

A G R E E M E N T
on
Rules of Procedure
for
settlement of securities transactions

The Central Bank Iceland, national ID no. 560269-4129, Kalkofnsvegur 1, Reykjavík, (hereinafter referred to as the Central Bank), and the Icelandic Securities Depository hf., national ID no. 500797-3209, Laugavegur 182 (hereinafter referred to as the ISD), hereby agree upon the following rules of procedure for the settlement of securities transactions; cf. the Act on Electronic Registration of Title to Securities, no. 131/1997.

The purpose of the rules of procedure agreed upon by the Central Bank and the ISD is to safeguard the interests of purchasers and sellers of securities. This entails ensuring that sellers of securities do not gain access to sales proceeds without delivery of the securities, and vice versa.

1. Definitions

In these rules of procedure, the following terms shall be defined as specified:

1.1 Delivery versus payment: The linking of securities delivery and the delivery of funds, or another comparable arrangement that ensures, in a secure manner, that the seller of securities does not gain access to the proceeds of the sold securities without delivering them, and vice versa, in accordance with the Bank for International Settlements' Recommendations for securities settlement systems of 2001.

1.2 Regular banking days: Days on which commercial banks and savings banks are open for business, from Monday through Friday.

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- 1.3 Payment orders:** Orders that are sent electronically via the RTGS system, containing instructions to deduct payment from the payer's account and deposit it to the account of the recipient. Payment orders include the necessary information on the account owners and the transaction so that the payment can be completed.
- 1.4 Cash for settlement:** Funds that are used for financial completion of securities transactions are claims against the Central Bank.
- 1.5 Matching system:** The ISD matching system/Trade Reporting System (TRS) receives notifications from account operators concerning transactions that are to be settled between parties through ISD intermediation. All transactions that are to be settled in the securities settlement system are reported to the matching system/TRS system, where they are matched. Only matched transactions will be settled.
- 1.6 Account operator:** An undertaking or institution that, on the basis of a membership agreement with the ISD, is authorised to act as an intermediary for the registration of title to securities in dematerialised form in the ISD system.
- 1.7 Operational security:** Risk related to the settlement process and the operation of the RTGS system, on the one hand, and the operation of the securities settlement system, on the other. Operational security also applies to the ISD and to the Icelandic Banks' Data Centre (RB), which handles the technical operations of the above-specified systems.
- 1.8 Real-time gross settlement (RTGS) system:** The Central Bank of Iceland Real-Time Gross Settlement System (the RTGS system).
- 1.9 Time of settlement finality:** Settlement is considered final at the moment when securities and funds are exchanged. The securities are transferred from seller to purchaser versus the agreed payment, and the transaction is thereafter irrevocable and is considered final.
- 1.10 Settlement date:** The date (S) when the finalisation of a securities transaction is considered to take place.
- 1.11 Settlement agent:** An institution, cf. Article 2, Item 2 of Act no. 90/1999, which is a member of the Central Bank of Iceland RTGS system and carries out financial intermediation for an account operator's settlement in the RTGS system.

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- 1.12 Allocation account:** An account in the securities settlement system where matched transactions are stored in the name of the account operators until the account operator has recorded the name of the ultimate purchaser/seller.
- 1.13 Securities settlement system:** A system owned by the Icelandic Securities Depository (ISD), which receives confirmation of securities transaction terms, and determines (allocates) entitlements and obligations in connection with the transaction, and settles the transaction by delivering the securities versus secure payment.
- 1.14 Securities settlement account:** Separate accounts in the Central Bank RTGS system that are used for monetary settlement of securities transactions.
- 1.15 Securities transaction:** A trade with dematerialised (electronic) securities that are registered at the Icelandic Securities Depository (ISD).
- 1.16 Contingency plan:** A plan outlining responses to problems that could arise in the settlement process – at the Central Bank and in the RTGS system, on the one hand, and at the ISD and in the securities settlement system, on the other; or at the service provider, the Icelandic Banks' Data Centre – together with a description of responses to malfunctions in the operational environment, so as to enable the finalisation of securities settlement within specified time limits in spite of operational malfunctions.
- 1.17 Transaction date:** The transaction date (T) is the date on which the purchase or sale of securities takes place. T+1, T+2, T+3, and so on refer to the number of days that elapses from the transaction date until the settlement date.
- 1.18 VS account:** A custodial account in the ISD system, where dematerialised securities issued by ISD are held in custody; cf. the Act on Electronic Registration of Title to Securities, no. 131/1997.

2. Participation

2.1 Participation in settlement of securities and funds

An account operator is authorised to register title to securities in a securities settlement system, and if it is also a participant in the Central Bank RTGS system, it will be accorded the status of a settlement agent. If an account operator is not a member of the RTGS system, it must negotiate with a settlement agent (an RTGS system participant) concerning the monetary settlement of its securities transactions. Account operators

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and settlement agents shall conclude formal agreements with the Central Bank and the ISD, in accordance with the regulatory provisions that apply to each party (see the Central Bank Rules on the Real-Time Gross Settlement System, no. 703/2009 (Appendix A) and an excerpt from the Rules on Account Operators' Membership to the VS System (Appendix B).

A settlement agent that takes on monetary settlement of securities transactions for an account operator is responsible for, in addition to its own transactions, the monetary settlement of the account operator concerned. The ISD shall send the Central Bank of Iceland a copy of the settlement agent's declaration concerning its service to the account operator in connection with the monetary settlement of securities transactions.

3. Settlement of dematerialised securities at the ISD

3.1. Basis and arrangement for settlement

The ISD's securities settlement is based on delivery of securities versus payment, in accordance with the Bank for International Settlements' Recommendations for securities settlement systems, issued in November 2001. All accepted buy and sell offers for exchange-based trading of dematerialised securities settled by the ISD are reported to the ISD matching system. It is also possible to send off-exchange transactions that are to be settled in the ISD system to the matching system.

The system is open for notification from 09:00 hrs. to 17:45 hr. on regular banking days. System members can send buy and sell offers to the matching system until 17:45 on the day before settlement.

Matched transactions are stored in allocation accounts in the name of the account operators until the account operator has recorded the name of the ultimate purchaser/seller.

3.2. Liability of sellers of securities and actions by the ISD

Sellers are responsible for depositing the negotiated securities to their accounts within the specified time limits. After the transactions have been entered to the accounts of the ultimate sellers and it has been ensured that there are sufficient assets to complete the transactions, those securities are locked until settlement has taken place. If sellers have not submitted the negotiated securities within the specified time limits, the ISD will cancel the transactions with a negative balance before final payment orders are sent to the Icelandic Banks' Data Centre for processing. The ISD sends the purchaser and seller information on the transactions that were cancelled, as well as information

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on the potential payment obligation. The Central Bank also receives information on such instances.

Purchasers and sellers must re-enter trades cancelled by the ISD in the ISD matching system, and they will be settled on the following day, or thereafter.

3.3. Tasks of the Icelandic Banks' Data Centre

Pursuant to an agreement between the ISK and the Icelandic Banks' Data Centre (RB), RB nets out payment orders for matched transactions on behalf of the ISK, according to accepted buy and sell offers, and then, on behalf of the ISD, sends net payment orders to the RTGS system on the basis of the authorisation granted to the ISD by the settlement agents.

4. Monetary settlement of securities transactions at the Central Bank

4.1. Arrangements for monetary settlement

Monetary settlement of securities transactions takes place during the RTGS system's hours of operation. (The Central Bank does not close the RTGS system for securities settlement, and the arrangement aims, among other things, to cause as little disturbance as possible in RTGS system payment flows.) The Central Bank establishes special interest-free securities settlement accounts in the name of each settlement agent. The accounts are used to set aside cash for securities settlement. Securities settlement accounts are sub-accounts of the respective institutions' RTGS accounts, and their purpose is to facilitate the monetary part of securities settlement. The Central Bank has sole access to securities settlement accounts. Settlement agents themselves can make deposits to their securities settlement accounts, but only the Central Bank is authorised to issue payment instructions involving disbursements from these accounts, in accordance with a request from the ISD for the settlement of securities transactions.

Settlement agents can assign the Central Bank the task of making deposits to their securities settlement accounts in amounts exceeding RTGS limits, in accordance with the net payment instructions received from the ISD. Responsibility for satisfaction of the claim is not transferred from the settlement agent to the Central Bank, however, if terms and conditions are not met.

Monetary settlement takes place as follows: the Central Bank transfers/enters net payments between participants' securities settlement accounts in accordance with confirmed underlying securities transactions, which are based on the netted amounts that RB handles on behalf of the ISD, according to payment orders that are sent from

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the ISD system and are ISD's responsibility, in accordance with authorisation from the settlement agents concerned. When this is complete, the Central Bank notifies the ISD that the monetary settlement for the underlying securities is assured.

4.2. Seller access to net proceeds of securities sales.

When it has been confirmed that the transfer of dematerialised securities is complete, the Central Bank transfers/enters the transferred amounts to the sellers' RTGS accounts, thus giving the sellers full access to the net proceeds of the securities sales.

Both parts of the securities settlement process should take place simultaneously at 12:05, provided that it has been confirmed that the underlying securities and funds are available and accessible to the ISD and the Central Bank for settlement.

5. Operating hours – final settlement

The securities settlement system is operated from 9:00 hrs. to 17:45 hrs. on regular banking days.

5.1. Times and processes in securities settlement

Securities settlement takes place at 12:05 hrs. on regular banking days. Before this occurs, the preparatory actions listed below must have been completed within the stated time limits, assuming a normal settlement process:

- **17:50** On the day before settlement (S-1), the ISD sends settlement agents preliminary information on their payment obligations relative to securities settlement. These payment obligations will not change on the following day unless it proves necessary to cancel a trade. This information is also sent to the Central Bank at the same time as it is sent to the settlement agents.
- **11:00** Matched transactions wait in allocation accounts until the account operator has recorded the name of the ultimate purchaser/seller. This must be completed by 11:00 hrs.
- **11:00** Settlement agents must have deposited funds to their securities settlement accounts with the Central Bank by 11:00 hrs. on the settlement date, in accordance with the information sent out by the ISD at 17:50 hrs. on the day before settlement (S-1). The Central Bank

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sends the ISD a confirmation of whether purchasers have fulfilled their obligations or not.

- **11:00** The ISD runs a preliminary settlement to verify the availability of sufficient securities for settlement.
- **11:00** If the preliminary settlement reveals that account operators (sellers) do not have sufficient securities for settlement, the ISD will cancel the trades with a negative balance. These transactions will be entered in the matching system once again, with a new settlement date. The ISD sends both parties to the transaction information on the trades that must be cancelled, and sends the respective settlement agents new information on their payment obligations. The ISD shall inform the Central Bank of the trades that are cancelled.
- **11:15** The ISD sends a final payment register to RB for netting. At this time, all ISD members have in their accounts the securities required to finalise securities settlement, and they have in their securities settlement accounts the monetary balances necessary to fulfil their payment obligations. RB calculates the net payment instructions for the settlement agents and sends the payment instructions to the Central Bank.
- **11:15** If a change in the final payment register means that settlement agents no longer have sufficient funds in their securities settlement accounts with the Central Bank, they have until 11:45 hrs. to deposit the remaining balance so that settlement can take place on the basis of the payment register sent by the ISD to RB at 11:15.
- **11:46** The Central Bank sends the ISD a confirmation of whether the relevant settlement agents have sufficient funds in their securities settlement accounts to fulfil their payment obligations according to the payment register sent at 11:15.
- **11:46** If it is revealed that a settlement agent does not have sufficient funds to fulfil its payment obligations, the ISD will unilaterally cancel enough of its securities purchases to enable settlement to take place. The ISD then sends a new payment register to RB, which recalculates the settlement. Trades will be cancelled in accordance with the ISD rules authorising the selection of trades for cancellation so as to guarantee that settlement will take place within the specified time limits.

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- **11:55** If the number of cancellations is so high that it is foreseeable that the time limits for the settlement process will not be met, the ISD is authorised to keep the system closed beyond the conventional settlement time, until settlement has been ensured; that is, until the securities and monetary sides of settlement have been balanced.
- **12:00** The ISD closes its system and prepare securities settlement based on the funds that settlement agents have deposited to their securities settlement accounts according to information from the Central Bank.
- **12:05** The ISD settles the securities and sends the Central Bank a confirmation that settlement is complete.
- **12:05** The Central Bank transfers/enters net settlement transfers between the securities settlement accounts of the buyers and sellers and sends the ISD a confirmation that settlement is complete.
- **12:05** The Central Bank enters the balances on securities settlement accounts over to RTGS accounts.
- **12:15** The ISD system opens for business again and sends a confirmation to this effect to the Central Bank.

5.2 Deviations from the normal settlement process

If, by 11:55 hrs., it emerges that account operators or settlement agents do not have the required securities or funds to carry out settlement, the finalisation of settlement – that is, the transfer of securities and funds between purchasers and sellers and the opening of the system – is delayed. The ISD maintains a detailed register of all deviations of this type and sends information on them to the Central Bank.

The account operators and/or settlement agents that do not meet the requirements for submittal of securities or funds for settlement at the prescribed time shall pay a fine to the ISD, in accordance with its tariff.

If an account operator or settlement agent is found negligent, the ISD is required to issue a written warning to the party in question. In instances of repeated negligence, the Central Bank and the ISD may revoke that party's membership to the securities settlement system.

5.3 Entry into force

The rules of procedure set forth in this agreement take effect on September 21, 2009. On that date, the parties' previous settlement arrangements according to the agreement

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of May 25, 2000, shall expire. Both parties are authorised to request the review or cancellation of this agreement with six months' notice.

5.4 Disputes

Any dispute arising from this agreement may be referred to the District Court of Reykjavík, pursuant to Act no. 91/1991.

This agreement is signed in two identical copies, and each party shall retain one copy.

Reykjavík, August 25, 2009

CENTRAL BANK OF ICELAND

ICELANDIC SECURITIES
DEPOSITORY HF.

Már Guðmundsson
Governor

Einar Sigurjónsson
Managing Director

Tryggvi Pálsson
Director

Enclosures:

- A. Rules on the Central Bank of Iceland Real-Time Gross Settlement system, no. 703/2009.
- B. Excerpt from the rules on account operators' membership to the VS system, dated July 4, 2008.