



EUROPEAN ASSOCIATION OF CO-OPERATIVE BANKS

EUROPEAN SAVINGS AND RETAIL BANKING GROUP

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## TARGET Working Group response to the ESMA Discussion Paper – The Distributed Ledger Technology Applied to Securities Markets

The TARGET Working Group (TWG) represents the industry in discussions with the ECB/Eurosystem in respect of the TARGET 2 euro RTGS system (T2)<sup>1</sup>. We are therefore limiting our response to issues relevant to the TWG scope and to Target 2. Given the nature of our comment, we have deliberately not answered specific questions in the Discussion Paper (DP) but merely sought to ensure that our comments contain a clear rationale.

The TWG's interest arises from the fact that ultimately cash settlement takes place in central bank money (see section 32 of the DP) and it is, of course, of paramount importance that certainty of finality including protection under the relevant national implementation of the SFD applies to transactions across accounts containing central bank money. In the case of euro this means TARGET2 which is underpinned by the T2 Guideline. Although badged as a Guideline, this is actually a legally binding instrument which includes annexes forming the basis for contracts between central banks and their account holders in T2. We make no comment about non-euro currencies except for brief references to connected NCBs and their currencies.

Whilst historically CSDs have settled euro cash transactions through T2 in bulk after netting within their own books, with the advent of TARGET 2 Securities (T2S) an increasing number of cash settlements are being effected on an individual transaction basis utilising so called Dedicated Cash Accounts (DCAs) held on the T2S platform, the balances on which are considered to be central bank money. However, although DCAs are maintained on the T2S technical platform, they come within the legal perimeter of TARGET 2 and are governed by the T2 Guideline. For ease of reference, we outline below the various scenarios for entry of cash payment/transfer orders arising from securities transactions into the T2 system and their irrevocability for SFD purposes.

### CSDs settling in bulk

For the purposes of the first sentence of Article 3(1) of the Directive 98/26/EC payment orders are deemed entered into TARGET 2 at the moment that the relevant participant's PM (payments module)

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<sup>1</sup> As successor to the European users' group of the TARGET system, the Target WG (TWG) is continuing the dialogue and formal user consultation on TARGET2 (T2) with the ECB/Eurosystem and acts as counterparty for the Eurosystem and the 3CB (Deutsche Bundesbank, Banca d'Italia, Banque de France) for activities of an operational, functional, application, legal documentation and product management nature. Additionally, the TWG comments on relevant papers from other bodies such as CPMI - IOSCO.

The TWG is a European WG coordinated by the European Credit Sector Associations (EBF, ESBG, and EACB). TWG members ensure a link to the TARGET 2 National User Groups. The membership of the WG takes into account geographical and sectoral balance as well as the representation of critical players. The secretariat is held by the European Banking Federation.

account is debited. Payment orders may be revoked until they are entered into TARGET 2 in accordance with the previous sentence<sup>2</sup>.

#### Transactions settling across DCAs in T2S (current position)

For the purposes of the first sentence of Article 3(1) and Article 5 of Directive 98/26/EC and for all transactions settling on DCAs and which are subject to matching of two separate transfer orders, such transfer orders are deemed entered into TARGET 2 and are irrevocable at the moment that the relevant DCA holder's DCA is debited<sup>3</sup>.

#### Transactions settling across DCAs in T2S (proposed future arrangements not yet in force)

An agreement is to be signed between the Euro system CBs and the connected NCBs (connected NCBs are not relevant to euro but have been included for completeness), on the one hand, and all CSDs participating in T2S, on the other hand, on the exchange of information in the event of the insolvency of a participant, and the liability of each of the signatories to the agreement. Two weeks after the ECB has confirmed to all of the agreement's signatories that the procedures for the exchange of the abovementioned information have been established and approved by all parties thereto, the existing rules shall be replaced by the following:

- a) For all transactions settling on DCAs and which are subject to matching of two separate transfer orders, such transfer orders are deemed entered into TARGET 2 at the moment at which they have been declared compliant with the technical rules of T2S by the T2S platform and irrevocable at the moment the transaction has been given the status "matched" on the T2S platform; or
- b) As an exception to point (a), for transactions involving one participating CSD having a separate matching component where transfer orders are sent directly to that participating CSD to be matched in its separate matching component, transfer orders are deemed entered into TARGET 2 at the moment at which they have been declared compliant with the technical rules of T2S by that participating CSD and irrevocable from the moment the transaction has been given the status "matched" on the T2S platform. A full list of CSDs for which this point (b) applies is available on the website of the ECB<sup>4</sup>.

In summary,

- We note that section 80 of the DP paper states that the rest of the document focuses on the SFD applied to securities settlement systems and not payment systems, which fall under the scope of the EBA. However, for the reasons explained above, an increasing number of cash transfers arising directly from individual securities transactions are being settled across T2S DCAs which for legal purposes form part of a payment system, namely TARGET 2.
- We do not dispute that DLT gives rise to a number of complex issues in relation to CSDs. We make no comment on these and where bulk settlement of netted amounts occurs using one of the T2 ancillary system interfaces (ASIs), we accept that the moments of entry and irrevocability in T2 are probably outside the scope of the DP.

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<sup>2</sup> Abbreviated and slightly paraphrased version of Article 22 of Annex II to the T2 Guideline which should be consulted for the full text.

<sup>3</sup> See Article 16 of Annex IIa to the T2 Guideline for the full text

<sup>4</sup> See footnote 3

- However, the moments of entry and irrevocability of cash transfers being settled on an individual basis through T2S are subject to the T2 Guideline irrespective of the IT architecture used by the relevant CSD. Consequently, we recommend that a reference to this is added in the paper. It may also be appropriate to mention other currencies that may join T2S in future although so far as we are aware only the Danish krone is foreseen at the present time and the exact implications are unknown.

We will be happy to discuss our comments in more detail. Should you wish to discuss further, please contact Ms Denisa Mularova (e-mail [d.mularova@ebf.eu](mailto:d.mularova@ebf.eu))

Yours sincerely,

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