

**Draft framework for recognition  
of a Self-Regulatory  
Organisation for Payment  
System Operators |  
*Submission to the Reserve Bank of  
India***

**September 2020**

# About Vidhi

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Vidhi Centre for Legal Policy (“Vidhi”) is a not for profit independent think-tank doing legal research to make better laws and improve governance for the public good.

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# Table of Contents

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About Vidhi.....	2
Table of Contents.....	3
Background.....	4
Our Submission.....	5
Setting the Context .....	5
Comments & Recommendations .....	6

# Background

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On 18 August 2020, the Reserve Bank of India (“RBI”) released a draft framework (“**Draft Framework**”) for recognition of a self-regulatory organisation (“**SRO**”) for payment system operators (“**PSOs**”). The Draft Framework proposes to recognise an SRO which will be a not for profit company that will be responsible for “setting and enforcing rules” for PSOs. For the purposes of this framework, a PSO has been defined to include “system participant”<sup>1</sup> and “system provider”<sup>2</sup> as defined under the Payment and Settlement Systems Act, 2007 (“**PSS Act**”). Notably, the idea for setting up an SRO was envisaged in the Payment and Settlement Systems in India: Vision 2019-2021 released by RBI on 15 May 2019 (“**Vision Document**”). Similar to the Draft Framework, the Vision Document envisages the need for a self-regulatory governance framework to foster best practices on aspects like security, customer protection, pricing, etc. The Vision Document contemplates an SRO that covers the entire gamut of digital PSOs, including retail products of National Payments Corporation of India (“**NPCI**”).

In setting out its rationale for an SRO model of governance, the Draft Framework notes that:

- (a) It is in the interest of optimal use of regulatory resources, that the payments industry develops industry standards in respect of system security, pricing practices, customer protection measures and grievance redressal mechanisms. This will release regulatory resources that can be better focussed on issues of systemic importance.
- (b) Industry standards will encourage better compliance by virtue of it being developed by the industry.
- (c) By designing standards that confirm to international best practices, the industry will be better served in global competitiveness.

The Draft Framework requires an SRO for PSOs to be recognised by the RBI. We understand that the SRO under the Draft Framework is envisaged to play a role in “supplementing and complementing the present regulatory / supervisory arrangements” and the RBI still retains all its powers under the PSS Act to issue standards, guidelines and directions in respect of payment systems or PSOs. Any standard or benchmark developed by the SRO should not be viewed as replacing existing regulatory directions. Given that currently under the PSS Act, only RBI is empowered to issue standards, guidelines and directions in respect of payment systems, it is pertinent to ensure that the SRO model should not be viewed as a delegation of such statutory powers of RBI to the SRO, which is impermissible under the existing law.

This submission sets out our comments on the Draft Framework released by RBI. To give context to our detailed comments on specific issues, this submission also sets out a general analysis of the SRO model of governance as set out in the Draft Framework. We hope that our comments and recommendations will be useful for RBI for finalising the SRO framework.

<sup>1</sup> Section 2(1)(p) of the PSS Act defines “system participant” as a bank or any other person participating in a payment system and includes the system provider.

<sup>2</sup> Section 2(1)(q) of the PSS Act defines “system provider” as a person who operates an authorised payment system.

# Our Submission

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## Setting the Context

The safe and efficient functioning of payment systems is critical to modern economies. This has been reaffirmed by the ongoing pandemic that has brought digital payments into sharp focus and has underscored the need for a resilient and scalable digital payments ecosystem. As we adjust to a new social order marked by the pandemic, the role of contactless payments is likely to assume more significance.

Traditionally, payment system regulators, which is mostly the central banks, have focused on systemic stability while regulating payment systems. However, technological disruption in the payments ecosystem combined with network externalities that the industry exhibits has led to a transformation of the industry, with new business models and players. Traditionally dominated by banks, the payments industry has been witnessing the gradual entry of non-banks. Therefore, other regulatory objectives relating to promotion of competition, innovation, and protecting and maximising consumer welfare have also assumed significance for regulators.

To realise such policy objectives, regulators may consider different regulatory designs ranging from pure command and control regulation (or government-imposed regulation)<sup>3</sup> to pure self-regulatory structure or a model of co-regulation which is a hybrid between command and control and self-regulation models. Co-regulation encompasses initiatives in which the government and industry share responsibility for drafting and enforcing regulatory standards.<sup>4</sup> India has so far witnessed a pure command and control framework for payment systems, with the PSS Act empowering RBI to regulate the payments industry. Pursuant to this, RBI has the power to issue standards, guidelines for the industry and also the power to enforce the same in case of non-compliance. Through the Draft Framework, RBI seeks to encourage the payments industry to develop standards and benchmarks through an SRO recognised by RBI that will complement and supplement the existing regulatory framework. The operation of the SRO will be subject to RBI oversight. In the Indian financial regulatory landscape, the SRO model has been adopted by Securities and Exchange Board of India (“SEBI”) through the SEBI (SRO) Regulations, 2004 (“SEBI SRO Regulations”)<sup>5</sup> and the RBI through the framework for SRO for Non-Banking Financial Company – Micro Finance Institutions (“NBFC-MFIs”)<sup>6</sup>. An SRO model of governance is not unusual for modern economies especially in sectors that are constantly evolving and are based on technical expertise.

Given the fast-evolving nature of the payments industry, many jurisdictions (such as Australia, Canada, Singapore and South Africa) closely work with industry associations while developing standards for the payments industry. However, the structure, scope and mandate of these associations vary. In cases where such associations are also responsible for operating payment systems (such as in Canada and South Africa), they are recognised under the statute. In case of Australia which has relied on a co-regulatory model of governance for the payments ecosystem, the regulator has entered into a memorandum of understanding with the industry association to outline their roles and mode of correspondence. Contrary to this, in Singapore, the payments association has been set up by the regulator and is headed by the chairperson of the regulator

The SRO model aspires to be dynamic and adaptable to markets, while at the same time being subject to regulatory oversight in areas of significance. **The Draft Framework correctly sets out the several advantages of this form of governance, which we are not reiterating in this submission for the sake of brevity.** However, in designing an

<sup>3</sup> This is the traditional form of regulatory structure where the government prescribes rules or lays down clear prescriptions through which it regulates industry participants. Non-compliance with these rules necessarily entails sanctions.

<sup>4</sup> Dennis D. Hirsch, ‘The Law and Policy of Online Privacy: Regulation, Self-Regulation, or Co-Regulation?’ 34 Seattle University Law Review 439 (2011), pp. 441 <<https://digitalcommons.law.seattleu.edu/cgi/viewcontent.cgi?article=2003&context=sulr>> accessed 15 September 2020; Hans-Bredow-Institut and Institute of European Media Law, ‘Final Report: Study on Co-Regulation Measures in the Media Sector’ (2006), <<https://www.hans-bredow-institut.de/uploads/media/default/cms/media/cd368d1fee0e0cee4d50061f335e562918461245.pdf>> accessed 15 September 2020

<sup>5</sup> Securities and Exchange Board of India, Self Regulatory Organizations Regulations, 2004 <[https://www.sebi.gov.in/legal/regulations/feb-2004/sebi-self-regulatory-organisations-regulations-2004-last-amended-on-march-6-2017-\\_34631.html](https://www.sebi.gov.in/legal/regulations/feb-2004/sebi-self-regulatory-organisations-regulations-2004-last-amended-on-march-6-2017-_34631.html)> accessed 15 September 2020

<sup>6</sup> Reserve Bank of India, ‘Master Circular- ‘Non-Banking Financial Company-Micro Finance Institutions’ (2015) <[https://www.rbi.org.in/Scripts/BS\\_ViewMasCirculardetails.aspx?id=9827](https://www.rbi.org.in/Scripts/BS_ViewMasCirculardetails.aspx?id=9827)> accessed 15 September 2020

SRO model it is also important that the regulator is cognisant of the challenges and concerns associated with SROs. This is critical so that the final framework has sufficient safeguards to minimise such concerns.

### **Taking into account the challenges of the SRO model of governance**

Perhaps one of the biggest concerns with an SRO model is the threat (potential or perceived) of conflict of interest that could arise if the industry participants that operate payment systems are also responsible for regulating it. Second, if incentives are not aligned properly, SRO designed standards may prioritise industry interests<sup>7</sup> at the cost of systemic stability and consumer welfare. *Third*, the balance between regulatory oversight and independence is also tricky. In creating such an oversight framework, care must be taken to avoid potential broadening of the RBI's role from oversight to supervision, direction, and policy making at the SRO level, thereby rendering the SRO as an agent of RBI for policy making. *Fourth*, such a model may also give rise to anti-competitive concerns. For instance, some payment systems may exhibit monopolistic trends. Coupled with network characteristics, such payment systems and their operators may enjoy a certain degree of market power, which may create potential or perceived risk of influencing the SRO. Therefore, internal processes should incorporate adequate checks and balances to ensure that the interests of such operators do not overshadow the interests of other stakeholders. Another concern is that well-established companies can use collaborative negotiations to establish standards that may benefit them or hinder entry of new firms.<sup>8</sup> *Finally*, from a legal perspective and specifically in the context of an SRO for PSOs which are currently regulated by RBI, it is important to ensure that the mandate of the SRO under the SRO framework does not overlap with RBI's power under the PSS as the same may be viewed as delegation of RBI's functions under the PSS Act, which is impermissible without an express authorisation from the parent statute.

Our detailed submission below takes into account the aforesaid challenges and concerns and seeks to suggest recommendations that can address these issues in the final framework.

## **Comments & Recommendations**

### **Clarity of Objectives and Guiding Principles**

The need to have an SRO in the Indian context has been justified by the Draft Framework and has already been highlighted in the 'Background' section of this submission. While the Draft Framework clearly sets out the RBI's rationale for introducing an SRO, it stops short of clearly setting out the broad objectives for the SRO framework. However, some of the objectives may be traced to the section on powers and functions of the SRO in paragraph 6 of the Draft Framework. It may be useful to clearly set out the objectives for setting up an SRO earlier, and the same should not be confused with the detailed mandate of the SRO. This will ensure that all stakeholders have a common understanding of the framework and will enable them to participate in the SRO in an informed and efficient manner. For instance, the Payments Council of Singapore has been established by the Monetary Authority of Singapore with the objective of encouraging collaboration within the payments industry, promoting interoperability among e-payments solutions and developing strategies to drive the pervasive adoption of e-payments.<sup>9</sup>

While the SRO should be allowed sufficient level of independence to discharge its functions, it may also be useful to set out certain good governance principles that should guide the functioning of the SRO. Such principles will be relevant to address some of the concerns already highlighted in the preceding section. These principles will also be relevant for RBI to assess if the SRO has been able to discharge its mandate effectively.

**Recommendation:** *The final framework should: (a) clearly outline the objectives of the SRO framework; and (b) delineate certain good governance principles that will guide an SRO in the discharge of its functions under the framework. In designing such principles, the RBI may consider the following: (i) the SRO should be required to adopt a fair, transparent, consultative and democratic process in discharging its functions; (ii) the SRO should ensure a fair representation of its*

<sup>7</sup> Dennis D. Hirsch, (n 4)

<sup>8</sup> DLA Piper, EU Study on the Legal Analysis of a Single Market for Information Society, 'New rules for a new age?' (2009) <[http://ec.europa.eu/information\\_society/newsroom/cf/document.cfm?doc\\_id=842](http://ec.europa.eu/information_society/newsroom/cf/document.cfm?doc_id=842)> accessed 15 September 2020

<sup>9</sup> Monetary Authority of Singapore, 'MAS Establishes Payments Council' (2017) <<https://www.mas.gov.sg/news/media-releases/2017/mas-establishes-payments-council>> accessed 15 September 2020

members in the management and administration of the SRO; (iii) the members of the governing board must be required to act independently and not as representatives of the organisation where they work; (iv) the SRO should ensure that standards designed by it do not cause uncompetitive situations or grants undue advantage to certain interest groups; and (v) the SRO should ensure that in discharging its functions it complies with existing regulatory framework under the PSS Act, including directions issued by RBI. The SRO should be given the liberty to implement such principles through different provisions in its bye-laws and governance processes. For instance, the transparency principle highlighted in (i) may be implemented by the SRO through publication of governance processes, standards, benchmarks, etc., engagement with the concerned stakeholders for finalising such standards, a process for reviewing such standards, etc. A consultative approach may be adopted through a formal consultation policy for designing its standards and benchmarks. Fair representation of members as highlighted in (ii) may be assured through norms governing elections to the board and committees of the SRO. Similarly, to ensure that standards and benchmarks designed by the SRO is in line with the existing regulatory framework, consultation with the regulator prior to finalisation of standards and benchmarks may be considered.

## Legal Sanctity

The Draft Framework stresses that an “ideal SRO” must have the “legal authority to enable it to set policies / standards and enforce them on industry participants.” Therefore, the authority for recognising the SRO, its powers to issue and enforce standards against members and its decisions must be legally sanctioned. This is necessary for the effective enforcement of the SRO framework and to get a buy-in from the industry.

**Recommendation:** The final framework of recognising the SRO for PSOs should clearly refer to the statutory power that has been relied on by RBI for issuing this framework. This will give necessary legal sanctity to this framework.

## Eligibility of SRO

The Draft Framework sets out the eligibility criteria for grant of recognition as an SRO, including requirements relating to incorporation as a not for profit company under section 8 of the Companies Act, 2013, membership of the SRO, bye-laws and adequate infrastructure to discharge functions. In prescribing the eligibility conditions, the Draft Framework does not refer to any capital or net worth requirements of the SRO. Such a condition may be considered to ensure that the SRO is able to discharge its functions efficiently without being solely dependent on member fee. This issue has also been addressed in the RBI SRO framework for NBFC-MFIs, which requires that the proposed SRO has adequate capital to discharge its functions. Similarly, the SEBI SRO Regulations also prescribe a net worth requirement for an applicant. Further, while the Draft Framework specifies that the board of directors and management of the SRO is required to meet the fit and proper person criteria specified by RBI, contrary to RBI’s usual practice, such fit and proper criteria is not set out in the framework.

**Recommendation:** The RBI may consider specifying the following in the final framework: (a) capital / net worth requirement as one of the criteria to determine the eligibility of an SRO; and (b) detailed fit and proper criteria for the management and board of directors to provide clarity to prospective applicants.

## Membership of SRO

Any group or association of PSOs desirous of being recognised as an SRO by the RBI is required to have a majority of the relevant industry segment it seeks to represent (in terms of number / volume / value) as its members. The membership of an SRO must be broad based and accurately reflect the industry interests.<sup>10</sup> To ensure effective implementation of the standards designed by the proposed SRO, a buy-in from all actors across a payments value chain (banks, authorised payment system operators and non-banks) will be necessary. The provisions relating to the membership of the SRO raises the following issues:

- (a) The membership of RBI in its capacity as a payment system operator of wholesale or large value payment systems must be clarified.
- (b) The term PSO has been defined to include both payment “system participant” and “system provider” as defined under the PSS Act. Given that the Draft Framework adopts an inclusive definition for PSOs, it may be clarified if there are entities other than system participants and system providers that can become

<sup>10</sup>International Council of Payment Association Chief Executives ‘Principles of Payments Industry Self-Governance’ (November 2007) <[http://13.70.137.214/docs/policy-debate/icpace\\_principles\\_07.pdf](http://13.70.137.214/docs/policy-debate/icpace_principles_07.pdf)> accessed 15 September 2020

members of an SRO. We understand that the SRO will include banks as its members. However, it may be useful to clarify the participation of non-bank entities such as third-party app providers in the UPI ecosystem, payment gateways, technology service providers, etc. as members of the SRO.

- (c) The title of the Draft Framework read with para 1.3 indicates that the RBI seeks to recognise one SRO for the payments industry. However, the eligibility criteria that requires an SRO to represent the industry segment, raises a question if the RBI is considering different SROs for different industry segments within the payments ecosystem.<sup>11</sup> Therefore, the final framework may clarify the number of SROs the RBI seeks to recognise under this framework.

**Recommendations:** *The final framework should clarify the following: (a) the participation of RBI in the SRO as an operator of payment systems; (b) the number of SROs that RBI intends to recognise; and (c) clarification on membership of entities other than system providers and system participants in the SRO, including membership of non-bank entities (as referred to above).*

## Scope of Activities

For efficient functioning of an SRO, it is necessary that there is no duplication of the work performed by the SRO and the regulator.<sup>12</sup> As discussed above, this is also necessary to ensure that the SRO model is viewed as a delegation of RBI's powers under the PSS Act. This is possible by clearly delineating the role of the regulator and SRO vis-à-vis industry standards and guidelines. While delineating the functions and obligations of a recognised SRO, the Draft Framework envisages the SRO to set out minimum benchmarks and standards. Currently, the power to issue guidelines, standards, or directions in respect of payment systems vests with RBI under section 10<sup>13</sup> read with section 18<sup>14</sup> of the PSS Act. Exercising such powers, RBI has already issued different directions relating to customer protection, merchant discount rates, system security to system providers.<sup>15</sup> The SRO framework is intended to supplement the existing legal and regulatory framework. Therefore, in designing the mandate of the SRO, due consideration must be given to ensure that such mandate does not overlap with regulatory mandate of RBI under the PSS Act for reasons already discussed above.

**Recommendation:** *First, the final framework should clearly outline the scope of activities of the SRO. It may be useful to provide an indicative list of areas where the SRO is expected to come out with benchmarks and standards. This may include standards already specified in the Draft Framework such as security standards, pricing practices, customer protection measures, grievance redressal mechanisms, etc. to the extent it does not interfere or conflict with standards already issued by RBI in this regard or RBI's power under the statute. In particular, technical standards for interoperability may be considered by RBI to be within the mandate of the SRO. Second, the final framework should also require the SRO to ensure that standards or benchmarks designed by it are consistent with the existing regulatory framework. Third, the final*

<sup>11</sup> Currently, the list of 'Payment System Operators' released by RBI informally categorises payment system operators as Retail Payments Organisation, Cards Payment Network, Cross border Money transfer, ATM networks, prepaid payment instruments, Trade Receivables and Bharat Bill Payments System. RBI 'Certificates of Authorisation issued by the Reserve Bank of India under the Payment and Settlement Systems Act, 2007 for Setting up and Operating Payment System in India' (25 August 2020) <<https://www.rbi.org.in/scripts/publicationsview.aspx?id=12043>> accessed 15 September 2020

<sup>12</sup> Report of the SRO Consultative Committee of the International Organization of the Securities Commissions, 'Model for Effective Regulation' (2000) <<https://www.iosco.org/library/pubdocs/pdf/IOSCOPD110.pdf>> accessed 15 September 2020

<sup>13</sup> Section 10(1) empowers RBI to prescribe format of payment instructions, timings to be maintained by payment systems, manner of transfer of funds, such other standards to be complied with payment systems generally, membership criteria of payment systems, etc. Section 10(2) empowers RBI to issue such guidelines as it may consider necessary.

<sup>14</sup> Section 18 empowers the RBI to on the regulation of payment systems and issue necessary directions for this purpose on the conduct of business relating to payments systems to system providers or participants, generally or specifically to individuals or agencies. Such policies or directions may be issued in public interest, or to enable the RBI to regulate payment systems, or in the interest of managing or operating payment systems.

<sup>15</sup> See Reserve Bank of India, 'Customer Protection – Limiting Liability of Customers in Unauthorised Electronic Payment Transactions in Prepaid Payment Instruments (PPIs) issued by Authorised Non-banks' (2019) <<https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11446&Mode=0>> accessed 15 September 2020; Reserve Bank of India, 'Online Dispute Resolution (ODR) System for Digital Payments' (2020) <<https://www.rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=11946>> accessed 15 September 2020; RBI, 'Rationalisation of Merchant Discount Rate (MDR) for Debit Card Transaction' (2017) <<https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11183&Mode=0>> accessed 15 September 2020; RBI 'Master Direction on Issuance and Operation of Prepaid Payment Instruments' (updated in 2020) <[https://www.rbi.org.in/ScriptS/BS\\_ViewMasDirections.aspx?id=11142](https://www.rbi.org.in/ScriptS/BS_ViewMasDirections.aspx?id=11142)> accessed 15 September 2020.

framework should also clarify the applicability of the standards issued by the SRO to RBI operated payment systems. This aspect will be linked to the issue of RBI's membership in the SRO as pointed out earlier.

## Recognition of the SRO

The Draft Framework proposes that RBI will issue a letter of recognition to an entity that is found eligible to be an SRO under the framework. Further, RBI can withdraw such recognition to an SRO after giving due opportunity to the entity to further its views. A reading of the process for recognition and de-recognition presents the following issues.

- (a) There is no clarity regarding the period for which recognition is conferred or if the same is expected to be a perpetual recognition, unless withdrawn by RBI.
- (b) In setting out the functions and obligations of the SRO, the Draft Framework mandates the SRO to comply with the criteria under which it has been recognised as an SRO. The final framework may consider including a provision in the recognition process to expressly empower RBI to issue a letter of recognition subject to certain conditions.
- (c) While RBI has the power to withdraw recognition of an SRO, the Draft Framework is silent on the grounds of such recognition. The grounds for withdrawing recognition may be considered to provide certainty to the SRO and to avoid any allegation of arbitrariness.

**Recommendation:** The final framework should: (a) clarify the period for which the letter of recognition is valid and if the letter of recognition is valid for a specified period, the process for renewal should also be set out; (b) empower the RBI to issue the letter of recognition to the SRO subject to certain conditions; and (c) the grounds for withdrawing the letter of recognition from the SRO should be considered. Such grounds may include non-compliance with the conditions subject to which the letter of recognition was issued by RBI, violation of the SRO framework or on grounds of public interest that impacts the smooth functioning of the payment systems in India.

## Board of Directors / Governance Structure

The governance structure of the SRO is critical since it will be the basis for determining its decisions. While membership of an SRO should be representative of the industry it represents, it should also strive to maintain independence from vested interests. The legitimacy of an SRO can be threatened if there is a perception that it is acting in the interest of specific participants of the industry. Therefore, the governance structure may have a combination of representatives from key industry players and independent members. The Draft Framework provides that the board of directors and management of the SRO shall satisfy the fit and proper person criteria set out by RBI. Further, as per the Draft Framework RBI shall have the right to clear appointment of important positions in the governing board. In this regard, the following points emerge.

- (a) One possible way to address the issue discussed above is to introduce the concept of independent directors in the governance structure. This has been adopted by RBI itself in its SRO framework for NBFC-MFIs, which requires that 1/3<sup>rd</sup> of the board of directors should be independent and not associated with member institutions. Similarly, the SEBI SRO Regulations require that majority of the directors should be independent directors. In a SEBI Consultation Paper that proposes to amend SEBI SRO Regulations<sup>16</sup>, SEBI has proposed that the governance structure of the SRO consists of elected representatives of the members of the SRO, SEBI nominated "Public Interest Directors" and shareholder directors which are representatives of the promoters. A similar concept of independent directors must be considered for the final framework.
- (b) While the RBI Draft Framework specifies that RBI will have the right to clear appointment of important positions in the SRO, it does not clarify which positions RBI can clear. Any provision which confers RBI with the power to clear the appointment of all directors, chairperson and the managing director may be viewed

<sup>16</sup> Securities and Exchange Board of India, 'Consultation Paper on Self Regulatory Organizations in Securities Market' (2019) < [https://www.sebi.gov.in/reports/reports/apr-2019/consultation-paper-on-self-regulatory-organizations-in-securities-market\\_42573.html](https://www.sebi.gov.in/reports/reports/apr-2019/consultation-paper-on-self-regulatory-organizations-in-securities-market_42573.html) > accessed 15 September 2020

as an excessive regulatory interference in the functioning of the SRO. In line with the SEBI SRO Regulations and the NBFC-MFI SRO framework that seek to strike a balance between the directors elected by the members of the SRO and the ones nominated by RBI, a similar approach may be considered by RBI, where members can elect certain representatives as directors and RBI can nominate independent directors.

- (c) The Draft Framework does not specify the fit and proper criteria for directors.
- (d) The role of the board of directors and the chairperson is not clearly delineated in the framework.

**Recommendations:** First, the final framework should consider the insertion of the concept of independent directors in the governance structure of the SRO. Independent professionals with relevant domain expertise meeting the criteria of independence (such as no association with the members of an SRO) as set out in the framework may be nominated as independent directors by the RBI to the board of the SRO. Second, as opposed to RBI clearing the names of all-important positions, including directors, a balance should be struck between directors elected by members and independent directors nominated by RBI. Third, RBI should clearly set out the fit and proper criteria of directors in the final framework to provide certainty to prospective applicants. Fourth, the role of the board of directors and the chairperson should be clearly delineated in the framework.

## RBI Oversight

Some form of government oversight is an essential element in a co-regulatory model to ensure a system of checks and balances. Such oversight ensures that all interests are given due consideration. One of the biggest challenges that government faces in devising and administering an oversight framework is to provide an appropriate level of government oversight of SRO activities without encumbering or usurping an SRO's ability to respond quickly and flexibly to changing market conditions and business needs. The Draft Framework seeks to establish an oversight framework through several measures such as grant of recognition to the SRO, power to appoint important positions in the SRO, imposing an obligation on the SRO to provide any information to the RBI, investigate any matter referred to it by the RBI and abide by any direction issued by the RBI. A review of such provisions indicates certain concerns as highlighted below:

- (a) Power of RBI to direct SRO to investigate any matter: The Draft Framework empowers RBI to direct the SRO to investigate "**any matter**" referred to it by RBI. There is no mention about the nature of investigation, the grounds for investigation, the persons who may be investigated and the process to be adopted for such investigation. Notably, the PSS Act empowers only the RBI to inspect the premises where a payment system is operated and the employees of a system provider, system participant or any other person on such premises. Further, the power of inspection can only be exercised to ensure compliance with the PSS Act or any regulations. A reading of the proposed investigative power in the Draft Framework does not clarify if RBI seeks to use this provision to involve SROs in the exercise of such investigate powers in the PSS Act. Given that the power to inspect is a specific statutory regulatory power conferred exclusively on the RBI, any such power must only be exercised through RBI. Any attempt to exercise such power through the SRO may be viewed as a delegation of essential functions by RBI which is impermissible.

Alternatively, it may be worthwhile to consider the power of RBI to appoint an officer to inquire into the affairs of the SRO in case RBI has reasonable grounds to believe that the SRO or its management may have been acting in violation of the SRO framework and the PSS Act.

- (b) Power to call for information: Currently, the Draft Framework provides that an SRO must provide **any** information, including data that is sought by RBI. This may be interpreted as a broad power as there is mention of the nature of information that may be sought or the grounds for seeking such information. For instance, the PSS Act itself requires that the power to call for information is limited to the operation of a payment system. Similarly, the SEBI SRO Regulations require that SEBI may require the SRO to furnish to SEBI such periodical returns as may be specified. Accordingly, it may be useful to caveat this broad power by setting out the nature of information that may be sought, including information relating to its affairs.

Adequate care must also be taken to ensure that this power is not used by RBI to exercise its statutory power of requisitioning information under the PSS Act for reasons already discussed above.

- (c) It may also be useful to require the SRO to submit a periodical report on specific items in relation to its performance. This may include reporting on various aspects of its functioning including policy initiatives, standards and benchmarks developed, implementation of such standards, number of members admitted and disciplinary action taken against members, if any. This will be useful for the RBI to assess how far the SRO has been able to carry out the functions entrusted to it.
- (d) Currently, the Draft Framework requires an SRO to immediately report to RBI any change in directorship or adverse development about any director. Similarly, the final framework may have a provision requiring an SRO to immediately report to RBI any change in its bye-laws and any standard or benchmark issued by it and any amendment to the same.

**Recommendations:** *First, the final framework should clarify the power of RBI to direct SRO to investigate any matter in light of the concerns raised above. In conferring such powers, adequate care must be taken that essential functions conferred on RBI under the PSS Act should not be viewed as delegated to the SRO, as the same is impermissible. Second, it may be worthwhile to consider conferring a power on RBI to inquire into affairs of the SRO if there is a reasonable ground that the SRO may be acting in violation of the PSS Act or the SRO framework. Third, the power to call for information from the SRO should be clearly spelt, including setting out the nature of information that may be sought and the grounds for seeking such information. Fourth, a requirement for submission of periodical reports on specific aspects of its functioning may be considered. Fifth, the final framework may consider including a reporting requirement for change in bye-laws, issuance of new standards and benchmarks, and any amendment thereof.*

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