

License Application Review Procedures, Responsibilities and Criteria

Introduction

This document will provide a guide for the review and assessment of an application for operation of a payment system. It will also provide criteria for the assessment of payment system provider applications. The payment system licensing process requires understanding of the required policies and procedures for operation of a safe and efficient payment system and a strong working knowledge of both the existing payments environment and the areas of payments that represent strong potential for growth in Egypt. Proficiency is required in these areas to ensure an effective licensing regime. The goal of the process is to put in place payment system providers that provide services commensurate with the needs of the participants that are sustainable over the long term.

The document recommends a cooperative relationship between the Banking Supervision Department (BSD) and the Payment System Department (PSD) to ensure consistency in oversight and regulation. Broadly, the role of BSD is to regulate and supervise the policies, procedures and provisions for risk mitigation employed by banks in the processing of electronic payment instruments. The responsibility of PSD is on the licensing, oversight and regulation of the payment service providers that offer services to banks and others for the processing of electronic payment transactions. Coordinated scrutiny of both will help to ensure that the practices, policies and operations of banks and payment system providers are well understood. In the licensing stage, support from the licensing section of the BSD will be helpful in the initial phases as capacity is built. Longer term, this will be the sole responsibility of the PSD.

The following identifies the opportunity for the PSD and the licensing section of BSD to work together and proposes when and how they will cooperate. The balance of the document is focused on the criteria for assessment of a license application for the operation of a payment system.

Application Process Steps

1. Prospective payment system supplier requests application (PSD)
2. Application is submitted to the CBE Payments Department (PSD)
3. Application is reviewed to assure completeness (PSD)
4. Applicant management team presentation is scheduled and performed (PSD, BSD)
5. Assessment process takes place (No more than 60 days from receipt of completed application) (PSD, BSD)
6. Provisional granting of license or rejection of application (PSD)
7. Completion of final requirements and provisions including on-site inspection (PSD)
8. Final granting of full license (PSD)

Assessment Guidelines

The following are a recommended set of guidelines for the review of retail payment system providers' applications for the provision of retail payment services. Application of these

guidelines will enable the assessment team to more objectively assess the qualifications of each applicant. The assessment should be based on both the written application and meetings with the management committee of the applicant. The results of this review will enable the team to determine whether approval for a license should be granted on a provisional basis and what additional requirements need to be fulfilled for the granting of a full license. Alternatively, if the team determines that rejection of the application is appropriate, the guidelines will assist the team in developing the response that details the reasons for rejection. The guidelines are based on the licensing methodology and will be addressed on a subject by subject basis. The categories of assessment are as follows:

1. Ownership and Organization
2. Business Plan
3. Financials
4. Policies
5. Operational Procedures
6. Compliance
7. Audit
8. Systems including Disaster Recovery and Business Continuity Planning
9. Human Resources

Background

To date, there has not been a licensing or supervision process for retail payment service providers in Egypt. This methodology will support the licensing process for applicants. This is the first step in the initiation of an oversight process for new and existing service providers.

The goal of this review procedure is to determine the extent to which the service provider is capable of providing safe, secure and efficient payments processing. This means the entity must demonstrate it has a sustainable business plan, suitable shareholders, adequate financial strength, sufficient expertise and the integrity to operate the payment service in a sound and prudent manner. This is the spirit of the license regulation and should be the intent of the review/inspection procedure.

At the outset, the licensing process should be focused on the existing payment system service providers. The approach with the existing service providers should be assessment of their current offerings, procedures and processes with the goal of making recommendations for improvement where necessary. While it is possible, it is unlikely that one of the existing service providers would be denied a license. It is recommended that in addition to following the assessment process described in this document, it would be appropriate to survey the existing customer base to elicit comments regarding their performance and practices of the existing providers. Such a review should start with interviews of existing participants to ascertain the:

1. Quality of the service
2. Effectiveness of the provider in resolving issues including the status of any outstanding problems
3. Responsiveness to customer inquiries

4. Level of adherence to the Service Level Agreement (SLA), if it exists
5. Participants understanding of contingency measures in the event of a disruption of service
6. Participants understanding of risks associated with participation in the payment service
7. Effectiveness of the service provider policies and procedures

This review should be conducted with a minimum of five participants and documented prior to the visit to the service provider. This will help identify issues that may require clarification by the service provider. The PSD should provide this input prior to the initial meeting so that the service provider can address the issues raised and propose remedies as appropriate.

Defined below is the recommended process and criteria to be followed in the assessment process. The information provided by the existing service providers will be used to build a profile that will need to be maintained and updated over time.

License Methodology and Review Criteria

1. Ownership and Organization

a. General Information

- Signed memorandum of agreement and articles of association

(This is a matter of receiving a signed copy of their articles of incorporation to confirm the organization is legally registered. This should be maintained in the provider profile.)

- Incorporator' minutes of the meeting that include the election of the Incorporators committee that shall supervise the establishment procedures and the authorized signatories during the establishment.

(Corporations are required to hold a meeting to establish the procedure and authorize the signatories to apply for the license. This process must be documented in the meeting minutes. The CBE must obtain a copy of the minutes for documentation purposes. This should be maintained in the provider profile.)

b. Incorporators Information

- Data regarding the management body and the operator of the payment system, i.e. business name, registered address, Investment Authority registration number, amount of registered capital and the subject of business or activities.

(This should include the details of the business including the registration number from the Investment Authority and the amount of registered capital and the Bank(s) in which it is held. This should include a one page description of their existing or planned business activities that can be easily understood. This information should be maintained in the provider profile.)

- Details on the owners (including major shareholders and Board of Directors) and participants and a plan for the organization and operation of the system, including the distribution of responsibilities of tasks between banks participating in the system.

(The applicant needs to provide detailed information regarding the owners, shareholders, Board of Directors and senior management team. They must provide for each individual their name, date of birth, business address, contact information, CV's, references and clearance from both the tax and police boards. They also need to provide a detailed plan for the organization that provides names of senior managers along with their CV's. This should include responsibilities and the extent of their decisioning authority. The goal of this process is to determine if the people listed are in fact qualified and reputable. References must be checked with previous employers as well as other boards. This information should be maintained in the provider profile.)

The persons proposed by the incorporators should use the following guidelines for the selection of the senior management and the management body. Professionally qualified shall mean:

- i. That persons proposed as members of the management body and the operator of the payment system and as managers reporting directly to the management body must have:
 - a. completed their higher education in the subject required for the professional conduct of their function,
 - b. have a minimum of five year's management experience working in the area of payment systems, the banking sector or other payments related enterprise.
- ii. For persons proposed as members of the management body and as managers directly reporting to the statutory body, the Central Bank of Egypt may also accept as a professional qualification demonstration of significant knowledge of payment systems or in the banking sector and the completion of secondary professional education.
- iii. For persons proposed as members of the supervisory board of an operator of the payment system professionally qualified shall mean adequate knowledge and experience of the banking sector or other financial sector.
- iv. A person of probity shall mean a person not found guilty of a criminal offence, of negligence committed with regard to the exercise of a management position or of a premeditated criminal offence; these facts shall be attested and documented by an extract from the criminal records register not older than three months; and if the person is a foreign national, these facts shall be attested and documented by a similar certificate of probity issued by the competent body in the state of his residence.
- v. The following details need to be provided for each of the senior managers and major shareholders:

- a. Full name, address, contact details, legal status, of applicant’s firm (where applicable)
- b. Curriculum Vitae
- c. Income Tax Department Clearance
- d. Police Department Clearance
- e. Reference Letters

(The applicant must be able to prove to the licensing committee that the people they have chosen to run the operation have sufficient depth of knowledge and expertise to effectively operate a payments service. This information should be maintained in the provider profile.)

2. Business Plan

- A business plan shall be attached with the application including the following data and information:
 - i. Full description of the payment service activities the applicant intends to offer. For each activity, the applicant must fully describe the clients, the specified products and services and the scale of activity. The plan should detail competitive advantages and how this fits with current and future market conditions.

(This is an extremely important part of the application. They must be able to prove that there is a real and viable business case for their existing or planned venture. The description of the planned services must be substantiated with a clearly identified need that will be filled by the services offered by the applicant. They must be able to substantiate the basis for an on-going sustainable enterprise in both business terms and financial terms. The CBE must be thoroughly knowledgeable of the existing market to make a qualified assessment of the business proposal. Based on this knowledge, the CBE must assess the need for the payment services proposed by the applicant. If there are other providers in the same area who are not running at capacity, one should question the need for another provider in the same space. On the other hand, if the applicant has proposed providing payment services for a new and growing sector like that of debit and credit transfers, that should be viewed with strong potential assuming they can also demonstrate that they can put the appropriate people and systems in place. This information should be maintained in the provider profile.)

- ii. Details of the applicant’s business plan for the next twelve months for the commencement of activities. This should include the pro forma financial statements and projections of funds required to support the organization over this initial period.

(The applicant needs to provide a logical and achievable plan for the first year of operation. The focus should be on ensuring that the goals are not overly aggressive, but in fact can be realized. Determination of what is feasible will be based on staffing, systems, participants and market fit. If the applicant is attempting to solve a short term need that is highly focused for which they already have interested clients, this will require a different type of assessment than an applicant that is seeking to position

themselves in the market in anticipation of future needs. Financials must be presented so that the committee can determine what funds flows will look like in the first year. The applicant must have sufficient funding to cover the start-up process until such time as sufficient revenues are realized to make the entity self sustaining. This information should be maintained in the provider profile.)

- iii. Details of the business plan for the first five years including financial statements for the period and additional services that are planned during this period.

(It is crucial for the granting of a license that the applicant demonstrate how the entity will progress from a start-up to an on-going sustainable business. The business plan must demonstrate how the business will grow and how the business will adjust to the inevitable changes that will occur in the industry over the period of five years. The committee should ask a series of “what if” questions that provides some indication as to how the entity will adjust to changing market conditions and to ensure that it has sufficient breath to handle these unanticipated changes. One would generally expect the organization to become profitable by year three or four at the latest. The committee must ensure that there is sufficient funding in place to carry the entity through the initial stages. The use of “what if” questions are highly applicable to the discussion of sustainability. These would be asked at the review committee meetings in which the applicants present their business plan. These questions would be developed based on the review and assessment of the original plan submitted with the application. An agenda has to be developed in advance of the applicant presentation to ensure that all questions are answered during the meeting. This information should be maintained in the provider profile.)

3. Projected Financial Statements

- The applicant must submit *pro forma* financial statements for each year of the first five years of operation. The financial statements must include the following:
 - i. Sources and uses of funds
 - ii. Projected cash flows
 - iii. Estimated income and anticipated expenses
 - iv. Assumptions used in calculating the estimations listed above

(The financial statements must substantiate the business plan. They must clearly show how the entity will become a viable profitable entity over the long term. The cash flows must demonstrate there is sufficient funding in place to carry the organization through to profitability. Often the projections are made based on an overly optimistic view that assumes things go according to plan. It is the role of the committee to test the assumptions and as suggested above, play out “what if” scenarios assuming that things will likely change from the original plan. This information should be maintained in the provider profile.)

4. Policies (All of this information should be maintained in the provider profile.)

- The applicant shall provide clearly written drafts for each of the policies or procedures listed below.

- i. The criteria established for direct and indirect participation in the system. If participation in the system is conditional on membership or capital contributions, the application should also specify these conditions,

(The applicant must state the rules and basis for participation of both direct and indirect participants including any fees associated with membership.)

- ii. The principle of operation of the payment system (real time, net, etc.),

(This section defines the type of clearing and/or settlement that will be performed by the system. It should also indicate the limits of the system.)

- iii. The draft rules or rules of the payment system, including liabilities, fees, etc.,

(The applicant must present a comprehensive listing of the rules associated with participation in the system. This should include rules for the participant and the operator. It should also cover the process for resolution of issues. This is typically provided in the form of an agreement between the operator and the participant. In addition, the participant must fully understand all fees, penalties and other charges that can be levied by the operator.)

- iv. The operation schedule of the payment system,

(This should contain a description of the operating schedule including start of day, close of day, etc. and any exceptions, if appropriate and under whose authority exceptions are granted.)

- v. An analysis of the risk and measures to limit risks in the system arising from illiquidity or insolvency of participants in such systems including capacity to manage risk,

(This is a particularly important to the CBE as the primary goal of the licensing process relates to the minimization of risk. The committee and the participant need to understand the risk associated with participation in the system. Many retail systems utilize loss sharing mechanisms requiring the pledging of collateral; some set limits based on the assessed creditworthiness of the participant and other apply both principles. It is most important to avoid the possibility of having to “unwind” the day’s transactions. It is also important to understand what rules exist regarding insolvency. Is there a bankruptcy law in place that defines how creditors obtain restitution and if laws like the “zero hour” exist which limit participant liability to the

beginning position at the start of day. All of these need to be made clear to the participant. The evaluation committee must protect the rights of the operator and the participant.)

- vi. The measures to safeguard technical operations, including a contingency plan in the event of any operational disruption should the ordinary system fail to function,

(The applicant must demonstrate to the committee that they have a disaster recovery site including network and systems with procedures that are well understood internally. Plans must exist for the testing of the back-up site and back-up of data on a periodic basis. Security procedures such as entry into the computer room and logging of activities are important procedures for ensuring good operational security. A business continuity plan must also be in place that is comprehensive and practical for the operator and the participants.)

- vii. The measures taken to secure the protection of electronic processing and the storage of data relating to the system of payments against disclosure, misuse, damage, destruction, loss or theft,

(As stated above, this is largely based on a detailed set of procedures that are documented and reviewed by the operator.)

- viii. A declaration of the applicant that the submitted application and data contained in the application including its annexes is up-to-date, accurate and complete,

(Self Explanatory)

- ix. The place and date of the preparation of the application and the officially authenticated signature of the statutory body of the applicant.

(Self Explanatory)

- x. Principles of linkage to systems for payment services and other funds transfer between customer accounts.

(It is necessary to define what systems outside those of the operator will be involved in the payments process. For example, settlement may occur over the RTGS system or in the case of Visa settlement; Bank MISR is responsible for settlement amongst the banks.)

- xi. A payment system management body shall establish the following operational arrangements:

- a. rules and procedures setting out the rights and liabilities of the operator and the participants and the financial risks the participants may incur;
- b. system rules shall stipulate:

1. the operator of the payment system,
2. the settlement agent of the payment system and the method for ensuring the finality of payments,
3. the participants in the payment system,
4. the conditions for participation in the payment system and the conditions for exclusion from the payment system,
5. the rights and obligations of the participants and the operator of the payment system,
6. the method of transmission and delivery of payment instructions, their form and structure,
7. the method of transmission and the form of payment instructions and settlement instructions,
8. the method of securing data against misuse,
9. the method of settlement of payment instructions submitted to the payment system,
10. the principle of operation of the payment system,
11. the moment of acceptance of an order by the payment system, the period during which the payment system will accept orders, and the time when payment instructions become irrevocable,
12. the currency or currencies in which the payment system operates,
13. the point of time when the settlement is considered final and irrevocable
14. arrangements to permit settlement to be made in the event of the failure of a participant;
- xii. procedures, controls and measures for the management of credit, liquidity and settlement risk, including rules determining the time when a payment instruction and a settlement is final;
- xiii. criteria for participation in the designated payment system;
- xiv. measures to ensure the safety, security and operational reliability of the designated payment system including contingency arrangements; and
- xv. measures to ensure that the payment system will not lead to a monopoly in providing services and will not violate rules of monopoly in Egypt.

(Self Explanatory)

5. Operational Procedures (All of this information should be maintained in the provider profile.)
 - The applicant needs to provide detailed explanations of its operational procedures that will assure the Central Bank of Egypt that its operational regime will ensure safe and reliable processing of payments.

(This must also include security procedures taken by the operator. Operational procedures should document all procedures and processes that take place from the beginning of the day at system start-up to end of day shutdown.)

6. Compliance Arrangements (All of this information should be maintained in the provider profile.)

- The applicant must provide documentation demonstrating what processes will be put in place to ensure conformity with the standards and regulations defined as part of the regulatory regime of the Central Bank of Egypt.

(In addition to the procedures, the applicant must state who will be responsible and how compliance information is reported and authenticated.)

7. Internal Audit (All of this information should be maintained in the provider profile.)

- Details of the internal audit function including structure, scope, reporting lines and the regularity of reporting must be provided as part of the application.

(This is similar to the discussion above regarding compliance. The main goal here is to determine who is responsible for auditing the compliance of the organization's rules, procedures and accounting processes. In some cases, the entity may have an external audit performed. The CBE should have access to any external audit reports.)

8. Systems Plan including Business Continuity Plans (All of this information should be maintained in the provider profile.)

- An overview of the Information Technology functions, including scope, structure and reporting lines with an attached organizational chart must be documented and presented as part of the application.
- Detailed descriptions including the systems, networks, system design and architecture and the application functionality of each of the systems used to support the processing of payments.
- Plans and procedures must be presented and documented for the development and testing of application software used in the processing of payments.
- A plan must be presented that details the information security that will be put in place including responsible individuals, organization, policies and procedures to ensure a highly reliable and secure processing environment for payments.
- A description of the clearing and settlement (if appropriate) procedures and controls and the designation of the person responsible for maintaining the procedures.
- A description of the procedures that will be implemented to mitigate credit, liquidity, systemic and operational risk.
- A business continuity plan must be provided which includes disaster recovery and back-up arrangements for all systems involved in the processing of payments.

(Self Explanatory)

9. Human Resources

- A human resource plan must be prepared and submitted that details current staffing requirements and anticipates future needs. This should include plans for ongoing training and development of personnel.

(This is particularly important given the general lack of experienced payments people in Egypt. It is likely that most organizations will need to build expertise and experience on their own or through training received from organizations outside Egypt. The committee should have a clear picture of how applicants will ensure a professional and experienced staff capable of delivering safe and secure services.)

Licensing of the Existing Payment Service Providers

The basic process described above will be similar for licensing the existing payment system service providers. The licensing of the existing providers will enable the CBE to gain needed experience in the licensing process and a thorough understanding of their service offerings and longer term plans. The process for the existing providers will be as follows:

1. Ownership and Organization – Documentation of the Existing Organization
2. Business Plan – Focus is on 1 Year and 5 Year Plans
3. Financials – Review of Previous Financial Statements with Five Year Projection
4. Policies – Documentation of Existing Policies
5. Operational Procedures – Documentation of Existing Procedures
6. Compliance - Review of Compliance Procedures
7. Audit – Review of Audit Procedures
8. Systems including Disaster Recovery and Business Continuity Planning – Review of Current Systems and Practices
9. Human Resources – Review of HR Policies and Internal Training

The goal of the process will be to make an assessment of the business plan for the coming years (Next 5 Year Plan), historical and projected financials and current practices. The result should be a series of recommendations for improvements as appropriate based on the results of the review process. As with the licensing of new payments providers, we will expect a completed application, presentation and on-site inspection.

These reviews of the existing providers are important because they help us understand the state of the current retail payment business. As a result, we understand who has been successful and the longer term plans for each of the providers. This enables us to have a clear picture of the industry with the insight to determine where the CBE wants to encourage the introduction of new payment system providers. The secondary benefit of this process is the detailed understanding that will be gained by the Payments Department of the services and operations of each. This will prepare the payments group for the submission of new payment system provider applicants. Applications for new licenses should not be entertained until the existing service providers has been reviewed and documented.