



Dnr 2020-01330

Summary of responses to the consultation Use of T2S for securities settlement in central bank money

May 12 2021

# T2S and securities settlement in Swedish kronor in central bank money

## **Summary of consultation responses**

#### The consultation

In February 2021, the Riksbank published the consultation "Use of T2S for securities settlement in central bank money" which was focused on taking part of the market participants' views on changes to how the Riksbank provides central bank money in Swedish kronor to its participants for the settlement of securities transactions.<sup>1</sup> Participants in the Riksbank's system for large-value payments, RIX, and other stakeholders were invited to respond to the consultation and provide their organisation's opinion on potential future changes in the area of securities and on future arrangements for securities settlement in central bank money in Swedish kronor. The Riksbank currently provides central bank money for securities settlement to only one central securities depository (CSD). But the conditions for securities settlement in Europe are changing and cross-border securities transactions are expected to increase over the next five to ten years. In the future, one, or several, additional CSDs might therefore request for access to central bank money in Swedish kronor for securities settlement. There is a need to examine how the Riksbank shall supply central bank money in Swedish kronor for securities settlement in the future and one option is via the Eurosystem's technical platform for securities settlement, TARGET2-Securities (T2S). One part of the consultation is therefore focused on taking part of the opinions of the respondents on T2S and other alternatives for the provision of central bank money for securities settlement to more than one CSD.

## **Consultation responses**

The Riksbank received 18 responses to the consultation. A summary of these is provided below.

In general, respondents expect a slow increase in competition among CSDs and a faster increase in cross-border securities transactions in the future. Harmonisation and standardisation are a driving-force and a prerequisite for cross-border activity. There is a consistent agreement in the responses that funding via the capital market will be a more important source of funding for companies and respondents also see a growing need for being able to move collateral rapidly between financial institutions and across borders. Most respondents also think that more links between CSDs will be established in the future but that this will happen slowly. Various harmonisation initiatives, in the form of, for example, standards and regulations, are facilitating this development. Settlement via links between CSDs outside T2S is considered less efficient than settlement on T2S. Interoperability between settlement platforms is considered to be supported by the harmonisation of opening hours/operating hours, cut-off times and business days.

 $<sup>^1\,</sup>https://www.riksbank.se/globalassets/media/ovrigt/remiss-t2s/consultation---on-the-use-of-t2s-for-securities-settlement-in-central-bank-money.docx$ 



Common message standards, such as ISO 20022, are also considered important for interoperability.

Respondents see increased efficiency and economies of scale as benefits of T2S, for example regarding the development driven by standards and regulatory frameworks. They also see that it will enable competition among CSDs and allow Sweden to keep up with the rest of Europe and the Eurosystem. Another benefit of T2S is that liquidity in Swedish kronor would not be fragmented if several CSDs settle in Swedish kronor. Highlighted drawbacks are mostly linked to concern about the overall costs for T2S and the CSD, both transition costs and day-to-day running costs. Another highlighted aspect is whether the influence over system development of the Swedish market and the CSD would decrease if T2S were used. A number of respondents are positive about using T2S for securities settlement in central bank money in Swedish kronor and some are negative. In addition, a few respondents are more neutral and a few others are cautious about the issue and do not communicate a clear standpoint at this stage. The latter point out that more analysis is required before a conclusion can be drawn.

Other aspects highlighted by respondents and considered important regarding how future securities settlement shall be implemented include accessibility, robustness and that the chosen settlement system should have a sound continuity solution, regardless of whether it is via a shared platform or not.

The consultation questions and an overall summary of the responses to each question can be found in the Appendix.



## **Appendix**

## General questions related to the expectations on the developments in the securities settlement landscape

#### Question 1

Please provide your organisation's views on potential future changes in the securities settlement landscape in Europe.

a) Does your organisation believe that the evolving securities settlement landscape may give rise to requests for access to central bank money for the purpose of securities settlement from new, prospective, CSDs? Does your organisation expect changes in competition among CSDs for settlement services in Swedish securities? Please elaborate below.

Most respondents consider it likely that there will be more CSDs wishing to have access to central bank money in Swedish kronor but that this will probably take time or be to a limited extent. However, others considered it less likely that new CSDs will establish themselves in Sweden, especially with the current integrated model for liquidity and securities settlement. They also see a limited interest in settling domestic securities in foreign CSDs.

Several respondents think that competition among CSDs will increase over time, but that this will not happen particularly quickly. Despite the CSD Regulation (CSDR) having improved the conditions for competition, as a result of, for example, the so-called 'passporting' feature, there is still a high degree of fragmentation among European CSDs, in part due to differences in tax legislation. The respondents think that the CSDR has not had the expected effects so far. Most respondents take the view that more links between CSDs are unlikely in the short term. Instead, it is pointed out that the conditions may change as a result of buyouts and consolidations of CSDs.

b) What are your organisation's expectations on the development of cross-border securities transactions within Europe? What are your views of the development in the European financial infrastructure for securities settlement in the coming 5 to 10 years? Please elaborate below.

In the responses to this question, many respondents point out that T2S has not led to the increase in cross-CSD settlement and links between CSDs as expected. But connectivity between CSDs and access to a larger European investor and issuer base will become increasingly important over the next 5-10 years.

Most respondents expect more harmonisation, standardisation and integration of trade as a result of, for example, the Capital Markets Union, the Eurosystem Collateral Management System (ECMS), the CSDR and its forthcoming review, as well as new tax models, will lead to more cross-border securities transactions. Another factor that may conceivably drive cross-border securities transactions is the use of new technology, such as Distributed Ledger Technology. The major obstacles



to cross-border securities trading that exist today relate partly to differences in tax legislation and differences in the handling of corporate actions. This makes cross-border securities trading complex, expensive, inefficient and thus less attractive. It also leads to high entry barriers for CSDs to establish themselves on new markets. If cross-border securities transactions can be made more cost-effective, it may prompt an increase in the handling of securities by foreign CSDs.

c) Does your organisation expect changes in companies' choices regarding form of financing (e.g. funding via the capital market or via bank loans)? Please elaborate below.

Respondents have an expectation that funding via the capital market will become an increasingly important form of funding for companies going forward, but that the growth rate will be lower in the future. Driving-forces behind the changes are considered to be both various regulations and the Capital Markets Union, respectively, and that bank loans are considered expensive, partly as a result of capital requirements for bank lending. One aspect highlighted, however, is that bank loans continue to be an important part of the funding mix, as the capital market can be difficult to access in times of stress.

d) What need for moving collateral quickly across financial institutions and across borders does your organisation anticipate in the coming 5 to 10 years? Please elaborate below.

Many respondents see an increased need for being able to move collateral quickly, efficiently and easily in the years to come, both securities and cash, partly as a result of increased international trade, growing repo trading and a greater need for real-time settlement. Certain regulatory frameworks also impose strict requirements on this. TIPS is put forth as an example of how cash collateral can be transferred in real time. Cross-border settlement via T2S is another example of how the efficient transfer of securities can be facilitated. There is also a growing interest in being able to pool collateral and it will be more important to pledge collateral for risk exposures. With more efficient processes for moving and exchanging collateral intraday, the need for a surplus can decrease, leading to more efficient handling of cash collateral. There are also different views on what effect ECMS will have on collateral management, where some consider that ECMS cannot fully address the growing needs while others believe it can have positive effects by centralising collateral management from national central banks to the Eurosystem.

Several respondents also add that it would be valuable if central banks in the Eurosystem and other central banks that use T2S were to accept Swedish kronor and Swedish securities as collateral. Cross-CSD settlement is affected by the various requirements from central banks regarding which securities can be used as collateral. A number of question also remain from a legal perspective, some of which are linked to rights in rem and enforcement.



e) In the CSDR Review, the European Commission addresses the topic of CSD links and the review, in part, is aimed at facilitating the establishment of CSD links.<sup>2</sup>
The Riksbank accepts foreign financial institutions (non-domestic credit institutions, clearing organisations, CCPs, CSDs and investment firms) as RIX participants. Thus, there are good conditions for foreign market participants to settle securities transactions in central bank money in Swedish kronor, also via a CSD that is not a Swedish CSD.<sup>3</sup>

What are your organisation's expectations on the developments and importance of CSD links in the coming 5 to 10 years? Does your organisation expect that a structure will evolve where Investor CSDs will establish links with Issuer CSDs in order to offer settlement services?<sup>4</sup> Please elaborate below.

Most respondents highlight the fact that links between CSDs have so far not been developed to the extent expected and, to the extent they have been developed, most have been established by two international CSDs (so-called (I)CSDs). The development of so few links between CSDs is considered to be due to the complexity of, for example, tax issues and corporate actions and high costs for establishing and maintaining the links. However, most seem to expect more links to be developed going forward, but at a relatively slow pace. Harmonisation through European standards in general, the Capital Markets Union, the CSDR and new tax models, as well as the Swedish market's harmonisation plan (*Coordination Forum for Swedish Post-trade Harmonisation*) are considered to be factors that may facilitate the establishment and maintenance of CSD links.

However, some respondents put forth the view that, while harmonisation can be positive for cross-border settlement, it will not necessarily provide incentive for CSDs to create the links required for cross-CSD settlement. There must be a business advantage, with sufficiently high volumes, and it must be cost-effective for CSDs if the effect is to materialise. Neither is T2S considered to have had the positive impact on links between CSDs as expected. Several respondents see that (global) custodial banks can fulfil the same, or a better, function as links between CSDs.

<sup>&</sup>lt;sup>2</sup> CSD links are arrangements that enable a CSD's participants access to securities held at another CSD. With a CSD link, the participants do not have to be a direct participant of the second CSD.

<sup>&</sup>lt;sup>3</sup> Under the condition that the CSD offers settlement of Swedish securities and has a link to an Issuer CSD, e.g. Euroclear Sweden.

<sup>&</sup>lt;sup>4</sup> An Issuer CSD is a CSD in which securities are issued (or immobilised). The issuer CSD opens accounts allowing investors (in a direct holding system) and intermediaries (including investor CSDs) to hold these securities. Investor CSD is term used in the context of CSD links. An investor CSD - or a third party acting on behalf of the investor CSD - opens an account in another CSD (the issuer CSD) so as to enable the cross-system settlement of securities transactions. Please see the <a href="MISIOSSARY">CPMI Glossary</a> for more information.



#### Question 2

Has your organisation identified business requirements for securities settlement that may call for new technical interoperability arrangements between settlement platforms or changed operating hours for the Riksbank's settlement services? Please elaborate below.

There is a consistent agreement among respondents that, above all, harmonisation of opening hours/operating hours, cut-off times and business days is needed. Harmonisation leads to cost-effectiveness, minimises risk and creates scalability, while national differences prevent efficient settlement and collateral transfer. Several respondents highlight that the Swedish market should move towards the standard set via TARGET2 and T2S. However, one participant noted that extended opening hours for the Riksbank's settlement services would result in higher resource costs.

Some respondents point out that, in addition to the problems concerning opening hours/operating hours, links between CSDs require technical interoperability, where, for example, common message standards such as ISO 20022 are of great importance. However, settlement via links between CSDs established over different platforms is not considered to be as efficient as local CSD or T2S settlement. The aspect that centralised settlement of securities can give rise to vulnerabilities is also highlighted. One respondent considers interoperability to be positive from a redundancy perspective, but possibly at a higher cost.

#### Question 3

Do you have comments on other aspects than those addressed above which you believe should be of interest for the Riksbank to consider in the context of domestic and cross-border securities settlement?

Respondents point out that, regardless of whether T2S is used or not, harmonisation with European standards is important. For example, the securities account structure differs both within the Nordics, and in relation to the rest of Europe. In addition, there are local regulations that can pose an obstacle to cross-border settlement. Some consider a holistic perspective regarding the TARGET services to be important as they are seen as being of considerable importance for the future financial infrastructure landscape in Europe.

Some respondents think that there are not necessarily clear arguments in support of the Swedish market joining T2S, as the Swedish market so far has retained its attractiveness and has well-functioning processes, even for non-domestic investors (see also the responses to Question 4). Harmonisation via the Coordination Forum's plan and full implementation of the CSDR will be important aspects in the work to simplify cross-border securities settlement, even without T2S. Other aspects highlighted are that T2S and its effect on market participants should be carefully analysed before a decision is taken. Many other things are also happening in the area of securities that may affect securities settlement and the financial market infrastructures (FMIs) that are involved in post-trade and are therefore important to bear in mind when discussing T2S. It is also important to maintain accessibility, robustness and resilience and the chosen settlement



system should have a sound continuity solution regardless of whether it is via a shared platform or not.



### Specific questions on T2S and central bank money in Swedish kronor available for settlement on T2S

#### Question 4

Below, the Riksbank asks for your organisation's input in relation to the use of T2S as a settlement platform for securities in central bank money in Swedish kronor as well as an alternative for the provision of central bank money in Swedish kronor to more than one CSD.

a) Which are the most important aspects to consider in making a decision as regards T2S as a settlement platform? Please elaborate below, both from a short-term and a long-term perspective.

A general aspect highlighted by several respondents is the need for a broad analysis among market participants, focusing on how secure and efficient securities settlement can be safeguarded, the way in which the use of T2S would benefit the Swedish market, and what changes are required in CSD processes.

As a positive aspect it is put forth that a participant with a direct connection for settlement instructions to/from T2S (a so-called Directly Connected Participant, DCP) will have standardised message handling in relation to all CSDs and central banks using T2S. This entails lower costs, both running costs and new development costs, and less risk. Using T2S enables a simplified technical set-up and infrastructure at CSDs for their other operations, which should involve lower running costs (for example for cybersecurity, development and tests). Harmonisation of the operative processes for securities settlement is seen as a positive aspect as is the possibility of using a single liquidity account for securities settlement in Swedish kronor for many securities accounts even if they are at different CSDs. Respondents also considers there to be potential for improving the settlement ratio as the settlement day on T2S is longer than it is at present. If auto-collateralisation were possible between currencies whose central banks use T2S, it is considered to be of benefit in order to improve settlement efficiency.

It is considered that T2S could create synergies, as a result of harmonisation to European standards, improved settlement efficiency and ratio and technical interoperability.

Several institutions point out that a major potential benefit of T2S would be if the Swedish krona and Swedish securities were to be accepted as collateral for credit by other central banks, whose currencies are also on T2S. In addition, some respondents consider that if T2, T2S and ECMS were to be used, there probably are positive effects concerning liquidity and collateral management.

The main negative aspects are considered to be the risk of increased costs, where there is concern that using T2S will lead to a higher total cost. For the use of T2S to be cost-effective, the current cost base of CSDs must decrease. The costs must be weighed against the benefit of using T2S. The same conditions for synergies are not considered to exist for the Swedish market as for the euro markets. An area highlighted by several respondents in the context is how the securities account structure is organised; analysis of the structure is important from an efficiency



perspective and that a large number of (active) accounts on T2S gives rise to higher messaging costs.

Influence and control are also mentioned as an important area to take into consideration, where it is important to look after Swedish interests and to ensure that there is Swedish influence in the relevant forums and groups. Neither should the use of T2S lead to limitations as regards the handling, accessibility and control of information and not lead to negative effects on efficiency, financial stability or the central bank's ability to conduct monetary policy. Another aspect highlighted is a potential concentration risk if T2S is used.

Larger participants are considered to benefit the most, especially in the short term, while smaller and medium-sized participants can benefit in the long term if they can manage securities settlement on several markets in a cost-effective way. In the longer term, there is a risk of concentration to a small number of larger CSD participants as they are considered to be the primary beneficiaries of T2S economies of scale.

b) What is your view of T2S as an option for the provision of central bank money in Swedish kronor for the purpose of settling securities transactions? Please elaborate below.

The respondents are distributed relatively evenly in three different groups. One group of institutions has a positive attitude to T2S being used to provide central bank money for securities settlement. One group considers that an in-depth analysis is required, for example within the framework of the work being done as a result of the Coordination Forum's harmonisation plan, before it is possible to adopt a position. One group has a negative attitude.

Those who have a positive attitude think that the use of T2S can guarantee a minimum level of harmonisation of the post-trade market. This creates synergy effects for the benefit of investors and creates opportunities. It is considered to be of major importance that the future settlement system is stable, secure and that it is continuously maintained and developed to be in line with applicable standards and regulatory requirements. Furthermore, the opinion was put forward that the Riksbank should not provide central bank money for securities settlement in any way other than via T2S, to avoid liquidity becoming fragmented. It is highlighted that T2S should be very favourable for market participants even from a Nordic harmonisation perspective, as Denmark already uses T2S and Finland will soon do so too. Swedish kronor on T2S would enable more CSDs to offer settlement services for Swedish securities. It would also facilitate securities settlement in Swedish kronor for participants who already use T2S. One advantage highlighted is that securities settlement in Swedish kronor would be facilitated for a larger number of investors, as an alternative to using (a chain of) custodial banks.

Those respondents who are negative to T2S say their main reason is because they do not see a clear need for T2S and because its main advantages are mostly applicable to the Euro markets. T2S is considered not to offer any further benefit from a settlement, liquidity or collateral management perspective for the Swedish market. Instead, the currently used integrated model for securities settlement enables efficient settlement of securities denominated in Swedish kronor.



Furthermore, respondents say that it is unclear what the costs would be for, for example, issuers and securities account holders if T2S is used, given that there are currently a large number of owner accounts at Swedish CSDs and T2S is designed for another type of account (nominee accounts). Neither do this group of respondents think that there are any problems on the Swedish market that justify the use of T2S.

c) Against the background that the Swedish market's harmonisation road map will lead to the market using European standards which enables the use of T2S as a settlement platform for Swedish securities, what advantages and disadvantages has your organisation identified regarding T2S? Please elaborate below.

All respondents expressed very strong support for harmonisation to European standards. One opinion expressed is that the investment in harmonised processes would be wasted if T2S is not used. Readers are also referred to the responses to Question 4 a) and b) as the responses to this question largely reflect the responses to those questions.

In addition to the benefits highlighted in earlier questions, respondents say here that some of the benefits are related to the fact that it would make it easier for Sweden to manage the adaptation to international market standards for settlement and so-called asset services. In addition, well-integrated financial infrastructure systems could enable faster and more transparent crisis management procedures. It is thought that T2S could facilitate the distribution of issued securities, both as a result of lower entry thresholds for CSDs wishing to offer settlement services in Swedish securities, and because fewer adjustments would be required for European settlement banks to conduct operations directly on the Swedish securities market.

The main disadvantage highlighted is linked to costs; there is concern over both increased running costs and greater transition costs. Some respondents express uncertainty as to whether owner accounts can be used, as they would increase costs as a result of a higher volume of message traffic. Neither is it clear what the costs would be for issuers, account holders and their agents in order to introduce a Nordic owner account model in T2S, to restructure the local CSD account and settlement model or to transfer existing owner account holders. Aspects such as a possible reduction in influence and competition are also put forth. It may also take longer time to gain access to information on incidents related to the settlement platform.

d) Which major risks have you identified that may arise if the Swedish market would not use T2S, i.e. not use the same platform that many other European countries are using? Please elaborate below.

Respondents differ in their opinion on this issue, where some participants have identified few, or no, risks of not using T2S. It is instead considered more important for the Swedish market to implement the Coordination Forum's harmonisation plan. Some of the respondents consider it too early to determine any possible risks associated with not joining T2S.

Participants who have identified risks do so within the areas of costs, the risk of non-harmonisation and business risk for the local CSD. If the Swedish market does not

<sup>&</sup>lt;sup>5</sup> In other words, administrative services for the management of rights and corporate actions for securities.



use T2S, costs for further and new development cannot be shared with other parties. For example, there has been a need for the Swedish market to make adjustments in the current VPC system (i.e. Euroclear Sweden's system) as a result of the CSDR, while other markets have been able to utilise shared development on T2S. Additional needs for new development will remain over the next five years. If T2S is not used, it could also lead to relatively higher costs for new development for Swedish CSD participants in the long-run compared to participants at CSDs connected to T2S. There may also be a risk of significantly increased infrastructure costs in comparison with the costs for Eurosystem platforms that are shared among more participants. In the longer run, this may also have an adverse effect on the attractiveness of the Swedish capital market for foreign investors, as it will be easier to manage holdings on markets other than the Swedish market.

As regards harmonisation, participants see a risk that the Swedish market will not keep up with the changes made in the rest of Europe. Differences in operational processes and operative standards could lead to higher entry thresholds on the Swedish market, which could make it less competitive from a foreign investors' perspective. It is considered important that the harmonisation of post-trade processes is promoted in order to, among other things, support a strong Nordic capital market.

Participants saying that there may be a business risk for the local CSD point out that there is a risk of Swedish securities being transferred to other CSDs further ahead and, ultimately, of issuers moving to other CSDs. In addition, the Swedish market can be marginalised by not using T2S, as it will be more difficult and less attractive for issuers and investors to use settlement systems with local characteristics. Finally, there is also considered to be a risk of markets that use T2S becoming a strong group to compete against for smaller markets, with T2S markets taking over a large share of post-trade services.

e) Would your organisation be positive to a decision to use T2S for securities settlement in central bank money in Swedish kronor? Please share below the reason(s) for your opinion.

The responses are relatively evenly divided between a positive attitude to T2S, a neutral attitude and a negative attitude. Several participants consider it to be too early to come to a decision on T2S and instead advocate for a more in-depth analysis before they do so. The opinion is that the analysis should primarily bring clarity to how future solutions should be designed at local CSDs and what the future costs might be. When deciding on the future solution, it must be ensured that the total cost does not increase. A few respondents also point out that they wish to see clearer efficiency in cross-border securities settlement on T2S, as in this aspect T2S has so far not fulfilled the objectives that were originally set up.



#### Question 5

The Riksbank has identified the outsourcing of central bank accounts to one, or several, additional CSD(s) as an alternative to T2S.

a) What advantages and disadvantages do you see with the alternative? Please elaborate below.

The benefits that are mentioned are centred on flexibility, increased competition and that it may reduce concentration risks and be easy, and cheaper than T2S, to implement. Another benefit highlighted is that it would provide the opportunity to reach other markets with the help of global custodial banks or links.

As drawbacks, respondents have above all identified that the outsourcing of central bank accounts to more CSDs would fragment liquidity and split development among several different settlement platforms. This would in turn lead to negative consequences for efficiency and entail increased costs, complexity and risks. Some respondents think that T2S is preferable to a model with outsourced accounts to more than one CSD.

One participant expresses some uncertainty as to whether there would be an interest in having access to central bank money for securities settlement via the outsourcing of accounts (in a so-called integrated model<sup>6</sup>), but thinks that there might instead be an interest in a so-called interfaced model<sup>7</sup>.

b) Is your organisation positive to the alternative of outsourcing accounts to several CSDs? Please share below the reason(s) for your opinion.

Just under half of the respondents are positive to this option and see it as a good way of providing central bank money to more than one CSD. About the same number of respondents are negative to this option as they see it as neither realistic nor efficient. There is also a few respondents who see a need for further analysis before a concrete standpoint can be adopted.

<sup>&</sup>lt;sup>6</sup> An integrated model involves securities accounts and central bank accounts being on the same platform.

<sup>&</sup>lt;sup>7</sup> An interfaced model involves securities accounts and central bank accounts being on different platforms. This means that messages must be sent between systems each time a security is to be settled to ensure that there is adequate funds for the transaction so that the payment and the security can be transferred between the parties' accounts.



#### Question 6

Has your organisation identified other options than those listed above in questions 4 and 5? Which advantages and disadvantages do you see with that option? Please elaborate below.

Only a few participants have responded to this question.

One option highlighted is to use an interfaced model, possibly as a transitional solution until a decision on a long-term solution has been taken. Another participant who has responded to the question, but not highlighted any option other than those previously identified, stresses the importance of implementing and maintaining harmonisation of post-trade processes in the event of the Swedish market not using T2S for securities settlement. An upgrade to or replacement of the existing settlement system is also highlighted as important if T2S were not to be used. A third participant maintains that T2S is the strongest option.

#### Question 7

Do you <u>have other aspects or comments</u> than those addressed in the questions above which you believe the Riksbank should consider in the context of T2S?

The small number of comments received in response to this question are focused on control, risks and influence. For example, it is mentioned that the use of infrastructure located outside Sweden could pose additional challenges as regards communication about, and coordination of, measures aimed at banks and other institutions in crisis. Another example highlighted is the Eurosystem's management of the two major incidents that occurred in 2020, which was described as inadequate.

One institution points out that the speed of development in general increases as a result of technological development and digitalisation. A decision on future platforms for securities settlement should therefore be taken based in part on an assumption about the platform's lifecycle. It is also predicted that there will be significant costs associated with the replacement of the legacy CSD system.

In addition, a few institutions summarise the standpoints submitted in responses to previous questions in the consultation.