

**PAYMENT SYSTEMS  
OVERSIGHT UNIT**

**OPERATIONAL  
FRAMEWORK**

**PSOU/OPFK/001**

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## 1. Introduction

Payment and settlement systems are essential components of a market economy. At its simplest, buyers and sellers must be confident that their transactions will be completed in a safe and efficient manner. However, all payment systems face certain risks such as:

- Credit risk when a buyer is unable to settle
- Liquidity risk when a buyer is unable temporarily to settle
- Operational risk when a system failure delays settlement
- Legal risk when an existing law overrides a buyer's obligation to settle

A failure to settle can undermine the stability of both financial markets and government monetary policy. Thus, the Central Bank has established a Payment Systems Oversight Unit (PSOU) to monitor the UAE's payment systems and to ensure that risks are identified and managed.

This document describes the scope of the PSOU's remit, its method of working, and the sanctions it might apply. In carrying out its tasks the PSOU assesses payment systems against internationally-accepted best practice and with current and future versions of the 'Core Principles for Systemically Important Payment Systems' as published by the Bank for International Settlements (BIS).

## 2. The Core Principles

The Core Principles were agreed by the G10 group of countries and published by the BIS in January, 2001. The Core Principles are defined fully elsewhere but are summarised by the BIS as follows:

1. The system should have a well-founded legal basis under all relevant jurisdictions.
2. The system's rules and procedures should enable participants to have a clear understanding of the system's impact on each of the financial risks they incur through participation in it.
3. The system should have clearly defined procedures for the management of credit risks and liquidity risks, which specify the respective responsibilities of the system operator and the participants and which provide appropriate incentives to manage and contain those risks.
4. The system should provide prompt final settlement on the day of value, preferably during the day and at a minimum at the end of the day.

5. A system in which multilateral netting takes place should, at a minimum, be capable of ensuring the timely completion of daily settlements in the event of an inability to settle by the participant with the largest single settlement obligation.
6. Assets used for settlement should preferably be a claim on the central bank; where other assets are used, they should carry little or no credit risk and little or no liquidity risk.
7. The system should ensure a high degree of security and operational reliability and should have contingency arrangements for timely completion of daily processing.
8. The system should provide a means of making payments which is practical for its users and efficient for the economy.
9. The system should have objective and publicly disclosed criteria for participation, which permit fair and open access.
10. The system's governance arrangements should be effective, accountable and transparent.

### **3. Role of the Central Banks**

As a serious settlement failure can affect the government's wider economic and monetary policies central banks around the world have assumed responsibility for overseeing payment systems. The BIS agrees that oversight should be a central bank function. The Core Principles specify that central banks should:

- A. Be open with respect to their role and policies
- B. Ensure that their own systems are compliant
- C. Ensure the compliance of systems operated by others
- D. Cooperate with other central banks

The BIS (Lamfalussy Report) recommends also that central banks cooperate with each other in respect of cross-border payments and provides guidelines for cooperation. This is particularly relevant to the PSOU where systems provide multi-currency or international services.

The PSOU shall comply with the above criteria.

#### 4. Objectives of the PSOU

The PSOU was established in April 2009 pursuant to HE The Governor's Administrative Decision number 77/2009. The role of the PSOU was enhanced by HE the Governor's Administrative Decision number 193/2009 issued on 18 August 2009. Article 1 of the Decisions describes the main function of the PSOU as to supervise payment systems in general and ensure their compliance with the Core Principles.

Article 4 of the Decisions makes clear that the PSOU's remit covers all payment systems operating in the UAE and that the Unit is empowered to propose changes to improve the country's settlement systems.

#### 5. Systems Certification

All payment systems in the UAE are potentially subject to PSOU oversight and must be certified by the PSOU in order to provide payment and settlement services.

Any system already in operation as at 14 April 2009 (the date the PSOU was established) shall be granted a certificate. Thereafter, any new system offered by an existing or new operator must be certified by the PSOU prior to entering service.

The PSOU shall issue a certificate if, overall, the system is at least broadly compliant with the Core Principles. Broadly compliant means that the PSOU takes into account the level of risk, the impact of failure upon the wider economy, and the availability of alternative payment systems.

#### 6. Scope of Oversight

The Core Principles are directed specifically at systemically important payment systems i.e. those whose failure would have serious consequences throughout the financial market. Systemically important systems tend to be those facilitating large-value payments and thus normally exclude retail systems. However, at least initially, the PSOU takes a broader approach and includes prominent retail systems which may become more important in the future. The PSOU may impose a less rigorous assessment where these systems are concerned.

The following paragraphs refer to current systems and services. However, the PSOU is authorised to oversee any payment system whether established now or in the future.

## 6.1 Central Bank Systems

The PSOU will assess existing Central Bank systems:

- The funds transfer system (UAEFTS)
- The image cheque clearing system (ICCS)
- The wages protection system (WPS)
- The electronic switch (UAESWITCH)

## 6.2 Non-Central Bank Systems

The PSOU will assess payment systems operated by other organisations, such as:

- The DIFC's real-time gross settlement system operated by RAPID Ltd
- The settlement systems operated by the UAE's stock exchanges
- International card schemes e.g. Visa, MasterCard and American Express

## 6.3 Participating Banks' Systems

Some Central Bank systems such as UAEFTS and UAESWITCH require on-line access by the participating banks. The security of these networks and their participants may be compromised should even one connecting system be non-secure. Hence, the PSOU shall mandate minimum operational and technical security standards for connecting to Central Bank systems.

Such mandates may be extended to include systems such as ICCS. Here, the PSOU might stipulate minimum standards for the safe storage and transfer of cheques.

## 6.4 Payment Instruments

In the view of the PSOU payment instruments are integral to and inseparable from their systems and, therefore, subject to PSOU oversight. The PSOU's main concern is with security such as anti-fraud features and compliance with international standards.

## 6.5 Non-Banking Organisations

An increasing number of non-banking organisations provide systems and services to the UAE market. The PSOU will assess (or liaise with) them in order to develop a wider community of interest. The following organisations have been identified so far:

- Payment gateway operators
- Card transaction processors
- Terminal providers
- Card manufacturers
- Card personalisation bureaux

It is acknowledged that equipment suppliers are not directly involved in payment systems. However, they are included here because their cooperation will be required should EMV become mandatory. It is further acknowledged that these companies require certification by the relevant card schemes.

## 7. Payments Strategy

The Central Bank collaborates with banks and industry representatives in the formulation and implementation of the UAE's national payments strategy. This collaboration is expressed through the Payments Steering Committee.

### 7.1 Payment Steering Committee

The Payments Steering Committee (PSC) comprises senior business representatives from the banks and other interested parties. The PSOU chairs PSC meetings and acts as the PSC's secretariat. The PSC is responsible for:

- Recommending national objectives
- Identifying business requirements
- Recommending priorities and solutions
- Proposing timescales for the introduction of new systems and services
- Recommending optimal structures for the delivery of the services
- Contingency planning in the event of market failure

The committee meets periodically and its proceedings are recorded and the minutes published on the PSOU Web site.

The PSOU reports PSC recommendations and decisions to HE The Governor of the Central Bank and ensures that these are consistent with Strategy Unit policy. All proposals for new or additional services must be submitted via the PSOU to the PSC for its approval.

A series of sub-committees operates under the aegis of the PSC to provide specialist knowledge of various markets, products, operations and IT.

### 7.2 Strategic Initiatives

The PSOU supports the PSC's efforts to promote new payment systems, channels and instruments in order to reduce costs, provide more options for banks and their customers, and to make the market more competitive. For example, the PSC might consider and recommend any of the following:

- A UAESWITCH payment card (POS)
- A national migration to EMV to counter fraud
- Facilities for processing standing orders, direct debits and credits
- Enhanced RTGS functionality to meet modern banking requirements
- Use of the RTGS system for settling other payment systems
- Reducing the reliance upon cash and cheques
- Innovative payment methods such as mobile payments and banking
- An Internet payment gateway

The PSC might also recommend an appropriate organisation or structure to deliver specific payment services. Thus, the PSC might recommend any of the following delivery options:

- An operational unit within the Central Bank
- Outsourcing to a third-party service provider
- Outsourcing to a service provider owned by the Central Bank and participating members

## 8. Communications

The PSOU considers effective and timely communications an essential feature of the Central Bank's leadership role in providing both oversight of and direction to the payments market. To this end, the PSOU shall ensure that its role and responsibilities are made known within the Central Bank and throughout the wider market.

The PSOU shall make every effort to ensure that market participants are kept informed of plans and schedules so that they, in turn, can make their views and requirements known to the Central Bank. The PSOU recognises that such ongoing liaison is necessary to allow participants time to schedule their own development activities and resources so as to participate fully in the evolution of Central Bank systems.

In keeping with its preferred partnership approach the PSOU shall continue to post all relevant documents on its Web site and these shall be available to all participants. In the interests of commercial confidentiality the PSOU may communicate directly and privately with participants.

In order to ensure best practice and that the UAE's payment systems remain at the forefront of market developments the PSOU shall establish close working relationships with other central banks and with international standards organisations such as the Bank for International Settlements in Basle.

## 9. Support Services

The PSOU will assist banks, service providers and other interested parties to become compliant with the Core Principles. The PSOU will:

- Establish ongoing communications
- Provide information
- Respond to queries
- Facilitate workshops
- Review system designs

The above list is by no means exclusive as the PSOU welcomes and encourages the involvement of all interested parties.

## 10. Assessment Methods

The main methods of working are to gather information and to carry out site surveys. The PSOU may request documents from and interviews with system operators and their participants. In sum, the PSOU may inspect any relevant document, process or procedure and shall always define a payment system in broad terms i.e. beyond the operator's central computer system. In carrying out its assessment the PSOU may:

- Request information from system operators
- Issue questionnaires
- Inspect and test systems
- Co-opt specialised resources
- Request a self-assessment
- Cooperate with other central banks
- Take comments from system participants
- Monitor the service
- Undertake follow-up assessments

### 10.1 Gathering Information

Information provided by system operators is a major asset for the PSOU so must be:

- Timely
- Comprehensive
- Not misleading

After an initial meeting the PSOU will meet payment system operators on a quarterly basis to discuss issues arising and, if appropriate, progress towards greater compliance with the Core Principles. Prior to this first meeting, operators shall provide the following information:

- Name of settlement system(s)
- Major system functions
- Organisations using the system
- Rules and regulations
- Settlement basis
- Risk mitigation and management strategy
- Value of transactions during previous quarter (minimum, maximum, average)
- Volume of transactions during previous quarter
- Maximum participant exposure, permitted and achieved

- Peak periods
- Contingency arrangements
- System availability
- Availability of participants' systems (if relevant)
- System scalability
- Capacity planning

Thereafter, organisations shall provide on a quarterly basis:

- Value of transactions during previous quarter (minimum, maximum, average)
- Volume of transactions during previous quarter
- Maximum participant exposure, permitted and achieved
- Details of any deviations from the rules
- Availability of system and of participants' systems
- Any information that might affect compliance with the Core Principles.

**NB** Payment system operators must notify the PSOU immediately of any event arising that might incur systemic risk or otherwise affect their system's compliance with the Core Principles.

During the course of its assessments the PSOU might seek confidential information. In all cases the Central Bank shall respect commercial confidentiality and shall only share confidential information with other regulators and if required to do so.

## **10.2 Inspecting and Testing Systems**

If requested, operators of systems being assessed should cooperate with the PSOU. Such cooperation might include, for example, work-shops, demonstrations and testing the system in the presence of the PSOU.

This cooperation is essential to the efficacy of the PSOU. Obviously, operators are more familiar with their systems than are the PSOU – especially if the system has been developed in-house.

## **10.3 Co-Opting Resources**

At times, oversight requires specialised legal, audit, technical, financial and operational risk skills. If necessary, the PSOU will co-opt appropriate resources from within the Central Bank or hire external consultants to provide the requisite expertise.

#### 10.4 Self-Assessment

The PSOU may request an organisation to assess its own compliance with the Core Principles. In these cases the organisation shall submit a comprehensive report to the PSOU whereupon the PSOU may either accept the findings or require they be audited and tested. If not satisfied, the PSOU reserves the right to undertake its own assessment.

#### 10.5 Cooperating with Other Central Banks

In accordance with BIS recommendations the PSOU will coordinate its oversight activities with other central banks. This will certainly be the case with regards to assessing any company processing foreign currency transactions where the PSOU will partner with the issuers of those currencies.

The PSOU will also work closely with other GCC central banks through the GCC Payment Systems Committee which reports to the Committee of GCC Governors. All GCC member states have undertaken to share knowledge and to collaborate in devising consistent oversight policies.

### 11. Sanctions

Whereas the PSOU is seeking collaborative relationships it is clear that any oversight function requires effective sanctions in extreme cases. The Central Bank has many powers of law and in convention that may be brought to bear and these are available to the PSOU.

In general, the PSOU may impose by regulation any requirement aimed at improving the safety and efficiency of payment systems. If the PSOU is not satisfied with an operator's compliance status this will be communicated to the operator in writing together with a date by which a remedy must be in place. If the date is missed without reasonable explanation then the PSOU may take any of the following actions:

- Impose a fine
- Temporarily suspend the operator's certificate
- Revoke the operator's certificate

In practice, the PSOU expects that informal sanctions should suffice. For example, a report will be published each year detailing the extent of all systems' compliance with each of the Core Principles; the PSOU believes participants will wish to avoid bad publicity.

## 12. Annual Report

The PSOU shall publish an annual report detailing each system's status with respect to the Core Principles. Where relevant, copies of the report shall be sent to partner central banks. For each of the ten Principles the status may be:

- Fully-compliant
- Broadly-compliant
- Partially-compliant
- Non-compliant
- Not applicable

If the PSOU assesses compliance as broadly-compliant this indicates a satisfactory condition. There may be some improvements possible but these might not be cost-effective or efficient.

If the status is partially-compliant this means that the operator must make improvements. These will be identified and scheduled in agreement with the PSOU. Progress will be monitored and included in the annual report.

Partial compliance with one or more principles does not mean that the system overall is not compliant. This depends upon the PSOU's judgement as to the degree of risk, the impact upon the wider economy, and the availability of alternative payment systems.

## 13. Conclusion

The Central Bank intends that national payment systems should be of a standard commensurate with the high quality of infrastructure found elsewhere in the UAE's economy. In this context the PSOU will play a leading role in initiating the changes needed to support a world-class business environment.

This document describes the work of the PSOU at a high level and should be read in conjunction with the PSOU's related document *PSOU Assessment Criteria*. This latter document describes in detail the oversight criteria and the way in which the PSOU arrives at its overall assessment of a system.

This framework document has benefited from documents published by the BIS and other central banks. Thus, in terms of payment systems oversight, the PSOU believes its proposed framework to be both typical and appropriate for the UAE.

## 14. References

The following publications were referenced in the preparation of this document:

*Core Principles for Systemically Important Payment Systems*  
Bank for International Settlements, January 2001

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Federal Reserve Board, December 2008

*Payment Systems Oversight Report, 2008*  
Bank of England, April 2009

*Detailed Assessments of Payment Systems, 2008*  
Bank of England, April 2009