T2S: Transforming the European post-trade landscape

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WHO AM I AND WHERE AM I GOING?
T2S AND BUSINESS PLANNING

ALAN CAMERON, BNP PARIBAS: BNP Paribas is a large local custodian across Europe and we undertake about 50m settlements a year, most of them in Europe and most of them in T2S markets. In that regard, T2S is very important to us and we are working hard to get ready for it. You can divide our work into four categories: First, we are active in the many working groups in the local markets to ensure that T2S provides good pan-European harmonisation that also fits in with local market practices. This work has been going on for many years and will continue way after T2S goes live.

Second, we are working to ensure that our clients achieve real advantages in settlement from T2S. Actually, T2S comes with some quite cool functionality; allowing prioritisation, linking and auto-collateralisation, for example. We continually update our systems to make sure that we can pass these advantages on to our clients.

Third, as T2S brings in harmonisation we have to ensure that we achieve economies of scale and process simplification. In practice, this means building up our settlement capabilities through our international operating centre in Lisbon, although asset servicing remains a much more local functionality.

Finally, (and this is what takes up a great deal of time) we are working with some of our key clients to help them find ways to take more control over settlements, but still receive the benefits of using agent banks to provide asset servicing. We have a specific service for this we call ‘sponsored access’. We have spent a lot of time working with clients on developing this service and we can all see what might be possible. Though frankly, clients are finding it hard to come to any final decisions about implementation, because the pricing of the various options is still unclear at this point mainly because we do not know how the CSDs will charge post-T2S. There’s still a great deal of work to be done, so it is a work in progress.

DIANA DIJMARESCU, JP MORGAN: At JP Morgan, we have a number of businesses that will be impacted by T2S. We are a global custodian; we are also offering direct custody and clearing services, collateral management, and prime brokerage services, among others. We trade on our own behalf and on behalf of our clients. We manage our own treasury and are a direct member of the Target2 system. We are a large asset manager. All these businesses and functions will be impacted by T2S. As such we have been very involved in the project from its launch back in 2006 and we have been represented in the governance of the project. We continue to be a member of the T2S advisory group and in a number of related working groups, for instance.

The relevant project management teams in the bank continue to look at the impact of T2S on the bank’s various businesses and how we and our clients will benefit from the system once it goes live. Right now we are accessing these markets via a network of local custodians. We are interested in the directly connected participant solution and, as such, we are part of an informal group of banks that are in talks with the various central securities depositories to try to better understand their offering. We continue to assess the changes that this will involve and how we might respond.

We are also looking at the options of perhaps concentrating our access via one depository, or a selection of depositories, or alternatively buying services in bulk or unbundled from one of the agent banks that we are using today such as buying asset servicing from an agent while self-settling.

As you can imagine, it is a long and complex process, where all parties have been involved in regular dialogue spanning the last three or four years. Although the project is well advanced, and the ways forward are clearer, we are still some way from finalising our decisions. A key objective is to provide our clients flexible, efficient access to T2S and the benefits it brings, while maintaining high service standards for asset servicing.

GRAHAM RAY, DEUTSCHE BANK: I represent the Direct Securities Services business within our Global Transaction Bank. T2S is pivotal and at the forefront of our DNA. One of the main key objectives of T2S is to ensure our diverse client base fully understands the opportunity that it provides, not just looking at the headlines that focus on the proofing of our and our clients’ businesses.

I can categorise our work with our clients into a number of streams. Some involve looking at the account opportunities and account structures that can be leveraged from T2S and other initiatives within the European space; others involve the functionalities of T2S, whether they involve the core functions listed in T2S, or whether they involve the functions that can be created from new operating models.

We are also very engaged/co-chairing the forum around T2S connectivity. From our perspective, connectivity is very important (particularly as we are one of the main sub-cus-
more a monopolistic situation and I think that is going to what we consider to be a T2S hub, which will come from our home market of Germany via DBAG Frankfurt. This hub will be complimented and serviced by our on the ground expertise, local Deutsche Bank market presence.

The last element is for us to leverage the experience we have gained so far from T2S and look at its potential application across the product management footprint in both the cash and collateral worlds. Certainly, we look to find the opportunity for our clients to find efficiencies either through the management of collateral or the utilisation of liquidity via various netting, consolidation or distribution opportunities.

**KARLA AMEND, CLEARSTREAM:** The Clearstream group represents two CSDs, as well as an ICSD in Luxembourg. The CSDs are clearly impacted by T2S and will outsource settlement to the joint T2S platform. At Clearstream, we consider T2S as an opportunity, for our clients and for us. The initiative sits at the heart of our strategy. We have a vital interest in making it all happen. We have been involved in the project since the very beginning, helping define the system jointly with the euro system, the market and other CSDs in various working groups to help us all work together effectively and to come closer together. The end goal is of course efficient settlement across the eurozone. To get to that point we have worked intensively in all the relevant groups covering governance structures and ensuring that everything is working towards the introduction of market improvements to ensure efficient settlement in the future.

In reality we have put T2S at the core of our business strategy and have been in a process of adapting our business model to meet T2S requirements. Therefore, we are rephrasing and optimising our network and services to ensure seamless operation across the various CSDs. In addition, we are upgrading our other services, such as collateral management, cash services and other related offerings to ensure that we optimise and enhance our participation in a new post trade landscape.

**DEFINING TOMORROW’S POST-TRADE WORLD: WHY T2S IS A GAME CHANGER**

**PAUL BODART:** In the CSD world today we have more or less a monopolistic situation and I think that is going to change. You will see more competition among the CSDs over time. The caveat is that I believe it will take a long time, but we should see the number of CSDs reduced. The other thing that will happen is that the functional boundary between infrastructures, such as CSDs and, on the other end, banks and intermediaries, will blur.

You will see CSDs offering services that are very similar to what the custodian provides and, as we have seen recently, you will see some banks becoming CSDs. This is a significant shift of responsibilities.

We should be looking at T2S as a platform. I think a good analogy is that it is like an electricity grid, where CSDs will provide electricity on that grid and then all the market players, the bank, the broker, the investor, the issuer, will use the electricity to power the service that can fulfill their requirements.

Now, Alan and Diana have implied, and this is important, that the way the CSD services operate today is going to change as well, because to date, when you contract with a custodian, you give them everything. The contract includes settlement, asset servicing and so forth. With T2S you will have the option of settling yourself on the platform. That will in turn tempt the CSDs to offer more on the asset servicing side, I think. Particularly as investors will be looking to ensure that they get the right services for their transactions. The big players (banks and asset managers) are looking for a flexible service model that will allow them to connect directly with T2S, and do the settlement itself. This will be possible and they will be able to service the client’s assets as best as possible. This is another important change coming from T2S.

**FRANCESCA CARNEVALE:** Graham, are you and your clients prepared for these relationship shifts?

**GRAHAM RAY:** Most definitely. We recognise the word transformational that’s being used around T2S. The project is transformational and is widely understood as such. Even so, the journey for T2S will be quite long, and therefore it will take time for all parties to actually understand what this transformation will mean to their business models. Moreover, this understanding will continue to evolve, just as T2S will continue to evolve. From a market perspective, T2S isn’t just an isolated component; it will create opportunity, which fundamentally creates competition. During that journey, and the recognition that it will be transformational which, is taking the end-to-end process and unbundling it into components, you have the dynamics of what that will mean to different client segments to play with.

What is becoming very clear to clients, is the expertise a sub-custodian delivers through its knowledge of the local...
markets and the continued value, importance this has even with the introduction of T2S, once you've unbundled the components, you find particular components are still really dependent upon that expertise. That continues to require massive investment, Deutsche Bank has invested significantly to T2S to ensure that from a technology platform and from a resource platform, we comply and actually deliver tangible benefits to our clients in a post T2S landscape.

Deutsche Bank engages with a diverse client base and it is our focus to ensure that each of these diverse market segments fully understand the implications of T2S. I think many segments have made the effort to understand T2S, though there’s still some debate about how best to optimise the solutions T2S will provide. However, our role is to ensure that we partner effectively with the client to help them understand the various options open to them. The repercussions of unbundling have still to be fully quantified; but I would say that one of the key things that the local sub-custodian still offers to the community is the ability to look for the complimenting component opportunities that can come from unbundling the end-to-end chain.

DIANA Dijmarescu: I would say that we probably had much greater expectations in terms of the transformations that T2S will deliver at the start of the process than we do now. I think now, seven years down the road, after all the work that Paul and Karla alluded to, we realise that it’s much more complicated to reach the level of harmonisation required that would enable real market transformation. In that regard I agree that any significant change in the environment in terms of the CSDs and their service offering, in terms of the global custodians changing their business models will take time

Certainly, it won’t be a big bang. There is of course an analogy to be made with MiFID; but only up to a point. It was much easier to establish new trading platforms and new CCPs than it is to change the infrastructure of the post-trading environment when substantial cross-border legal harmonization is yet to happen. In part, that is because T2S only addresses the settlement piece. Moreover, we now know very well that it involves significant work in sourcing all the other components that go into providing comprehensive securities services, beyond settlement. It will take a lot of time, a lot of effort and many years.

ALAN CAMERON: I think it worthwhile to remembering why we’re all doing this. Clearly, the real reason is that companies need to be able to finance themselves through the capital markets rather than just through banks. That need has become even clearer since T2S began and it’s generally thought that one of the stumbling blocks preventing this is the structure of the post-trade world in Europe, which is expensive and somewhat difficult to navigate. Therefore, T2S is an important step is changing things, but it’s just a step along this road and one among many. Previous progress includes immobilisation, dematerialisation, CCPs, netting and the introduction and shortening of settlement cycles. Stuff happened before T2S and we will need more stuff to happen after T2S.

However I would suggest that T2S will have significant impact on safety; it will make settlement safer. It will bring in more harmonisation and finally, which I think is probably the most difficult one to achieve, it will bring about cost reductions. Our belief is that it will bring cost reductions if we all adapt our processing to take advantage of it, but this may not be as immediate as some of us had hoped.

KARLA AMEND: I think it is valuable to focus on the objectives of T2S; its contribution to the integration of the European markets and, in this instance, the post trade infrastructure. On the one hand it is an end-goal; on the other hand it is the beginning of a much larger round of harmonisation. It has a dual function and out of the T2S infrastructure, we can image a host of new opportunities where the whole business of the capital markets can then change and deepen over time; but, as we keep saying, it will take time.

The practical question is how much will costs be reduced by the exercise. I can speak only from the Clearstream perspective, as we are one of the biggest CSDs and one of the cheapest CSDs (in settlement only). We pass on the ECB’s fee of 15 eurocents to our customers without adding on an additional margin.

Can standardisation of costs be achieved on a pan-European basis? It is too early to say. But it is certainly an important goal. The introduction of harmonised T2S processes will lead to a unified infrastructure.

WHO WILL DO WHAT AND WHEN? REDEFINING SECURITIES SERVICES

PAUL BODART: First, I’m not sure that the impact is bigger on the banks than on the CSDs quite honestly. A bank could very well limit the system change or business change to a minimum and continue to work with a custodian or directly with CSDs. I think for the CSD the change is neutral. However, if a custodian wants to be successful and benefit from T2S, they will have to put in place significant changes. In that regard, there will be winners and losers in this game. And we should never forget that the post-trade custody is a scale business, so you have to be big just to be successful, or more accurately survive.

I believe that JPMorgan, BNP and Deutsche Bank with their multi-market infrastructure will probably be among the winners, while the sub-custodian that have been active only in one market will probably suffer. We are already seeing changes in this segment. The UK is a good example. There are no more UK custodian banks, so consolidation in the custody business has happened. There were about 50 custodians in the US ten years ago. There are only six or seven surviving today. I think the same will happen in Europe. You will see a much smaller number of custodians playing mostly in a multi-market approach and the smaller players will gradually disappear.

The CSD space will also have to consolidate; but I honestly think that that will take much longer; though over the long term, it is inevitable.

ALAN CAMERON: I’d agree with Paul absolutely that
transaction banking is all about scale and it’s becoming increasingly so, but that’s been the case for a number of years. T2S will make this clearer and more pronounced. The skill will be to exploit scale and manage to keep the high quality that you have around asset servicing, because there’s very little point in saving cents per settlement if you lose millions in corporate actions. Some banks will consider becoming CSDs, but I think that’s driven much more by regulatory changes and collateral and the banks that are considering it are probably more famous for collateral and issuing services than they are for European settlement services. The CSDs? Well, yes, they are in a difficult situation. What we really need is a consolidation of CSDs, but we seem to be looking at a proliferation of them. The worst thing would be if they were all to believe that they could become global custodians, because Europe has been a graveyard for global customers over the years and those that had built up a business based on local client groups have all failed, because they cannot get the scale that’s required. The best thing would be if the CSDs would consolidate. The worst thing would be if they were all to try and become global custodians and ultimately pass the expense of this on to the clients who have to use them for monopoly services still. So there is change ahead for the CSDs; I think it will take some time and I think we all know what we would like to see. KARLA AMEND: Yes, for the CSDs, it’s the biggest burden for the time being. The reality is that T2S is clearly representing new opportunities for CSDs at a time when many of them are thinking intently about their business model. T2S will provide those CSDs capable of working across multiple markets with a real opportunity to build up links with a range of market participants. But then, there is the realisation that some of the opportunity is not for them; why would a CSD really want to become a global custodian, for example? Nevertheless, CSDs will have to redefine their services. Then again, if you look at the 23 CSDs in Europe, there are only a few who currently have experience in linkage and this kind of business. So what happens to the rest? Some of the CSDs are monopolistic, state institutions that serve a dedicated function. It will be a challenging market for them. Others are more private market institutions and they will definitely face competition, but also enjoy more freedom of movement. Consolidation may make sense for some of these; in some markets talks are already underway and it has happened in others (in some of the Nordic markets, for instance). DIANA DIJMAIRESCU: What everyone agrees on is that we will see a re-drawing of local sub-custody services and of local CSD services. It is unlikely we will see a redrawing of the global custody offering as a result of T2S. As Paul has said, the global custodians could do nothing, stay as they are today, just tweak connectivity a little and continue to use their agent bank network to access T2S markets. Most of the global custodians are looking at optimising their access, but the sub-custodians will definitely have to reassess their business model, particularly the single market providers. Multiple-market providers will be in a much better position and they already have quite a strong product offering. I also agree with Karla, it’s true that the larger CSDs will develop links, build their investor services, and by doing so they will at best compete with their local sub-custodians for a domestic client base. There are only one or two CSDs, which are of a decent size, who will be really able to target a multi-country client base. So what we expect to see is a number of domestic CSDs building a multi-market offering that will be targeted at their local audience, which are already direct members in that CSD. Obviously, we will see over the coming years both winners and losers in the CSD space. ALAN CAMERON: The thing to remember about the global custody world is that it is under intense price pressure. Margins are very thin and to make money out of it, you have to have a whole range of ancillary services— most of which involve taking on a degree of risk, so the important thing here is that if CSDs want to get into this business, they have to have the risk-taking businesses separated from the CSD businesses. KARLA AMEND: Absolutely and that’s coming up also on the CSD Regulation initiative. Even with this separation, I would say that the larger CSDs do have the capacity to be a CSD, offer investor services and be T2S compliant. That will set a benchmark of sorts. GRAHAM RAY: We all recognise that there are a number of CSDs who potentially can redefine themselves in a T2S landscape and provide functionality that the market participants will require across the T2S landscape. However, in creating a T2S landscape, we have created a competitive landscape, which still has a period of time to be bedded down and that time is still a lengthy period. So even in two years’ time, the pure benefits of T2S will not totally be realised. Therefore, we will all have to be honest in the interim who will win and who will not win in the new landscape: we have at least 23 participants coming to the opportunity of T2S; not all will be able to take full advantage of it over the long term.
With that in mind, Deutsche Bank has a strategic approach to what T2S really means to us and our clients. We have to acknowledge that a component of the end-to-end service chain has become commoditised and potentially moving away from the services we were originally providing. We all continue to redefine our business models and Deutsche Bank is fully committed to the success of T2S and the integration of such a momentous infrastructure development across the European landscape; but in redefining it means you need to also find value in what your clients require. T2S is not a one-size fits all for your end clients, so actually in redefining and finding the tangible value that you can add to each client, you have to start categorising what that means to different client segments.

**COME IN BOATS NUMBER 3 & 6! (THE UK AND SWITZERLAND TO THE REST OF YOU)**

**KARLA AMEND:** Some 23 markets have signed up, which are mostly the eurozone countries, or countries with euro currency markets.

**FRANCESCA CARNEVALE:** What is the impact on T2S if a major financial market, such as the United Kingdom, does not sign up to the platform?

**ALAN CAMERON:** Well, one important aspect of T2S is that it is to be run on a cost recovery basis and in transaction banking we have all discovered that our fixed costs are much higher than we thought. The more transactions you have, the better the headline price. So with the UK and Switzerland not being in, volumes for T2S are likely to be lower than originally anticipated. And more transaction taxes are yet to come which will lead to lower volumes than we’d anticipated. So there is potential for a higher per unit charge than originally thought.

**FRANCESCA CARNEVALE:** So will the lack of participation by the UK and Switzerland in T2S ultimately undermine its effectiveness?

**PAUL BODART:** I think the more volume we have the better the economies as Alan said. The project is run on a full-cost recovery basis, so the project is fully funded by the eurosystem, but the eurosystem expects to completely recover its investment without making a profit, just recovering what it has put on the table. However, there is a gap between the projection that we made when we had to put a price for T2S on the table and the volume that we see today as a result of the financial crisis. So any market that joins us will help to close the gap and we have basically four options to try to solve the conundrum.

The first one is that we reduce costs, but that will probably be tough. As Alan says, a project like this involves a lot of fixed cost. We are spending exactly what we anticipated to spend, which for a project of this size and complexity is quite remarkable. However it is probably not realistic to believe that we might significantly reduce the amount that we are going to spend going forward to complete T2S.

Two, you can bring new volumes in T2S and thereby try to convince other markets to join. I believe that some markets are waiting for T2S to be successfully launched and then if it works, will join. We are getting positive signals from some Eastern Europe markets for example. Some of the Scandinavian markets are clearly waiting and seeing what happens. The Norwegian and Swedish authorities have told us if T2S is successfully launched, they will sign up.

Three, we can try to bring to T2S business that is today not done in central bank money. I’m thinking about Eurobond activity, or fund activity, or collateral management activity. Some of that could shift to T2S and bring new volume.

The fourth option is to look at the recovery period. Originally we thought we would recover the investment within 8.75 years. We could change that. We can make it nine years, ten years, or 12 years. Remember that we started this project in 2006 and it will be launched in 2015. So it’s almost a ten year investment before it’s launched, so is 8.75 the right number? I don’t know, but it’s clearly something that we could decide. The Governing Council could decide that rather than amortising over 8.75 years, we amortise on ten and 12 years and then we will have more time to recover.

The last option is always the possibility to increase price. We have that option in the contract. It will be looked at in 2018. We are taking any decision for the time being. We are just watching the markets and trying to convince more countries to join. We will try to bring new business in T2S and wait for a decision on pricing in 2018.

**GRAHAM RAY:** I agree we need to deal with this dilemma, but from a sub-custodial perspective and definitely from a client perspective, if T2S delivers as now anticipated within the timeframe that we have set out and delivers the solution that is set for its objective, then I think we will see other markets want to join. We have to be pragmatic in dealing with the gap, as well as recognising if there is a success; people always want to join success, so other markets will want to play in the T2S landscape. It’s very important with all the complexities that we have going on with T2S and other such regulations like FTT and suchlike that can obviously have an impact upon volumes that we actually stabilise the objective of T2S and we deliver on T2S to then fundamentally create the opportunity to expand.

**DIANA DIJMARESCU:** Looking at the impact on the markets which are not joining T2S, we think that there is a very clear concern that these markets will not be as keenly involved in the harmonisation process that is directly linked to T2S. That is a consequence of not having the whole of the EU joining the platform. Also for the ultimate participants and investors, having all the markets in the EU joining T2S would have really enabled to look at a single market and concentrate liquidity and assets on the same platform. Obviously this is not going to happen and we have the massive pool of assets represented by the UK being outside of the platform.

**ALAN CAMERON:** I would say that we’re disappointed that the UK isn’t in it, but the flat pricing structure and the governance issues that the UK faced make it unlikely that that this will change. The addition of smaller Eastern...
European markets won’t help hugely on the pricing side. I’m not sure about the Asian expedition, so the best places to look for additional volumes must surely be the Eurobond market and funds.

PAUL BODART: Another interesting question is the case of Switzerland, Romania and Hungary, because these three markets are joining T2S, but they are not joining T2S with their local currency. The question is whether we will see some of their local equities trading shifting from their local currency to the euro and then settle on T2S. Will it be easier for UBS, Credit Suisse, and Morgan Stanley to trade Swiss stocks in euro instead of in local currency because everything would happen on T2S? This may be another twist. We’re going to watch. We have no clear answer to that. We have mixed signals.

We are working with Romania and Hungary to see whether they could rethink their initial not to bring their local currency in T2S, after both CSDs have decided to completely revamp their CSD platform. They’ve acknowledged that they have to make a change for T2S. Now, it’s probably easier to have that new platform operating the same way both for the euro and their local currency. We are in discussion with the respective central banks to see if the efforts of the CSDs could be facilitated by bringing the Romanian currency and the Hungarian currency into T2S as additional settlement currencies. This will be a plus.

FRANCESCA CARNEVALE: Essentially what you’re saying is that because of these holes, T2S will have become much broader and multi-asset to compensate.

PAUL BODART: Only in Europe. The idea of T2S may be exported but not the European version of T2S. We should never forget the legal and time zone issues. You can therefore not think that the European T2S could be used by an Asian CSD, or an American CSD, because of the legal and time zone issues, so that’s completely out of the discussion and something we are not even thinking about; though the concept of T2S may be exportable.

DIANA DIJMARESCU: Or maybe foreign CSDs linking their platform to the T2S platform would allow, for example, Japanese securities to be settled in euros.

GOLDEN DATA/SEGREGATED DATA: WHAT IS IT? WHO HAS IT AND WHAT WILL IT MEAN?

GRAHAM RAY: One of the interests around data is the risk element, we say golden data, but if we talk towards the element that the CSD plays in this component a client’s intention is focused on safety and liability, we are seeing more of a move towards account segregation.

From a local sub-custodial perspective and other market participants, segregation of data is quite a complex process, quite a controlled process with multiple reconciliations in place to manage, so actually I look at the use of the word golden data with a little bit of hesitance and actually ponder do we understand the complexity when we use the word golden data and what it truly could mean. Do we recognise that segregating data can be a function? However, it could also introduce a risk and if we don’t control the management of that segregation we actually implement into a complex value chain an anomaly that could actually be extremely dangerous as an industry and specifically the perception of the industry in the wider world.

KARLA AMEND: It’s pretty essential to define what golden data means, and specifically what golden data means in a T2S environment. We already had interesting discussions in the market about how CSDs are making their positions transparent, via golden data on transactions in our local settlement infrastructure. Originally we had a huge debate that CSDs should or should not publish this data, because in part it is sensitive and in part highlights the risk positions or performance of market participants. Should this data be completely visible (or not); and who should see it? How secure should it be? Who does it ultimately belong to? Other considerations in play centre around the day to day practicalities of generating, presenting and analysing data: how secure is the data held? What does it cost to maintain? Again, who has access to it and why? How will it be used? Is it a good indication of performance? These are all important questions and there are no clear answers to all of them. There are still many areas we need to finalise around the definition and usage of data in the post trade world.

PAUL BODART: T2S again is a platform and the data on that platform belongs to the client of the platform, so the data belongs to the CSDs. What you suggest Karla is correct: T2S will have a lot of information on transactional volumes, transaction settlement and on positions, but it will be the position of the client of the CSD, not the client of those clients, but it’s certainly a plus if a regulator wants to have an idea of who has no cash and who does. It was maybe an option, but we can only provide that information if we get agreement with the client of the CSDs. This data belongs to them and as Karla intimates some of them have strong...
banking secrecy, privacy rules that we have to respect, so we have to be careful in managing that.

There is clearly an opportunity for T2S there, because issuers, so the ones that have issued shares or bonds, are extremely entitled to know who their shareholders are. In a domestic environment that works pretty well as each CSD provides this service. In the cross-border environment, it becomes much more complex and if T2S is successful, then you will see more investment made by investors outside of the country of the issuer. For the issuer to have a view who has both his stock, or who has both his fund share is very important. T2S has the information, but could provide the information. It’s not on the radar screen for the time being. We have postponed that discussion, but in terms of shareholder transparency as we call it. T2S could be a plus, but it’s something for phase two. I want to be very clear. We have nothing planned for the time being regarding that. I repeat the data belongs to the CSDs.

**MIGRATION TO T2S, WAVE UPON WAVE: WHERE ARE WE NOW? WHO IS STILL WAVING?**

**PAUL BODART:** Maybe I can give some feedback first on the way the waves have been defined. The T2S Board asked CSDs when they want to migrate and based on their initial feedback, we ended up with a three wave scenario: one wave on June 2015, with one big CSD (Italy) and then four smaller ones. Two other waves will occur in the second half of 2016.

In the event, we realised the gap between wave one and wave two was too long and the concentration in the second semester in terms of number of CSDs per wave and volume in one wave was not acceptable. It was really too risky. So we had a very constructive discussion with the CSDs and we ended up with the four wave scenario. The first wave is unchanged; the second wave is in the first part of 2016; a third wave in the second part of 2016 and the last wave in February 2017.

The biggest wave will be the third one, because Clearstream will be in that wave and Clearstream brings more volume. So that’s how we ended up and I think this balanced, so there is not too much volume in one wave. You don’t have too many CSDs. I don’t believe that this migration plan will change much. There is always the risk that when we start user testing, one CSD may say they are not ready. If that happens we have to move it to another wave and look at what that will mean for subsequent waves.

**GRAHAM RAY:** The impact of the waves to the different client segments is treated in a different manner, which brings complexity to the exercise. There’s recognition of where the volume comes in the various waves, but there’s also the importance of being ready for 2015 when T2S is implemented and starts.

That brings us to another dynamic of the tangible benefits that a local sub-custodian provider can bring to their clients through T2S. The opportunities between the waves will be a definition of what T2S means to the underlying clients and its implementation. Moreover, the risks that come with that implementation period are quite substantial, which brings opportunities for the sub-custodian to shield its clients. Deutsche Bank is on hand to help clients through this key initiative and any diversions that do arise from such a large implementation.

**KARLA AMEND:** CSDs were not very happy with the original three wave approach; and we think the latest model is better. Of course, this has involved intensive work to help our clients balance it out and meet the requirements of the Eurosystem. It has also involved masses of internal work to ensure we can comply at any and all stages. In the first wave we look to have around 15% of the euro business and 23% in the second wave. This involves the euro markets and the Belgian market. Some 44% of the market will transfer in the third wave and 18% in the last wave, with some contingencies for those institutions which were perhaps not ready to move across in previous waves.

Interestingly, and I agree with Graham on this point, I think everyone underestimated the impact of the whole migration programme on every client segment in the Euro-markets. As there are independencies between the links and sometimes complex interdependencies between various market players and you begin to understand the potential for something going wrong, or something not really being prepared for. It has put all of us involved in the project under immense pressure to ensure that all contingencies are covered both pre-migration and post migration.

What we did not expect, but are now pleased to have, is the long preparation period, because every actor has to be ready and on board by February 2017 and in some cases will require a redrawing of historical relationships and practices.

**ALAN CAMERON:** The implementation waves seem reasonable and well balanced to me. I think from the CSDs’ point of view, it’s hard to see there being a first mover advantage in this anyway. The benefits come from the cascading effect of everybody being in, but there may be important to financial institutions who want to consolidate their banking relationships to avoid going through multiple testing scenarios with different agent banks, etc. So that is the main impact that they may have.

**THE NEW T2S LANDSCAPE: WHO WINS, WHO LOSES AND WHY?**

**DIANA DIJMARESCU:** For our clients, the main benefits of T2S are related to safety and risk reduction aspects. These are especially important in the post financial crisis environment. We should remember though that the T2S project was initiated before the onset of the financial crisis. Whereas at that time the focus was more on cost reduction and market efficiencies, today we are in an environment where the risk reduction is really uppermost in everybody’s mind, and having the opportunity to settle across Europe in central bank money is a key attraction of the T2S solution.

Then, as we have discussed before, we all look towards the ability to reduce costs. That’s still on the table and we can
achieve that by benefiting from any resulting low settlement fees, through the reorganisation of the way we do business and by changing the way we access the EU markets. These benefits should cascade along the investment chain to clients and end investors.

Costs reductions will have to be balanced against the cost of adapting to T2S, the costs of migration to the platform and testing. Ultimately though, we should see at each level more savings and improvement in efficiency. Then, there are the significant opportunities from the concentration of liquidity, the pool of securities and collateral on T2S. This should ultimately result in more business coming to T2S due to the network effect.

GRAHAM RAY: The opportunities are clear, irrespective of the client segment. Clients will enjoy better use of collateral, liquidity and cash and will work with an account structure that better meets their day to day requirements. The benefits of being able to take the end to end process and unbundle components are very clear.

I’m going to probably steer away from the benefits of the fundamentals and focus on what I see as one of the key benefits to our end clients. T2S by default is actually driving an integrated partnership between clients and their local sub-custodians to find partnering solutions that are beneficial to the end clients, which is probably an anomaly that sometimes cannot be measured by purely looking at T2S. It is measured by the scale that the local sub-custodian providers have, like Deutsche Bank in the T2S landscape. I think my main focus is on creating more of an integrated market in a relationship between clients and their support infrastructure.

ALAN CAMERON: The core benefits include improved settlement functionality and the better use of collateral. Equally, investors should also benefit from agent banks managing to build scale and passing on the economic advantages of that. Moreover, with post T2S CSD pricing unclear, the agent banks have to draw up fee schedules that include unbundled pricing. This may well be an advantage to some people, but the reality is that it can’t be an advantage to everybody.

KARLA AMEND: Among the many benefits of T2S streamlining the asset servicing component is an important one. It allows investors to streamline their network, with all the attendant cost reduction activity on the other side.

T2S is also enabling access to a wonderfully large collateral pool, this is important given changing regulatory conditions and a desire by regulators for a more secure market. Collateral optimisation will become more important.

I think we have come a long way along the harmonisation route informally; what is now vital is formalising this harmonisation and what it means in terms of service level agreements and costs for investors and other market participants.

PAUL BODART: The big change will be for the issuers that will have more choice to see who is going to support them when they want to issue bonds and money market instruments. They will not be forced any more to go to their local provider, but they will likely benefit from the competition brought by T2S. The fundamental benefit of T2S is that it settles cross border transactions at the same price, or the same cost, as domestic transactions. You should see issuers getting a broader range of investor buying their securities and that should probably reduce the cost of issuing debt and shares over the long term. You should also see investors investing more outside of their home market than they do today. We should never forget regulations such as CRD 4, EMIR and so on and what it means in terms of additional capital risk reduction.

In addition T2S will allow you to pool all your liquidity on one account, or fewer accounts, to move collateral around much faster and more efficiently than today; and to use efficiently the collateral and the liquidity that you need to meet your post-trade commitments. Today we often forget the role that, for example, the sub-custodians play in providing the oil in the machine, in other words, how sub-custodians provide liquidity for intraday settlement. By bringing everything onto one platform, T2S, and using a smaller number of cash accounts investors will need less cash, or less liquidity to settle their trades and less collateral to support the risk related to that activity.

KARLA AMEND: Talking about that new cash/liquidity requirement, we recently undertook an enterprise-wide study in cooperation with PwC (please refer to page 58) around the cost of direct cash accounts (DCAs); the study, published in September this year found a clear 15% advantage or liquidity reduction by using only one DCA, “says Amend. Photograph © Berlinger, August 2013.

NAVIGATING THE REGULATION JUNGLE: DOES T2S CLEAR OR HINDER THE PATH?

PAUL BODART: I’d like to start by saying T2S is an infrastructure, it’s not a regulation. T2S is part of a wider programme around harmonisation of markets in Europe.
On top of T2S, you have the CSD Regulation that describes the regulatory framework. Will the CSD Regulation be adopted in time? I believe it will. You have MiFID for trading, EMIR for CCPs and CSD Regulation for the CSDs, which are critical [infrastructure].

Infrastructures worked extremely well in the crisis, but I think that regulators have recognised that if an infrastructure were to fail, it would be a major problem. I therefore believe that a European-wide level playing field, a stronger risk management framework and stronger governance around CSDs, are good things and I think it’s required.

In this regard the CSD regulation and T2S are complementary and not conflicting and will help to create, as Diana said earlier, a more integrated European financial market as opposed to a combination of 27, or 28 financial markets.

DIANA DJIMARESCU: I would just make the observation that from a market participant perspective, the combination of a major infrastructure change at a time when we are heavily involved in implementation of a number of significant regulatory changes poses a challenge in terms of resources and (clearly) management. We view 2015 as a critical year when a number of regulatory changes will already be in place and in implementation phase, and then we will have the first wave of T2S to deal with. While I agree that many regulations do indeed complement each other and will, in fact, help T2S to deliver on all its opportunities, we have to acknowledge that the next few years will be very busy indeed, for everybody, and we will need to make sure that we have the resources in place to deal with this successfully and look at the combined effects of all these simultaneous changes.

GRAHAM RAY: Most definitely there’s a complementary element in CSD Regulation and T2S. There are also challenges, as Diana noted, with regards to dealing with all this change. For T2S it is important that CSD Regulation comes in on time so that T2S can benefit and we can optimise our responses to the new post trade infrastructure.

However, I have to acknowledge that, looking at it from the point of view of the market participants, there’s an element of fatigue creeping in around T2S and some of the changes that follow. It might be time now to bed down some of the more important regulations and give them time to be implemented and see what the effects of the regulation are on the market community before we look to overcomplicate things with any additional regulatory developments or infrastructural changes.

ALAN CAMERON: Two of the most important aspects of T2S are safety and harmonisation. Both would be improved with shorter and harmonised settlement cycles. To get the most out of T2S we need T+2 settlement to come in before it goes live. If we need CSD Regulation to get to T+2 then CSD Regulation is important.

PAUL BODART: Of course, Alan is right. We definitely need T+2 implemented before T2S. However, if you do it at the same time, it might be a too complex project. The CSDs have decided to join in, so I am hopeful it will happen.

Another question is whether T2S will be ready on time. We don’t know. I think we are on track; though we still have two years of full testing ahead of us. Up to now the results are better than we anticipated for a project of this complexity. Soon we will start testing with the central banks, then in late summer 2014 with the CSDs and after that the CSDs will start testing with their users. Of course, surprises can happen, so we are preparing for that eventuality too.

However, I want to make the point that the work and the mind-set around this work have changed. We are working together with CSDs across Europe and they are really constructive and all the work around testing is underway. I’m not nervous about the CSDs being ready. I think they will be. I’m a little bit nervous about whether (in each European market) the users of the CSDs will be ready. That is something we need to watch, but we still have two years in front of us and we know that a complex project like this may lead to some surprises. There’s nothing that’s telling me today that we will suffer any delays, or whether the results of our testing are better than what we expected.

KARLA AMEND: I recently ran a T2S conference in Frankfurt where we surveyed attendees on their preparedness for and understanding of T2S. Interestingly, around 79% of the 130 customers that attended responded that their preparedness for T2S was more or less on schedule. We ran that same exercise last year and then only 40% of respondents said they were ready and preparing for T2S. In the intervening period then, there has been a substantial shift in attitude and commitment to the project and we have taken that response as a positive sign. At least I can say this is the case for the German market: I cannot be sure of the same in other European markets. T2S entails investments of several hundred million euros, not only for the eurosystem, but also for market participants across Europe. It is in all our interests to ensure that the numerous advantages offered by T2S actually become a reality. As the largest central securities depositary in Europe, we believe it is our responsibility to continue to offer the market (in Germany and beyond) the right services for a world with T2S.

GRAHAM RAY: I think Karla hits a very salient point, market evolution within T2S for more mature markets, or higher-scale volume markets, is definitely tracking in line to the T2S plans. I suppose the complexity around it all is that there are still many steps involved in the process to ensure that all participants are ready for change. If you bring that back to CSDs, all of the adaptation plans for T2S are not delivered yet; but as long as everyone adheres to the principles of T2S to be ready by the date, from a sub-custodial perspective, with multi-market coverage, then our significant investment into T2S and our own multi-market coverage will begin to dovetail with each CSD.

I really do believe that the dynamics of the impacts on the European sub-custody network will depend on what the underlying CSDs will do. In the meantime we will be dealing with specific issues, such as reform in the Spanish market, CSD adaptation plans for T2 and so forth. So there is a lot of work to do in between now and the complete implementation of T2S/all waves. ■