EUROPEAN CENTRAL BANK

**OPINION OF THE EUROPEAN CENTRAL BANK**

**of 11 July 2006**

**at the request of the Cypriot Ministry of Finance**
**on two draft regulatory decisions issued by the Cyprus Stock Exchange Council**

**(CON/2006/37)**

## Introduction and legal basis

On 24 May 2006 the European Central Bank (ECB) received a request from the Cypriot Ministry of Finance (hereinafter the 'consulting authority') for an opinion on two draft regulatory decisions issued by the Cyprus Stock Exchange Council (hereinafter jointly referred to as the 'draft decisions').

The ECB's competence to deliver an opinion is based on the fifth indent 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 decisions relate to 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 decisions

The purpose of the draft decisions is to (i) regulate the operation of the Central Depository and Central Registry (CDCR) for securities traded on the Cyprus Stock Exchange (CSE); and (ii) govern the clearing and settlement of transactions in book-entry securities in the CDCR. The draft decisions, *inter alia*, touch upon the operation of investors' securities accounts, the registration of securities with the CDCR, the trading currency for transactions in securities in the CDCR and the clearing and settlement of such transactions.

## 2. General observations

2.1 The ECB is pleased to note that the present consultation request follows the recent consultation on a draft law amending the Cyprus Securities and Stock Exchange (Central Depository and Central Securities Registry) Laws of 1996 to 2005 (hereinafter the 'Law') and appreciates that several of

1 OJ L 189, 3.7.1998, p. 42.

the recommendations made in the ECB opinion issued on that occasion[2] have been taken on board by the Cyprus Stock Exchange Council (hereinafter the 'CSE Council'). Moreover, the ECB understands that the entry into force of the draft decisions will signal a major overhaul of the operational and trading rules and regulations of the Cyprus Stock Exchange (CSE) and welcomes the opportunity to comment on the draft decisions.

2.2 The ECB also notes that upon adoption of the euro in Cyprus, the CDCR will have to be assessed against the Eurosystem standards for the use of EU securities settlement systems in ESCB credit operations (the 'Eurosystem user standards')[3]. For that reason, the ECB's comments in this opinion are without prejudice to a future assessment of the CDCR against the abovementioned standards.

## 3. Specific observations on the draft decision on clearing and settlement

*Use of the euro as a trading currency*

3.1 In ECB Opinion CON/2006/9, the ECB commented on a draft provision purporting, *inter alia*, to delegate to the CSE Council the power to designate the currency in which transactions are to be conducted in the context of the planned common trading platform between the CSE and the Athens Stock Exchange (ASE). In its opinion, the ECB invited the legislator to clarify whether the purpose of the proposed amendment was to enable the CSE Council to designate the euro as a reference unit for transactions or to institute the euro as the settlement currency for such transactions, noting that '[w]hilst the use of the euro as a trading unit of account in a common platform raises no concern, its use as a settlement currency would need to take into account that, before Cyprus adopts the euro, it qualifies in Cyprus as a foreign currency, and thus it is subject to liquidity and credit risks. This may have implications for the smooth settlement of securities transactions'[4].

3.2 Article 2 of the draft regulatory decision governing the clearing and settlement of transactions in book-entry securities in the CDCR (hereinafter the 'draft decision on clearing and settlement'), entitled 'Trading currency', *inter alia*, provides that the financial value of such transactions must be denominated in euro[5]. In this regard, the ECB draws the consulting authority's attention to its comments in ECB Opinion CON/2006/9, as cited above.

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2 ECB Opinion CON/2006/9 of 22 February 2006 at the request of the Cypriot Ministry of Finance on a draft law amending the Cyprus Securities and Stock Exchange (Central Depository and Central Securities Registry) Laws of 1996 to 2005, available on the ECB's website at www.ecb.int

3 Published in 1998, the Eurosystem user standards have been regarded as de facto common standards for EU securities settlement systems. Nevertheless, they are not intended to be a comprehensive set of standards for the oversight or supervision of securities settlement systems. The standards are available on the ECB's website at http://www.ecb.int/home/html/index.en.html.

4 Paragraph 6.1 of ECB Opinion CON/2006/9.

5 It is also noted that Article 4 of the draft decision on clearing and settlement does not specify the clearing and settlement currency.

*Settlement finality issues*

3.3 In ECB Opinion CON/2006/9, the ECB commented on a draft provision purporting, *inter alia*, to delegate to the CSE Council the power to determine settlement finality issues. On that occasion, the ECB noted that as Cyprus has implemented the Settlement Finality Directive (SFD)[6], the draft law could further clarify that settlement finality issues are governed by the national law implementing the SFD, and that it is only on technical issues (including deadlines, transfer of funds issues, etc.) that the CSE Council will enjoy decision-making powers[7].

3.4 Articles 9.2 and 9.3 of the draft decision on clearing and settlement set out rules regarding the finality of transactions. The ECB recommends that these should be supplemented by express provisions regarding the moment of entry into the system in accordance with Article 3(3) of the SFD.

3.5 The ECB reminds the consulting authority of the provisions of Cypriot law implementing the SFD[8] and draws its attention to the interaction of those provisions with Article 16.6 of the draft decision on clearing and settlement, which, *inter alia*, provides that settlement of each purchase or sale must be construed as final and irrevocable, subject solely to the facility to correct records in the CDCR, as provided for in the Law and the draft regulatory decision governing the operation of the CDCR (hereinafter the 'draft decision on the operation of the CDCR').

3.6 Article 16.4 of the draft decision on clearing and settlement sets out the modalities for the settlement of transactions on a delivery versus payment basis. The ECB recommends that this provision should be supplemented by a reference to the requirements and effects of transfers to the securities accounts referred to therein, which the ECB understands to be intended as legally effective book-entry credits, valid *erga omnes*.

*Access to the CDCR*

3.7 Article 26 of the draft decision on clearing and settlement provides that remote CSE members (i.e. members not legally established in Cyprus) may carry out the actions provided for in the draft decision on clearing and settlement through a single depository acting as the remote member's agent. The ECB notes that this provision is inconsistent with Articles 34 and 36 of the Markets in Financial Instruments Directive (hereinafter the 'MiFID')[9], pursuant to which investment firms

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6 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 (OJ L 166, 11.6.1998, p. 45).

7 Paragraph 4.1 of ECB Opinion CON/2006/9.

8 Law 8(I)/2003 on settlement finality in payment and securities settlement systems (Official Gazette of the Republic, No 3679, 31.1.2003). Also see ECB Opinion CON/2005/28 of 10 August 2005 at the request of the Central Bank of Cyprus on a draft law amending the Settlement Finality in Payment Systems and Securities Settlement Systems Law of 2003.

9 Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (OJ L 145, 30.4.2004, p. 1). Directive as amended by Directive 2006/31/EC (OJ L 114, 27.4.2006, p. 60).

from other Member States have a right of access to central counterparty, clearing and settlement systems under the same conditions as the those applying to local participants[10].

## 4. Specific observations on the draft decision on the operation of the CDCR

*Access to the CDCR*

4.1 Article 2 of the draft decision on the operation of the CDCR states that securities listed on the CSE must be registered with the CDCR. The ECB notes that this provision is inconsistent with Article 34 of the MiFID and draws the consulting authority's attention to its implications for the listing as well as for the clearing and settlement of transactions in securities listed on the CSE, including those issued by non-Cypriot issuers[11].

*Pledge of securities*

4.2 Article 32 of the draft decision on the operation of the CDCR governs the pledge of securities. In this regard, the consulting authority's attention is drawn to the the Cypriot law implementing the Financial Collateral Directive (FCD)[12], and governing pledge together with all other financial collateral arrangements[13]. The relationship between the existing provisions of Cypriot law on pledge, which implement the FCD, and those set out in the draft decision on the operation of the CDCR should be clarified. Moreover, apparent conflicts between the FCD and the draft decision should be removed, as in the case of paragraphs 3.2 and 5.1 of Article 32 of the draft decision. The former of these paragraphs prohibits the re-use of pledged assets, which is contrary to Article 5 of the FCD, while the latter contemplates a realisation with court approval, unlike Article 4 of the FCD, which does not.

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10 In this regard, the ECB also draws the consulting authority's attention to the recommendations of the Giovannini Group on 'Cross-Border Clearing and Settlement Arrangements in the European Union' of November 2001 (the 'First Giovannini Report') and the 'Second Report on EU Clearing and Settlement Arrangements' of April 2003 (the 'Second Giovannini Report'), in particular, to the Group's recommendations for the elimination of barrier 5 ('Practical impediments to remote access to national clearing and settlement systems'), according to which '[O]perators of systems should seek to ensure that access to their systems is on the basis of non-discriminatory criteria, and that where possible those accessing the system remotely are on a level footing with local members' (First Giovannini Report, p. 48, Second Giovannini Report, p. 18). The texts of the Giovannini Reports are available at http://ec.europa.eu/economy_finance/giovannini/clearing_settlement_en.htm.

11 In this regard, the ECB also draws the consulting authority's attention to the recommendations of the Giovannini Reports and, in particular, to the Group's recommendations for the elimination of barrier 9 ('National restrictions on the location of securities'), for the purposes of which '…restrictions [on the location of securities] can limit the choices for issuers when placing their securities and/or make it more complicated to hold and settle those securities in Member States other than the place of issuance' (First Giovannini Report, p. 49, Second Giovannini Report, p. 19).

12 Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements (OJ L 168, 27.6.2002, p. 43).

13 Law 43(I)/2004 on financial collateral arrangements (Official Gazette of the Republic, No 3823, 19.3.2004).

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

Done at Frankfurt am Main, 11 July 2006.

[signed]

*The President of the ECB*

Jean-Claude TRICHET