



Response to the public on the revision of the SIPS Regulation

Amendments to the ECB Regulation on oversight requirements for systemically important payment systems (SIPS): outcome of the public consultation and explanatory notes

Introduction

In July 2014 the Governing Council of the European Central Bank (ECB) adopted a Regulation setting out the Eurosystem oversight requirements for SIPS in the euro area (the SIPS Regulation¹). The SIPS Regulation implements the Committee on Payments and Market Infrastructures (CPMI) and International Organization of Securities Commissions (IOSCO) Principles for financial market infrastructures (PFMI), to the extent that they are relevant for payment systems. In accordance with Article 24 of the SIPS Regulation, the Governing Council reviewed the general application of the SIPS Regulation. This review had three aims:

- to further enhance the clarity of the requirements, where possible;
- to strengthen requirements where the practical implementation of the SIPS Regulation was not fully in line with oversight expectations; and
- to reflect developments in the threat landscape and related international guidance.

The ECB consulted the public on the envisaged revisions from 20 December 2016 to 20 February 2017. It also consulted the public on a methodology for calculating potential sanctions under the SIPS Regulation. The ECB received responses from ten entities, including banks, banking communities and operators of payment systems, four of which did not object to the publication of their responses. The ECB wishes to thank all respondents for their valuable feedback, questions and proposals for amendments.

This communication summarises the main amendments to the Regulation and the main issues raised in the public consultation, and aims to clarify potential interpretational issues around some of the revisions introduced to the SIPS Regulation.

¹ See [Regulation of the European Central Bank \(EU\) No 795/2014 of 3 July 2014 on oversight requirements for systemically important payment systems](#).

1 Main amendments to the SIPS Regulation

Among other things, the revised version of the SIPS Regulation sets clearer requirements on credit and liquidity risk mitigation and new requirements on cyber resilience, and assigns additional powers to the competent authorities. This section briefly touches on these core elements of the amending SIPS Regulation. Additional explanations relating to other changes can be found in the recitals of the amending Regulation itself.

1.1 Credit and liquidity risk in deferred net settlement (DNS) systems

Having assessed the treatment of liquidity risk in different SIPS, the Eurosystem considered that there is a need to improve the mitigation of liquidity risk in DNS systems. Following careful examination, the Eurosystem concluded that such improvement in DNS systems is to be achieved through ensuring effective liquidity risk mitigation for all cycles from the moment a transfer order is included in the calculation of net settlement positions and the position is visible to the participant.

By way of background, the Eurosystem considers that liquidity risk (in an economic sense) naturally exists in a DNS system and should, at least in systemically important systems, be mitigated by the system. DNS systems create (and accumulate) liquidity risk by bundling individual transfer orders together and attempting to settle a (high) number of transfer orders at dedicated times. The bundling of transfer orders enables settling on a net basis (thereby reducing liquidity needs) but also creates a risk that major recalculations will occur if a short participant does not pay up its position. If participants expect funds to come in (or rely on a lower payable position) they may not be able to cover the shortfall caused by a recalculation. The Eurosystem considers that systems are in a better position to manage these risks than individual participants and hence expects DNS systems of systemic importance to take mitigating actions. Accordingly, the amending SIPS Regulation requires DNS SIPS to establish financial obligations and manage the credit and liquidity risks arising from bilateral obligations.

The questions and answers (Q&A) below are intended to provide further explanations on the interpretation of the new requirements in the revised SIPS Regulation for credit and liquidity risk as well as on financial obligations.

Table 1

Q&A on new requirements relating to credit and liquidity risk

	Question	Answer
Background of the new requirements	What are credit and liquidity risk?	Credit and liquidity risk describe the risk that funds are not received from a counterparty – “liquidity risk” covers the short term (i.e. receiving funds as and when due), while credit risk takes a long-term perspective (i.e. not receiving funds at all).
	When do credit and liquidity risk arise?	In legal terms, credit and liquidity risk arise with the establishment of a financial obligation. In economic terms, however, liquidity risks can also arise in the absence of obligations, e.g. on the basis of expectations, when there is a direct impact on the processing of other transactions. For DNS SIPS, the Eurosystem considered it important to further align the economic and legal definitions by requiring obligations to arise at a certain point in time.
	Why is the requirement introduced only for DNS SIPS?	DNS systems typically settle at predetermined times, so participants may expect and rely on funds to come in at these times. To avoid systemic disruptions, these risks should be mitigated in DNS SIPS.
Moment of financial obligations	What does “financial obligations” mean?	Financial obligations trigger both credit risk and liquidity risk in a legal sense.
	What are the limits of the financial obligations?	Only financial obligations arising within SIPS are relevant; obligations that may exist outside the SIPS are not relevant.
	When do the financial obligations have to arise?	The obligations have to arise, at the latest, when the participant’s net position is updated and accessible/visible to the relevant participant(s). This is the point in time when liquidity risk arises from an economic point of view.
	Are the operators free to establish obligations at another point in time?	DNS SIPS operators are free to establish obligations at an earlier point in time but must not establish them later than the moment when the participant’s net position is updated and accessible to the relevant participant(s).
	Precisely, what is the latest point at which obligations can be established?	The latest point at which obligations can be established is once the DNS SIPS makes the calculation of net settlement positions visible to participants. The SIPS operator may, however, perform internal calculations without establishing obligations, e.g. to check if sufficient cover is available for updating net settlement positions.
Consequences of financial obligations	What do financial obligations imply?	DNS SIPS are required to cover liquidity and credit risk arising from financial obligations in accordance with Articles 6 and 8 of the SIPS Regulation.

1.2 Cyber resilience

The cyber threat landscape has evolved rapidly since the publication of the SIPS Regulation in 2014, as shown by the higher frequency and greater sophistication of cyber attacks. Public authorities and international standard-setters have developed legal requirements² and guidance³ to raise awareness, foster cooperation and, ultimately, increase cyber resilience. A particular challenge in mitigating cyber risks is the dynamic nature of the threats, which requires SIPS operators to continuously monitor developments and be prepared to take action, as and when needed, within a short timeframe.

The amending SIPS Regulation incorporates the CPMI-IOSCO guidance. The Eurosystem has also started to work jointly with SIPS operators and other financial market infrastructures to enhance cyber resilience.

1.3 Additional powers for competent authorities

To further strengthen the conduct of oversight, the amending SIPS Regulation grants two additional powers to competent authorities. First, they have the power to require SIPS operators to appoint an independent expert to perform an investigation or independent review of the SIPS' operation. This enables, for instance, supplementary analyses in very specific areas when the competent authority does not have the capacity to conduct the analysis itself. Second, in line with Responsibility B of the PFMI, competent authorities can conduct on-site inspections. On-site inspections are a standard tool to ensure the practical application of, in particular, operational measures.

The procedure and conditions for exercising these powers will be set out in further detail in a separate ECB Decision.

2 Comments received in the public consultation

Comments received in the public consultation focused on three aspects:

- level playing field issues between retail payment systems that are subject to the SIPS Regulation and those that are not;
- additional credit and liquidity risk requirements for DNS SIPS; and
- the powers of competent authorities.

² For example, at EU level the [Directive on security of network and information systems \(NIS Directive\)](#) was adopted in July 2016.

³ For instance, see the CPMI-IOSCO [Guidance on cyber resilience for financial market infrastructures](#).

2.1 Level playing field between SIPS and non-SIPS

A number of respondents were concerned that the new requirements would increase costs related to liquidity management at SIPS, thereby widening the regulatory gap between SIPS settling retail payments and other retail payment systems. This was considered to lead to a competitive disadvantage for retail SIPS and push traffic into less safe systems, thereby leading to an increase in systemic risk.

It is noted that level playing field concerns were already raised in the public consultation on the original SIPS Regulation back in 2013. Since then, the Eurosystem has been monitoring the situation but has not identified a migration of traffic from SIPS into smaller systems. Moreover, the Eurosystem notes that SIPS also benefit from economies of scale, considered to be sufficient to compensate for higher regulatory costs. Nevertheless, the Eurosystem will continue to carefully monitor whether the application of the Regulation has any adverse effects on fair competition in the retail payments market, and make adjustments to the SIPS Regulation or the oversight framework for non-SIPS retail payment systems if deemed necessary.

2.2 Financial obligations and liquidity risk requirements

Comments received on the new requirements relating to credit and liquidity risk, and financial obligations more broadly, indicated that there have been diverging interpretations of these new requirements. To facilitate a common understanding and avoid misunderstandings, the Q&A above provides some guidance on the interpretation of the requirements. The Eurosystem considers that a number of the concerns expressed towards the envisaged revisions were based on misunderstandings and that these concerns are addressed or at least alleviated by the explanatory guidance provided above.

One respondent pointed out that reputational, operational and client impacts provide strong incentives for participants to provide funds so that payments can be made on time. The Eurosystem acknowledges the incentives in this respect and notes that, while they may reduce the likelihood of risks materialising, they would not provide any safeguards in the event of a failure.

Another comment raised by several respondents was that the pace of regulation is too high and a longer transition period should be granted for the new requirements to be implemented. The Eurosystem acknowledges that major system changes may be required by DNS SIPS to accommodate the new requirements on credit and liquidity risk. Accordingly, the transition period for these requirements has been set to 18 months (as opposed to 12 months for addressing other changes to the Regulation).

2.3 Powers of the competent authorities

As mentioned above, the amending SIPS Regulation gives competent authorities additional powers, in line with Responsibility B of the PFMI. These powers enable them to require a SIPS operator to appoint independent experts to perform investigations or independent reviews on the operation of the SIPS, and grant them the right to conduct on-site inspections. Several respondents asked for more information on the envisaged procedures around the two additional powers, more clarity on the circumstances under which these powers would be applied, and an explanation of how they would be executed. Moreover, significant concern was voiced around the disclosure and publication of independent reports, noting that publication of sensitive information should be avoided and that a SIPS operator should be able to review and comment before publication.

As indicated in the draft amending Regulation that was subject to public consultation, the Eurosystem envisages adopting an ECB Decision on the procedure and conditions for exercising the powers. The comments received are very helpful when developing this accompanying ECB Decision. Specifically with respect to the publication of independent reports, the Eurosystem wishes to stress that, in line with normal oversight practice, there is no intention to reveal sensitive information and, thereby, bring risk to the system. While this aspect should also be further developed in the associated ECB Decision, the amending SIPS Regulation has been slightly revised to clarify that only certain elements should be published.