



**BANK OF ENGLAND**

# **Self-assessment of the Bank of England's Real-Time Gross Settlement and CHAPS services against the Principles for Financial Market Infrastructures**

December 2021

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## I. Preface

The Bank of England, as operator of the Real Time Gross Settlement (RTGS) and CHAPS services, publishes a self-assessment against the Principles for Financial Market Infrastructures (PFMIs).

The formal assessment has been completed as at end-October 2021. The accompanying introduction and principle-by-principle narrative closely follow the published PFMI disclosure template. This is to aid comparison with the disclosures published by the operators of other FMIs. However, it is important that this formal self-assessment is put in a broader context.

First, this is a point in time self-assessment. Our self-assessment is to remain ‘broadly observed’ on *Principle 3 - Framework for the comprehensive management of risks* based on a continued conservative view that a small number of risk management processes need time to further mature; this reflects the high standards we want to reach given the criticality of RTGS and CHAPS. Whilst we already execute a comprehensive range of risk management activities, we have recently reviewed our capabilities and identified further enhancements. This is to ensure that our risk management approach across all three risk domains (participant, internal, supplier) is sufficiently consistent and integrated, enabling us to enhance the extent to which we can aggregate and consider risk in a more holistic manner. Additionally, we have identified series of actions, including defined timelines, which aim to deliver these enhancements during the next review period.

Second, we are part way into a significant, multi-year, programme of change brought about by the RTGS Renewal Programme. As well as strengthening business as usual operations, the RTGS Renewal Programme will deliver a resilient, more interoperable and innovative sterling payment system for the United Kingdom. It will meet the challenges posed by a rapidly changing landscape. This self-assessment is largely focused on the live RTGS and CHAPS services, with some references to future changes under the Renewal Programme, such as implementation of the common payment messaging standard – ISO 20022 – for CHAPS.

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## II. Executive summary

- II.1 This publication is the Bank of England’s public disclosure and self-assessment for the RTGS and CHAPS services against the Principles for Financial Market Infrastructures.<sup>1</sup> The self-assessment assesses the RTGS and CHAPS services as at end-October 2021.
- II.2 Consistent with the objectives of the PFMIs, this self-assessment has been completed by the Bank in its role as operator of the RTGS and CHAPS services, and not as a user of those services, or in its broader roles as supervisor of financial market infrastructures and banks.<sup>2</sup> A brief introduction to RTGS and CHAPS and a separate, longer, service description for RTGS and CHAPS is also available on the Bank’s website.<sup>3</sup> The Bank regularly updates the public disclosure and self-assessment of the CHAPS and RTGS services.
- II.3 This section summarises the current self-assessment as well as providing a broader context around the provision of the RTGS and CHAPS services and how the UK’s payments landscape is changing.

### **What are RTGS and CHAPS?**

- II.4 ‘RTGS’ stands for Real-Time Gross Settlement – the real-time settlement, in central bank money, of payments, transfer instructions or other obligations individually on a transaction-by-transaction basis.
- II.5 The terms ‘RTGS’ and ‘HVPS’ (High-Value Payment System) are often used interchangeably to describe a country’s wholesale payment system, given that both services are often offered by the central bank. However, there is an important distinction between the two services, explained below. Since November 2017, the Bank has been responsible for operating both of the UK’s RTGS and HVPS (known as ‘CHAPS’) services. The Bank operates the RTGS and CHAPS services in support of its mission to promote the good of the people of the United Kingdom by maintaining monetary and financial stability.

### *RTGS*

- II.6 The Bank’s RTGS infrastructure is an accounting system (or ledger) that records financial institutions’ holdings of sterling balances in central bank money, called ‘reserves’, at the Bank.<sup>4</sup> RTGS is the

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<sup>1</sup> The Principles are international standards for the risk management of Financial Market Infrastructures; see [http://www.bis.org/cpmi/info\\_pfmi.htm](http://www.bis.org/cpmi/info_pfmi.htm). There is additional guidance covering application of the Principles to FMIs operated by central banks; see <https://www.bis.org/cpmi/publ/d130.htm>.

<sup>2</sup> Unless stated otherwise, references to banks include building societies.

<sup>3</sup> <https://www.bankofengland.co.uk/payment-and-settlement>

<sup>4</sup> Central bank money is the ultimate secure and liquid asset, offering the lowest risk means of final settlement of the claims and liabilities that arise between the participants in payment systems.

mechanism through which the Bank implements monetary policy decisions (reserves accounts being remunerated at Bank Rate), provides liquidity to the UK's financial system and settles obligations arising from the Bank's Note Circulation Scheme.

- II.7 Balances in RTGS can be used to settle the obligations arising from payments and securities transactions made by financial institutions and their customers on a gross or net basis.
- II.8 These considerations show that the UK's RTGS is not a payment system per se. Rather, it is the infrastructure that permits the final settlement of obligations, arising from payments and securities transactions, across accounts at the central bank. In addition to the CHAPS payment system, RTGS provides sterling settlement in central bank money for a number of privately operated payments systems. RTGS provides sterling settlement for UK's securities settlement system, CREST, managed by Euroclear UK & International, three retail payment systems operated by Pay.UK (Bacs, Faster Payments and the cheque Image Clearing System) and three other retail payment systems (LINK, Mastercard Europe and Visa Europe). The sterling pay-in and pay-out legs of CLS (a multi-currency settlement system) as well as the embedded sterling payment arrangements for LCH Ltd are also settled, via CHAPS, across RTGS.
- II.9 A separate function of the Bank undertakes prudential supervision of payment systems<sup>5</sup> and other FMIs.

#### *CHAPS*

- II.10 CHAPS is the UK's high value payment system. A payment system is a set of arrangements to facilitate the transfer of money. The arrangements are typically made up of a rulebook, infrastructure, messaging services, and contractual arrangements between the payment system operator and the participants. The Bank is the 'payment system operator' for CHAPS. The Bank, as operator of CHAPS, sets the rules and technical standards for the CHAPS system and acts as an end-to-end risk manager. The Bank, as operator of RTGS, provides the settlement infrastructure for CHAPS.
- II.11 Other key parts of the end-to-end CHAPS payment system are:
- CHAPS Direct Participants who submit CHAPS settlement instructions to RTGS (via the SWIFT network);
  - the SWIFT network used for CHAPS payment messages;

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<sup>5</sup> HM Treasury recognises payment systems under the Banking Act 2009 for supervision by the Bank. A list can be found on the Bank's website, see <https://www.bankofengland.co.uk/financial-stability/financial-market-infrastructure-supervision>

- indirect participants and end-users who access CHAPS payments via one of the CHAPS Direct Participants; and
- a range of hardware, software and other service providers to these organisations.

II.12 The CHAPS service provides efficient, risk-free settlement and irrevocable payments. As well as high-value, wholesale payments, CHAPS is also used for time-critical lower-value payments such as house purchases.

#### *RTGS Renewal*

II.13 The Bank is part way through the multi-year RTGS Renewal Programme to develop a renewed RTGS service. Whilst the new core ledger will not be operational until at least 2023, certain aspects of the Renewal Programme are already in place, such as the broadening of access to new types of institutions and bringing the operation of CHAPS into the Bank.

#### **Changes to the RTGS and CHAPS services since the previous self-assessment**

II.14 The Bank operates RTGS and CHAPS with combined operations, risk, and analytical teams. Since the last self-assessment, our focus has been on augmentation of our risk management arrangements and preparation and realisation of the forthcoming changes driven by the RTGS Renewal Programme.

II.15 To deliver on the Bank's role as an end-to-end risk manager, we have focussed on: further maturing our risk management arrangements; enhancing the CHAPS rulebook – with a stronger focus on risk management and operational resilience; and seeking to maximise the financial stability benefits of being part of the central bank.

II.16 With respect to the RTGS Renewal Programme, we have focussed on policy and technical preparation for the adoption of ISO 20022 for CHAPS payment messages including publication of the message schema and a list of purpose codes.

#### **Context of future changes to RTGS, CHAPS and the broader payments industry**

II.17 The structure of UK payments continues to change significantly. The Bank is either driving or engaged in a number of activities across the industry that are critical to the future landscape. In particular:

- Renewing the Bank's RTGS service is necessary because the way payments are made has changed dramatically in recent years, reflecting changes in the needs of households and companies,

changes in technology, and an evolving regulatory framework. The Bank's vision is to develop an RTGS service which is fit for the future, increasing resilience and access, and offering wider interoperability and improved user functionality. The renewed RTGS service is being delivered through a multi-year programme of work.

- The move to common payments messaging standards to support interoperability across industry. This includes a single UK Common Credit Message shared with Pay.UK based on the ISO 20022 payments messaging standard. This will improve domestic interoperability. The Bank is also working to align standards with other central banks and high value payment system operators to enable international harmonisation. In 2020, the Bank published the final message schema for CHAPS payment messages. We have worked with wider stakeholders to raise awareness and readiness for the ISO 20022 over the past year including through the publication of market guidance covering the property market.
- More broadly, Pay.UK is also undertaking a multi-year programme to develop a New Payments Architecture (NPA). For its part, the Bank is working closely with Pay.UK on ISO 20022 – as described above as well as on understanding the settlement models that RTGS can support for Pay.UK in the future and exploring the potential for the NPA and RTGS/CHAPS to provide contingency for each other. We host a Standards Advisory Panel with Pay.UK to gather industry advice on the adoption of new payment standards in the UK, including ISO 20022.

II.18 The Bank uses a horizon scanning process to identify and assess developments in the payments landscape. This includes looking at areas such as emerging technology, industry initiatives to tackle fraud, and new regulation that may affect how the UK payments industry operates and how this could impact the RTGS or CHAPS services. This informs our strategy setting and development for the RTGS and CHAPS services.

#### **How has the Bank assessed RTGS and CHAPS?**

II.19 The Bank's joint assessment of the RTGS and CHAPS services is a self-assessment. The assessment has been undertaken by the business area that operates and manages the delivery of the RTGS and CHAPS services, and has been reviewed by subject matter experts within the Bank. It is an input to the regular supervisory review undertaken by the Financial Market Infrastructure Directorate area of the Bank in its role as the non-statutory supervisor of the Bank's operation of CHAPS. The published version of the assessment has not been reviewed, undertaken or endorsed by the Bank in its capacity as supervisor of FMIs.

II.20 While RTGS is not a payment system, the RTGS aspects of the self-assessment have primarily been undertaken against the principles that apply to payment systems. For certain principles, a judgement has been made as to how they apply to the RTGS and CHAPS services – this is set out in the self-assessment where relevant.

**What were the findings?**

II.21 The table below summarises the findings of the self-assessment.

<i>Assessment category</i>	<i>Principle</i>
Observed	Principles 1 – Legal basis, 2 – Governance, 4 – Credit risk, 5 – Collateral,* 7 – Liquidity risk,** 8 – Settlement finality, 9 – Money settlements, 13 – Participant-default rules and procedures, 15 – General business risk, 16 – Custody and investment risks,* 17 – Operational risk, 18 – Access and participation requirements, 19 – Tiered participation arrangements,** 21 – Efficiency and effectiveness, 22 – Communication procedures and standards and 23 – Disclosure of rules, key procedures, and market data.
Broadly observed	Principle 3 – Framework for the comprehensive management of risks.
Partly observed	Nil
Not observed	Nil
Not applicable	Principles 6 – Margin, 10 – Physical deliveries, 11 – Central securities depositories, 12 – Exchange-of-value settlement systems, 14 – Segregation and portability, 20 – FMI links and 24 – Disclosure of market data by trade repositories.

\*Not applicable for CHAPS

\*\*Not applicable for RTGS

- II.22 Several principles do not apply to the RTGS or CHAPS services as the services do not have the characteristics of a central securities depository, a central counterparty or a trade repository.<sup>6</sup> In addition, *Principle 12 – Exchange-of-value settlement system* does not apply as the Bank does not operate as such a system.
- II.23 The Bank does not require liquidity to operate RTGS; therefore *Principle 7 – Liquidity risk* is not applicable in relation to RTGS. Whilst the Bank takes on no liquidity risk as part of its operation of CHAPS, as an end-to-end risk manager the Bank monitors the extent to which liquidity risk arises between CHAPS Direct Participants and seeks to mitigate it where possible and proportionate. *Principle 7 – Liquidity risk* is therefore relevant to CHAPS but not RTGS. Similarly, tiered participation arrangements exist for access to CHAPS but not to RTGS, therefore *Principle 19 – Tiered participation arrangements* is applicable to CHAPS only.
- II.24 *Principle 5 – Collateral* and *Principle 16 – Custody and investment risks* are relevant to RTGS but not CHAPS. This is because the collateral held by banks with the Bank forms part of the Bank's balance sheet with the provision of intraday liquidity part of the operation of RTGS but not CHAPS.

### **Summary findings and scope for improvement**

- II.25 Key findings under each theme are summarised below. Where relevant, the summaries highlight policy changes that have been announced but not yet delivered.

#### *General organisation*

- II.26 The Bank observes *Principle 1 – Legal basis* and *Principle 2 – Governance*. The Bank has self-assessed that it continues to broadly observe *Principle 3 – Framework for the comprehensive management of risks*, consistent with last year's assessment.
- II.27 The Bank has implemented appropriate and robust legal coverage for the RTGS and CHAPS services. The Bank draws on in-house legal experts and where appropriate external legal services to produce legal documentation and to review any legal agreement that the Bank enters into.
- II.28 The Bank has defined governance arrangements for the RTGS and CHAPS services, with a strong focus on the Bank's mission to maintain monetary and financial stability. The governance arrangements for RTGS and CHAPS have been designed to meet best practice, where appropriate.

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<sup>6</sup> *Principles 10 – Physical deliveries, 11 – Central securities depositories, 14 – Segregation and portability, 20 – FMI links and 24 – Disclosure of market data by trade repositories.*

- II.29 The Bank as a whole has a clear high-level risk management framework operating with a standard ‘three lines of defence’ model. Within the Bank-wide framework, the RTGS/CHAPS Board determines the strategy and risk tolerances that apply for the RTGS and CHAPS services. This is codified through a local ‘end-to-end’ risk management framework and includes four CHAPS-specific risk tolerances; the approach spans three risk domains relevant for RTGS/CHAPS: internal; supplier; and participant.
- II.30 Our self-assessment to remain ‘broadly observed’ for *Principle 3 – Comprehensive framework for the management of risks* is based on a continuing conservative view that a small number of risk management processes need time to further mature; this reflects the high standards we want to reach given the criticality of RTGS and CHAPS. Whilst we already execute a comprehensive range of risk management activities, we have reviewed our capabilities and identified further enhancements. This is to ensure that our risk management approach across all three domains (participant, internal and supplier) is sufficiently consistent and integrated, enabling us to enhance the extent to which we can aggregate and consider risk in a more holistic manner. Additionally, we have identified series of actions, including defined timelines, which aim to deliver these enhancements during the next review period.

*Credit and liquidity risk management*

- II.31 The Bank observes *Principle 4 – Credit risk, Principle 5 – Collateral, and Principle 7 – Liquidity risk*.
- II.32 In running RTGS, the Bank takes only very limited credit risk through the provision of intraday liquidity against the very highest quality collateral supported by prudent margins. The Bank also takes minimal credit risk through the potential non-recovery of the RTGS or CHAPS tariff. The Bank takes on no liquidity risk in its operation of either of the RTGS or CHAPS services. However, as an end-to-end risk manager, the Bank monitors the extent to which liquidity risk arises within CHAPS system and seeks to mitigate it where possible and proportionate.

*Settlement*

- II.33 The Bank observes *Principle 8 – Settlement finality and Principle 9 – Money settlements*.
- II.34 The RTGS service provides settlement in real-time, and real-time settlement is used for CHAPS. All settlement across accounts in RTGS is in central bank money. CHAPS is a designated system under the Financial Markets and Insolvency (Settlement Finality) Regulations 1999 (SFR).

### *Default management*

- II.35 The Bank observes *Principle 13 – Participant-default rules and procedures*. Actions the Bank can take if an account holder, including a CHAPS Direct Participant, defaults are set out in the RTGS Terms & Conditions (and associated CHAPS and CREST documents), supported by internal procedures. The likelihood and magnitude of credit losses are minimised and would not put the Bank's operation of the RTGS service at risk.

### *General business and operational risk management*

- II.36 The Bank observes *Principle 15 – General business risk, Principle 16 – Custody and investment risks and Principle 17 – Operational risk*.
- II.37 The Bank carefully monitors, manages and recovers operating and investment costs associated with the RTGS and CHAPS services. The Bank adopts a risk-averse approach in relation to securities used to generate intraday liquidity for account holders.
- II.38 The Bank reduces and mitigates operational risks in order to provide a high degree of security, reliability and availability for RTGS and CHAPS. The Bank has comprehensive arrangements for business continuity and crisis management, based on a standard Gold, Silver and Bronze framework. The RTGS/CHAPS risk management framework includes the operational risk arising from the Bank's delivery of RTGS and CHAPS. A Board-approved risk tolerance statement defines the nature and extent of risks (including operational risk) that the Bank is willing to accept for RTGS and CHAPS; the Board monitors this. The executive is responsible for maintaining risks within agreed tolerance levels.
- II.39 The Bank introduced the Market Infrastructure Resiliency Service (MIRS) in 2014 as a contingency infrastructure for RTGS. MIRS is operated by SWIFT, with SWIFT's sites geographically remote from the Bank's own sites, and is technologically independent. The Bank undertakes a wide range of testing and exercises; in 2021 we completed a 'live test' of MIRS activation – this was done in live systems during an extension to the CHAPS settlement day called for the purpose of the test. During 2021, the Bank has continued to demonstrate it can operate RTGS and CHAPS safely through a sustained period of remote working.

### *Access*

- II.40 The Bank observes *Principle 18 – Access and participation requirements and Principle 19 – Tiered participation arrangements*.

- II.41 The Bank publishes and periodically reviews the access criteria for settlement accounts, taking due consideration of risks to its balance sheet. The Bank looks to ensure that access is available as widely as possible, whilst ensuring the integrity of the RTGS and CHAPS systems and its role regarding maintaining monetary and financial stability. In 2021, we published our policy for access to omnibus accounts for payment system operators.
- II.42 The access criteria for CHAPS are published as part of the CHAPS Reference Manual on the Bank's website. Additional information is available on the Bank's website and through private disclosure to applicants on the nature of the technical and operational arrangements.
- II.43 The Bank has clear, published, tiering criteria for the CHAPS system. Payments data is regularly assessed against these criteria and the Bank considers what the appropriate course of action would be to reduce risks to the CHAPS system and wider financial stability. This may include activities to explore organisations moving from indirect to direct access.

#### *Efficiency*

- II.44 The Bank observes *Principle 21 – Efficiency and effectiveness* and *Principle 22 – Communication procedures and standards*. The Bank prioritises the mitigation of risks to monetary and financial stability in its design and operation of the RTGS and CHAPS services. Wherever it can do so without compromising stability, the Bank seeks to provide value for money and functionality demanded by users. Messages to, and from, RTGS, including CHAPS settlement instructions, use SWIFT messaging formats. ISO 20022 will be adopted for CHAPS payments as part of the RTGS Renewal Programme.

#### *Transparency*

- II.45 The Bank observes *Principle 23 – Disclosure of rules, key procedures, and market data*. The Bank publishes the RTGS Terms & Conditions, RTGS tariff and other information relating to RTGS, alongside the CHAPS Reference Manual and CHAPS tariff on its website. Certain confidential or sensitive documents are only shared with account holders, CHAPS Direct Participants, and payment system operators.

#### **Scope**

- II.46 The assessment reflects the RTGS and CHAPS services as at end-October 2021.
- II.47 The PFMI self-assessment is based on all the principles relevant to the Bank's RTGS and CHAPS services. Some principles are relevant only to characteristics associated with specific types of FMIs, and hence do not apply to one or both of the Bank's RTGS and CHAPS services. For example,

*Principle 24 – Disclosure of market data by trade repositories* has not been assessed. In total, seven of the twenty-four Principles have not been assessed for either the RTGS or the CHAPS services.<sup>7</sup>

- II.48 Four principles are only relevant to either RTGS or CHAPS, but not both.
- *Principle 5 – Collateral* and *Principle 16 – Custody and investment risks* are only relevant to RTGS, as no collateral is taken in the operation of CHAPS.
  - *Principle 7 – Liquidity risk* and *Principle 19 – Tiered participation arrangements* are only for CHAPS; liquidity and tiering risks are not applicable to RTGS as it is not a payment system.
- II.49 The Bank has self-assessed itself against the remaining thirteen principles in relation to its operation of both the RTGS and CHAPS services. Some of these self-assessments have considered the two services separately, where discrete arrangements exist, such as the processes under *Principle 13 – Participant default arrangements*. For other principles, such as *Principle 2 – Governance*, largely integrated arrangements exist, leading to a joint assessment.
- II.50 The self-assessment includes an explanation of the scope and applicability of each of the self-assessed seventeen principles. Where relevant, the narrative also notes where the Bank, as operator of the RTGS service, supports CHAPS Direct Participants and payment system operators in their management of liquidity and tiering risks.
- II.51 A CPMI-IOSCO publication<sup>8</sup> outlining the application of the PFMI to central bank FMIs recognises and provides guidance for exceptions where PFMI are applied differently to central bank operators. It notes that nothing in the PFMI is intended to constrain certain central bank policies. The guidance has been used in this self-assessment. This is particularly relevant to principles such as *Principle 5 – Collateral*, where the Bank’s requirement for collateral provided to generate intra-day liquidity to be of the highest quality and liquidity restricts the type of collateral the Bank will accept.
- II.52 Where the Bank’s operation of RTGS is being considered, the application of, and self-assessment against, the PFMI also takes into account the specific nature of the current RTGS service. RTGS is not a payment system itself – RTGS is infrastructure that permits the final settlement of obligations, arising from payments and securities transactions, across accounts in RTGS on a real-time gross or deferred net basis. In the UK, the arrangements that make up each of the payment systems aside from CHAPS are operated and managed by the private sector. For example, Euroclear UK and

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<sup>7</sup> Principles not assessed as they do not apply to either the RTGS or the CHAPS service are: *Principles 6 – Margin; 10 – Physical deliveries; 11 – Central securities depositories; 12 – Exchange-of-value settlement systems; 14 – Segregation and portability; 20 – FMI links; and 24 – Disclosure of market data by trade repositories.*

<sup>8</sup> See <http://www.bis.org/cpmi/publ/d130.pdf>.

International (EUI) manages the CREST service and there are a number of different operators of retail payment systems.

- II.53 In terms of the RTGS service, the self-assessment captures the RTGS infrastructure and all of the accounts within it, the use of those accounts to hold reserves and undertake settlement, connections to RTGS under the control of the Bank – including the Enquiry Link service – and the provision of related services such as cash prefunding. The Bank’s collateral management system sits outside the RTGS service (and hence outside the scope of this self-assessment), other than in respect of the crediting of RTGS accounts against collateral.
- II.54 In terms of CHAPS, the self-assessment captures not only the Bank’s own operations, but also the Bank’s role as an end-to-end risk manager. This means that in assessing the risks in the end-to-end CHAPS system, it considers not only the risks arising to itself and that it causes in the payment system but also the end-to-end risks inherent in the system’s operation. For example, the risks that arise within the end-to-end CHAPS system from the potential actions or inactions of CHAPS Direct Participants, indirect participants, the suppliers to those participants and suppliers to the Bank itself. For instance, the Bank takes on no liquidity risk from its operation of CHAPS and is a positive contributor to reducing liquidity risk to the system through the design of the system. As an end-to-end risk manager, however, the Bank monitors the extent of liquidity risk within the system and actively takes steps to mitigate it, both on a proactive and reactive basis.

### III. Introduction

**Responding institution:** Bank of England.

**Jurisdiction(s) in which RTGS and CHAPS operate:** The RTGS and CHAPS services are operated within the UK in sterling. RTGS and CHAPS operate under the laws of England and Wales.

**Authority(ies) regulating, supervising or overseeing RTGS and CHAPS:** CHAPS (and those elements of RTGS that directly support CHAPS) are supervised, on a non-statutory basis, by the Bank's Financial Market Infrastructure Directorate. Supervision is conducted to the same standard as that applied to FMIs recognised by HM Treasury for statutory supervision.<sup>9</sup>

The CHAPS system remains designated by HM Treasury for regulation by the Payment Systems Regulator (PSR) which has statutory objectives focussed on promoting competition, innovation and the interests of service-users. The PSR does not have any regulatory powers over the Bank. However, continued designation preserves the PSR's regulatory powers over the payment service providers that participate in CHAPS.

RTGS is not a payment system. The Bank's management and operation of the RTGS service, except when it directly supports CHAPS settlement, does not directly fall under any regulatory, supervisory or oversight framework for Financial Market Infrastructures (FMIs). Many of the payment system operators and other FMIs in the UK that directly or indirectly use the RTGS service have been recognised by HM Treasury as systemically important and are therefore subject to statutory supervision by the Bank's Financial Market Infrastructure Directorate.

**The date of this disclosure (i.e. the point of assessment) is 31 October 2021. It was published on 22 December 2021.**

This disclosure can also be found at: <https://www.bankofengland.co.uk/payment-and-settlement>

For further information, please contact [enquiries@bankofengland.co.uk](mailto:enquiries@bankofengland.co.uk)

III.1 This self-assessment was carried out against the Principles for Financial Market Infrastructures (PFMIs)<sup>10</sup> and is based on the methodology set out in the associated Disclosure Framework and Assessment Methodology.<sup>11</sup> In line with the requirements on other FMIs, the Bank, as operator of CHAPS, has submitted a version of this self-assessment to the Bank's FMI Directorate. This public

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<sup>9</sup> CHAPS, when operated by CHAPS Co, was previously recognised by HM Treasury and subject to statutory supervision under the Banking Act 2009 as a systemically important FMI.

<sup>10</sup> See <http://www.bis.org/cpmi/publ/d101a.pdf>.

<sup>11</sup> See <http://www.bis.org/cpmi/publ/d106.pdf>.

disclosure does not include information that is confidential to the Bank or external stakeholders including, but not limited to, information that is commercially sensitive, legally privileged or restricted for security reasons.

- III.2 The objective of publishing this self-assessment is to increase the transparency over the Bank's management of the RTGS and CHAPS services, and increase visibility over the associated governance, operations and risk management framework amongst a broad audience. The audience includes current and prospective RTGS account holders, payment system operators settling in RTGS, current and prospective CHAPS Direct Participants, indirect participants, other market participants, authorities and the general public, including those that use CHAPS payments. Better understanding of the activities of the Bank with regards to the provision of the RTGS and CHAPS services should support sound decision-making by various stakeholders. The assessment also serves to facilitate the implementation and ongoing observance of the PFMLs.
- III.3 This assessment was conducted by the Bank's Market Services Division. This is the area responsible for the day-to-day operation of the RTGS and CHAPS services. Subject matter experts with supervisory, risk, audit, legal and IT backgrounds were consulted and have provided internal challenge. The self-assessment was also reviewed, and the ratings agreed, by the RTGS/CHAPS Board.

## **Principle 1 – Legal Basis**

***An FMI should have a well-founded, clear, transparent and enforceable legal basis for each material aspect of its activities in all relevant jurisdictions.***

*Scope and applicability: This principle refers to rules, procedures and contracts. The provision of RTGS and CHAPS services remain governed by separate legal documentation reflecting the different nature of the services and different participants. It also reflects the historically separate governance arrangements by the Bank for the RTGS infrastructure and CHAPS Co for the CHAPS payment system, prior to the responsibilities for CHAPS transferring to the Bank in November 2017.*

### **Rating: Observed**

Summary of compliance: The Bank has implemented appropriate and robust legal coverage for the RTGS and CHAPS services. The Bank draws on in-house legal experts and external legal services to produce legal documentation and to review any legal agreement that the Bank enters into as operator of the RTGS and CHAPS services. Where there exists a risk for legal uncertainty, the Bank commissions legal opinions to help it assess the potential legal risk and to consider any appropriate mitigants.

***Key consideration 1.1: Legal basis should provide a high degree of certainty for each material aspect of an FMI's activities in all relevant jurisdictions.***

#### *Provision of accounts in RTGS*

Eligibility criteria and policies for admitting account holders into RTGS are specified in the Bank's published Settlement Account Policy, which is reviewed periodically. Recent updates include permitting non-bank payment service providers to access RTGS settlement accounts (July 2017); accommodating new technical access models including where a group or entity operates two segregated business lines on completely separate and independent technology platforms (March 2019, see *Principle 18 – Access and participation requirements*); and an additional policy covering access to omnibus accounts for payment system operators (April 2021).

The Bank has robust legal documentation which governs the provision of accounts in RTGS, primarily the RTGS Terms & Conditions. These set out the legal framework for how accounts are operated. Account holders in RTGS sign a mandate letter, agreeing to be legally bound by the RTGS Terms & Conditions and by the relevant annexes. The annexes set out additional terms and conditions

depending on the services provided, and whether the institution will be a directly-settling participant in a particular payment system,<sup>12</sup> or wishes to open a reserves or settlement account.

The intraday liquidity loans annex to the RTGS Terms & Conditions sets out the terms and conditions pursuant to which the Bank provides intraday liquidity to certain CHAPS Direct Participants.

Additional documents are required for CREST settlement banks setting out the terms and conditions pursuant to which we provide the Delivery versus Payment settlement arrangements for CREST.

Where an institution wishes to participate in the Bank's Sterling Monetary Framework (SMF) (which has its own eligibility criteria) and therefore hold a reserves account, that institution will need to sign up to the RTGS Terms & Conditions and the Reserves Accounts Annex. The institution will also need to sign up to the SMF Terms & Conditions which govern, amongst other things, the provision of collateral to cover any RTGS exposures using collateral held by account holders in the single collateral pool.

The documents referred to above are amended periodically and published on the Bank's website (except the additional CREST documentation).

#### *CHAPS-specific documentation*

CHAPS Direct Participants enter into a Participation Agreement with the Bank with respect to the CHAPS system. CHAPS Direct Participants are required to comply with obligations set out in the CHAPS Reference Manual. CHAPS Direct Participants are also required to sign the CHAPS Sterling Payments Annex to the RTGS Terms & Conditions.

The CHAPS payment system is designated under the Financial Services (Banking Reform) Act 2013 (FSBRA) for regulation by the Payment Systems Regulator (PSR). This gives the PSR certain powers over Payment Service Providers (PSPs) who participate in the CHAPS system. The PSR may require a CHAPS Direct Participant to undertake a specific action in relation to the CHAPS system under section 54 of FSBRA; for example, to adopt Confirmation of Payee. Ordinarily, the PSR would have regulatory powers over the payment system operator and infrastructure provider(s) for systems designated under FSBRA. However, the Bank is exempt from the application of these regulatory powers.

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<sup>12</sup> For the avoidance of doubt, payment system and payment system operator include CREST and EUI respectively through this self-assessment unless noted otherwise, reflecting the embedded payment arrangements within the CREST securities settlement system. There is additional contractual documentation for CREST.

### *Relationship with EUI*

The CREST system is operated by Euroclear UK & International (EUI). CREST operates on a Delivery versus Payment basis, meaning that the legal transfer of a security occurs if, and only if, the payment for the security is settled. The Bank and EUI have put in place arrangements to enable sterling payments for securities settlement to be made on a real-time basis through the CREST system. The rights and obligations of the Bank, as operator of the RTGS service, and EUI are set out in a bilateral contract.

Separately, the contractual framework governing the service between the Bank, EUI and each of the CREST settlement banks is set out in a framework agreement. A new CREST settlement bank is required to enter into the RTGS CREST mandate agreement with the Bank governing the operation of the sterling CREST accounts. The Bank also has a contractual framework in place to govern the operation of the auto-collateralising repurchase transactions which the Bank enters into with the CREST settlement banks.

### *Relationship with retail payment system operators*

The Bank, acting as settlement service provider, provides settlement services, pursuant to Settlement Service Provider Agreements, to a number of payment system operators of retail payment systems that settle on a net basis (Bacs, Faster Payments, and the cheque-based Image Clearing System operated by Pay.UK, as well as the LINK, Mastercard and Visa systems). These enable directly-settling participants to settle multilateral net obligations arising in the relevant payment systems across their RTGS accounts.

Directly-settling participants in Bacs, Faster Payments and the Image Clearing System hold cash in separate accounts to cover the maximum possible net debit positions they could reach in those systems. For institutions with a reserves account, the balance on each account forms part of their overall reserves balance and is remunerated at the same rate (i.e. Bank Rate). If one of the participants defaults, the cash set aside can be used to fulfil its obligation enabling the multilateral settlement to complete. This eliminates credit risk between the directly-settling participants in each of Bacs, Faster Payments and the cheque-based Image Clearing System and removes the mutualised risk that was inherent in the previous arrangements. This is underpinned by a set of contractual agreements.

## *Jurisdictions*

The Bank only provides sterling settlement within the United Kingdom. All contractual relationships with RTGS account holders, payment system operators and CHAPS Direct Participants are governed by English law and subject to the Courts of England and Wales.

Some institutions participate in RTGS and/or CHAPS that are incorporated in a jurisdiction other than England and Wales. In these cases, the Bank may ask for legal opinions. In such an instance, the Bank may require that the legal opinion (a) confirms the institution's power and authority to enter into and to execute the documentation and (b) opines on the enforceability of the RTGS and/or CHAPS documentation as applicable (and the rights and obligations thereunder).

The Bank also allows RTGS account holders to generate sterling liquidity by posting euro-denominated central bank money held outside RTGS as collateral. When euro cash is used for liquidity generation, the cash is held by the Bank in a named account with a Eurozone central bank. The agreements between the Bank and the Eurozone central bank underlying this arrangement are subject to the relevant local law.

***Key consideration 1.2: An FMI should have rules, procedures, and contracts that are clear, understandable, and consistent with relevant laws and regulations.***

The Bank's legal documentation for the RTGS and CHAPS services is clear, understandable and consistent with English law. It is comprised of standardised agreements which have been drafted in a clear and considered manner. Documents are drafted, regularly reviewed, and if necessary updated by the Bank's internal legal team (together with external legal advisors), in consultation with business area experts. Reviews also take place at certain trigger points. For example, documentation is reviewed and revised to align with changes to legislation. The CHAPS documentation was also reviewed and updated at the point the Bank took responsibility for the CHAPS service. We have completed a refresh of the CHAPS Reference Manual to further enhance its clarity, and alignment with international best practice. The new CHAPS Reference Manual will take effect in January 2022.

The Bank seeks external legal advice on any substantial changes it makes to RTGS and/or CHAPS documentation. The Bank provides a RTGS Reference Manual and a number of user guides to supplement the RTGS legal documentation, and a CHAPS Operational Reference Manual, CHAPS Technical Reference Manual and other documents to supplement the CHAPS legal documentation. These documents are made available both to existing and potential account holders, payment system operators and CHAPS Direct Participants, as relevant. These provide clear and

understandable descriptions of the RTGS and CHAPS services consistent with their respective legal frameworks.

The Bank works with prospective RTGS account holders and CHAPS Direct Participants to ensure they have a sufficient understanding of the RTGS and/or CHAPS requirements and procedures. As part of the signing of the legal documentation, applicants for an RTGS account confirm to the Bank that they understand the legal and operational requirements of holding and operating an RTGS account. Similarly, CHAPS Direct Participants confirm to the Bank that they understand and will adhere to the obligations contained in the CHAPS Reference Manual.

Material changes to the CHAPS rules, procedures and contracts require a non-objection from the Bank's FMI Directorate, which supervises the Bank's operation of the CHAPS system on a non-statutory basis. The FMI Directorate also review changes that might impact the adequacy of CHAPS default arrangements, as the designating authority under the SFR.

***Key consideration 1.3: An FMI should be able to articulate the legal basis for its activities to relevant authorities, participants, and, where relevant, participants' customers, in a clear and understandable way.***

The Bank articulates the legal basis for its activities in the RTGS Terms & Conditions and CHAPS system documentation, as well as its contracts with the payment system operators and the documents governing the Bank's provision of settlement arrangements for CREST. All documents are governed by, and enforceable under, English law. This documentation is clearly set out and made available to relevant stakeholders, with most documents available on the Bank's website.

***Key consideration 1.4: An FMI should have rules, procedures, and contracts that are enforceable in all relevant jurisdictions. There should be a high degree of certainty that actions taken by the FMI under such rules and procedures will not be voided, reversed, or subject to stays.***

The Bank's contracts with account holders, including CHAPS Direct Participants, and payment system operators are governed by, and enforceable under, English law. Where an institution is incorporated in a jurisdiction other than England and Wales, the Bank asks, where required, for a legal opinion covering, amongst other things, the enforceability of the agreements (and the rights and obligations contained therein). As such, the Bank has a high degree of confidence that the relevant rules, procedures and contracts are enforceable in all relevant jurisdictions.

The documentation is reviewed regularly and in advance of any changes to RTGS and CHAPS to ensure they remain enforceable and provide robust legal protection.

### *Collateral*

The Bank, as operator of the RTGS service, takes collateral to secure intraday exposures to RTGS account holders in its liquidity provision operations. All relevant collateral is transferred by way of full title transfer to the Bank, which ensures that the Bank can enforce on the collateral immediately if required.

The SFR modifies the law of insolvency, in so far as it applies to collateral security provided to the Bank in connection with its functions as a central bank.

### *CHAPS – transfer orders*

The CHAPS payment system is designated under the SFR. As a designated system, payments within CHAPS have certain protections against normal insolvency law. This guarantees that payments which enter into the CHAPS payment system are finally settled, even if the sender has become insolvent or transfer orders have been revoked i.e. CHAPS payments cannot be voided or reversed at the request of an insolvency practitioner. The CHAPS Reference Manual defines the point at payments are deemed as finally settled and therefore transparently marks the point at which settlement finality occurs within the CHAPS payment system.

The Bank has a very low risk tolerance to uncertainties in, or a lack of, settlement finality protection for CHAPS.

### *Non-CHAPS payment systems that settle across RTGS*

Bacs, CREST, Faster Payments, the cheque-based Image Clearing System and Visa Europe are all designated under the SFR and payments in those systems receive similar protections against insolvency law to ensure that, amongst other things, notwithstanding a directly-settling participant's insolvency, any transfers within these systems that have been submitted into the relevant system are irrevocable (beyond a defined processing point) and that collateral security is enforceable.

Further reference is made to settlement finality in the self-assessment against *Principle 8 – Settlement Finality*.

***Key consideration 1.5: An FMI conducting business in multiple jurisdictions should identify and mitigate the risks arising from any potential conflict of laws across jurisdictions.***

While RTGS and CHAPS are operating solely within the UK in sterling, and all RTGS and CHAPS documentation is governed by English law, some account holders, including some CHAPS Direct Participants, operate outside the UK. Where required, the Bank may ask for legal opinions opining

on (amongst other things) the enforceability of the documentation, including an opinion of whether (a) the choice of English law to govern the documents will be recognised and upheld as a valid and effective choice of law by a court of the relevant home country; and (b) the judgment of an English or Welsh court would be recognised and given effect in the relevant home country without a re-examination or re-litigation.

## Principle 2 – Governance

***An FMI should have governance arrangements that are clear and transparent, promote the safety and efficiency of the FMI, and support the stability of the broader financial system, other relevant public interest considerations, and the objectives of relevant stakeholders.***

*Scope and applicability: Applicable to the combined governance arrangements for the RTGS and CHAPS services. Under the CPMI-IOSCO guidance note on application of the PFMI to central bank FMIs, where an FMI is operated as an internal function of the central bank, the PFMI are not intended to constrain the composition of the central bank's governing body or that body's roles and responsibilities.*

### **Rating: Observed**

Summary of compliance: The Bank has defined governance arrangements for the RTGS and CHAPS services, with a strong focus on the Bank's mission to maintain monetary and financial stability. These are defined through: codified roles, compositions and reporting lines; a governance manual for the RTGS/CHAPS Board; business area objectives; and individual job descriptions. The RTGS/CHAPS Board completed a self-assessment of its effectiveness in 2021, concluding that the Board was functioning well and had become more effective and cohesive since it was established in 2017.

***Key consideration 2.1: An FMI should have objectives that place a high priority on the safety and efficiency of the FMI and explicitly support financial stability and other relevant public interest considerations.***

The Bank's mission is to promote the good of the people of the UK by maintaining monetary and financial stability, as detailed in the Bank's Annual Report.<sup>13</sup> This mission informs the operation of the RTGS and CHAPS services, and ensures that the Bank places a high priority on the safety and efficiency of the RTGS and CHAPS services.

RTGS was developed to enhance financial stability by removing credit and settlement risks from CHAPS and, later, CREST. The Bank also provides a net settlement service to several retail payment systems. This removes the risks associated with net obligations settled in commercial bank money for these systems. The Bank supports its financial stability objectives by providing a reliable, resilient and responsive system for high value sterling payments and settlement.

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<sup>13</sup> <https://www.bankofengland.co.uk/annual-report/2021>

To ensure that the RTGS and CHAPS services contribute towards monetary and financial stability, and, where appropriate, support other relevant public interest considerations, the Bank regularly engages with a range of users and consults on material changes to the RTGS and CHAPS services.

***Key consideration 2.2: An FMI should have documented governance arrangements that provide clear and direct lines of responsibility and accountability. These arrangements should be disclosed to owners, relevant authorities, participants, and, at a more general level, the public.***

#### *Governance arrangements*

The management and operation of the RTGS and CHAPS services sits within the Bank and is subject to the Bank's standard governance arrangements such as oversight by the Bank's Court of Directors and its sub-committee, the Audit and Risk Committee. There is also governance structure specific to the Bank's management and operation of the RTGS and CHAPS services.

The RTGS/CHAPS Board (the Board) provides strategic leadership for the RTGS infrastructure and CHAPS payment system. The Board supports the delivery of the Bank's mission to promote the good of the people of the United Kingdom by maintaining monetary and financial stability. It also seeks to promote efficiency, innovation and competition in sterling payments, wherever that can be safely done without impairing stability.

The Board has delegated the monitoring of the RTGS/CHAPS risk management framework, risk tolerance and risk profiles to the RTGS/CHAPS Board Risk Committee, a sub-committee of RTGS/CHAPS Board chaired by an external member of the Board. The governance arrangements for the RTGS/CHAPS Board and Risk Committee are set out in respective Terms of Reference and a governance manual.

As operator of a systemically important payment system, the Bank is accountable for the end-to-end risk management of the CHAPS payment system. The Board supports this through the oversight of all risks that could impact the resilience of the payment system.

Each committee has a codified role, responsibilities, composition and reporting line. Ultimately, these committees are accountable to, and act under delegated authority from, the Bank's Governor and through the Governor, to the Bank's Court of Directors. Although the Bank is not legally required to adhere to the Senior Managers Regime, the Bank publishes how the regime would apply to the

Bank. The Deputy Governor for Markets & Banking (DGM&B) has overall responsibility for the RTGS and CHAPS services.<sup>14</sup>

#### *Supervision of the governance arrangements*

Supervision of the Bank as the operator of the CHAPS payment system is carried out on a non-statutory basis, by the Bank's FMI Directorate, to the same standard applied to payment system operators recognised by HM Treasury for statutory supervision.<sup>15</sup>

The supervisory model emphasises transparency and independence between the areas of the Bank responsible for the operation and supervision of the CHAPS system. Each area reports into a separate Deputy Governor. RTGS is not subject to supervision. These arrangements mitigate potential internal policy tensions where the Bank, as operator of the RTGS and CHAPS services, provides services to payment service providers and FMIs.

#### *Disclosure of governance arrangements*

The Bank's enterprise-wide governance arrangements are published on its website and described in its Annual Report.<sup>16</sup>

A high-level description of governance arrangements for the RTGS and CHAPS services is included: on the Bank's web page;<sup>17</sup> as part of the Bank's PFMI disclosure; and in the RTGS/CHAPS Annual Report. Further information regarding the communication channels and the lines of accountability to stakeholders are detailed in the assessment of *Principle 23 – Disclosure of rules, key procedures and market data*.

***Key consideration 2.3: The roles and responsibilities of an FMI's board of directors (or equivalent) should be clearly specified, and there should be documented procedures for its functioning, including procedures to identify, address, and manage member conflicts of interest. The board should review both its overall performance and the performance of its individual board members regularly.***

#### *Roles and responsibilities of the Board*

The collective responsibilities of the Board are set out in the Terms of Reference and broadly cover for RTGS and CHAPS: setting strategy aims and risk tolerance, reviewing the risk management

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<sup>14</sup> <https://www.bankofengland.co.uk/-/media/boe/files/about/human-resources/smr.pdf>

<sup>15</sup> <https://www.bankofengland.co.uk/news/2021/december/supervision-of-financial-market-infrastructures-annual-report-2021>

<sup>16</sup> <https://www.bankofengland.co.uk/annual-report/2021>

<sup>17</sup> <https://www.bankofengland.co.uk/payment-and-settlement>

framework described in *Principle 3 – Framework for the comprehensive management of risks* and overseeing the risk profiles and risk mitigation, reviewing the audit programme, and reviewing business continuity and crisis management.

The Board has ten members including: Deputy Governor for Markets and Banking as chair; five executive members; and four external members. The external members provide additional independent and expert challenge, and broader experience and insight. One of the external members chairs the Board Risk Committee and another leads the strategic engagement with users and wider stakeholders.

#### *Board Risk Committee*

The Board has delegated the monitoring of the RTGS/CHAPS risk management framework, risk tolerance and risk profiles to the RTGS/CHAPS Board Risk Committee. The Board Risk Committee oversees, and advises the Board on, how the executive is discharging its risk management responsibilities as the operator of RTGS and CHAPS. It also plays a key role in providing strategic steer and challenge on the design and implementation of the risk framework.

The Board Risk Committee has four members, of which three are external. The Board Risk Committee also forms part of the Bank's 'three lines of defence' risk management framework.

#### *RTGS Renewal Committee*

The RTGS Renewal Committee (RRC) is a sub-committee of the Bank's Court of Directors. The Committee is comprised of two non-executive members of the Court of Directors, two RTGS/CHAPS Board independent members, the Bank's Chief Operating Officer and the Deputy Governor for Markets and Banking. It is responsible for overseeing the delivery, overall scope and financial management of the RTGS Renewal Programme.

The Renewal Committee works closely with the RTGS/CHAPS Board which provides strategic leadership for RTGS and CHAPS. While the RTGS Renewal Committee is responsible for the delivery of RTGS Renewal, the RTGS/CHAPS Board is responsible for strategic decisions to manage the impact and risk to the live RTGS and CHAPS services from the Renewal Programme including ensuring all participants are ready to transition to the new RTGS service. The Board and the RTGS Renewal Committee are jointly responsible for the key decisions to transition to the new RTGS service. Information flows and consultation requirements are in place between RRC and Board on matters that would impact the others' responsibilities.

### *Conflicts of interest*

The career experience of the external members, in particular, can raise the possibility of commercial interests that could give rise to a potential conflict. The Board has robust procedures in place to manage such conflicts to ensure the integrity and impartiality of the Board's decision making.

All Board members must declare their interests (personal, business and financial) and financial assets and liabilities. This includes Board members whose roles within the Bank's executive could give rise to specific potential conflicts. The Chair informs the Board of any interest which may give rise to an actual or potential conflict and, the Board agrees the appropriate manner to manage that conflict.

A Board 'conflicts register' of all members' material potential conflicts and their treatment is maintained.

### *Review of performance*

The Board, through the Chair, has committed to an annual assessment of its individual and collected skills. One such review, a self-assessment by the Board, was completed in 2021, concluding the Board was functioning well and had become more effective and cohesive since it was established in 2017. No material weaknesses were identified.

Board executive members' performance is reviewed as part of the Bank's wider performance review process. The Board Chair discusses performance of the independent members with them individually.

***Key consideration 2.4: The board should contain suitable members with the appropriate skills and incentives to fulfil its multiple roles. This typically requires the inclusion of non-executive board member(s).***

Board members as at the assessment date are: Deputy Governor for Markets and Banking; both the Executive Director and head of division responsible for the areas that operates RTGS and CHAPS; the Bank's Chief Information Officer; the Executive Director for the Bank's Markets Directorate; a Director with prudential supervisory experience; and four external members, as appointed by Deputy Governor for Markets and Banking. This provides for a wide diversity of skills, experience and backgrounds.

The Bank publishes the names and biographies of all ten Board members on the Bank's website, including identifying those who are external members. Some of the executive members are also

drawn from outside the RTGS and CHAPS functions, providing a degree of additional independence and challenge.

The Bank has defined a list of skills required collectively within the RTGS/CHAPS Board. The list covered three broad categories: (i) institutional and strategic skills, such as understanding the environment around CHAPS; (ii) technical knowledge and experience; and (iii) soft skills such as independence of thought and interpersonal skills.

The external members were specifically recruited for their strong risk management expertise, and ability to challenge the executive. The external members all have a firm grasp of risk management, and are well-equipped to provide the challenge necessary to the executive.

The executive members were also selected based on their seniority and their responsibilities for business functions and/or expertise closely connected to RTGS and CHAPS. Skills and knowledge are inherent and continually developed in relation to their specific executives roles.

Incentives for the executive members are linked to performance against their personal performance objectives that comprise an aspect of their employment with the Bank. These objectives cascade down to executive members of the RTGS/CHAPS Board from the Bank's Court and are ultimately linked to the Bank's objectives of maintaining and enhancing monetary and financial stability.

The Board and Risk Committee are able to draw on the advice of a wider range of relevant experts, who will attend meetings. They are not, however, members of the Board. For example, the Bank's Chief Information Security Officer, a senior Bank executive responsible for enterprise risk and resilience, a senior legal advisor, a senior internal auditor and a representative from the National Cyber Security Centre.

***Key consideration 2.5: The roles and responsibilities of management should be clearly specified. An FMI's management should have the appropriate experience, a mix of skills, and the integrity necessary to discharge their responsibilities for the operation and risk management of the FMI.***

The day-to-day executive decision-making is delegated to the head of the division that operates the RTGS and CHAPS services, supported by a local management team. The head of division is a member of the RTGS/CHAPS Board and attends Board Risk Committee, and is advised by other members of the executive including those from wider Bank functions such as technology and risk functions. Certain key decisions are escalated to Executive Director for Banking, Payments and Innovation (BPI) or 'reserved' to the RTGS/CHAPS Board.

Roles and responsibilities are codified for the RTGS and CHAPS governance arrangements, Bank-wide and local business area objectives. Performance objectives are set (and assessed) for each member of staff each year.

The RTGS Renewal Programme has a parallel executive governance structure, reporting in to the RTGS Renewal Committee and the RTGS/CHAPS Board, as defined, through an executive programme board.

#### *Experience, skills and integrity*

Local management sits at the end of the delegated chain of authority and has the appropriate integrity, skills and experience to operate the RTGS and CHAPS services. Training is provided where individual knowledge gaps are identified. Managers in the area responsible for the management and operation of the RTGS and CHAPS services are typically employees with a broad range of experience and skills, leaving them well placed to understand the relevant risks.

The Bank has a formal process for assessing performance. The Bank's People and Culture Directorate owns the Bank's recruitment, training, competency and retention strategies. Succession planning is in place to maintain staffing and experience levels. Local management put forward appropriate budget and staff numbers for adequate resourcing of the RTGS and CHAPS services, which are approved and monitored under the Bank's governance arrangements. Staff are also subject to robust vetting.

***Key consideration 2.6: The board should establish a clear, documented risk-management framework that includes the FMI's risk-tolerance policy, assigns responsibilities and accountability for risk decisions, and addresses decision making in crises and emergencies. Governance arrangements should ensure that the risk-management and internal control functions have sufficient authority, independence, resources, and access to the board.***

#### *Risk management framework*

The Bank's enterprise-wide governance arrangements include a clear and documented risk management framework. The Bank's arrangements for risk management were described on pages 45 – 52 of the Bank's Annual Report for 2021.<sup>18</sup> A Bank-wide risk tolerance statement was agreed by the Bank's Court in December 2015.

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<sup>18</sup> <https://www.bankofengland.co.uk/annual-report/2021>

Generally, the Bank seeks to keep its exposure to risk low and aims to have a control environment and risk culture that supports this. There is a very low tolerance for operational risks which impact business-critical functions such as the operation of the RTGS and CHAPS services.

Consistent with these arrangements, the RTGS/CHAPS Board is responsible for setting the RTGS and CHAPS risk tolerances, consistent with the overall Bank risk tolerance, and overseeing the RTGS and CHAPS Risk Management framework. The Board most recently approved an end-to-end risk management framework for RTGS and CHAPS in July 2020. This is covered in greater detail under *Principle 3 – Framework for the comprehensive management of risks.*

Board Risk Committee is responsible for: overseeing, and advising the Board, on the adequacy of the RTGS/CHAPS risk management framework, risk tolerance and risk profiles. Board Risk Committee also seeks to ensure that, where relevant, the RTGS/CHAPS risk management framework will operate in a manner aligned with the Bank-wide risk framework. It is responsible for escalating to Board if it has concerns of whether the risk management framework is fit for purpose.

Risk monitoring is performed through: continuous monitoring of the RTGS and CHAPS services; periodic reporting to Board and executive governance; regular penetration testing and other security testing; and regular updates on vulnerabilities. In respect of the CHAPS service, the Bank also undertakes assurance over the CHAPS Direct Participants to ensure they meet requirements for system participation.

An annual, externally-commissioned ISAE 3402 control audit considers whether the Bank meets certain specified controls for the RTGS service. This is in addition to internal audit and other risk and control reviews, and the Bank's internal operational risk and compliance function.

#### *Authority and independence of risk management and audit functions*

Risks arising to the operation of its RTGS and CHAPS responsibilities fall within the Bank-wide risk management framework. This framework is considered at the Bank's Executive Risk Committee and Audit and Risk Committee. Where appropriate, the RTGS/CHAPS Board will raise specific risk matters with the Bank's Executive Risk Committee.

The first line, the business area responsible for RTGS and CHAPS delivery, is responsible for owning the RTGS and CHAPS risks, developing and delivering the end-to-end risk management framework and implementing controls as appropriate. It is in control of deploying local risk policies, tools and methods to effectively manage the risks. A Bank-wide second line function is responsible for defining the Bank's overall risk management framework, as well as providing tools, support and

challenge to the first line of defence. It reports directly into the Governor, and the risk function has a direct reporting line to the Audit and Risk Committee of the Bank's Court.

The Bank's third line (Internal Audit) provides assurance that the RTGS and CHAPS risk management framework is robust and that internal controls are appropriate and effective.

The Board Risk Committee has agreed the interaction between the RTGS/CHAPS governance structure and Bank's second line and the information flows between the two areas. The Board Risk Committee assesses the effectiveness of the RTGS/CHAPS risk management function. This includes whether it has sufficient authority, independence and resource, within the context of the operating model for RTGS and CHAPS, and the Bank's 'three lines of defence'.

The Board Risk Committee provides a recommendation to the Board on the adequacy and timeliness of the executive's proposed response to risk-based audit assessments. It also reviews whether the Bank's Internal Audit programme of review adequately reflects the key risks to RTGS and CHAPS, and provides sufficient assurance on the activities of the first and second lines of defence and makes recommendations to the Board based on this.

The Bank's overarching framework for crisis and incident management, based on a standard Gold, Silver and Bronze set of arrangements, is applied to RTGS and CHAPS. This framework is subject to continuous improvement, and provides clarity for decision making and information flows in emergencies that might affect the operation of the RTGS and CHAPS services. Parallel arrangements exist for a financial crisis that might, for example, include the resolution of an RTGS account holder (including a CHAPS Direct Participant).

***Key consideration 2.7: The board should ensure that the FMI's design, rules, overall strategy, and major decisions reflect appropriately the legitimate interests of its direct and indirect participants and other relevant stakeholders. Major decisions should be clearly disclosed to relevant stakeholders and, where there is a broad market impact, the public.***

The Bank, as operator of the RTGS and CHAPS services, considers the legitimate interests of RTGS account holders, including CHAPS Direct Participants, payment system operators and other relevant stakeholders. As the end-to-end risk manager for the CHAPS system, this includes the interests of indirect participants, end-users and the wider public of the safe and efficient operation of CHAPS to support monetary and financial stability as well as other public interests.

The Bank undertakes a range of layered engagement and communications with CHAPS users. One of the key channels for seeking input from users is the Strategic Advisory Forum, chaired by one of the

external Board members. The purpose of the Strategic Advisory Forum is to support an ongoing and effective dialogue between the RTGS/CHAPS Board, the executive responsible for the operation of RTGS and CHAPS, and a balanced set of senior and experienced users in respect of the CHAPS service. The forum is advisory, providing user input into RTGS/CHAPS governance.

In addition, the Bank's executive meets with CHAPS Direct Participant representatives at strategic and operational levels on a range of topics, gathering input from the Direct Participants. The Bank also looks to engage with a range of relevant trade associations.

Through these channels, the interests of the participants and other users feed into decision-making at Board. For instance, the Board receives an update from the Strategic Advisory Forum chair following every Forum meeting.

The Bank's RTGS Renewal Programme includes a significant engagement programme with key stakeholders. For example, the Bank has held regular stakeholder workshops, issued consultations, and hosted industry events on key policy areas. The Bank also provides regular bulletins on the progress of the Programme to wider industry and stakeholders.

The Bank is also subject to challenge from payment system operators and their directly-settling participants, and meets with them regularly to discuss the RTGS service and consults them on all material changes. The Bank, in its capacity as operator of the RTGS system, attends EUI's Settlement Bank Committee as an observer. The Bank also attends Pay.UK's Participant Advisory Council as an observer. Major decisions are cascaded to the payment system operators and relevant account holders, and communicated to the public where appropriate.

#### *Disclosure*

The Bank communicates and publishes information relating to relevant major decisions involving RTGS and CHAPS to relevant stakeholders including other payment system operators and their settlement participants, CHAPS Direct Participants, other RTGS account holders, market committees (such as the Bank's Money Markets Committee) and other channels as relevant. However, information relating to major decisions is only communicated externally to the extent that it would not, amongst other things, risk prejudicing the security and integrity of RTGS or CHAPS, the Bank and the financial system or release commercially sensitive information.

### **Principle 3 – Framework for the comprehensive management of risks**

***An FMI should have a sound risk-management framework for comprehensively managing legal, credit, liquidity, operational, and other risks.***

*Scope and applicability: Applicable to the combined risk management arrangements for the RTGS and CHAPS services. Under the CPMI-IOSCO guidance note on application of the PFMI to central bank FMIs, Key Consideration 3.4 (recovery and wind-down) does not apply.*

#### **Rating: Broadly observed**

Summary of compliance: The Bank as a whole has a clear high level risk management model operating with a standard ‘three lines of defence’ model, including a risk taxonomy and series of risk tolerances statements. Within the Bank-wide framework, the RTGS/CHAPS Board determines the strategy and risk tolerances that apply for the RTGS and CHAPS services. This is codified through a local ‘end-to-end’ risk management framework and includes four CHAPS-specific risk tolerances; in some cases, the tolerances for RTGS and CHAPS have been set at a tighter level than that of the wider-Bank due to the critical operational nature of the RTGS and CHAPS services.

The RTGS/CHAPS Board determines the strategic objectives and sets the risk tolerance statements covering RTGS/CHAPS to support the Bank’s mission. It takes the lead in setting a strong risk management culture and relies on a sound governance structure to ensure its risk management strategy is implemented through frameworks, policies and risk reporting. The Board approves the risk tolerances on an annual basis, or whenever there is a significant change to RTGS/CHAPS.

Our self-assessment to remain ‘broadly observed’ for *Principle 3 - Framework for the comprehensive management of risk* is based on a continuing conservative view that a small number of risk management processes need time to further mature; this reflects the high standards we want to reach given the criticality of RTGS and CHAPS. Whilst we already execute a comprehensive range of risk management activities, we have reviewed our capabilities and identified further enhancements. This is to ensure that our risk management approach across all three domains (participant, internal, supplier) is sufficiently consistent and integrated, enabling us to enhance the extent to which we can aggregate and consider risk in a more holistic manner. We have identified series of actions, including defined timelines, which aim to deliver these enhancements during the next review period.

***Key consideration 3.1: An FMI should have risk-management policies, procedures, and systems that enable it to identify, measure, monitor, and manage the range of risks that arise in or are borne by the FMI. Risk-management frameworks should be subject to periodic review.***

The primary risk to the RTGS and CHAPS services is operational risk. The Bank also considers a range of financial and other non-financial risks including credit, legal and third party risks. Both CHAPS and the RTGS infrastructure follow a common risk taxonomy with the principle areas of risks identified as, but not limited to operational, financial, legal and conduct, strategic and reputational risk.

#### *Risk management policies, procedures and systems*

Risks to the Bank's mission are managed through a Bank-wide risk management framework. Risks to the RTGS and CHAPS services are managed through an end-to-end risk management framework which is designed to provide consistency and transparency of risk management and ensure suitable mitigating actions are developed for those internal and external risks deemed out of tolerance. The end-to-end risks to the CHAPS system are assessed through three risk domains: internal; participant; and supplier.

Risks are identified, measured, monitored and managed via a variety of forward and backward looking processes, such as: horizon scanning for emerging risks; Risk & Control Self-Assessments (RCSAs), thematic risk analysis; participant assurance; and stress/scenario exercising. Reporting is regularly provided to the RTGS/CHAPS Board Risk Committee aligned with the three risk domains and based on agreed metrics.

#### *Review of risk management policies, procedures and systems*

The Bank operates a standard 'three lines of defence' model. Responsibility for enacting, oversight and review of the RTGS/CHAPS risk management function is allocated according to the 'three lines of defence model'.

The first line is responsible for owning the risks and implementing controls as appropriate. They are in control of developing local risk policies, tools and methods to effectively manage the risks. The first line consists of the RTGS/CHAPS risk management function reporting to the RTGS/CHAPS Chief Risk Officer and an operational risk team reporting into the Markets & Banking Chief Operating Officer. The second line is responsible for defining a Bank-wide risk management framework, including the Bank-wide risk taxonomy. They provide support and challenge to the first line. The third line internal audit function provides assurance that the risk management framework is robust and that internal controls are appropriate and effective.

The Bank's Court of Directors reviews the effectiveness of the risk management and internal control systems. Court determines the strategy for managing risk and the Bank's tolerance for risk. A Bank-wide risk tolerance statement is approved by Court and sets out the extent of financial, operational and policy implementation risk that the Bank is willing to accept. Executive Directors and Directors

certify compliance with the wider Bank's risk management and internal controls, including reviewing the risk and control issues identified and reported during the year.

The RTGS/CHAPS Board Risk Committee is responsible for monitoring and challenging the risk profile against the risk tolerances and the end-to-end RTGS/CHAPS risk management framework as approved by the RTGS/CHAPS Board. This includes reviewing the management and mitigation of risks. The Board Risk Committee reports to the Board any significant risks, conclusions or recommendations identified and Board is responsible for approving relevant policies.

In certain circumstances, risk matters will be escalated to the Bank-wide second line committee, the Bank's Executive Risk Committee (ERC). This monitors the operation of the risk governance framework and the overall risk profile across the Bank. In the event that the RTGS/CHAPS Board Risk Committee or RTGS/CHAPS Board considers risks within the RTGS and CHAPS services exceed tolerance, issues will be escalated to the ERC. This is in particular when changes may be required to Bank-wide policies in order to return risks to within tolerance.

A senior representative from the Bank's second line risk function attends (but is not a member of) RTGS/CHAPS Board Risk Committee. ERC, as part of its Bank-wide responsibilities, is responsible for monitoring RTGS/CHAPS risk profile against tolerance. The RTGS/CHAPS Board Risk Committee has agreed the interaction between the RTGS/CHAPS governance structure and Bank-wide second line and the information flows between the two areas.

The end-to-end risk management framework for RTGS/CHAPS is regularly reviewed by the RTGS/CHAPS Board to assess its effectiveness. This looks at all aspects of the framework, with a particular focus on ensuring that the risk tolerances remain appropriate.

***Key consideration 3.2: An FMI should provide incentives to participants and, where relevant, their customers to manage and contain the risks they pose to the FMI.***

All account holders in RTGS, including CHAPS Direct Participants, are subject to appropriate prudential supervision. The Bank's requirements on account holders include evidencing a sufficient level of technical capability and operational resilience. The Bank does not currently levy any penalties directly in respect of settlement agent activities, but will levy interest if, for example, an intraday loan is unable to be repaid.

*CHAPS participant performance – assurance and non-compliances*

The CHAPS participant assurance function reviews the risks posed to the CHAPS system from CHAPS Direct Participants and seeks assurance and evidence of how these CHAPS Direct Participants are

managing these risks, and the risks posed to them. The CHAPS participant assurance model is multi-layered. It uses a combination of self-assessment and attestation from each Direct Participant against the CHAPS Reference Manual (CRM).

This is complemented by targeted information requests including, for example, on tiering data and follow-up questions from the self-assessment process. We may also undertake additional verification where it is appropriate to do so. This picture is also completed by information on, for example, live incidents. The CHAPS performance management framework sets out how non-compliances are managed, including agreeing a path back to compliance and escalation if required. Further information on the CHAPS participant assurance is set out under *Principle 18 – Access and participation requirements*.

The Bank, as operator of CHAPS, holds regular bilateral and multilateral meetings with CHAPS Direct Participants, which provides an opportunity to discuss risks posed to CHAPS by the Direct Participants and how these are managed. Rules CHAPS Direct Participants are required to comply with are set out in the published CHAPS Reference Manual.

#### *Tools to support risk management*

The Bank, as operator of RTGS and CHAPS, uses a real-time dashboard to monitor operational performance. Information is also made available to CHAPS Direct Participants to help them manage their liquidity risk. The RTGS system also has several features that incentivise account holders to manage their risks. This includes a Liquidity Saving Mechanism (LSM), providing a more liquidity efficient method for making non-urgent CHAPS payments. CHAPS Direct Participants are incentivised to submit their CHAPS payments as early as possible to allow the greatest possibility of liquidity savings – which also reduces operational and systemic risks which in turn promotes financial stability. In addition, the Bank sets throughput targets for CHAPS Direct Participants, varying by category, and monitors adherence to these targets.

Operational information, particularly during stressed situations, is shared through the CHAPS Participant Engagement Forum to help the Bank and CHAPS Direct Participants effectively manage operational risks that may arise and any knock-on impact to financial risks. We can also share relevant cyber-related information with CHAPS Direct Participants through the Cyber Security Information Sharing Partnership (CiSP) platform, and draw on expert input from the CHAPS Security Forum.

As an end-to-end risk manager for CHAPS, the Bank considers all sources of risk within the system, including those emanating from participants. One of the three risk domains within the RTGS/CHAPS

end-to-end risk management framework comprises the direct and systemic indirect participants. Further information on managing risks arising from the relationships between direct and indirect participants is set out under *Principle 19 – Tiered participation arrangements*.

***Key consideration 3.3: An FMI should regularly review the material risks it bears from and poses to other entities (such as other FMIs, settlement banks, liquidity providers, and service providers) as a result of interdependencies and develop appropriate risk-management tools to address these risks.***

#### *Material risks in relation to other entities*

Key stakeholders that rely on RTGS are Euroclear UK and International (EUI) (regarding the operation of the CREST system), Pay.UK (regarding the multilateral settlement of the net obligations arising from the retail systems it operates), LINK Scheme Limited, Mastercard and Visa Europe.

The Bank's provision of these settlement services creates a dependency risk from the Bank to these FMIs and their settlement participants. Individual transactions in CREST and the retail payment systems can continue to be processed in the event of an RTGS outage, but financial and operational risks may increase in the event of a prolonged outage.

Contingency arrangements are in place to allow settlement using alternative settlement procedures in the event of an operational incident. These procedures are reviewed and tested on a regular basis and are detailed under the assessment of *Principle 17 – Operational risk*. The Bank, as RTGS operator, holds regular liaison meetings with each of the payment system operators in which any relevant changes in risk profiles and resulting impacts are discussed. The Bank also collaborates with a number of other key stakeholders in assessing the resilience of RTGS, the payment systems and the wider UK financial infrastructure. The Bank is an active participant in a number of sector exercises. Regarding physical and cyber security, the Bank works closely with EUI, SWIFT and the relevant UK authorities, such as National Cyber Security Centre, to ensure appropriate logical and physical controls are available and implemented.

The RTGS/CHAPS risk framework is designed to capture the risks to the wider RTGS/CHAPS ecosystem. Therefore, the measurement and monitoring of risks arising in relation to other entities forms an integral part of the standard risk management processes. This includes risk assessment of Direct Participants' usage of cloud technology and whether over-reliance on a single cloud provider would result in risk of payment flow concentration.

### *Risk management tools in relation to other entities*

The predominant risks arising from and to RTGS and the wider Bank are tracked in the RTGS/CHAPS risk report and underlying risk tools including emerging risks and key risk indicators. They are therefore reviewed by RTGS/CHAPS Risk Committee and Board on this basis. As the end-to-end risk manager for CHAPS, this includes all risks arising from, and to, the end-to-end CHAPS, system identified through participant assurance activities and other risk activities. Across RTGS and CHAPS, we also undertake horizon scanning, incident assessments, risk and control self-assessments and other control reviews and audits, such as the annual ISAE3402 and ISO27001.

Risk reporting, key risk indicators and the underlying risk register, where risks are assessed against risk tolerance, form the tools that the executive and Board Risk Committee use to monitor, review and challenge risks to RTGS/CHAPS. The tools themselves have been reviewed and agreed by RTGS/CHAPS Board. The RTGS/CHAPS risk framework is in place and operationally embedded and sets out clear risk management capabilities and sub-capabilities that make up our risk management approach. It also sets our key considerations when reviewing our risk capability for on-going effectiveness, which is reviewed by Board Risk Committee as part of the annual risk framework review.

## **Principle 4 – Credit risk**

***An FMI should effectively measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes. An FMI should maintain sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence.***

*Scope and applicability: Under the CPMI-IOSCO guidance note on application of the PFMI to central bank Financial Market Infrastructures, the PFMI are not intended to constrain central bank policies on provision of credit by the central bank, or the terms of or limits on such provision. Credit risk is predominantly only relevant when considering the Bank's role in operating RTGS, although a de minimis amount of credit risk remains in relation to the Bank's operation of the CHAPS system.*

### **Rating: Observed**

Summary of compliance: The Bank, as operator of RTGS and CHAPS, is not exposed to any material current or future credit exposures other than through the provision of liquidity against collateral, which is secured against the very highest quality collateral, and the non-payment of fees due under the RTGS/CHAPS tariff.

***Key consideration 4.1: An FMI should establish a robust framework to manage its credit exposures to its participants and the credit risks arising from its payment, clearing, and settlement processes. Credit exposure may arise from current exposures, potential future exposures, or both.***

Risk standards and frameworks are created and owned centrally for risks to the Bank's balance sheet. The Bank-wide risk framework is reviewed on an annual basis.

The area of the Bank that operates the RTGS and CHAPS services adheres to these and provides an annual sign-off of compliance. This includes standards for the mitigation of credit risk to the Bank. A dedicated second-line financial risk function monitors all of the Bank's credit exposures as part of a 'three lines of defence' framework.

***Key consideration 4.2: An FMI should identify sources of credit risk, routinely measure and monitor credit exposures, and use appropriate risk-management tools to control these risks.***

### *Exposure through settlement*

The nature of RTGS settlement fully eliminates credit risk between account holders. As settlement occurs in real-time, there are no intraday exposures built up between RTGS account holders through use of RTGS. RTGS requires sufficient liquidity to be in place before settlement can take place. This

applies both to bilateral settlement, such as CHAPS, as well as the multilateral settlement used for the retail payment systems, although in the latter case exposures build up outside RTGS.

No direct credit risks are posed to the Bank from settlement across accounts in RTGS. The Bank, as operator of RTGS, neither guarantees transfers to meet payment obligations, nor allows overdrafts that would permit payments to settle if the account holder lacks liquidity (for CREST, see below). This is understood by RTGS account holders and payment system operators and reflected in the relevant legal documentation.

There are system checks built into RTGS that prevent account holders from becoming overdrawn. The Bank monitors credit exposure through setting and enforcing a zero overdraft on all account groups.

In the event of a default of an RTGS account holder (including a CHAPS Direct Participant), procedures exist to prevent further transfers being carried out through RTGS, including CHAPS payments, where applicable (see *Principle 13 – Participant default rules and procedures*).

In the event of the Bank's tertiary solution, MIRS, being invoked, no additional credit or settlement risk is posed to the payment systems settling in RTGS. Settlement would restart with the same intraday liquidity positions. These positions are then unwound manually at the end of the day; this process is automated in business-as-usual operations.

#### *Exposure through liquidity provision*

The key credit exposure from the Bank's operation of RTGS is through intraday liquidity provision. Only Sterling Monetary Framework Participants – and on a case-for-case basis certain settlement account holders such as FMI – that are CHAPS Direct Participants can generate intraday liquidity, and CREST settlement banks can generate auto-collateralising repo to meet their liquidity needs in the course of the settlement day. Such liquidity provision is secured against the very highest quality collateral (known as 'Level A') and, in all normal circumstances, is intraday. The relevant framework is described in detail in the Bank's Market Operations Guide (BEMOG).<sup>19</sup> BEMOG lists the eligible collateral, the haircut principles and the daily valuation process.<sup>20</sup>

All institutions eligible for intraday liquidity in RTGS, i.e. SMF participants, are subject to appropriate prudential supervision. The operational areas of the Bank also monitor the credit worthiness of these institutions through internal risk assessment processes.

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<sup>19</sup> [The Bank of England's Sterling Monetary Framework](#)

<sup>20</sup> <https://www.bankofengland.co.uk/markets/eligible-collateral>

The Bank may provide contingency arrangements to turn this intraday exposure into an overnight exposure in the event of an operational or liquidity issue. In the unlikely event of an operational error in CREST resulting in a negative earmark being received in RTGS that cannot be covered from a relevant account, the Bank has a procedure in place to ensure that any credit risk incurred from such an error is effectively mitigated through the Operational Error Lending Scheme (OELS). This can arise from the Bank's irrevocable and unconditional undertaking, to debit paying CREST settlement banks and credit payee CREST settlement banks, which underpins CREST settlement.

#### *Haircuts*

The Bank takes only the very highest quality collateral, to which it applies prudent haircuts to control for market risk and minimise the arising credit risk exposure (see *Principle 5 – Collateral*). While the provision of intraday liquidity can have monetary and financial stability benefits, the Bank must also protect its balance sheet. Reserves are the principal source of liquidity held at the Bank. In the unlikely event that a credit risk materialised, the Bank could use these reserves to cover any shortfall.

There is no value limit on intraday liquidity generation. Such credit is, however, limited by the value of Level A collateral that each participant holds, subject to appropriate haircuts.

Haircuts are designed to be sufficient to cover intraday price movements. If these haircuts were found to be insufficient, there is a process for calling margin on liquidity provision including any that has been rolled overnight.

#### *Managing concentration risk*

The Bank monitors the level of liquidity generation and retains a right to exercise discretion to limit it, if deemed necessary. The Bank is also able to set a limit on auto-collateralising repo generation in CREST, though has not so far judged it necessary to do so. The positions are unwound automatically.

The Bank has the discretion to require counterparties to provide collateral diversified across a number of issuers. However, the acceptance of only the very highest quality collateral by a small number of issuers means that the Bank in practice has concentrated holdings of collateral. As outlined above, the assets accepted are of very high quality and have deep, liquid markets. The concentrated holding of these assets should not normally impair the Bank's ability to liquidate these assets quickly without significant price effects. This extends to the case where an account holder defaults and so wrong-way risk is largely mitigated; collateral is monitored at the account holder

level and the Bank can ask account holders to provide collateral diversified across a number of issues if further protection is deemed necessary.

***Key consideration 4.3: A payment system or SSS should cover its current and, where they exist, potential future exposures to each participant fully with a high degree of confidence using collateral and other equivalent financial resources (see Principle 5 on collateral). In the case of a DNS payment system or DNS SSS in which there is no settlement guarantee but where its participants face credit exposures arising from its payment, clearing, and settlement processes, such an FMI should maintain, at a minimum, sufficient resources to cover the exposures of the two participants and their affiliates that would create the largest aggregate credit exposure in the system.***

Operating RTGS does not expose the Bank to any material current or future credit exposures other than through the provision of liquidity against collateral and the non-payment of the RTGS/CHAPS tariff in the highly unlikely event that there are insufficient funds on their RTGS account to recover the tariff.

As the Bank does not accept direct credit risk, there is no requirement for the Bank to hold resources to cover potential exposure to account holders. See the self-assessment against *Principle 5 – Collateral* for how the Bank manages residual exposures associated with collateral.

Day-to-day monitoring of credit exposures is undertaken by a first-line risk function. A dedicated second line financial risk function monitors all of the Bank's credit exposures as part of a 'three lines of defence' framework. The Bank has a framework, which sets the standards for the Bank's exposures relative to the Bank's capital, consistent with the Bank's overall risk tolerance. There is a clear framework for remediation of breaches, with mechanisms for challenge.

The Bank encourages and supports payment system operators and their participants to manage credit exposures incurred within their systems. For example, the Bank implemented cash prefunding for Bacs, Faster Payments and the cheque-based Image Clearing System enabling a fully funded, 'defaulter pays' model to eliminate credit risk between the directly-settling participant in each system.

***Key consideration 4.7: An FMI should establish explicit rules and procedures that address fully any credit losses it may face as a result of any individual or combined default among its participants with respect to any of their obligations to the FMI. These rules and procedures should address how potentially uncovered credit losses would be allocated, including the repayment of any funds an FMI may borrow from liquidity providers. These rules and procedures should also indicate the***

***FMI's process to replenish any financial resources that the FMI may employ during a stress event, so that the FMI can continue to operate in a safe and sound manner.***

RTGS Terms & Conditions and associated CREST documentation set out the arrangements in the event of a participant default in RTGS, including the insolvency of an account holder. These detail the bilateral close-out and set-off provisions. There are no exposures between account holders in RTGS by virtue of holding an account in RTGS and so there are no mutualised loss-sharing arrangements between account holders that would require allocation of losses. More broadly, there are standardised Bank-wide procedures for the management of default. Further information is under the self-assessment against *Principle 13 – Participant default rules and procedures*.

Any credit losses due to non-payment or under-collateralisation would be recovered through the collection from RTGS accounts. This right is set out in the RTGS Terms & Conditions. As any credit exposures are generally low relative to the RTGS account balances, this will ensure any credit exposures can be fully recovered. Credit exposures arising from the historic provision of services, such as unpaid accrued fees, would be for negligible amounts.

## Principle 5 – Collateral

***A payment system that requires collateral to manage its or its participants' credit exposure should accept collateral with low credit, liquidity, and market risks. A payment system should also set and enforce appropriately conservative haircuts and concentration limits.***

*Scope and applicability: Under the CPMI-IOSCO guidance note on application of the PFMI to central bank FMIs, the PFMI are not intended to constrain policies on what can be accepted as eligible collateral in central bank lending operations. Principle 5 – Collateral is only relevant to the Bank in its role as operator of RTGS as no collateral is taken in the operation of CHAPS.*

**Rating: Observed (RTGS); Not applicable (CHAPS)**

Summary of compliance: The Bank provides intraday credit for liquidity purposes on a fully collateralised basis, in order to settle obligations in payment and settlement systems. The Bank accepts only the very highest quality collateral and sets prudent margins. By requiring the very highest quality collateral, the Bank ensures the collateral it accepts has deep and liquid markets. Because of this there is no need for a limit on the extent to which collateral is concentrated in certain securities.

***Key consideration 5.1: An FMI should generally limit the assets it (routinely) accepts as collateral to those with low credit, liquidity, and market risks.***

The Bank provides intraday credit for liquidity purposes, in order to settle obligations in payment and settlement systems. Acceptable collateral to secure intraday liquidity is drawn from a list of the highest rated sovereign and central bank debt, with low credit, liquidity and market risk. This is known as 'Level A' collateral. This approach is set out publicly in the Bank's Market Operations Guide, which describes the Sterling Monetary Framework, and the list of Level A collateral is published on the Bank's website.<sup>21</sup> The Bank also accepts euro-denominated central bank money as intraday liquidity collateral. The auto-collateralising repo mechanism for CREST is secured against gilts, Treasury bills and sterling bills issued by the Bank.

The list of Level A collateral is reviewed annually and is subject to second line challenge under the Bank's 'three lines of defence' model for financial risk management of the Bank's balance sheet. The Bank continually monitors the range of securities it accepts as collateral in its operations and can

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<sup>21</sup> See <http://www.bankofengland.co.uk/markets/eligible-collateral>

make ad hoc changes if necessary. The Bank's collateral management system will only use collateral that is specified as 'Level A' for intraday liquidity generation.

As the Bank only accepts the very highest quality collateral, the default of an account holder should not impact the value of the collateral, and wrong-way risk is largely mitigated. Collateral is monitored at the account holder level, meaning that the Bank can require account holders to provide collateral diversified across a number of issuers to help mitigate wrong-way risk if further protection is deemed necessary.

***Key consideration 5.2: An FMI should establish prudent valuation practices and develop haircuts that are regularly tested and take into account stressed market conditions.***

The Bank applies conservative haircuts to all collateral used to secure the provision of intraday collateral to minimise the chance of under-collateralisation. Collateral is marked to market on a daily basis. 'Level A' collateral only includes certain government securities with deep and liquid markets. The Bank is the pricing agent.

A dedicated first line financial risk management function analyses and controls risks from the securities held as collateral including the undertaking of valuation and haircut practices and coordinating their review. Haircuts are reviewed regularly and are subject to independent second line challenge. Haircuts, and which collateral is accepted, can also be adjusted in response to changes in market conditions and the underlying risks. The Executive Director for the Markets Directorate is responsible for haircut policy and can exercise discretion in stressed scenarios. The aim of the framework is to deliver valuation and haircut practices that are prudent, stable and robust.

***Key consideration 5.3: In order to reduce the need for procyclical adjustments, an FMI should establish stable and conservative haircuts that are calibrated to include periods of stressed market conditions, to the extent practicable and prudent.***

The Bank's haircuts are conservative and designed to be stable through time in order to mitigate pro-cyclicality. Calculations of haircuts are based around extreme price moves over a specified holding period. Changes in the liquidity of this collateral are not modelled explicitly, but market liquidity conditions are captured within the historical periods of market stress used. Furthermore, a conservative holding period assumption provides a further cushion as this collateral is of the very highest quality and intended to be held on an intraday basis only.

***Key consideration 5.4: An FMI should avoid concentrated holdings of certain assets where this would significantly impair the ability to liquidate such assets quickly without significant adverse price effects.***

The acceptance of only the very highest quality collateral by a small number of issuers means that the Bank has concentrated holdings of collateral and is potentially exposed to concentration risk. The assets accepted are of very high quality and have deep, liquid markets. The concentrated holding of these assets should not normally impair the Bank's ability to liquidate these assets in size quickly without significant price effects.

The Bank-wide risk management framework is reviewed annually. Policies relating to operation of the Sterling Monetary Framework, as described in the Bank's Market Operations Guide, are reviewed on a regular basis, at least annually. This will include the concentration risk policies relating to collateral held to secure against the provision of intraday liquidity, which are reviewed annually and subject to an internal second line review.

The Bank's general preference is to accept the concentration risk outlined above – and not set concentration limits – rather than widen the pool of issuers and accept increased credit, liquidity and market risks.

***Key consideration 5.5: An FMI that accepts cross-border collateral should mitigate the risks associated with its use and ensure that the collateral can be used in a timely manner.***

The Bank accepts sovereign or central bank securities in certain non-sterling currencies. The haircuts applied, alongside the depth and liquidity of the markets for 'Level A' collateral, are deemed sufficient to mitigate the associated risk, including pricing risk. This collateral is accepted through delivery to the Bank's account at the home central bank, in the issuing Central Securities Depository (CSD), or through accredited CSD links. This mitigates the operational risks associated with the use of cross-border collateral.

Collateral is held in the Bank's name through transfer of title, not 'on behalf of' the relevant RTGS account holder. The terms on which the Bank receives and holds collateral ensure it can be used in a timely manner during RTGS operating hours.

***Key consideration 5.6: An FMI should use a collateral management system that is well-designed and operationally flexible.***

### *Collateral management system design*

The key functionality of the Bank's collateral management system is a single collateral pool which allows account holders to manage their own collateral and the Bank to monitor margin, where exposures to counterparties are collateralised, in real-time. The system also offers straight through processing and a browser-based portal for participants to manage their activity.

As the Bank does not re-hypothecate collateral, there is no risk of re-use of collateral used to cover its exposures. Therefore, the re-use of collateral and the Bank's rights to the collateral are not tracked within the collateral management system.

### *Operational flexibility*

The collateral management system configuration can be easily altered to accommodate changes in the criteria for managing collateral and associated exposures. The system was designed with such flexibility in mind, with the ability to introduce new operations as well as to change the rules that dictate existing facilities. The Bank has a dedicated team that manages the configuration to ensure that it correctly captures the current and/or any changing requirements.

Collateral management activities for RTGS are tracked and reported to management. The Bank ensures that there are sufficient resources to maintain the operation of its collateral management system at a high standard. Collateral operations are normally staffed on a split site basis and use dual data centres to ensure smooth operation. During Covid-19 related restrictions, the relevant staff have been working remotely as appropriate.

## **Principle 7 – Liquidity risk**

***An FMI should effectively measure, monitor, and manage its liquidity risk. An FMI should maintain sufficient liquid resources in all relevant currencies to effect same-day and, where appropriate, intraday and multiday settlement of payment obligations with a high degree of confidence under a wide range of potential stress scenarios that should include, but not be limited to, the default of the participant and its affiliates that would generate the largest aggregate liquidity obligation for the FMI in extreme but plausible market conditions.***

*Scope and applicability: The liquidity risk principle is relevant to CHAPS as a payment system. Whilst the Bank takes on no liquidity risk as part of its operation of CHAPS, as an end-to-end risk manager the Bank monitors the extent to which liquidity risk arises between CHAPS Direct and indirect participants and seeks to mitigate it where possible and proportionate. Hence only Key Considerations 7.1 and 7.2 are relevant to the Bank as operator of CHAPS.*

*The Bank does not require liquidity to operate RTGS. The Bank is not a party to transfers between account holders, nor does the Bank provide a financial guarantee to underpin settlement. As the sterling central bank of issue, the Bank is not liquidity constrained and would not face a shortfall. Therefore, this Principle is not applicable in relation to RTGS.*

*However, the Bank does provide intraday liquidity and other arrangements to support timely settlement to CHAPS Direct Participants, CREST settlement banks and settlement participants in prefunded retail systems.*

- *For CHAPS, the Bank provides intraday liquidity to eligible CHAPS Direct Participants, including SMF participants, secured against the very highest quality collateral and based on prudent margins. More broadly, the Bank may lend to Sterling Monetary Framework (SMF) participants through a range of other facilities.*
- *For CREST, the Bank provides intraday liquidity to CREST settlement banks through auto-collateralised repo to help optimise the amount of liquidity committed to CREST.*
- *For Bacs, Faster Payments and the cheque-based Image Clearing System, Pay.UK requires cash prefunding – directly-settling participants must hold cash sufficient to cover their largest net position in each system with the Bank in special ‘prefunding accounts’. These balances would be used to complete settlement in the event of default.*

**Rating: Observed (CHAPS); Not applicable (RTGS)**

*Summary of compliance: As an end-to-end risk manager (see Principle 3 – Framework for the comprehensive management of risks), the Bank monitors the extent to which intraday liquidity risk*

arises between the Direct and indirect participants in relation to the end-to-end CHAPS system (see *Principle 19 – Tiered participation arrangements*). Tools used to manage intraday liquidity risk within the system include the Liquidity Saving Mechanism (LSM) – with parameters set by the CHAPS Direct Participants and the CHAPS throughput criteria.

***Key consideration 7.1: An FMI should have a robust framework to manage its liquidity risks from its participants, settlement banks, nostro agents, custodian banks, liquidity providers, and other entities.***

The Bank takes on no liquidity risk itself in the operation of CHAPS. Within the CHAPS system, the Bank primarily seeks to manage intraday liquidity risk through the CHAPS throughput criteria; the operation of the LSM; and the CHAPS tiering criteria.

The CHAPS throughput criteria are a target for the proportion of payments to be made by value by certain times in the settlement day. The Throughput Criteria set out certain criteria, principles, expectations and other matters to which the Bank, as operator of the CHAPS payment system, is required to have due regard and give due weight. With certain exemptions (FMIs, non-bank Payment Service Providers and the smallest participants) Direct Participants are required to have settled (by value and averaged over each calendar month) their 'target'. For non-exempt institutions this target is 50% of payments by 12pm, 75% by 3pm and 90% by 5pm, with tolerances dependent on the systemic importance of the relevant participant. This seeks to ensure that payments should not be unnecessarily delayed and receipt-reactive behaviour, i.e. where Direct Participants wait - to receive incoming payments – before making their own – is limited.

The Bank introduced the LSM in April 2013 to provide a liquidity management tool for Direct Participants. The LSM matches queued non-urgent payments for simultaneous, off-setting settlement. By matching and settling payments in this way the amount of liquidity required in the CHAPS system reduced.

For the end-to-end CHAPS system, the Bank seeks to manage liquidity risk through the tiering rules, supported by an analysis of tiered concentration risk. The CHAPS rules state that an indirect relationship may be prohibited if an indirect participant's average daily payment activities exceed either: (i) 2% of the average total payment activity, by value, processed each day; or (ii) 40% of the average daily value of the relevant CHAPS Direct Participants' own payments. CHAPS indirect participants may consider that their CHAPS Direct Participant is a provider of unsecured credit facilities under all conditions, both business-as-usual and stressed. Conversely, CHAPS Direct Participants may depend on the credit balances created by their indirect participants for their own intraday liquidity needs. The tiering criteria set out in the CHAPS Reference Manual looks to assess

the levels of concentration risk and mitigate the risk through exploring the possibility of moving institutions from indirect to direct participation, where appropriate.

The area responsible for the CHAPS function also works closely with the PRA which sets liquidity requirements for the banks it regulates, including those who are CHAPS Direct Participants.

***Key consideration 7.2: An FMI should have effective operational and analytical tools to identify, measure, and monitor its settlement and funding flows on an ongoing and timely basis, including its use of intraday liquidity.***

The Bank's business intelligence system can display statistics on all CHAPS flows across RTGS in easily customisable tables. Information is also provided on the use and performance of the Liquidity Saving Mechanism. The Bank uses this information in its own analysis, and provides each Direct Participant with access. This system contains information on CHAPS indirect participants with their own BIC, allowing partial monitoring of exposures between Direct and indirect participants. Data are also provided to the Bank from Direct Participants regarding their internal flows, on behalf of indirect participants, which do not settle across RTGS as CHAPS payments.

Liquidity analysis undertaken by the Bank feeds into the regular throughput reporting alongside stress test scenarios. If a Direct Participant fails to comply with the throughput rules and outside agreed tolerance levels, remediation actions or mitigation are agreed.

In specific, usually stressed, scenarios, some monitoring can be undertaken in real-time. Stress testing is also performed by the Bank including using scenarios such as an outage, suspension or exclusion of a Direct Participant. The Bank also requires larger CHAPS Direct Participants to undertake stress testing.

The Bank also monitors CHAPS values for indirect participants to identify any (presumptive) breach of the CHAPS tiering criteria (see *Principle 19 – Tiered participation arrangements*). If a CHAPS indirect participant is large enough to present a liquidity risk to the system, the Bank can encourage them to join directly. In extremis, the Bank can withdraw consent for the sponsoring CHAPS Direct Participants to process CHAPS payments on behalf of the relevant indirect participant.

## **Principle 8 – Settlement finality**

***An FMI should provide clear and certain final settlement, at a minimum by the end of the value date. Where necessary or preferable, an FMI should provide final settlement intraday or in real time.***

*Scope and applicability: CHAPS is a payment system designated under the Financial Markets and Insolvency (Settlement Finality) Regulations 1999 (SFR).*

*The RTGS system is not a payment system itself: rather it is the infrastructure that permits the final settlement of the obligations, arising from payments and securities transactions, across accounts at the central bank. Furthermore, the RTGS system is neither an interbank payment system for the purposes of the Banking Act 2009, nor is it designated under SFR.*

*However, as well as CHAPS, some of the other UK payment systems that settle across accounts in RTGS are also designated under the SFR: Bacs; the cheque-based Image Clearing System; CLS; the embedded payment arrangements within CREST; Faster Payments; and Visa Europe. Furthermore, UK central counterparties have also designed their sterling payment arrangements as to be settled through CHAPS and CREST, and such payment arrangements are themselves so designated: ICE Clear Europe, LCH Limited, LME Clear Limited and SIX x-clear. As a consequence, where a system is designated, the payment ‘transfer orders’ executed within that system and settled through the RTGS system benefit from statutory protections under the SFR.*

*For non-designated arrangements (LINK, Mastercard and settlement of positions from the Notes Circulation Scheme) and internal transfers within RTGS that do not originate from a designated system, protection is at a contractual level, for example, the RTGS Terms & Conditions and relevant documentation owned by the payment system operator.*

### **Rating: Observed (RTGS and CHAPS)**

Summary of compliance: The RTGS service provides settlement in real time. The point of settlement finality is clearly defined for CHAPS payments in the CHAPS Reference Manual and for all other payments in the RTGS Reference Manual (and the rulebooks of the relevant systems). This information is available to all participants and sufficiently advanced potential participants.

Arrangements in contingency situations, where links to SWIFT are not available, are also specified.

CHAPS is a designated system under the SFR. This provides statutory protection for CHAPS payments made by UK-incorporated CHAPS Direct Participants including UK-incorporated subsidiaries of overseas firms. The Bank, as CHAPS operator, relies on sound legal opinions regarding the

applicability of settlement finality in those jurisdictions where the Bank cannot rely on statutory settlement finality protection under the SFR.

'Recital 7' of the Settlement Finality Directive allows EEA member states to implement settlement finality protections in respect of their domestically-based entities that participate in systems designated outside the EEA. The Bank has received sufficient assurance from external counsel and EEA member states where a CHAPS Direct Participant is located that CHAPS will continue to benefit from statutory settlement finality protections under arrangements implemented as permitted by Recital 7 now that CHAPS is a 'third country' system following the end of the transition period.

***Key consideration 8.1: An FMI's rules and procedures should clearly define the point at which settlement is final.***

#### *Point of finality of settlement*

For all RTGS settlement instructions (including CHAPS payments), finality of settlement is set out in the RTGS Reference Manual, both in normal operations and in contingency scenarios. For CHAPS payments, the point of irrevocability is also set out in the CHAPS Reference Manual.

For each type of settlement instruction in RTGS, finality occurs at a different point and is defined in the RTGS Reference Manual. In normal circumstances finality of settlement is:

- For urgent CHAPS payments, the finality of settlement is at the point the settlement response has been stored by SWIFT.
- For non-urgent CHAPS payments, i.e. payments matched in the Liquidity Saving Mechanism, finality of settlement is at the point at which all messages marked for settlement related to a specific cycle have been stored by SWIFT.
- For payment systems that settle on a deferred basis, finality of the multilateral net settlement is the point at which the settlement confirmation has been stored by SWIFT.
- In CREST, finality of settlement is within the infrastructure operated by EUI. The CREST payment that discharges the buyer's obligation to the seller is supported by an irrevocable undertaking by the Bank to debit the buyer's CREST settlement bank and credit the seller's CREST settlement bank.
- Finality of settlement for so-called 'non-CHAPS transfers' is at the point the relevant settlement confirmation has been stored by SWIFT. Such transfers include the transfers that account holders may make between their own accounts and interest credits to reserves accounts. A full list is set out in the RTGS Reference Manual.

In a contingency, if MIRS is active, finality is when the payer's account is debited and the payee's account is credited.

#### *CHAPS Direct Participants outside the UK*

CHAPS is a designated system under the SFR.

In relation to non-bank payment service providers, the RTGS Settlement Account Policy and CHAPS access criteria current only permit Financial Conduct Authority-authorized non-bank payment service providers.

CHAPS payments made by CHAPS Direct Participants incorporated outside the UK are not covered by the protections arising from the SFR. However, the Bank seeks to ensure that the level of risk (given the absence of statutory protection) is not inconsistent with its low risk tolerance for settlement finality. This reassurance is provided by legal opinions which conclude that a successful challenge against the settlement finality of the CHAPS system would be highly unlikely.

'Recital 7' of the Settlement Finality Directive allows EEA member states to implement settlement finality protections in respect of their domestically-based entities that participate in systems designated outside the EEA. The Bank has received sufficient assurance from external counsel and EEA member states where a CHAPS Direct Participant is located that CHAPS will continue to benefit from statutory settlement finality protections under arrangements implemented as permitted by Recital 7 now that CHAPS is a 'third country' system following the end of the transition period.

***Key consideration 8.2: An FMI should complete final settlement no later than the end of the value date, and preferably intraday or in real time, to reduce settlement risk. An LVPS or SSS should consider adopting RTGS or multiple-batch processing during the settlement day.***

#### *Final settlement on the value date*

The RTGS service provides settlement in real-time. RTGS provides same-day settlement for CHAPS and other settlement instructions. CHAPS payments may be submitted to RTGS for settlement between 06:00 and 18:00. CHAPS Direct Participants submit CHAPS payments on their value date for same day settlement.

For CHAPS payments, the timing of payments is subject to constraints controlled by the relevant account holders, such as available liquidity, and their own internal exposure limits between each other, including those defined through the Bank's Liquidity Saving Mechanism (LSM).

The RTGS service also provides same-day settlement on the value date for systems where multilateral net obligations are settled on a deferred basis relative to the clearing of gross bilateral payments. These deferred settlements are scheduled at fixed points during the RTGS day, but may settle later than planned if there are operational delays or if an account holder lacks sufficient funds. The Bank can support multiple settlements per day per system. For example, Faster Payments currently settles three times per business day.

The Bank, as RTGS operator, seeks to settle all settlement instructions received on the same day. Any payments that are not settled, either due to lack of funds or operational error, are automatically cancelled by the Bank. Sending institutions may resubmit them the next business day.

In the event of an issue, a CHAPS/RTGS extension may be requested to provide up to an extra two hours (i.e. until 20:00) for final settlement to occur on the value date. Any extension to operating hours is exceptional and can provide additional time to ensure settlement takes place. Extensions are also covered under the self-assessment against *Principle 17 – Operational risk*.

***Key consideration 8.3: An FMI should clearly define the point after which unsettled payments, transfer instructions, or other obligations may not be revoked by a participant.***

Most settlement instructions submitted, and accepted as valid, to RTGS, including all CHAPS payments, can be unilaterally revoked up to the point of finality of settlement. For example, payments queuing in the LSM can be cancelled.

For payments made in error, the relevant payment service provider would need to agree to return the funds through the creation of a new (equal and opposite) payment.

Settlement instructions relating to CREST and the deferred net settlement systems have their point of irrevocability defined in the rules and procedures relevant to that system, and this can differ significantly from the point of finality of settlement. For example, for Bacs the point of irrevocability is defined as the extraction cut-off on input day i.e. the first day of the three day cycle for Bacs payments. Settlement takes place on the third day of the cycle.

## Principle 9 – Money Settlements

***An FMI should conduct its money settlements in central bank money where practical and available. If central bank money is not used, an FMI should minimise and strictly control the credit and liquidity risk arising from the use of commercial bank money.***

*Scope and applicability: This principle is applicable to CHAPS and RTGS. However:*

- *Key considerations 9.2 and 9.3 are not applicable and have not been assessed. They relate to where commercial bank money rather than central bank money is used for settlement.*
- *Key consideration 9.5 is not applicable and has not been assessed. It relates to an FMI conducting money settlement on its own books, where money settlement is conducted in commercial bank money.*

### **Rating: Observed**

Summary of compliance: All settlement, including CHAPS, across accounts in RTGS is in central bank money.

***Key consideration 9.1: An FMI should conduct its money settlements in central bank money, where practical and available, to avoid credit and liquidity risks.***

All settlement, including CHAPS, across accounts in RTGS is in central bank money.

***Key consideration 9.4: If a payment system conducts money settlements on its own books, it should minimise and strictly control its credit and liquidity risks.***

All settlement across RTGS is in central bank money, which is part of the Bank's balance sheet. However, the Bank, as operator of the RTGS and CHAPS services, is not typically a counterparty to settlement. The primary exceptions are where the Bank is itself a settlement participant in CHAPS, CREST and Bacs as part of its own banking business. The Bank is also the counterparty for settlement in relation to the Note Circulation Scheme and where it extends intraday liquidity. Separate arrangements for controlling credit and liquidity risks are in place, managed outside RTGS by the relevant business areas of the Bank.

The self-assessments against *Principle 4 – Credit risk* and *Principle 7 – Liquidity risk* explain how the Bank minimises and controls any credit and liquidity risks arising from the operation of the RTGS service.

## **Principle 13 – Participant default rules and procedures**

***An FMI should have effective and clearly defined rules and procedures to manage a participant default. These rules and procedures should be designed to ensure that the FMI can take timely action to contain losses and liquidity pressures and continue to meet its obligations.***

*Scope and applicability: Under the CPMI-IOSCO guidance note on application of the PFMI to central bank FMIs, the PFMI are not intended to constrain central bank policies on maintaining financial stability including managing participant defaults.*

*This self-assessment covers the default rules and procedures that relate directly to the Bank's operation of RTGS and CHAPS. The Bank interacts with RTGS account holders, including CHAPS Direct Participants, in a range of other capacities. Most notably in this context as: prudential supervisor for some of the payment system operators; prudential supervisor for most account holders such as banks, building societies and PRA-designated investment firms; and resolution authority.*

*In the case of a default, the outlined procedures for the RTGS and CHAPS services may be amended or driven by the Bank's actions and priorities in the capacities outlined above.*

*The participant default procedures for RTGS and CHAPS services are distinct but related, reflecting the separate but aligned contractual arrangements for the RTGS and CHAPS services.*

### **Rating: Observed**

Summary of compliance: Actions the Bank can take if an RTGS account holder, including a CHAPS Direct Participant, default are set out in the RTGS Terms & Conditions (and associated CREST document) and the CHAPS Reference Manual. These are supported by internal procedures. In December 2020, the Bank – as the operator of RTGS and CHAPS – published its response to the Financial Stability Board's survey on continuity of access to FMI which sets out further information.<sup>22</sup>

In the event that a default event does occur, there should be no material adverse effect on the Bank's ability to meet its obligations as operator of the RTGS and/or CHAPS services. Settlement does not complete in RTGS (including for CHAPS payments) unless there are sufficient funds. The likelihood and magnitude of any credit losses to the Bank are minimised (see *Principle 4 – Credit risk*).

The Bank regularly practices how it would handle the default of an RTGS account holder, including a CHAPS Direct Participant. Testing is undertaken at least annually to ensure processes and

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<sup>22</sup> <https://www.bankofengland.co.uk/-/media/boe/files/payments/continuity-of-access-rtgs-chaps.pdf>

responsibilities (internally and externally) are clear and understood under a range of specific scenarios.

***Key consideration 13.1: An FMI should have default rules and procedures that enable the FMI to continue to meet its obligations in the event of a participant default and that address the replenishment of resources following a default.***

#### *Identifying a default event*

Section 8 of the RTGS Terms and Conditions defines a wide range of scenarios that constitute an Event of Default. This includes ‘technical’ defaults – such as where the aggregate credit balance across a firm’s RTGS accounts falls below the minimum balance - and ‘external’ default events – such as if the Bank determines that a change in the corporate structure following a ‘designated event’ materially weakens the creditworthiness of an account holder. The CHAPS Reference Manual also sets out events of default.

In the event that a default event does occur however, there should be no material adverse effect on the Bank’s ability to meet its obligations as operator of the RTGS and CHAPS services. Funds must be available before settlement can take place in RTGS, including for CHAPS payments. The Bank has procedures in place for intraday liquidity to be unwound in the event of default – either recouping outstanding funds directly or through the liquidation of collateral provided.

#### *Retail systems settling in RTGS*

For retail systems that settle across accounts in RTGS, credit risk between the directly-settling participants can build up between when the payment is cleared, and when it is due to settle. If the default event were to affect a participant with an unsettled net debit position, losses would crystallise, particularly for settlement participants in a net credit position. In the event that a directly-settling participant of one of these systems defaults, the Bank’s own resources are not used to complete settlement.

Nevertheless, the Bank provides a role in assisting with managing settlements due in the event of a participant default, as a part of certain retail payment systems’ participant default arrangements. In particular:

- For Bacs, Faster Payments and the cheque-based Image Clearing System, settlement participants each hold cash prefunding in segregated accounts in RTGS. In the event of a participant default for these prefunded retail systems, the Bank would use funds from these segregated accounts to enable settlement to complete.

### *Default notification*

An account holder must notify the Bank when an Event of Default occurs.

The Bank is also the prudential supervisor of almost all RTGS account holders. Internal guidance and processes facilitate the sharing of supervisory judgments and information with other areas of the Bank as necessary. The FCA is the competent authority in the UK for authorising e-money institutions and payment institutions (collectively non-bank payment service providers, or non-bank PSPs). Where a non-bank PSP has a settlement account in RTGS, the FCA would share relevant information with the Bank including any decision to revoke authorisation. Where the Bank as RTGS operator gathers relevant information on the operational soundness of a non-bank PSP with access to RTGS, the Bank will inform the FCA where this could have a bearing on its supervisory activity with regard to the non-bank PSP. The relationship between the Bank and FCA in respect of non-bank PSPs is codified in a framework.

### *Default response*

Actions the Bank can take if an account holder defaults are well defined. In relation to CHAPS, they are defined in the CHAPS Reference Manual and the Participation Agreement. In the case of RTGS they are set out in the RTGS Terms & Conditions (and, in the case of CREST settlement banks, associated CREST documentation). An account holder must notify the Bank when an Event of Default occurs, and upon notification, the account may be suspended and credit and debit-disabled. The Bank has wide discretion to prevent further settlement activity occurring in the event of a default of an account holder who also settles in any of the payment systems. The Bank can also suspend, or exclude, CHAPS Direct Participants from the CHAPS system. In taking any such discretionary decision, the Bank will carefully consider its responsibilities in the widest sense i.e. as responsible for maintaining financial stability, and as an end-to-end risk manager.

If a CHAPS Direct Participant is suspended or excluded then no payment instructions can be accepted. The point of irrevocability and finality for CHAPS settlement instructions is clearly defined. CHAPS settlement instructions can be cancelled up to this point by the sending Direct Participant. There is no distinction made within RTGS between proprietary transactions and transactions made on behalf of a participant's customer. Prioritisation decisions are for the Direct Participant to manage, subject to the Payment Services Regulations.

Decisions made in respect of account holders, including Direct Participants, will not be made in isolation given the Bank's wider responsibility to maintain financial stability. This includes the Bank's

responsibilities for prudential supervision and resolution. Certain decisions will be taken at Governor-level (or will follow from a Governor-level decision).

For account holders other than deposit-takers, the Bank, as operator of RTGS and CHAPS would engage, and coordinate its actions with the Bank's FMI Directorate in respect of FMIs such as CLS and LCH as well as the FCA in respect of non-bank Payment Service Providers.

***Key consideration 13.2: An FMI should be well prepared to implement its default rules and procedures, including any appropriate discretionary procedures provided for in its rules.***

The Bank's internal procedures codify and sequence the steps the Bank would take in response to a default event. The procedures include the actions that the Bank, as operator of RTGS and CHAPS, can take in the event of a participant default and in its discretion.

The Bank regularly practices how it would handle the default of an RTGS account holder. Staff with appropriate system permissions can disable an RTGS account almost immediately if an authenticated instruction is received to do so. This is rehearsed during annual testing.

The roles and responsibilities involved in these processes are outlined in comprehensive process instructions and operational procedures, which are in turn referenced in a broader playbook, structured to support fast navigation in conditions of market or operational stress.

The Bank's incident management processes include roles and responsibilities for local management in the event of a critical incident, including a default situation of a CHAPS Direct Participant. The local management responsibilities in a response to an incident in relation to both the CHAPS and RTGS systems are well defined and the escalation route within the Bank established. The clear demarcation of responsibilities between the CHAPS and RTGS systems are well defined within local management and the escalation route within the Bank established, up to the Deputy Governor for Markets and Banking.

Indeed, it is likely that a financial default event will be immediately escalated up to the Deputy Governor for Markets and Banking due to the potential financial stability implications and cross-Bank impact. This would include close communications with the Bank's supervisory and resolution functions; the resolution function reports into the same Deputy Governor as the RTGS/CHAPS function.

The documents also set out the circumstances around which the Bank's Critical Incident Management Framework (CIMF) will be triggered and the extent to which the incident is escalated

within the Bank. The roles and responsibilities, including decision-making responsibility, depending on the level of invocation, are set out in the CIMF.

#### *External stakeholders*

The Bank will communicate directly with CHAPS Direct Participants and other external stakeholders in the event of a CHAPS default event, as operator of the CHAPS.

External communications concerning any default in respect of obligations for one of the other payment systems (CREST, retail systems) - beyond direct engagement with the defaulting account holder and the relevant regulators - are the responsibility of the relevant payment system operator, with whom the Bank would communicate.

The Bank may also co-ordinate with other financial authorities through the Authorities Response Framework.

#### ***Key consideration 13.3: An FMI should publicly disclose key aspects of its default rules and procedures.***

The publicly available RTGS Terms & Conditions disclose key aspects of the Bank's default rules. Section 8 of the RTGS Terms & Conditions describes a wide range of scenarios that could be a default, in order to provide certainty and predictability. Section 9 also sets out what action the Bank may take in such an event, including declining to process any more transfer instructions on behalf of the defaulting account holder. In addition, the Bank maintains wider discretion over default rules and procedures in light of its broader functions and responsibilities.

As described above, the publicly available CHAPS rules describe the key aspects, including potential default scenarios and the specific triggers for the Bank to act.

#### ***Key consideration 13.4: An FMI should involve its participants and other stakeholders in the testing and review of the FMI's default procedures, including any close-out procedures. Such testing and review should be conducted at least annually or following material changes to the rules and procedures to ensure that they are practical and effective.***

The Bank undertakes testing with its account holders and relevant payment system operators of its operational default procedures for an account holder in RTGS (including EUI in respect of CREST settlement banks). The operational process to suspend and then remove an account holder is documented in the RTGS process instructions and is straightforward and regularly tested.

The Bank reviews and internally tests annually its default procedures relating to a default event involving a CHAPS Direct Participant. Results of the scenario testing are reviewed by the RTGS/CHAPS Board and Board Risk Committee and, where appropriate, shared with external stakeholders including CHAPS Direct Participants, and relevant financial authorities.

The Bank also works with the other payment system operators, as requested, to support regular tests of the default procedures of the retail systems.

## Principle 15 – General business risk

***An FMI should identify, monitor, and manage its general business risk and hold sufficient liquid net assets funded by equity to cover potential general business losses so that it can continue operations and services as a going concern if those losses materialise. Further, liquid net assets should at all times be sufficient to ensure a recovery or orderly wind-down of critical operations and services.***

*Applicability: This principle is applicable to RTGS and CHAPS jointly. Key Considerations 15.2, 15.3, and 15.4 (ring-fenced liquid net assets to cover business risk and support a recovery or wind-down plan) do not apply, and have not been assessed, given a central bank's inherent financial soundness. Key Consideration 15.5 (a plan to raise additional equity) does not apply, and has not been assessed given the Bank's ownership arrangements.*

### **Rating: Observed**

Summary of compliance: The Bank carefully monitors, manages and recovers operating and investment costs associated with the RTGS and CHAPS services.

***Key Consideration 15.1: An FMI should have robust management and control systems to identify, monitor, and manage general business risks, including losses from poor execution of business strategy, negative cash flows, or unexpected and excessively large operating expenses.***

The Bank has an enterprise-wide risk framework for monitoring and managing risks. General business risk associated with the management and operation of the RTGS and CHAPS services is managed within this framework, informed by processes to identify and consider medium term opportunities and risks. This includes factors that could lead to significant reduction in volumes, which could impact cost-recovery given the current volume-based tariff. The financial position, income and costs of the RTGS and CHAPS services are monitored by the Bank's finance function, in particular through the annual tariff review process.

Major investment projects are generally subject to oversight from the Bank's Investment Board. Where necessary, the Court, the Bank's board of directors, is responsible for setting and monitoring the Bank's strategy and makes key decisions on spending. Given the scale of the RTGS Renewal Programme, a sub-committee of the Court of Directors (the RTGS Renewal Committee) has been set up specifically to oversee the Programme.

### *Cost recovery and tariff setting*

The Bank operates RTGS and CHAPS services with a public objective to recover its costs fully over the medium-term. The cost recovery approach aims to recover costs without generating any long-term profit or loss; to smooth costs where appropriate to reduce tariff volatility; and so there is no cross-subsidisation of one service by another.

Costs are recovered from account holders who use the RTGS service for settlement, including additional costs from CHAPS Direct Participants to cover CHAPS rulebook and participant assurance activities. Tariffs are reviewed set annually and apply from 1 April each year.

As the Bank uses a forward-looking measure of revenues and costs in its tariff calculations, it may in practice over- or under-recover against actual costs. The short-term implications of any over- or under-recovery are managed within the Bank's overall balance sheet. Nevertheless, the Bank aims to hold a small surplus of income in respect of each payment system (i.e. including CHAPS) to cover such fluctuations as well as any other unexpected changes in operating costs.

Tariffs are set annually to align expected income with budgeted costs, aligned with the above cost recovery approach. The annual review involves constructing robust projections on payment volumes settling over RTGS and operating costs and making an informed decision on whether the tariffs should be amended.

The RTGS settlement tariffs (for CHAPS and CREST Delivery versus Payment settlement), and the CHAPS tariff each consist of an annual participation fee and a per-item fee. To set the 'per item' tariffs, the Bank estimates CHAPS and CREST Delivery versus Payment volumes in the following years. The Bank offers CHAPS Direct Participants and CREST settlement banks, through EUI, sight of relevant operating costs and investment plans as part of the annual review process.

The Bank also charges an annual fee to the settlement participants of UK retail payment systems that settle in RTGS: Bacs, cheque-based Image Clearing systems, Faster Payments, LINK, Mastercard and Visa. The fee reflects the marginal costs of providing the service and an element of share costs. There is no per-item fee applied.

### *Investment*

When considering new functionality or investment project, the Bank identifies likely costs and how it will recover such costs. Account holders, in some cases through EUI and the retail operators, are consulted where any substantive investment plans would affect them and they would be expected to cover the Bank's costs.

The Bank intends to continue operating the RTGS and CHAPS services on a full cost recovery basis via the annual tariffs. The Bank does not intend to begin recovering costs of the RTGS Renewal Programme before the transition to a new core ledger for RTGS. This approach should ensure that the renewal is funded from future users, who stand to benefit from some of the new features, as well as current users.

From the 2019/20 tariff year onwards, the Bank has agreed that the current 'per item' tariff will not be reduced ahead of go live for the renewed RTGS system. This is to reduce long-term volatility in tariff, as capital and investment costs related to the original RTGS system diminish in the final years of operation, and before the capital and investment costs relating to the renewed RTGS are charged to participants

Former capital investments in RTGS, such as the introductions of the Liquidity Saving Mechanism (LSM) and the Market Infrastructure Resiliency Service (MIRS) contingency, were amortised over a three to five-year period. The scale of the RTGS Renewal Programme means that the amortisation period is likely to be somewhat longer.

#### *Financial risks*

If in-year income from the tariffs is not sufficient to cover the annual operating cost of the RTGS and CHAPS services, the Bank has sufficient capital and reserves to absorb an under-recovery in the short-term with no material adverse effect on the Bank's financial position or its ability to deliver these services. For example, the annual operating costs of the combined RTGS and CHAPS services are approximately £21mn, compared with the Bank's capital and reserves of £5.8bn (end-February 2021).<sup>23</sup>

Long-term deficits are considered a very low risk due to the Bank's policy of cost recovery and the annual tariff update process in which income against operating costs is reviewed. This process includes reviewing project-specific recovery. The majority of income is generated from account holders settling in CHAPS and CREST. The Bank monitors the risk of these systems ceasing to use RTGS, or of a critical mass of payment volumes migrating quickly to a net or commercially-settled system, leaving the Bank with unrecovered costs. The Bank judges the risk of a sudden, unexpected and permanent change causing an unrecoverable risk to the Bank's balance sheet to be extremely low.

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<sup>23</sup> The Bank's loss-absorbing capital was £3.5bn at end-February 2021 in line with the new financial relationship between the Bank and HM Treasury; this excludes intangible assets, pension and property reserves as well as illiquid investments.

## **Principle 16 – Custody and investment risks**

***An FMI should safeguard its own and its participants' assets and minimise the risk of loss on and delay in access to these assets. An FMI's investments should be in instruments with minimal credit, market, and liquidity risks.***

*Scope and applicability: Under the CPMI-IOSCO guidance note on application of the PFMI to central bank FMIs, the PFMI are not intended to constrain central bank policies on its investment strategy (including that for reserve management) or the disclosure of that strategy.*

*For the purposes of this assessment, the relevant assets are balances held in RTGS as well as euro cash and securities provided to the Bank in order to generate intraday liquidity. All relevant collateral is transferred to the Bank by way of full title transfer – the Bank does not hold assets in custody in connection with its operation of RTGS.*

*Key Consideration 16.4 (investment strategy) does not apply, and has not been assessed; no assets relating to the RTGS Service are invested other than as part of the Bank's overall approach to managing its balance sheet.*

*No assets are taken in relation to the Bank's operation of CHAPS. This principle is therefore not applicable to the Bank in relation to CHAPS.*

### **Rating: Observed (RTGS); Not applicable (CHAPS)**

Summary of compliance: The Bank adopts a risk-averse approach in relation to securities used to generate intraday liquidity for account holders.

***Key consideration 16.1: An FMI should hold its own and its participants' assets at supervised and regulated entities that have robust accounting practices, safekeeping procedures, and internal controls that fully protect these assets.***

Accounts in RTGS hold sterling cash balances, including intraday liquidity secured against collateral. The Bank uses a risk-based hierarchy when deciding where to hold collateral (i.e. cash and/or securities) provided by account holders, whilst taking into account the ease of dealing with the custodians in question and any regulations or restrictions that would apply when using the services of that entity. In descending order of preference the Bank's preferred means of holding collateral are through:

- a) direct Bank membership of a Central Securities Depository (CSD) or ICSD (International CSD) for securities issued directly into the CSD/ICSD;

- b) the relevant central bank acting as custodian; and then
- c) direct links (i.e. with no intermediary custodian) between an investor CSD and the relevant issuer CSD.

The selection is also subject to cost and operational efficiency, for example, it is not proportionate for the Bank to be a direct member of every CSD and ICSD which can both hold the relevant collateral and meet the Bank's criteria.

The three commercial CSDs of which the Bank is a member (i.e. CREST – the UK CSD – along with Euroclear Bank and Clearstream, the two ICSDs) are subject to prudential supervision. The Bank also reviews the ISAE 3402 audits for these institutions.

The Bank, as operator of RTGS, also undertakes a risk assessment of the small number of direct links between the ICSDs and other domestic CSDs which focuses on legal soundness, custody risk, risk management procedures and operational reliability. These assessments are reviewed and signed off at Executive Director level.

Internal controls and processes are in place to reduce the risk of fraud that could adversely affect account holders. The Bank maintains strict segregation between its own accounts and those of third parties.

***Key consideration 16.2: An FMI should have prompt access to its assets and the assets provided by participants, when required.***

RTGS has no assets itself – it is the accounting system which holds the commercial participants' funds at the Bank. The Bank takes full legal ownership of all collateral that is placed with it under the terms and conditions of the Sterling Monetary Framework. The Bank's assets are strictly segregated from those of third parties, and between those assets held as collateral and those held as reserves or other funds.

During RTGS operating hours, the Bank provides immediate access to funds held in RTGS, and the ability to settle in real-time. The securities the Bank holds against the provision of intraday liquidity can be accessed on demand if the Bank considers that the collateral is not required to cover any exposure.

For the Bacs, Faster Payments and the cheque-based Image Clearing System, the Bank holds cash on behalf of directly settling participants in prefunding accounts that the account holders have control over (and access to) these funds subject to a minimum balance set by the individual system operators to match the net sender cap in the relevant payment system.

The Bank has procedures for identifying, verifying and responding to potential or actual trigger events and events of default under the legal agreements in place between the Bank and account holders for collateral. These agreements outline the steps required for:

- issuing a default notice under one or more of the legal agreements;
- establishing gross and net exposures to the defaulting account holder;
- valuing collateral under the relevant legal agreements; and
- closing out/setting off exposures between the Bank and the account holder.

***Key consideration 16.3: An FMI should evaluate and understand its exposures to its custodian banks, taking into account the full scope of its relationships with each.***

Due to the Bank's hierarchy of preferences described above, the Bank's use of commercial custodians is low, and risk of actual loss is very low. The Bank is not exposed to any significant credit risk. Any cash balances held externally at a commercial custodian are either defunded overnight, or designed to be sufficiently low to be within the Bank's risk tolerance. Exposures to commercial custodians are monitored by the Bank's dedicated second line financial risk function as part of a 'three lines of defence' framework.

## **Principle 17 – Operational risk**

***An FMI should identify the plausible sources of operational risk, both internal and external, and mitigate their impact through the use of appropriate systems, policies, procedures, and controls. Systems should be designed to ensure a high degree of security and operational reliability and should have adequate, scalable capacity. Business continuity management should aim for timely recovery of operations and fulfilment of the FMI's obligations, including in the event of a wide-scale or major disruption.***

*Scope and applicability:*

*The nature of risks that are applicable to the delivery of RTGS/CHAPS are primarily operational risks. These risks are caused by deficiencies in information systems, internal and external processes, staff performance or disruptions. These events could cause deterioration or interruption of the RTGS and CHAPS services that in turn could impact monetary and financial stability.*

*In order to manage risks on an end-to-end basis, we have defined three domains that focus on the source of risks: participants, internal and suppliers. The primary source of operational risk to the CHAPS system is the potential failure of the RTGS infrastructure which enables CHAPS settlement. This risk is managed through the internal risk domain lens. The operational risk implications from both RTGS and CHAPS are considered as part of the broader integrated risk management framework.*

### **Rating: Observed**

Summary of compliance: The RTGS/CHAPS end-to-end risk management framework details the system of risk management for the Bank's delivery of RTGS and CHAPS, which ensures that relevant risks are identified, assessed, monitored, controlled and mitigated appropriately to provide a high degree of security, reliability and availability.

The Bank clearly defines operational reliability objectives for RTGS and CHAPS. The Bank-wide risk tolerance defines the nature and extent of risks (including operational risk) that the Bank is willing to tolerate. The RTGS/CHAPS risk tolerance statements are consistent in scope with those set Bank-wide, but given the criticality of the RTGS and CHAPS services, apply tighter tolerances in some areas. The Bank has a very low but non-zero tolerance for operational unavailability, and considers the trade-off between integrity and availability.

There are a number of key risk indicators for operational risk which are monitored by the executive and reported to the RTGS/CHAPS Board and Risk Committee. The Board is responsible for approving

these tolerances for operational risk on an annual basis and for monitoring that the executive is maintaining risks within these set tolerance levels.

The Bank has comprehensive arrangements for business continuity and crisis management, which supported our move to remote working as a result of the Covid-19 pandemic and associated restrictions. The Bank operates the RTGS service with no single point of failure. The tertiary option, in the event of both primary sites being unavailable, is to invoke MIRS. The operation of the RTGS and CHAPS services is subject to the Bank-wide business continuity plans.

RTGS has been operated remotely during the Covid-19 pandemic. Onsite working has been used to undertake critical change processes and where staff have chosen to come in support their wellbeing. With the relaxation of the UK Government's Covid-19 rules, the Bank is moving towards a new way of working and RTGS / CHAPS will be operated using a hybrid approach using a mix of staff working onsite and remotely.

Most CHAPS Direct Participant and RTGS incidents are managed at a local level, but those of a more significant nature have the potential to invoke the Bank-wide Critical Incident Management Framework (CIMF).

***Key consideration 17.1: An FMI should establish a robust operational risk-management framework with appropriate systems, policies, procedures, and controls to identify, monitor, and manage operational risks.***

#### *Operational risk management framework for RTGS/CHAPS*

The Bank has a robust enterprise-wide operational risk management framework with appropriate systems, policies, procedures and controls in place to identify, monitor and manage operational risks. It sets out a Bank-wide minimum standard for the management of risks, including operational risks.

Within the context of the Bank's risk management framework, the end-to-end RTGS/CHAPS risk management framework has been created which highlights appropriate systems, policies and controls in place to identify, monitor and manage risks that may impact the operation of the RTGS and CHAPS services. Risks are identified and logged, and the probability of their crystallisation and impact are assessed against the Bank's methodology. The controls and mitigation for these risks are also logged and monitored.

The RTGS/CHAPS Board has an overall responsibility to ensure the end-to-end RTGS/CHAPS risk management framework is fit for purpose and setting risk tolerance levels for RTGS and CHAPS. The

RTGS/CHAPS Board Risk Committee has delegated responsibility for monitoring of the risk profiles against the agreed risk tolerances and the operation of the Board-approved end-to-end RTGS/CHAPS risk management framework. The Board Risk Committee reviews conformance with business continuity and crisis management plans, including the results of relevant exercises that test the plans.

#### *Identifying operational risk*

The end-to-end risk management of RTGS/CHAPS is assessed through three domains: participant; internal; and supplier. Across these three risk domains we categorise our operational risks using the Bank's risk taxonomy, which includes people risks; cyber risks; information security (human) risks; technology risks; data risks; personnel security; physical security; process risks; outsourcing and procurement risks and facilities management risks.

Aside from external cyber risks, the Bank also has policies to mitigate against insider risks as part of its cyber security framework. This draws on a regular assessment of threats to RTGS. The Bank seeks to ensure that key person risks are identified and mitigated.

#### *Monitoring and managing operational risk*

The roles and responsibilities of day-to-day operational risk management are delegated to the executive from the Board through the Deputy Governor for Markets & Banking. This is recorded in governance documentation which covers responsibilities and routes of escalation and, for those staff that have specific objectives to identify and manage operational risks within their areas of responsibility, the Bank's performance review system. Further details on the potential categories and sources of operational risk are provided below.

The monitoring of operational risk is managed through the end-to-end RTGS/CHAPS risk management Framework. As described in *Principle 3 – Framework for the comprehensive management of risks*, the operational risks to RTGS and CHAPS are locally monitored via the RTGS/CHAPS risk register, and reported quarterly to the RTGS/CHAPS Board Risk Committee. As an end-to-end risk manager, this includes risks from, and to, the end-to-end CHAPS system. Horizon scanning and emerging risk processes capture key areas of risks drawing on internal and external expertise.

The risk report and underlying integrated risk register, emerging risk register and key risk indicators form the tools that the executive and Board Risk Committee use to monitor and review operational

risks to RTGS/CHAPS. The tools themselves have been reviewed and agreed by the RTGS/CHAPS Board.

For CHAPS Direct Participants, the CHAPS Reference Manual and supporting documents set out the necessary operational and technical requirements. Adherence to the CHAPS Reference Manual is monitored by an annual self-certification and review process incorporating industry-standard controls, e.g. ISO 27001.

#### *Policies, processes and controls*

The Bank has appropriate Bank-wide policies in place to attract, train and retain individuals with the experience required, and monitors key person risk on an ongoing basis; this is also a key focus of the RTGS/CHAPS Board Risk Committee. The Bank's Chief Information Security Officer is responsible for developing and contributing to policies regarding information security that covers RTGS and Bank-wide IT systems.

Operational controls for the RTGS and CHAPS services, such as daily checklists and process instructions, are documented and reviewed by local management. The annual, externally-commissioned ISAE 3402 control audit for RTGS looks at whether the Bank meets the Internal Control Policy as specified. This is in addition to any reviews undertaken by internal audit and compliance.

Additionally, the Bank is ISO2 7001 certified to validate the robustness of the Information Security Management System (ISMS) put in place by the Bank's central function and applied to RTGS/CHAPS. The main objective is to provide confidence that our ISMS is robust, which allows the provision of assurance to external stakeholders (Direct Participants, suppliers, other users of RTGS). This certifies that the Bank manages its information security in accordance with international standards. Furthermore to ensure that the Bank is aware of the applicable risks and have controls in place to manage those risks.

The Bank enforces segregation of duties and/or dual control over certain key processes to prevent fraud. For example, the operational team that manages the RTGS service on a day-to-day basis cannot transfer money within RTGS. This is undertaken by a separate division within the same directorate.

#### *Change management policies*

Risk management is a key element of all change evaluation, both at the design phase and throughout the delivery and evaluation phases.

A formal and proportionate sign-off process for changes is in place. The level of governance and sign-off required is dependent on the assessed potential impact of the change on RTGS and CHAPS. Assurance and risk mitigation plans form part of the approvals process. In later phases of the change management process, monitoring remains proportional to the size of the change.

A local system tracks all changes to RTGS currently in the pipeline; changes are allocated to a maintenance release or project based on their nature and priority. This process must be completed before the technological change procedure, outlined above takes place. If deemed necessary, an appropriate level of technical testing and user acceptance testing will take place, which involves processing messages through the system in order to ensure the software is functional and will often include external involvement (particularly in the case of larger project implementations), including participation from relevant account holders and payment system operators.

For change management decisions involving investment decisions and wider projects, the Bank's Technology directorate has a robust centralised change management process. Investment for projects is determined at the Bank-wide Investment Board.

The RTGS Renewal Committee (RRC), a sub-committee of the Bank's Court of Directors, is responsible for overseeing the delivery of the RTGS Renewal Programme, while the RTGS/CHAPS Board is responsible for strategic decisions for the management and operation of the RTGS system.

***Key consideration 17.2: An FMI's board of directors should clearly define the roles and responsibilities for addressing operational risk and should endorse the FMI's operational risk-management framework. Systems, operational policies, procedures and controls should be reviewed, audited, and tested periodically and after significant changes.***

#### *Roles, responsibilities and framework*

The governance arrangements for RTGS and CHAPS in relation to identifying, assessing, remediating and reporting risks (including operational risk) are set out in the end-to-end RTGS/CHAPS risk management framework. The governance arrangements that define the roles and responsibilities for maintaining a risk management framework (including for operational risk) are set out in more detail under the self-assessments against *Principle 2 – Governance* and *Principle 3 – Framework for the comprehensive management of risks*.

The responsibility for approving the end-to-end RTGS/CHAPS risk management framework is reserved to the RTGS/CHAPS Board. Operational risk is a key element of the end-to-end RTGS/CHAPS risk management framework. The role for the RTGS/CHAPS Board Risk Committee is to oversee and

advise the Board on the adequacy of the design of the risk management framework. It also ensures that, where relevant, it will operate in an aligned manner with the Bank-wide risk management framework.

The responsibility for managing risks on a day-to-day level is delegated to the executive from the RTGS/CHAPS Board through the Deputy Governor for Markets and Banking. On a day-to-day basis responsibility for managing risk resides with the head of the area responsible for operating RTGS and CHAPS.

Whilst RTGS/CHAPS Board is responsible for the delivery of the RTGS and CHAPS systems, the Board operates within the Bank-wide framework for the management of risks to the Bank's own assets. Critical assets relevant to RTGS and CHAPS include the Bank's staff, the RTGS infrastructure and a range of supporting technology. The Board cannot operate independently of the wider Bank, in particular this is true for how risks are managed and mitigated.

#### *Review, audit and testing*

The Bank, as RTGS operator, reviews, audits, and/or tests procedures and controls periodically and after significant changes to minimise operational risks. Under the 'three lines of defence' model, the Bank's internal audit function carries out an independent annual risk assessment of policies, procedures and controls to determine the focus of auditing carried out in relation to both RTGS and CHAPS.

In addition to the Bank's internal audit function, the Bank annually commissions an external control audit on the operation of defined controls related to the Bank's RTGS service. A report is produced to provide assurance to Bank's management and governance, and key stakeholders who use the RTGS service, on the operation of the Bank's control environment and procedures as they relate to the RTGS service.

The Bank undertakes periodic testing of some aspects of its operational risk management arrangements with account holders and payment system operators.

***Key consideration 17.3: An FMI should have clearly defined operational reliability objectives and should have policies in place that are designed to achieve those objectives.***

The Bank's mission is to promote the good of the people of the UK by maintaining monetary and financial stability. Given the importance of RTGS and CHAPS to financial stability, the Bank targets availability of CHAPS settlement in RTGS (urgent and non-urgent) to be at least an average of 99.95%

over any month. The Bank has a very low tolerance for the unavailability of RTGS to settle payments, and has resiliency arrangements in place that reflect this low tolerance.

In the case of an outage, however, the Bank's primary goal is to maintain data integrity. The Bank seeks to deliver this through either restoration of the live RTGS service, invoking standby arrangements in an orderly manner, or activating MIRS, the additional contingency infrastructure that can be used in the event of an RTGS failure.

Should the RTGS system become unavailable, the Bank has a near zero tolerance for restarting settlement without ensuring that to do so would be safe. This requires ensuring that opening balances are correct (to ensure that all payments settled once the system has restarted are valid) and being reasonably certain that restarting would not cause a reoccurrence of the fault or error. The Bank also has a near zero tolerance for payments settling any later than the day which CHAPS Direct Participants intended for their payments to settle.

For certain time critical processes, there is also a near-zero tolerance policy for delays to settlement in RTGS. For example, there are contingency arrangements in place for CLS pay-ins to ensure that they can settle within the CLS contingency window even in the event of an RTGS outage. The Bank also commits on a best endeavours basis to processing two CHAPS payments per participant per hour to ensure that the most critical payments can still be made.

CHAPS Direct Participant operational availability is monitored throughout the CHAPS settlement day, with action taken where breaches of agreed rates are indicated. Other performance measures regarding CHAPS Direct Participant availability are monitored on a monthly basis. Any breach outside tolerance is identified, root cause analyses undertaken and rectification/mitigation plans put in place and monitored. Where relevant, performance management is progressed with each Direct Participant, as necessary. CHAPS Direct Participant performance is also tracked on a rolling quarter by quarter perspective in order to measure trends and emerging potential systemic risks.

Policies are in place to achieve these stated operational reliability objectives. This include: the comprehensive and regularly reviewed and tested incident and crisis documentation; our continued intent to have a tertiary solution, and principles that relate to the invocation of MIRS.

The Bank also has an option of extending the RTGS operating day to 20:00, enabling CHAPS Direct Participants to resolve issues and finalise settlement of most critical payments. The settlement day can also be extended in the event of issues with the CREST system. .

***Key consideration 17.4: An FMI should ensure that it has scalable capacity adequate to handle increasing stress volumes and to achieve its service-level objectives.***

Volume testing takes place regularly to ensure that the RTGS system is able to consistently handle peak volume settlement. This includes testing the ability to process a full day's payments - in the event of an outage for part of the day – within a shorter window. Regular volume testing of both RTGS and MIRS is based on the transactions received on a peak day plus an additional 10%, all for processing within three hours.

The RTGS hardware and associated software has the capacity to settle a peak CHAPS day in three hours; on a 'normal' day, there is therefore significant excess capacity. If volumes were to start to increase significantly, the Bank would review how to increase capacity further. The RTGS hardware was upgraded in 2021 to a newer generation of servers.

The operational capacity of SWIFT is monitored through a regular monthly report of performance against SLA on FIN-Copy service. An annual incident review meeting is held as part of our relationship with SWIFT.

The Bank produces a series of volume forecasts – daily, monthly, and yearly. These are shared with CHAPS Direct Participants and are used as part of the Bank's capacity planning. Forecasting for peak days is performed monthly a year in advance, and forecasts reviewed if exceptional business peaks can be quantified. Total yearly volumes for the next ten years are forecast annually. Forecasts are used to adjust testing against CHAPS Direct Participants, RTGS and third party critical service suppliers if necessary.

***Key consideration 17.5: An FMI should have comprehensive physical and information security policies that address all potential vulnerabilities and threats.***

The Bank has a clear Information Security Management System (ISMS), appropriately restricted physical and logical access, an appropriate degree of staff security vetting before being allowed unescorted access within the Bank, or access to Bank systems, and local representatives to advise on data protection and Freedom of Information as well as central teams.

The Bank's information security policies are produced to apply across all platforms i.e. the policies are not specific to RTGS. The Bank's internally produced policies are complemented by a variety of international and domestic standards.

### *Physical security*

Physical access to the Bank's premises, systems, other equipment and documentation is restricted to authorised individuals. The Bank's guidelines on the information technology elements of physical security also cover the disposal of hardware and sensitive paper-based information.

Physical security is managed by a Bank-wide property and security function, responsible for security for the whole Bank working closely with law enforcement and governmental organisations to co-ordinate physical threat intelligence, ensuring the Bank meets national standards for physical security. The Bank aims to have the highest industry-level standards of physical security and to operate robust incident management processes to protect its people and physical assets from external or internal threats. Its tolerance for compromise of physical security is very low.

Appropriate controls are also in place for remote working. The policies and processes that the Bank would follow in the event of a physical security incident are detailed as part of the Bank-wide Business Continuity Planning framework.

Remote working, which will continue to be a feature even after Covid-19 restrictions have eased, can reduce the on-site vulnerabilities; the level of controls applied remains the same.

Employees and contractors are subject to the UK Government's security vetting process before being allowed unescorted access within the Bank. Once access is granted, further controls are in place over physical security including security passes and monitoring of access.

The Bank's approach to seek assurance over the security of Direct Participants is set out in the CHAPS Reference Manual which contains the obligations that Direct Participants must adhere to. Direct Participants self-assess against these obligations, provide an annual attestation to the Bank, and respond to an assurance questionnaire based on the obligations. The Bank further conducts selective risk-based verification to ensure compliance with the CHAPS Reference Manual and verify their compliance to SWIFT Controls.

### *Information security*

Within the wider Bank, the Bank's Chief Information Security Officer is responsible for managing information security policies, governance and risk, user education and conducting investigations. The Bank works closely with the National Cyber Security Centre and gathers intelligence from other external sources. The Bank's internally produced policies are complemented by a variety of international and domestic standards.

The Bank's critical information assets are protected by detecting and mitigating cyber threats, through robust governance of risk and compliance and management of information security policies, threat and risk assessments, appropriate access controls for staff and by providing all Bank staff with the knowledge they need to meet their information security responsibilities. This includes cultural awareness programmes such as regular phishing campaigns against staff. The end-to-end RTGS/CHAPS risk framework specifically refers to cyber risks and we have Board-approved risk tolerances for Cyber and Information Security (human) risks.

The Bank's risk tolerance for information security of critical assets is very low. RTGS, SWIFT and all external services are protected by firewalls. The RTGS infrastructure is hosted on a segregated network that is separated from the rest of the Bank's IT estate by 'boundary' firewalls with only permitted connections allowed. The Bank network is rigorously monitored to detect intrusion, with reports reviewed by security staff.

RTGS settlement instructions are protected from interception and messages are encrypted and authenticated in order to establish validity and non-repudiation.

Processes and technology are subject to external assurance such as penetration testing and the ISAE3402 control audit. The Bank has been certified in its operation of the RTGS infrastructure and of the CHAPS payment system as complying with the ISO 27001 standard.

***Key consideration 17.6: An FMI should have a business continuity plan that addresses events posing a significant risk of disrupting operations, including events that could cause a wide-scale or major disruption. The plan should incorporate the use of a secondary site and should be designed to ensure that critical information technology (IT) systems can resume operations within two hours following disruptive events. The plan should be designed to enable the FMI to complete settlement by the end of the day of the disruption, even in case of extreme circumstances. The FMI should regularly test these arrangements.***

#### *Objectives of business continuity plan*

Each operational area of the Bank undertakes an annual review and attestation of business continuity plans to ensure the viability of contingency arrangements. The Bank's Chief Operating Officer has overall accountability for the Bank's business continuity programme. Local Executive Directors are accountable for ensuring their directorates have developed and tested plans. A central Business Continuity team exists to review local plans annually or following any major changes within the business area.

The Bank has formal business continuity arrangements for the operation of RTGS and CHAPS. Policies are designed so that the Bank can maintain full operational capabilities even in the event of major disruption or loss of one site, and achieve recovery and timely resumption of critical operations. For major incidents, the Bank can fall back to a secondary site in under an hour for RTGS, including CHAPS, settlement.

In the event of loss of both sites, operational capabilities will be maintained by switching to a tertiary site (MIRS) operating on different software in no longer than two hours. For minor incidents, RTGS and CHAPS would continue to operate without impact because of back-up processes and redundancy built into the system. In April 2021, the Bank successfully completed a live test of MIRS with CHAPS Direct Participants that including sending and receiving payments.

The Bank maintains a recovery target of two hours, but cannot guarantee to achieve to it in every circumstance, for example where a serious loss of data integrity was uncovered, as integrity must be restored first. Recovery could be either restoring the primary site or switching to another site, including MIRS. Where necessary, the Bank is able to extend operation of RTGS up to 20:00 to give the Bank and the Direct Participants time to deal with technical issues and allow transactions to take place on the day intended.

The Bank has explored extreme but plausible cyber scenarios and uses the results to feed into continuous improvements into the continuity and resilience of its system.

Most RTGS and CHAPS incidents are managed at a local level, but those of a more significant nature have the potential to invoke the Bank-wide Critical Incident Management Framework (CIMF), which enables communication, information management and decision making processes and senior stakeholders up to Governor-level to help manage disruptive events. The CIMF is able to draw on technical, communication and leadership resources Bank-wide in order to resume interrupted services efficiently while managing communication with key external stakeholders. These arrangements are tested regularly. With regard to the Bank's role as an end-to-end risk manager for the CHAPS system, as part of the participant assurance work, the Bank requires the business continuity planning for CHAPS Direct Participants to at least meet the equivalent standards as set out in the PFMI. The requirements are determined by how systemic the CHAPS Direct Participant is. For example, the more systemic Direct Participants (Category 0, 1 and 2) must be able to receive payments at their contingency site within one hour of the decision to invoke their contingency site. Less systemic (Category 3) Direct Participants, are required to do this within two hours.

Direct Participants must be able to identify, monitor and document abnormal operating conditions in relation to their technical systems and operating components that support CHAPS; and develop, implement and test plans to maintain or restore operations.

#### *Data Integrity*

The Bank's primary concern is data integrity – it would not resume operations for RTGS or CHAPS until it was sure it was certain of this. There is a requirement for the reconciliation of all Direct Participants balances overnight to ensure the integrity of the data with no discrepancies at the opening of RTGS each day.

In the event of a processing interruption to Bank systems, procedures are in place which allow the reconstruction of data files, programs and transactional information (including the status of transactions), followed by the restart of processing and critical business operations at fallback locations.

The Bank has a set of principles defining the circumstances under which it would invoke MIRS, a tertiary solution; these principles have been shared with relevant external stakeholders. MIRS includes transactions replay functionality – allowing restoration of data integrity by taking the last known trusted set of balances, and re-applying transactions to bring up to the point the disruption occurred.

#### *Secondary site and alternative arrangements*

The Bank operates the RTGS service with no single point of failure under an active/hot-standby configuration. During operating hours, one of two sites is always actively processing payments (primary) whilst the other – technologically identical secondary site – is updated in real-time and stands ready to take over the processing of payments if required (standby). The fallback process should not take longer than an hour. Key operational documents are backed up on an auxiliary system.

The Bank has adopted MIRS as an additional layer of contingency to RTGS. SWIFT runs the MIRS service from outside the UK and it uses separate hardware and software. MIRS activation should take no longer than two hours, depending on the complexity of reconciliation calculations; MIRS takes the most recent balances that are known with certainty and applies all of the message confirmations received since that point i.e. transaction re-play. Having recourse to MIRS reduces a number of risks including those related to credit, technology, geographic concentration, operations, and complex designs.

The Bank regularly tests continuity arrangements for its secondary and tertiary sites for the provision of the RTGS service. For example, MIRS tests are performed at least four times a year, as well as regular fallbacks between the Bank's primary and secondary site.

The RTGS Reference Manual sets out detailed operating hours and intraday events. Any contingency extension to RTGS operating hours is exceptional and requires justification from the relevant account holder or payment system operator. This would typically be to complete processing after operational issues. The Bank can also call an extension.

The primary alternative arrangement in the event of a loss of both sites is the invocation of MIRS, as described above.

The Bank, as operator of CHAPS, and EUI make clear to the relevant RTGS account holders the rules governing an extension. As long as the extension is within the timetable agreed with payment system operators, the Bank will normally grant it. Any instructions that are not settled (either due to resource constraints or operational error) are cancelled by the Bank towards the end of the extension. Sending institutions may resubmit them the next business day. Specific contingency arrangements exist for instructions relating to CREST and deferred net settlements; for CREST this includes the option of a Non-Standard CREST Closure. There are contingency arrangements in place for CLS payments to ensure that they can settle within the CLS contingency window in the event of an RTGS outage.

#### *Review and testing*

The RTGS/CHAPS Board defines and assesses the extent to which the Bank complies with the associated risk tolerance statements within the RTGS/CHAPS risk management framework. Responsibility for reviewing and testing the business continuity plans in relation RTGS and CHAPS is delegated to the executive. However the outcomes in relation to the defined risk tolerance statements (including business continuity planning) are reviewed by the Board Risk Committee, and subsequently Board, as part of the risk framework. Periodic updates are provided to outline testing conducted and any industry wide exercising conducted.

To assess the ability of the Bank to be able to deliver on its business continuity plan, the Bank has engaged in an extensive programme of testing. This has encompassed both testing following the creation of the integrated incident management framework and the regular schedule for testing on an ongoing basis. Throughout the year, the Bank undertakes scenario-based, desktop exercises covering both RTGS and CHAPS incidents.

Alongside the internal testing of the Bank's incident management framework, the Bank also takes part in, or leads, industry-wide tests. In November 2019, the Bank worked with the industry to deliver a challenging scenario which looked at how participants could use alternative arrangements for sending payments.

Alongside the large scale external tests, the Bank runs multiple tests throughout- the year with a number of third parties. These include the regular testing of out-of-hours participant debit cap increase requests, with the prefunded retail systems and participants and a comprehensive bilateral testing plan with other RTGS stakeholders.

***Key consideration 17.7: An FMI should identify, monitor, and manage the risks that key participants, other FMIs, and service and utility providers might pose to its operations. In addition, an FMI should identify, monitor, and manage the risks its operations might pose to other FMIs.***

#### *Risks to the FMI's own operations*

The area that operates the RTGS and CHAPS services maintains and updates a risk register which assesses risks that operating RTGS and CHAPS pose to the Bank. Each risk on the risk framework is assessed for the likelihood and impact to the operation of RTGS and CHAPS. Monitoring of the risks is undertaken by the executive and is subject to review by RTGS/CHAPS Board Risk Committee. Where a breach is identified, decisions are made on how to manage that risk. Risk assessments take into account the impact of third parties on the delivery of the RTGS and CHAPS services.

There is regular horizon scanning of risks and monitoring against agreed Key Risk Indicators to ensure that risk levels do not exceed agreed tolerances.

For CHAPS, the Bank identifies and assesses Critical Service Providers. These are providers where a disruption to the services provided would impact CHAPS in the short term, to the extent that disruption to the continued smooth functioning of CHAPS was likely, with potential material adverse effects on financial stability.

Two sets of services provided by third parties have been identified as critical to the continued functioning of the CHAPS service. These are the Bank Reference Data service provided by Pay.UK via Vocalink, and the SWIFT messaging and network services.

Formal contracts, including service level agreements, are in place with third party service providers to RTGS and the Bank monitors their activities. Whilst most software pertaining to RTGS is written in-house, and therefore involves no third party risk, all of the Bank's hardware relating to the RTGS infrastructure is provided by third parties, although it is installed within the Bank's premises.

RTGS, including for CHAPS settlement, is currently reliant on the SWIFT messaging service to receive settlement instructions and communicate the outcome of settlement. The SWIFT messaging service is operationally robust with a high level of availability. In the event of a loss of SWIFT connectivity, the Bank aims to settle a small number of payments per hour manually to support the settlement of the most critical payments.

For SWIFT, the Bank, as operator of RTGS and CHAPS, takes account of co-operative oversight arrangements when considering what assurance to seek directly from SWIFT. The operators of the CREST and retail systems, where relevant, manage their own relationships with SWIFT.

The end-to-end risk management framework includes four CHAPS-specific risks: financial, cyber, technology and process risk. The Bank manages these risks through setting requirements for CHAPS Direct Participants within the CHAPS Reference Manual (CRM). Risks are managed on an ongoing basis through the participant performance and assurance framework which assesses compliance against rules and requirements within the CRM.

In January 2021 the Bank enhanced the CRM's requirements on outsourcing and third party management.

#### *Risks posed to other FMIs*

The clearing and exchange of individual payments in the retail payment systems are not dependent on RTGS. The retail payment systems are, however, dependent on RTGS for settlement of the net obligations in central bank money. Functionality to settle the retail payment systems on a deferred net basis is included in MIRS. If there are issues with transmission of the settlement figures to the Bank via SWIFT, these data can be received via other means and processed manually. CREST can continue to operate without the RTGS connection in 'recycle' mode, with any liquidity transfers with RTGS being made manually.

In the case of the Bacs, Faster Payments and the cheque-based Image Clearing System, net debit positions must be prefunded with cash held in RTGS. Lack of access to RTGS would therefore mean that additional cash could not be transferred to support increases to the limits of these net debit positions (unless MIRS had been invoked). It is feasible that a retail system net settlement could be delayed (either if manually input, or if RTGS and MIRS were unavailable). This would likely lead to an increase in settlement exposures for the non-prefunded systems, which could become more of a risk to financial stability over time.

## **Principle 18 – Access and participation requirements**

***An FMI should have objective, risk-based, and publicly disclosed criteria for participation which permit fair and open access.***

*Scope and applicability: Under the CPMI-IOSCO guidance note on application of the PFMI to central bank FMIs, the PFMI are not intended to constrain central bank policies on whom to offer central bank accounts to and on what terms. The Bank’s assessment of this principle in relation to RTGS was considered in the context of which accounts can be used for settlement of payment obligations, but not access to the Bank’s overnight and other central bank facilities under the SMF delivered through accounts held in RTGS. For example, central banks may have separate public policy objectives and responsibilities for monetary and liquidity policies that take precedence. The main guidance also states that “central banks ..... may exclude certain categories of financial institutions (such as non-deposit-taking institutions) ... because of legislative constraints or broader policy objectives.”*

*There is a separate set of criteria and requirements to become a CHAPS Direct Participant. This is covered separately in this assessment. However, it includes the requirement to hold a settlement account at the Bank that can be used for settling CHAPS.*

### **Rating: Observed**

Summary of compliance: The access criteria to hold an account in RTGS that can be used for settlement and to become a CHAPS Direct Participant are each carefully designed and regularly reviewed to ensure there are no unreasonable barriers to entry to specific institutions or group of institutions. The Bank looks to ensure that access is available as widely as possible, whilst ensuring the integrity of the systems and its role regarding maintain monetary and financial stability. The Bank publishes the access criteria for settlement (including omnibus) accounts in RTGS and CHAPS on the Bank’s website.

References to ‘settlement accounts’ refer to RTGS accounts that can be used for the purposes of settlement. This includes reserves accounts for institutions eligible for the Bank’s Sterling Monetary Framework (SMF) (which has separate eligibility criteria, outside the scope of this self-assessment) as well as settlement accounts for institutions ineligible for the SMF.

***Key consideration 18.1: An FMI should allow for fair and open access to its services, including by direct and, where relevant, indirect participants and other FMIs, based on reasonable risk-related participation requirements.***

There are two broad functions provided through accounts held in RTGS – participation in the SMF and the use of funds to settle payment system obligations, including CHAPS. Access criteria to the SMF are not covered in this self-assessment. The Bank can incur risks through its provision of settlement services; it mitigates these risks by choosing its counterparties carefully and by securing any exposures with appropriate collateral. The Bank provides access directly to account holders in RTGS and does not set any requirements on account holders regarding onwards provision of services.

#### *Participation criteria and requirements*

The Bank has published eligibility criteria for those wishing to become settlement account holders in RTGS (and access intraday liquidity) as well as operators of payment systems which want the Bank to act as settlement agent for their system and/or want to hold an omnibus account. The Bank publishes these criteria in section 4 and section 5 of the Settlement Account Policy and its new Omnibus Account Policy.

The Bank's Settlement Account Policy is clear that account holders must have the operational capacity to participate, and effectively settle transactions, in the RTGS system. The policy also sets out the high-level legal and technical requirements for accessing intraday liquidity. To be eligible for a settlement account in RTGS, an institution must be: a bank or building society; a broker-dealer; a CCP; or ISCD; or other Financial Market Infrastructure (FMI) that is ineligible for a reserves account but that provides a function that is systemically important and the Bank considers that financial stability would be enhanced if it settled in central bank money by becoming a direct member of a system for which the Bank acts as SSP; or an authorised electronic money institution or authorised payment institution.

For institutions that are ineligible for a reserves account under the Sterling Monetary Framework, the Bank's Settlement Account Policy document describes the eligibility criteria for a (non-reserves) settlement account. An institution that is eligible for a reserves account but is not granted access would not be eligible for a settlement account at the Bank for the purposes of directly settling payment obligations.

#### *CHAPS eligibility criteria*

The high level eligibility criteria for CHAPS Direct Participants are that a financial institution must: hold a reserves or settlement account at the Bank; be a participant within the definition set out in the Financial Markets and Insolvency (Settlement Finality) Regulations 1999 (SFRs); if domiciled outside England and Wales, provide information about company status and settlement finality

through a legal opinion; satisfy the Bank on security and resilience arrangements through a standard attestation process; and comply with the CHAPS Reference Manual on an ongoing basis. Technical requirements include access to the SWIFT network, the Bank's Enquiry Link, and the UK's Extended Industry Sort Code Database.

#### *Payment system requirements*

To hold a settlement account at the Bank, an entity must be *'a member of a payment system (or is in the process of applying to join a payment system) for which the Bank has chosen to act as settlement service provider'*. The payment system operators set their own access criteria for settlement participation. In the case of Bacs, the cheque-based Image Clearing Service, CREST and Faster Payments, the operator requires their directly-settling participants to hold an account at the Bank which can be used for settlement.

In the case of LINK, Mastercard and Visa, the operators require some direct participants to have access to an account held with the Bank which can be used for settlement. As such there are a number of direct participants in the LINK, Mastercard and Visa systems which settle indirectly across the account of a directly-settling participant that holds an account in RTGS. This arrangement is commonly used by institutions that are not eligible for a settlement account with the Bank (for example, independent ATM operators).

#### *Fair and open access*

In deciding whether to provide an RTGS settlement (including omnibus) account to an institution, the Bank will be guided by the eligibility criteria described above. However, access to an account remains at the sole discretion of the Bank. The Bank will consider all applications for a settlement (including omnibus) accounts in a fair and transparent manner whilst considering the risks that this would involve.

In addition to the risk of non-repayment of intraday liquidity and reputational risk, the Bank also needs to consider the financial stability impact that the failure of an institution holding a settlement account might have on the integrity of the payment system for which the Bank acts as settlement service provider.

Any organisation that meets the CHAPS criteria and requirements, as specified in the CHAPS Reference Manual, including holding an account in RTGS, has the ability to participate in CHAPS payment system as a Direct Participant. The precise timing of entry will be dependent upon a number of factors including access to a reserves or settlement account and technical readiness.

The Bank is, however, cognisant of the need as the end-to-end risk manager for the CHAPS payment system to balance its underlying operational and technical requirements with the need for strong risk management in the system. The categorisation model for CHAPS Direct Participants provides an objective and risk-based methodology for ensuring that, where appropriate, less onerous requirements are in place for smaller Direct Participants whilst ensuring stronger requirements remain in place for participants that transmit more significant values or support large indirect participation.

Prospective CHAPS Direct Participants are categorised in advance of direct participation, which also ensures that less onerous requirements are in place at the point of joining CHAPS e.g. tertiary connectivity requirements are not mandated for certain Direct Participants.

The Bank proactively seeks to provide fair and open access to a broad range of institutions. The Bank has expanded the perimeter of the type of institutions eligible for access to include institutions such as non-bank Payment Service Providers (PSPs). In 2021, omnibus account policy was published; this will allow payment system operators to offer innovative payment services, while having the security of central bank money.

***Key consideration 18.2: An FMI's participation requirements should be justified in terms of the safety and efficiency of the FMI and the markets it serves, be tailored to and commensurate with the FMI's specific risks, and be publicly disclosed. Subject to maintaining acceptable risk control standards, an FMI should endeavour to set requirements that have the least-restrictive impact on access that circumstances permit.***

When determining the criteria for access to settlement accounts in RTGS, and direct participation in CHAPS, as well as when assessing individual applications, the Bank considers the benefits and risks to monetary and financial stability. For RTGS, it also considers risks to the Bank through use of its balance sheet, for example, credit risk through the provision of intraday liquidity, reputational risk and operational risk. All reserves account holders are subject to appropriate prudential supervision; this provides a degree of assurance over governance, capital and liquidity. Non-reserves settlement account holders are typically subject to appropriate prudential supervision, either by the Bank in its role as supervisor of FMIs or by the FCA for non-bank PSPs.

To become a CHAPS Direct Participant, the entity must meet the definition of a "participant" as defined in the SFR. However, this requirement is in part risk-based, as it designed to be consistent with the designation of the CHAPS payment system under the SFRs, therefore ensuring that the protection afforded to CHAPS payment via the SFRs remains valid.

### *Proportionate access arrangements*

The participation and access arrangements for different types of institutions vary based on the type of institution. They have been designed so that the risk profile of RTGS/CHAPS is not materially increased by the opening up of access to new types of institutions.

For example, the Bank has worked with the FCA in the development of an enhanced supervisory regime for non-bank PSPs who want access to settlement accounts in RTGS, including both e-money institutions and other payment institutions. This ensures the widening of access to new types of participants to compete on a more level playing field does not impact the resilience of the system. Extending RTGS access to non-bank PSPs requires participants to comply with a comprehensive risk management framework to ensure that the resilience of RTGS and the broader sterling payment system is not compromised. This framework was developed by the Bank, working closely with the Financial Conduct Authority (FCA), HM Treasury, HM Revenue & Customs, the Payment Systems Regulator (PSR) as well as the retail payment system operators. As at end October 2021, there are around half a dozen non-bank PSPs with settlement accounts in RTGS.

The access criteria for RTGS and CHAPS are applied transparently and proportionately across all participants who must meet minimum compliance requirements via testing/trialling and self-certification against key requirements of the CHAPS Reference Manual. As noted above, the CHAPS Reference Manual proportionately categorises requirements according to risk posed to the CHAPS system.

### *Reviewing access criteria*

The Bank's Settlement Account Policy for accounts in RTGS is reviewed periodically and in response to demand. The Bank is mindful of its public duty to ensure access is as open to as wide a population of organisations as possible, whilst also protecting the Bank's balance sheet. Any significant review of the Settlement Account Policy is subject to scrutiny and approval by the RTGS/CHAPS Board.

The opening up of RTGS to non-bank PSPs is an example of how the Bank has ensured participation requirements are the least restrictive possible whilst maintaining the Bank's risk profile.

Participation criteria for CHAPS are also subject to comprehensive review periodically and in response to demand. The Bank seeks feedback externally to ensure all aspects of the participation requirements are necessary. Whilst a comprehensive review of participation requirements happens periodically, the review of the technical requirements happens on a more frequent basis, often multiple times per year. Ultimate responsibility for the CHAPS participation requirements is with the

RTGS/CHAPS Board, however for less significant technical changes, responsibility is delegated to the executive. All material changes to the access requirements, particularly those that alter the risk profile, are subject to a non-objection from the Bank's Financial Market Infrastructure Directorate in its role as the non-statutory supervisor of the Bank as operator of the CHAPS system.

#### *Disclosure of criteria*

The criteria for access to settlement accounts in RTGS is published on the Bank's website in the Settlement Account Policy. The criteria for access to omnibus accounts in RTGS is also published on the Bank's website. The Bank does not publish a list of institutions with accounts used for settlement (aside from CHAPS Direct Participants who are published by the Bank in its role as the CHAPS payment system operator); it is for the payment system operators to disclose, if they wish, the list of participants that settle directly in their respective systems. Nor does the Bank disclose a list of reserves account holders. Institutions with the same regulatory status are subject to the same access criteria.

The Bank publishes the CHAPS eligibility criteria on the CHAPS section of the website, together with links to the CHAPS Reference Manual and a summary of technical requirements. More detailed operational and technical requirements are disclosed to current and prospective CHAPS Direct Participants.

***Key consideration 18.3: An FMI should monitor compliance with its participation requirements on an ongoing basis and have clearly defined and publicly disclosed procedures for facilitating the suspension and orderly exit of a participant that breaches, or no longer meets, the participation requirements.***

#### *Monitoring compliance*

The Bank's and account holders' continuing rights and obligations are set out in the RTGS Terms & Conditions (and relevant annexes and associated CREST documentation). For CHAPS, the Bank's and Direct Participants' continuing rights and obligations are also set out in the CHAPS Reference Manual and the Participation Agreement.

Account holders must inform the Bank of any operational changes that might be significant for its fulfilment of the qualification requirements or for the functioning of RTGS. On an ongoing basis, monitoring of a firm's eligibility to hold a reserves account lies with the Bank's Markets directorate for SMF participants. The situation where an entity loses eligibility for RTGS account access due a default event is covered under *Principle 13 – Participant default rules and procedures*. For non-bank

PSPs, the FCA will inform the Bank where this could have a bearing on the Bank's decision to continue to provide an RTGS account to the non-bank PSP.

The Bank conducts extensive monitoring of CHAPS Direct Participant performance via the participant performance and assurance framework, as part of the end-to-end risk management of CHAPS.

Participants must comply with the CHAPS Reference Manual (CRM) which underpins the risk framework and looks to mitigate, through rules, requirements and procedures the impact of risk events crystallising by managing the risks of Direct Participants to the integrity and stability of the CHAPS payment system and ensuring Direct Participants meet the requirements as set out in the CRM through a robust performance and assurance framework based on a trust and verify approach.

The participant performance framework is designed to maintain the integrity of the end-to-end CHAPS system and to reduce systemic risk. The framework serves to achieve the following:

- Identify, mitigate risks and protect the CHAPS system from harm as a result of non-compliance or poor performance from one or more Direct Participants, or as a result of industry wide events;
- Restore non-compliant or poorly performing Direct Participants to (at a minimum) an acceptable state of compliance and performance;
- Standardise and drive efficiency in the treatment and monitoring of non-compliant or poorly performing Direct Participants; and
- Encourage Direct Participants to self-declare instances of non-compliance or poor performance, and initiate their own remediation plans where suitable in order to minimise risks to the CHAPS system.

#### *Suspension and orderly exit*

The Bank reserves the right in its legal documentation to disable or terminate an RTGS account. For example, pursuant to the RTGS Terms & Conditions, it can do so where:

- there is an Event of Default (as defined in the Terms & Conditions);
- there is a breach of the Terms & Conditions or other requirements related to RTGS; or
- the Bank determines that it is necessary or desirable for its own protection or for the protection of the stability or efficient operation of the financial system.

Suspending an RTGS account is a relatively straightforward, well established and documented operational process. The Bank engages with account holders through its role as the sterling

monetary authority and as prudential supervisor of deposit-takers and FMIs. For non-bank PSPs, the Bank engages with the FCA as the relevant prudential supervisor.

Internal guidance and processes facilitate the sharing of supervisory judgements and information with other areas of the Bank when necessary, for example if an account holder, including CHAPS Direct Participants, were presenting a significant risk to financial stability. Information on causes for exclusion, rights in connection with exclusion and requirements for warning and information are made publicly available in Section 9 of the RTGS Terms & Conditions. The payment system operators that settle through RTGS have their own processes for the suspension and exclusion of their respective settlement participants (which they are responsible for monitoring).

While the Bank reserves the right to disclose information where required in accordance with the RTGS Terms & Conditions, the Bank would generally not disclose such action to anyone other than the account holder and supervisors (and, if appropriate, relevant payment system operators if the account holder is a settlement participant). It would not generally disclose information to the public that could lead to speculation on the circumstances whereby an account holder may have been suspended or excluded from RTGS, because exclusion could lead to loss of confidence in an institution, presenting a risk to the Bank's mission of maintaining monetary and financial stability.

There is also a process for managing the suspension and orderly exit of a CHAPS Direct Participants that breaches or no longer meets the eligibility criteria, including if it poses a threats to the security, integrity or reputation of the CHAPS system. This can be found in the CHAPS Reference Manual.

The CRM states the circumstances, policies and process for off-boarding a CHAPS Direct Participant. The CRM is disclosed in full on the Bank's website.

## **Principle 19 – Tiered participation arrangements**

***An FMI should identify, monitor, and manage the material risks to the FMI arising from tiered participation arrangements.***

*Scope and applicability: Tiered participation occurs when direct participants in a system provide services to other institutions to allow them to access the system indirectly.*

*Tiered participation occurs within the CHAPS payment system.<sup>24</sup> This self-assessment therefore covers the operation of CHAPS.*

*However, with respect to RTGS account holders, they engage with the Bank as principal rather than as an agent. As such, the Bank does not consider that this principle applies to its role as operator of RTGS and provider of settlement in central bank money, and has therefore not assessed itself against it. As an accounting system, RTGS accepts settlement instructions from account holders to transfer funds from their account to another account holder. In that regard, there is limited technical or operational risk that arises from tiering.*

*Tiering does however exist in the payment systems that settle across accounts held in RTGS. Although no risks to the Bank, as operator of RTGS, stem from tiered accounts in the payment system, tiering does introduce broader risks to financial stability, and hence is an ongoing concern for the Bank across its broader central banking functions. The Bank works with the payment system operators and account holders to reduce such risks across a number of fronts.*

*Operators of systemically important payment systems are supervised by the Bank's FMI directorate. The regulatory regime is framed by the PFMI, and operators are expected to monitor and manage tiering risks within their systems accordingly. The Bank, as operator of RTGS, has previously worked with the operator of EUI to increase the number of CREST settlement banks. And the PRA, as the prudential supervisor of banks, encourages first-tier firms to consider the risks associated with the services they provide to others and, in some cases, encourage or require a second-tier firm to move to direct access.*

**Rating: Observed (CHAPS) / Not applicable (RTGS)**

Summary of compliance: Certain CHAPS Direct Participants provide payment services that allow other financial institutions to access CHAPS indirectly. This is known as 'tiering' and the higher the proportion of system activity arising from indirect participants through Direct Participants, the more

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<sup>24</sup> An introduction to tiering in CHAPS was given in <https://www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/2013/tiering-in-chaps>

‘tiered’ the system is. The number of CHAPS Direct Participants has more than doubled – from fourteen to over thirty five – since the 2007 -2008 financial crisis. Relative to international peers, however, CHAPS continues to be highly tiered.

Tiering arrangements in CHAPS are regularly monitored by the Bank using data provided by the Direct Participants as well data taken directly from CHAPS settlement instructions. The Bank has clear quantitative criteria for identifying tiered relationships. These criteria are published and kept under review. Crystallised breaches and near breaches of these criteria, as well as the overall concentration within the system, are reviewed within the RTGS/CHAPS risk framework.

***Key consideration 19.1: An FMI should ensure that its rules, procedures, and agreements allow it to gather basic information about indirect participation in order to identify, monitor, and manage any material risks to the FMI arising from such tiered participation arrangements.***

CHAPS is a relatively highly tiered system, particularly when compared to peer international high-value payment systems. This is largely due to the concentration in the UK banking system and the global nature of the UK’s financial sector, resulting in a large number of international financial institutions electing for indirect access. The current level of direct access represents a significant increase over the last few years, meaning that CHAPS is significantly less tiered, relative to if the population had remained constant.

Data on indirect participation is reported to the Bank quarterly by CHAPS Direct Participants, as applicable. Each Direct Participant is required to notify and seek consent from the Bank for any significant new indirect participant relationship above a defined threshold set out in the CHAPS Reference Manual.

The potential material risks to the CHAPS system and financial stability arising out of tiered participation arrangements are credit, liquidity and operational risk. Certain payments are also important by virtue of their nature e.g. margin payments to CCPs and CLS pay-ins.

- The extent of the credit risk is dependent on the size and fluctuations of the flows between Direct Participants and their indirect participants. The tiering criteria are designed to directly address this risk through direct access where there are not sufficient mitigating circumstances.
- Direct Participants and their indirect participants require intraday liquidity to make CHAPS payments. Each may rely on the other to provide some, or all, of this liquidity. Risks to the system arise if payments cannot be made – particularly in stressed circumstances – following liquidity being withdrawn. The associated liquidity risk is monitored through an assessment of tiered concentration risk, with a view to mitigating through direct participation, where appropriate.

- An operational incident at a Direct Participant can mean that its indirect participants may not be able to make their payments unless alternative arrangements are in place.

The Bank expects mitigants to be put in place by direct and/or indirect participants regarding payment flows. These are assessed as part of the annual participant assurance process. Further information on these mitigations are set out in the CHAPS Reference Manual. These include the requirement on CHAPS Direct Participants to identify, assess and document the risks associated with its provision of CHAPS-related services to the indirect participant.

***Key consideration 19.2: An FMI should identify material dependencies between direct and indirect participants that might affect the FMI.***

The largest dependencies between Direct Participants and indirect participants are identified by assessing the tiering data submitted by Direct Participants against the tiering criteria set out in the CHAPS Reference Manual (and detailed below). Stress and scenario testing is also undertaken to assess the risks arising from significantly tiered relationships in various stressed scenarios.

***Key consideration 19.3: An FMI should identify indirect participants responsible for a significant proportion of transactions processed by the FMI and indirect participants whose transaction volumes or values are large relative to the capacity of the Direct Participants through which they access the FMI in order to manage the risks arising from these transactions.***

The tiering data collected by the Bank is used to identify indirect participants responsible for a significant proportion of transactions by value. This assessment is taken relative to the system as a whole as well as relative to the Direct Participant(s) through which indirect participants access CHAPS. The Bank also identifies which Direct Participants process a significant value – in absolute and relative terms – on behalf of indirect participants.

The tiering criteria are that:

- the average daily value of CHAPS payments sent and received for, or on behalf of, the indirect participant<sup>25</sup> exceeds 2% of the CHAPS average daily value; or
- the average daily value sent and received for, or on behalf of, the indirect participant exceeds 40% of the average daily value of CHAPS and other internalised own account payments (often known as ‘on us’) across the books of the relevant Direct Participant.

The CHAPS tiering criteria set out the circumstances when the Bank could withdraw consent for a specific tiering relationship in the absence of sufficient mitigating circumstances, in order to enable

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<sup>25</sup> Including related entities within the same financial group

the indirect participant to move to direct access. Presumptive breaches or near-breaches of the tiering criteria are considered within the risk management framework that covers RTGS and CHAPS.

Beyond specific breaches, the Bank regularly undertakes a quantitative analysis of concentration risk, as well as a qualitative assessment of how tiered relationships might operate in normal and stressed scenarios. Continued compliance is monitored through the regular participant assurance programme.

CHAPS Direct Participants are expected to work with their indirect participant(s) to address any potential breach. If an indirect participant has been identified as potentially breaching a threshold, the Bank engages with all CHAPS Direct Participants sponsoring the relevant indirect participant. Mitigating options may include the indirect participant joining CHAPS directly, going through other CHAPS Direct Participants or other mitigations to the relationship between the CHAPS Direct Participant and its indirect participant such as greater operational, financial or legal controls.

***Key consideration 19.4: An FMI should regularly review risks arising from tiered participation arrangements and should take mitigating action when appropriate.***

The tiering criteria in the CHAPS Reference Manual are reviewed regularly. In particular, a change in the CHAPS population resulting in new types of CHAPS Direct Participants would lead to a review of the applicability of the criteria. For example, the tiering criteria were reviewed in light of planned admission of ring-fenced banks, aggregators and non-bank Payment Service Providers.

The CHAPS tiering criteria are positioned such that there is a presumption that the Bank, as CHAPS operator, will use its powers to withdraw consent within twelve months in relation to a breach of the tiering criteria. The exception to this is if a CHAPS Direct Participant or their indirect participant can demonstrate 'countervailing' factors and argue that the Bank using its powers for suspending or withdrawing consent where a breach has been identified would lead to deterioration in financial stability. The Bank would typically engage with the relevant prudential supervisors. A CHAPS Direct Participant has the ability to request a review of the executive's judgement of a presumptive breach of the tiering criteria. The review panel would be formed of a group of one or more external RTGS/CHAPS Board members (subject to conflicts).

## **Principle 21 – Efficiency and Effectiveness**

***An FMI should be efficient and effective in meeting the requirements of its participants and the markets it serves.***

*Scope and applicability: The Bank, as operator of RTGS and CHAPS, aims to be efficient and effective in meeting the requirements of participants and the wider market those participants support. For the retail systems, this is primarily the responsibility of the retail payment system operators with the Bank's focus typically limited to the settlement arrangements.*

### **Rating: Observed**

Summary of compliance: The Bank prioritises the reduction of risks to monetary and financial stability in its design and operation of the RTGS and CHAPS services. Wherever it can do so without compromising stability, the Bank seeks to provide value for money and functionality demanded by users.

Bringing responsibility for CHAPS into the Bank has enabled the Bank to integrate the operation of RTGS and CHAPS under a single governance and risk management framework. This now ensures that a single organisation – the Bank – has control over the operations, technology and procedures to deliver the CHAPS system.

The Bank engages with a wide range of stakeholders in the RTGS and CHAPS services, in order to understand the needs of users. This is achieved through a range of interactions, including group meetings with CHAPS Direct Participants, bilateral engagements with stakeholders, and a range of forums such as the Strategic Advisory Forum.

The Bank has evaluated the processes that it is responsible for and concluded that it is being as flexible as it can be in these areas under the current RTGS infrastructure whilst maintaining the integrity and resilience of the RTGS and CHAPS systems. Certain changes have been implemented, where feasible, to streamline some processes, particularly with respect to the requirements for other CHAPS Direct Participants to test when a new Direct Participant joins CHAPS.

***Key consideration 21.1: An FMI should be designed to meet the needs of its participants and the markets it serves, in particular, with regard to choice of a clearing and settlement arrangement; operating structure; scope of products cleared, settled, or recorded; and use of technology and procedures.***

The Bank seeks to ensure that it is taking into account the needs/interests of its participants, key stakeholders and the markets it serves through the provision of the CHAPS and RTGS services. The Bank's structured horizon scanning, and complementary emerging risk, process identifies relevant developments and potential risks to RTGS and CHAPS, drawing on an internal and external network of expert sources.

### *CHAPS*

The Bank undertakes regular engagement with the CHAPS Direct Participants to seek feedback. This is done through a range of groups that include topics such as assurance, rules, liquidity, testing, and operations. In addition, Direct Participants are normally consulted when considering changes to the CHAPS Reference Manual and other requirements, particularly where there may be a cost/impact on them of such a change.

The Bank also engages at a strategic level bilaterally with each Direct Participant and through the Strategic Advisory Forum, which includes CHAPS Direct Participants, indirect participants and end-users and is chaired by an independent member of RTGS/CHAPS Board.

The Bank seeks to ensure that requirements on CHAPS Direct Participants are proportionate to the risks they bring to the CHAPS service. Under the CHAPS Reference Manual, Direct Participants are categorised according to the potential risk each poses to CHAPS. The participation requirements of less systemic Direct Participants are less onerous, in places, to reflect the lower risk posed to CHAPS service.

### *RTGS*

RTGS fulfils multiple functions, including real-time gross settlement for CHAPS and CREST, holding reserves accounts underpinning the implementation of monetary policy and the provision of liquidity to the financial system, as well as net settlement for several retail payment systems. When considering the objectives for, and design of, RTGS, the Bank aims to balance the needs of its diverse users and the broader aims of public policy. Those needs are often aligned, however, at times the Bank may need to make trade-offs between competing objectives or prioritising investments into changes to functionality.

When the Bank plans major investments or change projects related to RTGS, it engages with the payment system operators, account holders and, where appropriate, with end-users such as corporates. Over the previous years, the Bank in its role as the RTGS operator has introduced a number of features to meet the needs of account holders and payment system operators, including:

a business intelligence tool and Liquidity Saving Mechanism for CHAPS Direct Participants; MIRS as an additional contingency infrastructure in the event of a failure to the RTGS infrastructure; and cash prefunding using reserves to eliminate settlement risk in Bacs, Faster Payments and the cheque-based Image Clearing System.

As part of the RTGS Renewal Programme, the Bank is also committed to gathering industry wide input into the design and development on the new RTGS system. The Bank holds regular working groups in which a broad range of stakeholders are represented. The Bank has sought to encourage wider engagement on key topic areas through open workshops, bilateral engagement with other key stakeholders, industry events and public consultations. The broad scope of the Programme's engagement, with both financial services and non-financial services stakeholders has allowed it to identify and implement significant advancements to RTGS (current and future).

***Key consideration 21.2: An FMI should have clearly defined goals and objectives that are measurable and achievable, such as in the areas of minimum service levels, risk-management expectations, and business priorities.***

#### *Defining objectives*

The 2021/22 RTGS/CHAPS strategy was agreed in February 2021. The strategy includes a mission statement for the Bank's operation of the RTGS/CHAPS services, consistent with the Bank's overall mission. This sets out that the purpose of the services is to deliver: the Bank's monetary and financial stability mission by providing a resilient, well-run and responsive RTGS infrastructure that enables access to central bank money accounts and payment services; and the Bank's financial stability mission by providing a reliable, resilient and responsive system for high value sterling payments.

For CHAPS, in line with the Bank's mission, the Bank seeks to act as an end-to-end risk manager – assessing, managing and responding to the full range of risk arising from all points within the system. The Bank also seeks to promote efficiency, innovation and competition in sterling payments, where that can be safely done without impairing stability. Subject to these principles, the Bank considers how to provide services that are: simple to develop, operate and use; flexible in response to changing demands; and provide value for money for the Bank and the wider payment and settlement industry. For RTGS, enhancements are made periodically in order to mitigate risks to the Bank's mission and RTGS/CHAPS mission statement.

The strategy also set out strategic vision for the future RTGS/CHAPS combined infrastructure:

- a renewed RTGS infrastructure for the UK that offers the service, resilience and responsiveness required to consistently deliver the Bank's monetary and financial stability mission in an evolving environment; and
- a high value payments system, with an enhanced proactive end-to-end risk management approach at its core, that is integrated into the Bank and consistently delivers a responsive, well run and resilient payment system to its users.

The RTGS/CHAPS strategy is formed of four key elements:

- Safe and resilient delivering world leading standards in the face of evolving threats through use of the full set of tools and resources available to the Bank.
- Well run providing efficient and cost effective services to users.
- Responsive to user voice and changes in the wider environment.
- Renewed to ensure that safe and resilient settlement in central bank money remains at the core of a rapidly changing payments landscape

The RTGS/CHAPS executive records and tracks the key actions/deliverables required during the year to meet the RTGS/CHAPS strategy, both in terms of overall timelines and specific milestones for each piece of work, and escalates any resourcing or timing issues to Board Risk Committee or Board where appropriate. Deliverables set by the Board are measurable and challenging but achievable.

#### *Evaluating progress*

Progress against the agreed strategy for RTGS and CHAPS is assessed at the Board. In the period since responsibility for CHAPS transferred to the Bank, an early focus has been on greater integration of the internal governance and risk management of RTGS and CHAPS.

The Bank has evaluated the processes that it is responsible for and concluded that it is being as flexible as it can be in these areas under the current RTGS infrastructure whilst maintaining integrity and resilience. There is recognition amongst participants that the Bank is aiming for high standards regarding systemic risk irrespective of what is demanded by comparative systems.

Where the Bank is unable to further streamline the process at present without compromising the resilience and integrity of the Bank systems, the Bank is incorporating the feedback in to the design specification of the renewed RTGS infrastructure. The Bank has completed a refresh of the CHAPS Reference Manual to enhance and simplify rules and requirements where appropriate to do so.

A key focus of the combined RTGS/CHAPS delivery is transparency. The RTGS/CHAPS Board is committed to seeking feedback from participants and users and taking into account feedback

received when making decisions. The Bank's engagement channels are examples of this approach, designed to explain the rationale for why decisions are made as much as possible.

***Key consideration 21.3: An FMI should have established mechanisms for the regular review of its efficiency and effectiveness.***

A range of performance and risk indicators are produced covering the RTGS and CHAPS services. These are used by the executive and the RTGS/CHAPS Board to consider the efficiency and effectiveness of the RTGS and CHAPS services.

The annual tariff review process is periodically reviewed by the Bank's internal audit function. Standard investment projects are considered through the Bank's standard project management process (with costs usually recovered directly from relevant account holders). The process for recovery of the costs involved in the RTGS Renewal Programme is covered under *Principle 15 – General business risk*. The costs associated with the RTGS and CHAPS services, the process of their recovery, are communicated to relevant account holders, together with an explanation for any significant changes (positive or negative) to charges. The budget/overall cost base for the RTGS and CHAPS service is also reviewed as part of the Bank's annual budget round.

Processes are reviewed on an annual basis to review whether all processes are still required, and for potential improvements.

The Bank also engages externally to understand their perspective on the efficiency and effectiveness of RTGS and CHAPS. In the past year, the Bank has undertaken a survey on stakeholder engagement to identify possible improvements.

## **Principle 22 – Communication procedures and standards**

***An FMI should use, or at a minimum accommodate, relevant internationally accepted communication procedures and standards in order to facilitate efficient payment, clearing, settlement and recording.***

*Scope and applicability: Applicable to both CHAPS settlement instructions as well as other messages sent and received by RTGS.*

### **Rating: Observed**

Summary of compliance: Messages sent and received by RTGS, including CHAPS settlement instructions, use SWIFT messaging formats. The Bank will adopt the ISO 20022 message standard for messaging in the new RTGS infrastructure and across CHAPS.

***Key consideration 22.1: An FMI should use, or at a minimum accommodate, internationally accepted communication procedures and standards.***

All payment messages involving RTGS, including CHAPS payment messages, use internationally accepted communication procedures which are commonly used for high-value payment systems (SWIFT FIN). SWIFT FIN messages have been the de-facto international standard for many years. The Bank owns the CHAPS message standard. Many of the fields are used to communicate information about the ultimate beneficiaries and senders – this supports reconciliation as well as screening for financial crime.

The Bank will adopt the ISO 20022 message standard for CHAPS as part of the RTGS Renewal Programme. ISO 20022 is a globally-agreed and managed method for financial messaging standards which has an open standard, is network agnostic and will increase data carrying capacity with an improved structure. Implementing ISO 20022 will enrich the data carried in payments messages, improve compatibility across technology platforms and create opportunities for collaboration and innovation.

The Bank uses a SWIFT message type for settlement instructions submitted to RTGS by retail payment systems and has set out its own domestic standard. This message will also move to an ISO 20022 message in due course.

The Bank provides a separate portal, the Enquiry Link, for payment queue management and liquidity management. This uses a proprietary messaging standard developed by the Bank and is accessed via SWIFT.

## **Principle 23 – Disclosure of rules, key procedures and market data**

***An FMI should have clear and comprehensive rules and procedures and should provide sufficient information to enable participants to have an accurate understanding of the risks, fees, and other material costs they incur by participating in the FMI. All relevant rules and key procedures should be publicly disclosed.***

*Scope and applicability: RTGS and CHAPS have separate sets of rules and procedures.*

*For many FMIs, rules set out how system participants engage with the operator of the system as well as each other, including management of risks to and from other participants.*

- *This is the approach following for CHAPS documentation with parts of the documentation describing how Direct Participants should behave with respect to each other.*
- *For RTGS's role as the settlement agent for other FMIs, the RTGS Terms & Conditions (and associated CREST documentation) are a bilateral relationship between the Bank and each account holder only.*
- *Interaction between account holders in the context of their system participation for example, in Bacs or CREST, is governed by the rulebooks and legal documentation owned and managed by the respective payment system operators.*

### **Rating: Observed**

Summary of compliance: The Bank publishes a comprehensive set of the documentation relating to the RTGS and CHAPS services. This includes the documents describing the rules, responsibilities and risks associated with the operation of both RTGS and CHAPS; the RTGS Terms & Conditions (with accompanying annexes) and the CHAPS Reference Manual. Additional information regarding the governance, cost recovery and user consultation within the RTGS/CHAPS systems is also disclosed on the Bank's website.

Certain information is disclosed on a need-to-know basis to CHAPS Direct Participants, applicants, payment system operators and RTGS account holders. This is typically more sensitive information relating to technical matters and security.

***Key consideration 23.1: An FMI should adopt clear and comprehensive rules and procedures that are fully disclosed to participants. Relevant rules and key procedures should also be publicly disclosed.***

### *Rules and procedures*

The RTGS Terms & Conditions (and associated annexes and CREST documentation), alongside the Bank's Settlement Account Policy, set out entry, continuing and exit requirements for access to an RTGS account. These are clear and comprehensive, and subject to review periodically. In practice, changes to the RTGS Terms & Conditions are driven by functional or policy changes. Changes made to any legal documentation are subject to thorough internal (and if necessary, external) review to ensure they are clear and comprehensive. The RTGS Terms & Conditions (and associated annexes and CREST documentation) include provisions covering the process, and circumstances in which they can be amended and/or waived. Any substantial changes are agreed through the RTGS/CHAPS governance process in conjunction with the Bank's legal advisors.

The Bank provides the RTGS Reference Manual and other documents to account holders and, where relevant, the payment system operators. The RTGS Reference Manual is updated on a regular basis. Documentation between the Bank and each payment system operator set out relevant information for the Bank's interaction with each operator and, where relevant, their directly settling participants.

The RTGS Terms & Conditions are published on the Bank's website (including service-specific annexes). Other documents, including the RTGS Reference Manual, Enquiry Link Guide, documentation covering CREST settlement, and agreements with the payment systems operators, are made available to current and potential account holders and/or the relevant payment system operators.

The key document that sets out the CHAPS rules and procedures is the CHAPS Reference Manual and this is publicly disclosed on the Bank's website.

Other documents including the CHAPS Participation Agreement, the CHAPS Operational Reference Manual, and the CHAPS Technical Reference Manual are disclosed to CHAPS Direct Participants (and applicants) but are not published.

### *Disclosure*

The RTGS Terms & Conditions (and associated CREST documentation) set out the steps that the Bank would take in non-routine events, including disablement and termination of accounts (including defining what constitutes a default). It also makes clear that the Bank has ultimate discretion to make unilateral changes if necessary for the UK's financial stability.

Rule changes follow a proportionate notification process. RTGS account holders will generally be notified of minor changes with an immaterial impact. For material changes, the Bank has a public

duty obligation to consult widely e.g. on significant changes to its operations. In this event, the Bank will generally design a consultation process which is appropriate for the nature of the change.

Appropriate measures are in place to deal with non-routine but foreseeable events involving the provision of CHAPS. These are set out in the CHAPS rulebook and key incident management and resilience policies and procedures. The documents are reviewed at least annually.

Specifically, information on extensions and the processes Direct Participants follow are covered in the CHAPS Reference Manual. The Bank has wide discretion to make changes to the settlement day to maintain financial stability and the Bank will keep in close communication with Direct Participants to ensure they are appropriately informed. The steps that the Bank can take to vary the timings relating to its operation of CHAPS following non-routine events are listed.

The CHAPS Reference Manual contains information regarding the internal change process. Information on changes made will be disclosed to Direct Participants. The CHAPS Participant Engagement Forum is a key conduit. And one of its working groups will typically be engaged on the nature of changes before changes are formally adopted.

***Key consideration 23.2: An FMI should disclose clear descriptions of the system's design and operations, as well as the FMI's and participants' rights and obligations, so that participants can assess the risks they would incur by participating in the FMI.***

The Bank's website provides information on the design and operation of RTGS and CHAPS, including service availability statistics and incidents.

The Bank discloses the rights and circumstances in which the Bank can exercise discretion (for example, if necessary for the UK's financial stability) in the RTGS Terms & Conditions as well as the CHAPS Reference Manual.

As set out in the PFMI, information is only disclosed to the extent it would not, amongst other things, risk prejudicing the security and integrity of the FMI or release commercially sensitive information.

#### *RTGS*

The RTGS Reference Manual describes the technical details of RTGS to account holders from a user's perspective. It is shared with potential account holders at an appropriate point in the application process. Rights and responsibilities within RTGS are set out in the RTGS Terms & Conditions, including the annexes and, where relevant, the associated CREST documentation.

## CHAPS

Documents comprising information about the CHAPS systems design and operations include the CHAPS Reference Manual, the CHAPS Operational Reference Manual and the CHAPS Technical Reference Manual. These are shared with potential Direct Participants at an appropriate point in the application process. The CHAPS Reference Manual is published on the Bank's website.

Rights and responsibilities within the CHAPS system are set out in the CHAPS Reference Manual and the CHAPS Participation Agreement.

***Key consideration 23.3: An FMI should provide all necessary and appropriate documentation and training to facilitate participants' understanding of the FMI's rules and procedures and the risks they face from participating in the FMI.***

The Bank provides relevant documentation related to RTGS and CHAPS to account holders, including CHAPS Direct Participants, and payment systems operators to facilitate their understanding of the RTGS and CHAPS services and the risk they face from participating. However, information is only disclosed to the extent it would not, amongst other things, risk prejudicing the security and integrity of RTGS or CHAPS, the Bank and the financial system or release commercially sensitive information.

## RTGS

The Bank has a defined process for on-boarding new RTGS account holders – or for a change to the account type – and supports account holders through the application procedure. This includes guiding them through costs, modelling their potential intraday liquidity needs and providing the requisite supporting documentation.

The Bank's support of RTGS account holders continues after on-boarding as necessary. The Bank has also run education sessions when new tools or services are delivered. For example, the Bank delivered a range of support ahead of the introduction of the Liquidity Saving Mechanism as well as cash prefunding.

## CHAPS

Standardised and structured on-boarding support for CHAPS is provided through a dedicated team. Each potential Direct Participant has access to the full set of legal and process documentation.

Prior to being allocated an on-boarding slot in CHAPS, a potential Direct Participant will be assessed for its readiness to join. A series of workshops is delivered to seek to ensure that the potential Direct Participant understands the rules, procedures and the risks associated with participating in CHAPS.

The Bank undertakes assurance of CHAPS Direct Participant against their ability to meet the rules and requirements set out in the CHAPS Reference Manual. The Bank may identify a Direct Participant's lack of understanding through this assurance work and supporting self-certification process. The Bank has a number of options available to address such shortcomings including education as well as escalation through a defined framework. This is designed to incentivise compliance with requirements and drive good risk management disciplines and ensure end-to-end risk is managed appropriately.

***Key consideration 23.4: An FMI should publicly disclose its fees at the level of individual services it offers as well as its policies on any available discounts. The FMI should provide clear descriptions of priced services for comparability purposes.***

The Bank publishes its fees policies and tariff for the RTGS and CHAPS services on its website. The Bank's documentation describes the services provided and how they are provided. No discounts are available. Tariffs for RTGS settlement (covering the retail payment systems, CREST and CHAPS) and the CHAPS 'scheme' are set for the year in advance and RTGS account holders, including CHAPS Direct Participants, are given written notice before any change, together with an explanation of any changes.

The Bank provides CHAPS Direct Participants and Euroclear UK and International sight of relevant operating costs and investment plans as part of this annual process. The retail payment system operators are consulted where any substantive investment plans would affect them, and they would be expected to cover the Bank's costs.

***Key consideration 23.5: An FMI should complete regularly and disclose publicly responses to the CPMI-IOSCO disclosure framework for financial market infrastructures. An FMI also should, at a minimum, disclose basic data on transaction volumes and values.***

This self-assessment is published alongside the Bank's response to the disclosure framework for the RTGS and CHAPS services. The Bank previously published an updated self-assessment of the RTGS and CHAPS services in December 2020, with the point of assessment 31 August 2020.

The Bank intends to publish a self-assessment of its operation of the RTGS and CHAPS services on a broadly annual basis.

Data on values and volumes are regularly published on the Bank's website for each payment system settling over RTGS, together with information about RTGS's monthly availability.

- For CHAPS, gross volumes and values are published on the Bank’s website as well as a description of summary trends.
- For CREST and the retail systems, the volumes and values reflect the net settlement across RTGS, not gross volumes and values.

The Bank, as prudential supervisor of payment systems, publishes annual values and volumes settled in CHAPS, CREST and some of the retail payment systems.<sup>26</sup>

The Bank publishes the RTGS Terms & Conditions, the CHAPS Reference Manual, fee policies and tariffs. The Bank also publishes: RTGS/CHAPS Board responsibilities and member biographies; the Terms of Reference and summaries from the Strategic Advisory Forum; and a list of CHAPS Direct Participants.

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<sup>26</sup> <https://www.bankofengland.co.uk/news/2021/december/supervision-of-financial-market-infrastructures-annual-report-2021>

## **Annex 1 – Key documents relating to the RTGS and CHAPS services**

### Legal documentation

#### *Published documents:*

- [RTGS/CHAPS fees](#)
- [RTGS Settlement Account Policy](#)
- [RTGS Terms & Conditions, including annexes](#)
- [CHAPS Reference Manual](#)
- [CHAPS Technical Requirements](#)

#### *Documents shared with current and prospective account holders and payment system operators:*

- Bespoke agreements with payment system operators
- Additional documentation for CREST settlement banks
- RTGS Reference Manual

## Annex 2 – Useful links

### General information relating to RTGS and CHAPS

- Background on RTGS/CHAPS including governance, risk management, and services provided on the Bank's [Payment and Settlement page](#)
- [A brief introduction to RTGS and CHAPS](#)
- [Dedicated page for the CHAPS system](#)
- [Volume, value, and availability statistics for RTGS/CHAPS](#)

### Quarterly Bulletin articles

- [Enhancing the resilience of the Bank of England's Real-Time Gross Settlement infrastructure](#)
- [The Bank of England's Real-Time Gross Settlement Infrastructure](#)
- [How has the Liquidity Saving Mechanism reduced banks' intraday liquidity costs in CHAPS?](#)

### General information relating to the Sterling Monetary Framework

- [Sterling Monetary Framework – Bank of England Market Operations Guide \(BEMOG\)](#)
- [Reserves Accounts in RTGS – Quick reference guide](#)

### General information relating to the Bank and related functions

- [Bank of England Annual Reports and Accounts](#)
- [Bank of England governance](#)
- [Bank's application of the Senior Managers Regime](#)
- [FMI Supervision Annual Report 2021](#)

### Websites of the payment system operators

- [Pay.UK](#) – operator of Bacs, Cheque Image Clearing System, and Faster Payments
  - o [Bacs](#)
  - o [Cheque Imaging](#)
  - o [Faster Payments](#)
- [CLS](#)
- [Euroclear UK & International](#)
- [LINK](#)
- [Mastercard Europe](#)
- [Visa Europe](#)

### Principles for financial market infrastructures publications

- [Principles for financial market infrastructures](#)
- [Principles for FMIs: Disclosure framework and assessment methodology](#)

- [Application of the Principles for financial market infrastructures to central bank FMIs](#)
- [Guidance on cyber resilience for financial market infrastructures](#)
- [Reducing the risk of wholesale payments fraud related to endpoint security](#)

#### RTGS Renewal Programme

- [RTGS Renewal Programme, including the Blueprint](#)
- [RTGS Renewal Programme News](#)
- [ISO 20022, a new messaging standard for UK payments](#)

## Annex 3 – Glossary

**Auto-Collateralising Repo (ACR)** – For the purpose of transactions settling in CREST, the repurchase agreement (repo) automatically generated by the CREST system between a CREST Settlement Bank’s repo member account and/or its linked member account and the Bank. It delivers collateral to the Bank against which liquidity is provided by the Bank in the event of that CREST Settlement Bank would otherwise have insufficient liquidity available in CREST to settle a transaction. The Bank’s agreements with each CREST Settlement Bank cover the generation and use of ACRs.

**Automated Liquidity Transfer (ALT)** – An automated movement of liquidity between different accounts, in RTGS. Certain ALTs are executed at the start of day as a means of putting liquidity into a CHAPS Settlement account. Enquiry Link also offers a facility, which transfers liquidity between a settlement bank’s CHAPS and CREST accounts intra-day, when balances reach certain pre-specified parameters.

**Bank or Bank of England** – The Governor and Company of the Bank of England.

**Bacs** – The Direct Debit and Bacs Direct Credit payment ‘schemes’, generally used to pay salaries, settle invoices from suppliers and for direct debits. The Bacs schemes are operated by Pay.UK.

**BEMOG (Bank of England Market Operations Guide)** – The document explains the framework for the Bank’s operations in the sterling money markets – the Sterling Monetary Framework (as previously covered by the Sterling Monetary Framework’s Redbook). It is periodically updated to reflect changes to the Bank’s operations.

**Central Bank Money** – The liabilities of the central bank, either in the form of banknotes, or reserves that are held by financial institutions at the Bank. Central bank money is close to risk-free: the risk of the Bank defaulting is the lowest of any agent in the economy.

**Central Counterparty (CCP)** – A financial market infrastructure (FMI) set up to act as an intermediary between trading counterparties to clear and settle trades. Importantly, a CCP becomes the buyer to every seller and the seller to every buyer. A CCP effectively guarantees the obligations to transfer cash or assets under a contract agreed between two counterparties. If one party fails, the other is protected as the CCP assumes the position of the defaulting party. Ultimately, resulting exposures to CCPs are protected by the default management procedures and resources of the CCP.

**Central Scheduler** – A logical process within the RTGS processor which allows CHAPS Direct Participants to manage their liquidity and control when CHAPS settlement requests are submitted

for settlement. Once in the Central Scheduler, payments can be 'matched' via the Liquidity Saving Mechanism, or cancelled by the sending CHAPS Direct Participant.

**Central Securities Depository (CSD)** – An FMI that holds records of individual securities and operates a Securities Settlement System, allowing transfer of ownership between parties through a book entry, rather than the transfer of physical certificates.

**CHAPS** – CHAPS is the sterling same-day payment system operated by the Bank, used to settle high-value wholesale payments, as well as time-critical, lower-value payments.

**CHAPS Reference Manual (CRM)** – The Document forms a core part of the legal basis for the Bank's operation of the CHAPS System and it aims to provide a clear and comprehensive description of the rules, requirements and key procedures relevant to the Bank's operation of the CHAPS System in a document which is publicly disclosed.

**CPMI-IOSCO** – Committee on Payments and Market Infrastructures (CPMI) and the International Organisation of Securities Commissions (IOSCO). Both institutions are recognised by the Financial Stability Board (FSB) as standards-setting bodies, and work in collaboration to agree and publish the PFMI.

**CRD (Cash Ratio Deposit)** – Non-interest bearing deposits that both banks and building societies (known in this context as 'eligible institutions') are required to place with the Bank of England in accordance with the Bank of England Act 1998.

**Continuous Linked Settlement (CLS)** – A settlement service based in New York that provides global FX settlement in major currencies, including sterling. For sterling operations, CLS is a CHAPS settlement bank, enabling CLS participants to use CHAPS to fund net sterling requirements arising in CLS. Settlement takes place during the defined window when all real time gross settlement systems in the CLS settlement currency jurisdictions are open and able to make and receive payments.

**CREST** – The securities settlement system operated by Euroclear UK & Ireland Limited to facilitate the transfer of gilts, eligible debt, equity securities and other uncertified securities.

**Custodian bank** – A custodian bank is responsible for the safeguarding and upkeep of their customer's securities. The Bank uses custodian banks abroad as sub-custodians in order to facilitate collateral links.

**Direct Participants (DP)** – Direct Participants are those banks, building societies and other PSPs that access one of the UK payment systems (such as CHAPS, Faster Payment or Bacs) directly.

**Deferred Net Settlement (DNS) Payment System** – A payment system where the obligations between participants are settled by calculating the sum of the payments made, minus the sum of the payments received, by each participant, over a defined period. This is opposed to settling each payment individually, and on a gross basis, like CHAPS. Settlement in RTGS takes place after the individual customer payments are cleared and exchanged.

**Delivery versus Payment (DvP)** – A mechanism to ensure that an asset is transferred if and only if the payment for the transfer of the asset is made at the same time.

**End-to-End Risk Manager** – The Bank is the end-to-end risk manager for the CHAPS system. At a high level, an end-to-end risk manager identifies, assesses, manages and responds to the full range of risks arising at all points in the system, looking at the system as a single entity.

**Enquiry Link** – The system that allows RTGS account holders and certain other organisations to interrogate RTGS balances and other information and to perform certain other functions.

**Euroclear UK and Internationald (EUI)** – The organisation that owns and operates the CREST system; part of the Euroclear group.

**Faster Payments (FPS)** – The UK retail system used for sending payments in near real-time. FPS is generally used for mobile or internet payments and for standing orders payments. It is operated by Pay.UK.

**Financial Conduct Authority (FCA)** – The FCA is responsible for the conduct regulation of a wide range of financial institutions. Banks are dual regulated by the PRA and the FCA for prudential and conduct purposes respectively. For certain firms, such as non-bank payment service providers, the firm is solo-regulated by the FCA for prudential and conduct regulation.

**Financial Markets and Insolvency (Settlement Finality) Regulations 1999** – The Regulations provide designated payment and settlement systems with certain protections against the normal operation of insolvency law, in order to reduce the likelihood of disruption to financial stability.

**Image Clearing System (ICS)** – A retail payment system for the processing and clearing of cheque images. It is operated by Pay.UK and has now replaced the previous paper cheque and credit system.

**Indirect participant** – A bank, building society or other PSP that accesses a payment system through another institution. Typically this institution is one of the Direct Participants of the relevant system.

**Intra-day liquidity** – Liquidity provided to certain CHAPS Direct Participants and CREST Settlement Banks to help ensure that they are able to make sterling payments, in addition to drawing on their reserves balances. The liquidity must be repaid before the end of the day.

**ISAE 3402** – The International Standard on Assurance Engagements (ISAE) 3402 replaces SAS 70 (the Statement on Auditing Standards No. 70), which defined the standards an auditor must employ in order to assess the contracted internal controls of a service organisation.

**ISO 20022 messaging standard** – ISO 20022 is a globally-agreed and managed method for creating financial messaging standards. It will enrich the data carried in payments messages, improve compatibility across technology platforms and create opportunities for collaboration and innovation.

**Level A collateral** – Level A collateral is a subset of the highest rated sovereign debt, with low credit, liquidity and market risk. A fuller definition is published in the BEMOG, and a list of eligible collateral is provided on the Bank's website.

**LINK** – LINK is the retail payment system that supports the UK's cash machine network. It settles on a deferred net settlement basis in RTGS.

**Liquidity Saving Mechanism (LSM)** – Functionality within the RTGS Processor which matches pairs or groups of CHAPS Payments, settling them in batches simultaneously to offset their liquidity needs against one another. CHAPS Direct Participants use the Central Scheduler to manage their payment flows within the RTGS Processor and the Matching Process employs algorithms to attempt to offset the queued payments.

**Market Infrastructure Resiliency Service (MIRS)** – A contingency payment settlement service provided by SWIFT that offers a market infrastructure operational resilience in the event of unavailability of its RTGS system. Once activated, MIRS calculates accurate balances for all RTGS accounts and provides final settlement in central bank money.

**Matching Cycle** – A single running of the LSM Matching Process.

**MT103** – SWIFT message type for single customer credit transfers.

**MT202** – SWIFT message type for general financial institution transfers.

**Market Services Division (MSD)** – The division within the Bank of England which supports the operation of the CHAPS and RTGS services.

**Mastercard** – A retail payment system settled on a deferred net basis in RTGS. Mastercard facilitates electronic fund transfers via cards.

**Non-bank Payment Service Provider (NBPSP or Non-bank PSP)** – The term used to describe two categories of regulated institutions that are not banks but specialise in providing payment services: E-Money Institutions and Payment Institutions.

**New Payments Architecture (NPA)** – The New Payments Architecture, under the governance of Pay.UK, will renew the technical infrastructure support the processing of Bacs and FPS retail payments and associated services.

**Non-CHAPS transfers** – Non-CHAPS transfers as real-time gross transfers of funds within RTGS but outside the scope of the CHAPS system. These are largely to support the functioning and administration of the RTGS system itself, and include the transfers account holders may make between their own accounts within RTGS, and interest credited to reserves accounts. A full list is set out in the RTGS Reference Manual.

**Note Circulation Scheme (NCS)** – The scheme operated by the Bank which governs the distribution, processing and storage of banknotes issued by the Bank. Payments associated the Bank's Note Circulation Scheme (NCS), such as purchases of banknotes by participants from the Bank are settled via RTGS.

**Omnibus Account** – A type of account available to payment system operators that can be used to holds funds for their participants' balances in central bank money.

**Operational Error Lending Scheme (OELS)** – Part of the error handling procedures for Delivery versus Payment (DvP) transactions in CREST. OELS govern how the Bank and EUI may request CREST settlement banks that are prematurely enriched due to an operational error, to temporarily lend an equivalent amount of liquidity back to the 'overdrawn' bank, on an unsecured intra-day basis.

**Pay.UK** – The consolidated entity responsible for the operation of three of the UK's retail payment systems– Bacs, Faster Payments and the Image Clearing System.

**Payment Minimum Balance Group** – A group of accounts in RTGS all held by the same account holder. The prime account within the group is the Payment Settlement Account (which may be the Reserves Account) across which all CHAPS payments are settled. Other accounts within the group are liquidity accounts. The prime account within the group may go overdrawn intra-day providing it is supported by funds on the Liquidity Accounts, i.e. the Minimum Balance Group as a whole may not go overdrawn.

**Payment Service Provider (PSP)** – Any institution that provides payment services by way of business, such as banks, building societies, E-Money Institutions, and Payment Institutions.

**Payment Systems Regulator (PSR)** – The independent economic regulator of payment systems in the UK. The PSR has objectives to ensure payment systems develop and are operated in the interests of consumers, whilst promoting competition and innovation.

**Point of Irrevocability** – The stage of a payment transaction specified in the payment system’s rulebook at which the payment has passed the point where it can be revoked by the payment initiator. It is defined separately for each payment system and is linked but not always equivalent to the point of finality.

**Prefunding Account** – A segregated account held at the Bank of England used for prefunding. There are three types of Prefunding Account:

- Reserves Collateralisation Accounts (RCAs) for members of the SMF already holding a reserves account;
- Settlement Collateralisation Accounts (SCAs) for institutions ineligible for SMF membership settling using their own funds; and
- Completion Funds Account (CFAs) for institutions ineligible for SMF participation settling using their clients’ funds.

Each settlement participant of a prefunded system has a separate prefunding account for each payment system. The Minimum Balance on each prefunding account is maintained by the operator of the relevant payment system to correspond to the net debit cap in the payment system, and a balance equal to or in excess of the net debit cap must remain in place at all times. The balance on an RCA forms part of an institution’s total reserves account balance. All prefunding accounts (RCAs, SCAs and CFAs) are remunerated at the same rate as reserves accounts (i.e. Bank Rate).

**Prefunding** – A model for prefunding Deferred Net Settlement Payment Systems that uses cash balances to eliminate settlement risk between direct settling members. Each settlement participant always has the necessary resources set aside in an RCA, SCA or CFA to meet their maximum possible settlement obligation. Prefunding is currently used within Bacs, Faster Payments and the cheque-based Image Clearing System.

**Principles of Financial Market Infrastructure (PFMIs)** – The PFMIs are internationally agreed standards published by the Committee on Payments and Market Infrastructures (CPMI) and the International Organisation of Securities Commissions (IOSCO). They are part of a set of standards

that the international community considers essential to strengthening and preserving financial stability.

**Real-Time Gross Settlement (RTGS)** – The accounting arrangements established for the settlement in real-time of sterling payments across settlement accounts maintained in the RTGS System.

**Reserves Account** – An account held at the Bank of England for the purpose of the Bank’s reserves account facility under the Sterling Monetary Framework, as described in the BEMOG.

**RTGS/CHAPS Board** – The RTGS/CHAPS Board (the Board) provides strategic leadership for the RTGS infrastructure and CHAPS payment system. The Board operates within the Bank’s wider governance structure, reporting to the Governor and Court.

**RTGS/CHAPS Board Risk Committee** – The RTGS/CHAPS Board Risk Committee has delegated responsibility (from the Board) for monitoring of the CHAPS and RTGS risk management framework risk tolerances and risk profiles.

**RTGS Reference Manual** – A manual describing the RTGS facility provided by the Bank for account holders in accordance with and subject to any limitations contained in their mandate agreement. It also contains the operating procedures describing intra-day liquidity advances between the Bank and relevant account holders.

**RTGS Renewal Programme** – In 2017, the Bank published a Blueprint for renewing the UK’s RTGS infrastructure. The multi-year Programme will deliver a resilient, flexible and innovative sterling payment infrastructure for the United Kingdom to meet the challenges posed by a rapidly changing landscape.

**RTGS Terms & Conditions** – A document that all RTGS account holders are required to sign up to, detailing the legal basis for the Bank’s operation of RTGS, and the rights and obligations of the Bank and account holders in the provision and use of this service.

**Settlement Service Provider Agreement** – The Settlement Service Provider Agreement is an agreement between the Bank of England and each Deferred Net Settlement Payment System Operator that governs the relationship between the Bank, as settlement service provider, and each operator.

**Settlement Account** – Term used for a reserves account used to settle obligations in a payment system which settles across RTGS. Or where the institution is ineligible for a reserves account, an

account held in RTGS for the purpose of settling obligations in a payment system which settles across RTGS.

**Strategic Advisory Forum** – The Strategic Advisory Forum is an advisory body which aims to support an ongoing and effective two-way dialogue between the RTGS/CHAPS Board, the executive responsible for RTGS and CHAPS, and a representative set of senior and experienced users of the RTGS and CHAPS services.

**Sterling Monetary Framework (SMF)** – The framework for the Bank’s operations in sterling money markets. The operations are designed to implement the Monetary Policy Committee’s decisions in order to meet the inflation target and reduce the cost of disruption to the critical financial services, including liquidity and payment services, supplied by SMF participants to the UK economy. The framework is explained in the BEMOG (see above).

**SWIFT (Society for Worldwide Interbank Financial Telecommunication)** – SWIFT is a global member-owned cooperative that provides secure financial messaging services.

**Throughput** – Throughput refers to the proportion of a day’s CHAPS payments that has been made by a particular time.

**Tiering** – Where indirect participants access a payment system through another institution.

**Vocalink** – Vocalink is an infrastructure provider that currently provides the clearing infrastructure for the Bacs, FPS, ICS and LINK payment systems.

**Visa** – A retail payment system settled on a deferred net basis in RTGS. Visa facilitates electronic fund transfers via cards.

## Annex 4 – CPMI-IOSCO PFMI Rating Definitions

The full set of possible ratings for applicable principles are:

- Observed.** *The FMI observes the principle. Any identified gaps and shortcomings are not issues of concern and are minor, manageable and of a nature that the FMI could consider taking them up in the normal course of its business.*
- Broadly observed.** *The FMI broadly observes the principle. The assessment has identified one or more issues of concern that the FMI should address and follow up on in a defined timeline.*
- Partly observed.** *The FMI partly observes the principle. The assessment has identified one or more issues of concern that could become serious if not addressed promptly. The FMI should accord a high priority to addressing these issues.*
- Not observed.** *The FMI does not observe the principle. The assessment has identified one or more serious issues of concern that warrant immediate action. Therefore, the FMI should accord the highest priority to addressing these issues.*
- Not applicable.** *The responsibility does not apply to the authorities because of the particular institutional framework or other conditions faced by the authorities with respect to this responsibility.*

Where an issue of concern is defined as: ‘a risk management flaw, a deficiency, or a lack of transparency or effectiveness that needs to be addressed. Assessors should distinguish between the three categories of issues of concern: (a) issues of concern that are serious and warrant immediate attention; (b) issues of concern that could become serious if not addressed promptly; and (c) issues of concern that should be addressed in a defined timeline.