



NÁRODNÁ BANKA SLOVENSKA
EUROSYSTEM

OVERSIGHT POLICY OF NÁRODNÁ BANKA SLOVENSKA

Oversight of payment systems and payment instruments

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OVERSIGHT DEFINITION AND OBJECTIVES

Individuals as well as companies and public authorities make tens of millions of payments within the EU every day. Securities trading is also becoming increasingly widespread. As transactions often take place between different financial institutions, a very important role in ensuring the smooth progress of those transactions is played by various market infrastructures. The following infrastructures are operated in Slovakia:

- payment systems,
- securities clearing and settlement systems.

The operation and use of payment systems by market participants have a long tradition in Slovakia. Payment systems contribute significantly to efficient and smooth payment processing. The faultless operation of payment systems and of securities clearing and settlement systems is an essential if market participants are to have confidence in financial system stability. Confidence in, and the stability of, the financial system are preconditions for the sound functioning of the whole economy.

As regards the functionalities available in payment systems, we differentiate between large-value payment systems (LVPSs) and retail payment systems (RPSs). LVPSs are primarily designed for processing large value payments, and are usually characterised by real-time final settlement of payments. Examples of LVPSs include the Trans-European Automated Real-time Gross settlement Express Transfer system (TARGET2) and EURO1.

Retail payment systems process ordinary client payments. Unlike LVPSs, they are designed for processing the bulk of low-value payments, which are mostly settled in batches and in what is known as clearing cycles, rather than in real time and individually.

As for payment instruments, non-cash payment instruments are among the most efficient ways for individuals to make payments. Credit transfer is the non-cash payment instrument most used in Slovakia (it is a payment service in which the amount of the payment is debited from the payer's account after the payer submits a payment order to the payer's payment service provider), followed by card payments and, finally, direct debit (a payment service in which funds are debited from the payer's account based on the payer's previous consent given to the payee).

One of the key tasks of NBS (under Act No 566/1992 Coll.) is to promote the safe and smooth functioning of payment instruments and market infrastructures. A function of NBS, called oversight, contributes significantly to the performance of that task.

Oversight is one of the core activities of the Eurosystem/ESCB and, at the same time, an integral part of European institutional law, governed by Article 3.1 of the ESCB Statute as well as by Article 127(2) of the Treaty on the Functioning of the European Union. Put very simply, oversight can be described as monitoring market infrastructures on an ongoing basis, assessing them against approved standards and, where necessary, inducing change.

Oversight in Slovakia is governed by *Act No 492/2009 Coll. on payment services*⁽¹⁾ and on amendments to certain laws.

The current oversight policy of NBS was approved by the NBS Bank Board at its meeting of 13 January 2015.

In general, oversight has two key objectives:

- The first is to contribute to the stable and safe functioning of payment systems and securities clearing and settlement systems. Oversight pursues that objective for both financial market infrastructures now in place, and those under development. This key objective is fulfilled mainly by assessing the infrastructures against defined standards.
- The second key objective of oversight is to prevent a possible rise in systemic risk by taking precautions. Systemic risk to the financial system arises if important payment systems and securities processing systems fail. Systemic risk may also arise if the participants in these systems fail to meet all of their mutual obligations, with this leading to a chain reaction, causing problems to the other participants and resulting in a domino effect.

Likewise, participants in the system may also be exposed to other risks, such as settlement risk, which includes operational risk, credit risk and liquidity risk. Operational risk generally arises from information system failure or human failure; credit risk from a counterparty's failure to discharge its payment obligations in the full amount, and liquidity risk from a counterparty's failure to discharge its payment obligations by the due date.

The term 'oversight' must be distinguished from 'financial market supervision'. The difference between 'oversight' and 'supervision' functions is fundamental. In general, it can be stated that oversight focuses on the operators of financial

market infrastructures (payment systems, securities processing systems and other FMIs) and on assessing them against approved standards while supervision supervises the participants in market infrastructures. For payment services these include payment service providers such as banks, payment institutions and electronic money institutions.

OVERSIGHT ROLE, STANDARDS AND SUBJECT MATTER

To fulfil efficiently the most important role of oversight, i.e. to ensure that market infrastructures function safely and smoothly, the following three steps are required:

Defining of the standards applied by the competent oversight authority, and drafting of the relevant working frameworks and methodology under which oversight is to be conducted (expressing the position and importance of the oversight function).

Conduct of oversight, i.e. the gathering and analysis of relevant information within a framework of regular and ad-hoc assessments; identification of possible weaknesses in the system's functioning, and subsequent issuance of recommendations to the system operator.

Fulfilment of recommendations, i.e. the recommendations made by the overseer are enforced by means of one or more of the following:

- formal instruments (such as the ECB Regulation, legislative acts of NBS);
- informal instruments (moral suasion);
- possible restrictions imposed by NBS or the Eurosystem on the services provided;
- cooperation with other competent authorities.

Defining oversight standards

The Governing Council of the ECB has approved as oversight standards the Eurosystem standards *CPSS – IOSCO Principles for financial market infrastructures*⁽²⁾ (PFMIs).

The adoption of the above standards by the Eurosystem is defined by *Regulation ECB No 795/2014 of 3 July 2014 on oversight requirements for systemically important payment systems*⁽³⁾, according to which the Eurosystem assesses systemically important payment systems (SIPs), including both LVPSs and RPSs.

The ECB Regulation also includes the *Revised oversight framework for retail payment systems*⁽⁴⁾. This framework classifies retail payment systems from the oversight perspective into multiple categories by their importance. Relevant PFMI against which the retail payment systems are assessed are assigned to each category.

The classification of all systems is included in the *Payment system classification*⁽⁵⁾ document (Explanatory note on payment system classification). The Regulation also includes an *Assessment methodology for payment systems*⁽⁶⁾ and *Explanatory note*⁽⁷⁾.

From the oversight perspective, payment systems are divided into:

- systemically important payment systems (**SIPSs**), which under the current classification include TARGET2, EURO1, STEP2-T and CORE;
- non-systemically important payment systems (**non-SIPSs**).

The distinction between the two categories is based on clear quantitative criteria that gauge payment systems in terms of their:

- a) financial impact;
- b) degree of market penetration;
- c) cross-border dimension; and
- d) settlement for other financial market infrastructures.

As for non-SIPSs, the Eurosystem differentiates between LVPSs on the one hand and RPSs on the other. In addition, it identifies two categories for non-systemically important retail payment systems (non-SIRPS):

- 1) prominently important retail payment systems (**PIRPSs**), which include the RPS operated by NBS, and
- 2) other retail payment systems (**ORPSs**).

These are classified according to only one factor: the market share of the payment system at the country level. For PIRPSs, the share is 25% or higher of total euro-denominated payments by volume, while for ORPSs it is below 25%.

Within the Single Euro Payment Area (SEPA), payment systems are being linked so that they can provide cross-border processing for participants. For payment systems to be linked, they must meet the relevant PFMI as well as the *Oversight expectations for links between retail payment systems*⁽⁸⁾ (OELRPS). The OELRPS were developed by the Eurosystem in November 2012 and focus on ensuring the safety and efficiency of the links between individual retail payment systems. SIRPSs must comply with all OELRPS while PIRPSs and ORPSs need only comply with a sub-group of these standards.

For the purposes of oversight of individual payment instruments, the Eurosystem has prepared specific oversight frameworks, with all payment instruments being assessed in compliance with the *Harmonised oversight approach and oversight standards for payment instruments*⁽⁹⁾.

Specifically:

- credit transfers are assessed according to the *Oversight framework for credit transfer schemes*⁽¹⁰⁾;
- direct debits are assessed according to the *Oversight framework for direct debit schemes*⁽¹¹⁾; and
- card payment schemes are assessed according to the *Oversight framework for card payment schemes-standards*⁽¹²⁾.

Národná banka Slovenska, as a Eurosystem member, also applies the CPSS – IOSCO PFMI as essential principles of its oversight activity, and conducts oversight in compliance with Eurosystem oversight frameworks.

Conduct of oversight

Národná banka Slovenska participates in the conduct of oversight within the Eurosystem, through oversight activities confined to the national level.

The essential document that defines the Eurosystem oversight activities is the *Eurosystem oversight policy framework*⁽¹³⁾. Approved by the Governing Council of the ECB, this document provides an overview of the instruments and tools that the Eurosystem employs to conduct its oversight policy.

Eurosystem oversight activities, in which NBS may co-participate as a Eurosystem member, can be categorised as follows:

- payment systems (both LVPSs and RPSs);
- central securities depositories and securities clearing and settlement systems;
- central counterparties;
- trade repositories;
- payment instruments (SEPA credit transfer schemes, SEPA direct debit schemes, card payment schemes);
- critical service providers (such as SWIFT).

The efficient conduct of Eurosystem oversight is based on its decentralised structure. In other words, the ECB and the national central banks efficiently coordinate their oversight activities, thus ensuring equal treatment across all euro area countries. The T2 payment system can be cited as an example of

oversight cooperation among national central banks, as T2 is a cross-border system and the oversight activities take place through mutual cooperation between the national central banks participating in it.

In accordance with the *Eurosystem oversight policy framework*⁽¹³⁾, the conduct of the oversight of a cross-border system is coordinated and managed by the national central bank within the jurisdiction of which the relevant system is legally incorporated.

For systems that have no clear domestic legal anchor, the body entrusted with primary oversight responsibility is the national central bank of the country where the system is legally incorporated, unless the Governing Council of the ECB decides otherwise and assigns the primary oversight responsibilities to the ECB.

The central bank entrusted with primary oversight responsibility takes care of the Eurosystem's interests in the prudent design and management of the systems it oversees.

Assessment conclusions for cross-border systems and systems that fall within the ECB's oversight as well as those classified as SIPs are subject to approval of the Governing Council of the ECB.

The Eurosystem and each central bank of the euro area present their oversight activities in their regular joint report entitled *Eurosystem oversight report*⁽¹⁴⁾, usually issued once in two years and subject to approval of the Governing Council of the ECB.

As for global systems that process the euro currency and the financial market infrastructures providing critical services to these systems, the oversight of such systems – where their legal incorporation lies outside Eurosystem jurisdictions – is governed by what is known as the “Co-operative oversight framework”. Examples of cooperation at the global level include the oversight of the Continuous Linked Settlement (CLS) system, which provides processing and settlement services in various currencies, and the oversight of the SWIFT critical services provider, which ensures communication between market infrastructures, i.e. between participants in the system.

An important aspect of oversight at the cross-border level is its active **function of preventing and eliminating the spread of possible crisis situations** through what is known as the “Oversight Crisis Communication (OCC)”; to this end, it uses the following:

- the “Crisis Communication Procedures”, applicable to the ESCB, which are followed by overseers in the event of a crisis situation; and
- various Memoranda of Understanding; for example, to achieve efficient cooperation in the event of a crisis situation, the *MoU on high-level principles of co-operation between the banking supervisors and central banks of the EU in crisis management situations* was signed in March 2003.

Overseers cooperate with other competent authorities at various levels, in particular:

- with other central banks at the international level, when oversight requirements for global financial infrastructures need to be defined;
- with securities regulators at the European level (ESMA) and international level, when defining common standards; and
- with supervisory authorities, through MoUs signed.

The conduct of oversight activities of the Eurosystem as well as NBS is closely related to the possibility of cooperation with the other authorities responsible for regulation and supervision; for NBS this specifically includes cooperation with relevant supervisory and regulatory units.

Conduct of oversight at the national level

Národná banka Slovenska also performs the oversight activities that are its primary responsibility at the national level.

These activities specifically cover:

- the SIPS operated by NBS;
- the system operated by First Data;
- the securities clearing and settlement system operated by the central securities depository – *Centrálny depozitár cenných papierov* (CDCP);
- payment instruments (monitoring of credit transfers, direct debits, card payments)

The outcome of assessing financial market infrastructures by NBS is an assessment report. In the assessment report the central bank assesses the entity’s compliance with all defined standards.

Depending on the significance of its findings, the assessment report is submitted to decision-making bodies of NBS. The assessment conclusions, including its recommendations and deadlines for eliminating shortcomings, are sent to the operator in writing. After the deadlines for eliminating shortcomings expire,

NBS reviews the measures taken by the market infrastructure operator and reassesses the current compliance with requirements against standards defined.

SYSTEMS SUBJECT TO OVERSIGHT BY NBS

The oversight activities of Národná banka Slovenska include the following responsibilities:

- **TARGET2 (T2) payment system** – T2 oversight is conducted in accordance with the relevant internal document *Oversight Guide for SIPSs*. The primary responsibility for the T2 oversight lies with the ECB. Národná banka Slovenska, as a Eurosystem member, contributes to the conduct of T2 oversight on a voluntary basis. NBS has sole competence to perform activities related to the operation of the T2 national component (T2-SK), specifically the local features. T2 is seen by the Eurosystem as a systemically important payment system and therefore its assessment is governed by the ECB Regulation and is performed in compliance with the *Assessment methodology for payment systems*⁽⁶⁾.

The function of T2 oversight at the local level also involves the assessment of domestic T2 ancillary systems, in order to ascertain whether these could cause problems in the functioning of T2 as a whole.

If problems that might put the functioning of T2 as a whole at risk are identified in T2-SK, NBS must notify this to the ECB, which has primary responsibility for T2 oversight.

- **The T2-SK ancillary systems** in Slovakia include:
 - a) the low-value payment clearing system **SIPS (Slovak Interbank Payment System)**, which according to the approved oversight classification is a Prominently Important Retail Payment System (PIRPS). The SIPS is assessed at NBS in compliance with the documents *Revised oversight framework for retail payment systems*⁽⁴⁾ and *Assessment methodology for payment systems*⁽⁶⁾.
 - b) **The First Data Slovakia** payment system, operated under licence from NBS, which NBS assesses against relevant standards for payment schemes according to the *Oversight framework for card payment schemes - standards*⁽¹²⁾.
 - c) **the central securities depository (CDCP)**, a securities clearing and settlement system. NBS assesses CDCP against relevant CPSS – IOSCO PFMIs in compliance with the Eurosystem’s assessment schedule for central securities depositories/securities settlement systems (CSDs/SSSs). The CDCP assessment

is part of a comprehensive assessment approach by the Eurosystem/ESCB, which also assesses the appropriateness of using CDCP in Eurosystem's credit operations (what is known as user assessment).⁽¹⁵⁾

The outcomes of assessing all the ancillary systems include preparing an assessment report and, where appropriate, issuing recommendations, compliance with which is monitored at defined deadlines. The Bank Board of NBS is kept informed of the assessment results.

The summary assessment conclusions for the systems subject to oversight are published on the NBS website, as are other oversight-related matters⁽¹⁶⁾.

REFERENCES

- Act No 492/2009 Coll., on payment services*⁽¹⁾
- CPMI-IOSCO Principles for financial market infrastructures*⁽²⁾
- Regulation ECB No 795/2014 on oversight requirements for systemically important payment systems*⁽³⁾
- Revised oversight framework for retail payment systems*⁽⁴⁾
- Payment systems classification*⁽⁵⁾
- Assessment methodology for payment systems*⁽⁶⁾
- Explanatory note and Payment system classification*⁽⁷⁾
- OELRPS (Oversight expectations for links between retail payment systems)*⁽⁸⁾
- Harmonised oversight approach and oversight standards for payment instruments*⁽⁹⁾
- Oversight framework for credit transfer schemes*⁽¹⁰⁾
- Oversight framework for direct debit schemes*⁽¹¹⁾
- Oversight framework for card payment schemes-standards*⁽¹²⁾
- Eurosystem oversight policy framework*⁽¹³⁾
- Eurosystem oversight report*⁽¹⁴⁾
- Framework for the assessment of SSSs and links to determine their eligibility for use in Eurosystem credit operations*⁽¹⁵⁾
- NBS website*⁽¹⁶⁾

ABBREVIATIONS

CPMI	Committee on Payments and Market Infrastructures
CPSS	Committee on Payment and Settlement Systems
ECB	European Central Bank
ECB Regulation:	<i>Regulation ECB No 795/2014 on oversight requirements for systemically important payment systems</i> ⁽³⁾
ESCB	European System of Central Banks
ESMA	European Securities and Markets Authority
FMI	financial market infrastructure
IOSCO	International Organization of Securities Commissions
LVPSs	large-value payment systems
MoU	Memorandum of Understanding
NBS	Národná banka Slovenska
PFMIs	<i>CPSS-IOSCO Principles for financial market infrastructures</i> ⁽²⁾
PSSC	Payment and Settlement System Committee (an ESCB Committee)
RPSs	retail payment systems
SEPA	Single Euro Payment Area
SIPS	Slovak Interbank Payment System
SIPSs	systemically important payment systems
T2	TARGET2
T2-SK	TARGET2-SK