



OPINION OF THE EUROPEAN CENTRAL BANK

of 24 February 2011

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

(CON/2011/14)

Introduction and legal basis

On 11 January 2011, the European Central Bank (ECB) received a request from the Lithuanian Ministry of Finance for an opinion on a draft law amending the Law on settlement finality in payment and securities settlement systems (hereinafter the 'draft law on settlement finality') and a draft law amending the Law on financial collateral arrangements (hereinafter the 'draft law on financial collateral arrangements') (both draft laws hereinafter the 'draft laws').

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 provisions¹, 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 laws

- 1.1 The main objective of the draft laws is to transpose 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 claims².
- 1.2 In addition to transposing Directive 2009/44/EC, the draft law on settlement finality provides for two new types of 'institutions' which participate in a system and are responsible for performing obligations according to transfer orders or payment instructions: (a) payment institutions licensed in Lithuania or in another Member State; and (b) electronic money institutions licensed in Lithuania or in another Member State.

¹ OJ L 189, 3.7.1998, p. 42.

² OJ L 146, 10.6.2009, p. 37.

1.3 In addition to transposing Directive 2009/44/EC, the draft law on financial collateral arrangements provides a legal basis for close-out netting arrangements, including their exemption from the scope of application of the general rules of Lithuanian insolvency law. As noted in the consulting authority's consultation letter, this should, *inter alia*, mitigate the systemic risks inherent in the operation of payment systems that are subject to the netting of payments by minimising the disruption to a system caused by insolvency proceedings against any of its participants.

2. New system participants: electronic money institutions and payment institutions

2.1 The draft law on settlement finality does not contain a definition of the term 'payment institutions'. The ECB nevertheless understands that, under Lithuanian law, a payment institution is considered to be a 'financial institution', but not a 'credit institution' since it cannot accept deposits or other repayable funds from non-professional market participants³.

2.2 The ECB understands that the term 'electronic money institutions', as used in the draft law on settlement finality, is intended to have the same meaning as the one attributed to it by Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC⁴. On a more general note, the ECB stresses that Directive 2009/110/EC should be properly transposed in Lithuania to ensure the appropriate regulation and supervision of electronic money institutions.

2.3 The definition of 'participant', for the purposes of Directive 98/26/EC, encompasses 'institutions' (whether credit institutions, investment firms or public authorities that participate in a system and are responsible for discharging financial obligations arising from transfer orders within that system), 'central counterparties', 'settlement agents', 'clearing houses' or 'system operators'⁵. Neither payment institutions nor electronic money institutions⁶ qualify as 'credit institutions', nor as other entities falling within the definition of an 'institution' under Directive 98/26/EC. It follows that, for the purposes of the draft law on settlement finality, neither payment institutions nor electronic money institutions, subject to further clarification as to the meaning of the term 'electronic money institutions', would be eligible to participate as 'institutions' in a Lithuanian 'system', designated under the draft law on settlement finality. However, they could participate in such designated Lithuanian 'system' in other capacities, which are eligible for participation in designated systems, for instance, as operators of payment systems, if they fulfil the respective legal and technical requirements.

2.4 In order to avoid any risk of confusion, the draft law on settlement finality should make clear that payment institutions and electronic money institutions should fulfil the conditions referred to above

³ Article 4(5) of the Law on payment institutions (*Valstybės žinios*, 2009, No 153-6887).

⁴ OJ L 267, 10.10.2009, p. 7; see recital 16.

⁵ Directive 98/26/EC, Article 2.

⁶ See, e.g., Recital 25, Articles 6(2) and 20(1) of Directive 2009/110/EC.

so as to qualify as participants in a designated Lithuanian ‘system’. Consequently, the consulting authority is invited to review the definition of the term ‘institution’, both in the interests of legal certainty and in order to remove the uncertainty surrounding the eligibility of payment institutions and electronic money institutions for participation in a designated Lithuanian ‘system’.

3. Use of credit claims as financial collateral in Lietuvos bankas’s credit operations

The ECB understands that Lietuvos bankas may, in the future, allow the use of credit claims as a new type of eligible financial collateral in Lietuvos bankas’s credit operations, including as collateral for the provision of intraday credit in TARGET2. The ECB expects to be consulted by the relevant national authorities should any such proposal result in draft legislative provisions amending Lithuania’s monetary policy legal framework.

4. Legal basis for netting and close-out netting provisions

4.1 The ability to close out on a counterparty’s insolvency is of critical importance in the financial markets. The issue of the enforceability of close-out netting is, therefore, not restricted to individual financial collateral arrangements, but is relevant to all kinds of arrangements aimed at reducing credit risk and exposure.

4.2 The ECB welcomes the netting and close-out netting provisions of the draft law on financial collateral arrangements, especially as regards their exemption from the scope of application of general rules of national insolvency law. The ECB nevertheless underlines that the draft law on financial collateral arrangements should in no way prioritise financial collateral arrangements that include netting and close-out netting provisions over financial collateral arrangements that do not.

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

Done at Frankfurt am Main, 24 February 2011.

[signed]

The President of the ECB

Jean-Claude TRICHET