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OVERSIGHT AND SUPERVISION OF MARKET INFRASTRUCTURES

Financial market infrastructures (FMIs)¹ are a key component of the financial system and play a central role in the economy as most trade and financial transactions are cleared, settled and registered through them. Given their importance, the smooth operation of these infrastructures is a specific area of focus for financial authorities in general and central banks in particular, and they are therefore subject to supervision and oversight by central banks. Box 5.1 sets out the main differences between these two functions.

5.1 Oversight of payment systems and instruments

Payment systems provide essential services to the real economy, offering efficient mechanisms for the payment of any purchase of goods or services, from international trade transactions to consumer purchases in a supermarket.

Overseeing the smooth operation of payment systems has traditionally been one of the main responsibilities of central banks, which are tasked with fostering their efficiency and safety. Although responsibility for the infrastructure lies with the operator, the central bank, through the oversight function, similarly promotes the smooth operation of payment systems by monitoring existing systems and future developments, assessing them against the standards defined and prompting any changes necessary. Oversight extends to payment instruments, a key component of payment systems, as they enable end-users to transfer funds. Although the supply and use of these instruments do not entail systemic risk, they must also be safe and efficient in order to maintain confidence in the smooth operation of the financial system and in the currency.

The Banco de España is entrusted with overseeing payment systems and instruments under Article 16 of Law 13/1994 of 1 June 1994 of Autonomy of the Banco de España. As oversight is also one of the core functions assigned to the Eurosystem, the Bank's role in this area is strengthened through its membership of the Eurosystem and it performs this function in a coordinated manner, applying uniform criteria based on the Eurosystem Oversight Policy Framework.

¹ FMIs include payment systems, securities settlement systems, central securities depositories (CSDs), central counterparties (CCPs) and trade repositories.

DIFFERENCES BETWEEN THE OVERSIGHT AND SUPERVISION OF FINANCIAL MARKET INFRASTRUCTURES

The oversight and supervision of FMIs¹ are separate but complementary functions which have quite a few points in common. The purpose of supervision is to verify compliance with the set of standards governing the functioning of the infrastructure (members, operations, etc.), whereas oversight focuses on assessing aspects that affect efficiency and safety as a result of the potential resulting impact on both the infrastructure itself and on the financial system as a whole, evaluating the degree to which these objectives are met and introducing changes where necessary.

A case in point of this complementarity is the National Electronic Clearing System (SNCE), which is subject to oversight and supervision by the Banco de España. As such, within the supervisory function, the Bank, among other activities, authorises the approval of and amendments to the articles of association of Iberpay, as system operator; receives and analyses the annual accounts, directors' report and external auditor's report; and approves the basic operating rules of the system. The oversight function, however, assesses aspects related to the safety and efficiency of the SNCE, such as the guarantee mechanism in the event of a member's default, evaluating the degree to which this mechanism meets its objective from the perspective of safety and efficiency for the system and members as a whole. The mechanism is also subject to supervision, in order to verify its compliance with prevailing legislation. The oversight assessment must also be used as an input for supervisory rulings.

Another major difference lies in scope: supervision focuses on infrastructure on an individual basis, whereas oversight has a broader perspective, analysing safety and efficiency within an ecosystem that encompasses other infrastructures and key actors and, therefore, takes account of systemic risk implications. Oversight considers the implications for financial stability and the currency. Nevertheless, this gap is increasingly narrowing, inasmuch as macroprudential stability responsibilities are conferred upon supervisory authorities.

Lastly, oversight is typically based on standards or principles, under which the FMI assessments are conducted. The outcome of these assessments can lead to the preparation of recommendations aimed at improving the efficiency and safety of the system, implementation of which by the operator turns on the moral suasion capabilities of the authority performing the assessment. Conversely, supervision is more prescriptive in nature, as it is founded on a standard which sets out obligations, and the supervisory authority is empowered to impose sanctions if cases of non-compliance arise. Nevertheless, oversight authorities occasionally also turn to prescriptive frameworks, such as the regulation on oversight requirements for systemically important payment systems (ECB/2014/28).

As a result, the oversight function may suggest changes to strengthen the operation of the system from a safety and efficiency perspective, which may ultimately be included in the related standards. Any such additions would require the approval of the infrastructure supervisor.

¹ The Principles for Financial Market Infrastructure issued by the Committee on Payments and Market Infrastructures (CPMI)-International Organisation of Securities Commissions (IOSCO) refer to payment systems, securities settlement systems, central securities depositories, central counterparties and trade repositories.

5.1.1 Payment systems

In the national arena, the Banco de España is the primary overseer of the National Electronic Clearing System (the SNCE, by its Spanish acronym), the Spanish retail payment system managed by Sociedad Española de Sistemas de Pago, SA (Iberpay). The SNCE mainly processes transfers, including instant transfers, direct debits, cheques and bills of exchange.

As part of its oversight of the SNCE in 2019, the Bank monitored the implementation of the Eurosystem cyber resilience strategy for financial market infrastructures² and security measures to reduce the risk of fraud. These security measures, adopted by the Eurosystem, stem from the CPMI's strategy on reducing the risk of wholesale payments fraud related to endpoint security.³ They have been implemented by the SNCE, as it is an ancillary system that performs settlements in TARGET2 (wholesale payment system of the Eurosystem) and is therefore considered an endpoint of this system.

An analysis has also been conducted of the set of initiatives undertaken by Iberpay, as system operator, aimed at reducing interbank settlement risk. These notably include the changes to the guarantee mechanism for the SNCE's Single Euro Payments Area credit transfer (SEPA credit transfer) sub-system (see Section 5.2 for more details).

In the European arena, as part of the Eurosystem's cooperative oversight arrangements, the Bank participates in the oversight of the real-time gross settlement system TARGET2, operated by the national central banks of all euro area countries. The ECB coordinates these tasks and has primary responsibility for the ongoing oversight of the overall system. TARGET2 is the largest payment system in the euro area in terms of processed amounts and is used for processing large-value interbank payments, including Eurosystem monetary policy operations. The system also processes urgent retail payments by customers of participating institutions. Further, the system performs final settlement of the cash legs from the majority of payment and securities clearing systems in the euro area. As such, the smooth operation of these systems largely depends on the correct functioning of TARGET2, and vice versa. The majority of TARGET2 oversight activities are focused on the technical platform shared by the central banks using the system. Each central bank also monitors the specific aspects of its national component.

Together with the other euro area central banks, the Banco de España also forms part of the cooperative oversight of the other pan-European payment systems, specifically EURO1 (large-value payment system), STEP2 (retail payment system) and RT1 (instant payment system), all of which are operated by EBA Clearing and for which the primary overseer is also the ECB. TARGET2, EURO1 and STEP2 are considered to be systemically important payment systems (SIPS) in the Eurosystem under the classification criteria set out in the ECB regulation on oversight requirements for systemically important payment systems (SIPS Regulation).⁴

2 For more information on the Eurosystem cyber resilience strategy for FMIs, see *Memoria Anual sobre la Vigilancia de las Infraestructuras de los Mercados Financieros 2017* (in Spanish): <https://www.bde.es/f/webbde/Secciones/Publicaciones/PublicacionesAnuales/MemoriaAnualSistemasPago/17/MAV2017.pdf>.

3 For more information on this strategy, see *Memoria Anual sobre la Vigilancia de las Infraestructuras de los Mercados Financieros 2018* (in Spanish): <https://www.bde.es/f/webbde/Secciones/Publicaciones/PublicacionesAnuales/MemoriaAnualSistemasPago/18/MAV2018.pdf>.

4 Regulation (EU) No 795/2014 of the European Central Bank on oversight requirements for systemically important payment systems (SIPS Regulation).

In 2019 an assessment was launched of the degree of compliance of TARGET2, EURO1 and STEP2 with the new requirements introduced in the SIPS Regulation in 2018, including new obligations relating to governance and financial risk management. This Regulation also refers to the Eurosystem's cyber resilience oversight expectations (CROE) for financial market infrastructures.

In parallel, and as part of the Eurosystem's implementation of the CPMI's strategy on reducing the risk of wholesale payments fraud related to endpoint security, an analysis has been conducted of the EURO1 and TARGET2 security measures in this area, with a view to fostering steps to reinforce them, if necessary.

As explained earlier, oversight extends to payment instruments and, in particular, payment schemes,⁵ which involves assessing their efficiency and safety.

5.1.2 Payment instruments

As with payment systems, there is cooperative oversight of payment instruments in the Eurosystem, applying the same common standards that comprise the Eurosystem's oversight rules. Specifically, oversight of international card schemes such as VISA, Mastercard and American Express is carried out by a lead central bank that acts as primary overseer, in cooperation with the other Eurosystem central banks.⁶ National card schemes are overseen by the corresponding national central bank. The Bank oversaw the three Spanish schemes (4B, EURO6000 and ServiRed) until 2018, when they merged into a single scheme (Sistema de Tarjetas y Medios de Pago, SA), which it also oversees.

During 2019 implementation of the recommendations made to the previous card schemes, which must also be adopted by the new scheme as their successor, was monitored. This work was concluded favourably, with all of the recommendations made having been incorporated into the operating rules of the new scheme.

In the area of cooperative oversight, in 2019 the assessment of the SEPA Credit Transfer (SCT) scheme was concluded and work was carried out to monitor the implementation of the recommendations made in the assessment exercises of the SEPA Core Direct Debit scheme and the SEPA Instant Credit Transfer (SCT Inst) scheme conducted in prior years.⁷

⁵ A payment scheme can be defined as the set of rules and procedures, aimed at its member institutions, that set out how operations performed through a specific payment instrument (transfer, direct debit, card, etc.) must be executed.

⁶ Specifically, the primary overseer of VISA and American Express is the ECB, whereas the primary overseer for Mastercard is the Belgian central bank.

⁷ These SEPA schemes are managed by the European Payments Council (EPC).

5.2 Supervision of Iberpay

Under Article 17 of Law 41/1999 of 12 November 1999 on securities payment and settlement systems, management of the SNCE is entrusted to Iberpay, which in turn is to be supervised by the Banco de España. In the exercise of this supervisory function, the Bank is empowered to approve the company's articles of association and amendments thereto, and the basic operating rules of the systems and services that it manages, which are its core purpose, prior to their adoption by the company's corresponding bodies.

Further, basic rules relating to the complementary or ancillary services provided by Iberpay and technical or operating instructions regulating the operation of the systems and services that it manages, including the SNCE, must be communicated, once adopted, to the Bank, which may present its objections within 10 business days of receiving them.

In 2019 the Banco de España received a total of 14 operating instructions for the SNCE, none of which was opposed. Notable among the changes introduced by these operating instructions were the following:

- Changes to the guarantee mechanism for the SNCE's SEPA credit transfer sub-system. A new settlement procedure with no interbank risk has been adopted, using funds previously provided by direct sub-system participants to sub-accounts held in TARGET2. This measure has significantly reduced the credit risk assumed by each direct participant in the system.
- Adoption of additional cybersecurity measures in end-to-end communications in SEPA credit transfers processed by the SNCE, through including an electronic signature in the files that institutions share with Iberpay.
- Extension of the timetable for submitting SEPA credit transfers to Iberpay and changes to the third settlement cycle schedule⁸ for this sub-system, in order to enhance operating procedures and reduce operational risk.
- Increase in truncation⁹ limits to €100,000, for cheques, current account notes and direct debit payments, and to €300,000, for banker's drafts and bills of exchange.

⁸ The "settlement cycle" is the period established for: 1) communicating transactions; 2) clearing the amounts corresponding to such transactions and obtaining data for the settlement in the TARGET2 account; 3) sending all the transactions received to the pertinent beneficiary institutions and/or payment systems, and; 4) making the account settlement in TARGET2 for the amount resulting from the clearing process, and sending the information on the outcome to the direct participants. The SEPA credit transfer sub-system currently has four different settlement cycles throughout the day to smooth settlement and liquidity management by institutions.

⁹ Procedure whereby the bank at which a document is presented electronically sends the relevant information on the document, through the SNCE, to the drawee, without needing to send the original document, which remains at the bank where it was presented.

- Adaptation of the SNCE's common operating instructions to the General Data Protection Regulation (GDPR) requirements, including, in this respect, changes to the contract for institutions' adhesion to the SNCE.

5.3 Oversight of securities infrastructures

Securities transactions are cleared, settled and registered through securities market infrastructures. An inadequate functioning of these infrastructures could have adverse effects on financial stability. Risks must therefore be managed efficiently to prevent disruptions arising in financial markets and passing through to other infrastructures with which they have a hierarchical relationship (such as payment systems) and market participants.

Spanish securities infrastructures are grouped in the holding company Bolsas y Mercados Españoles, SA. The securities settlement system, named ARCO, is managed by Iberclear, as the CSD, and BME Clearing, SAU, as the CCP.

Under Article 255 of the Consolidated Text of the Securities Market Law (LMV, by its Spanish abbreviation),¹⁰ the CNMV and the Banco de España are jointly entrusted with ensuring the smooth operation of Spanish securities clearing, settlement and registration systems so as to preserve the stability of the financial system as a whole. To this end, the two authorities shall assess the degree to which the procedures of the Spanish market infrastructures comply with international best practices and recommendations. Given that this function is shared with the CNMV, a Memorandum of Understanding between the two institutions is required in order to ensure efficiency and prevent duplications and overlaps in their activities.

5.3.1 Activities resulting from national legislation

Under the aforementioned regulatory framework, the Bank monitors Iberclear's activities in cooperation with the CNMV. For this purpose, in compliance with Article 73 of Royal Decree 878/2015 of 2 October 2015,¹¹ amended by Royal Decree 827/2017 of 1 September 2017 and implementing the LMV, Iberclear provides information to the CNMV and the Bank on its exposures to operational risk and the specific measures to be adopted to identify, monitor, manage and reduce these risks. Iberclear also sends information to the Bank on the activities through its

¹⁰ Approved by Royal Legislative Decree 4/2015 of 23 October 2015.

¹¹ Royal Decree 878/2015 of 2 October 2015 on the clearing, settlement and registration of marketable book-entry securities, on the legal regime for CSDs and CCPs, and on the transparency requirements for issuers of securities admitted to trading on official secondary markets.

links with foreign CSDs, which enables the Bank to gain detailed knowledge of cross-border mobilisation of foreign and domestic securities.

Under Article 101 of the LMV, the Banco de España is also required to first provide a report before the CNMV can approve the internal rules of Iberclear and any amendments thereto. This Article also stipulates that circulars implementing these rules be communicated to the Bank. In this regard, the Bank has collaborated with the CNMV on the amendments and developments that arose in 2019.

As regards BME Clearing, SAU, Articles 104 and 107 of the LMV stipulate that the Banco de España shall be required to provide a report prior to any amendments to the CCP's articles of association or internal rules, or the establishment of any trade, clearing or settlement agreements with other entities. The Bank issued four reports during 2019, all of which were favourable.¹²

5.3.2 Activities resulting from European legislation

Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories (CSDR) stipulates that CSDs already operating in the EU before the entry into force of the Regulation must apply for authorisation in order to continue pursuing their activities. Consequently, following approval of the technical standards implementing the aspects of the CSDR related to the authorisation process, European CDSs, including Iberclear, applied for authorisation from their respective NCAs in 2017. During the authorisation process, the competent authority for securities must consult and cooperate with other relevant authorities.

As part of the authorisation process for Iberclear, the Banco de España, as the relevant authority on behalf of the Eurosystem, conducted an assessment of Iberclear's compliance with the aspects of the CSDR and its implementing technical standards that had been previously identified as being relevant from the perspective of both functions, the central bank of issue of the euro and the cash settlement agent. The CNMV, as the competent authority in Spain, was notified of the outcome of this assessment, and it granted authorisation to Iberclear in September 2019. Since the completion of the process, the Bank has monitored the resolution of the shortcomings identified during the assessment.

Further, the implementation of monetary policy and the provision of intraday credit by the Eurosystem require collateral, which is provided by the counterparties to

12 Specifically, these reports refer to approval for the clearing of certain foreign exchange derivative contracts, for the clearing of government debt of other EU countries, for the inclusion of the Euro short-term rate (eSTR) as a benchmark rate in interest rate derivatives and for the signing of several agreements with EU trading platforms.

secure these operations. This collateral is, for the most part, deposited with Iberclear or another European CSD. In the latter case, the collateral must be mobilised on a cross-border basis through links between CSDs considered eligible by the Eurosystem. In 2019, the Bank, as a member of the Eurosystem, began an assessment of the eligibility of a new link established by Iberclear with the Portuguese CSD (Interbolsa), which will enable Spanish counterparties to use Portuguese securities deposited with Iberclear as collateral for their credit operations with the Eurosystem.

The college of supervisors of BME Clearing is chaired by the CNMV and includes among its members the Bank, in its triple capacity as a central bank of issue of the euro on behalf of the Eurosystem, overseer of the CCP and supervisor of the CCP members in one of the three Member States with the largest contributions to the default fund,¹³ in accordance with Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (EMIR).

The supervisory college is designed so as to enable other NCAs from the EU, along with the NCA for the CCP (the CNMV in the case of BME Clearing), to be involved in the processes of authorising and supervising a CCP, including analyses of changes therein.

As representative of the Eurosystem in the supervisory college of BME Clearing, the Bank analyses the impact that changes in the CCP could have on clearing and settlement processes (including the agreements established to perform these processes), on their liquidity risk management framework and on the interdependencies with other market infrastructures. As part of this activity, pursuant to Article 19 of the EMIR, in 2019 the Bank issued two opinions in relation to the clearing of foreign exchange derivatives and the clearing of repurchase agreements involving government debt of other EU countries (Italy, Germany, France, the Netherlands, Austria and Portugal).

¹³ The CCP fund for member defaults is regulated in Article 42 of the EMIR. This is a pre-funded default fund to cover the losses that exceed the margins contributed by the clearing members, arising from the default of one or more clearing members.