

Euro Finance Week  
European Transaction Banking Conference  
16 November 2009  
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## **Europe after the T2S revolution – what will change for you?**

Ladies and Gentlemen, it is a pleasure to speak again at the Euro Finance Week. Not only because it is in Frankfurt and, therefore, simply a short taxi ride away from my office, but also because the Euro Finance Week has already given me the opportunity to speak about a number of European projects in the field of market infrastructure: the opening of TARGET, the first RTGS system for the euro, in 1999; followed by the introduction of TARGET2 in 2007; and not forgetting SEPA of course. The Eurosystem has now taken up another challenge, an even bigger one: T2S.

T2S will be a single technical platform which will allow central securities depositories (CSDs) and national central banks to provide borderless and neutral securities settlement services in central bank money in Europe. Borderless, because it will handle cross-border transactions and domestic ones in the same way and at the same price. Neutral, because it will operate under the same conditions for all CSDs in Europe.

We know that the present situation, where cross-border transactions are ten times more costly to settle than domestic ones, creates excessive costs for society, issuers and investors, as well as artificial profit opportunities for some market participants who benefit from a lack of competition.

I have called T2S a revolution because it will eliminate the drawbacks of the present European fragmentation of the securities settlement industry along national borders. However, I should point out that the revolution is not triggered by T2S alone, but by the combined efforts of the EU Commission, on the legal side, and the Eurosystem, on the technical side. I will not speak here about the Code of Conduct, the removal of

the Giovannini barriers or the future directive on securities clearing and settlement but they all clearly play a crucial role in what I refer to as the “T2S revolution”.

I am glad to see that I am no longer asked to speak about the reasons why the Eurosystem has embarked on this project. This proves that it is now a very well accepted project. I will, therefore, concentrate my remarks today on the likely consequences of the T2S revolution. Before doing this, however, I will provide you with some information about the current status of the project.

I am happy to say that the whole Eurosystem, from the programmers to the governors, is extremely committed to this project. We have about 250 colleagues, in five different central banks, working exclusively on T2S. A Programme Board has been set up to coordinate the effort, so that T2S can commence operations in June 2013, as planned. It seems that we have been rather convincing since 28 European CSDs, including all of the 19 which are based in the euro area, signed a memorandum of understanding in July and are actively helping us to prepare the contractual framework, which will specify the rights and obligations for both sides. T2S and the CSDs are not yet married, but they are definitely engaged!

An interesting feature of T2S, which came about almost by chance, is the fact that it will not be restricted to the euro, in accordance with the EcoFin Council’s request. We are now discussing with the Scandinavian central banks and the Bank of England the possible inclusion of their currencies. I hope we can reach an agreement. This would be a win-win situation, in which non-euro area countries could benefit from T2S, while the euro area would benefit from higher economies of scale.

This leads me to tell you where we are concerning pricing. More than a year ago, I indicated that we were aiming for the settlement fee to be no more than 15 cent per DvP transaction. This objective is still there, even if the financial crisis has forced us to revise our traffic estimates downwards, and thus our revenues. This price implies a reduction of more than 90% for cross-border transactions. I sometimes hear local banks or some CSDs claiming that T2S could increase settlement prices for domestic transactions. I have already said that anyone who believes this should contact me to discuss figures. Nobody has reacted so far. This is because settlement fees are just the

tip of the iceberg. There are typically other fees (e.g. fixed fees, fees for queries, etc.) which increase customers' bills. The recent decision by the Governing Council that every market participant should pay the same settlement fee, directly or indirectly, should also reassure smaller local participants. The economies of scale generated by T2S will be sufficient to reduce settlement costs for all market participants in Europe, big and small alike.

A key issue for the success of T2S so far has been its "external governance". This is mainly represented by the T2S Advisory Group, which is made up of about 80 participants, mostly banks, central banks and central depository institutions. All important decisions that directly impact the market are discussed openly in this forum, before the Programme Board makes a proposal to the Governing Council. This is important to ensure that T2S meets market needs. Following the signature of the Memorandum of Understanding by the CSDs, a new forum for discussing the CSDs' special needs and requirements has also been set up.

Before I end this long digression on the current status of the project, I would add for the specialists that the 700-page document called the General Functional Specifications was approved by the Programme Board last week and will be available on the T2S website very soon.

Let us now turn to the intended purpose of my speech: Europe after the T2S revolution. While I can speak with some authority as far as the project is concerned, I must be modest when I speak about its consequences on market structures and participants. I will try to summarise what I have heard and what seems likely to happen.

One may think that only professionals will be affected, and not the general public. Allow me to remind you that the reduction of settlement fees in Europe will facilitate the financing of the economy and will, therefore, benefit everyone. Moreover, those who invest in securities should see a substantial decrease in the settlement fees they pay to their banks.

Investors and issuers are often forgotten about in the T2S debate although they are the most obvious beneficiaries of the reduction in intermediation costs triggered by T2S. But European political authorities – the Commission, the Parliament and the Council – have spoken, on their behalf, in favour of T2S.

For the intermediaries, banks and CSDs, the T2S revolution will represent a challenge. Revolution means change, and change means risks. Some of them run the risk of becoming unfit for the new reality.

The CSDs will clearly be most affected by T2S as they will outsource their settlement services to the new system. Today, there are 19 CSDs operating in the euro area and almost 40 CSDs in the whole EU. This fragmentation is clearly not optimal for the development of financial markets in a common currency area or in a single market. Compared with the United States – which has a highly centralised clearing and settlement infrastructure, with the DTCC responsible for clearing and settlement of all corporate bonds and equities, and the US Federal Reserve handling mostly government securities – Europe is clearly at a disadvantage.

T2S has no direct impact on the number of CSDs. It will simply allow CSDs to be more efficient as investor CSDs because they will be able to offer their clients securities issued in another European country much more easily than they can today. Naturally, they will have to support one another for custody services, but the combination of the Code of Conduct and the T2S rules will ensure that this can be done under fair conditions.

But this is probably not the end of the story. Sooner or later, the European Commission will initiate legislation which will ensure that CSDs will no longer have national monopolies as issuer CSDs. The day will come when Volkswagen and Renault will be able to choose freely between Euroclear, Clearstream and any other European CSD when issuing bonds and equity. This is the logic of European integration. It is not clear when it will happen, but it will happen! And maybe as soon as the forthcoming directive, recently announced by the European Commission, is issued.

Let me make a comparison with the railway system. Before European integration, railways companies were building tracks and running trains, but only within the borders of their own country. In moving towards the integrated European railway system which we will soon have, one important step was to separate the responsibility for trains from the responsibility for tracks and allocate them to different companies. The next step will be to allow trains of different companies to run on the same tracks, across national borders. For CSDs, T2S is the company providing the “tracks”, i.e. the infrastructure – what economists would call the natural monopoly. But T2S will do better than the railway track companies because, from day one, it will be European and not national. The CSDs will use T2S like railways companies will use the tracks. For the first time, CSDs will be able to compete against each other. This is why I have always claimed that **T2S does not hamper competition, but fosters it.**

You may ask if this will lead to a reduction in the number of CSDs. Again, this is probably more a consequence of European integration than a direct consequence of T2S. This will happen progressively through mergers rather than bankruptcies. And even if economies of scale may give bigger CSDs an advantage at the beginning, this may not last. What will matter is the quality of service, not mechanical economies of scale.

CSDs as a whole will lose a large part of the revenues and profits generated by pure settlement. However, they will be in a position to offer better custody services to their customers, in particular as far as cross-border services are concerned. They will, therefore, be in a better position to compete with custodian banks in this respect.

As far as banks are concerned, let me start with a paradox: unlike CSDs, which were generally very reluctant to embrace T2S at the beginning, custodian banks have been very positive from the start, even though the reduction of settlement fees for cross-border transactions will have a greater effect on them.

At a time when it is fashionable to be negative about banks, I am happy to say that part of the explanation for this is that bankers have proved themselves to be consistent when claiming to be in favour of free competition and European integration. They

knew that, sooner or later, they would have to adjust to the European reality and they have not tried to resist change.

It is true that the main support for T2S has come from the bigger custodians. They know that they will lose the benefits they gain today from cross-border inefficiencies. But they also know that settlement is a commodity and that T2S will only cover part of the process. The bigger agent banks expect to increase profits through volume and through serving specific customer needs.

Another reason why bigger banks have been in favour of T2S is probably because T2S is very neutral in terms of competition between CSDs and custodians. In the past, CSDs and custodians had different business model. However, in recent years, CSDs have competed more and more with banks in offering wholesale services to smaller or less specialised participants. Rightly or wrongly, banks have claimed that CSDs were using their local monopoly situation in order to cross-subsidise their activities that were subject to competition. By progressively eliminating all monopoly elements embedded in the CSD function, T2S and the European legislation will create a new framework which will result in a more level playing field.

What about the smaller banks? Will T2S drive them out of business? My understanding is that smaller banks focus on custody services to ordinary customers. They may therefore welcome the cost reductions offered by T2S as it will give them a way to serve their customers better. Many of them will probably abandon the local custody business which they will no longer need with T2S.

This could mean that agent banks' activities will become even more concentrated than they are today and that wholesale custody activities in Europe will end up in the hands of a dozen large banks. Whether we like it or not, that may well be the market reality after the T2S revolution. Of course, the systemic risks involved in this evolution will have to be carefully monitored. A positive element will be that Europe will be on a level playing field with the United States and this will give European banks a chance to become real global players.

The future is not written – it is not set in stone. I have a comprehensive understanding of the project itself and I am very confident about it because we have excellent staff within the Eurosystem, who are working on it with a high degree of dedication.

The success of T2S will also depend on the way the market adjusts to it. If most market participants do not adjust to it, T2S will probably fail. If some adjust and other not, the former will survive and the latter will fail. The T2S revolution is also a Darwinian process!

Thank you for your attention