

ELIGIBILITY CRITERIA for CSDs in T2S

In the framework of the T2S Guideline, the T2S Programme Board was asked to define eligibility criteria for a CSD in T2S. These criteria have been extensively discussed with the market during the 2nd half of 2009. They are indispensable for:

- ensuring that the legal and regulatory requirements to which CSDs in T2S are subject are sufficient to ensure that they do not pose a risk for other CSDs and their users (see criteria 1 and 2);
- preventing free-riding behaviour in T2S, which would be to the detriment of other CSDs and of the European financial markets in general. (see criteria 3, 4 and 5); and
- providing the Eurosystem with an minimum degree of confidence that the investment it makes on T2S will be recovered and it will therefore not have to subsidise T2S with public funds (see criterion 5).

In this context, the Governing Council of the ECB has adopted five CSD eligibility criteria for T2S.

The criteria are defined here at a level of the basic principles. The T2S Programme Board will need to further specify how the criteria are implemented. It will do so in the T2S Advisory Group in order to ensure the maximum transparency in the process.

Each criterion is followed by its justification and in some instances explanatory guidelines on how they will be implemented.

Meeting the criteria is a pre-condition for a CSD to join T2S and to remain in T2S. The T2S Programme Board will implement a continuous assessment of the criteria where non-fulfilment may lead to penalties to be specified contractually in the Framework Agreement between the Eurosystem and the participating CSDs.

Criterion 1: CSDs in T2S are recognised under Article 10 of the Settlement Finality Directive or, in the case of a non-EEA jurisdiction, must operate under a legal and regulatory framework equivalent to the relevant parts of the acquis communautaire.

Justification: The functioning of T2S would be seriously jeopardised if the participating CSDs would not enjoy a sufficient level of guarantee regarding finality of settlement and insolvency risk.

Criterion 2: CSDs in T2S have been positively assessed by the competent authorities against ESCB/CESR recommendations.

Justification: The criterion reflects the need for CSDs in T2S to be adequately regulated and overseen. The precise interpretation of this criterion will be discussed with regulators/overseers, submitted to the Governing Council of the ECB and communicated to market participants. If a regulator were to decide not to assess a CSD against ESCB-CESR recommendations, T2S would need to obtain comfort that it has been assessed against standards of a similar nature and level.

Criterion 3: Any CSD, which wishes to join T2S, must make each security/ISIN¹ for which it is issuer CSD (or technical issuer CSD) available to other CSDs in T2S upon request.

Justification: T2S has a strong interest to ensure that the CSDs participating in T2S open up to competition. Many market participants have mentioned the risk that some CSDs may be tempted to free ride on T2S. This would happen if a CSD used T2S to access securities issued by other CSDs, but did not make its balances available to other CSDs. The fear that some CSDs may free ride might in turn prevent other CSDs from bringing into T2S the securities they issue, in effect generating a "race to the bottom" to avoid competition.

Implementation guidelines: This criterion does not go as far as demanding that a CSD in T2S holds all its accounts and balances in T2S for every security/ISIN it issue. But it requires that if the users of another CSD in T2S (the investor CSD) wish to acquire and settle in T2S that security/ISIN, this can be done at no additional cost and without delay.

¹ An **International Securities Identification Number** (ISIN) uniquely identifies a security.

This criterion should be implemented in a more demanding way than the CSD Interoperability Guideline. In T2S CSDs will be sharing the same settlement platform, so access/interoperability by the investor CSD to the issuer CSD should be less costly/complex than it is today.

Criterion 4: A CSD in T2S commits to offer to other CSDs in T2S basic custody service on a non-discriminatory basis.

Justification: This criterion is a necessary complement to Criterion 3 above. It seeks to ensure that CSDs in T2S do not erect technical barriers when providing basic custody services (such as interest or dividend payments) to one another. It is also in line with the provisions in the Code of Conduct.

Criterion 5: A CSD in T2S commits towards other CSDs in T2S to carry out its CeBM settlement in T2S if the currency is available in T2S

Justification: This criterion requires that a CSD outsourcing its settlement to T2S effectively brings to T2S the volumes derived from DvP settlement in central bank money for the currencies that are in T2S.

The criterion acknowledges however that, when the currency is not in T2S, the CSD cannot conduct DvP settlement in central bank money in T2S. The CSD may join T2S and continue to perform DvP in its legacy platform, provided that the securities it issued are easily accessible to other T2S CSDs (see criteria 3 and 4).

This requirement is an indispensable condition for the successful introduction of T2S. As any network industry, the financial viability of T2S is dependent on network externalities generated by a “critical mass” of transactions. Without this criterion, some CSDs might join T2S with their full domestic and cross-border volumes, while other CSDs might join only with their cross-border / cross-CSD volumes. In this situation, the CSDs bringing their full volumes would be subsidising the cross-border volumes of the other CSDs. It is therefore essential that T2S is protected from such free-riding behaviour, which is detrimental to other CSDs and hinders the implementation of T2S’ main objective regarding the necessary increase of competition between CSDs.

Implementation guidelines: The implementation of the criterion should in any case continue to maintain a level playing field between direct and indirect holding markets.

Furthermore, if a CSD can make a convincing case at the T2S Advisory Group that for a very limited amount of settlement volumes it cannot comply with the criterion, but it has set the safeguards to ensure that it does not abuse the system, the Programme Board could make an explicit proposal to the Governing Council of the ECB to allow for this.