

PAYMENT AND SETTLEMENT SYSTEM

To perform banking functions on behalf of State Bank, BSC focuses on stability and efficiency of the payment and settlement system. Acting in the capacity of regulator of the system, its aim is to provide adequate liquidity and effective money transmission mechanisms to meet the needs of the national economy.

9.1 ELEMENTS OF PAYMENT SYSTEM

- Payment instruments
- Banking procedures
- Inter-bank fund transfer system

9.2 SIGNIFICANCE OF PAYMENT SYSTEM

The significance of an efficient payment system arises from the emerging payment environment where there is an increasing demand for rapid settlements. Fast pace growth in E-banking has been achieved in Pakistan with the number of ATMs having more than doubled and their transactions and online branch network more than tripled since 2000. Furthermore, conformity with best international practices fosters the need for an efficient payment system. In this regard, core principles have been introduced by the Bank of International Settlement (BIS) to ensure safety and strengthen the architecture of the payment system. According to these core principles, the rules and procedures of the payment system enables participants in having a clear understanding of the system's impact on every possible financial risks they may encounter during participation.

The role of the central bank is to ensure the irrevocability and finality of payments and at the same time management and containment of systemic risk involved. In order to streamline payments through financial system, the BSC has been providing clearing and settlement services since its inception, to commercial banks to ensure a safe method of transferring funds between banks and reducing risk and control over monetary policy. It manages the operations of clearing houses through which inter bank funds transfers are effected. In five major cities, the functions of the SBP clearing house have been handed over to National Institutional Facilitation Technologies (Pvt) Ltd. (NIFT) to the extent of sorting of payment instruments and preparing clearing schedules. In other financial centers of the country, Bank performs all the functions of the clearing house.

9.3 NATIONAL INSTITUTIONAL FACILITATION TECHNOLOGY (NIFT)

NIFT is a joint venture between a consortium of six major banks and the private sector. It is responsible for the establishment and management of automated clearing house facilities in Pakistan. NIFT is actively involved in the modernization of payment systems in the country. All commercial banks in Pakistan are members of NIFT's clearing system and Bank plays monitoring role on the clearing operations of NIFT.

9.3.1 Objectives

- To provide support to the financial industry in modernization of the payment systems in Pakistan.
- To facilitate automated solutions in the payment arena, (Utility Cos., Tax collection, Govt. receipts / payments etc., through cheques clearing process).

9.3.2 Functional Highlights

- Karachi, Lahore, Islamabad, Rawalpindi & Faisalabad have been automated including Overnight Clearing Facility
- Same day returned cheques processing.
- High value clearing
- Inter city clearing
- No transfer delivery
- NIFT provides service up to branch level (800 branches at Karachi, 500 branches at Lahore, 350 at Islamabad & Rawalpindi and about 300 branches at Faisalabad). It also provides a net settlement position to BSC and settlement advices to branches.
- The role of the main branch in clearing has been abolished and Banks do not exchange document.
- Image based processing of all documents can offer image and data on CD's; images effectively pave the ground for electronic clearing, enabling data communication.

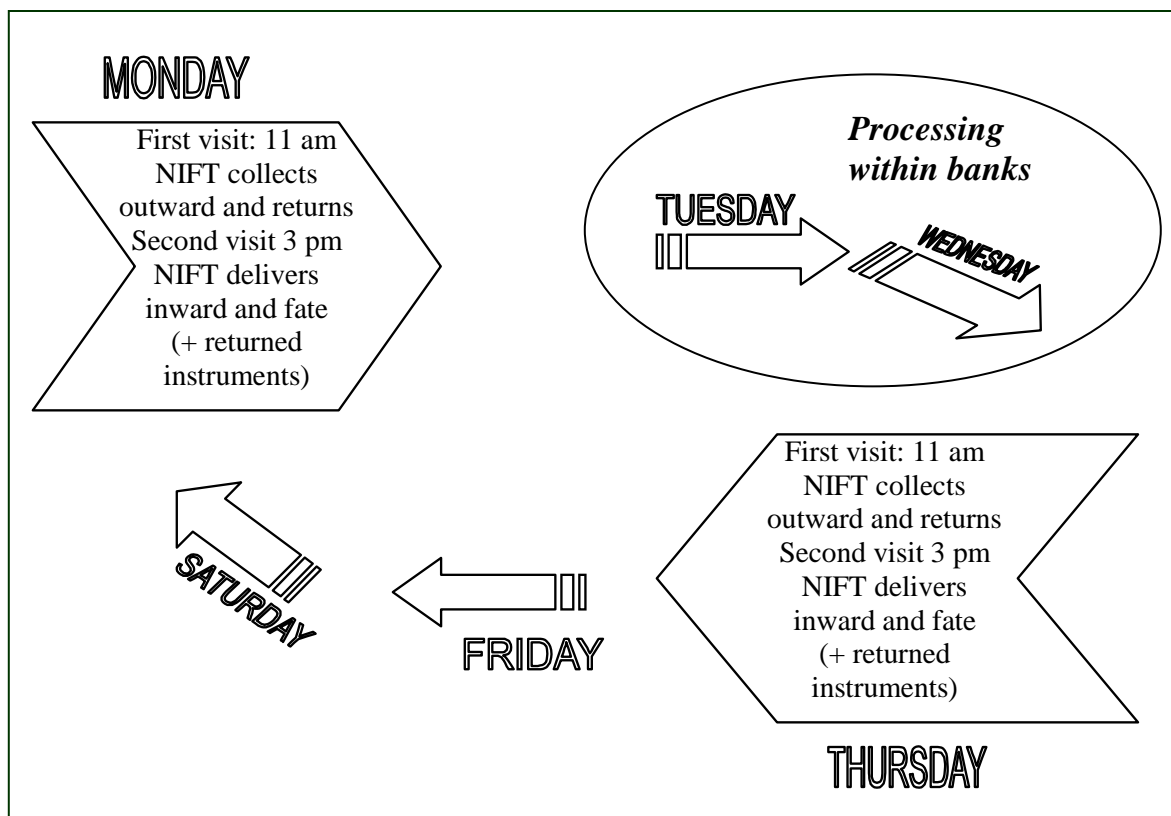
9.4 US \$ CLEARING

In the absence of a settlement system for US\$ denominated instruments, the clearing process was to be routed through New York, which used to take a long time in settlement. Further, the cost of the transfer was quite high for the account holders who wished to make US\$ transactions between accounts maintained in Pakistan. To facilitate customers in this regard and achieve customer satisfaction through effective banking services, the Bank has recently introduced a system of US\$ clearing.

The objectives of the system are: -

- Quick Settlement.
- Cost Effectiveness.
- To facilitate the Market Settlement system.

9.4.1 PROCESSING CYCLE



9.4.2 Settlement in Case of Insufficient Balances

At any point in time when the net debit (inward & outward) cannot be paid out of a bank's US Dollar clearing account (due to insufficient balance) held with the SBP BSC, Karachi, the State Bank reserves the right to adopt a suitable alternate. Primarily taking the shape of payment through an appropriate overnight SWAP from the Pak Rupees clearing account balance of the bank with the SBP to the extent of such shortfall in the US Dollar account.

9.5 REAL TIME GROSS SETTLEMENT SYSTEM

In line with the major initiatives taken by State Bank of Pakistan, SBP BSC is extending its full support to develop infrastructure for an automated National Payment and Settlement Systems. This system would enable Bank to comply with the core principles for systematically important system developed by Bank of International Settlement. Currently Payment System Department of SBP is working on the project of Real Time Gross Settlement System (RTGS) and in collaboration with all banks and financial institutions, Electronic communication links between SBP and banks will be created for real time settlement of inter bank and other time critical account settlements. Through this system of RTGS the settlement risks, systemic risks generally associated with payment system mechanism will be substantially reduced.