



EUROPEAN CENTRAL BANK

EUROSYSTEM

# OVERSIGHT EXPECTATIONS FOR LINKS BETWEEN RETAIL PAYMENT SYSTEMS

## INTRODUCTION

Oversight of payment systems, which aims to ensure the smooth functioning of payment systems and to contribute to financial stability, is an essential function of central banks. As part of its oversight function, the Eurosystem established the “Oversight standards for euro retail payment systems” in 2003. These standards are based on the “Core principles for systemically important payment systems” set by the Committee on Payment and Settlement Systems in 2001.

The Eurosystem has since recognised that these standards have not been designed to adequately cover the additional risks associated with links between retail payment systems (RPSs)<sup>1</sup>. Meanwhile, it has also noted that such links have consistently grown over the last few years, largely owing to the payment and banking industry initiative aimed at the creation of a single euro payments area (the “SEPA” project), which was launched in 2002.

The Eurosystem considers that links should be properly overseen. It has therefore established a harmonised single set of expectations for RPSs to comply with, specifically for risks that may arise when one RPS establishes a link with another. The national central banks (NCBs) responsible will, as part of their respective oversight functions, assess the compliance of an RPS for any links it may have. The goal is to ensure that the risks stemming from the establishment of links between RPSs are properly managed. The expectations cover risks related to legal, financial and operational arrangements, as well as issues related to governance, access and efficiency. With a view towards ensuring consistency in the implementation of expectations, the Eurosystem will draw up a single methodology to be applied by the NCBs.

This note elaborates on these aspects in three sections. The first section introduces the key notions related to links and different types of links. The second section explains the general approach taken by the Eurosystem as regards the application of the expectations. Finally, the third section reflects on the different risks associated with the establishment and operation of links, as well as looking at the oversight expectations that have been designed to mitigate them.

## I GENERAL INFORMATION ON RPS LINKS

### I.1 DEFINITIONS

**Link:** A link between RPSs can be defined as a set of legal and operational arrangements aimed at facilitating the transfer of funds and fulfilment of payment obligations between entities participating in different RPSs. Links may take different forms, but the basic types are “direct”, “indirect” and “relayed” links.

<sup>1</sup> An RPS is a “retail funds transfer system”, which is defined as “a funds transfer system which typically handles a large volume of payments of relatively low value in forms such as cheques, credit transfers and direct debits” (see Glossary of terms related to payment, clearing and settlement systems, ECB, December 2009).

Links can be established both between systems located in the same jurisdiction or between systems in different jurisdictions (i.e. cross-border links). Links can work unilaterally or bilaterally.

**Direct link:** A link established directly between two RPSs without intermediation by a third entity.

**Indirect link:** A link established between two RPSs, whereby a third entity (generally a commercial bank or a central bank) intermediates between them.

In an indirect link, there will be legal and operational arrangements involving the linked RPSs and an intermediary. The absence of a direct legal arrangement between two indirectly linked RPSs does not exclude an arrangement from being considered as an indirect link, provided that there are legal arrangements between each RPS and the intermediary. The legal relationship between at least one of the RPSs and the intermediary should expressly define the role of the intermediary as intermediating on behalf of an RPS. The legal relationship between the intermediary and the other RPS may either clarify the intermediation role or be a normal participation agreement.

**Relayed link:** A link involving three (or more) RPSs, in which at least one RPS intermediates between two other RPSs. A relayed link can be seen as a chain of two or more direct links.

In all cases of links (whether direct, indirect or relayed), all relevant aspects of the link should be assessed against all applicable expectations, as defined in this document.

## 1.2 OBJECTIVES OF LINKS

Links between RPSs provide organised channels for the transfer, clearing and settlement of payments. In this respect, links may be a key element for the development of SEPA, given that linked infrastructures are able to form networks, thereby facilitating the exchange of payments in the single area and improving the reachability of the RPS participants and their customers.

Establishing a link allows participants in an RPS to transfer funds involving multiple systems and jurisdictions through a single gateway and can thus reduce costs when compared with the costs of participating in a multitude of systems. Links can reduce the number of parties involved in the cross-system clearing and settlement of retail payments, which is conducive to mitigating legal and operational risk. However, inefficiently managed links may also increase risks. The design and potential risks of the link should therefore be carefully analysed before its establishment.

Establishing links between RPSs brings direct benefits for the RPSs themselves and their participants, but the ultimate objective is to improve efficiency when settling payments initiated by commercial banks' customers by shortening the settlement time and reducing fees for processing payments.

## 2 GENERAL APPROACH AND APPLICATION OF THE OVERSIGHT EXPECTATIONS

The assessment of whether the link established by RPSs complies with the oversight expectations shall be carried out under the responsibility of the respective overseers of the linked RPSs. The overseers involved are strongly invited to cooperate with, and coordinate, requests for information addressed to RPSs in order to prevent duplication or overlap in the requests from NCBs.

The main proposals as regards the scope and application of the expectations are as follows:

**Addressee:** The expectations are addressed to the governance authorities of the linked RPS.

**Geographical scope:** The oversight expectations for RPS links should be applied to euro area RPSs which plan to establish, or have already established, links between themselves or with non-euro area RPSs. In the latter case, the assessment process and final result will depend on cooperation from the RPS located outside the euro area and its willingness to comply with expectations.

**Type of links covered:** The expectations should be applied to any type of direct, indirect or relayed link.

### 3 OVERSIGHT EXPECTATIONS FOR LINKS BETWEEN RPSs

#### GENERAL

**Expectation 1: An RPS that establishes a link with one or more other RPSs should identify, monitor and manage link-related risks.**

#### *Key issues*

1. An RPS should identify and assess all potential sources of risk arising from a link arrangement before entering into it and on an ongoing basis once the link is established.
2. An RPS participating in a link should be able to meet all of its obligations to the linked RPSs and to its participants in a timely manner.
3. An RPS that establishes multiple links should ensure that the risks generated in one link do not spill over and affect the soundness of the other links and RPSs.
4. Link arrangements should be designed in such a way that each RPS is able to continue to observe other applicable oversight principles.

The clearing and settlement of cross-system payments is typically more complex and potentially entails more risks than processing transactions within a single system. For this reason, an RPS should conduct an initial risk assessment to evaluate the potential sources of risks arising from the linked RPSs and from the link itself before entering into a link arrangement. The type and degree of risk varies according to the design and complexity of a link and depending on whether one or more jurisdictions are involved, e.g. an indirect link may generate higher risk than a direct one. The resulting arrangements should be designed in such a way that, even if some additional risks are generated, these risks are adequately mitigated. If a link is not designed properly, clearing and settling across the link could subject participants to new or exacerbated risks.

The initial risk assessment of the linked RPSs should include sufficient understanding of the entirety of the other RPS's risk management arrangements. When weaknesses are evidenced, an RPS should take steps to mitigate the potential risks that may arise. In some cases, risk management methods, procedures and parameters used by the RPSs involved in a link may be different. If differences exist, the RPSs should take measures that effectively limit their impact on the link, as well as their potential consequences, e.g. depending on the kind of risk identified, an RPS may ask linked RPSs to implement additional risk management tools or, if possible, do so itself.

An RPS should assess its risk management tools to ensure that it can effectively manage the risks that may arise from linked RPSs and any intermediaries. In particular, an RPS should have robust risk management tools to manage the legal, financial and operational risks it is exposed to through other entities, as well as those it poses to other entities, in order to limit the effects of disruption to and from such entities and the broader financial markets. These tools could include business continuity arrangements that allow for a rapid recovery and resumption of critical activities, or alternative channels for processing cross-system payments. Because of the interdependencies between and among systems, an RPS should ensure that its crisis management arrangements allow for effective coordination among the affected interdependent entities.

An RPS participating in a link should be able to meet in a timely manner all of its obligations to the linked RPS and to its participants that use the link. Furthermore, an RPS's participation in a link should not compromise its ability to meet in a timely manner its obligations to those participants that are not using the link.

Furthermore, an RPS that establishes multiple links should ensure that the risks generated in one link do not spill over and affect the soundness of the other links and RPSs. Mitigation of such spillover effects may require the use of strong risk management controls.

The legal framework, the systems' rules and the operational procedures that govern the functioning of a link change over time. For this reason, the risk assessment should not only be carried out before the link is established, but on an ongoing basis.

Depending on their classification, RPSs are expected to comply with several sets of oversight principles. When designing a link, it should be ensured that its establishment would not affect RPSs' compliance with these principles.

Although each link will present a unique risk profile, a number of generic risks can be identified relating to legal, operational and financial risks. Issues related to governance, efficiency and access can also arise with the establishment of links between RPSs.

## LEGAL RISK

**Expectation 2: A link should have a well-founded, clear and transparent legal basis that is enforceable in all relevant jurisdictions, supports its design and provides adequate protection to the RPSs and their participants in the operation of the link.**

### *Key issues*

1. The legal framework (laws, regulations, rules and procedures) applicable to the linked RPSs and to the link itself should provide a high degree of certainty for each aspect of the link functioning in all relevant jurisdictions.
2. The rules, procedures and contracts governing the link should be clear, understandable and consistent with relevant laws and regulations. They should be readily available as appropriate for all parties with a legitimate interest.
3. The rules, procedures and contracts governing the link should be complete, valid and enforceable in all relevant jurisdictions. There should be a high degree of certainty that actions taken under such rules and procedures will not be stayed, voided or reversed.

4. Linked RPSs should identify and mitigate the risks arising from any potential conflicts of laws across jurisdictions.
5. Linked RPSs should comply with the applicable regulatory frameworks.

Payments processed via a link between two RPSs may be subject to higher legal risks, compared with those cleared and settled in a single system. Payment transactions channelled through a link are processed in different payment systems (and via intermediaries in the case of indirect links), which will have different applicable sets of rules and regulations, and will often be legally established in different jurisdictions.

In particular, conflicts may arise if it is not clear which are the specific laws, regulations, rules or procedures applicable to the payments processed via the link. In exceptional circumstances (e.g. the default of a participant in one of the systems), uncertainties or conflicts could also arise if the rules governing the link do not clearly specify the procedures to be followed.

Conflicts may also arise when the legal basis, and in particular the contracts, do not clearly define the rights and obligations of the linked RPSs (and of the intermediaries in the case of indirect links) and their participants.

Conflicts could also stem from differences in laws and regulations applicable to the linked RPSs (and to any intermediary to the transactions processed) and their participants. This includes the rules related to rights and obligations, finality and irrevocability, and settlement finality. It also includes the protection of netting arrangements that could lead to incompatibility between the respective legal frameworks. As an example, a payment order, or the result of a netting process, may be considered as final in one system, but not in the other. Consequently, the rules for finality and irrevocability of linked RPSs should be harmonised, and the moment of finality and irrevocability of the payment transmitted via a link should be clearly defined.

Furthermore, legal risks may result from mismatches between the default rules stated in the legal documentation of the linked RPSs. In order to safeguard the protection of participants' assets, RPSs should determine appropriate liability regimes to minimise the potential loss for their participants. The legal risk should also be mitigated in case the link involves a settlement agent that temporarily holds the funds transferred between one RPS and the other in a transitional account.

Legal risk can also stem from the linked RPSs, e.g. if they are not recognised as such or lack the necessary authorisations to provide clearing and settlement services in all relevant jurisdictions (in the event of such authorisations being necessary).

## **OPERATIONAL RISK**

**Expectation 3: RPSs should carefully assess the operational risks related to their links to ensure information security as well as scalability and reliability of IT and related resources**

### *Key issues*

1. The scope of RPS information security policy and requirements should cover the link arrangements.

2. The operational service level of the link should be agreed by the linked RPS and communicated to all relevant parties.
3. RPSs should ensure that the risk management arrangements and processing capacity are sufficiently scalable and reliable to operate the link for both the current and projected peak volumes of activity processed over the link.
4. The functioning of the link should be appropriately tested and monitored, and incidents should be logged and followed up. Linked RPSs and all parties involved should agree on business continuity arrangements for the link.

An RPS linked directly and/or indirectly to other RPSs should take a broad perspective and identify both direct and indirect effects on its own ability to process and clear payments in the normal course of business, and to manage risks that stem from linked entities experiencing an external operational failure. An RPS should be committed to providing a reliable service, not only for the benefit of its participants, but also for all entities that would be affected by its inability to clear payments.

Since the establishment of links between RPSs creates certain operational interdependencies, RPS information security policy and requirements also need to cover the link arrangements.

Linked RPSs (and, in the case of indirect or relayed links, all parties involved) should agree on a specific service level (possibly in a service level agreement), including operational reliability for the link, in order to prevent risks from materialising (for the RPSs and/or their participants).

Operational conflicts between the design of the link and the RPS's internal rules and procedures may arise if an RPS wishing to establish a link does not have a clear understanding of the rules and procedures of the other RPS. RPSs should therefore provide an appropriate level of information to each other in order for each RPS to perform a robust and periodic assessment of the operational risks associated with the link and take measures to contain these risks. Systems and communication arrangements between the RPSs should be reliable and secure so that the operation of the link does not pose a significant operational risk to the linked RPSs. Any reliance on a critical service provider by a linked RPS should be disclosed as appropriate to the other RPS. In addition, a linked RPS should consider operational risks resulting from complexities or inefficiencies associated with differences in time zones, particularly as these affect staff availability. Governance arrangements should ensure that change management in one RPS will not inhibit the smooth functioning of the link or the related risk management arrangements.

In addition, a linked RPS should ensure that it has sufficient capacity and scalability to handle increasing volumes or stress volumes, as well as to achieve the agreed service level objectives, such as the required processing speed. Capacity management requires that the RPSs monitor, review and test (including stress test) the actual capacity and performance of the link. The RPS should carefully forecast demand and make appropriate plans to adapt to any change in the volume of business or technical requirements.

In case of operational malfunctioning, an incident is likely to be resolved more efficiently if the measures are undertaken by both RPSs in cooperation with each other (as well as with intermediaries and all RPSs involved in the case of indirect and relayed links) and in accordance with pre-established, clear and immediately available procedures, stating the division of

responsibilities and contact information. It has to be taken into account that an incident in a link could also impact on the processing of payments not exchanged via the link, and vice versa. Thus, rules and procedures related to business continuity should be coordinated and regularly tested; contact lists should be kept updated for both normal and abnormal circumstances.

## FINANCIAL RISK

**Expectation 4: Linked RPSs should closely monitor and effectively measure and manage the financial risks arising from the link arrangement.**

### *Key issues*

1. RPSs should have a clear understanding of the impact the link has on each of the financial risks they incur.
2. The system's rules and procedures should enable participants to have a clear understanding of the impact the link has on each of the financial risks they incur.
3. The assets used for settlement via links should carry little or no credit or liquidity risk.
4. Payments exchanged via a link should be settled promptly, preferably on an intra-day basis.
5. The terms of the link agreement should ensure adequate arrangements for managing and containing the risks associated with the inability of one of the RPS's participants to fulfil its obligations promptly, especially in the event that a netting process takes place.

Participants in an RPS with links to other RPSs might be exposed to additional credit and liquidity risks, compared with participants in an RPS that has not established any links.

First, establishing a link causes an exposure of one RPS and its participants to participants of other RPSs. These participants might, for example, be subject to different access criteria and system rules, resulting in increased risks. A risk can materialise when the default of a participant in the linked system causes liquidity pressures in a given system because its participants were relying on incoming liquidity from the linked system. This risk may increase when a netting process takes place. Such a risk should be mitigated by defining adequate arrangements for managing and containing such risk in the terms of the link agreement.

Second, establishing a link causes an additional exposure if there is a settlement agent or an intermediary in the link that temporarily holds the funds transferred between one RPS and the other in a transitional account. This account can be held by an RPS, a commercial bank, a central bank or another intermediary, resulting in different levels of credit risk. If a commercial bank acts as an intermediary, the RPS may face the risk of the commercial bank becoming insolvent, acting negligently or committing fraud. Even if there is no loss from the funds, the ability of the RPS's participants to use their funds might be impaired temporarily. It is important that the respective RPSs choose the settlement agent/intermediary according to criteria which could minimise the respective financial risks. In addition, the RPS should ensure that it has adequate legal, contractual and operational protection to ensure that its funds held by an intermediary, other than a central bank, are segregated. In this context, the RPS should have an adequate level of information on the business continuity plans of its intermediary, as well as those of the linked RPS.

Another issue to be considered is the use of commercial bank money or central bank money as a settlement asset. If the settlement takes place in commercial bank money, the process could have a different risk profile, and appropriate additional risk controls may be necessary.

Third, links may also create significant credit and liquidity interdependencies between systems, depending on the nature of the link. Problems<sup>2</sup> could appear if, for example:

- one of the systems permits provisional transfers of funds that may be subject to an unwinding procedure;
- there are differences as regards the moment of finality;
- one of the systems experiences an operational problem that could expose participants in the linked system to losses (even participants who are not active in the link).

An RPS should provide participants with all the information necessary to conduct an assessment of credit and liquidity risks associated with a link between RPSs, including the rules concerning the functioning of the link and the relevant rules concerning the functioning of the linked RPS.

## ACCESS CRITERIA

**Expectation 5: An RPS should define objective criteria which permit fair access for other RPSs that request the establishment of a link.**

### *Key issues*

1. Access criteria should be clear, objective and non-discriminatory. They should be publicly disclosed.
2. Access criteria should be justified in terms of the safety and efficiency of the system, as well as the broader financial markets.
3. Access criteria can be tailored to specific kinds of link (direct, indirect and relayed) on the basis of the risks each kind of such a link poses to the RPS and its participants.
4. An RPS that refuses to establish a link should provide a written explanation to the applicant.
5. An RPS involved in a link should ensure that price-setting is non-discriminatory and transparent.
6. Exit rules and procedures should be defined.

To ensure transparency, all RPSs should define access criteria and disclose them publicly.

The access criteria should be clear, objective and non-discriminatory so as to ensure a level playing field among RPSs. Access criteria should be justified in terms of the safety and efficiency of the

<sup>2</sup> Legal and operational problems are described in more detail in the sections devoted to the respective risks, but are mentioned here as they may end up creating credit or liquidity risks.



system, as well as the broader financial markets.<sup>3</sup> From a risk mitigation perspective, the access criteria should aim at minimising legal, financial and operational risks. An RPS should assess whether any linked RPSs have the requisite operational capacity, financial resources, legal foundation and risk-management expertise so that risks are adequately mitigated and managed. From an efficiency viewpoint, the access criteria may be based on the business case. The access criteria should have the least restrictive impact on access that circumstances permit.

Access criteria should explain the status of the linked RPSs (normal participation, special participation or no participant status). An RPS should provide the information on the link models it offers (i.e. direct, indirect or relayed links) and indicate which related access criteria are applied to each model. Access criteria should be commensurate with the risks generated by the link and those that the RPSs and its participants may be exposed to.

If access is refused, the reasons should be explained to the applicant in writing on the basis of these criteria.

When access criteria constitute terms and conditions for maintaining a link, they have to be continuously applied. RPSs should monitor compliance with their participation requirements on an ongoing basis through the receipt of timely and accurate information. If conditions for maintaining a link are no longer met, termination rules and procedures should be legally set for the dismantling of the link.

The pricing for cross-system transactions should be transparent and non-discriminatory.

## EFFICIENCY

**Expectation 6: A link should meet the requirements of RPS participants and the markets it serves.**

### *Key issues*

1. An RPS should have clearly defined, measurable and achievable goals and objectives concerning the functioning of links, e.g. in the areas of minimum service levels, risk management expectations and business priorities. An RPS should have established mechanisms for the regular review of the efficiency and effectiveness of its links.
2. A link should be designed to meet the current and future needs of its participants and the markets it serves.
3. The establishment of links should not put the balance of RPSs at risk in terms of risk management and efficiency.

Before the establishment of a link, an RPS should define the objectives it is supposed to meet in terms of efficiency. In particular, a link should facilitate the clearing of cross-border payments by ensuring a single gateway to multiple systems and jurisdictions. Furthermore the establishment of a link should support the relevant public and Eurosystem policies, e.g. by facilitating the exchange of payments in the single payments area and improving the reachability of the RPS participants and

<sup>3</sup> Efficiency considerations may affect open access. In some instances, for example, factors such as minimum transaction volumes are also relevant to operational efficiency.

their customers. The ultimate objective of the link should be to improve efficiency when settling payments initiated by the customers of commercial banks in terms of shortening the settlement time and reducing the fees for processing payments.

In order to ensure efficiency for its users, a link should be designed regarding those users' current and future needs, e.g. the size of their cross-border activity (number of cross-border payments), the jurisdictions within which they exchange payments and the efficiency of the channels currently used for clearing cross-border payments. An RPS should avoid establishing links which are not in line with its participants' current and future cross-border activities or which would result in an unduly long execution time or high fees. The decision on whether to establish a link should be based on a cost-benefit analysis. If participants are expected to invest in order to be able to use the link, their costs should be at least equivalent to the benefits of the link.

A link is effective when it reliably exchanges payments in a timely manner and achieves the public policy goals of safety and efficiency for participants and the markets it serves. In the context of oversight, a link's effectiveness also involves meeting service and security requirements. To facilitate assessments of effectiveness, an RPS should have clearly defined goals and objectives. For example, it should set minimum service level targets (such as the time it takes to exchange a payment).

The objectives of the link's efficiency and effectiveness should be measurable. An RPS should have established mechanisms for the regular review of the link's efficiency and effectiveness, such as periodic measurement of its progress against its goals and objectives.

It should be ensured that the link is practical for users. Its design should take into account market practices and technology and/or accommodate internationally accepted communication procedures and standards adhered to by those using the linked RPS.

Before the establishment of the link, the balance between its expected benefits and the additional risks it may cause should be analysed. On the one hand, an RPS should not establish a link which could significantly increase risks, require serious changes to the RPS's risk management policy or lower RPS efficiency, bringing limited benefits for its participants. On the other hand, an RPS could accept the slight increase in risk that setting up a link may cause (provided this increase in risk is properly managed) if the link is expected to bring significant benefits for its participants.

## GOVERNANCE

**Expectation 7: The governance arrangements related to the establishment and operation of the link should be clear and transparent, promote the safety and efficiency of links, and support the objectives of relevant stakeholders and relevant public interest considerations.**

1. The management of the RPS involved in a link should formulate a clear strategy on the establishment of links which should be disclosed to owners, relevant authorities, users and, at a more general level, other RPSs.
2. An RPS should have objectives that place a high priority on the safety and efficiency of the link and explicitly support the public interest.

3. Governance arrangements should ensure whether a decision to establish a link appropriately reflects the objectives and interests of the relevant stakeholders and, if so, how.
4. An RPS involved in a link should preferably implement formalised mechanisms for sharing relevant information with the relevant stakeholders and consult them when needed.

Links represent a significant part of the global strategy of an RPS, as they increase reachability and allow an RPS to widen the service provided to its participants. An RPS should therefore define a clear strategy on the establishment of links, which should be disclosed to owners, relevant authorities, users and, at a more general level, other RPSs.

Since the establishment of a link may increase risks and functioning costs, an RPS should focus on the safety and efficiency of payment clearing in its strategy on the establishment of links. Furthermore, the strategy should consider supporting the public interest (including the relevant public and Eurosystem policies).

Establishing a new link does not only represent an operational or contractual change for an RPS, but an important decision. Any decision pertaining to the establishment or dismantling of a link should therefore not be taken without a proper decision-making process. It should be ensured that the relevant stakeholders are consulted and that their interests are addressed as much as possible. This implies that the governance of the links should, at the very least, include the relevant stakeholders:

- The relevant stakeholders should be consulted prior to the establishment of a link.
- The relevant stakeholders should be notified of its implementation (along with routing or reachability tables) and of any change affecting it once the link is established.

Links entail relationships between several parties (RPSs, those participating in each system and, in the case of indirect links, possibly an intermediary). The division and sharing of responsibilities for the operation of the link have to be determined. It may be the case that some decisions regarding the link need to be taken collectively. Therefore, all the parties involved should preferably implement formalised mechanisms for taking decisions on, for example: (i) the alignment of business strategies; (ii) problems encountered in the functioning of the links; (iii) user needs and claims; (iv) changes to business and operational procedures. The sharing of responsibilities should be strongly supported by an efficient exchange of information. Thus, all entities involved should agree on a regular exchange of information and periodic meetings allowing for issues of common interest to be discussed.

As opinions among parties involved in a link may differ, the RPS should have clear processes for identifying and appropriately managing the diversity of stakeholder views and any conflicts of interest between stakeholders and the RPS. Without prejudice to local requirements on confidentiality and disclosure, the RPS should clearly and promptly inform its owners, participants, other users and, where appropriate, the wider public of the outcome of major decisions concerning links. It should also consider providing summary explanations for decisions to enhance transparency where this would not endanger candid debate among the board or commercial confidentiality.



## INDIRECT AND RELAYED LINKS<sup>4</sup>

**Expectation 8: An RPS that uses an intermediary to operate a link with another RPS should measure, monitor and manage the additional risks (including legal, financial and operational risks) arising from the use of an intermediary.**

1. Before the establishment of an indirect or relayed link, an RPS should analyse all the risks related to intermediation in the exchange of payments.
2. An RPS that uses an intermediary to operate a link with another RPS should measure, monitor and manage the additional legal risks arising from the use of an intermediary.
3. RPSs should identify and mitigate operational risks introduced by the intermediary.
4. The RPS involved in an indirect or relayed link should monitor the role and financial soundness of any intermediary.
5. In indirect and relayed links, linked RPSs should ensure that the intermediary does not unduly restrict usage of the link by any participant.
6. The efficiency and effectiveness of the indirect and relayed links should be periodically assessed and compared with the alternative channels of payment exchange, e.g. direct links.

The clearing of payments via indirect or relayed links is typically more complex and potentially entails higher risks for participants of the linked RPSs than in the case of direct links. For this reason, before an RPS decides to establish an indirect or relayed link, it should conduct an initial assessment of risks related to the intermediation. The type and degree of risk varies depending on the kind of intermediary, as well as its legal, financial and operational soundness. In the case of a central bank acting as an intermediary, the risks are limited to legal and operational aspects. In the case of a commercial bank intermediating in the link, all kinds of risk should be analysed. In the case of a relayed link, all the risk management tools applied by an intermediating RPS should be analysed. If any additional risks related to the intermediation are identified, they should be adequately mitigated.

The RPS should measure, monitor and manage risks related to the intermediary on an ongoing basis and provide evidence to the overseers that adequate measures have been adopted to limit and monitor these risks.

In the case of indirect links, an intermediary providing clearing and/or settlement services (and, in the case of a relayed link, another RPS) may also intervene in the processing of the transactions, increasing the number of entities through which the payment is routed. For these reasons, there may be increased uncertainty as to the applicable laws or a higher possibility of a conflict of laws arising from the application of the rules for the different systems or the different legal frameworks.

<sup>4</sup> This expectation describes the additional risks of, and requirements for, indirect and relayed links. However, these links should be assessed against the whole set of expectations (expectations 1-8), as the risks described in expectations 1-7 also concern indirect and relayed links.

A specific analysis should be conducted on the coherence of the contractual provisions ruling indirect and relayed links, as there could be a higher number of legal arrangements governing the link (e.g. the intermediary could subscribe to separate agreements with each RPS or even with each of the RPS's participants).

In the case of indirect or relayed links, the management of operational risk should be appropriated to the number of parties involved in the clearing and settlement of transactions. Therefore, the RPSs should identify and mitigate operational risks introduced by the intermediary.

In the case of indirect or relayed links, the financial risks should be properly assessed, monitored and mitigated, taking into consideration the higher number of entities involved in the link. An RPS should provide participants with the information necessary to conduct an assessment of credit and liquidity risks associated with a link between RPSs, including the rules concerning the functioning of the link, relevant information on the intermediary and any relevant rules that apply to the linked RPS.

In an indirect link, the entity acting as an intermediary should not unduly restrict any participant's usage of the link. Therefore, RPSs linked via an intermediary should i) examine the rules and procedures set by the intermediary and ii) undertake any necessary action in the event of any restriction or discrimination.

Since the exchange of payments via indirect or relayed links may potentially take longer and entail higher costs than via direct links, the RPS should periodically re-assess the efficiency and effectiveness of its link. If the processing time and costs – or the risks – are considerably higher in comparison to a direct link, an RPS should consider replacing the indirect link with a direct link.

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