



**OPINION OF THE EUROPEAN CENTRAL BANK**  
**of 14 November 2006**  
**at the request of Latvijas Banka**  
**on a draft regulation on Latvijas Banka's securities settlement system**  
**(CON/2006/52)**

**Introduction and legal basis**

On 28 September 2006 the European Central Bank (ECB) received a request from Latvijas Banka for an opinion on a draft regulation on Latvijas Banka's securities settlement system (hereinafter the 'draft regulation').

The ECB's competence to deliver an opinion is based on the third and fifth 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 national provisions<sup>1</sup>, as the draft regulation relates to a national central bank and payment and settlement systems. 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 regulation**

As explained by Latvijas Banka, the main objective of the draft regulation is to optimise the operation of the securities settlement system operated by Latvijas Banka (hereinafter the 'VNS'). The draft regulation will replace an existing regulation on the VNS. The ECB also understands that the draft regulation would come into force simultaneously with the Regulation on the use of Latvijas Banka's monetary policy instruments since the draft regulation chiefly concerns the settlement of securities transactions for Latvijas Banka's monetary policy and intraday credit operations in the VNS.

**2. General observations**

2.1 ECB notes that, on adoption of the euro in Latvia, and provided that the VNS will be selected to provide securities settlement of central bank credit operations, the VNS will be assessed against the Eurosystem standards for the use of EU securities settlement systems in ESCB credit operations<sup>2</sup>.

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<sup>1</sup> OJ L 189, 3.7.1998, p. 42.

<sup>2</sup> The standards are available on the ECB's website at [www.ecb.int](http://www.ecb.int).

For that reason, this opinion is without prejudice to a future ECB assessment of the VNS against the abovementioned standards.

- 2.2 The ECB expects Latvijas Banka to ensure that the VNS complies with the Latvian Law on settlement finality in payment and security settlement systems (hereinafter the ‘SFD Law’).

### **3. Specific comments**

- 3.1 According to the explanatory memorandum submitted to the ECB, the main purpose of the VNS is securities settlement for Latvijas Banka’s monetary policy and intraday credit operations. Although it can be derived from Article 2.7 of the draft regulation, the clarity and transparency provided through the draft regulation could be enhanced by explicitly specifying this main purpose already in the provision defining the VNS (Article 1.1), especially in view of the existence of another securities settlement system operated by the Latvian Central Depository (LCD).
- 3.2 According to Article 1.2 of the draft regulation, a VNS participant is defined as a bank, the Financial and Capital Market Commission (hereinafter the ‘Commission’) and Latvijas Banka. Furthermore, Article 1.3 of the draft regulation defines a bank as a ‘bank or a branch of a foreign bank registered in the Republic of Latvia, as well as a bank and a branch of a bank of another Member State, entitled to deliver financial services in the Republic of Latvia and having a cash account for settlements in lati with Latvijas Banka’. This is in line also with Article 3 of the Law on credit institutions which provides that in Latvia, credit institutions registered in Latvia, branches of credit institutions of a foreign State, credit institutions registered in another Member State or the branches of credit institutions registered in Member States may perform credit institution activities. However, Article 1 of the SFD Law provides that a credit institution registered in Latvia or a Member State of the European Union or the European Economic Area, and a commercial company whose head office is located outside the European Economic Area and whose tasks correspond to those of credit institutions in Latvia and Member States of the European Union and the European Economic Area are eligible to participate in the system. The ECB notes that, according to the SFD Law, only entities covered by Article 1(2) may participate in a settlement system. The ECB further notes that, although a branch of a foreign bank does not have the legal entity status in Latvia, a number of provisions on credit institution insolvency in the Law on credit institutions apply also to branches of foreign banks in accordance with Article 6 of the Law on credit institutions. Thus, in the absence of an express reference to the foreign bank branches in Article 1(2) of the SFD Law, and considering the different insolvency proceedings applicable to foreign bank branches and banks established in Latvia, respectively, the ECB advises Latvijas Banka to carry out an assessment as to whether foreign bank branches fall within the scope of application of the SFD Law. If that is not the case, foreign bank branches should be excluded from the scope of Article 1.3 of the draft regulation.

- 3.3 Article 2.5 of the draft regulation foresees three different types of accounts: (1) a bank's securities account where Latvijas Banka records securities that are held and used by the bank as collateral in transactions with Latvijas Banka; and (2) the Commission's securities account where Latvijas Banka records securities of a fund managed by the Commission that are transferred from the LCD; and (3) Latvijas Banka's securities account where Latvijas Banka records securities held by itself. The draft regulation on the use of Latvijas Banka's monetary policy instruments, however, also refers to a collateral account which is defined as a securities account opened for the counterparty in the VNS in accordance with the draft regulation where securities are posted as collateral. The ECB understands that another Latvijas Banka's Regulation provides that all securities registered on a bank's securities account are posted as collateral for monetary policy operations. However, the ECB invites Latvijas Banka to consider clarifying this also in the draft regulation now under preparation. The ECB also notes that Article 17(9) of the SFD Law requires the system rules to include the procedure for creating and managing collateral security.
- 3.4 The wording of Article 2.13 of the draft regulation on Latvijas Bank's acceptance of security transfers and their VNS entry point needs clarification. In particular, it provides that (i) 'Latvijas Banka shall transfer securities in the sequence of receiving securities transfer orders'; and (ii) 'after receiving and examining each securities transfer order, Latvijas Banka shall accept it by conducting the respective securities transfer'; and (iii) 'a securities transfer order shall be deemed entered in the VNS from the moment it is accepted, i.e. when Latvijas Banka debits the deliverer's securities account'. The concepts of receipt and acceptance of transfer orders needs further clarification. The ECB understands that this aspect of the draft regulation is still under consideration and that Latvijas Banka envisages clarifying that reservation of securities in the respective securities account equals the entry of transfer orders in the VNS.
- 3.5 The ECB notes that Article 2.1 of the draft regulation provides that the VNS will operate in accordance with Latvian laws and regulations. The ECB also notes that Article 15 of the SFD Law provides that if insolvency proceedings are initiated against a system participant, the rights and obligations arising from, or in connection with, that participant's participation in the system will be determined in accordance with the law of the country where that system operates. Although Article 15 of the SFD Law in conjunction with Article 2.1 of the draft regulation in principle should ensure that the rights and obligations arising from, or in connection with, participation in the VNS will be governed by Latvian law also in the event of opening insolvency proceedings against a participant, in the interests of transparency and legal certainty, and given that Article 8 of the Settlement Finality Directive<sup>3</sup> (implemented by Article 15 of the SFD Law) is one of the Directive's most important provisions, the ECB suggests clarifying in the draft regulation that all rights and obligations arising from participation in the VNS are governed by Latvian law also in the event of opening insolvency proceedings against a participant. Furthermore, in view of the need for

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<sup>3</sup> 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 (OJ L 166, 11.6.1998, p. 45).

such transparency and legal certainty, the ECB suggests further clarifying paragraphs 10 to 12 of Annex 1, which currently appear to designate only the law applicable to the dispute settlement (*lex fori*), without designating the substantive law governing the rights and obligations of parties arising from their contractual relationship (*lex contractus*).

- 3.6 On Latvia's adoption of the euro, and provided that the VNS will be selected to provide securities settlement for central bank credit operations, the VNS will need to comply with the operating days and hours of the successor to the TARGET system. The ECB understands that Latvijas Banka intends to introduce such amendments to the draft regulation in a timely manner, thereby ensuring compliance with these rules.
- 3.7 With regard to the VNS operation in the event of technical problems or other contingencies, disaster procedures for critical functions should be in place in the event of a total failure of the telecommunication networks. The business continuity arrangements should also provide for a second processing site which should not depend on the same critical infrastructure components used by the primary site, such as telecommunications and electric power. In this regard, the ECB has been informed that Latvijas Banka has adopted the requisite regulations and procedures to ensure all necessary business continuity arrangements for Latvijas Banka's payment and settlement systems, including a second processing site, although these regulations and procedures do not form part of the draft regulation submitted to the ECB in the present consultation.

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

Done at Frankfurt am Main, 14 November 2006.

[signed]

*The President of the ECB*

Jean-Claude TRICHET