

FESE statement on TARGET2-Securities

04/12/2007

1. Introduction

The objective of this paper is to outline the views of FESE members¹ with respect to the evolution of the TARGET2-Securities (T2S) project. The competitiveness of Europe's capital markets relies on the efficiency of links between trading, clearing and settlement. The effectiveness of Regulated Markets depends on the efficiency of the entire value chain, of which settlement is a key component.

Regulated Markets have a unique perspective as major users of settlement services, as acknowledged by the ECB in its "**Impact (of T2S) on different stakeholders**"² where exchanges are considered as primary stakeholders of the T2S project. In addition, there are no CCP services available in number of our markets; as a result, Regulated Markets in these countries link directly to the relevant CSDs.

Clearing and settlement is critical to the proper functioning of securities markets as it serves to formalise the transactions concluded by investors. Regulated Markets are a key component of securities markets and it is therefore crucial that T2S' requirements take into account the specific **needs of Regulated Markets**.

2. Regulated Markets' regulatory responsibilities under MiFID obligations (articles 34 and 39)

MiFID imposes a number of requirements on Regulated Market's regarding the safety of the settlement systems. In particular:

- **Article 34 of MiFID** requires the Regulated Markets to offer their members and participants the right to designate the system (i.e. the CSD) for the settlement of transactions in financial instruments undertaken in that market under certain conditions. Therefore, it will be important that the system being designed under T2S takes into account the current and potential interactions and links between CSDs and Regulated Markets.
- Under **Article 39 of MiFID**, Regulated Markets must have effective arrangements to facilitate efficient and timely finalisation of the transactions executed on their systems. Regulated Markets must therefore be able to rely on T2S to allow them to fulfil their legal and regulatory obligations under MiFID.

Furthermore, some exchanges have additional obligations in the area of the settlement of their trades as a result of their regulatory position and face operational and legal risks stemming for instance from trade cancellations or failed trades. This means that these exchanges have a major interest in areas where T2S would be providing vital services including matching, monitoring settlement performance and failures as well as participants' default.

¹ The Federation of European Securities Exchanges (FESE) represents operators of the European regulated markets and other market segments, comprising the markets for securities, financial derivatives and energy and commodity derivatives. With 24 members, FESE represents close to 40 securities exchanges from all the countries of the EU, Iceland, Norway, and Switzerland. Through its members' activities on a global scale, FESE enjoys links with the regulatory community and industry from around the world.

² "Impact analysis of T2S. A key part of creating a single market for securities in the EU" Presentation by ECB T2S Project Team. Frankfurt 23 July 2007.

3. Definition and scope of T2S

T2S seems to have changed in terms of its scope and definition. At the beginning of the project, T2S was seen as an 'outsourcing' of the CSDs settlement function. Therefore, it was assumed that CSDs would be the entities interfacing with T2S. However, in more recent discussions and in particular following the "Direct Connectivity" working document of 12 September 2007, it became clear that other market participants would be allowed to connect directly to T2S.

Even today, the exact functionalities of the proposed system are not absolutely clear. For instance, there is no clarity yet on the budgetary implications of T2S and what exact developments CSDs and their users may have to pay if they would like to maintain certain useful national features. Hence, it is extremely difficult to work out a meaningful costs/benefit analysis and decide on whether T2S will be beneficial or not.

4. Conditions for delivering full benefits

FESE members are aware of the work of the technical groups and request that the following issues are considered in their discussions:

- **Cost impact**

FESE Members consider that T2S should not increase the costs of clearing and settlement to preserve the efficiency of the European securities market.

- **Full Product spectrum**

FESE members are seeking reassurance that all listed exchange products will be able to settle in T2S both across distinct asset classes and geographies zones (i.e. EU as well as non-EU securities).

- **Cross-border settlement and multiple currency function**

FESE supports frictionless cross-border settlement for our national and international market participants. Europe needs an efficient settlement process, including Euro as well as non-Euro countries. In addition, exchanges list foreign currency products. T2S should also support efficient settlement for securities issued in other key non-EU countries via links or other means.

- **100% coverage**

To deliver the full benefits to the market participants, T2S should ensure a 100% coverage from CSDs.

5. Efficiency of the markets must be the overall aim of T2S

Although T2S is aimed at achieving an efficient settlement platform, the **efficiency of the market as a whole** should be the overarching aim. It is therefore crucial to have a clear definition of the **business case** to **assess** the overall efficiency of the initiative. In particular, the research currently carried out by OXERA on behalf of the Commission could be used in this sense. Expected synergies of T2S as well as potential operational cost reductions should be weighted against the necessary investment and implementation costs for T2S. In addition, CSDs will face costs related to their remaining settlement and custody functions, in particular regarding corporate actions which have to be taken into account.

T2S may require that Regulated Markets adapt their **technological interfaces** with the CSDs. Europe's Regulated Markets are in a global competitive environment and are amongst the most technologically advanced in the world. Any changes triggered by the implementation of T2S that would lead to major adaptations of IT Systems (i.e. extension of trading hours, communication protocols with CSDs, deadline for DVP settlement and management of failed trades, etc.) should be considered carefully and in

synchronisation with the operators of Regulated Markets. This is especially important for those members that have a direct link between trading and settlement.

For bilateral settlement, CSDs currently provide services for **lifecycle management** of stock exchange trades. In case T2S considers including lifecycle management on its platform, a direct input of stock exchange trades (pre-matched trades) into T2S with respective trade management facilities should be considered as a matter of efficiency.

6. Impact on the Code of Conduct on Clearing and Settlement

T2S should support the implementation of the European **Code of Conduct on Clearing and Settlement**. Europe has recently set an example of better regulation with the adoption of the Code of Conduct which has been signed by over 60 institutions from 29 countries from all layers of the value chain. Access and interoperability between the three layers of the value chain are at the heart of the Code. The overall aim of the Code is to allow users the choice of the trading, clearing and settlement venues. Therefore T2S and the Code have to be very closely coordinated if they are to mutually enhance the efficiency of Europe's securities markets.

7. Governance Structure of T2S and level playing field

The governance of T2S should ensure that all stakeholders are represented in a balanced way. One of the fundamental principles of MiFID is to allow competition amongst different trading venues on a level playing field. Although MiFID does not explicitly extend to post-trading (except for Article 34), it is self evident that the same principle of equal conditions for competition should apply to post-trade services. It would conflict with the principles of MiFID to allow one type of operator of an execution venue (i.e. investment banks) to dictate the post-trade user requirements that could materially affect the competitive circumstances of other trading venues (such as Regulated Markets).

Conclusion

- FESE members generally favour European industry initiatives and support the operational and financial efficiency of the post-trading services. Regarding the evolution of the scope and the definition of User Requirements of the T2S project and taking into account the direct and indirect impact on FESE members and their clients, FESE members wish to continue contributing actively to efficient settlement in Europe. In the interest of its members and the users of its markets, it is essential that FESE is part of the future governance structure of T2S to ensure an appropriate representation of the trading arrangements of regulated markets in Europe. The technical expertise of exchanges will be crucial for the development phase of T2S. We would therefore be glad to continue our constructive dialogue with the ECB in particular regarding the future corporate governance of the T2S project.
- FESE members are strong supporters of the Single European Market in Financial Services. However, legal, fiscal and regulatory barriers still stand in the way of a true level playing field. Therefore FESE members call on the European and national authorities to continue their work towards the elimination of these barriers.