

RULES

on Activities of Netting Systems

Article 1

Definitions

Board of a netting system: A designated group of persons formally responsible for the operation of a netting system, including the compliance of its operations with these Rules. If a netting system is in the form of a limited company or private limited company, the board of the company is considered to be the board of the netting system in the sense of these Rules.

Maximum netting position: The maximum amount that a participant may owe to another participant in connection with netting within the day in a netting system.

Netting system: A payment system which receives requests from participants for the implementation of payment orders from one participant to another within the system. The payment system performs netting, i.e. converts multiple claims or liabilities into a single (net) claim or (net) liability for payment or obligation to make payment on the part of participants.

Netting account: An account held by a participant in a netting system which it uses to manage the netting balance vis-à-vis another participant.

Payment system: A formal arrangement among three or more participants based on collective rules and a standardised arrangement for the implementation of payment orders among them, provided that at least one of the participants has a main office in Iceland, and which fulfils the demands made of it and has been announced in accordance with Act No. 90/1999, on the Security of Payment Orders in Payment Systems.

Real-time gross settlement (RTGS) system: The Central Bank of Iceland's payment system which processes payment orders whereby payment is only transferred from the payer's settlement account and into the payee's settlement account if there is a sufficient balance on the payer's account or a sufficient negotiated intraday overdraft facility and satisfactory collateral security. Settlement is made as soon as the payment is transferred from the payer's settlement account and into the payee's settlement account (i.e. by a real-time gross settlement).

RTGS account: A current and settlement account held by a participant in the RTGS system.

Securities settlement system: A system which confirms trading terms for securities transactions, calculates and determines entitlements and obligations in connection with the transaction, settles it and handles custody of the securities.

Settlement account: An RTGS account used for making settlements in the payment system or securities settlement system.

Article 2

Participants

The Central Bank of Iceland decides on the approval of new participants in the system and exclusion of existing system participants.

Participants in netting systems may be institutions, cf. Article 2, item 2 of Act No. 90/1999, on the Security of Payment Orders in Payment Systems, provided that in other respects they fulfil the conditions for participation made by the board of a netting system, cf. Article 3 of these Rules. Participants shall have settlement accounts with the Central Bank and also participate in its RTGS system.

Rights and obligations of other participants, i.e. intermediaries, settlement agents and netting centres, are as provided for in Act No. 90/1999 and in Articles 2 and 3 of these Rules, as appropriate.

If a participant no longer fulfils the conditions of Articles 2 and 3, the board of a netting system shall refuse further participation by it in the system. The same applies to a participant violating these Rules.

Article 3

Conditions for participation

The board of a netting system shall specify in writing conditions for participation in it. These conditions shall serve to promote the security and efficiency of the system. They shall also be accessible, impartial, justifiable and necessary. At minimum, the conditions shall stipulate that participants shall:

- a. be subject to regulation by a financial supervisory authority in the European Economic Area,
- b. fulfil the requirements made by the relevant supervisory authority, including provisions for capital adequacy and liquidity ratio,
- c. have the necessary technical resources for participation,
- d. have the necessary management capability and employee expertise for participation,
- e. have a reliable system for monitoring risks in connection with participation in the system,
- f. have negotiated adequate collateral security with the Central Bank, and have submitted it,
- g. have paid, or negotiated payment of, a normal participation fee.

The provisions of paragraph 1, items a., b., f. and g. do not apply to the Central Bank of Iceland.

Article 4

Payment amounts

Payment orders of less than 10 m.kr. are covered by the netting system. Payment orders to the amount of 10 m.kr. or more are covered by the Central Bank's RTGS system (real-time gross settlement limits). However, transfers in connection with settlements in a netting system and securities settlement system are covered by the RTGS system irrespective of their amount.

In consultation with the boards of netting systems, the Central Bank of Iceland may decide that specific payments which are lower than the real-time gross settlement limits defined in paragraph 1 shall be covered by the RTGS system.

Payment orders may not be split up in order to prevent them from being covered by the RTGS system.

Article 5

Recognition of netting systems

The board of a netting system shall request recognition of it in accordance with Act No. 90/1999, on the Security of Payment Orders in Payment Systems.

Article 6

Operating time of netting systems

The board of a netting system shall decide its operating time in consultation with the Central Bank of Iceland. However, settlements in a netting system shall be made no later than 17.00 hrs. on regular banking days.

Article 7

Payment orders

Payment orders in a netting system are defined as directives by a participant, which the system has received and confirmed, for presentation of funds to a specified recipient by depositing, with a transfer, a specific sum into the account of a credit institution, central bank or settlement agent, or which obliges it or relieves it of the obligation to make over payment in the sense of this term as defined in general legal interpretation.

By no later than February 14, 2005, a netting system shall register and keep a record of the payer's name, address and account number.

Article 8

Request for implementation of a payment order

A request for the implementation of a payment order is submitted to a netting system via participants' electronic connections with the system. A request may relate to an individual payment or a number of payments which have accumulated within the same day.

Article 9

Time limits for payment orders

A payment order is regarded as having entered a netting system when the system has verifiably confirmed its receipt to the issuer of the order. Precise records shall be kept of the time that payment order was received by the system, and the time that confirmation of its receipt was sent.

Article 10

Legal effect of confirmation of receipt of a payment order

After receipt of a payment order has been confirmed pursuant to Article 9, the order is considered binding towards third parties and final, cf. however paragraph 2.

In the event that an obvious error has been made in transmission of a payment order which has been confirmed pursuant to paragraph 1, such an order may be cancelled vis-à-vis a netting system with a visible counter-entry within the same settlement day, providing that the respective recipients have not undergone bankruptcy proceedings until that time. Such cancellation invalidates the binding legal effect in connection with the order that had been created in accordance with paragraph 1. In other respects, the participant performing such a cancellation is responsible for its legitimacy.

The legal effect of a participant's bankruptcy is determined by the Bankruptcy Act, currently Act No. 21/1991, and Act No. 90/1999, on the Security of Payment Orders in Payment Systems.

Article 11

Counter and netting account

As soon as a payment order is performed, the change in the net real-time position of all transfers between individual participants (i.e. the netting position) is recorded in a counter which is accessible to the relevant participants and the Central Bank.

Participants use dedicated netting accounts in the Central Bank to manage the netting position between individual counter-participants. Each participant has a separate netting account for each counter-participant. Counter-participants may deposit funds in the relevant netting account in order to raise the maximum netting position temporarily.

Article 12

Maximum netting position

Participants shall agree on the maximum netting position towards one another. Participants shall notify the board of a netting system, and the Central Bank, of the maximum netting position with respect to other participants.

All changes in the maximum netting position with respect to one or more participants shall be notified at the earliest possible instance. The change in maximum netting position takes effect at the beginning of the following business day.

A netting system shall ensure that the netting position between participants according to the counter at any time shall not exceed the negotiated maximum netting position, cf. however the provisions of Article 11, paragraph 2 concerning payment into netting accounts. The Central Bank may grant an exemption from this provision.

Article 13

Rejection of a request to implement a payment order

If a netting system receives a request for a payment order which, were it confirmed and made, would cause the relevant netting position to exceed the negotiated maximum, the system is obliged to reject such a request and notify the relevant participants.

The Central Bank may grant an exemption from this provision.

Article 14

Collateral security for settlements

Participants in a netting system shall negotiate on and submit to the Central Bank secure and adequate collateral security to cover a payment default in connection with a settlement in the system.

The amount of the collateral security shall, at minimum, be based on allowing the settlement to be completed even though the participant with the highest negative position is unable to make payment. The amount of the collateral security submitted by each participant shall not be lower than its highest individual negotiated maximum netting position towards other participants.

The Central Bank of Iceland assesses and approves the collateral security. Collateral security for settlements shall be in the form of securities which are eligible for Central Bank repurchase transactions, cf. the rules to that effect, currently Rules No. 385 of May 29, 2002, on Facilities with the Central Bank for Credit Institutions Subject to Minimum Reserve Requirements. Collateral security for settlements may also be in the form of cash in a participant's blocked collateral account with the Central Bank. The Central Bank specifies conditions for the use of the account, in an agreement to that effect.

Article 15

Authorisation to dispose of collateral security in the event on default of settlement

A negative position between participants shall be settled with a payment in the RTGS system, irrespective of the amount.

In the event that a participant defaults on its settlement obligations, the Central Bank may redeem collateral security and/or new cash in a blocked collateral account submitted

by that participant and allocate it proportionally, without advance notice or notification, towards the claims that other participants have against the said participant.

If the collateral security is insufficient to complete the settlement, the Central Bank may redeem the collateral security of each individual participant in connection with its outstanding claim. In such cases the relevant participant retains its original entitlement to the claim. It is also entitled to repurchase the securities that had been redeemed in connection with the default of the settlement. Entitlement to repurchase ceases to be in effect at the end of five banking days from the time of default.

If an agreement on collateral security for settlement extends to both the RTGS system and a netting system, the division of collateral between the respective payment systems shall not be specified in the blocked collateral account or securities portfolio that the relevant participant has pledged as security for the settlement. In the event of a default of settlement, the Central Bank may redeem the collateral and dispose of it for completion of a settlement irrespective of which share of the collateral is involved.

Article 16

Requirements for technical resources

Participants shall have the technical resources specified by the system's board at any time.

Article 17

Risk surveillance system

Participants shall at all times have a secure surveillance system for risks associated with the use of a netting system and other payment and securities settlement systems in which they participate.

Article 18

Training

Employees of participants in a netting system who are in charge of payment intermediation shall be given a necessary introduction to the system and training in its use. In consultation with participants and the Central Bank, the board of the system shall produce standardised presentation material about the system for staff in charge of payment intermediation and for participants' customers.

Article 19

Monitoring of netting position

Participants are obliged to monitor their netting positions towards one another as shown on the relevant counters with the aim of preventing, in good time, the rejection of a request for implementation of a payment order.

Each participant shall have technical resources which facilitate monitoring of the payment position.

Article 20

Response to payment position

Before a maximum position is reached, the participant with a negative position is obliged to make every effort to prevent the implementation of a payment order from being rejected, by depositing funds in the counter-participant's netting account in order to increase its intraday overdraft facility beyond the maximum netting position.

The Central Bank shall have access to participants' netting accounts, so as to be able to monitor their responses in such cases.

Article 21

Participant's contingency plan

Each participant shall develop a contingency plan outlining its own responses to disruptions in the operation of a netting system.

Article 22

Contingency plan of the board of a netting system

In consultation with participants, the board of a netting system shall establish and maintain plans to ensure the necessary operational security in the event of delays, power failures or other technical mishaps. A participant shall set up the necessary reserve facilities, among other things in order to be able to receive notifications about debts on RTGS and netting system accounts if normal methods of communications break down or are disrupted. Such notification may mean that the relevant participant or other participants will need to procure an overnight loan or transfer liquid funds between accounts before payment settlement takes place. The reserve facilities should also ensure that a participant is able to decide to transfer liquid funds to or from its own account before payment settlement is made. A participant must also have the technical resources to be able to receive or transfer liquid funds if normal methods fail to function.

In consultation with participants and the Central Bank, the board of a netting system shall organise contingency exercises at least once a year.

Article 23

Tariff

The board of a netting system shall set a tariff for participants in connection with its activities and operation. This tariff shall be accessible.

Article 24

Oversight and supervision

The Central Bank performs systemic oversight of the operations of netting systems with respect to their operational security, effectiveness and efficiency. The Financial Supervisory Authority performs supervision of individual participants' implementation of Rules on netting systems.

Article 25

Provision of information

The board of a netting system and/or participants shall provide the Central Bank and Financial Supervisory Authority with all information they may request regarding the implementation of these Rules and notify them of all major incidents which may disrupt or may have disrupted the system's activities.

Participants shall inform any person who so requests, and has legitimate interests to safeguard, of their participation in a netting system and the main rules governing its activities.

The board of a netting system shall announce in the Legal Gazette the names of participants in the system. A new announcement shall be made if participation changes.

Article 26

Procedural rules

The board of a netting system shall set more specific procedural rules on activities of the system, conditions for participation, exclusion from participation, requirements for technical resources, implementation of payment orders and contingency plans.

Article 27

Entry into force

These Rules, which are adopted in accordance with Article 38, cf. Article 4, of Act No. 36/2001, on the Central Bank of Iceland, enter into force on October 1, 2003. From the same time, Rules No. 951 from December 29, 2000, on Access to Settlement Accounts with the Central Bank of Iceland, cease to be in force.

Transitional provision

Notwithstanding the provisions of Article 14, paragraph 3, participants shall be allowed, until January 1, 2004, to use deposits in a blocked required reserve account as settlement guarantees in accordance with Article 9 of Rules No. 388 of May 29, 2002, on Minimum Reserve Requirements, cf. Article 2 of Rules No. 180 of March 10, 2003, amending them.

Reykjavík, October 20, 2003

Central Bank of Iceland,

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Chairman, Board of Governors

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