

T2S PROGRAMME OFFICE

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T2S HARMONISATION

FIRST PROGRESS REPORT

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1. Executive Summary

The ECB Governing Council has supported post-trade harmonisation since its decision to launch T2S in 17 July 2008. Harmonisation is considered by market participants as a necessary drive for EU market consolidation and system interoperability and for the maximisation of T2S' added value to their business models. Harmonisation is also important in fostering the so called "lean T2S" operational framework, i.e. the avoidance of replicating national specificities into the system's operational blueprint.

The T2S Programme Office (PO), the T2S Advisory Group (AG) and ultimately the T2S project itself, have all committed resources and embraced post trade harmonisation via a multitude of actions and deliverables. The ECB Governing Council approved T2S User Requirements Document (URD), as well as its subsequent "T2S scope definition and specification" documents are structured around key harmonisation principles. The adoption of a single IT communication protocol (ISO 20022) and the single timetable of the settlement day are, among others, the most typical examples. In addition, the AG has worked via its substructures in delivering T2S standards and market practices, e.g. in settlement process efficiency, in corporate actions and in message standardisation.

The AG decided in its 7 March 2011 meeting, to create a new T2S Harmonisation Steering Group (HSG). The mandate of the HSG is to provide guidance to the PO and advice to the AG regarding the T2S harmonisation activities. The HSG assists AG in monitoring the implementation of the T2S harmonisation agreements and standards in T2S relevant markets. This will be achieved with the help of T2S National User Groups (NUGs) and other relevant actors. Furthermore, the HSG will advise the AG when an escalation process is necessary, either to the EU Commission or any other public authorities. The aim is to achieve harmonisation in T2S crucial areas prior to the T2S launch date (September 2014).

This is the first AG Progress Report on T2S harmonisation. A second report is planned for November 2011. The report includes a detailed presentation of the status of each T2S harmonisation activity together with proposals to the AG for further action.

The AG has identified three main phases/processes in a harmonisation activity: the definition of the standard, the monitoring process of its implementation and the actual implementation by the relevant actors. In summary, there is rather good progress in the definition process although some further work is needed in the context of formal endorsement by relevant bodies (AG, CSDs, Eurosystem and the EC Commission where necessary). On the other hand, the work on the monitoring and implementation processes is at the moment less advanced. However, these processes are only relevant once the definition process is complete.

The AG agreed with the HSG proposal. In particular the following action points were endorsed:

- 1 The AG chairman will send a letter to the EC Commission (DG-Markt) for clarifying the importance of the proposed CSD legislation's harmonisation aspects on the T2S project (*see sections 3.5.3-4, 3.6-7, 4.2.1-2 for more details*). The letter will focus on the following issues:**

- The relevant principles of settlement finality;
 - IT outsourcing to public authorities;
 - EU Settlement Discipline Regime;
 - EU rule for settlement cycle
 - Location of securities account (Law applicable);
 - Freedom (location) of issuance;
- 2 There is no need for establishing a monitoring process for CSD's implementation of the T2S ISO messages. However, a concrete implementation date for CSDs compliance should be maintained in the T2S harmonisation list: the Synchronisation Point (SP) 8: *ready for interoperability tests (section 3.1.1)*.
 - 3 The T2S matching fields monitoring process should be assigned to the T2S National User Groups (NUGs) as soon as the definition process is complete (UDFS finalisation). The follow up work on the market usage of optional matching fields should be postponed for a later stage of the project when the CSDs' adaptation plans on their accounts' mapping to T2S is clarified in detail (*section 3.1.2*).
 - 4 Once T2S Schedule of the settlement day is final (UDFS finalisation), T2S NUGs should monitor CSDs' compliance (*section 3.2*).
 - 5 The creation of an action list per market. Progress of this deliverable will be monitored by the T2S NUGs via their reports to the HSG and eventually to the AG (*section 3.3*).
 - 6 The AG takes note that CSDs' compliance with T2S CA standards is low (CASG survey 2010). Following the completion of the 2011 T2S CA survey, a more detailed report will be presented to the AG in November (*section 3.4*).
 - 7 The CSD Steering Group (CSG), i.e. the successor of the CCG, should further work on establishing such harmonised rule (Settlement finality I: moment of entry into the system) in coordination with the T2S PO legal experts (*section 3.5.1*). A progress report to be made regularly to the HSG.
 - 8 Following the signature of the T2S Framework Agreement (FA), the T2S PO should undertake the task of monitoring the CSDs' compliance with the established harmonised finality rules (*Settlement finality rules II and III: irrevocability of transfer orders and irrevocability of securities transfers see sections 3.5.2 - 3*). A progress report to be made regularly to the HSG

2. Introduction

Based on the HSG proposals, the AG agreed on the harmonisation reporting tools as well as the methodology for establishing and maintaining these tools. The T2S harmonisation list will be maintained as the key HSG deliverable to all AG meetings. The list will be accompanied by a status report on the progress of all T2S harmonisation activities. In addition and in line with its mandate, the HSG will deliver a T2S harmonisation progress report to the AG on a semi-annual base. This first report was delivered to the AG for approval on 30 June 2011. A second progress report is planned for AG discussion for 29 November 2011 AG meeting. The T2S Programme Board (PB) may consider presenting the harmonisation progress report (or parts of it) to the ECB Governing Council.

The progress report includes an update on each T2S harmonisation activity. For each activity, the background info together with the status and the potential risks for the T2S project are provided. In each topic and where relevant, the HSG provided the AG with a proposal on a follow up action (also summarised in the Executive Summary).

Section 3 provides the updated information on high priority harmonisation activities.

Section 4 provides the updated information on low priority activities.

Annex 1 includes the methodology used for compiling the T2S harmonisation list.

2.1 Harmonisation Activities

These activities are currently monitored by the PO under the guidance of the HSG. They are based on the HSG comments, the AG substructures' work and the PO's own analysis. Each activity may include more than one sub-activities and individual issues. For example, the AG has identified three distinct issues on settlement finality rules (I, II and III).

High priority activities

These are activities which are necessary for a successful T2S launch. HSG and T2S PO should focus their resources, as appropriate, on these activities.

- 1 T2S messages;
 - 1.1 T2S ISO 20022 messages;
 - 1.2 T2S matching fields;
- 2 T2S settlement day;
- 3 Smooth cross-CSD settlement;
- 4 Corporate actions on flows;
- 5 Legal harmonisation;

- 5.1 Location of accounts
- 5.2 settlement finality I (moment of entry);
- 5.3 settlement finality II (irrevocability of transfer order);
- 5.4 settlement finality III (irrevocability of securities transfer);
- 5.5 IT outsourcing;
- 6 Settlement discipline regime;
- 7 Settlement cycles.

Low priority activities

These are important harmonisation activities which are beneficial for the market but not necessary for the T2S launch. HSG/PO and AG should only monitor progress in these activities.

The fact that an activity is of low priority does not mean that the HSG/ PO or the AG can not maintain a regular contact with the relevant actors since the potential benefits to the T2S operations could be substantial (e.g. investment fund shares settlement)

- 1 Corporate actions on stocks
- 2 Place of issuance
- 3 Tax procedures
 - 3.1 Transaction tax
 - 3.2 Withholding tax
- 4 Shareholder transparency
- 5 Investment funds shares settlement

3. T2S Harmonisation Activities – High Priority

3.1 T2S Messages

3.1.1 T2S ISO 20022 messages

Issue description

The core objective of this activity is to develop the ISO 20022 T2S related messages. The AG (via the T2S Subgroup on Message Standardisation - SGMS) and the 4CB are the main actors in this activity.

Developments/Status

During the AG meeting of 7 March 2011 the SGMS chairman flagged that 11 changes would be required to improve the exchange of messages in T2S, at least four of which would trigger a formal change request to the URD. The 4CB mentioned that for five issues their rough assessment shows a high impact on the URD. The AG asked the 4CB to provide a detailed assessment in terms of cost and time for review by the T2S Programme Board (PB) and the AG.

In terms of implementation, the HSG recommends to the AG that compliance of relevant T2S actors should be achieved by 2 January 2014 (SP 8: ready for interoperability testing).¹ Here the term “compliance” is used as the readiness of T2S Actors to test in accordance with the T2S ISO standards. Actual “registration” of the T2S ISO messages is planned to take place after successful T2S testing.

The HSG does not see the need for the establishment of a T2S ISO messages monitoring process. T2S ISO messages are part of the technical specifications/requirements of the T2S actors’ interaction with the T2S services. (i.e. a T2S actors not complying with the T2S ISO messages will not be able to participate in the T2S testing phase)

The SGMS reviewed the schema files of the T2S messages prepared by the 4CBs in view of their insertion in UDFS v1.0. Out of the 123 messages that are currently expected to compose the T2S message catalogue, the UDFS v1.0 already contains 103 messages (83%). The remaining 20, notwithstanding additional ones, are expected to be ready for UDFS version 1.2 subject to the approval of the CRs.

Risks

Provided that the definition process progresses well (remaining T2S ISO messages in UDFS) no risks were identified by the HSG

The HSG proposed to the AG:

¹ By SP8, the Eurosystem will have prepared test cases and will confirm that: (i) test cases are ready, (ii) Eurosystem staff is trained and (iii) main testing support processes are clarified and communicated. At the same time, the T2S actors (CSDs, NCBs) confirm that connectivity tests were successful and internal changes on legacy systems, interfaces and static data are ready for testing with T2S.

- **That no monitoring process needs to be established for CSD's implementation of the T2S ISO messages;**
- **However, a concrete implementation date for CSDs compliance should be maintained in the T2S harmonisation list: the Synchronisation Point (SP) 8: *ready for interoperability tests*.**

3.1.2 T2S matching fields

Issue description

The target of the activity is to ensure a single list of T2S matching fields and their compliance with the ESF-ECSDA matching standards.²

Developments/status

Following a proposal from the smooth cross-CSD settlement task force, the AG has approved all proposals on the T2S matching fields, including the securities account field as an optional matching field (i.e. matching field becomes mandatory for settlement if both T2S instructing parties include the field)

Since the T2S matching fields' will be part of the UDFS, their definition process should be considered final once the UDFS is final.

The AG encouraged the definition of a single T2S market practice on the use of the securities account as an optional matching field. However, the same requirement is relevant for the usage of all optional matching fields.

As with all T2S ISO messages, implementation of the T2S matching fields is planned for SP8.

Risks

The HSG identified no risks

HSG proposals to the AG

- **that the T2S matching fields monitoring process should be assigned to the T2S National User Groups (NUGs) as soon as the definition process is complete.**
- **The follow up work on the market usage of optional matching fields should be postponed for a later stage of the project when the CSDs' adaptation plans on their accounts' mapping to T2S are clarified in detail.**

² ESF-ECSDA matching standards, 5 October 2006.

3.2 T2S Schedule of the settlement day

Issue description

The URD finalisation includes some key harmonisation agreements. One example is the use of a single schedule of the T2S settlement day. However after the URD and draft UDFS publication, market participants have raised a number of issues that required further clarification (e.g. start of the night time settlement (NTS) processes, timing of the night time sequences and their connection to the CA standards).

Developments/status

A workshop on the Schedule of the T2S settlement day was organised by the PO on 13 May 2011 with the 4CB, CSDs and market participants. The key outcome of this workshop was that the current T2S Schedule and its indicative timing as proposed in the draft UDFS should not be changed at this stage and should be reviewed in line with the expected T2S settlement volumes.

Regarding the key question raised by the CSDs and Corporate Actions Subgroup (CASG) members on the time available between end of day and start of day settlement, the workshop agreed that there are adequate tools in T2S for CSDs to manage their CA if they are delayed (i.e. the blocking of affected balances).

Finalisation of the T2S schedule is pending finalisation of the UDFS. Monitoring of implementation should only commence after UDFS finalisation. SP8 is also applicable for this activity in terms of implementation date.

Risks

None identified

HSG proposals to the AG

- **Once T2S Schedule is final (UDFS finalisation), T2S NUGs should monitor CSDs' compliance**

3.3 Smooth cross-CSD settlement

Issue description

Despite the URD agreement and the T2S harmonisation work conducted by the T2S substructures thereafter, the AG has agreed that further analysis was required on identifying national barriers to the T2S cross-CSD efficiency.

Developments/Status

The task force on smooth cross-CSD settlement has received extensive and detailed responses on the consultations it issued. The task force is still analysing the responses received.

At the moment, the issues raised by respondents have been classified in broader categories and in terms of relevance and scope for the task force's mandate. Some issues are a matter of CSDs adaptation plans for T2S. Others may require a technical solution in T2S. The remaining ones may trigger a harmonisation request to be included in the T2S harmonisation list. Some of the issues identified in the task force are already covered in the list (e.g. settlement finality)

The task force will provide the AG with its final report in 30 June 2011

Risks

The TF's report to the AG June meeting may not include all relevant harmonisation issues and follow up actions required for identifying responsible actors and for initiating implementation monitoring.

HSG proposals to the AG

- **Pending on the outcome of the Smooth cross-CSD settlement task force and assuming that harmonisation proposals are made to the AG, the HSG proposes to the AG the creation of an action list per market. Progress of this deliverable will be monitored by the T2S NUGs via their reports to the HSG and eventually to the AG.**
- **A renewed mandate for the task force or another AG subgroup to continue its work.**

3.4 Corporate Actions on flows

Issue description

The AG decided already in 2008 that work was required in establishing T2S standards on CA on flows (pending transactions). The T2S Corporate Actions Subgroup (CASG) formulated the detailed T2S standards based on the high level CA market standards (as defined by the Commission sponsored Corporate Actions Joint Working Group – CAJWG). The AG approved the standards in September 2009 and an updated version in March 2011.

Developments/Status

Work has progressed well in the drafting of the CA Business Process Description (BPD) document. The 2011 gap analysis for CSDs' compliance with the T2S CA standards is on time (launched in 1 April 2011).

Furthermore, the CASG has identified two key issues regarding the T2S specification where follow up work is urgently required (see also CASG status update to the March AG):

- Timing of NTS and CA. The issue is now solved following the 13 May 2011 Schedule workshop.
- Partial settlement of CAs during settlement restrictions. The issue is pending the assessment of the relevant change request to the AG;

Compliance of T2S CSDs and markets with the CA standards remains low.

Risks

The remaining T2S functionality (no partials during a CA) needs to be described in detail in the T2S documentation. Unless this functionality is offered by T2S in accordance with the established market practices, there will be serious inefficiencies with the settlement of CA in T2S.

HSG proposals to the AG

- **AG to take note that CSDs' 2010 compliance with T2S CA standards is low.**
- **Following the completion of the 2011 T2S CA survey, a more detailed report will be presented to the AG in November**

3.5 Legal Harmonisation

3.5.1 Location of securities accounts

Issue description

The issue of the location of accounts refers to the law applicable to the creation of rights and transfers of securities.

Clarity on the applicability of the national law of the SSS notified to the EC and operated by the CSD is important for T2S in two regards: (1) securities accounts in T2S remain legally attributed to the CSD, regardless of the physical location of the IT infrastructure and (2) all securities held on accounts in T2S are subject to the law applicable to the SSS operated by the CSD legally maintaining the respective accounts, regardless of the country of issuance (i.e. where the issuer CSD is located).

A harmonised rule for the location of securities accounts must be clearly determined and compatible with the set up of T2S so as to mitigate legal risk for CSD links in T2S. The lack of this harmonised rule would undermine the establishment and usage of CSD links in the context of T2S.

Developments/status

Securities Law Directive (SLD) and (possibly) also the proposed CSD regulation might provide such a harmonised rule. The ECB has commented on the consultations for the Securities Law Directive (SLD) and the CSD regulation in support of the establishment of a harmonised rule.

Risks

There is a risk that the harmonised rule might not be established in one or the other European legislation acts. In particular, the SLD adoption process in the national jurisdictions may not be complete by the time of the T2S launch.

HSG proposals to the AG

- That the issue is included in the AG letter to the Commission

3.5.2 Settlement Finality I (moment of entry)

Issue Description

Moment of entry of transfer order into the system (Art. 3 of the Settlement Finality Directive – SFD)

The issue is also covered in Art. 19 (par. 4) of the draft FA.

The aim of this activity is the elimination of uneven protection of CSD participants against the risk of insolvency of participants in other CSDs (interoperable systems in T2S) in accordance with the SFD. The moment of entry of transfer orders into the system is determined in the rules of all CSDs (as required by the SFD); however, this rule is not yet harmonised across the EU. To ensure a fully efficient finality in

T2S as well as for reasons of level playing field, the definition of a single moment of entry of transfer order would need to be agreed and implemented for all T2S CSDs.

Developments/status

The FA (Art. 19) discussion seems to recognise in its current draft, the need for establishing a harmonised CSD rule for the moment of entry of transfer orders into the system (the need but not the rule is also covered in Art. 3 of the Settlement Finality Directive - SFD). The HSG agreed to propose to the AG that the new CSG group (the successor to the CCG) should further work on establishing such rule in coordination with the T2S PO legal experts. In addition, the CSDs' compliance with the harmonised rules should be assessed [by the PO, T2S Board] against the obligation of compliance on a ongoing basis with the CSD eligibility criteria.

The issue will be part of the AG letter to the DG-Market.

Risks

There is a risk that there is a lack of consensus/agreement among CSDs on a single rule for defining the moment of entry and therefore uneven protection of CSD participants against the risk of insolvency of participants in other CSDs (interoperable systems in T2S).

HSG proposals to the AG

- **The CSD Steering Group (CSG), i.e. the successor of the CCG should further work on establishing such harmonised rule in coordination with the T2S PO legal experts. A progress report to be made regularly to the HSG.**
- **Part of the AG chairman letter to DG-Markt**

3.5.3 Settlement Finality II (transfer order irrevocability)

Issue Description

Irrevocability of transfer order (SFD, Article 5)

The aim of this activity is the elimination of the risk of transfer order revocation in a cross-border environment

Developments/status

The irrevocability of transfer orders in T2S is protected through the rule prohibiting the unilateral cancellation of instructions after T2S matching (URD v5.0). The current drafting of the T2S Framework Agreement (FA, article 19) is proposing that the T2S contracting CSDs shall make all necessary arrangement at harmonising definitions of the irrevocability of transfer orders.

The definition process is finalised via the completion of the URD (no unilateral cancellation in T2S after matching). Regarding the monitoring process, the HSG proposes to the AG that the T2S PO undertakes this task.

Risks

CSDs should by default comply with the T2S URD irrevocability of transfer order (i.e. no unilateral cancellation in T2S) and the FA (Art 19) obligation. However, there is a need to ensure that their regulatory environments are updated accordingly.

HSG proposals to the AG:

Following the signature of the T2S Framework Agreement (FA), the T2S PO should undertake the task of monitoring the CSDs' compliance with the established harmonised finality rules (*Settlement finality rules II*). A progress report to be made regularly to the HSG.

3.5.4 Settlement Finality III (securities transfers irrevocability)

Issue Description

Irrevocability of securities transfers.

In order to facilitate legally sound, seamless cross-border DVP settlement, T2S participating CSDs have to recognise account entries in T2S as unconditional, irrevocable and enforceable.

Developments/status

ESMA is aware of the issue and it has also raised it to the Commission.

Irrevocability of securities transfers is addressed in Article 19 of the draft T2S Framework Agreement and is explicitly stated in the ESCB/CESR recommendation (Recommendation 8, irrevocability and enforceability of settlement). According to the current FA drafting the T2S contracting CSD shall make all necessary arrangement with regard to its operational processes to achieve the unconditionality, irrevocability and enforceability of the settlement processed in T2S. This is particularly relevant in the case where the accounts representing legal ownership rights are maintained by the CSD in its local legacy IT-system, i.e. outside T2S. In these cases and independently of the holding model followed by each market, harmonisation of settlement finality rules would ensure that bookings in T2S maintained accounts are irrevocable, unconditional and enforceable.

This is a key critical issue for T2S and it needs to be ensured that relevant CSD legislation is adopted and implemented by the time T2S starts operations.

Risks

There may be regulatory or legal barriers for CSDs to adapt their rules in line with Art. 19

As with other legal harmonisation issues there is question as to the timing of issue resolution prior to T2S.

HSG proposals to the AG

- **Following the signature of the T2S Framework Agreement (FA), the T2S PO should undertake the task of monitoring the CSDs' compliance with the established harmonised finality rules (*Settlement finality rules II*). A progress report to be made regularly to the HSG**
- **The issue should also be part of the AG letter to DG-Markt.**

3.5.5 IT outsourcing (settlement services)**Issue Description**

The outsourcing of settlement services to T2S requires approval by the relevant regulator, subject to the applicable national laws and regulations. Some national legislation/regulations either prohibit or hamper outsourcing of settlement services.

Developments/status

The matter has been highlighted by ESMA and is also addressed in the proposal of the EU Commission on the CSD regulation. The ECB sent comments on the drafting of the EU Commission's CSD legislation consultation regarding the exception of the outsourcing to a public entity from any future potential CSD regulation.

The FA will recognise that participation in T2S requires regulatory approval. This will be accomplished by providing CSDs with a specific right to terminate the FA if such regulatory approval is finally refused. This is a key critical issue for T2S and it needs to be ensured that relevant CSD legislation is adopted and implemented by the time T2S starts operations.

Risks

As with other legal harmonisation issues there is question as to the timing of issue resolution prior to T2S.

HSG proposals to the AG

- **The issue should also be part of the AG letter to DG-Markt.**

3.6 Settlement Discipline Regime

Issue description

There is a need in the EU for a harmonised settlement discipline regime. This ensures a level playing field and avoids the risk of the so called regulatory arbitrage, i.e. volumes shifting to the softer regimes. In addition, weak settlement discipline regimes would have an impact on fails and potentially on financial stability.

Developments/status

The initiatives of ECSDA and the AG have flagged the need for a level-playing-field with regard to settlement discipline and put the issue on the EU agenda of post trade harmonisation. The ECB has prepared a comment in support of its inclusion in the forthcoming CSD legislation.

The forthcoming CSD legislation will define the follow-up steps. Assuming that the general principle for an EU wide settlement discipline regime is adopted in the legislation, ESMA and ESCB could be the right actors for defining the technical details of such a framework.

Risks

Relevant measures might not be implemented by the time T2S goes live. Depending on the progress of the CSD legislation and the potential involvement of ESMA, in coordination with ESCB, in establishing a regime for EU, any possible delays in view of the T2S launch have to be further assessed and reported to the AG.

HSG proposals to the AG

- **The issue should be part of the AG letter to DG-Markt.**

3.7 Settlement cycles

Issue description

The existence of differing settlement cycles in T2S has no impact on the core settlement process since T2S is settlement cycle neutral.

However, the establishment of a single settlement cycle in the EU will facilitate for T2S participants' technical infrastructures both the rationalisation of the back-office activities and the management of their cross border CAs (since the timelines of the CA standards are based on the settlement cycle rules). This is due to the fact that the Commission sponsored Corporate Actions Joint Working Group (CAJWG) standards are based on a single settlement cycle timeline.

Developments:

Work has been completed in the EU Commission working group on settlement cycles harmonisation.

The group has recommended for a T+2 settlement cycle rule in the EU.

France has already agreed on a T+2 rule but national implementation is postponed in view of the establishment of an EU wide rule.

Risks

Depending on the follow up actions by the Commission (e.g. CSD legislation) any possible delays in view of the T2S launch have to be further assessed and reported to the AG.

HSG proposals to the AG

- **The issue should be part of the AG letter to the DG-Markt**

4. T2S Harmonisation Activities - Low priority

4.1 Corporate Actions on stocks

Issue description

The market standards on corporate actions on stocks (settled balances) were finalised in October 2009 by the Commission sponsored Corporate Actions Joint Working Group (CAJWG). The standards were subsequently endorsed by the relevant forums and industry associations (CESAME2, EBF, Issuers etc). These market standards are the base of the T2S CA standards. Although T2S is not involved in maintaining or monitoring the CA market standards, the HSG would like to keep the issue in its radar for information purposes.

Developments/status

E-MIG: Overall good progress and in most cases action plans and timelines defined to resolve open issues. On average 70-90% of the distributions and reorganisations (the CA standards monitored by E-MIG) are met or are in the process of being met by the countries participating in the exercise (not all countries have provided responses).

Open issues

In Germany the implementation of record date and payment date for cash distributions.

Buyer Protection Standards 1 to 4 and related key dates have to be implemented also in markets that choose not to automate the process. CAJWG is requested to develop more detailed processing rules

The final timeline for comprehensive implementation of the standards in 2013 has been confirmed

The next E-MIG workshop Market Standards for Corporate Actions Processing will take place in October 2011. It will focus on (i) open issues and (ii) processing standards

HSG proposals to the AG

- none

4.2 Place of issuance

Issue Description

Freedom of importability/exportability of issuance of securities.

There are restrictions (in national law or market rules) on the place of issuance of securities and consequently on the choice of infrastructures/ service providers for issuers. This barrier has no impact or operation/legal risks for T2S but has an influence on market competition conditions for issuer CSD services.

Developments/status

The location of issuance can be connected to various comments sent to the T2S PO in the context of smooth cross-CSD settlement (section on access and interoperability). Provisions in the direction of removing barriers in choosing the place of issuance are contemplated in the context of the forthcoming CSD legislation.

Risks

No risks for T2S operations. Only impact on competition conditions for T2S actors.

HSG proposals to the AG

- **That the issue is assigned a low priority for T2S;**
- **That the issue is included in the AG letter to the Commission**

4.3 Tax procedures

Two of the Giovannini barriers (11 and 12) relate to fiscal compliance procedures³. The Commission sponsored FISCO Group explored issues linked to these barriers further and proposed solutions on how to dismantle them.

4.3.1 Transaction tax procedures

Issue description

Barrier 12 deals with national provisions requiring that taxes on securities transactions be collected via local systems. According to the Giovannini report any provisions requiring that taxes on securities transactions are collected via local systems should be removed in order to ensure a level playing-field between domestic and foreign investors.

Developments/status

According to the Commission, the urgent problems related to Giovannini barrier 12 and transaction tax procedures appears now, in general, to be successfully solved. The first FISCO Report – the Fact Finding Study- identified 2006 no less than 11 jurisdictions in the European Union with more or less problematic transaction tax procedures in the perspective of the Giovannini barriers and the internal market. However, in general, those problems appear now to be successfully solved by the Member States.

Risks

No substantial risks identified for T2S efficiency

HSG proposals to the AG

- None identified

4.3.2 Withholding tax procedures

Issue description

Barrier 11 relates to domestic withholding tax regulations, i.e. that foreign intermediaries cannot sufficiently offer withholding tax relief at source or only under the condition that they have a fiscal agent. Withholding tax procedures in the T2S relevant CSDs and markets should comply with the Commission's October 2009 Recommendation.

Developments/status

³ Giovannini Group, Second report on EU clearing and settlement arrangements, Brussels, April 2003 page 11. The findings regarding obstacles resulting from tax procedures of this Giovannini report are reflected within the Commission communication on "Clearing and settlement in the EU – The way forward", COM(2004) 312 final, under heading "3.2. Taxation issues".

Following the FISCO report, the EU Commission in October 2009 adopted a Recommendation on withholding tax relief procedures⁴ that outlines how EU Member States could make it easier for investors resident in one Member State to claim entitlements to relief from withholding tax on securities income (mainly dividends and interest) received from another Member State. The Recommendation also suggests measures to eliminate tax barriers for the securities investment activities of financial institutions. This is important because a study by the Commission services shows that at present the costs related to the present reclaim procedures are estimated to a value of €1.09 billion annually whereas the amount of foregone tax relief is estimated at €5.47 billion annually.

The Recommendation – the first one in the tax area since approximately nine years – was an important step forward in trying to solve fiscal barriers in the post-trading environment.

The recently created Tax Barriers Business Advisory Group (T-BAG) will consider the follow-up to the Commission recommendation from a business perspective and to identify any other remaining fiscal barriers affecting the post-trading environment

Withholding tax procedures in the T2S relevant CSDs and markets should comply with the Commission's October 2009 Recommendation

Risks

No substantial risks identified for T2S operations.

HSG proposals to the AG

- **None identified**

4.4 Cross-border shareholders transparency

Issue description

In most EU countries there are efficient models for identifying domestic shareholders. . There is no European model for enabling issuers to identify their owners in a cross-border (and T2S) holding.

Developments

This is a low priority activity for T2S harmonisation

The Task force on Shareholder Transparency (TST) presented its final report to the AG in March 2011. It includes proposals:

- on market practices for exchanging shareholders' disclosure requests and responses;

⁴ The Commission's Recommendation (COM (2009) 7924 final), the underlying study on "The Economic Impact of the Commission Recommendation on Withholding Tax Relief Procedures and the FISCO Proposals" and other background documents related to fiscal compliance procedures have been published on the Europa website: http://ec.europa.eu/internal_market/financial-markets/clearing/compliance_en.htm
[http://ec.europa.eu/taxation_customs/resources/documents/common/whats_new/C\(2009\)7924_en.pdf](http://ec.europa.eu/taxation_customs/resources/documents/common/whats_new/C(2009)7924_en.pdf)

- to the ISO community for a disclosure request/response message standard;
- a description of decentralised and centralised technical models for exchanging shareholder information on a cross-border basis;
- to amend the Transparency Directive to facilitate exchange of shareholder information on a cross-border basis.

The conclusions of the TF were supported by the vast majority of the AG and will be shared with relevant bodies for further action (EU Commission, EuropeanIssuers, ECSDA etc). The supporting institutions-members of the TST issued the request to the ISO community on 1 June 2011

The AG mandated the HSG to review the work of the Task Force and its implications for possible further harmonisation work in T2S.

Risks

No risks identified for T2S efficiency

HSG proposals to the AG

- **None identified**

4.5 Investment Funds settlement

Issue description

There is no need for special T2S functionalities for fund shares settlement in T2S. However, the introduction of fund share settlement in CSD accounts (not the case in all EU markets today) could have an impact on T2S settlement volumes and prices (although statistics on funds settlement volumes are not readily available).

Developments

In view of the introduction of T2S, the European funds industry considers the standardisation of its cross-border distribution models in the EU. The European fund industry association (EFAMA) has created a T2S working group to further elaborate on the relevant models.

Based on the input provided by EFAMA to the T2S PO in January 2011, a third T2S and Funds workshop took place on 10 March 2011 at the ECB. The T2S PO provided clarifications from a T2S perspective to the EFAMA concerns related to cross-CSD settlement in T2S.

The PO will also release the draft T2S Business Process Description (BPD) for a commenting procedure in summer 2011. Prior to the draft T2S BPD publication, the PO has provided the fund workshop participants with the draft BPD chapter on fund share settlement in T2S for informal comments.

A fourth T2S and Funds workshop may need to be organised following the draft T2S BPD publication and the progress in the work of the EFAMA T2S working group

This is a low priority activity for T2S harmonisation. It is sufficient to support the funds industry on an ad-hoc basis by means of dedicated workshops.

However, the potential high volumes of fund shares settlement (currently outside CSD accounts settlement) could have an impact on T2S prices.

Risks

No risks for T2S launch.

HSG proposals to the AG

- **None identified**

5. Annex 1: Methodology

The following methodology is used for compiling the deliverables of the HSG to the AG (Progress Report, T2S Harmonisation List and Status Update Dashboard)

Harmonisation Activities

Each activity may include sub-activities and issues

Example

Activity: Settlement Process Efficiency

Sub activity: Smooth cross-CSD settlement

Issues: to be proposed by the cross-CSD TF (e.g. CSD omnibus accounts availability)

Prioritisation of activities

According to the AG discussions so far, two prioritisation levels are used in the list:

High Priority: Activities necessary for successful T2S launch. HSG and T2S PO focus their resources in these activities.

The fact that an activity is of high priority for T2S does not mean that the HSG will be the key definition or monitoring actor (e.g. T2S ISO messages, legal harmonisation)

Low Priority: Activities beneficial for the market but not necessary for T2S launch. HSG and AG only monitor progress in these activities.

The fact that an activity is of low priority does not mean that the T2S PO or the AG can not maintain a regular contact with the relevant actors since the potential benefits to the T2S operations could be substantial (e.g. fund shares settlement model)

Harmonisation processes

Three harmonisation processes for each activity/issue in the List:

Definition: What are the standards and who is responsible for defining them?

Monitoring: What is the process and who are the actors responsible for monitoring that T2S Actors are complying with the standards/rules?

Implementation: What is the process and who ultimately needs to implement changes and adapt to the harmonisation standards/rules?

Responsible Actors

For each process clear responsible actors and concrete deadlines are proposed:

- **Definition Actors:** entities responsible for defining the standard (e.g. AG supported by CASG in the T2S CA standards)
- **Monitoring Actors:** entities responsible for monitoring that T2S Actors are complying with the standard (e.g. AG supported by CASG in the T2S CA standards)
- **Implementation Actors:** entities responsible for ultimately implementing changes and adapt to the standard (e.g. CSDs, their participants and perhaps regulators in the T2S CA standards)

Status

Colour/symbol scheme: A specific colour, based on a three colours scheme, is displayed in the status update dashboard to reflect the progress in each process (Definition, Monitoring and Implementation).

Colour	Description
Green	Harmonisation Activity/Deliverable is within the required scope and quality and is on time (NOTE: not necessarily completed)
Yellow	Harmonisation Activity/Deliverable will not have the required scope, will be/is delayed and/or not of the required quality if no corrective measures are taken
Red	Corrective measures have not delivered the expected effect or no corrective measures are possible. Deliverable/Activity will be delayed to achieve the required quality or scope if no extraordinary action is taken and requires escalation

Symbols

- X** process not started yet
- N/A** process not applicable
- ?** lack of information
- unchanged status from previous report
- ↗** status improves from previous report
- ↘** status deteriorates from previous report

6. Annex 2: T2S Harmonisation List

[version 1.2 attached]