

South African Reserve Bank

National Payment System Department

Position paper on access to the national payment system

Position Paper **NPS 02/2011**
Dated **June 2011**

1. Executive summary

This document outlines the position of the South African Reserve Bank (the Bank) with regard to access to the national payment system (NPS).

In South Africa many view the payment system as the domain of the major banks only, and consider it as a very restricted system. Banks do play a major role in the payment system; however, many other players, other than banks have entered into the area of providing payment services.

The Bank will continue to evaluate its position as and when required by future developments.

2. Introduction

The NPS is a broad concept that does not only entail payments between banks, but encompasses the total payment process. This includes all the systems, mechanisms, institutions, agreements, procedures, rules and laws that come into play from the moment an end-user, using a payment instrument, issues a payment instruction to pay another person or business (the beneficiary), through the final interbank settlement of transactions in the books of the central bank. The NPS thus enables transacting parties to exchange value to conduct business efficiently. For the purposes of this document, non-cash payment systems or mechanisms for goods and services are the main focus rather than cash.

There has been much speculation, conjecture and discussion concerning access to the NPS over the past ten years. The Vision 2010¹ published by the Bank in 2006 devoted an entire chapter to the issue of access to the payment system,

¹ The South African National Payment System Framework and Strategy – Vision 2010 document (also known as the “Vision 2010”) was published in 2006. This document is available online at www.reservebank.co.za.

and the implementation of the strategies that were contained in that document addressed most of the issues that were raised by the Banking Enquiry Report.²

The South African NPS has developed steadily over the past few decades into a sophisticated and complex environment that enables payment to take place in a safe, secure and efficient manner and, although the payment and settlement banks play a major role, many players other than banks have entered into the area of providing payment system services.

This position paper aims to explain the access system within the NPS and the way in which it has evolved over the past number of years. It also provides the Bank's position on access, as well as its constant oversight and re-evaluation of existing structures. It is important to note from the outset that, because of the systemic³ nature of the payment system, the Bank always acts in the interest of the payment system as a whole, and never in the interest of any individual participant.

3. The payment system network

The current world-class payment system in South Africa has been developed and has evolved over many years. However, since 1995, when South Africa was being reintegrated into the world economy, specific visions and strategies have been followed to create a modern, safe and efficient payment system.⁴ The development process has been based on a philosophy of risk reduction, starting with the most systemic (the core) risk level and moving outwards to lesser risk

² The Banking Enquiry of the Competition Commission of South Africa report was published in December 2008. For more information go to: <http://www.compcom.co.za/enquiry-in-to-banking/>.

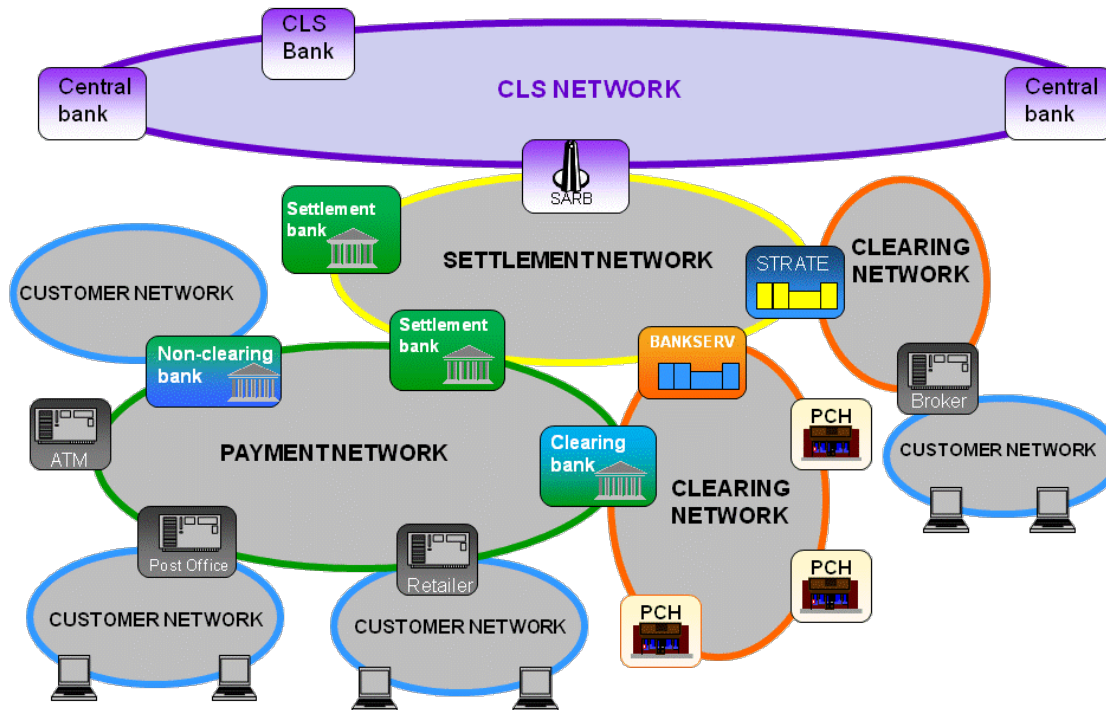
³ Systemic risk is defined by the Bank for International Settlements (BIS) as the risk that the failure of one participant in the payment system to meet its required obligations will cause other participants to be unable to meet their obligations. Such a failure may cause significant liquidity or credit problems and, as a result might threaten the stability of the financial markets.

⁴ The South African National Payment System Framework and Strategy document (also known as the "Blue Book") was published in 1995. All the strategies identified in the Blue Book were implemented by 2004. This document is available online at www.reservebank.co.za.

environments in terms of value and volume of payment services. The payment system in South Africa is best illustrated in terms of the diagram below that depicts the entire system from payment initiator through the retail and corporate environment entering into the banking, clearing and settlement environment and finally to the end beneficiary.

The diagram illustrates the individual networks in the payment system and the interaction points with one another. The outer rings (blue rings) represent typical points at which a payer would initiate a payment instruction to pay a beneficiary for goods and services delivered. The green rings represent the presentation of the payment instructions into the banking networks that could occur via different mechanisms and systems, including non-bank system operators and third-party service providers. These transactions would then follow one of two routes:

- 1) Where the payer and beneficiary utilise the services of the same bank, the transaction would be settled and completed in the books of the bank concerned;
or
- 2) Where the payer and beneficiary utilise the services of different banks, the transaction would enter the clearing and settlement environment (as illustrated by the red and yellow rings).



Of importance is the role the banks, including the Bank, fulfil in providing the vehicle to enter the payment system and settle payment instructions. The payment network comprises corporate and retail networks, system operators and third-party service providers, the banks as recipients of customer deposits and payment instructions, and the payment clearing house operators that determine interbank obligations for the various retail and securities payment streams. The interbank obligations that arise in the individual payment streams need to be introduced into the settlement network, where interbank settlement can be effected across the books of the Bank.

4. Access to the national payment system⁵

This section will focus on the more systemic area of interbank settlement rather than the transactions that are settled in the books of a particular commercial bank between payers and beneficiaries of the same bank.

⁵ This section should be read in conjunction with recommendations 15 to 18 of the Banking Enquiry Report of the Competition Commission.

4.1 Access to the settlement system in South Africa

The NPS is central to the stability of the financial system of the country and the efficiency of the banking system in South Africa.

The highest level of access to the NPS is the access to the settlement system. The Committee on Payment and Settlement Systems (CPSS)⁶ of the Bank for International Settlements (BIS)⁷ defines settlement as an act that discharges obligations in respect of funds or securities transfer between two or more parties (in the case of South Africa, these parties will be registered banks, defined as settlement system participants in the National Payment System Act, 1998 (Act No. 78 of 1998 (NPS Act⁸)).

The core of the South African settlement system is the South African Multiple Option Settlement (SAMOS)⁹ system that is owned and operated by the Bank. The introduction of the SAMOS system aligned the domestic interbank settlement practices with international best practice. SAMOS is a real-time gross settlement system.

Settlement in the SAMOS system includes the rand settlement of all the financial market transactions, interbank transactions and the settlement of foreign exchange transactions with other international banks. This is the highest level of access to the NPS and, because of its systemic nature, banking regulations and laws are strictly applied to ensure the safety and efficiency of the financial system.

⁶ The CPSS endeavours to strengthen the international financial infrastructure through promoting sound and efficient payment and settlement systems. See: www.bis.org.

⁷ The BIS is an international organisation, which promotes international monetary and financial co-operation, and performs the function of a bank for central banks. See: www.bis.org.

⁸ As defined in section 1 of the NPS Act. See: [www.reservebank.co.za/ Payment & settlement systems](http://www.reservebank.co.za/Payment%20&%20settlement%20systems).

⁹ For more information regarding the SAMOS system go to: [www.reservebank.co.za /Payment & settlement systems](http://www.reservebank.co.za/Payment%20&%20settlement%20systems).

Recent events in the global financial markets have, once again, underscored the important role that financial institutions play in the wellbeing of a country's financial affairs and how important the role of regulation is in ensuring a safe and efficient financial system.

Many observers have described the role of the payment system as the plumbing or backbone of a country's financial system. Observers and regulators alike are also in agreement that the payment system did not fail during the global financial crisis because of the prudent risk management practices followed by regulators.

In South Africa there are currently 23 settlement participants in the NPS. Only South African registered banks¹⁰ are allowed in the settlement domain. As mentioned earlier, strict rules and regulation are applied, and these banks have to meet statutory and prudential requirements as set by the Registrar of Banks and the Bank. Furthermore, settlement participants must have the ability to meet the liquidity, information, communication, technology and security requirements set by the Bank to participate in the SAMOS environment.

4.2 Access to the clearing system in South Africa

The second level of access to the payment system is that of clearing.

The CPSS of the BIS defines clearing as the process of transmitting, reconciling and, in some cases, confirming payment orders or security transfer instructions prior to settlement, possibly including the netting of instructions and the establishment of final positions for settlement.

¹⁰ To become a settlement system participant an institution must either be the South African Reserve Bank; a commercial bank registered in terms of the Banks Act, No. 94 of 1990; a mutual bank registered in terms of the Mutual Banks Act, No.124 of 1993; a branch of a foreign institution or a designated settlement operator.

The NPS Act defines clearing as “the exchange of payment instructions”. This definition is further elucidated in the Blue Book¹¹ as the physical exchange of payment instructions between the payer’s bank and the payee’s bank (or their agents).

Traditionally, in terms of the NPS Act only banks were allowed to clear, but as the payment system evolved, more non-banks began to participate in the payment system. The non-bank participants provide value-added services to banks and their clients in the clearing environment and banks outsource components of the clearing function to non-banks.

4.2.1 Evolution of the clearing system since 2006

Since the modernisation of the NPS, the Bank has acknowledged that non-bank payment providers have an important role to play in the payment system. Contained in the Blue Book is a fundamental principle which stated that the provision of payment services is not the exclusive domain of banks and that non-bank participants have a role to play in the provision of payment services to their customers.

In 2006 the Bank published the National Payment System Framework and Strategy document – Vision 2010¹² (the Vision 2010) wherein an entire chapter was devoted to access to the payment system. In this document the Bank provided details on how access to the payment system would be enhanced. Included in this chapter was a definition of the different types of participation in the NPS and the types of services that could be provided by the non-bank participants.

¹¹ Refer to footnote 1.

¹² The Vision 2010 document is available online at www.reservebank.co.za.

The NPS Act was amended in 2004 to, among other things, enable the Bank to issue directives.¹³ Directives provide for a more detailed interpretation of the NPS Act or the prohibiting of certain behaviour. Depending on the nature and/or impact of payment system issues, and whether intervention is required, directives may be issued from time to time.

During 2007 the Bank published, for the first time, directives aimed at non-banks and their participation in the NPS. These directives were drafted specifically for payments to third persons¹⁴ and system-operator¹⁵ service providers. By regulating non-banks, the Bank also afforded non-banks an opportunity to discuss payment-related issues with the overseer of the NPS (see also section 4.3 on the NPSSB).

By the end of 2008 the Bank had made amendments to the NPS Act. These changes, among other things, provided the Bank the opportunity to designate non-bank's to become clearing system participants. Section 6 (3) (a) of the NPS Act, therefore, empowers the Bank to designate a non-bank as a non-bank clearing system participant if it believes that such designation is in the interest of the integrity, effectiveness or security of the payment system.

Designation as a clearing system participant allows a participant access to the clearing domain and membership of the payment system management¹⁶ body, but excludes the designated clearing system participant from direct access to the settlement system.

The designation is made by way of a designation notice in a *Government Gazette* and the conditions for designation are listed in the designation notice.

¹³ Section 12 of the NPS Act.

¹⁴ For more information see Directive No. 1 of 2007 in respect of payments to third persons.

¹⁵ For more information see Directive No. 2 of 2007 in respect of system operators.

¹⁶ The Payments Association of South Africa (PASA) is currently recognised by the Bank in terms of the NPS Act as the payment system management body. PASA was created to manage the conduct of its members in the payment system. For more information go to: www.pasa.org.za

Criteria for designation are individually determined and applied by the Bank on a case-by-case basis. Development paths exist for designated clearing system participants to become clearing and settlement banks in the NPS should these participants wish to do so.

Designated clearing system participants have the same rights and obligations as other clearing system participants and have to be members of the PASA and of all the payment clearing houses (PCHs)¹⁷ in which they participate.

Designated clearing system participants have direct access to BankservAfrica¹⁸ and must be able to comply with all the related security and payment industry standards that are applicable.

4.2.2 Non-banks and PASA

As mentioned in the previous section, the payment system management body in South Africa is PASA, and PASA is recognised by the Bank in terms of the NPS Act. PASA was established as an umbrella body to represent and manage the conduct of its members in the clearing environment.

The NPS Act provides the management body with the guidelines under which it can operate and the functions to be performed by such a body. The NPS Act also prescribes the participants that may become members of PASA.

The purpose of PASA is to assist the Bank with the implementation and management of its members in the clearing domain. PASA manages the rule of engagement in the different payment streams and ensures that all the legal requirements are adhered to. PASA furthermore assists the Bank with matters

¹⁷ The PCH manage the PCH agreements and all the rules pertaining to the particular payment stream.

¹⁸ For more information go to: <http://www.bankserveafrica.com>.

within the clearing domain affecting its members, for example the licensing of the PCH system operators.¹⁹

The Bank is represented on PASA Council as an observer and all participants have recourse to the Bank should they have exhausted all the normal avenues for dispute resolution within PASA. For this reason, the Bank would not allow unilateral decisions on membership of PASA and PCHs to vest in the executive of PASA. Decisions will continue to be made by PASA in consultation with the Bank.

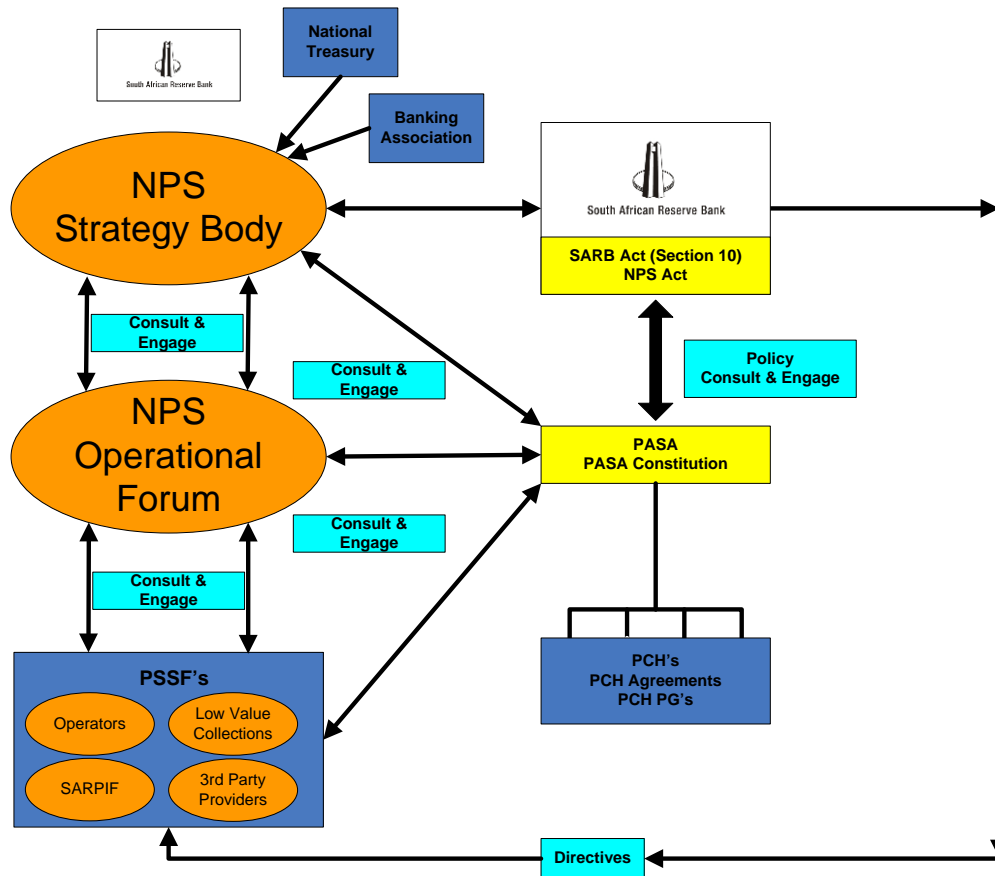
4.3 The national payment system strategy body²⁰

One of the strategies identified in the Vision 2010 document was the establishment of an overarching payment system management structure.

The Bank identified the need to consult and act in collaboration with the various stakeholders in the NPS. Accordingly, the Bank established the National Payment System Advisory Body (NPSAB) in 2008 which is representative of all the regulated stakeholders within the NPS and other interested parties, for example the National Treasury. (The name of the NPSAB was changed during 2011 and will be known as the national payment system strategy body – NPSSB.) The NPSSB allows banks, non-banks and other participants to establish associations to represent the interest of their members at the NPSSB.

¹⁹ A PCH system operator is a legal person that clears on behalf of two or more settlement system participants (banks).

²⁰ The national payment system strategy body was previously known as the national payment system advisory body.



The NPSSB focuses mainly on strategic payment system-related issues, most importantly those issues that may have a risk-related impact on the NPS and to the participants in the NPS. Furthermore, the NPSSB acts in the interest of the NPS as a whole and not in the interest of individuals or participant groups.

The NPSSB functions in an advisory capacity to the Bank and inputs received are considered in the policy and strategic decisions made by the Bank. The NPSSB has no juristic personality or decision-making powers. The NPSSB is chaired by a Deputy Governor of the Bank and the secretarial functions are performed by the National Payment System Department of the Bank.

The NPSSB is made up of the following groups:

- 1) The Bank
- 2) PASA

- 3) The Banking Association of South Africa
- 4) The National Treasury
- 5) The Payment System Stakeholder Forum (for low value payments)
- 6) The South African Retailers' Payment Issues Forum (SARPIF)
- 7) The Association of System Operators
- 8) The Third Party Payers Association.

During 2010 the Bank, after consultation with the various stakeholders, identified the need for participants (bank and non-bank stakeholders) to, in addition to the advisory role, have a forum in which to discuss high-level operational matters and provide input to the NPSSB.

The NPS Operational Forum (NPSOF) will enable all stakeholders to discuss operational matters with all participants. The NPSOF will provide strategic input to the NPSSB and will consult and engage with other stakeholders, for example PASA, and the Bank.

It is envisaged that the NPSOF will be formalised in 2011.

5. Position of the Bank

Discussion between different stakeholders in the NPS has highlighted the need for the Bank to clarify the access to the NPS, including issues raised in the Banking Enquiry Report.

5.1 The settlement system

Owing to the systemic nature of the settlement system and the prevailing international economic situation, access to the settlement system will remain

limited to the Bank, clearing system participants²¹ as well as settlement ²²system participants, as defined in terms of the NPS Act.

5.2 The clearing system

The formal designation of non-banks to the clearing system provides more opportunities for non-banks to participate formally in the payments space. Third-party service providers and system operators continue to provide substantive payment services to the business environment.

The global financial crisis re-emphasised the importance of balancing risks with more access and competition in the financial system. Non-banks are playing an increasingly important role in this systemic environment and it is, therefore, of utmost importance for the impact of non-banks in the payment system to be properly understood and managed.

The Bank will continue to look for ways to formalise and broaden the access for non-banks in the payments arena. This, however, will be done only after all the potential risks and benefits have been carefully analysed and understood, and safety and efficiency considerations have been taken into account. The Bank will continue to engage with other regulatory authorities to find a “best fit” model for South Africa. International comparisons have proven not to be very effective as the structures of the financial systems and the regulatory models differ.

5.3 The need for an ombudsman

The creation of an ombudsman would duplicate the functions that are already undertaken by the Bank in terms of its role as overseer of the NPS as legislated

²¹ The NPS Act defines a clearing system participant as a bank, mutual bank, co-operative bank, branch of a foreign institution or designated clearing system participant.

²² The NPS Act defines a settlement system participant as the Reserve Bank, a bank, mutual bank, co-operative bank or branch of a foreign institution or a designated settlement system operator.

in the South African Reserve Bank Act, 1989 (Act No. 90 of 1989) section 10 (1) (c) (i). All participants, current and prospective, have recourse to the Bank should they wish to discuss any matter regarding the NPS.

5.4 The role of PASA

Although PASA functions, to a certain extent, as an operational body and does not determine strategy for the NPS, it plays a major role in providing input to the Bank's strategy determination process by means of its existence as the payment system management body and its role in the NPSSB. However, once a vision and strategies have been determined by the Bank, PASA is required to establish the strategy of implementation, in consultation with the Bank, in order to give effect to its execution in the domain in which they assist the Bank, to ensure a safe and efficient payment system in South Africa.

As amendments have been made to the NPS Act, PASA has been working with the Bank and the banking industry to re-evaluate its role in the payment system and to renew its constitution to align it with the changing environment. PASA will continue to re-align and renew itself in order to conform to the changing needs of the payment environment. This re-engineering of PASA will continue under the auspices of the Bank, if and when, the need arises.

5 Conclusion

The Bank has and will in terms of its oversight role continue to endeavour to re-evaluate and broaden access for participants to the payment system based on sound risk evaluation principles. Furthermore, as legislation is amended to make provisions for various classes of banks, these are considered and provided for in the NPS Act.