

SUMMARY PAPER

ON THE OVERSIGHT OF PAYMENT AND
SECURITIES SETTLEMENT SYSTEMS

ISSUED: 5 DECEMBER 2001

TABLE OF CONTENTS

1. OVERVIEW.....	1
2. OVERSIGHT	2
2.1. GUIDING AXIOMS	2
2.2. OVERSIGHT OBJECTIVES	2
2.2.1. IN RELATION TO SYSTEMS	2
2.2.2. IN RELATION TO OPERATORS/TECHNICAL AGENTS.....	3
3. SYSTEMS, OPERATORS AND TECHNICAL AGENTS.....	3
3.1. SYSTEMS.....	3
3.2. OPERATORS.....	4
3.3. TECHNICAL AGENTS	4
4. RECOGNITION	4
4.1. DEFINITION	4
4.2. PROCESS.....	4
5. CORE PRINCIPLES AND OTHER RELEVANT RECOMMENDATIONS.....	5
6. RECOGNISED OPERATORS AND TECHNICAL AGENTS	5
6.1. OPERATORS.....	5
6.2. TECHNICAL AGENTS.....	5
7. BEST PRACTICE, SELF-ASSESSMENT, COMPLIANCE MONITORING AND INSPECTION.....	5
7.1. BEST PRACTICE.....	5
7.2. SELF-ASSESSMENT	6
7.3. COMPLIANCE MONITORING AND INSPECTION	6
8. SELF-REGULATION AND BCL OVERSIGHT	6
9. COOPERATION	6
APPENDIX.....	7
1 LIST OF CORE PRINCIPLES	7

1. OVERVIEW

The purpose of the policy and procedures is to set out the Banque centrale du Luxembourg (BCL) oversight of payment and securities settlement systems and other related mechanisms¹.

The competence of the BCL in this field is laid down in the circular BCL 2001/163 of 23 February 2001 (“La surveillance par la Banque centrale des systèmes de paiement et de règlement des opérations sur titres au Luxembourg”).

The BCL oversight mission, aiming to promote the smooth operation of payment and securities settlement systems and hence the stability and integrity of the financial infrastructure, can be described as being in proportion to its assessment of systemic risks or the respective level of efficiency.

In preparing its oversight policy and procedures, the BCL has considered among other factors the definition of systems, principles and recommendations issued by particular internationally recognised bodies in respect of such systems, market trends and future initiatives. Further, the BCL recognises the important role to be played by market practitioners in applying self-assessment of conduct of business rules normally described as best practice.

The BCL considers the following to be key features of oversight in its application:

- knowledge and understanding of the various systems and their interrelationships,
- BCL recognition of important systems, operators² and technical agents³,
- the application of the BIS Committee on Payment and Settlement Systems Core Principles for Systemically Important Payment Systems (hereafter Core Principles), – and other recommendations and standards, relating to payment, securities settlement and other mechanisms,
- self-assessment conducted by operators and/or technical agents,
- the use of independent key functions for compliance, internal audit and risk management where relevant,
- good records and/or easy access to information when required,
- monitoring relevant changes in the business environment and assessing impact on systems as such relate to efficiency and stability and,
- the use of routine and ad hoc inspections.

¹ Other payment mechanisms are defined as those which currently exist, e.g. credit and debit card, etc. or new payment- or securities settlement-related products and services which may appear in future.

² An operator is the central system organisation providing products and services.

³ A technical agent is a supplier of service where an operator has located a significant portion of its operational or IT infrastructure or where several payment- or securities settlement-related operational or IT infrastructures are centralised.

2. OVERSIGHT

In essence BCL oversight is focussed on the smooth operation of payment and securities settlement systems and other similar mechanisms. The BCL will continually research and analyse the various systems and mechanisms and examine the interrelationships and interdependencies of the relevant market infrastructures at both the EU and Luxembourg levels. Further, the BCL will monitor and check for compliance with its oversight policy and procedures, which are based on best practice and the use of self-assessment; where necessary the BCL may carry out inspections of operators and technical agents and make recommendations for corrective action as necessary.

2.1. GUIDING AXIOMS

Oversight in its application is based on the following guiding axioms:

Pragmatic and modern oversight style: The BCL is adopting a modern, efficient and cost effective approach to oversight.

Transparency: The authorities, system constituencies and the public at large should understand the oversight process.

Accountability and clear roles and responsibilities: Each authority must be accountable for its actions, so each must have unambiguous and well-defined responsibilities. The BCL believes that the roles and responsibilities of the relevant authorities and key players should be set out in a clear and concise way.

Avoid duplication: There is a need to avoid duplication of resources; this is necessary to avoid confusion, inefficiency and wasted time.

Regular information exchange: The regular exchange of information between system constituencies and authorities will ensure that all can fulfill their obligations as efficiently and effectively as possible.

Knowledge exchange: Co-operation between the BCL and the operator's and technical agent's internal and external auditor is considered appropriate for reasons of efficiency and to avoid unnecessary duplication.

Consciousness of regulatory creep: The BCL is aware of the evolving nature of oversight and is conscious of the phenomenon commonly referred to as 'regulatory creep'. Accordingly, the BCL in pursuit of its oversight mission will endeavour to maintain an appropriate balance between oversight and operator and technical agent compliance costs.

2.2. OVERSIGHT OBJECTIVES

2.2.1. IN RELATION TO SYSTEMS

In the context of oversight, the use of system requires a broad interpretation. It is therefore necessary to set appropriate objectives and these are:

- the smooth operation and efficiency of payment and securities settlement systems and related mechanisms, which contributes to the integrity of the financial infrastructure,
- to identify systems and related mechanisms, whether existing or new, and recognise those systems which are subject to oversight,
- to examine and determine the relationships between constituents,
- to examine the legal and regulatory framework within which the system operates and,
- to monitor changes to the system and its constituents.

2.2.2. IN RELATION TO OPERATORS/TECHNICAL AGENTS

It is also necessary to set appropriate objectives for the oversight of operators/technical agents:

- to determine if policies, practices, procedures, and internal controls are adequate,
- to determine if members of the governing body and executive management are operating in conformance with the established guidelines,
- to determine the scope and adequacy of the audit function,
- to determine the overall quality of the legal and regulatory framework and products and services and how that quality relates to the soundness of the system,
- to determine compliance with laws and regulations and,
- to initiate corrective action when policies, practices, procedures, or internal controls are deficient or when violations of laws or regulations have been noted.

3. SYSTEMS, OPERATORS AND TECHNICAL AGENTS

3.1. SYSTEMS

The general description of payment and settlement systems has been segmented to facilitate oversight. The following system descriptions are therefore relevant:

- payment systems,
- securities settlement systems embedded with payments and other securities settlement systems,
- other payment mechanisms and,
- central counterparty systems.

A system is defined as having five distinct components and these are the:

- the operator,
- participants,
- technical agents and suppliers,
- rules and contracts and,
- legal and regulatory environment.

3.2. OPERATORS

An operator is the central organisation, providing products and services to participants, often using technical agents and suppliers and operating in a legal and regulatory environment which can be wider than the home state, e.g. the Eurozone. See Section 6 for list.

Within the term operator, particular emphasis is placed on admissions, governance, products and services, IT, risk and risk mitigation, business continuity and external audit.

3.3. TECHNICAL AGENTS

Technical agents are deemed to be important for reasons of efficiency or stability and as such subject to oversight. A technical agent is a supplier of service where an operator has located a significant portion of its operational or IT infrastructure or where several payment- or securities settlement-related operational or IT infrastructures are centralised. Indeed wherever possible the requirements relating to the oversight of an operator, including the Core Principles will apply. See Section 6 for list.

4. RECOGNITION

4.1. DEFINITION

Recognition is an internal mechanism of the BCL, used to facilitate the oversight process.

4.2. PROCESS

The BCL has defined the following criteria in respect of recognition of systems, operators and technical agents:

- systems in which the BCL or another ESCB NCB participates,
- systems which are of systemic importance at EU and international level, defined by the function provided by the system, importance in ESCB monetary operations, transaction volumes, value, etc.,
- systems which are of systemic importance at the national level, defined by the function provided by the system, importance in economic, trade and public terms, transaction volumes, value, etc. and,
- systems which require to be monitored for efficiency (cost, investment, competitiveness, speed and risk).

The BCL will assess the operator's/technical agent's:

- financial resources,
- default arrangements,
- rules, which make clear certain key aspects of its business activities and,

- arrangements for monitoring and enforcing compliance with its rules.

5. CORE PRINCIPLES AND OTHER RELEVANT RECOMMENDATIONS

Operators, and where relevant technical agents, must be able to meet the Core Principles and other recommendations and standards, adopted by the BCL, relating to payment, securities settlement and other mechanisms or give reasons for non-compliance or corrective action plans where relevant. The summary of the Core Principles is described in Appendix 1.

6. RECOGNISED OPERATORS AND TECHNICAL AGENTS

The following operators and technical agents have so far been recognised and will be subject to oversight:

6.1. OPERATORS

- RTGS-L Gie (LIPS Gross),
- Sypal-Gie (LIPS Net) and,
- Clearstream Banking Luxembourg (CBL).

6.2. TECHNICAL AGENTS

- BCL for RTGS-L Gie and LIPS-Gross,
- CETREL for Sypal-Gie and LIPS-Net,
- CETREL for other operational and IT infrastructure services and,
- Clearstream Services for operational and IT infrastructure services.

7. BEST PRACTICE, SELF-ASSESSMENT, COMPLIANCE MONITORING AND INSPECTION

The BCL has adopted a modern and pragmatic approach to oversight and this is based on four foundations and these are as follows:

7.1. BEST PRACTICE

The BCL is adopting an approach based on self-assessment of conduct of business and as such the oversight policy and procedures sets out best practice in terms of governance, risk and risk mitigation. It sets out various principles and recommendations in particular the BIS Committee on Payment and Settlement Systems Core Principles for Systemically Important Payment Systems. Operators and technical agents are expected to meet such requirements or provide satisfactory explanation for non-compliance.

7.2. SELF-ASSESSMENT

Recognised operators and technical agents are required to self-assess against the oversight policy and procedures.

7.3. COMPLIANCE MONITORING AND INSPECTION

While self-assessment against best practice criteria forms an essential part of the oversight process which is applied to operators and technical agents, the BCL will also require various reports and information, and will conduct meetings and where necessary inspections to monitor compliance with its policy and procedures.

8. SELF-REGULATION AND BCL OVERSIGHT

The BCL requires RTGS-L Gie and Sypal-Gie, which are not subject to prudential supervision (law of 12 January 2001), to self-regulate. They are subject to the BCL's oversight policy and procedures.

The distinction between the BCL's compliance monitoring and operational role is as follows:

- The BCL's operational unit acts as technical agent for RTGS-L Gie and as settlement agent to RTGS-L Gie and Sypal-Gie participants and,
- The BCL's separate unit for Financial stability is involved with the compliance monitoring and inspection of all systems, operators and technical agents.

9. COOPERATION

The BCL, as an integral part of the ESCB, cooperates with other national central banks and the ECB in the execution of the objectives and tasks of the ESCB. The BCL remains open for cooperation arrangements with other national and international authorities.

The BCL has signed a Memorandum of Understanding on cooperation between payment systems overseers and banking supervisors in Stage Three of Economic and Monetary Union.

APPENDIX

The Governing Council of the ECB has adopted the Core Principles as Eurosystem oversight minimum standards.

1 LIST OF CORE PRINCIPLES⁴

- I. The system should have a well-founded legal basis under all relevant jurisdictions.
- II. The system's rules and procedures should enable participants to have a clear understanding of the system's impact on each of the financial risks they incur through participation in it.
- III. The system should have clearly defined procedures for the management of credit risks and liquidity risks, which specify the respective responsibilities of the system operator and the participants and which provide appropriate incentives to manage and contain those risks.
- IV.⁶ The system should provide prompt final settlement on the day of value, preferably during the day and at a minimum at the end of the day.
- V.⁶ A system in which multilateral netting takes place should, at a minimum, be capable of ensuring the timely completion of daily settlements in the event of an inability to settle by the participant with the largest single settlement obligation.
- VI. Assets used for settlement should preferably be a claim on the central bank; where other assets are used, they should carry little or no credit risk and little or no liquidity risk.
- VII. The system should ensure a high degree of security and operational reliability and should have contingency arrangements for timely completion of daily processing.
- VIII. The system should provide a means of making payments, which is practical for its users and efficient for the economy.
- IX. The system should have objective and publicly disclosed criteria for participation, which permit fair and open access.
- X. The system's governance arrangements should be effective, accountable and transparent.

⁴ Extracted from BIS paper on Core Principles for Systemically Important Payment Systems January 2001.

⁶ Systems should seek to exceed the minima included in these two Core Principles.