Payment systems are often regarded as the plumbing of the economy. They receive little or no attention until either something goes wrong or external events shine a spotlight on them. Although payment systems continued to operate as normal during the financial crisis – despite significantly increased payment traffic and the extra stress this put on them – politicians and regulators have since paid greater attention to reducing risk in banking operations generally, including payment systems.

This commitment to increase the integrity of payments and reduce risk means that attention is focused on the relationship of direct scheme members and indirect participants in critical payment systems. These are banks that are direct members of a scheme and those that choose to access it through another institution. CHAPS is a real-time gross settlement (RTGS) system in the UK, which means that the money being sent in the transaction is moving and being settled between banks within the same timeframe of the payment being made. The scheme currently has 19 member institutions, which between them send over 90% of the daily sterling payment value on behalf of themselves and financial institutions across the world. Around half of all CHAPS payments are made on behalf of indirect participants – those that aren’t direct members of the scheme.

The high number of indirect participants that send payments through CHAPS led the Bank of England to highlight concerns about the inherent risks in the system. The scheme currently has 19 member institutions, which between them send over 90% of the daily value going through the system that is sent via indirect participants.

Large credit lines being extended to these indirect participants, which can be withdrawn at short notice; and

- Worries over the operational risk posed to the indirect participant by the direct member in the event of an operational outage.

To reduce the risks posed by large indirect participants, the CHAPS scheme worked with the Bank of England and the scheme members to introduce the CHAPS Tiering Criteria, which allow CHAPS to prevent and stop CHAPS members from sponsoring indirect participants who meet, or exceed, agreed percentage values of the average daily CHAPS values that are sent and received. The Tiering Criteria came into force in April 2012.

CHAPS had just 14 members at the end of 2008. Since then, the number of direct members has risen to 19, with a further six confirmed to join CHAPS between now and the end of 2015. The growth in CHAPS membership means that the systemic risks that had been identified will decrease as the value of payments being made through CHAPS by direct members increases. Importantly, it also enables the CHAPS scheme to better monitor and control these payments and thus ensure the continued integrity of the UK payment systems.

The European model

One could reasonably look to the European equivalent of CHAPS – TARGET2 – and ask whether the European system faces the same challenges as CHAPS, in terms of its membership. TARGET2 is the RTGS system owned and operated by the Eurosystem, the eurozone’s monetary authority.

It processes cross-border transfers throughout the EU and, like CHAPS, provides a guaranteed same-day service for the bank-to-bank transmission of payments, with no imposed lower or upper limit on the value of payments. Both systems function on bank working days and operate within set times of day. TARGET2 has to be used for all payments involving the Eurosystem, as well as for settling the operations of all large-value net settlement systems and securities settlement systems handling the euro. This makes it one of the largest payment systems in the world. Its membership is made up of global financial institutions (all of whom are members of CHAPS). It uses TARGET2 to settle any euro payments that its international customers make, while CHAPS is used to settle its sterling payments.

There is a major difference between the two systems, however. This is the relative scale of direct members in proportion to the daily average values of the payments that they process, both inwards and outwards. In simple terms, TARGET2 has nearly 1,000 direct members and processed nearly €5,000bn daily in 2012, whereas CHAPS has only 19 direct members and processed £570bn daily.

The type of systemic risks mentioned above are highlighted by Principle 19, Tiered Participation Arrangements, in the document Principles for Financial Market Infrastructures,
which was published by the Committee on Payment and Settlement Systems for the International Organization of Securities Commissions in 2012. These risks impact CHAPS more severely than TARGET2 because of its highly tiered structure. Consequently, indirect participants are placed at greater risk in the UK system. This is because they rely on an extension of credit by their direct member, which could at any point be withdrawn. In addition, there are operational risks arising through the concentration of indirect payment flows through a small number of members. All of these risks apply to a much lesser extent to TARGET2 participants.

It is a mistake to deem CHAPS as just a UK payments system and to confine the CHAPS Tiering Criteria as relevant to the UK only. More than 4,500 indirect participants operate within CHAPS and 65% of the top 20 highest processing indirect participants (which collectively send and receive around £150bn worth of payments) are European-owned financial institutions. CHAPS is engaging with these participants and their sponsoring members to ensure that they comply with the tiering requirements. It will also work with them regarding the possibility of joining CHAPS directly. A quarter of indirect participants have already stated their intention to join the scheme. When this happens, CHAPS will reduce the average daily value of payments made by indirect participants by approximately 20%, subsequently mitigating risks even further.

### About CHAPS

CHAPS was founded in 1984 and it stands for Clearing House Automated Payment System. A CHAPS payment is an electronic bank-to-bank same-day value payment made in UK sterling, which is generally used for high-value interbank transactions. CHAPS represents 0.5% of total clearing volumes globally, but 93% of total clearing sterling values. In 2012, an average of 134,700 payments per day were sent through CHAPS. The total value of payments transmitted in CHAPS grew by 12% in 2012 to £71.7 trillion. CHAPS is run by CHAPS Clearing Company, which manages the day-to-day operations of the scheme.

For more information about CHAPS tiering, see [www.chapsco.co.uk](http://www.chapsco.co.uk)