



EUROPEAN CENTRAL BANK

ASSESSMENT OF SORBNET-EURO AND BIREL AGAINST THE CORE PRINCIPLES

JUNE 2005

ECB EZB EKT EKP

**CONNECTION
OF SORBNET-EURO
TO TARGET
VIA THE
BANCA D'ITALIA
AND ITS NATIONAL
RTGS SYSTEM BIREL**





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INTRODUCTION AND EXECUTIVE SUMMARY

In January 2005 the Governing Council of the European Central Bank (ECB) agreed to the connection of SORBNET-EURO, the real-time gross settlement (RTGS) system of Narodowy Bank Polski (NBP) for euro transactions, to the Trans-European Automated Real-time Gross settlement Express Transfer (TARGET) system via BIREL, the RTGS system of the Banca d'Italia (BdI).

In addition to the obligations stemming from the TARGET legal framework, the connection of SORBNET-EURO to TARGET was subject to two additional oversight requirements. First, SORBNET-EURO needed to comply with the "Core Principles for Systemically Important Payment Systems"¹ (the Core Principles), which the Governing Council of the ECB adopted on 25 January 2001 as the minimum standards for the Eurosystem's common oversight policy on payment systems. Second, it was necessary to assess BIREL's continued compliance with the Core Principles, following the connection of SORBNET-EURO.

On behalf of the Eurosystem, the ECB prepared and coordinated the oversight assessment exercise of SORBNET-EURO and BIREL. From a methodological point of view, the assessment exercise took place before the launch of SORBNET-EURO and was based on an *ex ante* assessment of SORBNET-EURO against the Core Principles, carried out by the NBP, and an *ex ante* impact assessment of BIREL carried out by the BdI. The Eurosystem then reviewed these assessments.

This assessment report summarises the results of the assessments. The overall outcome of the assessment exercise was positive. The SORBNET-EURO system has achieved a high degree of compliance with all relevant Core Principles.² The impact assessment of BIREL showed that its degree of compliance with the relevant Core Principles has not been adversely affected by the connection of SORBNET-EURO to TARGET via the BdI and its BIREL

system. Open issues relate to some legal matters (Core Principle I) and some aspects revolving around business continuity (Core Principle VII). The owners of SORBNET-EURO and the BdI are expected to adequately and effectively address the issues identified in this assessment and to investigate possible improvements (e.g. following up on action plans) in order to increase by as much as possible the level of compliance of SORBNET-EURO and BdI/BIREL (in relation to the connection of SORBNET-EURO) with the Core Principles.

It should be noted that the assessment exercise had to take place prior to the launch of SORBNET-EURO on 7 March 2005. Therefore, the present report may not in all instances reflect the latest developments, particularly regarding measures taken by the relevant NCBS to overcome the few minor deficiencies identified by the Eurosystem oversight function during the assessment process.

The report is structured as follows. Section 1 explains the procedures and the methodology followed by the NBP and the BdI in preparing the *ex ante* assessments. Section 2 provides both an overview of the overall results of the assessments carried out by the NBP and the BdI and a detailed description, principle by principle, of the main oversight findings from the ECB's review of the respective system's compliance with the Core Principles prior to the launch of SORBNET-EURO. The conclusions drawn from the review of these *ex ante* assessments are provided in Section 3. The Annex sets out the legal framework for the connection as reviewed for this assessment.

¹ Report of the Committee on Payment and Settlement Systems (CPSS) entitled "Core Principles for Systemically Important Payment Systems", Bank for International Settlements, January 2001.

² Core Principle V on multilateral netting is not applicable to RTGS systems. Consequently, TARGET components have been assessed against the nine relevant Core Principles.

I METHODOLOGY AND PROCEDURES

Since the adoption in January 2001 of the “Core Principles for Systemically Important Payment Systems”³ by the Governing Council of the ECB as the minimum standards to be used by the Eurosystem for its common oversight policy on payment systems, assessments have had to be and actually have been carried out against the Core Principles.⁴ In order to achieve a high degree of consistency and comparability when carrying out assessment exercises, the Eurosystem defined a common methodology, based on a number of questions (so-called terms of reference). The terms of reference are largely drawn from the IMF’s “Guidance Note for Assessing the Observance of Core Principles for Systemically Important Payment Systems”, issued in August 2001.

On the basis of the common methodology (the terms of reference), the NBP performed an *ex ante* assessment of SORBNET-EURO and the BdI performed an *ex ante* impact assessment of BIREL against the relevant Core Principles. The results of these assessments were summarised in individual assessment reports prepared by the NBP and the BdI respectively. On behalf of the Eurosystem, the ECB, as the overall coordinator of the *ex ante* oversight assessment exercise, peer reviewed these reports and performed a “gap analysis” using the issues addressed in the terms of reference as the benchmark for the review. Where needed, the ECB asked the NBP and the BdI to complement their assessment reports and/or provide further clarification on open issues.

2 OVERALL ASSESSMENT

The overall outcome of the *ex ante* assessment exercise was positive. SORBNET-EURO was assessed as having achieved a high degree of compliance with all relevant Core Principles.⁵ BIREL’s degree of compliance with the relevant Core Principles remains unchanged as compared to the situation existing before the

connection of SORBNET-EURO to TARGET via the BdI and its BIREL system.

The owners of SORBNET-EURO and the BdI are expected, where necessary, to adequately and effectively address the few issues identified in the assessment (concerning Core Principles I and VII) and to carry out a review of possible improvements (e.g. following up on action plans) in order to increase by as much as possible the level of compliance of SORBNET-EURO and BdI/BIREL (in relation to the connection of SORBNET-EURO) with the Core Principles.

Owing to the fact that the assessment exercise took place prior to the launch of SORBNET-EURO on 7 March 2005, the present report might not in all instances reflect measures taken by the relevant NCBs to overcome the few minor deficiencies identified by the Eurosystem oversight function during the *ex ante* assessment process.

2.1 OVERVIEW

Tables 1 and 2 show the degree of compliance of SORBNET-EURO and BIREL respectively with each of the Core Principles in the run-up to the launch of the system and its connection to TARGET via BIREL on 7 March 2005.

2.1.1 COMPLIANCE OF SORBNET-EURO

Table 1

Core Principle	Fully observed	Broadly observed	Partly observed	Not observed	Not applicable
I	X	-	-	-	-
II	X	-	-	-	-
III	X	-	-	-	-
IV	X	-	-	-	-
V	-	-	-	-	X
VI	X	-	-	-	-
VII	-	X	-	-	-
VIII	X	-	-	-	-
IX	X	-	-	-	-
X	X	-	-	-	-

³ See footnote 1.

⁴ Report on “Assessment of euro large-value payment systems against the Core Principles”, ECB, May 2004.

⁵ See footnote 2.

2.1.2 IMPACT ON THE COMPLIANCE OF BIREL

Table 2

Core Principle	Impacted	Not impacted	Change in the degree of compliance ¹⁾ Y=Yes; N=No	Not applicable
I	X	-	N	-
II	X	-	N	-
III	X	-	N	-
IV	X	-	N	-
V	-	-	-	X
VI	X	-	N	-
VII	X	-	N	-
VIII	X	-	N	-
IX	-	X	N	-
X	-	X	N	-

1) As compared with the degree of compliance identified in the report on “Assessment of euro large-value payment systems against the Core Principles”, ECB, May 2004.

2.2 DETAILED ASSESSMENT AND MAIN FINDINGS (BY CORE PRINCIPLE)

2.2.1 CORE PRINCIPLE I

The system should have a well-founded legal basis under all relevant jurisdictions.

When assessing compliance with Core Principle I, an examination was made of whether the legal infrastructure and legal risks had been clearly identified and whether those legal risks had been appropriately addressed to ensure the enforceability of the system’s rules. The draft legal framework for the connection, as reviewed for this assessment, is set out in the Annex to this report.

Legal relationships

BIREL is connected to the TARGET system through interlinking.⁶ SORBNET-EURO is connected to BIREL in a correspondent relationship, whereby NBP holds a correspondent account at the BdI, and the BdI provides correspondent services for and on behalf of the NBP. This indirect participation in BIREL is legally provided for. Under Italian law, this arrangement can be characterised as an agency contract (*contratto di mandato*), whereby the BdI acts in its own name on behalf of the NBP. This agency relationship is specified in the

agreements between the NBP and SORBNET-EURO participants. All obligations on the system’s side vis-à-vis SORBNET-EURO participants rest with the NBP.

Finality and irrevocability

For the purposes of this assessment, the terms “finality” and “irrevocability” are used in their legal sense; irrevocability refers to the moment in time when a payment order is irreversible *inter partes*, i.e. can no longer be revoked, reversed or otherwise made void by the sender, while finality refers to the moment in time when a payment order is irreversible *erga omnes*, i.e. can no longer be revoked, reversed or otherwise made void by anyone, including the system itself or a third party. According to Article 3 of the Settlement Finality Directive (SFD)⁷, the system’s rules must define the moment of entry of a transfer order into a system (which is the moment from which the SFD’s finality “protection” is relevant). According to Article 3(e)(3) of the TARGET Guideline, irrevocability must be achieved no later than when the RTGS account of the sending participant at the sending NCB is debited. According to Article 4(c)(3) of the TARGET Guideline, it is an obligation of the sending NCB to ensure finality is achieved in relation to the sending participant when the RTGS account of the sending participant at the sending NCB is debited. According to Article 4(d)(2) of the TARGET Guideline, it is an obligation of the receiving NCB to ensure finality is achieved in relation to the receiving participant when the RTGS account of the receiving participant at the receiving NCB is credited.

As regards outgoing payments sent by SORBNET-EURO participants, the moment when irrevocability is achieved is set out in

6 The interlinking mechanism is one of the components of the TARGET system. The term is used to designate the infrastructures and procedures which link national RTGS systems in order to enable the processing of inter-Member State payments within TARGET.

7 Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems (OJ L66/45 of 11 June 1998).

Paragraph 11 of the RTGS Account Agreement (*Entry of a payment order into the SORBNET-EURO System and irrevocability of a payment order*).⁸ This is also the relevant provision for the finality of outgoing payments sent by SORBNET-EURO participants.

As far as payments sent by a participant in an RTGS system to a SORBNET-EURO participant are concerned, the finality and irrevocability of the payment being paid into the account of the NBP at the BdI will be determined by the national RTGS provisions of the sending participant, all of which have been previously assessed.⁹ The obligation of the NBP to the SORBNET-EURO participant is set out in the Polish system's rules as above.

Legal risks

Subject to the points discussed in this report, the responsibilities of each of the two parties (the NBP and the BdI) appear clear. The BdI and the NBP are jointly responsible for all aspects of the connection, with the exception of the maintenance of the relationships with Polish banks (including access and exit criteria, collateral management and the provision of intraday liquidity) which is the sole responsibility of the NBP. Provided that an overdraft or intraday credit cannot under any circumstances be given to the NBP, that payment orders will only be processed when there are sufficient NBP funds on their account at the BdI, and that BIREL will reject any incorrect message sent to them, all as set out in the Italian assessment, there would not appear to be any new legal risk to the BIREL system in this respect.

Legal opinions

The TARGET Guideline contains a requirement for legal opinions on capacity, in the case of all participants, and also on country, for foreign participants¹⁰. The Guideline also refers to specific terms of reference, which are replicated in the Polish legal framework. As no "grandfathering" of Polish participants from the SORBNET-ZLOTY system into the SORBNET-EURO system was to take place,

capacity opinions of SORBNET-EURO participants have been sought. As regards foreign participants in SORBNET-EURO, country legal opinions are required under the TARGET Guideline. This also includes branches, whether of EEA or non-EEA institutions. For oversight purposes, the important issue is that such legal opinions are received in respect of foreign participants in order to allow the system to fulfil its requirements under Core Principle I. Although it mirrors the TARGET Guideline in this respect, this provision is unclear in the SORBNET-EURO rules and should be clarified.

Considering the fact that the NBP's participation in BIREL is of an indirect nature, it is not a strict requirement of the TARGET Guideline for the BdI to seek a legal opinion from the NBP and/or SORBNET-EURO participants. However, the BdI recognised in its impact assessment that it cannot be excluded that there may be issues in Polish law that could have an impact on, for example, finality in the BIREL system. Therefore, the BdI intends to ask the NBP to provide a note containing information in particular on its own legal status, its position in the Polish legal framework and whether it is subject to bankruptcy law.

Enforceability of the system rules and procedures

SORBNET-EURO is a new system. However, its rules are to a large degree based on those of the domestic SORBNET system operating in

8 Paragraph 11 of the RTGS Account Agreement reads "1. A payment order is deemed to be entered into the SORBNET-EURO system at the moment of its registration in the Computer Bookkeeping System. 2. A payment order cannot be revoked and is final once it has been executed, i.e. at the moment of the debiting the account of sending Participant with the amount of the payment order. 3. A payment order cannot be revoked also in case of insolvency of the Participant referred to in section 2."

9 The moment when finality of a payment sent by a BIREL participant to a SORBNET-EURO participant is achieved is specified in Article 8 of Annex 3 of the BIREL rules and is the moment when the account of the sending participant is debited.

10 "Foreign participants" include any participants incorporated outside the Member State in which the account-keeping NCB is located, even other Member States. Accordingly, branches of foreign banks are to be considered as foreign participants.

zlotys. Provided that no law or regulation concerning this system has ever been tested or successfully challenged in the Polish courts, there is no reason to question the binding nature of the rules of SORBNET-EURO. The intended legal investigations (see above) would contribute to confirming such information.

The use of Polish eligible assets (Treasury Bonds) was considered. Taking into account legal considerations, it was concluded that there are no grounds evident to call into question the financial soundness of the debt instruments proposed for use in TARGET (see also Core Principle III).

In conclusion, the review of the information and legal framework documentation provided leads to the assessment that, at this time, there is no reason to question the observance of SORBNET-EURO with Core Principle I or to believe that the connection has had any negative effects on BIREL's continued compliance with Core Principle I.

2.2.2 CORE PRINCIPLE II

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.

Under this Core Principle, the main aspects that were investigated are related to the clarity and availability of the system's rules and procedures, and whether or not they adequately cover the participants' rights and obligations, the system operator's discretionary powers and the handling of abnormal situations.

As regards BIREL, the system's rules and procedures will not change in substance. Nevertheless, in order to ensure the continued clarity and transparency of the set-up of BIREL, the BdI will disclose to the participants in BIREL and the general public the connection of SORBNET-EURO to TARGET via the BdI and its BIREL system. The disclosure will include a detailed description of the features of the link between the BdI and the NBP and their respective roles and responsibilities.

Regarding the rules and procedures governing the operation of the SORBNET-EURO system, the legal basis, the roles and responsibilities of the operator and participants both in normal and abnormal circumstances, and the design and operating times of the system are clearly documented, particularly in the "Agreement on Terms and Conditions for the Opening and Operation of an RTGS Account in the SORBNET-EURO system" (including a number of appendices providing a detailed description of the technical terms and conditions for the opening and maintenance of the euro bank account in SORBNET-EURO, the terms and conditions for the extension and reimbursement of intraday credit in euro, and the terms of reference for the provision of legal opinions). It is understood that this agreement largely mirrors the rules and procedures governing the existing SORBNET system operating in Polish zlotys.

The envisaged participation structure in SORBNET-EURO will basically be the same as in the SORBNET-ZLOTY system. As there is no information or indication of participants in SORBNET-EURO not clearly understanding the possible financial risks they may incur through participation in the system, it appears that the rules and procedures of the SORBNET-EURO system allow its participants to have a sound understanding of the potential financial risks inherent to the system. This is substantiated by the fact that the NBP has closely cooperated with all envisaged participants in developing the SORBNET-EURO system. In any case, it is understood that participants will be monitored for their understanding of the possible risks they may incur through participation in SORBNET-EURO and that training for existing participants will be offered by the system operator, if need be.

The system rules are available to the (potential) participants and also to the general public on the NBP's website (www.nbp.pl).

In conclusion, the review of the information and documentation provided leads to the assessment that SORBNET-EURO fully observes Core Principle II and that BIREL's degree of compliance (fully observed) remains unchanged.

2.2.3 CORE PRINCIPLE III

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.

The observance of this Core Principle was verified with a particular focus on the existence and management of credit exposures between participants, incentives to manage this risk (e.g. by using throughput guidelines), the irrevocability and finality of payments, and the management of liquidity risk (e.g. via queuing facilities, gridlock resolution mechanisms and monitoring facilities for participants).

TARGET payments are generally settled gross and in real time. No credit risk can arise between TARGET participants through their participation in the system. This situation will not change with the connection of SORBNET-EURO. Existing participants in the national RTGS systems participating in or being connected to TARGET will not be exposed to any credit risk through the connection of SORBNET-EURO to the TARGET system.

The correspondent account of the NBP held in the books of the BdI will make the NBP an indirect participant in BIREL. The correspondent account will be operated on a positive balance basis only. Although the BdI will not grant any intraday credit to the NBP, no liquidity shortage should occur given the expected volumes and values of TARGET payments from and to Poland and the significant intraday deposit in euro to be held by the NBP with the BdI on a daily basis.

The BdI will offer online and real-time facilities for the NBP. This will enable the NBP

to monitor and acquire information on settled payments, settlement balances and queues and will help it to efficiently manage its liquidity and support the smooth operation of the correspondent account avoiding any adverse impact on the TARGET system as far as possible.

As SORBNET-EURO is a euro RTGS system, no credit risk arises between its participants or between its participants and participants in any of the national RTGS systems participating in or being connected to TARGET. SORBNET-EURO will have an efficient queuing facility with the possibility of prioritisation. It will also include a warehousing functionality allowing for the storage of payment orders for execution on specific value days.

Considering the values of funds expected to be transferred via SORBNET-EURO, there does not seem to be a need for implementing a gridlock resolution mechanism in the system at this stage. The NBP will operate an intraday credit facility based on full collateralisation against eligible collateral. The list of eligible collateral has been approved by the Governing Council. Taking into account legal considerations, it was concluded that there are no grounds evident to call into question the financial soundness of the debt instruments proposed for such use in TARGET (see also Core Principle I). The extension of intraday credit to participants in SORBNET-EURO will be limited to the amount of the NBP's intraday deposit with the BdI. The reimbursement of intraday credit by SORBNET-EURO participants follows clear procedures and seems to be ensured under normal circumstances.

The moment until which participants in SORBNET-EURO may revoke payment orders sent to the system is clearly defined in the system documentation, as is the moment of finality of payments (see also Core Principle I). The necessary operational mechanism in place is safe and secure and is governed by sound legal provisions. It will ensure the sound

application of the irrevocability and finality rules for both intra and inter-Member State TARGET payments.

In conclusion, the review of the information and documentation provided leads to the assessment that SORBNET-EURO fully observes Core Principle III and that BIREL's degree of compliance (fully observed) remains unchanged.

2.2.4 CORE PRINCIPLE IV

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.

When assessing compliance with this principle, particular attention was paid to the definition of the different stages of the life of a payment (i.e. its submission, validation, irrevocability and finality) and to the information that is provided to participants on the status of a payment. In addition, the assessment covered explanations on cut-off times and rejections of payments.

In accordance with the Treaty establishing the European Community, including the Statute of the European System of Central Banks and of the European Central Bank, the legal frameworks of both SORBNET-EURO and BIREL must be fully compliant with the TARGET Guideline.¹¹ If these legal frameworks were in any way non-compliant with the TARGET Guideline, the reasons would need to be considered and any oversight consequences and conclusions made.

The NBP ensures that the full set of rules and procedures included in the TARGET Guideline are adhered to. The rules and procedures have been reflected in the contractual agreement between the NBP and the BdI and in the account agreements between the NBP and its participants in SORBNET-EURO. Furthermore, these rules and procedures have been transposed into the national RTGS rules, a draft version of which has been reviewed in the context of this *ex ante* assessment exercise.

In conclusion, the review of the information and documentation provided leads to the assessment that SORBNET-EURO provides prompt final settlement on the day of value, thus fully observing Core Principle IV. BIREL's degree of compliance (fully observed) remains unchanged.

2.2.5 CORE PRINCIPLE V

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.

Core Principle V is considered as not being applicable to any of the TARGET components as those systems provide real-time, unconditional and irrevocable settlement in central bank money.

2.2.6 CORE PRINCIPLE VI

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.

The assessment of Core Principle VI concentrated on the provider of the settlement asset, possible credit and liquidity risks inherent to the respective asset, and the analysis of the settlement mechanism.

There is no impact on the compliance of BIREL with this Core Principle.

SORBNET-EURO settles in the books of the NBP. As settlement occurs in central bank money, no credit risk or liquidity risk is incurred by the participants with respect to the settlement agent and the settlement asset.

In conclusion, the review of the information and documentation provided leads to the assessment that SORBNET-EURO fully observes Core Principle VI and that BIREL's degree of compliance (fully observed) remains unchanged.

¹¹ ECB/2001/3 on a Trans-European Automated Real-Time Gross settlement Express Transfer System (TARGET), as amended.

2.2.7 CORE PRINCIPLE VII

The system should ensure a high degree of security and operational reliability and should have contingency arrangements for timely completion of daily processing.

The assessment of this Core Principle was mainly related to the existence of a security policy, a risk analysis methodology and regular audits, the application of change management procedures, the availability of sufficient well-trained staff and the establishment of business continuity arrangements (including contingency and crisis management procedures).

The national RTGS systems participating in or being connected to TARGET are subject to the commonly agreed TARGET risk management methodology¹² which makes use of an international standard (ISO 17799) to define its security requirements. Close attention is given to business continuity and contingency arrangements, in terms of whether the infrastructure (i.e. a back-up site and a secondary site) is in place to ensure business continuity in the event of a disaster and whether contingency and crisis management arrangements (i.e. disaster recovery procedures) are in place to ensure proper utilisation of this infrastructure. Checks of whether change management procedures are in place and whether the infrastructure is tested periodically are also included. In accordance with the TARGET risk management methodology, each national RTGS system is subject to formal periodical risk analyses.

It appears from the assessment by the BdI that the connection of SORBNET-EURO does not have a negative bearing on the operational reliability and security of BIREL. In particular, the existing business continuity and contingency procedures of BIREL should be sufficient to cope with any eventual unavailability/failure of (i) a participant in SORBNET-EURO; (ii) the NBP; (iii) BIREL; or (iv) any other national RTGS system participating in or being connected to TARGET.

The NBP has adopted the common TARGET risk management methodology. Subsequently, SORBNET-EURO has been subject to a formal and comprehensive risk analysis which was reviewed by the ECB. The outcome of the risk analysis did not reveal any major shortcomings which would adversely affect the security and operational reliability of the SORBNET-EURO system. According to the conclusion of the status report on the risk situation in SORBNET-EURO, the general security level of SORBNET-EURO is comparable with other RTGS systems participating in or being connected to TARGET. The NBP has been continuously working on further strengthening the security level of SORBNET-EURO. Progress in implementing additional measures and improving further the security level of the system is monitored continuously by the NBP.

The business continuity and contingency arrangements in place do not yet fully meet the requirements. The NBP has prepared a “Business continuity plan for the SORBNET-EURO system” and an amended action plan. The action plan is continuously revised and updated and additional business continuity tests are carried out.

In conclusion, the review of the information and documentation provided leads to the assessment that SORBNET-EURO broadly observes Core Principle VII and that BIREL’s degree of compliance (fully observed) remains unchanged.

2.2.8 CORE PRINCIPLE VIII

The system should provide a means of making payments which is practical for its users and efficient for the economy.

The objectives of the national RTGS systems participating in or being connected to TARGET are to foster the smooth operation of monetary policy, reduce systemic risk and settle ancillary systems. When performing the assessments, particular attention was paid to

¹² This methodology checks if systems meet reasonable standards in terms of confidentiality, integrity, authentication, non-repudiation, availability and auditability.

the business objectives, to the balance between the system's capacity and the demand for it, and to the existence of a pricing policy, a cost methodology and the level of cost efficiency.

With respect to BIREL, it appears that the impact on its compliance with Core Principle VIII is negligible, given the fact that the NBP participates only indirectly in BIREL.

As regards SORBNET-EURO, the NBP takes the view that the system will meet the expectations of future participants in the system. It has been developed in close cooperation with the Polish banking industry and with all other relevant stakeholders, in particular the National Clearing House KIR SA and the National Depository for Securities KDPW SA. As a consequence, indications suggest that the system will meet the needs of its users.

Operationally, SORBNET-EURO will be able to cope with the level of demand and it will be able to handle unexpected rises in the number of transactions. In fact, there seems to be significant excess capacity considering the daily volumes to be processed.

SORBNET-EURO has a formal pricing policy in place which is one of full cost recovery. No public good factor is applied. The prices for intra-Member State and inter-Member State TARGET payments via SORBNET-EURO are regulated by a Resolution of the Management Board of the NBP and are publicly disclosed. The pricing policy for inter-Member State payments follows the common TARGET pricing policy.

SORBNET-EURO applies the common TARGET cost methodology. Costs which are taken into account include development costs, operating costs and overheads. The NBP expects SORBNET-EURO to fully recover its costs, taking into consideration the fact that the SORBNET-EURO system is a "clone" of the SORBNET-ZLOTY system, the number of payments to be processed via SORBNET-

EURO and the lower overheads in comparison to the national RTGS system operating in Polish zlotys.

In conclusion, the review of the information and documentation provided leads to the assessment that SORBNET-EURO fully observes Core Principle VIII and that BIREL's degree of compliance (broadly observed) remains unchanged.

2.2.9 CORE PRINCIPLE IX

The system should have objective and publicly disclosed criteria for participation, which permit fair and open access.

The assessment against Core Principle IX focused on the access criteria, their fairness and public availability, on the justification for any limitations restricting access to the system, on the fee schedule and its impact on access to the system, on exit criteria and on the continued compliance of participants with the access criteria.

The access criteria for the TARGET components are based on Article 3(a) of the TARGET Guideline¹³ and are laid down in the terms and conditions of the respective system, in membership agreements or similar documents. The documentation on access criteria is handed over to the participants and is available to the public, usually via the website of the system operator or in printed form on demand. Participants are generally required to open a central bank account, so that access criteria for NCB accounts, which are usually laid down in the terms and conditions of the current accounts at the NCBs, also apply.

The connection of SORBNET-EURO to TARGET via BdI and its BIREL system does not affect access to BIREL or its compliance with Core Principle IX.

As regards SORBNET-EURO, for formal legal reasons the NBP restricts access to supervised

¹³ ECB/2001/3 on a Trans-European Automated Real-Time Gross settlement Express Transfer System (TARGET), as amended.

credit institutions and institutions providing clearing and settlement services as defined in Article 3(a)1 of the Guideline. The current restrictions on direct access to SORBNET-EURO are not a problem from an oversight perspective.

Participant fees are a combination of a one-time access fee, a quarterly fee, and a transaction fee. This fee structure is intended to recover costs and is not seen as preventing fair and open access to the system.

Access and exit criteria and procedures are laid down in an Appendix to the Agreement on Terms and Conditions for the Opening and Operation of an RTGS account in the SORBNET-EURO system, which is publicly accessible.

In conclusion, the review of the information and documentation provided leads to the assessment that SORBNET-EURO fully observes Core Principle IX and that BIREL's degree of compliance (fully observed) remains unchanged.

2.2.10 CORE PRINCIPLE X

The system's governance arrangements should be effective, accountable and transparent.

The issues that were assessed in the context of Core Principle X were the following: the transparency of the system organisation and the decision-making procedures to the public, the accountability of management for the performance of the system, the involvement and consultation of the systems' users as well as auditors and overseers on decisions affecting the system, the existence of conflict resolution procedures, and the existence of business plans. In addition, the assessments considered whether or not there are any indications that the services delivered by the system are not useful to the users.

The connection of SORBNET-EURO to TARGET via the BdI and its BIREL system does not affect the governance arrangements of BIREL and its compliance with Core Principle

X. As to the oversight arrangements of the BIREL system, as already assessed, these are not affected by the Polish connection.¹⁴

It appears from the assessment by the NBP that, with respect to the SORBNET-EURO system, the NBP follows the rules concerning transparency and accountability for all NBP activities. The organisation and the decision-making procedures and the accountability of the management for the performance of the system are transparent and available to the public. The systems' users as well as auditors and overseers are involved and/or consulted on decisions affecting the system. Conflict resolution procedures do exist, as does a business plan.

SORBNET-EURO operations will be subject to regular internal audits and oversight. As to the oversight arrangements for SORBNET-EURO, this is a competence of the NBP, as set out in Article 16 of the Act of 24 August 2001 on finality of settlements under payment systems and securities settlement systems and principles of oversight of these systems. The oversight function is executed by the Large-Value Systems Division (LVSD) of the Payment System Department (PSD) of the NBP. LVSD reports to a Deputy Director of the PSD, whose competence does not extend to covering the operational side of the SORBNET-EURO system. A clear distinction needs to be made between the regulatory and prudential functions on the one hand, which include, for example, licensing, and the oversight function on the other hand. For oversight, no distinction should be made between systems operated by the NBP and other systems.

As the NBP develops the system in close cooperation with all relevant stakeholders, there are no indications that the SORBNET-

¹⁴ See the 1993 Banking Law, Article 146 "(1). *The Banca d'Italia shall promote the regular operation of payment systems. For this purpose it may issue regulations to ensure the efficiency and reliability of clearing and payment systems.*"

EURO system will not meet the expectations of its (potential) users.

In conclusion, the review of the information and documentation provided leads to the assessment that SORBNET-EURO fully observes Core Principle X and that BIREL's degree of compliance (fully observed) remains unchanged.

3 CONCLUSION

From an oversight perspective, the SORBNET-EURO connection to TARGET via the BdI's BIREL system required the compliance of the SORBNET-EURO system with the relevant Core Principles and the impact that the connection had on BIREL's continued compliance with the relevant Core Principles to be assessed. The oversight assessment exercise was coordinated by the ECB and took place *ex ante* to the launch of the SORBNET-EURO system and its connection to TARGET via the BdI and its BIREL system on 7 March 2005. The review was based on *ex ante* assessments provided by the NBP and the BdI and on final drafts of the documentation governing SORBNET-EURO (both in Polish and in English). The final documentation was adopted by the decision-making body of the NBP before SORBNET-EURO started its operation.

The overall outcome of the *ex ante* oversight assessment exercise was positive. SORBNET-EURO has been assessed as having achieved a high degree of compliance with all relevant Core Principles. The degree to which BIREL complies with the relevant Core Principles has not been adversely affected by the connection of SORBNET-EURO to TARGET via the BdI and its BIREL system. From an oversight perspective, there were no major obstacles which would have hampered the connection of SORBNET-EURO to TARGET. However, some minor deficiencies were identified in relation to Core Principles I and VII.

As far as minor deficiencies are concerned, the owners of SORBNET-EURO and BIREL have been expected, where necessary, to adequately and effectively address the issues identified in this *ex ante* assessment and to carry out a review of possible improvements (e.g. following up on action plans) in order to increase by as much as possible the level of compliance of SORBNET-EURO and BIREL (in relation to the connection of SORBNET-EURO) with the Core Principles. This should ensure that the NBP and the BdI fulfil responsibility B of central banks in applying the Core Principles.¹⁵ In order to fulfil responsibility A, it is recommended that the outcome of the *ex ante* assessments carried out by the NBP and the BdI be made public at both the national and the European level. By having successfully completed the *ex ante* oversight assessment exercise and by publishing the present report, the Eurosystem has collectively fulfilled the responsibilities of central banks in applying the Core Principles.

¹⁵ The following are the responsibilities of the central banks 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.

ANNEX

THE DRAFT LEGAL FRAMEWORK REVIEWED FOR THIS ASSESSMENT

THE RELATIONSHIP BETWEEN BIREL AND SORBNET-EURO

The relationship between the BIREL system operated by the Banca d'Italia and the SORBNET-EURO system operated by Narodowy Bank Polski is set out in the Correspondent Agreement, a contractual agreement between the respective operators of the two systems. This contract, which is governed by Italian law, regulates issues including the rights, obligations, roles and responsibilities of the two parties, as well as setting out technical requirements, the settlement mechanism and contingency arrangements.

SORBNET-EURO

As regards SORBNET-EURO, the specific legal framework is set out in (i) an agreement signed by the NBP and the system's participants, including the appendices and attachments to the agreement¹⁶ (the RTGS Account Agreement); and (ii) several legal instruments adopted by the NBP.¹⁷ These instruments are legally binding on the entities to whom they are addressed. These documents regulate all issues relevant to SORBNET-EURO participants, including the rights and obligations of the parties and of clearing agents, the conditions for the execution of payment orders, the types of transactions to be handled, the transaction processing environment and issues of liability, irrevocability and finality. In addition, Polish law provides a well-founded legal basis for making payments.¹⁸

On 10 February 2005 the NBP informed the European Commission of the designation of SORBNET-EURO as a system under the Settlement Finality Directive (SFD)¹⁹.

16 "Agreement on Terms and Conditions for the opening and operation of an RTGS Account in the SORBNET-EURO system, including: Appendix No 1: Detailed terms and conditions of opening and maintaining the banking account in euro in SORBNET-EURO; Appendix No 2: Terms and conditions for the granting and repayment of intraday credit in euro; Appendix No 3: Terms of reference for legal opinions for participants in SORBNET-EURO (Capacity Opinions); Appendix No 4: Terms of reference for legal opinions for foreign participants in SORBNET-EURO (Country Opinions); Appendix No 5: National RTGS systems; (final appendix not provided); Attachment No 1: Rules for bank module delivery and use; Attachment No 2: Technical requirements for the bank module; Attachment No 3: Operation Terms for Cryptographic Protection Suite; Attachment No 4: Terms of creating by the bank and submitting to the payment systems department of payment instructions and other messages using the electronic data exchange system, via the internet, and on protected floppy disks; Attachment No 5: Template for payment instructions submitted on paper media; Attachment No 6: Template for payment instructions sent by fax; Attachment No 7: Method, form, terms and amounts of basic fees charged by the NBP to the bank; Attachment No 8: Procedure of verifying the authenticity of packages sent and received by the parties to the bank account agreement; Attachment No 9: Terms of submitting specimen signature cards by the bank to the payment systems department; and Attachment No 10: Structure of packages, and types and structure of messages sent between the bank and the payment systems department using electronic data exchange systems, in protected files over the internet and on protected floppy disks" was considered.

17 Regulation No 6/2004 of the President of Narodowy Bank Polski of 20 April 2004 on the manner of performing interbank settlements and Resolution No 20/2004 of the Management Board of Narodowy Bank Polski of 22 April 2004 on the terms and conditions of opening and maintaining banks' accounts with Narodowy Bank Polski. In addition, see Regulation No 6/2005 of the President of Narodowy Bank Polski of 2 February 2005 amending the regulation on the manner of performing interbank settlements and Resolution No 11/2005 of the Management Board of Narodowy Bank Polski of 22 February 2005 amending the resolution on the terms and conditions of opening and maintaining banks' accounts with Narodowy Bank Polski.

18 This is based on the following: the Act on Narodowy Bank Polski of 29 August 1997, OJ 1997, No 140, item 938, as amended (Polish: ustawa z dnia 29 sierpnia 1997 r. o Narodowym Banku Polskim, Dz.U. z 1997 r., Nr 140, poz. 938 ze zm.), the Banking Law of 29 August 1997, OJ 2002, No 72, item 665 as amended (Polish: ustawa z dnia 29 sierpnia 1997 - Prawo bankowe, Dz. U. z 2002 r., Nr 72, poz. 665 ze zm.), the Act of 24 August 2001 on finality of settlements under payment systems and securities settlement systems and principles of oversight of these systems, OJ 2001, No 123, item 1351 as amended (Polish: ustawa z dnia 24 sierpnia 2001 r. o ostateczno[ci rozrachunku w systemach pB'atno[ci i systemach rozrachunku papierów warto[ciowych oraz zasadach nadzoru nad tymi systemami, Dz. U. z 2001 r., Nr 123, poz. 1351 ze zm.) and the Bankruptcy and Rehabilitation Law of 28 February 2003, OJ 2003, No 60, item 535, as amended (Polish: ustawa z dnia 28 lutego 2003 r. - Prawo upadB'owe i naprawcze, Dz. U. z 2003 r., Nr 60, poz. 535 ze zm.).

19 Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems (OJ L 166/45 of 11 June 1998).

