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Ms G Tumpel-Gugerell  
European Central Bank  
Kaiserstrasse 29  
D-60311 Frankfurt am Main  
Germany

Dear Gertrude

**SETTLEMENT OF STERLING-DENOMINATED SECURITIES TRANSACTIONS ON TARGET2-SECURITIES (T2S)**

I am writing to let you know our view on the proposal that the settlement of sterling-denominated securities should transfer from Euroclear UK & Ireland (EUI) to T2S.

We note that T2S is intended to provide a service based on a single platform offering delivery-versus-payment settlement in central bank money in an integrated environment. As such, we understand that the objective is to provide a more efficient settlement environment. This benefit would apply most clearly to settlement in euro-denominated securities, since that is currently characterised by a fragmented landscape for settlement. I can understand that addressing this situation has been identified as an important objective in the development of a single market in euro-denominated securities.

The situation is different in the UK, where there is single settlement infrastructure for all sterling-denominated securities, with a single pool of liquidity and delivery versus payment in central bank money. As you are aware, we are content with the well-established arrangement for the use of sterling central bank money in the settlement system.

You have asked for our view on the case for sterling-denominated securities settling in T2S. Over recent months, we have considered the available information on T2S, and have received the views of the UK National User Group and other interested parties. The overall summary of our assessment is that while there may be a case for a more integrated approach to securities settlement across Europe (going beyond euro-denominated securities), a number of very important issues require further careful consideration. As you will appreciate, these are matters of crucial importance for the future integrity of the sterling payment and settlement infrastructure.

The first of these issues concerns the governance of T2S. I should emphasise that our difficulties with the proposed model of governance are shared by the UK National User Group and the other parties that have commented to us. First, we would not be content with sterling settlement being part of a T2S system that is under the ultimate control of the Governing Council. This is not intended as a criticism of the Governing Council, but rather to emphasise that as a general matter we could not accept this sort of asymmetric governance structure. The second point on governance is that within an overall governance structure that should reflect the share of each currency in usage of the system, we would require a very clear arrangement that provides for the Bank and UK users to exercise direct control over sterling settlement in T2S. This is of critical importance to the Bank because we must have a sterling settlement system that is both robust in its daily operation and under our control in terms of development and modification to meet our changing needs (for instance, as we modify our central bank operations from time to time, something that we have needed to do at short notice in response to the crisis).

The second important issue that requires careful consideration concerns costs. We would need to have a very clear understanding of the cost of sterling settlement within T2S, and how that compares with the current and likely future cost of settlement in EUI. In order to do this, I would be prepared to require Euroclear to provide us with their cost calculations, but it will also require a lot more information on T2S costs. In short, we need to understand how migrating sterling settlement to T2S will enable all users here, including solely domestic ones, to achieve cost reductions. The importance of properly understanding the cost implications of T2S for sterling settlement has been stressed by the UK National User Group.

Finally on costs, I should emphasise that we would require a binding commitment that central banks would not absorb any of the development costs of T2S, and the costs of settlement once it is introduced.

I would welcome your thoughts on the issues raised in this letter. The Bank of England should then be in a better position to decide whether we want to continue to assess the integration of sterling securities settlement in T2S.

Yours Sincerely

Andrew

