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Article
T2 Balances: A Legal Perspective

ifo DICE Report

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Suggested Citation: Athanassiou, Phoebus L. (2018) : T2 Balances: A Legal Perspective, ifo DICE Report, ISSN 2511-7823, ifo Institut – Leibniz-Institut für Wirtschaftsforschung an der Universität München, München, Vol. 16, Iss. 3, pp. 35-40

This Version is available at:
http://hdl.handle.net/10419/199036

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INTRODUCTION

European developments in the spring of 2018 have rekindled public interest in T2 balances. The debate is not new: the issue of T2 balances first came up at the height of Europe’s sovereign debt crisis, and it has resurfaced since periodically, at times of heightened tension. Critics have argued that T2 balances resemble covert transfers (loans) from the national central banks (NCBs) of the euro area core to Member States (MS) in distress, without settlement terms or collateral, and with no legal or other democratic legitimation.1

This paper explores the risks of T2 balances for the ECB and the T2-participating NCBs, and seeks to shed light on the legal parameters of the debate. The latter have largely been neglected in the extant literature, whose main focus has been on the accounting and economic aspects of T2 balances.3

T2 BALANCES: NATURE AND RISKS

Introductory Remarks

In line with its statutory task of promoting the smooth operation of payment systems in the EU, the ECB and the NCBs own and operate the ‘Trans-European Automated Real-time Gross Settlement Express Transfer System’ (T2), the second generation of the interbank payment system for the real-time settlement, in central bank money, of cross-border payments in euros. Despite its technically centralised structure, T2 is legally decentralised, with the ECB and each participating/connected NCB operating its own T2 component.

The consolidated Eurosystem balance sheet (of which T2 balances are a component) consists, on the liability side, of banknotes, and of the deposit accounts of financial counterparties with the NCBs. On the asset side, the consolidated Eurosystem balance sheet consists of gold, foreign reserves, loans to financial counterparties and debt instruments purchased by the ECB and the NCBs.

T2 balances appear on the asset side of the Eurosystem’s consolidated balance sheet, and the ECB has defined them as ‘the claims and liabilities of euro area NCBs vis-à-vis the ECB that result from cross-border payments settled in central bank money’.4 The NCBs’ T2 balances mirror the cross-border fund transfers that T2-participating commercial banks routinely engage in, either for their own operations or on account of their customers. All of those operations generate payment flows processed through T2. At the end of each business day, all of the NCBs’ intraday positions are aggregated and netted-out before being transferred to the ECB, resulting in a single intra-Eurosystem NCB position on the ECB alone, in whose books the NCBs’ positions balance-out, adding up to zero.5

Although they may resemble national balances of payments, T2 balances are mere reflections of cross border monetary policy-related or private sector capital flows within the single currency area, the accounting treatment of which mirrors the decentralised nature of T2 as a multiplicity of systems.6 Significantly, the T2 positions of the NCBs on the ECB are not constitutive of the cross-border trade imbalances they mirror, nor is it the mission of T2 to redress them (its mission is the real-time settlement of cross-border transfers in euros).

T2 Balances and their Risks

To analyse the risks, real or perceived, that T2 balances may generate for the ECB and the NCBs, it is possible to distinguish between T2 balances resulting from ‘genuine’ cross-border payments, and ‘capital flight’ (or ‘crisis avoidance-motivated’) transactions. This distinction is, arguably, artificial, as T2 will book and process all transactions in exactly the same way. However, it can help to shed some light on the reasons underlying the concerns hitherto expressed over the build-up of T2 balances.

Risks of Genuine Cross-Border Payments

‘Genuine’ cross-border T2 payments are those aimed to enable economic actors in one MS to discharge their financial obligations vis-à-vis economic actors in another MS. As mentioned above, at the end of each T2 business day cross border payment transactions may leave the NCB of MS A with an intra-Eurosystem ‘liability

[1] ECB Legal Services. The views expressed here are purely personal, and they do not necessarily represent those of the ECB or the Eurosystem. The author is grateful to Yves Mersch and Ulrich Bindseil for his comments of an earlier draft of this paper. All remaining errors are those of the author who is solely responsible for the contents of this paper.


ity’ to the ECB and the NCB of MS B with an intra-Euro-
sytem ‘claim’ on the ECB. Both the claim and the lia-
bilities would have arisen.
Crucially, however, no direct asset transfers take place between the two NCBs: T2 will merely provide them with an accounting credit or debit, in the form of a posi-
tion in the ECB, but with no assets to back the creditor
NCB’s claim.1

To speak of an NCB ‘risk’ in the context of genuine cross-border transactions merely because they will later
leave the NCB of the funds’ recipient with an accounting
claim on the ECB is to disregard the particu-
larities of cross-border fund transfers within the frame-
work of the Eurosystem’s decentralised monetary
implementation structure. In a fully centralised
system, cross-border payment flows would not give
rise to intra-system ‘claims’ and ‘liabilities’: had the
ECB not allowed cross-border fund transfers within the frame-
work of the Eurosystem’s decentralised monetary
implementation structure, these transfers would have
been settled by domestic settlements. However, the
Federal Reserve Districts do not correspond in any
way to the Eurosystem’s decentralised monetary
implementation structure. In a fully centralised
system, cross-border payment flows would not give
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implementation structure, these transfers would have
been settled by domestic settlements.

For a moment, set aside the question of assets. As	we have seen above, settlement between NCBs does not
involve the movement of assets: the NCBs’ claims
and liabilities are settled by domestic settlements and
intra-system settlements only. However, the mere
existence of these accounts and the operation of the
system asset purchase programmes. Short of disconnect-
ing these non-euro area commercial banks from the T2
components of certain NCBs, and of diverting traffic to
NCBs in those countries, it would be difficult to see how an increase in the T2 positions of
certain NCBs can be arrested. Be that as it may, the increase in the T2 claims of certain NCBs is
likely to lead to the ‘creation of money’, this will invariably be

1 The ECB’s monetary policy is not to be understood as a policy of
teaching or instruction. It is, rather, a policy of promoting and 
encouraging the proper implementation of monetarist doctrine. It
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there are no repayment terms as one would have expected of genuine ‘debts’. Besides, to the extent that T2 debts represent claims, these are not only those of the creditor NCBs, but of all NCBs jointly, as monopolistic (co-)issuers of the single currency. The fact that the Eurosystem has chosen to account for that process by way of claims and obligations is more to do with the euro area’s decentralised monetary policy implementation model, where the ECB relies on the NCBs to provide liquidity to commercial banks, than with a discretionary attempt to institutionalize an intra-Eurosystem lending mechanism.

It has been argued that the absence of an NCB obliged by way of principal only applies at normal times, but not to a scenario involving the exit of a debtor NCB from T2: in such a scenario a disequilibrium would arise in the ECB’s balance sheet between T2 credits and debts, with the latter now no longer totalisable. For all its common sense attraction, the above argument is, in this author’s view, flawed. To accept it as valid would be to turn on its head the reality of cross-border fund transfers within a monetary union, where (the accounting) claim of the NCB of a net-exporting MS against the NCB of a net-importing MS (and, ultimately, the ECB) is invariably mirrored by an asset of equivalent value to the claim, in the form of funds actually transferred, through T2, from commercial bank accounts in the net-exporting MS to commercial bank accounts in the net-importing MS. This is corroborated by paragraph 1 of Article 6 of the T2 Guideline (entitled ‘Intra-Eurosystem settlement’): it is implicit in this provision that, for intra Eurosystem transactions, settlement takes place at the level of their T2 participants, not at that of the NCB through which they participate in T2. The fact that no direct asset transfers occur between the two NCBs changes nothing in terms of the legal and economic reality of cross-border T2 transactions: value does, actually, move from economic actors in the net-importing MS to those running deficits to economic actors in the net-exporting MS (those running surpluses), hence the decrease in the liabilities of commercial banks in the former, and the corresponding increase in the liabilities of commercial banks in the latter. To accept that T2 balances represent ‘debts’ is to posit, rather implausibly, that the exports to country A (where the pluses), hence the decrease in the liabilities of commercial actors in the net-exporting MSs (those running deficits) to economic actors in the net-importing MSs (those running surpluses), hence the decrease in the liabilities of commercial banks in the former, and the corresponding increase in the liabilities of commercial banks in the latter. The above scenario rests on three assumptions, which, however plausible, are not universally accepted as valid: firstly, that there is a debt on which default is possible; secondly, that the creditor NCBs are financially sound; and thirdly, that, in the event of ECB losses, the NCBs ought to recapitalize the ECB. On the first of these assumptions, we refer the reader to our discussion in the foregoing paragraph. On the second assumption, it is an open question whether calculating the exact amount of the ECB’s claim against a defaulting T2 debtor NCB serves to immunize creditor NCBs from the risk of losses. The above scenario rests on three assumptions, which, however plausible, are not universally accepted as valid: firstly, that there is a debt on which default is possible; secondly, that the creditor NCBs are financially sound; and thirdly, that, in the event of ECB losses, the NCBs ought to recapitalize the ECB. On the first of these assumptions, we refer the reader to our discussion in the foregoing paragraph. On the second assumption, it is an open question whether calculating the exact amount of the ECB’s claim against a defaulting T2 debtor NCB serves to immunize creditor NCBs from the risk of losses.
Concerns with a constant widening of trade deficits, capital flight from the euro area periphery, and the expansion of the monetary base are not, per se, unwarranted. However, neither trade imbalances, which many are bound to perceive negatively, nor money creation are attributable to T2, whose exclusive task is to facilitate fund transfers, after the funds in question have come into existence through the regular money creation channel. Targeted, long-term solutions, ranging from the more modest to the more ambitious, would need to be explored if rising trade imbalances are to be addressed effectively and systematically. Although this author is unqualified to assess the need for adjustments to the rules-based Eurosystem collateral framework, what is clear to him is that its contours are within the remit of the Governing Council, which is alone competent to determine and implement the collateral policy that best suits market needs and liquidity conditions in the euro area. Until such time as the Governing Council has decided that market developments render policy adjustments necessary, it seems unreasonable to blame trade imbalances on T2, when all that T2 does is to record, rather than to create, those imbalances. Similarly, to present T2 as an autonomous channel through which to expand the monetary base ad infinitum is to disregard the fact that what sets limits to the creation of money is the availability of adequate collateral, and to forget that, whilst the role of T2 is to facilitate the flow of liquidity, its infrastructure only comes into play after liquidity has been created through the regular monetary policy process.

The temptation to blame those bearing bad news is understandable. However, in this, as in all other contexts, this must be resisted vigorously, if the true causes of outcomes perceived negatively are to be identified and addressed, with the benefit of the intellectual probity that problem-solving necessitates.