Update on Developments in the National Payments System of Kosovo

Presentation to the National Payments Council

13 October 2010

DSPN

Agenda

• Introduction
• Pillar 2 - Large-Value and Time-Critical Payments
• Pillar 4 - Government Transactions
• Pillar 5 - Securities Depository, Clearance and Settlement
• Pillar 6 - Interbank Money Market
• Timetable
Introduction

• 2009: development and publication of the Vision and Action Plan for the National Payments System

• Further World Bank support is now in preparation

• This will assist CBK and the Kosovo financial community to develop new capabilities under Pillars 2, 4, 5 and 6

• In addition:
  – Pillar 1: WB legal consultant has developed a draft Payments Law
  – Pillar 3: modifications will be needed to EICS for:
    • ISO standard message types (Unifi 20022 and possibly SWIFT MTn.nn)
    • Automated interface to RTGS system (Pillar 2)

Present Payments System
Pillar 2 - Large-Value and Time-Critical Payments

- CBK has started to specify and procure a Real Time Gross Settlement (RTGS) system which will settle:
  - Interbank high value and urgent payments (Priority payments)
  - Interbank obligations arising from EICS clearing operations
  - Transactions in government securities
  - Transactions on the money market
- The RTGS system will be tightly-coupled with a Central Securities Depository (CSD) to support:
  - Delivery versus Payment (DvP) of securities trades (later slide)
  - CBK provision of intraday liquidity to RTGS participants

RTGS System – current thinking

- Only licensed commercial banks (and CBK) will be participants
- Banks will not send payments directly to RTGS, but via EICS – i.e. no change from present operations
- EICS will automatically forward Priority Payments to RTGS for immediate settlement
- Banks will have direct connections to RTGS (via the existing network) for:
  - Managing liquidity
  - Managing payment queues
  - Receiving notifications of payments made/received
  - Receiving reports
- Primary objective is to eliminate systemic risk by ensuring that each payment is settled:
  - In Real Time (as soon as it is sent)
  - Gross (one by one, no batching or netting)
  - With finality (once settled, the payment is irrevocable)
Systemic Risk

- High-value payments are a source of systemic risk – if a bank can’t pay, this can cause system-wide problems
- With an RTGS system, each bank has a settlement account maintained by the central bank (currently held in CBK’s GL)
- High-value payments are sent by EICS to RTGS for immediate settlement – if there are sufficient funds
- Settlement is final and irrevocable
- Unsuccessful payments (insufficient funds) can be either rejected or queued until funds are available
- Special procedures have to be in place to ensure that interbank net settlements (from clearing) can’t fail due to insufficient funds

Pillar 5 - Securities Depository, Clearance and Settlement

- MEF Treasury Department is planning to issue GoK debt instruments (securities)
- CBK is the Fiscal Agent for GoK, and will manage:
  - Sale of securities via on-line auction system
  - Custody of securities in Central Securities Depository
- Trading in securities (secondary market) will take place on a separate electronic system
- MEF Treasury Department has general responsibility for the whole process
Central Securities Depository (CSD)

- Holds information about all Government securities:
  - Details of each issue (date of issue, maturity, interest, etc.)
  - Details of holders (identity, amounts held, etc.)
- Updated each time:
  - A primary market sale (auction) is completed
  - A trade is completed on the secondary market
  - A security issue reaches maturity
- Calculates and pays interest, maturity payments

Pillar 4 - Government Transactions

- Government transactions will continue to be handled as at present (i.e. payments and receipts will go through EICS):
  - MEF Treasury Department will send payments from FreeBalance system to EICS via CBK General Ledger (FlexCube)
  - Tax Administration & Customs receipts will be collected by commercial banks and forwarded to CBK via EICS
- KPST may implement a connection to EICS (for receiving reports)
Coupling of RTGS and CSD Systems

• Best modern practice is to have the RTGS and CSD systems very closely coupled. Why?
• Two main reasons:
  1. Delivery versus Payment (DvP)
  2. Intraday Liquidity Management in the RTGS

Delivery versus Payment

• Avoidance of Settlement Risk:
  – I don’t want to pay for the securities until you let me have them
  – You don’t want to let me have the securities until I pay you

• Solution is to carry out the transaction simultaneously:
  – in the RTGS for the payment
  – in the CSD for the transfer of ownership
Changes of Ownership

- Securities can be traded between holders any time between issue and maturity
- Can be done:
  - By direct negotiation between parties (‘over the counter’ or OTC)
  - Using an electronic trading system
- In each case, details of each agreed trade are sent to the CSD
- CSD matches details from buyer and seller, then executes DvP for the trade, as shown in the previous slide

Intraday Liquidity

- RTGS systems are very safe but require liquidity in participants’ Settlement Accounts to support high-value payments continuously throughout the day
- If a bank has insufficient funds in its Settlement Account, it can’t make payments – this can lead to system-wide problems (‘gridlock’)
- One solution is for the Central Bank to lend money to banks to support the payments flow (to “oil the wheels”)
- This naturally requires collateral – one good source of collateral is the securities held by the borrowing bank
- The borrowing bank offers suitable securities, which the NB takes via an intraday pledge or repurchase agreement (‘repo’)

The World Bank Group
The Collateralisation Process

- With modern systems, the RTGS and CSD systems can effect this process automatically:
  - The RTGS system detects a requirement for liquidity (or the bank requests a loan)
  - The RTGS system sends a message to the CSD system to transfer ownership of identified securities from the commercial bank to the CBK
  - The CSD system confirms transfer of ownership
  - The RTGS system increases the balance in the bank’s settlement account by the corresponding amount
  - At end of day the reverse process occurs (if the bank has sufficient funds) and the securities are returned to the commercial bank’s ownership in the CSD
  - If the bank still has insufficient funds at end of day, the bank must borrow funds from another bank, or (if the central bank allows) the loan can be converted into overnight (at penal rates)

Pillar 6 - Interbank Money Market

- CBK will work with the Kosovo Bankers’ Association to build on the work already in place to facilitate inter-bank money transactions
- A Money Market System (MMS) is an important part of a modern payments system by providing an on-line platform for banks to lend and borrow between themselves
- It assists liquidity management and support safety and stability of the financial system
- It also supports securities settlement through enabling efficient borrowing by securities market players
- The MMS will be coupled with the RTGS system to settle deals according to Payment versus Payment (PvP)
Future Payments System

Thank you for your time and attention

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