

**Self-Assessment of Compliance with  
the Core Principles for Systemically Important Payment Systems:  
The BOJ-NET Funds Transfer System**

Bank of Japan

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## Introduction

In January 2001, the Bank for International Settlements (BIS) published the report *Core Principles for Systemically Important Payment Systems*, developed by the Committee on Payment and Settlement Systems (CPSS) of the central banks of the Group of Ten countries.<sup>1</sup> The report sets out ten “Core Principles for systemically important payment systems” (Core Principles) and four “Responsibilities of the central bank in applying the Core Principles” (Responsibilities).

The Core Principles were developed to serve as guidelines to promote safety and efficiency in the design and operation of systemically important payment systems.<sup>2</sup> The report states that one of the Responsibilities of central banks is to oversee payment systems to promote their safety and efficiency, and in particular to reduce systemic risk. This paper provides a self-assessment of compliance with the Core Principles by the funds transfer system owned and operated by the Bank of Japan (the Bank), and describes how the Bank fulfills the Responsibilities.<sup>3</sup>

Safe and efficient payment systems are critical for maintaining the stability of the overall financial system. In particular, systemically important payment systems are essential for the effective functioning of the financial system and, if such a system is insufficiently protected against risk, a disruption within it could be transmitted to other participants in the system and result in wider systemic disruptions in the financial system as a whole.

The Bank operates an interbank funds transfer system, the BOJ-NET Funds Transfer System,<sup>4</sup> and also oversees payment systems it does not operate,<sup>5</sup> as an integral part of

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<sup>1</sup> *Core Principles for Systemically Important Payment Systems*, BIS, January 2001. The report is available at <http://www.bis.org/publ/cpss43.htm>.

<sup>2</sup> Whether a payment system is systemically important or not is determined based on factors such as the size and nature of the individual payments and their aggregate value.

<sup>3</sup> Information contained in this paper is as of July 2003. The Japanese original of this paper, released in July 2003, is available at <http://www.boj.or.jp/set/03/set0307a.htm>.

<sup>4</sup> The Bank of Japan Financial Network System (BOJ-NET) is a computer network system linking the Bank’s computer center, its Head Office/branches, and the participants in the system, which is used to transmit and process payment instructions online. In this paper, “participants in the BOJ-NET Funds Transfer System” (the participants) signifies both current account holders with access to BOJ-NET (the online participants) and those without (the off-line participants). In addition to dedicated BOJ-NET terminals, online participants are able to access the system via computer-to-computer connection. Off-line participants, who are generally participants that handle a low volume of payment instructions, submit paper-based instructions at the Bank’s counters, and the Bank’s staff input the information into BOJ-NET terminals. As of March 2003, 373 out of 627 participants are online participants. The Bank also operates a book-entry system for the settlement of Japanese government bonds and bills (JGBs).

<sup>5</sup> The Bank promotes the safety and efficiency of payment and settlement systems it does not operate by monitoring those systems and, where necessary, encouraging and persuading the operators of

its activities for ensuring the safety and efficiency of Japan's overall payment and settlement system.<sup>6</sup> The Bank uses the Core Principles and the Responsibilities as the standards in carrying out these activities.

The BOJ-NET Funds Transfer System is a systemically important payment system that is used for transferring funds through current accounts held with the Bank. It settles large-value interbank payments including money market transactions, the cash legs of trades of securities such as JGBs, and net obligations of participants in private-sector clearing systems. The aggregate volume and value of payments it processes is very large—in 2002, it settled a daily average of more than 19,000 payments, with a daily average value of more than 73 trillion yen.

In order to prevent systemic disturbance, the operator of a systemically important payment system is responsible for continuously reviewing the system's compliance with the Core Principles, disclosing the resulting assessments and, where necessary, setting out action plans for achieving full compliance.<sup>7</sup> The Bank has conducted this self-assessment as the operator of the BOJ-NET Funds Transfer System. The Bank also believes that publicly reporting how the Bank fulfills the Responsibilities will enhance the transparency of its roles and policies in the field of payment and settlement. Based on the results of its self-assessment, which are described below, the Bank has concluded that the BOJ-NET Funds Transfer System complies with the ten Core Principles and the Bank fulfills the four Responsibilities. The Bank will keep a vigilant eye on the developments and changes in the environment surrounding the Bank's operation and oversight of payment and settlement systems, and will update and review its self-assessment from time to time to ensure that its system continues to comply with the Core Principles and that it fulfills the Responsibilities.

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these systems to make improvements.

<sup>6</sup> The role the Bank performs in the payment and settlement field, its major policies, and recent activities are described in "The Role of the Bank of Japan in Payment and Settlement Systems," Bank of Japan, *Bank of Japan Quarterly Bulletin*, November 2002, available at <http://www.boj.or.jp/en/set/02/set0211a.htm>.

<sup>7</sup> The Japanese Bankers Association (JBA) published in December 2001 its self-assessment of compliance with the Core Principles by the three systems it operates, namely the Domestic Fund Transfer System (Zengin System), the Foreign Exchange Yen Clearing System (FXYCS), and the Tokyo Clearing House's Bill and Check Clearing System (TCH-BCCS). See "Assessing the Compliance of Japan's Payment Systems with 'Core Principles for Systemically Important Payment Systems' by BIS," JBA, December 2001, available at <http://www.zenginkyo.or.jp/en/news/news0100.html>.

## 1. Core Principle I: Legal Basis

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

General Japanese law,<sup>8</sup> the Bank of Japan Law, other statutes, and contracts between the Bank and the participants thereunder (i.e., rules and procedures of the system) provide a sound legal framework for the BOJ-NET Funds Transfer System. The system's rules and procedures are enforceable under these laws, and their consequences are predictable under both normal and abnormal circumstances.

### *The Bank of Japan Law*

The Bank of Japan Law provides the legal basis for the Bank's operation of the BOJ-NET Funds Transfer System. The Bank accepts deposits and provides funds transfer services as part of its "regular business" listed in Article 33. The Bank's provision of online services through the BOJ-NET is authorized as "business deemed to contribute to the smooth settlement of funds among financial institutions" by the Commissioner of the Financial Services Agency (FSA) and the Minister of Finance based on Article 39 and Article 61-2.

### *Jurisdiction of law*

The system's rules state that the governing law in respect of rights and obligations between the Bank and the participants based on the rules is Japanese law and that any disputes related to their rights and obligations in this regard should be filed in the Tokyo District Court. The Bank does not generally allow remote access, or access by an institution that has neither its head office nor any other form of authorized establishment in Japan.<sup>9</sup>

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<sup>8</sup> Although there is no single law that covers the various aspects of payments and payment systems in a comprehensive way, laws concerning specific types of means of payment, laws concerning specific types of payment service providers, laws relating to counterparty relationships in payments, and individual contracts together form the legal basis for payments and payment systems in Japan. Deposit taking and provision of funds transfer services are permitted only to certain types of institutions that are regulated/supervised under specific laws (e.g., the Banking Law). The rights and obligations of relevant parties are governed by general laws such as the Civil Code and the Commercial Code, as well as by individual contracts under these laws. Where one of the parties concerned becomes the subject of insolvency proceedings, its rights and obligations are addressed under insolvency laws. The legal framework for payment systems in Japan does not currently pose any problem with respect to their stability.

<sup>9</sup> CLS Bank, the provider of the Continuous Linked Settlement (CLS) service, is the only exception where remote access is allowed. An Edge Act corporation based in New York, CLS Bank remotely accesses the real-time gross settlement (RTGS) systems for each currency it settles except for the

### *Timing of final settlement*

Timing of final settlement is clearly provided in the system rules. In the system's RTGS mode,<sup>10</sup> in which almost all payment instructions are processed, individual payment instructions are processed immediately upon receipt by the system, provided there are sufficient balances on the sending participant's account. Settlement through current accounts with the Bank is final once the sending participant's account is debited and the receiving participant's account is credited. In the "simultaneous processing" mode, final settlement takes place when processing of the payment instructions is completed. This occurs immediately after each of the following designated times: 9:00, 13:00, 15:00, and 17:00.

Provisions of insolvency laws in Japan do not include the so-called "zero hour rules," which could become an obstacle in achieving final settlement.<sup>11</sup>

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U.S. dollar. The Bank requires that any dispute between CLS Bank and the Bank be settled under Japanese law and at the Tokyo District Court, as it does for other participants in the BOJ-NET Funds Transfer System.

<sup>10</sup> The BOJ-NET Funds Transfer System has two settlement modes, the RTGS mode and the "simultaneous processing" mode. In the latter, settlement of payment instructions is deferred until designated times and then effected on a gross basis using batch processing. "Simultaneous processing" is mainly used to settle payments between the Bank and the participating financial institutions.

<sup>11</sup> "Zero hour rules" are provisions in insolvency laws that make all transactions by a bankrupt participant void from the start of the day of the bankruptcy.

## 2. Core Principle II: Understanding Financial Risks

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.

The rules and procedures of the BOJ-NET Funds Transfer System enable the participants to have a clear understanding of the financial risks they incur through their participation in the system. The rules and procedures are kept up to date and are readily available to all interested parties.

### *Coverage of rules and procedures*

The rules and procedures of the system, which basically take the form of contracts between the participants and the Bank, are comprehensive and clearly define the rights and obligations of all the parties involved. They explain the basic design of the system, typical daily timetable, and operating procedures. They also set out decision and notification procedures for handling abnormal situations. Abnormal situations addressed include system failure, inability of a participant to settle in the “simultaneous processing” mode, and inability of a participant to settle its net debit position arising from private-sector clearing systems.

The participants have ready access to updated rules and procedures. Whenever the rules and procedures are revised following changes in technical or other features of the system, the Bank promptly distributes the new rules and procedures to all the participants in paper form before they become effective.

### *Disclosure of rules and procedures*

The Bank discloses the rules and procedures to non-participants as necessary. Key rules relating to financial risks, including the participation criteria, guidelines on the use of the intraday overdraft facility, and guidelines on eligible collateral, are publicly disclosed.<sup>12</sup>

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<sup>12</sup> Criteria for parties eligible to hold current accounts with the Bank and have access to the Bank's lending, and guidelines on intraday overdrafts are available only in Japanese. Guidelines on eligible collateral are available at <http://www.boj.or.jp/en/about/basic/yoryo/yoryo18.htm>.

### 3. Core Principle III: Management of Financial Risks

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.

Credit and liquidity risks to the participants are managed and contained effectively under the rules and procedures of the BOJ-NET Funds Transfer System, which provide appropriate incentives for the participants to identify and manage those risks.

#### *Credit risk to the participants*

In the system's RTGS mode, the participants are not exposed to credit risk as defined in *Core Principles for Systemically Important Payment Systems*<sup>13</sup> as settlement is effected immediately upon receipt of the payment instruction by the system.

In the "simultaneous processing" mode, although settlement of payment instructions is deferred until designated settlement times, no credit risk to the participants is generally involved because it is mainly used to settle payments between the Bank and the participant. Also, in the delivery-versus-payment (DVP) settlement of corporate and other bond transactions, which is the only case where payments between the participants are settled in this mode, the principal risk is eliminated because transfers of funds and securities are linked.<sup>14</sup> This DVP procedure, together with arrangements for managing liquidity pressures as described below, significantly and effectively reduces the risk that a default of a participant using this arrangement would lead to systemic disruption.

#### *Liquidity risk to the participants*

In the RTGS mode, the participants are required to maintain sufficient balances on their current accounts with the Bank to settle individual outgoing payments. In order to address the liquidity risk that accompanies RTGS, the Bank provides intraday credit in the form of overdrafts. In practice, the participants are provided with a large amount of liquidity from the Bank for their daily settlement, which has proved to be sufficient to ensure smooth settlement of payments and to avoid gridlock in this mode.

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<sup>13</sup> *Core Principles for Systemically Important Payment Systems* states that "credit exposures between participants arise in systems in which there is a delay between a payment's receipt by the system for settlement and its final settlement."

<sup>14</sup> In the event a participant is unable to settle its payment obligation, the individual payment instructions involving that participant will be canceled, and the corresponding transfers of corporate and other bonds will not be made.



In the settlement of the cash legs of corporate and other bond transactions in the “simultaneous processing” mode, in the event a participant is unable to settle its payment obligations, payment instructions involving that participant will be canceled and the counterparties of the failed participant will not be able to receive the expected funds. The participants using this arrangement are thus exposed to liquidity risk. In practice, however, the total value and volume of payments settled using the arrangement are very small.<sup>15</sup> In addition, the procedure for payment cancellation is explicitly stated in the system rules and the participants clearly recognize this risk. Where additional liquidity is needed as a result of cancellation of payment instructions, the remaining participants are able to access intraday credit from the Bank. It is therefore extremely unlikely that the materialization of the liquidity risk described above would systemically affect other participants in the system.<sup>16</sup>

#### *Credit risk to the Bank*

Where the Bank provides intraday credit to a participant, it is exposed to credit risk of that participant. This risk is appropriately managed, not least because the Bank requires the participants to pledge eligible collateral to fully secure intraday overdrafts. The Bank limits the range of eligible collateral to securities and other assets which the Bank judges as having sufficient creditworthiness and marketability. There should also be no obstacle to measures the Bank might need to take in relation to its security and other interests. Collateral assets are marked to market weekly in principle,<sup>17</sup> with haircuts which vary according to the type of collateral and its residual maturity.<sup>18</sup>

#### *Incentives, information, and monitoring*

As described above, the Bank requires the participants to fully secure their overdrafts with eligible collateral. The participants also incur an interest rate of 6 percent plus the official discount rate in the event they are unable to repay the Bank by the end of the system’s operating day. Such costs involved in using the overdraft facility provide the participants with an incentive to manage their liquidity risks more carefully. In

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<sup>15</sup> In 2002, approximately 200 payments totaling 120 billion yen were settled daily using this arrangement. This is very small compared with the daily volume and value of payments settled through the whole system (19,000 payments and 73 trillion yen, respectively).

<sup>16</sup> Preparation is under way to introduce a real-time DVP arrangement for settlement of corporate and other bond transactions in the second half of 2005. Under the new DVP arrangement, securities transfers will be effected through the book-entry system newly established by the Japan Securities Depository Centre (JASDEC) under the Law concerning Book-entry Transfer of Corporate and Other Debt Securities (in effect since January 2003). Settlement of the cash legs will be effected on an RTGS basis through current accounts with the Bank.

<sup>17</sup> The Bank reserves the right to change the collateral value when necessary, as for example following a rapid and significant change in market prices.

<sup>18</sup> Haircuts for loans on deeds are determined according to the original maturity. For certain types of collateral such as bills, CP, and loans on deeds, haircuts are applied to the face value or the outstanding principal balance.

addition, the Bank provides the participants with tools such as the inquiry function of the BOJ-NET so that they can check their intraday balances on a real-time basis and manage their use of intraday credit.

The Bank also monitors individual participants' management of daily liquidity as necessary, including the participants' overdraft positions.

#### 4. Core Principle IV: Prompt Final Settlement

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.

Prompt final settlement on the day of value is achieved for both the RTGS mode and the “simultaneous processing” mode of the BOJ-NET Funds Transfer System.

##### *RTGS mode*

In the RTGS mode, in which almost all payment instructions are processed, individual payment instructions are processed immediately upon receipt by the system, provided there are sufficient balances on the sending participant’s account. Settlement through current accounts with the Bank is final once the sending participant’s account is debited and the receiving participant’s account is credited.

##### *“Simultaneous processing” mode*

In the “simultaneous processing” mode, final settlement takes place when processing of the payment instructions is completed. This occurs immediately after each of the following designated times: 9:00, 13:00, 15:00, and 17:00.<sup>19</sup>

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<sup>19</sup> Even though payment instructions may be canceled after receipt by the system in the “simultaneous processing” mode, this is not likely to have systemic implications. See assessment of compliance with Core Principle III.

## **5. Core Principle V: Settlement in Multilateral Netting Systems**

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.

The BOJ-NET Funds Transfer System does not conduct multilateral netting. Core Principle V is therefore not applicable.

## **6. Core Principle VI: Settlement Assets**

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.

Settlement assets used in the BOJ-NET Funds Transfer System are current account balances at the Bank, i.e., claims on the central bank.

## 7. Core Principle VII: Security and Operational Reliability

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

The BOJ-NET Funds Transfer System maintains a high degree of security, operational reliability, and resilience.

### *Security*

The Bank has a documented policy on the security of its computer systems such as the BOJ-NET and of information processed through those systems. The policy clearly defines the organizational structure and the basic measures for establishing appropriate security controls.

In accordance with the policy, the Bank identifies possible threats to the system, analyzes the scope and degree of their possible impacts, and implements safeguards that appropriately address the risks and vulnerabilities. In order to ensure confidentiality and to prevent falsification of data, messages transmitted via the BOJ-NET's communication network are encrypted. The validity of the sender of the messages is confirmed by individual passwords and chip cards given to registered senders. The participants' access is restricted to pre-authorized services.

At the Bank's computer centers, entrance/exit is strictly controlled by chip cards. The Information System Services Department of the Bank has a section specializing in security issues, which is responsible for maintaining the necessary high level of security controls and studying the latest security technology. In the event of a security violation, a security administrator checks the details of the violation and the likely scope of impact, and takes appropriate measures in accordance with pre-established contingency plans.

### *Operational reliability*

The Bank takes various steps to ensure stable operation of the system. Major computer and communication facilities/circuits are duplicated, and application programs are tested before they are put into use. Staff involved in the operation of the system and in related services are well trained, and operational and technical procedures are documented and kept up to date. Operation of the system is continuously monitored to detect any problem at the earliest possible stage.

In the event of disruption of the primary system, a hot standby on-site secondary system takes over immediately without any loss of data. All critical equipment at the main computer center, including the host computer and communication controllers, is redundant. The proprietary communication network between the Bank's Head Office and its branches is also duplicated, as are the telephone exchanges for the Head Office and major branches.

In the event both primary and secondary facilities in Tokyo are unavailable, the system is able to resume operation within about two hours at the out-of-region backup site in Osaka (500 kilometers away from the main center). The backup site has the same system configuration as the main center, and data are mirrored almost in real time.

Effectiveness of system operation and development are reviewed regularly by the Bank's Executive Auditors and the Internal Auditors' Office as part of their audits/examinations of the Bank's overall business. The Internal Auditors' Office also examines the BOJ-NET Funds Transfer System as part of its examination of selected systems. The audits/examinations cover (1) adequacy of system development, (2) compliance of its operation with its rules and procedures, (3) establishment of risk management features, and (4) whether necessary steps are taken to ensure smooth operation.

In the past ten years, although there have been a few cases where the system became partially unavailable, there has never been a case where the system as a whole failed to run properly.

### *Business continuity*

The Bank maintains a comprehensive business continuity plan to maintain smooth settlement of funds so as to ensure, through its funds transfer services, the stability of the financial markets. All aspects of the plan are clearly documented. Sections responsible for planning risk management policies and the operations sections of the system cooperate to identify possible threats to the system and develop appropriate countermeasures.

As part of the plan, there is a documented procedure for switchover to the backup site, and testing is conducted every year with the online participants. Staff at the Bank's Osaka branch are ready at all times to support operation of the system after the switchover. Other arrangements for continuing operation under contingency situations are also in place, and their effectiveness is reviewed through regular testing.

## 8. Core Principle VIII: Efficiency

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

The Bank takes steps to consult with the participants of the BOJ-NET Funds Transfer System and provides practical services that meet their needs. The Bank also analyzes possible impacts of changes made to the system and makes efficient use of its resources. The rationale for the Bank's pricing policy is publicly disclosed.

### *Practicality of service*

The Bank actively solicits requests/suggestions and identifies the needs for improving the system, through various channels such as dialogue with the participants and other relevant parties. Public consultation is used for major changes to the system. Issues which have been proposed for public comment include (1) changeover to the new RTGS system, (2) extension of operating hours of the BOJ-NET, and (3) improvement of the network infrastructure of the BOJ-NET.<sup>20</sup>

Based on consultation with relevant parties, various measures have been introduced to enhance the practicality of the BOJ-NET Funds Transfer System. For example, with the changeover to the new RTGS system at the beginning of 2001, the Bank extended the range of operations for which computer-to-computer connection is available,<sup>21</sup> introduced a new liquidity-saving facility called "simultaneous processing of DVP and collateralization (SPDC),"<sup>22</sup> and started operation of a new system for managing credit extension by the Bank and the collateral required (the BOJ-NET Credit-Collateral Management System).<sup>23</sup>

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<sup>20</sup> "A Proposal for the Extension of Operating Hours of BOJ-NET Funds Transfers" is available at <http://www.boj.or.jp/en/set/98/set9803a.htm>. Other public consultation documents are available only in Japanese.

<sup>21</sup> In order to allow the participants to streamline their operations, the Bank introduced computer-to-computer connection for funds transfers and JGB transfers on its books through the BOJ-NET; previously, computer-to-computer connection was available only for the FXYCS.

<sup>22</sup> With this new facility, the participants can pay for JGBs by drawing intraday overdrafts against the incoming JGBs. This allows the participants to save the liquidity necessary for settlement in the new RTGS environment, thereby streamlining JGB settlement.

<sup>23</sup> The BOJ-NET Credit-Collateral Management System was established to make it possible for the participants to manage and post/draw collateral for the Bank's credit extension more efficiently by online processing. In addition, the requirement that a participant post collateral separately for each type of credit extension has been dispensed with. Also, the necessity for separate posting of collateral at each office (Head Office/branches) of the Bank, due to the lack of a mechanism for the



The Bank also decided in March 2002 to improve the network infrastructure of the BOJ-NET, following public consultation in January 2002. The changes include a new method for computer-to-computer connection, replacement of dedicated BOJ-NET terminals with PCs, and expansion of the range of acceptable message formats to include those based on international standards.<sup>24</sup>

### *Efficiency of the system*

In making changes to the design and operation of the BOJ-NET Funds Transfer System, the Bank conducts a detailed analysis of the possible safety and efficiency benefits. Development objectives and projected benefits are clarified to justify the costs involved.

The Bank considers that the system resources are efficiently used, given the actual payment flows and the way they are processed. In fact, the system's operational performance, for example, time for processing individual payment instructions, has been kept at an appropriate level for the Bank and the participants, while no signs have been observed indicating excessive system capacity relative to the volume of payments processed. This is largely due to the Bank's careful estimation of the peak volume and distribution of payments prior to system development. The Bank also continuously monitors the capacity and performance of the system so that payment instructions are processed at an appropriate speed. In addition, the Bank's provision of the overdraft facility, which allows the participants to access intraday liquidity within the value of collateral pledged with the Bank, contributes to preventing such problems as gridlock or delay in daily processing of payments.

### *Pricing*

Pricing policy and its rationale are publicly disclosed.<sup>25</sup> The Bank bears the costs of development and maintenance of the BOJ-NET Funds Transfer System. This reflects the idea that the system is a public infrastructure supporting the nation's financial market and that it is the Bank's responsibility to make the investment necessary to enhance its safety and efficiency.

On the other hand, to cover the costs of the connection to the BOJ-NET and of telecommunications, the Bank charges the online participants monthly fixed fees and transaction fees, respectively. This is based on the idea that users of online services can enjoy the additional benefit of a reduced operational burden compared with those

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Bank's Head Office and individual branches to share it, has been eliminated.

<sup>24</sup> For details, see "Framework for Improving the Network Infrastructure of the BOJ-NET," available at <http://www.boj.or.jp/en/set/03/set0302a.htm>.

<sup>25</sup> See "The Role of the Bank of Japan in Payment and Settlement Systems."

with paper-based access.<sup>26</sup> Monthly fixed charges are 5,000–10,000 yen per line for the participants that access the Bank using BOJ-NET terminals, and 800,000 yen per line for those with computer-to-computer connection. Transaction fees are 40 yen per regular funds transfer, and 60 yen per third-party funds transfer.<sup>27</sup>

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<sup>26</sup> In order to promote online processing, the Bank also charges for paper-based payment instructions and for requests for credit using Bank of Japan checks.

<sup>27</sup> Payment instructions for third-party funds transfers (only available to online participants) contain information regarding the sending participant's and/or the receiving participant's customers.

## 9. Core Principle IX: Access Criteria

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

Criteria for access to current accounts with the Bank permit fair and open access, and are publicly disclosed.

### *Participation criteria*

In accordance with its objective defined in Article 1 of the Bank of Japan Law (i.e., price stability and financial system stability), the Bank has set out criteria for parties eligible to hold current accounts with the Bank and have access to the Bank's lending, and detailed criteria for parties eligible to hold current accounts with the Bank, both of which are publicly available.<sup>28</sup>

The criteria specify the following categories of institutions as eligible to hold current accounts with the Bank: (1) institutions playing a key role in payments (banks, central organizations of credit, agricultural and fishery cooperatives, *shinkin* banks, bankers' associations); (2) institutions playing a key role in securities settlement (securities companies, securities finance companies, stock exchanges); and (3) institutions playing an intermediary role in interbank money markets (money market brokers). The Bank requires applicants to conduct their business properly, be in sound financial condition, and have appropriate operational capability. Financial condition is assessed based on capital adequacy ratios, and specific criteria are set according to the type of institution. If the institution is a "financial institution" as defined in Article 37 of the Bank of Japan Law,<sup>29</sup> it must also enter into a contract under which it agrees to be subject to on-site examination by the Bank.

### *Exit from the system*

The Bank has set out a clearly defined procedure for a participant's exit from the system, whether at the participant's request or by the Bank's decision. A participant can terminate its participation in the system after the specified period of notice. Also, the Bank retains the right to cancel a contract regarding the use of the system or suspend

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<sup>28</sup> These documents are available only in Japanese.

<sup>29</sup> According to Article 10 of the Bank of Japan Law Enforcement Order, "financial institutions" as defined in Article 37 of the Bank of Japan Law refers to (1) banks and other institutions engaged in deposit taking and funds transfers, (2) securities companies, (3) securities finance companies, (4) foreign securities firms, and (5) money market brokers.

access to services for a certain period of time in the event the participant violates the system rules, and also where the Bank determines that the participant may impair the smooth operation of the system.

## 10. Core Principle X: Governance

The system's governance arrangements should be effective, accountable and transparent.
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The governance arrangements of the BOJ-NET Funds Transfer System are effective and accountable, with relevant information publicly disclosed.

The governance arrangements of the Bank, the system's owner and the operator, are established based on the Bank of Japan Law, By-Laws of the Bank of Japan, and Rules on Organization of the Bank of Japan, all of which are available to the public.<sup>30</sup>

### *Decision-making structure*

The Policy Board, the Bank's highest decision-making body, makes basic decisions regarding the Bank's policy, operation, and governance. Departments/offices at the Head Office as well as the branches and local and overseas representative offices carry out their responsibilities in line with the Policy Board's decisions. Within this structure, the Policy Board makes final decisions on issues related to the BOJ-NET Funds Transfer System. The Policy Board's decisions and underlying considerations are publicly disclosed in the *Monthly Report of the Policy Board of the Bank of Japan*. Participants are clearly and promptly notified of decisions associated with the system.

### *Consultation with relevant parties*

In order to ensure adequate preparation for changes made to the system, the Bank seeks, where necessary, comments/suggestions from the participants and other relevant parties prior to making final decisions, and also provides the participants with sufficient time from release of the outline of the change to its implementation. Information for improving the system is obtained through dialogue with the participants and surveys. The Bank also hosts the "Payment System Forum" to exchange views with operators of major payment and settlement systems on practical issues related to payment and settlement.

### *Disclosure of relevant information*

The annual *Outline of Business Operations* describes the Bank's policies and business

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<sup>30</sup> An English translation of the Bank of Japan Law is available at <http://www.boj.or.jp/en/about/basic/law/bojlaw1.htm>. Except where noted, other documents and publications mentioned in this section are available only in Japanese.

operations including operation of the BOJ-NET Funds Transfer System. Financial statements with the Executive Auditors' opinions are also available to the public.<sup>31</sup> In addition, following discussions and decision by the Policy Board, the Bank discloses the "Strategic Framework," which specifies issues to be addressed in the coming fiscal year by the Bank's officials and staff under the direction of the Governor, Deputy Governors, and Executive Directors. The document also describes underlying considerations and sets out specific plans for addressing the issues, including human resources, budget, and IT investment.

#### *Audit/examination*

Executive Auditors, who perform their duties independently from the Governor and other members of the Policy Board, conduct audits of the Bank's overall business. Internal examinations are carried out by the Internal Auditors' Office, a section independent from sections responsible for daily operation of the system, and the results are reported to the Policy Board. Internal examinations cover issues such as daily business operations, risk management including aspects related to the system's security, effective use of business resources, organizational efficiency, and compliance of the operation with the system's rules and procedures.

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<sup>31</sup> An English version of the financial statements can be found in the Bank's *Annual Review*, available at <http://www.boj.or.jp/en/about/about.htm>.

## **11. Responsibility A: Disclosure of Objectives, Role and Major Policies**

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.

### *Payment system objectives and roles*

In order to fulfill its payment system objective of ensuring the safety and efficiency of Japan's overall payment and settlement system, the Bank operates the BOJ-NET Funds Transfer System and oversees payment and settlement systems operated by the private sector. As part of its efforts to achieve this objective, the Bank ensures that its own system complies with the Core Principles and also oversees compliance by systemically important private-sector payment systems. As for payment systems that are not systemically important, the Bank encourages system operators to take appropriate measures in line with the Core Principles.

### *Disclosure of the roles and major policies*

The Bank's roles in the field of payment and settlement and major policies regarding systemically important payment systems are clearly described in the paper "The Role of the Bank of Japan in Payment and Settlement Systems," published in September 2002.

## 12. Responsibility B: Compliance of Central Bank Systems

The central bank should ensure that the systems it operates comply with the Core Principles.

### *Compliance with the Core Principles*

As seen in sections 1 to 10, the BOJ-NET Funds Transfer System, a systemically important payment system operated by the Bank, is judged to be compliant with the ten Core Principles. The Bank will continue to further enhance the safety and efficiency of the system.

### *Arrangements for achieving compliance*

The Bank has various governance arrangements in place for adequate operation and management of the system, which is essential in order for the system to achieve compliance with the Core Principles. Major decisions related to the operation of the system are taken by the Policy Board as required by the Bank of Japan Law, and the decisions are released in the *Monthly Report of the Policy Board of the Bank of Japan* and the *Outline of Business Operations*.<sup>32</sup> The section responsible for payment system research and policy planning, which formulates policies related to the Bank's services, is separated from the section in charge of daily operation. Before providing new services or making changes to the system, the Bank obtains opinions and requests from relevant parties through various channels including public consultation and participant surveys. The Bank's operation of the system is audited by Executive Auditors, who perform their duties independently from the Governor and other members of the Policy Board as provided in the Bank of Japan Law.

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<sup>32</sup> Both documents are available only in Japanese.



### 13. Responsibility C: Oversight of Non-Central Bank Systems

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.

#### *Basis for oversight*

The Bank conducts oversight as one of the activities in which it engages in pursuit of its objective defined in Article 1, Paragraph 2 of the Bank of Japan Law, which is to “ensure smooth settlement of funds among banks and other financial institutions, thereby contributing to the maintenance of an orderly financial system.”

#### *Scope and intensity of oversight*

The Bank uses the Core Principles as its standards for oversight of private-sector payment systems. For systemically important payment systems, the Bank continuously evaluates their compliance with the Core Principles and persuades system operators to take necessary measures to remedy any deficiency.<sup>33</sup> As for payment systems that are not systemically important, the Bank encourages system operators to take appropriate measures in line with the Core Principles, depending on the size and nature of the risks associated with each system.

#### *Oversight tools*

Reflecting the legal, institutional, and historical background, the main tool used in the Bank’s oversight is moral suasion. Specifically, the Bank continuously monitors and assesses the design and operation of private-sector systems and, where necessary, encourages and persuades system operators to make improvements through discussions with them. Where a system settles through current accounts with the Bank, the Bank checks the adequacy of the system’s operational capability and risk management measures when the system applies to open a current account with the Bank. The Bank is also involved in the process of making changes to risk management measures of systems that hold current accounts with the Bank—for example, operators of such systems consult with and gain approval from the Bank as necessary.<sup>34</sup>

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<sup>33</sup> In addition to the BOJ-NET Funds Transfer System, the Bank recognizes the Zengin System, the FXYCS, and the TCH-BCCS as systemically important payment systems.

<sup>34</sup> The Zengin System, the FXYCS, and those bill and check clearing systems which settle participants’ net obligations through current accounts with the Bank are required to do so when making changes to relevant rules of the system.

### *The Bank's dual roles*

The Bank acts as both the operator of the BOJ-NET Funds Transfer System and as overseer of private-sector payment systems. The Bank takes great care to address any possible conflicts of interest arising from these two roles and to avoid any possible misperception that the Bank might use its oversight capabilities to put private-sector systems at a disadvantage relative to its own. For example, the section that carries out oversight, i.e., the section that specializes in policy planning and research of payment and settlement system issues, is separated from the section in charge of daily operation of the Bank's own system. This section assesses the safety and efficiency of the private-sector payment systems against the same standards as those for the BOJ-NET Funds Transfer System.

#### **14. Responsibility D: Cooperation with Other Authorities**

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.

##### *Cooperation with foreign authorities*

The Bank oversees the CLS system in cooperation with the relevant central banks based on the framework established among the central banks of the Group of Ten countries. The Bank also serves as a member of various international forums of central banks and other relevant authorities including the CPSS, where central banks undertake studies and discuss developments in the payment and settlement field. International standards used in central banks' oversight activities were formulated in such groups.

##### *Cooperation with domestic authorities*

The Bank also cooperates with relevant domestic authorities with the aim of promoting the safety and efficiency of Japan's overall payment and settlement system. For example, where necessary, the Bank exchanges information and views with the relevant authorities and encourages them to formulate and make revisions to relevant laws, government/ministerial ordinances, and other regulations. Although there is no formal basis for cooperation between these authorities and the Bank, the Bank believes that the current framework enables each authority to carry out its role effectively.