

Norwegian T2S NUG 2nd April 2008

Market Feedback on T2S User Requirements and Annexes from the Norwegian NUG

The Norwegian consultation group / NUG welcomes the proposal of harmonising clearing and settlement through Target 2 Securities. The group has representatives from VPS, Norwegian banks and Norwegian Securities Dealers Association. Meetings are hosted by Norges Bank, who also acts as secretariat for the group. The User Requirement Documents (URD) has been discussed in the consultation group. The comments in this note represent the view of the participants in the group, and should be read in view of the fact that Norway is a country of direct holdings.

1. Our main concern is to have safe and efficient solutions at a high service level and at acceptable prices for the end investors. There has been no proven business case for establishing links towards other CSDs for cross-border settlements. One obvious reason for this is that we are not part of the euro-zone. Hence it is not certain that T2S will represent efficiency gains in the settlement of trades in NOK. Though, cross-CSD-settlement through T2S might give efficiency gains for Norwegian markets players in euro.
2. We believe it is difficult to evaluate the potential gains to the end investors from establishing T2S without knowing the results of the economic impact analysis, pricing structure and governance model.
3. Harmonisation in the area of corporate actions is part of the Giovannini barriers. Although all transactions resulting from a corporate action will be updated in T2S, the lack of harmonisation across Europe still represents a huge cost to all players.
4. Legal harmonisation is crucial. If the different countries do not achieve substantial legal harmonisation, T2S will be a network of different systems instead of one common system. Consolidation between national CSDs in countries with similar legal framework may then create larger efficiency gains than T2S.
5. New regulatory framework, such as MIFID and Code of Conduct, incite flexibility and competition between different markets players in the trading and post trading arena. T2S might, in some aspects, perhaps be a step in the opposite direction.
6. As the financial markets are continuously changing both as regards market structure and services provided, we think it is important that T2S, if developed, should be designed flexible enough to adapt to future changes.
7. If a large part of the cross-CSD-settlement in Europe goes through T2S, this may give efficiency gains, but it also leads to higher concentration risk. It is therefore important to clarify the ownership and responsibilities of T2S, and how supervision and governance will be conducted.
8. As several other European countries, Norway is a direct holding country. We believe there are substantial differences between the direct holdings countries, beyond what is illustrated in Annex 14, in legislation, settlement systems and market practice. For some direct holding CSDs the most efficient solution may be to outsource only omnibus accounts and keep settlement on end investor accounts in the domestic CSD

(Annex 14 4.1.2). For others it may be better to outsource settlement also for end investors to T2S (Annex 14 4.2). It should be voluntary for direct holding CSDs to choose which accounts to outsource to T2S. We assume that this choice will depend both on national legislation and markets practice as well as the pricing structure in T2S.

9. Norway will, as a direct holding country (cf. the intermediary model, Annex 14, 2.1), need to do considerable adjustments in the present system to be able to settle the transactions through T2S. The possible Norwegian T2S-solution will most likely be similar to the description in Annex 14, 4.1.2, although this appears to be a two-step solution that seems to be more complex (and probably more costly) than the present Norwegian model for domestic transactions. Settlement in VPS will be divided in two steps; settlement at omnibus level in T2S and settlement at end investor level in VPS. This may raise some synchronising issues, and real DvP on investor level seems to be unachievable. Other solutions (as Annex 14, 4.2) require substantial alterations of the existing system and do not seem applicable to Norway.
10. We believe that it is very important that the T2S-pricing model should be transparent and not to any disadvantage for direct holdings countries.
11. Direct holding countries tend to face a lot of challenges unknown to those based on omnibus accounts. The Norwegian securities settlement system (VPO) includes liquidity optimising based on a linear programming model and an automatic securities lending facility. We consider the settlement rate at the end investor level in VPO to be at a very high level today and it is impossible to derive from the URD that T2S will improve this settlement rate.
12. In VPO liquidity is “locked in” for short periods of time, and then released for other purposes, as the liquidity is needed in other settlement areas throughout the day (retail settlements, CLS etc). It still seems unclear how T2S will affect the liquidity in the Norwegian interbank market.
13. We cannot see in the URD that T2S will offer participants functionality for making prognosis related to their liquidity needs.
14. As far as we can understand, the auto-collateral functionality cannot be used for direct holding systems. Assets pledged as collateral cannot be pledged by entities without title to the asset. The two-step-model, described in Annex 14, 4.1.2, does not seem to take this into consideration.
15. Mutual funds are registered in end investor accounts in VPS. If mutual funds are kept outside T2S, clearing and settlement of mutual funds units will require a separate process to be performed in the local CSD.
16. All consequences of outsourcing VPS’ accounts and settlement to T2S will need to be analysed in respect of legal responsibility and operational risk.

In conclusion: T2S may give the Norwegian market players in euro a good solution for cross-CSD-settlements. Though, it is not certain that T2S will represent efficiency gains in the settlement of trades in NOK. However, it is difficult to evaluate the potential gains from

establishing T2S without being aware of the result of the updated economic impact analysis, a pricing structure and a governance model for T2S.