding and lost cheques). These instructions come under 13 articles, some of which pertain to what banks should do in such cases, such as using the query system to inquire about customers requesting a chequebook, the Bank’s compliance with special settlement/reconciliation instructions through the PMA’s computerized system, applicable fees, and immediate notification of outstanding, lost and rejected cheques.

One of the steps taken by the PMA to develop work practices and supervisory tools to comply with best international standards was developing a computerized system for rejected cheques (NISHAM). It aspires to reduce the economic and social problems in the Palestinian market, ensuing from the return of cheques. The system classifies customers in categories from A to D, depending on the number of rejected cheques they issued.¹³ The system provides a comprehensive database on customers’ dealings at banks, which is beneficial to banks in rating their customers, and can help combat this rising phenomenon. These criteria are adjustable and can accommodate more stringent terms.

On the other hand, it is within the banks’ responsibilities to conduct a thorough investigation about their customers’ financial position and accounts to assess if they are capable of fulfilling their obligations.

¹⁰ Article 221-Paragraph 3- of the Code of Civil and Commercial Procedures No. (2) of 2001 state “The court may award damages if the appeal was filed with dilatory intent”.

¹¹ The Law on Criminal Procedure No. 3 of 2001

¹² Interview with lawyer Amir al-Tamimi

¹³ A – customer is eligible to get cheque books for unlimited time, while D- Customer is not eligible to get new cheque books and is blacklisted. More information is available on the PMA website. In 2016, the number of customers classified B or C was 140 thousand, about 40% of total number of classified customers (52% were classified as A).

Such a practice could mitigate the risk of rejected cheques. One Palestinian bank has made the initiative and achieved significant success in reducing the number of rejected cheques drawn on the bank. This has encouraged the PMA to issue instructions to banks to start implementing such measures of classification and scoring based on the banks' data on rejected cheques. Since this procedure raises the level of prevention, banks are expected not to issue a chequebook before investigation and scrutiny.

Reasons behind the Expansion of the Rejected Cheques Phenomenon and its Economic and Social Implications

It is evident in most laws, that the main reason for issuing a cheque without securing sufficient funds (a rejected cheque) is the *mala fide* of the drawer whose intention is fraud and deception, and that it is considered a deliberate crime regardless of its causes. Now the question is whether the expansion of this phenomenon is also related to the drawers' *mala fide* and should it be regarded a deliberate crime? Some economists and sociologists think that not all rejected cheques should be classified under economic crimes. Legal experts, on the other hand, believe that it is important to investigate the circumstances of each case, and to classify the cases based on causes in order to impose the appropriate penalty.

In Palestine, when talking about cheques returning because of the insufficiency of funds, there are a number of reasons to consider (while a portion of cheques bounce due to technical reasons). These include the *mala fide* intention of the drawer, deception, or for unintentional reasons. Although there is no statistical data that classify rejected cheques by cause, interviews with relevant parties (tradesmen, lawyers and economists) showed that a large portion of rejected cheques is attributed to the deteriorating economic situation and liquidity shortages, in addition to the poor planning by the cheques' drawers. On the other hand, the decline in the purchasing power of individuals who are unable to adapt to a different consumption pattern, has also contributed to this phenomenon. This is evident in the large portion of rejected cheques with small values issued in exchange for consumption goods, which were not cashed because of the drawers' insolvency.¹⁴

A number of facts and figures support the interviewees views, most importantly the number of clients listed in the PMA's "blacklist" and the lowest scoring list: more than 140,000 in 2016, about 6,500 of which are on the blacklist. More than 13,000 complaints were brought before courts 2015-2016 in all Palestinian cities, 28% of which were filed in Hebron. This number does not include cases that are brought to the Execution Department, when the cheque becomes a case of debt collection. Part of these cases were fraud, while other cases came as a consequence of the worsening economic conditions. Fraud cases constitute the lowest ratio of cheque crimes, as the percentage of those listed on the blacklist does not exceed 5% of the total number of issuers of rejected cheques.

Despite the aforementioned, issuers of rejected cheques should not be shown leniency and tolerance, according to economists and legal experts. Issuing chequebooks should undergo strict measures, or else this could lead to extensive and wider use of cheques, either in good or in bad faith, without monitoring, planning or adequate thought of the consequences whereby suddenly the drawer will find himself unwittingly implicated in a crime. For these considerations it is necessary to consider possible means for curbing this phenomenon, which also means avoiding its economic and social implications, and ensuring secure and smooth execution of commercial and non-commercial financial transactions. Banks, the PMA and the judicial and executive bodies should play a role in combating this phenomenon.

Any citizen who is involved in a rejected cheque case (whether in good or in bad faith), exposes himself to suffer its economic and social consequences. In case he was sentenced to serve a long time in prison, he will be at risk of losing his source of income and becoming unemployed, and thus will be unable to repay the cheque. Further to this, the social implications can be negative and destructive for the whole family, if its breadwinner is imprisoned.¹⁵ In some special cases, things become more complicated

¹⁴ Press releases published by Maan News Agency on 16/5/2017 on the implications of issuing cheques without securing sufficient funds, and on 12/1/2016 titled "One million cheques without sufficient funds and thousands of cases brought before courts".

¹⁵ During an interview with a case who was prisoned for three months for a rejected cheque (he lost his job, became unemployed, and had serious family problems. In a news story in Al-Hayat Al-Jadida - Hayat and Souk - Jamil Mustafa had no choice but to sell his house

socially, as some blacklisted clients (or on the lowest scoring list) tend to circumvent the PMA's instructions and laws, by using the chequebooks of their family member (wife's or son's) and continue issuing cheques without securing sufficient funds to honor them, raising social problems for the family.¹⁶

On the other hand, the availability of cheques encourages a higher consumption pattern among individuals through easy access to goods by issuance of post-dated cheques. This creates a mismatch between income and the needs of individuals, which complicates budget planning. In terms of commercial transactions, post-dated cheques increase the cash flow ratio of traded goods without accurately reflecting these transactions real values, which leads to great losses, liquidity shortages, and the closure of some businesses because of their inability to resume new business deals. All in all, this leads to slowing economic growth and deterioration of commercial conditions and reduced confidence in cheques in business transactions. This undermines the basic function of cheque as a guaranteed means of exchange. The lack of trust for credit among traders can make them prefer cash payments, which puts pressure on the currency in circulation (money supply and demand). Increase of cash transactions can cause imbalance in money supply or demand and impact interest rates as well.

Therefore, this phenomenon has numerous and diverse economic and social implications. However, the impact depends on the severity of the phenomenon, namely the percentage of rejected cheques to cleared cheques, their value to total deposits, and market circulation of cheques. No doubt that this ratio remains high in Palestine compared with neighboring countries. For example, the impact of rejected cheques in Saudi Arabia is very limited, standing at only 2600 rejected cheque with a worth of USD 200 million, whereas in Palestine there are more than 700,000 cheques reaching more than USD 1154 million. This raises important questions: why is there such a disparity between the two countries, what are its causes, why is it more severe in Palestine, and to what degree is it related to economic slowdown?

Where the Dilemma Lies

The above presentation reveals two conflicting issues. On one hand, there is a clearly defined problem which has negative economic and social implications. This problem of rejected cheques is accelerating and increasing in size, in terms of value and volume, especially in 2017.

On the other hand, legal procedures and deterrent penalties imposed in minimum and maximum are clearly set forth in legal texts, in addition to the PMA's latest efforts to curb the phenomenon, and other banking procedures carried out by commercial banks. However, all that did not prevent the rise in rejected cheques, on the contrary, the phenomenon accelerated in 2017 despite the PMA's strict procedures and regulations, adoption of new instructions and the use of different techniques and software.

The problem therefore lies with the fact that this phenomenon is expanding despite all legal and administrative procedures imposed by the PMA and Palestinian banks. At this point, there are many questions that need to be answered in order to combat this phenomenon. Most importantly, is the overall economic situation the main cause of this problem? Or is it because of the application of minimum penalties? Or, are the executive judicial proceedings insufficient or too slow? Could it be that drawers are unaware of the consequences of rejected cheques? Or maybe, is it because post-dated payments are the only way for maintaining solvency of customers drawing rejected cheques?

In conclusion, finding answers to all these questions needs continued examination and dialogue among experts and competent stakeholders, which this Roundtable session aims to encourage.

where he lives with his 9-members family and to live in a rented place in order to repay the rejected cheques he wrote. He also lost other traders trust and closed his shop (poultry trade). In another case, Mohammed Abdul Qader closed his shop (grocery shop) because of the rejected cheques he received from his customers and thus being unpaid for his goods.

¹⁶ Prosecutor Fuad Al Awwadeh, during an interview with Maan correspondent.

Guiding Questions for Discussion

- What are the causes underpinning the rejected cheques phenomenon, which keeps expanding despite the existing strict legal and administrative measures? Is it possible to enforce additional, stricter penalties?
- What kind of additional policies and means could be adopted to curb this phenomenon?
- Has the PMA taken all possible measures in this regard? Or is there still room for more stringent instructions?