Address by Mr Yandraduth Googoolye, First Deputy Governor of the Bank of Mauritius at the Workshop on the Legal Aspects on the National Payments System –

Achieving Compliance with Principle 1 of the CPSS-IOSCO Principles for Financial Market Infrastructures (PFMI) organized by the IMF's Regional Technical Assistance Center for Southern Africa (AFRITAC South), 27 November 2017, Ebene, Mauritius

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Learned Resource Persons

Ladies and Gentlemen

Good morning. I extend to you a warm welcome to Mauritius. Thank you for the privilege to providing the opening for the Workshop, indeed very timely for Mauritius, as we are currently finalizing our National Payment Systems Legislation and working towards a National Payment Switch.

I am also delighted to see Ms Onnene Partsch in our midst today. Ms Onnene Partsch has, as part of the IMF Technical Assistance Mission, provided assistance to the Bank of Mauritius in reviewing our draft National Payment Systems Bill. I am confident that she, as well as all the resource persons, will partake their invaluable experience and knowledge with you during this week.

Amidst its basic traditional functions, a central bank is called to ensure that liquid resources in the economy are efficiently managed. This function allows for the use of cashless payment systems by economic agents. Cash payments make economic agents incur costs in terms of interest foregone and higher security risks. A primary function of a central bank is to conduct monetary policy, the impulses of which are typically transmitted from banks to the rest of the economy. The operational features of the transmission, however, rests upon the smooth functioning of payment infrastructure. If the operation of payment systems is underdeveloped, these institutions will opt to retain a higher buffer of central-bank money for liquidity management purposes, with a view to better manage their liquidity. This, in turn, leads to weaker than intended monetary-policy impulses from the central bank.

Another primary function of the central bank is to ensure stability of the financial system. This implies that the financial system is robust to systemic risk. Financial stability allows the financial system to withstand shocks without impairing the processing of payments in the economy, and ultimately, the allocation of savings to investment opportunities. Accordingly, a robust and resilient market infrastructure is key to financial stability. The interest of central banks in financial stability can be traced as far back as late June 1974, when the closure of the Herstatt bank left transactions half-done due to the time-zone difference between Frankfurt and New York. This incident led central banks to develop a continuous linked settlement platform, whereby commercial banks manage settlement of foreign exchange amongst themselves on a payment versus payment basis.

More often than not, we have tended to underestimate the role of payment systems in an economy. At one point in time, we even took the payments system for granted, assuming that transfers will be settled as expected, and that the system will perform as solidly under market stress as it does under normal conditions. Let me reassure you… central banking is a serious job and we do acknowledge that payment systems play a critical role in the design of the broad spectrum of a central bank's policies. Thus, it is in the interest of the central bank to ensure that the payment system is efficient, as it enables the orderly functioning of the interbank, money and capital markets. This also reduces the cost of exchanging goods and services, expands opportunities for commercial and financial transactions, and supports higher investment and economic activity. Settling payments in accounts at the central bank still provides the link with the latter's two main tasks, namely monetary policy and financial stability. In sum, a national payment system is a vital mechanism for ensuring a country's economic development, since almost all transactions involve some kind of payment and maintain confidence in the domestic currency both in normal times and during crisis times.

Central banks are also required to nurture the various characteristics that underpin the design and development of the payment system. Specifically, a central bank has to put forward the legal framework through the establishment of rules and regulations, standards, and policies that will govern the nation's payment and settlement services; while facilitating payment finality. It is also called upon to regulate private agents in the payment system; and to administer payment services, especially the large-value payment systems that underpin financial activity. Last but not least, the central bank musty also provide credit for participants in the payment system.

As the lender of last resort, the central bank ought to have the required information and means to oversee and, if necessary, assist the institutions participating in the payment system. The central bank has to exercise oversight on the design and the operations of payment arrangements to improve the speed and reliability as well as reduce financial risk, transactions costs and the risks of fraud, errors and other major types of risks inherent in the payment system. A well-developed statutory and regulatory framework for the payment system, thus, reduces uncertainty and risk, and provides the needed clarity.

Let us recall that payments systems are but one of the five key types of Financial Market Infrastructures (FMIs). The four others being the Central Securities Depositories, Securities Settlement Systems, Central Counter Parties and Trade Repositories. FMIs are key components of the financial system. They play a critical role in the smooth functioning of the financial market and can be a source of both financial stability and operational efficiency by, inter alia, establishing and ensuring secure arrangements for the timely clearing and settlement of obligations between counterparties. To manage the relationships among the various counterparties and stakeholders and also to mitigate risks, it is imperative for the National Payment System (NPS) to operate on sound legal premises.

Legal certainty brings confidence, and Principle 1 of the CPSS-IOSCO Principles for Financial Markets Infrastructures underscores the importance for FMIs to have a well-founded, clear, transparent, and enforceable legal basis for each material aspect of their activities.

The CPSS-IOSCO Principles further set out the five key considerations in order to fully comply with the first Principle, which are as follows:

1) the legal basis should provide a high degree of certainty for each material aspect of an FMI's activities in all relevant jurisdictions;
2) an FMI should have rules, procedures, and contracts that are clear, understandable, and consistent with relevant laws and regulations;
3) an FMI should be able to articulate the legal basis for its activities to relevant authorities, participants, and, where relevant, participants' customers, in a clear and understandable way;
4) an FMI should have rules, procedures, and contracts that are enforceable in all relevant jurisdictions. There should be a high degree of certainty that actions taken by the FMI under such rules and procedures will not be voided, reversed, or subject to stays; and
5) an FMI conducting business in multiple jurisdictions should identify and mitigate the risks arising from any potential conflict of laws across jurisdictions.

A proper understanding of these key considerations is, thus, mandatory for central bankers. I need not dwell further on these as they would surely be covered by the resource persons in the Workshop.

The legal framework must accordingly provide explicit and defined authority of Central Banks over payment systems, including amongst others the powers to license, authorise or designate payment systems and clearly define their oversight functions. The basis for cooperation with the regulators of other domestic FMIs as well as foreign FMIs must also be clearly spelt out in the law.

We must not ignore the regional dimension to this lively subject. Cross-border trade in the region is rapidly expanding and various initiatives are evolving for the continent. To facilitate payment transactions, Africa is host to a number of cross-border payment systems: the SADC Integrated Regional Electronic Settlement System (SIRESS) and the COMESA Regional Electronic Payment and Settlement Systems (REPSS), West African Monetary Zone (WAMZ), the East Africa Payment Systems (EAPS) of the East African Community (EAC). I am sure that AFRITAC member states must be participants to at least one of them. The Bank of Mauritius is itself a participant in the REPSS and SIRESS.

However, there is currently no harmonised legal and regulatory framework for payments in the Continent and member states are at varying stages of development of their legal and regulatory frameworks for their respective NPS.

In the SADC Region, for example, in the absence of an appropriate SADC wide legal and regulatory framework, Member States participating in the SIRESS have structured the legal arrangements between themselves through a number of multilateral agreements, in view of providing for legal certainty. SADC countries have, however, already committed themselves to harmonise their legal and regulatory frameworks and to establish institutional and organisational structures conducive to the establishment of an integrated payments market.

Ladies and gentlemen, payment services are considered to be the stepping stone for financial inclusion. People's demand for ever faster, more convenient and flexible means of payments has led to a dramatic evolution in the payment ecosystem, especially in the retail payment services.

Today, the contours of the global financial system are different from what they were, say, a decade before. Major developments have underscored the implications for payment systems and financial stability as they have exposed central banks to additional sources of risks. For instance, the issuance of new financial instruments, the increasing size and complexity of financial systems, and globalization of financial markets have contributed to generate new areas of risks. Financial innovations, due to technological advances in information and communications, have impacted strongly on the speed, variety and costs of transactions. These have increased the size of the financial sector vis-à-vis the real economy and the number and volume of transfers that take place through the payment system have magnified significantly. Consequently, the smooth running of the financial system and the economy is turning out to be very reliant on the non-stop provision of market liquidity and, obviously, on the orderly functioning of the payment system.

Fintechs are nowadays the new kid on the block. They are rapidly positioning themselves as the key players in the financial industry, partly due to some sort of regulatory void in which they have been operating so far, and partly as some regulators around the world have adopted a somewhat adaptive approach to regulation in order not to stifle innovation. Since financial companies are creating faster, cheaper, and more convenient payment systems out of technology, a customer centric approach for service is emerging with the notion of anytime, anywhere payments. At the same time, the payment service provider is moving out of the banking domain to the non-banking one.

The regulatory challenges thrown up by Fintechs can be summarised thus:

i. the need to focus on activity rather than technology and literally educating the consumer of risks involved;

ii. when an activity is innovative, or embedded within the underlying technology, regulators need to understand how they work, while allowing such activities to mature at the same time, the so-called, "Regulatory Sandbox" which enable regulators to address the potential risks of new technologies without stifling innovation; and

iii. with applications built on the Blockchain technology, regulators are faced with the challenge of ensuring the right balance between transaction transparency and privacy.

The Basel Committee on Banking Supervision has lately issued a Consultative Document, which assesses how technology-driven innovation in financial services may affect the banking industry and the attendant activities of supervisors in the near to medium term. At the Bank, we have established an internal committee as well as an inter-bank committee on Fintechs and Distributed Ledger Technologies to study Fintech models and propose the regulatory frameworks and technological infrastructures conducive to promote an enabling environment for emerging technologies.

Broadly, central banks have to ensure that they remain in sync with the markets. As they become more global and interconnected, authorities have to cooperate more closely in their oversight and operational activities, and towards mitigating risks associated with Fintech. In this rapidly changing environment, regulators need to show flexibility but, at the same time, they have to ensure that there is no regulatory arbitrage. As the boundaries between banks and non-banks involved in financial activities get thinner, regulators need to closely collaborate in order to come up with smart regulation for the jurisdiction as a whole.

Ladies and gentlemen, I am confident that this Workshop on the Legal Aspects of NPS will provide the basis to better understand key requisites for devising or revising legislation regarding the payments system. On this note, I wish you all a fruitful workshop and a pleasant stay in Mauritius.