

TARGET2-Securities maximises settlement efficiency in the European securities market

What is TARGET2-Securities and which problems does it aim to solve?

On 6 July 2006, the Governing Council of the ECB decided to evaluate opportunities for a new centralised settlement of securities transactions in central bank money. The service, called TARGET2-Securities (T2S) is to provide a single platform for settling both cash leg and securities leg of transactions. Currently there is little consolidation in the European settlement market which is characterised by a large number of central securities depositories (CSDs). In particular T2S will improve the settlement of cross-border transactions in central bank money and therefore contributes to the integration of the European money and capital market. One starting point for T2S was the estimate that the so-called "integrated model" can offer efficiency benefits under certain conditions. In this model, central bank cash accounts are either outsourced to individual

CSDs or the securities accounts of the CSDs are concentrated on a single central bank platform. The concept of T2S pursues the second option and integrates the settlement of central bank cash leg and securities leg on a single Eurosystem platform. The Eurosystem has a clear preference for this approach. Central banks focus their attention on maintaining financial stability, which is considered a key prerequisite for fulfilling the functions of an economy's financial sector, especially in stress situations. Obtaining full control over their central bank cash accounts, on which both monetary policy operations are carried out and intra-day credit is provided, is essential in order to ensure that they are able to act discreetly and without any third-party involvement in times of crisis. Therefore the Eurosystem has a keen interest in maintaining control of the settlement in central bank money and in integrating the central bank cash accounts that in some cases have been outsourced to the CSDs. Having taken into consideration economic, legal, operational and technical aspects, as well as the use of the common platform designed for TARGET2 the Governing Council of the ECB confirmed in principle the feasibility of the project at its meeting on 8 March 2007. The Bundesbank, Banque de France and Banca d'Italia (3CB), which are already responsible for the development and operation of TARGET2, are ready to develop and operate the new service on the joint platform together with the

Benefits of TARGET2-Securities

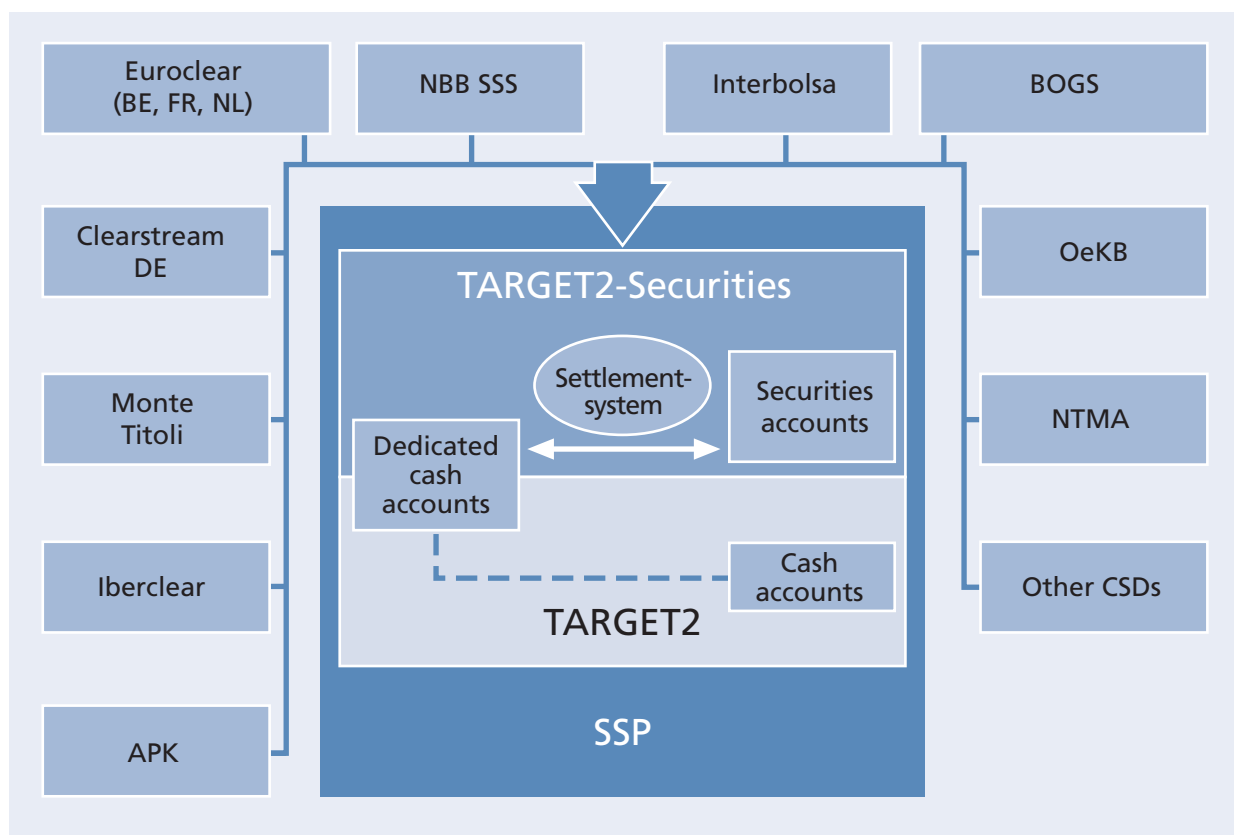
- Contribution to the integration of the European capital market
- Contribution to the removal of certain Giovanni-barriers and acts as catalyst for further harmonisation
- Equally efficient settlement of domestic and cross-border securities transactions
- Improvement of banks' liquidity and information management and support of Eurosystem's collateral management

Banco de España (3CBplus) on behalf of the Eurosystem. As a result of the exploitation of the synergies with the payment side and the greater economies of scale, the efficiency of T2S could be further increased and the market could be provided with a cost-effective infrastructure from a single source.

From TARGET2 to TARGET2-Securities

TARGET2 is the Eurosystem's new real-time gross settlement system that will be launched in November 2007. Due to a common technical IT platform,

TARGET2 will be more efficient, cost-effective and user-friendly than the current decentralised system. TARGET and synergies will be created as a result of the shared platform use of TARGET2 and T2S. T2S is a service offered by the Eurosystem for all types of euro-denominated securities to European central securities depositories which maximises settlement efficiency by integrating cash leg and securities leg on a single platform, and which contributes towards the creation of a single European capital market. T2S is therefore in line with other European initiatives (Giovannini, Code of Conduct, etc.). Custody and associated services remain in the hands of the national CSDs. In T2S, the CSDs also



retain all legal and business relationships with their participants and issuers, as well as the non-settlement business activities (eg notary function, safe custody, lending). The national central banks will act as the operators of T2S and as the providers of cash accounts for the market participants.

Impact on markets and market players

The offer of the Eurosystem will be made on a cost-recovering basis, whereby a profit-maximising monopoly behaviour will be excluded. Furthermore, economies of scale, which are not currently achievable at the national level can be realised, as well as synergies by implementing T2S on the TARGET2 platform and the associated optimal use of existing IT resources. During the assessment of the economic feasibility of T2S in March 2007, the Eurosystem came to the conclusion that the estimated average cost of a T2S transaction (excluding the costs on the CSD side) would be around €0.29. In assessing the following impacts on banks and central securities depositories, it is important to note that, owing to the fact that a large number of institutions had to be taken into consideration and that their individual situation cannot be accurately assessed from the outside, the Eurosystem's cost and savings evaluation was based on rough indications only.

Impacts on central securities depositories

- Investment costs amounting to €172 million (project costs, IT development costs, migration costs)
- Potential savings in operation costs of up to €85 million p.a. through the (partial) decommissioning of IT systems

Impacts on banks

- Investment costs amounting to €38 million (project and migration costs)
- Potential savings of between €140-€330 million p.a. (cross-border settlement, collateral costs)

Impacts on issuer

- Largely simplified settlement of euro-denominated issues
- Improved sales opportunities for domestic issues throughout the euro area

Impacts on investors

- Both retail and institutional investors benefit from reduced settlement costs of cross-border transactions

Cost-benefits analysis for the market as a whole

- One-off investment costs of around €200 million
- Annual savings of around €225 million

Source: ECB, TARGET2-Securities Economic Feasibility (March 2007)
(Figures will be re-evaluated at the end of 2007 and will take account the user requirements)

Timetable

T2S is currently in the first phase of the project, the formulation of the user requirements. A final market consultation of the fully articulated user requirements is planned for the end of 2007. Until then, additional consultations on detailed issues will also take place on a case-by-case basis.

The user requirements will then serve as a basis for the creation of the General Functional Specification of T2S. Once the current project phase has been completed, the Governing Council of the ECB plans to consult the central securities depositories at the beginning of the 2008 about their participation in T2S and to decide on the entrance into the realisation phase.

