Economic Review March 2013

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1. Modernization of the Payment System in Lesotho

The Central Bank of Lesotho in collaboration with commercial banks and other relevant stakeholders has been reforming the National Payment System framework in Lesotho. This has been carried out through modernization of the legal and regulatory framework and development of new systems. ……..

1.1. Introduction

A payment system is a set of instruments, banking procedures and typically, interbank funds transfer systems that ensure the circulation of money (Committee of Payments and Settlement Systems, March 2003).

In the past, Lesotho's Payment Systems involved manual processes which did not conform to international standards and best practice. In view of this, the Central Bank of Lesotho introduced the Lesotho Payment System Modernization Project (LPSMP) in 1999. This initiative was meant to improve the payment system through the use of advanced technology.

Economic and financial integration among countries, sub-regions and regions has also necessitated cross-border, regional and international payments and settlements arrangements.

A payment system process consists of a paper-based mechanism for handling cheques and drafts and an electronic mechanism for handling electronic commerce transactions. Figure 1 below depicts a stylized process of a non-cash payment. This process encompass the systems themselves, institutions, settlement agreements, procedures, rules and laws that come into play from the moment one party issues an instruction to pay another party.

Figure 1: Stylized process of a non-cash payment

Source: European Central Bank

The objective of this paper is therefore to review recent developments in the modernization of Lesotho's payment system.

1.2. Why Payment Systems?

In every economy a large number of transactions take place each day initiated by a variety of economic players. If modern economies are to function smoothly they require reliable and efficient payment systems. Payment systems enable safe, cheap and timely ways of conducting business between transacting parties. This is because payment systems exhibit economies of scale thus implying that efficient payment systems reduce costs of transactions for consumers.

Moreover, accurate data is generated and easily extracted from the systems and transparently communicated and disseminated. This tends to create trust between trading partners far apart hence increased trade and economic growth.

Monetary policy is one of the most important tools for central banks in maintenance of price stability. Kokkola, (2010) states that well-functioning payment and settlement systems are an essential precondition for the implementation of a market based monetary policy. This is because payments systems ensure the smooth and homogenous transmission of monetary policy impulses through different channels.

Lastly, payment systems are an integral part of the financial sector. The stability of the financial system is intricately linked to the reliability and effectiveness of payment and settlement systems.

1.3. The Lesotho Payment System

Since the introduction of the LPSMP, several reforms were implemented and some are still ongoing. These reforms were carried out through modernization and development of new systems and introduction of the legal and regulatory framework.

1.3.1. RTGS

The first step was the development of the Real Time Gross Settlement (RTGS) system – also known as the Lesotho Wire (LSW) in 2006. This system is meant to process large value transactions (M100, 000 and above) but low in volumes as well as time critical transactions.

The system is also accompanied by another system known as the Straight Through Processing (STP). This system eliminates human intervention in RTGS systems because it exposes the system to operational risks.

1.3.2. Electronic Funds Transfer (EFT)

Further still, towards the end of 2011 the Electronic Funds Transfer (EFT) commenced operation. The EFT ensures that funds are transferred promptly by reducing the clearance cycle to the same day. In addition to this, the Automated

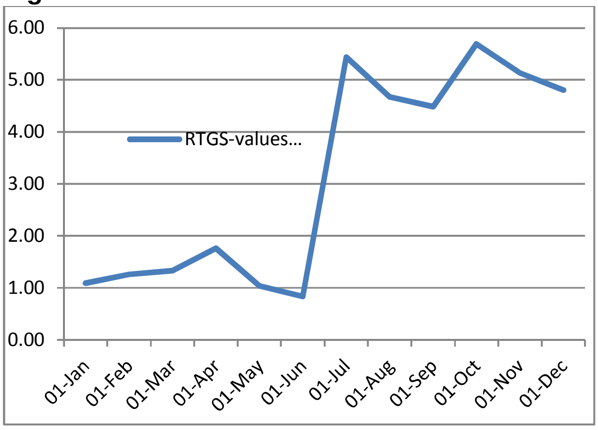
Clearing House (ACH) was implemented in 2012. The ACH is an interbank payment system for processing small value (less than M100 000) and large volume transactions.

1.3.3. *Maseru Image Automated Clearing House (MIACH)*

Lastly the MIACH is currently under development. This system is meant to reduce the time taken to clear an instrument and therefore avail funds to customers on the same day.

The convenience of these systems is reflected by the increase in their usage. The year 2012 displayed an upward trend in the usage of RTGS as seen in figure 2 below.

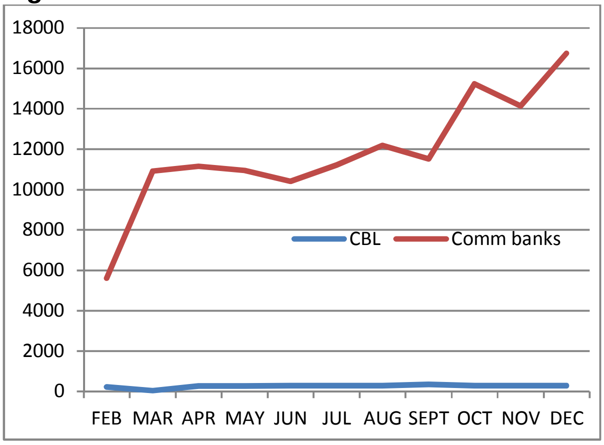
Figure 2: Volume of Transactions of RTGS



Source: CBL

Transactions through the ACH were also seen to steadily increase as shown in figure 3 above. This increase demonstrates the high usage of ACH to clear payments made through cheques, Electronic Funds Transfers and card transactions (debit and credit cards).

Figure 3: Volume of transactions of ACH



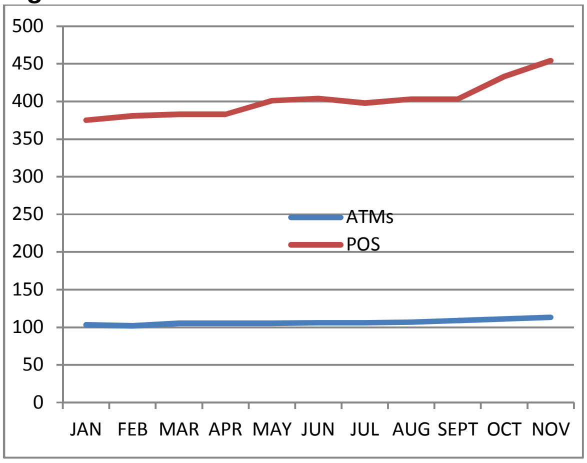
Source: CBL

The convenience of these systems is also seen through their usefulness to the public and the extent to which they facilitate financial innovation of other services that are augmented to these systems. For instance, ATMs, point of sale devices, internet banking and the invention of mobile money and other services developed to reach the public at large. These systems enhance financial inclusion and provide banking services in areas where majority of the previously non banked public resides.

1.3.4. *Point of Sale Devices and ATMs*

Point-of-sale (POS) terminals are computerized replacements for cash registers. The POS system has the ability to record and track customer orders, process credit and debit cards, connect to other systems in a network, and manage inventory. Generally, a POS terminal has as its core a personal computer, which is provided with application-specific programs.

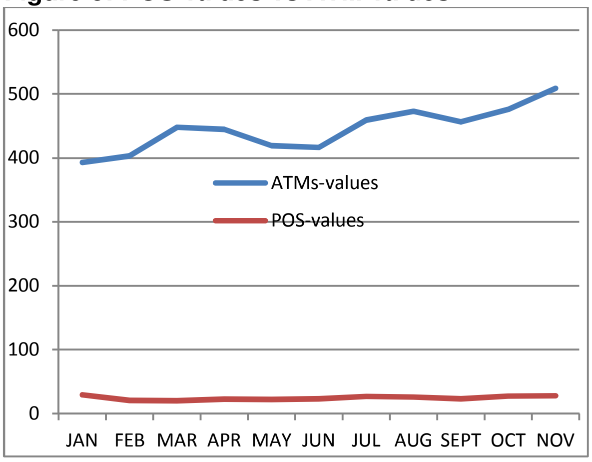
Figure 4: POS terminals vs ATM terminals



Source: CBL

In the past year POS terminals increased significantly compared to ATM terminals. Throughout 2012 POS terminals increased to around 4000 while there were 1100 ATMs. The value of money withdrawn from ATMs was however higher than the value of money used for POS therefore showing that holding cash is still preferred.

Figure 5: POS values vs ATM values

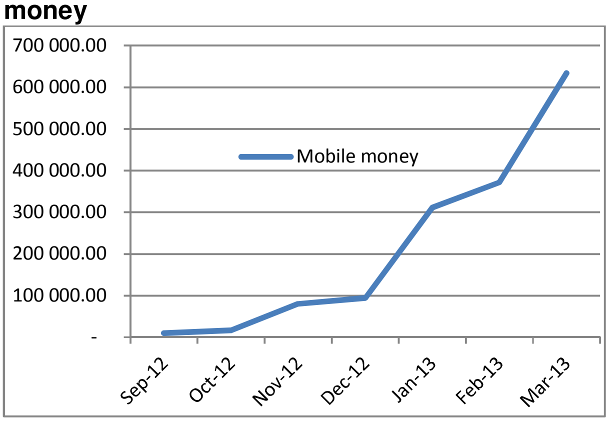


Source: CBL

1.3.5. Mobile Money

The Mobile Money allows individuals to transmit transactions through mobile phones. It is a system which was introduced to take advantage of increased coverage of mobile phones particularly in rural areas. Through this system money can be send through the local mobile phone networks. In addition, one can buy groceries and receive salaries through this system. Mobile Money in the same manner has been showing an increase in usage. There was a 62 per cent increase in usage of funds in March 2013 compared to September 2012 when the facility began operation.

Figure 6: Funds processed through mobile money



Source: CBL

1.4. Lesotho National Payments Systems Bill 2013

Enforcement of the payment systems mentioned above is to be done within a sound legal and regulatory payments system environment. This is expected to be achieved through enactment of the National Payments Bill. The bill contains clauses that strengthen and complement regulation of the payment systems. It recognizes the Payment System Management Body (currently known as the Payment Association of Lesotho) as a fundamental tool that is meant to enhance the payment systems in Lesotho. This is an industry-level Payments Management body which aims to provide safe and efficient payment systems in Lesotho.

The Bill also emphasizes the importance of licenses for a payment operator. This license will be used as a form of regulation for payment systems and is granted for a year, after which it should be renewed (penalty for non-renewal is 12 months imprisonment or a fine of M50 000). The importance of this license is to ensure that a payment operator aligns themselves with the laws of Lesotho, does not endanger the stability of the financial system and is not insolvent. Renewal of the license is therefore a regulatory tool with which up to date information is required from the license holder to ensure that they are still complying with the above mentioned conditions. This conditions when met will ensure efficiency and usage of the payment system as they will increase public awareness of operators because an updated list of license holders will always be published (National Payment System Bill, 2013).

If however the Payment system operator has not commenced operation within 12 months of the date on which the license was granted or if the operator has ceased operating for a period of more than 30 days, the license is suspended.

To add on to this, as per the Bill a payment system operator is declared insolvent if it is no longer able to make payments. However, 6 months prior to the insolvency it is expected to perform its obligations and it still has its rights. Further, it is expected to inform all relevant parties of its insolvency. As the last regulatory tool the Bill states that a person is only allowed to participate in the settlement system and allowed to make payment if they are the Central Bank, a commercial bank or a member of the payment settlement body.

It is therefore apparent that the Payment System Bill will strengthen the national payment system. This is because it will reinforce the currently used rules for payment systems therefore increasing the integrity of the national financial system.

1.5. *Lesotho's Payment Systems Rating by the World Bank*

In 2007 the World Bank undertook a global payment system survey based on four measures of the national payments systems.

First the assessment of the large value payment system which is based on two aspects; the system design and key policy decisions that affect the safety, soundness and efficiency of the system and the actual usage of the large-value system. Lesotho rated medium to high for this index because the Lesotho Wire was already operational during that time.

Secondly, the scoring of retail payment systems which is based on the following: deployment of infrastructure to process retail payment instruments and key policy decisions that have an impact on the safety, soundness and efficiency of the services provided; the extensiveness of the usage of cashless payment instruments typically used for retail transactions; and the share of transactions made with electronic versus paper-based payment instruments. In this aspects Lesotho rated low. This could have been due to the fact that the improvements in retail payments programs accessible to the public had not been developed when the survey was made. It is expected that Lesotho's rating will have improved with the development of new systems accessible to the public

The third indicator was the measurement of the legal and regulatory framework. This is based on the assessment of the specific payment system concepts covered by existing laws and regulations and the legal powers of the Central Bank to oversee payment systems. In this regard Lesotho ranked medium to low. This ranking is expected to improve once the National Payment System Bill, 2013 is enacted.

Lastly the survey measured the enabling environment for the payment system oversight function. This indicator assesses the organizational arrangements for the oversight function, evaluating the clarity and formality in the objectives of payment system oversight and evaluating the system's cooperation with other authorities and stakeholders. In this area Lesotho was rated medium to low. Progress in this area is likely to come when the new payments systems have been interfaced fully with government systems and after formalization of the payment rules through enacting the National Payment System Bill, 2013.

In comparison with other Southern African Custom Union (SACU) countries, Lesotho's is ranked fourth just above Swaziland as depicted on Table 1 below. From the table it is clear that the Republic of South Africa (RSA) ranks highest in terms of payment systems and Swaziland ranks lowest.

Table 1: World Bank ranking of SACU countries

Country	Legal and regulatory	Large value payment system	Retail payment System	Payment System oversight
RSA	Medium to high	High	High	High
Botswana	High	Medium to high	Medium to high	High
Namibia	Medium to high	Medium to high	Medium to low	High
Lesotho	Medium to low	Medium to high	Low	Medium to Low
Swaziland	Medium to low	Low	Medium to low	Low

Source; Cirasino, 2008

1.6. Challenges and Conclusion

The following have been seen to be the challenges of the modernization initiatives:

- Some of these innovations are high-tech and may not be user-friendly nor easily comprehended by most users especially the illiterate. This may expose some people to financial scams.
- The pace of regulation may be slower than that of financial invention leading to the possibility of financial stability exposures. This may be exacerbated by regulation of systems in different jurisdictions and in different regulatory environment. Therefore there may be need for regional or international standards to provide a more

harmonized regulatory framework. However regulation should not restrict innovation but facilitate it.

- Noncompliance to some of the rules made for the new systems by payment operators. Currently, the national payment systems are governed by rules which may not be easily enforced than if the Bill was enacted into law.
- Generally, these systems could be expedited by rolling out a financial literacy program that will educate users. This should not only be on how these systems could be well appreciated and utilized but also how users can protect themselves against other forms of financial crimes especially cyber related.

This featured article benefited from:
-Massimo Cirasino and Jose Antonio Garcia (2008) Measuring Payment System Development.
-Committee on Payment and Settlement Systems (2003) A glossary of terms used in Payment Settlement Systems.
-Tom Kokkola (2010) Payments, securities and derivatives and the role of the Euro system.

2. Featured Definition

Financial Inclusion: it refers to the delivery of financial services at affordable costs to the sections of disadvantaged and low income segments of society in a fair and transparent manner by mainstreaming financial institutions in various sectors like the education, communications and the electrification sector. Through using the Global Financial Inclusion Indicators (Global Findex) it was found that in Africa less than a quarter of adults have an account with a formal financial institution. For the case of Lesotho, the percentage of people with an account with a formal financial institution is 58.1 per cent.

This featured definition benefitted from:
-Dr Deepali Pant Joshi (2011) Reserve Bank of India. Financial Inclusion and Financial Literacy.
-Fin scope Consumer Survey, Lesotho 2011.

3. Featured Descriptor

A *basis point* is one hundredth of a percent (0.01%). This means that 100 basis points is equal to 1 percentage point. Basis points – abbreviated bps and pronounced “beeps” – are used to express percentage changes in yields, costs or prices of financial securities.

When there has been a change from 4 per cent to 5 per cent, say in the monthly CPI, then the CPI will be reported to have gone up or increased by 100 basis points.

This descriptor makes it easier to report changes in yields and other variables for which changes occur in fractions of a per cent. It is easier to report the change in the discount rate of a 91-day T-bill rate from 5.38% to 5.41% in “beeps” than in percentage terms. The discount rate is up by 3 bps compared to the same period last year.

4. Featured Economic Event

2012-13 Cypriot Financial crises

The 2012–2013 Cypriot financial crisis was a major economic crisis in the Republic of Cyprus that involves the exposure of Cypriot banks to the Greek Debt Crisis, the downgrading of the Cypriot economy to junk status by international rating agencies, the consequential inability to refund its state expenses from the international markets and the reluctance of the government to restructure the troubled Cypriot financial sector.

The Cypriot crises started in 2007-2008 when the United States subprime mortgage crises led to negative consequences in the global economy including the European Union. As a result of the crises the Cypriot economy went into a deep recession in 2009 as the economy shrank by 1.67 per cent. As a result of this the Cypriot state, was unable to raise liquidity to support its financial sector and it therefore requested a bail out from the European Union.

On 25 March 2013, a €10 billion bailout was announced in return for Cyprus agreeing to close its second largest bank, the Cyprus Popular Bank (also known as Laiki Bank), levying all uninsured deposits there, and possibly around 40 per cent of uninsured deposits in the Bank of Cyprus (the Island's largest commercial bank), many held by wealthy citizens of other countries, significantly from Russia. The closure of the Laiki Bank helped significantly to reduce the required loan amount for the overall bailout package so that the€10 billion was still sufficient without need for imposing a general levy on bank deposits.

This featured economic event benefited from;
IMF Survey magazine: Countries and regions. May, 2013