Dear Ms. Russo,

**TARGET2-Securities (T2S)
Response by the European Repo Committee (ERC) to the first proposals and initial assumptions**

The ERC welcomes the ECB Governing Council initiative to study the creation of TARGET2-Securities (T2S). For many years, the European repo markets have been suffering from an inadequate euro zone settlement infrastructure.

As demonstrated in our semi-annual repo survey ([http://www.icma-group.org/surveys/repo.html](http://www.icma-group.org/surveys/repo.html)), growth of the repo markets in the euro currency has been spectacular. We remain deeply convinced that allowing easier transfer of collateral within the euro market and developing the current practise from legacy domestic markets into a true European settlement infrastructure will benefit the wholesale markets.

Please find in the annex to this cover letter our comments on various issues related to the project. As a general point, we would like to underline that any future design should properly reflect current successful practices in the respective markets, both cash and repo. We remain, of course, at your disposal for any further questions or clarifications.

Our contribution in this letter focuses exclusively on the practical benefits on the repo financing markets. We assume that most of our member banks will also respond to you separately, probably from a custody point of view. Likewise, ICMA may on behalf of its membership decide to provide comments from a more general point of view.

With kind regards.

Yours sincerely

Godfried de Vidts
Chairman
European Repo Committee
Annex – Detailed comments

User Committees

We welcome the intention to establish user committees, but advocate broad involvement in such committees. We witness today that in many industry infrastructure user committees the trading side is ignored. The ERC has been involved in similar initiatives by contributing to the debate from a market practitioners’ point of view.

Similar to our discussions around the creation of the legal framework for the GMRA, the optimisation of CCP functions, the development of triparty financing – only to give a few examples - , we believe that financial market actors should be involved in such a user committee. Only the professionals that use collateral on a day-to-day intense basis realise the difficulties that the European repo markets currently experience from the lack of an adequate European security settlement infrastructure. We would recommend and welcome the inclusion of a member of the European Repo Committee in this user committee.

Cost and Pricing

Repo financing is a high-volume but low-revenue activity. Advanced collateralisation techniques, intense discussions with the Basle committee on capital adequacy, and constant innovation in bilateral and triparty party financing, have made this product valuable for our respective institutions. Any additional cost would be unwelcome, as it would add to the already high charges for the services we need. Thus, the key to success for T2S in the markets would be a substantial decrease of the current charges allowing this new initiative to be incorporated.

Scope of assets and services

We argue that for efficiency reasons the project should cover all assets in euro. Ultimately it is the end user who will decide in which way settlement should be made. Central Bank money is currently unavailable for certain products like triparty. It would require the Eurosystem to allow both ICSDs to have direct access to the settlement system.

As euro bonds are currently only partially eligible for Eurosystem credit operations it would make perfect sense to allow all market participants to use the new service for all assets at their discretion. This means that the decision to use T2S must remain with each participant and participation should not be mandated.

With regard to the scope of the services offered, we think that T2S should only be a settlement tool allowing any type of collateral to move from one clearing area to another without complicated link systems as we currently have in place.

On the processing side, the goal should be to have real-time settlement across all products. Batch systems can block the process of settlement because of possible concentration in one clearing participant. To avoid unnecessary intra-day borrowing and lending, all transactions should be released immediately by the settlement agents as requested by their clients. As the pool could in principle include all euro collateral it would
optimise settlement and avoid the current practise by (I)CSDs to charge for intra-day borrowing.

We propose that T2S study and evaluate pre-matching facilities such as ICMA’s recently launched TRAX2 system (http://www.icma-group.org/products/trax.html) as this system will instruct both settlement legs on behalf of its clients.

To optimise the use of collateral in a same-day trading environment our clients need to have access to collateral – if possible – on terms equal to cash settlement or at least as close to real-time as possible, in particular for government bonds that are often used for liquidity purposes between market participants. This important principle has also been also reflected in a letter from the ERC to ECSDA in May this year where we requested full interoperability between ECSDA members until 17.30 CET of the same day.

**Stock exchanges and CCPs**

The repo market has been at the forefront of the development of CCP services for the fixed income area. CCPs are designed to net positions of market participants for balance and credit risk reasons. After netting the remaining balances should be settled through T2S and not the initial gross instructions received. Gross settlement will only increase the cost for the users which is counterproductive to the overall goal of bringing costs down in the EU markets.

With regard to cross-currency trading (where one leg, either currency or collateral, is denominated in euro), we could see major issues arising. In particular in triparty business, large settlement volumes could be excluded. The market is currently developing Euro GC Triparty basket trading - for the time being in the same currency. We regard it quite possible, however, that this activity may in the future involve cross-currency transactions, and we argue strongly against any foreclosure in this area.

For euro-denominated securities settled in non-euro area CSDs, the obvious solution for us would be to allow both ICSDs the same equal access to T2S as the CSDs. The T2S infrastructure could allow cross-currency instructions with one leg (as mentioned in the document FOP) which would have the benefit of concentrating the maximum amount of collateral in the pool. This should alleviate any squeeze of collateral due to technical issues, as all collateral will be in the single T2S system.

The ERC has on numerous occasions called for improved interoperability between (I)CSDs. In the view of its members, the T2S project could significantly contribute to more efficient settlement, thus paving the way for enhanced interoperability.

**Account structure**

In the interest of the overall purpose of the T2S proposal, namely to reduce costs and increase efficiency, we argue that users have the maximum benefit if they are required to maintain only one account for all collateral settlement purposes (similar to proposal (b)), irrespective of the location of the collateral. This should however not necessarily have to be at their “local” CSD, but rather at a CSD of their choice. CSDs participating in T2S should then open reciprocal accounts/links.

If the T2S proposal is ultimately successful, wholesale customers would clearly start to close down various custody accounts they are forced today to hold across the euro-area domestic markets. Ultimately, each customer would only have one sub-account with the
(I)CSD of his choice. For the repo market, this evolution would drastically decrease the complexity we currently have with collateral management within the same currency.

**Corporate actions**

There should be little difference between a cash payment and a security payment. Most, if not all, transactions are today based on book-entry. The evolution and development of IT systems has been such that processes in custody and corporate events should run fully automatically.

On the trading desk side, the GMRA and the ERC recommendations for margin calls have successfully streamlined procedures around corporate actions (coupons). We would be happy to provide additional views from the purely administrative viewpoint of our respective back-offices, should such views be required.

**Communication**

In order to avoid additional costs, we strongly encourage the use of SWIFT as it is the most widely used and proven efficient system for the settlement of wholesale transactions.

The role of the Eurosystem in settlement routing should be restricted to the processing of any incoming instructions from the users, i.e. the CSDs.

(Information for available from T2S)

Repo desks, often in charge of collateral management because of the specific financing tasks given to them, need to be immediately informed by the clearing agents or relevant CCP at the moment of the trade. In order to follow the liquidity and collateral impact of trading, it seems therefore be highly practical – if not indispensable – to provide for real-time communication throughout the day.

**Timing and priorities**

We would see no reason – and given its importance also no justification - why the launch of T2S should be unnecessarily delayed. We believe that Eurosystem has enough experience with TARGET and the settlement of the open market operations in order to ensure speedy and prioritised implementation of this project.

The only fundamental reason why some delay could be accepted is the required robustness of the system to be developed, and respective worries from the banking regulators. A sustained effort for education together with a clear road map should contribute towards eliminating any worries from the regulatory side.

In line with our argumentation for swift implementation, we recommend avoiding to the extent possible any staggered or phased implementation. Any hesitation in implementation could easily serve as an excuse for one or the other (I)CSD delaying any development. If absolutely unavoidable, we would accept a phased implementation approach similar to the implementation of TARGET2-Cash, but with very clear deadlines and as short as possible.
Potential obstacles

Certainly, market practices, IT developments and other elements of the business will have to be adjusted to the system. An early timetable, a clear road map, and tight project management with ongoing implementation oversight should permit market participants to direct their efforts and developments to compatibility with the new system with minimum delay. This would in our view considerably reduce the risk of delays caused by industry calls (some of them justifiable) for longer implementation phases.