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GENERAL NOTICE

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SOUTH AFRICAN RESERVE BANK

DRAFT NATIONAL PAYMENT SYSTEM BILL, 1998

The draft National Payment System Bill, 1998, is hereby published for general information and comment.

The background to and the envisaged operation of the proposed legislation are set forth hereunder in a memorandum on the objects of the Bill.

Interested persons are invited to address comments on the draft Bill in writing to the Head, Payment System Division, South African Reserve Bank, P O Box 427, PRETORIA, 0001, within four weeks from the date of publication of this notice.

NATIONAL PAYMENT SYSTEM BILL

To provide for the management, administration, operation, regulation and supervision of payment, clearing and settlement systems in the Republic of South Africa; and to provide for matters incidental thereto.

BE IT ENACTED by the Parliament of the Republic of South Africa, as follows :-

Definitions

1. In this Act, unless the context otherwise indicates -

“bank” means a bank as defined in section 1 of the Banks Act, 1990 (Act No. 94 of 1990);

“branch of a foreign institution” means a branch by means of which a foreign institution conducts, in terms of a written authorization granted by the Registrar of Banks under section 18A of the Banks Act, 1990, the business of a bank in the Republic;

“clear” or “clearing” means the exchange of payment instructions in order to determine the payment obligations of the respective system participants;

“Minister” means the Minister of Finance;

“money” means banknotes and coins issued by the Reserve Bank in terms of section 10(1)(a)(iii) read with section 14 of the South African Reserve Bank Act, 1989 (Act No. 90 of 1989);

“mutual bank” means a mutual bank as defined in section 1 of the Mutual Banks Act, 1993 (Act No. 124 of 1993);

“netting” means the set-off of payment obligations by two or more system participants within a payment clearing house or the set-off of settlement obligations by two or more system participants within the settlement system;

“payment clearing house” means an arrangement between two or more system participants governing the clearing of payment instructions between such system participants;

“payment instruction” means an instruction by one or more persons directed or routed to a system participant to transfer funds or to make payment to a specified beneficiary or specified beneficiaries;

“payment obligation” means an indebtedness that is owed by one system participant to another as a result of one or more payment instructions;

“payment system” means a system that enables payments to be effected between a payer and a beneficiary;

“payment system management body” means a body recognized by the Reserve Bank in terms of section 3(1);

“person” includes any partnership;

“Reserve Bank” means the South African Reserve Bank established by section 9 of the Currency and Banking Act, 1920 (Act No. 31 of 1920), and the status of which as a juristic person is re-confirmed in section 2 of the South African Reserve Bank Act, 1989 (Act No. 90 of 1989);

“settlement instruction” means an instruction given to the settlement system by a system participant or by a payment clearing house to effect settlement of one or more payment obligations;

“settlement obligation” means an indebtedness that is owed by one system participant to another as a result of one or more settlement instructions;

“settlement system” means a system established and operated by the Reserve Bank for the discharge, of payment and settlement obligations between system participants;

“system operator” means a person authorised by the payment system management body to provide clearing processing services on behalf of two or more system participants or a payment clearing house;

“system participant” means a member of the payment system management body;

“systemic risk” means the risk that the failure of one or more system participants, for whatever reason, to meet their payment obligations within the payment system or their settlement obligations within the settlement system, may result in any or all of the other system participants being unable to meet their respective payment or settlement obligations.

Powers and functions of Reserve Bank in relation to payment system

2. (1) The Reserve Bank shall, as contemplated in section 10(1)(c) of the South African Reserve Bank Act, 1989 (Act No. 90 of 1989), exercise the powers and perform the functions conferred upon and assigned to it by this Act.
- (2) The board of directors of the Reserve Bank may -
 - (a) delegate to any officer of the Reserve Bank any power conferred upon the Reserve Bank by this Act; and
 - (b) authorise any such officer to perform any function assigned to the Reserve Bank by this Act.

Payment system management body

3. (1) Subject to the provisions of subsection (2), the Reserve Bank may recognize a payment system management body established with the object of organizing, managing and regulating the participation of its members in the payment system.

(2) The Reserve Bank shall not recognise a payment system management body as contemplated in subsection (1) unless the Reserve Bank is satisfied -

- (a) that the payment system management body, as constituted, fairly represents the interests of all banks, mutual banks and branches of foreign institutions participating in the payment system;
- (b) that the provisions of the deed of establishment or constitution, as the case may be, as well as the rules, including rules relating to admission to membership, of the payment system management body are fair, equitable and transparent; and
- (c) that the Reserve Bank will be enabled to adequately oversee the affairs of the payment system management body and its members in the discharge of the Reserve Bank's responsibilities, specified in section 10(1)(c)(i) of the South African Reserve Bank Act, 1989, regarding the monitoring, regulation and supervision of payment, clearing or settlement systems.

(3) Only the Reserve Bank and a bank, mutual bank or branch of a foreign institution that meets the entrance and other applicable requirements laid down in the rules of the payment system management body shall be entitled to membership of that body.

(4) No body or any of its members, nor any other person, shall be entitled to participate in the settlement system unless -

- (a) in the case of such body, that body is recognized by the Reserve Bank as a payment system management body in terms of the provisions of subsection (1); or
- (b) in the case of such other person, that person is a member of a payment system management body recognized by the Reserve Bank as contemplated in paragraph (a).

Objectives and rules of payment system management body

4. (1) The objectives of the payment system management body shall be to manage and control all matters affecting payment obligations and the clearing and netting of payment obligations and, in connection with these objectives -

- (a) to provide a forum for the consideration of matters of policy and mutual interest concerning its members;

- (b) to act as a medium for communication with the South African Government, the Reserve Bank, the Registrar of Banks, the Registrar of Financial Institutions, any financial or other exchange, other public bodies, authorities and officials, the news media, the general public and other private associations and institutions; and
 - (c) to deal with and promote any other matter of interest to its members and to foster co-operation between them.
- (2) In addition to any other provisions thereof, the rules of the payment system management body shall empower that body to -
 - (a) admit members and to regulate, control and terminate membership;
 - (b) constitute, establish or disband any body, committee or forum consisting of its members and which has an impact on, interfaces with, has access to or makes use of payment, clearing and settlement systems or operations;
 - (c) determine the criteria subject to which any person is to be authorised and, in accordance with such criteria, to authorise such person, as a system operator within the payment system to provide specific services to one or more members of the payment system management body or to act on behalf of such members; or
 - (d) determine criteria subject to and in accordance with which a member may be authorised to introduce any person to provide payment services to or on behalf of that member.

Settlement provisions

5. (1) The discharge of settlement obligations between system participants shall be effected in money or by means of entries passed through the settlement system.
 - (2) A settlement that has been effected in money or by means of an entry to the credit of the account maintained by the beneficiary system participant with the Reserve Bank for settlement purposes, shall be a final and irrevocable settlement.
 - (3) No settlement in terms of a settlement instruction which has been finally and irrevocably effected in terms of subsection (2) shall be reversed or set aside.
 - (4) In the case of the winding-up of a system participant, a copy of the application for winding-up, when it is made, as well as of the subsequent winding-up order shall be lodged also with the Reserve Bank.
 - (5) In the case of a winding-up of a system participant the relevant winding-up order shall, notwithstanding the provisions of sections 341 (2) and 348 of the Companies Act, not affect any settlement that has become final and irrevocable in terms of subsection (2) prior to the lodgement of the copy of such order with the Reserve Bank in terms of subsection (4).

(6) The Reserve Bank may from time to time, in consultation with the payment system management body, prescribe by notice in the *Gazette* such conditions, rules or procedures as it deems necessary regarding the issue of settlement instructions and discharge of settlement obligations.

Clearing provisions

6. (1) No person shall clear payment instructions unless such a person is a system participant.

(2) Any person that contravenes the provisions of subsection (1) shall be guilty of an offence.

Netting agreements and netting rules

7. Notwithstanding anything to the contrary contained in the law relating to insolvency or in the Banks Act, 1990, or the Mutual Banks Act, 1993, if a system participant is wound up or placed under judicial management or a curator is appointed to a system participant, any provision contained in a written netting agreement to which such system participant is a party, or any netting rules and practices applicable to such system participant, shall be binding upon the liquidator, judicial manager or curator, as the case may be, in respect of any payment or settlement obligation which has been determined through netting prior to the date of the winding-up order, judicial management order or appointment of the curator, as the case may be, and which obligation is to be discharged on or after the date of the winding-up order, judicial management order or the appointment of the curator, as the case may be, or the discharge of which is overdue on the date of the winding-up order, judicial management order or the appointment of the curator, as the case may be.

Utilisation of assets provided as security to Reserve Bank or payment clearing house

8. Notwithstanding anything to the contrary contained in the law relating to insolvency, any asset of a system participant -

(a) which it has provided to the Reserve Bank as security for a loan in respect of its settlement obligations prior to the date of any order for the system participant's winding-up, may be utilised by the Reserve Bank to the extent required for the discharge of such settlement obligations of the system participant; or

(b) which it has in terms of a written agreement with any payment clearing house provided as security in respect of its payment obligations, prior to the date of any order for its winding-up, may be utilised by the payment clearing house to the extent required for the discharge of such payment obligations.

Information

9. (1) The Reserve Bank shall have access to, and system participants shall provide to the Reserve Bank, any information relating to the volumes or values of payment and settlement instructions or payment and settlement obligations.

(2) Subject to the provisions of subsection (3), any information obtained by the Reserve Bank under subsection (1) and which identifies a specific system participant is confidential and may not be disclosed by any director or officer of the Reserve Bank to any person other than an officer of the Reserve Bank who requires such information for purposes of the execution of his duties in terms of this Act, the South African Reserve Bank Act, 1989, the Banks Act, 1990, or the Mutual Banks Act, 1993.

(3) Notwithstanding the provisions of subsection (2) and of section 33 of the South African Reserve Bank Act, 1989, the Reserve Bank may disclose any information of which the disclosure is in the opinion of the Reserve Bank necessary to protect the integrity, effectiveness or security of the payment system.

(4) A person that contravenes the provisions of subsection (2) shall be guilty of an offence.

Settlement of disputes

10. (1) If any system participant considers itself wronged by a decision taken by the Reserve Bank under a provision of this Act, the matter shall be deemed to constitute a dispute between such system participant and the Reserve Bank, which dispute shall be settled as provided hereinafter in this section.

(2) The system participant concerned shall in writing furnish the Reserve Bank with full particulars of its grievance, and thereafter the system participant and the Reserve Bank shall attempt to settle the dispute by consensus within seven business days of the receipt by the Reserve Bank of the aforesaid written particulars.

(3) Should the system participant and the Reserve Bank not succeed in settling the dispute as contemplated in subsection (2), they may agree to attempt to settle the dispute by mediation within a further period of ten business days.

(4) Mediation as contemplated in subsection (3) means a process whereby -

(a) the system participant concerned and the Reserve Bank agree on a mediator;

(b) the mediator familiarises himself or herself with the position held by the system participant concerned and the Reserve Bank, respectively;

- (c) the mediator, the system participant concerned and the Reserve Bank discuss the dispute at a meeting attended by them all;
- (d) the system participant concerned and the Reserve Bank at or following such meeting attempt to settle the dispute by consensus; and
- (e) the system participant concerned and the Reserve Bank share the mediator's costs equally.

(5) If the system participant concerned and the Reserve Bank are unable to settle the dispute by consensus as contemplated in either subsection (2) or (4), the dispute shall be referred to a single arbitrator to be agreed upon between the system participant and the Reserve Bank or, failing such agreement, an arbitrator appointed at the request of the system participant and the Reserve Bank by a recognized body concerned with the facilitation and promotion of the resolution of disputes by means of mediation or arbitration, which arbitrator shall, as far as possible, be a person appointed on account of his or her knowledge of both the law and the payment system.

(6) The provisions of the Arbitration Act, 1965 (Act No. 42 of 1965), including the provisions relating to the award of costs in connection with the arbitration proceedings, shall, with the necessary changes, apply to an arbitration contemplated in subsection (5).

(7) The decision of the arbitrator shall be final and binding on the system participant concerned and the Reserve Bank.

Directives by Reserve Bank

11. (1) If reasonable grounds exist to believe that any person is engaging in or is about to engage in any act, omission or course of conduct, with respect to the payment system, that results or is likely to result in systemic risk, or is or will be contrary to the public interest, the Reserve Bank may issue a directive in writing to such a person requiring him to -

- (a) cease or refrain from engaging in the act, omission or course of conduct;
- (b) perform such acts as in the opinion of the Reserve Bank are necessary to remedy the situation; or
- (c) provide the Reserve Bank with such information and documents as the Reserve Bank may require,

within such period as the Reserve Bank deems advisable and may specify in the directive.

(2) Any person who neglects, refuses or fails to comply with a directive issued under this section shall be guilty of an offence.

(3) Irrespective of whether criminal proceedings have been or maybe instituted against a person in respect of an offence referred to in subsection (2), the Reserve Bank may apply to a division of the High Court having jurisdiction for an order directing such person to comply with the directive in question.

Retention of records

12. (1) Notwithstanding anything to the contrary contained in any law relating to the retention of records, the Reserve Bank and system participants shall retain all records obtained by them during the course of the operation and administration of the settlement system for a period of five years as from the date of each particular record.

(2) The retention of records in terms of subsection (1) may be effected by means of a computer as defined in section 1(1) of the Computer Evidence Act, 1983 (Act No. 57 of 1983).

Penalties

13. Any person convicted of an offence in terms of -

(a) section 6(2) or 11 (2), shall be liable to a fine not exceeding R1million Or to imprisonment for a period not exceeding five years, or to both such fine and such imprisonment; or

(b) section 9(4), shall be liable to a fine not exceeding R1 000 or to imprisonment for a period not exceeding six months, or to both such fine and such imprisonment.

Review of Act

14. The Reserve Bank shall, in collaboration with the payment system management body, establish a standing committee to review this Act from time to time and to make recommendations to the Minister with regard to amendments to this Act which, in the opinion of such committee, have become advisable owing to changed circumstances or which the administration of this Act has shown to be advisable.

Short title and commencement

15. This Act shall be called the National Payment System Act, 1998, and shall come into operation on a date fixed by the President by proclamation in the *Gazette*.

MEMORANDUM ON THE OBJECTS OF THE NATIONAL PAYMENT SYSTEM BILL, 1998

Clause 1. Definitions

Although the definitions are self-explanatory, it should be borne in mind that the Bill aims to regulate the activities of participants and other role-players within three distinct areas :

- The payment system in general, which encompasses all payment related activities from end-user to end-user;
- the clearing system, which will be the sole domain of system participants, albeit with the assistance of system operators as their duly appointed agents; and
- the settlement system, which will be provided exclusively to system participants by the SA Reserve Bank.

The distinction between payment obligations and settlement obligations are also important in order to, *inter alia*, obtain legal certainty with regard to netting agreements in insolvency situations, not only in respect of obligations between system participants within a payment clearing house, but also within the settlement system provided by the Reserve Bank.

Clause 2. Reserve Bank's powers and functions

The Reserve Bank, as managed by its board of directors, is statutorily entrusted, in section 10(1)(c) of the South African Reserve Bank Act, 1989, with supervisory and regulatory functions in respect of the National Payment System ("NPS").

Clauses 3 and 4. Payment system management body, its objectives and rules

System participants obviously have the right to associate themselves in groups as they wish. When it concerns payment system issues, however, the Reserve Bank, in view of its statutory responsibilities referred to above, needs to be statutorily empowered to recognize a body, representative of the majority or all of the system participants and which adheres to the principles of the NPS.

Clause 5. Settlement provisions

The crux of the payment system is the finality and irrevocability of settlement. Due to the cardinal role which a payment system fulfills within the financial system of the country and its economy, it is imperative that settlement obligations between system participants are settled finally and irrevocably. This implies that once settlement has taken place, it should not be possible, in law, to be reversed or set aside. This principle is also an internationally accepted prerequisite for a safe and sound payment system.

A further problem within the South African law is that the provisions of sections 341 (2) and 348 of the Companies Act renders the winding-up of a company retrospective to the date of the presentation to court of the application concerned. This means that all business conducted and dispositions made by the company after the date of the application to court up to the date of the winding-up order will be subject to the discretion of a liquidator. When one considers that an efficient computerised payment system, such as envisaged by the NPS, would facilitate the circulation of large amounts of money almost every minute of the day, it is clear that to unwind payments made by a system participant within a period of just one day would not only negatively affect other system participants, but would have a detrimental effect on the system as a whole. This, in turn, could lead to a systemic crisis, which in turn, could have an adverse effect on the financial system and economy of the country. Since system participants are subject to the provisions of the Companies Act, sections 341 (2) and 348 of the Companies Act will be applicable to them in the case of one of them being wound up.

In the light of the above, clause 5 *inter alia* proposes that in the case of the winding-up of a system participant, firstly, a copy of the application for winding-up as well as of the subsequent winding-up order be lodged also with the Reserve Bank and, secondly, that all settlements to which such system participant has been a party and which have become final and irrevocable, in terms of clause 5(2), prior to such lodgement of the winding-up order with the Reserve Bank, shall not be subject to the provisions of section 341 (2) of the Companies Act which prohibits the disposition of its property by a company once the winding-up of such a company has commenced. Such receipt of a copy of the winding-up order will also be the cue for the Reserve Bank to take steps to suspend all payment, clearing and settlement related transactions with regard to the system participant concerned.

This deviation from the normal principles of liquidation is vitally important to ensure a secure and stable payment system. In weighing up the interests of individual creditors of a liquidated system participant on the one side and the public's interest in having a safe and sound payment system on the other, it is considered that the public interest should weigh heavier than those of individual creditors and that a deviation from the normal rules pertaining to liquidations is justified. Once the deviation becomes law, however, all creditors dealing with system participants will or should be aware that obligations incurred by such system participants within the payment system in the ordinary course of business, will take precedence over any other claims against such system participant up to and until the winding-up order is lodged with the Reserve Bank.

Clause 6. Clearing provisions

In order to ensure that the clearing process remains the sole domain of system participants, it is imperative that all other persons are prohibited from performing clearing, as defined. System participants should be able to determine their own risk exposures *vis-à-vis* system participants, and the Reserve Bank, as supervisor of the payment system, should be able to determine the relevant risk exposures of all participants within the payment system. Were any other person permitted to clear payment instructions of system participants and to transmit the netted amount to one system participant for settlement, the risk exposures of the other system participants will not be known, and the total risk within the system could become distorted.

Clause 7. Netting agreements and netting rules

Netting is a payment system practice and not (yet) a legal term. The legal term that closely resemble netting is the term "set-off". The common law, however, only recognises set-off in a rigid set of circumstances. The common law requirements for set-off are, briefly, that the two debts being set-off should be those of the persons agreeing to the set-off, that the debts being set-off are of the same nature and that the debts should be claimable, liquid or easily proved. Although the question of whether the netting of interbank obligations falls within the above-mentioned requirements could be debated, it is submitted that netting as practised by banks within the payment system is not set-off as envisaged or provided for by the common law, but rather is an innovation brought about by payment system practices and further developed as a result of technological advances. The law should, therefore, define the practice of netting and provide the payment system with legal certainty in its participation in these practices.

The potential legal obstacle in this regard is contained in section 46 of the insolvency Act, which essentially affords the liquidator of an insolvent estate a discretion to abide by or to disregard a set-off agreement entered into by an insolvent. Since netting is not a legal term as yet and since it closely resembles set-off, the uncertainty exists that a liquidator might regard netting as set-off and might disregard such agreements, which may cause untold problems within the payment system or which may result in lengthy and costly law suits.

It is consequently proposed that the practice of netting, as defined, be recognised in law and that the uncertainties prevalent in insolvency or curatorship situations be adequately addressed. For this purpose it is proposed that a liquidator, judicial manager or curator, that has been duly appointed over a system participant, should be bound by netting agreements or netting rules between system participants within the settlement system as well as in a payment clearing house.

These provisions closely resemble the recent amendments to the insolvency Act, where sections 35A and 35B were inserted to address netting arrangements and netting rules between participants in certain defined markets. Unfortunately these amendments do not include netting arrangements and netting rules within the payment or settlement systems.

The recent amendments to section 69 of the Banks Act also provide that a curator that has been appointed over a bank should deal with netting arrangements and netting rules applicable to such bank in accordance with the provisions of sections 35A and 35B of the Insolvency Act. Unfortunately this does not include netting arrangements and netting rules applicable to system participants within the payment system.

The overriding interest that is served by the above-mentioned proposed provisions, is that of the public's interest in a safe and sound payment system. Were a liquidator, judicial manager or curator not bound by the netting arrangements or netting rules between system participants within the payment system, it could lead to transactions worth a large amount of money having to be reversed and unwound, which could in turn lead to a systemic crisis which, in turn, could have an adverse effect on the economy.

Clause 8. Utilisation of assets provided as security to Reserve Bank or payment clearing house

System participants will be required to either pre-fund their settlement obligations, or to provide adequate security for such settlement. In the case where security is provided by a system participant, and such a system participant becomes insolvent, it would adversely affect the settlement system if such security could not be utilised by either a particular payment clearing house or the Reserve Bank in respect of such a system participant's payment or settlement obligations prior to the date of any order for the winding-up of such a system participant.

Clause 9. Information

In order for the Reserve Bank to adequately fulfil its role as supervisor of the payment system and to have a holistic view of the risk exposures of the respective system participants, it is necessary to afford the Reserve Bank the right to information pertaining to the volume or value of payment and settlement instructions or obligations within the payment system. The Reserve Bank's right to disclose information that might identify a specific system participant is, however, limited.

Clause 10. Settlement of disputes

In the event of a system participant being aggrieved by a decision taken by the Reserve Bank, provision is made for the dispute to be resolved through a process of consensual settlement or mediation or, as a last resort, arbitration. This procedure will hopefully be used in place of the more costly and time-consuming court procedures.

Clause 11. Directives by the Reserve Bank

As the supervisor of the payment system as a whole, it is imperative that the Reserve Bank be granted the power to issue directives to any person who is engaging or is about to engage in any act, omission or course of conduct that results or is likely to result in systemic risk or is contrary to the public interest. Failure to comply with such a directive will be an offence.

Clause 12. Retention of records

Due to the fact that there are a number of Acts that regulate the retention of records, it is considered that in order to attain legal certainty a provision relating to the retention of records within the settlement system is necessary. A period of five years is considered more than reasonable considering the volumes of information that might be processed by the system. Since the system will be an automated one, it was also necessary to provide that such records may be retained electronically.

Clause 13. Offences and penalties

The proposed Act provides for three offences, namely in terms of clause 6(2), providing that any person other than a system participant will be prohibited from performing clearing, as defined, clause 11 (2), providing that the failure to comply with a directive from the Reserve Bank will constitute an offence and clause 9(4), providing that a director, officer or employee of the Reserve Bank may not disclose certain information. Since role-players within the payment system generally have a strong capital base, it is considered necessary, in the case of the first-mentioned two offences, to set the upper limit of a possible fine at R1 million to act as an efficient deterrent against committing the said offences. A conviction of an offence in terms of section 9(4) will bear a maximum fine of R1000.

Clause 14. Review of the Act

It is proposed that the Reserve Bank, in collaboration with the payment system management body recognized in terms of clause 3(1), will establish a standing committee to review the Act from time to time.

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