

The role of the Eurosystem in payment and clearing systems

One of the basic tasks of the Eurosystem is to promote the smooth operation of payment systems. Like most central banks, the Eurosystem also formulates payment systems policies, oversees payment systems, acts as a catalyst for the enhancement of the payment and clearing systems, and operates payment facilities. The close relationship between payment systems and securities clearing and settlement systems implies that central banks in general, and the Eurosystem in particular, also play a major role in securities clearing and settlement systems, although historically the formal competencies allocated to central banks in relation to these systems have been more limited. This article explains in its introduction why central banks generally have an important mandate with regard to payment, clearing and settlement systems (Section 1). It then focuses on the legal framework within which the Eurosystem operates in order to carry out this mandate (Section 2), the different roles of the Eurosystem and current policies (Section 3).

I Introduction

Definitions

Payment systems play a pivotal role in a modern economy, as most economic activity relies on them. The settlement infrastructure for securities markets is also crucial for the functioning of financial markets and, therefore, payment and securities clearing and settlement systems need to be safe and efficient.

For more than ten years, central banks have made efforts to establish internationally accepted definitions of the main concepts they use in this field. These definitions can be found in the glossary of the ECB's report entitled "Payment and securities settlement systems in the European Union (Blue Book)", June 2001. For the purpose of this article, the following three definitions, which are based on the Blue Book, are particularly useful.

Payment systems consist of a set of instruments, banking procedures and, typically, interbank funds transfer systems which facilitate the circulation of money. More specifically, payment systems require agreed technical standards and methods for transmitting payment messages between participants, an agreed settlement asset and a set of common operating procedures and rules, e.g. covering access criteria and pricing, etc.

Clearing systems consist of a set of procedures whereby financial institutions present and

exchange data and/or documents relating to funds or securities transfers to other financial institutions. Often, the procedures also include a mechanism for the calculation of participants' bilateral and/or multilateral net positions. Netting facilitates the settlement of transactions by reducing a large number of individual obligations or positions to a smaller number of obligations or positions.

Securities settlement systems comprise the full set of institutional arrangements for the issuance of securities and often also for the clearance, settlement and safekeeping of securities trades.

The responsibilities and interests of central banks

Central banks are responsible for the effectiveness of monetary policy and have a general interest in the overall stability of the financial system. The sound design and operation of payment systems, and in particular systemically important payment systems, are indispensable for the effectiveness of monetary policy and money markets and, more generally, for other national and international financial markets (such as foreign exchange, securities and derivatives markets). In the report entitled "Core principles for systemically important payment systems", Bank for International Settlements, January 2001, it is stipulated that "a payment system

is systemically important where, if the system were insufficiently protected against risk, disruption within it could trigger or transmit further disruptions amongst participants or systemic disruptions in the financial area more widely.” The great importance that central banks attach to the stability of financial markets derives both from the possibility that financial shocks can be transmitted rapidly between market participants (particularly via payment and securities settlement systems) and from the potential for financial shocks to cause disruptions in the broader economy, thereby generating substantial declines in welfare and output.

The policy objectives of central banks

The policy objectives of central banks with regard to payment systems are geared towards providing the economy with safe, efficient systems to make payments in central bank and commercial bank money. By pursuing the twofold objective of efficiency and safety, they contribute to systemic stability while facilitating the implementation of monetary policy. Historically, the promotion of safe, efficient payment systems has been the first, overriding objective of central banks. More recently, central banks have also started to pursue the same objectives with regard to securities clearing and settlement systems.

Promoting systems which are both safe and economically efficient

As a rule, payment and securities clearing and settlement systems may be economically efficient only if they are sufficiently widely used. Their use and acceptance depend, in turn, on their safety. Therefore, by addressing the risks associated with these systems, central banks set a precondition for their economic efficiency and promote the systemic stability of the financial markets as a whole. There are basically two kinds of financial risk associated with payment systems and securities clearing and settlement

systems. First, there is the risk that a party within the system will be unable to meet its obligations, neither when such obligations fall due nor at any time in the future (credit risk). Second, there is the risk that a party within the system will have insufficient funds or securities to meet its obligations as and when expected, although it may be able to do so in the future (liquidity risk). Both these categories of financial risk might lead to a situation where the failure of one participant in an interbank funds transfer or securities clearing and settlement system to meet its obligations results in other participants being unable to meet their obligations when due (a domino effect), possibly leading to widespread disturbances in the financial markets as a whole (systemic risk). Problems arising in payment systems could also affect the economy on a broader basis, as companies use payment systems when buying or selling goods and services or when paying salaries to their employees, the public relies on payment systems for retail purchases, and governments depend on them to receive taxes and pay benefits. In the case of securities clearing and settlement systems, there is also the risk of the loss or non-availability of securities held in custody caused by the insolvency or negligence of the custodian bank, or any other adverse situation in which it finds itself (custody risk). This too has an impact on the ability of a participant to deliver securities when needed. As a result, public confidence in the use of payment and securities clearing and settlement systems, payment and financial instruments, or even in the use of money as a broader medium of exchange, would suffer and might be seriously undermined in the event that key infrastructures were to be disrupted.

Besides being secure, payment and securities clearing and settlement systems should also be efficient and practical both for their users and for the economy as a whole. However, there is always a trade-off between minimising costs and meeting other objectives, such as maximising safety. In order to guide stakeholders in payment and securities

clearing and settlement systems in making their choices, central banks and regulators establish minimum safety and efficiency standards and recommendations. These standards and recommendations foster competition between payment systems on the one hand and among securities clearing and settlement systems on the other and help avoid regulatory arbitrage. To some extent, they may also lead to more harmonised rules and procedures.

Facilitating the implementation of monetary policy

Payment systems are the main channel for distributing liquidity both to and among market participants. Central banks use payment systems to execute their own monetary policy and intraday credit operations. Since such central bank operations have to be collateralised, securities clearing and settlement systems, payment systems and monetary policy are interrelated. Furthermore, the introduction by central banks of real-time gross settlement (RTGS) systems, i.e. systems in which processing and settlement take place in central bank money on an order-by-order basis (without netting) in real time (continuously), in itself contributes to an increase in demand for central bank money by participating banks.

The tools of central banks

In order to be able to fulfil their objectives with regard to payment systems, central banks have the following tools: i) they can

operate payment systems, ii) they can act as a catalyst for change, and iii) they can set safety and efficiency standards which, if necessary, can be implemented through the use of certain regulatory powers. With regard to the latter tool, the definition of standards, and the verification of their enforcement, are usually referred to as oversight of payment systems. In this context, oversight is different from banking supervision. Banking supervision involves monitoring individual banks/financial institutions with a view to ensuring their financial stability. It focuses on individual participants in a payment system, aims primarily to protect depositors/bank customers, and is based on an extensive regulatory framework. Payment systems oversight, on the other hand, concerns systems, arrangements and instruments. Based on a combination of moral suasion and regulatory pressure, its primary objective is to protect the functioning of the systems by examining their design and operation. Payment systems oversight is the competence of a central bank. One could argue that the same tools also apply, in principle, with regard to securities clearing and settlement systems, although it should be noted that the powers of central banks are less explicit with regard to these systems. In this context, the joint work on securities settlement systems by the G10 Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO) could be seen as a recognition, at the international level, of the interest and role, although not exclusive, of central banks in the oversight of securities clearing and settlement systems.

2 Legal framework for the involvement of the Eurosystem in payment and clearing systems

The Treaty and the Statute of the ESCB

The Treaty establishing the European Community (the Treaty) and the Protocol on the Statute of the European System of Central

Banks and of the European Central Bank (the Statute of the ESCB) contain a number of provisions which underscore the importance to the Eurosystem of clearing and payment systems.

Article 105 (2), fourth indent, of the Treaty, as repeated in Article 3 (1), fourth indent, of the Statute of the ESCB, mentions that one of the basic tasks of the Eurosystem is to “promote the smooth operation of payment systems”. These Articles, the essence of which was sometimes already contained in the statutes of national central banks (NCBs) prior to their integration into the Eurosystem, have traditionally been the basis for the provision of payment systems facilities by NCBs and for the oversight by NCBs of payment systems in their jurisdiction. After the establishment of the Eurosystem, these functions became the shared competence of the ECB and the euro area NCBs as provided for by the Treaty and the Statute, which form the legal basis for the involvement of the Eurosystem in clearing and payment systems.

The ECB is empowered to issue Guidelines and Instructions, make Regulations and Recommendations, deliver Opinions, and take Decisions. Article 22 of the Statute of the ESCB states that the ECB and NCBs may provide facilities and that the ECB may make Regulations to ensure efficient and sound clearing and payment systems within the Community and with other countries. Read in conjunction with Article 34.1 of the Statute of the ESCB, “Regulations” in this context mean Regulations in the Community law sense of the word, i.e. legal acts of general application, binding in their entirety and directly applicable in all Member States. Whilst the provision by the ECB and the NCBs of payment systems facilities (see Section 3 below) is based on the first part of Article 22, the second part of Article 22 – the making of Regulations – has not yet been applied.

Article 34.1 of the Statute of the ESCB empowers the ECB to make Regulations and Recommendations, take Decisions and deliver Opinions in the area of clearing and payment systems. The instrument of Decisions (which are binding on the addressees) has been applied on a number of occasions by the ECB, for instance to impose sanctions on

Eurosystem counterparties failing to comply with ECB legal acts, but is not currently used in the field of payment systems. Furthermore, the ECB has not yet made any Recommendations, non-binding instruments, in the area of clearing and payment systems.

The ECB’s legal (but not binding) Opinions are those which are delivered under Article 105 (4) of the Treaty and Article 4 (a) of the Statute of the ESCB, as further developed in Council Decision (98/415/EC) of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions. These Articles and the Council Decision oblige the Community and national legislators to consult the ECB on draft legislative provisions in its field of competence and, therefore, also in the field of clearing and payment systems. On this basis, the ECB and the European Monetary Institute (the ECB’s predecessor, for which a similar provision existed) have so far delivered four Opinions on draft Community legislation and 30 on draft national legislation in the area of clearing and payment systems.

Owing to its general applicability and direct effect, a Regulation is the most forceful legal instrument which the Statute of the ESCB bestows on the ECB in the field of clearing and payment systems. Articles 22 and 34.1 of the Statute of the ESCB vest the ECB with the capacity to make Regulations in the domain of “clearing and payment systems”. Such Regulations only have binding effect within the participating (i.e. euro area) Member States.

Article 22 of the Statute of the ESCB

In order to define the ECB’s powers to make Regulations under Article 22, it is necessary to determine the scope of this Article. An examination of the history behind this Article, introduced into the Statute of the ESCB at a rather late stage, does not, however, clarify this issue. Indeed, an analysis of the preparatory work fails to give sufficient explanation of the objectives of those drafting

the Treaty with regard to vesting the ECB with regulatory power in the area of clearing and payment systems. However, it is clear, also in view of Article 34.1 of the Statute of the ESCB (see above), that it was the unambiguous intention of the Community legislator to grant the ECB the power to make Regulations, in the Community law sense of the word, in the domain of clearing and payment systems. Furthermore, since Article 22 is rather broadly formulated (Regulations may be made by the ECB to “ensure efficient and sound clearing and payment systems within the Community and with other countries”), it is submitted that, within reasonable parameters, the Article is broad enough to be applied with a certain degree of flexibility so as to accommodate future developments in the fast evolving area of clearing and payment systems. At this juncture, whilst it is not possible to be exhaustive and precise on such parameters, some general guidelines may nevertheless be identified by studying the allocation of competencies between the ECB, other Community authorities and the national legislators of Member States.

In the field of the oversight of clearing and payment systems, the ECB’s Opinion (CON/99/19) concerning a consultation from Luxembourg on a draft law implementing the Directive of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems (98/26/EC; Official Journal of the European Communities, L 166 of 11 June 1998, p. 45 ff.) (the Settlement Finality Directive) stressed that the oversight functions in respect of clearing and payment systems are a competence of the central banks because of their intimate connection with monetary policy, monetary transmission mechanisms, the money market, and the stability of the financial system. Any interference with the competencies of a Community or national body, other than a central bank, acting within the framework of the ESCB/Eurosystem is therefore excluded. Whilst, contrary to prudential supervision,

oversight functions are traditionally less based on a regulatory framework, should the need arise, the ECB would have recourse to the power referred to in Article 22 of the Statute of the ESCB.

As regards Community bodies, the EU Council and the European Parliament are empowered by the Treaty to adopt legal acts in the area of financial services, which may also affect clearing and payment systems. An example of this is the above-mentioned Settlement Finality Directive. This Directive lays down rules on the finality of payments, the enforceability of bilateral and multilateral netting, the non-retroactive effect of insolvencies of participants in payment and securities settlement systems, and the insulation of collateral provided by such participants in the event of their insolvency. Whilst it is clear that the ECB may regulate operational features and technical aspects of clearing and payment systems, the question arises as to whether this competence could also cover issues such as those addressed in the Settlement Finality Directive. It is, perhaps, theoretically possible to distinguish between the technical-operational features of clearing and payment systems on the one hand and civil and insolvency law aspects on the other. However, in practice, if the ECB were to make a Regulation in the area of clearing and payment systems in order to ensure sound, efficient functioning, such a distinction might be more difficult to make. Indeed, Article 22 would seem to lose its meaning if any impact of an ECB Regulation on civil and insolvency law were excluded. It may therefore be argued that Article 22 Regulations may have such an impact as well, if and when restricted to the specific purpose of ensuring the efficiency and soundness of clearing and payment systems.

National legislators may regulate in the field of competencies of the ECB and other Community bodies only to the extent that neither the ECB nor the Community has used its powers in the relevant fields. The principle of primacy of Community law implies that national

legislation should not be applied in the event of incompatibility with a Community legal act, inclusive of ECB legal acts.

Turning now specifically to the scope of Article 22, the concept of clearing and payment systems needs to be defined. It should be noted that neither the Treaty nor the Statute of the ESCB develops this concept further. However, a starting-point for analysis is the close association which modern financial systems make between payment systems and securities clearing and settlement systems. The application of delivery versus payment mechanisms, whereby securities are only delivered against a simultaneous transfer of funds, means that operations with securities generally entail a cash payment. The settlement of both legs of the transaction needs to be subject to the same safeguards. Otherwise there may be asymmetries with systemic implications. Article 22 contains the terms “clearing” as well as “payment” when referring to “systems”. The text therefore suggests that “clearing” has a meaning on its own, different from the term “payment”. This textual interpretation may therefore lead to an affirmative answer to the question as to whether Article 22 encompasses securities clearing and settlement systems.

There are some other arguments in favour of such interpretation. For example, the Settlement Finality Directive does not define clearing or payment systems separately, but contains the more generic term “system” and covers both payment systems and securities clearing and settlement systems. The Settlement Finality Directive was adopted with a view to addressing systemic risk in “systems”. This objective coincides with that of Article 22, namely to ensure the efficiency and soundness of clearing and payment systems. Consequently, it may be concluded that the term “systems” as it is used in the Settlement Finality Directive is synonymous with the term “clearing and payment systems” in Article 22 of the Statute of the ESCB and would encompass both systems for the transfer of funds and securities clearing and settlement systems.

Another indication of the close association between payment systems and securities clearing and settlement systems can be seen in the recent recognition, although still informal, of the role of central banks in the oversight of securities clearing and settlement systems at the national and the international level in the framework of a shared project between the ESCB and the Committee of European Securities Regulators (CESR). In view of the common interest of central banks and securities regulators in the field of securities clearing and settlement systems in the EU, a framework for co-operation in this field was recently approved by the Governing Council of the ECB and by the CESR. This is expected to lead to the establishment of standards and recommendations for securities clearing and settlement systems across the EU, with oversight functions shared by central banks and securities regulators.

There is a general principle following which the law needs to be interpreted and applied in accordance with the social reality and circumstances at the time of application. This principle also applies to statutory provisions in the Treaty and Statute of the ESCB in the area of clearing and settlement systems. It would be unreasonable to expect that Article 22 (a Treaty provision) would need to be adapted on a regular basis to reflect the quickly changing environment of clearing and settlement systems. It is therefore argued that Article 22 may, in the context of modern clearing and payment systems, be applied so as to encompass both payment systems and securities clearing and settlement systems. However, the ECB would act *ultra vires*, i.e. beyond its statutory powers, if the regulatory powers vested in it by Article 22 were to be used to invade the competence of the Community or Member States as general legislators in the domain of securities law, private law or insolvency. The ECB is not a general legislator, but its regulatory powers are narrowly targeted either at establishing the rules for euro area-wide facilities provided by the Eurosystem itself, in a

uniform manner and without the interference of national laws, or at ensuring the efficiency and soundness of the systems if they relate to Eurosystem operations. In addition, it is necessary to mention several limitations to the use of regulatory power: first, the principle of proportionality, according to which the obligations imposed on the participants in a clearing or payment system have to be proportional to the objectives sought by the ECB; second, the ECB is bound by the principle of acting in the context of an

open market economy with free competition, whereby, in the substance of the rules contained in an ECB Regulation, no limitation to competition may appear; and, third, the principle of non-discrimination, whereby market participants should be treated equally. Indeed, ECB Regulations may be challenged before the European Court of Justice under Article 35.1 of the Statute of the ESCB, should doubt arise as to whether an ECB Regulation under Article 22 complies with the above criteria.

3 The different roles of the Eurosystem

Whereas the introduction gives an overview of the rationale and general scope of the role of central banks in the field of payment and securities clearing and settlement systems, this section illustrates the way in which the Eurosystem carries out its functions in practice. The Eurosystem is active as an operator of payment systems and fulfils its mandate by acting as a catalyst for change and as a setter of standards. These three roles are played to varying degrees in three fields: large-value payment services, mainly for interbank payments and payments stemming from financial market transactions; retail payments; and securities settlement services.

Operational role

From Article 105 (2), fourth indent, of the Treaty, among others, read in conjunction with Articles 3 (1), fourth indent, and 22 of the Statute of the ESCB, it can be derived that the ECB and the NCBs have the power to provide payment systems and clearing facilities (i) within the Community and (ii) with other countries.

Trans-European Automated Real-time Gross settlement Express Transfer (TARGET) system

The Eurosystem has implemented its operational competencies by setting up and

operating TARGET, a large-value payment system which processes euro payments. EU central banks took the view that the introduction of the single currency would necessitate the integration of payment systems in some form in order to establish a single “domestic” payment area, providing a level playing-field for market participants and a tool through which the monetary policy operations between the NCBs of the Eurosystem and credit institutions could be carried out in a timely, secure manner, fostering the singleness of the money market. Following a Decision of the Council of the European Monetary Institute (EMI) of March 1995, TARGET was developed to process efficiently large-value payments in euro throughout the euro area. Without TARGET, the supply and demand for central bank money would have had to be met at a national level. This would have been incompatible with the idea of Economic and Monetary Union (EMU), as it would have maintained fragmentation of national money markets, making a single monetary policy impossible. TARGET commenced live operation on 4 January 1999. It successfully fulfils its objectives as it provides an efficient, safe mechanism for the processing and settlement of large-value euro payments on an RTGS basis and serves the needs of the monetary policy of the ECB. It is the only “tool” carrying out “cross-border” payments in euro which is directly accessible to all monetary policy counterparties. TARGET has

a decentralised structure consisting of 15 national RTGS systems and the ECB payment mechanism (EPM)¹ which are interlinked through the Interlinking system so as to provide a uniform platform for the processing of euro payments. The Eurosystem has observed that since the introduction of the euro on 1 January 1999, technical evolution and market pressure have been supporting a process of consolidation of market infrastructures which may also influence the TARGET system. In this respect, the Eurosystem is currently examining how TARGET could evolve in the coming years. This is particularly important for countries which have applied for membership of the European Union. Clearly, the setting-up of an RTGS system cannot be seen as a prerequisite for accession to the EU. Accession countries should give priority to the development of modern market infrastructures which serve the needs of their economy, facilitate the development of safe and efficient financial markets, and support market participants in the country so that they may become competitive with other market participants both in the EU and globally. As market infrastructures are specifically designed to serve a currency, the national infrastructure put in place in accession countries will also continue to be used after those countries have joined the EU. Only when accession countries join the euro area may the use of national infrastructures have to be reconsidered.

Articles 12.1 and 14.3 of the Statute of the ESCB, which empower the ECB to issue Guidelines and Instructions to NCBs, formed the basis for Guideline ECB/2001/3 of the European Central Bank on a Trans-European Automated Real-time Gross settlement Express Transfer system (TARGET) of 26 April 2001 (OJ L 140/72), as amended by Guideline ECB/2002/01 (OJ L 67/74). The Guideline on TARGET lays down the rules governing the operation of the system as such, including its national components. It contains provisions on, inter alia, a number of minimum common features with which each national RTGS system participating in

or connected to TARGET shall comply (e.g. access criteria, currency unit, pricing rules, time of operation, payment rules, irrevocability, finality and intraday credit), arrangements for cross-border payments through the Interlinking system, security requirements, audit rules, and provisions on the management of TARGET. These rules apply to the Eurosystem's NCBs only. In order to create the same facilities for the NCBs of Member States which have not yet adopted the euro, a multilateral agreement has been adopted by the Eurosystem's NCBs and the ECB on the one hand and the non-participating NCBs on the other, which mirrors the provisions of the TARGET Guideline. The rules of the TARGET Guideline and the TARGET Agreement have been included in the national legal documentation between NCBs and their counterparties, through contractual and/or statutory provisions.

Given that they had to prepare their TARGET connections, the NCBs of the current EU Member States which did not adopt the euro on 1 January 1999 could connect to TARGET provided that they observe the rules and procedures as set out in the signed agreement, subject to certain additional modifications and specifications.² For the time being, no further legal instruments have been adopted and applied by the ECB in order to provide payment systems within the EU.

TARGET processes credit transfers only. According to the TARGET Guideline, all payments directly resulting from or made in connection with (i) monetary policy operations, (ii) the settlement of the euro leg of foreign exchange operations involving the

¹ In 1999, the terms and conditions governing the use of the ECB payment mechanism were adopted by the ECB. Through the EPM, the ECB participates in TARGET in order to process payments (in particular, the ECB's own payments and the payments of customers in the EPM) and supply settlement services to cross-border clearing and settlement organisations through the TARGET system.

² See "Conditions for the participation of non-euro area EU NCBs and credit institutions in TARGET" in http://www.ecb.int/press/pr980708_3.htm

Eurosystem, and (iii) the settlement of large-value systems handling euro transfers, must be carried out through TARGET. In the case of other payments, such as interbank and commercial payments in euro, TARGET may also be used. There is no upper or lower limit to the value of payments processed.

Automated clearing houses (ACHs)

The involvement of the Eurosystem in retail payment systems is rather diverse. Many Eurosystem NCBs, for example the Banca d'Italia, the Nationale Bank van België/Banque Nationale de Belgique and the Deutsche Bundesbank, have a long tradition of being operationally involved in retail payment systems. They offer a neutral and open network in which banks can participate, irrespective of the size of their business. The degree of involvement of the Eurosystem in retail payment systems largely depends on the efforts of the banking sector in providing an efficient retail payments infrastructure for the euro in the future.

Settlement agent for private systems

Besides operating large-value and retail payment systems on its own, the Eurosystem provides settlement facilities for payment systems which it does not operate itself (e.g. privately operated retail payment systems, securities settlement systems for the settlement of the cash leg, and the Euro 1 system operated by the Euro Banking Association).

Continuous Linked Settlement (CLS) system

The Eurosystem is also responsible for promoting efficient and sound systems with other countries. An example of this is the CLS system, designed to settle foreign exchange transactions between member banks on a payment-versus-payment basis in the books of the CLS Bank, which is

incorporated in New York. The CLS system is expected to eliminate settlement risk for transactions settled in the system and will substantially reduce the liquidity needed to settle a given amount of foreign exchange trades compared with current practice, since settlement members will have only one position per currency in the system. Given their time-criticality, CLS-related payments will pose a challenge for the banks' intraday liquidity management. The oversight of the CLS system or any other system or payment facility operated in a non-euro area country will entail close co-operation with other non-EU authorities and, to a certain extent, a harmonised oversight approach of the authorities involved. To this end, work has already been carried out in various international fora, such as the CPSS, under the auspices of the Bank for International Settlements (BIS). With specific regard to the CLS system, the primary overseer is the Federal Reserve Bank, whereas the ECB is the overseer in respect of the euro in accordance with the co-operative oversight framework set out in the "Report of the Committee on Interbank Netting Schemes of the Central Banks of the Group of Ten Countries", BIS, 1990. (In terms of importance, the euro is clearly the second currency in the CLS system and expectations are that it could account for around one-quarter of the system's turnover.)

Central securities depository (CSD) activities

Traditionally, Eurosystem NCBs have played an operational role in the settlement of securities. Today, although various tasks have been transferred to private entities, some of the NCBs still act as a CSD or registrar for certain government or other kinds of securities.

Correspondent central banking model (CCBM)

In the absence of a satisfactory solution for the cross-border mobilisation of assets, in 1999 the Eurosystem implemented the CCBM for its own operations to ensure that all its payment system participants and monetary counterparties would be able to provide collateral for Eurosystem credit operations, irrespective of the location of the collateral. With the CCBM, each NCB acts as a custodian vis-à-vis other NCBs. The CCBM was developed as an interim solution until such time as the market developed alternatives, whilst it was not intended to compete with market initiatives to provide cross-border services for market operations.

Catalyst for change

The Eurosystem not only acts as an operator but, in the particular case of retail payment systems, sometimes also aims to induce changes or encourage the market to move in a certain direction. This is done through its contacts and relationships with banks, striving in a spirit of co-operation to find solutions for the challenges ahead. Through bilateral or multilateral meetings, presentations, speeches and publications, etc. it provides a forum for discussion with market participants and paves the way for further enhancements in payment systems and new infrastructural developments.

The role of the Eurosystem as a catalyst is one of great importance, for example, with regard to the development of cross-border retail payments in euro where efficiency has been adversely affected by the lack of adequate co-ordination among participants. Despite the introduction of the euro and the fact that the euro area now has to be regarded as a single “domestic market”, there is still segmentation along the national borders of retail payment systems owing to largely differing service levels for national and cross-border payments. In its September 1999 report “Improving cross-border retail

payment services – the Eurosystem’s view”, its September 2000 report “Improving cross-border retail payment services – progress report”, and the article in the February 2001 issue of the Monthly Bulletin entitled “Towards a uniform service level for retail payments in the euro area”, the Eurosystem has made it clear to the banking industry and the public at large that it expects a substantial reduction in the differences in service levels for domestic and cross-border retail payments by 2002, and for them to disappear completely in the medium term. In its November 2001 report entitled “Towards an integrated infrastructure for credit transfers in euro”, the Eurosystem proposed a series of measures to which the banking sector should commit itself to bring the cost of cross-border credit transfers to the level of national ones by the end of 2004. The banks, however, would have to determine for themselves what best fits their particular needs. On 19 December 2001 the European Parliament and the Council adopted Regulation (EC) 2560/2001 on cross-border payments in euro (OJ L 344 of 28 December 2001). In accordance with the provisions of the Treaty, the ECB delivered its Opinion on the draft Regulation. In order to foster co-operation between market participants, the Eurosystem stresses the importance of co-ordination bodies for the euro area. Such bodies exist in most countries and have proven very useful in defining and implementing technical standards and business practices. The creation of such a co-ordination body for the entire euro area is deemed necessary and it is the intention of the Eurosystem to play the role of catalyst in this regard.

In the context of securities clearing and settlement, the Eurosystem cannot be indifferent to the consolidation process currently under way in the euro area. Increased consolidation has the potential to foster efficiency, but also to exacerbate risks. The focus of attention of central banks has recently extended to securities clearing organisations and is particular to central counterparties. The latter are entities which

assume obligations on behalf of their participants. The potential of central counterparties to concentrate risks is much higher than that of securities settlement systems. As a result, the Eurosystem has a special interest in central counterparties and their systemic relevance and, on 27 September 2001, issued a policy statement on consolidation in central counterparty clearing. The Eurosystem's attitude towards securities clearing and settlement systems is guided by the principles of efficiency and neutrality. Efficiency requires consolidation in the securities clearing and settlement infrastructure, and one of the first steps towards consolidation is to create the conditions whereby the Eurosystem's monetary policy counterparties are able to use all types of eligible collateral throughout the euro area. However, the benefits of consolidation should not only be limited to central bank operations. The present infrastructure needs to undergo reshaping in order to allow all euro area securities to be easily transferred from one part of Europe to another. The principle of neutrality means that the Eurosystem does not favour any particular solution in order to achieve integration: the Eurosystem will not interfere with market competition between systems, financial centres or categories of banks, in order to provide a more integrated solution.

Setting standards

It is the competence of the Governing Council to set safety and efficiency standards with which payment systems operating in euro must comply. In order to provide a clear definition of its payment system-related objectives and communicate its role and major policies with regard to payment systems, in June 2000 the Governing Council of the ECB adopted and published its "Statement on the role of the Eurosystem in the field of payment systems oversight". In performing its tasks, the Eurosystem supports the further achievement and smooth functioning of the Single Market and consequently contributes to market

integration. It ensures a level playing-field for the providers of payment and securities clearing and settlement services, in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources.

Oversight standards for payment systems

With regard to the Eurosystem as a whole, the Governing Council decides on the adoption of any standards for payment systems endorsed by other standard-setting bodies. For example, since February 2001, the Governing Council has included the "Core Principles for Systemically Important Payment Systems" (the Core Principles) by the CPSS in the set of standards used to evaluate the safety and efficiency of large-value euro payment systems. Where there are new developments in retail payment systems or where retail schemes may have potential cross-border implications, general policy lines for oversight are also defined at the Eurosystem level. Through oversight of payment systems, the Eurosystem ensures that the standards set are properly applied.

Since an increasing number of payments are being processed through private systems run by major banks, the Eurosystem is also paying attention to advanced correspondent banking and innovative payment arrangements. The possible risks involved in such arrangements are comparable with those that might occur in payment systems and disruptions therein could have the same negative systemic implications. Consequently, the Eurosystem will continue to monitor closely the systemic importance of such systems and developments in the field.

Standards for the use of securities settlement systems in Eurosystem credit operations

According to the Treaty, the monetary policy operations of the Eurosystem are to be fully collateralised and intraday credit in TARGET

is only provided against collateral. This makes the smooth delivery of securities/eligible assets to the Eurosystem indispensable. In order not to incur unacceptable risks when conducting its own credit operations and in order to ensure a level playing-field within the euro area, the Eurosystem has developed and endorsed nine standards to be met by EU securities settlement systems to qualify them for use for Eurosystem credit operations (“Standards for the use of EU securities settlement systems in ESCB credit operations”, ECB, January 1998). In order to

be eligible for use by the Eurosystem, the security and efficiency of individual securities settlement systems and the links established by securities settlement systems for the cross-border transfer of securities are regularly assessed in terms of these standards. Although the standards were set by the Eurosystem as a user of securities settlement systems, securities settlement systems themselves have made considerable efforts to comply with these standards. This clearly shows that the standards have acquired a de facto regulatory value.

4 Conclusion

Payment and clearing facilities constitute the core infrastructure of the financial sector. Their smooth functioning is not only beneficial but indispensable to the operation of modern market economies. For their basic task of providing the economy with central bank money, central banks have to provide and use payment and clearing infrastructures.

Owing to their characteristic of closely linking participants, payment and clearing systems are exposed to systemic risk. Central banks worldwide make a concerted effort to monitor and mitigate this risk and, for this reason, they have a natural involvement in payment and clearing systems arising directly from the performance of their basic tasks of implementing monetary policy and ensuring systemic stability. Their activities in this field are geared towards achieving sound, efficient systems, an objective which is pursued by operating payment and clearing systems themselves, by issuing regulations, acting as a catalyst for the improvement of systems, and by overseeing payment and clearing systems.

In line with the growing importance of securities in the financing of the economy, the importance of securities clearing and settlement systems has increased over the past few years. Central banks have actively followed developments and acted in this field with the same objectives and rationale as

providers of services, regulators, catalysts for enhancements and overseers setting and enforcing standards. This is being carried out in close co-operation with the authorities responsible for securities market regulation.

The responsibilities and activities of the Eurosystem in the field of payment and securities clearing and settlement systems are in keeping with what can be observed as standard international practice. The Treaty confers on the Eurosystem the basic task of promoting the smooth operation of payment systems. The Statute of the ESCB foresees that the ECB and the NCBs may provide facilities, and the ECB may make Regulations, to ensure sound, efficient payment systems within the Community and with other countries.

In practice, the TARGET system is considered to be the “payments backbone” of the Eurosystem. The involvement of the Eurosystem in setting up the CLS project can be seen both as operational involvement in the provision of payment facilities with other countries and as a co-operative oversight activity. The provision of automated clearing facilities in the retail area by some central banks in the Eurosystem, the function of the ECB as a settlement agent for the Euro I system, and the provision of the correspondent central banking facility are further examples of the Eurosystem’s

operational activity in both payment and securities settlement-related services.

The Statute of the ESCB provides the ECB with clear regulatory powers. It may make Regulations and Recommendations, take Decisions and deliver Opinions in the field of payment and clearing systems. It has an important advisory role vis-à-vis the Community and national legislators. So far, the ECB and the Eurosystem have not made a Regulation in this field. Their focus in both areas – payment systems and securities clearing and settlement systems – has been on their role as a catalyst for change by using moral suasion. The area of cross-border retail payments is a case in point. On this topic, the Eurosystem has issued a number of reports

with the aim of spurring and assisting the development of sound, efficient retail payments in the euro area. In the field of securities, the Eurosystem closely monitors the consolidation process, pursuing a policy line which fosters efficiency while remaining neutral.

Finally, the Eurosystem is a proactive overseer of payment and clearing systems, having declared publicly its intention to follow in its oversight the “Core Principles for Systemically Important Payment Systems”. In the field of securities clearing and settlement systems, it is currently working closely with securities regulators to establish specific criteria for overseeing these systems.