

to communicate to and discuss with ESA's board and management the recommendations resulting from the aforementioned assessment, as well as the strategy concerning ESA's common services and other issues;

- a *Technical Committee (TC)*, co-chaired by the Belgian authorities, and composed of all the signatory authorities assists the implementation of the agreed policies regarding the coordinated assessment of ESA's common services as defined by the HLC. The TC supports the coordinated assessment of all common functionalities and services of ESA.

In the absence of a consensus between the overseers/supervisors on matters of common interest, the HLC is in charge of drawing up the final compromise. Ad hoc working parties may be put in place by the TC in order to address those issues for which specific expertise is required. A permanent secretariat, managed by the Belgian authorities, provides the administrative support to both committees.

### 3. The cooperative oversight of SWIFT

#### 3.1 A short description of SWIFT

SWIFT s.c.r.l., the Society for Worldwide Interbank Financial Telecommunication ("SWIFT"), is a limited liability cooperative company, registered in Belgium, that supplies secure messaging services in 202 countries. Under SWIFT's company set-up, the liability of any member of the cooperative is limited to the amount of capital brought into the company. Flexible arrangements bound to the cooperative statute make it easy for members to join or leave the company.

SWIFT is owned and controlled by its members. It has an ongoing dialogue with its users through national member groups, user groups and dedicated working groups. These discussions relate, for example, to SWIFT's activities such as proposals for new or revised standards, providing industry comments on proposed corporate or business service changes, and comments on timeframes for new technology or service implementation. Each member has a number of shares proportional to its usage of SWIFT's message transmission services. Every three years, a share reallocation is implemented to reflect changes in each members' use of SWIFT.

Countries or country constituencies can recommend directors to the board according to the number of shares owned by all members in each country. SWIFT has a board of up to 25 directors, which governs the organisation and

directs its executive group of senior managers headed by a Chief Executive Officer. The board has 6 committees: Audit and Finance, Technology and Production, Banking and Payments, Securities, Compensation, Standards. The Audit and Finance Committee (AFC) is the governance and surveillance body for systems security, internal control and financial policy. The internal and external auditors report to the AFC on their reviews of systems security, accounting policy, reporting, auditing and control matters, as well as on the balance sheet and financial projections.

SWIFT provides messaging services to more than 7,500 financial institutions, including banks, broker/dealers, investment managers, and over 100 market infrastructures in payments, treasury, securities and trade. Many other types of financial institutions also hook into the SWIFT network, including among others, fund administrators, trading institutions, treasury counterparties or trusts.

The bulk of SWIFT messaging activity is related to the exchange of payment information between banks involved in correspondent banking arrangements. SWIFT also provides messaging and connectivity services to a growing number of market infrastructures. Over the last decade, most countries have set up large-value payment systems (LVPS) to help limit settlement risks in the interbank payments process. Many of these systems have chosen SWIFT as service provider for the messaging to and from its participants. SWIFT also provides messaging services to CLS (Continuous Linked Settlement), a settlement system that eliminates settlement risk for foreign exchange transactions between the world's major currencies.

While large-value payment systems have contributed significantly to the growth in messaging via SWIFT in recent years, the growth in securities traffic has been even greater. Securities messaging now accounts for nearly one third of SWIFT's total traffic. These messages flow between participants in stock exchanges, central securities depositories (CSDs) and international central securities depositories (ICSDs), and to central counterparties (CCPs).

SWIFT is also an active promoter of message standardisation in the financial sector. In close cooperation with its user community, SWIFT refines existing message types and defines message standards for new types of transactions or other financial information needs. This standardisation process contributes to straight-through processing, reducing industry inefficiencies and potential errors.

### 3.2 Oversight of SWIFT: Rationale

Central banks generally have the explicit objective of fostering financial stability and promoting the soundness of payment and settlement systems. While SWIFT is not itself a payment or settlement system and, as such, is not regulated by central banks or bank supervisors, a large and growing number of systemically important payment systems have become dependent on SWIFT, which has thus acquired a systemic character. If SWIFT were insufficiently protected against risk, disruption in financial messaging could trigger or transmit further disruption amongst its users.

Because of this, the central banks of the Group of Ten countries (G10) were of the opinion that SWIFT should be subject to cooperative oversight by central banks. The issue was first discussed at the (CPSS), and meetings with SWIFT started in 1987. The oversight of SWIFT in its current form dates from 1998, and the practical arrangements have gradually evolved since then. The oversight activity has intensified over the years, and the most recent strengthening of the practical arrangements took place in 2004. The next chapter presents the revised oversight arrangements in detail. The current arrangements may continue to evolve, as a periodic assessment of their effectiveness is taking place.

Throughout this evolution in the practical oversight arrangements, two core concepts in the set-up for the oversight of SWIFT have remained valid, i.e. the concept of cooperative oversight with the NBB as lead overseer, and the concept of moral suasion.

The oversight framework for SWIFT has drawn on the cooperative framework laid down in the 1990 the so-called Lamfalussy report (see box 1). That framework recognises that several central banks might have a legitimate interest in infrastructures operating on a cross-border basis, and that it would be inefficient, and could lead to inconsistent actions, if central banks acted independently. It provides for a cooperative approach to coordinate those interests, but it relies on achieving consensus to be fully effective. The cooperative arrangement increases central banks' influence, compared with acting on a solo basis, by enabling central banks to give a clear common message. In the case of SWIFT, the NBB is lead overseer, as SWIFT is incorporated in Belgium. Other central banks also have a legitimate interest in or responsibility for the oversight of SWIFT, given SWIFT's role in their domestic systems.

As is generally the case in payments systems oversight, the major instrument for the oversight of SWIFT is moral suasion. Overseers place great importance on the constructive and open dialogues conducted on a basis of mutual trust with the SWIFT board and senior management. During these dialogues, overseers formulate their recommendations to SWIFT.

No G10 central bank currently has direct statutory instruments (such as sanctions, fines or formal prior approval of changes) to formally enforce decisions upon SWIFT. This has never proven to be a drawback. Overseers can still exercise influence via a series of mechanisms to ensure that SWIFT takes account of their recommendations, including informing SWIFT users and their supervisors about oversight concerns related to SWIFT.

The common understanding of overseers and SWIFT about the oversight objectives, and the activities that will be undertaken to achieve those objectives, is laid down in a protocol. The protocol arrangement was signed between the NBB, as the lead overseer, and SWIFT. It can be revised periodically to reflect the evolving oversight arrangements.

### 3.3 Oversight of SWIFT: Current arrangements

The SWIFT oversight arrangements were reviewed in 2004. To that end, the NBB and SWIFT revised the existing protocol arrangement between them. The NBB also concluded bilateral Memoranda of Understanding (MoUs) with each of the other central banks participating in the oversight of SWIFT.

#### OVERSIGHT OBJECTIVES, AREAS OF INTEREST AND LIMITATIONS

The objectives of oversight of SWIFT centre on the security, operational reliability, business continuity and resilience of the SWIFT infrastructure.

To review whether SWIFT is pursuing these objectives, overseers want reassurance that SWIFT has put in place appropriate governance arrangements, structures, processes, risk management procedures and controls that enable it to effectively manage the potential risks to financial stability and to the soundness of financial infrastructures.

Overseers review SWIFT's identification and mitigation of operational risks, and may also review legal risks, transparency of arrangements and customer access policies. SWIFT's strategic direction may also be discussed with the board and senior management.

This list of oversight fields is indicative, not exhaustive. In short, overseers will undertake those activities that provide them comfort that SWIFT is paying proper attention to the objectives described above. Nevertheless, SWIFT continues to bear the responsibility for the security and reliability of its systems, products and services. It should be understood that the oversight of SWIFT does not grant SWIFT any certification, approval or authorisation.

#### INTERNATIONAL COOPERATIVE OVERSIGHT

As lead overseer, the NBB conducts the oversight of SWIFT in cooperation with the other G10 central banks i.e. Bank of Canada, Deutsche Bundesbank, European Central Bank, Banque de France, Banca d'Italia, Bank of Japan, De Nederlandsche Bank, Sveriges Riksbank, Swiss National Bank, Bank of England and the Federal Reserve System (USA), represented by the Federal Reserve Bank of New York and the Board of Governors of the Federal Reserve System. The relationship between the NBB and those other cooperating central banks has been laid down in bilateral MoUs.

Other central banks, beyond the G10, may have a legitimate interest in the oversight of SWIFT to the extent that financial institutions or market infrastructures located in their countries are important users of SWIFT services. To meet these information needs, while ensuring that the group involved in the cooperative oversight of SWIFT does not become too large and unwieldy, regular exchange of information on SWIFT oversight activities could be arranged on a need-to-know basis with the central banks concerned.

#### OVERSIGHT STRUCTURE – OVERSIGHT MEETINGS

The NBB monitors SWIFT developments on an on-going basis. It identifies relevant issues through the analysis of documents provided by SWIFT and through discussions with the management. It maintains a continuous relationship with SWIFT, with ad hoc meetings on a regular basis, and serves as the G10 central banks' entry point for the cooperative oversight of SWIFT. In that capacity, the NBB chairs the senior policy and technical groups that facilitate the cooperative oversight, provides the secretariat and monitors the follow-up of the decisions taken. The various SWIFT oversight groups are structured as follows:

- the SWIFT Cooperative Oversight Group (OG), composed of all G10 central banks, the ECB and the chairman of the G10 CPSS, the forum through which central banks conduct cooperative oversight of SWIFT, and in particular discuss oversight strategy and policies related to SWIFT. It meets twice a year;

- within the OG, the Executive Group (EG), which meets about four times a year, discusses with SWIFT's board and management the central banks' oversight policy, issues of concern, SWIFT's strategy regarding oversight objectives and conclusions. The EG supports the NBB in preparing for discussions within the broader OG and represents the OG in discussions with SWIFT. The EG can communicate recommendations to SWIFT on behalf of the OG. At one of the EG meetings, the annual reporting by SWIFT's external security auditor is discussed. The EG includes the Bank of Japan, the Federal Reserve Board, the Bank of England, the ECB and the NBB;
- at the technical level, the Technical Oversight Group (TG) has five full-day meetings a year with SWIFT management, internal audit and staff to carry out the groundwork of the oversight. Specialised knowledge is needed to understand SWIFT's use of computer technology and the associated risks. The TG draws its expertise from the pool of staff available at the cooperating central banks. It reports its findings and recommendations to the OG.

#### ACCESS TO INFORMATION

In order to achieve their oversight objectives, the overseers need to have timely access to all information they judge relevant for the purpose of the oversight. Typical sources of information are SWIFT board papers, security audit reports, incident reports and incident review reports. Another important channel for gathering information is through presentations by SWIFT staff and management. Finally, SWIFT also assists overseers in identifying internal SWIFT documents that might be relevant to address specific oversight questions.

Provisions on the confidential treatment of non-public information are included both in the protocol between the NBB and SWIFT and in each of the bilateral MoUs between the NBB and each (of the other) cooperative central banks.