

Oversight expectations for links between retail payment systems

Equens' response to ECB consultation

Final

Equens SE
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1 Introduction

Equens is pleased to respond to the Eurosystem's consultation document "Oversight expectations for links between Retail Payment Systems" (the Oversight Expectations). With this document, the Eurosystem has recognised that current oversight principles, as laid down in "Oversight standards for euro retail payment systems" and based on the "core principles for systemically important payment systems", have not been designed to adequately cover the additional risks associated with links between retail payment systems (RPS's). Meanwhile the Eurosystem has also noted that such links have consistently grown over the last few years.

The Eurosystem considers that the links between RPS's should be properly overseen and has therefore established a single set of expectations for RPS's to comply with, specifically for risks that may arise when one RPS establishes a link with another. Based on these expectations, the Eurosystem will draw up a single methodology to be applied by the National Central Banks (NCB's), when executing their oversight responsibilities towards RPS's. The Eurosystem has invited interested parties to comment on the consultation document.

Equens key considerations

While the payment services market is moving towards a full SEPA migration, we would like to point out that it is of utmost importance to establish a level playing field for providers of payment services. Such level playing field should not only apply amongst RPS's, but also amongst and vis-à-vis financial institutions (FI's) and payment service providers (PSP's). In our opinion, the Oversight Expectations put a significant burden on RPS's with links making it difficult for them to compete with others in the market. Such competition is imperative for the creation of an efficient integrated market for payment services.

One should also consider that the transaction volumes and value processed through RPS's with links is currently still quite low. The Oversight Expectations are, at least at this stage, disproportionate in the light of risks that are addressed. In this context, it is also important to distinguish between the risk profile of payment processing with settlement in central bank money as compared to settlement in commercial bank money.

Furthermore, we would like to point out that the Oversight Expectations should take into consideration that some RPS's have already mitigated a significant part of the risks identified in the consultation document in the way they have created their links. The members of the European Automated Clearing House Association (EACHA) are a good example thereof. The proposed Oversight Expectations do not appropriately recognise these risk mitigation measures and therefore unnecessarily hamper the ability of RPS's with links to function properly and establish themselves as efficient and fully functional providers of payment services in the SEPA market.

About Equens

Equens SE is one of the largest payment processors in Europe, leading the market for future-proof payment and card solutions. Thanks to an extensive and competitive range of services, the company seamlessly meets the requirements and wishes of the European payments market. Equens supports the development of a single, uniform European payments market (SEPA), and is dedicated to the standardisation and harmonisation of European and global payments.

Equens is one of the founding members of EACHA. Purpose of the EACHA framework is to create an efficient and low risk infrastructure for SEPA payments, built on the 'bricks' of individual RPS's in European countries. Equens has put in a major effort in the development of the EACHA framework. Based on this framework, Equens currently has 9 links with other RPS's in Europe.

2 Answers to the questions

Question 1: Taking into account SEPA, how do you see the evolution of retail clearing infrastructures in Europe and the role of links between retail payment systems?

One of the key objectives of SEPA is to increase efficiency by creating a common, open European market for payments. Initially there was only one European Clearing & Settlement Mechanism (CSM), but competition evolved when EACHA's framework emerged, with currently already 14 participants across Europe. EACHA enables its members to develop into a full reach European CSM, capable of offering an efficient and fully functional alternative for processing SEPA payments.

EACHA's framework is the latest and most advanced evolution of cross border SEPA payment processing, which is concretised in rules that minimise financial, legal and operational risks, and provides clear rules on access and governance. The framework is regularly updated in order to stay on par with the latest developments on risk management and mitigation, and to stay compliant with EPC rulebooks and other relevant developments in the payments business.

EACHA's philosophy is based on open market principles: by creating links between CSM's the reach of each individual CSM becomes more competitive, without the need to connect to thousands of European banks. Without links, or with links becoming very costly, the model will not work, and Europe runs the risk of falling back to a single pan European CSM and no open market development at all.

Today, the transaction volume and value of payments routed through EACHA is still relatively small, but this may change in the future as the framework further expands. We could also imagine that other retail clearing infrastructures may emerge that, similar to EACHA, make use of links between RPS's to process payments. In our view, it is important that the Eurosystem supports the development of these alternative retail clearing infrastructures. The competition between such infrastructures will increase efficiency, drive down cost and result in higher quality of service.

In this context, it is of great importance to establish a level playing field amongst providers of payment services also allowing new and developing retail clearing infrastructures to evolve into pan European, fully functional and efficient alternatives for payment processing. Putting a significant oversight burden, as suggested in the Oversight Expectations, on these infrastructures will hamper their development and limit competition in the market.

Furthermore, one should avoid that the Oversight Expectations are implemented by the various Central Banks, each having their own interpretation of the principles. This may e.g. lead to individual EACHA members having to cope with a variety of overseers. Market developments like EACHA are helped with clear rules to comply with, but not with many interpretations of oversight principles.

We fear that this may lead to an oversight situation that in practice hampers the further development of market infrastructures needed to support the realisation of the SEPA objectives. Equens would welcome a more detailed and preferably rule based single interpretation of the Oversight Expectations to ensure that the Central Banks apply a uniform implementation thereof.

Question 2: Are the definitions of links and scope of application of oversight expectations clearly defined in the document?

We feel that there are some issues with respect to definitions and scope of application which could be further clarified:

RPS definition

In our opinion, the term 'RPS' is not adequately defined in the consultation document. How does an RPS relate to a Financial Institution or a Payment Service Provider in the Payment Services Directive (PSD)? In our response we have assumed that an RPS refers to a CSM, responsible for the Clearing & Settlement process and the resulting clearing information. In this light we are of the opinion that the same oversight principles should also apply to the links of FI's or PSP's.

Information vs. financial flow

Clearing & settlement between linked RPS's relates to an information and a financial flow. The clearing information in the information flow leads to a financial flow in central bank money or commercial bank money. The definitions of 'direct', 'indirect' and 'relayed' links insufficiently explain whether they refer to the information flow or to the financial flow with its legal finality implications. In the case that settlement takes place through Target2, the risks resulting from a link are considerably reduced. We would expect this aspect to be addressed in the Oversight Expectations. Moreover, if the Oversight Expectations would be primarily directed towards the financial flow, the Equens CSM would have no links at all because settlement always takes place in Target2.

Consistency of terminology

The used terminology in the Oversight Expectations is not always fully clear: some terms are not defined and some are not univocal. For one, 'risk management' related terminology is not consistent and clear. In the document several expressions such as 'risk arrangements', 'risk management arrangements', 'risk management framework', 'risk management tools', 'risk control measures' et cetera are used. This may lead to different interpretations and expectations. Using the terminology of the international standard ISO Guide 73 "Risk Management - Vocabulary" and the ISO31000 Risk Management "Principles and Guidelines" defining a management system for risk management could be of help to prevent misinterpretation of the expectations. Furthermore, the expressions 'participant' and 'customer' are undefined terms. It is not always clear whether there is any difference between the two, e.g. an indirect participant can have a commercial relationship with a direct participant and therefore be considered to be a customer. This may lead to misinterpretation.

Other remarks

Below we have reflected some additional, predominantly technical, comments based on the consultation document:

- Oversight Expectations for links between RPS's, Page 3, General, Key Issue 4: "Link arrangements should be defined in such a way that each RPS is able to continue to observe other applicable oversight principles": Equens would recommend to have a clearly defined relation between the CPSS/IOSCO principles and the principles for links between RPS's. More in particular, we would recommend ensuring that the CPSS/IOSCO requirements for Financial Market Infrastructures are fully aligned with the Oversight Expectations.
- Oversight Expectation, Operational Risk, Page 6, first column and paragraph, second sentence: "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": it is unclear what the objective is and what exactly is expected of the RPS to deal with the objective. Depending on the way this is operationalised it may limit the individual flexibility of linked RPS's highly. It is fair to expect that each individual RPS can judge whether it should involve or inform linked partners or not, based on the principles.
- Oversight Expectation, Access Criteria, Page 7, Second column, Key Issue 2: "Access criteria should be justified in terms of the safety and efficiency of the system, as well as the broader financial markets": it is not clear what is meant with "The broader financial markets", with the result that it provides limited guidance for the development of access criteria.

Question 3: Do oversight expectations address all the risks and efficiency aspects inherent in link arrangements?

In our opinion, all relevant risks have been addressed in the Oversight Expectations and we have not identified any missing risks that should have been taken into account.

Regarding efficiency aspects, we have the impression that in the consultation document the positive effects of links are not fully recognised. Links between RPS's may reduce the need to establish (much more) links between banks mutually and between banks and RPS's. Furthermore, links between RPS's lead to a network that is far more resilient to contingencies. Therefore market efficiency is positively influenced by links between RPS's.

We would also like to point out that a significant part of the addressed risks are mitigated through measures which are already in place in EACHA's framework. Unnecessary severe oversight may hamper the process of establishing new links. We strongly suggest performing a common audit on the EACHA framework and limiting the essential oversight on individual links according to the findings on risk mitigations in the EACHA framework. This might improve the efficiency of oversight of the links without hampering the ability of RPS's to function properly and establish themselves as efficient and fully functional providers of payment services in the SEPA market.

The Oversight Expectations do not distinguish between RPS links that initiate settlement in Central Bank money and links that settle in commercial bank money. Equens recognises that settlement in commercial bank money brings about far greater risks than settlement in central bank money. Applying such a distinction in the Oversight Expectations would lead to more effective oversight and thereby to more efficient links.

When two NCB's are involved in a direct cross-border link and even three or more NCB's in an indirect link, the oversight on these links may become rather complex. An RPS with several direct and indirect links may be contacted by all NCB's of the Euro zone. Introducing the "home central bank" principle in the Oversight Expectations will have several positive effects:

- Treat RPS's equally by several Central Banks.
- Ensure bilateral coordination between the oversight authorities.
- Ensure a single, effective contact with one overseer for an RPS with several links.
- Solve the problem of coping with legal differences between the various NCB's.

Question 4: What is your opinion on the risks and efficiency of indirect and relayed links between retail payment systems in comparison with direct links? Do the proposed expectations appropriately address these risks? Have you established any indirect or relayed links with another retail payment system?

Firstly, we already indicated that the definitions of direct, indirect and relayed links are not sufficiently clear (example: is a link between EACHA members indirect because of the intermediation of Target2 (ECB) for settlement in central bank money?).

Although at first glance relayed links may seem to be less efficient, the opposite is true: because of these links EACHA members can limit the number of links amongst themselves and therefore operate more efficiently, while being assured that the risk of these links is effectively minimised by the EACHA framework. However, the processing cycle performed by the intermediate CSM may have some impact on cut off times, depending on its settlement frequency.

In our opinion, proposed expectations do appropriately address risks for links in general. However, Equens feels that adhering to the EACHA framework exposes it to far less risks than those mentioned in the document. In the EACHA framework the risks for indirect and relayed links do not differ from risks for direct links because all EACHA participants adhere to the same framework.

Equens does have a number of links with other RPS's. We consider these to be direct links only as we do not use RPS's (relayed link) or third entities (indirect link) as intermediaries to connect with others. We would like to point out that within the EACHA framework relayed links do exist. In all such cases Equens is acting as the relay for links between RPS's.

Other remarks

Below we have reflected some additional, predominantly technical, comments based on the consultation document:

- In chapter Operational Risk, Page 5, second column, fourth paragraph, last sentence of the document is stated that "the main aspects of the risk management framework [of individual RPS's] should be made available to all parties with legitimate interest": we believe that these aspects can be part of the commercial policy of individual RPS's and CSM's. Sharing possible commercial information of individual parties with potential competitors might hinder the development of the SEPA market. However, it should definitely be subject to oversight. We therefore advise to change this expectation.
- Oversight Expectation, Access Criteria, Page 8, First column, First sentence: "From an efficiency viewpoint, the access criteria should be based on the business case": Equens feels that legal and operational risks could be a reason not to grant access, although the business case is positive. On the other hand access could be granted for strategic reasons, although the business case is negative. We feel that this is up to the individual RPS to decide on.

Question 5: Which areas of these expectations could be subject to grading according to the importance of the link (proportionality)?

The Oversight Expectations have been established based on an assessment of relevant risks. We suggest that these expectations only apply to links with a material transaction volume and value. Equens would gladly support an initiative to establish appropriate threshold values for this.

In this context, one should consider that within the EACHA framework the use of links is currently limited to cross border SEPA payments and therefore, taking into account the transaction volume and value, of limited importance. As long as banks do not switch from existing (national) infrastructures for clearing and settlement of domestic SEPA payments to a CSM in another country, the importance of EACHA links will remain limited.

Furthermore, the risks involved in RPS links that base their settlement on Target2 fiduciary accounts are far less than existing Clearing & Settlement methods within or between FI's and PSP's. It seems inappropriate that the Oversight Expectations ensure that a small, developing and innovative infrastructure with a low risk profile becomes subject to far stricter oversight principles than infrastructures which are out of scope for this consultation document, but clearly have a higher risk profile. Once again, we would like to reiterate the importance of establishing a level playing field amongst RPS's, but also amongst and vis-à-vis FI's as a crucial component for fully realising the objectives of SEPA.