

T2S financial statements for the fiscal year 2018

March 2019

T2S operating statement¹

Financial results for the fiscal year

(amounts in euro)

	Notes	2018	2017
Revenues		73,608,332	63,051,227
T2S fees charged to customers	1	73,608,332	61,997,698
Other income		-	1,053,529
Expenses		(124,489,362)	(124,689,156)
Services provided by the 4CB	2	(82,550,227)	(81,435,316)
Services provided by the ECB	2	(4,372,071)	(6,798,958)
Insurance costs and other expenses		-	(3,367,379)
Amortisation of T2S platform	3	(37,567,064)	(33,087,503)
Interest charged by NCBs	4	-	-
Net surplus/deficit		(50,881,030)	(61,637,929)

T2S financial situation¹

Year-end balances

(amounts in euro)

Assets	Notes	2018	2017
T2S platform	5	325,581,218	360,705,950
Current accounts		13,092,681	19,157,420
Accrued income	6	7,021,893	5,430,942
Total assets		345,695,792	385,294,312
Liabilities	Notes	2018	2017
Pre-financing of T2S by the Eurosystem	7	588,114,470	490,393,816
Provisions for 4CB expenses	8.1	-	68,749,823
Other provisions	8.2	113,414	79,234
Accrued expenses	9	4,372,071	22,094,572
Accumulated deficit		(246,904,163)	(196,023,133)
Total liabilities		345,695,792	385,294,312

¹ Figures might not add up due to rounding.

Explanatory notes

The notes on the 2018 T2S financial statements provide explanations and additional information about the figures in the T2S operating statement and the T2S financial situation report for 2018.²

Notes on the accounting policies

The T2S financial statements have been prepared in accordance with specific accounting policies developed by the T2S Board (Market Infrastructure Board). These policies are based on generally accepted accounting principles.

The T2S financial reporting framework covers standards for the annual T2S operating statement (expense and revenue accounts), the annual T2S financial situation report (asset and liability accounts) and the related disclosures.

T2S platform

Owing to their integral characteristics, both the hardware and software of the T2S system are treated homogeneously and represented as a single intangible asset under the position “T2S platform”. The latter represents the carrying amount of the T2S platform. The value of the T2S platform is made up of the capitalised development costs paid to the European Central Bank (ECB) and the four service-providing central banks (4CB), capitalised interest incurred during the construction phase, and additional development costs incurred during the operational phase, e.g. for new releases, after deduction of accumulated amortisation amounts and any impairment losses. Impairment tests are taking place annually as of the end of the migration phase (September 2017); impairment losses are recorded when the book value is lower than the asset’s expected recoverable amount.³

Amortisation

The amortisation method reflects the pattern in which the asset’s future economic benefits are expected to be consumed. The method was based on the (expected) proportion of settlement volumes already migrated in T2S during the migration phase (completed in September 2017), and is thereafter based on a linear method from January 2018 to September 2027 (ten years after the end of migration).

² For an introduction to, and further information on, the T2S financial statements, please refer to the [explanatory note](#) for the fiscal year 2015, which was prepared in parallel with the 2015 T2S financial statements.

³ The recoverable amount of an asset is the greater of its “fair value less costs to sell” and its “value in use”.

Pre-financing of T2S by the Eurosystem

This item relates to the amounts owed to the Eurosystem national central banks (NCBs) that have been pre-financing T2S, namely the covered costs incurred for both the development and the operation of T2S. This liability effectively reflects the expectation that the participating central banks will eventually be reimbursed for the development and operational costs included in the T2S pricing envelope (the total amount, including capital cost, to be recovered through fees). The reimbursement will be funded by cash surpluses generated from T2S usage fees paid by T2S customers (central securities depositories (CSDs) and central banks). Reimbursement will begin once the collected fees exceed the annual operational expenses.

Operating statement

During the operational phase, the T2S operating statement shows a net surplus or deficit, depending largely on whether the T2S fees are sufficient to cover the T2S operational costs, the amortisation of the T2S platform, impairment losses, if any, and other expenses. A deficit could trigger an extension of the amortisation period and/or a price increase in order to reach full cost recovery within the given cost recovery period. A surplus would make it possible to repay the pre-financing loan given to T2S by the Eurosystem central banks. The yearly surplus/deficit is reflected in the net accumulated surplus/deficit account.

Income/expenses

Income and expense items are recognised once earned/incurred. In the operational phase of T2S, all operational costs are expensed as incurred to the T2S operating statement, while additional development costs (e.g. for new releases) are capitalised to the T2S platform and reported in the T2S financial situation report.

Accrued income and expenses

Procedures are in place to calculate and establish, at each year-end, the costs incurred by T2S but not yet reimbursed to the service providers, as well as income not yet collected but earned in the reporting year.

Post-balance-sheet events

This refers to relevant events that occurred after the reporting period which have a material impact on the reports for that period.

Cost recovery

In 2010 the Governing Council of the ECB decided that T2S would be developed and operated under the principle of full cost recovery. The T2S Board regularly monitors developments that may affect the prospects of cost recovery. The cost recovery target is based on: i) the T2S pricing policy (see Schedule 7 (Pricing) of the T2S Framework Agreement and of the Currency Participation Agreement),⁴ ii) a given cost recovery period, iii) the total costs for developing and operating T2S, and iv) the usage of T2S resources which generate revenues for T2S.

While the use of T2S resources is dependent on market dynamics, the Governing Council of the ECB aims to steer costs and adjust pricing in order to ensure that T2S is in a position to recover all, and only, its total costs in the long term. On 21 June 2018 the Governing Council of the ECB decided to extend the cost recovery period to the end of 2029 and increase the prices as of 2019 in order to ensure full cost recovery.⁵ This decision was in response to the need to adjust the T2S pricing policy to the actual volume, cost, and revenue situation (see the [announcement for more information](#)).

Notes on the Financial Statements

1 Revenues – T2S fees charged to customers

The account “T2S fees charged to customers” shows the net revenues earned in 2018 by T2S. No discounts were applied in 2017 and 2018 since the “fee holiday” regime (reduction of the monthly fees by one third) for the 9 CSDs that had signed the contract with the Eurosystem (the T2S Framework Agreement) by 30 April 2012 expired in November 2016. For those CSDs, as well as for the other 13 that had signed the contract by 30 June 2012, the prescribed one-off joining fee⁶ was also waived.

The T2S fees also include revenues related to the application of the rules and procedures laid down in Article 32(9) and in Section 5.9 of Schedule 7 (Pricing) of the T2S Framework Agreement.

2 Services provided to T2S

As of its launch in mid-2015, T2S has been incurring annual operational expenditures which are paid to the service providers: to the 4CB for running and maintaining the T2S platform and to the ECB for its coordination activities. The

⁴ Both documents are available on the T2S website, www.t2s.eu, under “For professional use” in the section “Legal documents”.

⁵ See the T2S Framework Agreement, Section 2 (T2S pricing policy) of Schedule 7 (Pricing).

⁶ See the T2S Framework Agreement, Section 5.9 (One-off joining fee) of Schedule 7 (Pricing).

expenditures for 2018 amounted to €86.9 million. This amount includes 4CB service provider costs attributable to the year 2018, which were higher than initially budgeted (see note 8.1). The increased 4CB service provider costs are due to an intensified use of resources for testing and additional migration activities. A provision for the increased expenditures of the 4CB was recognised in the financial years 2015, 2016 and 2017. This provision amounted to €68.7 million as at the end of the financial year 2017. The provision was used upon the full payment of the increased 4CB service provider costs (i.e. the expenditures for which the provision was originally recognised) in the second half of 2018.

3 Amortisation

See note 5, “T2S platform”.

4 Interest charged by national central banks

T2S owes interest to the Eurosystem NCBs for the loan that has financed both the development of the platform and T2S operations. The Eurosystem (pre-)financing effectively covers the liabilities of T2S vis-à-vis the T2S service providers (i.e. the 4CB and the ECB for its T2S coordination functions).

The interest rate used for the calculation is the annual average rate applied to the ECB’s main refinancing operations (MRO rate). The accrued interest is calculated at year-end on the principal amount of the pre-financing of T2S by the Eurosystem.

In 2018 the applicable interest rate was 0.0% (annual average MRO rate). For this reason, T2S did not incur interest expenditures in 2018.

5 T2S platform

As at the end of 2018, the T2S asset value comprised: (i) capitalised costs incurred during the development phase up to the launch date, (ii) accumulated amortisation, (iii) capitalised interest incurred during the development phase, and (iv) additional development costs related to change requests.

The amortisation amount of the T2S platform in 2018 was €37.6 million (2017: €33.1 million). Following completion of the migration phase and after the full volume capacity of contracting CSDs was reached in September 2017, the linear calculation method has been applied for calculating the amortisation in 2018.

Changes to the value of the T2S platform in 2018

(in euro)

Year	Event	Amount
2018	Opening balance	360,705,950
2018	Capitalisation of development costs for Release 2.0	2,442,332
2018	Amortisation	(37,567,064)
2018	T2S platform closing balance	325,581,218

The T2S Board decided to start impairment testing after the end of the migration phase (September 2017) once the information on the full potential of T2S revenues would be available. As at the end of 2018, there was no indication that the T2S platform may be impaired.

6 Accrued income

Accrued income reflects T2S revenue in December 2018 that had not yet been billed at year-end 2018.

7 Pre-financing of T2S by the Eurosystem

The Eurosystem (pre-)financing effectively covers the liabilities of T2S vis-à-vis the T2S service providers (the 4CB and the ECB for its T2S coordination functions).

The balance of the pre-financing of T2S corresponds to the loan that T2S received from the Eurosystem NCBs to cover the costs of developing, running and maintaining the T2S platform, plus the accumulated interest on the loan (see note 4). The cost recovery target corresponds to the full balance of the pre-financing.

On 31 December 2018, the outstanding loan with the Eurosystem amounted to €588.1 million (2017: €490.4 million). The increase is due to additional pre-financing payments allowing T2S to pay its operational costs to the T2S service providers.

8 Provisions

8.1 Provisions for 4CB expenses

An annual provision was set aside to cover an expected increase in the 4CB service provider costs during the migration phase, relating to an intensified use of resources for testing and migration activities. As at 31 December 2017, the total provision amounted to €68.7 million.

The expected costs were paid in the second half of 2018, which is when the provision was used.

8.2 Other provisions

Other provisions of €113,414.00 were set aside. This includes €63,414.00 to cover an amount erroneously invoiced to CSDs in 2018 that is to be reimbursed in 2019. In addition, an amount of €50,000.00 was recognised for a conditional participation fee paid by one CSD.

9 Accrued expenses

Accrued expenses relate to operational costs of the ECB as a T2S service provider incurred in 2018 for which no invoice had been received by year-end. On 31 December 2018, a total amount of €4.4 million was accrued (2017: €22.1 million, which included the annual ECB expenses and one quarter of the expenses incurred by the 4CB).

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Postal address 60640 Frankfurt am Main, Germany

Telephone +49 69 1344 0

Website www.ecb.europa.eu

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For specific terminology please refer to the [ECB glossary](#).

INDEPENDENT AUDITOR'S REPORT

TARGET2-Securities

To: The Chairperson of the Market Infrastructure Board and its Members

Sonnemannstraße 20

60314 Frankfurt am Main

15 April 2019

Opinion

We have audited the financial statements of TARGET2-Securities (the entity), which comprise the financial situation report as at 31 December 2018 and the operating statement and other explanatory notes. The financial statements have been prepared by the Market Infrastructure Board acting for the Eurosystem based on the TARGET2-Securities Financial Reporting Framework as approved on 24 March 2017 and as amended on 05 October 2018 by the Governing Council of the European Central Bank.

In our opinion, the accompanying financial statements of the entity for the year ended 31 December 2018, are prepared, in all material respects, in accordance with the principles of the TARGET2-Securities Financial Reporting Framework as approved by the Governing Council.

Basis of Opinion

We conducted our audit in accordance with International Standards of Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the entity in accordance with the ethical requirements that are relevant to our audit of the financial statements in Germany, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of Matter

Basis of Accounting

We draw attention to the explanatory notes to the financial statements, which describe the basis of accounting. The financial statements are prepared to assist the Eurosystem in meeting its financial reporting requirements originating from the TARGET2-Securities Framework Agreement. According to Article 20 "Obligations of the Eurosystem related to the provision and use of the T2S Services" in Chapter 2 of the TARGET2-Securities Framework Agreement the Eurosystem shall provide the contracting Central Securities Depositories (CSD) with financial statements, reports and other information on TARGET2-Securities on a regular basis that fairly represent the business and financial conditions, result of operations and state of the cost recovery in relation to TARGET2-Securities on the respective dates or for the respective periods covered by such financial statements, reports and other information. As a result, the financial statements may not be suitable for another purpose.

Our opinion is not modified in respect of these matters.

Responsibilities of the Eurosystem and those charged with governance for the TARGET2-Securities Financial Statements

The Market Infrastructure Board acting for the Eurosystem is responsible for the preparation and fair presentation of the financial statements in accordance with the TARGET2-Securities Financial Reporting Framework as approved by the Governing Council of the European Central Bank, and for such internal control as the Eurosystem determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Market Infrastructure Board acting for Eurosystem is responsible for assessing the entity's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the Eurosystem either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the entity's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgement and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the entity to cease to continue as a going concern.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Yours sincerely,

Baker Tilly GmbH & Co. KG
Wirtschaftsprüfungsgesellschaft (Düsseldorf)



Ralph Hüsemann
Wirtschaftsprüfer



Dr. Stefan Fischer
Wirtschaftsprüfer

