Global trends in payment and settlement systems vis-à-vis the new standards

Findings from the WB Global Payment Systems Survey

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World Bank Global Payment Systems Survey 2010

- Answers received from 132 Central Banks worldwide, representing 139 countries
- Topics covered:

i. *Legal and Regulatory Framework*
ii. *Large-Value Funds Transfer Systems*
iii. *Retail Payment Systems*
iv. *Foreign Exchange Settlement Systems*
v. *Cross-border Payments and International Remittances*
vi. *Securities Settlement Systems*
vii. *Payment System Oversight and Cooperation*
viii. *Planned and On-going Reforms to the National Payments System*

- NEW: Annex 1! Survey on innovations in retail payments issued as an Annexure to GPSS. Builds on CPSS "Survey of Developments in Electronic Money and Internet and Mobile Payments". Annex 1 is divided into 5 key areas:

i. *Type of Products*
ii. *Design Features of the Products*
iii. *Legal and Regulatory Framework*
iv. *Statistics*
v. *Planned Reforms/New Products*

Methodology

For the purposes of the analysis countries have been classified on the following basis:

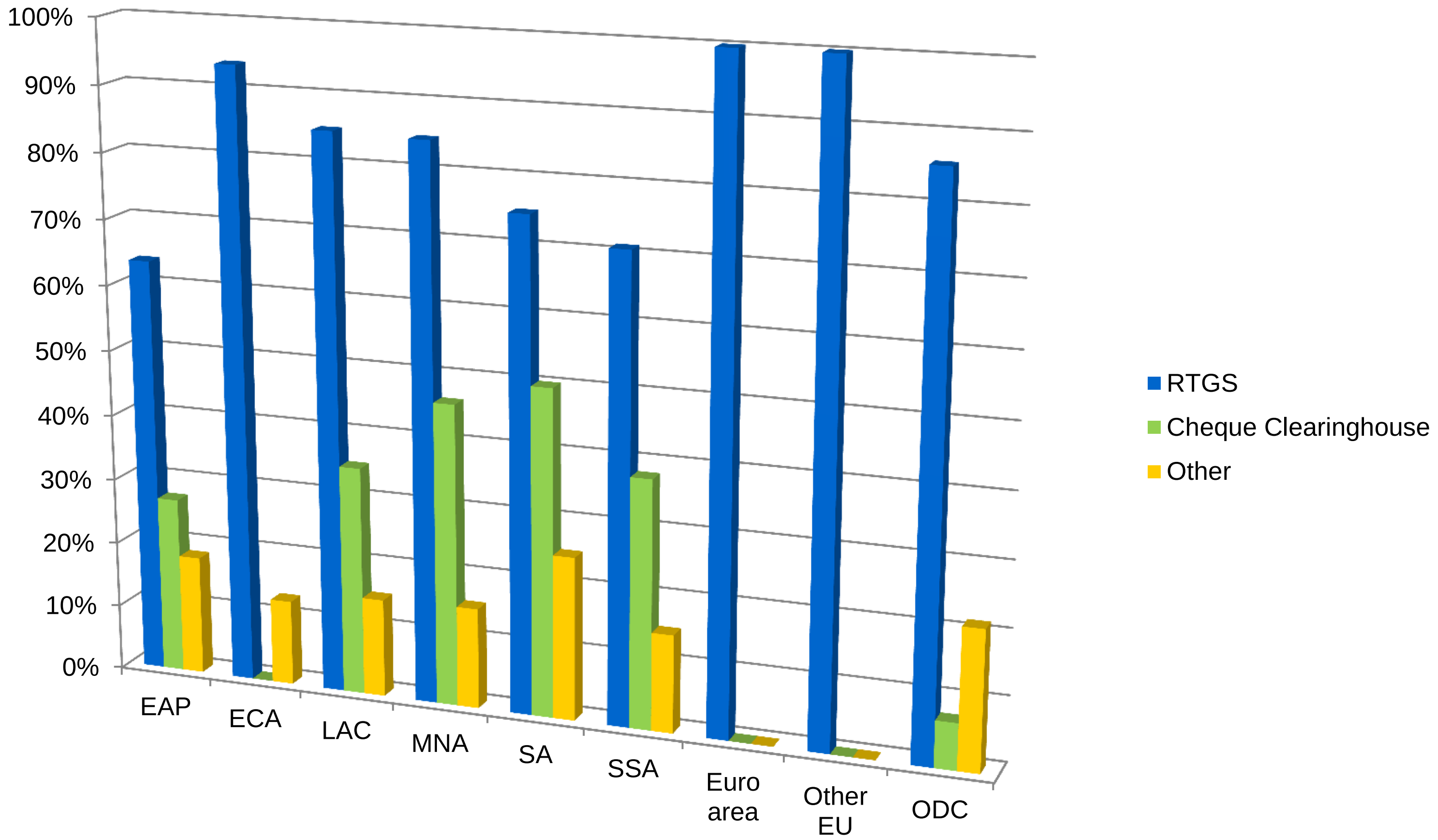
- ✓ **By level of per capita income:** high income, upper-middle income, lower-middle income, low income – *according to WB list economies*
- ✓ **By geographical region:**
  - Developing/emerging economies were classified according to WB regional classification: East Asia and Pacific (EAP), Europe and Central Asia (ECA), Latin America and the Caribbean (LAC), Middle East and North Africa (MNA), South Asia (SA), Sub-Saharan Africa (SSA)
  - EU countries: euro area and other EU members.
  - Other developed countries (such as Australia, Canada, Japan, etc.) are classified as “ODC”
  - *Exceptions. ECA countries belonging to EU are not classified as “ECA”. Estonia is not included in the euro area for the purposes of this Survey*
- ✓ **By population size:** less than 5 million inhabitants (SMALL), between 5 and 30 million (MEDIUM) and over 30 million (LARGE)

Trend #1: Payment and securities settlement systems worldwide largely support financial system stability

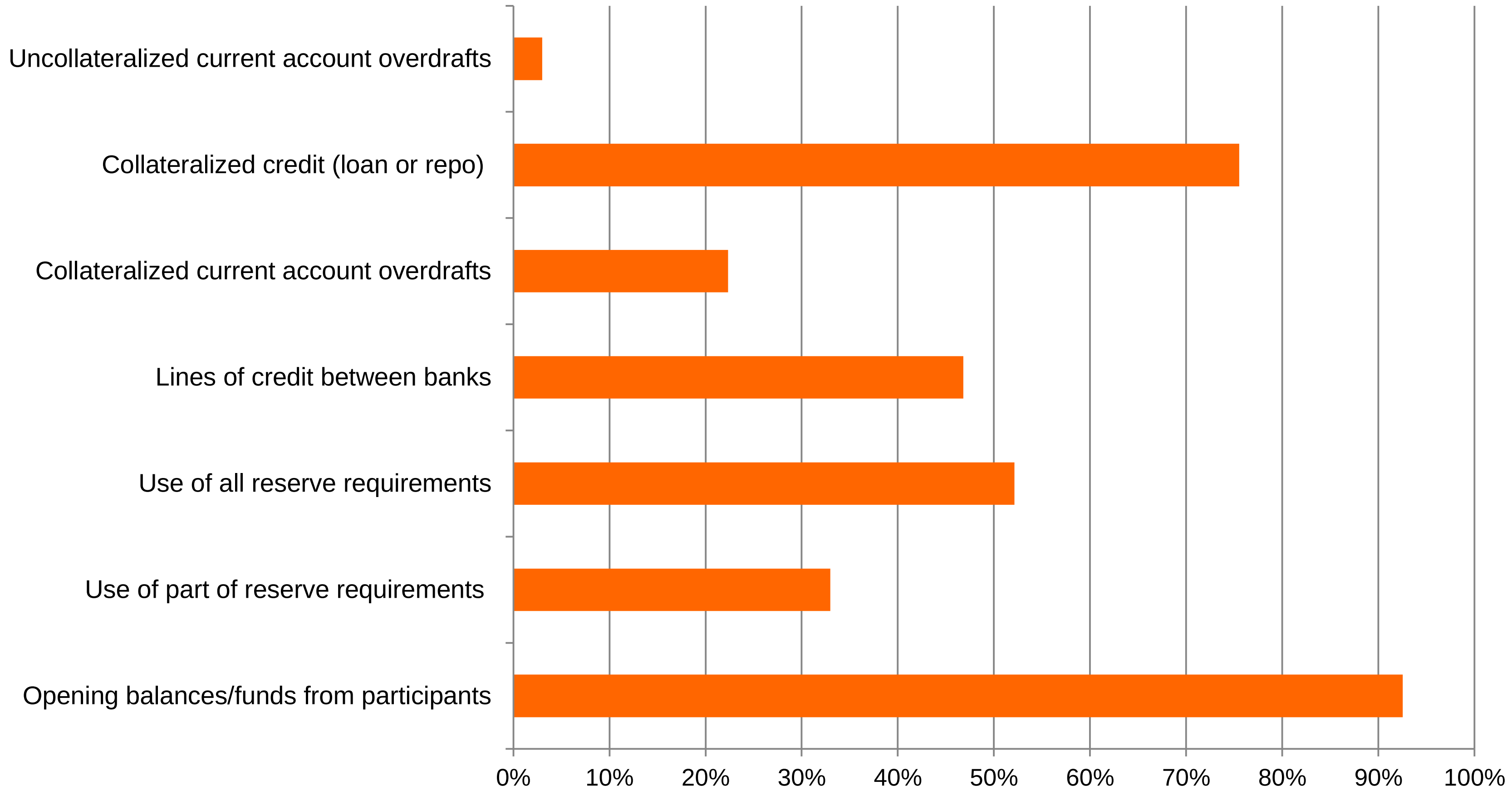
The 2008 financial crisis showed that the domestic (e.g. RTGS systems) and global (e.g. CLS Bank) payment infrastructure was able to withstand the financial storm, and was instrumental in facilitating immediate responses by authorities

- Growing awareness of the need for sound risk management in large-value funds transfer systems has pushed the development of **REAL-TIME GROSS SETTLEMENT SYSTEMS**, a powerful mechanism for limiting systemic and settlement risk in the interbank settlement process
  - A total of 116 countries report having a RTGS in place
  - Large value payments processed in a year worldwide are equivalent to over 40 times the global GDP
  - RTGS have not only fostered growth in total amounts settled (21% between 2006 and 2009) but also allowed for a safe and efficient processing of payments accounting for 80% the value of the total payments processed worldwide

System(s) Used for Large-Value Payments
Global Payment Systems Survey 2010



RTGS: Sources of Liquidity During the Day
Global Payment Systems Survey 2010

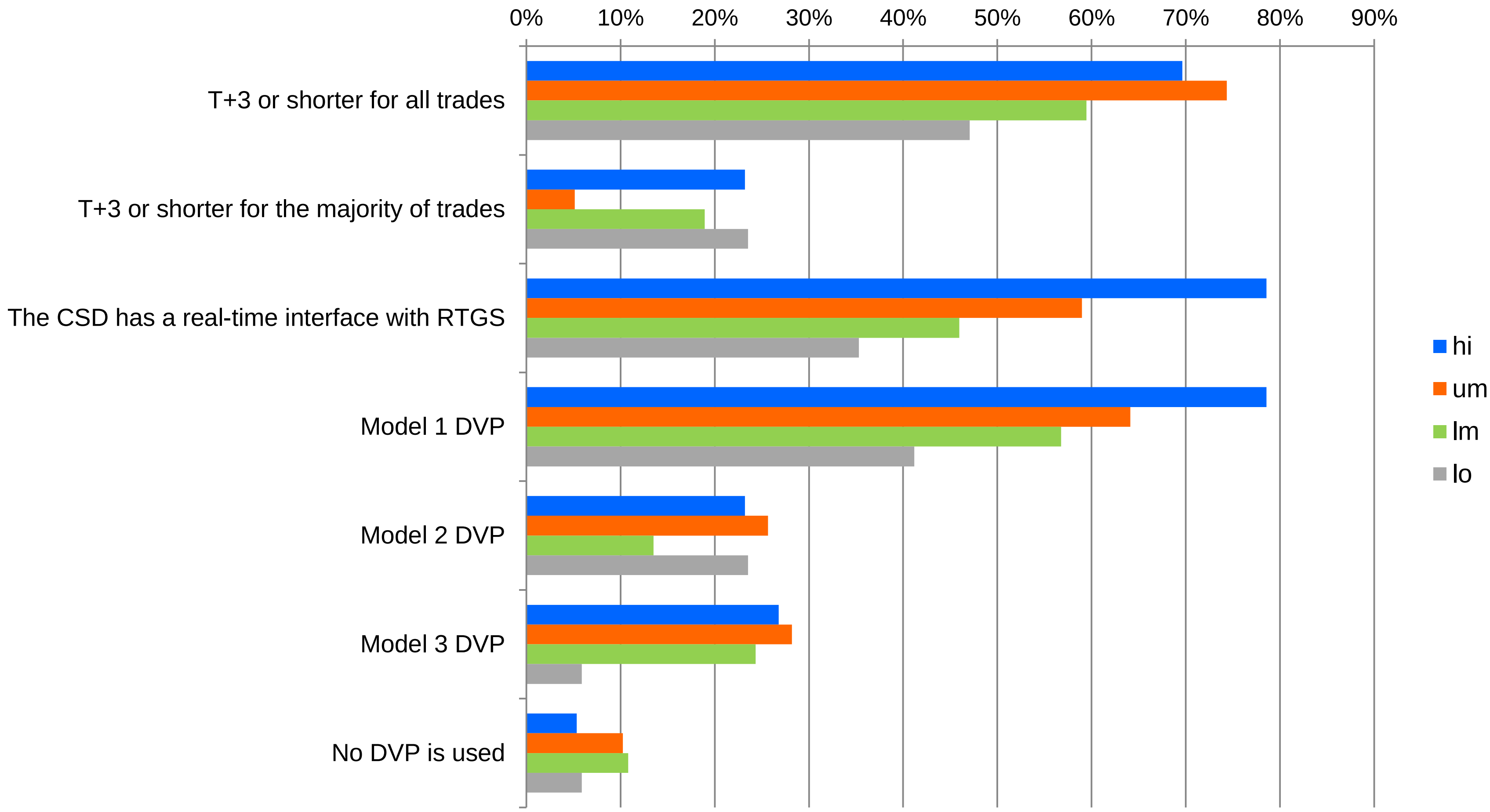


Trend #1 (cont.): Payment and securities settlement systems worldwide largely support financial system stability

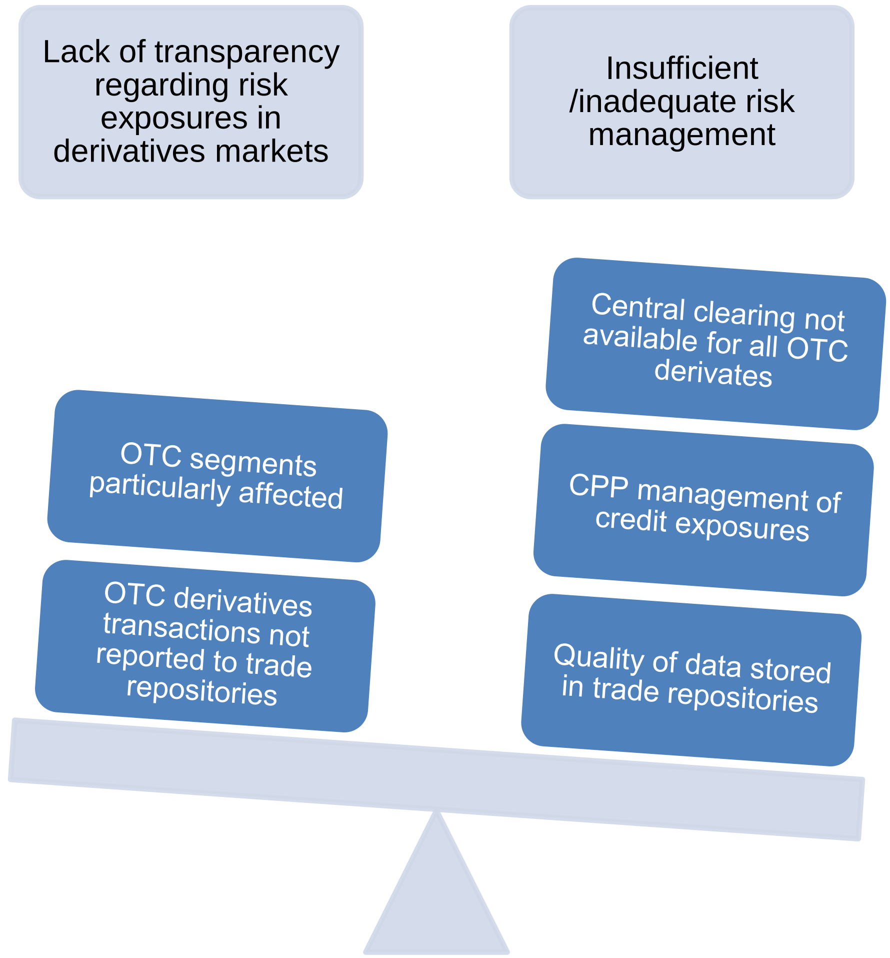
Securities settlement systems are increasingly interlinked to funds transfer systems and operate under **a DVP ARRANGEMENT**. These are crucial for the development of capital markets, and for the timely delivery of collateral for payments and other purposes

- Securities immobilization or dematerialization have been largely accomplished in 71% of the countries worldwide
- About 60% of Central Securities Depositories (CSDs) worldwide have a real-time interface with RTGS system
- The use of DVP as a measure to reduce principal risk is widespread, with only 8% of CSDs worldwide not using a DVP model at all

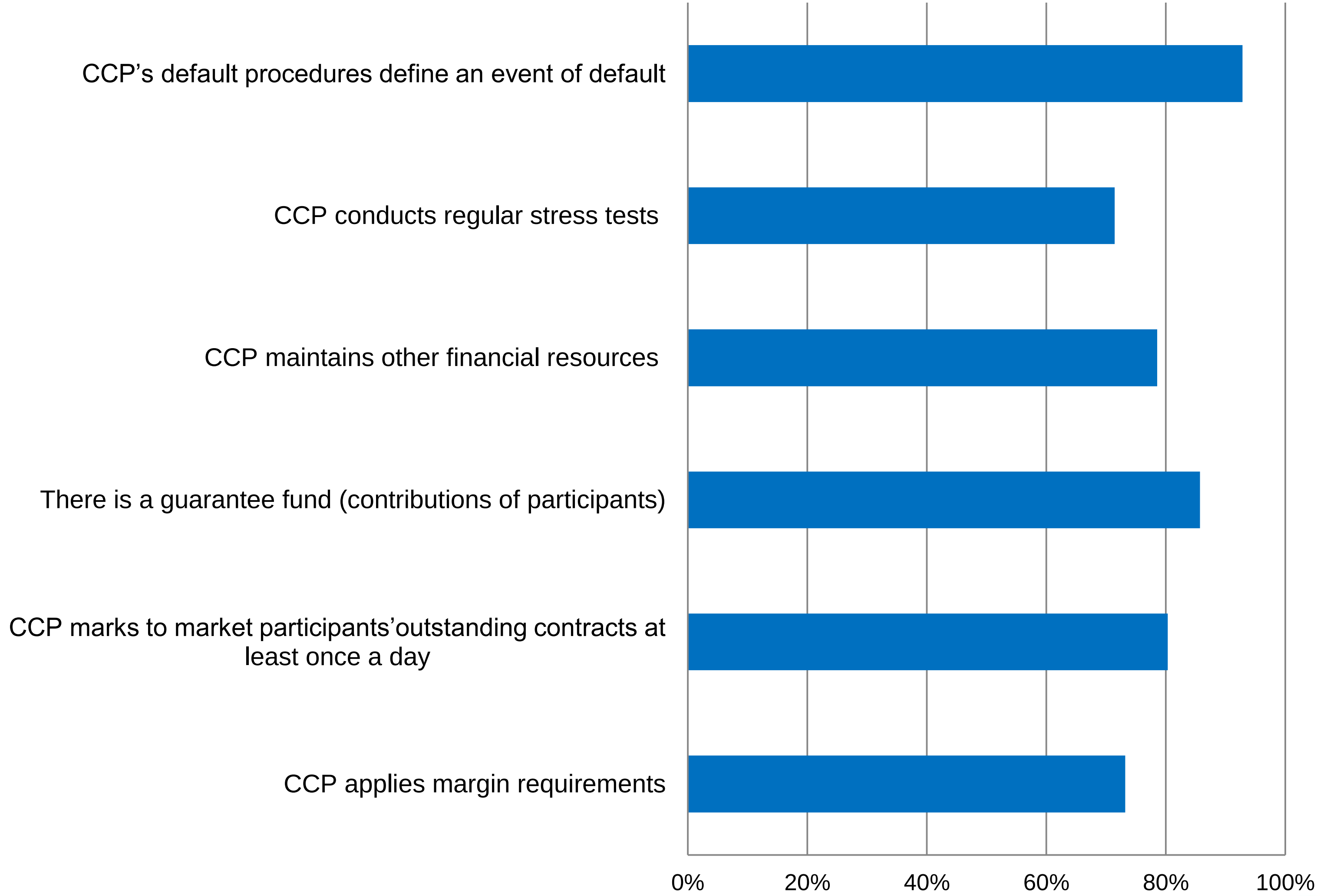
CSDs: Risk Management Features
Global Payment Systems Survey 2010



Trend #2: OTC derivatives markets can create systemic risk



CCPs – Management of Credit Exposures
Global Payment Systems Survey 2010



Trend #2 (cont.): OTC derivatives markets can create systemic risk

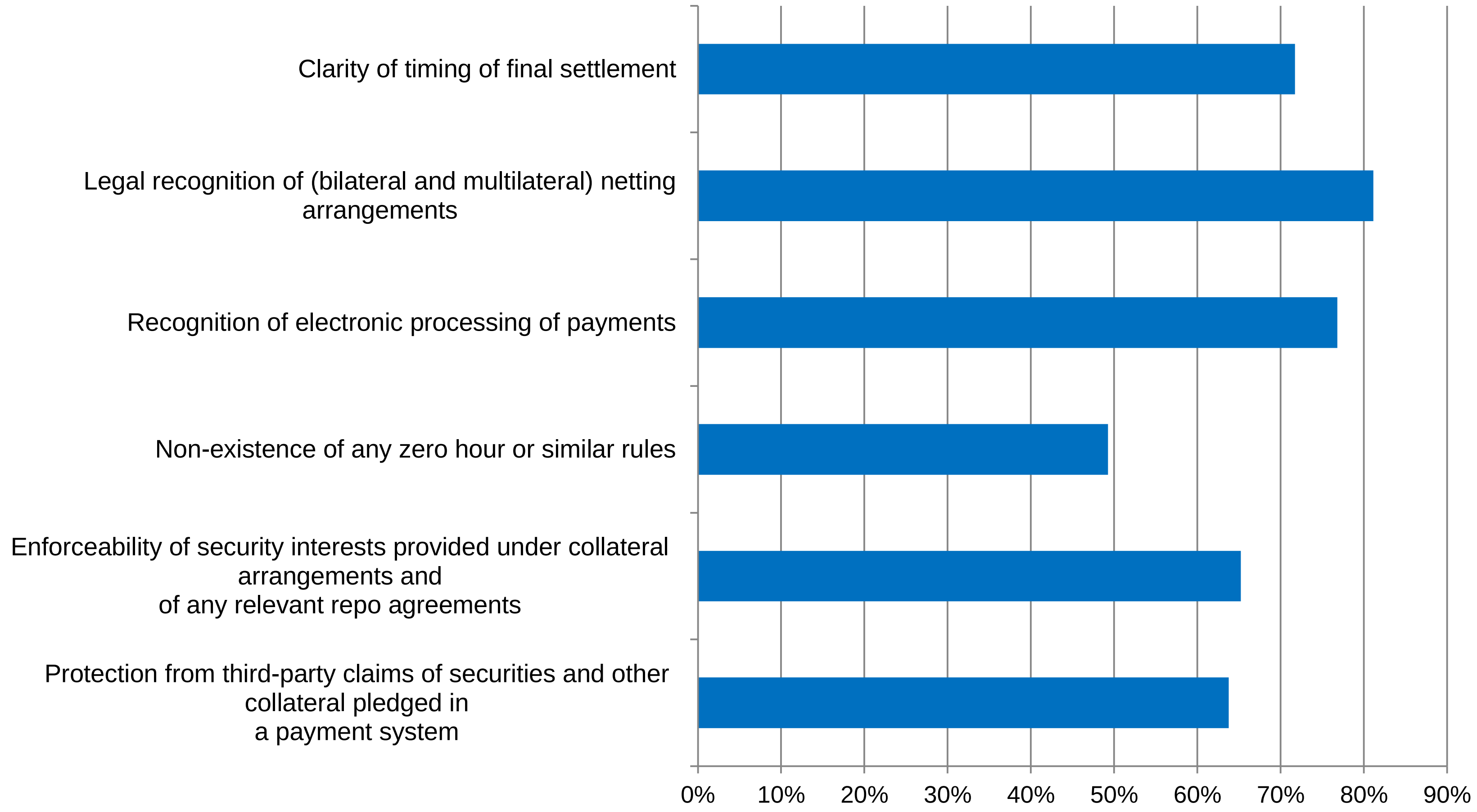
- **September 2009 G20 Pittsburgh Summit Declaration**

All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties ***by end-2012 at the latest.*** *OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements. We ask the FSB and its relevant members to assess regularly implementation and whether it is sufficient to improve transparency in the derivatives markets, mitigate systemic risk, and protect against market abuse.*

- June 2010 G20 Toronto Summit Declaration, Annex II

We pledged to work in a coordinated manner to accelerate the implementation of over-the-counter (OTC) derivatives regulation and supervision and to increase transparency and standardization. We reaffirm our commitment to trade all standardized OTC derivatives contracts on exchanges or electronic trading platforms, where appropriate, and clear through central counterparties (CCPs) by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories (TRs). We will work toward the establishment of CCPs and TRs in line with global standards and ensure that national regulators and supervisors have access to all relevant information.

Trend #3: There have been significant improvements in the legal framework, though some deficiencies persist



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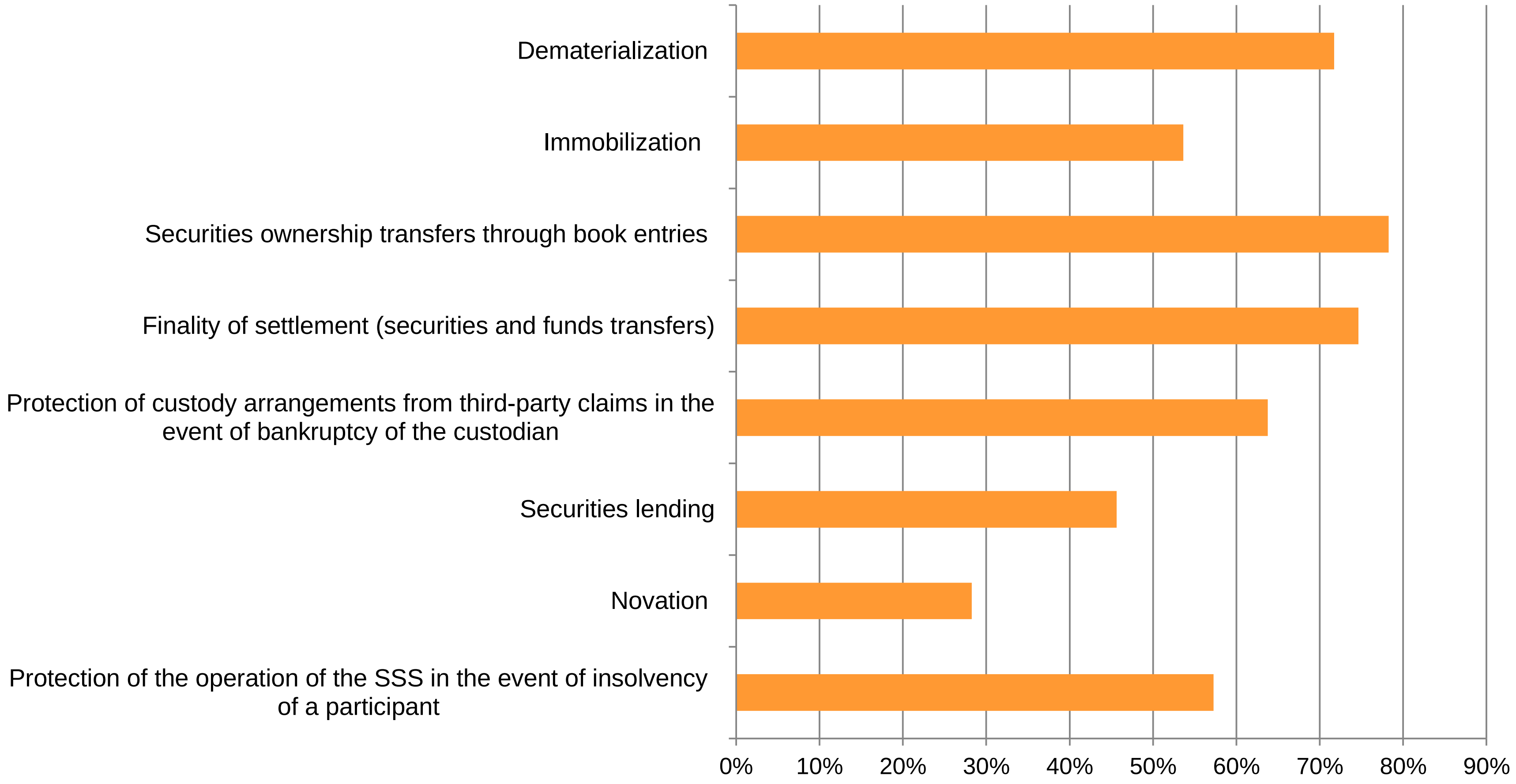
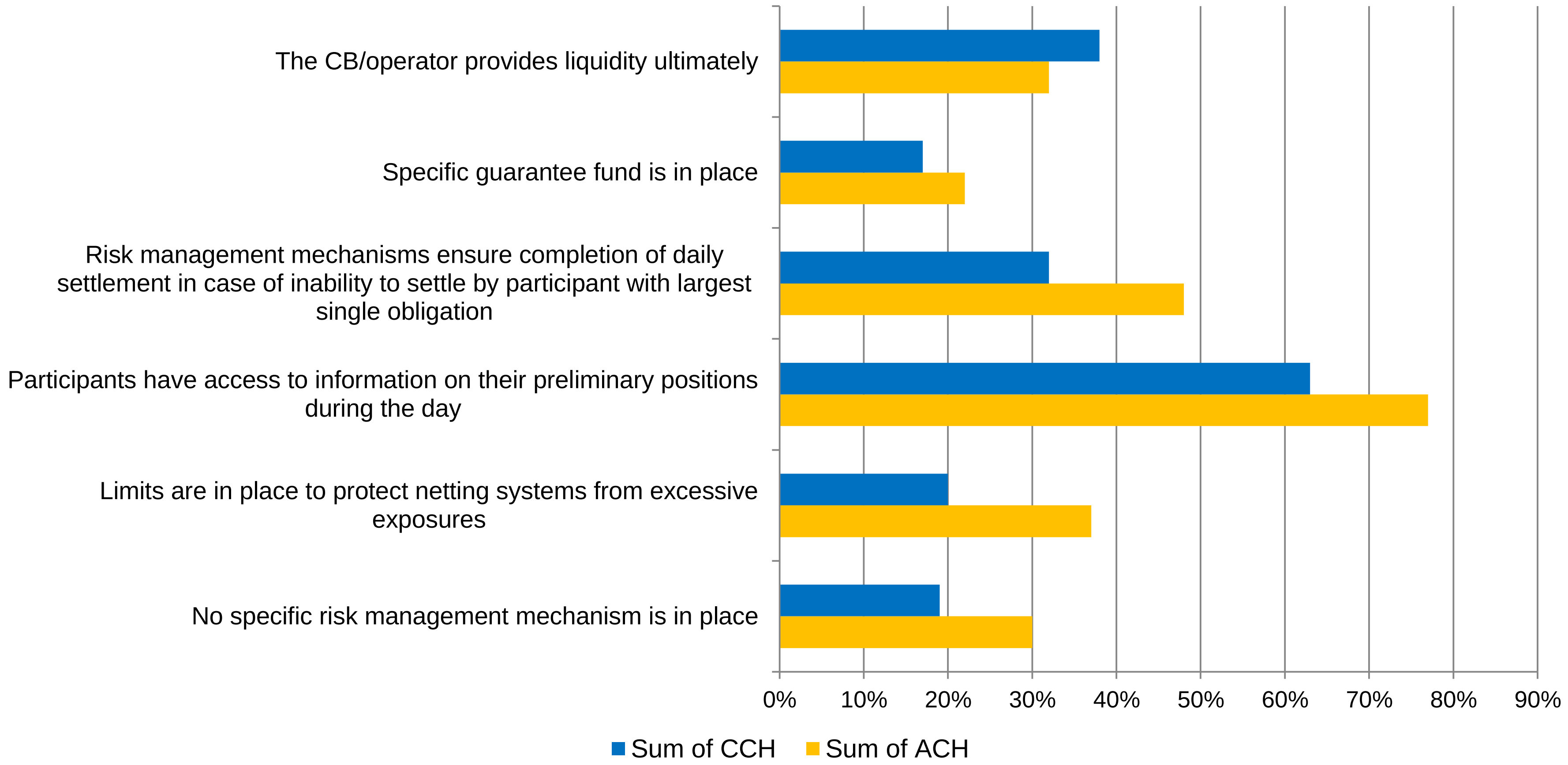


Trend #4: Risk management in cheque systems and ACHs worldwide is still weak



"Raising the Bar" in International Standards

- Issued by the CPSS and IOSCO, the new standards (called "principles") are designed to ensure that the infrastructure supporting global financial markets is more robust and thus well placed to withstand financial shocks. *Published on April 16, available at www.bis.org + Assessment Methodology and Disclosure Framework for public consultation*
- The principles replace the three existing sets of international standards set out in the *Core principles for systemically important payment systems* (CPSS, 2001); the *Recommendations for securities settlement systems* (CPSS-IOSCO, 2001); and the *Recommendations for central counterparties* (CPSS-IOSCO, 2004). The need for a single set of principles lies in the need to ensure consistent risk management amongst infrastructure that more and more are interdependent
- The main objective of this review of existing standards is to incorporate the lessons drawn during the Lehman crisis and in particular "raise the bar" of the existing requirements in some critical areas
- The Principles aim at ensuring consistency among requirements to different FMIs while reflecting the "unique" role of certain infrastructure (e.g. CCPs or TRs), i.e. some room for specific requirements for some FMIs only

Assessment Methodology: objectives

- Developed by a sub-group chaired by the World Bank and the IMF, provides a framework for assessing an FMI's observance of each of the 24 Principles and the relevant authorities' observance of each of the five Responsibilities *vs. DF as a tool to assist FMIs in providing the consistent and comprehensive disclosure that is expected of them under Principle 23*

- Is a tool to promote the implementation and ongoing observance of the principles and responsibilities and to help ensure objectivity and comparability across all relevant jurisdictions

- Draws from the methodologies that were developed for the CPSIPS, the RSSS and the RCCP, taking into account the lessons learned from the use of the existing approaches

- The AM was developed in parallel with and as an adjunct to the FMI Report. The AM and FMI Reports should be taken together as closely related and supporting documents. The AM avoids repetition of the discussions of the Principles and Responsibilities included in the FMI report

Disclosure Framework

- Background. Principle 23, “Disclosure of rules and key procedures” requires an FMI to publicly disclose sufficient information to participants and prospective participants *so that they can understand the system’s design and operations, their rights and obligations, and the fees and risks from participating in the system*

- Objectives. FMIs are expected to provide responses that are thorough and at an appropriate level of detail to:

  1) improve the transparency of FMI governance and operating and risk management structure

  2) provide the public with a comprehensive understanding of the FMI, its role in the market it serves and the range of its relationships, interdependencies and interactions

  3) describe key rules, risks, policies, procedures and controls on a principle-by-principle basis

- Relationship AM/DF (under discussion). As a result of the public consultation period, and to help reconcile the trade-off between level of comparability and burden for the FMI, an option of merging the AM and DF under one framework is being discussed

Use of the Assessment Methodology

FMIs may have to conduct formal periodic full/partial self-assessments, where this is consistent with national practice

As part of their regulation/oversight Responsibilities, **national authorities** are expected to regularly assess observance of the Principles by FMIs. Authorities are also encouraged to conduct periodic self-assessments of their observance of the Responsibilities

The CPSS and IOSCO are encouraging external assessments of FMI observance of the Principles and authorities' observance of the Responsibilities, including assessments conducted by **IFIs, namely the IMF and WB**, in particular as part of FSAP

1. The AM is at the moment primarily intended for external assessors at the international level such as World Bank and IMF
2. The AM also provides a baseline for national authorities to assess FMIs under their oversight/supervision. National authorities should use the assessment methodology in its current format or develop an equally effective methodology for their national oversight/supervision processes

FSAP FAQs

Q. How is an FSAP conducted?

A. The Financial Sector Assessment Program (FSAP) provides in-depth examinations of countries' financial sectors

A. Done jointly by WB and IMF in IBRD countries, by IMF alone in advanced economies

A. 2 components: the financial stability assessment and—in developing and emerging market countries—the financial development assessment. Assessed at the same time or at different times in separate stability and development "modules"

Q. Do all FSAPs include ROSCs?

A. Assessments of compliance with international financial sector standards (summarized in a Report on Observance of Standards and Codes or ROSC) are <u>voluntary</u> for the country, even in countries for which an FSAP stability assessment is a mandatory part of surveillance. They are an <u>optional</u> but potentially very useful component of the FSAP, *especially if standards have changed*. ROSCs can also be conducted outside an FSAP, on a stand-alone basis

Q. FSAPs outputs and confidentiality

A. Aide-Mémoire for the country authorities summarizing the main findings and recommendations of the mission. <u>Confidential</u>

B. Technical notes and detailed assessments reports (DARS) of compliance with international standards/codes are prepared as appropriate. <u>Publication is voluntary</u>

C. Financial Sector Stability Assessment (FSSA) report is prepared for discussion at the IMF Executive Board. <u>Publication is voluntary but presumed</u>. Where the World Bank is involved, it prepares a Financial Sector Assessment (FSA) for its Executive Board

The "new" FSAP

Revisions Bank/Fund Boards '09

-Preserve and capitalize on the successes and wide acceptance of the Program

-Flexibility through modules (stability, development) focused and responsive to country circumstances

-Enhanced analytical tools for more comprehensive, consistent diagnostics

-Integrating assessments better with surveillance and World Bank operations

-Introduction of targeted (risk-based) ROSCs

Changes by Fund Board '10

-Mandatory FSAP stability modules every 5 years for 25 countries with systemically important financial sectors, focused on:

→Source, probability, potential impact of the main risks to macro-financial stability in near-term

→Country's financial stability policy framework

→Authorities' capacity to manage and resolve a crisis should the risks materialize

Impact of the new Principles

-Principles will be used for FSAP when endorsed by the IMF/WB boards

-Meanwhile, assessments against new Principles on a voluntary basis

-G20 countries have committed to publish their assessments

Assessment Methodology: structure

The five steps involved in an assessment against the PFMI report are

(1) determining the appropriate scope of an assessment;

(2) gathering facts useful to evaluate the key considerations;

(3) developing key conclusions by key considerations;

(4) assigning a rating category to each principle or responsibility; and

(5) indicating an appropriate timeframe for addressing each identified issue of concern, including a discussion on priorities

- *The AM also provides assessment report templates for assessing an FMI against the 24 principles and authorities against the five responsibilities as well as supporting questions for assessing observance with the principles and responsibilities*

Assessment Methodology: use of rating framework

- Different types of assessors may communicate the outcome of their assessments of FMIs differently, depending on their specific objectives
- The rating is built on the key conclusions and reflects the assessors' judgment regarding the type or impact of the risks, concerns, or other issues associated with each identified gap or shortcoming

Where consistent with national practice, **FMIs** should use the AM rating scheme

National authorities may choose to use the AM rating scheme or may choose to use another EQUALLY EFFECTIVE rating scheme, in particular when they are legally bound to use a different assessment methodology. The AM rating scheme is expected to be used in the context of cross-border cooperative oversight arrangements unless agreed otherwise

IFIs use the rating scheme presented in the AM in the context of the FSAP. Technical assistance (TA) assessors are not necessarily expected to use a rating scheme

Ratings for Principles

UNDER DISCUSSION. MAY BE SUBJECT TO CHANGE

The rating scale is built on the gravity and urgency to remedy identified "issues of concern". For the purpose of this scale, an "issue of concern" is a risk management flaw, a deficiency, or a lack of transparency or effectiveness that needs to be addressed

Observed	The FMI observes the Principle. Any identified gaps and shortcomings are not issues of concern and are minor, manageable, and of a nature that the FMI could consider taking up in the normal course of its business
Broadly Observed	The FMI broadly observes the Principle. One or more issues of concern have been identified that the FMI is encouraged to address and follow up to better manage risks or improve operations. The FMI should pursue such improvements in a defined timeline
Partly Observed	The FMI partly observes the Principle. The assessment has identified one or more issues of concern that could become serious if not addressed in a timely manner. The FMI should accord a high priority to address these issues
Not Observed	The FMI does not observe the Principle. The assessment has identified one or more serious issues of concern that warrant immediate action. Therefore, the FMI must accord the highest priority to timely address these issues
Not Applicable	The Principle does not pertain to the type of FMI being assessed because of the particular legal, institutional, structural or other characteristics of the FMI

Thank you

Payment Systems Development Group
The World Bank

www.worldbank.org/paymentsystems