A Framework for Central Bank Oversight of the National Payments System

World Bank Global Payment System Conference
“Redefining the Landscape of Payment Systems”
Cape Town, South Africa, April 7-10, 2009

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The World Bank Framework for the Development and Governance of Payment Systems in Emerging Economies
The oversight of a payment and settlement system aims to ensure that the infrastructure and the market for payment services work smoothly, efficiently, and fairly to all participants and users. It also minimizes the risk of transmitting shocks across the economy via the reverberation across the payment system of failures to settle payment obligations by individual participants. Additionally, it pursues the level of technological and institutional development necessary to satisfy the payment needs of a growing and open economy.
Framework: Some Factors that have made PSO more important

A. Technological development:
   - Faster systems and with much larger capacity
   - Virtual: less relevance of physical presence complicates surveillance, enforcement, crisis management via traditional methods and channels
   - Cross border: transcending physical, market, and jurisdictional boundaries (: cross border business)
   - Technological failures
   - Industry transformation: more competition and innovation, but also more risk of experimental failures (: confidence problems); unregulated institutions and non-financial institution

B. Financial Liberalization & Interdependencies

C. Increased Role of the Private Sector
Framework: Foundations of the Oversight Function

- Existence of Market Failures (externalities, information asymmetries, non-contestable markets)
- Coordination Failures
- Existence of Dominant Positions (potentially leading to abuse)
Framework: Why the central bank should be the overseer

- CB’s role in maintaining public confidence in money
- CB’s responsibility for monetary policy (MP) and its MP strong link with payment systems
- CB’s lender of last resort’s function
- CB’s ability to act in emergencies and prompt government support for its actions
Framework: Role of the Overseer:

• Develop principles and rules
• Assess/enforce rules compliance
• Promote/coordinate individual and collective actions
• Ensure system functioning
• Promote system development
Ultimate Objectives of Oversight

- Economic Development
- Financial Stability
Operational Objectives of Oversight

• Development of efficient, safe and reliable payment systems
• Prevention of market abuse
• Extension of Payment Services
• Prevention of Criminal Abuse
Intermediate Objectives of Oversight

• Competitive Market Conditions
• Cooperation
• Sound Legal Foundations
Instruments of Oversight

• Regulations and Incentives
  • For Large Value Systems, defining organizational, functional and technical features of the system
  • For retail, minimum reliability and efficiency requirements/criteria for interoperability of payment systems
Instruments of Oversight

• Policy Dialogue (under the traditional activity of moral suasion)
  • To secure a fair representation of the public and private interests and to create consensus for policy choices
  • At times, formalized in structured cooperative bodies
Instruments of Oversight

- Monitoring (through collection of information, on site inspections, etc.)
- Governance Structure of the system
- Direct Provision of Payment Systems (beyond the tradition provision of way to mobilize settlement accounts, e.g. RTGS systems, especially in emerging economies)
Targets of Oversight Activity

- Access
- Risk Control
- Information Transparency
- Pricing
- System Reliability
- System Development
The Scope of Oversight

- Consensus that systems that pose systemic risks should fall under overseer’s control

- Increasing attention to securities C&S as relevant components of the overall PS

- In a growing number of countries also retail systems fall under the scope because of their importance for overall efficiency of the PS, impact on public trust on money and support to economic activity
The Scope of Oversight

In emerging economies it might be justified to have a wide scope, since the overseer is likely to be called to play a proactive role to ensure: national coverage of payment services, public trust on money, support in the development of the payment infrastructure.
Volumes and cost savings for remittances & payment systems

2006 Emerging Market GDP = $11,527 BN

<table>
<thead>
<tr>
<th>Volumes</th>
<th>Total Payment Volume</th>
<th>Total Potential Payment Volume</th>
</tr>
</thead>
<tbody>
<tr>
<td>Remittances</td>
<td>$462</td>
<td>$222</td>
</tr>
<tr>
<td>Payment Systems</td>
<td>$154,196</td>
<td>$64,845</td>
</tr>
</tbody>
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Appropriate Infrastructure helps reduce transaction costs

Cost per $100 lent or sent

- Remittances
  - Least efficient system: $25
  - Most efficient system: $5
  - Total potential reduction in costs: $20

- Domestic Payments
  - Least efficient system: $20
  - Most efficient system: $0
  - Total potential reduction in costs: $20

Notes: “Total potential reduction in costs” is indicative of the broad range of potential cost reduction. Actual cost savings realized is contingent ultimately on the efficiency of the system. For remittances, costs are of sending remittances to remitter’s home country. For domestic payments, costs are sending payments within a country.
Extending Payment System Oversight to retail payment systems and mobile payments/money

- According to the World Bank’s Global Payment Systems Survey, 73 payment system overseers or 57% of the 128 central banks covered explicitly include retail payment systems in their oversight policies and activities.

- Moreover, in addition to the traditional objectives of safety and efficiency, already 40 overseers have embraced formally broader oversight objectives such as consumer protection or avoiding collusive practices.

- Therefore, in many countries mobile money is having or will have soon its regulatory debut with the payment system overseer.
Oversight: Types of Action

Structural
Routine
Crisis Management
Antitrust
R&D
TA Resource Mobilization
Oversight: Staffing

Adequate Technical and Human Resources must be devoted to this Function which requires excellent timing, continuous contacts with the market and a full understanding of the mechanics of the system.
Oversight: Cooperation

- Oversight role is not exclusive of the central bank that should cooperate with other authorities (e.g., Banking Supervision, Securities Regulators, Antitrust agencies)

- Formal arrangements are preferable to avoid conflicts among regulators
Oversight: Cooperation

- Cooperation between the Payment Systems Overseer and all stakeholders is essential to achieve the oversight objectives.
- Ad hoc Cooperative bodies (e.g. Payments System Committee) should be formed to guarantee this cooperation.
- Cooperation between market participants (e.g. through Bankers’ Associations, users groups, etc.) is equally important to achieve the oversight objectives.
Oversight: Recommendations for Emerging Economies

1) Well functioning payment systems need a strong oversight underpinning

2) Central banks should create a specific PSO function (legally based and supported with all necessary skills)

3) The overseer should set a cooperative framework with all the institutions involved in the payment business

4) PSO strategies and policies should be transparent

5) The overseer should make sure all the systems are safe and efficient, including those operated by the central bank itself
Oversight: Recommendations for Emerging Economies

5) PSO must be based on incentive-compatible strategies: the overseer should engage the private sector and work with the markets

6) To the extent possible, market for payment services should be competitive/contestable

7) A level playing field must be achieved for financial and non-financial PS participants

8) Attention must be given to the impact of e-finance on the stability of payment systems

9) Appropriate crisis management is essential

10) Overseers should invest more in payment system research and policy issues
Oversight as defined by CPSS Reports
THE CPSS CORE PRINCIPLES FOR SYSTEMICALLY IMPORTANT PAYMENT SYSTEMS

• Two Public Policy objectives (safety and efficiency) in systemically important payment systems (SIPS)

• Ten core principles for SIPS

• Four central bank’s responsibilities in applying the core principles
A: The Central Bank should define clearly its payment system objectives and should disclose publicly its role and major policies with respect to systemically important payment systems.

B: The Central Bank should ensure that the systems it operates comply with the core principles.
The Central Bank’s Responsibilities in Applying the Core principles

C: The Central Bank should oversee compliance with the Core Principles by systems it does not operate and it should have the ability to carry out this oversight.

D: The Central Bank, in promoting payment system safety and efficiency through the Core Principles, should cooperate with other central banks and with any other relevant domestic and foreign authorities.
Oversight Principle A: Transparency
Central banks should set out publicly their oversight principles, including the policy requirements or standards for systems and the criteria for determining which systems they apply to.

Oversight Principle B: International Standards
Central banks should adopt, where relevant, internationally recognized standards for payment and settlement systems.
Oversight Principle C: Effective Powers and Capacity

Central banks should have the powers and capacity to carry out their oversight responsibilities effectively.

Oversight Principle D: Consistency

Oversight standards should be applied consistently to comparable payment and settlement systems, including systems operated by the central bank.
CPSS Principles for Effective Oversight (2005)

Oversight Principle E: Coordination with other authorities

Central banks, in promoting the safety and efficiency of payment and settlement systems, should cooperate with other relevant central banks and stakeholders.
Cross-Border and multicurrency payment and settlement systems are of potential oversight relevance to more than one central bank.

Therefore, the 2005 CPSS Oversight Report has set up five principles for international cooperative oversight.
Principle 1: Notification

Each Central Bank that has identified the actual or proposed operation of a cross-border or multicurrency payment or settlement systems should inform other central banks that may have an interest in the prudent design and management of the system.

Principle 2: Primary Responsibility

Cross-Border and multicurrency payment and settlement systems should be subject to oversight by a central bank which accepts primary responsibility for such oversight, and there should be a presumption that the central bank where the system is located will have this primary responsibility.
Principle 3: Assessment of the system as a whole
In its oversight of a system, the authority with primary responsibility should periodically assess the design and operation of the system as a whole. In doing so, it should consult with other relevant authorities.

Principle 4: Settlement arrangements
The determination of the adequacy of a system’s settlement and failure-to-settle procedures in a currency should be the joint responsibility of the central bank of issue and the authority with primary responsibility for oversight of the system.

Principle 5: Unsound process
In the absence of confidence in the soundness of the design or management of any cross-border or multicurrency payment or settlement system, a central bank, should, if necessary, discourage use of the system or the provision of services to the system, for example by identifying these activities as unsafe and unsound practices.