Payments Systems Paper

on

Adoption of Committee on Payment and Settlement Systems (CPSS) and International Organization of Securities Commissions (IOSCO) Principles for Financial Market Infrastructures by the Central Bank of Trinidad and Tobago.

1. Introduction

Financial Market Infrastructures (FMIs) play a critical role in the financial system and the broader economy and contribute to maintaining and promoting financial stability and economic growth. At the same time, FMIs also concentrate risk and, if not properly managed, can transmit and even amplify shocks across financial markets.

An FMI is defined as ***"a multilateral system among participating institutions, including the operator of the system, used for the purposes of clearing, settling, or recording payments, securities, derivatives, or other financial transactions***". The term FMI is used in reference to systemically important payment systems (SIPS), Central Securities Depositories (CSDs), Securities Settlement Systems (SSSs), Central Counter Parties (CCPs), and Trade Repositories (TRs) that facilitate the clearing, settlement, and recording of financial transactions.

Over the years various standards have been established for FMIs by international standard setting bodies such as the Bank for International Payments (BIS) Committee on Payment and Settlement Systems (CPSS) and International Organization of Securities Commissions (IOSCO).

In February 2010 CPSS and IOSCO launched a comprehensive review of the three existing sets of standards[1] for FMIs incorporating the lessons learned from the financial crisis. This was initiated in support of the Financial Stability Board's[2] (FSB) broader efforts to strengthen core financial infrastructures to adapt to greater uncertainties and risks in financial markets.

In April 2012, CPSS and IOSCO published 24 new standards for FMI - called Principles for Financial Market Infrastructures (PFMI). These new standards harmonized and consolidated the existing sets of international standards (CPSIPS, RSSS and RCCP), raised minimum requirements for more effective risk mitigation, provided more detailed guidance and broadened the scope of the standards to cover new risk-management areas and new types of FMIs.

As a tool to guide regulators in their adoption of these PFMI, the new standards also describe the general responsibilities of relevant authorities for FMIs in implementation. CPSS and IOSCO have also published the Principles for Financial Market Infrastructures: disclosure framework and assessment methodology which recommends standard disclosure of information by FMIs and consistent assessments by international financial institutions such as the IMF and World Bank, and national authorities.

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[1] The three existing sets of international standards are the Core Principles for systemically important payment systems (CPSS, 2001); the Recommendations for securities settlement systems (CPSS-IOSCO, 2001); and the Recommendations for central counterparties (CPSS-IOSCO, 2004).

[2]The FSB has been established to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies. It brings together national authorities responsible for financial stability in significant international financial centres, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts. http://www.financialstabilityboard.org/about/overview.htm

In Trinidad and Tobago the responsibility for the supervision and oversight of CSDs and SSSs resides with the Trinidad and Tobago Securities and Exchange Commission (TTSEC), while that of Systemically Important Payment Systems (SIPS) rests with the Central Bank. The Central Bank currently uses the BIS Core Principles as the framework for assessment of the systemically important payment systems in Trinidad and Tobago. As at October 20th 2014, the Central Bank has taken a decision to adopt the PFMI in the execution of its Payments System Oversight Function and has set a two year timeframe for its implementation.

2. The Payments System Oversight Function

Oversight is defined as a "***central bank function whereby the objectives of safety and efficiency are promoted by monitoring existing and planned systems, assessing them against these objectives and, where necessary, inducing change***"[3].

In 2006, the Central Bank issued a Payment System Policy document which was heavily informed by the Bank for International Settlements' (BIS) Core Principles for Systemically Important Payment Systems (CPSS, 2001). In addition to this, significant changes were made to strengthen the legislative framework in order to better allow the Central Bank to fulfil its stated objectives. In December 2008, the new Financial Institutions Act (FIA) was proclaimed. The FIA and other consequential amendments to the Central Bank Act, CH 79:02 (CBA) addressed several important issues. Among these were the explicit recognition of the responsibility of the Central Bank for payment systems including remittance services and the authority to create regulations to execute its responsibilities; the creation of a payments system oversight framework for interbank payment systems; the establishment of payment finality; removal of the 'zero hour' [4]rule in regard to payment systems; recognition of netting agreements; and the protection of collateral arrangements and their enforceability in case of participant insolvency.

To give effect to the CBA and FIA with respect to payment system matters, the Central Bank issued a number of guidelines in 2012. These guidelines covered the operation of interbank and non- interbank payment systems, the operation of payment service providers (including bill payment service providers) and the oversight of payment systems. The Central Bank elected to issue these guidelines (as opposed to regulations) for two main reasons. Firstly, this gave the Central Bank the opportunity to assess the effectiveness and completeness of the measures before embodying them in the law; and secondly, it allowed time to incorporate the newly emerging international standards articulated in the PFMI by the CPSS-IOSCO.

Through the Oversight Policy published in 2006 and in subsequent legislation and guidelines, the Central Bank in the first instance, has prioritized interbank payment systems in its oversight function. Currently, the Payments System Unit (PSU) of the Central Bank of Trinidad and Tobago oversees the following payments systems:

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[3] From the *'Central Bank Oversight of Payment and Settlement Systems'*, May 2005, published by the Committee on Payment and Settlement Systems, Bank for International Settlements.

[4] The 'zero hour' rule is a provision in insolvency law whereby bankruptcy declared by a court is effective from 0.00 a.m. of that day. This generally retroactively voids all transactions of the failed institution that have taken place after 0.00 a.m. on that date.

i. Real Time Gross Settlement System (RTGS);

ii. Automated Clearing House (ACH);

iii. Debit Card Clearing System (LINX); and

iv. Cheque Clearings System

The new PFMI speak to SIPS which are defined as having two or more of the following characteristics:

- ***having the potential to trigger or transmit systemic disruptions;***
- ***the sole payment system in a country or the principal system in terms of the aggregate value of payments;***
- ***systems that mainly handle time-critical, high-value payments; and***
- ***systems that settle payments used to effect settlement in other systemically important FMIs[5].***

The Real Time Gross Settlement System (RTGS) operated in Trinidad and Tobago, called Safe-tt, is the only true systematically important payment system in Trinidad and Tobago and thus the only domestic payment system for which the application of the PFMI is entirely relevant.

Over the period 2014/2015 the PSD will be working closely with the operator of the RTGS to introduce the new framework for oversight which will be guided by the CPSS-IOSCO, Disclosure Framework and Assessment Methodology, published in December 2012. Discussions among other regional regulators in Latin America and the Caribbean are also ongoing regarding some of the challenges in this area and will provide additional support for the implementation effort going forward.

Once work on the RTGS is concluded, the Bank intends to apply a more appropriate and modified set of standards, for the interbank retail payment systems it oversees. Interbank retail systems are deemed by the Central Bank to be of significance as they involve the same set of systemically important financial institutions, perform unique functions in the domestic economy and process payments with a significant aggregate value. However, these systems pose no systemic risk to the international environment and do not independently pose any similar risk in the national system, particularly in light of the fact that all settlements are conducted via the RTGS system. The implementation process of the modified PFMI for Significant Retail Payment Systems (SRPS) will be a highly consultative one in which key stakeholders will be actively engaged.

For more detailed information on these principles and the associated assessment methodology please access the links below.

Bank for International Settlements, Principles for financial market infrastructures, April 2012, http://www.bis.org/publ/cpss101a.pdf

[5]Committee on Payment and Settlement System, Technical Committee of the International Organization of Securities Commissions, Principles for financial market infrastructures, April 2012, http://www.bis.org/cpmi/publ/d101a.pdf

Principles for financial market infrastructures: disclosure framework and assessment methodology, Dec 2012, http://www.bis.org/publ/cpss106.htm