



# **The latest work of the Committee on Payment and Settlement Systems (CPSS)**

FSI Seminar on Selected Issues in Financial Stability

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Can Okay

CPSS Secretariat

Bank for International Settlements



## Outline

### *Background – Main topics*

- Introduction to FMIs
- CPSS and role of standards
- Oversight function
- Issues with Interdependencies and interconnectedness
- Recent experience during the financial crisis

### *CPSS recent works*

- Review of the standards  
=> New Principles for Financial Market Infrastructures (FMIs)  
=> Follow up work...
- Other works



## Introduction

### Financial Market Infrastructures (FMIs)

- Facilitate recording, clearing and settlement of monetary and other financial transactions
  - Strengthen the markets they serve
  - Mitigate systemic risk
- ⇒ thus, they play a critical role in fostering financial stability...

However, particularly through interdependencies, FMIs also concentrate risk, if not properly managed they can be sources of :

- Financial shocks
  - Liquidity dislocations
  - Credit losses
- ⇒ thus, they could be major channels through which shocks are transmitted across domestic and international financial markets

**international risk management standards for FMIs have been established over the years to address these risks**



## CPSS and role of standards

➤ *public policy objectives to limit systemic risk  
and foster transparency and financial stability*



# FINANCIAL SYSTEM



## INSTITUTIONS

### **SUPERVISION**

Basel Committee on  
Banking  
Supervision (BCBS)



## MARKETS

### **SURVEILLANCE**

Committee on the  
Global Financial  
System (CGFS)



## INFRASTRUCTURES

### **OVERSIGHT**

Committee on  
Payment and  
Settlement Systems  
(CPSS)



## Role of the committee

*CPSS serves as a forum for central banks to monitor and analyse developments in domestic, cross-border and multicurrency FMs*

Two key functions:

- **Descriptive/Analytical** (share information, carry out joint analysis, discuss issues, increase mutual understanding ...)
  - eg Role of central bank money in payment systems (2003)*
  - New developments in large value payment systems (2005)*
  - The interdependencies of payment and settlement systems (2008)*
- **Standard Setting** (including setting common policies)
  - eg Core standards (CPSIPS (2001), RSSS (2001), RCCP (2004))*
  - Settlement risk in foreign exchange transactions (1996)*
  - Central bank oversight of payment and settlement systems (2005)*

*the term "standard" is used as a generic term to cover all normative statements such as standards, principles, recommendations, and responsibilities.*



## Role of the standards

- CPSS is recognised by the FSB as one of the 12 major standard setting bodies. Core standards are amongst key standards for sound financial systems
- CPSS and CPSS-IOSCO standards are increasingly becoming the basis of oversight and other regulatory provisions
- Compliance of CCPs with the *new* CPSS-IOSCO standards is likely to be a condition for banks to benefit from lower capital requirements (*please see: Capitalisation of bank exposures to central counterparties, BCBS*)
- Basis of assessments by IMF and World Bank for FSAPs



## Public policy objectives for financial market infrastructures

Two public policy objectives to limit systemic risk and foster transparency and financial stability:

- Safety

Robust management of the risks such as: legal, credit, liquidity, general business, operational risks etc.

- Efficiency

Best use of resources by financial market infrastructures and their participants in performing their functions effectively





## Oversight function

➤ *public policy activity to promote the safety and efficiency of financial market infrastructures and to reduce systemic risk*



## Definition of oversight

“Oversight of payment and settlement *systems* is a central bank function whereby the objectives of safety and efficiency are promoted by *monitoring* existing and planned systems, *assessing* them against the objectives and, where necessary, *inducing change*.”

*Central bank oversight of payment and settlement systems, BIS, 2005*



## General oversight principles

- GOP A: **be transparent** (*policy, which FMIs, standards*)
- GOP B: **use international standards** (*such as CPSS/CPSS-IOSCO*)
- GOP C: **have effective powers and capacity** (*to obtain information and induce change*)
- GOP D: **be consistent** (*in applying the standards to comparable FMIs*)
- GOP E: **cooperate with other authorities** (*including other relevant central banks*)

## International cooperative oversight principles (for cross-border multicurrency systems)

- COP 1: **Notification** (*inform the other central banks of issue of the currencies*)
- COP 2: **Primary responsibility** (*generally hosting central bank*)
- COP 3: **Assessment of the systems as a whole** (*assessing design and operations jointly*)
- COP 4: **Settlement arrangements** (*joint determination for settlement and failure-to-settle procedures*)
- COP 5: **Unsound systems** (*discourage the use if not designed or operated well!*)



## Issues with Interdependencies and interconnectedness of FMIs

➤ *important implications for the safety and efficiency of both domestic and global financial market infrastructures...*

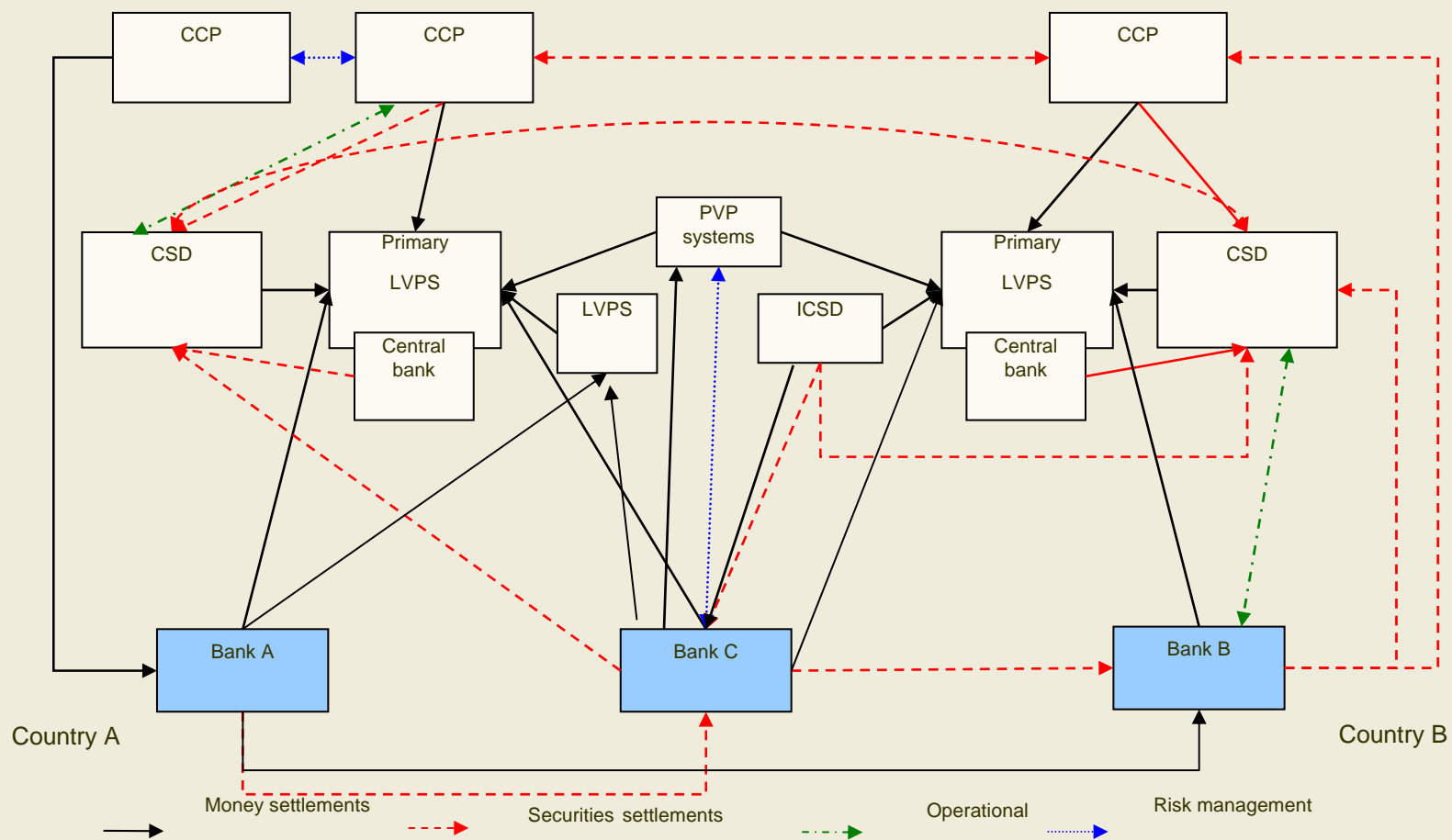


## **Reasons for growing interdependencies and interconnectedness**

- Globalisation and regional integration
- Consolidation (of banks and systems)
- Public policy (eg DvP and PvP)
- Technology (including real-time functionality)



## Diversity of roles and relationships of FMIs



*Smooth functioning of an individual system depends on the smooth functioning of the other systems both domestic and cross-border...*

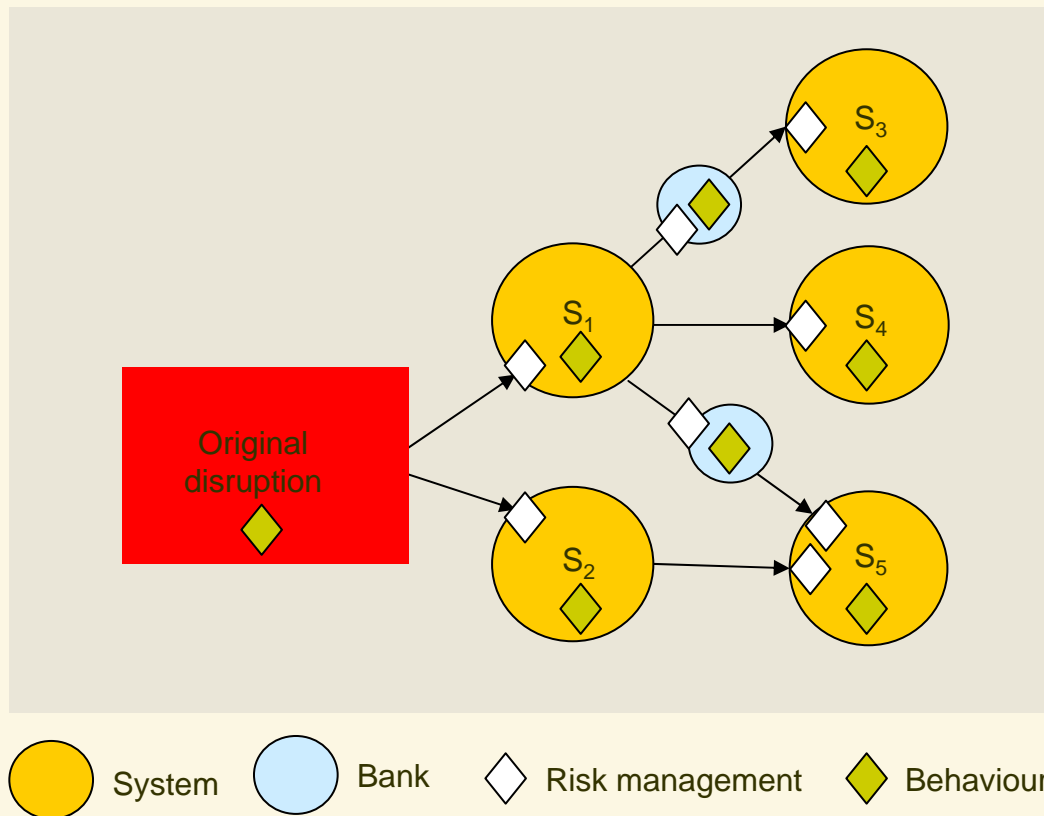


## Effects?

- Primary effect of many interdependencies is to **strengthen** financial systems – safer and more efficient (eg DvP, PvP, SWIFT, liquidity)
- But can also cause **disruptions to spread** more easily



## Effects may be hard to predict during crisis...



***Issues with harmonising risk-management frameworks and sharing information and cross-border cooperation between authorities***





Recent experience during the financial crisis

➤ *resulting in increased use of FMIs for OTC derivatives*



## Recent experience during the financial crisis?

- **FMI generally proved resilient to the crisis due to the efforts of last 20 years**
  - *No materialisation of systemic risk in FMIs*
  - *Global efforts towards intraday finality were essential: RTGS, DvP and PvP (eg during the days of the Lehman collapse)*
  - *Abnormally high settlement volumes managed during volatility*
  - *Swapclear demonstrated that a CCP for OTC Derivatives could cope well with the default of a large counterparty (Lehman).*
  - *in particular, the benefits of CLS and the CCPs were widely acknowledged, among other things*
- **However the recent financial crisis also highlighted:**
  - *significant counterparty credit risk in OTC derivatives markets*
  - *severe lack of transparency in the OTC derivatives market*
  - *insufficient cross-border information flow*
- **Conclusion: additional infrastructures would be beneficial**
  - *CCPs for OTC Derivatives and trade repositories*



## G20 recommendations Pittsburgh communiqué in September 2009

- **Trading and clearing:** All standardised OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties (CCPs) by end-2012 at the latest
- **Reporting:** OTC derivative contracts should be reported to trade repositories (TRs)
- Non-centrally cleared contracts should be subject to higher capital requirements
- The FSB and its relevant members should assess regularly implementation and whether it is sufficient to improve transparency in the derivatives markets, mitigate systemic risk, and protect against market abuse



## New Principles for Financial Market Infrastructures

- *Replacing current 3-core standards with one single and comprehensive set of standard for all FMIs*



## **Review of the current CPSS-IOSCO standards**

- Spring 2009:
  - CPSS and IOSCO initiated review of RCCPs, focusing on OTC Derivatives
- Fall 2009:
  - Financial Stability Board (FSB) requested measures to strengthen the resilience of the financial system
- CPSS and IOSCO decided to review the standards for financial market infrastructures (“General Review” of CPSIPS; RSSS and RCCP)



## The “New” Principles for the Financial Market Infrastructures

- Replacing current standards with one single, comprehensive set of principles for all FMIs
  - CPSIPS (2001), RSSS (2001), RCCP (2004)
- Incorporate the lessons drawn from financial crisis (eg Lehman) and 9/11
  - more demanding requirements in many areas
  - new principles that were not fully addressed by the existing standards
- Ensure consistency among requirements to different FMIs while reflecting the “unique” role of certain infrastructure (eg CCPs, TRs)

The new principles are designed to be applied holistically because their significant interaction



## FMI contained in the report

- FMI are sophisticated multilateral systems among participating financial institutions that handle significant transaction volumes and sizable monetary values
- FMI facilitate the recording, clearing and settling payments, securities, derivatives, or other financial transactions

They are:

- Systemically important payment systems (SIPS)
- Central counterparties (CCP)
- Central securities depositories (CSD)
- Securities settlement systems (SSS)
- Trade depositories (TR) *(they are included for the first time!)*

CCPs, CSDs, SSSs and TRs are regarded as systemically important because of their critical roles in the markets they serve!



*Table 1: General applicability of principles to specific types of FMIs*

Principle		Payment systems	CSDs and SSSs*	CCPs	TRs
1: Legal basis	General organisation	●	●	●	●
2: Governance		●	●	●	●
3: Framework for the comprehensive management of risks		●	●	●	●
4: Credit risk		●	●	●	
5: Collateral	Credit and liquidity risk	●	●	●	
6: Margin				●	
7: Liquidity risk		●	●	●	
8: Settlement finality	Settlement	●	●	●	
9: Money settlements		●	●	●	
10: Physical deliveries			●	●	
11: Central securities depositories			●		
12: Exchange-of-value settlement systems	CSDs and Exchange Value Settlements	●	●	●	
13: Participant-default procedures		●	●	●	
14: Segregation and portability	Default Management			●	
15: General business risk	General business and operational risk management	●	●	●	●
16: Custody and investment risk		●	●	●	
17: Operational risk		●	●	●	●
18: Access and participation requirements	Access	●	●	●	●
19: Tiered participation arrangements		●	●	●	●
20: FMI links		●	●	●	●
21: Efficiency and effectiveness	Efficiency	●	●	●	●
22: Communication procedures and standards		●	●	●	●
23: Disclosure of rules and key procedures	Transparency	●	●	●	●
24: Disclosure of market data					●

\* The applicability of certain principles for CSDs and SSSs will vary with the design of the FMI.





## Responsibilities of Regulators and Overseers

### A: Regulation and oversight of FMI

- *What to oversee? Who to oversee?*

### B: Regulatory and oversight powers and resources

- *Have powers to obtain information and induce change*
- *Have sufficient resources for these*

### C: Disclosure of objectives and policies with respect to FMIs

- *Define your objectives, roles and regulations including standards*
- *Disclose your policies*

### D: Application of the principles for FMI

- *Adopt the principles in this report*
- *Apply them consistently to FMIs within and across jurisdictions*

### E: Co-operation with other authorities

- *Cooperate domestically and internationally*
- *Use current and evolving best practices on international cooperative arrangements*
- *Coordinate to ensure timely access to trade data recorded in a TR*

*Two standards still continue :*

*CPSS' Central bank oversight of payment and settlement systems (2005)*

*IOSCO's Principles regarding cross-border supervisory cooperation (2010)*



## Selected additional/enhanced requirements (1)

### Credit risk

(raising the bar)

More demanding financial resources required

- CE to *all* participants, not just *single largest*
- CCPs: PFE coverage of a “participant family”
- CCPs: Coverage “Plus” additional scenarios/resources (eg multiple defaults)
- Enhanced back testing and stress-testing (reverse testing)

### Liquidity risk

(raising the bar)

- More liquid assets (cash, committed/collateralised credit lines) to effect same-day and, where appropriate, intraday settlement of payment obligations with a high degree of confidence
- Considering strong inter-linkages/exposures; assessing multiple failures and their contagion effect
- “Plus” additional liquidity resources required
- Due diligence on liquidity providers
- Limiting procyclical adjustments in margin arrangements

### Business risk

(new standard)

- Capital requirements for non default-related losses  
[6 or 9 or 12] months enough equity capital to continue operations



## Selected additional/enhanced requirements (2)

Segregation and portability (new standard)	<ul style="list-style-type: none"><li>● Protection of clearing banks and customer positions and assets so as to port them onto remaining ones in default</li></ul>
Risks in tiering (new standard)	<ul style="list-style-type: none"><li>● Also understanding and managing the risks of indirect participants</li></ul>
Comprehensive risk management (raising the bar)	<ul style="list-style-type: none"><li>● Review and develop risk management tools for interdependencies</li></ul>
Disclosure of market data (new standard)	<ul style="list-style-type: none"><li>● Special requirements for Trade Repositories to make relevant information available to relevant authorities</li></ul>



## Follow up work is continuing...

- SG on Resolution of FMIs (some requirements already included under Legal basis, General business risk, CSD and Segregation and portability)
- SG on Domestic and cross-border cooperation between authorities (some requirements already covered under Responsibility “E” and additional requirements are developed for this part)
- SG on CCP access and links
- Assessment methodology
- Stress testing methodology



## Next steps (1)

- *10 March 2011*
  - *Start of consultation*
- *March-July 2011*
  - *Meeting with the industry to discuss consultative report, possible regional initiatives with authorities involved, follow-up work.*
- **Early 2012**
  - Finalise the report, taking into account the feedback from the consultation



## Next steps (2)

- Relevant authorities will try to include the principles in their regulatory frameworks by the end of 2012
- They will apply the principles as part of their regulatory, supervisory and oversight activities as soon as possible
- FMIs will be expected to take appropriate and swift action in order to meet the principles



## Other CPSS works (1)

- **CPSS-IOSCO: Report on OTC derivatives data reporting and aggregation requirements**  
in consultation from 24 August 2011 until 23 September 2011
  - => Addressing market participants and Trade Repositories (TRs)
    - Minimum data reporting requirements and standardised formats
    - Methodology and mechanism for the aggregation of data on a global basis
- **Payment, clearing and settlement systems in the CPSS countries, Vol. 1, September 2011**
  - Description of current payment and settlement systems in member countries
- **Statistics on payment and settlement systems in the CPSS countries - Figures for 2009**
  - Yearly statistics updates
- **Innovations in retail payment systems**
  - Fact finding and classifying innovations with respect to certain characteristics
  - Issues for central banks



## Other CPSS works (2)

- **BCBS-CPSS: Intraday liquidity management**
  - Discussing intraday liquidity issues  
based on BCBS' Report: *Principles for Sound Liquidity Risk Management and Supervision, 2008*
- **BCBS-CPSS: Review of FX settlement risk guidance**
  - Revising the supervisory guidance on FX risk  
BCBS's report: *Supervisory guidance for managing settlement risk in foreign exchange transactions (2000)*





The CPSS reports are accessible at:  
**<http://www.bis.org/list/cpss/index.htm>**

THANK YOU!