

Application Process for Payment Systems

Introduction

Payment systems provide channels through which funds may be transferred among credit institutions and other institutions to discharge the payment obligations arising in the financial markets and across the entire economy. Payment systems allow financial obligations to be settled securely and efficiently between debtors and creditors or between originators and beneficiaries of payments. This function makes payment systems critical to the effective functioning of financial systems worldwide.

When a payment system's role in the economy is very critical, this is regarded as a Systemically Important Payment System (SIPS). A payment system is regarded as systemically important:

- i) if it is the only payment system in the country, or the principal system in terms of the aggregate value of payments;
- ii) if it handles mainly payments of high individual value; or if it is used for settlement of financial market transactions or for the settlement of other payment systems in the same currency.

In order to avoid any disruptions that a payment system or a participant in a payment system may cause within the financial market, a SIPS must be sufficiently protected against credit, legal, operational and other risks. The Core Principles for Systemically Important Payment Systems which have been drawn up by the G-10 Governors' Basle-based Committee on Payment and Settlement Systems serve as a guideline for the design and operation of safe and efficient SIPS worldwide.

The Main Elements for a Stable, Secure and Efficient Payment System

A stable and secure payment system should operate in a well-defined legal environment, setting out the rights and obligations, in normal as well as in adverse circumstances, of each party involved in transmitting a payment through the system. The legal environment should cover payment instruments as well as the system itself and all the participants in the payment system, irrespective of their country of incorporation, thereby eliminating the possibility of conflicting bankruptcy and insolvency laws.

The legal and regulatory environment for every SIPS should ensure the finality and irrevocability of all payments made through the system.

A payment system promotes social efficiency through considerable, mostly positive, externalities like the smooth exchange of goods, services and financial assets.

The Role of Central Banks in Oversight of Payment Systems

General

In order to achieve the efficiency and soundness of payment systems, central banks are entrusted with the function of oversight. The main objectives pursued are the maintenance of systemic stability, the promotion of efficiency and the safeguarding of the transmission channel for monetary policy.

A payment system should be subject to effective oversight. The overseer's role should be to ensure the development of rules, regulations and procedures for the system; assess and enforce compliance with those rules; promote and co-ordinate individual and collective action by the participants; ensure the smooth functioning of the system and promote its future development.

The overseer should have arrangements in place to ensure co-operation with relevant authorities, domestic and foreign, including the supervising authorities of credit and other institutions that participate in the system. These arrangements should preferably be based on Memoranda of Understanding or similar arrangements which permit the timely exchange of information between different authorities.

So as not to compromise whatever discretionary authority a central bank may have as lender of last resort, central banks do not guarantee, even implicitly, the settlement of payments through an approved payment system. Nor should participants in the system have any grounds to assume that in the event of a serious problem, central banks will automatically provide sufficient funds to complete the daily settlement.

The Central Bank of Malta's Role

Through its oversight function the Central Bank of Malta ("the Bank") seeks:

- a) to ensure that payment systems are organised and operated in such a way so as not to trigger or spread systemic risk;
- b) to guarantee the efficiency of payment systems;
- c) to guarantee the safety of payment instruments;
- d) to safeguard the essential vehicle for the transmission of monetary policy; and
- e) to establish a level playing field between market participants.

By virtue of article 34 of the Central Bank of Malta Act, the Bank is legally entrusted with the responsibility to oversee and regulate payment systems. Furthermore, it is also one of the Bank's objectives to promote and participate in the establishment of a sound and efficient payment system¹.

The Bank must determine whether a system is a payment system within the meaning of the Central Bank of Malta Act. In order to fall under this definition a system:

¹ Article 5 (1)(d) – Central Bank of Malta Act

- i) must have a formal arrangement between three or more participants; and
- ii) must have common rules and standardised arrangements for the execution of transfer orders between participants or for the settlement of payments relating to securities.

The Bank will assess an applicant for a payment system against a set of criteria. The Bank would require the applicant to have:

- i) adequate financial resources;
- ii) appropriate default arrangements;
- iii) operating rules of the system²; and
- iv) adequate arrangements for monitoring and enforcing compliance with its rules.

Payment systems which are not deemed to be systemically important will be required to supply information on an annual basis for the Bank to be able to monitor whether their status has changed.

In order to determine whether a payment system may be classified as a systemically important payment system, the Bank requires information and documentation which will enable it to assess whether that system may be operated in such a manner as to pose systemic risk. Particular attention will be given to systems, which process significant volumes of large-value payments such that the failure of a participant could have substantial implications for the whole system or for the financial markets.

The Bank considers that there is systemic risk where the inability of a participant to meet its obligations in a payment system could cause:

- a) other participants in the payment system to be unable to meet their obligations as they become due;
- b) financial institutions in other parts of the financial system to be unable to meet their obligations as they become due; or
- c) the system's clearing house to become unable to meet its obligations as they become due.

Relying upon the Core Principles for Systemically Important Payment Systems³, the Bank intends to apply the following minimum standards to the design and operations of systemically important payment systems:

- I. The system should have a well-founded legal basis under all relevant jurisdictions.
- II. 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.
- III. The system should have clearly defined procedures for the management of credit risks and liquidity risks, which specify the respective responsibilities of the system operator and the participants and which provide appropriate incentives to manage and contain those risks.
- IV. The system should provide prompt final settlement on the day of value, preferably during the day and at a minimum at the end of the day.

² These rules should make clear certain aspects of the system, including the point of entry of a payment transfer order into the system and the point after which it cannot be revoked, entry and exit criteria, etc.

³ Bank of International Settlement, Committee on Payment and Settlement Systems, January, 2001

- V. A system in which multilateral netting takes place should, at a minimum, be capable of ensuring the timely completion of daily settlements in the event of an inability to settle by the participant with the largest single settlement obligation.
- VI. Assets used for settlement should preferably be a claim on the central bank; where other assets are used, they should carry little or no credit risk and little or no liquidity risk.
- VII. The system should ensure a high degree of security and operational reliability and should have contingency arrangements for timely completion of daily processing.
- VIII. The system should provide a means of making payments, which is practical for its users and efficient for the economy.
- IX. The system should have objective and publicly disclosed criteria for participation, which permit fair and open access.
- X. The system's governance arrangements should be effective, accountable and transparent.

Payment systems that do not qualify as SIPS will not be required to comply with all the above-mentioned Core Principles.

The Bank will provide a brief summary on its payment systems' oversight activities in its Annual Report.

Application Form For Payment Systems



BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

Application Form

Introduction

Before a payment system may begin to operate in Malta, such a system **must be authorised by the Bank**. When reviewing a request to approve a payment system to operate in Malta, the Bank shall focus on the safety, efficiency and accessibility of that system and on whether or not that system meets the international requirements for payment systems¹.

When applying to the Bank for approval and authorisation to operate a payment system, a person shall submit the attached Application Form duly completed. Please read the questions carefully before completing this form. All questions should be answered and the completed form should be signed prior to submission.

Together with the Application Form, the applicant is required to submit to the Bank the following documentation:

1. A detailed contingency plan;
2. Detailed information regarding the management of risks associated with all aspects of the payment system;
3. The operational safety of the products being used;
4. For an existing payment system, any statistical information related to the turnover of the payment system, and also the level of participation;
5. For new systems, a business plan outlining anticipated turnover, expected level of participation and anticipated growth is required.
6. Operating rules of the payment system.

The Bank reserves the right to seek further information and clarifications. If the applicant is in doubt about how any of the questions should be answered, he should contact The Manager, Payment Systems office on telephone number: 2550 3601

¹ Bank for International Settlement, Core Principles for Systemically Important Payment Systems

| 1. Details of the Payment System | | | |
|---|---|------------|--------|
| 1.1 | Name of the Payment System | | |
| | | | |
| 1.2 | Registered / business address of the Payment System | | |
| | | | |
| | Telephone Number | Fax Number | E-Mail |
| 1.3 | Details of person/company promoting the Payment System (Promoter) in this application. (The name of the natural person submitting this application and his/her contact details should be provided here. This person will be the Bank's contact point regarding this Application). A copy of the authorisation document to represent the other participants in the payment system should also be attached. | | |
| | Name and Surname of person submitting Application | | |
| | | | |
| | Address | | |
| | Telephone Number | Fax Number | E-Mail |
| 1.4 | List of initial participants in the Payment System. (Please supply addresses, telephone numbers, fax numbers, e-mail addresses, ID Card numbers if individuals, date of registration or incorporation if companies. Please submit a true copy of deed of partnership, Memorandum and Articles of Association, etc, as applicable) | | |

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| 2. Analysis of Main Features of the Payment System | |
|---|---|
| | Description of the Payment System |
| 2.1 | Give a brief description of the overall concept of the system, i.e. how the system will function. |
| | |
| 2.2 | Submit the operating rules for the payment system. |
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| 2.3 | Which law has been identified as the applicable law to govern the payment system? |
| | |
| 2.4 | What is the cost structure of the payment system? (entry fee, periodical fee, transaction fee, custody fee) |
| | |
| 2.5 | What are the operating hours and days of the payment system? |
| | |
| | Type of Payment System |

| | |
|------|---|
| 2.6 | What is the nature of the system? (e.g. RTGS, netting system, clearing house) |
| | |
| 2.7 | What is the purpose of the system? (e.g. settlement of retail payments, of large-value payments, of securities transactions. Is it card based, network based or a combination of both.) |
| | |
| | Settlement Procedures |
| 2.8 | Describe the settlement procedures envisaged for the payment system. |
| | |
| 2.9 | Will transactions be traceable and auditable? |
| | |
| 2.10 | What will be the typical execution time (customer to customer) of a transaction under normal circumstances? |
| | |
| | Technology |
| 2.11 | Give a brief description of the technology envisaged for the payment system (e.g. network usage, security features applied, etc). |
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| | Risk Assessment |
| 2.12 | Give an outline of the risks perceived in the proposed payment system. |

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| 2.13 | If the functioning of the system involves collateral (e.g. for central bank credit in RTGS systems or to guarantee final settlement in a net settlement system), what kind of assets are eligible as collateral? |
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| 2.14 | How is the quality of the collateral assessed? |
| | |

Apart from the information provided above, any other issues identified during the initial discussions held with the Central Bank of Malta will need to be adequately addressed in this application.

| | |
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| | |
| Signature | Date |

All personal data will be processed in accordance with the Data Protection Act.

The information given above will be assessed by the Bank in accordance with the following legal requirements and principles.

| Legal Definition | | | For Office Use only | | | |
|------------------|---|--|---------------------|----|----|----|
| Question | | Reference to source | FC | BC | PC | NC |
| 1. | Is the system established between at least 3 participants? | Central Bank of Malta Act article 34(7) | | | | |
| 2. | Does the system have common rules and standardised arrangements for the execution of transfer orders? * | Central Bank of Malta Act article 34 (7) | | | | |
| 3. | Is the system established as a clearing house or for the settlement of payments relating to securities? | Central Bank of Malta Act article 34 (7) | | | | |
| 4. | Does the system operate as a clearing, settlement or netting system? | Central Bank of Malta Act article 34 (7) | | | | |
| 5. | Is the system though not established between at least 3 participants considered to be systemically important? | Central Bank of Malta Act article 34 (7) | | | | |
| | | | | | | |
| 6. | Does the law to which the payment system is subject provide a comprehensive and well-established legal framework for funds transfers? | Core Principle 1 | | | | |
| 6.1 | Is there a comprehensive set of rules which define the rights and obligations of participants in the system? * | | | | | |

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|-----|---|------------------|--|--|--|--|
| 6.2 | Do the liquidation provisions of the applicable law contain a zero hour rule that would have the general effect of voiding a settled funds transfer over the system involving an insolvent participant? | | | | | |
| 6.3 | Are there rules which require the pledging of collateral to secure daylight overdrafts? * | | | | | |
| 6.4 | If the system is a netting system do the home country laws of a foreign-incorporated participant recognize netting arrangements in an insolvency context? | | | | | |
| 7. | Do the system's rules and procedures allow participants to have a clear understanding of the system's impact on each of the financial risks they incur through participation in it? * | Core Principle 2 | | | | |
| 7.1 | Are the rules and procedures clear, comprehensive and up-to-date? * | | | | | |
| 7.2 | Do the rules and procedures fully define the rights and obligations of all involved parties? * | | | | | |
| 7.3 | Are the systems rules and procedures readily available to the public? | | | | | |

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|-----|---|------------------|--|--|--|--|
| 8. | Does the system have clearly defined procedures for the management of credit risks and liquidity risks, which specify the respective responsibilities of the system operator and the participants and which provide appropriate incentives to manage and contain those risks? | Core Principle 3 | | | | |
| 8.1 | Is the system a real time gross settlement system or is it a netting system? | | | | | |
| 8.2 | Does the system settle through central bank money? | | | | | |
| 9. | Does the system provide prompt final settlement on the day of value, preferably during the day and at a minimum at the end of the day? | Core Principle 4 | | | | |
| 9.1 | Do the system's rules provide a clearly defined and legally effective moment of final settlement? * | | | | | |
| 10. | If multilateral netting takes place in the system, is the system capable of ensuring the timely completion of daily settlements in the event of an inability to settle by the participant with the largest single settlement obligation? | Core Principle 5 | | | | |

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|------|---|-------------------|--|--|--|--|
| 11. | Does the system use assets held at the central bank to settle claims? If other assets are used, please give details and clarify what credit and/or liquidity risk these carry Core Principle 6 | Core Principle 6 | | | | |
| 12. | Does the system have a high degree of security and operational reliability? | Core Principle 7 | | | | |
| 12.1 | Are contingency arrangements for timely completion of daily processing in place? | Core Principle 7 | | | | |
| 13. | Does the system provide a means of making payments which is practical to users and efficient for the economy? | Core Principle 8 | | | | |
| 14. | Does the system have objective and publicly disclosed criteria for participation which permit fair and open access? Details on the safety and efficiency of these criteria and also any details of exit/exclusion criteria, if any should be examined. | Core Principle 9 | | | | |
| 14.1 | Does the system define the rights and obligations of indirect participants? | | | | | |
| 15. | Are the system's governance arrangements effective, accountable and transparent? | Core Principle 10 | | | | |

FC – Fully compliant; BC – Broadly compliant; PC – Partially compliant; NC – Not compliant.

* A copy of these rules, if any, should be submitted with the application.