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EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 15 March 2007

at the request of the Dutch Ministry of Finance

on a draft law concerning systemic oversight of settlement institutions

(CON/2007/7)

Introduction and legal basis

On 5 February 2007 the European Central Bank (ECB) received a request from the Dutch Ministry of Finance for an opinion on a draft law concerning systemic oversight of clearing and settlement institutions (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 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 legislative provisions[1], as the draft law relates to De Nederlandsche Bank (DNB) 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 law

The draft law will amend the Law on financial sector supervision (hereinafter the 'LFSS')[2] by adding a Part 6 concerning systemic oversight of clearing and settlement institutions[3]. This is aimed at achieving an efficient system to supervise the safety and reliability of payments clearing and settlement services and securities clearing and settlement services, in order to safeguard financial infrastructure stability. Adequate supervision of clearing and settlement institutions' compliance with the relevant rules will increase confidence in the financial sector by managing risks associated with the provision of clearing and settlement services and by establishing clear rules for market participants. To this end, the draft law provides the financial market supervisors, DNB and the Autoriteit Financiële Markten (AFM, Authority for the Financial Markets), with the legal instruments necessary for enforcing supervisory measures. In particular, the supervisors can require participants to comply with a certain line of conduct, appoint one or more persons as liquidator, impose incremental penalty payments and impose administrative penalties.

1 OJ L 189, 3.7.1998, p. 42.

2 Published in the *Staatsblad* (the Dutch Official Journal) No 475 of 31 October 2006. The date of entry into force of 1 January 2007 is laid down in Decision of 11 December 2006 published in the *Staatsblad* No 664 of 20 December 2006. See also ECB Opinion CON/2006/20 of 25 April 2006 on the Dutch draft law concerning financial sector supervision.

3 Currently the Law contains 5 parts: the General Part, Market Access Financial Undertakings, Prudential Supervision Financial Undertakings, Market Conduct Supervision Financial Undertakings, and Market Conduct Supervision Financial Markets.

Furthermore, the supervisors may modify, withdraw fully or in part, or attach conditions to, an authorisation. The draft law adopts a functional approach by referring to clearing and settlement services instead of clearing and settlement systems.

2. General observations

2.1 As a rule, systemic supervision aims at preventing financial problems encountered by one financial institution from spreading to other financial institutions and to the financial markets. The ECB understands that systemic oversight under the draft law is limited to clearing and settlement institutions and is aimed at ensuring the timely completion of clearing and settlement services, efficiency and the mitigation of legal, settlement, operational and financial risks. Moreover, the draft law is also intended to prevent one participant's default from causing another participant to default, which may disrupt the financial infrastructure or, in the worst-case scenario trigger a systemic crisis. To this end, the draft law implements the Committee on Payment and Settlement Systems and the International Organization of Securities Commissions' (CPSS-IOSCO) recommendations for securities settlement systems and the CPSS Core Principles for Systemically Important Payment Systems[4]. The ECB takes the view that the draft law should clarify that DNB continues to conduct oversight within the common Eurosystem oversight policy framework[5].

2.2 The clearing and settlement institutions that currently operate on the market are: (i) Equens[6], for payments clearing; (ii) LCH.Clearnet, as central counterparty for transactions in financial instruments; and (iii) Euroclear Netherlands/Necigef, for financial instruments settlement. The draft law does not apply to the Dutch real-time gross settlement payment system, TOP, since DNB is not a clearing and settlement institution, clearing institution or credit institution within the meaning of the draft law.

2.3 The ECB also notes that the draft law is a response by the Dutch authorities to the IMF Country Report assessment of the Netherlands which states that '[i]f the new Act makes it clear that e.g., an institution that operates as a central counterparty or a securities settlement system, are subject to direct supervision, and that the roles of DNB and AFM are clear, Recommendation 18 would be observed'[7].

2.4 The ECB understands that payment products are not covered by the draft law and that DNB continues to conduct oversight of payment products, based on its task of promoting the smooth operation of the payment system laid down in Article 105(2) of the Treaty and Article 3.1 and Article 22 of the Statute of the European System of Central Banks and of the European Central

4 Available on the Bank for International Settlement's website at www.bis.org.

5 See ECB Opinion CON/2003/14 of 7 August 2003 at the request of the Banca d'Italia on a draft regulation on payment systems, payment infrastructures and payment instruments, p. 3.

6 On 30 November 2006 Equens was formed following the merger of Interpay and Transaktionsinstitut für Zahlungsverkehrsdienstleistungen AG.

7 IMF Country Report, No 04/310 of September 2004, p. 166, available on the IMF's website at www.imf.org.

Bank, as well as the Eurosystem's common oversight policy framework and Article 3(1)(e) and Article 4(2) of the Law on DNB[8].

2.5 The ECB also notes that under Section 6.21, the Nederlandse Mededingingsautoriteit (the Dutch Competition Authority) can impose measures, with regard to prices charged for clearing and settlement services, after receiving authorisation from the Minister for Finance, who must consult DNB and the AFM prior to granting such authorisation. These provisions are aimed at establishing objective, transparent and non-discriminatory prices.

2.6 The ECB welcomes the introduction of direct systemic supervision as it greatly improves transparency and accountability and provides the financial market supervisors with a clear basis for enforcing measures with regard to systemic, prudential and market conduct supervision.

3. DNB's oversight of payment systems

3.1 In Opinion CON/2006/20, the ECB noted that certain parts of the LFSS did not distinguish between DNB's Eurosystem- and non Eurosystem-related tasks. Under the LFSS, the AFM supervises the market conduct of financial institutions, including clearing and settlement institutions. The draft law provides that the AFM will supervise the market conduct of clearing and settlement systems, including payment systems not operated by DNB. Market conduct supervision is defined in Section 1.25 of the LFSS (previously Section 1.8 in the draft available at the time of the adoption of Opinion CON/2006/20) as 'promoting orderly and transparent financial market processes'. Given the similarity between the concepts of market conduct supervision and the Eurosystem's statutory task of 'promoting the smooth operation of payment systems', which is performed through its oversight function, and also considering Article 25 of the Statute on the ECB's financial stability role and the fact that payment systems are interlinked with securities clearing and settlement systems (SCSSs), this may give rise to a conflict between DNB's responsibilities as an integral part of the Eurosystem, and AFM's responsibilities as provided for in the draft law.

3.2 Since payment systems are interlinked with SCSSs, there is a strong argument in favour of the model followed by some Member States to have the national central bank perform the oversight of both payment systems and SCSSs. The draft law combines the integrated oversight model with respect to payment systems and SCSSs and divides the responsibilities and powers between the prudential and systemic supervisor, DNB and the supervisor for market conduct, the AFM. In that sense, the draft law formalises DNB's role in the oversight of SCSSs as part of systemic and prudential supervision.

3.3 At Community level, the general legal basis for the oversight of payment systems is in Article 105(2) of the Treaty and Article 3.1 and Article 22 of the Statute, with more detailed policies introduced by the Eurosystem's common oversight policy as defined by the Governing Council. In the interest of clearly defining responsibilities, the ECB recommended in Opinion CON/2006/20 that the oversight of payment systems, including market conduct, should be

8 *Bankwet* 1998 (Bank Act 1998), *Staatsblad* 26 March 1998, p. 200.

explicitly assigned to DNB, which would be consistent with DNB's participation in the Eurosystem. As this has not been taken into account in the draft law, the ECB reiterates this recommendation and strongly advises amending the draft law to make it clear that DNB enjoys full oversight over payment systems.

4. Division of powers

4.1 Under Section 2.3(c) of the draft law, if an authorised clearing and settlement institution no longer complies with the provisions laid down in Part 4.3.4(A), the AFM may advise DNB to withdraw the authorisation or to exercise its authority to appoint one or more persons as liquidator. The ECB notes that the draft law divides responsibilities between DNB and the AFM.

As DNB will be the lead overseer, meaning that DNB is the entity authorising the overseen entities to provide clearing and settlement services, the draft law should also provide for an advisory function for DNB in relation to the AFM, to exercise its own powers in the event that the clearing and settlement institution no longer complies with Part 4.3.4(A).

4.2 Furthermore, Section 4.76a(2) provides that a participant may only be refused access by the clearing and settlement institution if such access would negatively affect the proper functioning of the settlement services offered by the clearing and settlement institution. This provision is laid down in Part 4, which covers the AFM's responsibility over market conduct supervision. The ECB notes that DNB, as the prudential and systemic supervisor, should play a role in assessing whether the rules of the clearing and settlement institution contain criteria limiting access on grounds other than risk.

5. Supervisory powers in the Securities Giro Law

The ECB notes that Article 2 of the Securities Giro Law[9] provides for the appointment of the supervisor of the Central Institution, i.e. the Central Securities Depository, and specifies the supervisor's powers. Given the definition of settlement services in Section 1.1 of the draft law[10], the ECB would suggest adding these supervisory provisions to the draft law and removing them from the Securities Giro Law.

6. Influence on financial sector stability

Section 2.3a(2) provides that 'the first subsection is not applicable to the provision of categories of clearing and settlement services to be established by order in council that do not or cannot have any significant influence on the stability of the financial sector'. The ECB notes that the criterion of insignificant influence is quite open-ended. Therefore, the ECB would encourage establishing objective and transparent criteria, after consulting DNB, and making them publicly available.

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9 *Staatsblad* 1977, No 333, as last amended by the Law of 25 June 1998, *Staatsblad* No 446.

10 Section 1.1(c) defines settlement services as the performance of 'activities for the purpose of managing, safeguarding and administrating financial instruments and facilitating the processing of transactions in financial instruments by funds transfer'.

7. Conflicts of interest

Section 6.3(1)(a) states that a clearing and settlement institution should avoid conflicts of interest, but the draft law does not further define the term. The explanatory memorandum defines 'conflicts of interest' as 'evident violations of the relevant social standard seriously damaging confidence in the clearing and settlement institution or financial markets', which is narrow in scope. The ECB considers that this definition is not sufficiently clear and recommends defining it more precisely. In particular, the term should refer to situations where there is an incompatibility between differing aims, such as between an agent and its principal. It also includes situations where the aims of different groups of persons within a clearing and settlement institution, such as the users, owners and public authorities, are not completely aligned.

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

Done at Frankfurt am Main, 15 March 2007.

[signed]

The President of the ECB

Jean-Claude TRICHET