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Translation: mem

Letter

To: Secretariat Division, ECB
From: Marcel Roncin, President, GSIT (French Interbank Teleclearing Consortium)
Date: 30 September 2002
Subject: **Letter and response to the public consultation on oversight standards for euro retail payment systems**

In July, you forwarded to us, for the purposes of a public consultation, draft oversight standards for euro retail payment systems.

The French banking community asked GSIT (*Groupement pour un Système Interbancaire de Télécompensation*) to respond.

GSIT is the leading European automated clearing house and currently clears all retail means of payment in France.

A working group worked on this matter during the summer. A summary follows.

RESPONSE OF THE FRENCH BANKING COMMUNITY TO THE EUROPEAN CENTRAL BANK'S CONSULTATION ON OVERSIGHT STANDARDS FOR EURO RETAIL PAYMENT SYSTEMS

The French banking community is carrying out an in-depth study of the principles and arrangements to ensure optimal protection of its system against the failure of one of its direct participants.

During 2002, SIT was deemed by the Banque de France to be a system of systemic importance. With more than 11 billion transactions per year, SIT is now the leading clearing system for retail transactions in volume terms in both Europe and the world. France is the only country in Europe to have dematerialised 100% of the interbank exchanges of payment instruments and to exchange them within a single system.

Upon reading these principles, their irregular nature becomes apparent. Some seek to enhance the safe functioning of the retail systems themselves, from both a technical and financial point of view, whereas others neglect the principles necessary to ensure protection against default by a bank which could trigger a systemic risk.

In view of the adaptation – or even profound changes – to which the national banking communities will have to agree in order to conform with the core principles, we envisage that this bringing into conformity could take place in two stages:

- The first would involve the taking into account by each country of the six “essential” core principles.
- The second, after an in-depth study of the appropriate mechanisms, would involve compliance by each country with the four principles related to the “day-to-day” protection of interbank exchanges.

The French banking community would therefore like to go beyond the notion of systemic importance and to see the core principles, which form an indissociable body, implemented by each of the systems and countries belonging to the Eurosystem.

To do this, each country should commit itself to a timetable for compliance with these core principles.

The European System of Central Banks could therefore be placed in charge of monitoring the implementation of the different stages and of assessing over time the efficiency of the measures proposed concerning the core principles.

Replies of the French banking community to the ECB's questions

The following are the replies to the various questions of your consultation.

What do you think about the application of some of the core principles to certain types of euro retail payment systems, even if they are not systemically important?

The existence of systemic risk seems to us to be independent of the notion of a “retail payment system”. The risk arises as soon as there is an exchange of a means of payment followed by a settlement between two institutions.

Countries, in which there is no organised system and exchanges can be made on a bilateral basis, should thus respect the core principles related to the protection against default from the moment that there is a settlement risk.

We therefore think that it is necessary to distinguish between the risk associated with the system itself and the risk related to settlement. The definition of a systemically important system seems to us, at this stage, to confuse these two notions.

Therefore, in financial terms, if one bank is a direct participant in three different systems, its overall debit position on a given day in the three systems, which *in fine* must be covered by central bank money, could cause a default with major consequences for the whole financial system.

Furthermore, the homogeneity of the composition of the circle of direct participants in a retail system can have an influence on the potential consequences of a non-payment.

In fact, a default by one of the major participants, although inconsequential for the other key participants, can turn out to have particularly serious consequences for the “small” institutions.

Moreover, a failure to settle, even if involving only small sums relative to those exchanged in RTGS systems, for example, can indicate the worsened situation of an institution, for which the financial system as a whole will, in any case, have to find solutions if the failure is confirmed, probably in the form of a cancellation of transactions booked in customer accounts.

In addition, customers might be led to think that it is more risky to entrust transactions to a bank using a system identified as being systemically important, thereby distorting competition.

Lastly, in view of the consumer protection and smooth functioning that the different economic agents (individuals, firms, administrations) are entitled to expect of the European financial system, the notion of systemically important payment systems (SIPSs) or non-SIPSs becomes somewhat abstract, and the only thing that would be visible is the non-execution or cancellation of payment orders sent.

In conclusion, we think that the most important action concerning the robustness of the European financial system would be the uniform application in all Eurosystem countries of a “base” of indissociable core principles, applicable irrespective of the organisation of exchanges and independently of the notion of systemically important systems.

Should other payment systems also conform with the adopted core principles?

Settlement risk arises as soon as there is an exchange between banks (on a bilateral or multilateral basis) and an associated settlement. Therefore, all these exchanges must be covered by the core principles, irrespective of whether there are organised systems or not.

Furthermore, some large banking networks in Europe play a “pre-clearing” role for other banks of lesser importance and systemic risk is still just as present.

Lastly, all the systems handling domestic **and** cross-border transactions or only cross-border transactions should comply with the same core principles in order to avoid any spreading of systemic risk from one country to another, which would lead consumers to think that cross-border transactions are less protected than domestic ones.

The French banking community therefore wants the core principles to have the widest possible application, which should be independent of the organisation of retail payment transactions.

What is your opinion about the proposed choice of core principles to be followed by certain retail payment systems? Is this selection appropriate or should other core principles be added?

The arguments in favour of a homogeneous application of the core principles by each of the systems were given in the reply to the first question.

The six principles (I, II, VII, VIII, IX and X) applicable to all retail systems, as proposed by the ECB, can effectively be considered as a minimum to be applied to all interbank exchanges with associated settlements.

However, Core Principle II *Understanding financial risks: The system's rules and procedures should enable participants to have a clear understanding of the system's impact on each of the financial risks they incur through participation in it* could be understood at the level of the overall impact of the default by a bank participating in several systems of one country (or of different countries) in terms of the spread of the failure and the size of the related shock wave.

To supplement our first reply, we can say that in addition to the interbank risk, which may be minimal, arising from the failure by a system participant to cover a debit balance, the Eurosystem will be responsible to economic agents which suffer the effects of the failure of a bank.

The building of a single euro payments area and of public confidence in the euro are crucial and will require compulsory maximum protection of all retail systems. To achieve this, all the retail systems in this same payments area must uniformly apply the core principles.

Remarks on the application of the core principles

Our various analyses have highlighted a certain number of constraints that the GSIT has had to take into account to implement effective protection of its system against the failure of one of its direct participants.

Thus, the protection of existing interbank exchange systems (today's RTGS systems) is primarily based on same-day-value transfers. The principles adapted to these systems seem appropriate for this type of transaction.

These same principles are not necessarily easily adaptable to retail systems which handle several types of transactions (e.g. credit transfers, direct debits, card payments, cheque payments), for which the exchange date can be anticipated relative to the settlement date. In particular, the characteristics of collection operations call for careful thought about how to apply the principles.

It is therefore necessary to develop protection arrangements adapted to these different means of payment, the sensitivity of which differs, as do the consequences of a non-payment, according to their nature, the rules governing their use and the economic agents involved.

Furthermore, an analysis of the clearing balances of each direct participant over one year shows that the protection for an amount equivalent to the largest debit balance requires specific protection arrangements adapted to the management of the debit peaks relative to an average of the debit balances.

Moreover, the time-lag between the exchange date of the payment orders and the date of the interbank settlement calls for a trade-off in the protection of these means of payment between protection over one or several days before settlement and the ability to block transactions before they are recorded in customer accounts if there is a risk that settlement will not occur.

In addition to the previous remark about the differences in the nature of the various principles, these principles involve very uneven levels of obligations.

Core Principle VIII backs up the concept of efficiency with the implementation of international standards (e.g. SWIFT, BIC, IBAN, IPI) in the national systems “to allow for straight-through processing of domestic as well as cross-border transactions”. It appears that the creation of common standards for transactions which are currently effected through specific channels of which there are national variants is somewhat premature.

Annex

Upon its creation in 1983, the GSIT implemented operating rules for its retail payment system, SIT. These rules define the rights and obligations, as well as the access criteria, for banks participating in SIT. These rules are recorded in a charter governing the terms of interbank exchange (CIRCE) signed by each direct participant in the system.

At the start of the 1990s, the GSIT took the six Lamfalussy standards into account.

In 1992, on the basis of SIT’s operating rules and access criteria, the GSIT drew up a notification to the European Commission (DG IV).

In 1994, this notification led to the designation of the system under the Settlement Finality Directive (as announced in the Official Journal of the European Communities).

In 1999, an “Observatory for Banking Risks” was set up.

As SIT is a real-time exchange system operational throughout the day, this observatory permits a real-time comparison of each direct participant’s forecast and actual exchanges. Any significant difference between the forecast and the actual exchange triggers a warning to the participant(s) involved and can result in the blocking of the flows of the participant(s) in question. The warning thus allows possible errors to be rectified before interbank settlement in central bank money.

In 2001, SIT’s overall service rate reached 100%, meaning that at no time were any SIT participants prevented from issuing or receiving their transactions. This rate has remained at 100% since the beginning of 2002.