

7 Oversight of payment and settlement systems

7.1 Results of oversight activities

Oversight results improved
for most subjects ...

... in spite of peak volumes
and the default of some
participants

Oversight is a form of supervision aimed at promoting the smooth functioning of payments and securities systems. Oversight seeks to limit the risks relating to Dutch payments and settlement systems and to prevent systemic risks from arising in payments and securities systems which are relevant for the Netherlands. The results of the oversight activities performed in 2008 show a generally positive picture. In 2008, nearly all institutions and products subject to oversight complied with the standards more than or just as closely as in 2007. This improvement took place against the background of the financial crisis, which did not fail to affect payment and securities clearing and settlement systems, too. The numbers of transactions peaked in September and October, and several participants failed. The collapsed Lehman Brothers was a direct participant in the TARGET2 payment system and the securities clearing systems of Icb.Cleernet and EMCF. The payment and securities clearing and settlement infrastructures successfully weathered these tensions, and continued to function properly. The exclusion of Lehman Brothers from these systems proceeded in conformity with the procedures. Retail payments were not subject to any significant consequences of the financial crisis.

7.2 Legal basis and oversight method

DNB performs oversight on payments both pursuant to the Bank Act 1998 and the EC Treaty. Oversight on securities clearing and settlement systems is underlain by the *Wet op het financieel toezicht* [Financial Supervision Act] and the ensuing permission to operate a stock exchange. DNB exercises oversight on all institutions, systems and products which are relevant to Dutch large-value and retail payments. In principle, DNB's oversight covers all institutions and systems which perform the clearing and settlement of securities transactions relevant to the Netherlands. These oversight tasks entail monitoring these systems and products, assessing them against internationally recognised standards and – if necessary – enforcing changes.

New European
assessment framework
for payment products ...

DNB assesses the systems and products concerned in terms of standards. For large-value payments and securities transactions, international standards have been drawn up by the Committee on Payment and Settlement Systems (CPSS) of the BIS and by the International Organisation of Securities Commissions (IOSCO). To assess payment products, DNB has made use, since 2006, of its own assessment framework, Recommendations for Payment Products. In the ESCB context, work has since been done on a harmonised standard for payment products. In January 2008, the first result was published, viz. a set of standards for oversight on all payment cards, the Oversight Framework for Card Payment Schemes. In mid-2008, it was decided, at the European level, to apply this framework to oversight on SEPA credit transfers and

... means Recommendations for Payment Products will be phased out

SEPA direct debits as well. This approach will be worked out in more detail in 2009. Where possible, DNB works on the basis of standards drawn up internationally for these products. Starting with the examination of the debit card product in the first quarter of 2009, the new framework will also be adopted by DNB; the Recommendations for Payment Products will be phased out.

The changeover will be facilitated by the fact that the differences between the two frameworks are relatively minor.

The measure of compliance in 2008 is shown in Tables 7.3 to 7.5. The scoring system used for the oversight standards is set out in Table 7.1.

Over the past few years, the technical processing of an increasingly large proportion of payments and securities systems relevant to the Netherlands has been shifted to companies that operate internationally. This internationalisation of the clearing and settlement of Dutch payments and securities transactions results in a greater geographical spread of operational risks. Oversight on international systems is increasingly being conducted through international cooperation. This usually takes the form of a group of overseers, chaired by a lead overseer. For various systems, the oversight group works together with other supervisors (prudential and securities supervisors). Table 7.2 presents an overview of the national and international oversight arrangements with participation of DNB.

7.3 Assessment of large-value payments

7.3.1 TARGET2

The Trans-European Automated Real-Time Settlement Express Transfer system or TARGET2 is the payment system of the European System of Central Banks (ESCB). TARGET2 is used for euro-denominated payments within Europe between accounts held at central banks. The system was introduced in the Netherlands on 18 February 2008 to replace the domestic payment system, TOP. Like the other central banks in euro countries and several non-euro countries, DNB has outsourced the technical management of TARGET2-NL to the central banks of Germany, France and Italy. TARGET2 makes use of a central technical platform, the Single Shared Platform, which obviates the need for national payment systems. Financial systems can submit large-value payments to this platform directly. Legally, TARGET2 is still structured as a multitude of national systems. This means that every central bank in the Eurosystem remains responsible for its own system. To make oversight more efficient, DNB will cooperate, where

Table 7.1 - Scores based on oversight standards

Score	Abbreviation	Meaning of the score
Observed	O	meets all requirements
Broadly observed	BO	minor deficiencies with limited impact on the system's security and efficiency
Partly observed	PO	serious deficiencies on which action is to be taken in the near future
Not observed	NO	serious deficiencies with no plans for action in the near future
Not applicable	NA	the standard in question does not apply
Not examined	NE	the system has not yet been subjected to an initial examination in terms of the standard in question

Table 7.2 - Oversight subjects involving DNB

System	Lead overseer/regulator	Other overseers/regulators
Interbank large-value payments		
target2	ECB	Eurosystem NCBS
target2.nl	DNB	
EURO1	ECB	Eurosystem NCBS
CLS	Federal Reserve System	G10 central banks and other central banks of the 17 currencies involved
SWIFT	National Bank of Belgium (NBB)	Other G10 central banks
Securities clearing and settlement		
LCH.Clearnet sa	Rotating chairmanship for regulators Euronext countries	Other regulators from Belgium, France, Netherlands and Portugal
LCH.Clearnet Group Ltd	Commission Bancaire (France)	AFM, DNB and regulators from Belgium, France, Portugal and the United Kingdom
EMCF	AFM and DNB	
Euroclear SA	NBB and CBFA (Belgium)	afm, dnb and regulators from France and the United Kingdom
Euroclear NL	AFM and DNB	
ECC	Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)	AFM, DNB and Bundesbank
Retail payments		
Equens	DNB	
Paysquare	DNB	
VISA Europe	ECB	DNB and NCBS from Belgium, Germany, France, Italy, Austria and the United Kingdom
Mastercard Europe	NBB	DNB, ECB and NCBS from Germany, France, Italy and Austria
Currence (Chipknip, Acceptgiro, PIN, Incasso, iDEAL)	DNB	
NVB (Spoedopdracht)	DNB	
UPSS	DNB	

possible, with the lead overseer, the ECB, and with the other overseers of TARGET2.

7.4 Assessment results for securities transactions

7.4.1 LCH.Clearnet SA

LCH.Clearnet SA is the Central Counterparty or CCP for transactions effected on Euronext securities and derivatives exchanges, including Euronext Amsterdam. It also functions as CCP for over-the-counter transactions in bonds, repos and energy contracts. A CCP bears the financial risk if one of its participants defaults and thus takes over counterparty risk. By redistributing credit risk in the capital market, a CCP reduces this risk. But the CCP itself can also fail, causing shocks to the system because of its central position. A CCP is required to cover this risk by a sound organisation of its operational and risk management systems. LCH.Clearnet operates in a market which saw fierce competition, with CCPs competing to connect to new trading platforms during the past year.

In consultation with the Netherlands Authority for the Financial Markets (AFM) and other regulators, DNB has provided LCH.Clearnet SA with a non-objection with regard to the offering of clearing services to four trading platforms, including the Bourse du Luxembourg and Bluenext. In October 2008, LCH.Clearnet Group announced that it intends to merge with DTCC in 2009. DTCC is the central American clearing and settlement house for transactions in shares, bonds, mortgage-backed securities, money market instruments and OTC derivatives, including transactions effected on the New York Stock Exchange and the Nasdaq.

Possible merger with DTCC
subject to an assessment
by DNB and AFM

Any merger or acquisition must be approved by the regulators, including DNB. As CCP, LCH.Clearnet SA must comply with the fifteen CPSS/IOSCO recommendations for CCPs. LCH.Clearnet meets fourteen out of the fifteen recommendations (see Table 7.3). Only the recommendation on operational risk is not yet fully met, since operational improvements were deemed necessary at the moment of the assessment. Since then, LCH.Clearnet SA implemented improvements that significantly increased its operational resilience.

7.4.2 European Multilateral Clearing Facility NV

The European Multilateral Clearing Facility NV (EMCF) is the CCP for transactions in European shares effected on the trading platforms of Chi-X, Nasdaq OMX and BATS Europe.

Table 7.3 - Oversight assessment of securities clearing and settlement

		O	BO	PO	NO	NA	NE			
		Observed	Broadly observed	Partly observed	Not observed	Not applicable	Not examined			
No	ccp recommendation	LCH.Clearnet SA				EMCF		No	sss recommendation	Euroclear ESES 2008
		2007	2008	2007	2008	2007	2008			
1	Legal basis	O	O	O	O			1	Legal basis	O
2	Participation requirements	O	O	O	O			2	Transaction confirmation	NE
3	Calculation of credit risks	O	O	O	O			3	Settlement time	NE
4	Margin requirements	O	O	O	O			4	CCP	NA
5	Financial resources	O	O	O	O			5	Securities lending	NA
6	Default procedures	O	O	O	O			6	Dematerialisation	O
7	Custody and investment risks	O	O	O	O			7	DVP	NE
8	Operational risk	BO	BO	PO	O			8	Finality	O
9	Settlement assets	O	O	O	O			9	Credit risks	NA
10	Physical deliveries	O	O	O	O			10	Settlement assets	O
11	Risks in links between CCPs	O	O	O	O	NA	NA	11	Operational risk	O
12	Efficiency	O	O	O	O			12	Ownership protection	O
13	Governance	O	O	O	O			13	Governance	O
14	Transparency	O	O	O	O			14	Access	PO
15	Regulation and oversight	O	O	O	O			15	Efficiency	O
								16	Communication standards	O
								17	Transparency	NE
								18	Regulation and oversight	BO
								19	Risks in links between csp	O

Like other CCPs, EMCF operates in a market competing to connect to new trading platforms. In 2008, DNB, in consultation with the AFM, has provided EMCF with a non-objection with regard to the offering of clearing services to the trading platforms of Nasdaq, OMX Europe and BATS. EMCF services now also extend to Belgian, Danish, Finnish, Italian, Norwegian, Austrian, Spanish and Swedish shares.

In the year under review, DNB, together with the AFM, again assessed EMCF against the fifteen CPSS/IOSCO recommendations for CCPs.

Assessment results for
EMCF improved since 2007

The results have considerably improved since the 2007 assessment (see Table 7.3). Two years after its establishment, EMCF meets nine out of the fourteen standards, though not yet the requirements regarding the structure of the money side of the settlement. The reason lies mainly in EMCF's dependence on Fortis Bank Nederland. Fortis Bank Nederland is both the settlement bank and the settlement and paying agent for EMCF, with an account at the relevant central banks and CSDs. The absence of a harmonised European legal framework for CCPs makes it difficult to open accounts at CSDs. For the coming year, EMCF has scheduled several activities to enhance its independence.

7.4.3 Euroclear Nederland

Euroclear Nederland is the Central Securities Depository or CSD in the Netherlands. It offers settlement, custody and securities administration services to banks and investment firms. In 2008, Euroclear Nederland and the Euroclear CSDs in Belgium and France prepared the launch of the new securities settlement system called Euroclear Settlement for Euronext-zone Securities (ESES).

ESES launched successfully

Given the market turmoil in the autumn of 2008 and following initial less-than-satisfactory test results, DNB and the AFM gave permission to Euroclear Nederland to launch the new settlement system in January 2009, instead of November 2008. The launch on 19 January proceeded successfully.

Since then, ESES performs the settlement of all securities transactions in central bank money, i.e. between accounts held at a central bank. This is done on a delivery-versus-payment basis, which means that the delivery of the securities and the final payment coincide, thereby strongly reducing counterparty risks. New to the ESES system is that the settlement of transactions of the Euronext exchanges of Belgium, France and the Netherlands, and all orc trades take place on a single technical platform; the differences between the domestic and the cross-border securities transactions of these three countries have thus been eliminated. DNB assessed the initial setup of ESES in 2008 (see Table 7.3). As the system was not yet operative, four CPSS/IOSCO recommendations have not been assessed. This assessment will take place once production data for several months are available. In 2009, a complete assessment of ESES in terms of the CPSS/IOSCO recommendations, made in conjunction with Belgian and French regulators, will become available. The setup of Euroclear Nederland/ESES meets most of the recommendations for which it was assessed. DNB has arrived at the conclusion that improvements are needed with regard to two recommendations, concerning access, and regulation and oversight.

7.5 Assessment results for retail payments

7.5.1 Equens

Equens processes financial transactions effected by means of a variety of payment products. Its services cover the entire range of the processing, clearing and settlement of non-cash and card-related transactions.

Transactions in the Dutch market are processed by the Clearing and Settlement System (css). Once all the payments have been processed, Equens periodically determines, via this css, the amounts which the banks owe one another on behalf of accountholders or customers (consumers and retailers).

This is called clearing. The clearing amounts are notified to DNB, where all Dutch-based banks have an account in the TARGET2.NL system. Equens is authorised to have DNB debit and credit these accounts, and therefore to settle the payments. Once settlement has taken place, the banks inform their own accountholders about changes to their bank balances, on the basis of the processing data which they receive from Equens.

Equens emerged in 2006 from the merger between Interpay Nederland bv and the German Transaktionsinstitut für Zahlungsverkehrsdienstleistungen. Since 17 July 2008, Equens is a Societas Europaea (European legal form); its name is consequently now Equens SE. Its head office and domicile have remained in Utrecht, the Netherlands. At end-2008, Equens SE set up a joint venture with the Italian ICBPI Group: Equens Italia.

Equens in joint venture
with Italian party ...

Equens is among the largest payment processors in Europe, with 8.7 billion payments and 3 billion OTC payments and cash withdrawals a year (including Equens Italia). The market share of Equens' css in the Netherlands is over 90%, and the five largest participants in the css account for more than 80% of all transactions. Within the Eurosystem, Equens' css has therefore been classified, on the basis of a common methodology, as a systemically important retail payment system. In 2008, the css was subjected to a number of assessments against standards applicable to retail payment systems. As in 2007, DNB concluded that the css fully observes eight out of the ten standards set at the European level. One standard, the legal basis, is broadly observed by Equens, while the standard on multilateral netting systems does not apply (see Table 7.4).

... continues to observe
the standards to
the same degree

In addition to the css, Equens manages the Interbank Authorisation Network (also known as the IAN switch), which facilitates, among other things, debit and credit card authorisations and transactions which use the PIN code as a means of identification (for, for instance, cash withdrawals, point-of-sale payments and

Table 7.4 - Oversight assessment of Equens

		O	BO	PO	NO	NA	NE
		Observed	Broadly observed	Partly observed	Not observed	Not applicable	Not examined
				Equens			
No	Standard			2007	2008		
1	Legal basis		BO		BO		
2	Transparency of financial risks		O		O		
3	Control of financial risks		O		O		
4	Prompt final settlement		O		O		
5	Multilateral netting systems		NA		NA		
6	Settlement assets		O		O		
7	Operational reliability		O		O		
8	Efficiency		O		O		
9	Access		O		O		
10	Governance		O		O		

Equens SEPA system goes live

Chipknip loading). This infrastructure is important to the proper functioning of Dutch payments. DNB has examined the operational reliability of this switching facility, and checked whether access to the switch is fair and open, and whether management has been properly organised. The conclusion is that the requirements regarding reliability and access are observed. The requirements with regard to the management of the switch are broadly observed. It would be advisable though to further formalise the manner in which participants are involved in decision-making concerning the switch. Since the introduction of the SEPA transfer in January 2008, Equens operates a settlement system for the processing of SEPA payments. This system runs on the zvs (ZahlungsVerkehrService) platform, where Equens also processes the retail payments for the German market.

7.5.2 IDEAL

Assessment result for IDEAL improved on last year

A prerequisite for using IDEAL, a payment product for Internet payments, is that payers have access to Internet banking at a Dutch bank which supports IDEAL. Currence is the legal owner of the IDEAL product. Owing to the importance of interbank payment products in Dutch retail payments and Currence's role as owner of the IDEAL payment product, it is subject to active oversight by DNB. In this context, an oversight framework has been agreed with the parent company, Currence Holding BV (Currence), which contains information about the way this oversight is exercised and the requirements in force, which are based on the Recommendations for Payment Products. Following the initial assessment in 2007, the measure of observance by IDEAL of these standards was evaluated in 2008. On the basis of this assessment, it was concluded that Currence's organisation and functioning are adequate, including the existence and functioning of Currence's internal control. Currence's governance structure was also found to be sufficiently transparent and effective. Currence IDEAL observes eight out of the ten Recommendations for Payment Products and broadly observes the other two Recommendations (see Table 7.5). This is a clear improvement on the result of the initial assessment in 2007. The improvements relate notably to formalisation of the requirements which Currence imposes on its licence holders and the way it enforces compliance with these requirements. Currence intends to complete the risk analysis in 2009.

7.5.3 Debit cards

Debit card fraud has grown forcefully in recent years

Debit card payments are very popular in the Netherlands, expanding without interruption since they were introduced nearly twenty years ago. The number of debit card transactions continued to grow in 2008, by over 10% to 1.8 billion transactions. Unfortunately, debit card fraud has also increased materially over the past few years, from less than EUR 4 million in 2005 to several tens of millions of euro in 2008. Fraud mainly takes the form of skimming.

Faster introduction of EMV can underpin confidence in debit cards

Skimmers copy magnetic stripe data during regular debit card transactions and get hold of the PIN code. With this information, they make false debit cards and withdraw money from – mostly foreign – cash dispensers. The growing debit card fraud is a cause of concern. A changeover to safer chip technology (EMV) is therefore foreseen as from 2011. In 2006, DNB issued a status report about the safety of the debit card product, containing the recommendation to advance the introduction of EMV and to phase out the magnetic stripe faster if fraud were to expand significantly (see www.dnb.nl). In the current migration path, the magnetic stripe can be used for debit card payments on some locations until end-2013. The increase in debit card fraud over the past few years shows that a speedier changeover to EMV is needed and

Governance of
Spoedopdracht
remains insufficient

occasion of the changeover from TOP to TARGET2 in February 2008. On these points, the Spoedopdracht broadly observes the standards in force (see Table 7.5). The Spoedopdracht's governance observes the standards set only partly. Here a role is notably played by the fact that the Netherlands Bankers' Association lacks information about the use of the Spoedopdracht, because a formalised periodic supply of information from the participating banks has not been provided for.

