

T T Mboweni: A historical review and a look at the future prospects of the National Payments System in South Africa

Address by Mr T T Mboweni, Governor of the South African Reserve Bank, at the 10th Anniversary function of the Payment Association of South Africa, Pretoria, 15 November 2006.

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Honoured guests,
ladies and gentlemen.

1. Introduction

It is with great pleasure that I join you in celebrating the tenth anniversary of the Payment Association of South Africa (PASA). As financial systems have become increasingly complex, stricter regulation, overview and co-ordination of payment systems has been required. South Africa has been no exception, and PASA was born as an integral part of this process. As with most young children, there have been many growing pains, but it is a tribute to all those involved with the organisation that with the passage of time, PASA is developing into a mature adult.

For the benefit of those unacquainted with the system, the NPS is a broad concept which not only entails systems to clear payments (cheques, electronic payment and card payments) between banks, but encompasses the total payment process. This includes all the systems, mechanisms, institutions, agreements, procedures, rules, laws etc that come into play from the moment an end-user issues an instruction to pay another person or a business, through to the final settlement between banks at the South African Reserve Bank. The NPS thus enables transacting parties to exchange to do business efficiently.

2. Background to the creation of PASA

In the late 1980s, the risks emanating from the settlement of payment-related activities increasingly became of particular concern to central banks. The Bank for International Settlements (BIS) gave this issue further prominence when it started publishing reports highlighting the risks associated with the payment system. These reports highlighted the discomfort of central banks with the level of credit and liquidity risks to which participants in the payment system were exposed. Furthermore, concern was also raised about the regulatory and supervisory responsibilities of central banks in the payment system.

In response, central bank Governors agreed to establish an ad hoc committee to investigate the findings of the various reports. Consequently, the Committee on Payment and Settlement Systems (CPSS) at the BIS was established. The Committee is currently convened by Mr Timothy Geithner, President of the Federal Reserve Bank of New York. It has become a trend, especially among the central bank fraternity, for regular attention to be paid to payment systems. This is part of the contribution that central banks make to overall financial system stability.

With the reintegration of South Africa into the world economy in the early 1990s, it was clearly evident that this would bring increased obligations in order to ensure that the domestic clearing and settlement systems and risk management procedures conformed to international best practice.

In February 1994, the banking industry requested the South African Reserve Bank to take the lead in the modernisation process of the domestic payment system. The NPS project, which was initiated by the Bank in April 1994, was launched as a collaborative effort between the Bank and the banking industry and the initial focus was to formulate a long-term strategy for the modernisation and development of the domestic payment system. This initial work resulted in the development of the South African National Payment System Framework and Strategy document (the so-called Blue Book) which was published by the Bank in 1995. The Blue Book contained the vision and strategy for the NPS up to 2004.

An important component of the implementation strategy entailed the establishment of an umbrella body – the Payment Association of South Africa (PASA). It was envisaged that PASA would play a central role in establishing and controlling Payment Stream Associations representing the banks

participating in each particular payment stream. It was the view at the time that although the Bank would remain responsible for the overall safety and soundness of the NPS, the clearing environment should be managed by an association made up of participants in that environment.

Although the NPS Act, which makes provision for a Payment System Management Body, was only promulgated in October 1998, PASA was already formally established on 26 September 1996. The Act made provision for a Payment System Management Body, not only to manage the affairs of its members in relation to payment instructions, but also to act as a medium of communication with the different stakeholders, namely the Bank, Government, public bodies, the media and even the general public.

From what we understand there were some "teething" problems but PASA has over the past ten years matured in terms of both the structural arrangements and its stature. Today PASA has a governing council, an executive office and several strategic, risk and payment clearing house workgroups or committees which has increased its operational efficiency and effectiveness quite significantly. This is good progress for which all of us must take credit.

Much of what has been achieved in the development of our NPS over the past ten years has been through consultation, collaboration and co-operation between the members of PASA and the Bank. While the Bank supports the consultative and collaborative approach, we have observed on occasion that competitive issues between the banks themselves, and the banks and other stakeholders, can impede the collaborative process and sometimes cause unnecessary delays in the implementation of certain initiatives.

It should be remembered that collegiality, co-operation and inter-operability are vital elements of a world class payment system. To achieve this does sometimes require an above average effort from stakeholders. In this regard, the Bank is committed to ensuring that new developments or any response to problems in the NPS will always be taken in the interest of the system as a whole, and not in the interest of individual participants.

3. Achievements in the NPS over the past 10 years

Collaboration between the Bank and the banking industry, particularly with PASA, has resulted in the South African Payment System being recognised as an example or model for development initiatives in the region and internationally. Much has been achieved during the past ten years and although I do not want to go into detail of any particular achievement, there are a few major milestones which are worth highlighting tonight.

The first major milestone was reached on 9 March 1998, when the South African Multiple Options Settlement (SAMOS) system was implemented, enabling banks to settle their obligations on a real time gross settlement basis (RTGS). Various changes and upgrades to the SAMOS framework have been implemented since 1998, including facilities for the South African financial markets to conform to international best practice with the introduction of the principle of delivery versus payment (DVP) for settlement of equity, bond and other financial market transactions.

The second milestone was reached with the promulgation of the NPS Act in October 1998. The Act provides the SARB with the mandate to oversee and monitor the payment system and provides the objectives and rules for the Payment System Management Body. It also provides for the final and irrevocable settlement in the SAMOS system. The oversight function of the Bank was extended in the amendment of the Act in 2004 when the Bank was given the power to issue directives to any person regarding a payment system or the application of the provisions of the Act. I will return to the role of the Bank in the NPS later on.

The third highlight relates to risk-reduction initiatives in the retail payment environment. The Blue Book identified several risk-reduction measures to be implemented in the retail environment. Although risk reduction is an ongoing process in the NPS, two important issues have been dealt with recently. Firstly there was the signing of new contractual agreements between the participants of each payment clearing house in the NPS. Secondly, there was the introduction of item limits for retail payment streams to a maximum of R5 million to reduce the values being settled in these streams and to encourage high value payments to be processed through the SAMOS system.

Finally, perhaps one of the most important achievements in the NPS recently was the inclusion of the South African Rand in the CLS Bank settlement system. The Bank and the banking industry were proactive in this regard and the Bank issued a position paper late in 2002 supporting the inclusion of the

rand as a settlement currency in the CLS system. South African registered banks were also encouraged to become members of CLS. Following a major collaborative effort, the Rand became a CLS currency in December 2004.

4. The Competition Commission investigation

We are all aware of the current Competition Commission investigation into the NPS. This investigation was triggered by the report on *The National Payment System and Competition in the Banking Sector*. The Bank will most certainly not want to give an opinion on the matter or in any way pre-empt the conclusions or recommendations that the Commission may make. However, I should point out that despite the achievements to date, there is little doubt that there is still a perception that access to the NPS is restricted, and that it operates like a "closed club" or a cartel of the big four banks. This is probably related in part to the lack of transparency in entry criteria. Indeed, if anti-competitive pricing collusion does exist, it is appropriate for the Competition Commission to investigate this and make a ruling so that fairness and competition can be the rule of the day.

It is heartening to see a new willingness by the banking industry to open access to the payment system. I should however point out that the Bank as the current overseer of the NPS has an obligation to ensure that restricting or facilitating access to the system does not compromise the overall integrity of the system. Access should be available to any institution qualifying in terms of internationally accepted risk-based criteria, as contained for example in the BIS core principles for systemically important payment systems which are geared at ensuring safety and efficiency of payment systems.

5. The way forward

There are new and complex challenges facing the NPS and the different stakeholders operating within the system. As you are aware, the Bank, after consultation with the industry and other stakeholders, published a new Vision and Strategy document (Vision 2010) for the NPS in April this year. The purpose of this document was to provide high-level strategic guidance for the payment system up to 2010.

Finally, there appears to be a general misunderstanding that the Bank has a "hands off" approach to the oversight and regulation of the NPS. I would remind all NPS stakeholders that section 10 (i) (c) of the South African Reserve Bank Act states clearly that the Bank, "perform such functions, implement such rules and procedures and, in general take such steps as may be necessary to establish, conduct, monitor, regulate and supervise payment, clearing or settlement systems". Furthermore, as I noted earlier, the 2004 amendment to the NPS Act makes provision for the Bank to issue directives pertaining to the NPS.

We raise this issue as the Bank will soon be issuing directives in terms of the NPS Act which will regulate non-bank participants in the NPS for the first time. We have noticed that the number of non-bank participants has increased to the extent that the risk associated with their operations and the risk that they bring to the clearing and settlement environment requires some formalisation. Of particular relevance in this regard are system operators and third party service providers, who mostly operate in or on behalf of the retail sector. We want to make it clear, particularly to the banking sector, that strict regulation will be applied as far as the NPS is concerned. This should not be perceived negatively, nor do we wish to stifle innovation or competition in the industry. However we need to apply strict supervision and regulation to both bank and non-bank participants in the critical area of the NPS and avoid the risk of turbulence that may emanate from a hands-off approach to regulation.

This may require some adjustment to current structures in the NPS and the Bank will have to start playing a far more prominent role in areas such as supervision, regulation and licensing of participants. We also need to ensure that these newly regulated entities have channels to engage with the Bank and other stakeholders, including PASA, in a fair and transparent way. The Bank has already initiated discussions with various international central banks and consulted with NPS stakeholders with a view to adopting a model which will facilitate such engagement. This may take some time but I can assure you that the Bank will continue with the collaborative approach it has used for NPS matters in the past before making any final decisions in this regard.

6. Concluding remarks

In conclusion, I would like to congratulate PASA and the industry for the effort, and achievements of the past ten years, not only in the area of systems and infrastructure, but also in the manner in which they have co-operated in the flow of liquidity and the conclusion of commitments in the system on a daily basis. The Bank looks forward to the continued co-operation of PASA and other stakeholders as we tackle the challenges that lie ahead in an effort to ensure that the NPS continues to comply with international best practice.

Thank you.