

# Implementing Cross-border Payment, Clearing and Settlement Systems: Lessons from the Southern African Development Community

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## Abstract

This paper investigated the experience in implementing cross-border payment, clearing and settlement systems in the Southern African Development Community (SADC). Such systems are critical in the circulation of money and the general economic activities in the region. In line with the SADC Protocol on Finance and Investment, central banks in the region are to co-operate in order to define and implement a cross-border payment strategy. Regional blocks that are in the process of implementing regional integration projects can learn from the implementation process in the SADC region.

**Keywords:** Southern African Development Community, Cross-border, Payment Systems, Success Factors, Challenges

## 1. Introduction

This paper investigated the experience in implementing cross-border payment, clearing and settlement systems in the Southern African Development Community (SADC). Cross-border payment and settlement systems are different from domestic systems. The latter are meant for transactions originated, processed, cleared and settled in the borders of a particular country. There are situations in the payments literature where a payer is domiciled in one country but the payee is in another. In this regard, transactions between the two parties should ideally be cleared and settled in regional payment, clearing and settlement systems. Cross-border payment, clearing and settlement systems such as Real Time Gross Settlement Systems (RTGS) and automated clearing house (ACH) systems are better compared to correspondent banking relationships. Challenges associated with the latter include no direct relationship with downstream banks; limited data transport capabilities; high cost for services due to multiple banks involved in the payment process; and that it is difficult to implement change as there is no central authority to mandate or direct new processes.

A study on cross-border payment, clearing and settlement should be appealing to Namibia for two reasons. Firstly, there is scarcity of research in this area in the SADC. Consequently, this is an attempt to fill this knowledge gap. Secondly, regional blocks that are in the process of implementing regional integration projects can learn from the implementation process in the SADC region.

The paper is comprised of the following sections: an introduction; the literature review; implementation of cross-border payment, clearing and settlement systems in the SADC region; success factors; challenges experienced; and concluding remarks. The literature review follows next.

## 2. Literature Review

The United Nations (2005: 122) defines payment system as a set of institutions, laws, regulations and other mechanisms needed for a buyer to make a payment and seller to receive payment. This is related to the definition by Sheng (1995: 1) who said it is a basic infrastructure that facilitates trading. Payment system is part of a wider national payment system although these two terms are often used interchangeably in practice. According to the Payment System Management Act 2003.s.1, the national payment system (NPS) means the payment system as a whole, and includes any payment system, settlement system, clearing system and payment system arrangement used in the process of effecting payment between payers and beneficiaries.

Participants in payment systems include banks, non-banks and central banks. There are users of payment systems

as well as providers of payment system services. Central banks have a special role to play in payment systems. They oversee the entire payment system infrastructure with the view of achieving public policy objectives of ensuring their safety and efficiency (Fry et al 1999: 76; Spindler and Summers 1994: 164). Central bank legal and regulatory framework cover both domestic and cross-border payment systems.

Cross-border payment and settlement systems are different from domestic systems. The latter are meant for transactions originated, processed, cleared and settled in the borders of a particular country. Such systems take several forms and these cover card, cheque, electronic fund transfer and high value real time gross settlement systems (RTGS). The first three systems are normally used for low value payments that are batched and submitted to a settlement system via an automated clearing house (ACH). Although settlement systems such as an RTGS system can also settle batched transactions, a high proportion of transactions settled, in value terms, emanates directly from direct participants such as banking institutions. According to Norman et al (2011: 19), settlement in modern day monetary systems ultimately occurs in central bank money so that central banks stand at the center of the network of clearing and settlement arrangements in their currency.

There are situations in the payments literature where a payer is domiciled in one country but the payee is in another. In this regard, transactions between the two parties should ideally be cleared and settled in regional payment, clearing and settlement systems. Bech et al (2008: 65) show that since the late 1990s, systems have emerged that allow payments to settle across national borders, facilitate settlement in multiple currencies, and permit participants to be located in a foreign jurisdiction. They added that the key driver for the development of cross-border and offshore systems have been the introduction of the euro and the demand for payment settlement in foreign currencies as part of payment-versus-payment forex transactions. Park (2006: 16) indicates that transnational systems have traditionally focused on providing payments within a region or to a small number of countries and usually support a single country.

Evidence show that cross-border payment systems in the form of RTGS systems are replacing correspondent banking relationships. Bech et al (2008: 66) pointed out that large value payment systems can be understood as substitutes for traditional correspondent banking services. Rosati and Secola (2005: 7) say that RTGS systems ensure finality to take place for each single transaction in real time. It should be understood that RTGS system normally use central bank money for settlement purposes as a claim on the central bank is free of credit and liquidity risks (Bank for International Settlements, 2001: 34).

According to Park (2006: 5) most of the world's major banks maintain correspondent banking relationships with banks in each of the foreign cities of the world and this two-way link between banks is one of many interbank relationships, such as nostro/vostro accounts and selling of cash management and treasury services to other financial institutions. Glenbrook (2011: 14) maintain that although there are great advantages to users of the current system of international correspondent banking, challenges are prevalent. These challenges include no direct relationship with downstream banks; limited data transport capabilities; high cost for services due to multiple banks involved in the payment process; and that it is difficult to implement change as there is no central authority to mandate or direct new processes.

Cross-border payment, clearing and settlement systems have been implemented or are being implemented in a number of regional blocks. In the euro area, two main large value payment systems, Target and Euro 1 went live from 1999 (Rosati and Secola, 2005: 5). The former system is owned and operated by central banks of the Euro System while the latter system is owned by the European Banking Association. Implementation of regional large value payment systems is ongoing in East African Community (EAC); West African Monetary Zone (WAMZ); and Common Market for Eastern and Southern Africa (COMESA).

### **3. Cross-border Payment, Clearing and Settlement Systems Implementation in SADC**

This section documents the experience in the process of implementing cross-border payment, clearing and settlement systems in Southern African Development Community (SADC). Key aspects including background information, governance, model, phases, success factors and challenges are discussed. The rest of the section appears below.

### **3.1 Historical Background**

The need to have regional payment systems in the Southern African Development Community (SADC) is well documented. Such systems are critical in the circulation of money and the general economic activities in the region. In line with the SADC Protocol on Finance and Investment, central banks in the region are to co-operate in order to define and implement a cross-border payment strategy (Southern African Development Community, 2006: 63). Ensuring a safe and efficient payment system, in each SADC country, based on internationally accepted principles is essential in implementing a regional strategy.

It is noted that the Framework for SADC Vision, Principles and Strategy document outlines four strategic objectives of the regional cross-border payment strategy (Southern African Development Community, 2012: 1). These are:

- Enhance and harmonize the regional legal and regulatory frameworks to facilitate regional clearing and settlement arrangements;
- Implement and integrate regional cross-border payment settlement infrastructure;
- Implement an integrated regional cross-border payment and post-trade clearing infrastructure; and
- Establish a co-operative oversight arrangement based on the harmonized regulatory framework for regional cross-border payment and settlement among participating member countries.

### **3.2 Project Governance**

The Committee of Central Bank Governors (CCBG) resolved that the SADC Payments Project be launched in the Southern African Development Community (SADC) in line with the requirements of the SADC Finance and Investment Protocol. Consequently, the SADC Payment System Project Team was set up under the CCBG to provide leadership for the day-to-day implementation of the massive project.

Commercial banks were encouraged to fully participate in the roll-out process since January 2011. In this regard, the SADC Banking Association was tasked to co-ordinate the implementation of the project to ensure that banking institutions in SADC take part in all processes leading to full implementation. There is also an oversight component to the implementation process. The responsibility to oversee implementation rests with central banks through various structures including the Common Monetary Area Cross-border Payment Oversight Committee (CMA CPOC) and SADC Payment Oversight Committee (SPOC).

### **3.3 Agreed Model**

Several models were discussed on how cross-border payments can be processed, cleared and settled. Consequently, the region agreed on a suitable model or models for cross-border payments. In this regard, it was agreed that national real time gross settlement systems (RTGS) systems to continue be used for domestic transactions and that cross-border transactions be settled in the regional or central settlement system (Southern African Development Community, 2010: 11; Southern African Development Community, 2011: 2). This involves participants connected directly to the central system. With respect to the low value or retail payments, participants are at liberty to link to the regional automated clearing house (ACH) directly or via a domestic ACH. The regional ACH interfaces the central settlement system.

### **3.4 Project Phases**

The implementation of the SADC Payments Project was divided into manageable phases. It was resolved that the SADC Integrated Regional Electronic Settlement System (SIRESS) be implemented first in 2013 and the automated clearing house (ACH) to be implemented in 2015 in the Common Monetary Area (CMA). This route was accepted considering that currencies of Lesotho, Namibia and Swaziland are linked to the South Africa Rand. In terms of the vision, implementation in the wider SADC region is to follow after the systems have been successfully rolled-out in the CMA region.

#### **4. Success Factors from the SADC Region**

This section dwells on key factors that contributed or leading to the successful implementation of the SADC Payments Project. Only one phase, SADC Integrated Regional Electronic Settlement System (SIRESS), has been completed on 22 July 2013 in CMA with the remaining part, automated clearing house (ACH), to be realised by 2015. The following factors can explain why the SADC Payments has been or is being rolled-out well in the region.

##### **4.1 *Dedicated Team at the Secretariat Level***

In general, the SADC Banking Association is doing a sterling job as far as co-coordinating cross-border activities of member countries is concerned. It is coordinating the implementation of the SADC Payments Project well. Where there are issues in the process, the SADC Banking Association is being instrumental in ensuring that these are resolved within reasonable time limits in association with relevant bodies and institutions.

##### **4.2 *Implementation of in-country Governance Structure.***

The regional governance framework, developed by SADC Banking Association, requires each member country to have an In-country Payments Leader (IPL) who shall co-ordinate the implementation of the SADC Payments Project at a banking industry level. Within each banking institution, there must be a project manager who ensures that the project is managed to realize its successful implementation. The IPL links the SADC Banking Association and the local banking industry and sees to it that there is a local documented governance framework in place to encourage participation in the project.

##### **4.3 *Reporting to Authorities***

Providing progress reports to authorities on status of the implementation of the SADC Payments Project is crucial with the view of ensuring that stakeholders are aware of what is going on. The In-country Payments Leader (IPL) is accountable in terms of providing regular progress reports to various industry stakeholders on the roll-out process. These stakeholders include Payment Clearing House (PCH) groups; Payment System Management Body Management Councils; regulators; and banking associations. The principals of various streams of the SADC Payments Project and project managers are playing a key role in providing input into reports to and for various stakeholders.

##### **4.4 *Interaction at Domestic and Regional Level***

The SADC Payments Project is programmed in such a way that there must be interaction at local and regional level to ensure information sharing. Domestically, relevant teams do meet as often as possible, in line with in-country governance framework, to share information including action items that require resolution. There are meetings at the regional level and these are used to discuss progress made, issues being experienced, and matters to be tackled in future. Regional meetings are attended by representatives from member countries.

##### **4.5 *Clear Vision***

A clear vision is important because it shows what needs to be achieved in future and how to get there. The vision statement as communicated by the regulators is very clear as far as implementation of the SADC Payments Project is concerned. For example, member banks and other participants know that the roll-out program includes a settlement system, clearing component, delivery-versus-payment mechanism, and sound regulatory framework. All these components would have been completed by the time the project is implemented.

#### **5. Challenges Experienced**

In this section, challenges experienced during the implementation of the SADC Payments Project are outlined. These challenges include absence of a regulation; take-off phase; clarifying roles of different stakeholders; keeping in-country members informed of the roll-out process, and preparation for going live. These are briefed discussed below:

### **5.1 Absence of a Regulation**

Apart from the SADC Finance and Investment Project, which requires central banks to implement a cross-border payment, clearing and settlement strategy, there is no legal instrument that mandates members to implement the SADC Payments Project and consequently ensuring that cross-border payments are channeled through central systems. Legal instruments could take forms such as regulation, directive or determination. The current approach is moral suasion and it is expected that a regulation will be issued once central systems have been implemented SADC-wide. It is advisable that any form of a regulation to be issued should be clear on the cut-off when all financial institutions are expected to use regional systems for cross-border transactions. Further, a regulation should be clear when correspondent banking relationships should be phased out to ensure certainty in the process and to avoid a situation where certain payments are processed outside the central systems.

### **5.2 Take-off Phase**

It took time and effort to explain the rationale of the SADC Payments Project to different stakeholders. Several questions were asked at the start of this exercise. What will be achieved as far as the SADC Payments Project is concerned? What is the role of banks and central banks in the process? Who gave a go ahead for such a project to be initiated and implemented? Does the region need central systems when the nostro/vostro relationships are working well? The list is not exhaustive. Consequently, stakeholders, SADC Banking Association and regulators, played an important role in ensuring that members appreciate the importance of the project and this led to countries embracing the implementation.

### **5.3 Clarifying Roles of Stakeholders**

The SADC Payments Project has different role players. These include SADC Banking Association, regulators, country representatives for payment streams, project managers; and In-country Payments Leaders (IPL). Roles were clarified to make sure that each stakeholder knows what they are responsible for. For example, it was made clear that project managers are responsible for implementing the project within their institution with the IPL co-ordinating at country level. In addition, it was clarified that compliance falls outside the IPL as this is a responsibility of payment regulators.

### **5.4 Keeping in-country Members Informed**

One of the basic tenets of project management is reporting to relevant stakeholders. Key stakeholders as far as the SADC Payments Project is concerned include payment regulators, Bankers Associations; Payment Clearing House Participant Groups (PCH PG); Payment System Management Body Management Councils (PSMB MC); and internal stakeholders within a particular member. All stakeholders had to be kept informed in terms of the progress made. There is a commitment to keep them informed of developments until the SADC Payments Project has been successfully implemented SADC-wide.

### **5.5 Preparation for Go Live**

Members across the region had to fulfill necessary preconditions before going live in the production component of the regional settlement system. Connectivity and transactions testing had to be completed. Key documents including legal documents, business models, rules, exceptions handling processes, just to mention but a few, were reviewed. Resources including testing resources had to be made available to ensure that the go-live date is met.

## **6. Concluding Remarks**

This paper investigated the experience in implementing cross-border payment, clearing and settlement systems in the Southern African Development Community (SADC). It outlined the literature review after which details in terms actual experiences were discussed. There are success factors that led to the SADC Payments Project being implemented successfully from the settlement side. Challenges experienced were discussed in the paper. Going forward, the region expects the second phase of the implementation, that is regional automated clearing house phase, to be implemented with vigor and determination between now and 2015 in the Common Monetary Area

(CMA). SADC-wide, implementation is expected to follow after CMA has been covered.

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