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| From: | Mr Fabio PANETTA, Member of the Executive Board, European Central Bank (ECB) |
| date of receipt: | 21 July 2021 |
| To: | Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union |
| Subject: | Oversight of TARGET2-Securities (T2S) - Central Securities Depositories CSD Regulation (CSDR) |

Delegations will find attached a letter from the ECB regarding the subject mentioned above.

Encl.

Received on
21.07.2021

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Member of the Executive Board

Ms Mairead McGuinness
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Re: Oversight of TARGET2-Securities (T2S)

Dear Commissioner McGuinness,

In connection with the ongoing review of the Central Securities Depositories CSD Regulation (CSDR), I would like to share some considerations on a number of aspects related to the current arrangements for the oversight of TARGET2-Securities (T2S), the Eurosystem service for securities settlement in central bank money. As you may be aware, the operation and the oversight of T2S are direct responsibilities of the Eurosystem, exercised on the basis of its Treaty mandate. This letter clarifies certain aspects of the current arrangements for the oversight of T2S, including cooperation of the Eurosystem with other interested authorities. The letter also expresses the position of the Eurosystem on the proposal recently shared by the European Securities and Markets Authority (ESMA) to amend the CSDR in order to include T2S in its scope, and to ensure that the legislative framework provides for a cooperative arrangement in respect of the

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supervision of T2S, with clear roles for the participating authorities (possibly in the form of a college of supervisors)¹.

Relevant background on T2S and the T2S Cooperative Arrangement

T2S was launched by the Eurosystem to “[facilitate] post-trading integration by offering core, neutral and borderless pan-European cash and securities settlement in central bank money so that central securities depositories (CSDs) can provide their customers with harmonised and commoditised delivery-versus-payment settlement services in an integrated technical environment with cross-border capabilities. As the provision of central bank money is a core task of the Eurosystem, T2S has the nature of a public service”². With the start of T2S operations in 2015, the Eurosystem thus achieved the fundamental objective of making settlement of securities transactions in central bank money as efficient on a cross-border basis as on a domestic (national) level.

T2S is not a CSD or a securities settlement system (SSS), nor was it ever intended to be.³ It is defined as a service based on a single technical platform integrated with central bank real-time gross settlement systems⁴. However, at the time of drafting the CSDR, the T2S initiative was factored into the text of the Regulation, inter alia by including in it requirements which apply specifically to CSDs using a “common settlement infrastructure” (i.e. T2S). Such legal provisions in relation to T2S provided for in the CSDR, notably the need to coordinate finality moments in relation to both cash and securities⁵, currently underpin the safety of the settlement in T2S.

Taking into account the systemic relevance of T2S and its importance for the conduct of Eurosystem credit operations and more generally the smooth operation of payment systems, **the Eurosystem oversees T2S**, on the basis of the Treaty and the Statute of the ESCB⁶, to ensure the safety and efficiency of T2S services on a continuous basis. The European Central Bank (ECB) acts as lead overseer with the primary oversight

¹ ESMA letter to EC regarding the review of the CSDR (ESMA70-156-4519), available at: https://www.esma.europa.eu/sites/default/files/library/esma70-156-4519_letter_to_ec_-_csdr_review.pdf

² See Recital 2 of ECB Guideline 2012/473/EU of 18 July 2012 on TARGET2-Securities.

³ T2S User Requirements Document, General Principles of T2S, Principle 3: “T2S shall not involve the setting-up and operation of a CSD, but instead serves only as a technical solution for providing settlement services to CSDs.”

⁴ See Article 1(1) of ECB Guideline 2012/473/EU.

⁵ Article 48(8) of the CSDR: “Interoperable securities settlement systems and CSDs, which use a common settlement infrastructure shall establish identical moments of: (a) entry of transfer orders into the system; (b) irrevocability of transfer orders. The securities settlement systems and CSDs referred to in the first subparagraph shall use equivalent rules concerning the moment of finality of transfers of securities and cash.”

⁶ According to the fourth indent of Article 127(2) of the Treaty on the Functioning of the European Union, as mirrored in Article 3.1 of the Statute of the European System of Central Banks and the European Central Bank, one of the basic tasks to be carried out through the ESCB is “to promote the smooth operation of payment systems”.

responsibility, the Eurosystem national central banks participate in the oversight of T2S and the Governing Council is the ultimate decision-making body. A dedicated framework (the T2S Oversight Framework) was established by the Eurosystem and sets out how the conduct of all T2S oversight activities is organised so as to ensure the compliance of T2S with the relevant regulations and oversight standards, namely the CPMI-IOSCO Principles for financial market infrastructures (PFMI).⁷ The T2S Oversight Framework is comprehensive in scope and includes not only all relevant PFMI requirements applicable to CSDs and the SSSs they operate, but also requirements related to other functions performed by T2S which fall outside the remit of the CSDR, such as cash settlement aspects and specific functions performed by payment systems.⁸

Naturally, the close involvement in the oversight of T2S of all authorities with an interest in the smooth functioning of T2S services is of paramount importance to the Eurosystem. According to Responsibility E of the PFMI, in order to promote the safety and efficiency of financial market infrastructures, central banks, market regulators and other relevant authorities have the responsibility to cooperate with each other, both domestically and internationally, to strengthen oversight and supervision and to minimise any potential duplication of effort and/or regulatory burden. To this end, in 2016 the Eurosystem established⁹ the **T2S Cooperative Arrangement**, through the signature of a Memorandum of Understanding between all authorities with an interest in the smooth functioning of T2S. The signatory authorities are the Eurosystem central banks including the ECB (as the lead overseer of T2S), overseers of CSDs participating in T2S, central banks of issue for currencies settled in T2S, competent authorities for the supervision of those CSDs which have signed the T2S Framework Agreement, and ESMA (as coordinator of competent authorities for the supervision of CSDs). The authorities in the T2S Cooperative Arrangement are involved in the ongoing oversight of T2S through their participation in regular and ad hoc meetings and frequent written consultations, where they can exchange views and share information on T2S that facilitates the fulfilment of their respective mandates. In particular, the T2S Cooperative Arrangement authorities were consulted on the scope of application of PFMI to T2S before the final approval of the T2S Oversight Framework and, on an ongoing basis, they review and have the opportunity to comment on all Eurosystem oversight assessments on T2S which are shared by the ECB. As for the specific work of the T2S Cooperative Arrangement in

⁷ In line with Recital 6 of the CSDR, the CSDR follows the PFMI to ensure international convergence of the prudential requirements to which CSDs are subject.

⁸ Out of 24 principles, only six are not applicable to T2S because of their scope: (6) Margin, (10) Physical deliveries, (14) Segregation and portability, (16) Custody and investment risks, (19) Tiered participation arrangements and (24) Disclosure of market data by trade repositories. Specifically, principles (4) Credit risk, (5) Collateral and (9) Money settlements are applied to T2S exclusively from the perspective of a payment system. Principle (7) Liquidity risk is applicable from both a securities settlement perspective and a payment system perspective.

⁹ The Eurosystem actively cooperated with the supervisors of CSDs and ESMA during the project phase of T2S. In particular, the authorities jointly conducted an assessment of T2S design and monitored the migration of CSDs to T2S.

relation to the CSDR, a task force was established in early 2021 to look into a number of provisions in the CSDR and the Delegated Regulation (EU) 2017/392 related to settlement finality and interoperable links, among other things, for which CSDs' compliance is to be assessed at T2S level.

Taking stock of the six years that T2S has been in operation, the experience of the current oversight arrangement of T2S has clearly been positive. The comprehensive assessment of T2S finalised by the Eurosystem in 2019 concluded that T2S is largely compliant with the PFMI and that **T2S services are provided in a safe and efficient manner**. While shortcomings were identified in certain areas, none were assessed by the Eurosystem or the T2S Cooperative Arrangement to pose a serious risk if not addressed promptly. In response to a request from the T2S oversight function, an action plan to address all oversight findings was drawn up by the T2S operation function and its implementation progress is regularly monitored by the T2S oversight function and the T2S Cooperative Arrangement.

Eurosystem views on the ESMA proposal

Considering that the ESMA proposal was not brought to the T2S Cooperative Arrangement, and hence the Eurosystem central banks could not formally express their views on the matter, allow me to share such views with you now.

First and foremost, the Eurosystem considers that **the current arrangement for the oversight of T2S, which includes the close involvement of all authorities with an interest in the smooth functioning of T2S, is fully adequate and cannot be considered a light approach**. As mentioned above, the oversight of T2S during its six years of operation delivered good results – importantly with the acceptance/implementation of measures by the operator to address oversight recommendations issued by the Eurosystem and agreed with the T2S Cooperative Arrangement. From a Eurosystem perspective, the proposal to directly subject T2S to CSDR provisions and to include the T2S Cooperative Arrangement in the text of the CSDR does not seem to bring any additional benefits given that T2S is already subject to a comprehensive set of relevant international standards and the T2S Cooperative Arrangement already exists and operates effectively, within the legal framework that establishes the tasks and responsibilities of EU institutions or bodies and national authorities. Moreover, **the ESMA proposal is not considered to comply with the principle of proportionality**, in particular because no evidence of risks that would endanger financial stability have been identified in the current set-up so as to justify a change in the arrangements.

Second, the **ESMA proposal would require the establishment of a very complex oversight and supervision structure which would not facilitate greater efficiency in the conduct of T2S supervision/oversight as compared to today and could ultimately affect the safety of T2S**. In particular, the CSDR has insufficient scope to address all the potential risks related to the complete range of functions that T2S performs (among others those related to the provision of central bank money by the Eurosystem).

Furthermore, **the objective of the proposal may conflict with the independence of the Eurosystem** in conducting its mandate, be it as overseer or as operator of its infrastructure through which settlement in euro

central bank money is carried out. Eurosystem oversight of T2S stems from the basic Eurosystem task to promote the smooth operation of payment systems. Such competence has already been recognised in the CSDR¹⁰ and cannot be prejudiced. The practical implementation of the ESMA proposal is also called into question, given that T2S has no legal personality other than the central banks behind the provision of T2S services. Supervising T2S under the CSDR would in practice amount to directly regulating activities performed by Eurosystem central banks within their Treaty mandate. Additionally, the ad hoc reference to T2S in the ESMA proposal is at odds with the general application that EU regulations are supposed to have (Article 288 TFEU).

In conclusion, I would kindly request that the Commission takes note of the explanations provided above and that, in the context of the review of the CSDR, the Commission considers the view of the Eurosystem that:

- a) the current arrangement for the oversight of T2S, as conducted by the Eurosystem and based on internationally recognised oversight standards, is comprehensive in the scope of risks that it addresses, effective in inducing changes and corrective actions where needed and sufficiently flexible to cover the complete range of functions that T2S performs;
- b) efficient mechanisms for cooperation among authorities in relation to T2S already exist today involving all authorities with an interest in the smooth operation of T2S through the T2S Cooperative Arrangement.

Yours sincerely,



CC: Irene Tinagli, MEP, Chair of the Committee on Economic and Monetary Affairs, European Parliament
Andrej Šircelj, President of the ECOFIN Council, Council of the European Union
Jeppe Tranholm-Mikkelsen, Secretary-General of the Council of the European Union
John Berrigan, Director-General, DG Financial Stability, Financial Services and Capital Markets Union, European Commission
Anneli Tuominen, Interim Chair of the European Securities and Markets Authority

¹⁰ See Recital 8 and the CSDR provisions to which it refers.