EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 29 April 2011

on amendments to the legislation on settlement finality and financial collateral arrangements

(CON/2011/41)

Introduction and legal basis

On 4 April 2011, the European Central Bank (ECB) received a request from the Nationale Bank van België/Banque Nationale de Belgique (NBB), acting on behalf of the Belgian Ministry of Finance, for an opinion on a draft law amending the law on settlement finality and the law concerning financial collateral arrangements (hereinafter the 'draft law')[1].

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union, and the second, 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 provisions[2], as the draft law contains provisions on means of payment, payment and settlement systems, as well as rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets. 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 law

1.1 The main objective of the draft law is the transposition into Belgian law of Directive 2009/44/EC[3]. To this end, the draft law amends the Law on settlement finality in payment and securities settlement systems[4] and the law concerning financial collateral arrangements[5].

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1 Draft law transposing Directive 2009/44/EC of the European Parliament and the Council of 6 May 2009 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.

2 OJ L 189, 3.7.1998, p. 42.

3 Directive 2009/44/EC of the European Parliament and of the Council of 6 May 2009 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 (OJ L 146, 10.6.2009, p. 37). The ECB commented on an early draft of Directive 2009/44/EC in Opinion CON/2008/37 of 7 August 2008 (OJ C 216, 23.8.2008, p. 1).

4 The Law of 28 April 1999 transposing Directive 98/26/EC of 19 May 1998 on settlement finality in payment and securities settlement systems.

5 The Law of 15 December 2004 on financial collateral and on various tax provisions in relation to *in rem* collateral arrangements and loans for financial instruments. The ECB commented on an early draft of this Law in Opinion CON/2004/27. All ECB opinions are available on the ECB's website at www.europa.eu.

1.2 In addition to transposing Directive 2009/44/EC, the draft law[6] will set aside the rules providing for a simplified realisation of certain financial collateral (i.e. pledges of cash and of banking claims)[7] in the event of judicial reorganisation proceedings of the debtor. This exemption to the regime currently in force in Belgium[8] will not apply where the default[9] consists in the non execution of an obligation, i.e. where it is a 'payment default'. Under the amended regime all creditors will be prevented from invoking the rules on the simplified realisation of pledges of cash and of banking claims, as well as those ensuring the validity and enforceability of 'netting arrangements', in the event of judicial reorganisation proceedings concerning a debtor who is not a 'public or financial legal person'[10]. In the event of judicial reorganisation proceedings concerning a public or financial legal person, creditors who are not public or financial legal persons will be prevented from invoking the abovementioned rules on realisation and netting arrangements. Similarly, where the King adopts an act disposing of property with regard to an insurance undertaking, a credit institution or a settlement institution[11], the creditors of such institution who are not public or financial legal persons will be prevented from invoking the abovementioned rules on realisation and netting arrangements. However, the draft law will not affect the rules governing the realisation of pledges of financial instruments in the Law of 15 December 2004.

1.3 Furthermore, the provisions ensuring the validity and enforceability of netting arrangements, (including close-out netting clauses[12]) in case of insolvency, will be set aside where one of the parties is a non-merchant natural person[13]. This amendment in the draft law became necessary following a decision of the Belgian Constitutional Court, which held that these provisions breach

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6 Article 14, 4° and 5° of the draft law, introducing Article 4 § 3 and § 4 in the Law of 15 December 2004.

7 The simplified realisation procedure for pledges of banking claims provides that in case of default, the pledgee may realise the pledged banking claim without the need for a prior notice or a Court authorisation and notwithstanding the existence of an insolvency procedure, an attachment, or any other situation of concourse between the creditors of the debtor or of the third party who provided the collateral (Article 9(1) of the Law of 15 December 2004, introduced by Article 17 of the draft law).

8 See ECB Opinion CON/2004/27, in particular paragraphs 4, 7 and 11.

9 Under general Belgian law, the concept of 'payment' refers to the execution of a counterparty's obligations. Hence, a 'payment default' covers all cases of non-execution of an obligation, including notably an obligation to deliver securities.

10 The public or financial legal persons are: (a) credit institutions, (b) investment undertakings, (c) insurance firms, (d) management companies of collective investment undertakings, (e) undertakings for collective investments, (f) central counterparties, settlement agents and clearing houses, (g) financial institutions, (h) Belgian or foreign legal persons acting in their own name but on behalf of the beneficiaries of securities, (i) public authorities except companies covered by a State guarantee, (k) the NBB, the ECB, the Bank for International Settlements, multilateral development banks, the International Monetary Fund, the European Investment Bank, (l) any other foreign legal person which belongs in its home country to one of the categories referred to in Article 1(2)(a) to (d) of Directive 2002/47/EC (Article 13, 4° of the draft law, introducing an Article 3, 11° in the Law of 14 December 2004).
The 'financial institutions' are undertakings that are not credit institutions and whose principal activity consists in the acquisition of shares or which carry out one or more of the activities for which credit institutions benefit from mutual recognition, e.g.: (a) mortgage companies, (b) consumer credit companies, (c) leasing companies, (d) payment institutions or electronic money institutions.

11 i.e. the transfer, sale or contributions of such institutions' assets, liabilities or activities, or of the securities or shares they issue. These measures may be adopted by the King where the fact that such institution is not operated according to the applicable law presents a risk for financial stability. See ECB Opinion CON/2010/7.

12 Articles 14 and 15 of the Law of 15 December 2004, respectively.

13 Articles 19 and 20 of the draft law.

the principles of non-discrimination and equal treatment enshrined in the Belgian Constitution, insofar as they apply to non-commercial natural persons[14].

2. General observations

2.1 The ECB notes that when transposing Directive 2002/47/EC, the Belgian legislator had first opted for a broader scope than required by the Directive[15]. The explanatory memorandum to the draft law underlines that the proposed amendment to this regime seeks to balance, on the one hand, the protection of the collateral obtained by financial institutions and, on the other hand, the safeguard of the economic activity of non-financial companies when they encounter temporary difficulties[16]. The rationale of these amendments lies in the willingness to preserve some substance in the Belgian judicial reorganisation procedure for natural or legal persons who are not public or financial legal persons in respect of transactions that do not concern financial instruments[17].

2.2 The ECB understands that the exemption introduced by the draft law does not prejudice the protection of settlement finality in payment and securities settlement systems (SSS) under the Law of 28 April 1999. Hence, when an entity is a participant in such system[18], its operations will continue to be covered by the settlement finality protection under the Law of 28 April 1999[19], regardless of whether that entity is a public or financial legal person within the meaning of the amended Law of 15 December 2004.

3. Provisions relating to settlement finality in payment and securities settlement systems

Definition of institutions and participants

The Belgian legislator had already availed, in previous legislation[20], of the possibility in the second subparagraph of Article 2(b) of Directive 98/26/EC of considering as 'institutions' certain undertakings participating in an SSS that do not fall within the categories of institutions listed in the Directive[21], provided that such assimilation is warranted on grounds of systemic risk and that at least three other participants in this SSS do fall within one of these categories. Under the draft law[22], the NBB will determine the existence of systemic risk grounds, in the context of its oversight

14 Explanatory memorandum, pages 1, 20 and 21.

15 See ECB Opinion CON/2004/27, in particular paragraph 4.

16 Explanatory memorandum, p. 14.

17 Explanatory memorandum, p. 16, and the reference to the use by the French authorities of their opt out possibility.

18 Also where a participant is assimilated to an institution for reasons of systemic risk (Article 3, 2° of the draft law). See paragraph 3.

19 See also Article 6, 1° and 2° and Article 11 of the draft law.

20 See the Royal Decree of 3 June 2007, inserting a last subparagraph in Article 2 §2 of the Law of 28 April 1999. The ECB commented on an early draft of this provision in Opinion CON/2006/34.

21 The categories of institutions listed in Directive 98/26/EC are: credit institutions, investment firms, public authorities and third country undertakings performing similar functions.

22 Article 3, 2°, penultimate subparagraph of the draft law, introducing a definition of 'institution' in the Law of 28 April 1999. See also Article 4, 2° of the draft law, replacing Article 2 §2 of the Law of 28 April 1999.

competence[23], and will establish and publish the criteria it uses. The NBB will also be competent to determine the existence of systemic risk warranting considering an indirect participant as a participant[24]. The ECB notes that the requirement related to the existence of systemic risks grounds is now explicitly mentioned in the draft law[25]. For the remainder, all comments and recommendations made in ECB Opinion CON/2006/34 remain applicable to the draft law[26].

4. Provisions relating to financial collateral arrangements

The introduction of credit claims as eligible collateral in financial collateral arrangements

4.1 The application of the Law of 15 December 2004 on financial collateral is extended to agreements creating a security over banking claims pledged or transferred by contract[27]. The draft law defines 'banking claims' as pecuniary claims arising out of an agreement whereby a loan or a credit is granted by (i) a credit institution, (ii) a mortgage company, (iii) a consumer credit company, or (iv) any other foreign legal person which, in its home country, belongs to one of the preceding categories[28].

4.2 The ECB in general welcomes the proposed amendment, which will facilitate the use of credit claims as collateral for Eurosystem credit operations. The ECB notes that the Belgian definition of 'banking claims' is wider than the definition of credit claims in Article 2 (5)(a)(ii) of Directive 2009/44/EC, which only covers credit claims granted by credit institutions defined in Article 4(1) of Directive 2006/48/EC[29], including the institutions listed in Article 2 of Directive 2006/48/EC. By contrast, the 'banking claims' in the draft law cover, in addition, pecuniary claims arising out of an agreement whereby a loan or a credit is granted by a mortgage company or a consumer credit company. The ECB understands that this difference aims at avoiding any discriminatory treatment between these different categories of lending institutions[30].

The restriction on the realisation of pledges on credit claims and on the rules ensuring the enforceability and validity of netting arrangements

4.3 As already mentioned, the draft law will set aside (i) the rules providing for a simplified realisation of pledges on cash and of banking claims, and (ii) the rules ensuring the enforceability and validity of netting arrangements, in the event of judicial reorganisation proceedings of a debtor that is not a 'public or financial legal person', unless there is a payment default. The ECB notes that by

23 Explanatory memorandum, p. 3. Where under the draft law, it is the parties who trigger the assimilation, the NBB could nevertheless issue a recommendation to that end in the context of its oversight tasks.

24 Article 3, 6°, second subparagraph of the draft law, introducing a definition of ' participant' in the Law of 28 April 1999.

25 Article 3, 2°, penultimate indent of the draft law, introducing a definition of 'institution' in the Law of 28 April 1999.

26 See CON/2006/34, in particular paragraph 2.1.

27 Article 14, 2° of the draft law, introducing an Article 4 §1 3° in the Law of 15 December 2004.

28 Article 13, 3° of the draft law, introducing an Article 3, 10° in the Law of 15 December 2004.

29 Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast) (OJ L 177, 30.6.2006, p. 1).

30 Explanatory memorandum, p. 8.

introducing this provision, the Belgian legislator, similarly to other Member States[31], will use the exemption provided for in Article 1(3) of Directive 2002/47/EC, under which Member States may exclude arrangements where one of the parties is a person other than a natural person, including unincorporated firms and partnerships, provided that the other party is an institution as defined in points (a) to (d), which includes a central bank and the ECB.

This exemption might, in certain cases, be an obstacle to the swift realisation of the collateral provided for Eurosystem credit operations. This might notably be the case where the NBB accepts as collateral from a Eurosystem counterparty, a credit claim[32] which is a debt obligation of a non-financial corporation[33] that is not a 'public or financial legal person' and where both the Eurosystem counterparty and the non-financial corporation default in their respective obligations. The ECB emphasises that in order to ensure that a valid security is created over credit claims, and that the credit claim can be swiftly realised in the event of a counterparty default, in general, there should be no restrictions regarding the realisation of the credit claim used as collateral. However, the ECB notes that the exemption provided by the draft law does not seem to represent major risks for the Eurosystem, as: (i) the exemption does not apply in case of a payment default; and (ii) the probability is low that a double default would occur where all the specific conditions for the exemption to apply are fulfilled.

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

Done at Frankfurt am Main, 29 April 2011.

[signed]

The President of the ECB

Jean-Claude TRICHET

31 See the explanatory memorandum, p. 16.

32 To be eligible as collateral for Eurosystem credit operations, a credit claim must be a debt obligation of a debtor vis-à-vis a Eurosystem counterparty; the eligible debtors are non-financial corporations, public sector entities and international or supranational institutions (Section 6.2.2 of Annex I to Guideline ECB/2000/7of the ECB of 31 August 2000 on monetary policy instruments and procedures of the Eurosystem (OJ L 310, 11.12.2000, p. 1)).

33 As defined in the ESA 95 (see Section 6.2.2 of Annex I to Guideline ECB/2000/7). Under Council Regulation (EC) No 2223/96 of 25 June 1996 on the European system of national and regional accounts in the Community (OJ L 310, 30.11.1996, p. 1), the sector non-financial corporations (S.11) consists of institutional units whose distributive and financial transactions are distinct from those of their owners and which are market producers …, whose principal activity is the production of goods and non-financial services.