Gertrude Tumpel-Gugerell: Towards an integrated securities market – The TARGET2-Securities project

Speech by Ms Gertrude Tumpel-Gugerell, Member of the Executive Board of the European Central, Bank, at the 12th FESE Convention, Stockholm, 18 June 2008.

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Ladies and gentlemen,

I am delighted to be here today at the FESE convention to share with you my vision of the T2S initiative, and its important role in creating an integrated European securities market.

But let me start by putting the T2S project into the broader context of overall financial integration in Europe.

I am often asked why we need to integrate financial markets

There is enough economic evidence to convince even the most hardened sceptic that financial integration at European level will create substantial gains for society as a whole. Financial integration will foster a more efficient allocation of resources, increase competition, reduce costs, lead to higher trading activity, and more transparent pricing and thereby raise the overall potential for stronger economic growth. It will increase consumer choice, open a multitude of new investment opportunities, strengthen the EU banking sector and make Europe a centre for financial innovation.

Moreover, more from my perspective as a central banker, increased financial integration will enhance the smooth transmission of monetary policy and is crucial for global resilience of financial markets which constitutes an important element for safeguarding financial stability. Efficient integrated markets generally reinforce the shock-absorbing capacity of the economic system as they offer a wider range of options for sharing risk among economic agents.

The economic gains of financial integration coincide with the objectives expressed in the Lisbon agenda, of granting the citizens of Europe access to a genuine single market in which financial services are offered on the same conditions within and across borders. Thus every cross-border business in Europe needs to become truly domestic. Achieving this requires action of several kinds at all stages in the process – in trading and in post-trading.

I think there is evidence of already great progress on the trading side; notably, European Stock Exchanges and the relatively new MTFs (multilateral trading facilities) are extending the range of instruments offered on their trading platforms to create genuine competition. This offers the potential for lower costs for intermediaries and all classes of investors. It also improves the prospects for retail investors to diversify their securities portfolios across Europe, increasing the potential returns on investments and diversifying their exposure to financial risks. Issuers should also benefit from greater market depth for their fund raising.

But what about the post trading arena?

There is considerable evidence that costs in the European post trading area are much higher – particularly for cross border activity – than in other very large markets, such as the US market, but also several markets of the Eastern Hemisphere states.

The cost gap – for example – in relation to the US market arises in large part because of differences between different European local markets. The lack of harmonisation is often the result of history – differences in market practices, laws, tax administration and so on. Often, the post trading infrastructure in the local market has been rapidly developed in the relatively recent past to provide very efficient means of accommodating such local market features.

The solutions were often created under huge pressure, to help each individual market to cope with the dynamics of innovation and of trading volumes. These were major achievements in that context, but the world has changed and we now need to move to the next stage of development.

Our today's task is, therefore, to become more competitive in a rapidly changing global financial market environment. Differences across Europe's post trading markets have to be overcome. For this, integration and harmonization need to be promoted, synergies need to be used and economies of scale have to be exploited. This will foster competition and the expansion of markets, facilitating a more efficient allocation of better-priced capital.

We, the Eurosystem, contribute our part in promoting further financial integration in the post trading sector by acting in several roles – as market operator, facilitator and catalyst.

The Eurosystem already offers core, neutral and borderless infrastructure to support real-time settlement in central bank money with the TARGET2 system. Moreover, we are working to produce the next generation of the Eurosystem's collateral management system (Collateral Central Bank Management or CCBM2). The Eurosystem also supports market initiatives such as SEPA – the new Single Euro Payments Area – enabling customers to make payments anywhere in the euro area as quickly, safely and easily as they can in their own country, by using a single set of payment instruments.

How can the TARGET2-Securities initiative contribute to this process?

Let me focus today on the Eurosystem's TARGET2-Securities initiative (T2S). T2S is a proposal to overcome the fragmentation in the European market for securities settlement providing a harmonised venue, a single European, borderless, settlement platform, offering highly secure delivery versus payment for any security, using central bank money. T2S reinforces the other main European Union initiatives, the Code of Conduct for clearing and settlement, the Giovannini harmonisation process and of course the MiFiD in driving forward the single market objectives set out by the Lisbon agenda.

In particular, T2S will be tightly integrated with the TARGET2 system, combining cash and securities settlements in a single shared platform in real time to provide the single European settlement platform for securities in central bank money, irrespective of the location of the issuer, the security or the settlement counterparty. This will create a single pool of securities available to market users and service providers through their chosen CSD, eliminating the costly process of cross-border security settlement in Europe.

In this way, T2S will provide – just like an airport servicing various airlines – a basic infrastructure. In this basic infrastructure the CSDs can operate, offering – for example – a mix of products and services to their customers. In this regard, T2S will simply provide the basic platform that offers its services to all CDSs at the same unit costs. This will obviously contribute to more competition among the CSDs, leading to more transparent and efficient pricing, and facilitating competition to provide cross-border trading venues. This will create substantial gains for the European financial industry.

Thanks to efforts made by hundreds of experts from over 80 European institutions and from the Eurosystem over the last year, the Governing Council of the ECB has been able in the last few weeks to invite the European CSDs to express their support for T2S.

We have sent the European CSDs detailed user requirements, an economic impact analysis, a description of governance for the next project phase, and a presentation on harmonisation efforts in the context of T2S. These are the outcome of a transparent and constructive consultation process, cooperating with CSDs and market users.

Let me just point to a few elements of the economic impact study which you can find on our website. This analysis confirms that the economic benefits of T2S will be substantial. Despite using rather conservative assumptions it shows that T2S has the potential to bring significant benefits to both the securities market participants in particular and to the European economy in general. The analysis concludes that the costs of settlement can be reduced substantially from the 73 cents a CSD charges on average in the euro area (excluding communication costs) today to 32 cents per transaction under T2S.

The T2S benefits would be even higher if the CSDs of the UK, Sweden, Denmark and Switzerland were to join; in such a scenario the T2S settlement cost would decline to 21 cents, and the annual savings would range between EUR 220 million and EUR 340 million.

These numbers represent only the narrow business case, and do not capture – of course – the full dynamic impact of T2S arising from enhanced competition in a more complete single market for security settlement and related services. The Commission estimates the impact on EU welfare of such post-trading cost reductions to be in the range of EUR 1.1 billion to 1.6 billion.

Let me stress very clearly that while there is room for much discussion about the exact estimates I just mentioned, we definitely cannot contest the overall benefits of a more competitive and more integrated European financial market.

You may wonder why I call for more competition but at the same time offer only one single settlement engine for Europe.

The answer is in two parts. First, the alternative to what we offer is the creation of many cross CSD settlement links, which have to be highly efficient and safe. This has not been realised today, partly because of cost and partly because of commercial dynamics; and I suspect it would take many years for a suitable such network to become a reality. It is very likely that the cost and time would be better employed in providing cross border asset servicing, which is of course necessary to take full advantage of borderless settlement in T2S. This activity is high value-added, and can involve taking commercial risk; it is a clear priority for investment and effort by the private sector.

Second – in my view – there is unlikely to be much benefit in the form of innovation gains from preserving a multiplicity of competing platforms; and there is in any case likely to be competition from settlement in commercial bank money.

Let me also stress that integration and harmonisation have become a core objective of the European Union; the European financial industry is requested to increase competitiveness by giving access to an efficient, state of the art financial infrastructure supporting a true single market.

In this respect, T2S has been developed with harmonisation in mind. T2S will deliver and embody a significant amount of settlement harmonisation in important areas such as common interfaces, common set of rules for intra-day settlement finality, a common daily timetable, and common messages. These features are an immediate contribution to the elimination of 6 of the 15 so-called Giovannini barriers. For the future, we expect T2S to foster greater harmonisation efforts beyond the area of pure settlement, addressing more barriers – as already addressed in the current concept of T2S – of the kind identified by the Giovannini Group. Accordingly a Harmonisation Group will be established by the T2S Advisory Group to agree and implement an action plan for harmonisation with the support of market leaders.

It is likely to be necessary to harmonise market practices for – among others – repo instructions, collateral management procedures, auto collateralisation and multilateral settlements without a central counterparty.

And on top of this I expect that changes in legislation – where there is a credible consensus within the market that these produce significant benefits – will be proposed.

Before coming to an end, let me come back again to the decision that lies ahead of us. Since the participation of CSDs in the T2S project is voluntary, the ECB has asked all European CSDs to express – by 4 July 2008 – whether they support T2S. We are sure that CSDs will consult their clients and other stakeholders, many of whom have already expressed strong support. I would like to encourage all of you to express your views so that CSDs have a sound basis to decide on the future of the European settlement landscape.

Let me be very clear. The Eurosystem is ready to firmly commit to deliver T2S as a state-of-the-art settlement system to the market via the CSDs by 2013 at the latest. But it is also clear that the Eurosystem cannot do it alone. As substantial financial investments will need to be made for building T2S; we need the support and the commitment of the CSDs and their customers.

To conclude, I see T2S as Europe's best route to a single securities settlement system, in which secure real time settlement in central bank money is provided across accounts held within a single platform, open to all. It will be operated by a neutral and trusted entity, the Eurosystem. Therefore, it can be relied on to operate in a transparent way and on a not for profit basis.

Let me also use this occasion, to express my warm "thank you" to all the stakeholders, the members of the national user groups, individuals and institutions who have worked together with the Eurosystem on the T2S project, for their openness and expertise and their contribution to the successful completion of work done so far. This is an example of how Europe can co-operate to harmonise and innovate in pursuit of the economic benefits of the single market.

Nearly 10 years ago, the euro was introduced and is now the common currency of more than 320 million Europeans. The euro has been a great success in harmonising the exchange of cash across the euro area. Let us strive for a similar success in a harmonised security settlement market. It's now time to implement the monetary union that we began 10 years ago in the post trading sector. I am sure we can do so with your support and co-operation.

Thank you very much.