

March 19, 2010
Bank of Japan

**Request for Comments on the Proposed Bank of Japan Policy on
Oversight of Offshore Yen Payment Systems**

The Bank requests comments on the attached proposed "Policy on Oversight of Offshore Yen Payment Systems," which explains the Bank's approach to oversight of yen payment systems that are operated by entities located outside Japan. This policy statement supplements another Bank document, "Policy on Oversight of Payment and Settlement Systems,"¹ which is also currently under consultation.

The Bank welcomes comments from payment system operators and other interested parties on the proposed policy by April 14, 2010. Comments should be sent via e-mail to the Oversight Section of the Payment and Settlement Systems Department (post.payment-2@boj.or.jp) in English or Japanese, with the name and contact information of the person or institution submitting comments. The comments received, including the names of the commentators, may be released on the Bank's web site. The Bank will not respond individually to each comment.

¹ Details on the Bank's requests for comments on the two policy statements are available at <http://www.boj.or.jp/type/release/adhoc10/set1003a.pdf> (available only in Japanese).

Bank of Japan Policy on Oversight of Offshore Yen Payment Systems

A Proposed Draft as of March 15, 2010¹

I. Introduction

The Bank of Japan oversees payment and settlement systems with the objective of ensuring the safety and efficiency of the payment and settlement arrangements in Japan.² The Bank's objectives and policy on oversight in general are described in a separate policy statement entitled "Policy on Oversight of Payment and Settlement Systems."³

The Bank's oversight primarily focuses on payment and settlement systems located in Japan. In recent years, however, with the globalization of financial markets, there has been an emergence of yen payment systems that are operated by entities located outside Japan (offshore yen payment systems). While offshore yen payment systems are mainly used to settle yen-denominated transactions executed in offshore markets or on a cross-border basis, the settlement processes in those systems usually involve a transfer of yen funds using payment systems in Japan or across accounts held with a financial institution in Japan. As such, depending on the size and characteristics of the system, offshore yen payment systems could have a significant impact on the safety and efficiency of payment arrangements in Japan. Therefore, in principle, the scope of the Bank's oversight covers offshore yen payment systems.

At the same time, oversight of offshore yen payment systems entails issues that do not arise in oversight of domestic payment systems. These include the issue of jurisdictional authority, as well as difficulties in obtaining information due to the time difference and/or geographical distance between the Bank and the system operator. With this in mind, this statement sets out the Bank's policy on the oversight of offshore yen payment systems as a supplement to "Policy on Oversight of Payment and Settlement Systems."

¹ This document is an English translation of the Japanese original released on March 15, 2010.

² Oversight of payment and settlement systems is a central bank function whereby the objectives of safety and efficiency are promoted by monitoring of existing and planned systems, assessing them against these objectives and, where necessary, inducing change.

³ This document, currently under public consultation, is available only in Japanese.

II. International Cooperation

The Principles for International Cooperative Oversight, published by the Committee on Payment and Settlement Systems (CPSS),⁴ provides a framework for international cooperation on oversight of payment and settlement systems that operate with a cross-border aspect (see Annex).⁵ A core element of the principles is to create a cooperative oversight arrangement among interested central banks,⁶ which normally include the central banks of issue of the currencies in the system and the central bank where the operator of the system is located. In practice, such an arrangement has been developed among relevant central banks, including the Bank of Japan, for CLS,⁷ a cross-border payment mechanism for settling foreign exchange transactions for major currencies.⁸

The Bank is guided by these principles in its cooperation with other central banks on oversight of offshore yen payment systems. At the same time, the Bank encourages central banks with relevance to offshore yen payment systems to also adopt these principles. For example, the Bank encourages a relevant central bank that has identified the actual or proposed operation of an offshore yen payment system to immediately inform the Bank, and to coordinate with the Bank in sharing information on and, where necessary, developing an international cooperative oversight arrangement for the system.

⁴ CPSS serves as a forum for central banks to monitor and analyze developments in payment and settlement systems, and consider related policy issues. The Committee consists of central banks from 24 countries and regions.

⁵ *Central bank oversight of payment and settlement systems* (Bank for International Settlements, May 2005).

⁶ For the purpose of this policy, "central banks" include other relevant authorities as appropriate.

⁷ Settlement service is provided by CLS Bank, located in New York, for seventeen currencies including the yen, U.S. dollar, and euro. The cooperative oversight arrangement for CLS is led by the U.S. Federal Reserve.

⁸ The Bank also takes part in the international cooperative oversight of SWIFT. SWIFT provides messaging services globally to financial institutions and other entities for financial transactions including customer payments, interbank payments, and securities transactions. While SWIFT is essentially an infrastructure supporting the payment process and is not a payment system per se, a problem in the operation or other aspects of SWIFT could have a significant impact on the global payment and settlement arrangements. As such, central banks of the major economies have developed a cooperative process for monitoring, assessing, and inducing changes for SWIFT.

III. Oversight Based on Impact on Domestic Payment Arrangements

The depth of the Bank's oversight of offshore yen payment systems is commensurate with the importance of the system to domestic payment arrangements. Specifically, the Bank places particular focus on systems that potentially have a significant impact on domestic payment arrangements should the system fail to perform as expected. Determining whether an offshore yen payment system will potentially have a significant impact depends on a combination of factors, including the value and volume of yen payment transactions processed by the system and the extent of interdependency between the offshore payment system and domestic payment systems.⁹

A. Oversight of Offshore Yen Payment Systems that Potentially Have a Significant Adverse Impact on Domestic Payment Arrangements

For offshore yen payment systems that potentially have a significant adverse impact on domestic payment arrangements, the Bank seeks to establish an international cooperative oversight arrangement with the central bank where the system operator is located, as well as other relevant central banks. In principle, internationally recognized standards¹⁰ are used to assess the system against the objectives of safety and efficiency.¹¹

Where the Bank identifies a need for enhancement in the design, operation, risk management, or other aspects of the yen payment processes in the system, the Bank will work with the relevant central banks to induce necessary changes in the system. At the same time, in line with the Principles for International Cooperative Oversight, there may be cases where the Bank will decide to take action at its discretion, apart from the cooperative oversight process, in order to ensure the safety and efficiency of domestic yen payment

⁹ For practical application of the policy, the Bank will consider, as a benchmark, whether the system has processed yen payment transactions exceeding 500 billion yen on an average day during the past twelve months.

¹⁰ The Core Principles for Systemically Important Payment Systems, published by the CPSS in January 2001, are used for offshore yen payment systems.

¹¹ For offshore yen payment systems that have a particularly large impact on domestic payment arrangements, or those that have sophisticated risk management methods, the Bank may expect a higher level of risk management than those set out in the international standards, in line with the characteristics of and the level of risks within the system.

arrangements.¹²

B. Oversight of Other Offshore Yen Payment Systems

For other offshore yen payment systems, the Bank will first confirm whether the system is subject to appropriate oversight by the central bank where the system operator is located, and/or other relevant central banks. As deemed necessary and commensurate with the size and other features of the system, the Bank will then seek to obtain information from relevant central banks on the design, operation, risk management, and other aspects of the system in order to monitor, on an ongoing basis, developments in and characteristics of the system in terms of the Bank's safety and efficiency objectives. Where necessary, the Bank will exchange views with relevant central banks based on the information gathered.

¹² *Central bank oversight of payment and settlement systems* recognizes that, although central banks involved in cooperative oversight should make every effort to reach consensus, there may be cases in extreme circumstances where it is impossible to reach common agreement on the assessment of the soundness of a system's design and operation. In such cases, each central bank retains the right to take action against the system or its participants to induce necessary changes.

Annex: Principles for International Cooperative Oversight

An Extract from the CPSS Report *Central bank oversight of payment and settlement systems*

Cooperative oversight principle 1: Notification

Each central bank that has identified the actual or proposed operation of a cross-border or multicurrency payment or settlement system should inform other central banks that may have an interest in the prudent design and management of the system.

Cooperative oversight principle 2: Primary responsibility

Cross-border and multicurrency payment and settlement systems should be subject to oversight by a central bank which accepts primary responsibility for such oversight, and there should be a presumption that the central bank where the system is located will have this primary responsibility.

Cooperative oversight principle 3: Assessment of the system as a whole

In its oversight of a system, the authority with primary responsibility should periodically assess the design and operation of the system as a whole. In doing so it should consult with other relevant authorities.

Cooperative oversight principle 4: Settlement arrangements

The determination of the adequacy of a system's settlement and failure-to-settle procedures in a currency should be the joint responsibility of the central bank of issue and the authority with primary responsibility for oversight of the system.

Cooperative oversight principle 5: Unsound systems

In the absence of confidence in the soundness of the design or management of any cross-border or multicurrency payment or settlement system, a central bank should, if necessary, discourage use of the system or the provision of services to the system, for example by identifying these activities as unsafe and unsound practices.