



RESERVE BANK OF MALAWI

Oversight Policy

For

Payment, Clearing and Settlement Systems

Reserve Bank of Malawi

November 2007

1. INTRODUCTION

The payment system is a vital part of the financial infrastructure of any economy and its efficient functioning contributes to economic performance of the country. The payment system, however, has risks inherent in it. The risks, among others, may involve the inability of a participant in a system to meet its settlement obligations, thereby causing other participants to also fail to meet their settlement obligations. This tends to cause system-wide disturbances which may threaten the stability of the financial system. In order to ensure financial stability, central banks endeavour to design and implement payment systems oversight policies. The extent and mandate of central bank involvement in oversight activities however differ from country to country.

In Malawi, the mandate for payment systems oversight activities by the Reserve Bank of Malawi (RBM) is derived from the Reserve Bank of Malawi Act, 1989. The Act empowers the RBM to promote a sound financial infrastructure with a robust and efficient payment and clearing system. Pursuant to this mandate, the RBM has formulated the Payment Systems Oversight Policy which assesses and formulates the RBM's objectives and scope of payment systems oversight activities. The policy also outlines the principles and techniques to be used to fulfil payment systems oversight objectives.

2. FRAMEWORK FOR RBM'S NATIONAL PAYMENT SYSTEMS OVERSIGHT

2.1 **Legal framework**

The RBM is responsible for promoting robust and efficient payment systems and financial markets in Malawi, thereby ensuring financial stability. RBM's payment systems oversight is based on its legal mandate as outlined in the Reserve Bank of Malawi Act, 1989. According to Chapter 44:2, one of the *principle objectives of the Reserve Bank of Malawi is to promote a sound financial structure in Malawi, including payment systems, clearing systems and adequate financial services*. In accordance with this mandate, the RBM has in the recent past collaborated with various stakeholders in developing and implementing a robust payment systems infrastructure that endeavors timely completion of payments.

Participation of financial institutions in the national payment system may also introduce, among others, solvency and liquidity risks not only to individual financial institutions but also to the entire financial sector. In this regard, payment systems oversight is regarded as a monitoring activity that is applied on services and products provided by financial institutions that may at times implement payment activities without prior authorisation by the central bank.

The Banking Act, 1989 empowers the RBM to supervise banks and financial institutions with the aim of protecting the interest of depositors and creditors with regard to solvency, liquidity, and profitability of financial institutions. Hence, the Banking Act, 1989 also complements the legal mandate of the RBM to conduct oversight activities in the country's national payment system.

The Banking Act also empowers the RBM to periodically or at its discretion examine the business of any bank or financial institution in order to determine whether it is in a sound financial condition and complies with the requirements of this or any other Act relevant to its banking business. The RBM has the authority to issue directives and regulation in the financial sector to address specific issues.

Within the framework of the RBM Act and the Banking Act the RBM will work with the banks to promote safe and efficient payment and settlement systems, and the Acts give the RBM authority to issue directives and regulations of the National Payment System. However, promulgation of the Payment Systems Bill will contribute to a strengthening and clarification of the RBM's oversight role.

RBM's oversight function is also closely related to its key tasks of implementing monetary policy to maintain price stability and facilitating the stability of the national currency.

2.2 Scope of the RBM's oversight

The scope of the oversight function includes all payment systems, which are identified as Systemically Important Payment Systems (SIPS) or payment systems of system-wide importance (SWIPS). It is customary to divide the payment system into two levels: interbank systems and systems for payment services. The interbank systems are systems for clearing and settling the cash flows between the banks and with the RBM. The interbank systems include systems or arrangements for the clearing or settlement of payment obligations and systems or arrangements for the clearing and settlement of securities transactions, foreign exchange transactions, or other transactions, where such systems or arrangements also clear or settle payment obligations arising from those transactions. The systems for payment services (retail payments) include solutions for bank cards and electronic and paper-based systems for paying bills. In addition, there is cash, which remains the dominant mode of payment in Malawi.

A payment system is regarded as systemically important where, if the system were insufficiently protected against risk, disruption within it could trigger or transmit further disruptions amongst participants or systemic disruptions in the financial area more widely¹. SWIPS, on the other hand, are payment systems which are of importance to the economy as a whole due to the high volumes, low values of transactions they process, but which are unlikely to generate or transmit financial shocks if they fail. Such systems, however, are widely used and have poor short-term substitutes.

To ensure financial stability, robust and efficient interbank systems are a prerequisite, and the RBM's main focus in its oversight activities will normally be on interbank systems that are important for the stability of the financial system. Where the disruption to a retail payment system threatens or has a severe impact on the stability of financial markets, the oversight of non-cash payment instruments may also be regarded as an integrated part of the oversight of payment systems.

Oversight by the RBM will therefore focus on institutional arrangements, operational and technical structures of such payment systems. RBM's oversight function of

¹ SIPS defined according to BIS "Report on Core Principles for Systemically Important Payment Systems"
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payment systems shall be based on international oversight principles namely the Core Principles for Systemically Important Payment Systems and Central Bank Responsibilities issued by the Committee on Payment and Settlement Systems (CPSS) of the Bank for International Settlements (BIS)².

The criteria used to designate a payment system as SIPS or SWIPS shall include:

1. **Volume:** The total number of transactions, number of direct participating institutions and number of clients that are serviced by the direct participant of a particular payment system.
2. **Value:** The system's throughput and the total value of exposure of each participating institution
3. **Risks:** These include Operational, Legal, Credit and Liquidity risks.

In this regard, the RBM has designated the following inter-bank payment systems as SIPS:

- a. The Perago RTGS system owned by the RBM
- b. The Electronic Cheque Clearing House (ECCH) owned by the Bankers Association of Malawi

Meanwhile, SWIPS comprise of:

- a. The MALSWITCH Smart Card system (e-purse) operated by MALSWITCH
- b. The Electronic Funds Transfer (EFT) system operated by MALSWITCH
- c. Other payment processing streams created in the future.

3. OBJECTIVES OF OVERSIGHT

Oversight of payment systems is a public policy activity focused on the efficiency and safety of payment systems as a whole, rather than on individual participants. RBM payment system oversight policy is designed to ensure that risk reduction in the entire system is understood and supported by all participants and operators. The oversight of payment systems involves monitoring, assessing and where necessary inducing change with the aim of promoting the smooth functioning of payment systems and instruments. RBM's oversight activities shall be applied in accordance with best international practice based on the recommendations of the BIS in the report *Central Bank Oversight for Payments Systems* (May 2005) and shall be pursued as follows:

² Refer to Appendix II for the Ten Core Principles for Systemically Important Payment Systems and Four Central Bank Responsibilities that will be used as guidelines for the management and implementation of RBM's oversight activities

3.1 Monitoring

3.1.1 Determination and Description of Payment Systems Oversight Policy Objectives and Scope

Any subsequent objectives and scope of the oversight activities shall be formulated by the RBM as mandated by the RBM and Banking Acts and supported by relevant stakeholders such as the National Payments Council (NPC) and the Bankers Association of Malawi (BAM).

3.1.2 Communication of the RBM Policy for Oversight Activities

The Board of Directors shall approve the objectives and scope of the RBM's and any major amendments of oversight payment systems policy, and the Ministry of Finance shall be duly informed. The oversight policy shall also be presented and discussed by the NPC, and publicly disclosed on the website of the RBM.

3.1.3 Collection of Information about the Designated Systems

RBM shall periodically collect data and information on different payment systems to analyse individual participant's performance and the entire national payment system. Sources of information shall include official documents, other publicly available information about the systems, statistics (i.e. values and volumes of transactions), agreements between participants and system provider(s), agreements between the system provider(s) and institutions responsible for the operation of the system, information about back-up solutions and contingency arrangements and any other relevant system related information.

To provide information about the Malawian payment system the RBM shall present payment systems statistics, other information about payment systems, and the RBM's view on certain payment systems issues in an Annual Report on Payment Systems. The report shall constitute a key reference for market participants, consumers and government agencies.

3.2 Assessing Payment Systems

Assessment on whether the payment systems comply with the appropriate policy requirements, standards and the BIS Core Principles shall be the set standard for systems that are designated as systemically important payment systems.

Assessment shall, among others, involve examination of the completeness and suitability of the operating rules of payment, clearing and settlement systems and their compatibility with the applicable legal framework and in particular, the criteria for participation in/suspension/exclusion from such systems.

The RBM shall not get involved in the actual operations of privately owned systems. Owners of the private systems shall be required encouraged to conduct self-assessment of their systems to underscore the system owners' responsibility for the risks and efficiency of their systems. This contributes towards the system owners' better understanding of any changes and improvements that the RBM may consider necessary. It must be indicated that where necessary, the RBM shall conduct an on-site inspection of the private systems. The findings and recommendations shall be discussed with the relevant parties.

3.3 Inducing Changes

As supervisor of participating institutions, the RBM shall use statutory powers as stipulated in the RBM and Banking Acts to induce change in systems that do not comply with the core principles and other relevant oversight policy standards.

Other measures to induce change shall include moral suasion, discussions in the NPC and bilateral meetings with the concerned parties. Where necessary, the RBM shall also disclose its findings and recommendations through letters and speeches by the Governor, public statements and articles in the RBM's ad hoc and annual reports.

4. NATIONAL PAYMENT SYSTEMS ACTORS

The major players in the National Payment System are the institutions and organisations whose activities have an impact on the use and operations of payment, clearing and settlement systems. The RBM, as an overseer and catalyst of reforms, shall ensure maximum cooperation with all the relevant payment systems stakeholders in the country. The identified key stakeholders in the National Payment System include:

- a. The RBM (as the Perago RTGS system owner, operator and participant, Settlement Agent for Retail and Card based transactions, Regulator, Overseer, Facilitator and Promoter of Reform)
- b. Markets (Payment Systems – Gross and Retail-, Forex, Securities Settlement Systems)
- c. Securities Settlement Systems Regulators (to be developed in future)
- d. Institutions (Bankers Association of Malawi, Payments Clearing Houses, MALSWITCH, National Payments Council, Operators (both relating to central systems and to participants sub-contractors))
- e. Malawi Government
- f. Infrastructure (Telecommunications, Electricity, etc)
- g. International Regulatory authorities

The NPC shall be the main meeting forum for exchanging information and discussions between the RBM and the banking industry on payment issues. In 2001, the RBM in collaboration with the NPC published the report; “**Malawi National Payment Systems Vision and Strategy Framework**”. The report defined the role of each of the actors in payment systems reform, requirements of the reform, the vision and a proposed strategy to achieve these goals, and evaluation criteria for success. Although the report created a good basis for the development of an efficient and robust National Payment System, the RBM in cooperation with the NPC will assess developments and formulate the overall vision and strategic framework for the future National Payment System in Malawi. In this context, the role and structure of the NPC will have to be reviewed. The RBM will concentrate on its oversight role, leaving the operational functions to the banks and other interested actors.

5. CONCLUSION

The Payment Systems Oversight Policy document assesses and formulates the RBM’s objectives and scope of payment systems oversight. It also outlines the general principles, tools and methods to be used to manage various risks inherent in the identified payment systems in Malawi. The Policy Document is a living document and is subject to review as required to ensure that the National Payment System in Malawi is robust and efficient at all times.