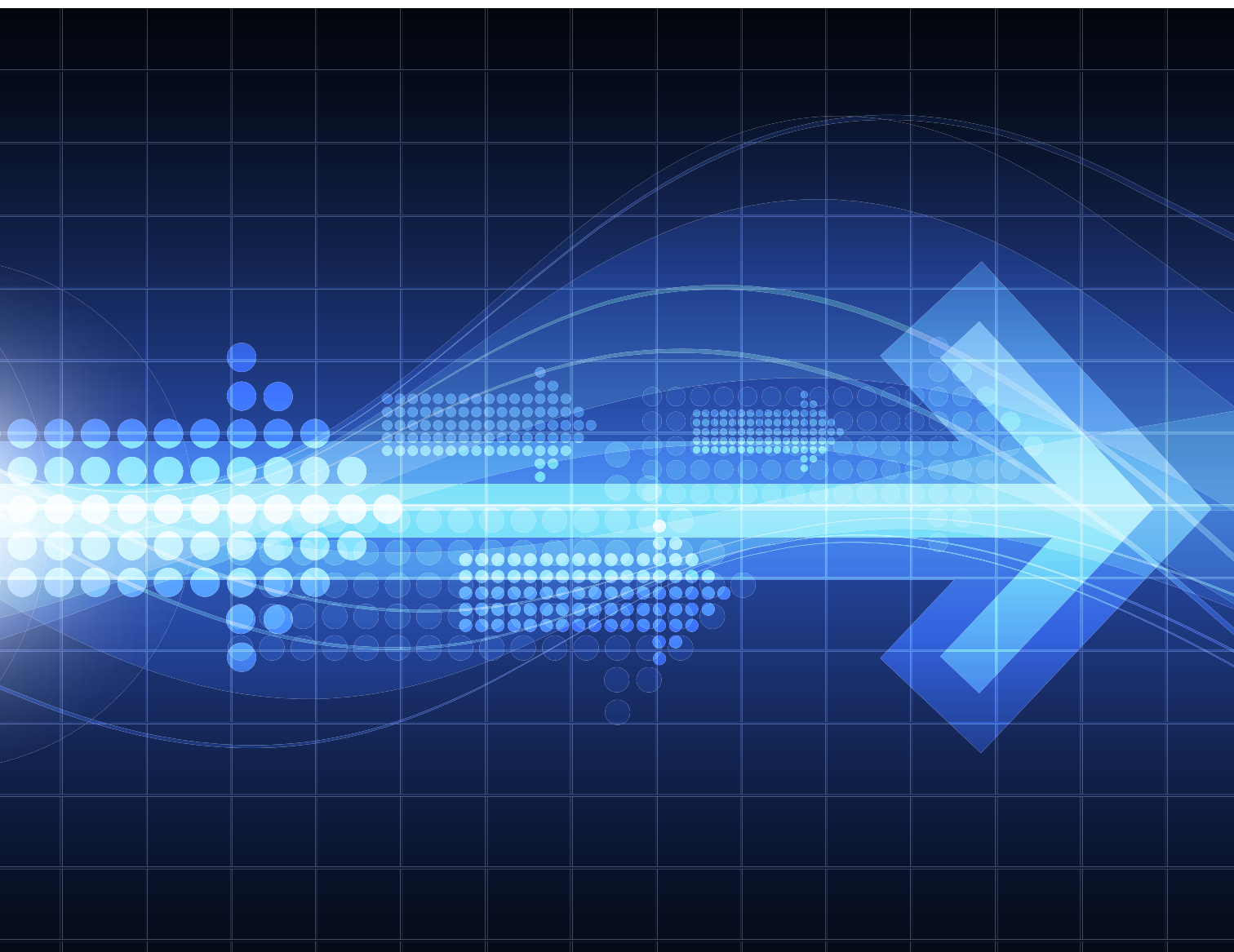




# Taking the Direct Route to T2S: the industry view





## Introduction



*Isabelle Olivier*

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AS THE 22 JUNE 2015 DEADLINE LOOMS FOR THE FIRST WAVE OF MIGRATION TO THE EUROPEAN CENTRAL BANK'S (ECB'S) TARGET2-SECURITIES (T2S) SETTLEMENT PLATFORM, ACTIVITY AMONG MARKET PARTICIPANTS THAT HAVE CHOSEN TO DIRECTLY CONNECT TO THE PLATFORM IS INTENSIFYING. TOGETHER WITH THE CENTRAL SECURITIES DEPOSITORIES REGULATION (CSDR), T2S WILL TRANSFORM THE EUROPEAN POST-TRADE LANDSCAPE AND AFFECTS EVERY PARTICIPANT IN THE POST-TRADE SPACE. COMPETITION AT THE CSD AND CUSTODIAN LEVELS WILL BE STRENGTHENED AND GREATER EFFICIENCIES WILL BE INTRODUCED IN EUROPE.

T2S will provide delivery versus payment for securities against central bank money. CSDs will maintain their relationships with intermediaries, investors and issuers, as well as their asset servicing functions (such as the management of corporate actions). T2S will become a key component of the European market infrastructure and is designed to address the costly fragmentation of securities settlement market infrastructure. Put simply, the core intention of T2S is to enable efficient and integrated securities settlement in Europe.

There are two options for connecting to T2S: direct or indirect. Those institutions that choose to become directly connected participants (DCPs) will be able to send instructions directly to T2S. Through individual contractual relationships DCPs have with their CSDs, each CSD can define additional conditions under which they will accept a participant to become a DCP for each part of the service they offer. CSDs will grant access rights to the DCP specifying exactly what the participant is permitted to do on T2S.

Indirectly connected participants (ICPs) will send their settlement messages to a CSD or a DCP, which will be responsible for managing the connectivity with T2S. Becoming a DCP requires high levels of investment and work for the institutions that have chosen this path; business models are being reviewed and networks optimised. However, the anticipated benefits and opportunities are substantial. Settlement operations will be rationalised and standardised across Europe, domestic markets will be opened up and there is hope that settlement costs will fall.

DCPs not only have to ensure their internal processes are adapted for T2S, but they also must ensure that their clients – the ICPs – are prepared for T2S. Many DCPs have chosen to shield their clients as much as possible from the impact of T2S, but there are still changes and adaptations that ICPs must make in order to operate in the T2S landscape. The focus of solutions for ICPs is on minimum adaptation and smooth transitions to T2S.

## Transforming European settlement

**Migration to T2S will be phased, with the first wave scheduled for 22 June 2015 and the fourth and final wave set for 6 February 2017. The objective of a phased migration is to enable a smooth and successful transition to the usage of the T2S services for the CSDs, central banks and their communities. In the lead-up to T2S, a large number of operational issues are being tackled by all market stakeholders.**

Some institutions have adopted a 'wait and see' approach to T2S, preferring to assess their response to the initiative once it is under way. On the other hand, not everyone is waiting as evidenced by the financial institutions and market infrastructures that have unveiled their strategies to take full advantage of the opportunities within T2S.

The cost of direct participation is not insubstantial but for those institutions with large volumes, the return on investment is expected to be worthwhile. An alternative for other institutions with cash accounts in TARGET2 will be a similar arrangement in T2S, but with a slimmer connection and processing left to another organisation, such as the larger custodians and CSDs.

A technical group has been set up within the T2S governance structure called the Directly Connected Parties Group (DCPG). Its aim is to track and monitor the resolution of general concerns that are of importance for DCPs. The group comprises representatives of DCPs, CSDs, central banks and the T2S Programme Office. It reports to the steering bodies (T2S Board, CSD Steering Group) and continues the work of the informal gathering of DCPs in the DCP Forum. The DCP Forum is an informal group of entities that are interested in becoming DCPs. Established in February 2013; it is focused on dialogue with CSDs on topics specifically relevant to DCPs. By working collaboratively the Group hopes it can help to achieve the maximum level of standardisation across the T2S CSDs, thus increasing the efficiency of T2S implementation for the market as a whole.

Citi was one of the founders of the DCP Forum, which Keith Berrett, Director at Citi describes as "a group that enables market participants to evaluate shared areas of concern and speak collectively to the market infrastructures about them." He points out that it is better to present a common view on how migration should work in Italy, for example, as a group of 13 institutions, rather than as 13 individual institutions. Once best practice is established, it can then be proposed across the other T2S markets. "A consistency of view and strength of opinion in one market should in turn assist across all of the markets. It was always the intent of the ECB that market participants should play a role in how T2S is developed," he says.

## To be or not to be a DCP

For those institutions that have opted to become DCPs, the choice was compelling.



**“BY BEING A DCP WE CAN RATIONALISE, SENDING OUT ALL OUR INSTRUCTIONS FOR SETTLEMENT TO THE ONE PLACE. WHILE IT IS TRUE WE WILL HAVE TO MAINTAIN CONNECTIVITY WITH EACH CSD FOR ASSET SERVICING, WE CAN NEVERTHELESS RATIONALISE A GREAT DEAL AND IMPLEMENT A DIFFERENT ORGANISATIONAL APPROACH.”**

*Dario Locatelli, BNP Paribas Securities Services*

Hugh Palmer, Product Manager, Financial Institutions & Brokers at Societe Generale Securities Services (SGSS) says the decision to become a DCP was strategic and technical; strategic because a growing number of CSDs are joining the T2S platform and technical because the advantage of being a DCP will be in the ability to amortise the investment in the T2S technology. "We will develop only one infrastructure that will connect us to all T2S markets. This is a significant improvement on the situation today, where we have to connect to CSDs in a different manner market by market."

Direct connectivity underpins Citi's existing Direct Custody and Clearing Services and the picture will be the same under T2S. Says Berrett: "Only by being directly connected to the platform can we offer our clients first-hand information, the sharpest deadlines and the most up to date information possible." The bank will be a direct participant in T2S in the 14 markets in which it already offers DCC services and will add Denmark and Finland. This will extend the bank's direct coverage to more than 95% of its T2S volumes.

T2S has the potential to “really upset the traditional global custody value chain”, says Tom Casteleyn, Managing Director at BNY Mellon. As participants choose to connect to market infrastructures directly, T2S will generate more competition from sub-custodians and CSDs. The bank is direct in the Netherlands and Germany and will continue to be so under T2S. It plans to also be direct in other markets such as France and Belgium (in order to cover the ESES markets), Italy and potentially Spain as that market reforms.



**“T2S WILL ENABLE US TO BE MORE COMPETITIVE IN THE EUROPEAN CUSTODY SPACE; BY BEING A DIRECT PARTICIPANT, BNY MELLON WILL HAVE BETTER ACCESS TO MARKETS AND BE ABLE TO OFFER BETTER DEADLINES. WE ALSO WILL BE ABLE TO MORE QUICKLY REACT TO ISSUES THAT MIGHT OCCUR WITH A TRANSACTION. THERE ALSO WILL BE LIQUIDITY BENEFITS AS WE WILL BE USING A SINGLE CASH ACCOUNT FOR ALL MARKETS IN WHICH WE ARE DIRECT, ENABLING US TO BETTER MANAGE LIQUIDITY AS A GLOBAL CUSTODIAN.”**

*Tom Casteleyn, BNY Mellon*

The ability to continue to offer clients “the best possible deadlines” was also a driving factor in Deutsche Bank’s decision to become a DCP. In addition, says Mike Clarke, Director, Global Product Management, Deutsche Bank, early indications are that participation as a DCP may be more cost effective than as an ICP. For example, he says, Monte Titoli’s fees will be lower for DCPs than for ICPs.

For central counterparty EuroCCP, becoming a DCP is a “logical extension of our strategy to have the most robust settlement arrangements wherever possible and economically viable”, says Albert-Jan Huizing, Chief Technology Officer, EuroCCP.



**“EUROCCP ALWAYS OPTS TO BE A DIRECT PARTICIPANT IN CSDS AND TO USE CENTRAL BANK ACCOUNTS, WHICH WE BELIEVE INCREASES THE ROBUSTNESS OF OUR OPERATIONS. BEING A DCP WILL BRING SIMPLIFICATION AND HARMONISATION, MAKING OUR LIVES MUCH SIMPLER.”**

*Albert-Jan Huizing, EuroCCP*

Similar thinking was behind LCH.Clearnet’s decision to become a DCP. Says Anne Mairesse, Director Market Infrastructure Repos and Exchanges, Head of Brussels Branch.



**“BY BEING A DCP, WE WILL BE CLOSE TO THE SETTLEMENT ENGINE, WHICH IS CONSISTENT WITH OUR OBJECTIVE AS A CCP TO MONITOR AND TO REDUCE AS MUCH AS POSSIBLE THE OPERATIONAL RISKS. BEING AS CLOSE AS POSSIBLE TO THE SETTLEMENT ENGINE AND RECEIVING IN REAL TIME THE RESULTS OF OUR SETTLEMENT IS MORE APPROPRIATE FROM A RISK VIEWPOINT.”**

*Anne Mairesse, LCH.Clearnet*

The DCP service is designed as a specific connectivity service for clients of CSDs and national central banks to access all eligible securities via a single technical channel. The T2S infrastructure will provide all of the technical means for inter-linkage of CSDs, says Karla Amend, Head of T2S Governance Team, Clearstream. This will enable CSDs to perform an efficient issuer CSD and investor CSD business. As an international CSD (ICSD), Clearstream will connect as a DCP in wave one of T2S migration, while Clearstream Banking Frankfurt will connect as a CSD in wave three.

Because T2S is “one among many initiatives”, says SGSS’s Palmer, emphasis will be placed on the size and scale of the business required to absorb the multiple investments needed to adapt to the changing regulatory and technical landscape. Only institutions with significant pan-European businesses and transaction volumes will have a sufficient business case to become a DCP in T2S. “For those actors for whom the business case is less clear-cut there are alternatives to maintain direct connection without bearing investment costs; for example, technical sender opportunities by which one institution can connect to T2S by using the infrastructure of another institution,” he says.

## The impact of becoming a DCP

DCPs can send core settlement instructions in DCP mode directly to T2S via the ISO 20022 message format. The CSD receives copies of selected messages exchanged between T2S and the DCP from T2S. However, T2S will not support information flows out of value-added services provided by the CSD. Hence a DCP will still have to be connected to the CSD for asset servicing functions such as corporate actions, new issues, etc.

DCPs will have the possibility to communicate with T2S in two ways: Application-to-Application (A2A) interaction, or User-to-Application (U2A) interaction. The A2A interaction requires ISO 20022 messaging and U2A connection is via the T2S GUI, which can be accessed via standard Web browsers over one of the two selected Value Added Networks. The A2A mode offers the majority of T2S functionality such as sending settlement instructions; creation of static data in T2S; querying T2S for settlement instructions, account postings and balances etc.; receiving reports from T2S and managing liquidity. U2A interaction provides these functions as well as the ability to maintain a relationship between the CSD participant and a securities account; creating links between a securities account and a dedicated cash account (DCA); maintaining static data in T2S and the creation and maintenance of privileges and restriction rules in T2S.

The work of the DCP Forum provides an example of how complex the changes required by T2S will be for these institutions. The Forum is focused only on the securities aspects of the DCP and CSD relationship and does not cover smaller banks using the T2S GUI only, investor CSDs in their relationships with issuer CSDs via T2S or DCPs exclusively on the cash side. Among the discussions that have been under way in the Forum are the identification of the most efficient handling of DCP relationships towards CSDs during the testing, migration and production phases of T2S. The Forum is also looking at how to achieve optimum and efficient arrangements and solutions on a harmonised and standardised basis. The topics covered by the Forum are focused on non-competitive aspects such as authorisation, testing, migration, DCP readiness and legal documentation.

Becoming a DCP involves significant investment in terms of technical connectivity and also the transformation required to use the ISO 20022 format, says Clearstream’s Amend. For example, Clearstream will have to align its accounts on every CSD, each of which has its own account structure that has to be translated into the T2S account mapping process. However, becoming a DCP will create opportunities in the T2S world, including the ability to centralise and optimise via a single account. CSDs such as Clearstream Banking Frankfurt can offer access to all 23 markets, including those of its rivals, and vice versa. Nevertheless CSD clients can choose different CSD service providers for different countries and may organise operations based on regional activity, for example.

Because T2S does not cover asset servicing, DCPs do not escape the ICP model as they will need CSD connectivity for contingency and for dedicated asset servicing, reporting and international settlement activity.



**“YOU CANNOT UNBUNDLE EVERY SERVICE FROM THE SETTLEMENT ITSELF, SO THESE ELEMENTS WILL BE COVERED BY THE EXISTING CONNECTIVITY OFFERING FROM CLEARSTREAM BASED ON THE ICP MODEL.”**

*Karla Amend, Clearstream*

BNP Paribas Securities Services plans to consolidate core settlement in an excellence centre in Lisbon. However, the level of efficiency that was originally envisaged, says Locatelli, cannot be reached because to manage certain types of settlement such as cross-border transactions outside of T2S, some CSDs will require the bank to maintain ICP connectivity as well. This is an added element of complexity, he says. “Also, in order to properly service some other clients we need information that is not available in T2S, for instance evidence of the market executions for the ‘on exchange’ members. In these cases we will have to go back to the domestic settlement system in order to capture this information and provide reconciliation services.”

Deutsche Bank will request direct connectivity status in the CSDs in which it is an existing direct member, although it will operate a slightly different business model, based on a centralised location combined with a local presence. At present, Deutsche Bank is a direct participant for 90% of its assets under custody and the volumes it expects to settle via T2S. In the remaining markets it will utilise an account operator model with either a local agent bank or investor CSD, depending on the business case.

Because of the strong link between T2S and TARGET2, Deutsche Bank is creating a centralised booking model for T2S. Clients will move to a single regulatory relationship and technical platform for T2S. Within that, the bank will maintain a distributed operating model that will enable it to continue to offer to clients a local market presence and expertise in asset servicing, taxation and market policy. Deutsche Bank will also introduce a set of value-added services for collateral and liquidity to enable clients to move cash and securities to the optimum location. Deutsche Bank’s connectivity investments will be split into three areas: direct connectivity with T2S, connectivity to the CSDs, and connectivity with the client. The DCP connection will use a wide range of A2A message types in ISO 20022 format utilising SWIFT to provide both the value-added network and the Alliance interface suite (Connector for T2S, Alliance Access and Gateway) to connect into T2S. Clients communicating with Deutsche Bank can choose to migrate to ISO 20022 or stay with ISO 15022, depending on their requirements and the cost benefit of moving to ISO 20022.

EuroCCP is analysing the 130 different message types within T2S to determine which it will use. It is likely to be a subset, based on the functionality EuroCCP will require every day and that therefore should be automated. Other message types that will be rarely used can be dealt with via the T2S GUI. It is also probable that some message types won’t be required initially but may be introduced at a later stage.

LCH.Clearnet will migrate to ISO 20022 and while that requires some investment, the benefits will be very positive, enabling the clearer to rationalise the number of messages it exchanges with

CSDs, says Mairesse. “We do not yet offer ISO-based reporting and messaging for our members for the stage between trading and clearing, which remain proprietary. But the result of the settlement related to our CCP business will be provided either by T2S for our members being DCPs or the CSDs themselves for the ICPs.”

Citi’s Berrett says the adoption of ISO 20022 has been the biggest change the bank has had to make for T2S and is the biggest common challenge for all DCPs. The market is a long way from replacing ISO 15022 with ISO 20022 and he anticipates that for some time there will be co-existence and therefore mapping from ISO 15022 to ISO 20022. “However the market needs a common approach to this mapping and SWIFT and other standards groups can help to more quickly adopt a common approach, but the signs are not encouraging that this will happen overnight.” Another challenge is staying abreast of all of the local market specifications for T2S and understanding any functionality gaps, differences in message flows etc. He says Citi plans to adopt T2S message flows for all T2S markets, particularly related to four functions that will potentially have the most impact on the market – hold and release, prioritisation, linking and partial settlement.

BNP Paribas Securities Services will reorganise its activities as a result of becoming a DCP. Today in Europe, the custodian operates several separate securities settlement systems, which work in a different manner, according to different local rules. Maintaining this approach under T2S would require huge adaptation and running costs. Instead, core settlement will be consolidated, while non-core settlement and asset servicing will continue to be performed in the specific CSD locations.

**“ T2S WILL ALSO OFFER US THE OPPORTUNITY TO CONSOLIDATE CASH AND LIQUIDITY MANAGEMENT AND LIMIT THE NUMBER OF DCAS WE HAVE TO OPERATE. OUR TREASURY AMBITION IS TO HAVE ONLY ONE DCA IN T2S, BUT THE COMPLEXITY OF OUR BUSINESS AND THE ACTIVITIES OF OUR CLIENTS MIGHT OBLIGE US TO HAVE A FEW MORE. ”**

*Dario Locatelli, BNP Paribas Securities Services*

The agent banks that today are managing multiple direct memberships of European CSDs, which involves costs and complexity in managing different settlement rules, processes, message formats and technologies, will see benefits in the DCP approach, says Palmer. Becoming a DCP will enable them to rationalise part of their infrastructure, processes and messages involved in dialoguing with multiple CSDs. Once this idea is anchored, the next step will be to see how that model can be extended to markets where institutions are currently using agent banks. The functional split between settlement and asset servicing in T2S and also the mechanisms now available that allow for the insertion of third party asset servicing-only agents in the loop facilitates the widest possible use of the DCP channel for settlement and liquidity management. "The ultimate goal for institutions is to adopt a solution that corresponds to their everyday operational requirements and reduces risk. But this is a complex task and institutions should seek to work with experienced partners who can help them to determine – and who can adapt the solutions to – their precise requirements," he says.

## Impact of T2S on DCP's clients

Many of the agent bank DCPs will attempt to shield their clients from as much of the impact of T2S as possible as they view this as part of their role as an agent bank. There are likely to be market participants that will seek to protect themselves from an investment spend related to T2S. However, there are concerns that the longer these players are screened from this necessity, the more time it will take for the full harmonisation benefits of T2S to come through.

Palmer says a majority of SGSS's clients are buy-side institutions that rely on the bank, as their custodian, to cushion them from the major impacts of T2S. "We have focused on delivering usable information to them regarding the impact of T2S," he says. "For our financial institutions and other sell-side customers, we have taken a more strategic approach, detailing how they could handle their business in T2S and the impact it will have on network management and liquidity management. We have held bilateral discussions with these institutions to help them to forge a strategy for the T2S environment."

BNP Paribas is also acting to shield its clients from the impact of adaptation, says Locatelli. The bank will offer clients the possibility clients to connect to and send instructions via the ISO 20022 message format. However, most clients want to remain with the ISO 15022 format, says Locatelli. "If clients feel it is important to move on to ISO 20022, we will support that." Many of the bank's clients are very positive about T2S and the options and advantages that harmonisation will deliver in the medium term, he says. Some clients are willing to take advantage of functionalities such as prioritisation, hold and release and linked trades. A few are considering using different operational scenarios such as asset servicing-only and sponsored access.

Berrett says Citi has had an open dialogue with its clients regarding T2S for more than two years and the advantages of T2S are well understood. There is still a large part of the industry that is adopting a 'wait and see' approach to T2S.



**“A FAIR PERCENTAGE OF OUR CLIENTS HAVE EVALUATED THE BENEFITS T2S CAN DELIVER IN THE SHORT-TERM AND REACHED THE CONCLUSION THAT THERE ARE MORE PRESSING AND IMPORTANT INITIATIVES IN THE INDUSTRY, SUCH AS REGULATORY AND MARKET MANDATORY CHANGES THAT REQUIRE A MORE IMMEDIATE FOCUS AND INVESTMENT. LOCAL MARKET PARTICIPANTS OF CSDS WITH PRIMARILY DOMESTIC BUSINESS MAY BELIEVE THEY DON'T HAVE SUFFICIENT OUTFLOWS INTO OTHER MARKETS TO REALISE ANY BENEFIT FROM T2S. PERHAPS MORE COULD BE DONE TO ALERT SUCH PARTICIPANTS TO THE ADVANTAGES OF T2S AND TO THE CHANGES THAT THEY WILL NEED TO MAKE.”**

*Keith Berrett, Citi*

There is no "one size fits all" when it comes to developing T2S solutions for clients, says Deutsche Bank's Clarke. There are, however, common market problems and themes. The choices clients will make with regards to T2S will be based on their volumes in particular markets or on the types of business they do. Many clients, however, are in a wait and see mode and will make minimal changes, utilising existing providers until it is clearer what the impact of T2S will be. One of the main reasons for this, he says, is bandwidth: clients are also facing multiple regulatory changes and are focused on complying with these.



**“IT IS LIKELY MANY CLIENTS WILL DO WHAT THEY NEED TO DO FOR T2S INITIALLY AND THEN ONCE THE REGULATORY COMPLIANCE BURDEN EASES, THEY WILL MORE CLOSELY EXAMINE THE APPROPRIATE T2S MODELS TO IMPLEMENT.”**

*Mike Clarke, Deutsche Bank*

Client understanding and awareness of T2S also varies. Casteleyn points out that some of BNY Mellon's sell side customers are very aware of T2S and what it will bring, as are some of the larger buy side firms such as the big pension funds and sovereign wealth managers. On the other hand, there are some buy side clients that consider T2S is a problem for custodians to help them deal with. While there is no single benefit in itself that “would move the needle”, he adds, collectively the benefits provide a compelling proposition for clients. “For example, by being a DCP, we will be able to offer better deadlines to our clients for cash, securities and corporate actions. Sell side firms will also benefit from the ability to link trades as we will be able to better execute back-to-back trades for them. Buy side clients will also benefit as commercial banks will be removed from the custody chain, thus reducing risk. This is especially important in light of the AIFMD [Alternative Investment Fund Managers' Directive] requirements.”

Clearstream's Amend believes some of the main challenges regarding T2S will be experienced by clients that have chosen to be DCPs, because T2S is very different and will require them to act like a CSD from a technical perspective. Clients will have to be ready for each of the migration waves and the testing procedures will be long and complex. Those organisations that have opted to become DCPs will have to conduct certification on the Eurosystem side and an authorisation process for the CSDs. There are also challenges around some constraints on T2S functionality such as access rights, rules and definitions of privileges for individual CSDs. In addition, DCPs must adapt to the new infrastructure channel with new standards while at the same time maintaining their existing connectivity layers to CSDs.

Business flows during the migration waves at LCH.Clearnet will be maintained in the issuer CSDs as the first priority is to secure migration, but that does not prevent both LCH.Clearnet and its clearing members from concentrating their settlement in the CSD that will offer the most advantageous pricing in terms of settlement price, says Mairesse. “The positive effects of such competition would be appreciated not only by us but also by our members because it will lead to reduced prices. We expect under T2S we will be able to propose more attractive prices to our members, which in turn will help us to increase our market share as a CCP in Europe.”

Most of the DCPs said fees will be reviewed for clients, but will take into account the need to amortise the expenses of the project. Once this is done, they believe that settlement fees will be reduced. However, Casteleyn believes there is something of a myth around the notion of the 15 euro cents fee promoted by T2S as the settlement fee. “That is not what I will pay for a settlement; it is the theoretical amount that CSDs will pay to the operator of the platform. The communications charges and other fees for getting the trade to T2S also have to be considered, as do the investment costs of becoming a DCP. I think costs will come down, but only in the long run.”

CSDs have been “quite late to the table” in terms of publishing their fee schedules, says Clarke. In some cases, asset servicing fees have risen as settlement operation costs have gone down.

**“FROM DEUTSCHE BANK'S POINT OF VIEW, WE WILL REVIEW OUR PRICING MODELS FOR THE FUTURE; WE WILL HAVE A FEE AND WILL PASS THROUGH THE CHARGES OF THE CSD IN A PARTICULAR MARKET. WE WILL ALSO LOOK AT HOW THE PRICING MODELS ARE STRUCTURED AND WILL UNBUNDLE SERVICES AND THE RELATED FEES. THE MOST IMPORTANT ASPECT OF THIS WILL BE IN DELIVERING PRICE TRANSPARENCY TO OUR CLIENTS.”**

*Mike Clarke, Deutsche Bank*

## Benefits of T2S

There is a range of features and functionality within T2S that will help users to improve settlement processing across Europe. These include partial settlement, whereby instructions can be split into a settled and a remaining part in case of a lack of securities or cash; hold and release, a voluntary mechanism to hold back and release instructions at any time during the lifecycle until they are settled or cancelled; message prioritisation, which offers four different levels of priority for settlement instructions; liquidity management, which supports the provision and management of sufficient liquidity on the cash accounts in T2S and enables users to efficiently use capital; and instruction linking, which allows for instructions to be linked to other instructions.

The ability to offer linking of trades, prioritisation and auto-collateralisation on a harmonised, pan-European basis, will be very beneficial for clients, says Casteleyn. "Sell-side clients in particular are very interested in these features. T2S is a catalyst for innovation as we will look to bundle some of the features into our existing products and also to develop new product offerings. BNY Mellon has also innovated by establishing a CSD that will join the T2S platform in wave four of the migration. We will participate in T2S in two ways, as a global custodian and also as a CSD."

EuroCCP's Huizing believes T2S will change the business of those who become DCPs "considerably and for the better when operating across several markets". The most important benefit for EuroCCP, he adds, will be the partial settlement function and the ability to send matched instructions on behalf of customers. This will bring EuroCCP on par with incumbent CCPs and will increase settlement efficiency. From EuroCCP's point of view, T2S will level the playing field with incumbent CCPs, where they often have had access to special functionality within the local CSD that other CCPs did not. Further down the road, EuroCCP aims to use just one CSD to concentrate all of its settlements, instead of using separate accounts at various CSDs. This will trigger some competition not only at the CSD level but also among pan-European agent banks that develop specialised services.



Another advantage of T2S is that at present, EuroCCP communicates with many CSDs every day and each of them have peculiarities in messaging and different ways of processing corporate actions. T2S will harmonise some of these and represents a very big step forward in terms of efficiency in IT and operations. Currently EuroCCP is a direct participant in 15 CSDs across Europe but sometimes for economic reasons it is an indirect participant in some CSDs (although it invariably has its own segregated account). Also, sometimes EuroCCP has been precluded from having full membership of a CSD, but that is changing, particularly in the light of European regulation. EuroCCP is engaging with some CSDs in which it is not yet a direct participant to explore again whether direct participation is valid.

Optimisation of liquidity management and collateral transformation are two of the key benefits of T2S, according to SGSS's Palmer. Institutions such as SGSS will be able to optimise back office processes and therefore reduce costs for cross-border activity, but also, going forward, for domestic flows. T2S is regarded by Palmer as an opportunity to review operations and how the bank can best serve its customers.



**“T2S ENCOURAGES US TO TAKE A HOLISTIC APPROACH TOWARDS EUROPE, AND EVENTUALLY BEYOND TO A MORE GLOBAL VIEW.”**

*Hugh Palmer, SGSS*

Liquidity is also cited by Clarke, who says the key benefit of T2S for clients will be in reducing the liquidity needs of firms. The separate liquidity pools at CSDs, linked to central banks that are operated today will be replaced by a link to TARGET2 in the cash space. This will enable firms to use a single, central bank funding pool spread across all settlement accounts in T2S markets.

**“T2S IS A CATALYST FOR CHANGE AND AN ENABLER TO HELP OUR CLIENTS OVERCOME KEY REGULATORY CHALLENGES THEY FACE IN AREAS SUCH AS ASSET PROTECTION, COLLATERAL AND LIQUIDITY MANAGEMENT.”**

*Mike Clarke, Deutsche Bank*

For example, regulations are putting a squeeze on eligible assets for collateralisation. T2S gives harmonised, real-time links that will enable clients to move assets from where they are held domestically potentially into triparty collateral programmes,” says Clarke.

Palmer believes there are two categories of innovation that will be driven by T2S: the visible type, which are apparent in the services DCPs will offer to clients, and also the less visible: back office operating models, information systems and information architecture. T2S will act as a catalyst for new solutions and Palmer says SGSS has already made moves such as unbundling settlement from asset servicing, which was introduced some years ago for a major European client.

Palmer says T2S presents interesting opportunities for payment banks to offer liquidity management services for institutions, whether they also use the bank as a custodian or not. Services to optimise settlement, such as hold and release and the possibility to link transactions will enable custodians to create value added tools for their clients. Clients will look to custodians to route, settle and report transactions but also to take a more active role in optimising matching and settlement, particularly as the markets move from T+3 to T+2. In the shorter settlement cycle environment, clients will need to ensure they have a partner that can help deliver high levels of settlement on the intended settlement date. The days of the single market, small volume service providers are numbered as T2S will bring more competition and consolidation at the European level for agent banks and CSDs. A similar phenomenon occurred with the introduction of MIFID as the number of actors increased in the short-term but consolidated after the initial expansion.

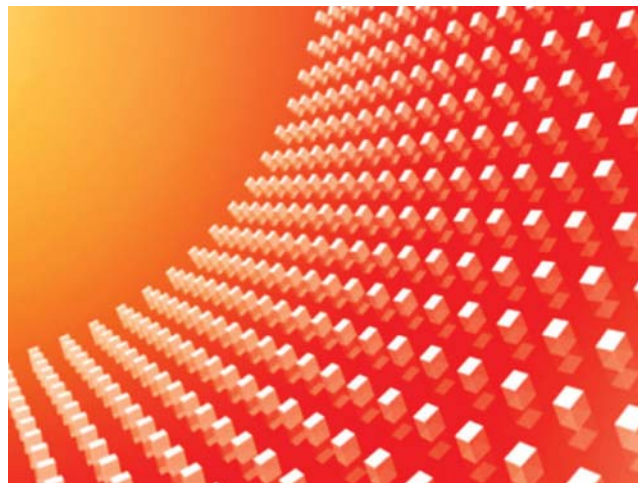
Berrett says T2S cannot deliver all of its objectives overnight. While the harmonised settlement day and common transaction lifecycle will be welcome from day one, these in themselves will not deliver immediate, material benefits. The same can be said for the settlement features such as linking, prioritisation or partialling. “However, over time Citi does foresee that there will be benefits from the standardisation of settlement processes that T2S will deliver. This should result in reduced costs for

providers, which in turn should result in reduced costs for consumers of post-trade services.” The most tangible benefit of T2S, he adds, will be in the area of liquidity and funding. The option to use a single account at one central bank to fund all T2S activity should bring significant benefits to market participants.

**“OVER TIME CITI DOES FORESEE THAT THERE WILL BE BENEFITS FROM THE STANDARDISATION OF SETTLEMENT PROCESSES THAT T2S WILL DELIVER. THIS SHOULD RESULT IN REDUCED COSTS FOR PROVIDERS, WHICH IN TURN SHOULD RESULT IN REDUCED COSTS FOR CONSUMERS OF POST-TRADE SERVICES.”**

*Keith Berrett, Citi*

T2S will also act as a catalyst for harmonisation of the Euro zone post-trade settlement landscape. Supporting legislation such as the CSDR and EMIR has contributed to encouraging harmonisation across markets. For the past couple of years the European harmonisation discussion has progressed very rapidly, says Mairesse, with contributions from both the private and public sectors. The private sector has developed standards for the processing of corporate actions, while the European Commission, via regulations such as EMIR and the CSDR are encouraging harmonisation across markets. “Over a middle and longer term – maybe two to three years – we can anticipate harmonisation in the settlement discipline and buy-in regimes, as well as in the handling of a default or bankruptcy in Europe. So there are still great challenges to come.”



T2S represents a great opportunity to harmonise European settlement but with a project so complex and involving so many different existing market practices it will be difficult to get everyone on board and everything implemented for day one of wave one, says Paola Deantoni, Head of Post-Trading Market, SGSS. Budget concerns, implementation costs and availability of resources have acted as hurdles to harmonisation, but the 'traffic light' approach of T2S, which will be introduced in a series of migration waves, will help to move all European countries involved in the same direction.

"There will be significant benefits once harmonisation is established in Europe, and I do not think that institutions will have to wait until the final migration wave before gains can be realised; harmonisation benefits will exist from day one of wave one," says Deantoni.

While T2S will be a catalyst, Berrett believes there are still "far too many" practices that will not be harmonised by the platform. Not many of these practices are messaging related, however. "As we progress with migration it is likely that some of the declared market specifics will become standard processes, and then organisations such as SWIFT can help to adopt these into market practice. It is accepted now that anything that is not harmonised at this stage will not be until after wave one of migration," he says.

With the development of a common standard format for instructions, the first step in harmonisation has been achieved; all market participants in Europe have started to adapt their internal standards to optimise their own infrastructures, says Amend. Also, some of the rules and restrictions related to accounting and reference data and not yet covered by T2S are being tackled and once developed will lead to further harmonisation of European settlement in central bank money.

Huizing says T2S will definitely be a catalyst for change and harmonisation; all the players in Europe will have access to the same functionalities. Corporate actions to a very large extent will be harmonised and settlement messaging will be fully harmonised. Intraday funding will be easier because firms will no longer have to separately fund specific accounts at various CSDs. There are big advantages related to harmonisation and with each wave of migration to T2S this advantages will grow.

Locatelli says T2S will "certainly" be a catalyst for harmonisation of settlement and also for corporate actions. The focus on harmonisation of corporate actions processing is positive but now the priority should be to ensure harmonisation of the settlement finality and in the settlement discipline.

## The remaining challenges

As a large harmonisation project, T2S does not come without challenges for market participants. Many of the organisations that have chosen to become DCPs have done so in an environment of competing industry and regulatory initiatives. The move to T+2 settlement in Europe, major changes to the Spanish and Finnish markets, the requirements of CSDR and EMIR, are all competing for valuable development and investment resources.

For example, Berrett points out that one of the main challenges has been to manage the significant disruption to day to day activity caused by the migration to T2S, a process that will run for more than 20 months. Community testing, pre-migration activities, the migration weekend itself and post-migration bedding down will have to be performed per CSD, per migration wave. This has placed relentless demand on operations and technology resources.

It is essential for institutions to precisely define static data management descriptions and ensure that testing environments are configured to be as close as possible to the real world scenario, says Palmer. Becoming a DCP requires market by market testing and there is a technical infrastructure challenge in managing multiple testing environments. Another challenge in the testing period is that institutions have to test not only their own readiness but also that of their clients. On this point, DCPs must ensure they can get the right information to the right people at the right time.

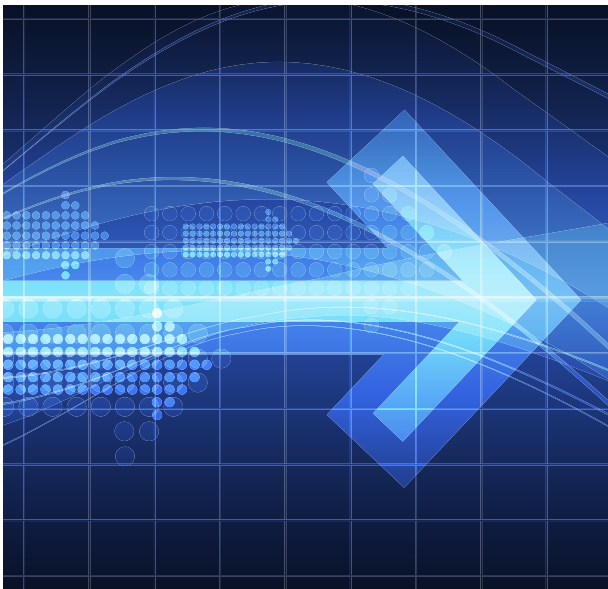
Another challenge posed by T2S is the opening up of competition for all participants. Mairesse says LCH.Clearnet will keep a close eye on its competitors and particularly the multilateral CCP arrangements that are being established at some venues. These arrangements are likely to be further facilitated by the post-trade harmonisation created by T2S, she says.

There are also issues related to the ability to offer cross-CSD services. However, the Cross-Border Market Practice Group (XMAP), a sub-group of the Harmonisation Steering Group of T2S, is working to identify, eliminate or mitigate the impact an issuer CSD in a specific market might impose on other investor CSDs that would prevent cross-CSD settlement. "It is not easy today to offer cross-CSD services but we anticipate that at the end of the last migration wave, this will be easier and that market participants will be able to do cross-CSD settlement in a large range of ISINs that currently are unable to settle outside their issuer's CSD," says Mairesse. In anticipation of this, LCH.Clearnet will offer its clients a free choice in terms of the CSD in which they settle.

**“IT IS NOT EASY TODAY TO OFFER CROSS-CSD SERVICES BUT WE ANTICIPATE THAT AT THE END OF THE LAST MIGRATION WAVE, THIS WILL BE EASIER AND THAT MARKET PARTICIPANTS WILL BE ABLE TO DO CROSS-CSD SETTLEMENT IN A LARGE RANGE OF ISINS THAT CURRENTLY ARE UNABLE TO SETTLE OUTSIDE THEIR ISSUER’S CSD.”**

*Anne Mairesse, LCH.Clearnet*

As T2S is rolled out and becomes successful it will strengthen harmonisation – once it is set in motion, harmonisation will be “like a train that can’t be stopped”, says Casteleyn. “After all four migration waves have been completed, I suspect we will see a new wave of harmonisations taking place as participants see the benefits working.”



## The role of SWIFT

SWIFT is one of two organisations that will provide connectivity services to T2S. SWIFT’s Value-Added Network (VAN) Solution for T2S will allow for the secure exchange of information in ISO 20022 formats between T2S participants and the T2S platform. This offering is complemented with optional products and services including an integration layer into organisation’s back-office applications. As SWIFT is already the de facto provider for connectivity and interoperability services in the European clearing and settlement environment, the SWIFT single window means that users will not have to make significant changes to connect to T2S.

Moreover, SWIFT has taken part in the T2S project from the very start by supporting the ECB in developing the ISO 20022 standards supporting the T2S functionalities. This vast and deep knowledge is shared with SWIFT customers via specific training and consulting services looking at impact assessment, gap analysis, messages mapping, technical implementation and more recently, testing activities.



**“SWIFT WAS AN ORIGINATOR OF THE HARMONISATION PROCESS, THROUGH ITS SUPPORT OF THE SECURITIES MARKET PRACTICE GROUP, WHICH BEGAN LOOKING AT HARMONISATION IN 1996. SWIFT FOSTERED THE IDEA OF A COMMON UNDERSTANDING REGARDING HARMONISATION AND THEN THE SUBSEQUENT MOVE TO DEVELOP COMMON PROCESSES IN ORDER TO ENSURE A STANDARD APPROACH ACROSS COUNTRIES. T2S IS BASED ON THIS LOGIC THAT HAS BEEN BUILT UP OVER THE YEARS.”**

*Paola Deantoni, SGSS*

An important element in some DCPs' T2S strategy is SWIFT's MyStandards, a collaborative, web-based platform that facilitates the management of global standards and related market practice. MyStandards helps users to centralise standards information, manage releases and streamline market practice management. This helps to reduce the cost, risk and effort in managing standards. Deantoni says MyStandards has helped SGSS to accelerate its strategic decision to become a DCP because it will facilitate testing and ensure SGSS can meet the T2S time frame.

SWIFT has developed the Readiness Portal for T2S, a testing tool for T2S ISO 20022 messaging and the most common scenarios. This tool allows DCPs, CSDs and central banks to check their developments before the T2S engine is open for tests.

Huizing says by preparing to offer connectivity services for T2S, SWIFT has developed additional tools and consultancy that have been "very helpful". By hosting MyStandards, for example, SWIFT is playing a very important role in the industry, says Huizing. EuroCCP is also using the roadmap and tools offered by SWIFT to make migration to ISO 20022 easier, and will use the Alliance Integration Platform (IPLA) for transformation and translation.

IPLA enables data to be transformed and enriched from any format (ISO 15022, proprietary) to ISO 20022 and vice-versa. Moreover SWIFT integration services are proposed to DCPs, CSDs and central banks to ease the adoption of the ISO 20022 messages to be used with the T2S platform.

While settlement will be harmonised under T2S, there is still a lot to do and some market specificities will not be harmonised, says Casteleyn. The market should continue to focus on that to ensure that work continues on corporate actions, tax and registration differences. SWIFT has a role to play not only in harmonising messaging but also in the harmonisation of market practices and standards. MyStandards can help to get participants to agree on how certain elements should be formatted to achieve certain goals within T2S, he adds.

Deutsche Bank's Clarke has similar views and says on the wider harmonisation front SWIFT needs to "come to the fore" to ensure that standards in messages are adhered to in asset servicing and settlement in T2S by all market participants.

**“SWIFT HAS A GREAT DEAL OF KNOWLEDGE ABOUT INDIVIDUAL MARKETS AND IF IT WERE ENDORSED BY ITS BOARD AND ITS MEMBERS, IT COULD ACT AS A CENTRAL KNOWLEDGE REPOSITORY AND CONSULTANCY FOR T2S. A LARGE NUMBER OF INDUSTRY PLAYERS VIEW SWIFT AS A VENDOR, RATHER THAN AS A VALUE-ADDED PARTNER, AND IT IS WELL PLACED TO DISSEMINATE KNOWLEDGE AMONG AND PROVIDE GUIDANCE TO INDUSTRY PLAYERS.”**

*Keith Berrett, Citi*



## Conclusion

THE MAIN PLAYERS IN THE CUSTODY BUSINESS SHOULD NOW HAVE DEFINED STRATEGIES AND KNOW WHERE THEY ARE GOING IN THE T2S WORLD, SAYS SGSS'S PALMER. "THERE ARE BOUND TO BE TEETHING PROBLEMS TO BEGIN WITH, AND NATIONAL REGULATORY FRAMEWORKS WILL TAKE TIME TO ENCOMPASS THE REQUIREMENTS OF T2S." SGSS, WHICH WILL BE A DCP FROM WAVE ONE OF MIGRATION, WILL ROLL-OUT ITS NETWORK STRATEGY INCREMENTALLY; THE LAUNCH OF T2S IS THE START OF THE STORY, NOT THE END. PALMER SAYS ACHIEVING THE END OBJECTIVE WILL TAKE MORE TIME THAN THE FOUR MIGRATION WAVES, ALTHOUGH ULTIMATELY IT WILL BE DICTATED BY CUSTOMER DEMANDS.

WHEN T2S WAS FIRST MOOTED IN 2006, THE MAIN FOCUS WAS ON SAVINGS AND COST BENEFITS. NOW WITH THE PLATFORM ABOUT TO BE LAUNCHED, THERE IS A REALISATION THAT T2S WILL DELIVER MANY BENEFITS TO USERS. THE OPPORTUNITIES TO BUILD NEW BUSINESS MODELS, PARTICIPATE IN MARKETS PREVIOUSLY CLOSED AND TO DELIVER NEW SERVICES TO CLIENTS ARE NOW BEING EXPLORED BY THE FIRST WAVE OF PIONEERING DCPS.



SWIFT is a member-owned cooperative that provides the communications platform, products and services to connect more than 10,500 banking organisations, securities institutions and corporate customers in 215 countries and territories. SWIFT enables its users to exchange automated, standardised financial information securely and reliably, thereby lowering costs, reducing operational risk and eliminating operational inefficiencies. SWIFT also brings the financial community together to work collaboratively to shape market practice, define standards and debate issues of mutual interest.

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