SOUTH AFRICAN RESERVE BANK

National Payment System Department

Consultation Paper

The phasing out of cheques in the national payment system

October 2020

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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. The functions provided for in the SARB Act and the NPS Act are performed by the National Payment System Department (NPSD) within the SARB.

1.2 The national payment system (NPS) encompasses the entire payment process, from payer to beneficiary, and includes settlement between banks. The process includes all the tools, systems, mechanisms, institutions, agreements, procedures, rules or laws applied or utilised to effect payment. The NPS enables the circulation of money, that is, it enables transacting parties to exchange value. The NPS further contributes to the economy and financial stability in South Africa.

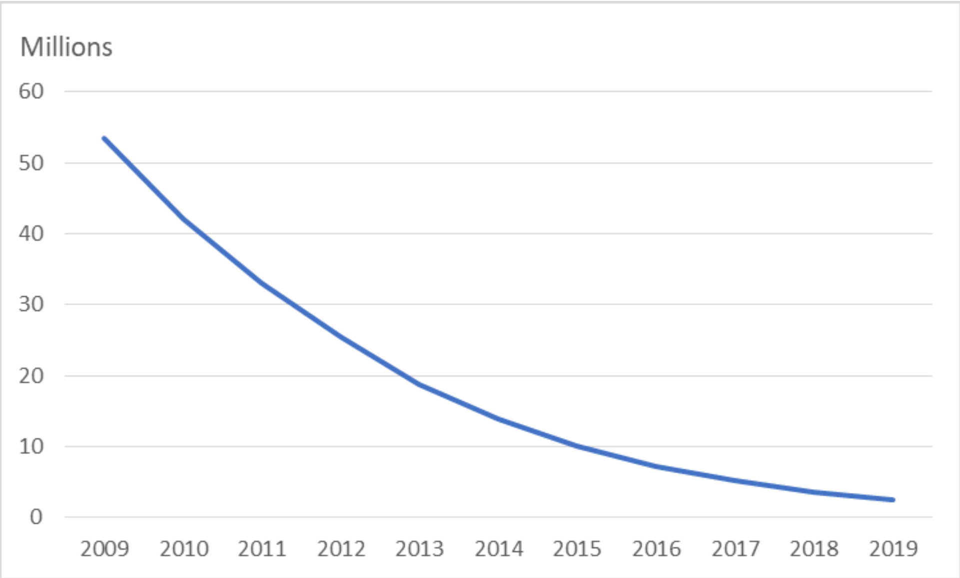
1.3 In 1998, the SARB recognised the Payments Association of South Africa (PASA) as a payment system management body (PSMB) in terms of section 3 of the NPS Act. Since this recognition, the SARB has exercised oversight responsibilities over PASA, as provided for in section 3 of the NPS Act. At present, PASA manages 19 payment clearing houses (PCHs), including the Paper Based Payment Instruments PCH.

1.4 The Bank for International Settlements (BIS) Committee on Payments and Market Infrastructures (CPMI) defines a ‘cheque’ 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 The usage of cheques has been declining year on year (see Figure 1) as consumers increasingly adopt alternative, safer, more efficient and convenient electronic payment instruments. Furthermore, the usage of cheques is not contributing positively to the safety or efficiency of the NPS, as is described in section 5.

1.6 Notwithstanding the various interventions that have taken place over the years (see section 4), it became necessary for the SARB to review the future of cheques in the NPS.

Figure 1: The decline of cheque volumes in South Africa



Source: BankservAfrica

2. Purpose

2.1 The objective of this Consultation Paper 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 phasing out of cheques and the proposed implementation timelines.

2.2 The optimal outcome should promote the safety, efficiency and integrity of the NPS, and provide better outcomes to consumers in the Republic of South Africa.

3. Overview of the cheque industry

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

3.2 Over the past years, South Africa initiated a process of implementing “cheque item limits’. A simple definition of a ‘cheque item limit’ is the maximum transaction value permitted for a cheque transaction. The current cheque item limit in South Africa is R50 000.

3.3 In terms of the process flow of a cheque payment, a bank normally issues a cheque book linked to a transactional account to its customer. This provides the customer an option to discharge his/her payment obligations with a cheque.

a) In a given scenario where a customer wishes to purchase furniture in a shop. The customer (buyer) writes a cheque in favour of the merchant (shop owner / seller). The cheque must contain all the necessary details, such as the full name of the merchant, the date of the cheque, the amount to be paid (in numbers and in words), and the signature of the account holder (customer). In order to conclude the transaction, the merchant must also be willing to accept a cheque as a form of payment.

b) The merchant provides the furniture to the customer upon receipt of the duly completed cheque.

c) The merchant deposits the cheque into his/her bank account at his/her bank.

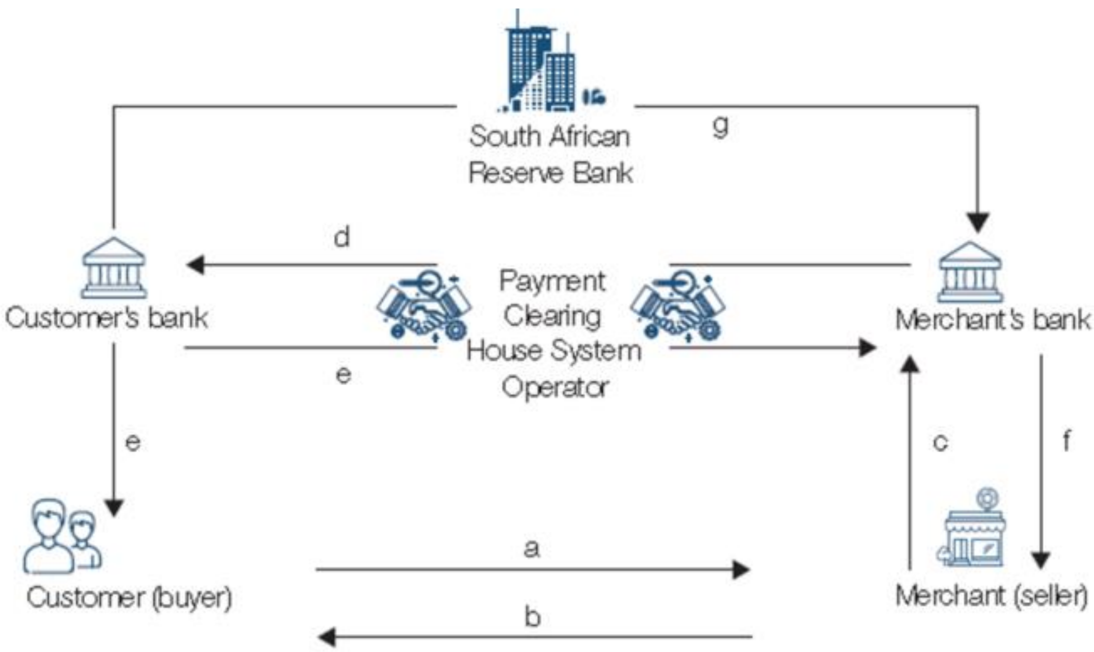
d) The merchant’s bank passes the cheque on to the customer’s bank to honour it, through a payment clearing house system operator (PCH SO).

e) The customer's bank checks if the cheque is legitimate and funds are available in the account. If these conditions are met, 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 then credits the merchant's account in its books.

g) The customer's bank settles the transaction with the merchant's bank (through the South African Multiple Option Settlement (SAMOS) system, operated by the SARB).

Figure 2: The process flow of a cheque payment



Source: SARB

4. The challenges of cheque usage

4.1 The **duration of processing** a cheque transaction is relatively lengthy when compared to the processing of other payment instruments. 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 be less than

10 days, circumstances (and/or individual bank terms and conditions) may warrant a longer or a shorter processing period.

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*** that is not written or authorised by the legitimate account holder, but issued from a genuine bank account. This normally occurs when a legitimate cheque or cheque book is lost or stolen, and the fraudster forges the signature of the legitimate account/cheque book holder.

4.2.2 A ***counterfeit cheque*** that is fake. It has a high resemblance to an original cheque but is created on non-bank paper.

4.2.3 An ***altered cheque*** that is legitimately issued and has been intercepted by an unauthorised third party who alters the beneficiary's name and/or the amount on the cheque or adds additional information.

4.2.4 ***Cheque washing*** where the information on a ligeitimately issued cheque is erased 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 has been closed, but unwritten cheques still exist for issue on that particular account.

4.2.6 ***Overpaid cheques*** are used when a fraudster approaches the targeted merchant with an urgent order for goods and/or services, with the promise of immediate payment using a cheque. The fraudster then informs the merchant that they have mistakenly deposited a cheque with a larger amount than required into the merchant's account. The fraudster requests the merchant to pay him/her back the difference. The fraudster's cheque then bounces, and the merchant suffers the loss of the amount paid to the fraudster. Moreover, some banks may charge the merchant for the bounced cheque that was deposited into their account.

4.2.7 ***Bad-cheque writing*** occurs when 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 assumes 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 payment methods can be carried out at the click of a button, enabling a faster payment and reconciliation process, and are significantly cheaper. Cheques are also expensive to process. The cost of processing cheques within the NPS continues to increase due to the system overheads having to be spread across fewer transactions as less cheques are written.

4.4 There is **restricted cheque acceptance.** The 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, using visible signage on the outside of their premises and/or at their payment points, explicitly state 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. The previous cheque item limits also contributed to the reduction of cheque usage.

4.6 There is a **lack of innovation** in cheques. Over the years, the industry has focused on innovation in electronic payment methods. The objective is to provide consumers with faster, cheaper and more reliable payment methods. Consumer demand for cheques has been decreasing rapidly with less demand for innovation on cheques. Globally, the trend of innovation has focused on electronic payments, which are fuelled by the growth of e-commerce, mobile phones and other devices, as well as access to the Internet, including the introduction of significant digital players such as Amazon, Apple, Ebay, Google, Paypal, Samsung, takealot etc. Other factors that contribute to the lack of cheque innovation include the lack of interest from financial technology (fintech) players 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 a cheque with the expectation that the cheque will clear and not bounce. This is different to the debit card environment where the buyer's bank first checks if the buyer has enough funds available and debits the buyer's account before authorising the transaction, therefore giving the merchant comfort that they can release the goods and/or services as they will receive payment. Also, fraudsters normally target consumers who are selling goods and/or services, who are unfamiliar with how cheques operate, because when the consumer sees the cheque amount reflected in their bank account they believe the amount has cleared successfully in their account, similarly to electronic transactions. The consumer then releases the goods and/or services unaware that a cheque can take up to 10 days to clear and may still bounce.

4.8 The **ageing interbank cheque infrastructure** which is expected to reach its lifespan by December 2021 as well as the **diminishing skills** to support and maintain the processing of cheques are also challenges facing the industry. The industry is focusing on investment in electronic payment methods, which are cheaper to operate and are more convenient for consumers.

4.9 The **impact of the coronavirus disease 2019 (COVID-19)** has contributed to the lower usage of cheques. Between August 2019 and August 2020 volumes and values have decreased from 216 757 to 88 230 (-59%) and from R5 195 300 945 to R942 352 199 (-82%) respectively. COVID-19 poses a health risk to cheque users and those responsible for the various activities throughout the cheque value chain due to proximity requirements when handling cheques. South Africa's cheque processing and clearing model is manually intensive, requiring multiple physical interactions between cheque users, bank staff, courier companies, and the cheque processing staff to clear the cheque.

5. The initiatives implemented to address cheque usage challenges

In light of the challenges associated with the usage of cheques, the following interventions have already been implemented.

5.1 Industry intervention

5.1.1 The interbank rules relating to the processing of cheques are determined the Paper Based Payment Instruments PCH members of PASA. In July 2012, PASA with the endorsement of the SARB, initiated the reduction of the cheque item limit from R5 000 000 to R500 000 in order to reduce the inherent risks relating to the usage of this instrument in the NPS. These risks include fraud risk.

5.1.2 Furthermore, on 29 April 2019, the SARBD provided a no-objection to PASA’s proposal of reducing the cheque item limit further from R500 000 to R50 000. This reduction of the cheque item limit was implemented on 1 May 2020. The SARB made its no-objection decision following consultation through the Consultation Paper titled *Reviewing the cheque item limit* published on 2 November 2018.

5.1.3 On the PASA website (under the ‘FAQs’ section), the public is provided with consumer protection information regarding the various payment methods available, including cheques. The information includes the following:

- what to do if certain scenarios materialise;
- whom to contact for assistance;
- the processes regarding specific (popular) transactions;
- how to protect oneself against fraud;
- when fraud is likely to occur and what to do if fraud is suspected;
- consumer rights (such as disputes);
- the advantages and disadvantages of various payment methods; and
- an explanation of terms.

5.1.4 Other industry stakeholders – such as the Banking Association South Africa (BASA), the South African Banking Risk Information Centre (SABRIC) and banks continuously sensitise consumers to the various cheque-related fraud and scams, and how consumers may protect themselves. This information is available on the respective websites.

5.1.5 Some banks caution 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 found to be cheaper, faster and more efficient than cheques. In addition, banks have introduced initiatives and incentives to encourage the usage of safer payment methods, including value-added services, loyalty programmes and, in some instances, free transactions or services. These incentives or benefits are not available with the usage of cheques.

5.1.6 Most banks have already publicly communicated that they will no longer issue cheque books to their clients, as cheque usage is declining and consumers/clients are encouraged to rather use electronic payment instruments that are cheaper, more convenient and less risky than cheques.

5.2 Regulatory intervention

5.2.1 **Risk-reduction measures:** Over the years, the SARB requested the payment industry to implement risk reduction measures in the NPS and the industry opted for the item limit as one such risk-reduction measure for all payment streams, and not only for cheques. Upon the implementation of the SAMOS system, which is an automated interbank settlement system provided by the SARB for banks to settle their obligations to each other, it was established that certain retail payment systems were being utilised inappropriately for large-value payments. This situation resulted in excessive exposures in those payment streams that posed a risk to the entire NPS. To address this situation, item limits were introduced for specific payment streams in the retail payment system.

5.2.2 **The National Payment System Framework and Strategy – *Vision 2025*[1]:** In March 2018, the SARB published *Vision 2025* outlining the NPS goals and strategies to be achieved by 2025. In this document, there is reference to the importance of electronic payments in the NPS including how electronic payments are linked to the achievement of several of the goals. Below are some of the examples extracted from *Vision 2025:*

a) **Overarching vision:** Consumers 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 ensuring efficiency and scale for banks and other NPS participants. This applies both to the costs of developing and implementing payment systems as well as containing ongoing operating costs.

e) **Financial inclusion:** Financial inclusion entails access to electronic payments as well as access to savings, credit and insurance services.

6. The benefits of phasing out cheques in the national payment system

6.1 **Supporting the *Vision 2025* goals:** The future NPS landscape, as outlined in *Vision 2025,* foresees electronic payments as a vital mechanism that contribute to the achievement of the majority of the *Vision 2025* goals. On the other hand, the continued use of paper instruments such as cheques does not contribute towards safe, efficient

[1] The National Payment System Framework and Strategy – *Vision 2025, available at* https://www.resbank.co.za/RegulationAndSupervision/NationalPaymentSystem(NPS)/Documents/Overview/Vision%202025.pdf

and cost-effective payment systems that serve the needs of South Africans. As stated before, cheque usage increases consumer vulnerability to fraud, introduce delays for access to funds and is expensive.

6.2 **Promoting electronic payments, consumer protection and consumer education:** Consumers are encouraged to use safer, more efficient and reliable payment methods. They should thus benefit from the protection afforded to consumers based on the respective payment methods such as 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. The payment industry's current and future efforts are focused on encouraging usage of electronic payments and educating consumers on the benefits, risks and consumer protection issues related to electronic payments.

6.3 **Increased cost savings:** Financial service providers currently charge higher fees due to the decline in cheque volumes and additional charges for cheque usage, such as cheque book issuance, cheque clearing and cheque encashment fees. In comparison, the fees charged for electronic payments or services are lower. In addition, financial service providers and non-bank payment providers, including fintechs, are innovating in the electronic space to offer consumers user-friendly, convenient and cheaper financial products and services.

6.4 **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, electronic payments eliminate the cost associated with dishonoured cheques. Reconciliation is faster and easier because most electronic payments are concluded in an environment where the purchase and the payment occur on the same day. The accounting and operational functions for businesses are consequently not overburdened by multiple processes and controls making it possible to have better management of payment records and to generate daily and intra-day reports.

6.5 **Security and reduced risk of fraud:** Electronic payments help to reduce fraud and security concerns by providing a full audit trail, and they reduce the risk of incorrect, dishonoured and lost payments.

6.6 **Improved business continuity:** There is constant advancement in the skills, management, operations and business continuity for electronic payments. The industry constantly develops better, more effective plans for disaster management of incidents and business disruptions.

7. The consultation process

7.1 In terms of engagement with the industry, the SARB has engaged with BASA and PASA, both of which are supportive of the phasing out of cheques.

7.2 The Competition Commission, Financial Intelligence Centre (FIC), Financial Sector Conduct Authority (FSCA) and National Treasury (Financial Sector Policy Unit) have also been consulted, and they are all in support of the phasing out of cheques.

7.3 Further, the SARB is engaging the Office of the Accountant-General at the National Treasury in relation to government departments and user groups such as non-profit organisations.

7.4 The SARB is working closely with banks and the FSCA in this process to ensure that adequate consumer education will be provided.

8. Recommendations

8.1 **The phasing out of cheques:** The SARB supports adoption of electronic payments as opposed to cheques in the NPS. This is aligned to the phasing out of cheques meaning that cheques would no longer be issued and accepted/collected in South Africa. A directive would be issued to all South African cheque issuers and acquirers/collectors in this regard to manage this process in an orderly manner.

8.2 **Alternative payment instruments:** Cheque issuers and acquirers/collectors are expected to make appropriate, cost-effective and efficient alternative payment instruments available to customers.

8.3 **Consumer awareness and education:** All cheque issuers and acquirers/collectors are expected to inform their customers of the phasing out of cheques, and educate them about alternative payment instruments.

8.4 **Timelines:** The payment industry is expected to manage the transition that will lead to stopping the issuance of cheques by 31 January 2021 and to completely phase out cheques from the system by 30 June 2021.

9. Comments and contact details

9.1 Stakeholders are invited to submit their comments on this Consultation Paper by **02 November 2020.** Comments should be addressed to npsdirectives@resbank.co.za.

Abbreviations

BASA	Banking Association South Africa
BIS	Bank for International Settlements
COVID-19	coronavirus disease 2019
CPMI	Committee on Payments and Market Infrastructures
EFT	electronic funds transfer
FAQs	frequently asked questions
FIC	Financial Intelligence Centre
fintech	financial technology
FSCA	Financial Sector Conduct Authority
NPS	national payment system
NPS Act	National Payment System Act 78 of 1998
NPSD	National Payment System Department [of the South African Reserve Bank]
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
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
UK	United Kingdom
Vision 2025	National Payment System Framework and Strategy