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PRETORIA, NOVEMBER 1995

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*Printed by Creda Press and obtainable from the
Payment System Division
South African Reserve Bank
P.O. Box 427
Pretoria, 0001
Telephone (012) 313-3419
Fax (012) 313-3934*

FOREWORD

South Africa has in recent years experienced many changes, and political and social developments have resulted in the country's re-entry into the international financial arena. Although this creates business opportunities which are imperative for growth and development, it also demands adherence to internationally accepted standards and disciplines.

Furthermore, the growth in values transferred through payment systems, as well as the systemic risk inherent in the clearing and settlement of payments, compelled central banks world wide to introduce risk-reduction measures in their respective domestic payment systems.

South Africa's national payment system has served the country well for many years, and there has fortunately been no major systemic crisis. Notwithstanding this fact, the SA Reserve Bank, in line with international developments, identified the need to reform the national payment system.

The National Payment System (NPS) framework and strategy is a product of intensive debate and consultation between the SA Reserve Bank, the banking industry and various other stakeholders. The work done and the effort taken to achieve consensus serves as a fine example of interorganisational co-operation which bodes well for the implementation of the various strategies.

It is my belief that this document provides the basis for the development of a sound and robust payment system, serving the requirements of domestic and international business, and providing access to secure payment mechanisms for all South Africans.

Dr C.L. Stals
Governor of the SA Reserve Bank

NATIONAL PAYMENT SYSTEM

ACCEPTANCE OF THE DOMESTIC FRAMEWORK AND STRATEGY FOR IMPLEMENTATION

IT IS HEREBY STATED that this document encompasses the general principles, strategies and framework for the reform of the domestic national payment system in the Republic of South Africa.

IT IS FURTHER STATED that the details regarding the implementation of the said national payment system will be negotiated between the South African Reserve Bank and the South African banking industry prior to the practical implementation of the various components of the system. Due consideration will be given to the cost implications.

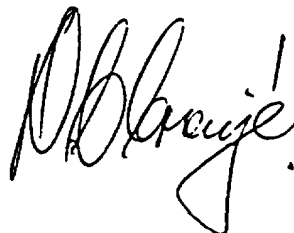
IT IS THUS STATED that the South African Reserve Bank, in conjunction with the South African banking industry, will proceed with the research, investigation, negotiation and practical implementation that may be necessary to bring about the said national payment system.

**SIGNED AT PRETORIA ON THIS THE
15th DAY OF NOVEMBER 1995.**



**Dr C.L. Stals
Governor**

South African Reserve Bank



**Dr D.C. Cronjé
Chairman**

**The Council of
Southern African Bankers**

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EXECUTIVE SUMMARY

INTRODUCTION

South Africa is fortunate in having an efficient infrastructure for the clearing of payments between banks. This infrastructure has been built up over the last twenty-five years and provides a cost-effective service to the banking industry. This includes the systems of banks and the processing capabilities of interbank utilities, for instance, the Automated Clearing Bureau (ACB), for the clearing of cheques and electronic payments, and SASWITCH, for the exchange of automatic teller transactions between banks.

The National Payment System (NPS), however, does not end there. The NPS is a broader concept, which not only entails clearing systems, but encompasses the total payment process, that is, 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 SA Reserve Bank. The NPS thus enables the circulation of money, that is, it enables transacting parties to exchange value.

Furthermore, the NPS is concerned with ensuring that non-cash payments are irrevocable and that risks, specifically systemic risk, are adequately contained.

THE ENVISAGED NPS

It is envisaged that the NPS will serve all the people of South Africa. This will require that the NPS be opened up to encourage effective competition in the provision of payment services to the public and businesses, thereby creating a multitude of access points and a wide variety of payment instruments. This does not mean that the clearing and settlement of payments will be opened up to non-banks, but that non-banks will be able to act as payment-system access points and that all banks will be able to participate on an equal footing. All banks will thus be eligible to have a settlement facility at the SA Reserve Bank and to participate in interbank clearing, on condition that they comply with fair, equitable and transparent entry criteria, applicable to the particular payment stream in which they wish to render services to their customers.

To render effective support to the emergence of South Africa as an international market and a regional financial centre, the NPS will need to be recognised, both domestically and internationally, as being sound and efficient. To achieve these high standards, risk-control measures will have to be implemented and the legal framework will have to be adapted to support NPS practices and agreements.

Every bank participating in the NPS will need to take responsibility for the risks it introduces into the payment system, and banks that enter into payment clearing house (PCH) arrangements will assume responsibility for the settlement risk of that PCH. In the event of a systemic crisis, notwithstanding the risk-reduction measures implemented, the SA Reserve Bank's actions remain discretionary, depending on the circumstances prevailing at the time, and its main concern will be the continued operation of the overall financial system.

Final interbank settlement, which will be subject to the availability of funds in the accounts of the paying banks at the SA Reserve Bank, is effected in the central bank. Irrevocable payment finality can be given only after settlement finality has been obtained from the central bank.

The ultimate responsibility for overseeing the NPS will be vested in the SA Reserve Bank. Different NPS service providers will establish and operate specific components of the NPS processing infrastructure.

CHANGES TO CURRENT PRACTICES AND SYSTEMS

To give effect to the envisaged NPS, various changes are required to existing payment systems, practices and organisational arrangements.

• Implementation of risk-reduction measures

A major shortcoming in the current NPS infrastructure, preventing effective interbank exposure management, is the lack of an electronic settlement system that can support interbank payments and the intraday settlement of interbank obligations. To this end, a settlement network, interbank fund-transfer system and supporting systems, accessible only to banks that have settlement accounts at the SA Reserve Bank, recognised PCHs and depositories, will be implemented. The settlement system will provide banks with settlement-exposure monitoring facilities and multiple settlement options, *inter alia*, immediate real-time settlement and guaranteed delayed settlement. These facilities will enable banks to manage their payment exposures more effectively and will also provide the necessary information to the SA Reserve Bank to identify problem areas.

The systemic risks introduced through delayed settlement will be contained by implementing exposure-capping arrangements, agreed upon by banks and the SA Reserve Bank for each settlement net. Adequate collateralisation of bilateral and/or multilateral netting agreements will ensure that delayed settlement will be effected successfully. A multitude of bilateral and multilateral settlement arrangements will be accommodated.

Banks will be able to integrate their payment systems with the settlement system, to give timeous irrevocable finality of payment to their customers by utilising either the immediate or guaranteed delayed settlement options offered by the central bank settlement system.

The participants in the various payment streams will need to take appropriate steps to contain the risks inherent in the bulk clearing of customer payments.

Banks will have a number of options as far as clearing and settlement are concerned. They will be able to clear and settle on their own account, or could clear in their own name, but settle through a settlement bank. They could also have different arrangements for different payment streams.

- **Enhancement of collateral and reserve management**

The implications of prefunding interbank payments designated for immediate real-time settlement and the introduction of collateral to reduce the risks inherent in settlement arrangements need to be taken into account when prudential requirements are assessed. Furthermore, the extent and cost of intraday liquidity to the participants will need to be negotiated.

To enable the settlement system to utilise collateral designated for funding settlement, if and when required, on a dynamic basis, securities acceptable as collateral will be immobilised, and a system will be put in place to take up and release the pledged collateral dynamically.

- **Obtaining legal certainty and a sound NPS legal framework**

Current legislation does not provide adequate protection for envisaged payment practices. Specifically, the need for legal certainty requires that the current legal framework be adapted.

- **Institution of NPS management arrangements**

To ensure the smooth functioning and evolution of the NPS, effective management is required. To this end, the roles and responsibilities of the different parties involved have been defined. The SA Reserve Bank will play an important role in ensuring the overall safety and soundness of the NPS. The Bank will also endeavour to accommodate the payment-processing needs of all stakeholders within the NPS. A broadly representative South African national payment system discussion forum (SANPAY), under the chairmanship of the central bank, will be constituted.

The Council of Southern African Bankers (COSAB), together with the SA Reserve Bank, will establish an umbrella body (the Payment Association of South Africa - PASA), which will play a prominent role in establishing and controlling Payment Stream Associations (PSAs) representing the banks participating in each particular payment stream.

PCHs will be appointed by the various PSAs, and it is possible that multiple PCHs could be created per payment stream, depending on the needs of the stream and the participating banks.

Bank-owned and other operators would be licensed to provide NPS infrastructural components and render NPS services, subject to predetermined criteria. Participation agreements will be introduced to formalise the participation of banks in the various PCHs. This will clearly separate ownership and user interests.

- **Harmonisation of payment and trade practices**

The NPS will support financial market and trade practices, and *vice versa*. To this end, financial market practices, as well as cross-border and foreign-currency market practices, will be reviewed to ensure that the NPS adequately harmonises with practices in these areas.

CONCLUSION

The envisaged NPS will place the South African payment system on a par with international standards, and also provide an attractive environment for international participation in the domestic economy. The attributes of the NPS will not only improve the international standing of the South African financial system, but also serve the interests of all South Africans, directly and indirectly. Measures aimed at decreasing risk in the provision of customer payment services will give the public access to safe and efficient mechanisms to transfer money and effect payments. This will allow for the entry of more banks into the clearing and settlement system and provide for the admission of non-banks as providers of customer payment services.

INTRODUCTION

PROJECT RATIONALE

The central bank is central to the payment services of a country and, therefore, has an undeniable interest in the soundness and safety of the payment system. Although this has always been the case, payment system issues have started moving from the backroom to the boardroom in recent years. It is a worldwide trend, especially within the central bank fraternity, for renewed attention to be paid to payment systems.

The South African payment system has evolved and successfully serviced the country for a number of years. It is, however, also displaying a number of deficiencies that need to be addressed urgently. According to Dr C.J. de Swardt, Deputy Governor of the SA Reserve Bank: "South Africa is likely to be drawn into the international financial society which is becoming increasingly integrated. Participation in such an integrated system will bring new international obligations and disciplines in terms of required proper clearing and settlement systems and risk management procedures."

Dr De Swardt quoted Mr Eddie George in saying: "The financial 'revolution' during the past decade has resulted in 'a massive expansion in the value of financial transactions, within and across national and market borders, and there has, of course, been a corresponding explosion in the values passing through the world's payments and settlement systems ... The resulting interdependence of financial intermediaries, including interdependence through their involvement in payment and settlement systems, is potentially an extremely powerful means of communicating problems arising in one financial institution very widely around the world ... What is new about the present situation is the sheer scale of intra-market exposures and the extent of the contagion that could result from a major failure, even a technical or operational failure of the payment or settlement system'."¹

In February 1994, the banking industry, through the then chairman of the Clearing Bankers Association (CBA), Mr D.R. Busse, requested the SA Reserve Bank to take the lead, and this project is therefore an endeavour to provide the industry with strategic leadership in the evolution of the NPS.

On his return from an international payments conference in Washington, in March 1994, Mr P.J. Liebenberg, executive officer of COSAB, confirmed the implications for South Africa when he said: "The over-riding impression is the realisation, once more, not only of the truly significant changes in technology, communications and banking that took place during the past decade or so, but also the great responsibility of our banking industry to cope with the essential changes that will be required during the next few years. In addition to our changing domestic environment we must also prepare for our re-entry into the international arena."

The Governor of the SA Reserve Bank, Dr C.L. Stals, introduced the project during a meeting with the chief executive officers of banks held in Pretoria on 21 April 1994.

1. Mr Eddie George, Governor, Bank of England - "International Banking, Payment System and Financial Crises", 1994.

PROJECT OBJECTIVE

The objective of the NPS project was to create a blueprint of the NPS architecture, as it is envisaged in the longer term, representing the views of the central bank, the financial services industry and other stakeholders.

PROJECT SCOPE

The term payment system in the context of this project placed payment issues in a systems context, viewing payment-related issues from a systems-oriented perspective (systems thinking). It encompassed the overall framework and structures of the NPS, that is, everything that could impact the smooth functioning of the NPS in its broadest business sense. It did not focus, however, on payment-related computer systems, although computer systems will be part of the overall payment system.

PROJECT APPROACH

The approach to the project was:

- to address the architecture as a joint financial services industry project and to involve representatives from, especially, the banking industry extensively throughout the project;
- to focus on the ideal architecture that would position South Africa for the future;
- to take cognisance not only of reality and the South African situation, but also of international trends;
- to create a vision of the ideal situation, in a manner that could be communicated and shared throughout the industry;
- to keep the architecture on a conceptual level;
- to address the many facets of the NPS and to provide a comprehensive, holistic and integrated view of the envisaged NPS;
- to ensure that the project was driven to conclusion in a suitable time frame, with the SA Reserve Bank fulfilling the project-management role;
- to involve multidisciplinary skills in determining the requirements and in conceptualising the ideal system;
- to involve the most appropriate individuals, who would be able to provide the most constructive input and contribute towards the architecture and do so in the most suitable manner;
- to follow a process that would ensure wide consultation with all interest groups and promote consensus within the time frame given;
- to ensure that the knowledge base on payment system issues was broadened. This implied developing a group of payment system experts who would be able to act as mentors for the various projects that would be initiated as a result of the architecture; and
- to ensure the existence of a clear understanding between banks and other stakeholders in terms of their responsibilities in the payment system, resulting in greater consensus on non-competitive facilities and infrastructures.

PROJECT PARTICIPANTS

- **Project co-ordination, groundwork and support services**

The members of the SA Reserve Bank team who are responsible for the NPS project, and who provided the technical and administrative support to create the NPS framework and strategy, are listed in Table 1.

Table 1: SA Reserve Bank core team

Payment System Division	Mr R.T. Bamber, Mr J.M. Bence, Mr M.S. Blackbeard, Mr M.N. Huber, Mr E. Leach, Ms P.A. Smith, Mr G.C. Stokes, Ms I. Ströh, Dr P.J. Tromp
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- **Strategy formulation**

A strategy team was established to participate in the formulation of the framework and strategy. The persons who participated during the course of the process are listed in Table 2.

Table 2: Strategy team participants

ABSA Bank Limited	Mr N. Havinga, Mr J.W.P. Pienaar, Dr M.J. Venter
Bankserv	Mr E. de Klerk
Boland Bank PKS Limited (representing other banks)	Mr S. Roux
First National Bank of Southern Africa Limited	Mr C. Coetzer, Mr P.A. Rawlings, Mr J.R. Wareing, Mr J.G. Wildman
Nedcor Limited	Mr F.W.A. Britz, Mr F. Erasmus, Dr L. Porter, Mr G.J. Steyn
South African Reserve Bank	Mr R.T. Bamber, Mr M.N. Huber, Mr E. Leach, Ms I. Ströh, Dr P.J. Tromp
The Standard Bank of South Africa Limited	Mr M.S.T. Backwell, Mr S.R. Epstein, Mr M.F. Lear, Mr A.N.D. Toms

Multidisciplinary perspectives

Participants from various disciplines and institutions in the financial sector who also contributed towards the formulation of the strategic framework in one way or another are listed in Table 3.

Table 3: Other participants in the formulation of the strategy

ABSA Bank Limited	Mr G. Brewer, Mr C.J. Engelbrecht, Mr R. Johnson, Mr M. Lammas, Mr F. Leach, Mr F. Meisenholl, Dr P. Morgenrood, Mr C. Parker, Mr W. Robinson, Mr P. Roux, Mr A.J. Smal, Mr F. van Biljon, Mr A. Wilke
Automated Clearing Bureau (Pty) Ltd	Mr J. Coombes, Mr J. Prentzler
First National Bank of Southern Africa Limited	Mr P. Aucamp, Mr N. Crawford, Mr K. Drawbridge, Mr C. Edwards, Mr R. Foltan, Mr G. Grigoratos, Mr A. Hart, Mr K. Moir, Mr W. Smith, Mr D.A. van der Merwe
Nedcor Limited	Mr D.I. Adams, Mr J. Forbes, Mr S. Gericke, Mr B.C. Kemp, Mr W.J. Kruger, Mr A. Lichkus, Mr L. Nagan, Mr G.D. Nel, Mr P.J. Pieterse, Mr R.B. Plowman, Mr S. Rechtorik, Mr J. Snyman, Mr A.M. Sorgdrager, Mr J.H.L. Stander, Dr F. Viljoen
Mercantile Bank Limited (representing other banks)	Mr P.G. van Deventer
South African Reserve Bank	Mr A. Bezuidenhout, Mr A.R. Buckland, Mr I.W.A. de Villiers, Mr D.J. Ehlers, Mr M.A. Kock, Mr H.W. Krull, Mr D. Naude, Mr C.L. Oosthuizen, Mr G.J. Terblanche, Dr J.P. van den Heever
The Standard Bank of South Africa Limited	Mr A.W. Cousins, Mr J.A. Cruickshank, Mr K. Daley, Mr D. Flint, Mr N.J. Gericke, Mr K.C. Gill, Ms V.M. Mileman
University of South Africa Department of Mercantile Law	Ms I. Meiring, Prof C. Visser