



EUROPEAN CENTRAL BANK

EUROSYSTEM



T2S OnLine

QUARTERLY REVIEW
No 4, Spring 2010

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Jean-Michel Godeffroy

EDITORIAL

T2S: THE WAY FORWARD

Since the last issue of T2S OnLine, which was published in January following our Advisory Group's meeting in Amsterdam, the Governing Council has approved the Programme Board's proposal to freeze the User Requirements Document (URD). T2S now has a rock-solid basis for its future development. Over the last few weeks the General Functional Specifications (GFS) have also been updated to incorporate the latest changes made to the URD.

Since the end of last year, the Programme Board has been carrying out an extensive review of the T2S work plan. As I also mentioned in January, this review was triggered by, inter alia, the delay in finalising the technical documentation, in particular the GFS.

The detailed plan is not yet available. This is partly because we have yet to conclude our planning discussions with the central securities depositories (CSDs). Nevertheless, I can already announce the key dates of our new and final plan: T2S will be ready for testing by CSDs in January 2014, and ready to be used by the first group of CSDs in September 2014. This is just over a year later than we had initially hoped, but we are now very confident that no further adjustments to the timetable will be necessary. The new plan includes some additional buffers in case of any unforeseen events.

Over the last few months we have also carried out a comprehensive review of our organisational set-up, and the problems identified are now being addressed. T2S is a project without precedent and we are finding our way towards new and better internal governance solutions. It was as if, having been cruising along the racing track without any problems, we have been forced by a sudden change in weather conditions to come in for a pit-stop slightly earlier than expected. But we now have fresh tyres and a full tank, and have made some technical adjustments, and are ready to go full speed ahead until the end of the race without stopping. The review has certainly strengthened our organisational structure, and we are now focusing our attention on the finalisation of the Framework Agreement with the CSDs.

The negotiation of the Framework Agreement will be, by far, this year's most important activity. It will be the basis for contractual relations between the CSDs and the Eurosystem. There have been so many issues to deal with that we have occasionally risked losing momentum in lengthy discussions. We have had to find the right balance between the need for consensus and the need to bring the work to a quick conclusion. Another important step will be when we will seek the views of the regulators. In order to allow them to intervene early enough in the process, the Programme Board intends to submit a draft to the Committee of European Securities Regulators by the end of July, after an interim validation by the Governing Council. It will still be a Eurosystem document at that stage, but it is important that it is as close as possible to the final version. The CSDs and the Programme Board have therefore agreed to speed up their discussions in May. Two further important milestones in this dossier will be the adoption of the Framework Agreement by the Governing Council in January 2011 and then by the CSDs in April 2011.

EDITORIAL

Overall, aside from a few sensitive issues that have yet to be settled, the negotiation process has progressed well over the last three months, with both sides acting in a spirit of cooperation.

Yet another major activity for 2010 is the negotiation of the Currency Participation Agreement with those non-euro area central banks that have envisaged to allow their currency to be settled in T2S. The article in this issue by Marc Bayle, T2S Programme Manager, provides some more details on this process.

One of the main issues to be addressed in both the Framework Agreement and the Currency Participation Agreement is governance. In this respect, the T2S Programme Board has analysed, with the help of the T2S Advisory Group, the pros and cons of establishing a separate legal entity.

Some stakeholders were in favour of establishing a separate legal entity for T2S. The reasoning behind this was that it could potentially lead to a differentiated governance model in which decisions relating to the infrastructure would be taken by the Governing Council, while strategic decisions relating to the operation and future development of the platform would be taken by a broader range of stakeholders. The Programme Board noted that this idea met with limited support from the T2S Advisory Group.

In its April meeting, the Governing Council requested the Programme Board to continue its work on governance without envisaging a separate legal entity. Efforts are now being focused on creating an alternative governance model that will adequately address the needs of the non-euro area central banks, as well as those of other stakeholders. I am confident that, by engaging in frank and open dialogue, and by defining transparent and accurate procedures, we will be able to find a solution, which would meet the needs of all parties concerned equally well as a separate legal entity.

I am also pleased to say that in April, the Governing Council adopted the T2S Guideline. The Guideline is the basis for the legal framework for T2S and all other legal agreements to come in place in the future. You can read more about it in the T2S project update.

Let me now introduce the other articles in this quarter's issue of T2S OnLine. We start with an update from Helmut Wacket on the latest developments in the T2S Programme. We then have an article by Roland Broese, a member of the T2S team, on the Credit Memorandum Balance: a new tool that has been introduced into the URD in order to make it easier for payment banks to manage their clients' credit lines. There follows an interview with Adolfo García from Banco Santander, who shares his views on, among other things, pricing and governance. Next, as mentioned above, Marc Bayle, the T2S Programme Manager, gives an update on our negotiations with the non-euro area central banks regarding the Currency Participation Agreement. To round off, we introduce the T2S Advisory Group.

I hope you enjoy this issue of T2S OnLine.

Jean-Michel Godeffroy
Chairman of the T2S Programme Board

26 April 2010

T2S STATUS UPDATE

T2S Guideline

On 21 April 2010, the Governing Council adopted the T2S Guideline (ECB/2010/2). The Guideline is the cornerstone of the legal framework for T2S and the basis for all other legal agreements to come in place in the future. The Guideline is binding for the Eurosystem national central banks, but does not create obligations on third parties. Briefly summarised, the T2S Guideline contains (i) a list of decisions reserved for the Governing Council; (ii) the roles and responsibilities of the T2S Programme Board and the 4CB and their mutual relations; (iii) provisions on the relations with external stakeholders; (iv) the basic procedures for the financial regime, the Eurosystem's rights to the platform, CSD access criteria and other CSD related issues and eligibility conditions for non-euro currencies. The Guideline will soon be made public on the Official Journal of the European Union.

T2S timeline

The T2S Programme Board and the Governing Council have carefully reviewed the T2S project plan. According to the new plan, CSDs will have the opportunity to start testing the T2S software in January 2014, and T2S will be ready to go live in September 2014 (see Jean-Michel Godeffroy's editorial in this fourth issue of T2S OnLine).

External governance

In exploring different options for the future governance of T2S, consideration was given to the question of whether it would be advisable to structure T2S as a separate legal entity (SLE) during the operational phase. In order to analyse this matter, the T2S Advisory Group established a Task Force in December 2009, which focused on the business perspective and left aside the legal implementation of its proposals. During the discussion of the Task Force report at the Advisory Group's March meeting, it emerged that market participants were prepared to accept a continuation of the current arrangement without establishing an SLE if the proper and transparent involvement of stakeholders was ensured. Most of the non-euro area central banks appeared to be in favour of a governance arrangement with an SLE, as they felt better able to control their currencies under such an arrangement. The Programme Board accepts this legitimate interest of non-euro area central banks, but considers that other governance arrangements could similarly safeguard their ability to control their currencies and allow them to ensure financial stability in their countries. Given the limited support in the market for an SLE, and the fact that the Eurosystem did not see convincing arguments in favour of an SLE at this stage, the T2S Programme Board will focus its governance discussions with the market on an adaptation of the current arrangement in a way that ensures that stakeholders' concerns can be adequately met.

Internal governance

The Governing Council decided to adapt the mandate and the rules of procedure of the T2S Programme Board, in particular in order to specify the roles and responsibilities of the T2S Programme Board in relation to T2S financial issues. The changes do not affect the external role of the T2S Programme Board.

T2S STATUS UPDATE

Network issues

The Governing Council has decided that connectivity to T2S should be provided by competing network providers. These network providers will obtain a licence to carry messages between T2S and the CSDs (and other actors). The Governing Council has also decided to limit the number of providers to three in order to mitigate operational and project risks. T2S will act as an interface with each of the chosen providers and market participants will decide which of these they wish to use. The Eurosystem will conduct a public consultation in summer 2010 on the selection criteria and will launch in the autumn the formal selection process. It is anticipated that the T2S network providers will be selected by autumn 2011.

Framework agreement

The framework agreement is one of the cornerstones of the T2S legal architecture and will formalise and regulate the relationship between the Eurosystem and the CSDs (see T2S OnLine, No 3, "Bayle's view"). The T2S Programme Board intends to finalise the draft framework agreement by summer 2010 and thereafter to offer EU regulators the chance to comment on it. The Eurosystem and the participating CSDs are expected to sign the agreement in the second quarter of 2011.

Currency participation agreement

The currency participation agreement between the Eurosystem and the non-euro area central banks stipulates the rights and obligations of both parties regarding the settlement of currencies other than the euro in T2S (see "Bayle's view" for more information). The currency participation agreement is expected to be ready for signing by the end of 2010.



Helmut Wackett, Head of the External Stakeholders Management Section in the T2S Programme Office

INSIGHT

CREDIT MEMORANDUM BALANCE: FURTHER INCREASING SETTLEMENT EFFICIENCY

T2S will enable the efficient settlement of securities on a single platform. It will thus include a number of features designed to increase efficiency. These integrated features will include technical netting, which will reduce the amount of securities needed for settlement, and auto and client-collateralisation, which will be used to finance securities purchases through the provision of collateral on an ad hoc basis.

Auto-collateralisation is an automated process within T2S that will allow the exchange of securities eligible as collateral in return for the cash needed for settlement. The securities provided as collateral can either be the purchased securities or other securities that have been selected for auto-collateralisation. Additional features of auto-collateralisation will be dynamic reimbursements and automatic substitutions of collateral in the event that collateralised securities are needed for settlement and either cash or other securities are available for the substitution.

Auto-collateralisation is designed for central securities depository (CSD) participants that are operating their own accounts at the national central banks (NCBs) and have been granted a credit line with their NCB.

Client-collateralisation is a T2S function that will support credit provision by settlement banks to CSD participants that do not have an NCB account or credit line. It will use the same technical processes as auto-collateralisation. Settlement banks will use client-collateralisation to provide credit to clients who are not eligible to open accounts with the central bank, for example, if they are non-bank securities firms or asset management companies. Other participants may include those that are eligible to open accounts with the central bank but do not have access to central bank credit facilities or do not hold sufficient central bank eligible collateral, or those that simply prefer to outsource cash settlement to liquidity providers. Collateral provided through client-collateralisation would be transferred to the settlement bank. As for central banks, T2S will allow settlement banks to set limits for the credit they are willing to extend to clients against collateral.

The Credit Memorandum Balance (CMB) will control and define limits for auto and client-collateralisation; via this tool, T2S will ensure that, as part of the settlement process, the extension of credit is within the limits set by the credit provider. Different limit types have been defined to allow users maximum flexibility in deciding if credit should be extended on the basis of secured credit in T2S or elsewhere, and which type of credit should be provided first.

The Eurosystem's goal is to build a state-of-the-art settlement engine. Having automated collateralised credit and limit controls at the heart of the settlement process will allow for the optimal provision of cash and will thus increase settlement efficiency. Placing them in T2S is a more efficient and cost-effective solution than each bank developing them individually.



Roland Broese, T2S Programme Office



INSIGHT

Adolfo Garcia

INTERVIEW WITH ADOLFO GARCIA, HEAD OF SECURITIES FORUMS, BANCO SANTANDER

Mr Adolfo García, Banco Santander has been involved in the T2S project from the beginning via the T2S Advisory Group (AG). You have thus seen how the governance structure has evolved with the project during the different project phases. As the project has entered into the development phase, preparations for the future operation of T2S have begun. How do you see the future governance of T2S once it is in operation?

Banco Santander has been involved in the T2S project since it was embryonic. I recall that it was a great satisfaction to host the November 2007 AG meeting at our headquarters in Madrid. Later, Banque et Caisse d'Épargne de l'État de Luxembourg, HSBC and RBS followed and this year it will be the turn of ING Bank and Bank Austria. Indeed, banks have clearly shown their commitment to this project and users have provided their expertise and allocated extensive resources to it.

There is currently a voiced concern that banks may lose relevance in the future governance of the project, not only when T2S becomes operational, but even at an earlier stage, after the Framework Agreement is signed. Although it is clear that certain matters pertain intimately to the relationship between CSDs and the “public task” (which seems to be the new name for referring to this outsourcing), the CSD Contact Group (CCG) should have a clear mandate for properly identified issues only. Besides, users have a point when they raise the issue of fair representation at the CCG and I would suggest having between three and five users as observers in that group.

AG meetings should not become high-level informative sessions; it is important to secure the engagement of all of the various stakeholders in such a way that their opinions are taken into account. Users should provide input on all change requests that affect them and they should, therefore, be represented at the AG meeting on an equal footing with central banks and depositories.

With regard to the creation of a separate legal entity, the task force chaired by Marye Humphery presented an excellent report. It is understandable that the non-euro area central banks want to have a high level of decision-making and adequate control of their currencies. The final outcome, however, will be a political compromise between the euro and the non euro area that takes into account the expectations of the market to achieve economies of scale and enlarge the geographical scope of T2S. The decision of the Governing Council is being awaited with interest: the CSDs want to know with whom they will be working and how this will affect governance in this Eurosystem-owned and operated project.



INSIGHT

The most important and most direct benefit of T2S will be a significant reduction in cross-border settlement fees, which are still, on average, more than ten times higher than domestic fees. As a user, what are the other most attractive benefits you see in T2S?

A fee schedule is very much expected. If the fees are low, the schedule will have a very positive impact on users and, in addition, it will attract other currencies to the project. Since the inception of T2S, this proposal has contributed to maintaining users' interest in the project. Unfortunately, time is running quickly and we are still far from reaching a consensus on the level of the fees. This is a key point for us to set up our own projections and budgets.

What we do know so far is that it may not have the desired simple structure. Although the project is more complex and its current scope is more ambitious and less lean than was initially intended, too complex a fee structure would be a disappointment, regardless of the fact that, today, we already have to live with the complexity of local settlement fees applied by local central depositories. I think that an item on everybody's agenda is the endeavour to strike a good balance between a simple fee schedule – with few additional items charged separately – and a complex one.

Apart from the fees issue, the focus placed on market practice harmonisation is one of the main promised benefits to be delivered by this project. I praise the work done by many colleagues, in particular Paul Bodart and Joël Mérére. This work is an ongoing exercise and there will be new grounds for advancement. I also welcome the set-up of a new task force on shareholder transparency, a discussion forum attended by the European Commission. Whether issuers find a home in T2S for solutions on shareholder visibility remains to be seen.

In January 2010 the Governing Council decided to freeze the User Requirements Document (URD) on the basis of the AG recommendation. This will provide a stable basis on which to develop the system. The “frozen” URD includes the Credit Memorandum Balance (CMB) functionality. The CMB will provide an enhanced service to payment and settlement banks for the management of their clients' credit lines. How do you regard this additional feature in T2S?

The CMB functionality is not a service that we would have demanded or a must for all banks. However, I think that it will become a standard functionality and, in the end, it will be perceived positively. The debate rather hinges around the additional time needed for its implementation and its cost. Each time that a new initiative requiring development is put forward, concerns about possible delays in its implementation are aired. The fact that it will be priced separately has calmed the less enthusiastic participants.



INSIGHT

During February and March 2010 the Spanish securities regulators ran a consultation on a possible reform of the securities clearing, settlement and registry system. The objective is to improve the efficiency of the Spanish system and its ability to participate, for instance, in T2S. What are your reflections on the proposed reform and how will it help the Spanish participants prepare for T2S?

At two informative sessions, in Frankfurt on 22 January 2008 and in Madrid on 21 April 2009, I praised the joint report issued by the Spanish authorities in December 2007 on the need for deep reforms in the Spanish post-trade market in order to adapt it to MiFID and T2S. I also expressed the urge to start working on them swiftly. Some time has elapsed, but at last the complex exercise has started and it is moving in the right direction. The sooner these reforms are finalised and implemented, the more easily users in Spain can prepare for the launch of T2S.

The document submitted for consultation earlier this year echoes the fact that specific national features can only survive in a T2S environment if they are efficient and compatible from an operational point of view.

In a cross-border environment, the reform of the Spanish post-trading system on equities is not only of interest to and for the benefit of Spanish participants, but it is relevant for all. In fact, the demand for this reform has been fostered just as much by non-Spanish participants. It should also be borne in mind that the Spanish central depository is made up of participants from a variety of countries. The reform is analysing the possibility of setting up a CCP system for securities trades and the possible shift of finality from trading to settlement time.

Most relevant for T2S is the reform of the Spanish ownership tracking references (RRs). It will hopefully mean that directly connected users will not need to provide RRs before the settlement process. However, RRs will still be maintained or perhaps changed into a similar system capable of efficiently tracking ownership. Whatever the outcome, it will certainly be T2S friendly.



BAYLE'S VIEW

T2S CURRENCY PARTICIPATION AGREEMENT

T2S is not only a platform for settlement in euro: it can also be used to settle transactions in other currencies. This is enshrined in the “general principles” of T2S, which form the cornerstone of the project. This openness to other currencies was strongly welcomed by the ECOFIN Council. Enabling multi-currency settlement on T2S not only increases settlement volume, which in turn helps reduce prices for all participants, but also brings us closer to achieving our single market objectives. It certainly makes it more straightforward for a Central Securities Depository (CSD) from a non-euro area country to join T2S if its national currency is also in T2S. So far, three non-euro area central banks – Danmarks Nationalbank, Norges Bank and Sveriges Riksbank – have formally indicated that they are willing to enter into negotiations for their currency to be settled in T2S, and a number of other non-euro area central banks are following developments closely.

Of course, T2S only settles in central bank money. For a central bank to outsource the settlement of its currency to T2S is a rather sensitive decision. Among other things, this is because a central bank needs to be able to maintain full control over its currency for monetary policy and financial stability purposes. However, outsourcing settlement is not an entirely new concept for central banks: for example, Banque de France and Bank of England have been outsourcing the settlement of their currency to their national CSDs for many years. Furthermore, in the case of T2S, any concerns over outsourcing can to some extent be assuaged by the knowledge that the platform will be operated by a group of fellow central banks, the Eurosystem.

The key legal instrument for regulating the inclusion of the non-euro currencies will be the [Currency Participation Agreement \(CPA\)](#). Along with the Framework Agreement, which is in the process of being negotiated with CSDs, the CPA will be one of the key pillars supporting the T2S's legal structure. The preparation and eventual signature of the CPA by non-euro area central banks is therefore a very important milestone for the T2S project.

Some preliminary discussions on the CPA have already been taking place with a group of experts from non-euro area central banks. However, the formal negotiation of the agreement is due to start soon with the setting up of a dedicated task force, composed of legal and technical representatives from the non-euro area central banks and the Eurosystem. The timetable for the preparation and signature of the CPA is still rather fluid, but it will approximately mirror the timetable of the Framework Agreement. We are therefore aiming to have the agreement ready for signature by autumn 2010.

Although we are only at the very beginning of negotiations, I can say that they have so far been very smooth. After all, central bankers do have a certain mutual understanding of each other's concerns. However, it is already very clear that one of the trickiest issues to resolve will be governance.

BAYLE'S VIEW

To some extent one can compare the governance issue to a relationship between two best friends who have known each other for many years. One of the friends has recently built and paid for a fantastic new house for his family. The house not only has a state-of-the-art architectural design, but also the most up-to-date energy-saving technology, and its furnishings are elegant but simple so as to avoid unnecessary clutter. It is even big enough that it has enough space for the best friend's family to live there as well, and the owner has offered that they move in together. This way they can both benefit: the friend can enjoy living in a modern, energy efficient house, and the owner can have some help with paying off the mortgage.

But moving house, of course has a number of transaction costs, and sharing a house can sometimes lead to disagreements, even between best friends. For example, they know that they are both non-smokers. But it is still possible that in a few years' time one of them may start smoking. Of course, as a last resort the friend knows that he could always decide to move out, but in our context this would really be a very expensive option, to be avoided in all but the worst case scenario.

An effective governance arrangement between the friends sharing the house, as with T2S, would enable the parties to amicably and fairly resolve their differences if and when they arise. As one of the non-euro area central banks said at a meeting, *governance can be ignored 99.9% of the time, but when you need it, you really need it.* Of course, the owner of the house is likely to be reluctant at first to cede control over decision-making for a property that he took the risk to finance. But, at the same time, if he wants his friend to move in he will need to give some ground.

The recent report submitted to the T2S Advisory Group by the "Task force to explore a separate legal entity" helped to identify some of the key concerns of both the non-euro area central banks and the Eurosystem, and explored some potential solutions for a future governance arrangement. Further discussions will take place in the coming months, and we are very confident that we will come to a mutually beneficial conclusion.



Marc Bayle, T2S Programme Manager and Head of the T2S Programme Office

INTRODUCING THE T2S ADVISORY GROUP

In March 2007 the Governing Council of the ECB decided that T2S was feasible from an operational, technical, economic and legal perspective and established the T2S Advisory Group (AG). It initially mandated the AG to define the T2S user requirements, but over time the AG has developed into a forum that provides valuable advice to the Eurosystem on the market needs regarding T2S. A major asset of the AG is its ambition to solve existing difficulties in a consensual way. In fact, the AG has managed to solve almost all relevant matters by consensus and has only had to vote formally on three occasions so far. The AG will also remain an important pillar in the future governance of T2S.

The T2S Advisory Group



Composition

The members of the AG are composed of three stakeholder groups: central securities depositories (CSDs), users and central banks. CSDs and users are represented equally to ensure an equilibrium of market views. Besides its full members, the AG also consists of a number of observers, making a total of almost 90 participants. The chairman of the AG is Jean-Michel Godeffroy, who is also the Chairman of the T2S Programme Board (see T2S OnLine No 1, summer 2009).

Responsibilities

The AG has been instrumental in defining the T2S user requirements and its work has contributed to the completion of a number of technical documents such as the General Functional Specifications and the User Requirements Document. The AG also addresses harmonisation issues in the field of securities settlement related to T2S and assists in the discussion concerning policy issues, e.g. the pricing framework, articulating the market needs regarding T2S.

For further information on the AG, its meetings, agendas and members, etc., please see <http://www.ecb.europa.eu/paym/t2s/progress/ag/html/index.en.html>.

T2S IS ONLINE FOR YOU

What is T2S OnLine?

T2S OnLine is a quarterly review that will provide you with first hand information about the T2S programme. It will give you project updates, insights into T2S and details on the current outlook, but one should not forget that behind any project there are people. Therefore, in each issue, T2S OnLine will take you closer to the people of the T2S community. We hope you will find T2S OnLine to be an enjoyable tool for obtaining up-to-date information about T2S.

Where can you find T2S OnLine?

T2S OnLine can, of course, be found online, with the option to print if you would still like to have a hard copy.

How can you use T2S OnLine?

The best way is to read it from top to bottom in order to absorb all of the information on T2S. However, T2S OnLine is designed to allow for a quick read – by simply hovering with the cursor, for example, relevant information will pop up automatically (visit the webpage¹ to see how this works). For those requiring more specialised information, the Insight section will offer two articles on subjects of particular interest.

How can you contribute?

As with the project itself, we would also welcome your views on T2S OnLine. If you have any comments or if you would like to propose a subject for the Insight section, we would be very happy to hear from you. You can contact us by e-mail at T2S_team@ecb.europa.eu



Elin Amundsen and Stefania Secola, T2S Programme Office

¹ <http://www.ecb.europa.eu/paym/t2s/html/index.en.html>

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