



CEMLA

Western Hemisphere Initiative

Lessons from IMF/World Bank Financial
Sector Assessment Program—FSAP

Payment and Securities Settlement
Systems

Kai Barvell-International Monetary Fund
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Financial Sector Assessment Program - FSAP

- Joint IMF-World Bank Initiative
- Two-times two weeks on-site and with 10-20+ mission members
- Evaluation of the Financial System
- Observance of Codes and Standards
 - ▼ BIS - CP for Effective Banking Supervision
 - ▼ IOSCO-Capital Markets and supervision
 - ▼ IAIS-Insurance Regulation and supervision
 - ▼ IMF-Transparency Code in Monetary and Financial Policies
 - ▼ CPSS-Core Principles for Systemically Important Payment Systems
 - ▼ CPSS-IOSCO Recommendations for Securities Settlement Systems (formally as from mid-2002)

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FSAP Mission by end 2002

- 45 countries and 60 payment systems have been assessed.
- Areas of major concerns are
 - ▼ Legal foundation
 - ▼ Managing risk
 - ▼ Governance
 - ▼ Central Bank lacks a statutory oversight role

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Core Principles I *Legal foundation*

- *Observance 65%; Non Observance 35%*
- Zero hours rule exists
- Bankruptcy Law does not accept netting
- Lack of laws dealing with payment systems and/or payment instruments
- Uncertainty about pledging of securities
- Real-Time finality is not assured
- Central bank's role in payment systems is unclear

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Core Principle II

Clear understanding of financial risk

- *Observance 80%; Non Observance 20%*
- System rules and procedures are not fully described
- Rules and procedures for handling a crisis situation have not been defined
- Roles of various parties are not defined
- Perception that the Central Bank guarantees settlement exists

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Core Principle III

Procedures for management of risks

- *Observance 75%; Non Observance 25%*
- No real-time information system on outstanding positions
- No central bank intraday lending
- No queuing facilities in RTGS systems
- Unwinding, the only way to solve a participant's default
- Bilateral and or multilateral limits on positions exist, but are not effective
- Check clearing systems handle large value payments

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Core Principle IV *Final settlement on the day of value*

- *Observance 80%; Non Observance 20%*
- Final positions are known only the following morning
- Zero hour rule exists
- Legal uncertainty about finality of payment
- Legal uncertainty about netting

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Core Principle V *Ensuring settlement in a multilateral net settlement system*

- *Observance 35%; Non Observance 65%*
- No "Survivors Pay" or "Defaulters Pay" schemes exist
- Unwinding is the only way to solve a participant's default
- Difficult/impossible to ensure settlement in a check clearing system

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Core Principle VI *Settlement Assets – Central Bank Money*

Observance 95%; Non Observance 5%

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Core Principle VII *High degree of security and operational reliability*

- *Observance 75%; Non Observance 25%*

- Low level of system security
- No back up system
- No secondary site for the back up computer
- No contingency arrangements
- No comprehensive regular testing of continuity and disaster recovery arrangements, also involving the secondary site and the participants.
- No regular independent risk analysis

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Core Principle VIII *Practical and efficient for its users*

- *Observance 70%; Non Observance 30%*
- No cost benefit analysis
- Operational and/or development costs are not covered by the fees
- Central Bank takes the risk in the settlement process
- Lack of real-time and intraday settlement
- Too many settlement failures

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Core Principle IX *Objective and publicly disclosed access criteria*

- *Observance 90%; Non Observance 10%*
- Access criteria have not been disclosed
- Exit criteria do not exist, or have not been disclosed

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Core Principle X *Governance*

- *Observance 70%; Non Observance 30%*
- Lack of written strategic objectives and plans
- No clear lines of responsibility
- No independent audit function
- No riskmanagement function
- Information about the system's performance, and how it is governed, are not published on a regular basis
- Legal protection is not provided to Central Bank officials performing payment system related duties
- **A number of the other Core Principles are not observed**

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Central Bank Responsibility A *Disclosure of objectives and policies*

- *Observance 55%; Non Observance 45%*
- The Central Bank
 - ▼ has not clearly defined and disclosed its payment system objectives
 - ▼ does not have a formal oversight responsibility
 - ▼ has not separated its responsibilities for oversight and of operations of payment system, respectively
 - ▼ approaches payment system issues only from a supervisory perspective

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Central Bank Responsibility B
*Ensuring own systems observe
CPSIPS*

Observance 65%; Non Observance 35%

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Central Bank Responsibility C
*Oversee Observance of Private
Systems*

Observance 60%; Non Observance 40%

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Central Bank Responsibility D *Cooperation with central banks/authorities*

Observance 70%; Non Observance 30%

The Central Bank

- ▼ has no formal agreement with relevant domestic and foreign oversight/supervisory agencies

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FSAP Missions by end 2002 Securities Settlement Systems

- 10 countries and 21 securities settlement systems have been assessed.
- Areas of major concerns are
 - ▼ Legal framework
 - ▼ Lack of Delivery versus Payment (DvP)
 - ▼ CSD Risk Control (improvement needed)
 - ▼ Lack of Transparency (procedures/risks)
 - ▼ Regulation and Oversight (co-operation)

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Recommendation 1 *Legal framework*

Observance 60%; Non Observance 40%

- Bankruptcy proceedings may invalidate settlement rules and procedures
- No legal foundation for netting
- No legal foundation for secured interest
- No definition of finality
- Securities not fungible
- Legislation does not cover all securities
- Dematerialization is not allowed

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Recommendation 2 *Trade confirmation*

Observance 80%; Non Observance 20%

- Equity trades are not confirmed on T+0

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Recommendation 3 *Settlement cycles*

Observance 95%; Non Observance 5%

- Need to shorten timing of settlement
- Information between clearing members/ brokers and their clients need to be improved

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Recommendation 4 *Central counterparties*

Observance 50%; Non Observance 20%
Non Applicable 30%

- No evaluation of the cost and benefits of a CCP has been undertaken

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Recommendation 5 *Securities lending*

*Observance 70%; Non Observance 25%
Not Applicable 5%*

- Too many securities are not dematerialized.
- Too many Bearer Instruments
- No legal basis for repurchase transactions

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Recommendation 6 *Central Securities Depositories (CSDs)*

Observance 70%; Non Observance 30%

- No requirement to dematerialize securities

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Recommendation 7 *Delivery versus Payment (DvP)*

*Observance 75%; Non Observance 20%
Not Applicable 5%*

- No DvP, as principal risk is not eliminated
- Unclear if principal risk could be mitigated due to bankruptcy laws

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Recommendation 8 *Timing of Settlement Finality*

Observance 80%; Non Observance 20%

- No intraday settlement
- No specification when settlement is final
- Settlement takes place on S+1

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Recommendation 9 *CSD Risk Controls*

*Observance 30%; Non Observance 35%
Not Applicable 35%*

- Timely settlement is not ensured
- Overdrafts on securities accounts are allowed
- The risk control mechanism does not guarantee end of day settlement
- Unwinding of transactions is the only solution should a participant default

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Recommendation 10 *Cash Settlement Assets*

Observance 80%; Non Observance 20%

- No settlement in Central Bank Money
- Concentration risks due to a few settlement banks
- Perception that supervised settlement banks would be supported by the authorities in case of a default
- Settlement of the cash side occurs in a net settlement system, even though an RTGS system is in place

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Recommendation 11 *Operational Reliability*

*Observance 90%; Non Observance 5%
Not Applicable 5%*

- No back-up site exists
- No contingency arrangements
- No regular independent risk analysis

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Recommendation 12 *Protection of Customers' Securities*

*Observance 90%; Non Observance 5%
Not Applicable 5%*

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Recommendation 13 *Governance*

*Observance 75%; Non Observance 10%
Not Applicable 15%*

- The Board of an SSS (owned by banks) is avoiding taking necessary steps to upgrade the system due to concerns that such a move may have on the banks' custodial activities

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Recommendation 14 *Access*

- *Observance 65%; Non Observance 20%
Not Applicable 15%*

- The Board of the SSS are free to decide which institutions that should have access to the SSS even though neutral access criteria exist

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Recommendation 15 *Efficiency*

Observance 70%; Non Observance 30%

- More than one CSD exist, but no CCP and no RTGS system to settle the cash side of securities transactions

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Recommendation 16 *Communication Procedures*

*Observance 65%; Non Observance 10%
Not Applicable 25%*

- The system has not adopted a message format based on international standards (ISO 15022)

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Recommendation 17 *Transparency*

*Observance 60%; Non Observance 25%
Not Applicable 15%*

- Fragmentation of the settlement procedures
- Information about the risks in participating in the system has not been made public

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Recommendation 18 *Regulation and Oversight*

Observance 55%; Non Observance 45%

- No framework between domestic regulators and with concerned foreign authorities
- No supervision/oversight schemes exist
- Limited ongoing oversight
- Supervisory agency lacks the necessary knowledge about SSS
- The Central Bank has not publicly disclosed to the public its role as overseer of the SSS

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Recommendation 19 *Risks in Cross-border Links*

*Observance 30%; Non Observance 0%
Not Applicable 70%*