T2S is right on target

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BNP PARIBAS SECURITIES SERVICES

SOCIETE GENERALE Securities Services

The Panel

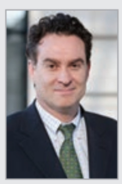
Jesús Benito is chief executive officer of **Iberclear**, the Spanish Central Securities Depository, and he has been managing director of REGIS-TR, of which he is a board member. He participates in the T2S Advisory Group, in the T2S Harmonization Steering Group and serves as chairman of the CSD Steering Group. Jesús joined Iberclear in 2000, and has been CEO since 2006. From 1988 to 2000 he worked for the Banco de España.

Alan Cameron is responsible for **BNP Paribas Securities Services**' relationships with major brokers and banks. He has more than 30 years of experience of securities services. Alan holds an MA in economic history from the University of Edinburgh and is a chartered banker. He is also a member of the Association for Financial Markets in Europe's post-trade board.

Andy Duffin has been with **Societe Generale Securities Services** since 2007 and is head of sales, emerging markets. He has more than 25 years of experience in the securities services industry, having started in the custody division of RBS in 1987. A decade later, Andy joined the network management group of Deutsche Bank and headed the Europe, Middle East and Africa team. He joined Clearstream Banking in 2005 as a sales and relationship manager in London.

Mehdi Manaa is head of the Market Infrastructure Development Division at the **European Central Bank**, where he has worked since 2007. From 1996 he worked for Euroclear France and, prior to this, Euronext (then Bourse de Paris), which he joined in 1994. Mehdi is a graduate of the Institut d'Informatique d'Entreprise, Paris.

Daniela Peterhoff is a partner in **Oliver Wyman**'s Zurich office. She leads the firm's market infrastructure work in EMEA, covering a broad range of cash and derivatives exchanges, listed and OTC central clearing counterparties, (international) central security depositories, custodians, and data and index providers.



Fabian Vandenreydt is a director at **SWIFT**, where he leads the traffic development and strategic initiatives teams for securities, treasury and banking markets. He joined SWIFT in 2004 from Capco, and previously was a vice-president at Euroclear. Fabian is based at SWIFT's headquarters outside of Brussels.

Alessandro Zignani joined the **London Stock Exchange Group** as general manager of Monte Titoli in 2010, and in 2013 was appointed head of sales for the post-trade division. He started at Citibank Securities Services, where he spent 11 years covering different roles. In 2002, he was responsible for the start-up bond platform EuroTLX and has been managing director since 2009.

Custody Risk: Under Target2-Securities (T2S), what will be the effect of liquidity flows in and out of Europe and how will participants handle the new collateral landscape? Should T2S be extended to other geographies and currencies?
Alan Cameron, BNP Paribas Securities Services: If the market participants are able to utilise T2S to bring costs down through simplifying their own operating models, then it should be a good thing in making post-trade more efficient in Europe and this should have the knock-on effect of making Europe a more attractive place to invest in. So, yes, I think it could have a beneficial effect on liquidity in the long run. On the question of other geographies and currencies, I think we are still left with a governance problem that kept the UK out of T2S in the first place. This is a political issue, it is not just an economic or a commercial question.

Mehdi Manaa, European Central Bank: In the past, there has been a problem of governance that has prevented the UK from being willing to join T2S from its inception. We are confident that, over time, this issue of governance will disappear. It was expected, however, since the European Central Bank and the other euro area central banks put money on the table and so are dominant in the governance arena. When the costs are recovered, the issue will likely be of a totally different nature and the UK could reconsider joining T2S on that basis. In terms of other currencies, T2S is already open for other currencies and we know that other currencies, such as the Danish krone, will be in T2S from 2018. Others will probably follow very quickly afterwards or maybe at the same time as the Danish. With regard to other geographies, T2S will probably be a model that inspires other regions to undergo a consolidation of settlement, such as the south Asian region and Latin America. A direct extension and opening of T2S to other markets is more challenging from the governance and regulatory perspective.

Fabian Vandenreydt, SWIFT: There are a lot of initiatives in southeast Asia to look at some form of harmonisation of practises, and T2S is seen as a best-practice model. In terms of timing that might take a number of years because there are lots of regulatory and even basic standardisation processes that are not there right now.

Andy Duffin, Societe Generale Securities Services: In terms of T2S, there is no doubt that it will allow users to optimise liquidity in terms of pooling and netting. But, before we talk about other geographic locations, we must make the first four waves a priority. The question is not talking about replicating a system, rather extending T2S to other geographic locations, which is different. For me, we need to see that economic value delivered in the first four waves and then start thinking about other geographic locations.

Mehdi Manaa: Yes, but in other geographical locations, there are some initiatives – for example, Latin America is looking pretty closely at T2S and trying to get the best out of it, at least in terms of models or barriers that we have faced to avoid going through the same hurdles.

Jesús Benito, Iberclear: Indeed, in Latin America I can confirm there is a lot of interest in knowing more about T2S and how they can benefit from our experiences. But I also agree that, at this time, it is much better to be focused on how we can reap the benefits from the new T2S environment.

Alessandro Zignani, London Stock Exchange Group: I agree that there is an opportunity also outside Europe, and we are discussing with interested infrastructures but we need to make it work effectively first. The next step then will probably be extending that into other geographies around the world.

Custody Risk: What does it require to satisfy regulatory intraday liquidity reporting requirements?
Alan Cameron: What we have today are recommendations and we are waiting for these to be turned into regulations in order to get clarity on what is actually required. We know that everyone is looking at this subject, but we don't really know the information that is required to be reported as yet. It has to come from each individual market and be agreed by the home and host supervisors, and that always takes a little bit of time. So I guess the strict answer to the question is that we don't quite know yet. What we do know is that the industry faces a huge challenge in putting all this information together and making sense of it. It's actually quite difficult to measure information on a continuum rather than at various points throughout the day. We certainly made progress on that and we are able to provide the information that clients seek. But, as for how that information is actually going to be used, we don't have the final answer to that as yet.

Fabian Vandenreydt: A symptom of the fact that people are looking at it – if I can use the example of the reporting we see on the SWIFT network – from a cash statement, is the move to intraday. Not necessarily real time, but several batches per day, putting out all cash statements for all parts of the organisation, has really increased dramatically. Because indeed, you have the challenge of bringing all that to one place, and then you need to figure out the buyer's requirements. But, just as a symptom, you see this booming.

Alan Cameron: That's right. A couple of years ago, not so many people were really talking about liquidity and, when they did, they were usually confusing it with credit. So everyone has become much sharper on the subject.

Custody Risk: Will T2S put pressure on custodian banks that don't want to perform the functions traditionally undertaken by central


Alan Cameron

securities depositories (CSDs)? Are the borderlines between CSDs, sub-custodians and custodian banks becoming increasingly blurred?
Alessandro Zignani: This will be one of the effects of T2S and each player has to review their strategy. In particular, there are three major areas that could change what custodians, sub-custodians and CSDs are offering. First of all, with T2S, there is a much stronger need for accessing central bank money, rather than commercial bank money. The harmonisation, of course, is in favour of the standardisation of all corporate actions. On the other side, CSDs are now enlarging the scope of their services they offer, such as asset servicing, which has traditionally been offered by sub-custodian banks. So I would say that there will definitely be much more competition among those players.

Andy Duffin: If you allow CSDs to move up the value chain, there would be a lot of questions raised from a systemic risk perspective. I think there is strong argument in saying that CSDs remain dedicated to their core functions and the role they currently play in the post-trading architecture.

Alan Cameron: I would go further than the question asks and suggest that the lines are becoming blurred, not just between the CSDs and sub-custodians, but between global custodians, sub-custodians, international CSDs (ICDSs) and CSDs. We are seeing some clients wanting to buy everything from one provider, while others are taking a modular approach and buying specific services from providers across geographies. We are all going to have to work together to provide clients with these packages, but the traditional sales approach is changing.

Jesús Benito: I think the challenge for some CSDs is in deciding to continue to be a market infrastructure. I think, at least from our perspective, this is extremely important – to continue to be neutral, riskless, a market infrastructure for the sake of our clients. But, at the same time, I understand it's going to be complicated to compete with other CSDs, custodian banks and global custodians entering into the CSD space. All in all, I think it's going to be very complicated for CSDs to be exclusively concentrated on CSD core services competing against global custodians, ICSDs and bank team CSDs. I think it's going to be a big challenge for the future.

Andy Duffin: Previously, the only risk the CSDs took on board was operational risk but, as they move into banking and custodial services, the whole risk profile changes and that, for me, raises a number of questions.

Mehdi Manaa: The question of competition between CSDs and custodians and which will survive has been in the air from the start of T2S. Personally, I think that the CSDs in the post-T2S environment will be slightly different from what they are today. They have to adapt. The same will apply to custodians and to all categories of actors through the whole chain. There will be competition, but I don't think that the main competition will be between different categories. I expect it to be within each category. Not all CSDs will survive, for sure, and not all custodians will make the benefits that are expected from T2S. However, between the different categories, I expect to see collaboration rather than competition. We'll see more and more partnerships between CSDs and some custodians to implement creative models and service offering. This is already starting and we'll see more and more of this.

Alessandro Zignani: We should not forget the CSD Regulation (CSDR). The aim is that, in creating a level playing field, there will be much more competition in the industry. From Monte Titoli's perspective, our focus is to keep offering clients services as agent in a very low risk environment in central bank money and we will not offer banking services.

Daniela Peterhoff, Oliver Wyman: We have recently completed a study on the future state, post-T2S implementation and most important levers that participants can pull to reap the full benefits/future cost savings around T2S, beyond just implementing the regulation operationally. We think that this will, in some respect, lead to more of a polarisation of the landscape across those that are able to provide delayering of settlement exposures, pooling of settlement collateral, netting of settlements and simplification of operations. It could be both CSDs and custodians that would actually take that role. Traditionally, CSDs have been positioned to do so, but we believe that this is not fully decided yet and it's really going to hang on those capabilities and the speed at which savings can be realised.


Daniela Peterhoff

Custody Risk: How have you streamlined and adapted your T2S operating systems to produce cost efficiencies?
Alan Cameron: For BNP Paribas, and I guess for all custodian banks, it is really important to use T2S to give our clients economic advantages. So we have deployed the same operating system across markets but, more significantly, because of the settlement harmonisation, we've been able to build up our international operating centre in Lisbon, which now has more than 1,000 people concentrating on the settlement side of our business. It is equally important to emphasise that asset servicing hasn't been harmonised to the same extent

and we intend to keep our services local. So, it is a question of getting the balance right. You've got to keep the expertise where you need it and get the economies where you can get them. The real skill – we all know the direction we have to go in – is to manage it and get the balance right.

Andy Duffin: I would say it's not just a question of T2S, for example, there are regulatory drivers around the European Market Infrastructure Regulation and Dodd-Frank. So, when we at Societe Generale Securities Services look at our operating platform, we have to take all of that into consideration, and efficiently adapt our systems for all the regulations. The plan is to have a single European platform for custody pan-European fund account services and transfer agency services. So, yes, I would say we are streamlining and adapting our systems to T2S, but in the wider context of other regulations that have come in.

Jesús Benito: For Iberclear, at least, T2S is a good opportunity. So far we have two technical platforms. One is for fixed-income instruments, another one for equities. Until the Spanish reform is implemented, equities are settled completely differently from fixed-income instruments. We are going to harmonise our equity system in exactly the same way as other CSDs. For corporate events, we are going to standardise following the standards established in Europe and we are creating from scratch a new technical platform, called Arco – which will replace the two current platforms mentioned earlier – and we will then have much lower operating costs in the future.

Fabian Vandenreydt: From a SWIFT standpoint, we are helping you adapt to T2S, but I think what we see also – even for those who are not directly connected – is that they are looking at the implication of other processes, settlement, collateral and liquidity and corporate actions. There are lots of new service level agreements (SLAs) being put in place with regard to insourcing and outsourcing. But there are still many open questions on how to best improve corporate actions, because there are new agreements being made all over the place, it's not only the T2S programme. There are lots of things around it that are being redesigned.

Alessandro Zignani: For Monte Titoli, we are helping our clients to minimise the impact and the cost of moving to T2S, maintaining the same interfaces and channels of communication where possible. We are also expanding the range of services so they can use the same account to manage all the T2S markets. We are moving to become a fully fledged investor CSD, and it should help clients minimise costs and reduce complexity.

Mehdi Manaa: We are not adapting any systems, we are delivering T2S itself. We are keeping it as lean as possible, focusing on its initial scope, working towards delivering it on time in order to keep it cost-effective.

Daniela Peterhoff: From a consultant's angle, what we see around streamlining and cost reductions are two things. On the one hand, the few markets that are – despite the time pressures – still moving in the direction of changing their core systems will have a lot of implementation challenges. On the other hand, there are a number of markets preparing themselves to outsource specific T2S-related services to other CSDs, which will lead to a polarisation of the CSD landscape between those that are able to provide CSD systems capabilities and those that are not.

Custody Risk: **In line with T2S, T+2 was introduced on October 6, and will reduce the need for collateral. It has been estimated that a harmonised move to T+2 in Europe will create net savings of around €700 million per year, as a result of reduced counterparty risk exposure. But, with everyone in the cash equities markets in Europe already on a delivery versus payment (DVP) model, just how much counterparty risk exposure is there?**

Alan Cameron: Counterparty risk exposure is normally thought of in two ways. There is pre-settlement risk, which is the risk that somebody will default and, hence, create a market risk; and there is settlement risk, which is the risk that somebody does not complete their part of a settlement exchange. That second settlement risk has been reduced with improved DVP and RVP [receive versus payment] settlement, which has increased over the years. So, shortening the settlement cycle by one-third is all about reducing pre-settlement risk. It cuts down pre-settlement risk by approximately one-third, and it will save money on the collateral that is put up as margin. So, overall, it can only be a good thing, as long as it is not replaced by operational risk.

Fabian Vandenreydt: One aspect of operations that will need to be improved is everything related to standard settlements. When we look at the trade matching that we do in pre-settlement for equities for others, 90% of the fails at that pre-settlement matching is – because we also match the settlement route – caused by the standard settlement instructions, which are not up to date. That will still need to be quickly improved if you don't want to have too great a fails rate in the future.

Jesús Benito: I don't think counterparty risk is related to DVP or no DVP. It is principal risk or settlement risk, as Alan mentioned, related to DVP. We have, for a long time, used the DVP model to eliminate principal risk. Moving from T+3 to T+2, in theory, reduces one-third of the counterparty risk, which is an enormous advantage for the market. But you definitely have to put into balance whether or not you will need an increase in the settlement efficiency. That might be operationally necessary to deal with in order not to have an increase in settlement fails.

Alan Cameron: The other interesting question is whether the over-the-counter (OTC) leg of these transactions will really move to T+2, or whether the big brokers will carry that for their clients, who still might want to stay on T+3. I guess what we really need to get us over the line


Andy Duffin

and make sure that all transactions move to T+2 is for the US to move to T+2 as well, and then that demand from some clients to stay in T+3 should be reduced. Then we need some changes in the funds industry as well. Subscriptions and redemptions are usually in T+4. Of course, fund managers want to be fully invested the whole time, so they face an issue. So much could be done on the market side to get us towards T+2, but other things need to happen to ensure that this becomes the market norm.

Daniela Peterhoff: The staged movement that you are describing and this mismatch of timelines, from our perspective, is a strong manifestation of the movement of the risk, particularly the counterparty risk, into the infrastructure layer. In many respects, the regulation has been pushing for that risk to go onto (I)CSDs and central counterparties, and be managed there with the operational changes still under way. So that causes significant need to adjust the risk frameworks of the infrastructures themselves to deal with what you exactly describe, because adjusting the mismatch will take five to 10 years, at least.

Custody Risk: **Has an anticipated global collateral shortage predicted by the push of OTC derivatives onto centrally cleared platforms failed to materialise? Is it out there, but just in the wrong place?**
Alan Cameron: All the rules and regulations that have been driving this are not applicable as yet, so it is probably too early to be too confident on this subject. There hasn't been the huge increase in demand that we probably thought there would be at this stage, but I think it's too early to say whether this will be the final outcome.

Andy Duffin: I'd tend to agree, because it's a staged migration implementation. I think what a lot of the securities services providers are doing is bringing together products and tools to assist their clients. For example, Societe Generale has launched a product called Orchestra, which brings together the clearing capabilities of Newedge, the post-trade derivatives processing and reporting of Societe Generale Securities Services and the execution services of the investment bank. It has clear visibility of cross-margining and allows the client to predict their liquidity requirements. Actually, it's a simulation tool that allows the client to determine and select the best execution to clear based on the aggregate cost and margin commitments. So I think we're developing products in anticipation.

Mehdi Manaa: I fully agree on that, but I think that, in fact, the issue has changed. We now know there will probably not be such a shortage of collateral at a global level. There will probably be enough collateral, but the issue will be having the right collateral in the right place at the right time. This will be the challenge in the future. With T2S, we are trying to facilitate this at the European level. One of the key achievements and benefits of T2S is to allow quick and efficient movement of collateral from where it is to where it should be and where it is needed by the different actors.

Fabian Vandenreydt: What I see – but not necessarily on the central clearing side – are new players in the collateral landscape. Corporates and the buy side are collateral givers and I think there is a need for all of us to help them integrate with the rest of the industry, because I don't think they have been exposed to such complexity before. There is some


Alessandro Zignani and Fabian Vandenreydt

education to be done as well if we want them to help with the fluidity of collateral.

Daniela Peterhoff: We would agree with that, not only looking at the shortage, but also looking at the status of implementation of regulations, for the buy side relative to other parties. We believe that, if the buy side is to make more direct use of the infrastructures, then we need education and also help – collaborative models, for example, between infrastructure providers and the buy side to adjust their business models to be able to make that direct link work. Otherwise there will be a gap in the system at some point.

Custody Risk: **On July 23, the Council of the European Union adopted Ucits V, which covers eligibility to act as a depository, criteria for delegating custody, and liability for the loss of financial instruments held in custody. What impact has this had on the sub-custody business?**
Andy Duffin: From my perspective, obviously Ucits V is for depository oversight duties and the key issue here is the restitution of assets. But, as sub-custodians, we always have to look at the highest-level regulations our clients are under. So I would say that the benchmark formerly would have been the US Securities and Exchange Commision rules, then the Alternative Investment Fund Managers Directive (AIFMD) and now Ucits V as the highest level of regulation. But, for the sub-custodian, we are seeing more detailed questionnaires from our clients, in particular around the restitution of assets. We're seeing greater requests for segregated accounts both at a sub-custody level, for our books and records, and at depository CSD level. The greater change is for the depository banks rather than the sub-custodians, but we are feeling the ripple effect downstream.

Alan Cameron: There is definitely a higher degree of diligence around the appointment and the monitoring of sub-agents and being able to evidence this. And there is increased interest in the local insolvency laws in the market because, if they do not accept segregation, then it's not clear that any sub-custodian can be appointed to act. So we're seeing a lot more scrutiny than previously, but I'm not sure this is just because of the AIFMD and Ucits V – I think this was happening anyway.

Andy Duffin: Alan, are you seeing more global custodian clients and depository clients restricting the markets they make available to certain segments of clients? Because that is what we are noticing.

Alan Cameron: We've not seen that so much, but you are in some more interesting markets than we are.

***Custody Risk*: Under AIFMD, 'depository-lite' services deliver oversight over functions largely performed today by a fund administrator, but not custody. With no strict liability for loss of assets, how safe are they?**
Alan Cameron: Depository lite is a transitional phase. It won't last forever. I guess you end up looking below the depository and at where the liability ends up, and the liability for loss will then be dependent on the local law and the local practices that pertain to the market that the securities are in. You have to look at each country and understand their laws much better to get to the bottom of that question. The result Is probably dependent upon where you invest.

Andy Duffin: I'd tend to agree with Alan. At the end of the day, it comes down to the insolvency regulations and the laws as to how safe the assets are.

***Custody Risk*: What are your predictions for the coming year?**
Mehdi Manaa: I've been working on market infrastructure for 20 years now and change has been a constant feature, so I think next year we will already be thinking about what is next after T2S in terms of major change.

Andy Duffin: I'd prefer to say what is not going to happen next year rather than what is going to happen. Mehdi said earlier that not all CSDs will survive, but I think that statement is going to be played out over maybe a five-year period as opposed to the next 12 months. My prediction is that there will be no change to the CSD landscape from a consolidation perspective in the next year.

Alan Cameron: On Andy's point, I think next year will be the year of consolidation, but only really in the commercial world. We will see clients consolidate their networks so that they can get process simplification and prepare for T2S, and we will see continued consolidation in the agent bank world as the investment in technology just increases and some banks will get out of it. The other thing I think we'll see is a move towards different credit facilities to back this whole industry. Today, the industry is backed by inter-day, undisclosed, somewhat secured credit lines. I don't think that will be the situation in the years ahead and we will see regulators and clients wanting to have committed and secured lines to back all of this activity.

Daniela Peterhoff: From our perspective, there will be two key changes next year. We will see post-trade participants start preparing for the future cost savings from T2S by rearranging their operations in those areas in which it is required, by delayering their exposures, by essentially working through all the levers they are able to pull to prepare for the post-T2S agenda. The second thing we think will happen in many T2S markets is that, in 2015, we will see the implications of the economics of T2S, meaning economics for individual client segments such as broker dealers, global custodians and regional banks. We fully understand that some markets will need to adjust to that by rearranging their value propositions.


Jesús Benito

Jesús Benito: I think, for the CSD landscape next year, we are going to be extremely busy testing and adapting our systems to T2S. Wave one will be in June 2015 and the other CSDs will continue adapting and testing our systems afterwards, so I hope we'll be celebrating the first wave of T2S.

Fabian Vandenreydt: We will be helping all of you prepare for T2S and then, because there are so many new SLAs being created between the ones who outsource and the ones who insource, there is a greater need for standardisation, and that is our mission. We didn't talk about buy-in processes under CSDR, because I believe next year it will also be good to have more clarity about the process for the buy-ins, how that is that going to work and how the players are going to exchange that information between themselves? Some standardisation will be required.


Mehdi Manaa

Alessandro Zignani: Monte Titoli is in wave one of T2S, so the priority next year will be the go-live on 22 June. We have started functional testing and will continue to work closely with our clients over the next nine months to make sure everyone is ready and to deliver a full harmonisation of our market.

Mehdi Manaa: Next year, it is not just T2S going live. Our friends from the US Federal Reserve are also launching a major modernisation of their platform in September 2015. The same applies to the Bank of Japan in October. So, over three or four months, it's three major central banks delivering huge changes of infrastructure.