

ECB Regulation on oversight requirements for systemically important payment systems: outcome of the public consultation

Introduction

On 7 June 2013 the ECB published for public consultation a draft regulation on oversight requirements for systemically important payment systems (SIPS). The draft regulation aims to implement in the euro area the “Principles for financial market infrastructures” (PFMIs), published in a report by the Committee on Payment and Settlement Systems (CPSS) of the Bank for International Settlements (BIS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO) in April 2012, and adopted on 3 June 2013 by the Governing Council as minimum requirements for the conduct of Eurosystem oversight in relation to all types of financial market infrastructures (FMIs).

The ECB received nine responses from banking communities and from operators of FMIs, seven of which did not object to publication of their responses. This note summarises the most important issues raised in the public consultation: several helpful comments improving the clarity of the regulation have been incorporated into the draft text.

The Eurosystem would like to thank all respondents for their valuable feedback, questions and proposals for amendments.

1. Level playing field

Respondents highlighted the need for a level playing field for all SIPS in the European Union (EU). This concerns, in particular, the following aspects: (i) a level playing field between privately operated SIPS and Eurosystem SIPS; (ii) a level playing field between systemically important retail payment systems falling under the regulation and non-systemically important retail payment systems that do not fall under the regulation and have to comply with a subset of those PFMIs that are addressed to payment systems; and (iii) a harmonised implementation and enforcement of the PFMIs by all EU central banks.

With regard to the first issue, the PFMIs acknowledge the specific needs of payment systems operated by central banks resulting from requirements laid down in relevant law, regulation or policy, and thus allow for varying application in exceptional circumstances. Certainly, the Eurosystem has public policy objectives and responsibilities as well as an institutional set-up defined in the Treaty on the Functioning of the European Union (the “Treaty”) and the Statute of the European System of Central Banks and of the European Central Bank (the “Statute of the ESCB”). Consequently, Eurosystem SIPS may be exempted from certain requirements under the regulation: Eurosystem SIPS have in fact been exempted from

requirements on governance, wind-down plans, equity and liquid assets, collateral and investment risks. These exemptions are specified in several provisions of the regulation.

As regards the second issue, the Eurosystem is aware that the retail segment of the payments market has become more competitive as a result of SEPA migration, and that the operators of retail SIPS are thus concerned that they may have a competitive disadvantage due to higher regulatory costs. However, making all retail payment systems subject to the full set of requirements of the regulation would not be proportionate from a risk perspective. Therefore, the regulation introduces objective and non-discriminatory criteria for the identification of all SIPS, be they retail or large-value payment systems. Nevertheless, the Eurosystem will carefully monitor whether the application of the regulation has any adverse effects on fair competition in the retail payments market. A review clause has been added in Article 24 of the final draft text partly for this purpose.

In respect of the third issue, the regulation will be enforced in a harmonised way within the Eurosystem, *inter alia*, through joint assessment teams and the use of a common assessment methodology. As far as uniform application beyond the euro area is concerned, Responsibility D of the CPSS-IOSCO Report requires all the relevant authorities to adopt the PFMI and apply them consistently in order to ensure a level playing field. Monitoring of the implementation of the PFMI is conducted at the CPSS-IOSCO level and monitoring reports are published on the BIS website.

2. Scope and addressee of the regulation

Two respondents mentioned that the wording of Article 1 may be understood as including central securities depositories (CSDs) which execute transfer orders as well as SIPS where the operator is located outside the euro area but which have established a branch in the euro area. It was also remarked that, while the PFMI would impose requirements on FMIs (including their participants), the regulation would impose obligations on the operators of SIPS and hence the nature of these obligations must be clarified.

As regards its scope, the Eurosystem would like to clarify that the regulation is indeed *not* intended to cover CSDs and finds the wording of Article 1(3) sufficiently clear in this respect. In the same vein, the term “established in the euro area” mentioned here does include establishment through branches – to the extent that there is direct involvement in the operation of a SIPS. In any case, the list of SIPS to be published on the ECB’s website according to Article 1(2) of the regulation will eliminate any doubts as to the payment systems concerned.

With regard to the addressee of the regulation, the PFMI are descriptive principles, i.e. they can apply abstract notions (e.g. “systems”). A regulation, however, is a prescriptive text, and, as such, it must have a subject, i.e. the legal entity that is legally obliged to comply with it. For a systemically important payment system, including outsourced functions, this entity is the system operator.

3. Definition of “participant”

It was commented by one respondent that the definition of “participant” should be aligned with the definition used in the Settlement Finality Directive (SFD) and that “addressable entities” should be out of the scope of the regulation.

The definition of “participant” deliberately includes direct **and** indirect participants. When reference is made to either category only, this is specified in the regulation. Moreover, the application of the regulation or any specific parts of it should not depend on the naming conventions in a given system (e.g. they may be called “indirect participant” in one system and “addressable entity” in another). The criteria chosen in the definition, i.e. being identified or recognised by a system and being allowed to send/receive either directly or indirectly payment orders to/from the system, are considered to be sufficiently clear.

4. Framework for the comprehensive management of risks

One respondent remarked that the risk management framework described by the regulation would go far beyond the payment system activity and would require also measuring, monitoring and managing the SIPS’s credit exposures to its participants and credit exposures amongst participants arising from the SIPS payment, clearing, and settlement processes. Information about indirect participation would also need to be gathered in order to identify, monitor and manage any material risks to the SIPS arising from participation. Clarification was therefore sought regarding the content of the required risk management framework and the possibility for the SIPS operator to obtain certain information directly from participants.

As it was phrased, the comment seemed to suggest that only *operational risk* issues are considered by the commenter as “payment system activity”. However, this would be a too narrow perspective. Risks threatening the smooth operation of the SIPS or the financial soundness of the SIPS operator and/or risks causing adverse effects on SIPS participants and/or other FMIs may arise also from other aspects of the SIPS operations. Therefore, it is important that all different types of risk (e.g. legal, credit, liquidity, investment, business and operational risks) as well as their possible interrelations are properly identified and managed. The requirements for dealing with the individual risk types are comprehensively laid down in the regulation. Moreover, Article 5 specifies that the management of individual risks is to be complemented by a comprehensive and integrated view on all types of risks taken together. Where necessary, the SIPS operator must obtain information from its participants (e.g. to meet the requirements under Article 17 on tiered participation arrangements).

5. Systemically important retail payment systems

In relation to Article 6 on credit risks, one respondent requested clarification whether the “cover two” requirement, stipulating sufficient resources to cover credit exposures related to the two participants (and affiliates thereof) with the largest aggregate credit exposure, would apply to any type of system design where participants face credit exposures resulting from a SIPS’s payment, clearing or settlement process. In this context, it was also asked whether retail payment systems, including but not limited to systems

adopting a multiple-batch processing mechanism, should comply with the cover two minimum requirement.

The Eurosystem would like to reiterate that the regulation does not distinguish between systemically important large-value payment systems and systemically important retail payment systems. If a system has been identified as a SIPS, it is subject to the regulation in its entirety. Therefore, a SIPS processing primarily (or exclusively) payments of a retail nature also has to comply with the “cover two” requirement of Article 6 if the conditions of the same article are fulfilled. The same holds true for any other requirement defined in the regulation.

6. Tiered participation arrangements

Several respondents commented on the requirements related to tiered participation arrangements. For example, it was mentioned that direct participants should remain fully responsible for the indirect participants for whom they settle; it was questioned whether only the information requirements laid down in Article 17(1) would have to be met or whether more information may need to be gathered by the SIPS operator. Furthermore, it was remarked that information gathering should not involve accessing the payment data of participants’ customers, as this could raise concerns about data protection and system design.

The Eurosystem would like to clarify that Article 17 does not put into question the responsibility of a direct participant for the indirect participants for whom it settles, in line with the respective legal arrangements in each SIPS. However, as large indirect participants may directly or indirectly (via the direct participant) put the SIPS as a whole at risk, the SIPS operator is required to monitor and manage risks related to tiered participation requirements. In this respect, Article 17(1) describes minimum information requirements that apply to each SIPS. It is for each SIPS operator to decide whether more information is required in its specific case in order to properly assess the risks related to the tiering arrangements in its system. Should the information collected under Article 17(1) indicate that there are considerable risks stemming from one or more specific indirect participant(s) (either for the respective direct participant(s) or for the SIPS as a whole), then the SIPS operator would be required to collect additional information (e.g. as regards if and how each direct participant manages financial and operational risks related to these major indirect participants).

The information to be collected by the SIPS operator under Article 17(1) is of a level that does not raise data protection concerns. Nevertheless, a new Recital 14 has been introduced clarifying that “provisions of this regulation requiring a SIPS operator to collect, process and transmit data should be without prejudice to any applicable rules on protection of data of participants or customers”.

7. Disclosure of rules, procedures and market data as well as public consultations

Some respondents commented that, in their view, the requirements with respect to publication of, among other things, system rules and procedures or fees and discount policies would go too far. Similarly, the

meaningfulness of public consultations on aspects such as business strategy, choice of clearing and settlement arrangement and use of technology was questioned.

The Eurosystem wishes to clarify that the regulation aims at implementing the PFMI to the fullest extent allowed by the EU legal framework, in accordance with Responsibility D of the PFMI. This includes disclosure requirements. Therefore, unless there would be legal obstacles to do so, the Eurosystem does not envisage lowering the disclosure requirements defined by the CPSS and IOSCO. As regards public consultations by SIPS operators, the regulation leaves some room for discretion (e.g. as regards aspects defined in Article 4(8), the public shall be consulted “*where appropriate*”). It should be borne in mind that payment systems also serve a public utility function, which may at times justify them having to consult the public. Moreover, in practice, it may not always be possible for a SIPS operator to identify all individual stakeholders. There may be interested and affected parties that the operator is not aware of. For reasons of practicality, a public consultation may be advisable in such cases.

8. Length of transition period

Respondents generally considered a transition period (i.e. the time from the notification of a payment system operator that its system falls under the regulation and the date as from which compliance with the regulation is required) of one year as too short. The proposals made range from leaving it to the SIPS to assess how much time is needed to two years for systems considered to have been a SIPS in the past and *at least* two years for systems that will only now become a SIPS, namely with the new regulation.

The Eurosystem considers it very important that all SIPS comply with the regulation as early as possible and maintains the envisaged one-year period. To ensure that this is the case, it stands ready to provide support and discuss with the respective system operators throughout the transition period which enhancements are required from their SIPS. Moreover, fully fledged oversight assessments will be conducted only after the end of the transition period.

The wording of Article 25(2) has been amended to clarify that payment systems which become a SIPS at a date after the regulation has entered into force will also benefit from a transition period of one year.