

Information package on payment system reform



Nigeria Financial System Strategy 2020 Workshop

December 18-20, 2006
Washington, D.C.

1: Retail: The example of remittance payments reform

2: Central Bank of Brazil: Experiences from payment system reform and retail challenges

3: Information: Reforming Payments and Securities Settlement Systems



Payment Systems Development

Retail payments: The example of remittance payments reform



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World Bank Payment Systems Development Group *Implementing the General Principles for International Remittance Services*

The Payment Systems Development Group provides advice to authorities:

- A professional and comprehensive stocktaking of the entire payments infrastructure
- Help countries develop vision, strategy, implementation meeting global standards
- Advice on oversight, the role of authorities, and cooperation between authorities
- Provide expert advice on legal framework, large value and retail payments, government payments, securities settlements, cross-border arrangements, interaction between systems, domestic cooperation – and integration with other financial infrastructure, such as credit reporting, trading platforms, and capital markets.
- Develop access to finance through expanded, modern retail and remittance systems

Multilateral cooperation is at the core of our work:

- Connect countries to international initiatives and implement international standards
- Assessment teams composed from multiple partner institutions and initiatives

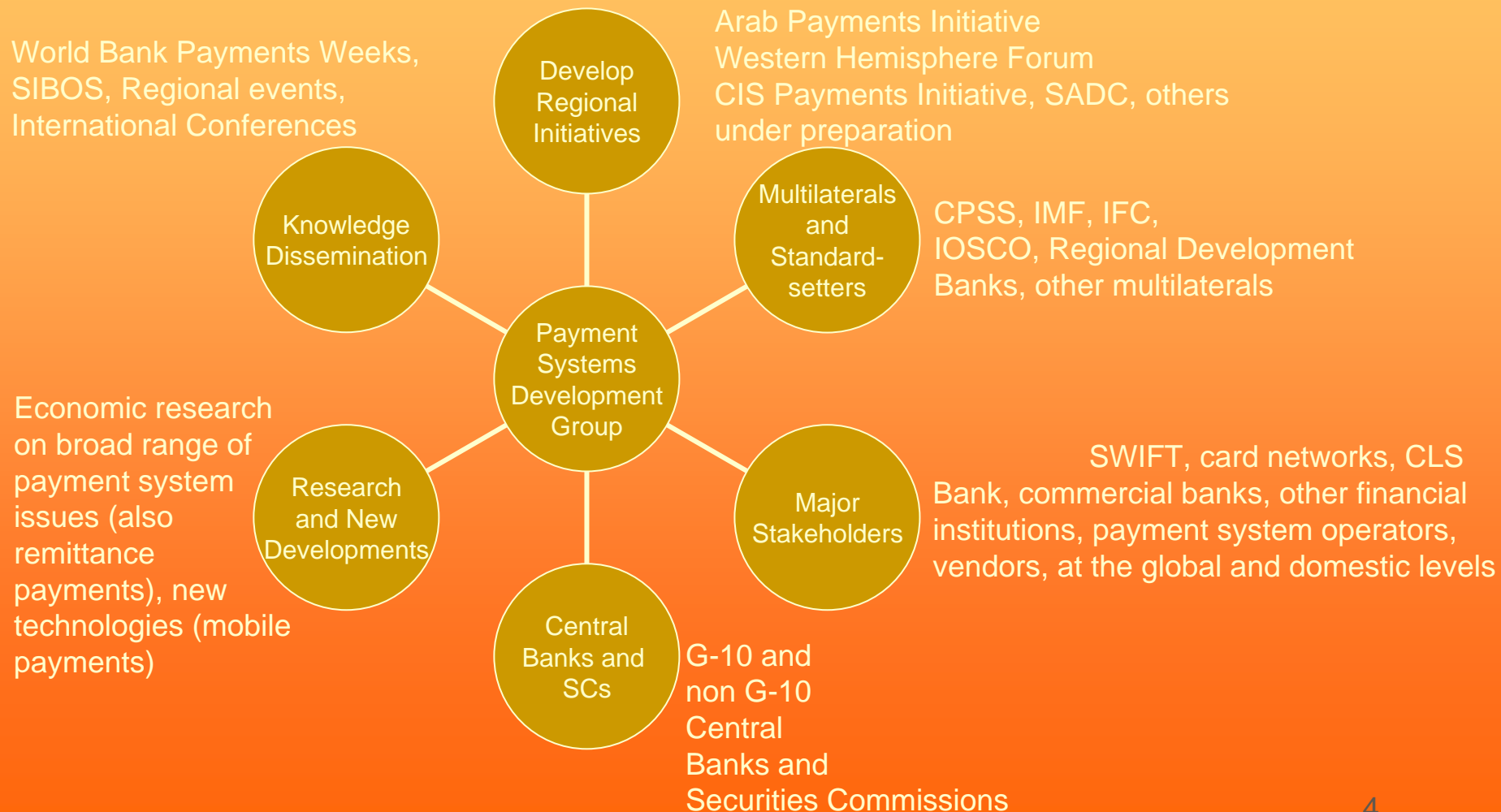
•Funding comes from World Bank loans for system implementation and technical assistance, fee-based technical assistance, regional initiatives, FSAPs, others



World Bank Payment Systems Development Group

Implementing the General Principles for International Remittance Services

- The Payment System Development Group is at the center of an international network, whose main objective is supporting countries to reform Payments, Remittances and Securities Settlement Systems





- The General Principles are a multilateral effort to address a global challenge



The World Bank was asked by the G-8 to take the lead in an international effort to improve remittance services and data. The Payment Systems Development Group worked with the Bank for International Settlements to address the request for better remittance services.



- The General Principles are a multilateral effort to address a global challenge



Chairs:

World Bank PSDG and CPSS

Members:

AMF, ADB, Central Banks of Brazil, Europe, Germany, Italy, Mexico, Philippines, Sri Lanka, Turkey, EBRD, HKMA, IADB, IMF, Fed Board of Governors, Fed of New York, World Bank

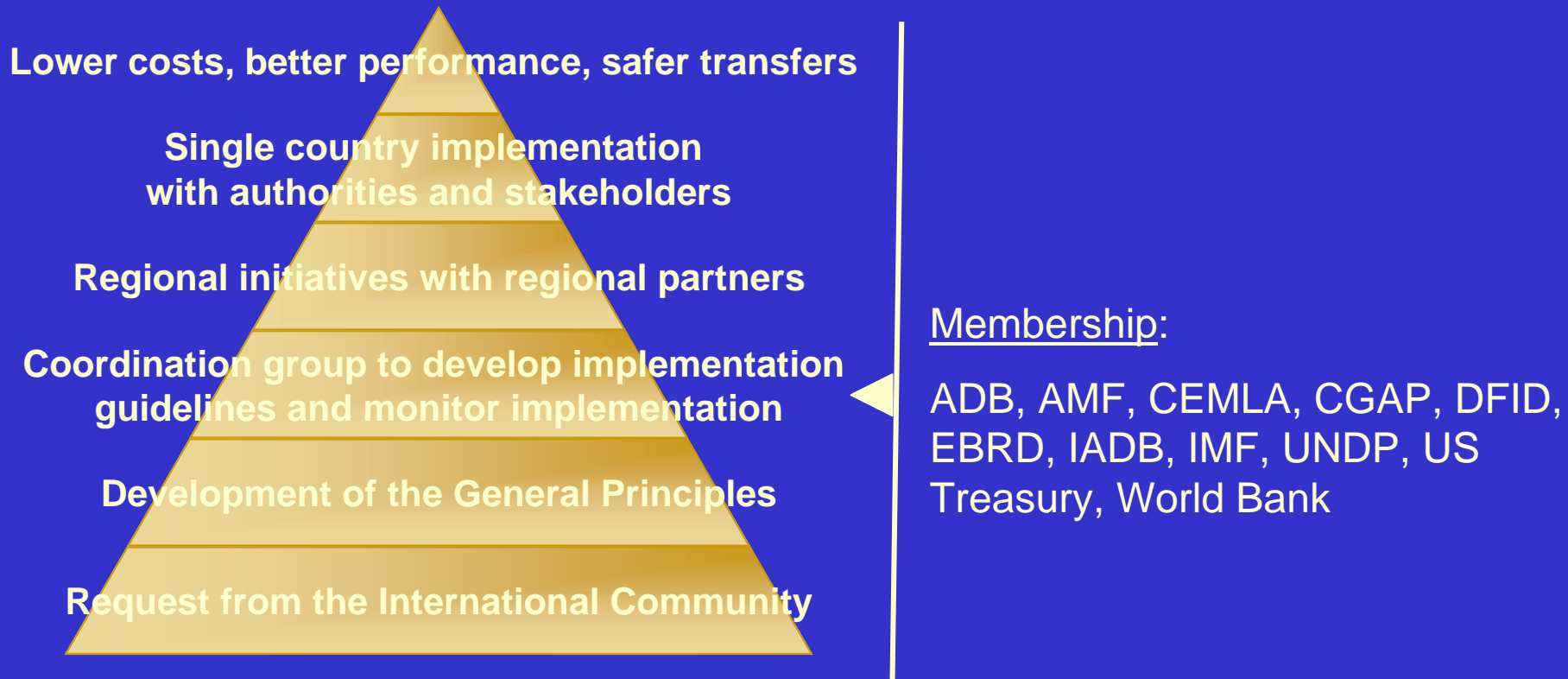
Secretariat:

World Bank PSDG, CPSS, DFID

The World Bank PSDG and the Bank for International Settlements CPSS chaired the Task Force that developed the Principles. The Principles have been endorsed by the G-20 and should be acknowledged by the G-8 after the final report is published in January



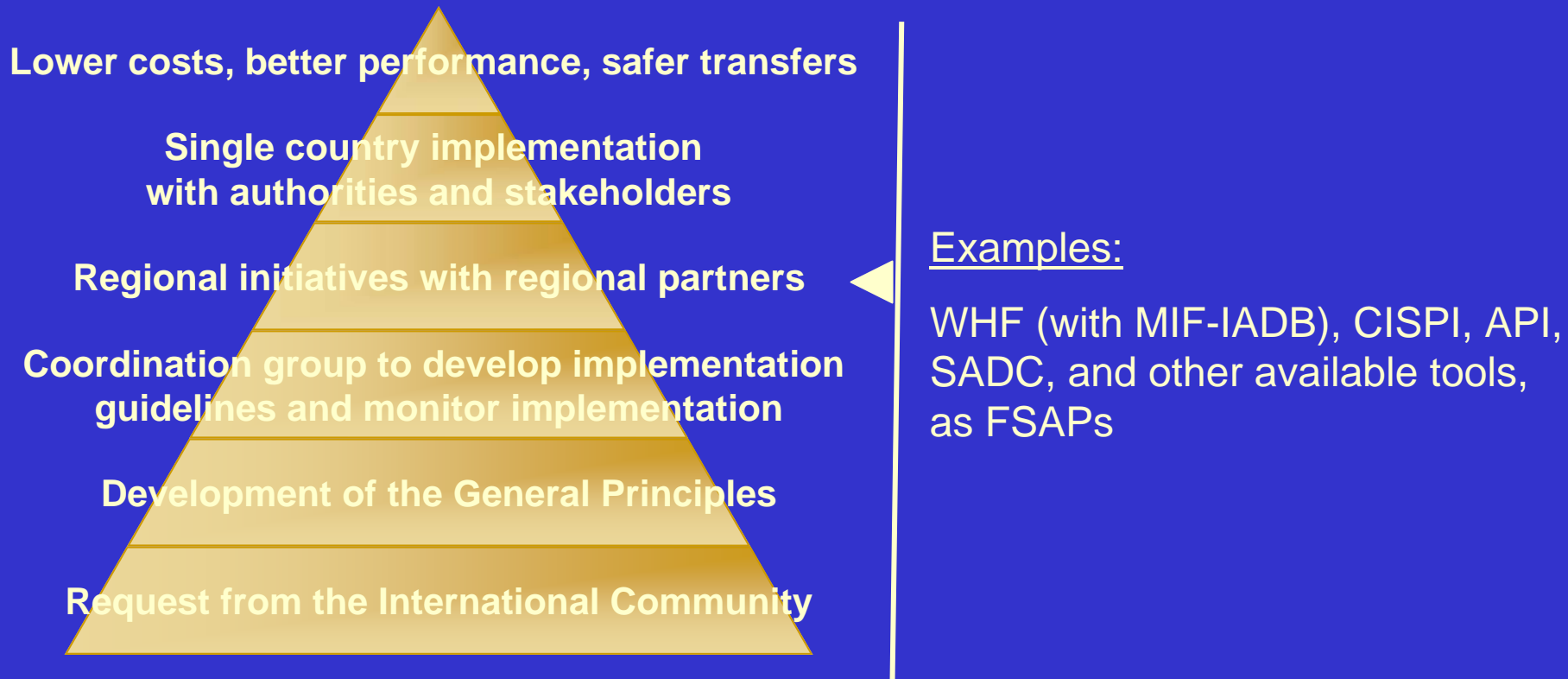
- The General Principles are a multilateral effort to address a global challenge



The World Bank PSDG is chairing a Coordination Group that is developing Guidelines for the application of the General Principles and stocktaking methodology



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Authorities showed interest in applying the Principles and in concrete actions and benefits that can be drawn from implementation. The World Bank Payment Systems Development Group harnesses its, and its partners', expertise to ensure concrete recommendations that yield tangible benefits to the countries



- GP1: The market for remittances should be transparent and have adequate consumer protection
- GP2: Improvements to payment system infrastructure that have the potential to increase the efficiency of remittance services should be encouraged
- GP3: Remittance services should be supported by a sound, predictable, non-discriminatory and proportionate legal and regulatory framework
- GP4: Competitive market conditions, including appropriate access to domestic payments infrastructures, should be fostered in the remittance service industry
- GP5: Remittance services should be supported by appropriate governance and risk management practices

- Role A: Remittance Service Providers should participate actively in the application of the general principles.
- Role B: Public authorities should evaluate what action to take to achieve the public policy objectives through implementation of the general principles



Implementation Challenges may include:

- Few players and exclusive distribution arrangements
- Many systems, many small and informal, and each bank may have a “system”
- Authorities may not have the powers to assess or implement
- Coordination between multiple authorities (more compared to domestic payments)
- Besides AML/CFT, there may be no oversight/regulation of remittance payments
- Create understanding for integration with domestic payments and access to finance
- Some problems may require actions from several sending countries

Final Reminders:

- The General Principles are voluntary, and countries can improve unilaterally
- The key is increased competition and open markets (avoiding exclusive structures)
- Integration into existing domestic payment systems can increase access to finance
- Low price may be more important than short transaction time



World Bank Payment Systems Development Group
Implementing the General Principles for International Remittance Services

Lower costs, better performance, safer transfers

Single country implementation
with authorities and stakeholders

Regional initiatives with regional partners

Coordination group to develop implementation
guidelines and monitor implementation

Development of the General Principles

Request from the International Community

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Reforming Payments and Securities Settlement Systems



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Reforming the National Payments System

Presentation structure

- A. The Importance of Payment Systems
- B. Payments and Securities Settlement Systems: Major Trends and Shortfalls Worldwide
- C. Lessons from Reform Experience and CPSS General Guidance for Payment System Development
- D. The Growing Attention to migrants' remittances
- E. The Role of the World Bank in the transformation process in payments and securities settlement systems

What is a Payment System?

1. A payment system is the collection of procedures, rules, standards, instruments, institutions and technical means used to exchange financial value between two parties discharging an obligation.
2. Although the purpose is simple, payment systems evolve over a period of years. The different conditions in each country (size, legal systems, business practices, technological infrastructure, stages of development of financial sector institutions) make each set of payment mechanisms unique.
3. Appropriate payment systems will satisfy the "evolving needs and requirements" of both current and future users - all users - of the payments clearance and settlement mechanisms.
4. Securities systems, because of their close linkages with payment systems, are increasingly considered as integral part of the payment system.

A. The Importance of PSS Systems

- **Payment systems and securities settlement systems represent a basic infrastructure for the functioning of market economies**
- PSSS are essential components for the smooth transmission mechanism of monetary policy
- The soundness of PSSS is fundamental for the stability of the currency

A. The Importance of PSS Systems

- The soundness of the PSSS is indispensable for the stability of financial markets - Financial market crises are likely to show their first signs in the payments system
- The soundness and, especially, efficiency of PSSS are fundamental factors in sustaining economic activity and economic development

A. The Importance of PSS Systems

- A major source of banking costs and profits
- Many innovative products and services
- Electronic technology is removing traditional barriers of time and space
- New players: a threat to traditional banks
- Trade-offs: competition and cooperation/ efficiency and risk

B. Payment Systems Trends and Shortfalls: legal framework

- o A growing attention is being given to the legal framework for payments and securities settlement, which, however, in many countries still presents important deficiencies
- o Typical shortfalls include: the definition of finality, protection of the systems against bankruptcy procedures, improvement of the legal basis for custody arrangements, legal basis for netting arrangements, and the regulation of oversight powers of the central bank

B. Payment Systems Trends and Shortfalls: systemically important payments systems (SIPS)

- o In many countries, SIPS are being designed following the CPSS Core Principles for SIPS
- o The backbone of the National Payments System is increasingly represented by an RTGS system operated by the central bank
- o Some RTGS systems are characterized by the presence of liquidity saving mechanisms, based on a combination of gross and net features

B. Payment Systems Trends and Shortfalls: systemically important payments systems (SIPS)

- o However, in some systems, some important issues have not been assessed properly
- o Apart from the legal issues presented above, other typical shortfalls include:
 - Risk control management is weak: no sufficient provision of intra-day liquidity; no optimal integration with securities settlement systems; no or insufficient guarantee schemes for systems based on netting

B. Payment Systems Trends and Shortfalls: systemically important payments systems (SIPS)

- Operational reliability and business continuity measures might be insufficient in light of recent debate on the issue
- Too many large value payments are still processed in relatively risky systems (especially cheque systems)
- Access is restricted to few participants without disclosure of risk considerations. Exit criteria are uncertain
- Governance arrangements are not transparent and system participants do not have appropriate fora to express their needs

B. The Core Principles

As a result of these weaknesses, too many SIPS are still not compliant with international standards

B. Payment Systems Trends and Shortfalls: retail systems

- o Attention to retail issues is still low worldwide
- o In many countries, despite the existence of an electronic funds transfer system, cheques are still often used as an instrument for the exchange of large value interbank payments
- o In some countries, cheques are not standardized and are, therefore, processed with cumbersome procedures
- o In many countries retail systems are characterized by a low degree of interoperability
- o In most of the countries, payment instruments are used in a sub-optimal way, from the efficiency point of view

B. Payment Systems Trends and Shortfalls: government payments

- o In many countries government payments are processed in a less than efficient way and have several negative implications for the payments system as a whole
- o For example, collection and disbursements of the public sector are not processed electronically and timely through current and envisaged automated systems. It must be noted that, in many cases, the gains in efficiency and cost reductions for government payments have been the main result of the reform effort, being able to recover the initial investment in a very short time-span

B. Payment Systems Trends and Shortfalls Transparency

- o In many cases, conditions applied to payment services are not transparent nor is it clear to the stakeholders and the public the policies pursued by authorities
- o Banks and other financial institutions are not forced to provide information to the public on the services they offer in the payments system and the general public nor are able to resort to a bank's Ombudsman and/or to the central bank and/or the consumers' protection agencies for resolution of conflicts related to payment services

B. Payment Systems Trends and Shortfalls: FX and cross-border settlement

- o Attention of these issues is still too low, and the consequences potentially disrupting especially in countries with significant volumes of cross-border activities
- o Financial risks are present in foreign exchange trading and settlement. In particular, in some countries, true PvP is not achieved in the vast majority of foreign exchange transactions
- o In many countries, cross-border retail payments are costly and not adequately regulated

B. Payment Systems Trends and Shortfalls: interbank money market

- o In many countries, interbank money markets are not deep since they are characterized by the heavy use of bilateral and OTC unregulated arrangements
- o This deficiency creates liquidity pressures in the payments system
- o On the other hand, insufficient integration of payments and securities is one cause of the insufficient development of these markets

B. Payment Systems Trends and Shortfalls: Cooperation

- o In many countries cooperation (among authorities, between authorities and stakeholders, and among stakeholders) is largely insufficient
- o Lack of cooperation is characterized by the absence of joint bodies to address problems of common interest and/or appropriate memoranda of understanding among authorities

B. Payment Systems Trends and Shortfalls: Oversight

- o Many central banks are in the process of strengthening their oversight function. However, in many countries:
 - ❑ The central bank does not have clear legislative authority for the oversight of clearance and settlement systems. Nor is secondary legislation (bylaws, circulars, etc.) implemented
 - ❑ The central bank does not disclose publicly its implementation strategies to achieve its objectives relating to all significant payment system matters
 - ❑ The central bank in exercising its oversight role does not have the ability to carry out this function effectively, especially in terms of human and financial resources

B. Payment Systems: Oversight

- ❑ the central bank does not verify that individual payment systems satisfy user needs as well as risk and efficiency requirements through appropriate interventions both at the development stage and during the on-going system implementation and operational phases
- ❑ the central bank does not define and implement appropriate actions should participants not comply with published rules and regulations (e.g. the application of pre-determined penalties and sanctions for compliance failures)
- ❑ the central bank does not collect and distribute relevant statistical information to demonstrate the use being made of each system and the extent to which the systems are satisfying end-user and other market needs

B. Trends and Shortfalls: Securities Settlement Systems (SSS)

- ⌘ In many countries SSS and funds transfer (payment) systems are not adequately integrated creating disruptions to the payments system as a whole
- ⌘ Many SSS around the world do not comply with the CPSS-IOSCO Recommendations for SSS
- ⌘ Some countries are considering the introduction of Central Counterparties (CCPs)

B. Trends and Shortfalls

The good news: Many countries in the world have implemented or are in the process of implementing reforms of the payments system

B. Trends and Shortfalls

The bad news: in many cases the reform has not been conducted or designed following a strategic approach. This has led or is likely to lead to sub-optimal equilibria

C. Lessons from Experience

Implementation: Typical Problems

- **Ad hoc implementations: developing individual systems without adopting the holistic approach**
- **Technology driven decisions (e.g. deciding on software before elaborating the vision and strategy)**
- **Finding Payment System Experts**
- **Intra- and Inter-organizational Politics**
- **Ineffective Communication within Participant Organizations**

C. Lessons from Experience

Implementation: Typical Problems

- **Changes in Representation**
- **Affinity towards Operational Issues (deviating from the strategic approach)**
- **Questioning the Role of the Central Bank**

C. Lessons from Experience

Implementation: Prerequisites for Success

- **A Driving Force - Top Level Sponsor**
- **Process Management Skills**
- **Project Management Discipline**
- **Patience with Process**
- **Continuous Progress - manage sub-projects**

C. Lessons from Experience Implementation: Prerequisites for Success

- **Continuity in Participation by Senior Personnel**
- **Wide and Active Involvement**
- **Communication with Stakeholders**
- **Perseverance**

C. The CPSS Guidance Report

- In January 2006, the Committee on Payment and Settlement System of the Bank for International Settlements released the final version of a Report on "Guidance for Payment System Development"
- The Report endorses an integrated and holistic approach to payment system reforms and sets up XIV guidelines for this process
- The Report builds on the experience of the World Bank, IMF and many central banks around the world in reforming the payment infrastructure

C. The CPSS Guidance Report

A. Banking system

Guideline 1: Keep the central bank at the centre: *due to its overall responsibility for a sound currency, the central bank has a central role in the development of the use of money as an effective means of payment.*

Guideline 2: Promote the role of a sound banking system: *payment accounts, instruments and services available to end users are mainly provided by banks, which compete individually but often need to act cooperatively as a system.*

C. The CPSS Guidance Report

B. Planning

Guideline 3: Recognise complexity: *planning should be based on a comprehensive understanding of all the core elements of the system and the principal factors influencing its development.*

Guideline 4: Focus on needs: *identify, and be guided by, the payment needs of all users in the system and by the capabilities of the economy.*

Guideline 5: Set clear priorities: *plan and prioritise payment system development strategically.*

Guideline 6: Implementation is key: *ensure effective implementation of the strategic plan.*

C. The CPSS Guidance Report

C. Institutional framework

Guideline 7: Promote market development: *the expansion and strengthening of market arrangements is a key aspect of the evolution of the payment system.*

Guideline 8: Involve relevant stakeholders: *encourage the development of effective consultation among relevant stakeholders in the payment system.*

Guideline 9: Cooperate with other authorities: *effective payment system oversight by the central bank requires collaborative arrangements with other authorities.*

Guideline 10: Promote legal certainty: *develop a transparent, comprehensive and sound legal framework for the system.*

C. The CPSS Guidance Report

D. Infrastructure

Guideline 11: Retail – give more choice to more people: *extend the coverage and choice of noncash payment instruments and services available to end users by expanding and improving infrastructures.*

Guideline 12: Large value – business case leads, technology follows: *develop a large-value payment system based primarily on the needs of financial markets and the growth in time-critical interbank payments.*

Guideline 13: Securities – plan securities and payment systems together: *coordinate the development of the infrastructures for securities and large-value payments.*

Guideline 14: Retail, large value and securities – coordinate settlement: *coordinate settlement processes for the core systems to effectively manage the interrelated liquidity needs and settlement risks among them.*

D. Remittances as a Payment System Issue

- ⌘ *KEY IDEA: Remittance services are part of the broader retail payment systems - both domestic and cross-border*
 - ☒ Remittances are cross-border retail payments with particular access requirements (on both the demand and supply sides)
- ⌘ An efficient domestic payment system infrastructure is key to reduce costs of remittance services, especially in receiving countries
- ⌘ The development of payment system oversight is fundamental to enhance transparency and improve efficiency in the retail payment sector

D. Remittances as a Payment System Issue

- ⌘ *KEY IDEA: Remittance services are part of the broader retail payment system both domestic and cross-border*
- ⌘ The CPSS of the BIS is the standard setter and a forum for discussion in the area of payment systems
- ⌘ The World Bank is a leading institution in payment system development, in particular in Latin America through the Western Hemisphere Payments and Securities Settlement Forum (WHF) and other regional initiatives. In the context of payment system reforms, the World Bank has recommended improvements in the remittance area since 1999
- ⌘ Payment system development projects are a good vehicle to address the issue

D. Remittances as a Payment System Issue

- ⌘ Remittances are part of an individual's access to financial services
- ⌘ A good remittance product improves value to the user in the short term and access to other financial products in the long term
- ⌘ A good remittance product increases competition and could move transactions to the formal sector
- ⌘ There are no standard solutions

D. CPSS/WB Task Force on “General Principles for International Remittance Systems”

- ⌘ International remittances initiated by migrant workers are an important source of family income in many developing economies (representing in some cases a significant percentage of the GDP of the receiving countries).
- ⌘ Some obstacles identified include:
 - ⊠ Lack of physical access to financial institutions
 - ⊠ Inadequate financial education
 - ⊠ Inefficient and costly remittance services available at financial institutions
 - ⊠ Regulatory barriers to the provision of remittances services
 - ⊠ Inadequacy of data on remittance flows
 - ⊠ Lack of guidance on what regulation/supervision of remittance service providers is necessary to ensure safety and integrity of these services

D. CPSS/WB Task Force on “General Principles for International Remittance Systems”

⌘ As part of the Sea Island remittance initiative, the G7 Finance Ministers and Central Bank Governors called for work toward developing prudential standards/guidelines for remittance services.

D. CPSS/WB Task Force on “General Principles for International Remittance Systems”

⌘ The Task Force is co-chaired by the CPSS and the World Bank.

⌘ Additional Members:

☒ Central banks of Brazil, Germany, Hong Kong, Italy, Mexico, the Philippines, Sri Lanka, Turkey, the United States, and the ECB, as well as the IMF, the Arab Monetary Fund, the Asian Development Bank, the European Bank for Reconstruction and Development, and the Inter-American Development Bank

D. CPSS/WB Task Force on "General Principles for International Remittance Systems"

Public policy objectives

- ⌘ International remittance services should be safe and efficient. To this end, the markets for the services should be contestable, transparent, accessible and sound

The means

- ⌘ Premise is that best way to reduce cost is to have competition as far as possible
- ⌘ The principles are not a call for remittances to be regulated. Sometimes it may be more important to remove existing regulation
- ⌘ Publicity (and political pressure) may be the most effective action (but note that this can be similar to "soft" regulation)

D. CPSS/WB Task Force on “General Principles for International Remittance Systems”

GP1: The market for remittances should be transparent and have adequate consumer protection

GP2: Improvements to payment system infrastructure

that have the potential to increase the efficiency of remittance services should be encouraged

GP3: Remittance services should be supported by a sound, predictable, non-discriminatory and proportionate legal and regulatory framework

D. CPSS/WB Task Force on “General Principles for International Remittance Systems”

GP4: Competitive market conditions, including appropriate access to domestic payments infrastructures, should be fostered in the remittance service industry

GP5: Remittance services should be supported by appropriate governance and risk management practices

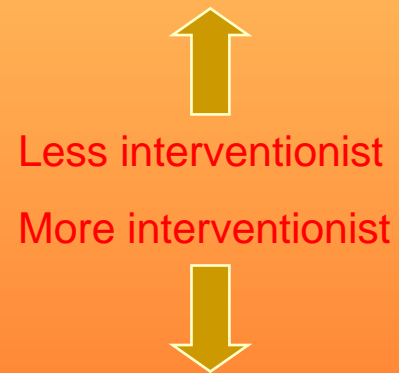
D. Who should take action?

Many people may need to take action. But RSPs and the authorities have particularly important roles:

- ⌘ **Role A: RSPs should participate actively in the application of the general principles.**
- ⌘ **Role B: Public authorities should evaluate what action to take to achieve the public policy objectives through implementation of the general principles**

D. Form of action by authorities?

- ⌘ Monitoring?
- ⌘ Dialogue?
- ⌘ Communication and outreach?
- ⌘ Catalyst/facilitator?
- ⌘ Regulation?
- ⌘ Direct provision?



D. Application of the principles

- ⌘ Purpose is to tackle weaknesses in the market (including poor regulation). They do not aim to set specific service levels. (low price may often be more important than high level of service)
- ⌘ They are voluntary. Designed to help countries that want to improve the market for remittance services. Not designed to be a basis for judging countries
- ⌘ May have to apply to all cross-border retail payments (difficult for RSPs to tell purpose of a payment or if it is person-to-person)

D. Implementation of the General Principles

- The Multilaterals (ADB, AMF, EBRD, IADB, and IMF), under the leadership of the World Bank, are developing detailed Guidelines for the application of the GPs and a stocktaking methodology, which will be released in June 2006
- Remittance systems might be evaluated against the GPs, and policy recommendations will possibly be implemented by authorities, service operators and other stakeholders
- Available tools will be used for the stocktaking and to foster the dialogue within the country and among countries (e.g. regional initiatives in payment systems, e.g. WHF, CISPI, API, FSAPs, etc.)
- The World Bank plans to be involved in these assessments together with other development banks, the IMF and country authorities (pilots to be started in June 2006)
- The World Bank will be open to support the implementation of action points after the assessments

E. Overcoming Shortfalls: The World Bank Role in the Transformation Process

Who we are ...

- Finance and Private Sector Vice Presidency
- *Payment System Development Group*

E. Overcoming Shortfalls: The World Bank Role in the Transformation Process

Areas in which we intervene:

- Providing a professional and complete stocktaking report
- Helping create momentum for the reform
- Supporting the country to adopt a holistic approach to financial infrastructure reform
- Supporting the country to develop the vision and the strategy
- Supporting the implementation of the reform providing advice

E. Overcoming Shortfalls: The World Bank Role in the Transformation Process

- Providing the most updated expert advice on all areas related to payment system reform:
- Legal Framework
- Retail systems with particular regard to the wide availability and efficient distribution of instruments, and access for the underserved population
- Government Payments and their importance for both large value and low value systems
- Cross-Border Payment Arrangements and (for some countries) settlement of domestic foreign exchange denominated transactions

E. Overcoming Shortfalls: The World Bank Role in the Transformation Process

- Large Value systems and their relations with interbank money market
- International Remittances
- Securities settlement systems and their interactions with other settlement systems
- Central Bank Oversight (both domestically and at the international level)
- The role of other authorities in the reform process and in the on going oversight activity

E. Overcoming Shortfalls: The World Bank Role in the Transformation Process

- Cooperative arrangements
- International Cooperation through regional initiatives
- Integration of payment system reform with the reform of other components of the financial infrastructure such as credit reporting, the development of trading platforms and the enhancement of the capital market structure.

E. Overcoming Shortfalls: The World Bank Role in the Transformation Process

Typical Tools:

- Funding through regular Bank loans for system implementation and technical assistance
- Fee-based Technical Assistance
- Regional Initiatives and FSAPs
- Others