

CENTRAL BANK OF LESOTHO



PAYMENT SYSTEM OVERSIGHT POLICY FRAMEWORK

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1.0 OVERVIEW OF PAYMENT SYSTEMS

1.1 Introduction

One of the key roles of the Central Bank of Lesotho (CBL) is oversight of payment systems. The objective of oversight is to ensure the smooth functioning of payment systems. The efficient functioning of payment systems allows for the safe and timely completion of financial transactions and thereby ensuring a vital contribution to overall economic performance.

Though payment systems are a vital part of the economic and financial infrastructure, they have the potential to expose their users to significant financial risks and can be a channel for the transmission of disturbances from one part of the economy or financial system to another. Their interlinked nature implies that problems in one or more members are likely to have direct and knock-on effect on other members, thus the potential for systemic risk. This may also arise from operational failure and malfunction of systems leading to unexpected financial exposures among members. These disturbances are more crucial in large value payment systems such as Real Time Gross Settlement systems.

Systemic risk is the major cause for concern that calls for active oversight of payment systems, hence the development of this oversight policy framework. This policy framework seeks to address the role of the CBL as the Payment Systems Overseer. It focuses on institutional foundations, operational objectives and instruments and the organizational building blocks of an effective oversight function.

This policy and framework document lays out the objectives and scope of the oversight function and the manner in which CBL intends to conduct its oversight.

It is intended to be a guide that would bring transparency to the role of CBL as the overseer of payment systems. It is intended to ensure the financial and technical integrity of Lesotho's payment systems, their robustness against shocks, and that the overall efficiency are upheld through adherence to the Principles for Financial Markets Infrastructure are aimed at guiding the design and operation of payment systems. These principles form the basis for Lesotho National Payment System Oversight function and the development of this policy framework.

1.2 Rationale for and Objectives of Payment System Oversight

The CBL's oversight function is one of the key aspects of its broad responsibility for monetary and financial stability. The efficient and effective operation of payment systems is also a requirement for meeting both the business needs of the economy and the personal banking requirements of the public at large. The focus of payment system oversight is to identify potential risks in the design and operation of payment systems and to take steps to minimize these risks. The ultimate objective of oversight is both to ensure an efficient and safe system as well as to avert system crises, thus preserving confidence in the payment system.

The role of the CBL in oversight of payment systems is closely aligned to its operational role as the provider of the settlement asset since settlement is through transfers between commercial banks' accounts that are held at CBL. CBL is also the ultimate provider of liquidity to the banking system through intra-day credit and overnight credit facilities, against eligible securities.

The main objective of CBL's oversight of payment systems is to ensure adequate risk reduction and management in their design and operation, taking into account the efficiency aspects of timeliness, reliability and affordability.

In terms of the Principles for Financial Markets Infrastructures, the responsibilities of the Central Bank in applying the principles are:

Responsibility A: Regulation, supervision, and oversight of FMIs

Financial markets Infrastructure should be subject to appropriate and effective regulation, supervision, and oversight by a central bank, market regulator, or other relevant authority.

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

Central bank should have the powers and resources to carry out effectively their responsibilities in regulating, supervising, and overseeing FMIs.

Responsibility C: Disclosure of policies with respect to FMIs

Central banks should clearly define and disclose their regulatory, supervisory, and oversight policies with respect to FMIs.

Responsibility D: Application of the principles for FMIs

Central banks should adopt the CPSS-IOSCO Principles for financial market infrastructures and apply them consistently.

Responsibility E: Cooperation with other authorities

Central banks, market regulators, and other relevant authorities should cooperate with each other, both domestically and internationally, as appropriate, in promoting the safety and efficiency of FMIs.

1.3 Background of Lesotho National Payment Systems (LNPS) Modernisation Project

The importance of payment and settlement systems in the economy cannot be overemphasized. Globally, central banks have begun to pay due attention to this importance. Payment systems have a potential for transmitting shocks in financial systems and with rapid advances in technology, such shocks could be transmitted instantly across national and international borders. It has therefore become essential that central banks keenly take interest in their responsibility of promoting safe and sound payment systems. In almost all countries, the value of payments that go through the payment and settlement system is more than twice the size of the GDP of such economies.

The Lesotho National Payment Systems (LNPS) Modernization project formulated a Vision and Strategic Framework Document (Vision Document)

that reads “By 2015, Lesotho shall have a widely accessible, secure, reliable and efficient payment and settlement system. The system shall facilitate and support Lesotho’s development objectives.” The Vision Document spells out objectives and strategies to be followed to attain the envisaged payment System. The main strategies include the reform of legal and regulatory framework consistent with modern payment system, introduction of Real Time Gross Settlement and implementation of Automated Clearing House. The implementation of these strategies commenced in 2004 and is continuous. The reform of the legal and regulatory framework, which is one of the strategies for payment system modernisation, has afforded the Bank the legal basis and support as the Overseer of payment systems. In accordance with the Vision Document, CBL will actively oversee LNPS with particular emphasis on the followings:

- Ensuring that there is continuous modernisation of the payments system in line with the requirements of Lesotho.
- Regulating participation in the payment system to ensure that participants conform to the rules and procedures of participation and to ensure that the roles of different participants in the payment system are clearly defined.
- Ensuring there are no pirate operators in the payments system.
- Ensuring that payment system related risks including settlement, liquidity, and credit, legal, operational, fraud and systemic risks are well understood and managed.
- Monitoring the financial position (clearing and settlement) of all participants in the payment system at all times, daily and historically.

1.4 Public Policy Goals of Payment Systems

Payment systems give rise to public policy issues. The public policy objectives refer to the desirable properties of a well functioning payment system. There are three broad policy objectives namely efficiency, safety and customer interest in payment systems;

1.4.1 Efficiency of Payment Systems

Efficiency refers to the appropriate market arrangements and institutional structures for the allocation and management of resources so that users' payment needs are satisfied, in a timely fashion at the lowest cost possible to service providers and users. Efficiency is related to the pace of technological innovation in payment services. As new information and telecommunications technologies are brought on board, existing and potential providers develop applications for use in payments systems, with the view to reduce the cost of providing existing payments instruments and services or to create new, commercially-viable and more efficient instruments and systems. A payment system that is sufficiently flexible to adopt new technologies and innovations quickly benefits both providers and users.

CBL will work with market participants and commercial banks to promote improvements and will seek to support market-led developments that are deemed essential. The CBL will take a more active role in leading the developments to be in line with the Vision and Strategic Framework for modernization of the payment systems, in line with international best practice and regional and domestic developments.

1.4.2 Safety of the Payment Systems

Safety of the payment systems is defined in terms of a system that adequately controls and manages risks while maintaining robustness to adverse shocks and is governed by a solid and transparent legal and regulatory framework. Payment system risks are generally measured in terms of the frequency of payment failures or the expected value associated with payments losses. The safety of the payment system can be considered in terms of how robust or well-protected the overall system is with respect to major shocks, from within the system as well as from outside the system. CBL will ensure that design of a payment system is in accordance with the Principles for Financial Markets Infrastructure and tested on a regular basis in accordance with Business Continuity Plans.

1.4.3 Consumer interests in the Payment Systems

Public policy interest is concerned with ensuring that a competitive environment exists and that any competitive abuses are curbed. This encompasses issues such as privacy and broad access to payments services. In considering payments systems, efficiency and safety are generally accepted as two of the key policy objectives. Customers of payment systems are, of course, well served by an efficient and safe system. All users of retail and wholesale payment services are concerned about the security of payment information, while providers of payments instruments and support services in the system are driven by market forces to respond to these concerns. In order to protect consumers, CBL will undertake regular surveys to determine customer satisfaction.

2.0 OVERSIGHT FUNCTION

The definition of Oversight adopted by the Bank for International Settlements (BIS) Committee on Payment and Settlement Systems (CPSS) is as follows: “Oversight of payment and settlement systems 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.”

In an effort to promote safety, soundness and reliability in payment systems, CBL undertakes to:

- Ensure the risks inherent in payment systems are well understood and managed
- Monitor LNPS to ensure that there is continuous modernization of payments and settlement systems and participation in LNPS shall be regulated in accordance with relevant legal and regulatory framework and ensure that the participants conform to such rules and procedures.
- Support public policy objectives such as control of money laundering, consumer protection and avoidance of anticompetitive practices
- Ensure that payment systems are fair that is, the rights and obligations of parties to the funds transfer are allocated in an equitable manner to ensure a level playing field for all participants.
- Protect participants and users from provider contractual provisions that limit consumer choice and ensuring that the payment services offered are in compliance with the law while promoting free operation of market forces in the payment system to enhance competition and openness to the entry of new operations.

- Enhance cooperation among payment system Stakeholders, like between overseers, payment system stakeholders, bank supervisory authorities and securities regulators. Cooperation guarantees mutual exchange of information and action coordination necessary for each agency to intervene promptly and appropriately when necessary.

3.0 SCOPE OF PAYMENT SYSTEM OVERSIGHT

The scope of oversight refers to payment and settlement systems that the CBL oversees by applying safety and efficiency standards policy. The scope and depth of oversight will be set to achieve soundness, safety and efficiency. Oversight will essentially cover systems that are deemed to be of systemic importance. A system is considered systemically important if its failure could have system wide consequences. It bears on systems whose size and/or risk profile makes them important.

CBL has the responsibility to designate payment systems as systemically important payment systems (SIPS) in accordance with the BIS Core Principles.

In all cases CBL will consider systemic risk when determining whether the payment system is systemically important.

Currently Lesotho has two payment systems, namely the RTGS system (Lesotho Wire), and the Maseru Clearing and Settlement House, and both are considered systemically important, therefore subject to oversight.

Oversight function on systemically important payment systems will also include the infrastructure comprising:

- Hardware and Software

- Technical and administrative procedures used to ensure operational reliability
- Adequate business continuity plans;
- Payment instruments that are efficient, reliable and are in line with industry standards.

Oversight function will pay special attention to promoting the development of innovative instruments, taking advantage of advances in technology.

Over and above SIPS and payment instruments, the scope of oversight will also include correspondent banks and third-party service providers. Such oversight would be through cooperative oversight arrangements with other central banks, special contract/service level arrangements and periodic surveys and returns.

3.1 Oversight Standards and Principles

Oversight as described in this document seeks to ensure that payment systems optimize their provision of services to the economy as they develop over time. Specifically, it seeks to counteract undesirable developments in the banking and financial services sector which may endanger the safety of the assets entrusted to institutions, impair the proper conduct of banking business or provision of financial services or involve serious disadvantages for national economy. The execution of the function is guided by the provision of Principles for Financial Markets Infrastructure together with the responsibilities of CBL. Oversight activity aims to establish compliance by Lesotho payment systems to these Core principles and is requiring payment system operators to take all reasonable measures to achieve full compliance. These Core Principles are set out in attached tables I & II.

3.2 General Principles for Oversight

Principles for effective oversight were set by BIS to assist central banks to organize and conduct effective oversight. In performing its oversight function, the CBL shall align itself with the following general principles for oversight:

- Transparency – Oversight policies should be set-out publicly by central banks, including the policy requirements or standards for systems and the criteria for determining which systems these apply to;
- International standards – Internationally recognized standards for payment and settlement systems should be adopted by central bank;
- Effective powers and capacity – Powers and capacity to carry out oversight responsibilities should be effectively maintained by central banks;
- Consistency – Oversight standards should be applied consistently to comparable payment and settlement systems, including systems operated by central banks;
- Cooperation with other authorities - There should be cooperation of central banks and other relevant authorities in promoting safety and efficiency of payment and settlement systems.

In the conduct of the oversight function, CBL will be guided by the following set of assumptions:

- That CBL is vested with the responsibility of overseeing domestic payment systems and cooperating with domestic and international regulatory/supervisory institutions involved in payment system matters and that CBL has clear legislative authority to carry out the oversight function;
- That CBL will commit enough resources for the unit conducting oversight, staffing it with skilled professionals to deal with the composite dimensions of oversight and to carry out effective dialogue with the various parties involved in payment system operations. Adequate intelligence resources should also be provided for effective system research and analysis. CBL will ensure safe and efficient functioning of the Clearing and Settlement System that it operates. CBL will make its payment system oversight strategy well known

to all participants and ensure that the participants and service providers act transparently by publicly disclosing its objectives and policies;

- That CBL will periodically review the design and functioning of such systems. CBL will refrain from undertaking payment activities that the private sector can perform more efficiently and will promote competition in the market for payment services by engaging the private sector to take initiatives that enhance this objective;
- CBL will strive to ensure that SIPS are adequate to serve the economy's needs and have capacity to operate safely even in conditions of exceptional contingencies and market distress;
- CBL will also seek to ensure that the domestic payment systems meet user's needs adequately, both in terms of the range of payment instruments, service delivered and territorial extension.

3.3 Principles for International Cooperative Oversight

In conforming to international best practices, CBL shall align itself with the following principles for international cooperative oversight¹:

- Notification – Each central bank that has identified the actual or proposed operation of a cross-border or multi-currency payment or settlement system, should inform other central banks that may have an interest in the prudent design and management of the system
- Primary Responsibility – Cross-border and multi-currency payment and settlement systems should be subject to oversight by a central bank which accepts primary responsibility for such oversight, and there should be a presumption that the central bank where the system is located will have this primary responsibility

¹ Bank for International Settlement, Committee on Payment and Settlement Systems; Central Bank Oversight of Payment Systems, May 2005.

- Assessment of the system as a whole – In its oversight of a system, the authority with primary responsibility should periodically assess the design and operation of the system as a whole. In doing so it should consult with other relevant authorities
- Settlement Arrangements – The determination of the adequacy of a system’s settlement and failure-to-settle procedures in a currency should be the joint responsibility of the central bank of issue and the authority with primary responsibility for oversight of the system
- Unsound Systems – In the absence of confidence in the soundness of the design or management of any cross-border or multi-currency payment or settlement system, the central bank should, if necessary, discourage use of the system or the provision of services to the system, for example by identifying these activities as unsafe and unsound practices. It also considers how central banks organise their oversight function

4.0 OVERSIGHT APPROACH

This section explains how CBL intends to undertake three key activities of oversight namely: monitoring, assessment, and inducing change. In order to carry out effective oversight, CBL needs to have a good understanding of how key payment systems function and how they relate to each other as part of the overall financial system and to obtain this understanding, CBL needs to have information on the design and operation of the those systems. The Central Bank’s approach to oversight will be guided, as benchmarks, by the Principles for Financial market infrastructure and the Principles for Effective Oversight

4.1 Collection and analysis of information

CBL will develop and use appropriate instruments and operational manuals and procedures that allow it to carry out its oversight function. CBL will collect statistical information on a regular basis and analyze it to develop full awareness of the weaknesses and developmental needs of the systems across various dimensions (i.e. legal, operational, financial, and technological). This exercise may also involve the work of third party experts, such as independent security evaluators or auditors. The information is required in order to make an initial assessment of the safety and efficiency of a system. The collection and analysis of information will assist CBL in determining the system's efficiency and safety to determine appropriate corrective action.

In order for CBL to obtain this information, it must have statutory and generally the information shall include, but not limited to:

- Publicly available information, system reports, statistics, system rules, legal opinions
- Company records, audit reports, information from other regulators
- Bilateral and multilateral meetings and discussions
- Information from on- site and off-site inspections
- Customer feedback

4.2 On-site Inspections /examination

In order to enhance the effectiveness of the collection of information CBL will undertake on-site examination and validate information provided. This will also determine whether rules, regulations and procedures are properly followed and the risks are prudently managed. Other information, which is not normally submitted, will be examined such as minutes, log-books, internal memos and reports. One

such example is the review of the outcome of the work of internal and external auditors, which may indicate potential weaknesses or breakdowns in procedures.

4.3 Surveys

CBL will conduct periodic market surveys in order to obtain the information it needs for its oversight activities. This instrument is of particular importance when compiling payment statistics

4.4 Evaluation and assessment against standards

The objective of system assessment is to determine the system's compliance with Principles for Financial Markets Infrastructures or recommendations established by the Bank and other international organizations. The system assessment methodology shall contain the desired system assessment process and parameters. Payment systems are formally assessed against the standards adopted by the Bank. The oversight role will involve periodic checks on the system integrity by monitoring the functioning of the technical and risk-management infrastructure (including back-up facilities). Information may also be obtained through regular off-site data reporting by participants and system operators and on-site inspections or even on-line monitoring of real-time payment and settlement flows and of risk levels across the payment circuit.

4.5 System registration

The objective of the system registration is to legalize the operation of the systems and disclose information on these system participants, thus forming the conditions for assessment and monitoring of registered systems. CBL shall take a decision on the registration of a system or revocation. CBL reserves the right to refuse system registration and communicate the circumstances underpinning the decision.

4.6 Contact with market players

CBL will hold regular meetings directly with market players and association of the banking industry at various levels. It will also participate in events organized by the banking industry and mount its own conferences, seminars and working meetings. Where necessary, technical working groups to deal with specific payment system subjects, may be constituted. The above instruments are aimed at achieving the right mix of competition and cooperation of the payment systems besides the core objectives of safety, efficiency and reliability.

4.7 Regulations and incentives

The Bank will develop regulations and incentives with the intention to define organizational, functional and technical features of payment systems as well as to establish infrastructural security standards such as information transfer, use of intraday liquidity and queues, cancellation of payment account reconciliation. Regulations are also intended to define access criteria, business conduct, sanctions for non-compliance to rules and commitments from participants. Incentives shall be used to engage participants in pre-arranged loss sharing and liquidity sharing mechanism in the event of illiquidity or insolvency by any one of them

4.8 Policy dialogue

Regular contact with operators and participants in payments systems will be maintained in order to enhance cooperation and communication. Oversight will seek to promote dialogue with all payment system stakeholders with a view to creating consensus for policy choices. This approach gives CBL a channel to exert moral suasion and to shape its policy agenda by using feedback from the market and to assess the efficiency, reliability and fairness of the payment services delivered by the system. Through policy dialogue CBL will also seek to encourage self-regulation by organizations as this complements CBL's oversight role.

4.9 Follow-up

The outcome of the assessment process will be in the form of a report which will include a description of the evaluation and the conclusions of the work performed. These will preferably be in the form of specific recommendations which, when adopted, will ensure that the relevant assessment criteria and standards are satisfied.

5.0 RISKS IN PAYMENT SYSTEMS

The objective of financial stability requires that the payment systems' risks be recognized, evaluated and contained or mitigated. This is a primary concern of the payments systems oversight, as the repercussions may extend beyond the system to financial markets and the economy at large. Furthermore, the oversight function deals with risks such as intra-day credit and liquidity risk, operational reliability and legal soundness of the system itself. Thus, the oversight function must ensure that all the risks are understood, quantified and mitigated by participants, operators of payment and settlement systems and the public. . In its oversight function, CBL shall give due regard to the following types of risks in particular:

Credit risk – the risk that a counterparty will not meet an obligation for full value, either when due or at any time thereafter;

Liquidity risk – the risk that the counterparty will not settle an obligation for full value when due, but at some time thereafter;

Operational risk – the risk that hardware or software problems, or human error, or malicious attack will cause a system to break down or malfunction giving rise to financial exposures and possible losses;

Settlement risk – the risk that the flow of funds between transacting parties fails or delays owing to credit, liquidity and operational risk or use of risky settlement medium which does not coordinate delivery and payment;

Legal risk – the risk that unexpected interpretation of the law or legal uncertainty will leave the payment system or members with unforeseen financial exposures and possible losses;

Systemic risk - the risk that the inability of one or more of the participants in a payment system to meet its obligations or a disruption in the system itself, could result in the inability of other system participants or financial institutions in other parts of the financial system to meet their obligations as they become due. Such a failure could cause widespread liquidity or credit problems and as a result could threaten the stability of the system or of financial markets.

Custody and investment risks - Investment risk is the risk of loss faced by an FMI when it invests its own or its participants' resources, such as collateral. These risks can be relevant not only to the costs of holding and investing resources but also to the safety and reliability of an FMI's risk-management systems. The failure of an FMI to properly safeguard its assets could result in credit, liquidity, and reputational problems for the FMI itself.

General business risk - risk related to the administration and operation of an FMI as a business enterprise, excluding those related to the default of a participant or another entity, such as a settlement bank, global custodian, or another FMI. 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.

CBL may propose changes to the rules, design or operations of a system, or to the environment in which such systems operate (e.g. legal framework), in order to eliminate, reduce or better manage identified risks. The key objective of CBL is to achieve prompt final settlement in order to minimize the duration of financial exposure between participants, especially when the amounts involved are large.

6.0 LEGAL FOUNDATION OF PAYMENT SYSTEMS OVERSIGHT

According to Central Bank of Lesotho Act of 2000, CBL is mandated to promote the sound, safe and efficient operation of the payments system. It is explicitly provided in the National Payment Systems Bill that the CBL shall oversee the systems, as well as the issuance and use of the payment instruments, and may impose norms and standards for the reliability, soundness and efficiency of the latter and the former. CBL's oversight role recognizes that the legal and regulatory framework affects efficiency, reliability, safety and stability of the payment system. Legal framework also affects the protection of participants and users from unfair allocation and criminal abuse. Payment system oversight seeks to establish and encourage legal rules that govern the transfer of money, in a way that serves the interest of commercial parties who use the payment system to settle their financial obligations in a timely, safe and efficient manner. Such legal foundation should be built around the principles which help to achieve legal certainty and enforceability of settlement. The payment system law governing funds transfer should be in the form of an Act. The payment system law must be part of the broad commercial and

bankruptcy framework. Accordingly rules, concepts and incentives created by the different components of the overall legal framework must be mutually consistent.

Appropriate safeguards must be implemented that create incentives for all payment systems participants to exert reasonable care in managing and executing funds transfer. Security procedures should be well designed based on negotiation among participant parties. The developed legal framework should anticipate and address itself to the future needs of the financial community. The oversight role will involve supporting and advising law-making authorities in developing and strengthening payment system legal provisions that incorporate the above principles. The Bank's oversight activity will therefore seek to highlight legal risks that could cause unforeseeable financial losses to the operator or participants of the settlement system.

7.0 CO-OPERATION AND CO-ORDINATION WITH OTHER AUTHORITIES

7.1 Domestic perspective

Various components of payment systems are inter-linked either directly or indirectly. Their individual operations are affected by the activities and risk management policies and practices of their participants and customers. The Bank and the financial sector stakeholders need to establish an information sharing and liaison mechanism so that all information that is relevant to the discharge of their respective responsibilities will be shared fully and freely in order to ensure that actions taken by one of these parties neither cut across nor contradict the objectives of others.

7.2 International and Regional perspective

CBL has established good relations with IMF and other central banks within the SADC region. In the long run Central Banks within the SADC region plan to undertake joint oversight program and information sharing relating to their oversight role.

8.0 TARGETS OF OVERSIGHT

The oversight function of the Bank is aimed at achieving the following targets:

- Access
- Risk control
- Information transparency
- Pricing
- System Reliability

8.1 Access

Oversight ensures that access is controlled in order to protect the systems and their stakeholders from participation by institutions that might expose them to excessive legal and operational risks. Defining minimum eligibility criteria will be necessary to ensure that participants possess the reputation, financial, governance, technical and operational requisites as well as the business commitment to operate within the set standards. Oversight function will also ensure the incumbents do not erect economic, technical and legal barriers to potential entrants or discriminate against such entrants.

8.2 Risk control

Payment system risks which are financial, operational and legal in nature grow with the volume, value and composition of financial transactions made possible by technology. The speed with which funds settlement takes place also increases the above risks. Oversight will seek to ensure that participants adopt consistent

methods to manage their risks and that systems have enough incentives and safeguards against excessive risk-taking by individual participants. Collective action by participants in this area which ties the risk position of each participant to the behaviour of others will be encouraged.

8.3 Information Transparency

Information transparency is important for both competition and stakeholders' protection. Oversight will therefore encourage participants to inform users of all relevant aspects concerning legal, operational, financial and cost profiles of their services by regularly disclosing updated information on their financial and technical status, performance and their risk position and capital. Appropriate information channels will be established to collect service information evaluations and complaints from users and conveyed to the participants for corrective action. Information sharing with independent external expert payment system evaluation bodies is another dimension that oversight will take to enhance transparency.

8.4 Pricing

Oversight will be directed at monitoring the evolution of pricing policies across payment systems to ensure that pricing practices are fair to users and beneficiaries of payment system services.

8.5 System Reliability

Oversight will confirm that payment and settlement systems have enough warning devices guarding against abnormalities across the payment circuits and have tested emergency procedures that would allow them to operate smoothly at all points of the process and be resilient to disturbances.

9.0 REPORTING OVERSIGHT ACTIVITIES OF THE BANK

To further improve on the transparency, CBL will produce an Quarterly and Annual reports on its oversight activities. CBL will provide a summary of its payment systems oversight activities developments in Lesotho's payment systems in its Annual report. Information that may enhance the effective functioning of the other departments of the Bank and other institutions shall be handled with promptness. The Bank will from time to time also disseminate information of a general nature to promote public awareness on the developments in Lesotho's payment systems using appropriate print and electronic media, professional journals, monthly economic review and the Bank's website.

10.0 TABLES

10.1 Principles for Financial Markets Infrastructures

Principle 1: Legal basis

An FMI should have a well-founded, clear, transparent, and enforceable legal basis for each material aspect of its activities in all relevant jurisdictions.

Principle 2: Governance

An FMI should have governance arrangements that are clear and transparent, promote the safety and efficiency of the FMI, and support the stability of the broader financial system, other relevant public interest considerations, and the objectives of relevant stakeholders.

Principle 3: Framework for the comprehensive management of risks

An FMI should have a sound risk-management framework for comprehensively managing legal, credit, liquidity, operational, and other risks.

Principle 4: Credit risk

An FMI should effectively measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes. An FMI should maintain sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence. In addition, a CCP that is involved in activities with a more-complex risk profile or that is systemically important in multiple jurisdictions should maintain additional financial resources sufficient to cover a wide range of potential stress scenarios that should include, but not be limited to, the default of the two participants and their affiliates that would potentially cause the largest aggregate credit exposure to the CCP in extreme but plausible market conditions. All other CCPs should maintain additional financial resources sufficient to cover a wide range of potential stress scenarios that should include, but not be limited to, the default of the participant and its affiliates that would potentially cause the largest aggregate credit exposure to the CCP in extreme but plausible market conditions.

Principle 5: Collateral

An FMI that requires collateral to manage its or its participants' credit exposure should accept collateral with low credit, liquidity, and market risks. An FMI should also set and enforce appropriately conservative haircuts and concentration limits.

Principle 6: Margin

A CCP should cover its credit exposures to its participants for all products through an effective margin system that is risk-based and regularly reviewed.

Principle 7: Liquidity risk

An FMI should effectively measure, monitor, and manage its liquidity risk. An FMI should maintain sufficient liquid resources in all relevant currencies to effect same-day and, where appropriate, intraday and multiday settlement of payment obligations with a high degree of confidence under a wide range of potential stress scenarios that should include, but not be limited to, the default of the participant and its affiliates that would generate the largest aggregate liquidity obligation for the FMI in extreme but plausible market conditions.

Principle 8: Settlement finality

An FMI should provide clear and certain final settlement, at a minimum by the end of the value date. Where necessary or preferable, an FMI should provide final settlement intraday or in real time.

Principle 9: Money settlements

An FMI should conduct its money settlements in central bank money where practical and available. If central bank money is not used, an FMI should minimise and strictly control the credit and liquidity risk arising from the use of commercial bank money.

Principle 10: Physical deliveries

An FMI should clearly state its obligations with respect to the delivery of physical instruments or commodities and should identify, monitor, and manage the risks associated with such physical deliveries.

Principle 11: Central securities depositories

A CSD should have appropriate rules and procedures to help ensure the integrity of securities issues and minimise and manage the risks associated with the safekeeping and transfer of securities. A CSD should maintain securities in an immobilised or dematerialised form for their transfer by book entry.

Principle 12: Exchange-of-value settlement systems

If an FMI settles transactions that involve the settlement of two linked obligations (for example, securities or foreign exchange transactions), it should eliminate principal risk by conditioning the final settlement of one obligation upon the final settlement of the other.

Principle 13: Participant-default rules and procedures

An FMI should have effective and clearly defined rules and procedures to manage a participant default. These rules and procedures should be designed to ensure that the FMI can take timely action to contain losses and liquidity pressures and continue to meet its obligations.

Principle 14: Segregation and portability

A CCP should have rules and procedures that enable the segregation and portability of positions of a participant's customers and the collateral provided to the CCP with respect to those positions.

Principle 15: General business risk

An FMI should identify, monitor, and manage its general business risk and hold sufficient liquid net assets funded by equity to cover potential general business losses so that it can continue operations and services as a

going concern if those losses materialise. Further, liquid net assets should at all times be sufficient to ensure a recovery or orderly wind-down of critical operations and services.

Principle 16: Custody and investment risks

An FMI should safeguard its own and its participants' assets and minimise the risk of loss on and delay in access to these assets. An FMI's investments should be in instruments with minimal credit, market, and liquidity risks.

Principle 17: Operational risk

An FMI should identify the plausible sources of operational risk, both internal and external, and mitigate their impact through the use of appropriate systems, policies, procedures, and controls. Systems should be designed to ensure a high degree of security and operational reliability and should have adequate, scalable capacity. Business continuity management should aim for timely recovery of operations and fulfilment of the FMI's obligations, including in the event of a wide-scale or major disruption.

Principle 18: Access and participation requirements

An FMI should have objective, risk-based, and publicly disclosed criteria for participation, which permit fair and open access.

Principle 19: Tiered participation arrangements

An FMI should identify, monitor, and manage the material risks to the FMI arising from tiered participation arrangements.

Principle 20: FMI links

An FMI that establishes a link with one or more FMIs should identify, monitor, and manage link-related risks.

Principle 21: Efficiency and effectiveness

An FMI should be efficient and effective in meeting the requirements of its participants and the markets it serves.

Principle 22: Communication procedures and standards

An FMI should use, or at a minimum accommodate, relevant internationally accepted communication procedures and standards in order to facilitate efficient payment, clearing, settlement, and recording.

Principle 23: Disclosure of rules, key procedures, and market data

An FMI should have clear and comprehensive rules and procedures and should provide sufficient information to enable participants to have an accurate understanding of the risks, fees, and other material costs they incur by participating in the FMI. All relevant rules and key procedures should be publicly disclosed.

Principle 24: Disclosure of market data by trade repositories

A TR should provide timely and accurate data to relevant authorities and the public in line with their respective needs.

10.2 Table 1: CBL Responsibilities		
	Description	CBL action
A.	Regulation, supervision, and oversight of FMIs.	FMIs should be subject to appropriate and effective regulation, supervision, and oversight by a central bank, market regulator, or other relevant authority.
B.	Regulatory, supervisory and oversight powers and resources	Central banks, market regulators and other relevant authorities should have the powers and resources to carry out effectively their responsibilities in regulating, supervising and overseeing FMIs
C.	Disclosure of policies with respect to FMIs	Central banks, market regulators and other relevant authorities should clearly define and disclose their regulatory, supervisory, and oversight policies with respect to FMIs
D.	Application of the principles for FMIs	Central banks, market regulators, and other relevant authorities should adopt the CPSS-IOSCO Principles for financial market infrastructure and apply them consistently.
E.	Cooperation with other authorities	Central banks, market regulators, and other relevant authorities should cooperate with each other, both domestically and internationally, as appropriate, in promoting the safety and efficiency of FMIs.

The table below visualizes the framework for payment system oversight.

10.3 Table II: Summary of the oversight Framework

Role of the Bank as Payments System Overseer		<ul style="list-style-type: none"> • Develop principles and rules • Assess/enforce rule compliance • Promote/coordinate individual and collective action • Ensure system functioning • Promote system development 	
Operational Objectives		<ul style="list-style-type: none"> ▪ Development of efficient, reliable, safe and stable payment systems ▪ Prevention of market abuse ▪ Extension of payment services ▪ Prevention of criminal abuse 	
Intermediate Objectives		<ul style="list-style-type: none"> • Promote competitive market conditions • Enhance Cooperation • Achieve Sound Legal foundations. 	
Instruments	Targets	Scope of Action	Types of Action
<ul style="list-style-type: none"> • Rules and incentives • Policy dialogue • Monitoring • Analysis • System governance • Direct service provision 	<ul style="list-style-type: none"> • Access • Risk control • Information transparency • Pricing • System viability • System development 	<ul style="list-style-type: none"> • Service providers, participants, and users • Instruments and services • Technical infrastructures 	<ul style="list-style-type: none"> • Structural • Routine • Crisis management • R & D • Resource mobilization

11.0 GLOSSARY OF TERMS AND ABBREVIATIONS

In this document, unless the context otherwise requires,

“ACH” - Automated Clearing House. This is an electronic clearing system in which payment orders are exchanged among financial institutions, primarily via magnetic media or telecommunication networks and handled by a data processing centre.

“The Bank” means the Central Bank of Lesotho

“BIS” means the Bank for International Settlements

“CBL” means the Central Bank of Lesotho

“Clearing and Settlement System” means a set of procedures whereby financial institutions present and exchange data and/or documents relating to funds or securities transfer to other financial institutions at a clearinghouse. The procedures often also include a mechanism for the calculation of participants’ bilateral and/or multilateral net positions with a view to facilitating the final settlement of their obligations.

“CPSS” (Committee on Payment and Settlement Systems). It is a forum for the central banks of the Group of Ten countries (G10) to monitor and analyze developments in domestic payment, settlement and clearing as well as in cross-border and multi-currency schemes.

“CSDS” (Central Securities Depository System) An institution for holding securities that enables securities transactions to be processed by means of

book entries. Physical securities may be immobilized by the depository, or dematerialized so that they exist only as electronic records.

“Designation of Payment System” means the declaration of a payment and securities system as systematically important payment system based on defined minimum standards that designated systems will be expected to meet in order to adequately control systemic risk.

“DVP” (Delivery versus Payment). It is a link between securities transfers and funds transfers that ensures that final transfer of securities or other financial instrument occurs if, and only if payment occurs.

“IOSCO means the International Organization of Securities Commissions”. The organization has the principles/recommendations to be adhered to in order to achieve safety, effectiveness and efficiency in securities training

“LSW” (Lesotho Wire) this is a Real Time Gross Settlement System for Lesotho Inter-bank exchanges that facilitate continuous settlement of large value transfers of funds instructions in central bank money on a gross basis.

“NPS Act” means the proposed National Payment System Act.

“Payment Systems” means a set of instruments, banking procedures, telecommunication networks and typically inter-bank funds transfer systems that ensure the circulation of money.

“Participant” means designated payment systems and institutions that participate in those systems.

“PVP” (Payment versus Payment). It is used to describe wholesale foreign exchange transactions market in which one side receives value if and only if the other side does.

“RTGS” (Real Time Gross Settlement System) - This is a transfer system in which the settlement of funds or securities transfer instructions occur individually (on an instruction by instruction basis) without netting on a continuous basis throughout a business day.

“Securities Settlement System” means the full set of institutional arrangements for confirmation, clearance and settlement of securities trades and safekeeping of securities.

“SIPS” (Systemically Important Payment System) - A System is likely to be of systemic importance if at least one of the following is true:

- It is the only payment system in the country or the principal system in terms of aggregate value of payment
- It handles mainly payments of high individual value or
- It is used for the settlement of financial market transactions or the settlement of other payment systems.

“System operator” means an Entity authorized by the Bank to operate a designated system.

“System Oversight” means all activities by the bank to influence the architecture, the rules and business conduct of payment system and securities settlement systems principally intended to promote the smooth functioning of payment systems and to protect the financial system from possible ‘domino effects which may occur when one or more members in that system incur credit or liquidity problems.

“Systemic risk” means the risk that the inability of one or more of the participants in a payment system to meet its obligations or a disruption in

the system itself, could result in the inability of other system participants or financial institutions in other parts of the financial system to meet their obligations as they become due. Such a failure could cause widespread liquidity or credit problems and as a result could threaten the stability of the system or of financial markets.

“Zero Hour Rule” means provisions in the insolvency Act that gives retroactive effect to insolvency pronouncements by a court of competent jurisdiction. The effect of the zero hour is when an event is specified to have occurred on a particular day, that event takes place at the earliest point in time after midnight on that day. For instance, if a court orders the winding up of a company at 2pm on a particular day, the winding up is deemed to have commenced one second past midnight on the day that order is made. Therefore, any transactions entered into by the company before 2pm that day can be rendered void. This rule gives a liquidator ability to challenge the results of netting arrangements through which such payments were made with possible catastrophic results.