



# Payment and Settlement Principles for Africa's Market

June 4, 2021

## Introduction

The efficiency, speed, and safety of high-value cross-border payments on the African continent are critical to facilitating cross-border trade, especially under the African Continental Free Trade Area (“AfCFTA”) Agreement. High value payments effected timeously and securely encourage market stability and foster global competitiveness. Payment systems are often key infrastructures in facilitating cross-border fund transfers, and over the years, Africa has seen a number of such systems develop regionally, including the Southern African Development Community (“SADC”) Integrated Regional Electronic Settlement System (“SIRESS”), the East African Payment System (“EAPS”), and the Common Market for Eastern and Southern Africa (“COMESA”) Regional Payment and Settlement System (REPSS).

While a regional approach to cross-border payment system implementation allows for solutions geared toward addressing region-specific needs and challenges, systems designed without regard to a set of robust common standards can amplify certain risks. For example, one regional payment system may prioritize the timely operational transfer of funds, which is its main business purpose, while paying scant attention to the adequacy of its risk management and legal frameworks. This narrow emphasis on speed at the

expense of safety can heighten the possibility of systemic disruptions to the institutions and markets supported by the relevant regional payment system, and the materialization of contagion risks may potentially destabilize other regions.

Material discordance in the continental approach to wholesale payments also gives rise to practical challenges in any future pursuit of consolidating or linking various regional systems. More specifically, there is a danger of operational frictions, risk management and legal framework incongruencies, and technical incompatibilities that would likely impede inter-regional system integration.

To support safe and stable market functioning, and to mitigate discordance and incompatibility risks, this paper proposes the establishment of a common set of Afro-market-centric foundational principles (“African Core Principles for Systemically Important Payment Systems”, or “Afro-SIPS Principles”) to provide a baseline framework of standards to which all African cross-border payment systems – including systemically important national payment systems – should adhere and incorporate into their applicable rulebooks and risk management frameworks.

## **The Principles for Financial Market Infrastructures and key Definitions**

The Principles for Financial Market Infrastructures (“PFMI”)[1] are existing international standards geared toward strengthening and preserving financial stability and apply to **systemically important financial market infrastructures** (“**FMI**s”), including **payment systems**[2].

The PFMI define an **FMI** as “a multilateral system among participating institutions, including the operator of the system, used for the purposes of clearing, settling, or recording payments, securities, derivatives, or other financial transactions”. [3] FMIs play a central role in enhancing efficiencies, reducing risks and costs, and promoting transparency in the market. They may be owned and operated by a central bank or by the private sector, as for-profit or not-for-profit enterprises.[4]

A “**payment system**” is “a set of instruments, procedures, and rules for the transfer of funds between or among participants”[5]. The system includes the participants and the operator of the arrangement. Payment systems are usually

based on an agreement among participants and the system operator, and fund transfers are effected by way of an operational infrastructure. In general, payment systems can be classified as either retail payment systems or large-value payment systems (“LVPS”). Both are fund transfer systems; however a retail payment system tends to handle a large volume of relatively low-value payments (e.g. direct debits) whereas an LVPS by contrast tends to handle large-value and high-priority payments.[6]

While definitions of “**systemically important**” vary by jurisdiction, in general, a payment system is systemically important if it has “the potential to trigger or transmit **systemic disruptions**”[7] for example, a payment system that primarily facilitates high-value, time-critical payment transfers[8]. In broad terms, “**systemic disruption**” is disruption to financial services that is triggered by an impairment in the financial system, and which “has the potential to have serious negative consequences for the real economy”. [9] Central to the concept of systemic disruption is the idea of negative externalities arising from such financial system impairment.[10]

In the wake of the 2008 financial crisis, the Committee on Payment and Settlement Systems (“CPSS”) of the Bank for International Settlements (“BIS”), and the International Organization of Securities Commissions (“IOSCO”) launched a comprehensive review of the existing international standards for FMIs (i.e., (i) the *‘Core principles for systemically important payment systems’* (January 2001), (ii) the *Recommendations for securities settlement systems* (November 2001), and (iii) the *Recommendations for central counterparties* (November 2004)) aimed at harmonizing and strengthening the three sets of standards.[11] The result of this review and consolidation effort was the PFMI, issued by the Committee on Payments and Market Infrastructures (“CPMI”) and IOSCO in 2012. The PFMI comprise 24 key principles, and each principle in turn is underpinned by ‘Key Considerations’ (115 in total) that set out the more granular requirements pertaining to each principle.

For example, Principle 1 (Legal basis) states that “[a]n FMI should have a well-founded, clear, transparent, and enforceable legal basis for each material aspect of its activities in all relevant jurisdictions,” and the following ‘Key Considerations’ underpin Principle 1:

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".[12]

## **An African Approach**

As noted above, the PFMI are intended to apply to all systemically important FMIs, and while the principles are non-legally binding, authorities are encouraged to incorporate the principles and obligations into their legal and regulatory frameworks.[13] By many accounts, the PFMI are viewed as the 'gold' FMI standards, and indeed the PFMI are exceptionally thorough and clear, and address a broad range of potential risks including, but not limited to, systemic, legal, credit, liquidity, and operational risks. That said, as noted by the BIS, the PFMI "[raise] the minimum requirements" for FMIs and "[broaden] the scope of the standards to cover new risk management areas",[14] which presents a potential compliance challenge for payment systems operating in less mature frontier or emerging markets within Africa or elsewhere. The challenge presented is that if the standards are too stringent, systemically important payment systems may not even attempt to comply.

In addition, the heightening of the international FMI standards was in part a response to the 2008 financial crisis and was aimed at ensuring that the "infrastructure supporting global financial markets [was more] robust and thus well placed to withstand financial shocks".[15] However, broadly speaking, the African continent was relatively shielded from the types of direct financial shocks to the banking system that were experienced elsewhere in the

world.[16] This is in part because of Africa's limited financial integration, and even though the banking sector dominates formal African financial systems, many financial markets tend to be less mature and, in some countries, even non-existent.[17] The point is that the drivers behind, and the value proposition underpinning, the PFMI are not like-for-like with those that might be at play in African markets.

This paper suggests that, while compliance with the PFMI should be the ultimate goal, a common set of Afro-market-centric foundational principles should be established to provide a baseline framework of standards to which all African cross-border payment systems – including systemically important national payment systems – should adhere and incorporate into their applicable rulebooks and risk management frameworks. Implementing such a framework would require public-private cooperation to identify (i) the market-specific risks that need to be mitigated, (ii) the unique operational, technological, and liquidity realities that must be accounted for, and (iii) the appropriate legal requirements in light of existing national laws. While these standards would be architected specifically for the African context, it would remain important to draw critical themes and relevant components from the PFMI wherever appropriate. By suitably modulating relevant PFMI principles, it would be possible to create a cohesive continent-wide framework that reflects standards in respect of which compliance would be imminently attainable, while laying bricks on the path to full PFMI compliance.

With respect to the aforementioned Principle 1, a narrow instance of this modulation approach might be to incorporate into the Afro-SIPS Principles the requirement that systemically important payment systems should have a well-founded legal basis for material aspects of their activities. However, the standard would be adapted to one that both addresses 'legal basis' risk and is more likely attainable in the near-term. This might be achieved by reducing the gauge in Key Considerations 1. and 4. from a "high" to a "reasonable" degree of certainty, or limiting the breadth of Key Consideration 1 from applying in "all relevant" jurisdictions to "significant" ones.[18]

Principle 8 is another interesting example to consider: it addresses settlement finality, and provides that:

“[a]n FMI should provide clear and certain final settlement, at a minimum by the end of the value date. Where necessary or preferable, an FMI should provide final settlement intraday or in real time.”[19]

Settlement finality is the legally defined moment where the transfer of an asset or financial instrument, or the discharge of an obligation, is irrevocable and unconditional.[20] Practically, settlement and funding finality means that debit and credit book entries related to payments cannot be reversed, and funds that have been transferred cannot be clawed back through the system. In general, for legal finality to obtain, it must be provided for in law, and usually, but not always, a system must be specially designated by the relevant central bank or other monetary authority to benefit from finality protections. Finality laws tend to be technical, setting out the jurisdiction-specific ‘tests’ as to when and how finality protections attach, and when finality protections may be lost. These technical complexities are compounded by varying finality standards that may apply in each jurisdiction implicated in a cross-border payment system fund-transfer life-cycle. When drafting any common core African standards, thought needs to be given to the most appropriate way to address the Africa-specific risks that finality seeks to address. Some questions to be explored include: is there a possible ‘lower’ level of finality protection that could be acceptable if, upon a historic and structural assessment of the market, the risks of clawback and reversal are miniscule? Or even if a clawback were to occur, would the system and market reverberations be readily containable? Are finality protections necessary in all jurisdictions touched by a cross-border payment system, or can the existence of finality protections in one jurisdiction be leveraged? Are there mechanisms other than finality legislation that could satisfactorily be used to mitigate the impact of reversal or unwind, such as a guarantee by a central bank or other participants in the system, a loss-sharing arrangement, or some other potential means of risk mutualization? Could an African Union-wide finality legal instrument, similar in concept to the European Union Settlement Finality Directive,[21] be implemented to address conflicts of laws and to facilitate the effort in unifying and streamlining a finality standard across the continent?

## **Conclusion**

How to answer these questions, and indeed, determining which PFMI principles could be leveraged and how those standards might be modified in designing an Africa-focused set of rules needs to be further explored. In addition, the practical point of which entity would be the most appropriate issuing body of these standards would need to be resolved. For example, is there a role for an African Central Bank, as contemplated by the African Union Treaty Establishing the African Economic Community (the Abuja Treaty), perhaps working in cooperation and consultation with IOSCO (in which many African nations have representation, and which is a co-issuer of the PFMI) and/or with the Pan-African Payment and Settlement System (“PAPSS”)?

Working toward implementing an Africa-customized set of principles presents several benefits in the near term: standardized requirements would mitigate the risk of extreme fragmentation in the continental approach to wholesale payments, provide appropriate baseline specifications to ensure a minimum level of stability and market safety, introduce efficiencies, and more readily enable regional system integration and interlinkages in the future. Leveraging the PFMI while at the same time factoring in continent-specific realities when crafting these rules would have the dual benefit of increasing the likelihood of adherence on the one hand while forging a path toward eventual compliance with the PFMI on the other.

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\* Ms Andrea S. Mparadzi is a New York-based lawyer who works in the payment and settlement systems industry. She holds an LL.B (*cum laude*) and a PGDip in Corporate Law (*with distinction*) from the University of Cape Town, and an LL.M from Cornell University. She practiced mergers and acquisitions for a number of years at a New York law firm before holding her current position. She writes this paper in her personal capacity. These are her own views, and not necessarily those of her employer.

[1] Committee on Payment and Settlement Systems, International Organization of Securities Commissions, Bank of International Settlements, [Principles for Financial Market Infrastructures, April 2012](#)

[2] See footnote 1 at paragraph 1.20

[3] See footnote 1 at paragraph 1.8

[4] See footnote 1 at paragraph 1.9

[5] See footnote 1 at paragraph 1.10

[6] See footnote 1 at paragraph 1.10

[7] See footnote 1 at paragraph 1.20

[8] See footnote 1 at paragraph 1.20

[9] Financial Stability Board, International Monetary Fund, Bank for International Settlement, *Report to [Financial Institutions, Markets and Instruments: Initial Considerations, October 2009](#)*

[10] See footnote 9

[11] See footnote 1 at paragraph 1.6

[12] See footnote 1 at page 21

[13] See footnote 1 at paragraph 1.30. Note that the end of 2012 was the original target date for implementation, however, many countries are yet to implement the PFMI into national law.

[14] Bank for International Settlements, *[New standards for financial market infrastructures issued by CPSS-IOSCO, 16 April 2021](#)*

[15] See footnote 14

[16] African Development Bank, African Development Fund, *[Impact of the Global Financial and Economic Crisis on Africa, February 2009](#)*

[17] To be clear, Africa was impacted by the financial crisis, but in unique ways. For example, Africa saw a decline in capital flows, a fall in the demand for - and hence subsequent price reductions of - African commodities, and less foreign aid than anticipated.

[18] The precise implications of this latter proposal would need to be worked through.

[19] See footnote 1 at page 64



[20] See footnote 1 at paragraph 3.8.1

[21] Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems, as amended.

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