



EUROPEAN CENTRAL BANK

OPINION OF THE EUROPEAN CENTRAL BANK**of 5 July 2006****at the request of the Belgian Ministry of Finance****on a draft royal decree extending the list of the participants in securities settlement systems****(CON/2006/34)****Introduction and legal basis**

On 7 April 2006, the European Central Bank (ECB) received a request from the Belgian Ministry of Finance for an opinion on a draft royal decree extending the list of the participants in securities settlement systems as referred to in Article 2§2 of the law of 28 April 1999 implementing Directive 98/26/EC of 19 May 1998 on settlement finality in payment and securities settlement systems (hereinafter the 'draft royal decree').

The ECB's competence to deliver an opinion is based on Article 105(4) of the Treaty establishing the European Community and on the fifth and sixth indents of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions¹, as the draft royal decree concerns the criteria for direct participation in securities settlement systems (SSSs), which raise issues in terms of assessing their systemic risk and financial stability implications. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. Purpose of the draft royal decree

The purpose of the draft royal decree is to extend the list of participants to SSSs that are covered by the Belgian law of 28 April 1999 implementing Directive 98/26/EC of 19 May 1998 on settlement finality in payment and securities settlement systems (hereinafter the 'Law of 28 April 1999') and, thus, by the settlement finality protection of Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems² (hereinafter the 'Settlement Finality Directive'). To this end, the draft royal decree introduces a third subparagraph in Article 2§2 of the Law of 28 April 1999. This new provision is intended to allow any legal person to acquire the status of direct participant in an SSS within the meaning of the Law of 28 April 1999, thus benefiting from settlement finality protection even if this legal person does not qualify as a credit

¹ OJ L 189, 3.7.1998, p. 42.

² OJ L 166, 11.6.1998, p. 45.

institution or investment firm or does not perform similar functions (see current first subparagraph of abovementioned Article 2§2) or as a designated central counterparty, settlement agent, clearing house or similar institution (see current second subparagraph of abovementioned Article 2§2), provided at least three other participants in this SSS fall within one of these two categories.

2. General Observations

- 2.1 The draft royal decree intends to use the possibility under the second subparagraph of Article 2(b) of the Settlement Finality Directive for Member States to opt for such extension. The ECB trusts that, in accordance with the principle of supremacy of Community law and with Article 2§52° of the Law of 28 April 1999, the extension of the list of participants by the draft royal decree will, besides the condition already expressly mentioned in this draft, also be subject to the other two conditions in Article 2(b) of the Settlement Finality Directive, namely (i) that the legal entity in question has responsibility for discharging the financial obligations arising from transfer orders with the SSS; and (ii) that the extension decision is warranted on grounds of systemic risks. For reasons of legal certainty, the Belgian legislator could clarify this, for instance through an express statement to this effect in the statement of reasons accompanying the royal decree.
- 2.2 In view of the Eurosystem and ECB tasks, amongst others the protection of financial stability through the removal of systemic risks, the ECB is particularly attentive to the systemic risk requirement in the second subparagraph of Article 2(b) of the Settlement Finality Directive (see also paragraph 4 above). In this respect, the ECB understands that the draft royal decree is intended to respond to an issue regarding Recommendation 1 ('Legal risk') of the CPSS/IOSCO Recommendations for Securities Settlement Systems³. The ECB notes that this issue was addressed as follows in the 2006 Financial System Stability Assessment on Belgium by the International Monetary Fund⁴: 'There are adequate rules for addressing the event of a participant default, including the effective use of collateral, and these rules can legally be enforced. However, non-financial participants in the [Euroclear System], which account for less than 0,5 percent of total settlement activities, are not protected against the zero hour rule. A legislative project is already underway that would address this residual risk'. The ECB therefore strongly welcomes the objective of the draft royal decree of swiftly removing this residual risk, especially as there is neither a limitation on the potential number of such non-financial participants, nor on the possible volume of instructions that such non-financial participants might give.
- 2.3 Finally, the ECB points out that the Settlement Finality Directive grants far-reaching legal protection, which amongst others consists of the exclusion of the zero-hour rule in case of insolvency. It should therefore only cover payment and security transfer orders by participants

³ Available at www.iosco.org.

⁴ See IMF Country Report No 06/75, Belgium, Financial System Stability Assessment, including Reports on the Observance of Standards and Codes on the following topics: Banking Supervision, Securities Regulation, Insurance Supervision and Regulation, and Securities Settlement Systems, p. 52, No 112 and p. 55, Table 11, Recommendation 1.

who, because of their nature, activities and/or status, merit the benefit of this protection. In this context, the ECB notes that the ‘normal’ categories of direct participants that benefit from this protection are, in one way or the other, either public authorities or entities subject to a supervisory regime (see first subparagraph of Article 2(b) of the Settlement Finality Directive and Article 2§2 of the Law of 28 April 1999). By contrast, this is not the case for the entities covered by the second subparagraph of Article 2(b) of the Settlement Finality Directive, and similarly also the draft royal decree, which only generally designate the direct participants that can benefit from the extension of the protection of the Settlement Finality Directive (compare ‘undertaking’ and ‘legal person’, respectively). This designation does, in particular, not require any specific legal supervisory status or other statutory qualifications for such participants. This is particularly relevant for ‘undertakings’ within the meaning of the second subparagraph of Article 2(b) of the Settlement Finality Directive whose head office is outside the Community (compare with ‘any undertaking’ in the first subparagraph of Article 2(b)). For financial stability and systemic risk reasons, the ECB considers that all legal persons that benefit from this extension should first be subject to the same conditions, including access conditions, as those imposed by an SSS for public authorities or supervised entities to be accepted as direct participants and retain this capacity. Furthermore, the ECB trusts that both the authority responsible for oversight of the concerned SSS and the authority responsible for prudential supervision of the entity operating this SSS will ensure as part of their supervisory and regulatory duties that the extension of the direct participation benefit is, in practice, only granted to legal entities that do not endanger the reputation and financial stability of the concerned SSS.

This opinion will be published on the ECB’s website.

Done at Frankfurt am Main, 5 July 2006.

[signed]

The President of the ECB

Jean-Claude TRICHET