

Eurosystem oversight policy framework

Revised version (July 2016)

1 Introduction

Financial market infrastructures (FMIs) form the backbone of the financial system. They provide the networks through which financial institutions and financial markets are connected and financial transactions are cleared and settled. Given the economies of scale associated with them, and considering also the significant growth in financial activity over the past decades, FMIs typically handle very large volumes and values. Safe and efficient FMIs are therefore essential for a stable and well-functioning financial system. While the primary responsibility for appropriate measures to achieve this rests with FMI operators, public authorities also aim to ensure prudent FMI design and risk management.

Central banks are closely involved in this work as the conduct of monetary policy crucially depends on the availability of reliable and effective FMIs. In addition, systemic risk arising from any malfunctioning of an FMI could impair financial and monetary stability. Ultimately, the smooth functioning of FMIs is a precondition for users' confidence in the stability of the currency. Against this background, the Eurosystem pursues three complementary approaches to promote the safety and efficiency of FMIs, namely: (i) owning and operating FMIs; (ii) conducting oversight activities; and (iii) acting as a catalyst.

The Eurosystem also acts as the central bank of issue in EU and international cooperative arrangements for securities and derivatives clearing and settlement systems.

The purpose of this framework is to describe the role of the Eurosystem in the field of oversight. It updates and replaces the earlier Eurosystem oversight policy framework of July 2011 in view of significant regulatory and institutional changes and market developments that have affected the oversight function since then.

As part of the wider regulatory reform in response to the global financial crisis, revised, enhanced and more harmonised international standards and EU rules for FMIs have been adopted. These include notably the Principles for Financial Market Infrastructures of the Committee on Payment and Settlement Systems and the International Organization of Securities Commissions (CPSS-IOSCO PFMs) on an international level and the European Market Infrastructure Regulation (EMIR)¹, the

¹ Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, OJ L 201.

Regulation on settlement and central securities depositories (CSDR)² and the ECB's Regulation on oversight requirements for systemically important payment systems (SIPS Regulation)³ on an EU level. In addition to raising the bar for the risk management of FMIs, several new standards provide for much closer cross-sectoral and cross-border cooperation between authorities, including enhanced involvement of central banks, with important implications for the exercise of the Eurosystem's oversight function.

This revised Eurosystem oversight policy framework continues to follow the structure of the report "Central bank oversight of payment and settlement systems" that the CPSS⁴ of the G10 central banks issued in 2005. In line with that report, oversight is defined as "a central bank function whereby the objectives of safety and efficiency are promoted by monitoring existing and planned systems, assessing them against these and, where necessary, inducing change".

Within the Eurosystem oversight policy framework, the term "FMI" encompasses, inter alia, payment systems, and clearing and settlement systems. Furthermore, as payment instruments and payment schemes are an integral part of payment systems, the Eurosystem includes these in central bank oversight of payment systems.

By publishing this framework, the Eurosystem seeks to further increase the transparency of its oversight policies. Transparency enables FMI operators to understand and follow applicable oversight requirements. Through transparency the Eurosystem can also demonstrate an appropriate degree of consistency in its oversight approach. Finally, transparency enhances the effectiveness of the Eurosystem's oversight policies, and thus ensures that oversight is carried out in an accountable manner.

The following sections provide an overview of the Eurosystem's role in promoting the smooth functioning of FMIs (Section 2), explain the Eurosystem's specific role in oversight and its various responsibilities (Section 3), and describe the scope of oversight and the main oversight activities for the different types of FMIs (Sections 4 and 5). The Eurosystem's cooperation with other authorities in the pursuit of its oversight objectives is covered in Section 6.

The Eurosystem's role in the field of oversight is expected to develop further in the coming years, as FMIs and their competent authorities will have to keep abreast of risks affecting the FMI landscape. Key challenges will include, for instance, establishing effective recovery and resolution arrangements for all FMIs, and reviewing and potentially updating both international standards and EU rules for the ongoing risk management of FMIs.

² Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories, OJ L 257.

³ Regulation of the ECB (EU) No 795/2014 of 3 July 2014 on oversight requirements for systemically important payment systems (ECB/2014/28), OJ L 217.

⁴ On 1 September 2014 the CPSS was renamed Committee on Payments and Market Infrastructures (CPMI).

2 The Eurosystem's role in promoting the smooth functioning of financial market infrastructures

2.1 The rationale behind the Eurosystem's involvement

The Eurosystem's involvement in promoting the smooth functioning of FMIs is directly related to its monetary policy mandate. Monetary policy measures are transmitted to the financial system and to the wider economy through the money market which crucially depends on safe and efficient payment systems. Given that monetary policy operations typically take the form of collateralised central bank credit, safe and efficient clearing and settlement systems for securities are also important.

Eurosystem interest in the functioning of FMIs also relates to the potential systemic risk implications of FMIs because monetary stability cannot be achieved if the financial system does not operate smoothly. Owing to the central role of FMIs in the markets they serve – e.g. in terms of size of business, interdependencies with major financial institutions and limited substitutability – any malfunctioning of an FMI is likely not only to have a negative effect on the FMI's participants but it could also give rise to broader risk externalities, if participants are no longer able to complete their payment or securities transactions on time. As a result, processing backlogs, liquidity and/or credit strains might spread more widely through the financial system, putting pressure on asset prices, reducing market confidence, and potentially endangering the stability of the financial system as a whole. Furthermore, the malfunctioning of an FMI, depending on its severity and the systemic knock-on effects, could negatively affect public trust in the currency and thereby fundamentally challenge the stability of the euro. In view of the severe risks that the malfunctioning of an FMI would have for the accomplishment of the Eurosystem's core mandate, the Eurosystem is keen to ensure that FMIs safeguard their soundness and resilience at all times.

In addition to focusing on safety, the Eurosystem also aims to promote the efficiency of FMIs.

On the one hand, on account of inherent network effects and economies of scale, the FMI landscape is characterised by a limited number of large-scale providers or even monopolies. This means that competition among providers is typically limited. At the same time, the operation of FMIs requires substantial financial resources. It is thus very important to ensure that FMIs are operated efficiently in terms of their cost and pricing structure, without compromising appropriate risk management and by taking proper account of market needs.

On the other hand, the euro area financial market infrastructure still suffers from fragmentation in certain areas which results in inefficiencies and higher costs, especially for cross-border transactions. The Eurosystem's policies towards FMIs are consequently also focused on overcoming cross-border frictions where they persist. While financial integration is a public policy goal, achieving this is essentially a

market-led process. Nonetheless, it is difficult for the private sector alone to remove some barriers effectively.

2.2 Eurosystem approaches to promote FMI safety and efficiency

To promote the safety and efficiency of FMIs, the Eurosystem plays three complementary roles: it takes an operational role, conducts oversight, and acts as a catalyst.

1. As the owner and operator of a system, the Eurosystem has the most immediate and powerful tools to determine the safety and efficiency of that system. A notable example of this is TARGET2.
2. While primary responsibility for an individual system's safety and efficiency rests with its owner and operator, the Eurosystem needs to be reassured that the systems (irrespective of whether they are run by a private entity or by the Eurosystem) and the overall FMI landscape in the euro area are safe and efficient. The Eurosystem carries out oversight activities within the framework set out in this document.
3. Finally, the Eurosystem also acts as a catalyst, especially when the objective is to improve the overall functioning of the euro area market infrastructure, including by means of harmonisation and integration. In this role, the Eurosystem aims to induce, support or speed up market developments by acting as a partner or facilitator, using its technical and analytical expertise and its consultative and cooperative contacts with the private sector, banking supervisors and other public authorities. Given the network character of payment, clearing and settlement systems, and the economies of scale from European financial integration, the Eurosystem plays a particularly important role in supporting coordination among market participants and with public authorities so that they can set common market standards and practices and ensure interoperability.

3 Oversight responsibilities

3.1 The legal basis for oversight

The Treaty on the Functioning of the European Union (hereinafter referred to as the "Treaty") and the Statute of the European System of Central Banks and the European Central Bank (hereinafter referred to as the "Statute") provide for the Eurosystem to conduct oversight as part of its mandate.

Pursuant to the fourth indent of Article 127(2) of the Treaty, as mirrored in Article 3.1 of the Statute, one of the basic tasks to be carried out through the ESCB shall be "*to promote the smooth operation of payment systems.*" To further the performance of

this basic task, “the ECB and the national central banks may provide facilities, and the ECB may make regulations, to ensure efficient and sound clearing and payments systems within the Union and with other countries” (Article 22 of the Statute). Two distinct elements of the general mandate can be discerned from the above:

1. the ECB and the national central banks (NCBs) should use the powers available to them to promote the smooth operation of all aspects of clearing and payment systems; key to this general task is carrying out operational, catalyst and oversight responsibilities; and
2. the Statute explicitly provides the ECB with the regulatory powers to achieve the smooth operation of payment systems and therefore also with the powers to impose legal obligations for both the operation and the oversight thereof.

The Eurosystem also has an interest in the smooth functioning of securities clearing and settlement systems (including for derivatives transactions) across the euro area. Through their direct links to payment systems, clearing and settlement systems play important roles in the stability and efficiency of the financial sector and the euro area economy as a whole, in the smooth conduct of the single monetary policy, and in the stability of the euro. The oversight of these systems is carried out by national authorities, in addition to cooperative oversight governance arrangements set out in EU law (EMIR and the CSDR) and in combination with national law or other arrangements (memoranda of understanding) where oversight competences over securities clearing and settlement systems are also recognised.⁵

3.2 Oversight objectives and standards

The Eurosystem has translated its oversight objectives of safety and efficiency into specific oversight regulations, standards, guidelines or recommendations as relevant for different FMIs. Oversight standards therefore provide the benchmark for the Eurosystem to monitor and assess the safety and efficiency of relevant FMIs on an ongoing basis and to induce change where gaps are identified.

The definition of the Eurosystem’s oversight standards takes place in a context of increased cross-border and cross-sectoral cooperation of authorities in the definition of prudential requirements for FMIs. This enhanced global and EU cooperation of the various authorities with responsibility for FMIs – notably central banks, securities regulators and banking supervisors – aims to promote the safety, resilience and integration of the post-trade infrastructure on the basis of a regulatory level playing field.⁶

The process of regulatory convergence affects the Eurosystem’s oversight function in two ways: on the one hand, the Eurosystem provides input for the definition of international standards and EU rules for FMIs; on the other hand, the Eurosystem’s

⁵ See Sections 4.2 and 6 below for further information.

⁶ See Section 6.2 below for further information on regulatory cooperation.

oversight standards are closely aligned with international standards and EU requirements for FMIs.

This two-way feedback mechanism is illustrated by the recent fundamental overhaul of international standards and EU laws and regulations for FMIs:

The Eurosystem was closely involved in the definition of the CPSS-IOSCO PFMI. Published in April 2012, the PFMI updated and strengthened existing international standards for systemically important payment systems, clearing and settlement systems, and trade repositories, notably in view of the lessons learned from the financial crisis about FMI resilience. The PFMI also introduces five explicit “Responsibilities” for central banks and other relevant authorities for regulating, supervising and overseeing FMIs, including for cross-border and cross-sectoral cooperation between the different authorities. Although the PFMI are in principle non-binding, all CPMI and IOSCO members have undertaken to implement them and are monitoring progress in this respect.

In June 2013 the Governing Council of the ECB adopted the PFMI as the standards for Eurosystem oversight of all types of FMIs in the euro area under Eurosystem responsibility. With respect to systemically important payment systems (SIPS), the PFMI have been implemented through the SIPS Regulation, which entered into force in August 2014.

In parallel, the Eurosystem provided input to the drafting of EU legal acts implementing the PFMI for central counterparties and trade repositories (EMIR) and central securities depositories (CSDR). The ECB issued formal opinions on the draft text of the two regulations, and the ESCB subsequently worked with the European Securities and Markets Authority (ESMA) in developing the relevant regulatory technical standards.

4 Scope of oversight

The term “scope of oversight” refers to which FMIs are subject to oversight. The scope of Eurosystem oversight is guided by the Eurosystem’s objectives of promoting the safety and efficiency of FMIs as determined by the relevant provisions of the Treaty. Within these general boundaries, the focus and depth of oversight may change as the FMIs themselves develop over time. A key consideration of the Eurosystem in specifying its scope of oversight is to apply any oversight requirements or standards in a consistent way so as to prevent competitive distortions between comparable systems.

This section provides an overview of the scope of Eurosystem oversight for the different types of relevant infrastructures, entities and instruments. A summary of the main reference documents is provided in the annex.

4.1 Payment systems

While large-value payment systems form the backbone of the euro area financial market infrastructure, retail payment systems are used for the bulk of payments between private customers and businesses. Even though many of them are not of systemic importance, they still play a major role with respect to both the safety and efficiency of the financial system as a whole and citizens' confidence in the euro.

In terms of application of oversight requirements for payment systems, the Eurosystem primarily distinguishes between SIPS and non-SIPS. This distinction is based on clear qualitative and quantitative criteria related to size, market share, cross-border activity and the provision of settlement to other FMIs, as laid down in Article 1(3) of the SIPS Regulation. The classification of euro area payment systems is reviewed annually. The SIPS Regulation implements only those PFMI that are applicable to payment systems in a legally binding manner. In proportion to the risks posed to the market they serve, non-systemically important retail payment systems are subject to a sub-set of the PFMI as defined in the Revised oversight framework for retail payment systems of February 2016. This framework also confirms the Oversight expectations for links between retail payment systems, which are addressed to retail payment systems operating in the euro area and applied in proportion to their systemic relevance.

4.2 Securities settlement systems and central counterparties

Securities settlement systems (SSSs) and central counterparties (CCPs) are key components of the financial system. A financial, legal or operational problem in any of the institutions that have critical functions in the clearing and settlement process can be a source of systemic disturbance for the financial system as a whole. This is particularly true for CCPs, which are, by nature, a focal point for credit and liquidity risks. Furthermore, because securities and derivatives transactions are typically composed of a securities/derivatives leg and a cash leg, difficulties in the transfer of securities or derivatives may spill over into disruptions of payment systems that are used by SSSs or CCPs.

The oversight of clearing and settlement systems in most countries of the euro area is conducted by NCBs under national law competencies, alongside regulation by securities regulators and banking supervisors. The competencies and powers transferred to individual NCBs under such national laws differ.

Furthermore, under the PFMI, EMIR and the CSDR, new arrangements for cooperation among authorities with responsibility for CCPs and central securities depositories (CSDs) have been established or will be set up in the near future, also involving authorities with statutory oversight competencies for these FMIs.⁷

⁷ See Section 6.2 below for further information on cooperative oversight.

The Eurosystem promotes consistency among the oversight policies pursued by its members in line with the PFMI. To a very large extent, the PFMI for CCPs, CSDs and SSSs were implemented by EMIR and the CSDR respectively; where this is not fully the case, the PFMI constitute the relevant oversight standards.

4.3 Payment instruments

Non-cash payment instruments, such as payment cards, credit transfers, direct debits and e-money are personalised devices and/or sets of procedures agreed between the payment service user and the payment service provider, and are used to initiate a payment order⁸.

While the provision and use of payment instruments in itself generally does not generate systemic risk, their usage requires a high degree of safety and efficiency both to maintain confidence in the currency and promote an efficient economy. The smooth functioning of payment instruments facilitates commercial activities, and thereby benefits society as a whole.

The Single Euro Payments Area (SEPA) project to harmonise and integrate EU-wide payment services has increased the importance of consistent oversight of payment instruments. The Eurosystem has defined a harmonised oversight approach and oversight standards for payment instruments that can be used SEPA-wide (e.g. direct debit, credit transfers and cards). These frameworks are addressed to the governance authorities of payment schemes as these authorities define the functions, procedures, arrangements, rules and devices for issuing, accepting and using the various payment instruments. The oversight of payment schemes covers all relevant processes and functions within the entire payment cycle (e.g. access to the scheme, issuing of payment instruments, manufacturing of payment devices, switching, authorisation, clearing and settlement of transactions).

These oversight requirements for payment instruments are additional and complementary to the comprehensive EU regulatory framework for payment services (e.g. E-Money Directive⁹, Payment Services Directive – PSD2¹⁰, Interchange Fees Regulation¹¹). The PSD2 calls for close cooperation between the European Banking Authority (EBA) and the ECB in developing some of the measures related to this framework to align supervisory and oversight approaches on issues of common interest, such as operational reliability and security aspects of payment services. These measures are being developed and coordinated via the Forum for the Security of Retail Payments (SecuRe Pay) which was established in 2011 with the broader objective of fostering cooperation between supervisors of payment service

⁸ See Article 4(14), Directive (EU) 2015/2366 (PSD2).

⁹ Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions, OJ L 267.

¹⁰ Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, OJ L 337.

¹¹ Regulation (EU) 2015/751 of the European Parliament and of the Council of 29 April 2015 on interchange fees for card-based payment transactions, OJ L 123.

providers and overseers of payment systems and payment schemes/instruments within the EU/European Economic Area (EEA).

4.4 Other infrastructures and service providers

TARGET2-Securities (T2S)

T2S is a Eurosystem infrastructure providing a single, borderless core securities settlement process by offering settlement services to euro area and non-euro area CSDs and central banks. Given the scope of its activities, T2S provides critical settlement services to CSDs and central banks. It is expected that by the end of 2017, T2S will service 21 jurisdictions inside and outside the EU.

The Eurosystem oversees T2S as a central platform offering settlement services in central bank money.

Critical service providers

The operational reliability of FMIs may be dependent on the continuous and adequate functioning of service providers to whom they have contracted out critical parts of their operations such as IT and messaging services. In recognition of the importance of critical service providers, Annex F of the PFMLs sets out specific oversight expectations for these providers in terms of risk identification and management, information security management, reliability and resilience, effective technology planning, and communications with users.

The Eurosystem expects an FMI to retain full responsibility for any activity that is material to the FMI's operation, including responsibility for ensuring that the service provider complies with the applicable oversight policies. If a service provider supplies important services to several key systems, direct oversight activities may also be undertaken.

Correspondent and custodian banks

Correspondent banks (which provide payment and other services to other banks) and custodian banks (which hold securities for their customers and provide related services) are key components of an economy's payment and settlement arrangements. To some extent, correspondent and custodian banking is also concentrated in a few large banks, thus giving rise to significant financial and operational risks. Risks may also arise when correspondent and custodian banks provide services similar to those of payment and settlement systems, or when they incur large exposures in connection with the provision of uncollateralised intraday or overnight credit.

The Eurosystem has an interest in monitoring these risks, notably in view of their potential implications for interdependent FMIs. Since 1999 the Eurosystem has conducted surveys on correspondent banking to monitor the size and development of this business.

5 Oversight activities

5.1 Methods

The Eurosystem performs oversight on those FMIs for which it has oversight competences in a three-step process: it collects relevant information, assesses the information against its oversight objectives and induces changes where necessary. When planning its oversight activities, the Eurosystem follows a risk-based approach that facilitates prioritisation with respect to not only the various systems and/or instruments overseen, but also different sources of risks.

The Eurosystem uses a wide range of information sources, including bilateral contacts with system operators, regular or ad hoc reporting on system activity, and system documentation. For the collection of information, the Eurosystem can rely on the SIPS Regulation and on national laws establishing the NCBs' powers to obtain information, or otherwise on moral suasion where system operators provide information on a voluntary basis. In addition, cooperative oversight arrangements with other authorities provide the Eurosystem with access to relevant information.

The Eurosystem assesses the information on the basis of the standards and recommendations it has developed itself or in cooperation with other authorities. The reliance on standards and recommendations allows a harmonised and systematic oversight of FMIs, facilitates its practical implementation and helps to compare the assessment results of different systems. In addition, the Eurosystem conducts regular monitoring, examination and research relating to developments in the euro area infrastructure.

On the basis of the assessment results and if it finds that a particular FMI does not have a sufficient degree of safety and efficiency, the Eurosystem takes action and induces change using the range of tools at its disposal. These tools are a function of the powers in relation to particular categories of FMIs, attributed to the Eurosystem as a whole under the Treaty, and the powers attributed to individual NCBs or other national authorities under their national frameworks. The tools include moral suasion, public statements, influence stemming from the Eurosystem's participation in FMIs and cooperative oversight arrangements as well as the potential to issue binding regulations and sanctions for euro area payment systems.

Throughout the oversight process, the Eurosystem attaches the utmost importance to constructive cooperation with the overseen entities to ensure there is effective interaction and avoid undue costs of compliance.

5.2 Allocation of roles within the Eurosystem

The Treaty assigns oversight responsibilities to the Eurosystem which comprises the ECB and the NCBs of the euro area. To achieve effective and efficient oversight, the Eurosystem shares these responsibilities in a way that enables it to benefit from its decentralised structure while ensuring that its oversight activities are coordinated and its policy stance is consistently applied throughout the euro area.

The common framework set out in this document is determined at the Eurosystem level and may be complemented by national policies, where necessary.

For the purposes of conducting oversight of individual FMIs, including collecting and assessing information and potentially taking measures to induce change, the Eurosystem assigns primary oversight responsibility to the central bank that is best placed to undertake it, either because of its proximity to the entity subject to oversight (for example, where the system is legally incorporated in its jurisdiction) or because of national laws that attribute specific oversight responsibilities to the central banks concerned, subject to any Treaty-based requirements. This is typically the case for systems with a clear national anchor, i.e. being legally incorporated in a jurisdiction or serving that particular national market. For systems that have no national anchor, the body entrusted with primary oversight responsibility is the NCB of the country when the system is legally incorporated, unless the Governing Council of the ECB decides otherwise and assigns the primary oversight responsibilities to the ECB. The latter is the case for the two systemically important euro systems of the EBA Clearing Company (EURO1 and STEP2-T), as well as for TARGET2 where the ECB also draws on the NCBs' oversight of the local features. This approach was confirmed in the various ECB Decisions of 13 August 2014 which assigned the role of "competent authority" under the SIPS Regulation to the ECB for the oversight of TARGET2, EURO1 and STEP2-T. For CORE(FR), a SIPS with a clear national anchor, this role was assigned to the Banque de France.

In the case of the Continuous Linked Settlement (CLS) system, the US Federal Reserve System has accepted primary oversight responsibility and leads a cooperative oversight framework, in which the ECB participates together with the G10 NCBs. Within the Eurosystem, the ECB has primary responsibility for the settlement of the euro by CLS in close cooperation with all NCBs. For payment instruments, a similar approach is applied: the main reasons for assigning the role of the primary overseer (for the Eurosystem) are the national anchor of the payment scheme and the legal incorporation of its governance authority whereas for the SEPA credit transfer and direct debit schemes as well as some of the international card payment schemes, the primary oversight role has been attributed to the ECB.

The Eurosystem central bank entrusted with (primary) oversight responsibility safeguards the Eurosystem's oversight objectives, while also taking into account specific oversight interests and expertise of other Eurosystem central banks.

Each central bank reports on its oversight policies, assessments and results to the Governing Council of the ECB via the ECB's committee structure.

In the case of securities and derivatives clearing and settlement systems, the Eurosystem also benefits from the oversight competencies that have been assigned to some NCBs by national laws. With due consideration of such national legal frameworks, each NCB reports on its assessments and results of activities conducted in cooperation with the securities regulators within the Eurosystem with the aim of facilitating transparency and a consistent implementation of oversight recommendations in the different countries. In addition, the lead overseer(s) of individual systems with systemic importance for the Eurosystem as a whole share further information on the assessment with other relevant Eurosystem central banks.

The Eurosystem ensures that the decentralised oversight activities it is involved in are coordinated effectively. Effective coordination is of particular importance in times of crisis when the sharing of appropriate information and close cooperation among central banks is crucial for determining the Eurosystem's ability to quickly and effectively identify and address the sources and the impact of a crisis. To this end, the ESCB has established an oversight crisis communication framework and a reporting procedure for major incidents. This includes sharing relevant information with other competent authorities (e.g. prudential supervisors and securities regulators).

The Eurosystem exercises its central bank of issue function for securities and derivatives clearing and settlement systems in a coordinated manner via EU and international cooperative oversight arrangements. For CCPs, the Eurosystem has also agreed on a cooperative approach, where the Eurosystem is generally represented as central bank of issue by the local NCB for euro area CCPs and by the ECB for non-euro area CCPs. At the same time, the Eurosystem has put in place a specific internal institutional structure to coordinate the exercise of the central bank of issue function across the various CCP colleges and cooperative oversight arrangements. This is to ensure that the views of all Eurosystem members are taken into account before a formal stance of the Eurosystem as central bank of issue is taken.

For CSDs, the Eurosystem will define the coordination of the central bank of issue functions once the cooperative arrangements under the CSDR are finalised. Work on this will begin during 2016.

6 Cooperation with other authorities

6.1 Cross-sectoral and cross-border risks affecting FMIs

In performing their tasks, overseers need to take into account cross-sectoral and cross-border risks affecting and arising from FMIs.

Cross-sectoral risks may arise in a number of ways. First, some FMIs grant credit as part of their settlement activity, which may affect their core FMI business and vice-versa. Second, there are substantial interdependencies between the soundness of

major global banks and the resilience of FMIs, given the role of the former as members of and service providers to the latter. Finally, in some areas – such as payment and custody services – FMIs may compete with banks for the same business. Close cooperation between overseers and banking supervisors is thus essential to ensure that cross-sectoral risks are effectively monitored and addressed without imposing potentially duplicative or inconsistent requirements.

In addition, the financial globalisation process has had fundamental implications for the design and operation of FMIs. To support more integrated financial markets and globally active financial institutions, the cross-border and cross-currency business of FMIs has significantly increased over time. In addition, interdependencies between FMIs operating in different jurisdictions have become more obvious, notably through indirect connections reflecting the participation of the same major global banks across FMIs, coupled sometimes with direct operational links between FMIs.

As a result, a growing number of FMIs have substantial risk implications in jurisdictions beyond those in which they operate. It may be difficult for authorities to exercise their statutory powers in foreign jurisdictions other than where the FMI is legally incorporated, as those authorities do not have direct ways of monitoring and influencing the risk management of the FMIs concerned. The introduction of mandatory central clearing for OTC derivatives has further compounded this issue because of the global nature of OTC derivatives markets and because clearing of OTC derivatives is largely concentrated in a limited number of major CCPs serving the global financial market.

These developments are of particular importance for the Eurosystem, as a significant number of FMIs with sizable euro-denominated business are located outside the euro area. The malfunctioning of these FMIs could have serious consequences for interdependent financial institutions and market infrastructures in the euro area by spreading processing backlogs, liquidity shortages or credit strains. Furthermore, an FMI's failure to settle could directly affect overnight or short-term money market interest rates. The resulting risks to the effective implementation of monetary policy, the smooth functioning of the domestic financial market infrastructure and indeed the financial system as a whole could impair the effective fulfilment of the Eurosystem's monetary and financial stability mandate.

In order to address these risks effectively, the Eurosystem considers that effective cooperative oversight arrangements, tailored to the risk implications of offshore FMIs to the euro area, are essential. Significantly enhanced frameworks for cooperative oversight under the PFMIs, EMIR and the CSDR have been important steps forward in this regard.

At present there is no major offshore payment system in euro outside the euro area. The Eurosystem considers that the risks of such a system would also be disproportionately high compared with any economic benefits that it might generate. The implementation of monetary policy and the processing of the payments in the relevant currency are intrinsically linked. Moving these payments offshore would therefore imply significant risks and inefficiencies. Participants in a domestic system might become dependent on the funds they are to receive in an offshore system to

fund their debit positions in the domestic system. At the same time, offshore payment systems lack the close link to the central bank of issue and would face unique liquidity risk management challenges in terms of the effective and timely management of liquidity strains across different time zones and also in view of the more limited depth of offshore currency markets, notably in the event of financial distress.

In an extreme scenario, where a substantial part of the domestic traffic was settled offshore in commercial bank money and in which key domestic payment systems were used merely for the settlement of end-of-day positions, the related financial risks would clearly endanger the central bank's control over the currency. Such considerations have led some central banks to adopt policies on the use and location of systemically important payment systems. The Eurosystem does not consider such a scenario to be in line with its statutory regulatory responsibility to promote the "smooth operation of payment systems", as it lacks adequate tools for intervention in offshore payment systems. It therefore considers that, as a matter of principle, payment systems settling a substantial amount of euro-denominated payment transactions should settle these transactions in central bank money and be legally incorporated in the euro area, and that full managerial and operational control and responsibility for all core functions for processing euro-denominated transactions should be exercised from within the euro area.

The Eurosystem accepts exceptions to this principle only in very specific circumstances and only on a case-by-case basis. One important exemption relates to multi-currency systems that settle payment transactions related to foreign exchange trades on a payment-versus-payment (PvP) basis which are, by definition, offshore with respect to one or several currency areas. For example, the Eurosystem has never tried to apply its location policy to the PvP part of CLS, but has instead insisted that the Eurosystem be closely associated with the oversight activities of the central bank with primary oversight responsibility, namely the US Federal Reserve System. However, the exemption does not apply to non PvP transactions. Another exemption concerns offshore payment systems that are relatively small in size and that are thus not likely to affect financial stability and monetary policy in the euro area. The Eurosystem therefore does not insist on the location requirement for offshore payment systems that either settle less than €5 billion per day, or account for less than 0.2% of the total daily average value of payment transactions processed by euro area interbank funds transfer systems which provide for final settlement in central bank money (whichever of the two amounts is higher).

The Eurosystem furthermore draws an important distinction between off-shore payment systems established outside the euro area which foresee no close involvement of the Eurosystem in the related oversight, and multi-currency platforms established by the Eurosystem itself, such as T2S. In the case of the latter, the Eurosystem opens the common securities settlement platform to non-euro area currencies only if the central bank of issue for the respective currency is willing to participate. Moreover, the Eurosystem invites the respective central bank of issue to participate in the governance arrangements for T2S as well as in the established cooperative oversight arrangements (see Section 6.2 for more details on the latter).

An approach similar to that for T2S may be applied by the Eurosystem in future if it reforms its RTGS services by developing these in a multi-currency context under the “Eurosystem’s vision for the future of Europe’s financial market infrastructure”¹².

6.2 Cooperative arrangements

To address cross-border and cross-sectoral risks for FMIs, the Eurosystem cooperates with other authorities in two main ways, namely through regulatory cooperation and cooperative oversight, and has specific arrangements for each activity.

Regulatory cooperation

As mentioned in the previous section, an important tool with which to address cross-border and cross-sectoral risks affecting and arising from FMIs is cooperation among authorities in rule-making and standard-setting. The main objective here is to ensure that requirements for FMIs reflect the concerns of all relevant authorities, so as to promote consistent approaches in the implementation of these requirements and safeguard a regulatory level playing field for the provision of FMI services in the EU or globally. Regulatory cooperation mainly involves central banks and securities regulators as the authorities with direct responsibility for FMIs. However, where FMIs also have a banking licence and as there are rules applicable to FMIs that may have a bearing on the prudential requirements for banks (e.g. as a result of their participation in FMIs), banking supervisors may also be involved.

At a global level, the Committee on Payments and Market Infrastructure (CPMI) is the main forum for central bank cooperation on FMI issues. Working with the IOSCO, the CPMI has led the development of international standards for FMIs, such as the PFMI. Where appropriate, the CPMI and IOSCO also liaise with the Basel Committee of Banking Supervisors (BCBS) to address any overlaps with banking prudential rules. Several Eurosystem members participate in the CPMI and provide the relevant Eurosystem input.

At EU level, Article 127(4) of the Treaty and Article 4 of the Statute provide for the consultation of the ECB on any proposed EU legal acts in the ECB’s fields of competence, including the area of payments, clearing and settlement. Furthermore, as noted above, EU law stipulates that ESMA and the EBA should cooperate with the Eurosystem in the drafting of EU technical standards affecting FMIs (including most recently EMIR, the CSDR and the PSD2), and the SecuRe Pay Forum, co-chaired by the ECB and the EBA, is drafting input to ESCB and EBA policies and regulations to foster the safety of retail payment services, systems and instruments.

The issue of coordinating the exercise of oversight and supervisory functions may also arise at the level of the Eurosystem. Some national central banks may also be

¹² https://www.ecb.europa.eu/paym/t2/shared/pdf/professionals/RTGS_services_consultative_report.pdf

responsible for regulating FMIs and/or banks under national law and accordingly also under EU legislation such as EMIR, the CSDR and the PSD2.. In addition, the ECB's Single Supervisory Mechanism assumed responsibility for the supervision of euro area banks in November 2014. Notwithstanding the coordination of approaches, the supervisory and oversight functions of Eurosystem members are, in principle, carried out independently of each other, and are subject to the applicable and distinct legal frameworks.

Cooperative oversight

Regulatory cooperation needs to be complemented by cooperation in the ongoing monitoring and assessment of FMIs, with a view to pre-empting potential inconsistencies, duplications or gaps in how jointly agreed rules or standards are applied. This also requires specific arrangements for communication and coordination in emergencies.

In recent years action has been taken to strengthen the involvement of all authorities which have an interest in the safety and soundness of any FMI. The PFMIs, published in April 2012, have clarified and strengthened the international requirements for cooperative oversight under "Responsibility E" on "Cooperation with other authorities". In line with Responsibility E, the Eurosystem has been part of cooperative arrangements for a number of FMIs, such as CLS. Similarly, to ensure that all authorities with a legitimate interest in the smooth functioning of T2S are involved, i.e. overseers of CSDs and payment systems using T2S services, supervisors of CSDs, and central banks of issue for currencies settled in T2S, the Eurosystem and ESMA have set up the T2S Cooperative Arrangement in line with Responsibility E and the CSDR. The CSDR provides for information-sharing and consultation of the relevant authorities in relation to the authorisation and supervision of CSDs, and the Eurosystem will be involved in forthcoming cooperative oversight arrangements for some EU CSDs in the near future.

EMIR has established colleges of authorities for the authorisation and supervision of all EU CCPs. Alongside the EMIR colleges, the ECB and the Bank of England have agreed additional bilateral arrangements on detailed information exchange and close cooperation regarding UK CCPs with significant euro-denominated business in view of the systemic importance of these FMIs for the euro area.

Finally, it is recalled that EMIR gives an exclusive competence for the supervision of trade repositories (TRs) to ESMA. TRs have continuously grown in importance in recent years¹³. In addition, TRs are also becoming increasingly important for other

¹³ Under EMIR, the details of all derivatives transactions must be reported to TRs, which maintain centralised electronic record storage for transaction data. This data enables EU regulators, overseers and supervisors to get secure access to information on the over-the-counter (OTC) derivatives market and developments that may have implications for the stability of the financial system as a whole. With the future implementation of the Securities Financing Transactions Regulation (SFTR), data on repurchase agreements and securities lending activities also have to be reported to TRs, providing further comprehensive information to authorities, including overseers, which they can use for assessing the stability of the financial system.

FMI, since TRs can provide key ancillary services beyond their core function of recording transactions (such services might include, inter alia, trade confirmation and trade matching, credit event servicing, provision of payment instructions, portfolio reconciliation, portfolio compression). The smooth functioning of other FMIs and the ability of authorities to fulfil their mandates may therefore directly depend on the safety and soundness of TRs. The Eurosystem therefore has an interest in their smooth functioning and looks forward to being part of relevant cooperative oversight arrangements under Responsibility E.

In the context of global and EU cooperative arrangements, central banks may be involved in a number of different functions. On the one hand, as noted above, several central banks participate in cooperative arrangements in line with their supervisory responsibilities for FMIs and/or banks. On the other hand, the role of central banks is acknowledged in two areas, namely as central banks of issue and, where applicable, as central banks with statutory oversight competence for an FMI. The central bank of issue and oversight tasks are similar as they share the concern for the systemic implications of the FMI – in view of an FMI's central role and limited substitutability in the markets served and its interdependencies with other FMIs – and both tasks also call on specific central bank expertise on overall payment and settlement arrangements that is used in the assessments. The distinction between the oversight function and the tasks of the central bank of issue is particularly relevant in the context of offshore and multicurrency systems where these two tasks are carried out by different central banks. Here, the mandate of the home central bank does not reflect the potential risks for the currency in the host jurisdictions. The involvement of all relevant central banks of issue in the ongoing supervision and oversight of the FMI in such cases is therefore essential.

Annex: Main reference documents for Eurosystem oversight

Payment systems	Payment instruments	Clearing and settlement systems
Regulation of the European Central Bank (EU) No 795/2014 of 3 July 2014 on oversight requirements for systemically important payment systems https://www.ecb.europa.eu/ecb/legal/pdf/oj_jol_2014_217_r_0006_en_txt.pdf	Harmonised approach and oversight standards for payment instruments, ECB, February 2009	CPSS-IOSCO Principles for Financial Market Infrastructures, April 2012 http://www.bis.org/cpmi/pub/d101a.pdf
Revised oversight framework for retail payment systems, ECB, February 2016 https://www.ecb.europa.eu/pub/pdf/other/Revised_oversight_framework_for_retail_payment_systems.pdf	Card payment schemes: <ul style="list-style-type: none"> • Oversight framework for card payment schemes – Standards, ECB, January 2008 • Guide for the assessment of card payment schemes, ECB, February 2015 	
	Credit transfer and direct debit schemes: <ul style="list-style-type: none"> • Oversight framework for direct debit schemes, ECB, October 2010 • Oversight framework for credit transfer schemes, ECB, October 2010 • Guide for the assessment of credit transfer schemes against the oversight standards, ECB, November 2014 • Guide for the assessment of direct debit schemes against the oversight standards, ECB, November 2014 	
	E-money <ul style="list-style-type: none"> • Report on electronic money, ECB, August 1998 • Electronic money system security objectives, ECB, May 2003 	

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