NATIONAL PAYMENT SYSTEMS DEPARTMENT

FRAMEWORK FOR

OVERSIGHT OF PAYMENT SYSTEMS

IN ZIMBABWE

ABSTRACT

This document has been compiled for the benefit of payment systems operators, participants and users. Its purpose is to provide insight on the Reserve Bank of Zimbabwe's oversight role in the Zimbabwean payment systems. It outlines the principles the Reserve Bank of Zimbabwe (the Bank) applies in assessing the infrastructure and operations of existing and new payment systems. The objective is to make all stakeholders aware of what is required to operate a payment system in a safe, sound and secure manner.

ACKNOWLEDGEMENT

Oversight of payment systems is as a core function of the central bank. In developing this Framework, the Bank has incorporated material from leading standard setting institutions such as the Bank for International Settlement (BIS) Committee of Payment and Market Infrastructures (CPMI), World Bank and Financial Action Task Force (FAFT) in the area of oversight of payment systems. More importantly, we continue to benefit from the ongoing collaboration with key stakeholders, locally, regionally and internationally in ensuring the development of payment systems.

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1. INTRODUCTION

1.1 The Reserve Bank of Zimbabwe (Bank) has a statutory obligation to foster financial stability through the creation of an enabling environment which does not stifle innovation. This is largely attained through the Bank's oversight of **payment, clearing and settlement** systems.

1.2 The Bank also aims to enhance public confidence by ensuring that monetary value is transmitted smoothly and securely through robust payment systems.

1.3 The Bank recognises that payment systems, if not effectively regulated, can be channels for transmission of shocks and risks in the financial system that ultimately affect economic performance. Payment systems are also prone to abuse and can be conduits for financial crimes which include terrorism financing and money-laundering among others, hence the need for Central Bank oversight.

2. PURPOSE OF OVERSIGHT FRAMEWORK

2.1 The purpose of this Framework is to:

2.1.1 Provide guidance on the Central Bank Payment System oversight function to payment systems providers, participants, users and other stakeholders thus;

2.1.2 Outline the scope of the oversight function which is expected to benefit stakeholders.

2.1.3 Improve awareness on payment system oversight requirements premised on the need to manage risks inherent in payment systems.

2.1.4 Enhance the effective governance of payment systems which should provide impetus for effective regulation of payment systems.

2.1.5 Assist the Bank on the day-to-day oversight activities thus creating an avenue for enhancing skills and techniques in payment systems oversight and supervision.

2.2 The Oversight Framework should be read in conjunction with the National Payment Systems (NPS) Act, Recognition Criteria of payment systems, and any other related laws, regulations, directives and guidelines.

3. DEFINITIONS

3.1 **Large value payment system** *(*LVPS) - a funds transfer system through which large-value and high-priority funds transfers are made between participants in the system for their own account or on behalf of their customers.

3.2 **Participant:** a party who participates in a payment transfer system. This generic term refers to an institution which is identified by a transfer system (e.g. by a bank identification number) and is allowed to send payment orders to the system or which is bound by the rules governing the payment transfer system.

3.3 **Payment System-** A set of instruments, procedures, and rules for the transfer of funds between or among participants; the system includes the participants and entity operating the arrangement.

3.4 **Payment System Oversight**- is a Central Bank function whereby the objectives of safety and efficiency are promoted by ***monitoring*** existing and planned systems, ***assessing*** them against these objectives and, where necessary, ***inducing change***.

3.5 **Payment system operator or provider -** an entity that operates a payment network and/or payment infrastructure.

3.6 **Primary supervisory authority –**A Central Bank in the jurisdiction within which a payment system is hosted from or mainly operating from (in terms of incorporation, management and operations). In consultation with other relevant central banks and supervisory authorities it could be agreed that another authority would undertake the primary responsibility for oversight.

3.7 **Proprietary payment system -** a funds transfer system which handles transactions which are not accepted as a means of payment by other undertakings.

3.8 **Public Interest Objectives" -** governance arrangements of the National Payment System that are clear, transparent, promote the safety and efficiency of the financial market infrastructure while supporting the stability of the broader financial system, other relevant public interest considerations and goals of relevant stakeholders.

3.9 **Retail payment system-** a funds transfer system which handles a large volume of payments of relatively low value.

4. LEGAL BASIS

4.1 World-over, central banks play the regulatory, administrative, surveillance, participant and settlement agent roles in payment systems.

4.2 The Bank is therefore best placed to regulate, facilitate, coordinate, persuade, and encourage system operators and participants to act in a collectively conducive manner.

4.3 The Reserve Bank of Zimbabwe Act and National Payment Systems Act specifically mandate the Bank to maintain the financial and technical integrity of payment systems and promote safe and efficient payment, clearing and settlement systems, hence the Bank's oversight role is an integral part of its wider responsibilities for ensuring stability of the financial system.

4.4 In carrying out its oversight mandate, the bank will also be guided by international best practice and standards to which it fully subscribes, including:

(a) The Bank for International Settlements (BIS) Committee on Payment and Market Infrastructures' (CPMI) 24 Principles for Financial Market Infrastructures (PFMIs). The 24 Principles mainly focus on the risk management in payment systems, legal, governance, transparency, access criteria and efficiency issues among others (Refer to Annexure1);

(b) BIS CPMI five responsibilities of regulators (Annexure II);

(c) BIS CPMI General Principles for Oversight (Annexure III).

5. OVERSIGHT FUNCTION OBJECTIVES

5.1 The Bank's oversight function seeks to ensure effective risk management in payment systems design and operation.

5.2 The Bank intends to achieve, *inter alia*, the following oversight objectives:

5.2.1 **Safety -** to develop and promote secure payment systems;

5.2.2 **Efficiency -** to promote timely and affordable payment arrangements;

5.2.3 **Reliability -** to build confidence of the transacting public in payment systems;

5.2.4 **Stability -** to ensure orderly performance of payment systems;

5.2.5 **Transparency -** to ensure openness and fairness across the entire payment systems value chain;

5.2.6 **Consumer protection-** to ensure that payment system operators and participants are operating responsibly, not prejudicing the clients and ensuring that customers get redress on their complaints;

5.2.7 **Prevention of market abuse-** to ensure that nefarious activities and anti-competitive practices are not permitted in the payment system which will cause uncontrollable damage and compromise the integrity of payment systems;

5.2.8 **Compliance-** to promote the operation of payment systems in line with relevant legislation, international best practices and standards; and,

5.2.9 **Accessibility-** to ensure that payment systems are extended to all users without prejudice.

6. SCOPE OF OVERSIGHT

6.1 The Bank's oversight interest in payment systems is premised on the need to ensure that financial stability, inclusion, intermediation and consumer protection issues are addressed consistently and systematically.

6.2 The Bank's oversight scope covers large value payment systems (LVPS) and retail payment systems such as cheques, cards, and mobile, among others, also known as system wide important payment systems (SWIPS).

6.3 Oversight focuses on both Systemically Important Payment Systems (SIPS) such as the Real Time Gross Settlement (RTGS) system and other retail payment systems. This Framework shall therefore apply to:

(a) Payment systems operating in Zimbabwe;

(b) Prospective and current payment, clearing and settlement systems infrastructure providers, participants and users;

(c) Payment, clearing and settlement systems, access devices and channels; and

(d) The governance structures, market practices, rules and procedures of a payment system.

7. RISKS IN PAYMENT SYSTEMS

7.1 Risk is a potential that events expected or unanticipated, may have an adverse effect on an institution's economic and social performance.

7.2 The risks in payment systems include: legal, liquidity, credit, settlement, systemic, operational, compliance, strategic, and reputational among others (Refer to Annexure IV).

7.3 All sound risk management programs to be put in place by providers and participants in the payment system should have several common fundamentals which include: risk identification, measurement, monitoring and adequate risk mitigation measures.

8. OVERSIGHT APPROACHES

8.1 The Bank, in conducting its oversight activities, uses the risk based approach, standard based approach or a combination of the two.

Risk Based Approach……

8.2 Risk based oversight is a forward-looking approach that allocates resources based on risk characteristics of a payment system.

8.3 It involves an assessment of risks posed by a particular system and activities posing the highest risk receive the most resources and time. This ensures that oversight attention remains properly focused on payment systems exhibiting greatest weaknesses or adverse trends.

8.4 Risk-based oversight entails moving away from a rigid rule-based style of regulation to one which is more reliant on the overseer's discretion and professional judgement depending on probability of risk occurrence.

Standard Based Approach….

8.5 Individual systems are regularly assessed to ensure compliance to international best practice and standards.

8.6 Pursuant to that, the Bank will apply the relevant internationally recognised standards and guidelines such as those by the BIS CPMI and International Organisation of Securities Commissions (IOSCO); in particular the 24 Principles for Financial Market Infrastructures (Refer to Annexure I).

In addition the Central Bank may from time to time formulate its own standards and guidelines in line with the market requirements.

Combination of Standard based and Risk based approaches……

8.7 The Central Bank may also use a combination of Standard Based and Risk Based Approaches and differences occur in the degree of application of either approach.

9. OVERSIGHT TOOLS

9.1 To ensure effective oversight, a number of tools will be used by the Bank and include:

Off-site analysis….

9.2 The following are offsite sources of information:

(a) Publicly available information on system design and performance;

(b) Official system documentation, for example system rules, member documentation, business continuity plans, procedures and process flows;

(c) Continuous monitoring, regular and ad hoc reporting on system activity: this includes volumes and values of transactions and operating performance or its financial position (including balance sheet and profit and loss information);

(d) Internal board reports, committee meetings, and internal audit reports;

(e) Self-assessments by system operators and participants of their compliance with RBZ oversight policy;

(f) Engagement with providers, participants and other key stakeholders;

(g) Expert opinion from the RBZ's legal advisors and external auditors including external audit reports; and,

(h) Customer feedback on system performance and participants' behaviour/conduct.

9.3 To preserve confidentiality, oversight information obtained from the system and settlement institution of a recognized system during the course of oversight is subject to official secrecy requirements as set out in section 21 (Preservation of Secrecy) of the National Payment Systems Act and may not be disclosed by the Bank to third parties except in the circumstances set out in sections 21(2) and (3) of the same Act.

On-Site Inspection…….

9.4 The on-site examination will complement the Bank's off-site review and provides the Bank with the opportunity to assess first-hand information on how a recognized system is operated, managed and controlled.

9.5 On-site examinations focus on issues identified through off-site review process that either present high risks or where control process deficiencies are noted.

9.6 The frequency of on-site examination varies from system to system. The Bank will on and ongoing basis conduct on-site examinations as part of its oversight functions.

Moral Suasion…..

9.7 Engagements with the system operators and participants with a view to encouraging adoption and implementation of the Bank's preferred policy position. This tool has the advantage that it encourages the Bank to present a clear and convincing case for change.

9.8 Through this policy dialogue, the Bank will also seek to encourage self-regulation by payment systems providers and participants as this would complement the Bank's oversight role especially with regard to determining access rules and managing market failures.

Directives…..

9.9 The Bank may, from time to time, issue further policy guidelines and directives as provided for in the National Payment Systems Act, among other regulatory requirements to ensure stability of the national payment system.

10. OVERSIGHT ACTIVITIES

Monitoring….…

10.1 The oversight function entails checking and getting information about existing and potential payment systems. The overseers need to have information on the design and operation of the systems, including regular updates on any changes to the systems.

Assessing…….

10.2 The monitoring activity described above provides information which is then used to evaluate and analyse the systems or participants against existing statutes, standards and policy requirements adopted by the Bank.

Inducing Change……

10.3 Having monitored and assessed systems and participants' conduct, the Bank may make the following recommendations:

10.3.1 That no further action is required; or

10.3.2 There is a requirement for change which will be enforced to ensure compliance.

11. OVERSIGHT COOPERATION

Internal ……

11.1 The Bank will foster and ensure regular cooperation among its functions responsible for payment systems oversight, bank supervision, financial intelligence unit and exchange control, among others, to avoid regulatory arbitrage, duplication of functions and ensuring information sharing.

Local……...

11.2 The Bank will collaborate and cooperate with other regulators, government agencies and bodies involved in the financial stability agenda and financial market infrastructures value chain supervision. These include among others Insurance and Pensions Commission (IPEC), Securities and Exchange Commission of Zimbabwe (SECZ), Postal and Regulatory Authority of Zimbabwe (POTRAZ) and Deposit Protection Corporation (DPC).

Regional and International …….

11.3 The Bank cooperates with other Central Banks as well as regulatory bodies regionally and internationally to achieve its oversight objectives.

11.4 Additionally, the Bank will rely on cooperative oversight arrangements with the primary supervisory authority of any recognised cross border system operating in Zimbabwe.

ANNEXURE I: PRINCIPLES FOR FINANCIAL MARKET INFRASTRUCTURES (PFMIS)

General organization 1. Legal basis 2. Governance 3. Comprehensive Risk management framework	*Credit and liquidity risk management* 4. Credit risk 5. Collateral 6. Margin 7. Liquidity risk	*Settlement* 8. 8: Settlement finality 9. 9: Money settlements 10. 10: Physical deliveries
Centralized Securities Depository (CSD) & Exchange-of-value Securities Settlement SS 11. CSD 12. Exchange-of-value settlement systems	*Default Management* 13. Participant-default rules and procedures 14. Segregation and portability	*General Business and Operation Risk Management* 15. General business risk 16. Custody and investment risks 17. Operational risk
Access 18. Access and participation requirements 19. Tiered participation arrangements 20. FMI links	*Efficiency* 21. Efficiency and effectiveness 22. Communication procedures and standards	*Transparency* 23. Disclosure of rules, key procedures, and market data 24. Disclosure of market data by trade repositories

ANNEXURE II: RESPONSIBILITIES OF CENTRAL BANKS, MARKET REGULATORS, AND OTHER RELEVANT AUTHORITIES FOR FINANCIAL MARKET INFRASTRUCTURES

Responsibility A: *Regulation, supervision, and oversight* of FMIs

Responsibility B: Regulatory, supervisory, and oversight *powers and resources*

Responsibility C: *Disclosure of objectives and policies* with respect to FMIs

Responsibility D: *Application of principles* for FMIs

Responsibility E: *Cooperation* with other authorities

ANNEXURE III: THE CPMI, BIS GENERAL PRINCIPLES FOR OVERSIGHT (MAY 2005)

	General Oversight Principle	**Explanation**
A	Transparency	Central Banks should set out publicly their oversight policies, including the policy requirements or standards for systems and the criteria for determining which systems these apply to.
B	International Standards	Central Banks should adopt, where relevant, internationally recognised standards for payment, clearing and settlement systems.
C	Effective Powers and Capacity	Central Banks should have the powers and capacity to carry out their oversight responsibilities effectively.
D	Consistency	Oversight standards should be applied consistently to comparable payment and settlement systems, including systems operated by the Central Bank.
E	Cooperation with other Authorities	Central Banks, in promoting the safety and efficiency of payment and settlement systems, should cooperate with other central banks and relevant authorities.

ANNEXURE IV: RISKS IN PAYMENT SYSTEMS

Credit Risk	The risk that a counterparty or participant in a clearing and settlement system will not settle an obligation for full value, either when due or at any time thereafter.
Custody Risk	The risk of loss of securities held in custody occasioned by the insolvency, negligence or fraudulent action of the custodian or of a sub-custodian.
General Business Risk	Refers to any potential impairment of the financial condition (as a business concern) of an FMI due to declines in its revenues or growth in its expenses, resulting in expenses exceeding revenues and a loss that must be charged against capital. Such impairment may be a result of adverse reputational effects The risk that your overall business strategy and plan will be ineffective leading to failure to meet revenue targets.
Legal Risk	In general, the risk of loss because of the unexpected application of law or regulation or because a contract cannot be enforced. For clearing and settlement systems, it means the risk that a party will suffer a loss because the relevant laws or regulations do not support the rules of such a system, the performance or related settlement arrangements, or the property rights and other interests held through the clearing and settlement systems. Legal risk also arises if the application of the relevant laws and regulations is unclear.
Liquidity Risk	The risk that a counterpart or participant will not settle an obligation for full value when due. Liquidity risk does not

	imply that a counterpart or participant is insolvent since it may be able to settle the required debit obligation at some unspecified time thereafter
Money Creation Risk	Refers to the risk associated with electronic money in which additional value is manufactured/created on the system without being backed by a bank corresponding actual cash holding.
Operational Risk	the risk that deficiencies in information systems or internal controls and result in unexpected losses; or the risk of a human error or a breakdown of some components of the hardware, software or communication systems that are crucial to the settlement process of a clearing and settlement systems.
Pre-settlement Risk (replacement cost risk)	The risk that a counterpart or participant in a clearing and settlement systems to an outstanding transaction for completion at a future date will fail to perform on the contract or agreement during the life of the transaction. The resulting exposure is the cost of replacing the original transaction at current market price and is also known as replacement cost risk.
Risk factor	A variable that affects the value of financial instruments or an entire portfolio. The most common market risk factors are interest rates, foreign exchange rates, equity prices and commodity prices.
Strategic risk	Strategic risk is current and prospective risk to capital arising from adverse business decisions, improper implementation of

	decisions or lack of responsiveness to industry changes. This risk is a function of the compatibility of the institution's goals, business strategies and resources deployed to accomplish these goals, and the quality of implementation. The institution's internal characteristics must be evaluated against the impact of economic, technological, competitive, regulatory, and other environmental changes.
Systemic Risk	The risk that the failure of one participant in a transfer (payment) system (or in the financial markets) to meet its required obligations will cause other participants or financial institutions to be unable to meet their obligations (including settlement obligations in a transfer system) when due. Such a failure may cause significant liquidity or credit problems and, as a result, might threaten the stability of financial markets" (Bank for International Settlement).
Technology Risk	Failure to plan for the entire lifecycle of the use of technologies and the selection of technological standards to ensure continuity and stability of payment systems.

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