

### THE CORE PRINCIPLES FOR SYSTEMICALLY IMPORTANT PAYMENT SYSTEMS

Safe and efficient financial infrastructures support the effectiveness of financial markets and can help in containing systemic risk. As payment systems are a core component of the financial system infrastructure, and as the volumes and values of transactions being transferred through payment systems around the world continue to grow, robust and efficient payment systems are indispensable. In order to contribute to preventing a potential malfunctioning of a payment system from triggering wider disruptions in the financial system and to maintain and promote robust financial systems, their design and operation should be based on internationally recognised and widely accepted standards. In January 2001, the G10 Governors endorsed a report entitled “Core Principles for Systemically Important Payment Systems” (also known as the Core Principles report).<sup>1</sup> The Core Principles report extends the Lamfalussy Standards,<sup>2</sup> which were designed for a very specific category of systems. It applies more broadly to systemically important payment systems of all types, not just to schemes that involve cross-border and multi-currency netting, and to all countries in the world. The Core Principles complement the six Lamfalussy Standards, the primary concern of which was the management of (non-)financial risk, with four further principles. These principles are concerned with the promptness of settlement (Core Principle IV), the credit risk associated with settlement assets (Core Principle VI), efficiency (Core Principle VIII), and governance (Core Principle X). The Core Principles are intended for use as universal guidelines to encourage the design and operation of ever safer and more efficient payment systems around the globe. In detail, the principles state that:

- 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. 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. 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.

<sup>1</sup> See Committee on Payment and Settlement Systems (CPSS), “Core Principles for Systemically Important Payment Systems”, BIS, January 2001.

<sup>2</sup> Report of the Committee on Interbank Netting Schemes of the Central Banks of the Group of Ten Countries, BIS, November 1990.

- 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.

In addition to these principles, the Core Principles report explicitly recognises that safety and efficiency in payment systems are key public policy objectives, and defines the distinctive role of payment systems oversight. Central banks, in their capacity as overseers of payment systems, should ensure that the systems they operate and/or oversee comply with the Core Principles. Central banks play a leading role in this respect, *“particularly because of their strong interest in financial stability, their role in providing settlement accounts for payment system participants, and their concerns with the functioning of money markets for the implementation of monetary policy and with maintaining confidence in the domestic currency both in normal circumstances and in a crisis.”* Against this background, the Core Principles report sets out four central bank responsibilities (Responsibilities A-D) in applying the Core Principles to systemically important payment systems, as follows:

- A. The central bank should define clearly its payment system objectives and should disclose publicly its role and major policies with respect to systemically important payment systems.
- B. The central bank should ensure that systems it operates comply with the Core Principles.
- C. The central bank should oversee compliance with the Core Principles by systems it does not operate and it should have the ability to carry out this oversight.
- D. The central bank, in promoting payment system safety and efficiency through the Core Principles, should cooperate with other central banks and with any other relevant domestic or foreign authorities.

The Governing Council of the ECB adopted the Core Principles as the minimum standards of the Eurosystem's common oversight policy on payment systems in January 2001. They are also part of the compendium of 12 standards that the Financial Stability Forum (located at the Bank for International Settlements (BIS)) considers essential for safeguarding financial stability.

According to the Core Principles report, 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. [...] Systemic importance is determined mainly by the size or nature of the individual payments or their aggregate value. Systems handling specifically large-value payments would normally be considered systemically important.”* The Eurosystem takes the view that, in general terms, at least one payment system in each country or currency area should qualify as a systemically important payment system. As a result, where there is only one system operating in a country or currency area, this system is considered systemically important irrespective of the value of the payments it handles. In the euro area, the Eurosystem regards the TARGET system and three net or hybrid settlement systems (EURO1, PNS, POPS) operating in euro as systemically important payment systems. Through its oversight activities, the Eurosystem contributes to ensuring that these systems continuously achieve a high degree of compliance with the Core Principles and do not adversely impact the stability of the financial system in the euro area.