

## **Amando M Tetangco, Jr: Pursuing financial stability thru innovations in cheque clearing and settlement**

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the Signing of the Memorandum of Agreement between BSP and the Philippine Clearing House Corporation (PCHC) to implement the Check Imaging Clearing System, Manila, 12 July 2016.

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### **Introduction**

We gather this afternoon to formalize a milestone in Philippine banking. Many may think that clearing and settlement as a whole is a facet of market operations best left to specialists who think of floats, talk in timelines and manage queues. This is partially true since this field is indeed highly specialized. Except perhaps for the brave souls who took on the responsibility of being on the Inter-Agency Committee on Check Truncation– the very same set of individuals whom we thank for making this day come to fruition – clearing and settlement risks are not the discussion one typically enjoys with one’s morning coffee, so to speak.

### **Role of clearing and settlement in a dynamic market**

But the truth is the rest of us are able to go on with our business because there is a functioning clearing and settlement process that operates quietly in the background. Whether we talk of securities, currencies or cheques, the ability of market stakeholders to settle obligations and transfer funds invariably depends on an efficient payments and settlements system.

The essentiality of the payments and settlement infrastructure is well recognized. It is particularly identified as a key element of what constitutes financial stability. An excellent example of this thinking is the second principle for financial stability espoused by Garry Schinasi (2004) where he argues that:<sup>1</sup>

“... financial stability not only implies that finance adequately fulfills its role in allocating resources and risks, mobilizing savings, and facilitating wealth accumulation, development, and growth; it should also imply that the systems of payment throughout the economy function smoothly (across official and private, retail and wholesale, and formal and informal payments mechanisms)”.

It is therefore clear that the payments and settlement infrastructure plays a critical role in a dynamic and growing economy. Stakeholders need to be assured that their payment instructions are faithfully carried out while recipients of the funds must believe that there is finality in the transfer of such funds. This is a pillar of business operations that fuels the network of transactions in the real economy. Absent this pillar, stakeholders are literally forced into bilateral means of settlement which take different forms across different counterparties.

### **Challenges in the Philippines**

From the BSP’s perspective, we have long recognized the importance of a viable payments and settlement system. Although a Payments Act has yet to be legislated in this country, we nonetheless established an RTGS system, now known as PHILPaSS, at the turn of the

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<sup>1</sup> Garry J. Schinasi. “Defining Financial Stability”. IMF Working Paper #187. October 2004. This paper heavily influenced the design of and approach for financial stability as applied in the BSP.

century to enable efficient settlement of payment obligations in central bank money. For nearly four decades now, we have also been collaborating with the PCHC in operating a cheque payment system, allowing both retail and corporate clients the ability to settle obligations thru a bill of exchange without the need for immediately providing physical cash.

It is perhaps not common knowledge that PCHC processes about 700,000 cheques ever day with an average value of Php135 billion. Certainly, that is an unthinkable amount of cash to be carrying around for bilateral and physical settlement if a cheque clearing system was not in place.

But volumes and values aside, our cheque clearing facility must face the unique challenge of operating within an archipelagic economy.<sup>2</sup> Clearing cheques in a physical manner necessitates a clearing cycle that is typically two to three days long. To complicate matters further, not every financial institution is a direct clearing participant and having conduits adds a layer of time inefficiencies, if not outright costs. Actually, our payment challenge goes beyond the issues associated with cheques. We should note that in a 2014 study by the Better than Cash Alliance, only one percent of monthly retail transactions are done in electronic form. This validates our heavy reliance on cash and cheques in conducting our business. At a time when technology has become scalable, portable and affordable, this apparent reluctance to parlay the benefits of technology can only translate to further inefficiencies via foregone opportunities.

### **Milestone today**

Let me be clear that the BSP recognizes that cheques will probably continue to play an important role in the country's payment system for the foreseeable future. But it needs to evolve and leverage on technology to improve its efficiency as a payment instrument.

In signing the Memorandum of Agreement with PCHC today, we are establishing the critical foundation for the adoption of check truncation technology. Simply put, we are moving from physical clearing of paper cheques to a system that digitizes those same paper checks to facilitate their electronic clearing.

Through the Check Image Clearing System (CICS) of the PCHC, all of our cheques are targeted to be cleared in a fully electronic environment starting January 6, 2017. For those of us who really are not specialists in this area, if there is one take away from this development, it has to be the fact that funds will now be made available by next day at the latest.

Cheques we issue to our family, friends and business partners in various parts of the country will now enjoy near real-time finality of payment. This will have a number of benefits. It will be good for those receiving funds. It will be good for managing the balances of those who issue the cheques. It better aligns payments data with money supply aggregates. And since cheque data are transmitted electronically, we necessarily eliminate transport risks on the physical cheques. We likewise address consumer protection issues that arise when our cheques are either pilfered and/or altered to benefit those with ill-motives.

### **The Journey ahead.**

On the whole, ladies and gentlemen, what we formalize today is a win-win for all stakeholders. It is an important step in that we strengthen our cheque clearing system by leveraging on the advantages that technology can provide. In the process, there is uniform handling regardless of whether the issuer is in Metro Manila or other parts of the archipelago.

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<sup>2</sup> In the region, the only other jurisdiction in this situation is Indonesia.

The settlement leg of this development will certainly still go thru the BSP via PhilPaSS. On that front, you can expect that the BSP will continue to improve its real time gross settlement system. You can also expect other payment reforms that ensure financial stability.

Beyond an efficient cheque clearing system, we are committed to promoting the modernization of our payment system through projects like the National Retail Payment System (NRPS) and other payments innovation projects to put in place secure, efficient, and affordable electronic payment platforms to drive the growth of trade and commerce. If you think about it, we are embarking on an infrastructure initiative no less ambitious than building roads, bridges, airports, seaports, and telecommunications facilities.

Ladies and gentlemen, we may not all be clearing and settlement specialists but we certainly are all stakeholders in a vibrant financial market that runs on efficient and secure payment systems. With this latest development, maybe... just maybe... we are on the road to including payments and settlement issues in our morning coffee discussions. Congratulations to all.

Thank you.