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LAUNCH OF THE PAN AFRICAN PAYMENT AND SETTLEMENT SYSTEM – A NEW DAWN FOR CROSS BORDER FINANCIAL TRANSACTIONS IN AFRICA

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The African Continental Free Trade Area On 1 January 2021, a new era began in Africa with the commencement of trade under the African Continental Free Trade Area ("AfCFTA") regime. The AfCFTA seeks to create a single market for goods and services facilitated by movement of persons, liberalise markets in Africa, and boost intra-African trade and economic and industrial development on the continent.

In order to achieve the goals highlighted above, the Agreement Establishing the African Continental Free Trade Area (the "Agreement") directs State Parties to progressively eliminate tariffs and non-tariff barriers to trade in goods, progressively liberalise trade in services, cooperate on investment, intellectual property rights and competition policy, and cooperate on all trade-related areas, among other things.

The State Parties of the AfCFTA and interested stakeholders understand that the lifeblood of trade is payments. If payments and the infrastructure that supports them are not present, then there is no trade. Consequently, in line with the objectives of the Agreement, the African Export-Import Bank (Afreximbank), some central banks of State Parties of the AfCFTA, the African Union, and the Secretariat of the AfCFTA, launched the Pan African Payment and Settlement System ("PAPSS") in July 2019 at an African Union summit in Niger.

Subsequently, on 28 September 2021, Afreximbank announced the formal rollout of the PAPSS stating that the system will serve as a continent-wide platform for the processing, clearing and settling of intra-African trade and commerce payments, leveraging a multilateral net settlement system, and its full implementation will save the continent more than US$5 billion in payment transaction costs each year.

FORMAL LAUNCH OF PAPSS

On 13 January 2022, PAPSS officially launched activities after a pilot phase in the West African Monetary Zone (WAMZ). According to the Secretary-General of the AfCFTA, PAPSS will enable Africa to reduce reliance on third currencies, and more importantly, it has the potential to significantly boost intra-Africa trade.

Now, the Central Bank of Nigeria (CBN) is urging financial institutions in Nigeria to accept the cross-border payments and settlement system and stated that PAPSS would help in the growth of e-commerce in Nigeria and can reduce the losses financial institutions in Nigeria make when they have to settle intra-African transactions with third currencies like the dollar.

The CBN hopes that the financial institutions and businesses that wish to take advantage of PAPSS will adhere to its Guidelines on the Operations of Pan African Payments and Settlements System (PAPSS) in Nigeria which was released on 11 October 2021.

In this article we examine how PAPSS will work and if it can truly improve intra-African trade.

WHAT IS PAPSS?

According to the PAPSS website, PAPSS is" … a continental financial market infrastructure for commercial banks, payment service providers, card schemes and other intermediaries…".

The system was created to enable cross-border financial transactions which will happen in real-time (Real-Time Gross Settlement) and in local currency and will carry out end-of-the-day net settlement with all the participating central banks. The PAPSS will serve as a payments and settlement system for the continent which commercial banks, payment service providers, card schemes and other intermediaries will connect to.

So, if for instance a customer wants to buy Maasai Beads from Kenya, the PAPSS allows the customer purchase the beads in Naira and the merchant receives the money paid in Kenyan Shilling. The system promises that payments will be received within 120 seconds and that PAPSS will also carry out legal and compliance checks within that time frame. Apart from Instant Payments which will be provided by the PAPSS instant payment system (PIP™), PAPSS will provide:

- cross-border direct debit payment services, invoicing, and billing; (Request to Pay "R2P")
- Keeping funds in safe custody until a transaction is completed; (Escrow Services)

- Intra-African remittance; (Remittance Services)
- Using aliases and pseudo names to process payments; (Proxy Addressing)
- Screening transactions against lists of terrorists or individuals that have been sanctioned (Sanctions Screening).

HOW DOES PAPSS WORK?

The first step in ensuring that transactions can be carried out, is for the central bank of a country to connect to PAPSS. The system provides for only the central banks of Afrexim member states to connect to it so that they can assist PAPSS with settling transactions as a national settlement agent.

To achieve this, the central banks enter into a PAPSS Membership Agreement and Settlement Bank Agreement, and once they are connected to the system they can oversee, supervise and enforce compliance of banks, fintechs, and financial institutions in their jurisdiction. They also enforce anti-money laundering and financing of terrorism laws and other local regulations.

Central banks can also provide payment and settlement services with the use of PAPSS. Once the central banks are connected, commercial banks, payment service providers, fintechs, card schemes and other intermediaries can connect to PAPSS as ‘Participants’ and facilitate cross border services for their clients. However, before they can connect as Participants, they must meet the requirements specified in the PAPSS Bye-laws. If they meet the requirements, they either become a Direct Participants or an Indirect Participant. To be classified as a Direct Participant, they must:

- be a separate and single legal entity. If the entity is part of a group or operates with a structure of more than one legal entity, each legal entity within the group that wishes to participate in the PAPSS must apply separately to become a Participant;
- be a financial institution with a full banking licence;
- comply with all financial and regulatory requirements set out by its applicable Central Bank; and
- must have a settlement account with the domestic central bank that is a Settlement Member in each country in which it wishes to use the PAPSS service.

If the intended participant does not have a settlement account with the domestic central bank, they become Indirect Participants and must be able to enter into individual sponsorship agreements with Direct Participants to facilitate the settlement of payment instructions. Once the eligibility criteria for Participants have been met, PAPSS will create an account for the prospective Participant, assist with onboarding and carry out due diligence and network connectivity checks. Once the bank or intermediary has been connected to PAPSS, they can begin processing payments and settlements for their customers.

Considering that PAPSS seeks real time processing of payments, Participants have to prefund their accounts to ensure liquidity (money is available for financial transactions). So, if a payments service provider is processing payments for the Maasai Beads the customer ordered, they need to ensure that as an Indirect Participant, their account with a Direct participant is liquid, the Direct Participant ensures their settlement account with the Central Bank of Kenya has money, and then PAPSS is notified that all the accounts are prefunded before effecting credits or debits.

With a Real-Time Gross Settlement System in place, PAPSS may create a myriad of benefits for intra-African Trade.

ADVANTAGES OF PAPSS

In Africa today, various barriers plague the payments systems of countries such as lack of infrastructure, regulatory requirements, and so on. With the PAPSS, these barriers can fall away and if implemented properly, it can revolutionise the way the continent trades.

Customers and traders may no longer have to spend days waiting for the confirmation or receipt of funds to facilitate a trade as payments will be cleared and settled in real time. Another factor that delays the clearing and settlements of funds is the issue of currency denominations. Payments are not usually made in local currency because of remittance issues and poor payments infrastructure. So, what happens is that the goods or services are priced in foreign currencies (United States Dollars or British Pounds) which means payments will be made to a foreign payment service provider who then has to convert the foreign currency to the local currency of the beneficiary and then send it to their bank causing a delay.

With the rollout of PAPSS, instant payments for cross-border transactions without the hassle of currency conversion becomes possible.

Another benefit of PAPSS is that if there is a reduction in the pricing of goods and services in foreign currencies because of PAPSS, there will be a reduction in the demand for foreign currency, thereby reducing the pressure on central banks for foreign currency and increasing the foreign currency liquidity in various jurisdictions. We may also see an uptick in the purchase of goods made in Africa with the removal of intra-African trade payments barriers with PAPSS.

CRITICISM OF PAPSS

Though we may see various benefits with the launch of the PAPSS, some leaders believe that asking various financial institutions and payment service providers to connect to the PAPSS as Participants will create inefficiency.

They believe that the proper approach to take is to ensure domestic switching companies (companies that facilitate communication and transfer of data between financial institutions and payment service providers) connect directly to PAPSS since most financial institutions and payment service providers are connected to their domestic central switch like the Nigerian Interbank Settlement System (NIBSS).

These critics consider that connecting national switches will reduce the time it will take in onboarding every financial institution and payment service provider on to the PAPSS rails.

CONCLUSION

Merchants and service providers hedge against the fall in African currencies with the use of foreign currencies; therefore, the PAPSS may not stop them from hedging against fluctuation. Also, trade barriers like poor transportation infrastructure, economic instability, poor digital infrastructure, and frequent change in governments may not allow the PAPSS to kick off as expected. However, the promise of instant payments is enticing and the opportunity for Fintechs to be able to connect to PAPSS is even more exciting.

Although only a few central banks are currently backing PAPSS, the efforts of Afreximbank, the central banks of Guinea, Sierra Leone, Liberia, Ghana, Senegal, the Gambia, and the West African Monetary Zone with the pilot phase of the PAPSS signals hope that PAPSS may change the way we trade with each other in Africa and how Africa trades with the world.

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