



# NEWSLETTER

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**Editorial**



**An opportunity to jointly shape the future (Clearstream)**



**“T2S on T2” one platform – two services (3CB+)**



**Outcome of the public consultation on T2S principles and proposals**



EUROPEAN CENTRAL BANK

EUROSYSTEM



Jean-Michel Godeffroy

## WORK HARD AND PLAY BY THE RULES

### EDITORIAL

We have now embarked on the process of defining the user requirements for the settlement platform for Europe as a whole, TARGET2-Securities (T2S). Certainly, the task is ambitious, and it will therefore require hard work – from the Eurosystem and market participants. The deadline fixed by the Governing Council for achieving this objective is a tight one: to submit user requirements by December 2007, which will then be subject to an extensive public consultation. Indeed, when we held our first Advisory Group meeting back in May 2007, the challenge ahead was known to all.

I acknowledge that T2S is requiring the settlement industry to invest a significant amount of work hours. Clearly the momentum is there to integrate securities settlement in Europe and we are thankful for the work done so far. So it is only fair to market players that the Eurosystem should set itself rules in order to ensure due process.

- [Ensure Transparency](#)

The governance structure for this phase of the project involves 180 persons from 80 institutions if we add up the Advisory Group and the six Technical Groups. Still, any person not participating in these groups can follow the work through the ECB website and influence it through the consultations to the National User Groups. Within the framework defined by the Governing Council, no major decision will be taken behind closed doors. From the start of the project, this transparency policy has been much valued and it will remain.

- [Consult and give time to respond](#)

Consultations have been carried out in one of two formats: public consultations (launched by the ECB Governing Council and covering the overall status of the project) and mini-consultations (launched by the Technical Groups and focusing on specific aspects). We received criticism recently because several mini-consultations coincided in time during the summer months. This was an inevitable constraint in order to respect both the need to consult and the deadline fixed by the Governors. The

Chairpersons of the TGs agreed to extend their duration, in general, from three to five weeks in order to alleviate the work pressure. The next public consultation will be launched early next year and will last three months. As a matter of fact, in the year spanning between April 2007 and April 2008, half of the time (six months) will have been devoted to consultation processes.

- [Listen and provide feedback](#)

Market participants invest substantial time in responding to consultations and need to make sure that the effort is worth it. The Eurosystem very much appreciates this feedback which is crucial to form our views. The recent public consultation on “Principles and Proposals” is a good example of this (see article in this newsletter). The responses were carefully scrutinised by the ECB Project Team during the month of July and many proposals were discussed and reviewed with market participants at the last Advisory Group meeting. How do we intend to provide further feedback in the future? Before taking a view, the AG will have at its disposal all comments received and the reasons for proposing a given course of action. A key element to report back to NUGs is that the 180 persons I referred to earlier are normally also part of a NUG. Where required, Project Team members may also attend a NUG to report back.

- [Allow time for debate](#)

Although the deadlines are tight, there are difficult decisions to take. The value of debates is fully acknowledged. In this respect, the objective is that the AG discusses the full set of Users Requirements on two occasions before the consultation is launched in 2008 and once afterwards.

I am conscious that we will be judged not only by the User Requirements we produce, but also on how we produce them. Like Jeff Tessler in the article that follows, I am convinced that fluid communication between the Eurosystem and market participants is crucial for this project. I hope you will find that this newsletter, which includes also an article of the 3CB+ on “T2S on T2”, contributes to this. Please do not hesitate to suggest to us topics for the next issue.



Jeff Tessler,  
CEO Clearstream International

## AN OPPORTUNITY TO JOINTLY SHAPE THE FUTURE

The Target2-Securities project (T2S) is an endeavour by the ECB and the Eurosystem to change, and ultimately improve, the post-trading landscape in Europe substantially. Some criticism has been raised whether the ECB/Eurosystem have the mandate and expertise to pursue this project. In my opinion these questions are secondary to the opportunity for the public and private sector to jointly shape the future of our industry.

The private sector's substantial experience in securities processing, beyond settlement, as well as its track record in delivering platform consolidation projects, combined with the ECB/Eurosystem's unique ability to influence policy setting and regulation on a national and European level, have the potential to provide an integrated and harmonised environment for Europe that will result in safer and more efficient payment and settlement services – on a domestic level and cross-border. This should be the vision for T2S. The fact that the ECB/Eurosystem have successfully started to facilitate an active and constructive discussion amongst all stakeholders is a promising start towards realising this vision.

In this respect it is crucial that T2S facilitates a truly harmonised legal and regulatory framework that addresses the current drivers for complexity and related costs in securities processing, such as national depository laws, finality issues and regulatory requirements. This is particularly valid for the requirement that T2S should also allow for efficient cross-border settlement with those European markets that decide to stay outside of T2S, which is totally aligned with the Lisbon agenda.

Most, if not all, of these drivers are clearly reflected in the Giovannini barriers, however, the progress of removing these barriers is lagging behind expectations, in particular for those under responsibility of the public sector. I am confident that the ECB/Eurosystem as part of the T2S initiative will be a driving force to substantially contribute to the removal of barriers 9 (National restrictions on the location of securities), 12 (Collection of transaction taxes via an integrated settlement system), 13 (Absence of an EU-wide framework for the treatment of ownership of securities) and 15 (National differences about how to resolve conflicts of laws).

From a CSD perspective we appreciate the opportunity to shift scarce resources away from commoditised settlement towards areas that will determine competitiveness in the future, namely cross-border asset servicing and securities financing capabilities. In order to achieve the envisaged cost savings, the functional architecture of T2S must allow CSDs to fully decommission their settlement lifecycles and the respective applications and IT platforms. In addition to the user requirements, the level of legal and regulatory harmonisation is a key driver for scope and functional setup. If T2S were not to facilitate harmonisation across all concerned markets but were to deliver the lowest common denominator only, CSDs would have to continue to provide market specific services – with little or no potential for cost savings resulting from decommissioning. In this case T2S would clearly fall short of the aforementioned vision.

The coming months will reveal the true potential of the project. In addition to the functional architecture outlined above, I consider the following as key deliverables of the current project phase: a more substantial business case with an end-to-end perspective, a governance structure for the running phase that properly reflects the requirements of CSDs as well as an interim solution for a level playing field for access to central bank money before the implementation of T2S. In the spirit of a synergetic co-operation between public and private sector, however, the ECB/Eurosystem should rethink its approach to market consultation. Key documents should be consulted with all relevant stakeholders. Deliverables such as the revised business case and the regulatory framework certainly fall into this category.

T2S is today's most tangible opportunity to design the future of the European post-trade infrastructure, and I consider it important to participate actively. Clearstream has constructively supported the project and the ECB/Eurosystem from the very beginning and is proceeding in this direction with experts in all Technical Groups. We will continue to carefully evaluate our participation in T2S based on the progress on the aspects mentioned above and the resulting value for our stakeholders.

## “T2S ON T2”: ONE PLATFORM – TWO SERVICES

Since thought was first given to a technically centralised European securities settlement service in central bank money (CeBM) and the name “TARGET2-Securities” was chosen, the similarities and differences between this new service and TARGET2 have been the subject of intensive discussions.

An important decision was made on 8 March 2007, when the Governing Council decided that *“the T2S service will be developed internally within the Eurosystem and operated on the TARGET2 platform in order to exploit synergies with TARGET2 to the fullest extent”*. This statement explicitly acknowledged the close relationship between T2 and T2S, and formed the basis for the now commonly used “T2S on T2” concept.

Since then, CSDs and participants have raised many questions, showing that this concept required further clarification. It seems worthwhile considering some concrete elements which could help to identify what T2S on T2 is and, perhaps more importantly, what T2S on T2 is not. Hence this article.

### TWO DISTINCT SERVICES

Does the operation of T2S on the TARGET2 platform mean that T2S and T2 will constitute a unique service? The answer is definitely no, since exploitation of the synergies between the two systems – the Eurosystem’s objective – must not lead to tight and risky dependencies between these two business-critical facilities. Moreover, the high complexity resulting from building one single application would make crucial project phases (notably tests) too laborious and would significantly increase maintenance costs by multiplying the impact of local modifications. Finally, in the operational phase, the merger of the two services would have the potential to result in a single point of failure and consequently increase the overall vulnerability of both services.

Distinguishing between two different services, T2 for payment services and T2S for securities settlement, appeared to be the most suitable solution. Naturally, there are obvious similarities: both deal with the closely interrelated business areas of large-value payments processing and securities settlement; both aim to increase the market efficiency by providing technically centralised tools, while preserving the existing legally decentralised framework. Therefore, building T2S without taking into account the solutions devised for T2 would deprive the European financial industry of the beneficial experiences gained from T2 project.

**The challenge was simple: “How to take the best from T2 while avoiding harmful constraints?” Let’s examine how the “T2S on T2” concept provides an efficient balance in this respect.**

### A SINGLE PLATFORM REUSING THE T2 ARCHITECTURE DESIGN

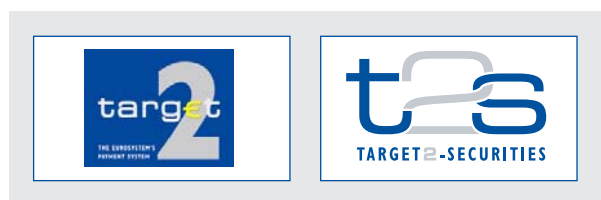
The TARGET2 software was based on a “building-block” concept, which consisted of reusing, as much as possible, pieces of software (the building blocks) taken from national components of TARGET1. However, the technical infrastructure had to be designed from scratch. The much higher standards of system resilience required as a result of the 9/11 terrorist attacks have made it necessary to define a new business continuity model which will manage the huge volume of data and procedures generated by the consolidation of all payment activities at Eurosystem level.

At the start of the T2S project, the situation will be different; the application software for settlement purposes will be a new development, whereas the existing T2 architectural design (the already available Single Shared Platform or SSP) is a very valid answer to the technical challenges of a European-wide settlement system. Indeed, T2S can draw on the existing technical architecture designed for T2, including a fully scalable central processing system, a storage sub-system with synchronous and asynchronous mirroring and a dedicated network to connect the different processing sites (3CBNet). Other components, like certain interfaces or the connection to the SWIFT network, could also be reused if relevant. Naturally, the existing components will have to be resized in order to cope with the expected T2S volumes, but reusing the SSP architecture for T2S ensures that T2S services will benefit from this architecture in terms of performance and overall resilience.

Notably, the full integration of T2S in the SSP architecture will allow T2S to inherit from T2 a state-of-the-art business continuity model, including intra- and inter-regional failover management, as well as an adaptable contingency framework. This will enable T2S to cope with the consequences of a variety of unpredictable events, ranging from local equipment failure to region-wide disasters. T2S will also be integrated de facto into the crisis management organisation set up by the Eurosystem for T2.

A leading-edge platform is of course of little use without skilled teams supporting it on a day-to-day basis. The 3CBPlus organisation, largely derived from the 3CB model for T2, constitutes a solid basis for the very high levels of service expected from a platform as critical to business as T2S. Similarly, the project framework set up by the Eurosystem to develop Target2 has demonstrated its efficiency in the management of a large-scale project involving many stakeholders and, sometimes, an equally large number of viewpoints.

**“T2S on T2” is essentially two distinct services: T2 for large-value euro payments processing and T2S for securities settlement in CeBM running on the T2 infrastructure.**



### SYNERGIES, OPPORTUNITIES AND MORE...

“T2S on T2” will bring direct synergies, as it will reuse or share resources currently available for T2. As for the technical architecture, the mutualisation of some components or the time-sharing of equipment and teams will allow an optimisation of the SSP resources by exploiting possible load-balancing between the services, and by improving the occupation rate of test & training environments, for example. This mutualisation of the infrastructure that will exclude cross-subsidisation will lead to lower costs for the users.

Sharing the same platform also allows common tools to be used for the two services (e.g. Change Management system, Trouble Management system or Technical Monitoring).

Apart from these immediate and concrete synergies, T2S on T2 also provides new opportunities to create added value for its users, thanks to the proximity of the two services. Notably, this proximity creates unique conditions for easing liquidity management and therefore make it more efficient for the underlying businesses of both T2 and T2S. For T2, for example, it will facilitate the provision of additional liquidity through the proximity of securities settlement features, while for T2S, it will allow an optimisation of the liquidity used in the securities settlement process. The already existing and sophisticated

liquidity management functions of T2 will be further enhanced to facilitate the usage of cash by the two services. Since all liquidity available for payments and for securities settlement will be accessible on a single platform globally, liquidity management will be more flexible and efficient than it is today.

Finally, the homogeneous presentation layer for T2 and T2S (based on ICM) will make it possible to integrate (at user workstation level) the full set of services provided by T2 and T2S through a “single window” access. Similarly, the development of the T2S accounting functions will benefit from the liquidity management introduced in T2.

### T2S ON T2 IS NOT T2S IN T2...

The current phase of the T2S project consists of compiling the users’ requirements through an extensive process of consultation of the market involving more than 180 high-level experts from nearly 80 financial institutions. The “White page” approach foreseen for the design of the future system will create the conditions for taking into account all the users’ requirements.

**“T2S on T2” is not “T2S in T2”: reusing T2 solutions for T2S is not an *a priori* posture. These solutions will need to be fully in line the T2S users’ needs “T2S on T2” is an open concept that should not impose constraints on the users’ requirements, while allowing significant cost savings because of the synergies with T2 and the reuse of the SSP architecture. Only this approach will ensure the timely delivery of a cost-efficient solution in the interest of CSDs, market participants and the Eurosystem.**

## OUTCOME OF THE PUBLIC CONSULTATION ON T2S ENDED IN JUNE 2007

On 26 April 2007 a public consultation on the document “T2S: general principles and high-level proposals” was launched. The public consultation was a channel for market participants to express their opinion on the proposals defining the nature and scope of the future TARGET2-Securities (T2S) settlement service. The consultation paper resulted from the preparatory work carried out by the Eurosystem in cooperation with market participants. It essentially sets the cornerstones for the current project phase, i.e., drafting the “T2S user requirements”.

Market participants were invited to make comments by 26 June 2007. The T2S project team received 57 replies. All non-confidential replies were published.<sup>1</sup>

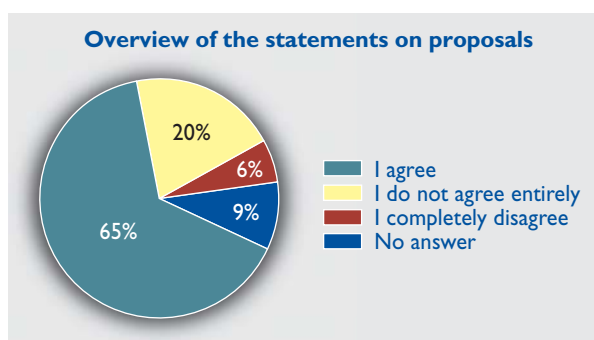
Judging by the wide range of market participants that replied (including banks, central securities depositories (CSDs), brokers, national user groups and financial services associations) and by the many different views expressed, the T2S project is the object of considerable interest in the markets.

Among the respondents, approximately thirty were banks or banking federations, a dozen were CSDs and another dozen market participants with different affiliations, based both in and outside the euro area. About 40% of the replies were sent by associations or groups of users, so the actual number of institutions that took part in the consultation was even higher than the number of replies received.

The first part of the document, the “general principles”, is intended to give market participants a better understanding of the aim and the constraints of the T2S project. The general principles were drafted following a dialogue with a wide range of market participants between July 2006 and March 2007 (during the “pre-project” phase). A first version of the principles was originally published in the Blueprint and the Feasibility Study for T2S.<sup>2</sup>

Although the general principles had not originally been intended for comment, about 15 institutions or groups of institutions provided constructive comments and drafting suggestions aimed at improving clarity. These comments have been given due consideration. Proposals for revision were submitted to the T2S Advisory Group at its meeting on 31 July and 1 August. The outcome of the Advisory Group’s discussion will be used as a basis for further work by the Technical Groups.<sup>3</sup>

The majority of the replies received in the public consultation focused on the “high-level proposals”, which will form the basis for drafting the T2S user requirements. An overview of the replies shows that feedback from the respondents was very positive. As the pie chart below reveals, 65% of statements on the proposals expressed full agreement, suggesting that the project is evolving in the right direction.



The proportion of agreement is relatively homogeneous among different types of institutions. About 67% of the replies from banks and 70% of replies from CSDs expressed full agreement with the respective proposal.

However, approximately a quarter of the respondents expressed partial or even complete disagreement with some proposals and called for them to be reviewed. The disagreement is fairly concentrated: 41% of fully negative statements relate to 12 out of 67 proposals. About 20% of the partial disagreements mention a perceived lack of detail or of a clear definition.<sup>4</sup>

The ECB T2S project team members subdivided all the statements and comments in three groups.<sup>5</sup> The first group, the proposals that encountered widespread agreement, were considered by the project team as confirmed by market participants; however, some rephrasing will be required in order to improve clarity and precision. In a second, smaller group of replies, there was no overall majority on the respective proposals, views were mixed. A third group included respondents that were in partial or total disagreement with the proposals.

The T2S project team prepared a note to the T2S Advisory Group and made suggestions on whether and how to modify the proposals. Three solutions were proposed. First, the project team proposed the validation of approximately 50% of the proposals as originally drafted or with minimal drafting changes. Second, some controversial proposals were reviewed by the Advisory Group, which discussed them at its July-August meeting and provided guidance to the T2S Technical Groups. Third, on some other controversial proposals, the Advisory Group mandated Technical Groups to further analyse the comments received and suggest how to accommodate them in the proposals. The Advisory Group will reconsider these proposals in September.

Further work on the user requirements is now under way. Information on technical issues is being collected from the national user groups to support the work of the Technical Groups. An information session is being organised on 29 August to keep market participants informed of latest developments. A second public consultation will be launched after the Governing Council of the ECB has discussed the user requirements towards the end of the year.

1 The letters and the excel files are available at <http://www.ecb.int/ecb/cons/html/t2s.en.html>

2 Published on 8 March 2007. See <http://www.ecb.int/paym/t2s/decisions/html/nextphase.en.html>

3 For the documents relating to the meeting, see [http://www.ecb.europa.eu/paym/t2s/defining/ag/html/ag\\_2.en.html](http://www.ecb.europa.eu/paym/t2s/defining/ag/html/ag_2.en.html)

4 For a summary of the responses, see <http://www.ecb.europa.eu/ecb/cons/html/t2s.en.html>

5 For a detailed analysis of the comments on the proposals at the Advisory Group meeting of 31 July and 1 August, see Point 2 of the minutes of the meeting: [http://www.ecb.europa.eu/paym/t2s/defining/ag/html/ag\\_2.en.html](http://www.ecb.europa.eu/paym/t2s/defining/ag/html/ag_2.en.html)

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