Assessment Methodology for the CPSS-IOSCO Principles for Financial Market Infrastructures

Semana de Pagos 2013
Cartagena, 21 November 2013

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Assessment Methodology: background

- Developed by a sub-group chaired by the World Bank and the IMF, the Assessment Methodology (AM) provides a framework for assessing an FMI's observance of each of the 24 Principles and the relevant authorities' observance of each of the five Responsibilities

- Together with the *Disclosure Framework*, it is a tool to promote the implementation and ongoing observance of the Principles and Responsibilities and to help ensure objectivity and comparability of assessments of observance across all relevant jurisdictions

- CPSS-IOSCO report *Disclosure framework and Assessment methodology* published in December 2012

Assessment Methodology: what's new?

- For the first time, framework to assess all types of FMIs' observance of each of the 24 Principles and the relevant authorities' observance of each of the five Responsibilities is provided under *one methodology*
- Draws from the methodologies that were developed for the CPSIPS, the RSSS and the RCCP, taking into account the lessons learned from the use of the existing approaches
- Balanced approach that allows flexibility in use of assessment methodology while ensuring comparability across time and FMIs/countries
- Clearly outlined 6-step process. Fact gathering is guided by detailed assessment questions. Answers to assessment questions should form the basis for "key conclusions"
- New, more rigorous rating framework based on concepts of seriousness of issues of concern and urgency to remedy. Rating should be based on "key conclusions" and reflect the *most serious* issue of concern
- New templates for assessment of Principles, Responsibility, and country assessment
- Published together with DF: a tool to assist FMIs in providing the consistent and comprehensive disclosure that is expected of them under PFMI 23

Use of the Assessment Methodology

FMIs may have to conduct formal periodic full/partial self-assessments, where this is consistent with national practice

As part of their regulation/oversight Responsibilities, **national authorities** are expected to regularly assess observance of the Principles by FMIs. Authorities are also encouraged to conduct periodic self-assessments of their observance of the Responsibilities

The CPSS and IOSCO are encouraging external assessments of FMI observance of the Principles and authorities' observance of the Responsibilities, including assessments conducted by **IFIs, namely the IMF and WB**, in particular as part of FSAP

- The AM is primarily intended for external assessors at the international level such as World Bank and IMF
- The AM also provides a baseline for national authorities to assess FMIs under their oversight/supervision. National authorities should use the assessment methodology in its current format or develop an equally effective methodology for their national oversight/supervision processes

Assessment process

Step 1

- Determine the appropriate *scope* of an assessment
- Identify systems for assessment
- Determine which FMI operations and services
- Determine which principles to assess

Step 2

- *Gather facts* on each applicable key consideration
- Identify what data/information are needed for all systems
- Assessment questions in Sections 5-6
- Develop a general understanding of an FMI's business and risks involved

Step 3

- Develop *key conclusions* for each principle/responsibility
- Identify any gap or shortcoming and determine if it is an *issue of concern*
- Develop a narrative summary

Step 4

- Assign *a rating* for each principle
- Note instances where a particular principles could not be assessed and reason
- Identify whether principle is not applicable and reason

Step 5

- Indicate the appropriate *timeframe* for addressing each issue of concern
- Identify priority areas according to the level of risks or lack of transparency
- Determine actions needed to address the gaps

Step 6

- Prepare an *assessment report*
- Assessment report templates provided in Annexes

Assessment Methodology: use of a rating framework

- Different types of assessors may communicate the outcome of their assessments of FMIs differently, depending on their specific objectives
- The rating framework proposed in the AM reflects the assessors' judgment regarding the type or impact of the risks, concerns, or other issues associated with each identified gap or shortcoming

Where consistent with national practice, **FMIs** should use the AM rating scheme

National authorities may choose to use the AM rating scheme or may choose to use another EQUALLY EFFECTIVE rating scheme, in particular when they are legally bound to use a different assessment methodology. The AM rating scheme is expected to be used in the context of cross-border cooperative oversight arrangements unless agreed otherwise

IFIs use the rating scheme presented in the AM in the context of the FSAP. Technical assistance (TA) assessors are not necessarily expected to use a rating scheme

The AM rating scale is built on the gravity and urgency to remedy identified "issues of concern".

For the purpose of this scale, an "issue of concern" is a risk management flaw, a deficiency, or a lack of transparency or effectiveness, among other potential shortfalls, that needs to be addressed

Observed	The FMI observes the principle. Any identified gaps and shortcomings are not issues of concern and are minor, manageable, and of a nature that the FMI could consider taking up in the normal course of its business.
Broadly Observed	The FMI broadly observes the Principle. The assessment has identified one or more issues of concern that the FMI should address and follow up on in a defined timeline.
Partly Observed	The FMI partly observes the Principle. The assessment has identified one or more issues of concern that could become serious if not addressed promptly. The FMI should accord a high priority to address these issues.
Not Observed	The FMI does not observe the Principle. The assessment has identified one or more serious issues of concern that warrant immediate action. Therefore, the FMI must accord the highest priority to timely address these issues.
Not Applicable	The Principle does not apply to the type of FMI being assessed because of the particular legal, institutional, structural or other characteristics of the FMI.

Disclosure Framework

- The Disclosure Framework (DF) is a tool to assist FMIs in providing the consistent and comprehensive disclosure that is expected of them under Principle 23
- Background: Principle 23, “Disclosure of rules and key procedures” requires an FMI to publicly disclose sufficient information to participants and prospective participants *so that they can understand the system’s design and operations, their rights and obligations, and the fees and risks from participating in the system*
- Objective: The DF directs the form and content of the public disclosures expected from FMIs under key consideration 5 of Principle 23. Standardized disclosure practices will allow for more robust comparison of FMIs by participants, authorities, and the broader public

Relationship
Assessment Methodology ↔ Disclosure Framework

- As a result of the public consultation period, the AM and DF have been consolidated into a single, final report
- The AM and DF are closely interrelated
    - ✓The DF uses the questions that have been developed for the AM to ensure comprehensive disclosure of the FMI's risks and risk management and other practices
    - ✓The AM uses the DF as one of the key sources of information for the assessment of observance of the PFMIs
- The AM and DF were developed in parallel with and as an adjunct to the FMI Report. Accordingly, the DF, the AM and PFMI Report should be taken together as closely related and supporting documents
- The DF also supports the AM by providing assessors with a basic set of facts from which to begin their assessments of FMIs

Disclosure Framework – what is expected from FMIs

- Summary of the key points of disclosure
- Summary of the major changes since last update
- Description of the FMI's function and the market it serves; basic data and statistics; FMI's general organization, legal/regulatory framework, design & operations
- Narrative disclosure of for each Principle with sufficient level of detail. FMI is expected to use same questions drafted for AM (Section 5 of AM/DF) *as a guide* to structure the narrative disclosure or may choose a *question-and-answer* format. Annex A provides templates
- List of public resources

Assessment Methodology implementation (1): definition of FMI and scope of assessment

- Context. FMI defined as a multilateral system among participating FIs, including the operator, used for the purposes of recording, clearing or settling payments, securities, derivatives or other financial transactions. FMIs can differ significantly in organization, function and design
  - Assessors may have to exercise judgment in determining which activities or functions of an FMI are to be assessed
- Challenge. This degree of judgment should not prejudice consistency of approach/comparability across countries (FSAP)
  - *Assessor's choice on presentation of assessment finding does not necessarily imply a judgment on the architecture of payment systems in the country*

Assessment Methodology implementation (1): definition of FMI and scope of assessment

- AM proposed approach (3.11)

A. Two or more FMIs operate under one entity. A single operator operates two FMIs that fulfill clearly distinct roles and only share some arrangements → the two key functions SHOULD be assessed separately

B. Two or more FMIs are integrated into one entity. A single operator operates two FMIs whose key functions are highly interrelated and complementary (a CSD that operates an SSS)→ the two key functions SHOULD be assessed as if they were one FMI

C. One FMI serves different markets with different arrangements. The assessment of the FMI SHOULD be split into separate assessments if the FMI has developed clearly distinct arrangements for the different markets it serves

Assessment Methodology implementation (2): assessment of responsibilities of authorities

- Context. The 5 responsibilities are addressed to CBs, market regulators, and other relevant authorities for FMIs = “authorities”. Responsibility E deals with cooperation among authorities
  - In general, authorities should be assessed at the *jurisdictional level ,* not at the level of the individual authority
- Challenge. Level of preparedness for assessment/ discharge of responsibilities could vary widely from one authority (and the FMIs under its jurisdiction) to the other
  - ‼ *In cases of multiple issues with differing degrees of concern, assessors assign the responsibility the rating that reflects the assessor’s judgment of the severity of the most serious concerns identified*
- Assessment of responsibilities where differences among authorities in discharging their responsibilities exist and are significant, could result, or be perceived as, less accurate or hard-hitting

Assessment Methodology implementation (2): assessment of responsibilities of authorities

- AM proposed approach. While the assessment and consequently the rating is applied to the *jurisdiction as a whole*, the AM approach does not preclude that some *actions/recommendations be addressed to a specific authority* within the country's oversight framework (or even to a particular type of FMI)
- Authorities encouraged to assess, jointly and individually, the jurisdiction's own observance of the responsibilities
- See also AM 4.5 on possible assessment of the regulatory, supervisory and oversight framework that applies to a specific FMI

Assessment Methodology implementation (3): market-wide issues

- Context. Principle 1 on legal basis is addressed to *each FMI*, who "should have a well-founded, clear, transparent, and enforceable legal basis for each material aspect of its activities in all relevant jurisdictions.

- This approach differs from Core Principle I, which was addressed *to the "system"* instead: "*The system* should have a well-founded legal basis under all relevant jurisdictions"

- Challenge. There are legal/institutional aspects which pertain to the *system as a whole* (e.g. the general legal framework for settlement)/overall NPS.
  - ‼ As such, these issues cannot fall under the assessment of the FMI's practices beyond a general evaluation of any measures that the FMI may take to proactively address them, or protect itself from possible negative implications

Assessment Methodology implementation (3): market-wide issues

- AM proposed approach. PFMIs indicate that market-wide recommendations on trade confirmation, settlement cycles, CCPs and securities lending from the CPSS-IOSCO Recommendations for securities settlement systems were not included in the review of standards for FMIs and <u>remain in effect</u>

- The AM includes a reference to market recommendations meant to avoid that a possible serious issue inherent to the institutional, market and/or legal framework (e.g. the general legal framework for settlement) is dismissed by the assessor as not applicable to either FMIs or authorities, or not properly regarded as an issues of concern that needs fixing

Thank you

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