

ECB-PUBLIC

DIRECTORATE GENERAL PAYMENTS AND MARKET INFRASTRUCTURE

TEMPLATE: COMMENTS ON THE DRAFT "REGULATION OF THE EUROPEAN CENTRAL BANK ON OVERSIGHT REQUIREMENTS FOR SYSTEMICALLY IMPORTANT PAYMENT SYSTEMS"

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¹ The TWG is a European Working Group coordinated by the European Credit Sector Associations (EBF, ESBG, and EACB). TWG members are ensuring the link to the TARGET 2 National User Groups. The membership of the WG takes into account the geographical and sector balance as well as the representation of critical players.

<p>Applicability of the CPSS-IOSCO Principles to central banks</p>	<p>Clarification</p>	<p>Whilst this point arises in a number of specific places in the draft regulation, we believe that it is also an underlying and important generic issue. Section 1.23 of the CPSS-IOSCO Principles states that in general the Principles are applicable to FMI operated by central banks except in certain cases due to requirements in relevant law, regulation or policy with further information being provided in principles 2-4-5-15-18. We have interpreted this to mean that adherence to the CPSS-IOSCO Principles is the default position for central bank operated FMI but there will be a limited number of exceptions. However, in a number of cases highlighted in our detailed comment below, it is not clear to us what reason is being used to justify some exclusions for Eurosystem SIPS. Consequently, in the interests of transparency, we request that where an exclusion is incorporated, the justification for this should be made publicly available. Also, we believe that such an approach accords with the CPSS-IOSCO Principles Responsibility D: Application of the principles for FMI which states that central banks market regulators and other relevant authorities should clearly define and disclose their regulatory, supervisory and oversight policies with respect to FMI.</p> <p>To summarise, we believe that the clear message conveyed by the CPSS-IOSCO Principles is that there should be a level playing field between public (CB) and privately operated SIPS. Consequently, we believe that exclusions for Eurosystem SIPS should only relate to central bank specific features and not features which apply equally to non-Eurosystem SIPS.</p>
<p>Application of the Regulation</p>	<p>Clarification & amendment</p>	<p>We understand that although currently for IMF purposes TARGET 2 is being assessed against the underlying CPSS-IOSCO Principles, the intention is that in future it is to be assessed against the proposed Regulation. The following remarks are based on this premise.</p> <p>We have given careful consideration to how to balance the need for a level playing field against the requirement for certain exemptions for Eurosystem SIPS, particularly where monetary policy operations are settled through TARGET 2. In addressing this, we believe it is important to take account of the fact that TARGET 2 is a multi-purpose system as described in Article 3(2) of the Harmonised Conditions. Having said this, we believe that irrespective of the reason for the payment, robust operational processes are required with the difference arising at the level of high level strategic decision making. Consequently, we would suggest that the cleanest way to address this issue is to redefine “ the Board “ and “ the Management “ in order to exempt Eurosystem SIPS from certain requirements relating to “ the Board “.It seems to us that doing this has two major advantages. Firstly, it avoids placing restrictions on the decision making power of the Governing Council. Secondly, it avoids the difficulty inherent in determining how the existing definition of “the Board “applies to Eurosystem SIPS. However, in making this recommendation, we have not researched whether any Eurosystem SIPS may be subject to additional requirements as a result of national law. If so, such national law will presumably need to be accommodated by the Regulation. Finally, where we suggest drafting changes, this has been done without taking legal advice. Nevertheless, we hope the Eurosystem will find such suggestions helpful in illustrating the points we are making.</p>
<p>Recital 7</p>	<p>Clarification</p>	<p>We have interpreted “statutory responsibilities“ to encapsulate the relevant law, regulation or policy referred to in</p>

		<p>section 1.23 Of the CPSS-IOSCO Principles including functions restricted to central banks such as monetary policy and provision of central bank liquidity. However, we do not understand the justification for adding “different risk profiles” unless this is intended to refer to the different ownership structure/functions of central banks. So far as operating risks (including credit, liquidity etc.) which apply equally to private sector FMIs, are concerned, we accept that certain such risks may not always be applicable to central banks but, if so, it simply means that the risk will not be applicable as opposed to being excluded. Conversely, except for a small number of cases such as “wind-down” which arguably relate to a central bank’s ownership structure anyway, we can see no reason to differentiate between private and central bank SIPS where similar functions are concerned. Any SIPS operator, including operators of Eurosystem SIPS does, of course, have the right to impose additional controls above the minimum level required by the Regulation.</p> <p>To summarise, we believe that any reference to different risk profiles “should be restricted to central bank specific risks and not extended to risks which may apply equally to a private sector SIPS.”</p>
Recital 12	Amendment	For clarity, we wonder if it may be worth adding “as amended by Directive 2009/44/EC” after “Directive 98/26/EC”.
Recital 13	Clarification	We strongly support the reference to acceptable risk control standards. However, it is not clear to us what “free provision of services” is referring to. It is also not clear how the disproportionate extent and the acceptable risk will be assessed given its subjective nature. Is it intended that this will be a SIPS decision subject to approval by its overseer / regulator?
Recital 17	Amendment	We would suggest replacing “in implementing the CPSS IOSCO principles to the fullest extent allowed” with “in implementing in a harmonized way the CPSS –IOSCO principles as allowed under the Treaty and the Statute of the ESCB”. In our view, this is important to ensure harmonisation and a level playing field in application of sanctions within the euro area.
Article 1(3)	Clarification	<p>For information, we have not suggested reference to Directive 2009/44/EC here since it is understood that technically designation is still undertaken under Directive 98/26/EC.</p> <p>We have also noted that section 1.3 of the CPSS-IOSCO Principles states that the term FMI refers to systemically important payment systems, CSDs, SSSs, CCPs and TRs which we assume is the reason the regulation has been restricted to SIPS. However, a concern has been raised that this could result in traffic moving to payment systems which are not regarded as being systemically important or, even worse, payment methods outside the regulated sector entirely. We suggest this should be monitored in order to enable appropriate action to be taken, if necessary.</p>
Article 2	Clarification Amendment	<p>For simplicity, we would suggest to arrange the definitions in alphabetical order. We would also suggest to add the following definitions:</p> <p>Transfer order - see comment below.</p>

		Automatic default - see Article 12 Discretionary default - see Article 12 Affiliate – see articles 6 and 8
Article 2(1)	Amendment	We note that the definition of “payment system” is based on the definition of “system” in the SFD. However, unlike the SFD, “transfer order” is not defined in the regulation and we suggest that this is done.
Article 2(2)	Amendment	Whilst we believe it is generally accepted that overall, payment systems performed well in the 2008 financial crisis, we understand it has been suggested some participants may have delayed payments even when they had liquidity available. Consequently, it is suggested that consideration be given to recognising such a scenario (i.e. deliberately delaying payments) in a financial crisis in the definition of “systemic risk”. In this connection, we note that section 2.2 of the CPSS-IOSCO Principles refers to the inability of one or more participants to perform as expected. However, we have deliberately not suggested including IT system failure whether centrally, at the level of SWIFT or at the level of a major participant since contingency plans already exist to cover these scenarios.
Article 2(3)	Amendment Clarification	We regard it as important to define “SIPS operator” more precisely. Whilst it will sometimes be clear, this is not always be the case. A good example of this is where the infrastructure and scheme are run by different legal entities. Also, we believe the term “SIPS operator” needs to be clarified in relation to TARGET 2. As noted in Recital 8 , (for legal purposes) TARGET 2 has a decentralised structure . However, for the purpose of this regulation, it would seem logical to treat it as a single technical system. This then gives rise to the question of who is the SIPS operator which in our understanding is the Eurosystem. To accommodate these points, a possible redraft of the definition could read :- “ SIPS operator “ means “ a eurosystem central bank “ in the case of a Eurosystem SIPS and for a private SIPS the legal entity legally responsible for operating the SIPS or where such function is split between two legal entities, whichever legal entity is responsible for the function concerned.
Article 2(18)	Amendment	In order to avoid the problem of defining “the Board “ in relation to a Eurosystem central bank. it is suggested that the definition of “The Board“ is amended to read :- “The Board “ means the administrative or supervisory board of a private SIPS operator or both in accordance with national law.
Article 2(19)	Amendment	It is suggested that this definition should be amended to restrict “the Management “ to persons responsible for day to day operations of the SIPS as opposed to strategy or major investment decisions. Also, we are concerned that the terms “unitary board “ and management board “ will not necessarily be interpreted in the same way in all relevant jurisdictions, particularly if such a structure does not exist in an affected jurisdiction. Consequently, we suggest amending the definition to read as follows.

		“The Management “means the members of the management of a SIPS operator responsible for day to day operations and acting under delegated authority from the Board of a private SIPS or the relevant Eurosystem central bank for a Eurosystem SIPS.
Article 2(21)	Amendment	We suggest adding “without utilisation of supporting collateral“. Alternatively, add “including utilisation of supporting collateral“but make it clear one way or the other.
Article 2(34)	Clarification Amendment	We assume that the term “one sided payment“is intended to apply to a system such as CLS. However, as currently defined it could refer to any euro payment system which seems nonsensical. Consequently, it is suggested that this definition is redrafted.
Article 3(4)	Amendment	We wonder if this should be extended to consideration of obtaining well-reasoned and independent legal opinions or analyses. In this connection, see section 3.1.3 of the CPSS-IOSCO Principles and Annex II Appendix III of the T2 Guideline.
Article 4(3),(4) and (5)	Amendment	<p>Assuming that our recommendation that Eurosystem SIPS are out of scope of provisions of the Regulation relating to “ the Board “ , it is suggested that all references to “ with the exception of Eurosystem SIPS “ and “ except for Eurosystem SIPS “ are deleted. Instead, it is suggested that requirements applicable to Eurosystem SIPS should be incorporated either as a completely new article or as an Article 4(b) with the existing article being renumbered as Article 4(a). Adopting this methodology, (1) and (2) would be the same in both articles 4(a) and 4(b). However, in Article 4(b) sub-article 3 would be amended to read:</p> <p>“For Eurosystem SIPS, Eurosystem central banks’ roles and responsibilities shall be clearly defined. Eurosystem central banks’ roles and responsibilities shall include all of the following.</p> <ul style="list-style-type: none"> (a) establishing clear strategic aims for the SIPS; (b) establishing documented procedures for the SIPS’ functioning , including procedures to identify, address and manage conflicts of interest of its members.” <p>The other sub-articles should be amended similarly.</p>
Article 4(3)(d)	Deletion	We understand that compensation policy for a SIPS which forms part of a much larger organisation such as the Eurosystem or Eurosystem CBs cannot be looked at in isolation but needs to be considered in relation to other parts of the parent organisation but this could apply equally to a private SIPS. We do not, therefore, regard this as being specific to Eurosystem SIPS. Having said this, we have not been able to locate a specific requirement re compensation in the CPSS-IOSCO Principles and believe that this issue is far better dealt with by overseers in the context of operational risk. Consequently, we suggest deletion of this sub-Article.
Article 4(6)	Clarification	Since this sub-article refers to managements’ role, it should remain in the proposed article 4(b).

Articles 4(7) and (8)	Clarification	It is considered that these two sub-articles should apply equally to Eurosystem SIPS and should appear in the proposed Article 4(b) with “the Eurosystem central bank” being substituted for “the Board “.
Article 6(3)	Amendment	At the end, we believe it should read “and/or other equivalent financial resources”, otherwise it would imply that “other equivalent financial resources “must always form part of the package.
Article 7(7)	Clarification	We believe that a clear distinction needs to be drawn between collateral connected with Eurosystem monetary policy operations including provision of finance and collateral used for the purpose of safeguarding a SIPS. If we are reading Article 7(1) correctly, this is intended to refer to the latter i.e. collateral required to safeguard a SIPS, in which case we do not see the justification for a Eurosystem exemption. Clarification of the Eurosystem’s intention will be appreciated.
Article 8(3)	Amendment	It is suggested that a specific comment relating to RTGS systems is considered since they only settle when sufficient liquidity is available anyway.
Article 8(4) and (5)	Amendment	As stated in our comment on sub-Article 2(34), we believe it is essential that the definition of “one-sided payment“ is amended, otherwise this sub-Article would appear to create a nonsensical result in relation to a system such as TARGET 2.
Article 10(1)	Clarification	Unless the definition of “ one-sided payment “ is changed , this would appear to be contrary to Principle 9 of the CPSS-IOSCO Principles which allows settlement in commercial bank money.
Article 10 (6)	Clarification	It is assumed that this sub-Article is intended to cover situations where settlement occurs on the books of a commercial bank as described in section 3.9.1 of the CPSS-IOSCO Principles. If so, is suggested some minor redrafting is undertaken to make this clear.
Article 14(3)	Clarification Amendment	We do not understand why this sub-Article does not apply to Eurosystem SIPS. Surely, if a Eurosystem SIPS is, or may be, exposed to custodian banks, it should evaluate and understand its exposures. If it isn’t, this sub-Article won’t apply anyway.
Article 15 (5)	Amendment	The formulated criteria do not match those with a “state of art” architecture on information systems security (standard ISO 27002). It does not seem to be consistent with Target 2 end of day settlement constraints and to the possibility to ask for a T2 end of day delay e.g. if a major AS has problems. Also, we believe the phrase “end of operational day“requires clarification. For example, our understanding is that in exceptional circumstances, the T2 operational day could be extended into the next calendar day.
Articles 21 and 22	Amendment	To avoid discrepancy of treatment and monitoring between SIPS based in different countries, we would recommend

		to insert in these two articles a reference to a minimum frequency of reporting and assessment by Eurosystem overseers.
Article 24	Clarification	It was apparent from discussion at the meeting at the ECB on 18 th July that the one year transition period referred to could cause a problem for some SIPS operators and possibly their participants who would like a longer period. However, based on our current knowledge, this is not likely to be an issue for TARGET 2 participants. Consequently, we leave it to the affected SIPS and their participants to provide details of the potential problems they envisage in their submissions in response to this consultation.