

Reforming Payments and Securities Settlement Systems: the World Bank Perspective

World Bank Training Course, in
Cooperation with AMF and BMA

Bahrain, March 15, 2005



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Reforming the National Payments System

Presentation structure

- Payments and Securities Settlement Systems: Major Trends and Shortfalls Worldwide
- Lessons from Reform Experience
- The Role of the World Bank in the transformation process in payments and securities settlement systems



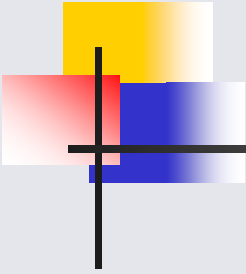
The Importance of PSS Systems

- **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



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 payment systems
- The soundness and, especially, efficiency of PSSS are fundamental factors in sustaining economic activity and economic development



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



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



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



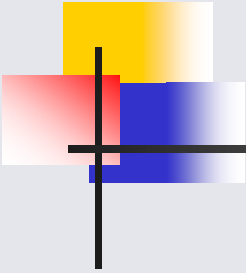
Payment Systems Trends and Shortfalls: systemically important payments systems (SIPS)

- 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



The Core Principles

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



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



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



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



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



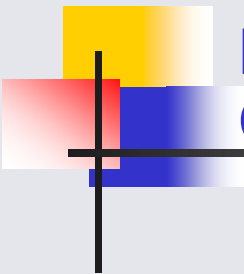
Payment Systems Trends and Shortfalls: interbank money market

- 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



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



Payment Systems Trends and Shortfalls: Oversight

- 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



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



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)**



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




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



Overcoming Shortfalls: The Role of the Central Bank in the Payments System

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- **The Central Bank normally plays a crucial role in reforming the payments system and guaranteeing its smooth functioning**
 - **A new function is emerging: Payments System Oversight**



Lessons from Experience

Implementation: Typical Problems

- **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**

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**



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**



Lessons from Experience

Implementation: Prerequisites for Success

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



Overcoming Shortfalls: The World Bank Role in the Transformation Process

Who we are ...

- Financial Sector Policy and Operations
- Technology, Financial Infrastructure and Access to Finance Group
- ***Reforming Payments and Securities Settlement Systems is one of our group's main activities***



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



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



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



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.



Overcoming Shortfalls: The World Bank Role in the Transformation Process


Typical Tools:

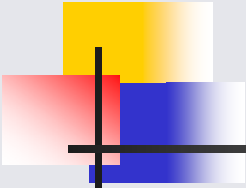
- Funding through regular Bank loans (support to the Regions in preparing and supervising the loan)
- Fee-based services (agreed with the Regions)
- Regional Initiatives (support to the Regions in launching and managing the programs)



The World Bank Role in the Transformation Process

What we do... Typical modernization objectives

- Provide the foundation for improved banking products and services, and geographical coverage
 - Ensure greater efficiency and liquidity in the banking system
 - Reduce risk and establish a sound risk management process
 - Optimize the costs of funds transfer transactions
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- Provide support for international funds transfer
 - Enhance the financial performance of the commercial sector
 - Lay the technical and procedural foundation for future developments, such as Electronic Commerce
 - Promote integration of payments and securities settlement systems



The World Bank Role in the Transformation process

- **Comprehensive initiatives:**

- ▶ Algeria, Angola, Azerbaijan, Bahamas, Barbados, BCEAO, BCEAC, China, Ecuador, Tanzania, Trinidad and Tobago, Uzbekistan, Venezuela, Vietnam, West Bank Gaza, etc.

- **Undertaking initial diagnostics and developing reform strategies:**

- ▶ Costa Rica, Dominican Republic, El Salvador, Guatemala, Haiti, Honduras, India, Indonesia, Jamaica, Libya, Madagascar, Morocco, OECS, Poland, Thailand, Tunisia, etc.

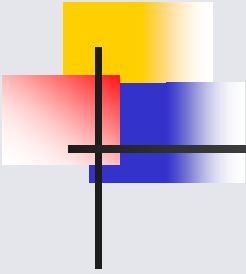
- **Providing specific technical advice:**

- ▶ Brazil, Chile, Colombia, Estonia, Hong Kong, Netherlands Antilles, Peru, Russia, Ukraine, Mongolia, Moldova, etc.



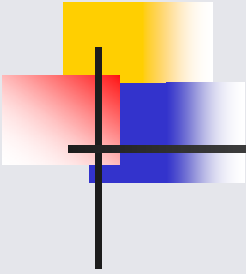
The World Bank Role in the Transformation Process

- Coordinating and managing multi-country and regional initiatives:
 - ▶ BCEAO, Central Bank of West Africa
 - ▶ BCEAC Central Bank of Central Africa
 - ▶ Southern African Development Community (SADC)
 - ▶ Western Hemisphere Initiative
 - ▶ Commonwealth of Independent States Initiative
 - ▶ Arab Initiative
- Commercial bank operational procedural improvements:
 - ▶ MIS, Decision Support, Products & Services, Global Modernization (India)



The World Bank Role in the Transformation process

- Supporting the launch of cooperative arrangements (e.g. Payments Councils)
- Organizing Training Activities
- Preparing support and educational materials including study methodologies - copies of several booklets are available
- Conducting Research in Innovative areas (e.g. Oversight)
- Preparing and publishing case studies



The World Bank Role in the Transformation process

- Participating in CPSS and IOSCO Task Force(s) and other influential bodies
- Supporting (with Fund colleagues), the Financial Sector Assessment Program and developing its methodology for assessments of payments and securities settlement systems
- Coordinating reform efforts with other areas in the financial sector network (e.g. credit reporting, access to financial services, capital markets)