TARGET2-Securities maximises settlement efficiency in the European securities market

Department
Payments and Settlement Systems
TARGET2-Securities – T2S for short – is the name of the Eurosystem’s harmonised centralised platform for settling securities in central bank money. Some of the main objectives of T2S include improving cross-border settlement, overcoming market fragmentation and strengthening competition.

In pursuing these objectives, it plays a role in creating an efficient, single European capital market and is entirely in keeping with other European initiatives, such as the European Code of Conduct for Clearing and Settlement and the removal of the Giovannini barriers. The harmonising effect of T2S is felt beyond the euro area because it also allows securities to be settled in currencies other than the euro.

Participation in T2S is voluntary for all CSDs. At all events, custody of securities and their associated value-added services remain in their hands. T2S should not, therefore, be viewed as a new pan-European CSD, but rather as a provider of settlement services for CSDs.

The concept of T2S is based on an integrated model that is an amalgamation of the cash leg of central bank money and securities settlement into one platform in delivery versus payment mode. It is run on the Eurosystem’s Single Shared Platform (SSP), which is already used for the TARGET2 real-time gross settlement system.

The T2S project was officially launched by the Governing Council of the European Central Bank on 17 July 2008. The Deutsche Bundesbank, Banque de France and Banca d’Italia (3CB), which were already responsible for developing and operating TARGET2, were instructed by the ECB Governing Council to develop the new service jointly with Banco de España (thus becoming 4CB) and to run it on the single shared platform. The official go-live date of T2S was 22 June 2015.
\section*{T2S functionality}

The securities accounts of all connected CSDs and the cash accounts of all participating central banks are integrated on the T2S platform. Central bank money is fed into the system on a flexible basis. In the case of euro injections, these are sourced from TARGET2 while injections of non-euro currencies are channelled via the respective central bank’s real-time gross payment system. This ensures that payments settlement and securities settlements are kept separate.

Communication with T2S is based on ISO 20022 messages. A graphical user interface (GUI) is also available. Instructions are validated and matched upon entering the T2S platform; this is followed by the simultaneous booking of central bank money and securities using sophisticated optimisation algorithms. This takes place continuously throughout the day in real time and in several settlement cycles during the night. To increase settlement efficiency, T2S also has an auto collateralisation function, which means that a transaction can be settled despite an initial lack of liquidity thanks to automatic refinancing by the central bank.
The role of a central bank in securities settlement

Particularly at the beginning of the project, the question was posed as to whether taking over settlement services is actually the role of a central bank. The Eurosystem has always responded openly to this issue, maintaining a dialogue with market players. Under the integrated model for securities settlement, either the central bank cash accounts are outsourced to the individual CSDs, or the CSDs’ securities accounts are grouped together on a central bank platform. The Eurosystem has a clear preference for the second option. Central banks pay close attention to safeguarding financial stability as an essential precondition for fulfilling the functions of the financial sector of an economy, also and not least in stress situations. Maintaining full control of their central bank cash accounts, on which both monetary policy operations are carried out and intra-day credit is provided, is essential in order to ensure that they are able to act discreetly and without any third-party involvement in times of crisis. Settlement via the central bank – an “insolvency-proof” institution – also promotes confidence and security. Consequently, any outsourcing of settlement in central bank money would be both politically undesirable and fraught with legal problems. An integration of central bank money and securities into one platform can therefore ultimately only be offered by the Eurosystem itself.

Effects of TARGET2-Securities on market players

T2S is provided by the Eurosystem for the European market. Developed and operated as a not-for-profit project, T2S was designed and is run with the explicit aim of fully covering its own costs. Any possibility of the Eurosystem displaying profit-oriented monopolistic behaviour can therefore be ruled out. On the contrary, competition among CSDs is encouraged.

Market involvement has played a major role since the project’s inception. All market players agreed that a project as complex as T2S could only be created with the constructive participation of all stakeholders. The user requirements were drawn up in close cooperation with market players, in order to cater to their needs. CSDs and their customers have been actively involved in the further development of T2S through numerous bodies.

As the platform’s owner, the Eurosystem only has a contractual relationship with the CSDs, which have therefore continued to organise their contractual relationships with their customers independently, just as before. From a legal perspective, securities accounts likewise remain in the hands of the CSDs. To date, more than 20 European CSDs have signed the T2S Framework Agreement with the Eurosystem which constitutes the contractual basis for the use of the single settlement platform. As a result, more than 99% of the settlement volume in the euro area will be handled via T2S in future.

T2S was primarily designed for settlement in euro, but it also expressly enables settlement in other currencies. Since T2S effects settlement in central bank money, the respective central bank must, of course, be willing to make its currency available to T2S. The Danish central bank, Danmarks Nationalbank, for instance, will make the Danish krone available for settlement in T2S as of autumn 2018.
Advantages and opportunities

By creating a level playing field for the settlement of securities transactions, T2S is not only a major step towards greater integration of Europe’s financial markets – it also spurs competition. Particularly in the world of cross-border securities trading, increased competition among CSDs can be expected to bring settlement costs down.

The harmonising effect of T2S is felt beyond the euro area because it also allows securities to be settled in currencies other than the euro. The Central Bank of Denmark is lined up to be the first non-euro-area central bank to make its currency, the Danish krone, available for settlement in T2S starting in the autumn of 2018.

The primary benefit of T2S is the scope it offers for optimising the management of liquidity and collateral. Participants can use a single dedicated cash account (DCA) in T2S, allowing them to run down the liquidity buffers they hold in different markets and thereby optimise their liquidity operations. Moreover, the option allowing refinancing from the central bank by means of auto-collateralisation reduces the liquidity needs of T2S users. T2S also offers individual institutions a wealth of opportunities to enhance their collateral management because it is so much easier to shift collateral between the CSDs participating in T2S, especially in cross-border terms.

Another major advantage is that T2S facilitates settlement in highly liquid and secure central bank money. This benefit, combined with real-time settlement and shorter settlement chains, minimises post-trading risk.
Development of TARGET2-Securities

T2S evolved over the course of four project phases: preparation, specification, development, and testing and migration. During phase one, the basic feasibility of T2S was investigated and the user requirements for the platform were established in collaboration with central banks, CSDs and credit institutions. In the course of phase two, these user requirements were then fed into detailed specifications. In addition to the General Specifications (GS), General Functional Specifications (GFS) and a General Technical Design (GTD) were established. These were then used for the purpose of generating detailed user-oriented specifications and concepts in the development phase. On this basis, work on development subsequently began in phase 3. Finally, before operations could start, the service was thoroughly tested in phase 4. Once these tests had been successfully completed, migration of the CSDs’ securities accounts and of central banks’ dedicated cash accounts to the SSP commenced.

CSDs and NCBs together with their markets are migrating to T2S in five waves between June 2015 and September 2017. The German CSD Clearstream Banking Frankfurt (CBF) migrated its settlement activities to the single shared platform on 6 February 2017 in the course of the fourth migration wave.

Further Information

For more information, visit www.bundesbank.de → Tasks → Payment systems
E-mail: t2s@bundesbank.de

Status: March 2017