



**OPINION OF THE EUROPEAN CENTRAL BANK**  
**of 7 August 2009**  
**on amending the legal framework for clearing operations**  
**(CON/2009/66)**

**Introduction and legal basis**

On 3 July 2009 the European Central Bank (ECB) received a request from the Finnish Ministry of Finance for an opinion on a draft government proposal for a law amending the Law on securities markets and certain other related laws (hereinafter the ‘draft law’).

The ECB’s competence to deliver an opinion is based on Article 105(4) of the Treaty establishing the European Community and the fifth indent 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<sup>1</sup>, as the draft law relates to 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. Existing legislation and purpose of the draft law**

- 1.1 The draft law relates to securities clearing, in particular to the operation, licensing and supervision of foreign clearing organisations; it proposes amendments to the Law on securities markets, the Law on the Financial Supervisory Authority and the Law on the supervision fees of the Financial Supervisory Authority. It is part of a more comprehensive reform of securities markets legislation, and it is planned that the remaining part of the reform will be carried out in the near future<sup>2</sup>.
- 1.2 Under the existing Law on securities markets, ‘clearing organisation’ is defined as a limited liability company that professionally and on a regular basis carries out clearing operations on behalf of organisations authorised to lodge securities transactions and other transfers for clearing. ‘Clearing operations’ are defined as the determination and realisation of obligations resulting from public trading in securities on behalf of the parties to the transaction. The operation of a clearing organisation is subject to a licence, which may be granted to a Finnish limited liability company by the Ministry of Finance. The law further provides that the stock exchange must arrange the clearing

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

<sup>2</sup> Under the Ministry of Finance’s decision of 2 February 2009 on the appointment of the working group, the working group’s term of office is from 3 February 2009 to 31 December 2010. The purpose of the comprehensive reform is to ensure, *inter alia*, that legislation on securities markets is effective, clear and comprehensible and that it promotes the competitiveness of the Finnish market, thereby permitting international structures and operating models that increase the efficiency of cross-border operations. The working group has the task of drafting necessary legislative proposals in the form of a government draft law.

of securities trades concluded in public trading in an appropriate manner. If the stock exchange uses a securities clearing and deposit institution other than a licensed clearing organisation in the clearing of securities trades, the stock exchange, the clearing organisation and the clearing and custody institution must arrange their cooperation so that the reliability of public trading is not endangered.

- 1.3 According to the current Finnish legislation, a clearing organisation undertakes both clearing and settlement. At present, the Finnish central securities depository, Euroclear Finland Ltd, is the sole licensed clearing organisation in the Finnish securities market. Foreign organisations whose business consists of both clearing and settlement are allowed to operate in Finnish markets through a licensed Finnish subsidiary. Currently, foreign organisations undertaking clearing but not settlement, such as central counterparties, have not been considered as clearing organisations and no licence has been required from them to operate in Finland.
- 1.4 The draft law proposes new provisions that would apply to foreign clearing organisations that are being used for clearing purposes by the stock exchange or an organiser of multilateral trading, allowing such entities to conduct clearing operations in Finland upon authorisation granted by the Ministry of Finance. Foreign clearing organisations domiciled within the European Economic Area (EEA) will be able to operate on a cross-border basis or through a branch, while entities domiciled outside the EEA will, in principle, only be able to operate through a branch. The draft law further provides that foreign clearing organisations and other foreign entities will be under an obligation to apply for clearing party status in a Finnish clearing organisation when they undertake the clearing of obligations arising from trading in securities that are regularly settled by a Finnish clearing organisation.
- 1.5 Under the draft law, foreign clearing organisations will be supervised by the Financial Supervisory Authority. According to the explanatory memorandum, the draft law aims to ensure that foreign clearing organisations chosen by the stock exchange or an organiser of multilateral trading are reliable and solvent, that adequate risk management measures are put in place, that the supervisory authorities receive necessary and adequate information from the foreign clearing organisation and from the competent supervisory authority of its home country, and that the authorities are, if necessary, able to restrict or prevent clearing operations conducted cross-border or through a branch in Finland.
- 1.6 The draft law proposes to amend the definition of the term ‘clearing operations’ so that it refers to the clearing ‘or’ settlement (formerly the reference was to ‘clearing and settlement’) of obligations resulting from public or multilateral trading in securities or from a trade or transfer concluded elsewhere than in public or multilateral trading of a security incorporated in the book-entry system or in a security subject to public or multilateral trading, on behalf of the parties to the transaction.

## 2. General observations

The ECB understands that the purposes of the draft law are to establish a consistent legal framework for entities providing clearing or settlement services in the Finnish securities market, in particular for foreign clearing-service providers, to ensure the reliability and stability of the market and to establish a level playing field between market participants. With a view to implementing the core tasks of the European System of Central Banks (ESCB) under the Treaty and the Statute of the European System of Central Banks and of the European Central Bank (hereinafter the ‘Statute of the ESCB’), the ECB has serious concerns relating to the proposed requirements for location/establishment of foreign central counterparties. In the ECB’s view, the provision of clearing services by foreign clearing organisations offering services in Finland is in line with the internal market freedoms, as laid down in the Treaty and addressed in further detail below. However, such provision of services may adversely affect the location policy of the Governing Council for infrastructures offering services in euro.

## 3. Location of infrastructures

### 3.1 *The Governing Council’s location policy*

3.1.1 The location policy has been publicly expressed on a number of occasions since the ECB’s establishment. Already in November 1998, the first policy statement<sup>3</sup> was made in which it was stressed, *inter alia*, that ‘As is the case with every central bank, the ECB has a direct interest in the prudent design and management of any payment and settlement system processing its own currency, the euro. Indeed, the smooth functioning of payment and settlement systems is a crucial aspect of a sound currency and essential to the conduct of monetary policy. These systems also have a significant bearing on the functioning of financial markets. Changes in payment systems may cause unpredictable shifts in the demand for, or supply of, base money. Moreover, safe and efficient payment systems are critical to the maintenance of banking and financial stability. Against this background, ... the Governing Council of the ECB wishes to underline that, as in any other monetary system, central bank money in euro can only be provided by the central banks that belong to the euro area.’

3.1.2 The November 1998 statement was followed up by another policy statement in September 2001 relating to central counterparty clearing<sup>4</sup>. Section 2(b) of this statement stated, *inter alia*, that the ‘logical geographical scope of a market infrastructure is in practice the currency area’, and that domestic infrastructures for the euro<sup>5</sup> ‘should logically be located in the euro area, as is the case with core infrastructures in other monetary areas. This would be preferable from a regulatory perspective and would help the Eurosystem, as the “central bank” of the euro, to ensure the smooth

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<sup>3</sup> See ‘Policy statement on euro payment and settlement systems located outside the euro area’, available on the ECB’s website at [www.ecb.europa.eu](http://www.ecb.europa.eu).

<sup>4</sup> See ‘The Eurosystem’s policy line with regard to consolidation in central counterparty clearing’, available on the ECB’s website.

<sup>5</sup> A domestic system is defined in the policy statement as a system ‘which handles mainly or exclusively assets denominated in one currency’.

functioning of payment systems, efficient monetary policy implementation and financial stability.’ It also stated that the ‘location of central counterparties in the euro area would facilitate the provision, when deemed necessary and appropriate, of central bank money in euro.’ In this regard, point b) of the conclusions stresses that ‘The natural geographical scope for any “domestic” market infrastructure (including central counterparty clearing) for securities and derivatives denominated in euro is the euro area. Given the potential systemic importance of securities clearing and settlement systems, this infrastructure should be located within the euro area.’

3.1.3 The Governing Council’s location policy is expressly based on the premise that ‘the ECB and the national central banks of the Eurosystem (the central banks of issue) need to retain, in any event, ultimate control over their currency, the euro. Therefore, from both a general policy and systemic risk perspective, the Eurosystem cannot, as a matter of principle, accept that payment infrastructures for euro transactions which are located outside the euro area (the home currency area) have the potential to develop into major euro payment infrastructures, particularly if this were to put at stake the Eurosystem’s control over the euro. ... Payment infrastructures settling euro-denominated payment-versus-payment (PvP) and/or non-PvP payment transactions (gross, hybrid, net, net with high underlying gross amounts) that have the potential to reach systemic relevance for the euro area should, as a matter of principle, settle these payment transactions in central bank money and be incorporated in the euro area with full operational responsibility for euro transactions’<sup>6</sup>.

3.1.4 Finally, the Governing Council confirmed its location policy more recently in relation to central counterparties for over-the-counter derivatives in December 2008 and July 2009<sup>7</sup>.

### 3.2 *Location policy and Treaty freedoms*

3.2.1 As to whether the Governing Council’s location policy could be seen to pose any regulatory or legal issues related to the concept of the internal market, it is recalled that Article 14(2) of the Treaty states that the internal market comprises ‘an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty’. These freedoms are further regulated in particular in Title III of the Treaty (Articles 39-60) and also apply to the Eurosystem (because Article 1.1 of the Statute of the ESCB provides that the ESCB and the ECB must perform their tasks and carry out their activities ‘in accordance with the provisions of [the] Treaty and [the] Statute’). Furthermore, Article 3(1)(c) of the Treaty provides that the establishment of an internal market characterised by the abolition, as between Member States, of obstacles to the free movement of, *inter alia*, services and capital is one of the activities of the Community. Moreover, under Article 4(1) of the Treaty, the activities of the Member States and the Community include the adoption of an economic policy which is based,

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<sup>6</sup> See paragraphs 2 and 3 of ‘The Eurosystem policy principles on the location and operation of infrastructures settling euro-denominated payment transactions’, published on 19 July 2007 and available on the ECB’s website.

<sup>7</sup> See ‘Decisions taken by the Governing Council of the ECB (in addition to decisions setting interest rates)’ for December 2008 and July 2009, available on the ECB’s website.

*inter alia*, on the internal market. From the foregoing it is evident that the establishment and functioning of the internal market is one of the core activities of the Community itself.

3.2.2 The Treaty freedoms underlying the internal market must be seen in the context of the Treaty as a whole. In this respect, the ECB emphasises that the tasks of the Community are identified under Article 2 of the Treaty as being achieved ‘by establishing a common market and an economic and monetary union’. Moreover, Article 4(2) of the Treaty states that ‘concurrently with the foregoing’ (i.e. with the adoption of an economic policy based, *inter alia*, on the internal market), the activities of the Member States and the Community include, *inter alia*, the introduction of a single currency and the definition and conduct of a single monetary policy the primary objective of which is ‘to maintain price stability and, without prejudice to this objective, to support the general economic policies in the Community, in accordance with the principle of an open market economy with free competition’.

3.2.3 The Eurosystem’s tasks relating to monetary policy, payment systems and financial stability are inextricably linked to the Governing Council’s abovementioned express statement in July 2007 that the Eurosystem central banks ‘need to retain, in any event, ultimate control over their currency, the euro’. While the Eurosystem generally has to comply with the Treaty freedoms, and in particular has to consider their implications if it wishes to make use of its regulatory power to ensure efficient and sound clearing and payment systems, this does not mean that the ECB may not impose measures that would have an impact on the Treaty freedoms, if such measures are strictly warranted in order to perform the Eurosystem’s basic tasks. In this respect, the ECB considers that it is highly significant that, under the Treaty, the Eurosystem’s monetary policy, financial stability and oversight tasks only apply to those Member States that have adopted the euro. In view of the above, the ECB is of the clear view that, in order for the Eurosystem to be able to perform its core central banking tasks, in particular the provision of central bank liquidity to infrastructures offering services in euro, such infrastructures need to be established and located within the euro area.

### 3.3 *Location policy and oversight of settlement systems*

3.3.1 In order to perform its core tasks, the Eurosystem needs to ensure the safety and efficiency of systems processing the euro. In the case of an infrastructure located outside the euro area, the Eurosystem’s ability to oversee these systems and to detect risks that could jeopardise the performance of its abovementioned core tasks at an early stage is undermined due to a mismatch between public responsibilities and public powers. Thus for instance, as highlighted by the ‘Eurosystem Oversight Policy Framework’ of February 2009<sup>8</sup>, cooperative oversight arrangements at international level can mitigate the loss of direct influence to some extent but cannot ensure the same level of influence of the issuing central bank as direct oversight, especially in a crisis situation, where access to timely information by the issuing central bank may not be possible.

3.3.2 Consequently, if such risks are not identified at an early stage, the malfunctioning of infrastructures located outside the euro area processing the euro could lead to spillover effects to infrastructures

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<sup>8</sup> Available on the ECB’s website.

- within the euro area. Direct Eurosystem oversight, which is possible provided that infrastructures are located in the euro area, is key to ensuring the safety and efficiency of infrastructures processing the euro and thus to maintaining ultimate control over the euro.
- 3.3.3 It is in this broader context that the draft Finnish government proposal opening up the possibility for foreign clearing organisations to provide services in Finland is being considered by the ECB.
- 3.3.4 It is appreciated that the examination of an application by a foreign clearing organisation includes measures to ensure that that clearing organisation does not constitute a risk to the interests of investors and of financial stability in general. In this regard, it is noted that Suomen Pankki and the Financial Supervisory Authority's opinion will, *inter alia*, be sought in relation to applications by foreign clearing organisations from another EEA/non-EEA Member State for authorisation by the Ministry of Finance. It is understood that there are plans to establish cooperative oversight arrangements between Suomen Pankki and the relevant competent authorities. Such prior process and cooperative oversight arrangements cannot, however, take the place of the Eurosystem's ongoing need for the same regular performance of direct oversight on the foreign clearing system that would be conducted in the case of a Finnish organisation in order to ensure the safety and efficiency of the systems in question.
- 3.3.5 Furthermore, it is noted that while an EEA clearing organisation will be able to offer services on a cross-border basis, non-EEA clearing organisations seeking to provide services in Finland will, in principle, be obliged to establish a branch in Finland. However, in the ECB's view infrastructures processing the euro should be incorporated in the euro area by way of establishment of a legal entity that has full responsibility for all critical functions of the infrastructure. This would ensure that the Eurosystem has regulatory power over and direct access to the decision-making body of the relevant infrastructure in order to bring about any necessary changes in relation to the infrastructure's compliance with the applicable Eurosystem oversight policies and standards. A branch, unlike a subsidiary, does not constitute a separate legal entity in the relevant jurisdiction.
- 3.3.6 Moreover, given that central counterparty clearing has a specific role in managing counterparty risk, but also given the aim that central counterparty clearing should expand in view of the recent market turmoil, it is of the utmost importance that the Eurosystem has direct oversight over infrastructures processing the euro. The need for this is even more pronounced due to the fact that crisis management is only vaguely addressed in the draft law.
- 3.3.7 Consequently, the ECB is of the view that enabling the use of foreign clearing organisations located outside the euro area in Finland without requiring that the Eurosystem should have sufficient means to ensure the safety of such non-Eurosystem clearing organisations has the potential ultimately to undermine the Eurosystem's control over the euro and the proper performance of its core tasks.

#### **4. Other specific observations**

##### **4.1 *Account-holding structures***

The ECB notes that the Finnish securities holding system (which is also a book-entry based system) is based on the principle of direct holding<sup>9</sup>, where the rights pertaining to the book entries are registered directly in each account holder's book-entry account. Book-entry securities owned by a foreign individual, corporation or foundation may be entered in a custodial nominee account administered by a custodial account holder on behalf of a beneficial owner on the basis of an authorisation. The ECB understands that the draft law does not intend to amend these securities-holding structures and that it is planned that the more comprehensive reform of Finnish securities markets legislation will follow in 2010. In this context, the ECB nevertheless would like to refer to the explanatory memorandum to the draft law, which provides that 'in the foreign central counterparty model, the objective of the legislation to ensure cost efficiency cannot be fully achieved unless the direct holding system will be developed towards a multi-tier holding structure, making indirect holding possible also to Finnish investors'.

##### **4.2 *Supervision***

The ECB notes that, under the draft law, the Financial Supervisory Authority will, in addition to Finnish clearing organisations, also supervise foreign clearing organisations and the provision of services by foreign clearing organisations without the establishment of a Finnish branch. Such foreign entities would be subject to Chapter 6 of the Law on the Financial Supervisory Authority, which contains general provisions on the supervision of foreign EEA/non-EEA entities as well as on cooperation and the exchange of information between Finnish and foreign authorities.

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

Done at Frankfurt am Main, 7 August 2009.

[signed]

*The Vice-President of the ECB*

Lucas D. PAPADEMOS

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<sup>9</sup> As provided for in the Law on the book-entry system (826/1991) and the Law on book-entry accounts (827/1991), the book-entry system consists of book-entry accounts and lists of the owners of book entries registered in the accounts. 'Book entry' means a dematerialised and transferable security that is issued or intended to be issued to the public, together with several other securities with similar rights.