



*A discussion paper  
from SWIFT*

**Highlights**

- The institutional community still sees the Giovannini Protocol as important to improve efficiency
- Institutions are generally compliant and using the Protocol today
- The settlement community – with notable exceptions – is relatively unprepared and some CSDs are likely to fail to meet the 2011 deadline
- The preparedness of the clearing community is difficult to ascertain, raising concerns about readiness for meeting the 2011 deadline
- SWIFT is calling for industry feedback on a series of key questions relating to the Giovannini Protocol by the end of August 2009

## Countdown to 2011: Are you ready to break the Giovannini Barrier?

*Who risks being left behind in implementing the common communications protocol for EU clearing and settlement - and why compliance still matters*

In 2001, a European Union (EU) advisory committee led by Alberto Giovannini (the Giovannini Group) famously identified 15 barriers to effective cross-border clearing and settlement of securities in the EU.

The first of these was the existence of national differences in information technology and interfaces across the EU. The Giovannini Group proposed that this 'Barrier 1' could be removed by the development and implementation of a standardised protocol for communication. SWIFT, in conjunction with the Securities Market Practice Group, was allocated the task of defining the industry protocol.

The so-called Giovannini Protocol was duly published by SWIFT on 3 April 2006, with a clear recommendation for mandatory implementation by all cross-border clearing and settlement players in the EU – institutions and market infrastructures – by the deadline of March 2011.

Eight years on from the original Giovannini report, and three years after the publication of the Protocol, how far has the industry progressed with implementing the solution to eliminate Barrier 1? Who has taken the initiative,

and who is lagging behind? Is elimination of Barrier 1 still a priority for the industry in light of the unprecedented circumstances heralded by the global financial crisis? Can the 2011 deadline be met, and is the demise of Barrier 1 in sight?

This paper examines the progress that has been made to date in eliminating Barrier 1, and argues that the drivers for adoption of the Giovannini Protocol are stronger than ever. It argues that other industry initiatives such as Target2Securities (T2S) and the Code of Conduct actually make progress on Barrier 1 even more important, and should not be used as distractions. It also proposes next steps the industry should take in order to ensure the adoption of this readily available solution to the long-understood problem of inefficient communications, which cause low levels of interoperability between players involved in clearing and settlement in the EU.

### **Progress to date: a short history of the Protocol so far**

To recap, the Protocol made two sets of recommendations: those to be implemented by SWIFT as the international standards body, and those to be implemented by EU market participants, both institutions and market infrastructures.

**Recommendations to be implemented by SWIFT: Standards gap analysis**

One of the key recommendations of the Protocol was that all securities market infrastructures and participants involved in EU clearing and settlement must support the use of ISO 15022 and/or ISO 20022 messaging standards where relevant. To enable this, the Protocol stipulated that by March 2008, a gap analysis of the ISO 15022 and ISO 20022 message suite must be completed across all EU Member States (plus other countries as necessary). The purpose of the gap analysis was to:

- a) Identify missing standards and messages required to provide full process coverage for relevant infrastructural activities.
- b) Extend the ISO standards and message catalogue based on the analysis above.

With detailed input from all EU clearing and settlement infrastructures, the gap analysis was completed on schedule in March 2008 (see table below) and the work to fill the identified gaps is well under way. SWIFT remains committed to having all the necessary standards in place by 2010.

The table below, provided for the EU Commission's 2008 CESAME report, summarises the estimated completeness of ISO standards for each key process as at March 2008.

Key process	Completeness
Settlement & Reconciliation	90%
Corporate actions	85%
Collateral management	80%
Cash management	80%
Clearing	58%
Other business processe (e.g., proxy, ref. data)	51%

SWIFT has also completed two additional pieces of work which have supported the final Protocol recommendation.

First, following publication of the Protocol, the SWIFT network business carried out an informal audit of its core capability against the Protocol recommendations,

and by the end of 2006 was able to declare full compliance with the Protocol.

Second, it became clear from industry feedback that in order to avoid the implementation of bilateral arrangements, there was a need to identify best practice for the implementation of file transfer solutions. Accordingly, in June 2007, following further industry consultation, SWIFT published a File Transfer Rule Book to complement the original Protocol.

**Recommendations to be implemented by industry participants**

The Protocol clearly recommended its mandatory implementation by all cross-

border clearing and settlement participants, both institutions and market infrastructures, by March 2011.

— Institutional compliance

Protocol-compliant messages have been available for some years for many of the downstream clearing and settlement business processes and are well used, especially in the global custodian to local custodian leg of the transaction lifecycle. Over the SWIFT network alone in 2008, there were almost 800 million messages sent between financial institutions, their clients and agents, all of which can be considered to be fully Giovannini compliant.

It is fair to say, therefore, that the cross-border institutional community is already

Country/CSD	ISO15022/20022 Barrier 1 Message Standards Supported: Yes, Partial or No	Barrier 1 Communications Layer Supported: Yes, Partial or No
Austria OekB	Y	Y
Belgium Euroclear	Y	Y
Bulgaria CDAD	Partial	Y
Cyprus CSD	N	N
Czech Rep Univyc	N	N
Denmark VP	Partial	Y
Estonia CSD	Partial	N
Finland APK	Y	Y
France Euroclear	Y	Y
Germany Clearstream	Y	Y
Greece Hellenic CSD	N	N
Hungary Keler	N	N
ICSD Euroclear	Y	Y
Italy Monte Titoli	Y	Y
Latvia CSD	Y	Y
Lithuania CSD	N	N
Luxembourg ICSD Clearstream	Y	Y
Malta CSD	Partial	Implementing
Netherlands Euroclear	Y	Y
Poland KDPW	Partial	Y
Portugal Interbolsa	Partial	N
Romania CSD	N	N
Slovak Rep CDCP	N	N
Slovenia KDD	N	Y
Spain Iberclear	Partial	Y
Sweden VPC	Y	Y
Switzerland ICSD SIS	Y	Y
UK and Ireland Euroclear	Partial	Partial

predominantly compliant with the Protocol - and indeed institutions are using it extensively in their current day to day business.

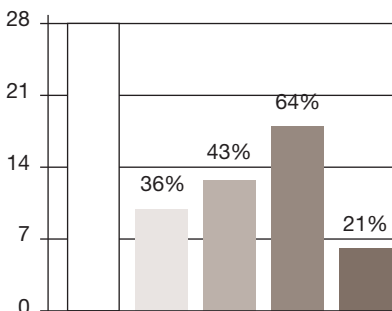
— Infrastructural compliance

Given that the lack of interoperability among infrastructures as highlighted by the Code of Conduct and the subsequent flurry of interoperability requests that remain (so far) unimplemented, empirical evidence suggests that the burden of responsibility for implementation of the Protocol currently rests with the infrastructural community.

In order to validate this assumption, in the third quarter of 2008 in conjunction with the European CSD Association (ECSDA), SWIFT surveyed the CSDs themselves to gain a comprehensive picture of each CSD's own estimation of its level of Protocol compliance for the key processes of settlement, reconciliation and corporate actions - together with plans for future implementation where relevant.

Twenty-eight CSDs were directly surveyed (EU 27 + Switzerland) and the detailed findings for each CSD and ICSD were provided to the EU Commission for inclusion in the autumn 2008 report to EU Finance ministers on the progress achieved on the dismantling of the Giovannini barriers. A high level summary of the results is shown in the table below.

High level analysis of the above survey revealed a mixed picture of Protocol compliance and usage as shown in the following table:



▲ Total number of CSD's surveyed

10 CSDs (36%) claimed full Giovannini compliance, with support for ISO standards covering the key processes of settlement, reconciliation and corporate actions. All of these CSDs were compliant at the technical level.

12 CSDs (43%) stated partial Giovannini compliance, with support for ISO standards for settlement and reconciliation only, together with technical level compliance.

18 CSDs (64%) either have, or in one case are implementing, technical compliance with the protocol. Of the other 10, only 2 stated plans to implement the technical recommendations within the next 12 months.

Only 6 of the fully compliant CSDs (21%) stated that the majority of their cross-border traffic (greater than 50%) currently went via their Protocol compliant interface.

It should be acknowledged, however, that several initiatives under way – including the Euroclear CCI project (now impacting seven markets) and Link Up Markets (involving a further eight) should prove drivers for uptake of the Protocol. Certainly, the Common Communication Interface for the Euroclear group will be Giovannini compliant, and it is anticipated that Link Up Markets will also encourage compliance and convergence.

However, a key question is, over what period of time will these initiatives lead to more widespread Giovannini compliance among market infrastructures? As at early 2009 the final timetable for the completion of the Euroclear project is still uncertain. The precise effect of the Link Up Markets initiative and associated take-up of the Protocol from impacted CSDs is also unclear. And what of the markets that currently fall outside the remit of either of these initiatives, and have yet to implement the Protocol?

In the background, and a likely big catalyst for change, is Target2Securities (T2S) – the centralised settlement platform from the European Central Bank (discussed further below). T2S will require those wishing to use its services to be able to operate in accordance with the Giovannini Protocol.

What is certain is that being compliant with the Giovannini Protocol by the deadline of March 2011 will position institutions and infrastructures well to be ready for all the above initiatives – including giving them plenty of breathing space ahead of T2S, slated for implementation in 2013.

— CCP Compliance

A similar survey of the EU CCPs by SWIFT and the European Association of Clearing Houses (EACH) proved not to be feasible, but ad hoc discussions with various CCPs throughout the EU confirm the existence of limited and varying degrees of compliance with the Protocol in the clearing space. The following reasons were most commonly cited for the lack of compliance:

- 1) The Protocol scope does not include all instrument types for which CCP's offer clearing facilities;
- 2) The Protocol scope does not include all CCP processes and/or message flows;
- 3) Of those processes covered by the Protocol, not all of the required message standards are in place.

SWIFT is currently leading industry efforts to address the issues above. A series of meetings has been initiated to drive forward the standards-setting process to ensure that all clearing processes covered by the protocol are satisfied. In parallel, further work is being undertaken to drive progress on bringing standardisation to a wider range of clearing processes, with more comprehensive instrument coverage. SWIFT, therefore, expects to see progress in 2009 that will make the adoption of the Protocol by clearing venues a more feasible option.

So who is ready to break the Giovannini Barrier - and who is not? SWIFT's experience with the institutional community in Europe suggests that institutions are largely Protocol-compliant already – and are making widespread use of the Protocol in cross-border communications with their clients and agents.

However, a few notable exceptions notwithstanding, market infrastructures in the EU are proving slower to embrace Giovannini compliance than their institutional counterparts – and some infrastructures still have no disclosed plans to do so, despite the 2011 deadline fast approaching.

## Why removing Barrier 1 still matters

The financial market landscape in 2009 within the EU and indeed globally is very different from the landscape of 2001. With the financial crisis threatening the very fabric of the industry, it would be understandable if upgrading the 'plumbing' between back offices had fallen down the list of priorities for the EU's financial markets participants. Even before the crisis, the pace of change in the markets, driven by technology advances and the constant development of new business strategies, was rapid, creating many potential distractions from the issue of harmonising clearing and settlement. However, the goal of improving operational efficiency to support the creation of a thriving, EU-wide marketplace for investment has arguably never been more important: as the process of rebuilding trust and resilience in the financial markets begins, it will be less and less possible to absorb inefficiencies in key market processes.

On investigation, there are a number of reasons why removing Barrier 1 should still be a priority.

### Why it still matters #1 - Customer pressure

To establish if the institutional community in Europe still wants to see the implementation of the Protocol, SWIFT and ISSA surveyed more than 50 institutions from among the ISSA membership that currently operate in the EU financial marketplace. The sample covered a cross-section of the institutional user community, including global and regional custodians, investment banks, broker/dealers and ICSDs.

The survey was constructed so that respondents could identify, by each specific EU infrastructure and by multiple specific business process within that infrastructure, what services they need to access via a Protocol compliant interface and by when.

The survey also asked for views on the level of compliant communications that users felt they already received from their infrastructure providers.

User opinions were sought on 29 European ICSDs/CSDs and 9 CCPs and the results for each individual infrastructure shared with the

infrastructure concerned. This provided each infrastructure with a tailored list of the order in which their services should be accessible via a Giovannini-compliant interface, together with deadlines and the names of specific clients making this request. In summary, the survey revealed the following key messages:

- 1) All of the clients surveyed who had direct relationships with infrastructures expressed the requirement for Giovannini-compliant communications across a variety of key business processes within the original five-year deadline to March 2011. Some expressed the need within 12 months.

The business processes against which compliant capability was assessed include settlement and reconciliation, corporate actions, proxy voting, collateral, repo, cash management and physical delivery, although not all CSDs currently offer all of these services and processes such as physical delivery are not applicable to all markets. Demand for Giovannini compliance was most pronounced in respect of the core processes of settlement/reconciliation and corporate actions.

- 2) CSD/CCP clients with indirect relationships also expressed requirements for compliant communications.

The majority of those connecting indirectly indicated that for the business processes and communication channels most important to them (invariably structured messaging) they already had compliant communications. This undoubtedly reflects the common use of standard messages over compliant networks such as SWIFT, usually to intermediaries such as a local market custodian. Whilst this finding has most relevance to the local intermediary used in these situations, clearly there is also applicability to the infrastructures, as some of these indirect users may wish to connect directly in the future and will both expect and require compliant communications to be available in order to achieve this.

- 3) Some CSD clients were uncertain about whether they were able to use compliant communications today with some of the infrastructures.

There needs to be better communication of the availability of compliant communications from infrastructures that have implemented the Protocol, as evidenced by the results of the ECSDA/SWIFT survey which revealed that only limited percentages of CSD activity are Giovannini compliant even where the CSD has compliant capability.

The results of the analysis clearly show that the implementation of the Giovannini Protocol by all participants in a harmonised European financial market remains a key expectation of the financial community in Europe.

Let's be clear. Failure by some market infrastructures to comply with the Protocol is a more serious issue than simply lagging behind on a high-level goal set in the name of the "greater good" of the industry. The client base of the EU's market infrastructures is already using the Protocol for other types of communication, and wants to maximise the benefits of its own investment in Giovannini compliant solutions by reusing that capability wherever possible. Those market infrastructures that are lagging behind are impeding progress for their customers – and, almost regardless of the aims of the Giovannini Group, failing to meet the expectations of customers who want to move forward with standardised processing could be a perilous path to follow.

### Why it still matters #2 - Regulatory pressure

The critical nature of the Protocol is increasingly recognised by the regulators. In October 2008 the Committee of European Securities Regulators and European System of Central Banks (CESR/ESCB) produced a draft consultation on proposed standards for settlement system and central counterparty system providers. One of the recommendations in the consultation was: "CSDs and participants in their systems, should use or accommodate the relevant international communication procedures and standards for messaging and reference data in order to facilitate efficient Clearing & Settlement across systems. This will promote straight-through processing (STP) across the entire securities transaction flow"

The consultation goes on to say: "Being aware of the crucial importance of promoting industry solutions for

standardising protocols regarding communication with national Clearing & Settlement systems and between the systems themselves, implying harmonised connection and messaging protocols, the application of the Giovannini Protocol Recommendations and the File Transfer Rulebook should be encouraged, and it is equally important that service providers define each component of their business in a consistent way in order to benefit from ISO 20022 for the entire securities transaction life cycle, including the asset servicing requirements”

This is a very clear call to action for the industry to move forward on the implementation of the Protocol for a wide range of clearing and settlement related communications. It also points to the need to implement open protocols and international standards for domestic as well as cross-border communication.

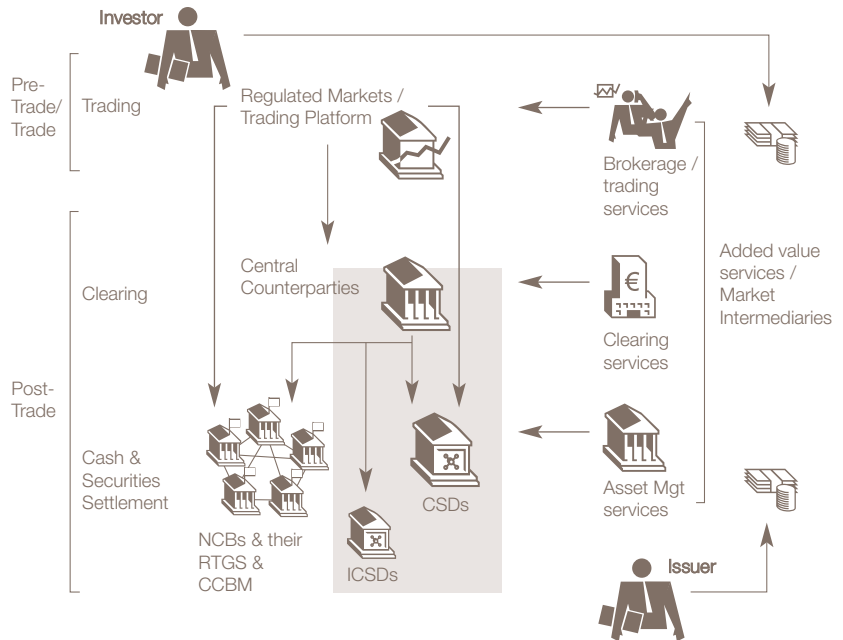
This domestic relevance is entirely consistent with the original Protocol recommendation. Although initially focused on cross-border clearing and settlement connectivity, there was always a clear vision by the financial community that ultimately it should be used for domestic communications as well.

In the current challenging financial environment, it makes no sense to support proprietary links for a domestic market and Giovannini-compliant links for cross-border activity, either for infrastructures or their users.

As the EU financial market integrates and the new post-trade linkages and infrastructure described above develop and use the Protocol, domestic proprietary communications for CSDs (and CCPs) must steadily be eliminated. The Protocol is the obvious solution.

### Why it still matters #3 - The impact of market change

The Commission’s focus on the end goal of improving operational efficiency in Europe to support the creation of a thriving, EU-wide marketplace for investment remains undiminished – as has been amply demonstrated by the pursuit of parallel initiatives implemented by the EU during the years since Giovannini first identified his 15 barriers. The two specific initiatives that have brought about most change – and make compliance with the Protocol an even



### Securities trading and Settlement in the EU – Model Today

greater imperative - are the Code of Conduct and the Markets in Financial Instruments Directive (MiFID).

#### Code of Conduct impact

The Code of Conduct for Access and Interoperability, signed in 2006 by all EU exchanges, central counterparties and depositories, clearly identified the need for downstream clearing and settlement venues to interoperate in order to provide support for the requirements of MiFID and to offer greater levels of user choice - increasing competition to reduce costs and improve service levels.

The results of this drive for interoperability have not been as positive or rapid as hoped for - and little physical progress has been made beyond the recognition in the Code that the Protocol is a key enabler for the Code’s access and interoperability provisions. Part of the explanation for the lack of progress has been the slowness of local legislation and market practice in responding to the change in market structure and requirements. This was highlighted in 2008 when LCH.Clearnet sought to establish linkages in Germany, but was blocked by the fact that to provide CCP services to German customers a banking licence is required.

Nevertheless, despite other impediments to the success of the code, the Protocol is fundamental to making a more open

approach to the selection of appropriate clearing and settlement infrastructures a more cost-effective option. The protocol removes the need for proprietary solutions to access each infrastructure. So, the imperative to implement the Protocol has become more acute now that the opportunity for trading beyond rigid national boundaries is a standard part of many investment firms’ business models.

#### MiFID impact

MiFID has three facets which make the implementation of the Protocol more relevant than ever before.

First, MiFID has increased competition at the European exchange level, providing a legislative framework that has encouraged the growth of multilateral trading facilities (MTFs) as competitors to traditional exchanges. A host of new entrants such as Chi-X, Turquoise and BATs Europe have emerged, and each has needed to establish downstream arrangements that have required connectivity to, in an increasing number of cases, multiple clearing and settlement venues.

Second, increased competition has prompted a wave of consolidation among traditional exchanges - such as the NYSE merger with EuroNext and the London Stock Exchange tie-up with Borsa Italiana. Consolidation usually implies the

need to rationalise access channels and mechanisms to the resultant consolidated entity.

Third, the direct impact of MiFID is not limited to trading. The obligation to provide best execution has required trading venues to examine their downstream clearing and settlement arrangements to ensure that end investors are receiving a service that is both appropriate and cost effective. This requires interoperability between infrastructures to bring about the necessary level of infrastructure choice required by best execution, and supported by the Code of Conduct for Access and Interoperability.

The diagram above shows the current EU securities trading and settlement landscape. The shaded area shows where the Protocol should be considered the key enabler of reducing cost and complexity in cross-border communications to and between CCPs, CSDs and ICSDs.

— Future market change

The European Central Bank's (ECB) T2S project to provide a centralised settlement utility for the EU is likely to have the

biggest future impact on the market. The EU post-trade infrastructure will evolve to resemble the model illustrated below, and again the Protocol will be central to optimising communications between the parties shown in the grey area, particularly as the ECB has publicly pledged to ensure T2S compliance with the Protocol.

### So removing Barrier 1 really does matter?

The Protocol is more relevant today than it was eight years ago. The financial crisis will undoubtedly cause a distraction, but the resulting cost and risk constraints and the strong imperative for the "plumbing" of the industry to stand strong whatever happens in the markets constitute a powerful driver for change. To fulfill their aims, MiFID and the Code of Conduct require widespread Giovannini compliance. In the future, T2S will require it as well, and while initiatives such as T2S, Euroclear CCI and Link Up Markets will promote it, compliance needs to happen EU-wide, at the individual initiative of every firm and infrastructure. Perhaps most important, the institutional side of the industry is already compliant

and wants its infrastructures to become so without delay, to maximise the benefits of EU-wide standardisation for all.

This means complying with the Protocol not just in a cross-border context, but domestically as well.

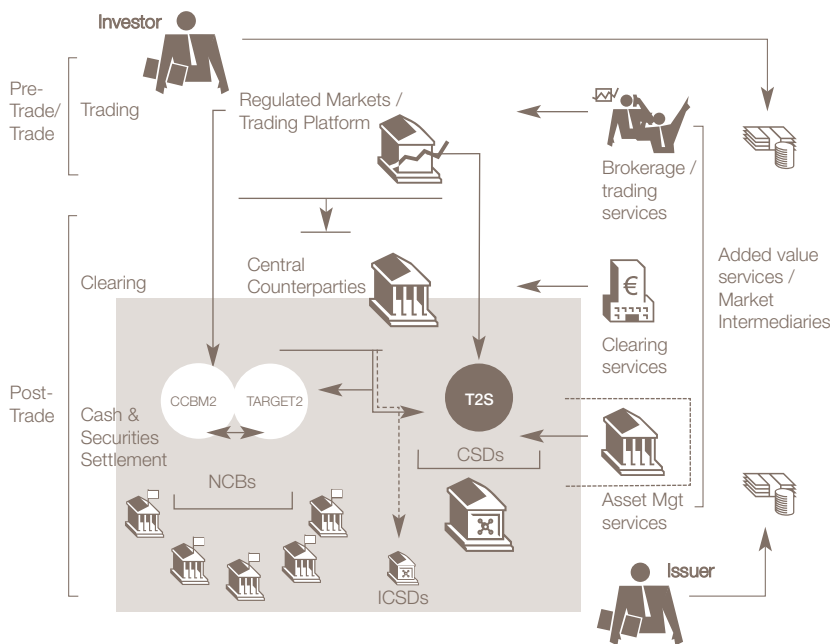
The March 2011 deadline is approaching fast, and all players need to focus their efforts to ensure that they are not left behind when it comes to breaking the Giovannini Barrier.

### What needs to happen next?

We are now eight years on from the original Giovannini report and in March 2009 it will be three years since the final version of the Protocol was published. Implementation of the Protocol has been publicly endorsed by a long list of bodies and institutions, including the ECB for T2S, Euroclear for its CCI implementation, ESCB/CESR in their 2008 consultation, the 2007 Code of Conduct signed by all infrastructures and the G30 in its 2006 report. The majority of financial institutions are compliant already, and they require compliance from their infrastructures – because Europe cannot derive maximum benefit from the potential cost reductions and improved institutional flexibility of access and interoperability until the problem of slow implementation by a number of the infrastructures has been addressed.

Barrier 1 is among the few Giovannini Barriers that are seen as being within the control of the industry and not dependent on legal or fiscal change at the government level. But continual 'foot dragging' over implementation and/or the promotion of proprietary solutions at the expense of the Protocol could result in voluntary initiatives being replaced with more intrusive action from regulators.

If industry participants want to keep control of the process - rather than having the process controlled for them - then 2009 needs to be the year in which the exposition and execution of clear action plans are prioritised, to remove the remaining communications barriers in clearing and settlement.



▲ Future EU Single Market Trading and Post-Trade Infrastructure

## Call for feedback

What do you think should happen next?  
SWIFT would like to hear your views, and specifically your answers to the questions below. We are asking for feedback on this paper and on the questions, to be submitted to Andrew Douglas, Head of Industry Initiatives at SWIFT (andrew.douglas@swift.com) by Monday 31 August 2009. We look forward to hearing your thoughts.

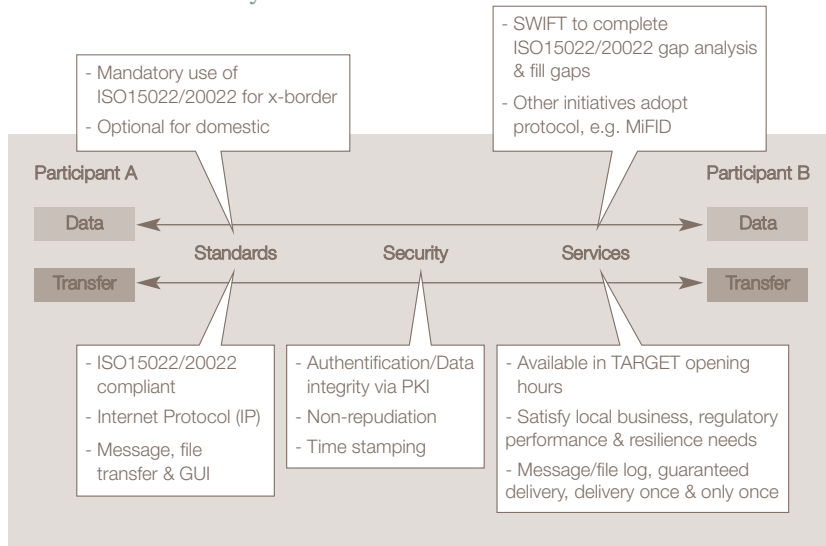
Questions:

- 1) Should the Giovannini Protocol implementation deadline of March 2011 be moved back, to be in line with the launch of Target2Securities?
- 2) If the deadline is delayed, should the Protocol be made mandatory for domestic as well as cross-border business?
- 3) If the deadline is delayed, should the 2010 Standards Release also be delayed?

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## Appendix 1 - Giovannini Barrier

### 1 Protocol Summary





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