

South African Reserve Bank

National Payment System Department

Consultation Paper

Reviewing the cheque item limit

November 2018

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1. Introduction and background

- 1.1 In terms of section 10(1)(c)(i) of the South African Reserve Bank Act 90 of 1989, as amended (SARB Act), the South African Reserve Bank (SARB) is required to 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, the National Payment System Act 78 of 1998 (NPS Act) provides for the management, administration, operation, regulation and supervision of payment, clearing and settlement systems in the Republic of South Africa, and to provide for connected matters.
- 1.2 The NPS Act authorises the SARB to recognise a payment system management body (PSMB) established with the objective of organising, managing and regulating the participation of its members in the payment system. The NPS Act requires such a PSMB to be constituted to fairly represent the interest of its members; to have a fair, equitable and transparent constitution and admission rules for members; to enable the SARB to adequately oversee the affairs of the PSMB and its members; and to assist the SARB in discharging its responsibilities as specified in section 10(1)(c) of the SARB Act.
- 1.3 The Payments Association of South Africa (PASA) was recognised by the SARB as a PSMB in 1998. Since this recognition, the SARB has exercised oversight responsibilities over PASA as provided for in section 3 of the NPS Act. Currently, PASA manages 18 payment clearing houses (PCHs), including the Code Line Clearing (cheque) PCH.
- 1.4 A **cheque** is defined by the Bank for International Settlements (BIS) Committee on Payments and Market Infrastructures (CPMI) as a written order from one party (the drawer) to another (the drawee, normally a bank) requiring the drawee to pay a specified sum on demand to the drawer or to a third party specified by the drawer. Cheques can be used for settling debt and withdrawing money from banks. In terms of the Bills of Exchange Act 34 of 1964, a cheque means a bill drawn on a banker payable on demand.

- 1.5 In July 2012, PASA initiated the reduction of the cheque item limit from R5, 000,000.00 to R500,000.00 to address the risks that are associated with cheques in the national payment system (NPS). The SARB endorsed the reduction as it contributed to the protection of consumers, the reduction of risk in the NPS, and the fact that alternative (safer) payment methods are available to consumers.
- 1.6 To further reduce inefficiency and risks – considering that cheques are outdated, expensive to process, and vulnerable to fraud in the NPS – the payments industry, through PASA, has recently proposed to the SARB a further reduction of the cheque item limit, from R500,000.00 to R50,000.00 (referred to as the ‘item reduction’ hereafter). The proposal of the item reduction seeks to achieve a safer and more efficient NPS that promotes safe, convenient and cheaper payment methods for all South Africans.
- 1.7 In view of the potential impact that the item reduction may have on consumers, the NPS and the broader economy, the SARB engaged with National Treasury, the Financial Sector Conduct Authority (FSCA) and PASA on the proposal. The engagement was aimed at arriving at a coordinated approach necessary to balance the policy objective of providing better outcomes to consumers through fairer treatment and protection, against the safety and efficiency of the NPS and financial inclusion objectives.

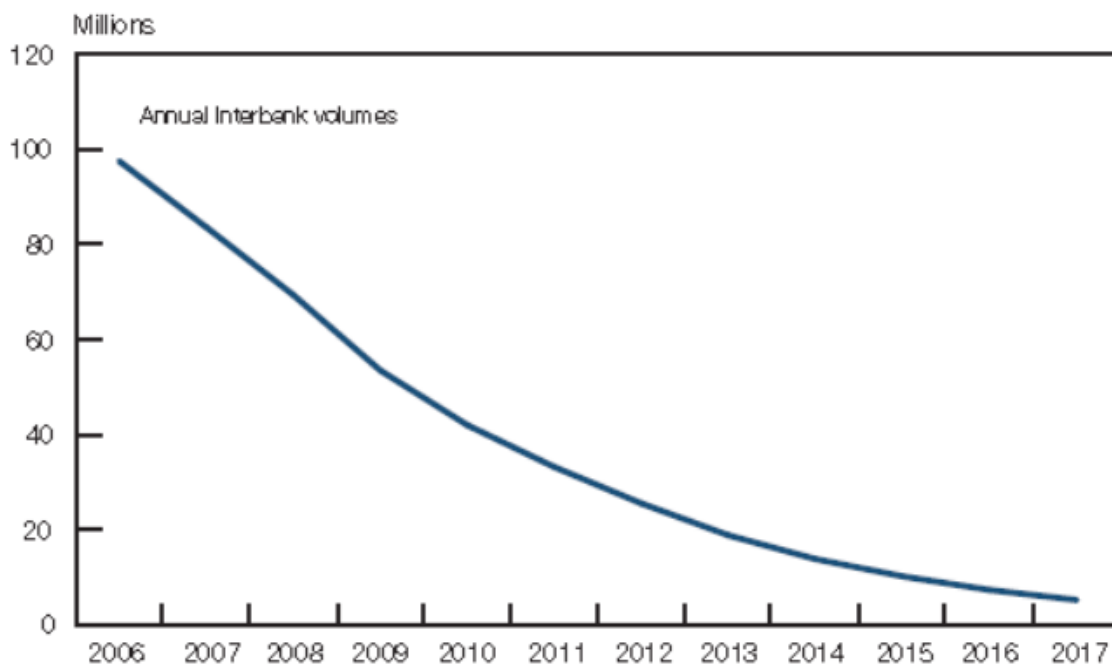
2. Purpose

- 2.1 The objective of the consultation is to solicit stakeholders’ input (i.e. that of individuals, municipalities, government departments, financial service providers, businesses, consumer groups and other relevant stakeholders) on the proposed cheque item limit reduction from R500,000.00 to R50,000.00 and the proposed implementation time frame, and to gather information on cheque-related matters.
- 2.2 The optimal outcome should promote the safety, integrity and efficiency of the NPS, and provide better outcomes to consumers in the Republic of South Africa.

3. Overview of the current cheque industry

3.1 A cheque is one of the oldest recognised payment instruments in South Africa and also globally. In the past, cheques were a popular form of payment. However, over the years, with the ever-increasing usage, cost-effectiveness, efficiency and convenience of electronic payments such as cards and electronic fund transfers (EFTs), the usage of cheques has declined. (See Figure 1 for South Africa.) Globally, countries such as Australia, Singapore and the United Kingdom are also experiencing a decline in cheque usage.

Figure 1: The decline of cheque volumes in South Africa



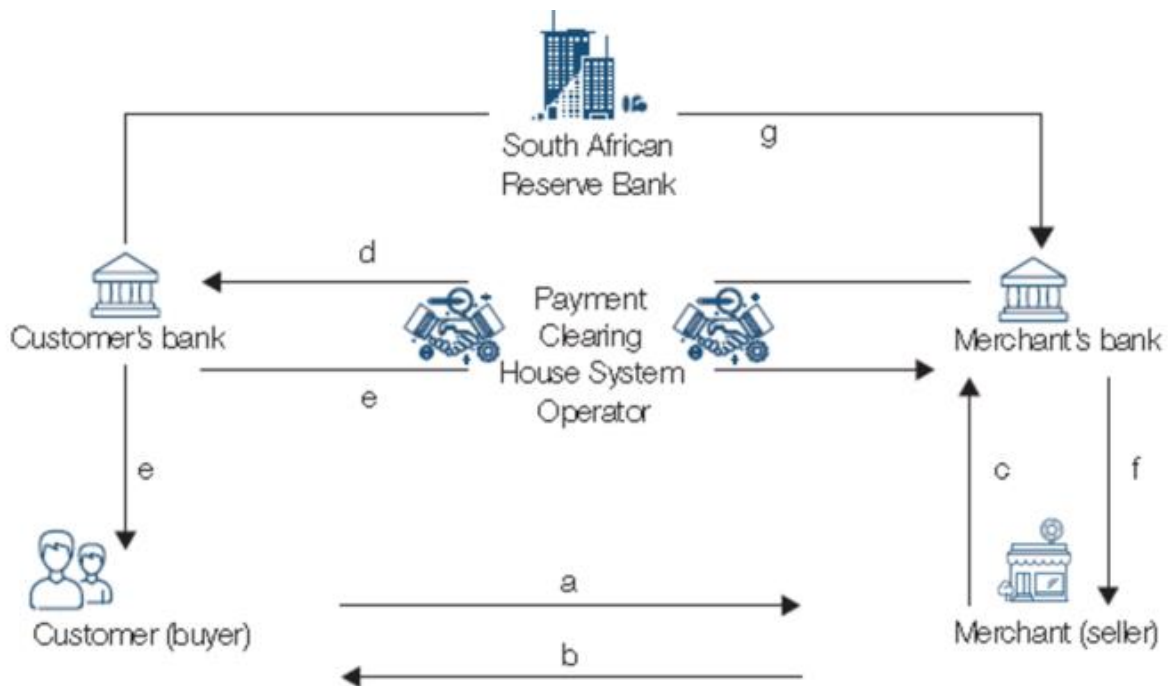
Source: BankservAfrica

3.1.1 A simple definition of a **cheque item limit** is the maximum transaction value permitted for a cheque transaction. Currently, in South Africa, a cheque can neither be issued nor accepted if it exceeds R500,000.00.

3.1.2 **Process flow of a cheque payment:** A bank normally issues a cheque book with a transactional account to its customer. This is done to provide the customer with an option to discharge his/her obligations with a cheque.

- a) Let us assume that a consumer wants to purchase furniture in a shop. The customer (buyer) writes a cheque in favour of the merchant (shop owner / seller). The cheque must specify all the necessary details, such as the full name of the merchant, the date of the cheque, the amount to be paid (in words and in numbers), and the signature of the account holder (customer). It is important that the merchant accepts a cheque as a form of payment.
- b) The merchant provides the furniture to the consumer upon receipt of a cheque.
- c) The merchant deposits the cheque with his/her bank.
- d) The cheque is passed on to the customer's bank to honour it through a payment clearing house system operator (PCH SO).
- e) The customer's bank checks if the funds are available. If the cheque is genuine, the bank debits the customer's account. A 'successful transaction' message is then sent back to the merchant's bank through the PCH SO.
- f) The merchant's bank credits the merchant's account in its books.
- g) The customer's bank settles with the merchant's bank (through SARB accounts).

Figure 2: The process flow of a cheque payment



Source: SARB

4. The current challenges of cheque usage

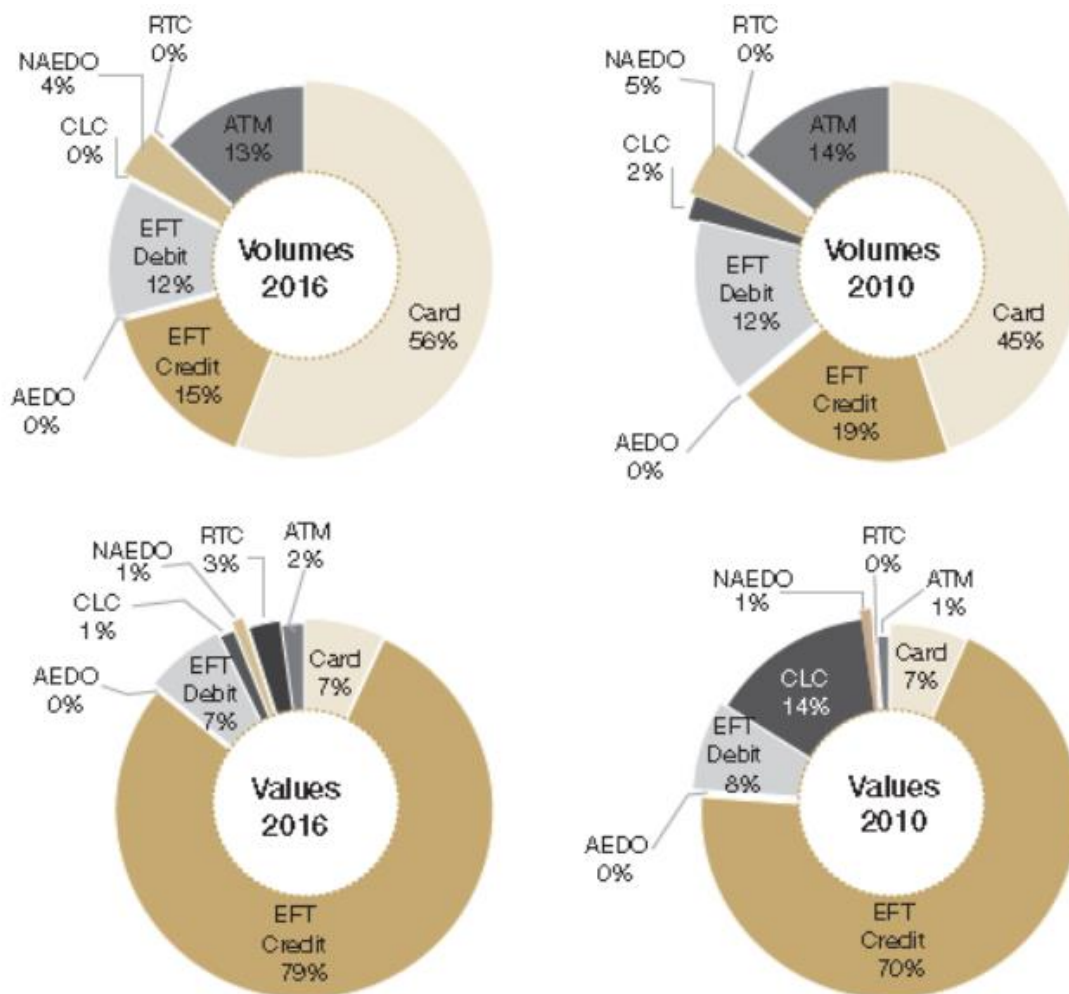
4.1 The **duration of processing** a cheque transaction: There is no standard processing period for cheques in the NPS. The processing time is largely dependent on the relationship between an account holder and his/her bank. Although the process tends to take not more than 10 days, circumstances (and/or individual bank terms and conditions) may warrant a longer or a shorter processing period. Banks normally withhold access to the funds credited in this manner to safeguard against the possible dishonouring and return of the cheque by the paying bank. To speed up the process, the information on a cheque is sent via an electronic information stream through an interbank operator, and the physical cheque follows to serve as final confirmation of the mandate. The speed of the transaction is slow, and it is difficult to manage the conclusion of a sale and purchase agreements effectively. Hence, instead of the life cycle of a transaction taking seconds, it takes days.

4.2 **Fraudulent activities and scams** are prevalent in cheques. Below are examples of various types of cheque fraud and scams:

- 4.2.1 A **forged cheque** is not written or authorised by a legitimate account holder, but it is issued from a genuine account. This normally occurs when a legitimate cheque or cheque book is stolen or lost, and the fraudster forges the signature of the legitimate cardholder.
- 4.2.2 A **counterfeit cheque** is a fake cheque. It has a high resemblance to an original cheque but is created on non-bank paper.
- 4.2.3 An **altered cheque** is a legitimately issued cheque but it has been intercepted and the beneficiary and/or the amount of the item has been altered, or new information has been added.
- 4.2.4 **Cheque washing** is the process of erasing all the information from a genuine issued cheque by 'washing' or 'cleaning' the cheque, either printed or written, with chemicals, in order to replace the details with false information.
- 4.2.5 A **closed account issued cheque** refers to a bank account that is not used anymore or is closed, but cheques still exist for that particular account.
- 4.2.6 **Overpaid cheques:** The fraudster approaches the targeted consumer with an urgent order for goods and/or services and a promise of immediate payment using a cheque. The fraudster then informs the consumer that a larger amount than required was deposited into the consumer's account. The fraudster asks the consumer to pay him/her the difference. The cheque bounces, and the consumer ends up losing the amount paid to the fraudster. Moreover, some banks charge the consumer for the bounced cheque that was made against their account.
- 4.2.7 **Bad-cheque writing:** A cheque is written on either a non-existent account or an account with insufficient funds, in the hope that the recipient will not suspect that the cheque will not clear. The buyer takes possession of the goods and/or services purchased with the bad cheque, and hopes that the recipient will not take action.

- 4.3 Cheques are an **expensive** payment instrument. Paying by cheque is a lengthy multi-stage process that adds additional costs at every stage and invites the risk of error, loss and/or fraud. In contrast, most electronic payments can be carried out at the click of a button, enable faster payment and reconciliation, and are significantly cheaper. Cheques are also expensive to process. The cost of processing cheques continues to increase due to the overheads being spread across fewer transactions as fewer cheques are written. Processing costs will continue to increase as cheque usage continues to decline.
- 4.4 There is **restricted cheque acceptance**. The wide acceptance of cheques has declined over the years. Fewer and fewer businesses and individuals are willing to accept cheques as a means of payment as the payment method is expensive, takes too much time to process, and is more susceptible to fraud than other payment methods. Some businesses explicitly state outside their premises and/or at their payment points, using visible signage, that they 'regrettably do not accept cheques'.
- 4.5 Cheques are a **declining payment method**. The use of cheques has fallen significantly over the past decade with the introduction of safer, faster and more convenient electronic payment methods such as cards and EFT debit and credit. Also, the previous item limit had contributed to the reduction of cheque usage. (See Figures 1 and 3.) In July 2012, the cheque item limit was reduced from R5, 000,000.00 to R500,000.00, and further reductions in the item limit were expected to be considered to better manage risk, which also supports the SARB's position regarding the support of initiatives that encourage the use of safer, more modern and more efficient payment instruments.

Figure 3: The growth of retail payment (2010 vs 2016)



Source: PASA, CLC (code-line clearing) represents cheques.

4.6 There is a **lack of innovation** in cheques. Over the years, the industry has focused on innovation in electronic payments. The objective was to provide consumers with faster, cheaper and more reliable payment methods. As a result, innovation in cheques has been neglected. Globally, the trend of innovation has focused on electronic payments which are fuelled by the growth of e-commerce, mobile phones and other devices, and access to the Internet, including the introduction of significant digital players such as Amazon, Apple, Ebay, Google, Paypal, Takealot, Samsung, etc. Other factors that contribute to the lack of cheque innovation include the lack of interest from fintechs and financial service providers as well as the lack of consumer demand as the interest is more focused on allowing mobile phones and other devices to easily access the payment system to effect payments.

4.7 There is **limited education and protection for the consumer**. Unlike with other payment methods, consumers regularly fall prey to fraudulent cheque activities, either due to the nature of doing business by accepting cheques or due to a lack of focus on educating consumers regarding cheques. For example, in the cheque environment, the recipient accepts the cheque with the trust that the cheque will clear and not bounce. Unlike in the debit card environment, the buyer's bank checks if the buyer has enough funds and debits the buyer's account before authorising the transaction, therefore giving the merchant comfort that they can release the goods as they will receive payment. Also, fraudsters normally target consumers who are unfamiliar with how cheques operate, because once the consumer sees the amount reflected in their account they believe the amount has cleared similarly to electronic transactions, and they release the goods unaware that a cheque takes days to clear and may bounce.

5. **Initiatives implemented to address cheque usage challenges**

5.1 Industry intervention

5.1.1 As mentioned above, the interbank rules relating to the operation of cheques are determined by the members of PASA. PASA initiated the reduction of the cheque item limit in July 2012 from R5, 000,000.00 to R500,000.00 with the endorsement of the SARB to reduce risk in the NPS. These risks include fraud risk and business continuity or operational risk (owing to the ageing processing capabilities and the general exiting of skills from the cheque processing environment), which in turn pose risks for cheque clearing infrastructure maintenance and support. Moreover, PASA is proposing a further reduction of the item limit from R500,000.00 to R50,000.00 citing the same risks in addition to the significant and constant decline in cheque usage over the years.

5.1.2 On the PASA website ('FAQs' section), the public is provided with consumer protection information regarding the various payment methods, including cheques. The information includes the following: a) what to do if certain scenarios occur; b) whom to contact for assistance; c) the processes regarding specific (popular) transactions; d) how to protect against fraud; e) when fraud is likely to occur and what

to do if fraud is suspected; f) consumer rights such as disputes; g) the advantages and disadvantages of various payment methods; and h) an explanation of terms.

5.1.3 Other industry stakeholders – such as the Banking Association of South Africa (BASA), the South African Banking Risk Information Centre (SABRIC) and banks – are continuously sensitising their consumers regarding the various cheque-related fraud and scams, and how consumers can protect themselves. This information is available on their respective websites.

5.1.4 Some banks also advise their clients of the expensive nature of cheques as a method to effect payments. Furthermore, banks are promoting the use of electronic payments such as cards and EFT debits and credits. These payment methods are cheaper, faster and more efficient than cheques. In addition, banks have introduced initiatives and incentives to encourage the usage of safer payment methods such as value-added services, loyalty programmes and, in some instances, free transactions or services. These advantages or benefits are not available with the usage of cheques.

5.2 Regulatory intervention

5.2.1 **Risk reduction measures:** The SARB has generally used the item limit for all payment streams, not only in cheques, as a risk reduction measure in the NPS. Upon the implementation of the South African Multiple Option Settlement (SAMOS) system, an automated interbank settlement system provided by the SARB for banks to settle their obligations, it was determined that certain retail payment systems were being used incorrectly for large-value payments, thus creating excessive exposures in those systems. These exposures posed a risk to the entire NPS. To address this, item limits were introduced for specific payment instruments in the retail payment system. For example, in EFT credit, the item limit is R5, 000,000.00; in EFT debit the item limit is R1, 000,000.00.

5.2.2 **The National Payment System Framework and Strategy – Vision 2025¹:** In March 2018, the SARB published *Vision 2025* outlining the NPS goals and strategies to be achieved by 2025. Throughout the document, there is reference to the future importance of electronic payments in the NPS and how electronic payments are linked to the achievement of the various goals. Below are some of the examples extracted from *Vision 2025*:

- a) The **overarching vision** states that the SARB expects consumers to have increased trust and familiarity with electronic payment systems.
- b) **Financial stability and security:** Consumers have confidence and trust in electronic payment systems and related access mechanisms or technologies.
- c) **Promoting competition and innovation:** Consumers are aware of electronic payment alternatives. Their rights and responsibilities are visible, clearly communicated, and understood.
- d) **Cost-effectiveness:** Cost-effectiveness is key to driving the usage of electronic payment systems as well as assuring efficiency and scale for banks and other NPS participants. This applies both to the costs of developing and implementing payment systems as well as to ongoing operating costs.
- e) **Financial inclusion:** Financial inclusion entails access to electronic payments but also access to savings, credit and insurance services.

6. Proposed initiative of R50,000.00 item limit and six-month implementation plan

6.1 Why R50,000.00?

6.1.1 The item limit is one of the levers used to reduce the risks of cheques in the NPS and to promote the safety, efficiency and integrity of the NPS. Introducing a lower item limit would reduce the risk of exposure to consumers, businesses and government who still issue and accept cheques. Also, it would reduce the impact to the value of transactions through the NPS in the event of a system failure.

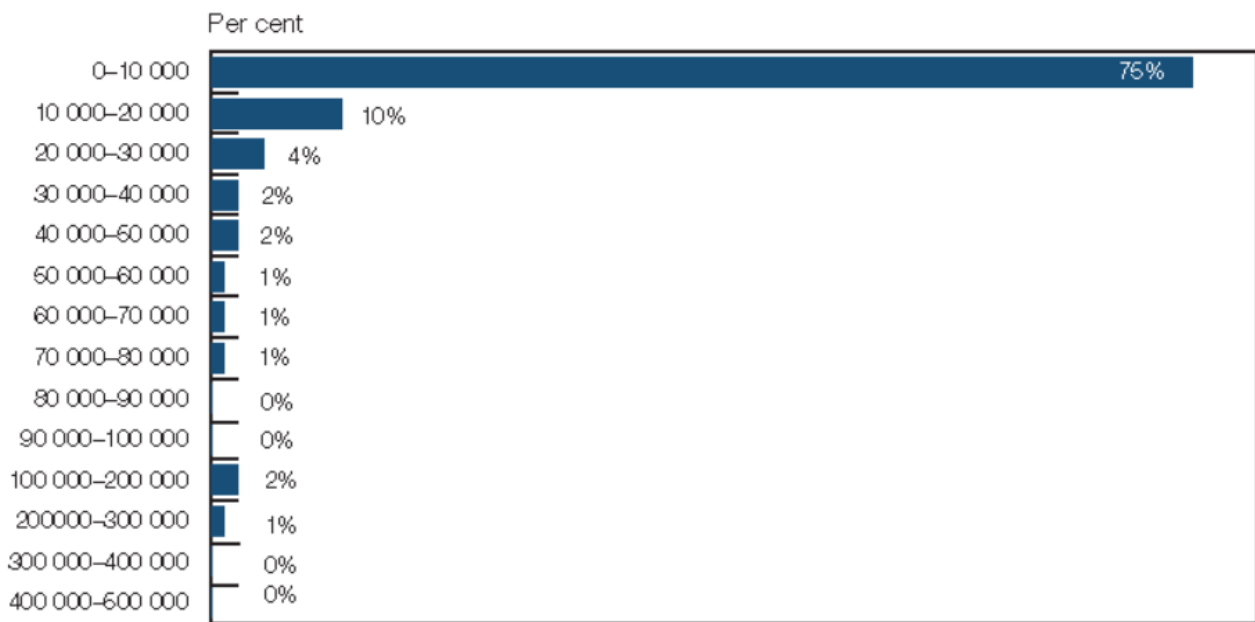
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[https://www.resbank.co.za/RegulationAndSupervision/NationalPaymentSystem\(NPS\)/Documents/Overview/Vision%202025.pdf](https://www.resbank.co.za/RegulationAndSupervision/NationalPaymentSystem(NPS)/Documents/Overview/Vision%202025.pdf)

6.1.2 The industry continues to discourage the usage of cheques as they are an inefficient and unsafe payment method for consumers. The proposal of the item limit reduction in July 2012, from R5, 000,000.00 to R500, 000.00, has therefore been put forward. A further reduction is envisaged to better manage cheque risks, which also supports the SARB’s position regarding the support of initiatives that encourage the use of safer, electronic and more efficient payment instruments. The industry has proposed a R50,000.00 item limit based on the current statistics on the value range of issued cheques.

6.1.3 Approximately 93% of the monthly volumes reside in the R0-50,000.00 value range (the bulk of the volumes), while 75% of the volumes are in the R0-R10,000.00 value range. The impact on consumers who use and accept cheques should be minimal. This observation is illustrated in Figure 4.

Figure 4: Percentage volume based on value range – September 2017



Source: BankservAfrica

6.2 Why the six-month implementation time frame?

6.2.1 An implementation time frame of six months is proposed to effect the changes of the item limit, considering that the previous reduction of the item limit from R5,000,000.00 to R500,000.00 in 2012 was also implemented over a six-month period. That implementation was overall successful, with only minor glitches. Implementation includes system and administrative changes for banks and consumers, notifying customers, and migrating affected consumers to electronic channels such as EFT credit.

7. Benefits of the item limit reduction

7.1 **Promoting the safety and efficiency objectives:** *The Position Paper on Risk Reduction Measures for Payment Clearing Houses in the National Payment System (NPS 01/2000)* addresses the implementation of item limits by PCH participants. It states that participants in the retail PCH batches have agreed, in principle, to remove high values from payment streams in order to reduce the settlement risk. Therefore, the SARB supports the item limit as a mechanism to reduce risk in the NPS; this will also promote the safety and efficiency objectives of the NPS.

7.2 **Supporting the *Vision 2025* goals:** The future NPS landscape, as articulated in *Vision 2025*, foresees electronic payments as a vital mechanism to achieve the majority of the *Vision 2025* goals, including financial stability and security, promoting competition and innovation, cost-effectiveness and financial inclusion. Hence, the continuous use of cheques does not contribute towards safe, efficient and cost-effective payment systems that serve the needs of South Africans. Cheque usage increases consumer vulnerability to fraud and delays access to funds, and is expensive.

7.3 **Promoting electronic payments, consumer protection and consumer education:** Consumers are encouraged to use safer, more reliable and more efficient payment methods. They benefit from the protection afforded to consumers based on the respective payment methods, e.g. charge-back rights, the Payment Card Industry Data Security Standards (PCI DSS) and 3D Secure in the card environment. This also includes value-adds, loyalty programmes and, in some instances, free transactions or

services. Industry's current and future efforts are focused on encouraging electronic payments and educating consumers on the benefits, risks and consumer protection related to electronic payments.

- 7.4 **Increased cost savings:** Financial service providers charge higher fees and additional charges such as cheque book, cheque clearing and cheque encashment fees. However, they charge cheaper for and, in some instances, offer free electronic payments or services. Also, financial service providers and non-bank payment providers, including fintechs, are competing in the electronic space to offer customers user-friendly, convenient and cheaper financial products and services.
- 7.5 **Improved cash-flow management and reconciliation:** Electronic payments assist with cash flow management by giving the consumer control over when payments are made or received, rather than having to wait for the other party to send or cash a cheque. In addition, they eliminate the cost associated with dishonoured cheques. Reconciliation is faster and easier because most electronic payments are concluded on the same day; the purchase and the payment occur on the same day. Businesses' accounting and operational functions are consequently not overburdened by creating multiple processes and controls. It then becomes possible to have better management of payment records and to generate daily and intra-daily reports.
- 7.6 **Reduced risk of fraud and security:** Electronic payments help to reduce fraud and security concerns by providing a full audit trail, and they reduce the risk of incorrect, dishonoured or lost payments.
- 7.7 **Improved business continuity:** There is constant improvement in the skills, management, operational and business continuity for electronic payments. Industry constantly develops better, more effective plans for disastrous incidents and business disruptions.

8. Questions for stakeholders

All expressions of views on the consultation paper would be welcomed. The SARB would particularly appreciate receiving stakeholders' responses to the following questions, including, in each case if possible, the reasons for your answers:

8.1 Cheque usage

- a) Are you an issuer or an acceptor of cheques, or both?
- b) What are your reasons for issuing and/or accepting cheques?
- c) If cheque usage is prevalent in your sector, in which sector do you operate and why are cheques still prevalent in your sector?
- d) As an issuer and/or acceptor of cheques, what are the benefits and risks associated with cheques relative to other payment methods?
- e) As an issuer and/or acceptor of cheques, what are your total costs associated with cheques compared to alternative electronic payment options?

8.2 Item reduction

- f) Should you prefer to use cheques, would an item limit of R50,000.00 be sufficient to conduct your business?
- g) Given that most cheque usage falls below the R50,000.00 mark, could an alternative item limit be considered?
- h) If so, what item limit level would be appropriate and why?
- i) What is the possible impact of the proposed item limit?

8.3 Time frame

- j) Would a time frame of six months be sufficient to implement the proposed item limit reduction?
- k) If not, what time frame would be sufficient?

8.4 Alternative payment methods

- l) Would you consider electronic alternatives for making payments given that they are safer, more efficient and cheaper?
- m) If not, why not? What would you like to see in alternative options?
- n) What are the barriers to increasing the adoption of electronic payments?
- o) If you have already reduced or even stopped the usage of cheques, what were the main reasons for moving to other payment methods?

9. Comments and contact details

- 9.1 Stakeholders are invited to submit their comments on this consultation paper by **03 December 2018**. Comments should be addressed to npsdirectives@resbank.co.za.

Abbreviations

AEDO	authenticated early debit order
ATM	automated teller machine
BASA	Banking Association of South Africa
BIS	Bank of International Settlements
CLC	Code Line Clearing
CPMI	Committee on Payments and Market Infrastructures
EFT	electronic funds transfer
FAQs	frequently asked questions
FSCA	Financial Sector Conduct Authority
NAEDO	non-authenticated early debit order
NPS	national payment system
NPS Act	National Payment System Act 78 of 1998
PASA	Payments Association of South Africa
PCH	payment clearing house
PCH SO	payment clearing house system operator
PCI DSS	Payment Card Industry Data Security Standards
PSMB	payment system management body
RTC	real-time clearing
SABRIC	South African Banking Risk Information Centre
SAMOS	South African Multiple Options Settlement [system]
SARB	South African Reserve Bank
SARB Act	South African Reserve Bank Act 90 of 1998, as amended