

ECB Operations Managers Group
Frankfurt am Main, Thursday 20 September 2018, 13:00 – 17:00 CET

Summary of the discussion

1. The Utility Settlement Coin (USC) initiative

R. Ram (Consortium Executive) and H. Jaffrey (UBS) introduced the Utility Settlement Coin (USC) initiative, which is an institutional project gathering major banking institutions to establish a tokenised form of cash for wholesale post-trade settlement purposes, based on existing currencies. Launched in 2015, the project is at the intersection of crypto-currencies (bitcoin) and central bank digital currencies (CBDC). It is expected to offer significant improvements in the management of liquidity at commercial banks. Any cash leg may be transacted peer-to-peer, in real-time from a single source of liquidity. It leaves behind the current sophisticated multi-currency pooling structures, and reduces market risk. Close collaboration with central banks is considered as key, in order to replicate the cash collateral holdings held on central bank accounts.

The project involves different stages of development. It first starts to tokenise at a jurisdiction level with cash transactions backed by central bank money on a currency specific distributed ledger. This enables specific local features and operational set-up to be accommodated. The first currency is expected to go live in the course of 2019 with subsequent currencies following shortly after, facilitating a multi-currency cash environment. Ledger interoperability is a key feature, especially for additional capabilities such as the full tokenised DvP process for Securities Settlement. Members discussed the improvements in liquidity management operations this project is expected to introduce.

2. Blockchain and applications

F. Roessig (Telindus S.A.) gave some insight into the world of blockchain, its functioning and underlying technology components. From the first generation of 'bitcoin' protocol, to the Federated Byzantine Agreement protocol (Stellar) plus permission chains with private channel (Hyperledger) technology, he explained that blockchain has today become a highly competitive domain, subject to increasing regulatory and compliance constraints, with a strong potential for operational efficiency gains. He elaborated on concrete examples of blockchain application such as digitalised KYC or the processing of transactions and the reconciliation of trade mismatches, for which he initiated an interactive demo live. By simulating trades in a blockchain environment. F. Roessig showed the traceability of operations and actions for audit purposes, and the possibilities, using smart contracts, for the resolution of trade discrepancies in a collaborative and timely way. While the Members acknowledged the potentials of blockchain to deeply affect their operations management, they shared their uncertainty with regards to the legal recognition and enforceability of the technology.

3. Blockchain and potential impacts on reconciliation processes

U. Milkau (DZ Bank) reviewed the potentials of blockchain technology in contrast with existing efficient infrastructures from an operations perspective. As blockchain represents a cost for any institution, he insisted on the importance to carry out a thorough cost-benefit analysis. He highlighted the challenges of synchronisation amongst remote processes in distributed computing, particularly relevant in banking where various systems have inherited of unidirectional protocols. In this context, blockchain



EUROPEAN CENTRAL BANK

EUROSYSTEM

competes with existing instant payment services, such as the new Target Instant Payment Settlement (TIPS) service, which offers fund transfers in real time. He also illustrated the lack of consensus around standards and objectives of a 'smart contract' with the example of collateral evaluation methods. Indeed, a smart contract offers the possibility to define a single method of calculation and source of quotes. Still, a central facility such as CCPs or TARGET 2, that are considered as efficient and secure, may also facilitate the generation of standard templates for common use. Reconsidering blockchain from a cost and efficiency perspective will lead banking institutions to adapt their operating model accordingly.

4. Middle and Back Office operating model at an international institution

M. Hickey (Head of ESM Middle and Back Office) gave some insights into the functioning of an international institution, the European Stability Mechanism (ESM), and discussed its particular operating features. He explained that the ESM has a mission to provide financial assistance to euro area Member States experiencing or threatened by severe financing problems. This is financed by the issuance of bonds and bills by ESM's Front Office. The Middle and Back Office have been organised in a way to facilitate these activities. In this context, the ESM has adopted a flexible outsourcing policy, which is fully applied to back office activities, and that is characterised as a Tier 1 outsourcing arrangement to the extent that it relies on advanced, complex and core service activities. The implications of outsourcing need to be reassessed periodically, be it from a strategic or contractual viewpoint, in order to adapt to changing organisation needs and ensure a flexible and efficient operating model. Members discussed practical considerations connected to outsourcing, for instance business continuity planning and the reliance on critical providers. They also emphasised on the importance of due diligence and audits on outsourcing parties.

5. Implementing the MiFID II Systematic Internaliser regime

Members shared the challenges faced with regards to the implementation of MIFID II Systematic Internaliser (SI) since the beginning of September 2018, whereby the quality of the figures published on transactions volumes for ISIN codes by ESMA was not satisfactory to determine their categorisation as SI. They expect solutions to be provided in the short term, as progress in the learning experience is made.