

USER REQUIREMENTS. Target 2 Securities

French NUG Executive Summary

Why T2S

Eight years after the introduction of the single currency, the Euro area still lacks an efficient, integrated securities infrastructure that would support the operations of a more efficient financial market. Integration is well advanced in the cash world (Target 1, Target 2, SEPA) but the securities world remains very fragmented with still 19 SSS to date in the Euro area.

Over the past years, despite some initiatives, the Industry has not been able to deliver consolidation. The Nordic CSD has consolidated only two SSS and further consolidation seems not underway. The EOC project will consolidate 4 CSDs, both for settlement and asset servicing, but this process to be fully implemented will last another 2 to 3 years.

The ECB initiative is a unique opportunity to foster harmonisation and deliver in a reasonable timeframe (2013) a settlement system for all securities denominated in Euro. In addition T2S was proposed as a solution to benefit from the efficient "integrated model" in central bank money on broader scale and not only for some markets.

T2S is one of the pillars to achieve European integration in the field of securities settlement, the two other pillars being the removal of the Giovannini Barriers and the implementation of the Code of conduct by market infrastructures.

What are the benefits expected from T2S?

- By providing a single settlement platform, cross border movements within the euro area will become as easy and efficient as domestic settlement. **It should reduce the cost of settlement** thanks to
 - Harmonisation of processes. T2S is in particular expected to help remove at least 5 of the 15 Giovannini barriers.
 - Investments' savings at CSD level as investment on settlement platforms would be shared among CSD joining T2S.
 - And maximisation of economies of scale.
- T2S will provide settlement in central bank money only. It will be a **risk averting pan European platform** with no risk of commingling central bank money and commercial bank money on the same platform. This set up should largely contribute to **limiting systemic risk** in the market even with a large concentration of settlement volumes on the same platform.
- T2S will allow CSDs to be compliant with the Clearing & Settlement code of conduct for infrastructures. We therefore expect that transparency and fair access requirements will be fulfilled.
- The T2S initiative should also **allow savings for financial players**: not only in their back offices but also in terms of collateral needs. We estimate that T2S will allow users to fully centralise Euro treasury management and will reduce by 30% collateral needs. According to the ECB, Target 2 is expected to save 20% collateral for banks and T2S is expected to allow another 20-30% savings.
- Finally we also see some benefits in the involvement of the Eurosystem. Being a public entity, not for profit, it can be seen as a neutral body that will be inclusive of small and large markets and can facilitate harmonisation.

- **Target 2 securities will also reinforce competition and allow full transparency on prices and recovery cost.** On the securities services level it will increase competition between custodians, by extending the size of the market in competition which will no longer be local but cover the Eurozone at a minimum: the number of custodians competing in the same space will increase. Some financial players may also opt for direct CSD access and no longer use local custodians. Finally, the ECB is suggesting that CSDs may also want to enter in the custody business and compete with custodians. But we see the project as giving asset services a chance to compete on a fair basis as fair and equal access should be provided to T2S.

French NUG position

- We support the T2S initiative for all the reasons explained above.
- You will find below the elements of the project that the French NUG considers as key.
 - The ECB is currently designing the project governance for the next phase. It is critical that banks remain closely and clearly associated to the governance structure. The ECB has already acknowledged that the Advisory group would most likely remain in place. However the ECB seems to envisage introducing a smaller steering committee for the next phase of the initiative that would directly manage the project and take the high level decisions. From what we understand, this steering committee would be only composed of CSDs and Central Banks. This proposal is not acceptable as it would undermine the banks' involvement in the governance of the project. The day to day Production governance has to be considered at a later stage. The next phases should allow the final users to continue to fully express their positions and ensure that the choices that will be made would neither be to the detriment of the banks nor to the general economic soundness of the project.
 - Direct connectivity is also essential for banks. Not only would it allow savings and efficiency but it would also ensure a more level playing field between custodians banks and potential Investors CSDs (= CSDs that would want to develop a custodian function and compete directly with some of their users).
 - Clarifications on a legal agreement frame are needed, especially on contractual relationships between CSDs and T2S and on the identification of T2S' system operator. We expect this document to be published and provided at a later stage by the ECB team.
 - For the French NUG, there is no chapter in the URD dedicated to the account structure in T2S. This level of information is key and therefore it is important that T2S' team provides us with detailed description on that topic.
 - A more technical document is missing on the architecture of T2S that is why a certain number of questions have been raised in the Market consultation feedback on T2S user requirements - specifically the chapters 14 to 20 are technical and more accurate information is needed.

Key points of the French NUG

- T2S should allow settlement of all euro denominated securities (equities, fixed income, funds and Eurobonds).
- T2S should offer DVP settlement in central bank money only (cf. principles 8, 9, 10 in the high level consultation).
- T2S should not allow cross currency settlement.
- T2S should be operated on a cost recovery basis and not profit oriented
- T2S should foster harmonisation.
- T2S should be a RTGS system allowing collateralisation on transaction flows and on stock.

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- T2S set up should include dedicated T2S cash accounts on the T2S platform to allow immediate settlement finality thus accelerating the availability of cash and securities for re-use.
- There should be a flexible cash management tool to sweep cash during the day between T2 PM cash accounts and the T2S dedicated cash accounts allow efficient treasury management.
- T2S should ensure a level playing field between directly connected custodians and “investors CSDs”, including functionalities available and cut-off times.
- The cut off time should be correctly defined to allow liquidity management and squaring of positions.
- T2S should provide direct connectivity for banks.
- CSD should not be allowed to prohibit direct connectivity to their users unless for strong justification (risk only).
- All transactions that can be matched in T2S should be matched in T2S, with exceptions to this rule being clearly defined.
- Integrity of static data should be ensured. In this respect, there should be only one CSD in charge of updating the static data for a given security, although the concept of administering party still needs to be clarified.
- Multiple T2S Dedicated Cash Accounts (DCAs) are and should be kept outside the perimeter of T2 Cash for operational and business reasons. Other existing functionalities as autocollateralisation proved to be sufficient to provide liquidity to the system. Therefore, it has to be considered as an optional module and cost should be supported by users.
- Transfers between DCAs that are not linked to the same RTGS account should be done via RTGS accounts.
- There is no transfer between the T2S dedicated cash account and T2 Cash during the night time settlement
- Even if several currencies are accepted, T2S is not a multi currency Delivery versus Payment system. T2S shall be able to accept several currencies but each one should be treated by different parallel processes.
- T2S on T2 Cash architecture and concept would merit further explanations at a later stage about infrastructure management, contingency and release management.
- Eurosystem Single Interface should be Giovannini Barrier One and ISO20022 compliant