

Norges Bank's oversight of payment systems – authorisation and supervision

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Throughout the 1990s a number of international recommendations on risk reduction in payment systems have been drawn up. The most recent recommendations were issued by the Bank for International Settlements (BIS) in the report "Core Principles for Systemically Important Payment Systems" from the Committee on Payment and Settlement Systems (CPSS), consisting of representatives of the G-10 countries. The principles are supplemented by recommendations on the responsibilities of central banks in this area. The new Norwegian Act of December 1999 relating to Payment Systems is in accordance with these recommendations. The Act introduces authorisation and supervision of payment systems, assigning responsibility for interbank systems to Norges Bank. The Act also establishes requirements concerning the organisation of payment systems and risk management, and it incorporates the EEA Settlement Finality Directive in Norwegian law. This article describes Norges Bank's oversight responsibility for payment systems on the basis of the Act relating to Payment Systems.

1. International recommendations on risk reduction

For several years there has been a broad international focus on payment system risk, and a number of international recommendations on risk-reduction measures have been put forward. One central recommendation is that participation in payment systems should have a well-founded legal basis. It was partly on the basis of this recommendation that the EU began work on the Directive on Settlement Finality in Payment and Securities Settlement Systems (Settlement Finality Directive). The most important recommendations and the main content of the Settlement Finality Directive are described in brief in the following section, providing a background for a more detailed exposé of recent developments in the Norwegian payment system.

1.1 The BIS and the EU

In 1990, the BIS issued the "Report of the Committee on Interbank Netting Schemes of the Central Banks of the Group of Ten Countries". This report, known as the Lamfalussy Report, made recommendations concerning requirements for multi-currency, cross-border private netting systems in order to reduce risk. These recommendations were followed up by the Committee of Governors of the Central Banks in the European Union, which recommended that they should also apply to national payment systems. The Lamfalussy Report set the pattern for central banks' work on risk-reduction measures in national payment systems, and laid the basis for subsequent recommendations in the area.

In addition, the European Monetary Institute (EMI), the precursor of the European Central Bank, drew up a report in 1994 on minimum standards for the functioning of domestic payment systems, with the aim of achieving greater harmonisation of national payment systems in the EU. The report recommends, among other things, that systems should be based on transparent and

objective criteria for participation and that the operating hours of systems should be harmonised. The EMI also recommended that national gross settlement systems be established.

1.2 Core Principles for Systemically Important Payment Systems

Partly as a result of the problems in the wake of the Asian crisis in the late 1990s, the BIS produced a report entitled "Core Principles for Systemically Important Payment Systems". The report sets out ten principles that should be applied to systemically important payment systems (see separate box), including how the principles should be interpreted and implemented. As at July 2000 the report was available in a consultative report edition. The final version is expected to be published by the beginning of 2001.

The report was drawn up by a task force consisting of payment system experts from 23 central banks, as well as the IMF and the World Bank, and therefore reflects a broad international consensus on the requirements for important payment systems. The report is written in such a way that it can be used by countries at different stages of development, including emerging markets. However, this does not imply that the report is of less relevance for countries with highly developed payment systems, such as Norway. The purpose of the report is to help strengthen the international financial infrastructure, as safe and efficient payment systems are important for ensuring financial stability.

The BIS Core Principles are largely based on the recommendations of the 1990 Lamfalussy Report. The original six Lamfalussy recommendations have, however, been augmented by four new principles, namely numbers 4, 6, 8 and 10 in the box below. In addition, the most recent BIS report contains four recommendations on how central banks, in line with their oversight responsibility, should apply these principles. Moreover, the report applies to all systemically important payment

systems, including national systems, whereas the recommendations in the Lamfalussy Report were originally confined to multi-currency, cross-border private netting systems. The most recent report also places greater emphasis on the need to balance the considerations of efficiency and risk reduction in payment systems. The report emphasises that the systems must meet stringent risk control requirements, while it is also important to limit costs, as this is necessary in order to be able to offer efficient payment services.

On the whole, the Core Principles are more flexible than the Lamfalussy recommendations, particularly with regard to accepting various approaches to reducing and managing risk. This must be viewed in the light of the experience gained in developing "hybrid systems", such as netting systems with several settlements through the day, which have reduced risk and require lower liquidity than gross settlement systems.

1.3. Settlement Finality Directive

The Settlement Finality Directive contributes to safeguarding the legal basis for payment and securities settlement systems. The objective of the directive is to reduce the legal risk associated with participation in these systems, to promote financial stability and to strengthen the internal market within the European Economic Area (EEA), not least through provisions on settlement finality and choice of jurisdiction. The directive is also intended to facilitate implementation of the European Central Bank's monetary policy.

The directive relates to both domestic and cross-border payment and securities settlement systems, but is confined to systems established within the EEA which have been notified to the European Commission or the EFTA Surveillance Authority, ESA. Member states are required to "satisfy themselves as to the adequacy of the rules of the system prior to notification". The directive does not specify how comprehensive this approval must be, but it provides for the introduction of fully developed authorisation and supervision arrangements. The most important provisions of the directive have been implemented in Chapter 4 of the new Norwegian Act relating to Payment Systems on legal protection and security (section 2.5).

In 1998, the Nordic Council of Ministers appointed a Nordic task force to maximise harmonisation of the implementation of the directive in Nordic law. All the Nordic countries have now implemented the directive in their national legislation.

2. The Norwegian Payment Systems Act – why do payment systems need regulation?

2.1 Risks in payment systems

When a customer uses a bank card to pay for goods in a shop, and the shop has an account at a different bank from the customer, this generates in reality at least three

funds transfers. First, the customer's bank debits the customer's account for the sum in question. Second, the shop's bank credits the shop's account with the same amount. Third, the same amount is transferred from the customer's bank to the shop's bank.

The number of card payments and other types of payment effected by banks on behalf of their customers in the Norwegian payment system can reach several million transactions per day. Participants in the payment systems may incur considerable risk in connection with the obligations which arise from these transactions should anything unforeseen occur. However, it is not card payments which give rise to the greatest risk in the payment system. The greatest exposure arises as a result of interbank trading in securities and foreign exchange and money market transactions. Most claims are settled via transfers between the banks' accounts at a settlement bank, referred to as interbank settlement. In order to handle smaller transfers more efficiently, banks have established procedures for calculating each bank's total net claim or net obligation vis-à-vis other banks, instead of settling each transaction individually. This process is known as netting. Payments where the time factor is crucial and transfers of large amounts are processed separately in the Real Time Gross Settlement (RTGS) system. Norges Bank is the ultimate settlement bank both for the RTGS system and for settlement of netted positions in the central retail netting system. These systems thus comply with BIS Core Principle no. 6 stating that assets used for settlement should preferably be a claim on a central bank. Some private banks also undertake settlement of retail transactions for smaller banks. The chart in the box provides a graphic illustration of transactions between participants in payment systems.

The daily turnover in the Norwegian payment system may reach several hundred billion Norwegian kroner. The bulk of this relates to transactions between banks in which no customers are directly involved. The positions taken by the banks in the payment system will often result in significant exposures. Financial legislation sets limits on the volume of loans banks may lend to individual customers, but these limits do not apply to payment system exposures. Since interbank exposures are not always subject to an explicit credit rating, and since the exposure arises in the course of a short period of time, the risk associated with participation in the payment system is unique. The ability to manage risk depends partly on the legal framework, the division of responsibility among the participants and the organisation of netting and interbank settlements.

The participants in the payment system in Norway have a long tradition of cooperating in areas such as agreements, technical standards and infrastructure for clearing and settlement. This cooperation has laid the basis for the coordination of banking services, allowing payment orders to be transferred efficiently from a customer in one bank to a customer in another bank. A great deal has been achieved through this self-regulation, but it has not always proved sufficient to safeguard fully the general public's interests in

Core principles for systemically important payment systems

1. The system should have a well-founded legal basis under all relevant jurisdictions.
2. The system's rules and procedures should enable participants to have a clear understanding of the system's impact on each of the financial risks they incur through participation in it.
3. The system should have clearly defined procedures for the management of credit risks and liquidity risks, which specify the respective responsibilities of the system operator and the participants and which provide appropriate incentives to manage and contain those risks.
4. *The system should provide prompt final settlement on the day of value, preferably during the day and at a minimum at the end of the day.
5. *A system in which multilateral netting takes place should, at a minimum, be capable of ensuring the timely completion of daily settlements in the event of an inability to settle by the participant with the largest single settlement obligation.
6. Assets used for settlement should preferably be a claim on the central bank; where other assets are used, they should carry little or no credit risk and little or no liquidity risk.
7. The system should ensure a high degree of security and operational reliability and have contingency arrangements for timely completion of daily processing.
8. The system should provide a means of making payments which is practical for its users and efficient for the economy.
9. The system should have objective and publicly disclosed criteria for participation, which permit fair and open access.
10. The system's governance arrangements should be effective, accountable and transparent.

* Systems should seek to exceed the minima included in these two principles.

Responsibilities of the central bank in applying the core principles

- A. The central bank should define clearly its payment system objectives and should disclose publicly its role and major policies with respect to systemically important payment systems.
- B. The central bank should ensure that the systems it operates comply with the core principles.
- C. The central bank should oversee compliance with the core principles by systems it does not operate and it should have the ability to carry out this oversight.
- D. The central bank, in promoting payment system safety and efficiency through the core principles, should cooperate with other central banks and with any other relevant domestic or foreign authorities.

connection with the payment system.

Central banks are concerned with risks in the financial sector, and Norges Bank has in recent years focused in particular on reducing risk in the payment system, not least through the development of the central bank's own settlement system. The Payment Systems Act gives Norges Bank responsibility for authorisation, thereby providing the Bank with a new instrument for assuring the quality and supervision of the systems external to the Bank's own settlement system. Approval from Norges Bank will therefore also imply a kind of quality stamp for an interbank system.

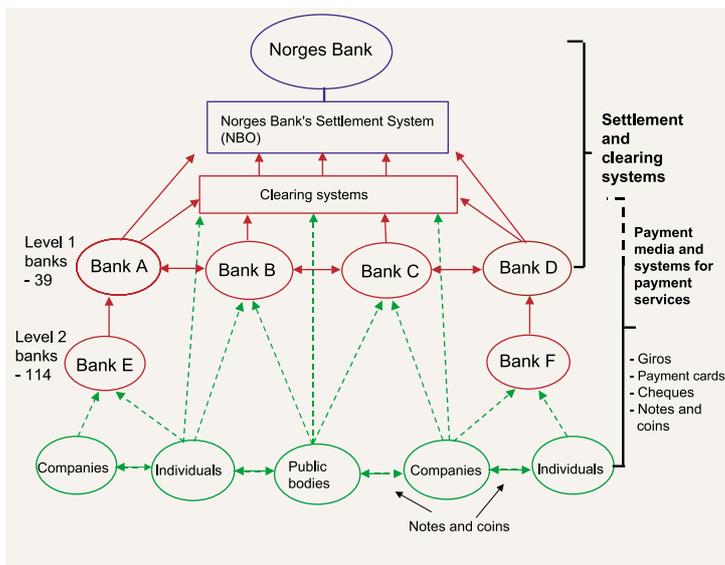
Level 1 banks settle accounts through the central bank, while level 2 banks settle in commercial or savings banks. Approximately 100 savings banks use Union Bank of Norway, and 12 to 15 savings banks use Sparebank1 Midt-Norge as their settlement bank for payment transfers.

Returning to the example of using a bank card for payment as mentioned at the beginning of this section, we can imagine a scenario where the customer (an individual) is a customer of Bank B, while the shop (a company) is a customer of Bank C. In this case both Bank B and Bank C carry out settlement at level 1 in Norges Bank. The green arrow from the private individual to Bank B illustrates how the customer's transfer order (card payment) passes through Bank B to the settlement system. There the payment is included together with many other transfer orders for calculating all the participating banks' net positions in relation to the other participants. These positions are settled in the settlement system by means of a transfer of funds between the banks' accounts at the settlement bank. This means that in the settlement system Bank C is credited with the card payment, while Bank B is debited for the same amount. Through the settlement system, notification is also sent to Bank B's customer account database that the customer's account is to be debited for the amount in question. In addition, notification is sent to Bank C's customer account database that the shop's account is to be credited with the same amount.

2.2 Key points in the Payment Systems Act

Act no. 95 of 17 December 1999 relating to Payment Systems entered into force on 14 April 2000.¹ The Act distinguishes between payment systems in interbank systems and systems for payment services. Interbank systems are defined as systems based on common rules for clearing, settlement or transfer of funds between credit institutions. Netting is the conversion into one net claim or one net obligation of claims and obligations resulting from transfer orders issued by two or more participants. The Act introduces a general rule requiring authorisation for establishing and operating such systems, and supervision of authorised systems. In line with the current division of responsibility between the

¹ The English translation of the Act is to be found on Norges Bank's web site at www.norges-bank.no. The Act is based on the Banking Law Commission's third report, NOU 1996:24 relating to payment systems etc., which in turn is based on a number of international recommendations. The EEA directive "Council Directive 98/26/EC" concerning settlement finality in payment systems and securities settlement systems is incorporated in Chapter 4 of the Act.



authorities in this area, Norges Bank has been given responsibility for the authorisation and supervision of interbank systems.

The Banking, Insurance and Securities Commission has been given responsibility for systems for payment services. Systems for payment services are systems based on standardised arrangements for the transfer of funds from or between customer accounts in banks and financial undertakings when the transfers involve the use of payment cards, numeric codes or any other form of independent user identification issued to an unrestricted range of customers. Those who operate or wish to establish systems of this kind must now send notification of this to the Banking, Insurance and Securities Commission, which may issue further specified rules on the standardisation of agreements, conditions and technical aspects for systems for payment services. Since the definition of the systems that are subject to the notification requirement is confined to transfers involving the use of payment cards, numeric codes or any other form of independent user identification, the Act does not encompass, for example, cheques, paper-based giro systems or electronic giro systems that are not based on independent user identification. Cheques are the only form of payment instrument regulated in a separate Act that was adopted as early as 1936.

The primary purpose of regulating the interbank systems is to ensure that interbank systems are organised in such a way as to safeguard the consideration of financial stability. In addition, emphasis may be placed on the importance of these systems for the efficiency of the payment system. Particular emphasis is placed on reducing the risks associated with liquidity or solvency difficulties experienced by participants in such a system. In other words, the Act is designed to help reduce systemic risk in payment systems. In this connection, Norges Bank considers it important that the system is organised in such a way as to ensure timely completion of the daily settlement, even in the event of an inability to settle by the participant with the largest settlement obligation, as recommended in Core Principle no. 5. There are about 8-10 interbank systems in Norway

today, but not all of them are of importance to financial stability. Norges Bank may according to the Act grant exemptions to the authorisation requirement for systems whose operations are limited to the extent that they are assumed to have no significant effect on financial stability. Nor are such systems subject to supervision under the provisions of the Act (see section 2.3 below.)

The Act requires each interbank system to have an operator that is responsible for its establishment and operation. In order to satisfy this requirement, some existing interbank systems must be reorganised so that full responsibility for operations rests with one entity. For instance, it is necessary to specify a separate legal entity that can serve as operator for the central clearing carried out by the Norwegian Banks' Payment and Clearing Centre Ltd (BBS). The provisions of the Act with regard to the responsible operator are described in section 2.4 below.

In a regulation of 13 April 2000 issued by the Ministry of Finance on the entry into force and transitional provisions of the Payment Systems Act, it was decided that interbank systems already in operation on the date the Act entered into force must apply for authorisation by the end of 2000. However, such systems may continue operations pending the outcome of applications for authorisation. No new system may be established or operated until authorisation has been granted.

The Act is intended to complement rather than replace banks' self-regulation in this area. It is stressed that the

Risks associated with participation in the payment system

Banks can be exposed to considerable risk when participating in the payment system. This risk can be divided into credit risk, liquidity risk, legal risk, operational risk and systemic risk.

- Credit risk depends, among other things, on to what extent banks credit customers' accounts before the banks themselves have received settlement. If a customer instructs his bank to transfer an amount to a customer in another bank, and the latter bank credits its customer before it has received settlement from the first bank, it will be exposed to credit risk which it cannot control.
- Liquidity risk is the risk that a participant will not receive anticipated funds as a result, for example, of delays in the execution of the settlement.
- Legal risk includes the risk associated with the legal status of transactions from or to a bank which is placed under public administration, and the national legislation to be applied to systems with participants from more than one country.
- Operational risk is the risk of failure or breakdowns in IT systems or communication between IT systems.
- Systemic risk is the risk that the inability of one of the participants in the payment system to meet its obligations, or a disruption in the system itself, could result in the inability of other system participants to meet their obligations.

systems remain the responsibility of the authorised operator, and that authorisation does not imply, for example, that the authorities guarantee the properties of the system's operations.

Together with the implementation of the Settlement Finality Directive in Norwegian legislation, the provisions of the Act concerning the establishment of agreements between participants in and the operator of the payment system will contribute to satisfying Core Principle no. 1 regarding a well-founded legal basis. Through its processing of applications for authorisation from the systems, Norges Bank will be able to confirm whether the systems comply with the other core principles.

2.3 Deciding which systems require authorisation

When determining whether a system should be exempted from the authorisation requirement, special emphasis will be placed on the importance of the system to the stability of the financial system. More specifically, this means determining whether the system is organised in such a way that any problems a participant might have in meeting its obligations could result in problems for other participants in meeting their obligations. In this context, systemic risk as a result of liquidity and insolvency difficulties is a central factor. This delimitation can be compared to the BIS report's delimitation of systemically important payment systems. However, when determining those systems that are to be subject to the authorisation and supervision requirement, Norges Bank will also take account of the importance of the system to the efficiency of and confidence in the payment system as a whole, and the system's need for legal protection of netting agreements.² The emphasis on the system's importance for efficiency as a determining criterion must be viewed in connection with Core Principle no. 8, which states that the system should provide a means of making payment which is practical and efficient for the economy. The final decision as to whether a system should be subject to or exempt from the authorisation requirement will be based on an overall and concrete assessment, in which emphasis is placed on whether the system has the properties described below.

The potential harm as a result of problems will in principle increase with the turnover in the systems and the value of transactions processed. A high turnover and large transaction values are therefore factors indicating a need for authorisation. If in addition there is significant credit and liquidity risk associated with the system, it should be subject to authorisation and supervision. Systems with a limited risk level will also normally be subject to the authorisation requirement if the risk level in an extreme situation could have serious consequences for financial stability. Such a situation might arise if the system's routines or organisation collapsed. Moreover, if a system with many participants fails, this may rapidly have major negative economic consequences, even if

turnover is relatively limited. Such systems may be of considerable importance to the efficiency of and confidence in payment systems, a factor which implies that they should be subject to authorisation and supervision.

Systems with limited turnover and a relatively small number of participants will also be subject to authorisation if they are linked to other important systems in such a way that the risk associated with the small system is transmitted to these larger and more important systems. This might occur as a result of the rules regarding when participants take on obligations in relation to one another.

It is usual to distinguish between interbank systems that clear and settle interbank transactions, on the one hand, and retail payment systems, on the other. The vast majority of payment transactions are retail payments, which are made when the general public uses cheques, payment cards or various paper-, telephone- or PC-based giro transactions. Payments of this kind are normally for relatively limited amounts. Even though they process a larger number of transfers, retail payment systems have a lower turnover than interbank systems, which mainly deal with foreign exchange, securities or money market transactions between banks.

The risk associated with interbank transactions is nevertheless not necessarily as large as the size of the transactions or the exposure of the participants might suggest. This is because banks are aware of the counterparties to the transactions and can monitor credit risk. However, the time factor will often be crucial in such payments, as is the case for settlement of transactions in securities and foreign exchange trading. The contagion effects associated with system difficulties may therefore spread very quickly through these markets. This means that systems that handle interbank transactions where the time factor is crucial should not be exempted from the authorisation requirement.

Banks may be subject to passive exposure in retail paymentsystems, for example if corporate customers initiate payment orders for large amounts in the retail systems, and the banks credit their customers before the interbank settlement. Such transactions may result in relatively large exposures, and a high potential risk for the beneficiary's bank, if the system is not organised in an appropriate and sound manner. Furthermore, these systems are of considerable importance to the efficiency of and the confidence in payment systems. The failure of systems that handle card transactions, which are very widespread today, may lead to loss of the public's confidence in the payment system as a whole. All in all, retail payment systems may therefore be of such importance to society that they might be required to authorise and supervise the clearing and settlement arrangements associated with the systems, even if the retail systems themselves are not regarded as systemically important.

On the other hand, there will be less need for authorisation and supervision of interbank systems with only a small number of participants, limited turnover or limited links to other interbank systems. If the exposure of

² Cf description of legal protection and security for netting and settlement agreements in section 2.5.

participants in these systems is small in relation to their capital, this may also provide grounds for exempting them from the authorisation requirement.

2.4 *The role of operator*

So far it has not been sufficiently clear in practice who has had the main responsibility for some of the Norwegian interbank systems. The Act's requirement that the systems appoint one operator will clarify the matter of responsibility. The operator is given responsibility for organising and operating the interbank system in accordance with the requirements laid down in the Act and the conditions for authorisation. It is the operator who will be the licensee and the institution to be addressed as to any requirements for adapting the system to comply with the Act. Other participants in the system must also comply with the Act, and loyally assist the operator in running the system in a sound manner. The requirements stipulated in the Act concerning the operator will fulfil Core Principle no. 10 on the system's governance arrangements.

The Payment Systems Act was formulated bearing in mind that interbank systems are constantly evolving. It is presupposed that the operator will play a key role in the operation of the systems, without this implying that the operator must take the initiative or decide on every change. The ultimate responsibility for ensuring that developments are not in contravention of the Act or the system's authorisation conditions nevertheless rests with the operator. In line with this, the operator is obligated to notify Norges Bank of any significant changes before they are implemented. Changes may be implemented, unless otherwise decided by Norges Bank, within two months of notification being received. The operator shall also suspend a participant in the system that acts in such a way that its continued participation may jeopardise financial stability. Before the decision to suspend a participant is taken, the case shall be submitted, to the extent possible, to Norges Bank.

In contrast to some other countries' implementation of the Settlement Finality Directive, the Payment Systems Act does not stipulate requirements regarding the enterprise form. The operator may be organised as a bank, another company, a non-stock institution or an association. Nor does the Act prevent several legal persons from functioning jointly as operator for a system. However, any such cooperation must take place through one legal entity, so that the authorities only have one responsible entity to deal with. The Act also allows one operator to operate several interbank systems.

Irrespective of the enterprise form, the operating body shall have a manager and a board of directors. As with institutional legislation, the Payment Systems Act requires that the manager and board members shall satisfy the necessary requirements for good conduct and experience, in accordance with the requirements for credit institutions in Council Directive 77/780/EC.

The Act requires that the agreement between participants shall specify the operator of the system. The rights and obligations of the operator and participants must also be agreed in detail. This applies, for example, to conditions for the suspension of a participant (including the operator's handling of suspension cases), the operator's responsibility to inform participants of decisions taken by the authorities, and the duty of confidentiality in connection with confidential information.

2.5 *Legal protection and security*

The Settlement Finality Directive provides approved payment and securities systems with protection against legal risk associated with the insolvency of a participant. As previously noted, the provisions of the Directive are mainly incorporated in the provisions in Chapter 4 of the Act relating to legal protection and security for clearing and settlement agreements.

The provisions in this chapter allow the systems to establish legal protection for their clearing and/or settlement agreements. Such legal protection means that the opening of insolvency proceedings cannot prevent the system from settling transactions from an insolvent bank, provided that the transactions were entered into the system prior to the decision to place the bank under public administration. The liquidator may not, for example, choose to accept incoming transactions and at the same time reject transactions that are to be charged to the insolvent bank. The general right of a liquidator, pursuant to insolvency legislation, to choose freely which agreements it will honour and fulfil has thus been eliminated. Legal protection pursuant to the Payment Systems Act also extends the participants' right to execute netting in the event of insolvency, as opposed to what follows from general insolvency legislation rules. This is because the Payment Systems Act permits multilateral netting and net settlement in insolvency situations, in contrast to the Creditors Security Act, which only allows bilateral netting.

If legal protection is established, the system can thus carry out netting and settlement even if a participant is insolvent. In order to have legal protection, the agreements must stipulate the time when transactions are entered into the system and the time when the right to revoke the order no longer applies. The Securities Trading Act also contains rules concerning legal protection for agreements on bilateral netting of financial instruments. These are general provisions that are not linked to participation in an approved interbank system.

However, agreements on legal protection are not always sufficient for executing a settlement with an insolvent participant, and the solvent participants may therefore still be exposed to credit risk. This risk could be reduced or eliminated by establishing guarantees that cover the obligations of the insolvent bank. Such guarantee arrangements may, for example, consist of a pool of securities furnished to the settlement bank. Since guarantee

arrangements can help to reduce settlement risk in a settlement system, the Savings Bank Act now allows savings banks, like commercial banks, to furnish the settlement bank with a guarantee. As the institution responsible for authorisation, Norges Bank may also instruct interbank systems to establish guarantee arrangements. The Payment Systems Act (like the Settlement Finality Directive) also provides protection against claims from the liquidator for invalidating collateral security for old debts. This means that the liquidator cannot prevent the system from realising this collateral security in order to meet the insolvent participant's obligations in the settlement.

The Act also contains important rules as to which country's legislation is applicable to securities that only exist in electronic form (dematerialised securities). These rules regarding choice of jurisdiction are relevant for cross-border pledging of collateral security, where, for example, collateral security provided to a Norwegian system is recorded in a register established in another EEA country.

Protection against legal risk associated with the insolvency of a participant is first achieved when Norges Bank notifies the systems to the EFTA Surveillance Authority. Notification will be sent when the interbank system has been authorised. Such a system is consistent with the Settlement Finality Directive, which requires national authorities to satisfy themselves as to the adequacy of the rules of the system before sending notification.

2.6 Other conditions for authorisation

The authorisation and supervision arrangement laid down in the Act shall ensure that interbank systems have a predictable regulatory framework. Central system requirements are laid down directly in the Act, such as the requirement that there be one operator. The openness requirement in the participation criteria is also explicitly laid down in the Act. This requirement may be compared to Core Principle no. 9 concerning objective and publicly disclosed criteria for participation. The Act further requires that the rights and obligations of participants be stipulated in agreements. The most central agreements are the systems' netting and settlement agreements, which are to be formulated in accordance with the requirements of the Act. As the institution responsible for authorisation, Norges Bank can stipulate other requirements regarding the systems, including capital and security requirements applicable to the operator, settlement bank or central counterparty. These requirements will have to be based on a concrete assessment of the risk factors associated with the individual system.

It is particularly important that the system be organised in such a way that it does not result in liquidity or solvency difficulties for participants. As a minimum, Norges Bank will require that participants are aware of the actual and potential risk in the system, and that the

system has procedures for providing information about such risk. Moreover, applications must present the results of a study of the risk level in the system as well as procedures for managing the risk. When applications for authorisation are considered, it will be required that the systems satisfy Core Principles nos 2 and 3. The systems must also provide information on contingency plans to ensure the timely completion of the daily settlement even if the ordinary system fails. This provision implements Core Principle no. 7 on contingency arrangements.

2.7 Norges Bank's supervisory responsibilities

Pursuant to the Payment Systems Act, Norges Bank is responsible for supervising systems that receive authorisation, and may instruct the operator to make any changes deemed necessary. The Act thus empowers Norges Bank to carry out the oversight recommended by the BIS report in point C of "Responsibilities of the central bank in applying the Core Principles". This oversight can to some extent be said to be institution-based, but will be limited to those activities of the operator that are directly linked to the interbank system. There is also a distinction between Norges Bank's system-based oversight, and the institution-based oversight for which the Norwegian Banking, Insurance and Securities Commission is responsible. System-based oversight can be looked upon as putting the central bank's traditional responsibility for monitoring payment systems into practice. Norges Bank's oversight of the systems must not encroach on the Commission's general institution-based supervision of the same institutions.

The aim of the system-based oversight shall be to ensure that the systems are operated in accordance with the purpose of the Act and the conditions for authorisation. Oversight will therefore be focused on ensuring compliance with the authorisation requirements with respect to sound procedures for managing risk in connection with clearing and settlement. Oversight will also be maintained to ensure that significant changes in operations and organisation do not influence the risk situation in a manner that is in contravention of the Act. Norges Bank may call a halt to planned changes in the system, or instruct the operator to make adjustments if the Act or the authorisation so indicates.

Applications for authorisation must, as mentioned, contain data from a study of the risk level of the system. The specific content of these studies will vary from system to system, but will normally consist of data on average daily gross turnover and maximum multilateral and bilateral positions. It may also be relevant to relate positions to the participants' capital. As a condition for authorisation, systems will be required to report key data at regular intervals. Norges Bank may also at any time require from the operator such information as is deemed necessary for determining whether the system is being operated in compliance with the Act and conditions for authorisation.

3. Summary

There is a long tradition of giving central banks responsibility for oversight of payment systems, but very few of them are empowered to instruct systems to make changes. As a result, central banks have mainly exercised their authority in this area through their role as ultimate settlement bank. This has also been the case for Norges Bank which, pursuant to the existing Norges Bank Act, "shall contribute to promoting an efficient payment system in Norway and vis-à-vis other countries". Some central banks also exert some influence on systems through part ownership and representation on the governing bodies of the systems.

Over the past ten years, there has been increased focus on the importance of payment systems to financial stability and to the economy in general. It has been found that a weak organisation of the systems may expose participants to undesired liquidity and credit risk. There has also been considerable legal risk, partly because the legislation of most countries has not provided the systems with the necessary protection in insolvency situations.

When the BIS issued the Lamfalussy Report in 1990, it became a cornerstone in the work on reducing risk in payment systems. The recommendations in the report were adopted as standards for many central banks and private systems. It also laid the basis for more detailed statutory regulation of the systems as, for example, in Canada. In its report on "Core Principles for Systemically Important Payment Systems", the BIS has further developed the recommendations from 1990, and the report stresses the central banks' responsibility for overseeing the systems. Moreover, the EU began its work on the Settlement Finality Directive partly as a result of the Lamfalussy Report, which revealed a need to establish a better legal basis for the systems. The Directive may be said to have increased national statutory regulation of payments systems in the EEA. In order to obtain the protection offered by the Directive, the system must be subject to some form of national approval. The Directive nevertheless does not require EEA States to establish a fully developed authorisation and supervisory arrangement like the one the Payment Systems Act is now introducing in Norway.

All in all, the purpose and orientation of the Payment Systems Act is closely in line with international recommendations in this area. With the introduction of an authorisation and supervisory authority for payment systems, Norges Bank is one of the first national central banks to have explicit responsibility for these systems. The central banks of Australia, Canada and Italy, as well as the ECB already have similar, explicit legal bases. This explicit statutory regulation makes the responsibilities and instruments of central banks clearer than, for example, part ownership of the systems. The BIS report on "Core Principles for Systemically Important Payment Systems" has prompted a number of central banks to consider how

they can best ensure that their systems are brought into line with the recommendations in the report, and whether central banks have an adequate legal basis for assuming decision-making powers. The result of the report in the longer term may well be that the authorities in a number of countries are given more explicit responsibility and the legal basis for intervening in the systems.

An overview was provided above of the risk factors associated with participation in a payment system. The BIS Core Principles provide guidelines on how these risk factors should be dealt with. The authorisation and oversight authority gives Norges Bank explicit authority to instruct operators to reduce risk and thereby bring their systems into line with these principles.

Norges Bank plans to finalise its conclusions as to whether the Norwegian payment systems meet with the requirements of the Act, and whether the systems comply with the BIS' Core Principles, by mid-2001.

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