WESTERN HEMISPHERE PAYMENTS AND SECURITIES SETTLEMENT FORUM

GLOBAL PAYMENTS WEEK 2016

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Executive Summary

Session 1. Risk management in payment systems (PS) and financial market infrastructures (FMIs) of the LAC region: current issues and approaches

Session facilitated by Rogerio Lucca, Banco Central do Brasil

Objective

This session focused on sharing good practices and recent developments related to risk management in PS and FMIs to identify new solutions and approaches to common issues/risks.

Background

Implementation efforts of CPMI-IOSCO Principles for Financial Market Infrastructures (PFMI) have unveiled challenges from various angles for authorities and operators. Risk management is at the very heart of such challenges; therefore, it is important to learn about different interpretations and approaches to risk management regarding legal, institutional and operational aspects of the operations of PS and FMI in each country of the region.

Discussion on financial risk management

The discussion began with a review of the work conducted by the Sub-Group for the PFMI (S-PFMI) of the Working Group on Payment Systems Issues of Latin America and the Caribbean (WGPS-LAC) on the implications stemming from the implementation of the PFMI.

It was stressed that thanks to previous efforts made to implement the previous standards (the 2001 CPSS Core Principles) to systemically important payment systems, from the perspective of financial risk management, PFMI implementation has been a relatively straightforward exercise. However, it was also noted that some PFMI novelties do not seem to be applicable in the region, either because of the absence of certain FMI types (e.g. trade repositories) in certain countries, or due to financial sector development issues. Considering this, the discussion focused on the implementation and evaluation of the PFMI (especially Principles 4, 5 and 7) for Prominently Important Payment Systems, including electronic money, faster payments, etc.

In this context, the discussion reinforced a common understanding that in light of the nature of risks and overall functioning of Prominently Important Payment Systems, for example electronic money and other electronic retail payment systems (ERPS), it is important to have good practices and clear references to strengthen risk management for these systems, which in turn has implications on public confidence in the financial system. In some cases, this is even more important given the systemic importance that such systems may have in a given countries; though in the absence of guidance on how to use the PFMI as reference for these systems, it is necessary to develop an appropriate framework to promote, among other good practices, suitable financial risk management for ERPS. In fact, PFMI implementation to ERPS involves a high degree of interpretation by each authority and the payment systems operators, thus making it difficult to compare risk management approaches between countries.

As part of this discussion, it was proposed that the WGPS-LAC[1] should suggest to the CPMI the development of ERPS-specific standards that do not focus on the same type of risks (i.e., systemic) as those considered for Systemically Important Payment Systems, but rather concentrate on the continuity of critical services that ERPS provide to their participants, the customer, and the economy as a whole.

It was mentioned that, although there are some references and guidelines applicable to ERPS, they are dispersed or have been developed at different times and in different work areas, reflecting the opportunity to establish a single set of best practices applicable to any ERPS at the regional or international level.

It was concluded ERPS new standards should be developed in a way that is applicable to all new systems and participants that are not necessarily from the financial sector (e.g. Telcos and other new providers of payment services), given the advances in technology affecting the ecosystem and the systems' "hybrid"-functionality that generates blurred areas.

Discussion on a framework for the comprehensive management of risks

This discussion started by recognizing that a comprehensive risk management framework should have:

a) Risk-management policies, procedures, and systems, for the range of risks that arise in or are borne by a PS / FMI
b) Participants' incentives to manage / contain risks
c) Consideration for interdependencies
d) Recovery or orderly wind-down of a PS or a FMI

At first, it was stressed that given the nature of PFMI Principle 3, it is essential that the PS / FMI organizational structure is such that responsibilities related to financial, legal, and operational risk management are fully identified. Hence, this Principle can be assessed and implemented as an exercise of corporate governance (corporate risk policy). For instance, reference was made to RTGS systems operated by central banks, which require an integrated and well-coordinated management among the different areas, even more for those areas that are not familiar with RTGS operations or with PS functioning in general, or have opposing operational priorities to certain aspects of safety and efficiency that must be fulfilled by RTGS systems.

One of the main conclusions is that an effective, comprehensive risk management will imply participation and involvement of several parties in the respective PS / FMI. In that sense, one way to ensure such organization and coordination is through the establishment of a monitoring committee (e.g. financial stability committee) that has the adequate hierarchical level and a vision to establish comprehensive risk management policies, procedures and systems. This coordinated framework should be designed in such a way that it can be continuously reviewed to identify and address deficiencies. Besides, implemented tools should also allow to incorporate, analyze and evaluate risk exposures in all the PS or FMI ecosystem, including the system itself and -if it is the case- other relevant parties such as participants and participants' customers.

Finally, it was noted that Principle 3 is qualitative in nature, so it is expected that the interpretation, implementation and operation of a framework for the comprehensive management of risks to be somewhat

[1] It was also proposed to deeply analyze the applicability of standards to ERPS, based on existing references such as those already developed by the ECB and the CPMI.

flexible to adapt to the governance characteristics of each PS / FMI. Therefore, one of the issues for the authorities to consider is that the Principle evaluation must be homogeneous at the national and, if necessary, also at cross-border level.

There were no conclusions on other discussion topics, such as the possibility of developing a standardized approach for evaluating the framework for comprehensive risk management in all LAC countries.

Session 2. How the PAFI (Payment Aspects of Financial Inclusion) framework can be operationalized?

Session facilitated by Marc Hollanders, Bank for Internationals Settlements and Massimo Cirasino, World Bank

Objective

This session was focused on discussing and sharing experiences on how to set an operational strategy based on the PAFI Guiding Principles and Recommended Actions in each country.

Background

Implementation support for specific PAFI based measures must build on an assessment; however, there are priority issues to guide implementation efforts around the PAFI Guiding Principles. Therefore, sharing experiences of countries where actions have already been implemented or are in the process of being implemented, is key to developing such implementation support.

Discussion

This session focused on discussing what role payment systems have in reducing cash and facilitate electronic payments between users, and as a mechanism to promote financial inclusion, and on identifying the central bank role in leading these efforts.

On the one hand, it was mentioned that despite the growing implementation of financial inclusion strategies, the effective use of ERPS has been limited because there is no cooperation - sometimes cooperation is not even a possibility - between traditional and non-traditional payment service providers to ensure an appropriate degree of accessibility and interoperability. This reduces the economies of scope and scale that ERPS could have and that are critical for the industry to foster financial access in a sustainable fashion. On the other hand, it was pointed out that the region has progressed considerably in promoting the use of transaction accounts given the structural need to increase financial access. In this regard, it was stressed that transaction accounts have shown potential to foster an effective bancarization of clients accessing financial system by means of a payment service.

One discussion issue that attracted significant attention is the design and functioning of transaction accounts, and the importance of balancing broader access and a more friendly approach to unbanked clients with proper risk management related to know-your-customer and customer-due-diligence policies bearing in mind the type of users and their payments behavior. In this regard, the importance of having a standardized identification system that is accessible and secure to validate and monitor the accountholders of transaction accounts was noted.

Due to the multiple payment needs for the population, besides transaction accounts, other payment systems and services that can promote financial inclusion should be designed in a way that potential users find incentives to create a behavior of paying/saving/investing.

Among the various tools that are necessary to leverage successful experiences of transaction accounts and other payment strategies to operationalize PAFI, it was mentioned that it is key to have reliable statistical information that allows adjusting and steer financial inclusion actions and strategies that rely on payments.

In conclusion, it was noted that to operationalize a framework such as PAFI alike, it is important to have a diagnosis of the current situation in each country that allows selecting the proper tools to foster access and the effective use of payment and financial services, as can be transaction accounts. Once they have implemented the identified actions to meet their financial inclusion objectives, central banks need to monitor and review the development of the payment instruments and services involved in those actions, in order to ensure innovation, safety, efficiency and convenience in the ERPS industry.

Session 3. Cyber Resilience, IT security and other relevant operational continuity related issues

Session facilitated by Victor de la Luz, Banco de Mexico

Objective

This session was focused on discussing and sharing experiences related to cyber security in PS and FMI and the implications for continuity of critical systems for the economy.

Background

Guidelines on FMI cyber resilience issued by CPMI-IOSCO encourage PS / FMI to put in place a governance structure to improve their cybersecurity policies, including plans and capabilities to meet the recovery time objective (RTO) of 2 hours.

Discussion

The discussion was focused on sharing recent experiences where central banks have faced cyber-attacks threats - or attempts of cyber-attacks - to PS / FMI, especially in view of recently events occurred like in the Bangladesh Bank.

Participants started by noting that, given the nature of information and communication technologies used within the financial system, to prevent, mitigate and respond to cyber-attacks threats is a complex task. Thus, central banks must be properly prepared to contain negative effects on the PS / FMI functioning, and also must promote a cooperative approach between PS / FMI operators and participants. One way to achieve this is working on the continuity and contingency plans to internalize challenges on PS and FMI functioning that derives from technology influence; likewise, promote testing and monitoring scheme on cyber security levels so that, in a coordinated environment, threats or attacks can be dealt.

It was noted the recent cyber-attacks were characterized by a lack of standards or best practices in information security management by PS / FMI providers and operators. In that sense, it was highlighted that data loss or critical services interruption are increasingly latent risks regarding operational continuity for PS / FMI or auxiliary infrastructure providers. Therefore, it is crucial that: 1) systems and policies that allow to identify responsibilities in the information security management (integrity and availability) are in place, as well as solid assessment of the information security management to reduce cyber security related risk vectors; and 2) the PS / FMI have a proper governance structure and coordination mechanism that enable the comprehensive risk management and allow meeting international standards, such as recovery time objective, established by the CPMI.

From the central bank perspective, it was mentioned that PS / FMI governance of risk management and information management functions must be adequately strengthened considering the criticality of these functions and the relevance of PS / FMI services provided to the economy, in a way that adequately mitigate the risks inherent to cyber-attacks. As for communication with other PS and FMI, central bank must maintain standardized requirements level for all operators, thereby ensuring credibility and compliance with the cybersecurity standards.

Finally, the discussion confirmed the importance to promote sharing of information on regional events or related incidents, for which the Working Group on Payment System Issues of Latin America and the Caribbean is considered a suitable and convenient platform.

Session 4. Mitigating de-risking: the perspective of the LAC region

Session facilitated by Fabiola Herrera, Banco Central de la Republica Dominicana and Carlo Corazza, World Bank

Objective

This session was focused on the potential monitoring initiatives to offset or mitigate the negative effects of de-risking at global level and, at the same time, on discussing the potential regional scenarios in this area, from a central banks perspective.

Background

International banks around the world are reassessing their correspondent banking relationships at global level, as a response to the tightening of international financial regulation aimed at fostering market integrity (in particular, around money laundering and financing of terrorism). This change in business strategy has led to the progressive exit of many banks from different business sectors, refusing the provision of banking services to different categories of stakeholders or entire countries. The phenomenon, known as de-risking, has impacted certain payment products (e.g. wire transfers, remittances and trade finance) or even entire jurisdictions. The closure of correspondent banking agreements and the denial of access to some businesses to the national payment systems infrastructure set new challenges for central banks, as they have to guarantee the well-functioning of the payment systems both domestically and at cross border level.

Discussion

The WB and CPMI provided some background to the discussion, presenting the work developed in the last few months and some recommendations that could help the authorities in improving the situation. The discussion initially focused on those measures that can increase the level of transparency and traceability of the market, like the utilities and the know-your-customer tools to support local banks and the financial system to meet the correspondent banks standards and requirements. The participants agreed on the fact that the industry must work in a coordinated way in those countries affected by a perception of higher risk for money laundering. Similarly the complexity to identify banks' customers in correspondent relationships should be further reviewed, so that the identification of the parts is clear and less cumbersome. The participants highlighted that the central banks should have a more active role in those cases when the de-risking is mainly driven by the increased costs of compliance with the regulation. For example if the rules or general standards issued to fulfill correspondent banking requirements cannot be met by smaller institutions, the regulators and the central banks should consider alternative solutions. Among them, the possibility to use a closed group as intermediary (e.g. SWIFT associated users), or to facilitate coordination between the regulators of the affected countries to harmonize the necessary processes and meet the relevant standards. It was also discussed that, in some cases, the activation of regional payment mechanisms could lead to a

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lower dependence on correspondent banking and therefore help in reducing the impact of de-risking practices.

The discussion stressed the severity of the problem in some economies, where the lack of correspondent banking services generates various levels of financial exclusion. In these situations, some operators move towards the creation of alternative or illegal mechanisms to continue making payments abroad and maintain their businesses alive.

The discussion was concluded by two final remarks: a) the first was related to the need for international banks providing correspondent banking services to recognize and adopt risk-based approaches for lower-risk customers using certain types of transactions such as remittances; and b) the second was aimed at reminding the central banks about the importance to keep informed and regularly record the difficulties their financial systems and their economies have with the issue of de-risking.