



BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

CENTRAL BANK OF MALTA

DIRECTIVE NO 2

in terms of the

CENTRAL BANK OF MALTA ACT
(CAP. 204)

PAYMENT AND SECURITIES SETTLEMENT SYSTEMS

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Issued on 31 October 2002

Amended on: 15 April 2003, 31 October 2003, 19 January 2004, 31 May 2004, 12 October 2005, 13 October 2008, 7 October 2010 and 1 January 2012

INTRODUCTION

1. In terms of article 34(5) of the Central Bank of Malta Act (*Cap. 204*) (hereinafter referred to as “the Act”), the Central Bank of Malta (hereinafter referred to as “the Bank”) has been empowered to make directives in respect of, *inter alia*, payments and security settlement systems. For the purposes of this Directive, terms used in this Directive shall have the same meaning as is assigned to them under the Act.
2. This Directive seeks to reduce the legal and systemic risks associated with participation in payment systems and securities settlement systems, and aims to minimise the disruption to a system caused by insolvency proceedings against a participant in that system.
3. This Directive limits the applicability of article 34 (6) of the Act to those payment systems which by virtue of paragraph (5) hereunder are deemed to be payment systems falling within the scope of this Directive.
4. The Directive is modelled on the requisites of the Directive 98/26/EC on settlement finality in payment and securities settlement systems as amended by Directives 2009/44/EC and 2010/78/EU.

SCOPE AND APPLICATION

5. This Directive applies to the operation of, and the participation in, domestic payment and securities settlement systems as well as any form of cash or security transactions, whether domestic or cross-border, that may be involved therein.

Provided that, for the purposes of this Directive, a payment system shall be deemed to be a payment system falling within the scope of this Directive if it is listed in Annex I attached to this Directive. Any such system shall be notified to ESMA in accordance with Directive 98/26/EC as amended by Directive 2010/78/EU. ESMA shall also be notified that the Bank is the competent authority for the purposes of that Directive.

6. (1) The competent authorities shall cooperate with ESMA for the purposes of Directive 98/26/EC as amended by Directive 2010/78/EU, in accordance with Regulation (EU) No 1095/2010.

(2) The competent authorities shall provide, without delay, ESMA with all the information necessary to carry out its duties, in accordance with Article 35 of Regulation (EU) No 1095/2010.

DEFINITIONS

7. In this Directive, unless the context otherwise requires:

“business day” covers both day and night-time settlements and shall encompass all events happening during the business cycle of a system;

“central counterparty” means an entity which is interposed between institutions in a system and which acts as the exclusive counterparty of these institutions with regard to their transfer orders;

“clearing house” means an entity responsible for, or an arrangement providing for, the calculation of the net positions of participants in a system;

“credit institution” has the same meaning assigned to the term in the Banking Act (*Cap. 371*), and includes equivalent institutions licensed by the competent authority of a Member State or an EEA State;

“collateral security” shall mean all realisable assets, including without limitations, financial collateral referred to in regulation 3(a) of the Financial Collateral Arrangements Regulations, 2004 (*LN 177 of 2004*) provided under a pledge (including money provided under a pledge), a repurchase or similar agreement, or otherwise, for the purpose of securing rights and obligations potentially arising in connection with a system, or provided to the Bank;

“EEA State” means a State which is a contracting party to the agreement on the European Economic Area signed at Oporto on 2nd May, 1992 as amended by the Protocol signed at Brussels on 17th March, 1993 and as amended from time to time;

“European Union” means the European Union referred to in the Treaty;

“European Securities and Markets Authority” (ESMA) means the Authority established under Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority);

“European Systemic Risk Board” (ESRB) means the Board established under Regulation (EU) No 1092/2010 of the European Parliament and the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board;

“financial institution” has the same meaning assigned to the term in the Financial Institutions Act (*Cap. 376*), and includes equivalent institutions licensed by the competent authority of a Member State or an EEA State;

“indirect participant” means an institution, a central counterparty, a settlement agent, a clearing house or a system operator with a contractual relationship with a participant in a system executing transfer orders which enables the indirect participant to pass transfer orders through the system, provided that the indirect participant is known to the system operator;

“insolvency proceedings” means any collective measure provided for by the law applicable in Malta or any other country either to wind up the participant or to reorganise it, where such measure involves the suspending of, or imposing limitations on, transfers or payments;

“institution” means:

- a) a credit or financial institution, or an institution licensed under the Investment Services Act (*Cap. 370*) to conduct investment services (hereinafter referred to as “investment institution”), including any undertaking whose functions correspond to those of a credit, financial or investment institution, as the case may be, which is licensed or otherwise authorised under the laws of a Member State or an EEA State; or
- b) a public authority or publicly guaranteed undertaking,

which may participate in a payment and security settlement system and which is responsible for discharging the financial obligations arising from transfer orders within such system;

“interoperable systems” means two or more systems whose system operators have entered into an arrangement with one another that involves cross-system execution of transfer orders;

“Member State” means a state which is a member of the European Union;

“netting” means the conversion into one net claim or one net obligation of claims and obligations resulting from transfer orders which a participant either issues to, or receives from, one or more other participants with the result that only a net claim can be demanded or a net obligation be owed;

“participant” has the meaning given to this term in article 34(7) of the Act and, for the purposes of this Directive, shall comprise an institution, a central counterparty, a settlement agent, a clearing house or a system operator;

“payment system” or “system” has the meaning given to this term in article 34(7) of the Act and, for the purposes of this Directive, shall exclude the system operator of that system, a possible settlement agent, a possible central counterparty, a possible clearing house or a possible indirect participant. An arrangement entered into between interoperable systems shall not constitute a system;

“restrictions imposed by the Competent Authority” means any type of restrictions or impediments which the Competent Authority, nominated under the Banking Act (*Cap. 371*), the Financial Institutions Act (*Cap. 376*) and the Investment Services Act (*Cap. 370*), may impose on credit institutions, financial institutions and investment services providers as listed under the said Acts;

“securities” means all instruments referred to in Section C of Annex 1 to Directive 2004/39/EC (see indicative list in Annex II of this Directive);

“settlement agent” shall mean an entity providing to institutions and, or a central counterparty participating in systems, settlement accounts through which transfer orders

within such systems are settled and, as the case may be, extending credit to those institutions and, or central counterparties for settlement purposes;

“settlement account” means an account at the Bank, a settlement agent or a central counterparty, used to hold funds or securities and to settle transactions between participants in a system;

“system operator” means the entity or entities legally responsible for the operation of a system. A system operator may also act as a settlement agent, central counterparty or clearing house;

“transfer order” means any instruction by a participant to place at the disposal of a recipient an amount of money by means of a book entry on the accounts of a credit institution, a central counterparty, a settlement agent or a central bank, or any instruction which results in the assumption or discharge of a payment obligation as defined by the rules of the system, or any instruction by a participant to transfer the title to, or interest in, a security or securities by means of a book entry on a register, or otherwise;

“the Treaty” has the same meaning assigned to it by the European Union Act (*Cap. 460*).

NETTING AND TRANSFER ORDERS

8. (1) Any transfer order and netting entered into by a participant in a system shall be legally enforceable and binding on third parties even in the event of insolvency proceedings against a participant, and shall not be affected in any manner by the insolvency or bankruptcy of any participant nor shall it be affected by any court orders or restrictions imposed by the Competent Authority which have the effect of interrupting payment or netting of obligations, provided that transfer order was entered into the system before the moment of opening of insolvency proceedings as defined in paragraph 9. This shall apply even in the event of insolvency proceedings against a participant (in the system concerned or in an interoperable system) or against the system operator of an interoperable system which is not a participant.

(2) Where, exceptionally, a transfer order is entered into a system after the moment of opening of insolvency proceedings and is carried out within the business day, as defined by the rules of the system, during which the opening of such proceedings occurs, it shall be legally enforceable and binding on third parties only if the system operator can prove that, at the time such transfer order became irrevocable, it was neither aware, nor should have been aware, of the opening of such proceedings.

(3) In the case of interoperable systems, each system determines in its own rules the moment of entry into its system, in such a way as to ensure, to the extent possible, that the rules of all interoperable systems concerned are coordinated in this regard. Unless expressly provided for by the rules of all the systems that are party to the interoperable systems, one system’s rules on the moment of entry shall not be affected by any rules of the other systems with which it is interoperable.

9. (1) The moment of entry of a transfer order into a system shall be defined by the rules of that system.

(2) A transfer order shall not be revoked by a participant in a system, nor by a third party, from the moment determined by the rules of that system.

(3) In the case of interoperable systems, each system determines in its own rules the moment of irrevocability, in such a way as to ensure, to the extent possible, that the rules of all interoperable systems concerned are coordinated in this regard. Unless expressly provided for by the rules of all the systems that are party to the interoperable systems, one system's rules on the moment of irrevocability shall not be affected by any rules of the other systems with which it is interoperable.

INSOLVENCY PROCEEDINGS

10. (1) For the purposes of this Directive, the moment of opening of insolvency proceedings shall be the moment when the court delivers its decision ordering the winding up and dissolution, or a shareholders' voluntary winding up resolution is passed, in respect of a participant in a system.

Provided that, in the case of a credit or financial institution which participates in a system and in respect of which insolvency proceedings have been commenced upon the order of the competent authority under article 29 of the Banking Act (*Cap. 371*) and article 18 of the Financial Institutions Act (*Cap. 376*) respectively, then the moment of opening of insolvency proceedings shall be the moment when the competent authority issues an order requiring the credit or financial institution to wind up its business or to wind up its business in Malta.

(2) The expressions used in this paragraph shall have the same meaning in this Directive as is assigned to them under the Companies Act (*Cap. 386*), the Banking Act (*Cap. 371*) and the Financial Institutions Act (*Cap. 376*), respectively.

11. Without prejudice to paragraph 8, insolvency proceedings shall not have any retroactive effects on the rights and obligations of a participant arising from, or in connection with, its participation in a system before the moment of opening of such proceedings as defined in paragraph 10. This shall apply, *inter alia*, as regards the rights and obligations of a participant in an interoperable system, or of a system operator of an interoperable system which is not a participant.

12. The opening of insolvency proceedings against a participant or a system operator of an interoperable system shall not prevent funds or securities available on the settlement account of that participant from being used to fulfil that participant's obligations in the system or in an interoperable system on the business day of the opening of insolvency proceedings and such a participant's credit facility connected to the system may be used against available, existing collateral security to fulfil that participant's obligations in the system or in an interoperable system.

13. In the event of insolvency proceedings being opened against a participant in a system, the rights and obligations arising from, or in connection with, the participation of that participant shall be determined by the law governing that system.

14. (1) On the opening of insolvency proceedings against a participant, the court or, in the case of a creditors' voluntary winding up, the participant, shall without delay notify the Bank and the system of the opening of such proceedings. In the case of a winding up order under the Banking Act (*Cap. 371*) or the Financial Institutions Act (*Cap. 376*), this obligation to notify the Bank shall devolve upon the competent authority.

(2) Upon receipt of such notification, the Bank shall immediately notify the ESRB, other Member States and ESMA of the opening of insolvency proceedings against the participant in question.

COLLATERAL SECURITY

15. (1) Collateral security provided by any participant or by a third party in the name of that participant, in relation to the participant's operations within a system shall not be affected in any manner by restrictions imposed by the Competent Authority or by the insolvency or bankruptcy of that participant or any other party nor shall it form part of the proceedings relating to such participant or other party except for any excess after close out of the collateralised transactions.

(2) A participant shall not provide as collateral security in relation to its operations within a system, assets which are subject to a pledge, hypothec or any other encumbrance in favour of a third party, without obtaining the prior release or waiver from the third party.

16. (1) The rights of a system operator or of a participant to collateral security provided to them in connection with a system or any interoperable system, and the rights of the Bank and other national central banks of the Member States or the European Central Bank to collateral provided to them, shall not be affected by insolvency proceedings against:

- (a) the participant (in the system concerned or in an interoperable system);
- (b) the system operator of an interoperable system which is not a participant;
- (c) a counterparty to the Bank, national central banks of the Member States or the European Central Bank; or
- (d) any third party which provided the collateral security.

Such collateral security may be realised for the satisfaction of those rights.

(2) Where securities including rights in securities are provided as collateral security to participants, system operators or to the Bank or to other national central banks of the Member States or the European Central Bank as described in paragraph 1, and their right or that of any nominee, agent or third party acting on their behalf with respect to securities is legally recorded on a register, account or centralised deposit system located in a Member State, the determination of the rights of such entities as holders of collateral security in relation to those securities shall be governed by the law of that Member State.

17. Without prejudice to the law applicable to the creation of and rights arising from or in securities, the law of the place where the register, account or centralised depository system is located and where the right is registered shall apply to the determination of the validity and effectiveness of any encumbrances granted by means of or within such register, account or centralised depository system.

GENERAL

18. Nothing in this Directive shall be construed to prevent systems testing, before the netting takes place, whether orders that have entered the system comply with the rules of that system and allow the settlement of that system to take place.

19. This Directive shall not prejudice participants in a system, or any other party, from exercising any right or claim resulting from the underlying transaction which is available to

them at law as long as this does not result in the unwinding of netting or the revocation of the transfer order in a system.

20. The system operator shall indicate to the Bank the participants in the system, including any possible indirect participants, as well as any change in them.
21. An institution shall, on request, inform anyone with a legitimate interest of the systems in which it participates and provide information about the main rules governing the functioning of the systems.

ANNEX I

(Paragraph 5)

DESIGNATED SYSTEMICALLY IMPORTANT PAYMENT AND/OR SECURITIES SETTLEMENT SYSTEMS

- TARGET2Malta
- MaltaClear

ANNEX II

(Paragraph 7)

SECURITIES AS DEFINED IN DIRECTIVE 2004/39/EC

- (1) Transferable securities;
- (2) Money-market instruments;
- (3) Units in collective investment undertakings;
- (4) Options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities, currencies, interest rates or yields, or other derivatives instruments, financial indices or financial measures which may be settled physically or in cash;
- (5) Options, futures, swaps, forward rate agreements and any other derivative contracts relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event);
- (6) Options, futures, swaps, and any other derivative contract relating to commodities that can be physically settled provided that they are traded on a regulated market and/or an MTF;
- (7) Options, futures, swaps, forwards and any other derivative contracts relating to commodities, that can be physically settled not otherwise mentioned in C.6 and not being for commercial purposes, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are cleared and settled through recognised clearing houses or are subject to regular margin calls;
- (8) Derivative instruments for the transfer of credit risk;
- (9) Financial contracts for differences;
- (10) Options, futures, swaps, forward rate agreements and any other derivative contracts relating to climatic variables, freight rates, emission allowances or inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event), as well as any other derivative contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned in this Section, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are traded on a regulated market or an MTF, are cleared and settled through recognised clearing houses or are subject to regular margin calls.