



Secretariat

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## The Committee on Payment and Settlement Systems

The Committee on Payment and Settlement Systems (CPSS) serves as a forum for central banks to monitor and analyse developments in domestic payment, clearing and settlement systems as well as in cross-border and multicurrency settlement schemes. This note reviews the history and organisation of the CPSS, the Committee's standard-setting activities and the analytical reports published by the CPSS.

### A. History, organisation, cooperation

#### *The early days*

In 1980 the Governors of the central banks of the Group of Ten (G10) countries set up a Group of Experts on Payment Systems, whose purpose was to take forward the work on payment system issues identified by the G10 Group of Computer Experts. One of the Group's first projects, a detailed review of payment system developments in the G10 countries, was published by the BIS in 1985 in the first of a series that has become known as "Red Books".<sup>1</sup> The Group also analysed interbank netting schemes in the *Report on netting schemes*, published by the BIS in 1989. The Group of Experts on Payment Systems was chaired successively by George Blunden of the Bank of England (1980-82), Hans Meyer of the Swiss National Bank (1983-88) and Wayne Angell of the Board of Governors of the Federal Reserve System (1988-90).

In 1989 the G10 Governors set up an ad hoc Committee on Interbank Netting Schemes (chaired by Alexandre Lamfalussy, then General Manager of the BIS) to study in more detail the policy issues relating to cross-border and multicurrency interbank netting schemes. Its report, published in 1990, contains a set of minimum standards for the operation of bilateral and multilateral cross-border and multicurrency netting schemes and sets out the G10 central banks' framework for the cooperative oversight of such systems.

In 1990 the G10 Governors established the Committee on Payment and Settlement Systems, as a follow-up to the work of the Committee on Interbank Netting Schemes, and more generally to take over and extend the activities of the Group of Experts on Payment Systems. The CPSS was set up as one of the permanent central bank committees reporting to the G10 Governors.<sup>2</sup>

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<sup>1</sup> *Payment systems in eleven developed countries*, February 1985. A "Red Book" provides a comprehensive description of a country's payment systems to a reader who has some familiarity with payment systems in general but who knows little or nothing about the particular arrangements in that country.

<sup>2</sup> The other main committees are the Basel Committee on Banking Supervision (BCBS) and the Committee on the Global Financial System (CGFS).



### **Organisation and focus of activities**

The CPSS consists of the National Bank of Belgium, Bank of Canada, European Central Bank, Bank of France, Deutsche Bundesbank, Hong Kong Monetary Authority, Bank of Italy, Bank of Japan, Netherlands Bank, Monetary Authority of Singapore, Sveriges Riksbank, Swiss National Bank, Bank of England, Federal Reserve Bank of New York, and Board of Governors of the Federal Reserve System.

Since June 2005 Timothy Geithner, President and Chief Executive Officer of the Federal Reserve Bank of New York, is Chairman of the Committee. The Committee was previously chaired by Wayne Angell, Member of the Board of Governors of the Federal Reserve System (1990-94); William McDonough, President and CEO of the Federal Reserve Bank of New York (1994-98); Wendelin Hartmann, Member of the Board of the Deutsche Bundesbank (1998-2000); and Tommaso Padoa-Schioppa, Member of the Executive Board of the European Central Bank (2000-05).

The CPSS addresses general concerns regarding the efficiency and stability of payment, clearing, settlement and related arrangements, and pays attention to issues related to these systems or arrangements and to their relation with the major financial markets that are relevant for the conduct of monetary policy. For this purpose, it undertakes specific studies at the request of the G10 Governors or at its own discretion, and working groups are set up as required.

### **Cooperation with non-CPSS central banks and other organisations**

The CPSS cooperates with other groups, including the International Organization of Securities Commissions (IOSCO), the Basel Committee on Banking Supervision (BCBS) and the Financial Stability Forum (FSF), to address issues of common concern. In the context of its activities the Committee maintains contact with many global payment system providers, industry associations and regulatory authorities.

In recent years the CPSS has developed relationships with other central banks, particularly in emerging market economies. In collaboration with the respective central banks and the BIS, it has published a number of Red Books on payment systems in non-CPSS countries. The Committee provides, if so requested and whenever possible, substantive expertise on payment system issues and organisational support to various regional central banking organisations (eg by providing speakers and/or co-organising seminars and workshops). It works together, for instance, with CEMLA in Latin America, the GCC in the Gulf Region, the AMF in Arab countries, SAARC in southern Asia, EMEAP and SEACEN in eastern and Southeast Asia, and SADC and MEFMI in southern Africa.

## **B. Standard-setting activities**

The standards published by the Committee, which are the *Core principles for systemically important payment systems*, the joint CPSS/IOSCO *Recommendations for Securities Settlement Systems* and CPSS/IOSCO *Recommendations for Central Counterparties*, have contributed to improving risk management practices in payment and settlement systems. The reports provide the main principles for the design and operation of such systems, and are used as a reference by central banks and international organisations in their efforts to improve the safety and efficiency of payment systems worldwide. They are part of a set of key standards that the international community considers essential to strengthen and preserve financial stability (see the "compendium of standards" published by the Financial Stability Forum, <http://www.fsforum.org>). As such, these standards are also used by the joint



IMF/World Bank "Financial Sector Assessment Programme" (FSAP) and the "Reports on the Observance of Standards and Codes" (ROSC).

All standards have been prepared by task forces comprising experts from both industrialised and emerging market economies, as well as the IMF and the World Bank<sup>3</sup>, and have been submitted to public consultation to achieve an international consensus.

The **Core principles for systemically important payment systems** were published in January 2001. They emphasise the importance of "systemically important" payment systems. If such systems are insufficiently protected against risk, disruption within them could trigger or transmit further disruptions amongst participants or systemic disruptions in the financial area more widely. Systemic importance is determined mainly by the size or nature of the individual payments or their aggregate value. Systems handling specifically large-value payments - mostly interbank transactions - would normally be considered systemically important.

The CPSS and the Technical Committee of IOSCO jointly published in November 2001 the **Recommendations for Securities Settlement Systems**, which concern the design, operation and oversight of securities settlement systems, and promote the implementation of measures that improve the safety and efficiency of such systems. The recommendations cover both individual systems and cross-border securities settlement arrangements. This report is supplemented by an assessment methodology, published in November 2002.

The CPSS and the Technical Committee of IOSCO also jointly set out a comprehensive list of standards for central counterparties, the entities which interpose themselves between counterparties in a financial transaction, becoming the buyer to the seller and the seller to the buyer. The **Recommendations for central counterparties** (May 2004) cover the major types of risk a central counterparty faces and includes an assessment methodology.

### C. Analytical and policy reports

Most reports published by the CPSS are analytical and explore various issues related to payment systems or, more specifically, to large-value payment systems, retail payment instruments and systems, settlement mechanisms for foreign exchange transactions, securities clearing and settlement systems, and clearing and settlement mechanisms for derivatives transactions.

#### **Payment systems: general issues**

**General guidance for national payment system development** (January 2006) provides guidance for central banks and other stakeholders on the planning and implementation of payment system reforms, including an overview of institutional and infrastructural arrangements that should be taken into account.

**Central bank oversight of payment and settlement systems** (May 2005) explains why and how central banks oversee payment and settlement systems. Central bank oversight promotes the objectives of safety and efficiency by monitoring existing and planned systems, assessing them against these objectives and, where necessary, inducing change.

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<sup>3</sup> In the case of the *Recommendations for Securities Settlement Systems*, the IMF and the World Bank only participated in preparing the *Assessment methodology*.



***The role of central bank money in payment systems*** (August 2003) studies various aspects of central bank money including banknotes and current accounts, primarily focusing on its function in payment systems. It considers access to central bank accounts, services provided by central banks, policies on settlement in central bank money, and alternatives to the use of such money.

### ***Large-value payment systems***

***Cross-border collateral arrangements*** (January 2006) analyses the possibility for central banks to accept collateral denominated in a foreign currency or located in a foreign jurisdiction to support intraday or overnight credit, either routinely or in extraordinary situations, and existing institutional arrangements as well as alternative models for the acceptance by central banks of foreign collateral.

***New developments in large-value payment systems*** (May 2005) takes stock of developments that have taken place since the publication in 1997 of ***Real-time gross settlement systems***. Some new large-value payment systems settle faster, with a lower amount of liquidity and at a lower cost. Recent developments in system design allow more flexibility in addressing the trade-offs between achieving lower risks and lower costs than traditional architectures.

### ***Retail payment instruments and systems***

***General principles for international remittance services*** (January 2007) provides an analysis of the payment aspect of remittances and sets out general principles designed to assist countries in improving the market for remittance services. The report also highlights the roles of both public authorities and remittance service providers in implementing the general principles.

***Policy issues for central banks in retail payments*** (March 2003) explores the involvement of the central banks of CPSS countries and Australia in retail payments. Although these countries display significant institutional differences, they also share common policy themes, presented in the report as high-level public policy goals. The report recommends minimum actions for central banks to further these goals and also identifies additional options that could be used in certain circumstances. It follows two previous publications on retail payments: ***Retail payments in selected countries: a comparative study*** (September 1999), which compares retail payment instruments used in the CPSS countries and Australia; and ***Clearing and settlement arrangements for retail payments in selected countries*** (September 2000), which analyses systems that are used to effect, clear and settle payments initiated with particular retail payment instruments.

A ***Survey of electronic money developments***, which has been carried out regularly since 1996<sup>4</sup>, provides information on electronic money products planned or in use and on relevant domestic policies. The ***Survey of developments in electronic money and internet and mobile payments*** (March 2004) extends the survey to other innovative products for small-value payments and covers 96 countries and territories. In August 1996 the CPSS and the G10 Group of Computer Experts jointly published a report on the ***Security of electronic***

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<sup>4</sup> Following a request by the G10 Governors to closely monitor global developments of electronic money products and potential policy issues.



**money**, describing the security measures that can be taken to protect electronic money products.<sup>5</sup>

### ***Securities clearing and settlement systems***

The CPSS and IOSCO jointly published ***Securities lending transactions: market developments and implications*** (July 1999), which analyses securities lending (including repo) transactions and their implications for market participants, infrastructure providers and market authorities. It also addresses the risks present in these transactions and the practices and procedures used by market participants to manage and reduce them.

The ***Disclosure framework for securities settlement systems*** (February 1997) encourages regulatory and supervisory bodies worldwide to ask system operators in their jurisdictions to complete a questionnaire and make the responses available to market participants. References to publicly available responses can be found on the respective BIS and IOSCO websites.

***Cross-border securities settlements*** (March 1995) studies the channels used by market participants for cross-border securities transactions, identifies the different risks that these arrangements may pose and stresses the importance of understanding the procedures used to effect cross-border settlements. Assessing the risks involved in cross-border securities settlement arrangements may pose challenges to market participants, due to their complexity and lack of transparency.

***Delivery versus payment in securities settlement systems*** (1992) defines and analyses the types and sources of risk in securities settlement systems, clarifies the meaning of delivery-versus-payment (DVP) and describes three common approaches to achieving DVP, each of which entails different risks to market participants. The report also provides a framework for evaluating the implications of the design and operation of DVP systems for financial stability.

### ***Foreign exchange settlement***

Settlement practices for foreign exchange (FX) transactions may expose market participants to the risk of paying the funds they owe on a trade but not receiving the funds due by their counterparty. Although the probability of a major disruption in the foreign exchange settlement process is low, the potential consequences of such a disruption are considerable. Central banks are concerned about the effects of large settlement exposures on the safety and soundness of banks, the adequacy of market liquidity, market efficiency and overall financial stability.

The 1993 report on ***Central bank payment and settlement services with respect to cross-border and multi-currency transactions*** examined possible central bank service options that might decrease risk in the settlement of FX trades.

***Settlement risk in foreign exchange transactions*** (March 1996) provides a definition of FX settlement risk and a method to measure it. The report sets out a strategy to reduce that risk,

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<sup>5</sup> Furthermore, drawing on the work done by the CPSS and by G10 monetary policy experts, in October 1996 the BIS published *Implications for central banks of the development of electronic money*, which summarises many of the key issues that may be raised by the emergence of electronic money schemes. The analysis carried out by the G10 central banks has provided useful input to the work of other international groups dealing with e-money issues, including the G10 Deputies and the Financial Action Task Force.



based on action by individual banks to measure and control their own exposures; by industry groups to develop well-constructed multicurrency services, including netting schemes; and by central banks and other relevant authorities to encourage private sector action in their domestic markets and to consider enhancements to national payment systems.

In the following years, significant progress was made in implementing the strategy. However, many banks were still not managing their exposures appropriately and industry efforts had still not realised their full risk-reducing potential. In light of this, the G10 central banks decided to reaffirm and strengthen the strategy in the July 1998 follow-up report ***Reducing foreign exchange settlement risk: a progress report***. Amongst other things, the BCBS was invited to develop international supervisory guidance for banks on the prudential management and control of FX settlement risk. This guidance was published in September 2000 and is available on the BIS website.

### ***Clearing and settlement arrangements for derivatives transactions***

Following the Barings failure, the CPSS undertook a systematic analysis of risks in clearing arrangements for derivatives.

***New developments in clearing and settlement arrangements for OTC derivatives (2007)*** analyses existing arrangements and risk management practices in the OTC derivatives market and evaluates the potential for risks to be mitigated by greater use of, and enhancement to, market infrastructure. This report follows-up on ***OTC derivatives: settlement procedures and counterparty risk management*** (September 1998), which had been drafted together with the CGFS (then the “Euro-currency Standing Committee”).

***Clearing arrangements for exchange-traded derivatives*** (March 1997) describes different arrangements and identifies possible weaknesses. It recommends stress testing by clearing organisations, timely trade matching for the calculation of margin requirements and the use of payment systems offering intraday finality.

## **D. Other work**

### ***Red Books***

The Red Book on ***Payment and settlement systems in selected countries*** (the CPSS member countries) is periodically revised (latest version April 2003) and a statistical update is published each year.

Other countries, in cooperation with the CPSS, have also published Red Books on their payment and settlement systems: Sri Lanka in 2004, Saudi Arabia, Lebanon, Kazakhstan and Russia in 2003, Singapore and Belarus in 2001, Israël and Turkey in 2000, Australia and the Southern African Development Community in 1999, the Czech Republic and Korea in 1997, Norway and Iceland in 1995, and Finland in 1994. All Red Books can be found on the BIS website.