



EUROPEAN CENTRAL BANK

Role of the Eurosystem in the field of payment systems oversight

I Introduction

The purpose of this policy statement is to clarify the role of the Eurosystem¹ in the field of payment systems oversight and to explain its objectives and principles.

This policy statement may be complemented by similar statements by the national central banks (NCBs) of the Eurosystem in order to illustrate the exercise of the oversight task in their specific national contexts.

2 The objectives of oversight and the role of the Eurosystem

The oversight of payment systems, which is an essential function for modern central banks, aims at ensuring the smooth functioning of payment systems.

Central banks are concerned about the smooth functioning of payment systems for a number of reasons.

First, central banks aim to maintain systemic stability in payment systems, by containing the exposure to systemic risk. This is the risk that the failure of one participant to meet its obligations in the system will result in other participants being unable to meet their obligations, thus leading to a chain reaction. Indeed, a major malfunctioning of payment systems could, under certain circumstances, undermine the stability of financial institutions and markets.

Every day, in the euro area, the total value of payments processed in large-value systems alone equals nearly EUR 1,500 billion, a value, which represents almost 25% of the annual GDP of the euro area. The amounts processed are such that a malfunctioning of the payment systems may have consequences for the financial markets. With modern technology, disruptions in one area of the market could spread quickly throughout the financial sector and put the whole system at risk. Disturbances

in the financial sector may also have an impact on the real economy.

Second, central banks are concerned with the efficiency of payment systems, which is a complementary objective to systemic stability.

Third, they are concerned with the security of the payment instruments used by the public.

The latter functions are material both to the confidence of the users of the payment systems and of the users of the payment instruments and, ultimately, to the maintenance of public confidence in the currency.

Fourth, since payment systems are an essential vehicle for the implementation of monetary policy, oversight is aimed at safeguarding the transmission channel for monetary policy.

It follows that the oversight of payment systems is an essential function of central banks (and hence also of the Eurosystem) which is directly linked to their core functions, i.e. the definition and implementation of monetary policy to ensure price stability and their interest in the

¹ The Eurosystem comprises the ECB and the NCBs of the Member States which have adopted the euro in Stage Three of Economic and Monetary Union. The Eurosystem is governed by the decision-making bodies of the ECB, which are the Governing Council and the Executive Board.

stability of the financial system, in the soundness of the currency and in the public's confidence in the currency.

In order to achieve these objectives, central banks (and hence also the Eurosystem) perform payment systems oversight. In many cases, they offer payment and settlement services directly and therefore have an operational role. In cases where the private sector manages payment and settlement systems, central banks perform an oversight function on those systems.

3 The legal basis

Oversight may or may not be based on explicit legal provisions. Oversight frameworks applied by central banks developed in the 1980s, mostly on a non-statutory basis. However, the oversight role of central banks gradually became recognised in law. This is now the case for the Eurosystem, whose Statute was adopted in 1992. The Treaty establishing the European Community (hereinafter referred to as the "Treaty") and the Statute of the European System of Central Banks (ESCB) and the European Central Bank (ECB) (hereinafter referred to as the "Statute") recognise oversight as one of the basic tasks of the Eurosystem and defines its broad objective.

Accordingly, the central bank's activity consists of:

- a) defining, implementing and ensuring compliance with, principles and standards which are established to promote safe, sound and efficient payment and settlement systems, whether these are operated by the central banks themselves or by private operators; and
- b) monitoring developments in the field of payment and settlement systems in order to assess the nature and scale of the risks inherent in these and ensuring the transparency of the arrangements concerning payment instruments and services.

Article 105 (2) of the Treaty and Article 3 of the Statute state that "*The basic tasks to be carried out through the ESCB shall be [...] to promote the smooth operation of payment systems.*"

In addition, Article 22 of the Statute states that "*The ECB and national central banks may provide facilities, and the ECB may make regulations, to ensure efficient and sound clearing and payment systems within the Community and with other countries.*" Article 22 is particularly explicit on two points: the possibility for the Eurosystem to have an operational role and the possibility for the ECB to issue regulations in the field of payment systems.

4 Oversight activities and repartition of tasks within the Eurosystem

The oversight role of the Eurosystem covers payment and settlement systems which process the euro. With regard to the systems managed by the Eurosystem (e.g. TARGET), the minimum standards applied are at least the same as those applied to privately operated payment systems.

Within the Eurosystem oversight activities are performed in the following manner:

- a) In line with the provisions of the Treaty and Statute, the Governing Council formulates the common policy stance. In particular, the Governing Council determines the

objectives and core principles of a common Eurosystem oversight policy in those cases where the functioning of payment systems may affect:

- the implementation of monetary policy;
- systemic stability;
- the establishment of a level playing-field between market participants; and
- cross-border payments within the EU and with other countries.

In line with the principle of subsidiarity, in areas not specifically covered by the common oversight policy, policies defined at the NCB

level apply within the framework of the objectives and core principles defined at the Eurosystem level, in relation to which the Governing Council can always take an initiative, where necessary. An appropriate level of co-ordination between the ECB and the NCBs is ensured for any proposed policy or action in the field of oversight which an NCB may wish to pursue at the national level. This is provided for in Article 105 (4) of the Treaty and Article 4 of the Statute, which state that the ECB shall be consulted on any provision in its field of competence; this includes national rules and regulations in the field of payment systems.

In respect of retail payment arrangements, such systems handle large volumes of payments of relatively low value and generally carry little, if any, systemic risk. As a rule, the definition of the oversight of retail payment systems will continue to be performed by the relevant NCBs. However, where new developments occur or where retail schemes would have potential cross-border implications, general policy lines for oversight are defined at the Eurosystem level.

The Eurosystem may also formulate policy concerning the security of payment instruments in order to maintain the confidence of the users of the payment systems. A typical example of the latter was the "Report on electronic money", published in August 1998.

- b) The enforcement of the common oversight policy stance can be ensured by ECB regulations – in accordance with Article 22 of the Statute – or guidelines. Where applicable, enforcement can be effected by legal instruments available to an NCB. More traditional, informal tools (e.g. moral suasion) can also be used.

In line with the principle of decentralisation, the enforcement of the policy stance is, as a rule, entrusted to the NCB of the country where the system is legally incorporated. In view of the increasing cross-border

participation in payment systems within the euro area, the Eurosystem favours a co-operative approach towards the enforcement of the oversight policy stance, with the local NCB acting as lead overseer, and being responsible for liaising with other relevant NCBs whenever this is required.

For systems which have no clear domestic anchorage, the body entrusted with oversight responsibility is the NCB where the system is legally incorporated unless the Governing Council decides otherwise on the basis of the features of the system and entrusts oversight responsibilities to the ECB. This was the case for the Euro System of the EBA Clearing Company (Euro 1) and the future Continuous Linked Settlement Bank (CLS Bank).²

The ECB and the NCBs ensure consistency in the enforcement of the oversight policy stance and, in particular, that standards are applied in the same way for all the payment systems concerned. To this end, these oversight activities are co-ordinated at the level of the Eurosystem, through appropriate committees and working groups.

- c) The management of emergency situations will be ensured by the NCB or the ECB, in their capacity as overseers of the different systems, as outlined above. Appropriate information and co-ordination channels are established within the Eurosystem to ensure timely communication between the overseers.

² It should be noted in this respect that the ECB is the primary overseer for Euro 1, while the primary overseer of the CLS Bank is the Federal Reserve Bank of New York, and the ECB plays the role of overseer in respect of the settlement of the euro, in the framework of co-operative oversight set out in the Lamfalussy report. NCBs of participating countries are associated with the oversight activity of the ECB as members of the Eurosystem – the central bank of issue of the euro – and as NCBs of the banks that act as settlement members of CLS Bank.

5 The principles and their implementation

In 1993 the Committee of Governors of the Central Banks of the Member States of the EC endorsed the Report entitled “Minimum common features for domestic payment systems”, which contained the guiding principles for the preparation of Monetary Union. In particular, this report set out as general principles for the minimisation of systemic risk that each country should have a real-time gross settlement (RTGS) system through which as many large-value payments as possible should be channelled and that other large-value systems may continue to operate in parallel with RTGS systems if they fully comply with the minimum standards set out in the “Report of

the Committee on Interbank Netting Schemes of the central banks of the Group of Ten countries”, published by the Bank for International Settlements (BIS) in November 1990 (“Lamfalussy report”), and settle on the same day at the central bank. The 1993 report also elaborated on access criteria, specifying the requirement set out in the Lamfalussy report in this respect within the context of EU legislation.

The common oversight policy of the Eurosystem for large-value interbank funds transfer systems (IFTs) is based, in particular, on these principles.

Oversight policy in practice

In order to implement this oversight policy, and with a view to the start of Stage Three of EMU, all large-value payment systems that intended to process the euro were assessed against the Lamfalussy standards.

The five systems assessed were: the Euro System (Euro 1) operated by the Clearing Company of the Euro Banking Association (EBA); Euro Access Frankfurt (EAF) in Germany; Servicio Español de Pagos Interbancarios (SEPI) in Spain; Système Net Protégé (SNP) in France and Pankkien On-line Pikasiirrot ja Sekit-järjestelmä (POPS) in Finland. The assessment, prepared by the respective overseer of the systems, was co-ordinated and reviewed by the ECB.

On the basis of the overall satisfactory outcome of this assessment, in December 1998 the Governing Council agreed that all such systems complied with the Lamfalussy standards and could operate in euro as from 4 January 1999.

When Paris Net Settlement (PNS) replaced SNP in April 1999 the new system was also assessed against Lamfalussy standards and was found to be compliant with these.

Moreover, in order to provide further guidance for the implementation of Lamfalussy standard I which requires that all systems should have a well-founded legal basis under all relevant jurisdictions, the Eurosystem has developed harmonised “terms of reference” for legal opinions for foreign participants in large-value payment systems.

Finally, in the field of electronic money, the Eurosystem oversight policy is based on the requirements set out in the ECB “Report on electronic money”, published in 1998.

Terms of reference for legal opinions

“Terms of reference” are a list of issues which legal advisers are asked to consider when preparing a reasoned legal opinion, which will be required by all new participants in all large-value systems as of 30 March 2000 with a view to assessing the legal risks which may arise as a result of their participation in such systems. The legal opinions will be reviewed by the relevant NCB or the ECB, in their capacity as overseer. The detailed requirements set out by the harmonised terms of reference are disclosed to the operators of the payment systems.

6 Co-operation with supervisory authorities and international authorities

The Eurosystem considers that close co-operation between payment system overseers and banking supervisors is essential. Such co-ordination contributes to an overall strategy of risk reduction in the financial system and helps to promote its stability.

The Eurosystem is endeavouring to clarify the manner in which co-operation takes place, paying particular attention to the principles and practices governing the exchange of

information between the authorities, which is necessary to ensure the soundness and stability of payment and settlement systems and of their participant credit institutions.

As regards co-operation with non-EU central banks in relation to multi-currency clearing and settlement systems and offshore systems handling the euro, the Eurosystem will be guided by the principles for co-operative central bank oversight set out in the Lamfalussy report.