



COMMISSION OF THE EUROPEAN COMMUNITIES

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Amended proposal for a

EUROPEAN PARLIAMENT AND COUNCIL DIRECTIVE
ON SETTLEMENT FINALITY AND COLLATERAL SECURITY
(TO BE RENAMED: "ON THE LIMITATION OF SYSTEMIC RISK
IN PAYMENT AND SECURITIES SETTLEMENT SYSTEMS")

(presented by the Commission pursuant to Article 189 a (2)
of the EC-Treaty)

I. STAGE REACHED IN THE PROCEDURE

1. On 30 May 1996, the Commission adopted a proposal for a Directive on Settlement Finality and Collateral Security.
2. The Council forwarded this text to the Parliament, the Economic and Social Committee and the European Monetary Institute, and began to examine the proposal on 20 September 1996.
3. The Economic and Social Committee unanimously adopted an opinion on the Commission proposal on 31 October 1996, in which it recommended that securities settlement systems be included in the scope of the proposal.
4. The European Monetary Institute delivered its opinion on 21 November 1996. It welcomed the proposal and stressed its crucial importance to the efficient and smooth functioning of payment systems; it also recommended that securities settlement systems should be included in the scope.
5. The European Parliament welcomed this proposal and adopted the legislative resolution embodying its opinion on the Commission proposal during its plenary meeting of 9 April 1997.
6. The amended proposal which is attached herewith has been drafted to take account of the outcome of the consultation of these institutions.

2. COMMENTS ON THE AMENDMENTS

The European Parliament proposed 21 amendments to the text of the Commission Proposal.

1. Accepted Amendments

The Commission will include amendments 2, 3, 5, 7, 8, 9, 13, 14, 15, 18, 20 in its amended proposal.

- Amendments 2 and 3 add a recital. These recitals are useful in view of a better understanding of the background against which this proposal was made.

Amendments 5, 7, 8, 9, 14 and 15 can all be accepted, as they aim at bringing securities settlement systems within the scope of this Directive. This inclusion is in line with the recommendations made both by the EMI and by the ECOSOC.

The European Parliament wishes securities settlement systems to be covered by the directive. In order to be consistent with that wish, not only should the words "or a securities settlement system" be added at the end of Amendment 7, but "investment firms as defined in point 2 of Article 1 of Directive 93/22/EEC excluding the institutions set out in the list in Article 2(2) points a)-k) thereof" should also be included in the definition of "institution", as securities settlement systems typically have investment firms as their participants.

The Directive covers collateral security provided in connection with monetary policy operations. Amendment 13 introduces derivatives within the definition of monetary policy operations. Insofar as central banks carry out operations concerning such instruments, they should indeed be included in this Directive.

As "securities institutions" are not defined in the European Parliament's amendments, and as the definition of "institution" in the Commission amended proposal also covers "investment firms", which is probably what the European Parliament means by "securities institution" in Amendment 15, the Commission amended proposal simply refers to "institution" instead of to "securities institution". It also replaces "participant" which is defined nowhere, with "institution".

Amendment 18 changes the wording of the original Commission proposal, but expresses the same idea and seems therefore acceptable.

Amendment 20 clarifies the text of paragraph 1. Paragraph 2 of the original Commission proposal explicated a subhypothesis covered by paragraph 1. Its deletion can therefore be accepted.

- Furthermore, the Commission could include amendments 1, 4, 10 and 12 subject to minor modifications.

In Amendment 1, a new title of the Directive is proposed: "Proposal for a European Parliament and Council directive on the treatment of payment systems and securities settlement systems in the context of insolvency proceedings concerning credit or securities institutions". Although a change in title is acceptable, the suggested one implies that the Proposal only aims at solving problems relating to insolvency. Therefore, a new title, "Directive on the Limitation of Systemic Risk in Payment and Securities Settlement Systems", shall be included.

Amendment 4 is acceptable, except for the mention "and the Euro" besides "Ecu". Firstly, the separate mention of "Euro" after the words "operating in any currency", suggests the Euro is not a currency. Where it is true that the Ecu is a basket and not a currency, this is not true for the Euro. Secondly and more importantly, the fact that Ecu and Euro are mentioned in the same legal text, suggests that the Ecu and the Euro will co-exist. However, the Ecu will be replaced by the Euro, so both will never exist at the same time.

Amendment 12 aims at including securities settlement systems within the Directive. It amends the definition of "third country *payment system*" by deleting the word "payment" so as to read "third country *system*". However, Parliament seems to have overlooked that the definition of "third country system" only refers to "payment systems" without mentioning "securities settlement systems", which is inconsistent with the Parliament's concern to include these securities settlement systems. The Commission therefore completes this amendment -in its amended proposal- in order to include securities settlement systems.

2. Rejected Amendments

Amendments 6, 10, 11, 16 and 21, and especially 17 and 19 cannot be included in the amended proposal.

Amendment 6(1) describes in a general way that Member States will have to amend their insolvency laws in accordance with this Directive in order to avoid disruptions in the case of insolvency of a system participant. Amendment 6 (2) contains the obligation for systems to deposit the system agreement with the authorities responsible for supervising the institutions which participate in the system. Amendment 6 (3) provides for the publication of a notice that an agreement has been deposited, that it is open for inspection; it must also indicate the participating institutions.

Although the idea of a notification procedure expressed in this amendment is in line with the current approach taken by the Council, the proposed procedure seems unnecessarily cumbersome and bureaucratic. Moreover, in a number of Member States, the authority responsible for supervising institutions participating in a system is different from the authority which supervises the system, so that the authority at which the system agreement should be deposited, should be better identified. Therefore, this amendment cannot be included in the amended proposal.

In Amendment 10, an addition is made to the definition of "payment system". The meaning of that addition needs clarifying. It can therefore not be accepted.

Parliament, in its Amendment 11, changes the criterion of location (to determine whether a system is an EU system covered by the Directive) from the choice of law made by the system participants (system located in the Member State the law of which the system participants have chosen to govern their agreement) to the place of settlement or book entry. Since the place of settlement can be different from the place where the correspondent book entry takes place, this amendment does not seem consistent. Moreover, several book entries can be made for one same transfer order (e.g. at the clearing house and at the settlement agent), so that it would be necessary to define which book entry is meant. This amendment can therefore not be taken up in the Commission amended proposal. However, the text of the article in the original Commission proposal has been altered in order to take into account the inclusion of securities settlement systems into the scope of this Directive, as requested by the European Parliament.

Article 3 states that netting of transfer orders is enforceable if entered into the system before the opening of insolvency proceedings. The Commission proposal stated that the *moment of entry* into the system was to be determined in the system agreement. Amendment 16 (1) deletes that statement. The question then arises when a transfer order can be considered to have entered a system. Parliament does not provide an answer to that question anywhere, so that this amendment cannot be included in the Commission's amended proposal. However, the text of the article in the original Commission proposal has been altered in order to take into account the inclusion of securities settlement systems into the scope of this Directive, as requested by the European Parliament.

Article 3(2) refers to rules on the setting aside of fraudulent contracts which have been *concluded* before the opening of insolvency proceedings. The wording in the Commission proposal "to enter into a contract" is synonymous of "to conclude a contract". It does not refer to the entering of transfer orders into the system, as Parliament's amendment 16(2) stipulates. Moreover, it is unclear what is meant by unwinding of "settlement or securities transactions" referred to in the Parliament's amendment. This wording seems to imply that it should not be possible to unwind payments or securities transactions once they are settled. However, the Directive aims at protecting transfer orders against unwinding while they are within the system, which is when systemic risk can occur. After settlement, no problem of systemic risk exists any more. Therefore, Amendment 16 cannot be included in the Commission's amended proposal.

Amendment 21, which replaces the previous amendment 16 (3), determines the moment of *opening of insolvency proceedings*, which are deemed to be the moment when the competent authority notifies the national supervising authorities, after which these have to notify the system participants. This procedure has been examined in depth in the past (Commission Working Group) and has not been retained for reasons of excessive heaviness of the procedure.

While the Commission proposal contains a prohibition to revoke a transfer order after the moment defined by the rules of the system, Parliament's Amendment 17 prohibits revocation after the moment when insolvency proceedings are opened. While the aim of this provision in the Commission's proposal was to protect a transfer when it went through the system, which is the situation where systemic risk can occur, the provision has a completely different meaning in the Parliament's Amendment. It does not seem necessary, to repeat -as it is done in Parliament's Amendment- that in case of insolvency, a participants' assets are frozen and that therefore revocation is not possible. Moreover, in Amendment 17, the reference to the third party (in particular the client), which was mentioned in the Commission proposal, has been deleted. The deletion of the reference to the third party (e.g. the client, originator of a transfer order), could mean that -in a cross-border system- an institution could be prohibited from revoking its client's transfer order once it has entered into a system (under the system agreement or under the other Member States' law), whereas the client could validly revoke that transfer order as against its institution (under the own Member State's law). It is clear that if this were to happen with a significantly large amount, it could trigger systemic risk. Therefore the reference to third parties should be maintained.

This amendment can therefore not be taken up in the Commission amended proposal. However, the text of the article in the original Commission proposal has been altered in order to take into account the inclusion of securities settlement systems into the scope of this Directive, as requested by the European Parliament.

Amendment 19 aims at deleting Article 6 on the applicable insolvency law in the event of a participant's insolvency. The deletion of this article runs counter the aim of this Directive which is to avoid systemic risk, and this for two reasons: a) legal certainty and b) avoidance of conflicts of law.

- a) **Legal certainty:** In the event insolvency of a system participant, it is essential to guarantee legal certainty as to the status of funds or securities in the system. The longer there is uncertainty, the longer these funds or securities will be unavailable for the other participants in the system. This can erode the liquidity base of these participants and hence lead to systemic risk. In order to achieve legal certainty, it is vital to know which insolvency law applies in the event of the insolvency of a system participant.
- b) **Avoidance of conflicts of law:** It is possible that the insolvency law of one Member State conflicts with the contract law of another Member State (as far as the exam of the validity of the claim is concerned). Therefore it is essential that the insolvency of a system participant be governed by the insolvency law of the Member State whose contract law governs the system agreement.

This amendment can therefore not be taken up in the Commission amended proposal. However, the text of the article in the original Commission proposal has been altered in order to take into account the inclusion of securities settlement systems into the scope of this Directive, as requested by the European Parliament.

**AMENDED PROPOSAL FOR A EUROPEAN PARLIAMENT AND COUNCIL
DIRECTIVE ON THE LIMITATION OF SYSTEMIC RISK IN PAYMENT AND SECURITIES
SETTLEMENT SYSTEMS**

Original Commission Proposal

Amended Commission Proposal

(Amendment 1)

Title

Proposal for a European Parliament and Council Directive on settlement finality and collateral security

Proposal for a European Parliament and Council Directive on the Limitation of Systemic Risk in Payment and Securities Settlement Systems

(Amendment 2)

Recital 1

Whereas laws on the bankruptcy of credit and securities institutions have not yet been harmonised; whereas a proposal dating back to 1985 on the reorganisation and winding-up of credit institutions (OJ C 356, 31.12.1985, p. 55 et seq. amended on 8 February 1988) is still pending before the Council; whereas the agreement of 23 November 1995 of the Member States meeting within the Council concerning insolvency proceedings explicitly excludes insurance undertakings, credit institutions and investment companies;

(Amendment 3)

Recital 7a

Whereas the "Report of the committee on interbank netting schemes of the Central Banks of the Group of Ten countries" by the Bank for International Settlements in Basle of November 1990, makes the following recommendations, inter alia: "Netting schemes should have a well-founded legal basis under all relevant jurisdictions and netting scheme participants should have a clear understanding of the impact of the particular scheme on each of the financial risks affected by the netting process";

Amendment 4

Article 1(1)

The provisions of this directive shall apply to:

(1) any Community payment system operating in any currency and the ECU and to collateral security provided in connection with participation in such a system.

The provisions of this directive shall apply to:

(1) any Community payment system or securities settlement system operating in any currency, the ECU or in various currencies which the system converts one against another and to collateral security provided in connection with participation in such a system.

Amendment 5

Article 1(2)

(2) any Community institution which participates directly in a third country payment system and to collateral security provided in connection with participation in such a system.

(2) any Community institution which participates directly in a third country payment system or securities settlement system and to collateral security provided in connection with participation in such a system.

(Amendment 6)

Article 1a

Rejected

(Amendment 7)

Article 2a

(a) "*institution*" means any undertaking as defined in Article 1 of Council Directive 77/780/EEC including the institutions set out in the list in Article 2(2) thereof, which participates directly in a payment system, and any other undertaking which participates directly in a payment system.

(a) "*institution*" means any undertaking as defined in Article 1 of Council Directive 77/780/EEC including the institutions set out in the list in Article 2(2) thereof, or any investment firm as defined in point 2 of Article 1 of Directive 93/22/EEC excluding the institutions set out in the list in Article 2(2) points a)-k) thereof, which participates directly in a payment system or a securities settlement system, and any other undertaking which participates directly in a payment or a securities settlement system

(Amendment 8)

Article 2b

(b) "*direct*" participation means participation in a payment system entailing responsibility for settlement.

(b) "*direct*" participation means participation in a payment system or a securities settlement system entailing responsibility for settlement.

(Amendment 9)

Article 2e

(e) "*payment order*" means any instruction to place at the disposal of a final recipient an amount of money by means of a book entry on the accounts of a credit institution or a central bank;

(e) "*payment order*" means any instruction to place at the disposal of a final recipient an amount of money by means of a book entry on the accounts of a credit institution or a central bank, and in the case of securities settlement systems, an instruction to an institution to transfer the claim to one or more securities by means of a book entry in a register or in another form;

(Amendment 10)

Article 2h

(h) "*payment system*" means any written agreement between two or more institutions for executing payment orders;

(h) Unchanged

(Amendment 11)

Article 2i

(i) "*Community payment system*" means a payment system located in a Member State. A payment system shall be deemed to be located in the Member State the law of which has been chosen by the institutions which participate directly in that payment system. In the absence of choice, the payment system shall be deemed to be located in the Member State where the settlement takes place;

(i) "*Community payment or securities settlement system*" means a payment system or a securities settlement system located in a Member State. A Community payment or securities settlement system shall be deemed to be located in the Member State the law of which has been chosen by the institutions which participate directly in that system. In the absence of choice, the Community payment or securities settlement system shall be deemed to be located in the Member State where the settlement takes place;

(Amendment 12)

Article 2j

(j) "*third country payment system*" means any payment system which is not a Community payment system.

(j) "*third country system*" means any payment or securities settlement system which is not a Community payment or securities settlement system.

(Amendment 13)

Article 2k

(k) "*monetary policy operation*" means an outright (spot and forward) buying and selling operation in the financial markets or such an operation under a repurchase agreement, or lending or borrowing of claims and marketable instruments, whether in Community or in non-Community currencies or in precious metals, by a Member State Central Bank or by the future European Central Bank; it also means the conduct of credit operations, by a Member State Central Bank or by the future European Central Bank, with credit institutions or other market participants, with lending being based on adequate collateral;

(k) "*monetary policy operation*" means an outright (spot and forward) buying and selling operation in the financial markets or such an operation under a repurchase agreement, or lending or borrowing of claims and marketable instruments, or derivatives from such claims or instruments, whether in Community or in non-Community currencies or in precious metals, by a Member State Central Bank or by the future European Central Bank; it also means the conduct of credit operations, by a Member State Central Bank or by the future European Central Bank, with credit institutions or other market participants, with lending being based on adequate collateral;

(Amendment 14)

Article 2l

(l) "*collateral security*" means all assets, provided for the purpose of securing rights and obligations potentially arising in a payment system or provided to Member State Central Banks or to the future European Central Bank in connection with monetary policy operations.

(l) "*collateral security*" means all assets, provided for the purpose of securing rights and obligations potentially arising in a payment system or a securities settlement system or provided to Member State Central Banks or to the future European Central Bank in connection with monetary policy operations.

(Amendment 15)
Article 2(la)

(1a) "securities settlement system" means a written agreement between institutions with rules for the transmission and execution of securities transactions between these institutions.

(Amendments 16 and 21)
Article 3

(1) Payment netting is legally enforceable and shall, even in the event of insolvency proceedings against any institution which participates directly in a payment system, be binding on third parties, provided that the payment order was entered into the payment system before the opening of insolvency proceedings. The moment of entrance shall be defined by the rules of that payment system.

(1) Netting is legally enforceable and shall, even in the event of insolvency proceedings against any institution which participates directly in a payment or securities settlement system, be binding on third parties, provided that the order was entered into the payment or securities settlement system before the opening of insolvency proceedings. The moment of entrance shall be defined by the rules of that payment or securities settlement system.

(2) Any rule on the setting aside of contracts and transactions entered into before the opening of insolvency proceedings, shall not lead to the unwinding of the netting.

(2) Unchanged

(2a) Rejected

(Amendment 17)
Article 4

(1) A payment order may not be revoked either by an institution which participates directly in a payment system or a third party as against the other direct participants in that payment system after the moment defined by the rules of that payment system. This rule applies notwithstanding the opening of insolvency proceedings.

(1) A payment order or an order for a securities transaction may not be revoked either by an institution, which participates directly in a payment or a securities settlement system, or by a third party as against the other institutions directly participating in that system after the moment defined by the rules of that system. This rule applies notwithstanding the opening of insolvency proceedings.

(Amendment 18)

Article 5

Insolvency proceedings shall not have retroactive effects on the rights and obligations of an institution in connection with direct participation in a Community payment system. Any other rule or practice which has a retroactive effect shall be superseded.

Insolvency proceedings shall not have retroactive effects on the rights and obligations of an institution in connection with direct participation in a Community payment or securities settlement system. Rules which have a retroactive effect shall not apply to institutions involved in insolvency proceedings.

(Amendment 19)

Article 6

In the event of insolvency proceedings against an institution which participates directly in a payment system, the rights and obligations arising from or in connection with direct participation in that payment system, shall be determined by the insolvency law of the country where the payment system is located.

In the event of insolvency proceedings against an institution which participates directly in a payment system or a securities settlement system, the rights and obligations arising from or in connection with direct participation in that system, shall be determined by the insolvency law of the country where the system is located.

(Amendment 20)

Article 7

(1) The rights of a pledgee in connection with liabilities of one participant to one or more other participants in a payment system or the rights of monetary authorities to whom collateral security has been pledged in connection with monetary policy operations, shall not be affected by the opening of insolvency proceedings against the pledger. The collateral security shall be realised for the satisfaction of rights in connection with participation in a payment system or with monetary policy operations with priority over all other creditors.

The rights of:

an institution or of a settlement agent to collateral security provided to it in connection with the system and

monetary authorities of the EC to collateral security provided to them in connection with monetary policy operations

shall not be affected by insolvency proceedings against the institution which provided the collateral security. Such collateral security may be realised for the satisfaction of these rights.

Where a third-country institution constitutes collateral security in a Member State in connection with participation in a Community payment system or in connection with monetary policy operations, the rights of the pledgee shall not be affected by the opening of insolvency proceedings against that third-country institution.

Articles 8 to 10

Unchanged.

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