EUROPEAN CENTRAL BANK

OPINION OF THE EUROPEAN CENTRAL BANK

at the request of the Director-General of the Treasury and Financial Policy of Spain, on a voluntary basis, concerning a draft law on the Payment and Securities Settlement Systems which constitutes the Spanish Implementation of Directive 98/26/EC of 19 May 1998 on Settlement Finality in Payment and Securities Settlement Systems

[**CON/99/01**]

1. On 13 January 1999 the European Central Bank (ECB) received a request from the Director-General of the Treasury and Financial Policy of Spain for an ECB Opinion on a draft law on the Payment and Securities Settlement Systems (the "draft law") which is intended to constitute the Spanish implementation 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 (the "Finality Directive" or the "Directive"). The draft law was submitted in the Spanish language only. A further revised Spanish text of the draft law dated 22nd March 1999 was subsequently received by the ECB. The ECB has produced an unofficial translation of the draft law into English for the purposes of the present consultation. On May 6th the ECB has received the final version adopted by the Spanish Government which has subsequently been sent to Parliament.

2. The purpose of the draft law is the implementation of the Finality Directive in the Spanish legal system and, consequently, the Spanish authorities were not legally obliged to consult the ECB under Article 1.2 of the Council Decision 98/415/EC of 29 June 1998. The ECB seeks to proactively promote 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. In view thereof, the ECB very much welcomes the opportunity to give advice on the draft law, which addresses matters pertaining directly to the core fields of competence of the ESCB, considering that the draft law contains provisions

purported to ensure the smooth operation of payment systems, and the rights of central banks in relation to collateral provided to them.

3. Article 8 of the draft law enumerates the Spanish systems falling within the scope of the draft law, pursuant to Articles 2 (a) and 10 of the Finality Directive, which enumeration includes the Spanish national RTGS system connected to TARGET. Accordingly, this provision clarifies that the Spanish RTGS system will be a "designated system", as defined in Article 1 of the Finality Directive, and benefit from the provisions of the draft law. However, the Spanish component of the TARGET system is linked with other components of the TARGET system outside Spain (through the "Interlinking" component), and payments effected through the Interlinking ought to fall also within the scope of the provisions of the draft law. Hence, the Spanish authorities are encouraged, in that respect, to ensure that Interlinking payments to and from the Spanish component of TARGET do indeed fall within the protection of the draft law. For instance, the fact that the Spanish RTGS system forms an integral part of TARGET may be clarified when the system is notified to the Commission.

   In addition, the ECB would like to make the following further comments concerning the scope of application of the draft law:

   (i) the reference to the interbank wholesale net clearing system "Servicio Español de Pagos Interbancarios" (SEPI) in Article 8 should mention as its currency unit the "euro", and not its temporary non-decimal sub-division of the euro, i.e. the "peseta";

   (ii) the definition of "participants" in Article 2(c) of the draft law seems to exclude "indirect participants" in a system; whilst this exclusion is possible under the Finality Directive, inclusion of "indirect participants" (as defined in the Directive) is also an option under the Directive which, to the extent it is followed, would contribute to the objective of avoiding systemic risk in the integrated financial markets of Europe;

4. Articles 2(b), 2(d), 14(2), 15(1), 15(2) of the draft law refer to "monetary policy transactions" and to "those [transactions] associated with the settlement of a system carried out by the Bank of Spain, the ECB and other central banks of the European Union". The Finality Directive, however, envisages more generally "operations of the central banks of the Member States functioning as central banks, including monetary policy operations" (Recital 10 and Article 1(c) of the Directive) and, therefore, the language of the draft law seems to be unduly restrictive.

Moreover, in Article 15.1 of the draft law the ECB has been omitted from the constellation of central banks without justification.

5. Article 11.1, first sentence, concerning the irrevocability of transfer orders, covers irrevocability vis-à-vis the issuer of the transfer order in question, but should also address any third party along the lines of Article 5 of the Finality Directive.

The drafting of Article 11-2 (a) of the draft law would suggest the following comment: Article 3-2 as well as Recital (13) of the Directive specifically mention that actions relating to the underlying transactions may in no way lead "to the unwinding of netting [or] to the revocation of the transfer order in the system"; this important element does not appear in the current drafting of Article 11-2 (a) of the draft law and should be expressly added.

6. The scope of finality is addressed in Articles 11, 13, 14 and 16 of the draft law. In this connection, the following comments are warranted.

(i) Article 13 of the draft law should ensure that finality is not only effective *inter partes*, but also *erga omnes*; provided that transfer orders were entered into the system before the moment of opening of insolvency proceedings (or the provisions of Article 3.1, second paragraph, of the Finality Directive apply), insolvency proceedings should have no effect whatsoever, neither on the legal position of the insolvent participant (and this is foreseen in the first paragraph of Article 13 of the draft law), nor as regards any other participant or third party (e.g. the liquidator or administrator of the insolvent entity). This latter aspect (which in Article 3.1 of the Directive is provided through the stipulation that "transfer orders and netting shall be legally enforceable and […] binding on third parties") should be clearly set out in the draft law. The broad wording of Article 11.1, second sentence of the draft law may be taken as a useful parallel to expressly broaden and clarify the scope of finality in the context of Article 13.

(ii) Article 14.1 of the draft law states the main effect of finality as a right to segregate collateral from the insolvency proceedings. However, Article 9.1 of the Finality Directive contains a more general formulation: the right of not being affected by the insolvency. The ECB notes that repurchase operations are already insulated from insolvency proceedings under Law 37/1998 amending the Securities Markets Law of 1988, and therefore Article 14.1 of the draft law basically addresses other kinds of

collateral. It is for the Spanish authorities to consider whether the regime resulting from the two Spanish legal acts is equivalent to the Directive's rule of "not being affected" by the insolvency.

7. Article 15 of the draft law implements Articles 8 and 9.2 of the Finality Directive. Here, the ECB would like to make the following comments:

(i) The first sentence of Article 15.1 of the draft law stipulates that "When insolvency proceedings are initiated against a Spanish organisation which is a member of a system recognised in another member State of the European Union as provided for under Directive 98/26/EC, the rights and obligations which accompany its membership of said system shall be defined by the national legislation governing said system". However, it is also necessary to stipulate in the draft law that, conversely, in case of insolvency proceedings against a foreign entity participating in a Spanish system, the rights and obligations of such a participant within the system will be governed by Spanish law. This is of particular importance regarding non-EU foreign participants.

(ii) Article 15.1 of the draft law seems to only apply "in the event of the opening of insolvency proceedings". It is not clear whether the second sentence of that paragraph falls within the same proviso, and if this was not the case such second sentence might usefully be set as a different paragraph. It is clear that Article 9.2 of the Finality Directive stipulates a general conflict-of-law rule which shall apply in all cases, and not only in the event of commencement of insolvency proceedings. There are no legal reasons to limit the scope of the Directive's rules in the field of private international law to situations of insolvency: the legal regime for collateral should be the same both before any insolvency occurs and after the opening of insolvency proceedings. The opening of insolvency proceedings, which is basically a procedural event, does not and cannot change the content and substance of the *iura in rem*. From a policy perspective, the achievement of the internal market in the area of securities following the introduction of the euro, would be better served by clear rules harmonising the private international law rules in relation to the taking of collateral; if such rules were only applicable in the case of insolvency proceedings, this policy objective of the Community would not be properly served.

(iii) Article 15.1 of the draft law would only apply to collateral "constituted in favour of a system" in relation "with the settlement of said systems"; such language would provide an overly narrow approach to Article 9 of the Directive, and, instead, the protection provided by Article 15.1 of the draft law should cover in general terms any form of security interest in favour of participants irrespective of the purpose underlying the creation of such security interest. The conflict-of-law rule in Article 9 of the Directive makes no distinctions whatsoever, neither with regard to the purposes of collateralisation nor with regard to the quality of the beneficiary of the collateral.

(iv) The rules, as stated in the draft law, are limited to the effects *in rem* (paragraphs 1 and 2 of Article 15 of the draft law read "en cuanto a sus efectos juridicos reales"). There seems to be no legal reason to limit the scope of the rule, and Article 9.2 of the Finality Directive does not demand such limitation. The contractual aspects of taking collateral are also paramount: the regulation of the formalities involved (*iura in personam* vis-à-vis counterparts, proper forum for disputes, etc.) requires a clear rule determining which national laws govern such aspects of taking collateral. It is to be borne in mind that the concept of collateral is not limited to pledges but encompasses also the technique of repurchase transactions. Article 9.2 of the Finality Directive is not limited in this respect. It is worth mentioning that the conflict-of-law rules in the Finality Directive are consistent with (i) the rule of Article 8 of the U.S.A.'s 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 cross-border trading of securities.

(v) The rule enshrined in Article 15.2 of the draft law should be reciprocal, in the sense that it ought to apply, *mutatis mutandis*, to collateral registered in Spain in favour of foreign systems.

(vi) The additional formalities required by Article 15.3 may increase the bureaucratic burden and hinder the rapidity of the collateral-taking process without any justification. Modern rules of evidence and means of communication would not appear to require the approach envisaged by this provision. Similar remarks in favour of a more stream-lined procedure, including less formalities, can be made also in respect of Article 14.5 of the draft law concerning the realisation of collateral.

8. 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 is arranging for this Opinion to be copied to the competent national authorities of Member States responsible for implementing Directive 98/26/EC of 19 May 1998 on Settlement Finality in Payment and Securities Settlement Systems.

Done at Frankfurt am Main on 26 May 1999.

The President of the ECB

[signed]

Willem F. Duisenberg