EUROPEAN CENTRAL BANK

OPINION OF THE EUROPEAN CENTRAL BANK

of 7 May 2003

at the request of the Belgian Ministry of Finance
on a draft proposal for a Royal Decree on the off-exchange market for linear bonds, strips and treasury certificates

(CON/2003/7)

1. On 10 April 2003 the European Central Bank (ECB) received a request from the Belgian Ministry of Finance for an opinion on a draft Royal decree on the off-exchange market for linear bonds, strips and treasury certificates (the draft decree).

2. The ECB's competence to deliver an opinion is based on Article 105(4) of the Treaty establishing the European Community, the second indent of Article 4(a) of the Protocol on the Statute of the European System of Central Banks and of the ECB, and the third, fifth and sixth indents of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the ECB by national authorities regarding draft legislative provisions[1], since the draft decree contains provisions regarding (i) the organisation, regulation and supervision of an off-exchange market for government securities, in which both the National Bank of Belgium (NBB) and private credit institutions may participate; (ii) operations carried out by the ECB, by the NBB on behalf of the ECB or by the other national central banks of the Eurosystem in the implementation of monetary policy; and (iii) the settlement by the NBB of certain transactions concluded on this market. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the ECB, the Governing Council of the ECB has adopted this opinion.

3. On 18 March 2002 the ECB was consulted on a draft Belgian law on prudential supervision of the financial sector and financial services (the Law). The ECB rendered its opinion on this draft on 24 April 2002 (CON/2002/13). The Law was adopted on 2 August 2002 and will enter in to force on 1 June 2003. The Law provides that the Belgian King may implement certain provisions of the Law by royal decree. The objective of the draft decree is to implement two provisions of the Law regarding the organisation, membership, transparency and supervision of the off-exchange market for linear bonds, strips and treasury certificates, which are financial instruments issued or guaranteed by the Belgian State. Considering the particular nature of a regulated market for

1 OJ L 189, 3.7.1998, p. 42.

government securities - i.e. a decentralised market with only one issuer (the Belgian State) and with primarily professional investors - the ECB broadly welcomes the draft decree.

4. The ECB notes that Article 1, 8º, of the draft decree defines "market member" as an "institution that belongs to one of the categories of institutions referred to in Article 3". Considering that both Article 3, §1, of the draft decree and Article 2, 10º, of the Law to which this Article 3, §1, refers use the term "qualified intermediary", it could be helpful if Article 1, 8º, of the draft decree also defined "market member" as an "intermediary that belongs to one of the categories of intermediaries referred to in Article 3".

5. The ECB notes that the third paragraph of Article 3, §1 of the draft decree specifies that the "quality of member is acquired either as a matter of law, or by a simple notification to the Committee or by a Committee decision taken pursuant to a request to obtain the quality of market member". Although the draft decree sets out how membership is acquired as a matter of law (see Article 3, §2, of the draft decree), it defines neither the difference between the two other means of acquiring membership nor the categories of qualified intermediaries to which these two means apply. The ECB notes in this respect that Article 2bis of the Royal Decree of 22 December 1995 on the organisation of the secondary off-exchange market for linear bonds, strips and treasury certificates ("the Royal Decree of 22 December 1995"), which the draft decree is intended to replace, also contains three similar options for acquiring membership. However, it explicitly mentions which intermediaries fall under each of them. It is proposed that the draft decree should also state which categories of qualified intermediaries (other than those mentioned in Article 3, §2, of the draft, who are members as a matter of law) may become members by simple notification or by Committee decision pursuant to a request for membership. The ECB suggests that the ECB and the other central banks of the Member States of the European Economic Area, which are listed in Article 2, 10º, h), of the Law, are categorised as qualified intermediaries who may become members by simple notification to the Committee.

6. The ECB notes that Article 4 of the draft decree specifically deals with the issue of market makers, who are in charge of contributing to the liquidity of the market (the ECB would point out that the Dutch version of the draft refers to "verhogen van de liquiditeit" ("increasing the liquidity"). The ECB also notes that this Article is drafted along the lines of Article 8 of the Royal Decree of 22 December 1995. However, in contrast to Article 8 of the Royal Decree of 22 December 1995, Article 4 of the draft decree refers to "primary dealers" without further specification. Therefore, the following proposed clarification to Article 4 of the draft decree could usefully be added: "The Minister of Finance shall establish, as necessary, organised bodies of market makers who are in charge of increasing the liquidity of the market, called 'Primary Dealers'. (…) Through the signing of the terms and conditions by the Primary Dealers a contractual relationship arises between them and the Belgian State and the Primary Dealers automatically become market members". The ECB further notes that on international financial markets the terms "market makers" and "primary

dealers" have different meanings and refer to different functions. The term "primary dealers" refers to credit institutions formally chosen by the issuer (the Treasury Ministry) on the basis of the fact that they guarantee regular participation in the primary market and ensure liquidity on the secondary market. In contrast, the term "market maker" is understood as meaning dealers who decide to be active on the secondary market and thus ensure its liquidity. The ECB understands that primary dealers in Belgian government securities also usually have to perform functions on both the primary and the secondary market. Due to their role on the secondary market, Belgian primary dealers are, thus, also market makers. However, given the conceptual difference between the two terms, they should not be used as synonyms in the text of the Decree. Therefore, Article 4 and Article 3, §2, 6º, of the draft decree should be clarified on this point. Finally, the ECB notes that Article 3, §2, 6º, of the draft decree mentions that "Primary Dealers" are market members as a matter of law. The first paragraph of Article 3, §1 of the draft decree provides in this respect that only "qualified intermediaries" as referred to in Article 2, 10º, of the Law (with the exception of the entities referred to in Article 2, 10º, g) and i), of the Law) may be market members. However, Article 2, 10º, of the Law does not refer to "Primary Dealers". It would therefore be good if the draft decree stated that "Primary Dealers" should be regarded as "qualified intermediaries" within the meaning of the first paragraph of Article 3, §1 of the draft decree.

7. The ECB notes that, according to the second paragraph of Article 5 of the draft decree, the Securities Regulation Fund ("RF"), which is both the market organiser and supervisory authority under the draft decree, will establish the market rules for the off-exchange market. The ECB notes and welcomes in this respect the fact that the penultimate paragraph of Article 5 of the draft decree provides that specific market rules may be established for, amongst other things, operations by or on behalf of the ECB or by the national central banks of the Eurosystem in the implementation of monetary policy. However, in view of the fact that the basic tasks to be carried out through the Eurosystem as listed in Article 105(2) of the Treaty are not limited to monetary policy operations, the following clarifications to the penultimate paragraph of Article 5 would be helpful: "for all operations carried out by the ECB or on behalf of the ECB by the NBB, or by other national central banks of the European System of Central Banks, in implementing their respective tasks, the market rules may differ from the general market rules." The ECB also points out that national law (e.g. rules established by the RF pursuant to the penultimate paragraph of Article 5 of the draft decree) cannot unilaterally impose obligations on the ECB and the Eurosystem with regard to operations conducted as part of their tasks. The ECB considers that the draft decree should explicitly confirm both this and the fact that "when carrying out such operations, neither the ECB nor the NBB acting on behalf of the ECB, nor the other national central banks of the European System of Central Banks shall be considered to be members of the market".

8. The ECB notes that the draft decree does not list the RF as a market member of the off-exchange market although, pursuant to the penultimate paragraph of Article 5, the RF can carry out

transactions on this market. Furthermore, although the RF primarily guarantees market liquidity on the (secondary) exchange fixing market of Euronext (Brussels) for the benefit of private investors, the legal tasks of the RF do not exclude it from intervening directly on the (secondary) off-exchange market for linear bonds, strips and treasury certificates to guarantee market liquidity for the benefit of professional investors. Indeed, according to Article 2, 1º, of the Law-Decree of 18 May 1945 on the establishment of the RF (the Law-Decree of 18 May 1945), one of the tasks of the RF is "to guarantee the liquidity of the secondary market for State securities, mainly [but not exclusively] for the benefit of persons that act on this market outside the exercise of a professional activity". Should the draft decree not intend for the RF to become a market member when it carries out transactions on the market, then, similarly to what is stated in Article 6, second paragraph, of the Ministerial Decree of 26 August 2002 on the establishment of the rules of the exchange market for bonds, the draft decree could also provide that the RF will not acquire the capacity of member of the market if it carries out transactions on that market. Such a provision would be in line with Article 14, §1, 2º, of the Law, according to which a royal decree may allow the RF to carry out transactions directly on a regulated market for government securities without becoming a market member for this purpose. The same remark would then apply to transactions carried out by the Belgian State.

9. The ECB welcomes the fact that Article 6 of the draft decree contains, for reasons of market transparency, guarantees with regard to informing the general public about the market conditions on the market (e.g. information about quotes, interest rates and trading volumes).

10. As regards the supervision and enforcement of the rules regarding the off-exchange market (see Articles 7 to 9 of the draft decree), the ECB notes that, whereas the Belgian Banking and Finance Commission (CBF) is the supervisory authority under the Law, the draft decree provides for a division of supervisory tasks between the RF and the CBF. The ECB understands that this division is permitted under Article 14, §1, 4º, of the Law and Article 2, 3º, of the Law-Decree of 18 May 1945. The ECB understands in this respect that the RF supervises, on its own behalf, compliance with the rules applicable to the off-exchange market and the market members with the exception of the rules laid down in the terms and conditions between the Belgian State and the "primary dealers" (see Article 7, §1, of the draft decree), whereas the RF supervises, on behalf of the CBF, compliance with the rules applicable to the transactions on the off-exchange market (see Article 7, §2, of the draft decree). The ECB also understands that the CBF itself is only involved in a supervisory inquiry undertaken by the RF, if the inquiry concerns rules applicable to transactions on the off-exchange market (see the first paragraph of Article 7, §4 of the draft decree), but not if the inquiry involves rules applicable to the off-exchange market and the market members since these rules are not explicitly referred to in Article 7, §4.

11. The ECB further understands that complaints regarding the rules applicable to the off-exchange market and the market members must be filed with the RF, which will carry out the inquiry on its

own behalf (see the first paragraph of Article 7, §5 of the draft decree). However, complaints regarding the rules applicable to transactions on the off-exchange market must be filed with the CBF, which will inform the RF thereof and the RF will, in principle, carry out the inquiry on behalf of the CBF (see the second paragraph of Article 7, §5). The third, fourth and fifth paragraphs of Article 7, §5 of the draft decree are thereby not entirely clear as to whether the CBF is only involved in the inquiry carried out by the RF when the RF is acting on behalf of the CBF, or also when the RF is acting on its own behalf. It could be helpful if the draft decree clarified this by including an explicit reference as is the case in Article 7, §4.

12. In general, as regards this division of supervisory tasks, the ECB notes and welcomes the fact that Article 7, §7, of the draft decree provides that the RF and the CBF will conclude a protocol to coordinate these tasks. Such a protocol will contribute to increasing the effectiveness and practicality of the division of tasks and will limit coordination issues related to the splitting up of supervisory tasks. The ECB also understands that, as a result of this division, the CBF will not be involved in supervising the rules applicable to the off-exchange market and the market members (not even within the framework of a so-called "secondary line supervision"), for which the RF shall be the sole supervisory authority. Considering that the RF is also the market organiser for the market (see the first paragraph of Article 5 of the draft decree), that the RF establishes the market rules (see the second paragraph of Article 5 of the draft decree) and that the RF itself can carry out transactions on this market (see the third paragraph of Article 5 of the draft decree), it is important to establish arrangements regarding independent control and the identification and management of the potential adverse consequences of conflicts of interest, in particular where these conflicts may arise from regulatory and supervisory functions delegated to the market organiser. The ECB welcomes in this respect the fact that decisions of the RF are subject to judicial review under Article 9 of the draft decree.

13. The ECB notes that pursuant to Article 11 of the draft decree certain enforcement provisions in the Law (regarding the appointment of a special commissioner and the levy of penalties) are not applicable to the RF as market organiser. The ECB understands that this deviation from the Law is permitted under Article 14, §1, 4º, of the Law and is justified by the public authority nature of the RF.

14. The ECB welcomes the fact that the NBB remains pursuant to Article 12 of the draft decree entrusted with the settlement of transactions in dematerialised linear bonds, strips and treasury certificates, which have been notified to its settlement system.

15. The ECB confirms that it has no objection to the competent national authorities making this opinion publicly available at their discretion. This opinion will be published on the ECB's website six months after the date of its adoption.

Done at Frankfurt am Main on 7 May 2003.

The President of the ECB

[signed]

Willem F. DUISENBERG