



**E U R O P E A N C E N T R A L B A N K**

**OPINION OF THE EUROPEAN CENTRAL BANK**

**of 20 January 2000**

**at the request of the Luxembourg Ministry for the Treasury and the Budget on a draft legislative proposal implementing Directive 98/26/EC on settlement finality in payment and securities settlement systems in the law of 5 April 1993, as amended, relating to the financial sector and completing the law of 23 December 1998 creating a commission in charge of the prudential supervision of the financial sector  
(CON/99/19)**

1. On 19 November 1999 the European Central Bank (ECB) received a request from the Luxembourg Ministry for the Treasury and the Budget for an ECB Opinion on a draft legislative proposal implementing Directive 98/26/EC on settlement finality in payment and securities settlement systems (hereinafter referred to as the “Directive”) in the law of 5 April 1993, as amended, relating to the financial sector and completing the law of 23 December 1998 creating a commission in charge of the prudential supervision of the financial sector (hereinafter referred to as the “Draft Law”).
2. To the extent that the Draft Law represents the implementation of the Directive in the Luxembourg legal system, the Luxembourg authorities were not, strictly speaking, legally obliged to consult the ECB under Article 1 (2) of Council Decision (EC) 98/415 of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions. The ECB is seeking to promote proactively a harmonised EU-wide implementation of the 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. In view thereof, the ECB very much welcomes the opportunity to give its opinion on the Draft Law.
3. In addition, the Draft Law addresses matters pertaining directly to the core fields of competence of the European System of Central Banks (ESCB) and introduces elements which go beyond the scope of the Directive. In this respect, the ECB’s competence to deliver an opinion is based on Article 105 (4) of the Treaty establishing the European Community (hereinafter referred to as the “Treaty”) and Article 2 (1) of Council Decision (EC) No. 98/415 of 29 June 1998, as the Draft Law deals with clearing and payment systems. In accordance with Article 17.5, first sentence, of

the Rules of Procedure of the European Central Bank, this Opinion has been adopted by the Governing Council of the ECB.

**A. General observations on the competence of the Eurosystem in the field of oversight and on the concept of central bank oversight of clearing and payment systems as distinct from the prudential supervision of financial institutions**

4. The Draft Law proposes entrusting the national prudential supervisory authority (the “Commission de surveillance du secteur financier” – “CSSF”) with the oversight (including the prior authorisation) of payment and securities settlement systems to the exclusion of the Banque centrale du Luxembourg (the “BcL”). Indeed, the Draft Law strictly confines the role of the BcL to the provision of settlement facilities to some systems, and excludes it from the oversight function. Moreover, the Draft Law intends to entrust the CSSF with the “prudential supervision” of payment and settlement systems, with the “prudential supervision” of systems as envisaged in the Draft Law corresponding to the usual oversight tasks performed by central banks.
5. First, this proposal would directly infringe the payment system oversight competence of the ECB and the national central banks of the Member States participating in Monetary Union (the “Eurosystem”), which is one of the core competences attributed to it by the Treaty. Second, if not reconsidered, the Draft Law would create a situation of conflict between the BcL and the CSSF in relation to the oversight function, since the BcL would continue to conduct oversight within the framework of the Eurosystem. Third, the Draft Law would fail to make an adequate distinction between the functions of prudential supervision, on the one hand, and those of payment systems oversight, on the other.
6. Prior to the adoption of the Treaty, the oversight of payment systems had already been recognised as one of the main functions of the national central banks, although this was not always based on a specific and clearly formulated legal basis. The framework for this function, although informal, was effective and successful, since it was based on the technical experience and on the moral authority of the national central banks. Moreover, international consistency and effectiveness were ensured through co-ordinated action among central banks on the basis of principles established either at the G-10 or at the EU level.
7. Article 105 (2)<sup>1</sup> of the Treaty and Article 3.1<sup>2</sup> of the Statute of the European System of Central Banks and of the European Central Bank (hereinafter referred to as the “Statute”) now provide the

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<sup>1</sup> “The basic tasks to be carried out through the ESCB shall be: [...] to promote the smooth operation of payment systems.”

legal basis for the oversight activities of the Eurosystem. In addition, the competence of the Eurosystem for systems oversight results from Article 22 of the Statute, which reads: *“the ECB and national central banks may provide facilities, and the ECB may make regulations<sup>3</sup>, to ensure efficient and sound clearing and payment systems within the Community and with other countries”*. Within the Eurosystem oversight activities are generally performed at the level of the national central banks, in line with the common oversight policy stance defined for the Eurosystem by the Governing Council of the ECB. The aim of the oversight of clearing and payment systems is the maintenance of systemic stability, the promotion of efficiency and the safeguarding of the transmission channel for monetary policy. In particular, payment arrangements are of crucial importance for the conduct of monetary policy in both the strategic and the operational sense. The above excludes the interference in the field of the Eurosystem’s oversight competence by any Community or national body other than a central bank acting within the framework of the ESCB/Eurosystem. Article 25<sup>4</sup> of the Luxembourg law of 23 December 1998 concerning the monetary status and the BcL is the national reflection of the framework created at the European level.

8. On the basis of the Articles of the Treaty and of the Statute referred to above, read together with Article 12.1, first indent,<sup>5</sup> of the Statute, the Governing Council of the ECB is the decision-making body responsible for the performance of the tasks of the Eurosystem in the field of oversight. According to Article 12.1, third indent,<sup>6</sup> of the Statute, within the Eurosystem, the national central banks shall be available, and the ECB shall have recourse to them to the extent deemed possible and appropriate, for the implementation of the oversight policy stance. Against this background, the Draft Law cannot entrust the oversight function to any authority other than the BcL, as part of the Eurosystem.
9. The payment system put in place by the Eurosystem and through which the Eurosystem’s operations are carried out is the TARGET system, the Luxembourg component of which is LIPS-Gross. The Governing Council is responsible for the direction, management and control of

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<sup>2</sup> “In accordance with Article 105 (2) of the Treaty, the basic tasks to be carried out through the ESCB shall be: [...] to promote the smooth operation of payment systems.”

<sup>3</sup> See Article 34.2 of the Statute: “A regulation shall have general application. It shall be binding in its entirety and directly applicable in all Member States.”

<sup>4</sup> “The Central Bank may provide facilities to ensure efficient and sound clearing and payment systems.”

<sup>5</sup> “The Governing Council shall adopt the guidelines and take the decisions necessary to ensure the performance of the tasks entrusted to the ESCB under this Treaty and this Statute.”

<sup>6</sup> “To the extent deemed possible and appropriate and without prejudice to the provisions of this Article, the ECB shall have recourse to the national central banks to carry out operations which form part of the tasks of the ESCB.”

TARGET. The basic principle of independence, as enshrined in Article 7 of the Statute, would be hindered if the Governing Council were subject, in this capacity, to the authority of the CSSF.

10. The “prudential supervision” of systems, as defined in the “Exposé des motifs” (the “Explanatory Memorandum”) and in the Draft Law itself, with regard to the CSSF in fact encompasses activities which are traditional oversight tasks, and refers to some of the principles defined by the central banks for the conduct of their oversight activities as indicated under point 6 above. Moreover, the notion of “prudential supervision” of systems (as such) is unknown in the developed world, where it is standard practice that payment systems are “overseen” by central banks. Should the CSSF nonetheless be entrusted with competence for the “prudential supervision” of clearing and payment systems under Luxembourg law, the Eurosystem will, for its part, remain entrusted with, and will have to perform, these oversight functions as prescribed by the Treaty and the Statute. In Luxembourg this would result, in practice, in an unusual, complex and potentially conflicting situation in which the oversight of clearing and payment systems would be carried out by both the BcL and the CSSF at the same time.
11. The Explanatory Memorandum reasons that the CSSF would be in an appropriate position to assume prudential functions in relation to Luxembourg’s payment systems because it does not itself operate systems and therefore cannot be subject to a conflict of interest between its operational and prudential functions. It should be noted that Article 22 of the Statute itself states that national central banks and the ECB may operate systems while at the same time being entrusted with oversight functions within the framework of the Eurosystem. This possibility expressly afforded by the very legal basis of the Eurosystem should be seen as an indication of confidence in the ability of the Eurosystem to avoid a possible conflict of interest between the operational and oversight activities of central banks.
12. In the same vein, and more specifically in relation to securities settlement systems (SSSs), the ECB notes that the Draft Law does not mention any need for collaboration between the CSSF and the BcL in the oversight of SSSs in Luxembourg, despite the international tendency to consider that the oversight of SSSs also requires the expertise of central banks. At least, whenever part of the service provided by the SSSs in Luxembourg has a direct impact on the smooth functioning of TARGET, the CSSF cannot be granted exclusive oversight competence. Indeed, Cedelbank provides services for the delivery of collateral securing intraday liquidity credit in TARGET and will soon provide facilities to settle in central bank money. With regard to these two aspects at least, the BcL should be directly involved in the oversight of that SSS. In addition, the “partnership” of the German SSS – Deutsche Börse Clearing AG – with Cedelbank leaves at present two national SSSs held by the same Luxembourg holding company, New Cedel

International. Therefore, the attribution of oversight competence by the Draft Law can initially relate only to the system operated by Cedelbank and not address the oversight of any other system operated outside Luxembourg or of any system that would have a “multi-country” dimension.

13. As indicated under point 5 above, the Draft Law does not make an adequate distinction between supervisory and oversight functions. Although drawing the dividing line between prudential supervision and payment systems oversight may be complex, a basic element of the distinction lies in the different subjects of the respective activities, which can clearly be separated. Prudential supervision aims to promote the stability of financial institutions (which may participate in and/or operate clearing and payment systems), while oversight pursues the promotion of the smooth operation of clearing and payment systems themselves. Both functions thus certainly have partially shared objectives, the clearest one of these being the stability of the financial system as a whole. The main focus of prudential supervision is, however, upon the safety and soundness of individual financial institutions, whereas the primary focus of oversight is the clearing and payment systems themselves in order to ensure their smooth operation, to avoid systemic risk within or between such systems and to ensure the efficient and sound transmission of monetary policy impulses. Hence, the objectives of prudential supervision and of oversight are conceptually distinct and are pursued with different viewpoints and tools. They need not therefore be combined and entrusted to a single authority. When the central bank is not also the banking supervisory authority, the shared objectives, the links between the systems and their participants, and the impact of failures in one area on the other call for close and extensive co-operation between the two functions in order to achieve the shared objectives in an optimal manner. With regard to this last point, the ECB would welcome the inclusion in the Draft Law of a specific provision governing the co-operation and exchange of information between the CSSF and the BcL.
14. In this respect, the ECB also notes that the consulting authority is not required to combine the implementation of the Directive with the modification of the Luxembourg law on the organisation of the prudential supervision of the financial sector. If, however, such is the preferred choice, then it will be important for the respective competence in the areas of prudential supervision and oversight to be clearly defined.

## B. Comments on the articles of the Draft Law

- *With regard to Article I of the Draft Law:*

15. (A), (C), (G), (H), (I), (J): The ECB notes the proposed role of the CSSF under the Draft Law and would like, in addition to the observations made under Part A above, to make a number of comments in this regard.

The ECB suggests that the Draft Law – including the Explanatory Memorandum – should identify and refer explicitly to the specific nature of the oversight of clearing and payment systems, on the one hand, and the prudential supervision of financial institutions, on the other. In this regard, the CSSF should maintain responsibility for the prudential supervision of the financial institutions involved in systems under the Draft Law, while the ECB recommends that the role of BcL, as part of the Eurosystem, as regards oversight (addressing clearing and payment systems as opposed to the entities involved) should be explicitly referred to in the Draft Law.

16. (A): **Article 28-2: “Les opérateurs de systèmes de paiement ou de systèmes de règlement des opérations sur titres”**

- (1) As also indicated below with reference to other articles, in Article 28-2 (1) the reference to the CSSF should be replaced by a reference to the BcL.
- (2) The ECB would favour clarification that this paragraph does not apply to the BcL.

17. (C): **Article 34-2: “Définitions”** provides a variety of definitions, including the following:

a) “système”: Again, the arrangements for oversight should make reference to the basic task of the BcL, which is to promote the safety and efficiency of payment systems (which corresponds to the equivalent task of the ESCB as determined by Article 105 (2) of the Treaty and Article 3 of the Statute). It should be noted that the Directive does not, as such, require that Member States establish a systems authorisation procedure. Should several Member States participating in the euro area find it necessary to implement such a procedure in a formal manner, the Eurosystem may at some point have to ensure that the level playing-field is maintained among the systems within the euro area. At a local level, this will involve the participation of the BcL. As a consequence, and although the CSSF may be assigned the task of formally designating the systems (as “systems”) and giving notification of such systems to the Commission of the European Communities, the verification (e.g. checking against principles which belong to the oversight activities) and approval of systems (as “systems”) should, in the ECB’s view, be undertaken by the BcL, possibly in co-

ordination and co-operation with the CSSF for all payment systems; with regard to SSSs, this should at least be the case for all aspects relating to the settlement of Eurosystem credit operations and settlement in central bank money. Finally, the ECB would welcome an acknowledgement in the Draft Law that all payment systems for which the BcL acts as settlement agent are automatically designated as systems to be notified to the Commission of the European Communities.

l) “moment d’ouverture d’une procédure d’insolvabilité”. In this respect, the Draft Law has inserted an addition to the definition provided in Article 6.1. of the Directive, this addition reading “*or any other moment defined by the national law applicable to the insolvency of a participant as being the moment of opening of an insolvency procedure*”. This addition should be deleted. The Directive does not provide for this alternative, but determines, in an imperative manner, the moment of opening of the insolvency proceedings as the moment at which a competent authority hands down its decision. This second part of the definition poses material risks and uncertainty which should be avoided. In the Draft Law it is important that the terms chosen for the definition in question be clear in relation to the Luxembourg legal system and that they do not depart from the definition stated in the Directive, since this is the point at which significant legal consequences arising from other parts of the Directive would be entailed.

18. **34-3: “Champ d’application”:** The ECB notes that the new Chapter 5 on the authorisation of payment systems and securities settlement systems “shall apply to all payment systems and/or all securities settlement systems authorised in Luxembourg”. The ECB notes the intention to cover all payment and securities settlement systems authorised under the Draft Law, and considers that such authorisation should be processed along the lines indicated under point 17 above. As for Lux Clear, to which reference is made in the Explanatory Memorandum as a system in itself, it is the ECB’s understanding that Lux Clear refers only to certain services of another existing system and not to a system or legally separate entity as such.

19. **Article 34-4: “La demande d’agrément”:**

(1) The ECB notes that the Draft Law implements the possibility to cover “a formal arrangement between two participants”, which is allowed under Article 2 (a), final paragraph, of the Directive, provided that such a designation is warranted on the grounds of systemic risk. The ECB would welcome an express reference to systemic risk in the Draft Law, to be evaluated within the framework of the ESCB (including BcL).

(2) The ECB would like to propose that the sentence “La Commission est l’autorité compétente pour accorder l’agrément aux systèmes” be amended along the lines indicated under point 17 above.

20. **Article 34-5: “La procédure d’agrément”:** The Draft Law subjects any amendment to the agreement, which forms the basis for the system, to prior authorisation. If it is the case that an “amendment” is also to be understood as the event of a new member joining, this request would appear to be too restrictive for the operation of the system. Moreover, the time-limits for a decision to be taken would appear to be unduly long.
21. (H): **Article 47-1: “La surveillance prudentielle des systèmes de paiement et des systèmes de règlement des opérations sur titres agréés au Luxembourg”:** The ECB proposes that the reference to “prudentielle” in the title of Chapter 2bis and Article 47-1 be deleted. It also proposes replacing the reference to “La Commission” with a reference to “La Banque centrale du Luxembourg” and deleting the references to “prudentielle” and to the “systèmes de règlement des opérations sur titres” in the sentence “La Commission est l’autorité compétente pour la surveillance prudentielle des systèmes de paiement et des systèmes de règlement des opérations sur titres qu’elle a agréés”. The ECB also proposes replacing “La Commission” with “La Banque centrale du Luxembourg” in the sentence “A ce titre, la Commission veille à l’application des règles de fonctionnement dont sont dotés les systèmes qu’elle a agréés”.

Paragraph (G) of the Draft Law would also need to be adapted along these lines.

22. (I): Again, the ECB proposes that the reference to “La Commission” be replaced with a reference to “La Banque centrale du Luxembourg” in the sentence “La Commission tient en outre le tableau officiel des systèmes de paiement et des systèmes de règlement des opérations sur titres agréés au Luxembourg”.
23. (J) **Article 61-2: “Les dispositions spécifiques au caractère définitif du règlement dans les systèmes de paiement et de règlement des opérations sur titres agréés au Luxembourg.”**

(1): The Draft Law does not incorporate the text of Article 3 (2) of the Directive concerning the rules relating to the “suspect period”. Given the general nature of the wording used in Article 61-2 (1), these provisions would not call into question the operations performed, at least not within the system. Nevertheless, legal certainty would be reinforced if the text of Article 61-2 explicitly referred to the rules concerning fraudulent operations.

(2): Paragraph 2 of Article 61-2 to a very large extent incorporates the wording of Article 3 (1) of the Directive. The following major differences should be noted and given further consideration: 1) the Draft Law inserts “between parties” after the words “shall be legally enforceable”; 2) the Draft Law adds the operator of the system to the list of persons who should not have been aware of the insolvency; 3) the text uses the conjunctive “and” instead of the disjunctive “or” in the list of persons mentioned.

(3): The ECB notes that, according to the Explanatory Memorandum (pages 12 and 20), the abolition of the “zero-hour rule” in Luxembourg is confirmed by the first indent of Article 61-2 (2) of the Draft Law. In this respect, the position adopted in the Explanatory Memorandum, namely that the above provision in the Draft Law is sufficient, should be further considered since Article 7 of the Directive, which relates to the disqualification of any “zero-hour rule”, is a key provision. Unless the abolition of the “zero-hour rule” is already clear and extensive enough under existing provisions of Luxembourg law as further specified by the Draft Law, an explicit statutory provision should be added to the Draft Law in order to reflect Article 7. Moreover, as was pointed out above, under the current wording of Article 34-2 (1) of the Draft Law, and contrary to Article 6.1. of the Directive, the moment of opening of the insolvency proceedings (which leaves it up to the national law applicable to the insolvency of the participant to determine otherwise) is not necessarily the moment at which the relevant authority hands down its decision, but could, for instance, be before. In the context of Article 7 of the Directive, this could lead to an indirect re-introduction of a retroactive effect of insolvency in spite of the provision contained in Article 61-2 (2) of the Draft Law.

(4): This provision is not part of the implementation of the Directive. It provides for the exemption from attachment of settlement accounts in respect of the operator of the system or the settlement agent. The provision seems to have been inspired by Article 9 of the Belgian law of 28 April 1999. The ECB notes, however, that this provision applies to any settlement account, whereas the corresponding Belgian provision is limited to cash settlement accounts. The ECB is pleased with the introduction of this rule, which would enhance the safeguarding of the systems, thus eliminating the danger that untimely attachments, or even improper attachments, could completely paralyse the settlement of a payment or securities settlement system.

24. **Article 61-3: “Les dispositions spécifiques à la préservation des droits du titulaire de garanties constituées dans le cadre de systèmes communautaires de paiement ou de règlement des opérations sur titres ou dans le cadre d’opérations des banques centrales des Etats Membres ou de la Banque centrale européenne contre les effets de l’insolvabilité de la partie ayant constitué les garanties.”** This provision implements Article 9 of the Directive. The

ECB is of the view that the protection provided for by Article 61-3 (2) of the Draft Law should be interpreted in general terms as covering any form of security interest in favour of participants, irrespective of the purpose underlying the creation of such security interest (i.e. it should not be limited to securing the obligations of participants vis-à-vis the operator or other participants in a system, these obligations arising from participation in such a system). It is worth mentioning that the conflict of law rules in the Directive are consistent with (i) the rule contained in Article 8 of the US Uniform Commercial Code, (ii) the national laws already in place in several Member States, and (iii) the current trend of academic authority on the complex matter of the cross-border trading of securities.

25. Article 61-4 (2) and (3): The ECB proposes that the reference to “la Commission” be replaced by “la Banque centrale du Luxembourg” in this Article.

- *With regard to Article II of the Draft Law:*

26. The ECB refers to the developments contained in Part A of this Opinion and proposes that the envisaged addition of a new paragraph 3 to Article 2 of “la loi du 23 décembre 1998 portant création d’une commission de surveillance du secteur financier” be deleted.
27. 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 general application of the observations made, and the importance to the international financial markets of a uniform application of Community law in this field, the ECB will arrange for this Opinion to be copied to the competent national authorities of Member States responsible for implementing the Directive.

Done at Frankfurt am Main on 20 January 2000.

The President of the ECB

[signed]

Willem F. Duisenberg