

PAYMENT SYSTEMS REFORMS IN MALAWI
A BRIEF HISTORICAL PERSPECTIVE

1.0 Background

Prior to 2002, Malawi was using the deferred net settlement (DNS)¹ system. Under this system, inter-bank funds transfer instructions were sent by the commercial banks to the Reserve Bank of Malawi (RBM) through tested fax messages. The sending bank transmitted a fax message requesting the RBM to debit its account and credit the beneficiary bank's account across the books of the RBM. Transmission of fax messages was done throughout the day but the actual debiting and crediting of commercial banks' settlement accounts was done at the end of the business day (i.e. 17:00 hours).

Processing of cheques was also done manually. Banks used to meet in the clearing house twice a day to exchange cheques drawn on each other. Calculation of the net obligations arising from cheque transactions was done in the afternoon and posting of the net positions into the general ledger of the RBM was also done at 17:00 hours on the same day.

Under the DNS system, each bank was not aware of its current position in the books of the central bank until the following business day. In addition, the RBM could not know the positions of banks until end of day processes were completed. The system was also characterized with long clearing period for cheques which ranged from seven days to twenty-one days. This therefore meant that funds were unnecessarily held up in the payment system.

2.0 Reform organs

Having identified the problems associated with the DNS system, the RBM and the relevant key stakeholders established the National Payments Council² (NPC) in 1993 with the aim of modernizing the national payment systems (NPS) infrastructure. The introduction of the SADC Payment Systems Project by the

¹ According to Bank for International Settlements (BIS), DNS is a system that effects the settlement of obligations or transfers between or among counter-parties on a net basis at some later time.

² The NPC is a grouping of financial institutions (chaired by the RBM), Malawi Government (through the Accountant General's Office) and payment systems service providers

Committee of Central Bank Governors (CCBG) in 1995 further added impetus to the reform process that was initiated under the NPC.

In 2001, the RBM, Bankers Association of Malawi, and NPC endorsed the “Malawi National Payment Systems Vision and Strategy Framework”. This is a blueprint upon which all NPS modernization projects in the country have been based.

3.0 Progress to date

The RBM fully financed the establishment of a frame relay-based national network infrastructure and a transaction switch called Malawi Switch Centre (MALSWITCH). This was a major stepping stone in the modernization process. Through MALSWITCH, Malawi has managed to link all commercial banks and discount houses onto a common network platform providing a number of electronic based payment, clearing and settlement facilities. The modern electronic facilities include:

i. The real time gross settlement (RTGS) system

The RTGS is a high-value inter-bank funds transfer system that settles transactions in real time and on an order-by-order basis (i.e. without netting). Using the software developed by Perago Financial System Solutions, Malawi launched the RTGS on 19th March 2002. Malawi was the third country in SADC to implement RTGS after South Africa and Mauritius.

ii. Smart Card Scheme

Malawi introduced the chip-based card scheme which uses biometrics in addition to the personal identification (PIN) code.

iii. Electronic Bidding System

This is an in-house workflow system that enables the RBM to simultaneously accept bids for Treasury Bills and RBM Bills from participating financial institutions in real time. Results of the bids are also communicated electronically. Settlement of the traded Bills takes place in the RTGS system.

iv. Electronic Cheque Clearing House (ECCH)

This was commissioned on 1st August 2005 and uses code line clearing based on cheque imaging and truncation. Malawi is the first country in SADC to implement cheque truncation.

4.0 Impact of reforms

The modern facilities have greatly minimised payment systems risks associated with the DNS system. For instance, the ECCH reduced the clearing period from seven days to around two days. RTGS settles transactions in real time thereby eliminating credit risk between system participants. The reduction in clearing period and immediacy in settlement leads to increased circulation of funds and enhances monetary policy implementation. The RTGS further provides the banks a facility to monitor their positions in real time and hence make cost effective investment decisions. The RBM, on the other hand is also able to monitor the liquidity positions of all banks on a minute-by-minute basis.

5.0 Conclusion

Malawi has made tremendous progress in modernizing her NPS. In order to ensure that the modernized NPS is efficient and conforms to internationally acceptable best practices, the Board of Directors of the RBM in December 2007 endorsed the NPS Oversight Policy which will be the guiding principle for the RBM to conduct payment systems oversight activities. The “Malawi National Payment Systems Vision and Strategy Framework” is due for revision. The revised Vision and Strategy will cover the period 2008 to 2013.