

## Payment Systems

10.1 The payment system is a key element of the financial infrastructure that facilitates efficient functioning of the financial system. Under Article 26 of the Bangladesh Bank Order, 1972 Bangladesh Bank through its Department of Currency Management & Payment Systems performs core functions relating to issuance of notes and coins and management of currencies in circulation. Although there is no specific reference in the Bangladesh Bank Order, the BB as all central banks do, accepts the responsibility for payment systems, driven not least by its concerns for the stability of the currency and financial system and the efficiency of the monetary policy operations.

### Modes of Payments

10.2 Owing to its intrinsic convenience, cash continues to be the predominantly used medium of transactions in Bangladesh. Bangladesh Bank makes efforts to satisfy transaction demand for currency through a steady flow of currency notes and coins of all denominations. The domestic cheque system is the second most important payment medium for national payments. Cheques and payment orders drawn on commercial banks are widely used by the industrial and commercial sector and to a lesser extent by individuals. Cheques drawn on Bangladesh Bank are used by commercial banks, mainly for inter-bank transfers and for government payments, which are considered as large value transactions. The volume and value of cheques have grown steadily over the years.

10.3 Table 10.1 presents the volume and value of cheques cleared and settled in Dhaka city during 2000 - 2006. The figures include both the normal clearing and from 2003 onward the same day clearing, which is for large value

**Table 10.1 Volume and value of cheques cleared through Dhaka Clearing House\***

Year	Number of cheques/ instruments	Amount (in million Taka)	Daily average value (in million Taka)
2000	6,687,756	1,107,189.16	4,193.90
2001	7,158,541	1,271,462.27	4,816.14
2002	8,178,496	1,471,313.41	5,091.05
2003	9,015,798	1,676,847.12	6,013.28
2004	10,055,817	2,090,179.99	7,085.63
2005	12,395,130	2,595,833.06	8,710.85
2006	12,957,114	2,977,493.11	12,202.84

\* Revised data including the same-day clearing.

transactions. In 2006, the number of cheques passing through the normal clearing rose slightly, as did the average value of cheques. Same day cheques, however, increased by 30 percent, while the average value per cheque increased by 2 percent to 5.5 million Taka as compared to only 165 thousand Taka for a cheque in the normal clearing. Thus most of the increase in the overall value of cheques clearing was due to increase in the number and value of the same day clearing.

### Payment Settlement Systems

10.4 There are four payment and settlement systems operating in Bangladesh. They are: (a) Bangladesh Bank's Clearing Houses in Dhaka and its branches in seven other cities; (b) Sonali Bank's Clearing Houses in 31 towns where there are no BB branches; (c) the BB large value cheque settlement system; and (d) the Bangladesh Bank Foreign Currency Clearing System in Dhaka which clears and settles foreign currency cheques and pay orders.

10.5 There are four clearings each day at the BB's clearing house in each branch. The first

clearing starts at 9:30 a.m. and returns of the first clearing are at 5:30 p.m. The Same Day clearing starts at 11.00 a.m. and returns occur at 2.00 p.m. The instruments cleared through the clearing houses are cheques, bank drafts, pay orders, dividend warrants, etc. drawn on commercial banks and BB. Except Barisal and Rangpur offices, other branch offices of BB have a computerized settlement process where the commercial banks, in addition to the physical instruments, present diskettes that contain each bank's paying obligations and receivables from other banks. Compared to the volume in Dhaka and Chittagong, the cheques cleared in outstation branches are insignificant.

10.6 Apart from non-cash payment instruments like cheques, drafts etc. card-based payments, which include credit card, debit card and ATM transactions are gaining popularity gradually. The commercial banks and the business community are trying to promote the use of credit and debit cards for point of sale transactions and direct debits. The use of such payment instruments, however, is popular in the urban areas only and the volume of such transactions is yet to reach a significant level.

### **Developments in Payment Systems**

10.7 The present payments and settlement system in Bangladesh is not at par with international best practices which emphasizes on safe and secured payments and settlements and the reduction of the gap between payments and settlement. Under the present clearing system, customers can use funds on t+2 or t+3. The collections of cheques take much longer time to clear. However, with these changing and demanding times, more rapid payments need to be initiated. The current environment has led commercial banks to maintain idle funds solely for settlement purposes and beyond any economic or business purpose. This liquidity is a burden to the banks. Moreover moving funds from one place to another is expensive and results in poor liquidity management. Besides, there are many risks involved in end-of-day settlements. Based on the Core Principles for Systemically Important Payment Systems

recommendations by the CPSS, Bangladesh Bank is moving towards developing a safe and efficient payment system that is core principles compliant.

10.8 Over the past few years, Bangladesh Bank has been actively working on the development of modern payment systems in Bangladesh. Significant effort has been expanded in the review of existing systems with focus on the capacity building necessary to define a long-term strategy for payments in Bangladesh. Because of these efforts, two major initiatives are underway to advance the scope and usage of payment systems. The first is the planned automation of cheque processing and the second is the development of internal capacity and a long-term strategy for payment systems in Bangladesh. Both projects come under a programme entitled the "Remittance and Payments Partnership" (RPP) Project which is being funded through a grant from the Department for International Development (DFID), UK.

10.9 A Center for Payment Expertise (CPE) has been established for developing expertise on the core competencies for payment systems policy and operations through team-based, cross-disciplinary intense training programme on prevailing aspects of payment systems under active guidance of internationally experienced consultants.

### **Bangladesh Automated Clearing House (BACH)**

10.10 Bangladesh Automated Clearing House (BACH), the new automated cheque processing system, will be responsible for the processing of cheques, credit and debit payment instruments. The BACH will effect the installation of systems and processes that support modern automated cheque processing utilizing Magnetic Ink Character Recognition (MICR) and Imaging Technologies. The system is based on a centralized processing centre located in Dhaka and its branches in seven other cities. The system will support both intra-regional and inter-regional clearings. The proposed processes and

systems will conform to best practices for MICR and Imaging and will represent the most cost effective solution for cheque processing.

10.11 The ACH component of the Remittance and Payment Partnership (RPP) Project is managed and implemented in a "fast-track" manner, as it is expected to be the engine that will drive the remittance and payments process in promoting pro-poor economic growth. It establishes the infrastructure for a modern payments system, which could be part of a future "e-Government Gateway" to provide services to financial sector using the Internet. All activities are closely coordinated with relevant counterparts in the partnership: commercial banks, Bangladesh Bank, DFID, RPP teams for all three outputs (infrastructure, challenge fund and information campaign) to ensure an enabling environment. Due diligence and lessons learned from previous procurement efforts are applied to ensure transparency and level playing field. Appraisals are underway for establishing appropriate legal, regulatory and policy framework for ACH. This is a complex undertaking with considerable risks, but safeguards have been put in place to mitigate these risks. The selection of vendor is completed. Development of detailed implementation plans, business requirements analysis, base line study of existing infrastructure, gap analysis and finalization of ACH operational and technical requirements are underway to start BACH in Dhaka within the first-half of 2008. Project management and reporting mechanisms will be established and coordinated through a Programme Implementation Unit (PIU); focus groups will be established; linkages with key counterparts in private sector will be established; cross-support from legal, regulatory and policy subcomponents will be received to ensure ACH implementation.

### Implementation Timeline

10.12 The Cheque Design Standards were released in September 2006 with the requirement that banks comply with the new standards by 31 December 2007. The cheques will be Magnetic Ink Character Recognition

(MICR) encoded with information regarding the amount, transaction type, account number, bank information and cheque number. In addition, the information on both the front and the back of the cheques will be recorded with imaging. The standards incorporate international standards and proven designs based on the experiences of various countries.

10.13 The new cheque processing system will be in place by first quarter of 2008 with the roll out to begin when the new cheques reach a circulation of approximately 70 percent. It is anticipated that the system will commence operations in Dhaka soon thereafter with operations in Chittagang and the other regional locations to be phased in over the coming months. The goal is to have the system operating nationally by end 2008.

### Strategic Planning Initiative for Payment Systems

10.14 The RPP also has a long-term component which focuses on the building of payments expertise within Bangladesh Bank and strategies for the deployment of additional payment systems to support both the retail and wholesale needs of the country's financial markets. The strategy will include the expansion of card systems both debit and credit, Point of Sale (POS) systems for use by merchants and interbank payment capabilities to support the need for fast and secure debt and credit transfers. Special focus will be given to the need to provide payment mechanisms that support high value transactions such as the sale of securities or foreign exchange. The implementation of a Real Time Gross Settlement (RTGS) system will also be considered as part of this focus on payment systems.

### Legal Reform

10.15 Another facet of the payment modernization process focuses on the need to support these new systems with the legal and regulatory frameworks necessary to operate such systems in a transparent manner with high standard of governance.

10.16 CPE's Legal and Strategy Working Groups are working together to provide policy assistance to the National Payments Systems Council (NPSC) through its Working Groups with analytical and research assistance from the CPE. Legal Working Group has drafted a proposed Consumer Protection Act for Migrant Workers Remittances based on best practices established by the BIS and World Bank as part of its contribution to Output 3 of the RPP. This is a groundbreaking piece of legislation that will assist in bringing migrant workers and remittances under the legal protection of formal channels. It is completing a comprehensive report identifying legal reforms based on International Best Practices for Large Value Payments, Best Practices for Small Value and Retail Payments and Best Practices for Informal Systems. This report is being prepared in conjunction with a baseline assessment of the current payments related legal infrastructure in Bangladesh.

10.17 Legal Working Group also provides legal assistance to Output 2 - the Challenge Fund. Most recently that assistance came in the form of advising the Challenge Fund's assessment panel on issues related to the concept notes submitted in accordance with the Challenge Fund's grant requirements. In addition, the CPE legal working group is now undergoing legal training in payment systems law. This training will continue throughout the project period.

### **Regulatory Reform**

10.18 CPE's Regulatory Component has designed a specific team oriented regulatory training methodology for the strategic development of CPE's regulatory component. A number of Regulatory Training Assignments have been structured focusing on a broad array of regulatory topics covering payments systems, remittances, governance and risk management, AML, Foreign Exchange, Islamic Banking, Bank Licensing, and assistance to the Challenge Fund on regulatory issues related to the development of concept notes submitted for grant funding. CPE has completed and produced 15 comprehensive regulatory papers outlining the issues and suggested

recommendations for each completed Assignment. The remaining Assignments are in the process of completion.

10.19 In addition, it will assist Regulatory Working Group (RWG) as it evaluates how and in what form regulation for payments systems will be reflected. This will be accomplished in concert with Legal Working Group (LWG) and will address strategic questions such as: What form will the new payments system law take? What additional authority, if any, does BB need to regulate the systems? Where should BB's regulatory responsibilities begin and end? What new regulations will likely be needed to oversee retail payments and a rudimentary inter-bank clearing and settlements system?

10.20 The Regulatory Component will also focus the regulatory framework to support introduction of the ACH. This will not require an extensive amount of new regulation but will require that the cornerstones of payments system regulation be structured and developed in respect to regulatory authority, consumer protection, and oversight of payment systems operations. Throughout the CPE training exercises reference to best practices has been and will continue to be an integral part of our daily work.

10.21 Finally, as the regulatory development process proceeds, industry consultation will be approached in two phases: (1) the first phase will involve strategic outreach with financial sector leaders shortly after the formation of RWG. The outreach will include banks and MTO (Money Transfer Operators) representatives, and other NBFIs representatives; (2) the second phase will involve solicitation of market feedback on proposed laws and regulation. This outreach and feedback will be most helpful to RWG as BB further strengthens its working relationship with the financial sector and moves the regulatory process forward.

### **Remittances and Payments Challenge Fund (RPCF)**

10.22 The Remittances and Payments Challenge Fund (RPCF) is a £2.1 million (Taka

28 crore) risk-sharing grant facility which will stimulate and catalyze the innovation of new remittance and transfer products, improvements to existing remittance infrastructure, and use of remittances. Grants are awarded to part-fund commercial projects in the private and NGO sectors. The Challenge Fund grant award mechanism is a two-stage process whereby short concept notes are prepared by grant applicants and, following evaluation, applicants with concepts that are deemed meritorious prepare a full grant application. The process revolves around Challenge Fund Rounds, where all concepts received in a six month period are evaluated in competition with each other.

10.23 RPCF has a three tier governance structure: the RPP Project Oversight Board (POB), an independent Assessment Panel (AP), and the RPCF managers. The POB, under the guidance of the Governor of Bangladesh Bank, provides strategic direction for RPCF and is responsible for the selection of the members of the AP. The AP, under the Chairmanship of Bangladesh Bank, assesses concept notes prepared by grant applicants, selects projects that meet set criteria, reviews full grant applications and approves grants. The RPCF managers are responsible for the day to day management of the challenge fund, including awareness raising with potential grant recipients; and project cycle management, including helping applicants in the finalization of their project concepts, due diligence, grant contracting, grant payment management, grant project monitoring and assessment. The RPCF managers are assisted by other RPP experts who provide their observations on project concept notes and full grant applications.

10.24 The RPCF was formally launched in Dhaka on 28 March 2007, and the first Challenge Fund Round, focusing on current and potential remittance industry participants located in Bangladesh, was closed on 13 May 2007. 39 concept notes were received before the closing deadline and the AP selected 7 innovative

project concepts to take to the full application stage, which closed on 12 August 2007. All of the selected projects build partnerships between remittance industry participants and can be expected to significantly improve the processing of international and domestic remittances. It is intended that a major proportion of available challenge funding will be awarded in the first Challenge Fund Round, with plans to disburse the grants in the latter part of 2007 and early part of 2008. The next Challenge Fund Round will close on 11 November 2007, and will be targeted at the concepts which will improve the use of remittances and migrant country remittance process.

#### **National Payment Systems Council (NPSC)**

10.25 One major motivation for change, for improvement in payment systems in Bangladesh is the need to keep up with the rest of the world, to meet international standards and to have a national infrastructure that will support competition with the rest of the world. To improve the payment systems in Bangladesh, in particular the interbank payment system, will require the cooperation and coordination of many stakeholders, the banks, the private sector, relevant government ministries, the regulators, central bank, and Government as overseer. The National Payment Systems Council (NPSC), an essential central institution, was established this year for the improvements and promotion of payment systems for the national and public interests.

10.26 The NPSC is made up of representatives from selected number of banks and other significant stakeholders such as Ministry of Finance (MOF), Ministry of Commerce (MOC), Controller General of Accounts (CGA), Bangladesh Telecommunication Regulatory Commission (BTRC) and is chaired by the Deputy Governor in charge of the Department of Currency Management and Payment Systems, Bangladesh Bank. The NPSC will be the central vehicle for the transfer of information, on policy and practice, and of technology for payment



systems in Bangladesh. It will also be the vehicle for mobilizing resources, human, financial and physical, for undertaking payment system improvements. NPSC will workout the long-term strategy and implementation priorities for payment systems in Bangladesh. This will include all forms of payments from cheque processing to retail payments including card payments and ATMs to interbank payments. Provision will also be made for the settlement of securities and foreign exchange payments. The NPSC will establish working groups to undertake these tasks, in particular in the areas

of Legal, Regulatory, Automated Clearing House, and Payment System Strategy, taking representatives from Commercial Banks and Bangladesh Bank.

10.27 Immediate initiation of these projects with the results to be implemented over the next three years will have a significant impact on the financial sector in Bangladesh. At the end of that time, Bangladesh will be well on its way to establishing a sound payment system consistent with its neighbours and international standards.