



**EUROPEAN CENTRAL BANK**

**OPINION OF THE EUROPEAN CENTRAL BANK**

**at the request of the Swedish Ministry of Finance concerning a legislative proposal for the implementation in Sweden 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 systems**

**(CON/99/09)**

1. On 19 July 1999 the European Central Bank (ECB) received a request from the Swedish Ministry of Finance for comments from the ECB concerning a legislative proposal entitled “Promemoria om Finalitydirektivets införlivande med svensk rätt” (the “legislative proposal”). The intention in respect of the legislative proposal is to implement in the Swedish legal system Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems (the “Finality Directive” or the “Directive”). The legislative proposal contains a proposed new draft law on settlement systems (the “draft law”) and certain proposed amendments to existing Swedish legislation (the “legislative amendments”), as well as an explanatory memorandum concerning the Finality Directive and the suggested additions and amendments to Swedish law (the “explanatory memorandum”).
2. Since the purpose of the legislative proposal is the implementation of the Finality Directive, the Swedish authorities were not legally obliged to consult the ECB under Article 1.2 of Council Decision 98/415/EC of 29 June 1998. The ECB, however, seeks to promote proactively a harmonised EU-wide implementation of the Finality Directive in the legislation of the Member States in order to foster maximum transparency and legal certainty for the closely connected payment and securities settlement systems and to ensure a level playing-field throughout the

European Union. Therefore, the ECB very much welcomes the opportunity to give its opinion with regard to the legislative proposal, considering that it addresses matters pertaining directly to the core fields of competence of the European System of Central Banks (ESCB). In particular, the draft law is closely related to the basic task of the ESCB to promote the smooth operation of payment systems, as set out in Article 105 (2), fourth indent, of the Treaty establishing the European Community, as amended (the “Treaty”), and Article 3.1, fourth indent, of the Statute of the European System of Central Banks and of the European Central Bank (the “Statute of the ESCB” or the “Statute”). In view thereof, and as a general remark, it may be useful for the consulting authority to consider the implications of the legislative proposal from the perspective of future Swedish participation in the third stage of Economic and Monetary Union (EMU). Accordingly, the Governing Council of the ECB has adopted this ECB Opinion in accordance with Article 17.5, first sentence, of the Rules of Procedure of the European Central Bank.

3. The legislative proposal indicates the Swedish systems which will fall within the scope of application of the draft law pursuant to Articles 2 (a) and 10 of the Finality Directive (Sections 1-7 of the draft law and Part 5.2 of the explanatory memorandum).
- 3.1 The explanatory memorandum contains an analysis and general description of the settlement systems that would be eligible for designation as “systems” and a notification to the European Commission under the draft law. In this respect, the ECB notes the references to the stability of the financial system (in Section 4, second paragraph, and Section 5, second paragraph, of the draft law and in the explanatory memorandum) and to systemic risk (in the explanatory memorandum). The ECB welcomes the general intention to cover all systems that can be said to be of importance for the stability of the financial system and the attention paid to systemic risk.
- 3.2 In addition, Section 2 of the draft law makes explicit reference to the national real-time gross settlement (RTGS) system operated by Sveriges Riksbank (RIX). Accordingly, this Section clarifies that RIX will be notified to the European Commission as a “system”, as defined in Article 1 of the Finality Directive, and benefit from the provisions of the draft law and the legislative amendments. The explanatory memorandum also refers to the RTGS payment arrangement of the ESCB for EU-wide fund transfers (TARGET). In this connection, it may be noted that the separate Swedish arrangement within RIX for the settlement of fund transfers in euro (euro-RIX) is linked with the other national RTGS systems of TARGET outside Sweden (through the “Interlinking” component). Fund transfers effectuated to and from Sweden through euro-RIX and the Interlinking should also fall within the scope of the provisions of the draft

law. Accordingly, the Swedish authorities are encouraged in this respect to clarify the fact that euro-RIX forms an integral part of TARGET, which may be explained when notification of RIX, including euro-RIX, is given to the European Commission.

4. The ECB notes the proposed role of the Financial Supervisory Authority (“Finansinspektionen”) under the draft law, and would like to make some comments. In this connection, Sweden’s present status as a Member State with a derogation under the Treaty is duly recognised (cf. Article 122 (ex Article 109k) of the Treaty). The exclusion of such a Member State and its national central bank (NCB) from rights and obligations within the ESCB is laid down in Chapter IX of the Statute of the ESCB. The exclusion covers, among other provisions, Article 105 (2) of the Treaty and Article 3 of the Statute of the ESCB and, therefore, the basic ESCB task “to promote the smooth operation of payment systems” (Article 105 (2), fourth indent, and Article 3.1, fourth indent). With reference to the general remark (in item 2 above) concerning the future participation of Sweden in EMU, however, the following observations are intended to clarify certain general concepts in relation to the ESCB’s conduct of this basic task. Whereas prudential supervision has as its subject financial institutions (which may participate in settlement systems as indicated in Section 7 of the draft law), the subject for payment systems oversight is the settlement systems themselves. There are several shared objectives between the supervisory activity in respect of individual financial institutions and the oversight of payment systems. For instance, an institution subject to supervision may act as the operator of a payment system, and supervision and oversight activities will have certain shared objectives in relation to such an institution, thus calling for co-operation between the authorities involved. As reflected in the explanatory memorandum, the general focus of payment systems oversight is the avoidance of systemic risk within or between systems.

4.1 It is true, as noted in the explanatory memorandum (in Part 5.2.4 on page 56), that the Finality Directive does not regulate the manner in which the Member States may arrange their respective oversight regimes in relation to domestic settlement systems. On the other hand, the explanatory memorandum refers to the many reports concerning the oversight of settlement systems, notably the reports by central banks prepared under the auspices of the Bank for International Settlements (BIS). In particular, the adoption of the so-called Lamfalussy standards for oversight contained in the Report of the Committee on Interbank Netting Schemes of the Central Bank of the Group of Ten Countries, Basel (1990), provided a framework for the traditional central bank function of oversight in relation to payment systems.

- 4.2 In addition to the stipulation in the Treaty and the Statute of the ESCB that the promotion of the smooth operation of payment systems shall be one of “the basic tasks to be carried out through the ESCB” (item 4 above), and the central bank reports concerning oversight (item 4.1 above), Article 22 of the Statute may be noted. According to the latter provision, “the ECB may make regulations, to ensure efficient and sound clearing and payment systems within the Community and with other countries”.
- 4.3 In Sweden, Section 2 of Chapter 1 of the amended Act on Sveriges Riksbank (“lagen (1988:1385) om Sveriges Riksbank”) which, in its revised version, entered into effect on 1 January 1999 (the “Riksbank Act”), stipulates that Sveriges Riksbank “shall [...] promote a safe and efficient payment system”. Prior to 1 January 1999 this task was laid down in Section 4 of the previous version of the Riksbank Act, as well as in Article 12 of Chapter 9 of the Constitution Act (“regeringsformen”). The governmental report of 2 October 1997 concerning the proposal for the new Riksbank Act (“Lagrådsremiss – Riksbankens ställning”) states (on page 69) that the promotion of a safe and efficient payment system “is a basic duty of the Riksbank” and that an “equivalent task applies for the ESCB”. This equivalent ESCB task is the oversight function.
- 4.4 In view of the above, the ECB suggests that the legislative proposal should identify and refer explicitly to the specific nature of the oversight of payment systems, on the one hand, and the supervision of financial institutions, on the other hand. The Swedish Financial Supervisory Authority should maintain responsibility for the prudential supervision of the financial institutions involved as system operators or participants in relation to systems under the draft law. Furthermore, the ECB recommends that the role of Sveriges Riksbank as regards oversight (addressing the settlement systems as opposed to the entities involved) should be explicitly referred to in the draft law, whereby any oversight activity should be allocated to the Riksbank. Hence, the arrangements for oversight should make reference to the basic task of Sveriges Riksbank to promote the safety and efficiency of payment systems (which corresponds to the ESCB’s equivalent task as determined by Article 105 (2) of the Treaty and Article 3 of the Statute of the ESCB). As a consequence, and although the Financial Supervisory Authority may be assigned the task of giving notification of systems to the European Commission, the envisaged approval of systems before notification should, in the ECB’s view, be undertaken by the Riksbank in co-ordination and co-operation with the Financial Supervisory Authority.
5. The definitions of “participants” and “indirect participants” in Article 2 (f)-(g) of the Finality Directive allow the Member States to accommodate the participation of “indirect participants”

in systems. While the exclusion of indirect participants is also possible under the Directive, the inclusion of indirect participants (as defined in the Directive) is an option which, to the extent that it is followed, would contribute to the objective of avoiding systemic risk in the integrated financial markets of Europe. However, the legislative proposal does not include indirect participants and the ECB notes that it is stated in the explanatory memorandum (on page 55) that there is no such need in Sweden at the moment.

6. Articles 3 and 5 of the Finality Directive concern the legal enforceability, binding effect and irrevocability of transfer orders. In this connection, it is possible to distinguish between the legal situation between contractual parties, on the one hand, and in relation to any third party, including a liquidator in the case of insolvency, on the other hand (cf. Part 5.3.2 of the explanatory memorandum).
- 6.1 Between the parties, and from the perspective of a sending (or receiving) participant, irrevocability means that a sending participant cannot revoke a transfer order, at least not beyond the time foreseen in the operating rules of a payment system. The ECB notes the conclusions of the explanatory memorandum in this respect (on page 64) and agrees that, between the parties in relation to a system, Swedish law already complies with the requirements of Article 3.1, first paragraph, and Article 5 of the Directive.
- 6.2 From the perspective of the receiving participant, irrevocability between the parties would not be sufficient, however, as a means to address systemic risk. The transfer of funds or securities, or the interest in securities, covered by a transfer order, should be settled through the system to the benefit of the receiving participant without the possibility for any third party, including in particular a liquidator, to hinder such settlement. Recital 9 of the Directive states, inter alia, that “the reduction of systemic risk requires in particular the finality of settlement.” Such finality vis-à-vis third parties shall be ensured by the respective legal system in each Member State and, in particular, in relation to any disruption to a system that could otherwise be caused by insolvency proceedings against a participant. Moreover, Article 5 concerning irrevocability also addresses third parties, including any liquidator. In this respect, the conclusion of the analysis of the explanatory memorandum (on page 65) that there is no need for specific rules in order to implement the Directive, may be further considered. Unless it is already clear under existing Swedish law, a statutory provision should be added, clarifying that transfer orders are legally enforceable and binding (Article 3 of the Directive), as well as irrevocable (in accordance with Article 5 of the Directive), also vis-à-vis a liquidator or any other third party.

- 6.3 In addition, Article 7 of the Directive stipulates that insolvency proceedings shall not have retroactive effect and the ECB notes that Swedish law does not provide for retroactive effects of insolvency proceedings through any so-called zero-hour rule. The ECB also notes the reference in the explanatory memorandum to Recital 13 and the interpretation of this provision (on pages 38-39 of the explanatory memorandum) concerning the possibility of recovery or restitution of any transfer order “outside the system”. The ECB would favour an approach in this respect (as indicated by the reference to “fraud or technical error” in Recital 13) which upholds the objective of avoiding any revocation of a transfer order (or any unwinding of netting) in the system.
7. The ECB notes and appreciates the very thorough Swedish analysis in relation to netting and welcomes the legislative amendment proposed for Section 1 of Chapter 5 of the Act on trading with financial instruments (“lagen (1991:980) om handel med finansiella instrument”). In particular, the ECB welcomes the stipulation concerning the validity and effectiveness of multilateral netting, and notes the coverage also of close-out netting, within systems.
8. The ECB notes the proposed Section 12 of the draft law concerning applicable law for systems and welcomes the clarification that the law governing the system shall also be binding vis-à-vis a bankruptcy estate (and, it is assumed, its liquidator) and the creditors in any insolvency proceedings. The ECB also notes the reflection in the explanatory memorandum (on page 56) concerning the risk of “forum shopping” by system operators with a view to applying the most favourable legal regime to its system, which again highlights the oversight aspect in relation to systems of which notification has been given under the Directive.
9. The ECB also welcomes the legislative amendment to Section 10 of Chapter 8 of the Swedish Bankruptcy Code (“konkurslagen (1987:672)”) in order to allow for the immediate realisation of certain collateral security by the security holder.
10. The ECB shares the view (expressed on page 93 of the explanatory memorandum) that Article 9.2 of the Directive concerning the applicable law in relation to dematerialised or immobilised securities ought to be given a general application. Accordingly, the ECB welcomes the corresponding proposed legislative amendment of Section 1 of Chapter 6 of the Act on trading with financial instruments.

11. The ECB confirms that it has no objection to this ECB Opinion being made public by the competent national authorities at their discretion. In the light of the importance to the international financial markets of a harmonised implementation of Community law in this field, the ECB is arranging for this Opinion to be copied to the competent national authorities of the Member States responsible for implementing the Finality Directive.

Done at Frankfurt am Main on 26 August 1999.

The Vice-President of the ECB

[signed]

Christian Noyer