EUROPEAN CENTRAL BANK

STRICTLY CONFIDENTIAL

THE MONEY MARKET:

LEGAL ASPECTS OF EURO AREA SHORT-TERM SECURITIES

8 February 2002

First Draft

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THE MONEY MARKET: LEGAL ASPECTS OF EURO AREA SHORT-TERM SECURITIES

1. Introduction

1.1 The money market

The present report and its annexes address legal aspects related to the short-term securities segment of the money market, particularly with regard to the legal regimes within the euro area for certificates of deposits, commercial papers and medium-term notes.

The term "money market" is generally used to refer to the wholesale market for low-risk, highly liquid, short-term debt instruments and to denote a part of the capital market that is different from the equity market and the bond market.[1] The money market differs from other financial markets in that it is typically a wholesale inter-bank market where large transactions take place. The money market provides the means through which banks and other entities in need of money can receive large amounts of funds from other banks and liquid entities. Moreover, the euro area money market plays a crucial role in the transmission of the monetary policy decisions of the European Central Bank (ECB), as described in more detail in the ECB publication on "The Monetary Policy and the ECB".[2]

> "A central bank steers short-term money market rates by signalling its monetary policy stance and by managing the liquidity situation in the money market. The central bank, as the sole issuer of banknotes and bank reserves, is the monopoly supplier of the monetary base. By virtue of its monopoly, the central bank is able to manage the liquidity situation in the money market and influence money market interest rates.
>
> As well as steering interest rates by managing liquidity, the central bank can also signal its monetary policy stance to the money market. This is usually done by changing the conditions under which the central bank is willing to enter into transactions with the money market.
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> In its operations, the central bank also aims to ensure an orderly functioning of the money market and to help banks meet their liquidity needs in a smooth and well-organised manner.

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1 For a general description of the term "money market", see M. Stigum, The Money Market, Third Edition, 1990.
2 See The Monetary Policy of the ECB, European Central Bank, 2001, in particular Chapters 2.6 and 4.

This is achieved by providing regular refinancing to the banks and facilities that allow them to deal with end-of-day balances and to cushion transitory liquidity fluctuations."[3]

Accordingly, the money market is important in allowing for large sums of money to be shifted between banks in order to ensure the availability and efficient use of liquidity where it is needed and as a means of transmission for monetary policy purposes. "A deep and integrated money market is a precondition for an efficient monetary policy, since it ensures an even distribution of central bank liquidity and a homogenous level of short-term interest rates across the single currency area."[4]

Another aspect of the money market, which is of particular relevance for any legal characterisation, is that the money market is not one market. Instead, it is rather composed of a number of different markets in respect of specific and distinct instruments used by the agents active in the money market in order to interact with one another within the above context. "The most significant segments of the money market are […] the unsecured deposit market (where credit institutions exchange short-term liquidity without the guarantee of collateral), the repo market (in which market participants exchange short-term liquidity against collateral), the swap market (in which fixed interest rate payments are exchanged for floating interest rate payments), the futures markets for short-term instruments, and the markets for short-term securities, including Treasury bills, commercial paper (CP), certificates of deposit (CDs) and other assets."[5] The purpose of the present report is not to describe the legal dimension with relation to the whole of the money market, but rather to focus on certain specific instruments traded within the segment of the money market referred to as the markets for short-term securities.

1.2 Short-term securities

It is possible to identify the short-term securities market as a segment of the money market. The instruments traded on the short-term securities market include government securities (mainly treasury bills) and securities issued by private entities, mainly commercial papers (which are short-term securities traditionally issued by non-financial corporations) and certificates of deposits (which are short-term securities issued by banks). Another, somewhat narrower, term used in relation to the short-term securities market is 'short-term paper', which can be defined as short-term securities with a maturity of up to two years issued by non-sovereigns (banks, corporations and local authorities).

In the ECB publication on "The Euro Money Market",[6] the market for short-term securities is referred to as an area where market integration can be improved. "The market for short-term securities took a further step towards integration, although some fragmentation among the euro area countries remains.

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3 The Monetary Policy of the ECB, European Central Bank, 2001, p. 59-60.
4 The Monetary Policy of the ECB, European Central Bank, 2001, p. 23.
5 The Impact of the Euro on Money and Bond Markets, ECB Occasional Paper Series, No. 1, July 2000, J. Santillan, M. Bayle and C. Thygesen, p. 11.
6 The Euro Money Market, European Central Bank, July 2001.

In some of the countries, the market is still embryonic, with few transactions that are essentially domestically oriented. This is seen by market participants as being mainly the result of infrastructure heterogeneity, such as a lack of harmonisation in the trading environment and settlement systems, as well as different legal and tax treatments."[7]

The degree of financing within the euro area through the issuance of debt securities was also addressed in the ECB publication on its monetary policy where it was stated that "[f]inancing through the issuance of debt securities is smaller in the euro area than in the United States and Japan. The amounts outstanding at the end of 2000 were 101% of GDP in the euro area, compared with 147% and 127% of GDP in the United States and Japan respectively […]. Looking at the non-financial corporate sector, the amount outstanding of debt securities issued by non-financial co-operations in the euro area was 6% of GDP at the end of 2000, while it totaled 25% and 16% of GDP in the United States and Japan respectively."[8]

Hence, there is scope for further integration and growth of the euro area market for short-term securities. In view thereof, the following text considers the legal situation in relation to three specific types of negotiable debt securities and whether the legal regimes in the Member States that have adopted the euro could be adjusted to facilitate integration. To this end, the following sections describe (i) certificates of deposit; (ii) commercial papers; and (iii) medium-term notes, and each of these securities are afforded a separate annex describing the legal rules governing the issuance, trading and settlement of transactions relative to such instruments.

1.3 Certificates of deposit

Negotiable certificates of deposits (CDs) are certificates issued by credit institutions as proof of receipt of large deposits made by corporations or other (large) investors, which have the added value compared to regular time deposits with a fixed maturity that they can be traded on a market. "Today, when large banks want to buy term deposits wholesale, they turn typically to the *deposit note* market. In this market, banks sell notes that are designed to resemble and to trade in the secondary market like a corporate note or bond, but which are in fact a bank deposit."[9] In the euro area, CDs are exclusively issued by credit institutions, including non-resident banks that can issue CDs in a particular domestic market under the European financial passport.

The situation in the various Member States of the euro area differs quite considerably with regard to the maturity of CDs, ranging from no restrictions at all or very short minimum maturity of only one day up to three years or even five years. CDs are in most Member States in book-entry form, although there are exceptions, and subject to the general rules concerning banking supervision and certain

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7 The Euro Money Market, European Central Bank, July 2001, p. 14.
8 The Monetary Policy of the ECB, European Central Bank, 2001, p. 28.
9 The Money Market, M. Stigum, Third edition, 1990, p. 54-55.

additional regulation in most Member States, including in some Member States the involvement of the national central bank (NCB).[10]

1.4 Commercial papers

The term commercial paper (CP) refers to short-term securities issued by corporates whereby "an unsecured promissory note issued for a specific amount and maturing on a specific day. All commercial paper[s] [are] negotiable, but most [of the] paper[s] sold to investors [are] held by them to maturity. Commercial paper is issued not only by industrial and manufacturing firms, but [also] by finance companies. Finance companies normally sell their paper directly to investors. Industrial firms, in contrast, typically issue their paper through dealers. Over the years, bank holding companies, municipalities and municipal authorities have joined the ranks of commercial paper issuers."[11]

Different categories of issuers of CPs exist in the euro area Member States. In most of the Member States, both corporations and financial institutions issue CPs, and in a few other Member States the issuers can be local authorities, international public institutions, as well as banks. As is the case for CDs, the lower limits on the maturity periods ranges between no limit at all or very short limits (one or two days) up and until two or three years or no limit at all. Again, with very few exceptions, CPs are generally issued in book-entry form.[12]

1.5 Medium-term notes

The emergence of a market for medium-term notes (MTNs) had its origin in the commercial paper markets whereby MTNs were initially CPs with longer maturities. Whilst the characteristic of longer maturities is true in some euro area Member States, the situation with regard to maturities differs from country to country and can in some instances be rather short. In practice, however, the minimum maturity would not be shorter than one year with the upper limit in some Member States being ten and thirty years, respectively. The possibility of longer maturities and additional features which have been added to MTNs over time, make MTNs somewhat similar to corporate bonds. One difference in some jurisdictions, however, is the characterisation of MTNs as underwritten. The general feature of MTNs as underwritten notes make them particularly useful when an issuer is looking to receive a large amount of money in a single maturity, on a given date at a given rate, rather than the continuous raising of money in different maturities. Within the euro area, the issuers of MTNs are generally the same type of institutions that may issue CDs and CPs. Whilst MTNs can be issued in book-entry form

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[10] For further details of the main features of certificates of deposit, see Annex I to the Euro Money Market, European Central Bank, July 2001.
[11] The Money Market, M. Stigum, Third edition, 1990, p. 48.
[12] For further details of the main features of commercial paper, see Annex I to the Euro Money Market, European Central Bank, July 2001.

in many of the Member States, they are in some Member States issued through physical delivery of the notes.[13]

1.6 The Money Market Contact Group and the ACI Short Term Paper Task Force

In the third quarter of 1999, the ECB's Directorate General Operations established the so-called Money Market Contact Group as an informal forum for contact between senior bankers to discuss structural and conjunctural market developments related to the money market. The Money Market Contact Group consists of senior managers representing the most important market participants in the euro area money market. Among the issues examined so far, the Money Market Contact Group has considered the insufficient level of development and integration of the euro area short-term securities market (in comparison, for example, with the United States) and why this market still has a national character. The reasons for this situation were identified as the differences of legal systems across the euro area, the lack of a single settlement system, the lack of homogeneity of the features and the terms and conditions for these securities and a limited investor demand, still segmented on a national basis.

Members of the group have put forward a set of proposals to overcome these limitations, distinguishing between a set of pragmatic actions for the short-term and some more ambitious programmes for the longer term. The set of proposed short-term actions includes the standardisation of product features, agreement on common settlement terms at the euro area level and the establishment of a euro area-wide collection of statistics. The possible long-term programmes include the establishment of a regulated market, standardisation of product documentation, the dematerialisation of the securities and the centralisation of the settlement at the euro area level

In order to find an appropriate grouping of euro area market participants outside the ECB Money Market Contact Group which could address the short-term initiatives indicated above, the Chairman of the Money Market Contact Group has written to ACI, the Financial Markets Association. As a result of this contact, a task force of market participants (the Short Term Paper Task Force) has been established by the ACI with a view to address the matter and develop the initial proposals for implementation under the auspices of market associations. The purpose of the establishment of the Short Term Paper Task Force is to take up the initiative of the ECB Money Market Contact Group and to promote the development and integration of the short term paper market in Europe, particularly within the euro area. The findings of the Task Force will be set out in a white paper to be presented to the ECB Money Market Contact Group during the course of 2002. In order to support the work of the Short Term Paper Task Force, the ECB's Directorate General Legal Services (DG-L) has initiated the preparation of the current report as a contribution to the analysis of the Task Force.

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[13] For further details of the main features of medium-term notes, see Annex I to the Euro Money Market, European Central Bank July 2001.

1.7 Legal aspects, the EFMLG and methodology

With the introduction of the euro, the previously national money markets have been integrated into a euro area money market, where a single monetary authority, the ECB (which together with the NCBs of the euro area Member States constitute the Eurosystem) conducts one single monetary policy for the whole euro area. This integration process was supported by the new central bank payment system for real-time gross settlement of funds transfers throughout the euro area, TARGET. Moreover, the two reference rates for the unsecured money market, EONIA (euro overnight index average) and EURIBOR (euro inter bank offered rate), together provide uniform price references for maturities from overnight to one year.

Whilst these developments were successful in integrating the euro area money market as a whole, the legal regimes relative to debt securities and the short-term securities market remain mainly domestic in nature. Accordingly, a review of the current legal situation with regard to short-term debt securities, such as CDs, CPs and MTNs, requires investigations of each of the various national laws in the Member States of the euro area. In addition, some of the rules governing these instruments are not of a statutory nature and it would therefore appear necessary to also consider such rules, whether they are issued as regulations authorised by statute or found in the documentation issued by market associations or used by market participants. In addition, the review of terms and conditions used by securities clearing and settlement systems for the purposes of settlement of short-term securities transactions may provide useful information with regard to the settlement process.

In order to initiate such investigation, a project team has been established within the ECB’s Financial Law Division. Within this legal project team, specific lawyers have considered the legal situation in all participating Member States in relation to a specific debt instrument under consideration. Moreover, at least one lawyer trained in the laws of a particular Member State under consideration has reviewed the legal situation in such country in relation to all the issues identified in respect of each of the three debt securities under consideration. A first draft report was prepared on the basis of these initial findings and communicated to the European Financial Markets Lawyers Group (EFMLG), a group of senior financial markets lawyers active in commercial banks in the EU and established under the auspices of the ECB. Based on this initial report, the EFMLG has elaborated the present text on the legal aspects of short-term securities with active support from the ECB Working Group of Financial Law Experts (FLEX), consisting of financial lawyers from the EU central banks.

The result of this research and work is presented in the following text and annexes. Chapter 2 contains a description of the existing EU legislation relative to short-term securities, followed by chapter 3 in the form of narrative summaries of the situation in the various Member States in respect of each of the three debt securities, CDs, CPs and MTNs. In addition, the legal provisions and rules relative to CDs, CPs and MTNs are described on a country-by-country basis in each of the three annexes. Annex I provides information on the legal situation in all euro area Member States for CDs, with Annex II addressing CPs and Annex III MTNs. Each annex covers ten areas and the national legal provisions in each of the Member States relative to each of these areas for CDs, CPs and MTNs, respectively. The ten areas covered are (1) legal basis; (2) legal definitions; (3) issuance; (4) rating; (5) investors and prospectuses; (6) trading; (7) the nature of rights; (8) procedures for clearing and settlement; (9) taxation and stamp duty; and (10) supervisory and regulatory aspects. Finally, chapter 4 if the report provides some overall conclusions with regard to the existing legal obstacles to integration. This concluding chapter also considers some legislative changes that could be proposed in support of integration and whether changes could be suggested to the legal documentation adopted by market associations or used by market participants.

2. EU legislation relative to the money market

Before considering the legal situation at the domestic level, the following remarks provide an indication of the Community law background to the current investigation of national law concerning debt securities with particular focus on the notion of "money-market instruments". This notion appears in several parts of the EU legislation, although the term does not appear to be used in a fully consistent manner.[14] Despite the inconsistent usage of the term, the various examples where this term is referred to provide an indication of the distinguishing features of money market instruments.

2.1 The Investment Services Directive

2.1.1 The current definitions

The Investment Services Directive[15] (ISD) distinguishes between the notions of "transferable securities" and "money-market instruments". The recitals of the current ISD explain that its wide definitions of transferable securities and money-market instruments are valid only for the purposes of the directive and, consequently, in no way affect the various definitions of financial instruments used in national legislation for other purposes, such as taxation. According to these recitals of the current ISD, "transferable securities" means "*those classes of securities which are normally dealt in on the capital market, such as government securities, shares in companies, negotiable securities giving the right to acquire shares by subscription or exchange, depository receipts, bonds issued as part of a*

[14] Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions, EC OJ L 126, 26 May 2000, pp. 1- 59, does not provide much information in this respect. Annex I of this directive only provides the list of activities subject to mutual recognition which includes in particular money transmission services and trading for own account or for account of customers in: (a) **money market instruments** (cheques, bills, certificates of deposit, etc.); (b) foreign exchange; (c) financial futures and options; (d) exchange and interest-rate instruments; (e) transferable securities; participation in securities issues and the provision of services related to such issues.

[15] Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field, EC OJ L 141, 11 June 1993, p 27-46.

series, index warrants and securities giving the right to acquire such bonds by subscription". "Money-market instruments" is referred to in the recitals as "*those classes of instruments which are normally dealt in on the money market such as treasury bills, certificates of deposit and commercial paper*".

In addition to the references in the recitals, Article 1(4) of the ISD provides that "transferable securities" shall mean: "*shares in companies and other securities equivalent to shares in companies; bonds and other forms of securitized debt which are negotiable on the capital market and any other securities normally dealt in giving the right to acquire any such transferable securities by subscription or exchange or giving rise to a cash settlement excluding instruments of payment*". Moreover, Article 1(5) of the ISD provides that “money-market instruments” shall be defined as "*those classes of instruments which are normally dealt in on the money market*".

2.1.2 The Commission proposals for amendments to the ISD

The ISD is currently under review by the European Commission and it is expected that the Commission will adopt a formal proposal for a directive amending the ISD in the course of 2002. In its consultation document of July 2001, the Commission suggests to introduce a new classification based on the notion of “financial instruments”, which would include transferable securities and derivative instruments as well as a combination of them, where transferable securities would cover the following products:

- Shares or certificates or depository receipts in respect of shares;
- Bonds or other debt securities whether or not convertible into shares;
- **Securities normally dealt in on the money market (CDs, euro-commercial paper);**
- Units in collective investment schemes (under the UCITS Directive) or units of other collective investment schemes); and
- Warrants or similar securities.

According to this preliminary proposal from the Commission, securities normally dealt in on the money market would become a sub-division of transferable securities within the meaning of the ISD, and included in the wider concept of financial instruments. In this respect, it is noted that the ISD does not define financial instruments by whether they are admitted to trading on a regulated market. One practical consequence of this is that investment services relating to financial instruments which are not traded on regulated markets may nevertheless be provided on a cross-border basis by authorised investment firms.

2.2 The UCITS Directive

The Council Directive 85/611/EC on the co-ordination of laws, regulations and administrative provisions relating to UCITS, as amended[16] (the UCITS Directive), provides useful definitions related to money market instruments. The UCITS Directive mirrors the structure of the current ISD in that “money market instruments” are distinguished from “transferable securities”.[17]

According to recital 4 of the UCITS Directive, money market instruments cover “*those transferable instruments which are normally not traded on regulated markets but dealt in on the money market, for example treasury and local authority bills, certificates of deposit, commercial paper, medium term notes and bankers’ acceptances*”. Money market instruments are defined in Article 1(9) of the UCITS Directive as “instruments normally dealt in on the money market which are liquid, and have a value which can be accurately determined at any time”.[18]

Taking into account market developments, it was considered desirable that the investment objective of UCITS be widened in order to permit them to invest in financial instruments, other than transferable securities, which are sufficiently liquid. Market developments have exposed a need to modernise UCITS through an extension of the list of assets in which an undertaking for collective investment may invest, such as other collective investment undertakings, **money market instruments**, deposits and financial derivative instruments.[19]

The UCITS Directive, once the amendments are implemented, will enable a unit trust or an investment company to invest in transferable securities and also in money market instruments admitted to or dealt in on a regulated market within the meaning of the ISD. It will also cover transferable securities and money market instruments admitted to official listing on a stock exchange in a non-Member State. As regards money market instruments other than those dealt in on a regulated market, the provisions of the UCITS Directive will apply if the issue or issuer of such instruments is itself regulated for the purpose of protecting investors and savings, and provided that they are issued or guaranteed by a

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16 European Parliament and Council directive amending Council directive 85/611/EEC on the co-ordination of laws, regulations and administrative provisions relating to UCITS (with regard to investments of UCITS) adopted in December 2001. It is expected that the publication in the OJ will take place in February 2002. Member States shall adopt the laws, regulations and administrative provisions necessary for them to comply with the directives 18 months after the date of publication in the OJ.

17 "Transferable securities" are defined in the amended UCITS Directive as "*shares in companies and other securities equivalent to shares in companies ("shares"); bonds and other forms of securitised debt ("debt securities"), any other negotiable securities which carry the right to carry the right to acquire any such transferable securities by subscription or exchange excluding the techniques and instruments referred to in Article 21*"

18 In its statement of reasons for its common position of 5 June 2001 (EC OJ of 23 October 2001, C297/35), the Council made the following statement. “Since money market instruments are not generally considered to be transferable securities (for instance, [the ISD] contains two separate definitions) and since the text of the [ISD] in a number of instances distinguishes between transferable securities and money market instruments, the Council has decided to introduce a separate definition of the term “money market instruments” in Article 1(9) of [the common position on the revision of the UCITS Directive above-mentioned]”

19 See in this respect AGEFI, 26 November 2001, 3 December 2001, 17 December 2001, N. Raulot: “La directive OPCVM va bouleverser les différents marchés domestiques de titres de créances à court terme.” “Le marché des papiers commerciaux constitue un enjeu de taille pour les banques et les places financières.”

public issuer (including central banks) or at least issued by specifically defined issuers where investor protection is ensured.

Article 22 of the UCITS Directive provides certain conditions and limits under which a UCITS may invest. In particular, a UCITS may invest no more than 5% of its assets in transferable securities or money market instruments issued by the same body. Member States may raise this limit to a maximum of 10%. However, the total value of the transferable securities and the money market instruments held by the UCITS in the issuing bodies in each of which it invests more than 5% of its assets must not then exceed 40% of the value of its assets. This limit may be raised to 35% if the transferable securities or money market instruments are issued or guaranteed by a Member State, by its local authorities, by a non-Member State or by a public international bodies to which one or more Member States belong.

It is noted that the European Commission, three years after the entry into force of the directive, will review the investment rules for UCITS, which will include in particular the rules applicable to money market instruments.

2.3 The proposed directive on financial collateral arrangements

The political agreement reached on 13 December 2001 by the ECOFIN Council on the proposal for a directive of the European Parliament and of the Council on financial collateral arrangements (the proposed Collateral Directive), refers to the notions of "money market" and of "money market instruments" without further specifying them.[20]

The notion of “money market instruments” is covered by the concept of “financial instruments” within the meaning of the proposed Collateral Directive. The term “financial instruments”[21] means “shares in companies and other securities equivalent to shares in companies and bonds and other forms of debt instruments if these are negotiable on the capital market, and any other securities normally dealt in giving the right to acquire any such shares, bonds or other securities by subscription, purchase or exchange or giving rise to a cash settlement (excluding instruments of payment) and including units in collective investment undertakings, **money market instruments** and claims relating to or rights in or in respect of any of the foregoing."[22]

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[20] For instance, the current recital 12 provides that: "[t]he simplification of the use of financial collateral through the limitation of administrative burdens will promote the efficiency of the cross-border operations of the European Central Bank and the National Central Banks of Member States participating in the Economic and Monetary Union, necessary for the implementation of the common monetary policy. Furthermore, the provision of limited protection of financial collateral arrangements from some rules of insolvency law will in addition support the wider aspect of the common monetary policy, where the participants in the money market balance the overall amount of liquidity in the market among themselves, by cross-border transactions backed by collateral".

[21] See Article 3(d) of the proposed Collateral Directive.

[22] Recital 18 of the proposed Collateral Directive provides that: "*It should be possible to provide cash as collateral under both title transfer and secured structures respectively protected by the recognition of netting or by the pledge of cash collateral. Cash refers only to money which is represented by a credit to an account, or similar claims on restitution of money (such as **money market** deposits), thus explicitly excluding banknotes*". Article 3 (d) defines “cash” as “money credited to an account in any currency, or similar claims on restitution of money (such as **money market** deposits)”.

2.4 ECB legal acts relative to the money market

The legal framework established by the ECB often refers to the notion of money market. For instance, the TARGET Guideline provides that: "*[t]he achievement of a single monetary policy entails the need for payment arrangements through which the monetary policy operations between NCBs and credit institutions can be effected in a timely and secure manner, and which will foster **the singleness of the money market within the euro area.***"[23] Furthermore, the recent Regulation of the European Central Bank of 22 November 2001 concerning the consolidated balance sheet of the MFI sector,[24] provides useful criteria regarding the notion of money market instruments for statistical purposes. For the purpose of defining money market funds (MMFs),[25] the Regulation provides the following:

"**money market instruments** shall mean those classes of transferable debt instruments which are normally traded on the money market (for example, certificates of deposit, commercial paper and banker's acceptances, treasury and local authority bills) **because of the following features**:

i. *liquidity,* where they can be repurchased, redeemed or sold at limited cost, in terms of low fees and narrow bid/offer spread, and with very short settlement delay; and

ii. *market depth,* where they are traded on a market which is able to absorb a large volume of transactions, with such trading of large amounts having a limited impact on their price; and

iii. *certainty in value,* where their value can be accurately determined at any time or at least once a month; and

iv. *low interest risk,* where they have a residual maturity of up to and including one year, or regular yield instruments in line with money market conditions at least every 12 months; and

v. *low credit risk.*

2.5 Concluding remarks concerning EU legislation relative to the money market

As explained above, the definitions of money market instruments used in the Community financial legislation are still far from being entirely consistent in the different directives, regulations or guidelines which refer to this notion. In addition, this legislation does not provide any indication regarding the characteristics of each category of money market instruments (CDs, CPs, etc.).

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23 Recital 4 of the Guideline of the European Central Bank of 26 April 2001 on a Trans-European Automated Real-time Gross Settlement Express Transfer system (Target) (ECB/2001/3), EC Official Journal L 140 , 24 May 2001, pp. 72 - 86. It is also noted that the ECB Guideline of 31 August 2000 on monetary policy instruments and procedures of the Eurosystem ECB/2000/7, EC OJ L310 of 11 December 2000, pp.1-82 (7.2. Institutions subject to minimum reserves) provides that "*[t]he Eurosystem's minimum reserve system primarily pursues the following monetary functions: **stabilisation of money market interest rates** […] and creation or enlargement of a structural liquidity shortage*"

24 ECB/2001/13, EC OJ L333 of 17 December 2001

25 See Annex I, Part 1, I.6 of the ECB Regulation which specifies further the conditions for low credit risk.

Despite these inconsistencies, it appears that money market instruments are usually characterised as follows:

- they are considered as “transferable instruments”[26] (or "transferable debt instruments"[27]);
- they are normally dealt in on the money market;
- they are normally not traded on regulated markets; however, the UCITS Directive envisages the existence of money market instruments admitted to or dealt in on a regulated market;
- they are liquid;
- they have a value which can be accurately determined at any time;
- they cover in particular treasury and local authority bills, certificates of deposit, commercial paper (including euro-commercial paper[28]), medium-term notes and bankers’ acceptances.

Furthermore, according to the recent Commission proposals to amend the ISD, securities normally dealt in on the money market (CDs, euro-commercial paper) may be defined as a sub-division of transferable securities within the meaning of the ISD, and would then be covered under the general regime applicable to financial instruments within the meaning of the ISD (once amended).

The above-mentioned ECB MFI Regulation has identified the following distinguishing features for "those classes of transferable debt instruments which are normally traded on the money market": liquidity, market depth, certainty in value, low interest risk, and low credit risk.

However, despite the efforts to clarify the definitions of money market instruments at the EU level, there is no indication of a wish to harmonize or approximate the legal regime applicable to such instruments within the EU. Instead, the legal rules relative to these instruments still remain mainly national in nature.

The current review of the ISD could be seen as an opportunity to consider the possibility to introduce a legal framework at the Community level applicable to these instruments with a view to increase the integration of these markets. However, such an addition would not seem to fit within the objectives of the current review. Moreover, the number of issues examined in the context of this review would render such exercise somewhat unrealistic, at least at this advanced stage of the procedure.

The UCITS Directive, as amended, will enable collective investment undertakings to invest in money market instruments. The period for national implementation of the amended UCITS Directive, until

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26 See Recital 4 of the amended UCITS directive

27 See ECB Regulation of 22 November 2001 concerning the consolidated balance sheet of the MFI sector above-mentioned

28 It might be worthwhile investigating further the peculiarities of euro-commercial paper.

mid-2003, may also provide an opportunity to adjust the national legal frameworks for short-term securities and other money market instruments in order to increase the degree of integration of the markets.

3. The legal situation in the euro area Member States

Any attempt to harmonise the legal rules applicable to short-term securities would require the prior assessment of the legal obstacles to further integration of these markets in Europe on the basis of an examination of the national legislation of the EU Member States. Annexes I - III to this report give an overview of the legal rules related to CDs, CPs and MTNs with regard to ten different areas. The ten areas covered are (1) legal basis; (2) legal definitions; (3) issuance; (4) rating; (5) investors and prospectuses; (6) trading; (7) the nature of rights; (8) procedures for clearing and settlement; (9) taxation and stamp duty; and (10) supervisory and regulatory aspects. The legal situation in euro area countries is also indicated in this chapter 3 in summary form, with the subsequent chapter 4 analysing the main obstacles to integration that flow from these different national rules.

3.1 Certificates of deposit

In a number of countries are specific laws that contain rules for CDs, or explicit definitions of what constitutes a "certificate of deposit" as laid down in Codes, Decrees or Acts dealing with securities or financial matters in general. Although CD is a money-market instrument that has been in use for some time, in the countries where specific legislation exists, it may be noted that such legislation has been enacted only relatively recently. Cases in point are Italy[29] and, to a certain extent, Belgium.[30]

In countries where no specific laws have been enacted, the existence of CDs is commonly based on general rules on contractual obligations. Certificates of debt in writing, such as promissory notes or commercial certificates of obligation, have been the object of legislation in several countries and, in the absence of specific provisions on CDs, these general rules are taken to be applicable to such instruments.

In the instances where national law contains definitions of CDs, these are typically rather general in scope and do not necessarily set out exact criteria for determining what constitutes a CD. The common features for CDs include requirements that they shall be debt instruments created for a limited period of time and, in many instances, issued by certain specified types of institutions. The legal definitions of certificates of deposit often include a reference to the duration of the time period, whereby it is qualified as "short" or "medium".

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[29] The Banca d'Italia Circular 229 of 21 April 1999, *Istruzioni di vigilanza per le banche.*
[30] Law of 22 July 1991 on treasury bills and certificates of deposit is *lex specialis* in this area.

As far as the issuance of CDs is concerned, this is an activity exclusively open to credit institutions in a majority of euro area countries. In some cases (e.g. Spain), this is the result of legal restrictions providing that only credit institutions can hold deposits from the public and that, consequently, only credit institutions can issue certificates over such deposits. In most countries, even in the absence of such statutory limitations, issuing of CDs is completely or almost completely carried out by credit institutions. There are also some countries where a minimum amount for the CD is set: the amount in question ranges from 150,000 euro (France) through 250,000 euro (Belgium) to a required minimum amount of 454,000 euro (in the Netherlands). As a general observation, it would appear that the stipulation of minimum amounts for CDs is closely correlated to the introduction of specific legislation for these instruments, as opposed to the more generic instruments created under laws on promissory notes or contractual obligations.

Rating or listing of CDs is not compulsory in any of the countries in the euro area, although the possibility to rate a certificate of deposit or to list it on a stock exchange exists in a few countries (e.g. Finland).

In most of the euro area countries, the issuer of a CD is under an obligation to provide the public with information in conjunction with the issuance of the instrument in question. Provisions on prospectuses may be found in *lex specialis* dealing with CDs, such as the Belgian Law of 22 July 1991. General rules on prospectuses for financial instruments in national law[31] may also apply directly to issuance of certificates of deposit, inclusive of the possibility of exemptions under specific circumstances. Even in those cases where no formal prospectus has to be released, issuers are generally obliged to provide the public with sufficient information to enable the potential buyers to judge the soundness of the investment.

There is a general absence of specific rules on clearing and settlement of CDs in euro area countries. If the CDs are traded in an official secondary market, the national central securities depository (CSD) may have an exclusive right to clear and settle securities traded in such a market. When such a monopoly on behalf of the national CSD does not exist, CDs are at any rate invariably eligible for clearing and settlement through the national CSD or an international central securities depository (ICSD).

Stamp duties are not levied on CDs in the euro area countries, although capital gains tax and withholding tax may apply and differ from country to country. In most countries, the national financial supervisory authorities are competent to supervise the issuing and trading of CDs. This mandate emanates from the role of the respective national supervisory authority in overseeing and ensuring the proper functioning of the financial market or from their role in supervising the issuers (when the issuers are within their scope of supervision, as is normally the case with credit institutions). For instance, Banque de France is mainly responsible for the supervision of this market in France. In one

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31 For instance, the German Prospectus Act, *Verkaufsprospektgesetz* or the Austrian Capital Markets Act.

country (Belgium), *lex specialis* in the form of a Royal Decree lays down several tasks for the central bank as supervisory authority over issuance and trading of, *inter alia*, CDs.

3.2 Commercial papers

In the field of CPs, euro area countries have very different levels of regulation. Market practices also differ from country to country.

While some countries have a specific legal basis for CPs in particular (Belgium), in some countries general securities and safe custody regulations, as well as general rules of civil law provide the legal basis for the area (Germany, Spain, Italy, the Netherlands, Finland) and in some other countries little or no legal basis exist (Greece, Luxembourg). As a consequence, CP is defined rather differently in national law provisions. In most jurisdictions, CPs are recognised as securities issued by corporates for a maturity of one year or less. In some cases, the maturity may be longer (up to three years or more) or the issuance may be limited to non-financial corporates. Public authorities may in some cases also issue CPs.

The issuance of CPs can be in dematerialised form as discount paper. In some jurisdictions, a minimum amount is set for an issue (Belgium, France), whilst in others commercial practice indicates a certain minimum amount (Germany, Finland, Spain). With the exception of Portugal, rating is common, but not compulsory. Almost all jurisdiction impose information obligations for the issuance, in many cases in the form of a duty to publish a prospectus. Under certain conditions, the issuer is exempt from this obligation in some countries (Austria, Germany, Luxembourg, the Netherlands). Prospectuses are generally required to provide all relevant economic and financial details pertaining to the issue, and must be updated (Luxembourg, Finland). Trading takes place on a regulated market or over the counter (OTC), although in some countries admission to a regulated market is usually not sought due to the short-term nature (Germany, Austria). There are no legal requirements for CPs in this respect.

In most jurisdictions general civil law governs the nature of rights. In some jurisdictions additional non-mandatory regulation covers guarantees provided for CPs (Belgium, Portugal). Clearing and settlement is also covered by general civil law, general securities and safe custody laws. In all jurisdictions CSDs can be used. Taxation varies greatly from country to country. In some jurisdictions there may be stamp duty, withholding tax or capital gains tax, or any combination of these. In general, the issuance of CPs is directly supervised by the central bank (Belgium, France, Ireland) or the designated securities supervision agency (Spain, Luxembourg, the Netherlands, Austria, Finland) or indirectly in the general supervision of the financial markets and the conduct of business of financial institutions by the competent authorities (Germany).

3.3 Medium-term notes

As a general remark, MTNs in a European context differ from CDs and CPs in that there are a number of jurisdictions where MTNs are neither defined nor provided for in the relevant laws and decrees. To a certain extent the legislation instead provides for the application of other generic terms of debt instruments. MTNs qualify as debt instruments and, as a result, there may not have been any need for a specific definition or other provision. In some cases, explicit provisions have been introduced in the laws of countries where the legislation on securities and financial instruments has undergone a legislative reform and been revised in recent years. In France, MTNs are covered by the definition of negotiable debt securities (titres de créances négociables, TCNs), and specific rules apply to this sub-category of TCNs.

It should be noted that the International Primary Markets Associations (IPMA) has elaborated Recommendations Applicable to Medium Term Note Programmes that are agreed upon by major banks which act as lead managers in the issuance of MTNs. The IPMA recommendations apply to all medium term note programmes and debt issuance programmes regardless of the terms used, where these debt instruments are to be placed in the international capital markets. The IPMA recommendations have in effect harmonised a part of the process of bond issuance, in particular dealing with the duties of the lead manager, conditions precedent fulfilled by the issuer, the form and standard clauses found in the invitations telex or the subscription agreement and the pricing supplement. IPMA Members are presumed to apply the IPMA recommendations. Other market participants make the IPMA recommendations part of the agreements by making reference to those recommendations. The IPMA recommendations apply irrespective of the law governing the terms and conditions of the MTNs. In fact, the standard practice for euro debt issuance programs governed by English or German law is that the IPMA recommendations apply.

In a number of countries, MTNs are covered by the general provisions on commercial paper or debt instruments in bearer form and, for legal purposes, are considered to represent a particular form of commercial paper with longer maturity. There are also some instances where *lex specialis* provide for instruments that display some of the characteristics of MTN's in terms of maturity criteria without any reference in the law to the concept of MTNs.[32] In one country where there is no legal definition of MTN's, it is asserted that they can be considered "atypical instruments" (Italy).

Banks, corporations and in many cases also entities in the public sector are usual issuers of MTNs. In countries where specific legislation for MTN's, or instruments akin to MTN's, is in existence (France and Portugal), the law sets out definitions of what entities may issue such instruments. Requirements may also be set out on the minimum unit value of MTN's (EUR 150,000 in France) or the minimum net assets to be held by the issuing credit institution (EUR 2.5 million in Portugal).

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[32] See the Portuguese *obrigações de caixa.*

At present, MTN's or comparable instruments under national law do not seem to be subject to any compulsory rules on rating or listing, although in most cases it is possible to rate and/or list an MTN. It is, however, quite common that national legislation lays down the requirement that a prospectus must be released in conjunction with the issuance of MTNs with the possibility of exemptions in specific cases. The prospectus must conform to certain formal requirements in some countries, whereas in other jurisdictions the law only stipulates that a minimum amount of information must be provided. There are also some countries where no such requirements at all are in place, and where MTN's consequently can be issued without any prospectuses being released.

The trading of MTN's can, in most countries, be carried out on a regulated market even if it is not mandatory that the transaction be effected in such a marketplace. It may be a requirement that certain formalities are met if the trading takes place outside a regulated market (in Spain, for instance, where such a transaction calls for the intervention of a public notary or a certified securities agent).

In the absence of specific rules on the clearing and settlement of MTN's, it would seem as if in most countries these instruments would be subject to the general rules of securities and safe custody laws and the terms and conditions of the national CSD or an ICSD, insofar as MTNs are eligible for deposit in such centres.

According to the information received so far, stamp duties are generally not levied on MTNs, although capital gains tax and withholding tax may apply and differ from country to country. In most countries the national financial supervisory authorities are competent to supervise the issuance and trading of MTNs. This mandate generally emanates from the role of the respective national supervisory authority in overseeing and ensuring the proper functioning of the financial market or from their role in supervising the issuers (when the issuers are within their scope of supervision, as is normally the case with credit institutions)[33].

4. Legal aspects related to the integration of the short-term securities market

The Short Term Paper Task Force has identified three possible ways forward with a view to promote the development of an integrated short term securities market:

- To create a new pan-European legal definition of short term European paper;
- To use an existing domestic legal framework in one country as a standard for other European countries;

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[33] Until the end of 1998, the issuance of bonds denominated in DM had to be authorised by the Deutsche Bundesbank, according to the so called anchorage principle ("Verankerungsprinzip"). The anchorage principle, which concerned the issuance of debt instruments, in particular MTNs, was abolished at the beginning of 1999 with the introduction of the euro.

- To place each domestic legal framework under a common European legal regime so that each domestic short-term paper will be treated equally in all countries.

These avenues are considered in the following (chapter 4.2), against the background of an identification of the main legal obstacles to integration (chapter 4.1). Also some alternative ways to promote integration are indicated and assessed below, including the possibility to harmonise the legal documentation for the issuance and trading of short-term securities (chapter 4.3). Finally, some concrete proposals for the achievement of a further integration of the short-term securities markets are given (chapter 4.4).

4.1 Legal obstacles to integration

4.2 Legislative changes in support of integration

4.3 Changes to the legal documentation used by market participants

4.4 Conclusion