

Policy on the use of prefunding by ancillary systems

1 Introduction

In 2017 the Eurosystem introduced a new settlement procedure in TARGET2 (ASI6 Real-time), initially to support the emergence of pan-European solutions for instant payments. ASI6 Real-time allowed an ancillary system to use a technical account to hold funds set aside by its participants to back their positions. This entailed an amendment to the TARGET2 Guideline, to allow ancillary systems in which payments and/or financial instruments are exchanged and/or cleared or recorded while funds are being held in TARGET2. The new functionality led to increased interest in prefunding. As of 20 March 2023 with the entry into force of the TARGET Guideline¹ and the go-live of the T2 system, the ASI6-real time settlement procedure was renamed into RTGS AS settlement procedure D.

Prefunding may hold certain advantages related to liquidity and credit risks and settlement outside central bank real-time gross settlement (RTGS) operating hours. However, extensive use of prefunding may also have a negative impact on the overall efficiency of the market (e.g. by leading to liquidity fragmentation) and the ability of the Eurosystem to fulfil its statutory tasks. Following a general review, this policy sets out the transaction types eligible for prefunding and the applicable conditions for the use of prefunding in TARGET.

For the purpose of this policy, “prefunding” is defined as a practice where an ancillary system participant places funds in central bank money under the control of the ancillary system for settlement purposes. When the liquidity is transferred to the account of the ancillary system, these funds are typically uncommitted and freely available to the participant, and the transfer of funds does not serve to discharge settlement obligations that have already been established.² This policy is agnostic as to the technical settlement model.³

2 Transaction types eligible for prefunding

Ancillary systems for the processing of SEPA payment instruments and foreign exchange (FX) transactions in payment-versus-payment (PvP) mode are eligible for

¹ See Guideline (EU) 2022/912 of the European Central Bank of 24 February 2022 on a new-generation Trans-European Automated Real-time Gross Settlement Express Transfer system (TARGET) and repealing Guideline ECB/2012/27 (ECB/2022/8), OJ L 163, 17.6.2022, p. 84–185.

² This policy does not cover mutual guarantee funds or funds pledged as collateral, as such funds are not at the free disposal of participants.

³ Prefunding can take place via an RTGS Dedicated Cash Account, the RTGS AS settlement procedure D, a TIPS technical account or theoretically also other technical settlement models.

prefunding as it facilitates 24/7 settlement or settlement across different time zones globally.

For other types of transactions, the use of prefunding is only allowed if the participants' (net) positions are settled in TARGET at least once per TARGET business day (with all funds placed on the prefunded account being returned and with no claims on these funds remaining between the participants and the ancillary system operator). This use case is considered acceptable because it preserves the role of central bank money in settlement.

A further limitation to the use of prefunding applies in the sense that the use of prefunding is in general⁴ not allowed for purposes that result in "tiered" structures i.e. a prefunded ancillary system allowing other financial market infrastructures to settle participants' obligations in its books. This limitation avoids risks arising from interdependencies between systems (as opposed to direct settlement in central bank money). For the avoidance of doubt, links between CSDs, CCPs that settle securities transactions in a CSD, or interoperable systems are not considered "tiered" structures for this purpose.

Finally, allowing ancillary systems access to TARGET was intended to enable the use of a risk-free asset to settle transactions between TARGET participants (also including entities that can be reached as addressable BICs via T2 or as reachable parties via TIPS). Its purpose was not for the custody of assets that back the issuance of means of payment or other assets to the public. Accordingly, access to TARGET will not be granted to ancillary systems to back stablecoins (or any other means of payment or assets) issued to the public.

3 Conditions

The following conditions apply to the use of prefunding by ancillary systems:

1. the liability of the Eurosystem is strictly limited to the overall amount of funds available on the account used for prefunding in TARGET;
2. directly enforceable claims of ancillary system participants on the Eurosystem central bank (acting as operator of TARGET) are prohibited (except in the event of insolvency of the ancillary system operator and subject, to the extent permissible by law, to the existence of a contractual arrangement, accepted by the participants and governing the enforcement process);
3. direct (but not directly enforceable) claims⁵ on the funds on the ancillary system's prefunding account or (where applicable) on the Eurosystem central

⁴ The Eurosystem might grant an exception taking into account the potential impact on settlement in central bank money as well as wider financial stability aspects and under the condition that the volumes settled by virtue of such exceptions are monitored over time in order to prevent increased risks.

⁵ A direct claim refers to having a claim on the funds held in TARGET. Entities that are not eligible for TARGET access could still have an indirect claim, i.e. a claim on the ancillary system's operator who has a claim on the funds held in TARGET. Enforceability should be considered a different concept, referring to the possibility to provide technical instructions to the operator of the relevant TARGET component system.

bank that is holding the prefunding account in its name are allowed only for entities that are already direct participants in TARGET or for entities that are eligible for direct participation in TARGET pursuant to Article 4(1) of Annex I Part I to the TARGET Guideline;

4. indirect claims on the funds held in the ancillary system's prefunding account via the ancillary system or its operator are allowed only for entities that are (i) direct participants in TARGET, including their branches with multi-addressee access; (ii) addressable BIC holders; and (iii) reachable parties.

Conditions 1 and 2 serve to avoid the Eurosystem accepting liability for money creation by a third party (e.g. in the event of fraud or errors in the ancillary system books), while conditions 3 and 4 are designed to prevent set-ups that could be seen as circumventing the restrictions placed on access to TARGET and to ensure that ancillary system accounts are not used to back the issuance of means of payment or other assets to the public.

The table below summarises the eligibility of ancillary systems to use prefunding for different types of transaction. As set out above, access to TARGET by ancillary systems (and hence the use of prefunding) is expressly not permitted for use cases such as the issuance of stablecoins to the public.

Types of transaction	Availability of prefunding*
SEPA payment instruments (SCT Inst, SCT, SDD)	Prefunding is allowed, irrespective of the operational set-up.
Settlement of FX transactions in PVP mode	Prefunding is allowed, irrespective of the operational set-up.
Other types of transaction (e.g. wholesale payments, card payments, securities/derivatives settlement)	Prefunding is allowed if the participants' (net) positions are settled in TARGET at least once per TARGET business day (with the balance of the prefunded account returning to zero and with no claims on these funds remaining between the participants and the ancillary system operator).

*Using prefunding for "tiered" settlement is generally not allowed.

The Eurosystem will review this policy in three years' time, or earlier if the need arises.