Dear Reader,

Welcome to the ninth edition of BNY Mellon RealTime, our newsletter designed to keep you up to date with changes to the European market infrastructure, provide information related to our TARGET2-Securities (T2S) strategy, and how BNY Mellon is positioning itself in the post-T2S European infrastructure landscape.

Following our last newsletter published in January 2018, BNY Mellon has become a directly connected participant (DCP) with another central securities depository (CSD) on T2S: Euroclear France. In this edition, we will provide further details on our migration as well as an article considering the impact of harmonisation activities.

As always, we are keeping a close eye on the regulatory changes that continue to unfold. In the coming years, T2S and Central Securities Depository Regulation (CSDR), the new EU Regulation on Central Securities Depositories, will be increasingly linked together as CSDR is implemented across Europe. With that in mind, we have included our regular update on recent developments within the CSDR space.

Finally, in his regular THE REAL IMPACT column, James Cunningham shares his thoughts from the 11th Annual Association of Financial Markets in Europe (AFME) Post Trade Conference in London, where he participated in a panel discussion on the topic of the “Integration of European Capital Markets.”

We hope you enjoy reading this newsletter, and should you wish to receive further information concerning the BNY Mellon T2S programme, please contact Allison Levy (Allison.levy@bnymellon.com), BNY Mellon’s T2S Product Manager.

Regards,

Tom Casteleyn
BNY Mellon Euroclear France T2S Pilot Client Migration

One of the key strategic aims of our T2S development programme is for BNY Mellon to become a directly connected participant (DCP) on T2S and to increase the number of CSDs that we directly connect to in Europe, therefore expanding our global model of direct connectivity to the major CSDs.

With that in mind, we are pleased to announce that as of Monday, 26 February 2018, BNY Mellon has become a direct participant of Euroclear France, the French CSD on T2S.

BNY Mellon’s migration strategy for France was to take a conservative approach as this is a large and significant market to our clients. We migrated an agreed group of pilot clients prior to the start of the main dividend season which runs from March to June. This has enabled us to fully utilise our new direct operating model in France, in particular the new process for portfolio servicing. We migrated approximately 17% of our clients’ French assets, covering over 700 accounts and nearly 8,000 securities movements. The migration was a great success, and we are now working on ensuring that the migration of their remaining French assets, due to take place on 23 July, will be equally successful.

The migration from a sub custodian in France to being direct with Euroclear France also required a re-papering exercise of tax documentation. This process is progressing well, and we are actively following up with clients for missing information.

Our migration to Euroclear France now means that BNY Mellon has direct connections to six CSDs on the T2S platform in the following markets:

- Belgium (National Bank of Belgium and Euroclear Belgium)
- France (Euroclear France)
- Germany (Clearstream Banking—CBF)
- Italy (Monte Titoli)
- Netherlands (Euroclear Netherlands)

Over the last month, our clients received specific market communications advising of our exact migration plans for France, any changes to our services, and the usual change to Standing Settlement Instructions (SSI) in readiness for our migrations.

Therefore, we ask that you please pay particular attention to BNY Mellon T2S related NetInfos® that you have or will receive.

TARGET2–Securities Harmonisation Activities

In our previous newsletter, we reported on the formal announcement of two major infrastructure projects by the European Central Bank.

The first project, “TARGET2-T2S consolidation,” will enhance the liquidity management functionalities of the TARGET2 (T2) real-time payments system. The launch date is scheduled for November 2021.

The second project will build a new Eurosystem Collateral Management System (ECMS), which will replace the existing collateral management systems of the 19 national central banks of the euro area. The launch date is scheduled for November 2022.

In this issue we are focusing on the TARGET2/T2S program. A market consultation on the user requirements for the future Real Time Gross Settlement (RTGS) services took place between May 10 and June 30 of 2017. The requirements will be divided in three documents describing the central liquidity management processes, the RTGS services and the shared services. T2S, TIPS (Target Instant Payment System), T2 and the ECMS application will share a common access gateway, Eurosystem Single Market Infrastructure Gateway (ESMIG), as well as a common reference database, operational and business monitoring infrastructure, billing application and data warehouse.

The European Central Bank (ECB) anticipates that the shared services will bring further efficiency and advantages to the platform. A common reference database will reduce the need to create and maintain multiple copies of reference data. It will also allow the ECB to block parties across the different services in case of an event (e.g. bankruptcy of a participant).

A shared billing application will streamline the creation of invoices as data is directly aggregated at the required level for all Eurosystem counterparties for the services used. The shared data warehouse will allow consolidation of data across the different services and provide access to historical data via reports and queries for the participants. The ECB expects that this will reduce the impact on live operations as the information will now be retrieved from the warehouse instead of the production environment. The single gateway access will also provide a shared communication infrastructure across all services with a single sign-on and user provisioning process.

Another important feature is the central liquidity management system which will provide the main cash account. This cash account centralises all necessary functions to manage the liquidity across all Eurosystem services that a participant uses. In the case of BNY Mellon, this account would cover liquidity needs arising from our settlement activity on T2S as well as our RTGS activity as euro clearer. Settlement and cash payment activity would continue to operate on the existing accounts however all provisioning would be done from the main cash account.

The ECB is developing a central liquidity overview via a dashboard to allow participants to easily access detailed information on liquidity usage.
CSD Regulation Recent Developments

In January’s edition of RealTime, a further update was provided on the three main implementation events for the European Union Central Securities Depositories Regulation (CSDR), including the authorisation of CSDs, the requirement for a quarterly internalised settlement report, and the outstanding settlement discipline technical standards.

CSDs were due to have their applications authorised by their National Competent Authorities approved by the end of March 2018. However, many submissions have not been fulfilled to their satisfaction. Further dialogue is taking place with the CSDs until it is complete, and this could be finalised much later. The operation of each CSD will continue to fall under their current local regulations until it becomes authorised.

From a cash perspective, the program entails the migration to the ISO 20022 standard for cash messages. This migration will take place with a “Big Bang” approach at the time of introduction of the new high-value payment services. In addition, the ECB expects that one of the benefits of the consolidation is to allow future RTGS services to be multi-currency. Each currency will be considered as a standalone currency, and there will not be any conversion feature between currencies settling on the same service. Each currency would have its own closing days and business day schedule.

From a planning and implementation perspective, the ECB foresees a development phase that will last until third quarter 2019. Internal testing will follow, which is expected to run until fourth quarter 2020. User testing will kick off in second quarter 2020 and run until fourth 2021 with a live date soon following.

BNY Mellon welcomes these initiatives as they will bring further improvements to our operational model and help us shape and improve our future service offering to our clients. We will provide further updates on the ECB initiatives as it impacts our clients and as more information becomes available.

There are some obligations on CSD participants that take effect at the same time that CSDs become authorised. Most notably, Article 38 of CSDR, which mandates that participants offer clients a choice between omnibus and segregated accounts at a CSD.

On 28 March, the European Securities and Markets Authority (ESMA) published an Internalised Settlement finalised guidance paper in response to feedback provided by the financial services industry on the 14 September 2017, and as requested in the ESMA consultation paper from July 2017. The finalised guidance paper provided further clarification for the reporting, with the first internalised settlement report due for submission to the competent authorities in July 2019.

The third main implementation event, relating to settlement discipline, the Technical Standards document was published on 25 May 2018 by the European Commission. The timetable provides for a two year period before its obligations come into force in September 2020.

Further information

The European Commission and ESMA have useful webpages which contain key source documentation on CSDR and other background information.


Intraday credit (credit line)

marginal lending/overnight deposit CB operations, including cash withdrawals

Main Cash Account

T2S DCA
Securities settlement

RTGS DCA
High Value Payments settlement

Ancillary systems settlement

Instant Payments settlement

TIPS DCA

(Source: https://www.ecb.europa.eu/paym/initiatives/shared/docs/192a0-ami-pay-item-2-t2-t2s-consolidation.pdf - slide 9)
**THE REAL IMPACT**

**Integration of Capital Markets—Connecting the Big to the Small**

On Wednesday, 23 May, I was privileged to be able to attend the 11th Annual AFME Post Trade Conference in London and participate in a panel discussion on the topic of the “Integration of European Capital Markets.”

The objective of the panel was explicitly to have a “big picture” discussion. The chair of the panel, William Wright, head of the think tank “New Financial,” introduced the discussion by presenting three slides that compared the size and depth of European and U.S. capital markets. He raised the question of why European capital markets are much smaller than those in the U.S., and what can be done about this.

For anybody working in a custodian bank, these are, of course, fundamental questions. The discussion identified high-level themes that can start to give an answer. But the discussion also raised a follow-up question in my mind. This is the question of how the technical, and much more humdrum, reality of market advocacy on post-trade issues fits into the “big” capital markets picture.

In recent weeks, we have been active on such topics as the draft Implementing Regulation for Shareholder Rights Directive 2 (SRD2), the European Central Bank’s proposed changes to the tariff schedule of T2S, and the implementation of the Code of Conduct on Withholding Tax by the tax authorities of different member states. We believe that these are important topics; we know that they are technically challenging, but their connection to the “big picture” themes is not always obvious.

I have two suggestions as to how we can make the connection. My first suggestion is to make the point that the post-trade process is an inseparable part of the lifecycle of a capital markets trade, and it can be argued is the most important part. If we look at the sequence of pre-trade, trade, and post-trade, the post-trade part is by far the longest in time (as it can last for the full lifetime of a security), and it deals with the flows of money, which is the essence of a trade. What this means is that without appropriate solutions for the post-trade process, there will be no initial capital markets trade. More broadly, this means that without appropriate work to tackle the numerous post-trade barriers, identified in last year’s report from the European Post Trade Forum, there will not be significant progress towards increasing the size of European capital markets, and building a Capital Markets Union.

My second suggestion relates to the application of the “big picture” themes to the reality of the post-trade process. At a high level, it is clear that end-users of capital markets will increase the usage of capital markets as a vehicle to channel savings into investments only if they have confidence in the integrity of the markets, and see benefits in their use. This means that such themes as transparency, trust, managing asymmetries of information, due recognition of environmental, social and governance factors, avoiding excessive short-termism, as well as the more down-to-earth considerations of cost, risk, and taxes, are all critical. I think that a very useful exercise would be to take the list of our post-trade activities and concerns, evaluate them in the light of the “big picture” themes, and answer the questions of whether we are moving in the right direction, and whether we are doing enough.

On SRD2, which relates directly to the theme of “governance,” I would say that we are moving in the right direction, but that there is still scope for public authorities to take some more radical steps to guarantee rights for end investors.

It is clear that we are moving in the wrong direction for T2S tariffs, but it is also clear that in the short and medium term there is no alternative, and we appreciate the efforts of the ECB to take account of the views of market participants.

On tax, it is clear that what is currently on the table is deeply inadequate. Interestingly, the ECB seems to share this analysis. In a speech on 3 May, Vitor Constâncio, Vice President of the ECB, argued that the Capital Markets Union requires “the harmonisation of tax on financial products.” I think it is fair to say that we do not know what he really means, but then in face of distribution, it would appear that the ECP is making a radical proposal to connect the big with the small.

James Cunningham
Managing Director and Senior Advisor
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