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ECCB CORE PRINCIPLE SELF ASSESSMENT

Introduction. - Self Assessment of the Payment System (1.6.3)

During the period May 26 through May 31, Mr. Howard Crumb, formerly Federal Reserve Bank of New York, and Mr. Peter Allsopp, formerly Bank of England, consultants for International Business and Technical Consultants, Inc. (IBTCI), visited the Eastern Caribbean Central Bank (ECCB) to perform a Self Assessment of the Payment System and the Securities Settlement System.

The consultants met with officials of the ECCB and commercial banks in St. Kitts and Nevis and reviewed various papers prepared by the ECCB staff. The consultants wish to thank Governor Sir Dwight Venner, Deputy Governor Errol Allen, Mr. John Venner, Director Banking and Monetary Operations Department, and Mr. Henry Hazel, Project Coordinator for arranging meetings with ECCB staff, bankers, the Securities Exchange, and others, providing papers and other information about the ECCB payment system, and for logistical arrangements to assure the effective and timely completion of this part of the project. The prompt response of all facilitated the work in completing the self assessment in a timely manner.

Section 1 of this report contains the self assessment for the payment system predicated on the GLOBUS accounting package and the RTGS capability supported by this software package. This assessment was based on the ten Core Principles for Systemically Important Payment Systems which set out best practices and international standards for any country. The format offered in the IMF and World Bank “Guidance Note for assessing Observance of Core Principles for Systemically Important Payment Systems” (CPSIPS) was used as a guide for this report. A summary is shown at the end of the section.

Section 2 of the report includes the self assessment for the Eastern Caribbean Securities Exchange (ECSE). This is limited to an assessment of those aspects of the design and operation of the system that could, in the event of a problem, have an adverse impact on the flow of funds through the GLOBUS/RTGS system, and to other aspects that are closely related to issues raised in the payment system self assessment in section 1. The format was based on the CPSS and IOASCO Recommendations of Securities Settlement Systems, although only seven of the 19 Recommendations are directly relevant to this project. A summary of the observance by the ECSE of those seven recommendations is shown at the end of section 2.

For both assessments there was no comparison made to other markets in the region since ECCB represents eight countries which is unique for the operations of a central bank. There are two other similar arrangements, the European Central Bank and French West Africa Economic and Monetary Union. Neither provides services in comparable markets. Rather, having the ECCB observe the Core Principles for the payments system and the Recommendations for Securities Settlement Systems would assure meeting international best practices, a much better comparison than attempting a comparison to local markets in the region.

1. The CPSS Core Principles

A. General

The primary non-cash payment instrument used in the Eastern Caribbean Currency Union of eight countries (all islands) is the cheque. Cheques are cleared on a daily basis within each of the eight countries using a multilateral net settlement approach. There are very few cheques drawn which clear between the countries, since the clearing and settlement time for these items is up to thirty days on a collection basis. For these latter type payments, book transfers are made through commercial bank accounts maintained at the Eastern Caribbean Central Bank or a bank draft is used. One bank in St. Kitts provides correspondent accounts for local banks among all the countries. Several foreign banks have offices in more than one country, which provides faster clearing for cheques drawn among their offices. It is noted that these banks are considered individual corporate entities in each country and each entity maintains a current account at the ECCB and a separate minimum required reserve.

The ECCB introduced an effective on-line real-time accounting software system (GLOBUS) in 2000. The software works effectively for posting accounting entries and was enhanced in 2001 to deliver advices about final and irrevocable payment and settlement transactions to commercial banks on a “straight through processing” (STP) capability over the SWIFT network. Work is underway to receive transactions over the SWIFT network from commercial banks which would allow for STP of incoming transfer orders. The software is further being developed to act as an RTGS system processing transactions on a FIFO basis throughout the day. This would also include settlement transactions from the cheque clearings in the various countries and the net settlement resulting from transactions on the ECSE (Eastern Caribbean Securities Exchange). This latter settlement is scheduled for 10:00 a.m. each morning, while the cheque settlements take place from 10:00 a.m. until noon depending on when ECCB in St. Kitts receives the settlement information from the outlying countries.

In addition to the upgrading the GLOBUS system for STP involving transactions received over the SWIFT network, the ECCB is developing remote access through an internet based “virtual private network” (VPN). The VPN capability will allow the banks to enter and authorize transactions directly into the GLOBUS system in addition to the query capability about account balances and executed transactions that already exists. It will enable banks to reprioritize payment and settlement transactions should there be times when liquidity is limited.

This assessment analyzes the capabilities of the current RTGS system being enhanced which will allow for the STP of incoming transactions from authorized users. Enhancements are funded with ECCB resources. Implementation is scheduled in the near future (by year end).

B. Information and methodology used for assessment

The ECCB is preparing for a FSAP mission in the third quarter 2003. Work is in progress to develop background information for that mission. The ECCB shared their responses for the “FSAP Questionnaire for Collecting Information to Assess Observance of the CPSS”. This information along with interviews with various departments in ECCB and commercial bankers, including two members of the Payments Committee, provided the background data to determine the assessment of each of the ten Core Principles and the four Central Bank responsibilities.

This assessment deals only with the RTGS system being enhanced using the GLOBUS on line real time accounting software package. Some may consider the cheque clearing system a Systemically Important Payment System. However, clearing house procedures already provide for special presentment of large value cheques (over EC\$ 50,000) at paying banks with accelerated settlement taking place in current accounts maintained at ECCB. These transactions are like a large value bank to bank payment with settlement on a transaction basis and irrevocable when posted. Third party information, by policy, is not included as part of the transaction. The process is used frequently, especially when the maker of the cheque is not well known to the collecting bank. Thus, large value cheques may be omitted from the clearings, thereby reducing the values involved in the cheque clearing multilateral net settlement process.

C. Institutional and market structure—Overview

The GLOBUS RTGS system is the primary payment system in the area served by the ECCB. It completes the net settlement for the nine cheque clearings arrangements which take place daily in each of the countries and the island of Nevis, the net settlement for the trades on the securities exchange on a T+1 basis and allows for collecting banks to expedite the collection of large value checks on a daily basis. It is the only system of its kind in the area served by the ECCB.

ECCB is undertaking an enhancement to its GLOBUS on line real time accounting system. In the near future it will allow for STP of incoming SWIFT messages without human interaction and will provide an internet based VPN to its member banks and other authorized users. These enhancements should provide an improved efficiency to the system. Current liquidity is ample in the banking system with little use being made of the interbank market and borrowing is nonexistent from the ECCB. Intraday liquidity is said to be available from ECCB, but has not been used. The banks have to maintain a minimum required reserve, currently at six percent (up to one percent may be held as vault cash), of deposit liabilities in their accounts at the ECCB. The reserve is maintained on a weekly average so that the banks have flexibility in drawing down their balances within a business day.

D. Payment systems infrastructure

There are 20 banks within the ECCU, although the requirement to hold a separate banking license in each country in the Union produces a total of 39 licensed banks; there are therefore 39 current (reserve and settlement) accounts for banks on the books of the ECCB. The locally-owned indigenous banks have no branches outside of their individual countries of origin. One French-owned bank has only one branch in the Union; the remaining foreign-owned banks, originating in Canada and the UK, all have branches in several of the countries, but no commercial bank has a branch in every ECCU country. The ECCB has its Head Office in St. Kitts and a representative office in each of the seven other countries.

The quality of the telecommunications links within and between the eight countries is variable, but seems to be improving as the erstwhile monopoly position of Cable and Wireless is eroding and new competitors move in.

The foreign-incorporated banks generally maintain their payment-processing systems outside the ECCU (in Barbados or in Canada), together with their IT and other specialist resources.

There is a Bankers’ Association in each country in the Union. There is, at present, no Bankers’ Association covering all eight countries, though the ECCB is encouraging one to be organized. The Caribbean Association of Indigenous Banks also includes banks in Trinidad & Tobago and Barbados.

E. Assessment of the CPs and Central Bank Responsibilities¹

Table 1 Detailed assessment of observance of CPSS Core Principles and Central Bank Responsibilities in applying the CPs—ECCB GLOBUS RTGS system

<i>CP I - The system should have a well-founded legal basis under all relevant jurisdictions.</i>	
<i>Description</i>	<p>There is no comprehensive legal framework for the ECCU payment systems; nor are the relevant laws that are in force all uniform across the eight member countries in the Currency Union. These laws are supplemented by regulations and guidelines issued by the ECCB, some of which are informal and have no legal force, and by written or verbal agreements between banks. There are no legally-binding rules and procedures for the operation of the GLOBUS RTGS system, so there is no clear statement of the responsibilities of the participating banks to each other, or to their customers, for the funds transfers and other transactions that they make or receive through the system.</p> <p>The relevant legislation, rules and guidelines currently include:</p> <ul style="list-style-type: none"> ▪ The ECCB Agreement and ECCB Agreement Act. The Agreement has the force of law in all eight member countries. Under Article 36 “The ECCB may at a suitable time in conjunction with other banks organise clearing houses in such places as may be desirable.” There is no other reference in the Agreement to any aspect of payment systems. ▪ The Uniform Banking Act provides for the regulation by the ECCB of financial institutions in the eight countries. ▪ The Bills of Exchange Acts, which are largely but not completely identical in all eight countries, deal with technical issues of bills of exchange, including cheques. ▪ The Companies Acts and Insolvency or Bankruptcy Acts, which are specific to each of the eight countries and are, therefore, not uniform, apply to banks as corporate entities. ▪ The Evidence Acts deal with the admissibility of documents as evidence in courts of law. ▪ The Securities Act establishes the regulatory framework for an EC securities market, and also covers the clearing and settlement arrangements for that market.

¹ Guidance Note for Assessing Observance of Core Principles for Systemically Important Payment Systems (CPSIPS). International Monetary Fund and The World Bank, August 2001

	<ul style="list-style-type: none"> ▪ The Aliens (Landholding Regulation) Acts, which are also specific to each of the eight countries, cover the legal validity of cross-border pledges, charges or similar security interests given to non-bank financial institutions in respect of equities or company debt securities, and the ability of those creditors to realise their security in the event of a default. ▪ The Rules of the ECCB Clearing House establish the clearing houses, in each of the eight countries, for cheques and other debit instruments, and set out their rules and procedures. The Rules have the force of law. ▪ The Procedural Guidelines for Operations between the Commercial Banks and the ECCB deal with the operation of the licensed banks' accounts with the ECCB. They do not have the force of law. ▪ The Procedural Guidelines for Operations between Participating Governments and the ECCB, which also do not have the force of law, cover the banking services supplied to the eight Governments and several statutory bodies by the ECCB. <p>In the context of these – not always consistent, and certainly not comprehensive – laws in the EC Currency Union countries, a number of vulnerabilities and potential vulnerabilities have been identified. These are summarised below.</p> <ol style="list-style-type: none"> 1. There is no clear definition of intra-day finality of all accounting entries in the ECCB's books through GLOBUS, or in the books of the banks that initiate GLOBUS transfers for their own account or for the account of their customers. 2. The acceptability of electronic signatures for transfer instructions from banks and other account-holders to be given effect through GLOBUS, through individual banks' ABMs and through any future ACH or other relevant system. 3. The acceptability of bank computer records as evidence in a court of law. 4. The validity of an interest held by a creditor (including a creditor that is not a regulated financial institution) in securities pledged or charged as collateral (including securities held in the EC CSD, and any other collateral pledged across national boundaries), and the rights and the ability of the creditor to realise that collateral quickly in the event of a default by the debtor. 5. The validity of transactions between banks, or between the ECCB and any bank, under repos and reverse repos in government or private sector securities (including any that may be entered into between the ECCB and a licensed bank, as a means of injecting intra-day liquidity into the RTGS system). 6. The validity of multilateral netting of participants' liabilities and claims in the cheque clearings, in the ECSE settlement, and in any future ACH or
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	<p>other relevant system which now settles, or will in the future settle, through the GLOBUS RTGS system.</p> <p>7. The legal basis for the ECCB to operate any component of the EC\$ payment systems, in addition to the existing clearing houses for cheques, to oversee any such component that it does not itself operate, and to impose restrictions or penalties, and otherwise to enforce the oversight regime.</p> <p>8. The responsibilities and liabilities of the ECCB, in providing the VPN for banks to communicate with the GLOBUS system.</p> <p>9. The validity of any DvP mechanism introduced for the settlement of securities transactions in the ECSE, or of transactions in any other financial instruments settled through the ECSE or otherwise, and the finality of the transfers of cash and of securities or other instruments settled through a DvP mechanism.</p> <p>10. The criteria for appropriately-regulated institutions (eg banks, and in the future perhaps securities houses, brokers, credit unions, etc.) to be permitted to open accounts with the ECCB for the settlement of transfers in GLOBUS, in any future ACH or in any other future component of the financial infrastructure.</p> <p>In summary, these vulnerabilities and potential vulnerabilities show that –</p> <ul style="list-style-type: none"> ➤ there is uncertainty about the enforceability of laws and contracts in all relevant circumstances; ➤ there is uncertainty about the timing of final settlement of transfers through GLOBUS; ➤ there is uncertainty about the legal validity of the netting arrangements in systems that now settle, or will in the future settle, through the GLOBUS RTGS system; ➤ there is uncertainty about the enforceability of security interests provided under collateral arrangements and of any repurchase agreements; ➤ there is uncertainty about the legal validity of the electronic processing of payments; ➤ there is uncertainty about the potential for conflicts of law, both between the member countries of the EC Currency Union and between those “domestic” laws and the relevant laws of foreign jurisdictions.
<i>Assessment</i>	Non-Observed
<i>Comments</i>	<p>These vulnerabilities and potential vulnerabilities are such as to create potentially substantial systemic risks across the Union. In present circumstances, with a relatively low volume of financial and economic activity in the eight countries, the likelihood of any of these risks materialising may be small. In the future, with an economic and financial market rebound, the chance of such a risk materialising may become greater.</p>

	<p>Moreover given the plans of the ECCB and the eight Governments to develop the “Single Financial Space” across the Currency Union, so as to build up the domestic economies, to expand the financial markets and to attract foreign investors, it is important that the legal vulnerabilities be addressed urgently so that the GLOBUS RTGS system meets, and can be seen to meet, international best practices.</p> <p>The ECCB is aware of these vulnerabilities and potential vulnerabilities. It is in the process of examining them in detail, with the assistance of consultants, and of considering whether all desirable changes could be obtained through the amendment of existing legislation, or whether new legislation will be required. Any legislative measures will need to be co-ordinated across the eight countries, which will necessarily take time to achieve. In the meantime the ECCB should consider whether any concerns can be reduced by means of either binding rules issued under its Agreement, or legally-binding contracts between the participants in the payment systems (including those participants that are incorporated in countries outside the Currency Union – currently Barbados, Canada and France).</p>
<p><i>CP II - The system’s rules and procedures should enable participants to have a clear understanding of the system’s impact on each of the financial risks they incur through participation in it.</i></p>	
<p><i>Description</i></p>	<p>Guidelines have been developed for the use of the RTGS system. However, they are incomplete and require some enhancements to improve the clarity, exposure to financial risks, and responsibilities of the users and the ECCB. Work is underway to meet this objective and as the rules are developed, training with the bankers will take place. Rules for the cheque clearing have been developed and published and also for the settlement of stock exchange transactions.</p>
<p><i>Assessment</i></p>	<p>Partly observed</p>
<p><i>Comments</i></p>	<p>Written rules and procedures are made available when approved by ECCB management to all participants. Currently, operations follow limited written procedures by users and operations function through on the job training approach. Meetings with bankers are regularly held to discuss issues of mutual concern, both policy and operational. There is much work to be accomplished in this area which the Bank realizes must be completed in the near future to meet the intent of this principle, including the approach banks must follow should an error be found after release of a transaction.</p>

<i>CP III - The system should have clearly defined procedures for the management of credit risks and liquidity risks, which specify the respective responsibilities of the system operator and the participants and which provide appropriate incentives to manage and contain those risks.</i>	
<i>Description</i>	There are no clearly defined rules for management of credit and liquidity risks. ECCB notes that banks are not permitted overdraft balances, although the technical capabilities of the GLOBUS system will allow the process should there be a policy change. If a bank is experiencing a liquidity shortfall, then it should seek funds from the interbank market (which has been less active during the past two years) or could make collateral available as security for a loan from the ECCB. No credit risk, or exposure, limits have been established.
<i>Assessment</i>	Non observed
<i>Comments</i>	The concern for the management of risks is understood by the ECCB and is part of the project of reforming the payment system. Payment queues are managed on a FIFO basis currently at the ECCB, but in the future a technical capability will allow banks to reprioritize their transactions should there be a queue caused by a temporary shortage of liquidity. ECCB provides for intra day liquidity, but banks must apply for its use and reapply every 90 days thereafter.
<i>CP IV - The system should provide prompt final settlement on the day of value, preferably during the day and at a minimum at the end of the day.</i>	
<i>Description</i>	The GLOBUS system updates accounts in a real time mode as authorized transactions are entered in the system by ECCB staff. Assuming the ordering bank has sufficient funds in its account at ECCB, the transactions will debit the ordering bank's account and credit the receiving bank's account within a few milliseconds. Advice and confirmation notices are sent to the banks shortly thereafter and the transactions are considered final and irrevocable when processed by GLOBUS. No unwinding of transactions is allowed for this process. (There is, however, no clear legal definition of intra-day finality – See CP I above.)
<i>Assessment</i>	Observed
<i>Comments</i>	While the ECCB observes this CP they will be clarifying the issue in more depth with the written rules, procedures and guidelines to provide a clearer understanding to the banks.

<i>CP V - A system in which multilateral netting takes place should, at a minimum, be capable of ensuring the timely completion of daily settlements in the event of an inability to settle by the participant with the largest single settlement obligation.</i>	
<i>Description</i>	The multilateral net settlement is the cheque clearing system which takes place in the eight countries plus Nevis. Net settlement figures are developed each day in the morning with the information forwarded to ECCB for posting through the RTGS (GLOBUS) on line real time accounting system. The ECSE settlement is also performed in a similar manner in St. Kitts with the settlement information forwarded from the Securities Exchange, currently located at the ECCB.
<i>Assessment</i>	RTGS system – not applicable; cheque clearing and securities settlement– non observed.
<i>Comments</i>	There are no lines of credit among the cheque clearing participants or securities exchange members, no pool of collateral and no loss sharing agreement. Since credit limit exposures have not been developed and a pool of collateral has not been assigned, there is no process to assure exposures do not exceed limits. It is noted, however, the payments for net settlement of securities are forwarded from the banks with net debit positions to a special ECSE account at ECCB. When monies have been collected, the amounts released for crediting the receiving banks accounts. This is an independent operation from the transfer of ownership of securities through the ECSE registry.
<i>CP VI – Assets used for settlement should preferably be a claim on the central bank; where other assets are used, they should carry little or no credit risk and little or no liquidity risk.</i>	
<i>Description</i>	Settlement takes places through bank accounts maintained on the books of the ECCB. There are no known private sector clearing arrangements or settlement banks at this time.
<i>Assessment</i>	Observed
<i>Comments</i>	Since the GLOBUS system has become operational and additional hardware has been installed, the system has worked effectively and efficiently for on line real time transactional posting. The batch process has been eliminated for net settlement and bank requested transactions.
<i>CP VII - The system should ensure a high degree of security and operational reliability and should have contingency arrangements for timely completion of daily processing.</i>	
<i>Description</i>	The Bank has installed a cluster arrangement of processors to provide redundancy of hardware and assure continuous processing of the GLOBUS software at the ECCB in St. Kitts. Physical access and electronic access is considered adequate using the SWIFT system for delivery services and improved access controls for operators. Software changes are documented

	<p>and reviewed by staff. However, there were comments about the low quality of telecommunications service between the banks and the seven countries (islands), not only at ECCB, but at the banks. It is a concern to all. ECCB is discussing business continuation strategies of its automation facilities in case of a significant disaster. There are several alternatives under consideration recognizing that another site would have to be some distance from the current office complex. Technical staff has spare component parts on hand for replacement when problems arise. BMOD has a Surveillance Officer as part of its staff to assure security procedures are being followed.</p>
<i>Assessment</i>	Partly observed
<i>Comments</i>	<p>Information Technology noted that the most significant disaster experienced to date has been from hurricanes. The Bank was able to operate, but on occasion it was reported that a banking holiday was enacted in St. Kitts. This allowed banks (and the ECCB) in St. Kitts to legally close, but the other member countries were without the services of the ECCB. Thus, no banking business impacting accounts on ECCB’s books could be carried on throughout the other countries even though only one country was impacted by the disaster. The issue is recognized by management.</p> <p>It is also noted that the data processing for one bank is performed in Barbados and another in Toronto, both with heavy reliance on data communications, which if unavailable could detrimentally impact the payment system.</p> <p>Internal Audit reviews the area on a periodic basis and under their risk management approach considers the area to be a high risk area. Internal Audit is also developing a program to review actions taken by the IT staff and follow up to software changes and modifications to Systemically Important Payment Systems. The internal Audit staff is consulted about internal controls and audit trails as software modifications are being developed and implemented. The external auditor reviews the Internal Audit work and performs test checks to assure internal controls are effective and working.</p>
<p><i>CP VIII - The system should provide a means of making payments, which is practical for its users and efficient for the economy.</i></p>	
<i>Description</i>	<p>Currently, the GLOBUS RTGS system is used for posting multilateral net settlement positions for cheque clearings and ECSE transactions, two party bank to bank transfers and selected government payments. There are no fees charged for the service or for the net settlement clearing transactions that are posted each day. (However, ECCB collects EC\$ 5 charge for each transaction confirmed over the SWIFT system.) These latter transactions account for over one third of all transactions. Participants have been advised of the many issues through the Payments Council and related committees. They have agreed on the SWIFT message format for transactions and use the SWIFT delivery system.</p>

	<p>However, by ECCB policy, transactions involving ordering party and/or beneficiary information are not included in the message as it is forwarded through the system. The sending bank in this case must send a second message to the receiving bank informing the receiver about the use of the money and when appropriate, the account number and other beneficiary information.</p>
<i>Assessment</i>	Partly observed.
<i>Comments</i>	<p>ECCB is studying the impact of pricing and cost recovery. The concept of cost recovery will be discussed and alternatives outlined which would help ECCB come to a conclusion about cost recovery for the RTGS service. Allowing third party information to be included in messages, already technically capable, will improve the efficiency of operations among the banks for they too, will be able to use straight through processing in their back office operations. (ECCB is considering this issue.)</p>
<p><i>CP IX - The system should have objective and publicly disclosed criteria for participation, which permit fair and open access.</i></p>	
<i>Description</i>	<p>Access to the system is offered to commercial banks, governments, certain statutory bodies and other authorized holders. Access is governed by the Banking Act. Other financial institutions access the system through a commercial bank, but users are limited to two party transactions. All participants must have an account at the ECCB so that there is an accounting relationship. Branch offices of commercial banks access the system through their headquarter office. It is noted that one bank has received a license in an ECCU member country and is operating, but has not been recognized by ECCB as a commercial bank. A court case is pending.</p>
<i>Assessment</i>	Broadly observed
<i>Comments</i>	<p>Access is governed principally by law and few documented policies. It was noted that banks with a license to operate may be denied access should there be substantial risk. However, there is no description of the substantial risk at this time.</p>
<p><i>CP X – The system’s governance arrangements should be effective, accountable and transparent.</i></p>	
<i>Description</i>	<p>ECCB owns and operates the GLOBUS RTGS systems and maintains rules and procedures about its operations. It consults with the banks from time to time through the Payments Council and related committees. Currently there are no documented objectives and business plans for the system, but an effort is underway to accomplish this need. Performance objectives are being developed and ECCB recognizes that much work needs to be completed before it will fully observe the other nine Core Principles. The system is audited on a regular basis by both internal and external auditors.</p>

<i>Assessment</i>	Non-observed
<i>Comments</i>	ECCB has a good relationship among the banks and keeps them informed using various communication techniques. These include one on one discussions, committee meetings, workshops and review of various ideas to enhance the role of ECCB to improve the payments system. However, documenting objectives, creating a business plan and developing a cost recovery mechanism will take time and will need to be understood by the bankers who have been receiving free services from ECCB for some time.

Central Bank Responsibilities in applying the CPSIPS	
Responsibility A – <i>The central bank should define clearly its payment system objectives and should disclose publicly its role and major policies with respect to systemically important payment systems.</i>	
<i>Description</i>	The ECCB has not clearly defined its payment system objectives nor disclosed them publicly. It is working through the process with the Payments Council.
<i>Assessment</i>	Non-observed
<i>Comments</i>	Much work is underway in this area. The ECCB Act does not provide responsibility for the ECCB to oversee the Payments system and its evolution throughout the ECCU. Thus, ECCB must seek a means to be proactive and continue to stay within its authority as the Central Bank among the eight countries. Any change may require legislative action to provide authority to the ECCB to carry out this role.
Responsibility B – <i>The central bank should ensure that the systems it operates comply with the core principles.</i>	
<i>Description</i>	There is a program underway for the ECCB to more fully observe the Core Principles. Much work remains. ECCB observes two Core Principles and partly observes several others. Three Core Principles are non-observed.
<i>Assessment</i>	Partly observed
<i>Comments</i>	Work is underway to improve the legal framework, upgrading some of the operational aspects and to improve reliability and business continuation planning over time. Also, governance approaches are under review to improve this aspect of the Core Principles.
Responsibility C – <i>The central bank should oversee observance with the core principles by systems it does not operate and it should have the ability to carry out this oversight.</i>	
<i>Description</i>	There are no known other interbank settlement systems operating in the private sector in the eight countries.
<i>Assessment</i>	Not Applicable

<i>Comments</i>	
Responsibility D – The central bank, in promoting payment system safety and efficiency through the core principles, should cooperate with other central banks and with any other relevant domestic or foreign authorities.	
<i>Description</i>	ECCB is participating in the FSAP exercise and is a member of the Working Group on Payment System Issues for Latin America and the Caribbean. It also maintains close relationships with Barbados, Jamaica, and Trinidad and Tobago.
<i>Assessment</i>	Observed
<i>Comments</i>	The IMF and World Bank are planning to conduct the FSAP exercise in September 2003. The ECCB is actively assembling and preparing background information for the exercise.

Table 2: Summary observance of CPSS Core Principles and Central Bank Responsibilities in applying the CPs—ECCB GLOBUS RTGS Payment System

<i>Assessment grade</i>	<i>Principles grouped by assessment grade</i>	
	<i>Count</i>	<i>List</i>
Observed	2+1	CP 4, 6; Responsibility D
Broadly observed	1	CP 9
Partly observed	3+1	CP 2,7,8; Responsibility B
Non-observed	3+1	CP 1,3,10; Responsibility A
Not applicable	1+1	CP 5; Responsibility C

2. CPSS and IOSCO Recommendations for Securities Settlement Systems: Assessment of Observance by the Eastern Caribbean Securities Exchange

A. Introduction

This assessment of the observance by the Eastern Caribbean Securities Exchange (ECSE) of the CPSS and IOSCO Recommendations² is limited to a consideration of those recommendations that relate to the ECCB's inter-bank transfer system (the current GLOBUS system, which is being modified to create the EC\$ RTGS system). Specifically, the assessment objective has been to look – in as much detail as has been possible in the time available – at those aspects of the design and operation of the ECSE system that could, in the event of a problem, have an adverse impact on the flow of funds through the GLOBUS/RTGS system, and at other aspects that are closely related to issues raised in respect of the GLOBUS/RTGS system in the report in section 1.

Funds will need to flow through the GLOBUS/RTGS system as a result of a transaction between ECSE participants in a security listed on the Securities Exchange; the counter-parties to that flow of funds will be licensed banks, on behalf of their customers, licensed broker-dealers, who will in turn be seeking to receive funds from the purchaser or to deliver funds to the seller of the security. Although the scope of the inter-bank transfer system is at present strictly limited to the movement of funds between licensed banks³, that movement can be directly affected by any problems on the part of the purchaser or his broker-dealer, as well as on the part of the broker-dealer's bank. It is therefore important, in assessing the stability and reliability of the GLOBUS system, to consider the potential impact of problems in external systems whose transactions are settled through that central system.

It is recognised that in the present circumstances, with a very low volume of trading in the small number of securities listed on the ECSE, and against a backdrop of low financial and economic activity in the eight countries of the Currency Union, the likelihood of any settlement problem in the ECSE adversely impacting on the GLOBUS/RTGS system may be small. In the future, however, with an economic and financial market rebound, the chance of such a risk materialising may become greater. Moreover in the context of the plans of the ECCB and the eight Governments to develop the “Single Financial Space” across the Currency Union, so as to build up the domestic economies, to expand the financial markets and to attract foreign investors, it is important that the settlement arrangements and procedures used by the ECSE meet, and can be seen to meet, international best practice.

² Committee on Payment and Settlement Systems and Technical Committee of the International Organization of Securities Commissions: Recommendations for Securities Settlement Systems, BIS and IOSCO, November 2001.

³ Although the system design envisages both bank-to-bank and third-party or customer transfers, the latter are at present accepted by the ECCB, for policy reasons, only from ECCU Governments, and not from banks.

This assessment uses the methodology published by the CPSS and IOSCO in November 2002.⁴ It has been prepared following a meeting with the Deputy General Manager of the ECSE, and after study of two procedural documents prepared by the ECSE.

B. Recommendations that are assessed in this Report

Recommendation 1 – *Securities settlement systems should have a well founded, clear and transparent legal basis in the relevant jurisdictions.*

- Key issues
1. There is no firm legal basis for the multilateral net settlement of the cash due to and due from any broker-dealer on any settlement day on which it has two or more transactions due to settle.
 2. It is not certain when any resulting transfer between the banks through the ECCB's GLOBUS/RTGS system will be final and irrevocable.
 3. There may be conflicts of law, with respect to the finality and irrevocability of transfers of cash or of securities, and with respect to the application of the relevant insolvency and bankruptcy legislation, between the legislation governing the operations of the ECSE and the home country legislation of any broker-dealers that are incorporated in the different countries of the Currency Union or that are (in the future) incorporated outside the Union.

In summary, it appears that important aspects of the settlement process are not supported by the legal framework, and that this poses risks to the overall safety and soundness of the system, and of the GLOBUS/RTGS system.

Assessment Non-Observed

Comment These issues are similar to those that apply to the GLOBUS/RTGS system, in the context of its assessment under the Core Principles. (See also section 1.) Any legislative or other measures that are taken to strengthen the legal basis of the GLOBUS/RTGS system should, where relevant, be extended to cover the operations and procedures of the ECSE.

Recommendation 5 – *Securities lending and borrowing (or repurchase agreements and other economically equivalent transactions) should be encouraged as a method for expediting the settlement of securities transactions. Barriers that inhibit the practice of lending securities for this purpose should be removed.*

Key issues The ECCB has encouraged the use by banks of repurchase and reverse repurchase transactions under a standard inter-bank agreement. The validity of this agreement under all relevant insolvency and bankruptcy legislation is uncertain. (See Recommendation 1 above.) In addition there is a lack of a DvP

⁴ Committee on Payment and Settlement Systems and Technical Committee of the International Organization of Securities Commissions: Assessment methodology for "Recommendations for Securities Settlement Systems", BIS and IOSCO, November 2002.

mechanism through which such transactions could be settled with finality in a timely fashion (see Recommendation 7 below).

Assessment Non-Observed

Comment Until these issues have been resolved, it appears that any repo/reverse repos in Government or other securities listed on the ECSE may not be legally well-founded or securely settled. This could inhibit the use of the repo/reverse repo mechanism in respect of listed securities to obtain liquidity (intra-day or for longer periods) to cover transfers by banks through the GLOBUS/RTGS system.

Recommendation 7 – CSDs should eliminate principal risk by linking securities transfers to funds transfers in a way that achieves delivery versus payment.

Key issues There is no technical, legal or contractual framework in place to ensure DvP. The program to effect final transfer of title to the sold securities from the account of the selling broker-dealer to the account of the buying broker-dealer is run by the ECSE on T + 1 before the ECCB has given effect to the required transfer of cash through GLOBUS; and there is no linkage, formal or informal, between the two transfers.

Assessment Non-Observed.

Comment The achievement of a DvP mechanism will need to incorporate a means of ensuring the timely settlement of the multilateral net cash obligations of participating broker-dealers – see also Recommendation 9 below. The lack of a DvP mechanism could disrupt the smooth flow of transfers through the GLOBUS/RTGS system.

Recommendation 8 – Final settlement should occur no later than the end of the settlement day. Intraday or real-time finality should be provided where necessary to reduce risks.

Key issues The transfer of securities appears to be legally final within the day on T + 1. The timing within the day of the finality (in legal terms) of the transfer of cash is uncertain, although the transfer appears to be final by the end of the day.

Assessment Partly Observed

Comment This issue has been raised in respect of the GLOBUS/RTGS system, in the context of the assessment of that system under the Core Principles (see Annex 1). It is expected that the issue will be resolved by the legislative or other measures that are taken to strengthen the legal basis of the GLOBUS/RTGS system.

Recommendation 9 – CSDs that extend intraday credit to participants, including CSDs that operate net settlement systems, should institute risk controls that, at a minimum, ensure timely settlement in the event that the participant with the largest payment obligation is unable to settle. The most reliable set of controls is a combination of collateral requirements and limits.

Key issues There are no limits on the net debit positions of participants, and no collateral requirements. There appears to be no provision in the ECSE procedures to address the failure of one participant to cover its net debit position in the daily settlement.

Assessment Non-Observed

Comment Implicit intraday credit occurs through the net settlement of participants' cash positions. (See also Recommendation 7 above.) The failure of any participant, or of the banker to that participant, to cover its net debit position in the daily settlement could disrupt the smooth flow of transfers through the GLOBUS/RTGS system.

Recommendation 10 – Assets used to settle the ultimate payment obligations arising from securities transactions should carry little or no credit or liquidity risk. If central bank money is not used, steps must be taken to protect CSD members from potential losses and liquidity pressures arising from the failure of the cash settlement agent whose assets are used for that purpose.

Key issues Although the settlement is effected in central bank money, transferred through the GLOBUS accounting system, that system does not fully comply with the Core Principles. (See section 1.)

Assessment Partly observed

Comment This recommendation should be observed in full when the ECCB's payment system reform project has resolved the application of Core Principles II and III to the GLOBUS/RTGS system.

C. Recommendations that are not assessed in this Report

Recommendation 2 – Confirmation of trades between direct market participants should occur as soon as possible after trade execution, but no later than trade date ($T + 0$). Where confirmation of trades by indirect market participants (such as institutional investors) is required, it should occur as soon as possible after trade execution, preferably on $T + 0$, but no later than $T + 1$.

Recommendation 3 – Rolling settlement should be adopted in all securities markets. Final settlement should occur no later than $T + 3$. The benefits and costs of a settlement cycle shorter than $T + 3$ should be evaluated.

Recommendation 4 – *The benefits and costs of a CCP should be evaluated. Where such a mechanism is introduced, the CCP should rigorously control the risks it assumes.*

Recommendation 6 – *Securities should be immobilised or dematerialised and transferred by book entry in CSDs to the greatest extent possible.*

Recommendation 11 – *Sources of operational risk arising in the clearing and settlement process should be identified and minimised through the development of appropriate systems, controls and procedures. Systems should be reliable and secure, and have adequate, scalable capacity. Contingency plans and backup facilities should be established to allow for timely recovery of operations and completion of the settlement process.*

Comment Although an operational problem in the clearing and settlement process could undoubtedly have an adverse impact on the smooth flow of funds through the GLOBUS/RTGS system, there has been insufficient time to assess the observance by the ECSE of this recommendation.

Recommendation 12 – *Entities holding securities in custody should employ accounting practices and safekeeping procedures that fully protect customers' securities. It is essential that customers' securities be protected against the claims of a custodian's creditors.*

Recommendation 13 – *Governance arrangements for CSDs and CCPs should be designed to fulfil public interest requirements and to promote the objectives of owners and users.*

Recommendation 14 – *CSDs and CCPs should have objective and publicly disclosed criteria for participation that permit fair and open access.*

Recommendation 15 – *While maintaining safe and secure operations, securities settlement systems should be cost-effective in meeting the requirements of users.*

Recommendation 16 – *Securities settlement systems should use or accommodate the relevant international communication procedures and standards in order to facilitate efficient settlement of cross-border transactions.*

Recommendation 17 – *CSDs and CCPs should provide market participants with sufficient information for them to identify and evaluate accurately the risks and costs associated with using the CSD or CCP service.*

Recommendation 18 – Securities settlement systems should be subject to transparent and effective regulation and oversight. Central banks and securities regulators should cooperate with each other and with other relevant authorities.

Recommendation 19 – CSDs that establish links to settle cross-border trades should design and operate such links to reduce effectively the risks associated with cross-border settlements.

Comment Since the ECSE has no established links to settle trades across the external borders of the Currency Union, this recommendation is not at present applicable.

Summary observance of CPSS and IOSCO Recommendations

<i>Assessment grade</i>	<i>Recommendations grouped by assessment grade</i>	
	<i>Count</i>	<i>List</i>
Observed	0	
Broadly observed	0	
Partly observed	2	R 8,10
Non-observed	4	R 1,5,7,9
Not applicable	1	R 19
Not assessed	12	R 2,3,4,6,11,12,13,14,15,16,17,18