Opinion of the European Economic and Social Committee on the 'Directive of the European Parliament and of the Council amending Directive 98/26/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims'

COM(2008) 213 final — 2008/0082 (COD)

(2009/C 175/13)

On 22 May 2008 the Council decided to consult the European Economic and Social Committee, under Article 95 of the Treaty establishing the European Community, on the

Directive of the European Parliament and of the Council amending Directive 98/26/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims

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The Section for the Single Market, Production and Consumption, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 6 November 2008. The rapporteur was Mr BURANI.

At its 449th plenary session, held on 3 and 4 December 2008 (meeting of 3 December), the European Economic and Social Committee adopted the following opinion by 172 votes to one with five abstentions.

1. **Summary and conclusions**

1.1 The Commission's initiative on payment systems, that was requested by the Council and is looked upon favourably by the market, sets out to update and bring greater certainty to the rules on settlement finality and on financial collateral agreements. As such, it also merits the support of the EESC. In a subject as highly specialised as that under examination, questions and doubts about the technical aspects or the proposal are bound to arise: these have been interpreted by specialists and decision-making bodies at the various stages of scrutiny of the Commission's text. The EESC only touches upon these issues in passing, preferring to contribute by debating Community policy on payment systems.

1.2 The initiative commenced more than a year ago, prior to the emergence of the US subprime crisis, which has since expanded with significant consequences for financial communities worldwide. The first symptoms of the crisis among individual establishments appeared in the form of liquidity difficulties, but which rapidly turned into solvability difficulties. The situation has become so serious as to trigger unavoidable government intervention in both the United States and Europe. The current situation puts the need for the market to be guaranteed by adequate collateral into sharp focus: new types of collateral are welcome, **provided that they are not detrimental to the quality of guarantees**.

1.3 It may well be wondered if the provision under which bank loans are to be considered eligible as collateral in financial collateral arrangements would have been included in the Commission's proposal if the question were to be raised now rather than a year ago. Bank loans are already accepted in a number of countries and make a real contribution to liquidity; they should therefore be viewed with approval. However, in the current fragile and volatile state of the markets, extending them to all Member States without prior harmonisation of the rules governing them might suggest greater prudence, leaving each central bank to continue 'monitoring' its own market in accordance with its own perceptions and needs.

1.4 More thought is needed, not so much about legal certainty, which the proposal quite rightly seeks to establish, but about the planned duration of the provisions contained in the proposal: the Legal Certainty Group has not yet finished its work, the UNIDROIT initiative is only just at the finishing stages and has not yet been signed, much less ratified, harmonisation of legislation on netting is a matter for future plans, and the harmonisation of legislation on insolvency procedures is a long-term goal. The EESC does not mean by this that the Commission's initiative is not helpful and worthy of support, but wishes to highlight that the market needs rules that are not only clear-cut, but also long-lasting. Hence the need to speed up legislative and regulatory work.

1.5 Last but by no means least, there are the prudential implications: the EESC wonders if the different aspects of the systemic risk inherent in operable systems, in one system operating within another, and in the quality of controls over the entire range of players, have been thoroughly assessed by the supervisory authorities, and if they have been asked to play a direct part in framing the proposals. As pointed out by the EESC opinion, market robustness prevails over all other considerations.

1.6 The EESC's opinion has not been influenced by the present situation. In 'normal' times, the rules on the operational capacity of participants and systems, together with the quality of collateral, must be strict, but **in emergencies must become flexible** without however becoming lax. The directive should contain a provision that would enable systems — under the responsibility of the supervisory authorities — to adopt **special measures to deal with emergencies**.

2. **Introduction**

2.1 The purpose of the Commission's initiative is to **bring the directive on settlement finality in payment and securities settlement systems, together with the directive on financial collateral arrangements, into line** with the latest market developments. Existing and newly introduced rules are extended to night-time settlement and to settlement between linked systems.

2.2 Market interconnection, which has been under way for some time, is becoming increasingly widespread: following the implementation of Directive 2004/39/EC and the European Code of conduct for clearing and settlement ('the Code'), interconnection is covered by clear and precise rules, facilitating its broad introduction. As well as introducing new types of settlement, the Commission's proposal also extends the list of types of asset that can be used as financial collateral: **credit claims accepted for the collateralisation of central bank credit operations** ('bank loans' or 'credit claims'). Since January 2007, the ECB has included credit claims as an eligible type of collateral for Eurosystem credit operations; this initiative has already been adopted independently by a number of central banks, but a legal framework allowing for cross-border use was lacking.

2.3 In brief, the existing legal framework, that the proposal for a directive aims to amend, is set out in the two EC directives: 98/26/EC on settlement finality (**SFD**, Settlement Finality Directive), and 2002/47/EC on financial collateral arrangements (**FCD**, Financial Collateral Directive).

2.4 In addition, and as is usual with amending directives, the Commission is taking the opportunity to introduce a number of **simplifications and clarifications**. The ultimate aim is to bring the regulations into line with market developments, a measure which is all the more necessary in the light of recent market turbulence, the effects of which may be greatly magnified as a consequence of globalisation.

2.5 The Commission's initiative was preceded by a preparatory phase lasting more than a year. Its evaluation report on the implementation of the SFD concluded that the system 'is functioning well', while pointing to the need for further analysis. The proposal is based on a series of consultations with the ECB, the national central banks, and a wide range of operators and organisations in the sector. **Consumer rights** receive special attention, and the proposal points out that 'the provisions relating to credit claims do not seek to encroach on the rights of consumers, and in particular the rights under the recently agreed Consumer Credit Directive', since the credit claims in question are those that are eligible for the collateralisation of central bank credit operations, '**which in principle excludes credit claims by individual customers**'.

2.6 Under normal circumstances, the new European rules appear to be properly geared to **dealing with emergencies**: the market's robustness should be ensured by the growing web of interconnections between payment and securities settlement systems that are already in operation, are all solid, have sufficient liquidity and are apparently closely monitored. Moreover, the Code (adopted in late 2006) has introduced an element of competitiveness — and consequently greater efficiency — to clearing and settlement systems, which is entirely to the benefit of users.

3. **General comments**

3.1 The operators see this initiative as a decisive step forward in creating a European financial area with harmonised rules: the new directive would effectively pave the way for any future measures that may have to be taken following the recommendations of the expert group set up by the Commission (the **Legal Certainty Group**) to remove legal barriers to the integration of Union markets. The directive would also enable a significant contribution to be made to **implementing the UNIDROIT initiative**, intended to establish **uniform rules of substantive law on intermediated securities** at international level, including rules on financial collateral arrangements.

3.2 No harmonisation, either European or international, can be considered as complete without a series of **additional or complementary measures**, which are likely to be included in future Commission programmes. One such additional measure should provide for the **harmonisation of rules governing netting agreements**, i.e. clearing of net amounts between parties, including clearing agreements under which the parties' respective obligations become immediately due (close-out netting).

3.3 Among additional measures, and certainly with a more long-term perspective, well-designed integration of the financial markets should help to bring about **greater consistency between national arrangements for insolvency procedures**: the current situation, with discrepancies at national level, can have a negative impact on financial collateral arrangements and clearing and settlement operations, entailing greater **systemic risk of instability**.

4. **Comments on the proposals concerning Directive 98/26/EC (SFD)**

4.1 Article 2 introduces a series of explanations and clarifications, some of which are purely routine while others are more important. Article 2(b) in particular clarifies the position of **electronic money institutions**, laying down unequivocally that, for the purposes of the directive, these are to be considered in exactly the same way as **credit institutions**.

4.1.1 While acknowledging that, insofar as they are participants in payment systems, they are on a par with fully-fledged credit institutions, the EESC would point out that the supervisory rules are not the same, or are so only in part. It remains to be seen if this will have an effect on the reliability of electronic money institutions in the event of serious market disturbance: the Committee has in the past expressed reservations about accepting them as members of the payment system. However, the Committee wishes to repeat a recommendation it has already made in the past: that **policies geared to achieving a level playing field for competition should be subordinate to those — which take priority — primarily ensuring market resilience, and consequently consumer protection (the end-investors)**.

4.1.2 These aspects assume even greater importance in light of the fact that **interoperable systems** (as defined in Article 2(n)) facilitate participants' access to clearing and settlement systems by means of the connections between them, unavoidably leading to a potential **increase in systemic risk**. This is the case in particular in the **securities settlement system** as a result of the links established between central securities depositories (CSD), responsible for holding traded financial instruments on a centralised, dematerialised basis [1], and central counterparties (CCP), which act as the single counterparty for the institutions involved in a system with respect to their respective transfer orders for traded financial instruments. The text of the directive should also make clear that the purpose of introducing a definition of 'interoperable systems' is not to allow the legally momentous creation of a 'super-system', but rather to enable the legal protection typically afforded to settlement finality to be extended to regulated transactions between systems.

4.2 The proposal to **allow one system to become a participant in another** also gives cause for concern. Clarification is needed: a system, as defined by Directive 98/26, is an arrangement or set of rules, which has no legal personality but is recognised by its various participants. This distinction should be made, with a view to greater legal certainty, in order to establish the responsibilities of the different parties, especially with regard to insolvency law.

4.3 Article 3 introduces an amendment, needed in order to 'remove any uncertainty about the status of night-time **settlement services**': it replaces the word 'day', currently in use, with the more specific '***working* day**' to reflect the fact that most markets work uninterruptedly through the night as well as the day. This measure is necessary, but should be accompanied by **harmonisation of netting agreements**. In addition, the previously mentioned differences between **insolvency arrangements**, which may be reflected in the provisions on financial collateral and clearance arrangements, must be resolved: harmonisation in this area, which although desirable is difficult to bring about, is of an all-embracing nature and goes beyond purely payment systems-related considerations.

5. **Comments on the proposals concerning Directive 2002/47 (FCD)**

5.1 The extension of Directive 2002/47 to **bank loans** (amendment to Article 1(4)(a)) is to be welcomed, since it permits greater availability of collateral and is therefore likely to improve market liquidity. However, the definition of 'credit claims eligible for the collateralisation of central bank credit operations' gives rise to some doubt: the **definition of 'eligibility' leaves too much discretion to each central bank** and leaves it unclear who is qualified and who is not. One solution to this problem might be to delete the words 'or credit claims eligible for the collateralisation of central bank credit operations' from Article 2(4)(a).

Brussels, 3 December 2008.

The President of the European Economic and Social Committee

Mario SEPI

The Secretary-General of the European Economic and Social Committee

Martin WESTLAKE

[1] Almost all centralised securities are nowadays managed in dematerialised form; those securities that are still represented in paper form are grouped together in large certificates (global or maxi-certificates) at central depositories in the various Member States.