

# **WESTERN HEMISPHERE PAYMENTS AND SECURITIES CLEARANCE AND SETTLEMENT INITIATIVE**

## **INICIATIVA DE COMPENSACIÓN Y LIQUIDACIÓN DE PAGOS Y VALORES DEL HEMISFERIO OCCIDENTAL**



### **WORKING PAPER 4: COOPERATION WITHIN THE PAYMENTS SYSTEM MODEL OF TERMS OF REFERENCE FOR A PAYMENTS COUNCIL**

*This working paper presents a model for Terms of Reference (TOR) for a cooperative body in the field of payments and securities settlement. This model is part of the methodology used for the assessment of the payments and securities settlement systems in the context of the Western Hemisphere Payments and Securities Clearance and Settlement Initiative (WHI). Following a request from the Western Hemisphere Finance Ministers, the World Bank in partnership with the Centro de Estudios Monetarios Latinoamericanos (CEMLA) has led this Initiative since 1999. The objective of the Initiative is to describe and assess the payments systems of the Western Hemisphere with a view to identifying possible improvement measures in their safety, efficiency and integrity. To carry out this mandate the World Bank has sponsored an International Advisory Council (IAC) comprised of several institutions with high expertise in payments and securities clearance and settlement system.<sup>1</sup> This document was prepared by Massimo Cirasino (World Bank, Financial Economist) and has benefited from comments by José Antonio Garcia (Senior Economist, CEMLA), Mario Guadamillas (World Bank, Financial Economist), Robert Keppler (World Bank, Adviser) and Fernando Montes-Negret (World Bank, Finance Sector Manager). New changes to this tool as a result of comments received or new experience gained from country assessments under the Initiative will be included.*

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<sup>1</sup> World Bank, CEMLA, Committee on Payment and Settlement Systems of the Bank for International Settlements, Bank of Italy, Bank of Portugal, Bank of Spain, Council of Securities Regulators of the Americas (COSRA), de Nederlandsche Bank, European Central Bank, Federal Reserve Board, Federal Reserve Bank of New York, Inter-American Development Bank, International Monetary Fund, International Organization of Securities Regulators (IOSCO), Securities Commission of Spain, Swiss National Bank, and U.S. Securities Commission (SEC).

## 1. INTRODUCTION

The *Western Hemisphere Payments and Securities Clearance and Settlement Initiative (WHI)*, that was launched in Mexico City in January 1999,<sup>2</sup> has been undertaking assessments of payments and securities clearance and settlement systems in the Western Hemisphere. One of the issues assessed during field missions is the extent to which overseers, payment systems operators, and other stakeholders cooperate towards the achievement of the common objective of enhancing the soundness and efficiency of payment systems in the country.

Thus, a model of Terms of Reference (TORs) for a cooperative body in the field of payments and securities settlement (Payments System Council) has been prepared to guide the discussion on this matter. The model is part of the methodology developed within the WHI.<sup>3</sup> The model represents a reference, and in no way has to be seen as a blueprint for establishing cooperative entities, since the Terms of Reference will always need to be adapted to country's specificities. A survey on cooperative arrangements in payments system world-wide will be conducted in the near future.

The rest of the document is organized as follows: Section 2 presents the context in which cooperation takes place in payment systems, while Section 3 develops the proposed model for the TORs of a Payments System Council.

## 2. CONTEXT FOR COOPERATION

Effective cooperation among market participants, between regulators and market participants and among regulators is essential for the development of a sound and efficient payment system. In particular, the “cross-nature” element that characterizes the transfer of money and the “systemic nature” of the underlying operating procedures make the payment system an “institution” whose existence and smooth functioning requires effective cooperation between all participants. On the one hand, the use of payment instruments generates significant externalities on the demand side, since the usefulness of an instrument is strictly linked to the degree of its acceptance and use for transaction purposes. Consequently, widespread use of new payment instruments and services relies heavily on public confidence in them.

On the other hand, within the payment system, the supply of services can be affected by coordination failures due to the existence of conflicts of interests (and information costs) as well as the intermediaries' unwillingness to cooperate. This can lead to “sub-optimal” equilibria in the organizational arrangements as to the system's reliability and efficiency. The payment system overseer is therefore entrusted with making up for a specific type of failure in the market for payment services, i.e. the coordination failures. Cooperation problems may be especially relevant within interbank clearing and settlement systems. In fact, in these systems the risk profiles – both at the system level and at the level of the individual intermediary – may not be fully assessed by participants. In addition, the concern with having to support less reliable intermediaries may lead larger participants to discriminate against smaller ones, even when these are technically eligible to participate in the system. Finally the payment system industry also depends on agreements between producers to ensure that different components of the system are compatible. Most recently, the emergence of new types of non-bank intermediaries and payment instruments has strengthened the need for a comprehensive level of cooperation in the payment system.

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<sup>2</sup> For a detailed description of the WHI, see Cirasino, M. and Guadamillas, M., *The Western Hemisphere Payments and Securities Clearance and Settlement Initiative, Payments System Worldwide, 2001*. Also available in [www.ipho-whpi.org](http://www.ipho-whpi.org)

<sup>3</sup> See also Working Papers 1, 2 and 3 available in [www.ipho-whpi.org](http://www.ipho-whpi.org)

With regard to the cooperation among regulators, the safety and efficiency objectives of payment and securities settlement systems may be pursued by a variety of public sector authorities, in addition to the central bank and the securities commission. Examples of these regulators include: legislative authorities, ministries of finance, competition authorities. There are also complementary relationships between oversight, bank supervision and market surveillance. Appropriate cooperation among supervisors can be achieved in a variety of ways, for example, exchanges of views and information between relevant authorities may be conducted by holding regular meetings. Agreements on the sharing of information may be useful for such exchanges. In several countries ad hoc cooperative bodies have been established to foster cooperation among all the stakeholders in the payments and securities settlement systems. These Committees/Councils are often led by the central bank and have a wide representation. The following paragraph presents a model of Terms of Reference for a cooperative entity in the payments system.

### **3. PAYMENT SYSTEM COUNCIL – TERMS OF REFERENCE**

#### Objectives

The Payment System Council aims to support the achievement of sound and efficient payment and securities clearance and settlement systems in (the country). It can also serve as a forum for cooperation to maintain orderly conditions in regional and international payment systems.

#### Main Tasks

- ◆ The Council works to facilitate the necessary cooperation between all market participants and regulators in the payment area.
- ◆ The Council promotes common initiatives towards the implementation of the payment system infrastructure. These initiatives should not impede, and should in fact foster, healthy competition among market participants.
- ◆ The Council plays a key role in preparing strategic documents for the overall payment system architecture in the country.
- ◆ The Council plays a key role in monitoring the implementation of payment systems reforms.
- ◆ The Council plays a key role in facilitating the sharing of information on economic and business requirements of all parties impacted by the payment system.
- ◆ The Council helps to identify the impact of different options on participants business and daily operations and on end-user interests.
- ◆ The Council plays a key role in selecting the main principles and options for system designs.
- ◆ The Council plays a key role in endorsing the priority and the schedule of individual projects to be launched, financed and implemented.
- ◆ The Council promotes standardization of procedures and systems.
- ◆ The Council is responsible for promoting knowledge of payment system issues in the country. To this end, the Council uses any means it might find appropriate (workshops, seminars, web pages, newsletter, etc.).
- ◆ The Council seeks to promote cooperation among all institutions active in payment and securities systems within the region and at the international level.

#### Methodology

- ◆ The Council prepares ad hoc reports on payment system issues. The reports would not have prescriptive nature. However, they would serve as a reference for the ongoing payment system reforms in the country.

- ◆ The Council establishes ad hoc working groups on payment matters. Working groups may or may not be composed of the totality of the institutions represented in the Council.
- ◆ The Council reports on its activities to the Top Management of the constituting institutions on an annual basis.

#### Representation and Organizational Structure

- ◆ The Council gives representation to all the stakeholders of payment and securities clearance and settlement systems. These include: the Central Bank, the Securities and Exchange Commission, the Banking Supervision, the Ministry of Finance/Treasury, the Bankers' Association and the commercial banks, the non bank financial institutions, the clearinghouses and payment service providers, the Stock Exchange, the Central Securities Depository(s), the broker/dealers, the end-users, and other regulators (e.g., antitrust authorities), et cetera.
- ◆ The central bank serves as the secretariat of the Payment System Council.
- ◆ Appointed representatives of the stakeholders are senior managers with an involvement in payment matters. They report directly to the top management of their respective institutions.
- ◆ The Council is comprised of an appropriate number of experts. The composition of the Council should be consistent with the objective of having effective discussion in the meetings.
- ◆ The Council has an internal governance structure with a chairperson and deputy(s), an executive body, formal rules to determine the terms and conditions for the appointment of the executive positions, and formal rules to govern the activity of the executive body.
- ◆ In the early stage of its life, the Council might seek, if necessary, assistance from other national and international entities highly experienced in managing payment system groupings.
- ◆ The Council may invite, if needed, other institutions and/or individual experts to participate in its meetings.