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EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 26 October 2009

on supervision by De Nederlandsche Bank of clearing and settlement services

(CON/2009/84)

Introduction and legal basis

The Dutch Ministry of Finance did not consult the ECB on an amended draft law concerning the supervision of clearing and settlement institutions (hereinafter the 'amended draft law').

The ECB's competence to be consulted on the amended draft law 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 legislation relates to De Nederlandsche Bank (DNB) and payment and settlement systems.

On 5 February 2007, the ECB received a request from the Dutch Ministry of Finance for an opinion on a draft law concerning systemic supervision of clearing and settlement institutions (hereinafter the 'draft law'). The draft law stated, *inter alia*, that it is forbidden to provide clearing and settlement services in the Netherlands without an authorisation from DNB, that DNB provides prudential supervision of the clearing and settlement institutions and that the Authority Financial Markets (AFM) performs market conduct supervision (defined as the promotion of orderly and transparent financial market processes). The ECB responded by adopting and communicating its Opinion CON/2007/7[2].

The initial draft law sent for an opinion to the Dutch Council of State did not include a separate provision on clearing and settlement institutions established in another State. It only prohibited the provision of clearing and settlement services in the Netherlands without DNB's authorisation for that purpose. This prohibition applied to clearing and settlement institutions whether established in the Netherlands or another State, whereby no distinction was made between other Member States and third countries. As regards clearing and settlement institutions established in another State, no distinction was made between conducting business from a branch situated in the Netherlands and providing services to the Netherlands. Hence the prohibition against unauthorised provision of clearing and settlement services applied to all these situations.

At the advice of the Dutch Council of State (Raad van State), the Ministry of Finance has subsequently amended, in particular, the cross-border aspects of the draft law as regards the authorisation obligations

1 OJ L 189, 3.7.1998, p. 42.

2 All ECB opinions are available on the ECB's website at www.ecb.europa.eu.

and requirements for providing clearing and settlement services to participants with whom the party providing the services is not affiliated in a group for the following cases:

- for clearing and settlement institutions established in the Netherlands intending to provide clearing and settlement services to participants,
- for clearing and settlement institutions established outside the Netherlands intending to provide clearing and settlement services to participants from a branch situated in the Netherlands,
- for clearing and settlement institutions established in a designated State intending to provide clearing and settlement services in the Netherlands to participants from a branch situated in the Netherlands who must notify DNB,
- for clearing and settlement institutions established in a non-designated State intending to provide clearing and settlement services in the Netherlands to participants by providing services to the Netherlands,
- for clearing and settlement institutions established in the Netherlands which have an authorisation as referred to in Section 2:3.0a of the amended draft law and intending to provide clearing and settlement services from a branch situated outside the Netherlands to participants; these clearing and settlement institutions require prior approval.

This amendment to the scope of the draft law does not differentiate between clearing and settlement institutions located in and outside the euro area.

The amendments to the authorisation obligation and requirements for clearing and settlement institutions are substantive changes which the Ministry of Finance should have submitted for consultation to the ECB.

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. Current situation and purpose of the amended draft law

1.1 Under the legislation in force, oversight of clearing and settlement institutions covers the promotion of the smooth operation of payment systems, the prevention of systemic risk, overseeing safety, reliability and efficiency of systems and products, maintaining consumers' confidence and targeting (parts) of infrastructure providers. Within this oversight environment, DNB is competent for prudential aspects and the Authority Financial Markets (AFM) for market conduct aspects.

1.2 The ECB understands that the legislative changes contained in the amended draft law introduce the supervisory framework and are justified on page 5 of the Explanatory Memorandum to the amended draft law. Nevertheless, the ECB stresses that the changes in the supervisory framework must not prejudice the Eurosystem's competences, in particular in relation to oversight.

1.3 The intended purpose of the amended draft law is to introduce direct supervision of clearing and settlement institutions to strengthen and complement the existing oversight framework. By introducing direct supervision, the legislator aims to promote the solidity and continuity of clearing

2. General observations

The draft law is intended to establish a consistent legal framework for the supervision of clearing and settlement institutions providing clearing and settlement services in and to the Netherlands to promote the reliability and stability of the market. The ECB notes the proposed introduction of direct supervision of clearing and settlement services to be conducted by DNB and views this as a means to complement and strengthen DNB's oversight role. With a view to implementing the core tasks of the European System of Central European Banks (ESCB) under the Treaty and the Statute of the European System of Central Banks and of the European Central Bank (hereinafter the 'Statute of the ESCB'), the ECB has serious concerns relating to the proposed authorisation requirements for clearing and settlement institutions. Although the enforcement of the Eurosystem location policy is not the aim of the draft law, the ECB would like to point out that the way in which the authorisation requirements are set out may adversely affect the location policy of the Governing Council for infrastructures offering services in euro.

3. Location of infrastructures

3.1 *The Governing Council's location policy*

3.1.1 The location policy has been publicly expressed on a number of occasions since the ECB's establishment. Already in November 1998, the first policy statement[3] was made in which it was stressed, *inter alia*, that 'As is the case with every central bank, the ECB has a direct interest in the prudent design and management of any payment and settlement system processing its own currency, the euro. Indeed, the smooth functioning of payment and settlement systems is a crucial aspect of a sound currency and essential to the conduct of monetary policy. These systems also have a significant bearing on the functioning of financial markets. Changes in payment systems may cause unpredictable shifts in the demand for, or supply of, base money. Moreover, safe and efficient payment systems are critical to the maintenance of banking and financial stability. Against this background, … the Governing Council of the ECB wishes to underline that, as in any other

3 See 'Policy statement on euro payment and settlement systems located outside the euro area', available on the ECB's website.

monetary system, central bank money in euro can only be provided by the central banks that belong to the euro area.'

3.1.2 The November 1998 statement was followed up by another policy statement in September 2001 relating to central counterparty clearing[4]. Section 2(b) of this statement stated, *inter alia*, that the 'logical geographical scope of a market infrastructure is in practice the currency area', and that domestic infrastructures for the euro[5] 'should logically be located in the euro area, as is the case with core infrastructures in other monetary areas. This would be preferable from a regulatory perspective and would help the Eurosystem, as the "central bank" of the euro, to ensure the smooth functioning of payment systems, efficient monetary policy implementation and financial stability.' It also stated that the 'location of central counterparties in the euro area would facilitate the provision, when deemed necessary and appropriate, of central bank money in euro.' In this regard, point b) of the conclusions stresses that 'The natural geographical scope for any "domestic" market infrastructure (including central counterparty clearing) for securities and derivatives denominated in euro is the euro area. Given the potential systemic importance of securities clearing and settlement systems, this infrastructure should be located within the euro area.'

3.1.3 The Governing Council's location policy is expressly based on the premise that 'the ECB and the national central banks of the Eurosystem (the central banks of issue) need to retain, in any event, ultimate control over their currency, the euro. Therefore, from both a general policy and systemic risk perspective, the Eurosystem cannot, as a matter of principle, accept that payment infrastructures for euro transactions which are located outside the euro area (the home currency area) have the potential to develop into major euro payment infrastructures, particularly if this were to put at stake the Eurosystem's control over the euro'[6].

3.1.4 The Governing Council confirmed its location policy more recently in relation to central counterparties for over-the-counter derivatives in December 2008 and July 2009[7].

3.2 *Location policy and Treaty freedoms*

3.2.1 As to whether the Governing Council's location policy could be seen to pose any regulatory or legal issues related to the concept of the internal market, it is recalled that Article 14(2) of the Treaty states that the internal market comprises 'an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty'. These freedoms are further regulated in particular in Title III of the Treaty (Articles 39-60) and also apply to the Eurosystem (because Article 1.1 of the Statute of the ESCB provides that the ESCB and the ECB must perform their tasks and carry out their activities 'in

4 See 'The Eurosystem's policy line with regard to consolidation in central counterparty clearing', available on the ECB's website.

5 A domestic system is defined in the policy statement as a system 'which handles mainly or exclusively assets denominated in one currency'.

6 See paragraphs 2 and 3 of 'The Eurosystem policy principles on the location and operation of infrastructures settling euro-denominated payment transactions', published on 19 July 2007 and available on the ECB's website.

7 See 'Decisions taken by the Governing Council of the ECB (in addition to decisions setting interest rates)' for December 2008 and July 2009, available on the ECB's website.

accordance with the provisions of [the] Treaty and [the] Statute'). Furthermore, Article 3(1)(c) of the Treaty provides that the establishment of an internal market characterised by the abolition, as between Member States, of obstacles to the free movement of, *inter alia*, services and capital is one of the activities of the Community. Moreover, under Article 4(1) of the Treaty, the activities of the Member States and the Community include the adoption of an economic policy which is based, *inter alia*, on the internal market. From the foregoing, it is evident that the establishment and functioning of the internal market is one of the core activities of the Community itself.

3.2.2 The Treaty freedoms underlying the internal market must be seen in the context of the Treaty as a whole. In this respect, the ECB emphasises that the tasks of the Community are identified under Article 2 of the Treaty as being achieved 'by establishing a common market and an economic and monetary union'. Moreover, Article 4(2) of the Treaty states that 'concurrently with the foregoing' (i.e. with the adoption of an economic policy based, *inter alia*, on the internal market), the activities of the Member States and the Community include, *inter alia*, the introduction of a single currency and the definition and conduct of a single monetary policy, the primary objective of which is 'to maintain price stability and, without prejudice to this objective, to support the general economic policies in the Community, in accordance with the principle of an open market economy with free competition'.

3.2.3 The Eurosystem's tasks relating to monetary policy, payment systems and financial stability are inextricably linked to the Governing Council's abovementioned statement in July 2007 that the Eurosystem central banks 'need to retain, in any event, ultimate control over their currency, the euro'. While the Eurosystem generally has to comply with the Treaty freedoms and, in particular, has to consider their implications if it wishes to make use of its regulatory power to ensure efficient and sound clearing and payment systems, this does not mean that the ECB may not impose measures that would have an impact on the Treaty freedoms, if such measures are strictly warranted in order to perform the Eurosystem's basic tasks. In this respect, the ECB considers that it is highly significant that, under the Treaty, the Eurosystem's monetary policy, financial stability and oversight tasks only apply to those Member States that have adopted the euro.

3.3 *Location policy and oversight of clearing and settlement systems*

3.3.1 In order to perform its core tasks, the Eurosystem needs to ensure the safety and efficiency of systems processing the euro. In the case of an infrastructure located outside the euro area, the Eurosystem's ability to oversee these systems and to detect risks that could jeopardise the performance of its abovementioned core tasks at an early stage is undermined due to a mismatch between public responsibilities and public powers. For instance, as highlighted by the 'Eurosystem Oversight Policy Framework' of February 2009[8], cooperative oversight arrangements at international level can mitigate the loss of direct influence to some extent, but cannot ensure the same level of influence of the issuing central bank as direct oversight, especially in a crisis situation, where access to timely information by the issuing central bank may not be possible.

8 Available on the ECB's website.

3.3.2 Consequently, if such risks are not identified and addressed at an early stage, the malfunctioning of infrastructures located outside the euro area processing the euro could lead to spill-over effects to infrastructures within the euro area. Direct Eurosystem oversight, which is possible provided that infrastructures are located in the euro area, is key to ensuring the safety and efficiency of infrastructures processing the euro and thus to maintaining ultimate control over the euro.

3.3.3 It is appreciated that the requirements that need to be met to obtain an authorisation to provide clearing and settlement services in or to the Netherlands will ensure that the clearing and settlement institutions do not constitute a risk to the investors' interests and to financial stability in general. DNB grants the authorisation. These requirements are to ensure the safety and efficiency of the systems in question.

3.3.4 Furthermore, under the draft law an authorisation is required to provide clearing and settlement services in the Netherlands to participants with whom the clearing and settlement institution is not affiliated in a group by providing these services to the Netherlands. This does not prevent these services from being provided from outside the euro area, including through a branch outside the Netherlands. Considering that clearing and settlement institutions are vital in ensuring and promoting the stability of the financial system, the ECB considers that the Eurosystem's direct oversight over infrastructures processing transactions in euro is crucial and that the need for this is also more necessary as the draft law does not directly address crisis management.

3.3.5 Consequently, the ECB is of the view that the possibility for clearing and settlement institutions not located in the euro area to provide services processing the euro, without requiring the Eurosystem to have sufficient means to ensure their safety, has the potential of undermining the Eurosystem's control over the euro and the proper performance of its core tasks.

3.3.6 Finally, the ECB reiterates its advice in Opinion CON/2007/7, and also in Opinion CON/2006/20, according to which oversight over payment systems, including market conduct, should be explicitly assigned to DNB in accordance with Article 105(2) of the Treaty and Article 22 of the ESCB Statute.

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

Done at Frankfurt am Main, 26 October 2009.

[signed]

The President of the ECB

Jean-Claude TRICHET