EUROPEAN CENTRAL BANK

EUROSYSTEM

EN **ECB-PUBLIC**

OPINION OF THE EUROPEAN CENTRAL BANK

of 19 March 2020

on the oversight of payment systems and payment system operators

(CON/2020/9)

Introduction and legal basis

On 10 January 2020, the European Central Bank (ECB) received a request from the Governor of the Central Bank of Cyprus (CBC) for an opinion on a draft directive of the CBC on the operation of payment systems under its oversight, on the role and governance of payment system operators and on the obligations of payment system participants (hereinafter the 'draft directive').

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union and the third and fifth indents of Article 2(1) of Council Decision 98/415/EC[1], as the draft directive contains provisions concerning the CBC and payment and settlement systems. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. Purpose of the draft directive

1.1 The main purpose of the draft directive is to enact a set of rules governing the functioning and operating methods of payment and clearing and settlement systems and of the operators of those systems that are subject to the provisions of the draft directive pursuant to a decision of the CBC[2]. According to the explanatory note, the draft directive will set out details regarding the CBC's existing role as overseer of retail payment systems. As stated in the explanatory note, in drafting the draft directive, the CBC had regard to the provisions of the Eurosystem's revised oversight framework for payment systems[3].

1.2 The draft directive governs participation in, and suspension or exclusion from, a payment system. More specifically, the draft directive makes participation in a payment system conditional upon the satisfaction of eligibility and continuing participation criteria approved by the CBC for every payment system, and sets the procedure governing the admission of participants to a payment system, including the procedure to challenge the decision if the candidate participant is rejected[4].

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1 Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions (OJ L 189, 3.7.1998, p. 42).

2 See paragraph 3(1) of the draft directive.

3 See Eurosystem oversight policy framework, Revised version (July 2016) available on the ECB's website at https://www.ecb.europa.eu/paym/pol/html/index.en.html.

4 See paragraphs 21 and 22 of the draft directive.

1.3 The draft directive governs the departure and discipline of payment system participants, including the conditions for voluntary departure, escalation and disciplinary procedures in case of infringement of the draft directive or system documents, the operator's powers after force majeure events, the exclusion of a participant by the operator from the system in relation to exclusion events approved by the CBC or in case of infringement of the continuing participation criteria or if the participant has materially or repeatedly infringed any provision of the draft directive or the system documents[5].

1.4 The draft directive requires participants to deposit sums of money with a collateral administrator as trustee for the participants so that they can be used in the event that one or more participants are unable to honour their obligations within the payment system[6].

1.5 The draft directive also addresses settlement finality, providing that the system operator ensures that the system rules and other documents are in line with Directive 98/26/EC[7] and the Settlement Finality in Payment and Securities Settlement Systems Laws 2003. The draft directive also requires the operator to ensure that the system rules define: (a) the time of entry of a transfer order in the payment system; and (b) the time after which a transfer order cannot be withdrawn[8].

1.6 The draft directive sets out the powers and role of the CBC over payment systems and their operators. According to the draft directive, the CBC may adopt a decision placing a payment system under its oversight and designating it as a payment system to which the provisions of the draft directive will apply. The CBC may permit gradual compliance with the draft directive based on a compliance plan to be implemented within a period of no more than two years[9].

1.7 The CBC may adopt decisions to recognise operators of payment systems meeting specified requirements, and may also impose further terms and conditions for the purpose of recognising an operator. The CBC may appoint one executive and one non-executive member of the operator's board of directors and may object to the appointment or request the removal of any board member who does not meet the requirements set out in the draft directive. The CBC approves the operator's memorandum and articles of association. The CBC may appoint one person to each of the operator's technical, business, legal, risk management, internal audit, disciplinary, objections, business continuity and dispute resolution committees. The operator's risk management committee is required to submit annual reports to the CBC, and the internal audit committee is required to submit quarterly reports to the CBC regarding compliance with the provisions of the draft directive. The CBC may make recommendations, provide guidance and require the operator to take any action to safeguard the attainment of the operator's governance objectives. The operator's organisational structure and reporting lines must be approved by the CBC. The CBC also approves the operator's transparency, conflict of interest, internal audit and compliance monitoring, redaction, risk management, physical security, data security, business continuity and recovery and

5 See paragraph 23 to 28 of the draft directive.

6 See paragraph 34 of the draft directive.

7 Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems (OJ L 166 of 11.06.1998, p. 45).

8 See paragraph 35 of the draft directive.

9 See paragraph 4 of the draft directive.

incident management policies[10].

1.8 Under the draft directive the CBC has a prominent role in relation to the operator's delegation of functions to third parties. The third party service provider must cooperate with the CBC in connection with the services provided by it. The operator is obliged to make available to the CBC, upon the CBC's request, all relevant data that may be required so as to enable the CBC to verify whether the service operator performs its functions in accordance with the draft directive. The CBC must be notified in advance of any delegation of function. The CBC's prior consent is required for the delegation of critical or important functions to a third party[11].

1.9 Under the draft directive the operator must cooperate closely with the CBC in performing its duties and notify the CBC of any information pertaining to a participant of which it has reason to believe might adversely affect the operation of the payment system. The CBC must develop and apply an audit programme to monitor the operation of the payment system, the performance of the operator's duties and system participant's compliance with their obligations. The CBC has the power to replace the operator unilaterally in the event of serious or repeated inability or failure; imminent serious inability on the part of the operator to perform its functions or comply with the draft directive; if necessary to safeguard the stability of the payment system or the wider financial system; or to ensure the continuity and proper operation of the payment system[12].

1.10 The draft directive provides that the method of calculation of operator fees is specified in procedural rules adopted by the operator and approved by the CBC. Each participant must also pay the CBC an annual regulatory fee set by the CBC on a cost basis. The CBC may also set additional fees for specific payment systems. All fees are required to be published on the websites of the operator and the CBC[13].

1.11 The draft directive provides that, as a participant in a payment itself, the CBC must ensure that it complies with all of a participant's obligations, and must pay fees and extraordinary charges on the same terms as other participants[14].

1.12 Finally, the draft directive provides that the CBC may require a payment system's rules to be amended for the purpose of ensuring the stability, security and reliability of the system[15].

2. General observations

2.1 The ECB welcomes the draft directive, which will provide a more robust legal basis for the CBC's existing tasks relating to the oversight of payment systems. The draft directive should thereby help to promote the sound governance, security and stability of retail payment systems and their operators.

2.2 Pursuant to the fourth indent of Article 127(2) of the Treaty, as mirrored in the fourth indent of

10 See paragraphs 5 to 12 of the draft directive.
11 See paragraph 14 of the draft directive.
12 See paragraphs 15, 16 and 20 of the draft directive.
13 See paragraphs 37 and 39 to 41 of the draft directive.
14 See paragraph 42 of the draft directive.
15 See paragraph 43 of the draft directive.

Article 3.1 of the Statute of the European System of Central Banks and of the European Central Bank (hereinafter the 'Statute of the ESCB'), the Eurosystem has the task of promoting the smooth operation of payment systems. Article 22 of the Statute of the ESCB furthers the performance of this task. Based on the foregoing the ECB and the national central banks should use the powers available to them to promote the smooth operation of clearing and payment systems. Oversight responsibilities are *inter alia* key to this general task[16].

2.3 The Eurosystem oversight policy framework states that for the purpose of overseeing individual financial market infrastructures, the Eurosystem assigns primary oversight responsibility to the central bank that is best placed to fulfil this function, either by virtue of its proximity to the overseen entity (e.g. where the system is legally incorporated in its jurisdiction) or by virtue of national laws that attribute specific oversight responsibilities to the central bank 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[17], such as the retail payment systems intended to be covered by the draft directive.

2.4 The explanatory note accompanying the draft directive does not make reference to the Eurosystem revised oversight framework for retail payment systems, which establishes variable oversight requirements depending on whether a retail system is classified as a 'prominently important retail payment system' (PIRPS) or an 'other retail payment system' (ORPS)[18]. In this respect, the ECB understands that the scope of the draft directive is to cover solely PIRPS and ORPS within the meaning of the Eurosystem Revised Oversight Framework for Retail Payment Systems (paragraph 3.1 below).

2.5 The oversight of payment systems has been recognised as one of the CBCs' main tasks under existing provisions of Cypriot law[19]. The draft directive does not confer new tasks on the CBC, but rather specifies the CBC's existing tasks by establishing a set of detailed rules governing the CBC's oversight of payment systems and payment system operators. Therefore, the issue of assessing whether the conferral of new tasks on a national central bank complies with the prohibition of monetary financing does not arise in the case at hand.

3. Specific observations

3.1 The ECB suggests amending the definition of 'payment system' in paragraph 2(1) of the draft directive, so as to clarify that the scope of application of the draft directive, as set out in paragraph 4 thereof, only covers PIRPS and ORPS within the meaning of the Eurosystem revised oversight framework for retail payment systems. This clarification would remove any residual uncertainty regarding the scope of application of the draft directive, and its interplay with Regulation (EU)

16 See Section 3.1 of the Eurosystem oversight policy framework, Revised version (July 2016), available on the ECB's website at www.ecb.europa.eu.

17 See Section 5.2 of the Eurosystem oversight policy framework, Revised version (July 2016).

18 See the revised oversight framework for retail payment systems, available on the ECB's website at www.ecb.europa.eu.

19 See Article 6(2)(g) of the Central Bank of Cyprus Law of 2002.

No 795/2014 of the European Central Bank (ECB/2014/28)[20], which applies to payment systems defined as 'systemically important payment systems' (SIPS) on the basis of certain quantitative and qualitative criteria[21]. Regulation (EU) No 795/2014 covers all SIPS, be they large-value or retail payment systems. Accordingly, such clarification would ensure that the draft directive is not in conflict with the Regulation. Furthermore, such clarification would be more in line with the CBC's intention as set out in the explanatory note which states that the draft directive will only apply with regard to retail payment systems.

3.2 Under the Eurosystem revised oversight framework for retail payment systems, the participation requirements of PIRPS and the relevant rules and key procedures of both PIRPS and ORPS should be publicly disclosed. PIRPS and ORPS should disclose clear descriptions of the system's design and operations, as well as the system's and participants' rights and obligations, so that participants can assess the risks they would incur by participating in the system[22]. The consulting authority may wish to consider whether these elements should be reflected in the draft directive.

3.3 The Central Bank of Cyprus Law of 2002 is silent on the issue of the CBC's liability with regard to the oversight of payment systems. The Central Bank of Cyprus Law of 2002 does not contain any provision excluding or limiting the liability of the CBC as the authority responsible for the oversight of payment systems. In line with previous ECB opinions, the Cypriot authorities should consider aligning the CBC's liability in relation to its oversight of payment systems with its liability concerning its supervision of credit institutions, given that potential liability issues could represent substantial financial risks for the CBC[23].

3.4 For the sake of legal certainty, the ECB suggests that the scope of the operator's legal responsibility under paragraph 5(2) of the draft directive could be further clarified. As currently phrased, it is unclear whether this provision creates a new statutory duty for the operator, or whether liability arises only if the operator is in breach of the provisions of the arrangement establishing the payment system.

This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 19 March 2020.

[signed]

The President of the ECB

Christine LAGARDE

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20 Regulation (EU) No 795/2014 of the European Central Bank of 3 July 2014 on oversight requirements for systemically important payment systems (ECB/2014/28) (OJ L 217, 23.7.2014, p. 16).

21 See Article 1(3) of Regulation (EU) No 795/2014 (ECB/2014/28).

22 See Principles 18(2) and 23(1) and(2) of the Eurosystem revised oversight framework for retail payment systems.

23 See, for example, paragraph 3.1 of Opinion CON/2017/44, paragraphs 2.3.6 and 2.3.8 of Opinion CON/2017/3, paragraph 3.1.7 of Opinion CON/2015/45 and paragraph 3.1.7 of Opinion CON/2015/37.