

RULES

on Activities of Netting Systems

Article 1

Definitions

Banking day: A day on which commercial banks or savings banks are open for business, from Monday through Friday.

Payment system: A formal arrangement of three or more participants that is based on collective rules and a standardised arrangement for the execution of payment orders among them, provided that at least one of the participants has a main office in Iceland. The system must fulfil set requirements and have been approved and announced pursuant to the Act on the Security of Transfer Orders in Payment Systems, no. 90/1999.

Maximum netting balance: The maximum amount (overdraft) that a participant may owe to other participants in connection with netting within the day in a netting system.

Overdraft lock: A technical lock to prevent the execution of payment orders from a participant that has reached its overdraft limit.

Netting system: A payment system that receives requests from participants for the execution 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 the 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 its netting balance.

Netting balance: The real-time net position of a participant's counter vis-à-vis all other participants in the system.

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 takes the form of a limited company or private limited company, the board of the company is deemed to be the board of the netting system for the purpose of these Rules.

Real-time gross settlement (RTGS) system: The Central Bank of Iceland payment system that processes payment orders whereby payment is transferred from the payer's settlement account and into the payee's settlement account only if there is a sufficient balance on the payer's account or a sufficient negotiated intraday

overdraft facility with 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.

Settlement account: An RTGS account used for making settlements in a payment system.

Securities settlement system: A system that 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.

Reference price of securities: The end-of-day price of securities on the last trading day before the reference date in an organised securities exchange or recognised information system approved by the Central Bank.

Article 2

Participants

The board of a netting system decides on the admission of new participants in the system and the exclusion of existing system participants.

Participants in netting systems may be institutions, cf. Article 2, Item 2 of the Act on the Security of Transfer Orders in Payment Systems, no. 90/1999, provided that in other respects they fulfil the conditions for participation according to Article 3 of these Rules. Participants must have settlement accounts with the Central Bank and must also participate in its RTGS system.

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

Should a participant no longer fulfil the conditions of Articles 2 and 3, the board of a netting system may, upon consultation with the Central Bank but without advance notice or notification, deny it further participation in the system or set special conditions for its continued participation. The same applies to a participant that violates these Rules or jeopardises the stability of the system. The permission to participate in the system according to this provision shall always be temporary.

If continuing participation causes disruptions, creates risk or jeopardises stability in any manner, the board of a netting system, after consulting with the Central Bank, may exclude the participant from further participation in the system, without prior notice or notification.

Article 3

Conditions for participation

The board of a netting system shall publicise the conditions for participation in the system. These conditions shall serve to promote the safety and efficacy of the system. They shall also be accessible, impartial, justifiable and necessary. As a minimum, the conditions shall require participants to:

1. be subject to regulation by a financial supervisory authority in the European Economic Area,
2. hold a valid operating licence from the relevant supervisory authority and fulfil that supervisory authority's requirements, including those on capital adequacy and liquidity ratio,
3. have the necessary technical resources for participation,
4. have the necessary management capability and employee expertise for participation,
5. have a reliable system for monitoring risks in connection with participation in the system;
6. have reached an agreement on and provided adequate collateral security to the Central Bank of Iceland,
7. have paid, or negotiated payment of, an appropriate user fee.

The provisions of Paragraph 1, Items 1, 2 and 6 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 in the amount of 10 m.kr. or more (gross payment limits) are covered by the Central Bank's RTGS system. The Central Bank may allow participants to use the RTGS system for payment orders under the gross payment limit. However, transfers in connection with settlements in the netting system and securities settlement system are covered by the RTGS system, irrespective of their amount.

While the RTGS system is closed, the Central Bank may, in consultation with the board of the netting system, determine a limit lower than 10 m.kr.

Payment orders may not be split 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 its recognition pursuant to the Act on the Security of Transfer Orders in Payment Systems, no. 90/1999. All changes to recognised payment systems shall be reported to the Central Bank in advance.

Article 6

Operating hours of netting systems

The board of a netting system shall determine its operating hours in consultation with the Central Bank of Iceland. Final settlement in a netting system on regular banking days shall be made no later than 17:00 hrs. following closure of the Central Bank's RTGS system. More than one settlement may be made per day in netting systems, subject to the approval of the Central Bank.

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 the delivery 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 oblige it or relieve it of the obligation to remit payment in the sense of this term as defined in general legal interpretations.

The netting system shall register and keep a record of the payer's name, address and account number.

Article 8

Request for execution of a payment order

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

Article 9

Time of payment order entry

A payment order is regarded as having been entered into 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 payment orders are received by the system and confirmation of receipt 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 may not be retracted after that time; cf., however, Paragraph 2.

In the event that an obvious error has been made in transmission of a payment order that 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, provided that sufficient funds are available on the account to which the payment was made to refund the amount and that the estate of the recipient has not entered insolvency proceedings before that time. Such cancellation invalidates the binding legal effect in connection with the order that had been created pursuant to Paragraph 1. In other respects, the participant performing such a cancellation is responsible for its legitimacy.

The legal effect of insolvency or winding-up of a participant's estate is determined by the Act on Bankruptcy, etc., no. 21/1991, the Act on the Security of Transfer Orders in Payment Systems, no. 90/1999, and the Act on Financial Undertakings, no. 161/2002.

Article 11

Counter and netting account

As soon as a payment order is executed, the change in the net real-time position of participants (i.e., the netting position) is recorded in a counter that is accessible to the participants concerned, the Central Bank, and the board of the netting system.

Participants use dedicated netting accounts to manage their netting balances. Participants may deposit funds in their netting accounts in order to raise the maximum netting balance temporarily.

Article 12

Agreement on overdraft limit

Participants shall negotiate an overdraft limit with the board of the netting system. Participants may request a change in their overdraft limits, and announcements to this effect shall be made to the board of the netting system and the Central Bank. A new overdraft limit takes effect when the Central Bank has confirmed that formal collateral has been provided for it.

Participants may raise their intraday overdraft by providing the Central Bank with additional collateral in the form of securities eligible as overdraft collateral.

A netting system shall ensure that the netting balance according to the counter at any time does not exceed the negotiated overdraft limit; cf., however, the provisions of Article 11, Paragraph 2, concerning payment into netting accounts.

To ensure the safety and business continuity of a netting system's operation, the board of the netting system and the Central Bank may insist on a specific overdraft limit for individual participants.

Article 13

Transfer of collateral when the RTGS system is closed

When the netting system is open and the RTGS system is closed, the Central Bank may allow part of participants' RTGS system collateral to be used for the netting system at that time. The temporary increase in the overdraft limit in the netting system shall be consistent with the appraised value of the transferred collateral and shall aim at reducing the likelihood that an overdraft lock will be activated in the netting system. If part of the collateral in the RTGS system is used in this way, the overdraft limit in the RTGS system shall be reduced correspondingly until collateral has been transferred back to it prior to the opening of the RTGS system. No more than 50% of participants' collateral in the RTGS system may be transferred to the netting system while the RTGS system is closed.

Article 14

Rejection of request for execution of a payment order

If the netting system receives a request for a payment order that would, if confirmed and executed, cause the relevant netting balance to exceed the negotiated maximum, the payment system is obliged to reject such a request and notify the participant in question.

Article 15

Collateral for settlements

Participants in a netting system shall negotiate on and present to the Central Bank sound and adequate collateral to cover any payment default in connection with a settlement in the system.

The amount of collateral provided by each participant, after adjusting for deductions, shall be based on enabling completion of settlement in accordance with that participant's overdraft limit (maximum netting balance) at any time.

The Act on Financial Collateral Arrangements, no. 46/2005, shall apply to collateral for settlements.

Article 16

Securities eligible as overdraft collateral

Both deposits and the following securities denominated in Icelandic currency are eligible as overdraft collateral in a netting system:

1. Securities issued by the national Treasury;
2. HFF bonds issued by the Housing Financing Fund;
3. Certificates of deposit issued by the Central Bank of Iceland;
4. Participants' fixed-term deposits with the Central Bank of Iceland.

Article 17

Eligibility requirements for securities used as collateral

Securities provided as collateral must fulfil the following conditions:

1. The market value of the series is over 3 b.kr. and it is confirmed that this amount has been sold.
2. The securities have a market maker on a regulated securities exchange or through recognised data vendors approved by the Central Bank.
3. The securities must be electronically registered in a central depository recognised by the Central Bank.

Article 18

Limits on the eligibility of securities as collateral

A participant guarantees that securities provided as collateral are without liens or encumbrances.

Subordinated instruments may not be provided as collateral.

Securities selected may not mature prior to the end of the contracted period. If securities are called or mature during the period of validity of the intraday overdraft of a participant in a payment system, or if the seller requests that they be returned, the participant must provide new eligible securities, the assessed value of which must be at least equal to that of the called or matured securities.

If no reference value of the securities is available on a regulated securities market or through recognised data vendors approved by the Central Bank, the

securities concerned may not be used as collateral unless a specific decision is made to this effect by the Central Bank.

The Central Bank shall evaluate the eligibility of the securities in question as collateral on a case-by-case basis. The Central Bank reserves the right to reject securities submitted as collateral if there is doubt as to whether the conditions for their eligibility as collateral are fulfilled.

Article 19

Valuation of eligible collateral securities

In appraising the value of securities provided as collateral for intraday overdrafts in the netting system, deductions shall be calculated from the reference price. No deduction is calculated on Central Bank certificates of deposit. The deductions applied to securities are published on the Central Bank website in the conditions for financial collateral arrangements with the Central Bank of Iceland.

If necessary, e.g. due to market conditions, the Central Bank may calculate deductions in addition to those stated in the Bank's conditions.

The Central Bank issues conditions for evaluating the eligibility of securities as collateral for overdrafts and for their valuation. The conditions are published on the Bank's website.

Article 20

Additional collateral security

Because the market value of securities may change without notice, the Central Bank reviews the value of collateral on a regular basis; cf. Article 19. Such a review may lead the Central Bank to require additional collateral security.

If the value of the collateral according to the Central Bank's assessment is lower than the participant's overdraft limit and below regulatory limits, the participant concerned shall provide additional collateral immediately.

The Central Bank may temporarily reduce the maximum intraday overdraft limit of the participant in question by a corresponding amount until the additional collateral has been provided.

Article 21

Custody of securities

Securities provided as collateral shall be registered with a securities depository that has been granted an operating licence pursuant to the Act on Electronic Registration of Title to Securities, no. 131/1997. Securities that are electronically

registered in a foreign securities depository recognised by the Central Bank may be provided as collateral.

Securities registered in an Icelandic securities depository shall be deposited in a securities deposit account (VS account) held by the participant concerned with the Central Bank; this account shall also be pledged to the Central Bank through a special declaration to this effect.

If securities are registered in a foreign securities depository, they must be deposited with a custodian (account operator) approved by the Central Bank.

Registration of collateral shall be as provided for in Chapter IV of the Act on Electronic Registration of Title to Securities, no. 131/1997.

Article 22

Authorisation to dispose of collateral in the event of settlement default

A participant's negative balance shall be settled in the RTGS system, irrespective of the amount.

In the case of default on settlement obligations in payment systems, the Central Bank may appropriate all of the settlement collateral provided by that participant, regardless of whether the claim concerns settlement in the netting system or the RTGS system.

The Central Bank may redeem securities provided as collateral and/or use cash in a collateral account and dispose of such, without advance notice or notification, in order to conclude settlement and eliminate debit balances in the system.

Article 23

Technical resources and risk surveillance system

Participants in a netting system must have the technical resources specified by the board of the system at any time.

Participants must, at all times, have a secure risk surveillance system associated with their use of the netting system and other payment and securities settlement systems in which they participate.

Article 24

Monitoring of netting balance

Participants are obliged to monitor their netting balances as shown on the relevant netting accounts and counters with the aim of preventing, in good time, the rejection of a request for execution of a payment order. Participants and the Central

Bank have access to participants' netting accounts, while the board of a netting system can see the position of netting accounts and the counter.

Each participant is obliged to have technical equipment to facilitate the monitoring of its payment position.

Article 25

Response to payment position

Before a maximum netting balance is reached, a participant with a negative balance is obliged to make every effort to prevent the rejection of a payment order by depositing funds in its netting account.

Article 26

Participants' contingency plans

Each participant must develop a contingency plan outlining its response to shocks to the operation of the netting system.

A participant shall set up the necessary reserve equipment in order to be able, among other things, to receive notifications about debit balances on RTGS and netting system accounts if normal methods of communication break down or are disrupted. Such notification may mean that the participant concerned or other participants will need to procure an overnight facility or transfer liquid funds between accounts before settlement takes place. The reserve equipment should also ensure that a participant is able to decide to transfer liquid funds to or from its own account before 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.

Article 27

Contingency plan of the board of a netting system

In consultation with participants, the board of a netting system shall establish and maintain contingency plans. The contingency plans must be structured so that they can be used in the event of technical malfunction, pandemic, or changed market conditions due to virus attacks, war, terrorist acts, financial crisis, etc. There must also be plans to ensure the necessary operational security in the event of delays, power outages, or other technical mishap.

The board of a netting system shall organise contingency exercises in consultation with participants and the Central Bank. The general aim shall be that contingency exercises are held once a year.

Article 28

Instruction on the operation of the netting system

Employees of participants in a netting system who are in charge of payment intermediation shall be given the necessary instruction on 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 employees in charge of payment intermediation, and for participants' customers.

Article 29

Tariff

The board of a netting system shall set a tariff for participants in connection with its activities and operation. The tariff shall be transparent and shall be accessible on the website of the system operator.

The board of a netting system pays a fee for netting system settlements through the Central Bank's RTGS system, in accordance with the currently valid RTGS system tariff.

Article 30

Oversight and supervision

The board of a netting system is responsible for day-to-day operation of the system and is obliged to ensure that the satisfactory capabilities, expertise and technical resources are available to operate it in accordance with currently applicable regulatory instruments.

The Central Bank oversees the operations of netting systems with respect to their operational security, efficacy and efficiency. The Financial Supervisory Authority supervises individual participants' implementation of the rules on netting systems.

Article 31

Information disclosure

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

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

The board of a netting system shall announce in the *Official Gazette (Lögbirtingablaðið)* the names of participants in the system. A new announcement shall be made if participation changes.

Article 32

Rules of procedure

The board of a netting system may set more specific rules of procedure for participants and publish them in suitable manner, e.g. on its website. The rules of procedure shall include detailed provisions on the activities of the system, conditions for participation, exclusion from participation, requirements for technical resources, execution of payment orders, and contingency plans.

Article 33

Entry into force

These Rules, which are adopted pursuant to Article 38, cf. Article 4, of the Act on the Central Bank of Iceland, no. 36/2001, enter into force on August 17, 2009. As of that same date, the Rules on Activities of Netting Systems, no. 313 of 11 April 2007, shall be repealed.

Reykjavík, August 13, 2009

CENTRAL BANK OF ICELAND

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