



Payment System Oversight Framework

NEPAL RASTRA BANK
Payment Systems Department
February 2018

Foreword

In the global context, central banks have genuine concern and control in the safety and efficiency of payment and settlement systems to ensure public confidence. As a custodian of public confidence in money, the central bank needs to establish efficient and reliable payment service providing institutions to transmit money as well as other financial instruments efficiently and effectively.

Nepal Rastra Bank (NRB) is a regulatory authority in the financial system of Nepal, as empowered by Nepal Rastra Bank, Act 2002, has been entrusted one of the major functions to accomplish is “establish a secured, healthy and efficient payment system in Nepal (NRB Act, 2002, Article 4c).” In this context, NRB has a statutory responsibility for the payment and settlement systems in Nepal. This responsibility requires the Bank to promote, regulate, and supervise these systems to ensure that they are safe, reliable and efficient. Inability to make payments in any economy would have far reaching and widespread impact on society. The Bank’s task is therefore to ensure that the public and businesses can make payments in a safe and efficient manner. Currently, Nepal’s payment and settlement landscape is made up of the following Policy and Operational Framework:

- Nepal Payment System Development Strategy - 2014
- Payment and Settlement Bylaw 2015
- Licensing Policy for Payment Related Institutions
- Directives

Going forward, this policy document outlines the framework for performing the Central Bank’s payment and settlement oversight function. The Bank will use as a benchmark, the ‘Principles for Financial Market Infrastructures’ issued in April 2012 by the Committee on Payment and Settlement Systems (CPSS) of the Bank for International Settlements (BIS) in collaboration with the Technical Committee of the International Organization of Securities Commissions. This will ensure that the payment systems in the country are of world class standard and also meet domestic and regional payment system requirements.

The effective oversight of the payment system infrastructure would ensure the safety, security and reliability of financial transactions, which are vital to monetary and financial stability. In this regard, I believe, this Payment System Oversight Framework – 2017 will be highly valuable and guiding policy document in attaining secured, healthy and efficient payment system in Nepal.

Deputy Governor

Nepal Rastra Bank

Contents

Foreword.....	2
List of Acronyms	5
1. Introduction.....	6
2. Objectives of Oversight	7
2.1. Ensure sound legal foundation	7
2.2. Enhance risk management and control.....	7
2.3. Integration and interoperability of different payment system	7
2.4. Assess reach and range of payment services.....	7
2.5. Prevention of market from abuse and frauds:	8
2.6. Safeguard customers and ensure their protection.....	8
2.7. Review competitiveness in the market:.....	8
3. Principles of Oversight	8
3.1. Fairness.....	9
3.2. Transparency	9
3.3. Continuity.....	9
3.4. Cooperation	9
3.5. International standard.....	9
4. Scope of Oversight.....	10
4.1. Institutions.....	10
4.1.1 Payment System Operators.....	10
4.1.2 Payment Service Providers	10
4.2. Instruments	10
4.2.1 Cards.....	10
4.2.2. Mobile Banking	11
4.2.3. Internet Banking	11
4.2.4. E-Money	11
4.2.5. Other Instruments	11
4.3. Systems.....	11
4.3.1. Large Value Payments System	11
4.3.2. Retail Payment System.....	12
4.3.3. Securities Settlement System.....	12

4.3.4. Other Payment and Settlement System	12
4.4 Any new payments services	12
5. Tools of Oversight	12
5.1. Regulations.....	12
5.2. Incentives and Sanctions	12
5.3 Monitoring.....	13
5.3.1 Off-Site Supervision	13
5.3.2. On-Site Inspection	13
5.3.3. Special Inspection.....	13
5.4. Assessment/Analysis.....	13
5.5. Policy Dialogue	14
5.6. Enforcement and Remedies.....	14
5.7. Agreements with Other Regulatory Institutions and Stakeholders	14
Annexure - 1	15

List of Acronyms

NRB	Nepal Rastra Bank
PSP	Payment Service Providers
PSO	Payment System Operators
RTGS	Real Time Gross Settlement System
CSD	Central Securities Depositories
CPSS-TCIOSCO	Committee on Payment and Settlement System Technical Committee on International Organization of Securities Commission
RCC	Recommendations for Central Counterparties
GPIRS	General Principles for International Remittance Services
BFI	Banks and Financial Institutions
P2P	Person to Person
P2B	Person to Business
P2G	Person to Government
B2G	Business to Government
B2B	Business to Business

1. Introduction

Payment System Oversight is a central bank function where safety and efficiency are promoted by monitoring existing and planned payment systems, assessing them against the objectives of safety and efficiency and inducing change, whenever necessary. Oversight differs from supervision in the sense that oversight uses a guideline and resolution based approach from a payment system viewpoint (and views this from a broad system wide perspective) whereas supervision uses a regulation and institutional based approach from a prudential solvency and liquidity viewpoint (and views this on the basis of individual institutions). Thus, oversight looks at systems, participants and instruments with its major role to ensure that systems are sufficiently protected against risk that may arise and also allowing funds to flow between individuals, business and financial markets efficiently and with safety. The responsibility of oversight has been conferred by Nepal Rastra Bank Act, 2002, Article 4c is “To develop a secure, healthy and efficient system of payment”; this responsibility was further elaborated by Nepal Rastra Bank (NRB) with release of the Payment System By-laws, 2015. The later document has highlighted that the charge of implementation rests with NRB’s Payment Systems Department.

Overseeing a payment system ensures that the infrastructural component and the markets for the provision of payment systems work smoothly, efficiently and fairly for all participants. Moreover, it controls and minimizes the risk of transmitting shocks through the economy via reverberation across the payment system failure by individual participants to settle payments obligations. An unsafe payment system may stifle the stability and potential of an economy; its failure can result in inefficient use of financial resources, inequitable risk sharing among the agents, actual loss for participants and loss of confidence in the financial system threatening the financial stability.

In this regard to facilitate the oversight function, this Payment System Oversight Framework has been work out in the context of Nepalese payment market infrastructure. The summary of Payment System Oversight Framework is presented in *Annexure 1*.

2. Objectives of Oversight

In general, NRB considers the oversight of national payment system as one of its core functions whereby the objectives of safety and efficiency are promoted by monitoring existing and planned systems and instruments, assessing them against these objectives and where necessary inducing change. Oversight is a necessary complement for NRB to achieve its public policy objectives for payment and settlement systems. The key aspects also termed as specific objectives are:

2.1. Ensure sound legal foundation

NRB will have the explicit legal authority and power to perform its oversight mandate and responsibilities in internationally accepted norms. NRB will have a specific law that defines the central bank's policy in terms of institutional and infrastructural arrangements relating to payments, transactions, clearing and settlement systems and various payments services with adequate power to oversee and regulate those systems.

2.2. Enhance risk management and control

Various risks that could arise in payment systems and settlement mechanism must be kept at a minimum level through prudent risk management by system owners, operators, participants and stakeholders. NRB, in its oversight role will monitor risk management practices across all the systems and assess them and induce change to mitigate risks.

2.3. Integration and interoperability of different payment system

Integration and interoperability of different payment systems enhances the efficiency, bandwidth and hassle free connectivity among systems. This eventually leads to competition. Competitive market conditions for most payment services including interbank payment services, offer the most promising results in terms of efficiency and innovation. NRB will make efforts to ensure that systems in Nepal are interoperable to enhance efficiency, in the payment system.

2.4. Assess reach and range of payment services

NRB ensures the availability of minimum or essential services to underserved users. NRB will make its best effort to create awareness in different places where the financial access is

less. Further, NRB will motivate and mandate (where necessary) Payment Service Providers(PSP) and Payment System Operators(PSO) to extend their digital financial services and products to inaccessible regions. NRB will encourage PSPs and PSOs to deliver multiple products to meet the financial needs of customers.

2.5. Prevention of market from abuse and frauds: NRB will promote the reliability of payment instruments and systems used. The payment system industry should be regulated through respective laws, bylaws and directives. NRB will ensure the safety of funds available in different settlement banks through directives and mandatory policies.

2.6. Safeguard customers and ensure their protection: The oversight will be directed at verifying that the payment services offered in compliance with the law and directives issued time being. NRB will prop up public confidence in the payment instruments and protect consumer rights and discharge obligations to circulate smoothly in the system.

2.7. Review competitiveness in the market: Through the oversight activities, NRB will review the payment market in regular basis. NRB will promote adequate protection of participants and users from risk of monopolistic practices by major PSPs and PSOs. Service users must be free to choose or change service providers. NRB will focus on ensuring a competitive environment for payment services and achieving appropriate balance between co-operation and competition.

3. Principles of Oversight

Payment and settlement systems are a crucial part of the financial infrastructure of a country and it is essential that they function safely and efficiently. Many systems may meet these safety and efficiency objectives without the involvement of the public sector. However, in certain circumstances the objectives may not be achieved without regulations, intervention, involvement, oversight and guiding directives of central bank. Oversight should be undertaken to identify any such circumstances and, where appropriate, induce change. Oversight is a necessary complement to any other means central banks may use to achieve their public policy objectives for payment and settlement systems.

3.1. Fairness

Central bank should review the market structure and nature to ensure the fair competition among the service providers. Central bank should always promote adequate protection of participants and end users from risk of unfair practices by major players of payment industry.

3.2. Transparency

Central bank should be transparent about its oversight policies to enable payment and settlement system operators to understand and observe applicable policy requirements and standards. Through transparency central bank can also reveal an appropriate degree of consistency of oversight approach by ensuring that the systems operated by the central bank are also subject to the same oversight standards.

3.3. Continuity

Oversight standards should be applied consistently to comparable payment and settlement systems, including systems operated by the central bank. Central bank should be aware about the continuity of payment systems and direct these systems achieve a sufficient and consistent level of resilience to disasters and efforts to improve resumption and recovery capabilities.

3.4. Cooperation

Cooperative arrangements provide a mechanism whereby individual responsibilities of central bank as overseers of payment and settlement systems and other authorities such as securities regulators and banking supervisors can be fulfilled more effectively through mutual assistance. Cooperation enhances oversight efficiency by minimizing the potential duplication of effort and the burden on the overseen system. It also promotes policy consistency.

3.5. International standard

The use of relevant international standards concerning safety and efficiency can enhance central bank oversight of payment and settlement systems. Central bank will follow international standards and principles such as the CPMI-IOSCO “Principles for Financial

Market Infrastructures”, General Principles for International Remittance Services(GPIRS), and any other relevant standards.

4. Scope of Oversight

NRB will oversee all SIPS that pose systemic risk and ensure compliance with international standards. Since Retail Payment Systems have a significant importance for the overall efficiency of payment system and because of their impact on public confidence in money as well as e-money, NRB will extend its oversight activities over such systems as well, including arrangement for new innovations in payment systems.

4.1. Institutions

4.1.1 Payment System Operators

Payment System Operators are those systems established with the objective of processing, routing/switching, operation, control and clearing of payment related activities. Clearing house, institution/mechanism operating electronic card network, institution/mechanism operating electronic payment network, etc are classified as PSOs.

4.1.2 Payment Service Providers

Payment Service Provider are those service providers providing the payment services through electronic means, carrying out domestic money transfer business, utility bills payments, goods and services payment and also have direct relationship with customers.

4.2. Instruments

In regard to modernization of payment system, NRB will envision towards minimization of cash transactions moving forward with digital payment system. For fostering digital payment services NRB will promote and enhance various payment instruments.

4.2.1 Cards

Cards are the basic instruments. Debit cards, Credit cards, Prepaid Cards etc will used in different ATMs , shopping centers, groceries, malls, and different payment centers. NRB will further enhance digitization through electronic payment platform. Such platforms can be operated by different payment gateways. The communication channel for such payment

gateways can be mobile network, internet or closed network groups. NRB will facilitate new instruments in digital payment industry.

4.2.2. Mobile Banking

Mobile banking are to be operated by Bank and Financial Institutions (BFIs). Mobile banking will be directed and guided through directives issued by NRB

4.2.3. Internet Banking

BFIs can provide Internet Banking facilities to their customers. Internet Banking facilities should be operated within the frame of directives issued by NRB.

4.2.4. E-Money

Electronic Wallets can be operated by licensed PSPs and such providers will be within the regulatory framework of NRB.

4.2.5. Other Instruments

Payment industry is technical and innovative industry. Numerous payment industry enters and operates in payment industry. NRB will promote and facilitate feasible innovative instruments to be registered and operate in payment industry.

4.3. Systems

NRB will introduce and boost various payment systems to strengthen and manage the smooth flow of payment transactions. Some of the systems will be owned by NRB whereas some will be operated by other representing institutions.

4.3.1. Large Value Payments System

NRB will define and implement a threshold to differentiate the transactions on the basis of value. Large value and time critical transactions will be processed through Real Time Gross Settlement Systems (RTGS).

4.3.2. Retail Payment System

All small payments, (mostly P2P, P2B, P2G, B2G and vice versa payments) with the threshold less than high value will be routed and processed through Retail Payment System.

4.3.3. Securities Settlement System

NRB will have a Central Securities Depositories System (CSDs) and a Securities Settlement System (SSS) for settlement of government securities.

4.3.4. Other Payment and Settlement System

NRB will initiate and facilitate new payment systems in the phase of modernization of payment system.

4.4 Any new payments services

NRB will initiate and promote new payment services. NRB shall further study innovations in payments and gauge their suitability and adaptability to the economy of Nepal. NRB will also welcome new payments services initiated by payment industry.

5. Tools of Oversight

NRB will implement a set of policy instruments to promote the safety and efficiency of Payment and Settlement Systems and Payment instruments. Such Payment and Settlement Systems and Payment Instruments should be registered, authorized and licensed through NRB prior to operation.

5.1. Regulations

Regulations and incentives are the typical tools used by overseer. Regulations are aimed at defining functional and technical features and minimum standards of payment systems. NRB will have power to induce change or enforce corrective action in PSPs and PSOs in case of not complying with relevant regulation or policies.

5.2. Incentives and Sanctions

Incentives involve commitments from participants to take costly action in the event of specific contingencies. Net settlement systems, for instance, may require participants to pre-

agree on loss sharing arrangements whereby they commit to mobilize own resources in the event of illiquidity or insolvency by any of them.

Sanctions on the other hand are a complementary for regulations requirements. Regulations will cover business conduct requirements and sanctions for rule noncompliance. Sanctions should be gradual and proportional to the level of risk of misconduct and should aim at improvements in the safety and efficiency of the overseen systems and instruments.

5.3 Monitoring

Monitoring of systems through regular or unplanned collection of information is the most common and powerful tool of oversight. NRB will periodically review system integrity regarding the functioning of technical infrastructure and risk management framework for compliance with oversight guidance and international standards. Monitoring includes various forms of collecting information, including requirements for regular assessment and sometimes special inspection or unexpected meetings with operators.

5.3.1 Off-Site Supervision

NRB will collect and analyze data collected through the specific templates of various system providers and operators. NRB will mandate the payment system operators to submit the data in periodic basis. The reporting requirement may differ depending upon the nature and size of PSPs and PSOs.

5.3.2. On-Site Inspection

NRB will perform onsite Inspection of PSPs and PSOs for assessment of technical, functional, financial and operational activities. The inspection frequency and timeline may depend upon the size, nature, risk and coverage of such operators.

5.3.3. Special Inspection

NRB may access the payment activities where and when necessary. Such special supervision depends upon the criticality and need based which will apply for PSPs and PSOs.

5.4. Assessment/Analysis

NRB after collection of data may analyze and assess the actual performance of any service providers. Most of the payment routes and values will be monitored through the dashboard

whereas NRB may also use statistical tools to analyze and interpret data. NRB shall operate a separate cell for grievance handling. However, all PSPs and PSOs need to manage and operate a well managed grievance handling unit and should operate 24/7.

5.5. Policy Dialogue

Regulations and incentives will be complemented by maintaining dialogue with system operators, participants and providers of payment services to exert moral suasion on them.

5.6. Enforcement and Remedies

NRB will enforce the PSPs and PSOs to operate within the regulations and manuals issued in periodic basis. Violation of regulations and malfunctioning will enforce the overseer to go-ahead consecutive remedial approaches.

5.7. Agreements with Other Regulatory Institutions and Stakeholders

NRB will maintain policy dialogue and will cooperate with all the stakeholders of the payment industry including end users. There is necessary to secure a fair representation of the public and private interest involved in payment activities and to build consensus for policy choices. NRB will cooperate and may have mutual agreement with other regulators and other stake holders as and where necessary.



Annexure - 1

NEPAL RASTRA BANK

Payment System Oversight Framework

Objectives of Oversight

General Objective

Ensure secure, healthy and efficient system of payment in Nepal

Specific Objective

1. Ensure sound legal foundation
2. Enhance risk management and control
3. Boost competitive market conditions
4. Integration and interoperability of different payment system
5. Assess reach and range of payment services
6. Prevention of market from abuse and frauds
7. Safeguard customers and ensure their protection

Principles of Oversight

1. Transparency
2. Fairness
3. Continuity
4. Cooperation
5. International standard

Scope of Oversight

1. Institutions
 - Payment System Operators
 - Payment Service Providers
2. Instruments
 - Cards
 - Mobile Banking
 - Internet Banking
 - E-money
 - Other instruments

3. Systems
 - Large Value Payments System
 - Retail Payment System
 - Securities Settlement System
 - Other Payment and Settlement System
4. Any new payments services

Tools of Oversight

1. Regulations
2. Incentives and sanctions
3. Monitoring
 - Off-site Supervision
 - On-site Inspection
 - Special Inspection
4. Assessment/analysis
5. Policy dialogue
6. Enforcement and remedies
7. Cooperation with other regulatory institutions and stakeholders