

T2S Wave 1

Lessons learned and the upcoming future

March 2016

The roadmap to Target2 Securities

Target2 Securities (T2S), the single pan-European platform for securities in central bank money scheduled for adoption by 23 CSDs and 21 European markets, represents one of the milestones towards the ongoing development of a European Capital Markets Union (CMU).

The project allows for several migration waves with subsequent timelines, between June 2015 and September 2017; and Monte Titoli was the first CSD to announce its intention to join the T2S platform in the first migration wave.



250.000

line of stocks

100.000

transactions settled daily

40.000

ISIN

99%

of settlement volumes of T2S

Recognising the complexity and importance of the project, Monte Titoli started its analysis, development and implementation of the new pan-European infrastructure from the very beginning.

The T2S transition required each joining CSD to replace its core internal settlement engine with a brand new one, assuming that all other custody components were fully integrated and properly working.

This significant effort in project and development activities, lasting more than five years, finally bore fruit on 28 August when the Migration Weekend started.

Accounting for about 99% of T2S Wave 1 volumes, Monte Titoli's migration was a real success.

1. Lessons Learned

1.1

Complexity

Target2 Securities has been the largest and most complex project ever managed by Monte Titoli over its 30-year history. A settlement engine like T2S is not a stand-alone tool.

The new platform introduced extended working hours, different settlement cycles, a new operational day, multiple countries, multiple central banks, different optimisation mechanisms, settlement models and auto-collateral rules.

Monte Titoli had to rethink the existing interfaces between settlement and custody and check, adapt or reshape all the core custody components.

While the T2S platform implementation was proceeding, most of the European CSDs introduced new proprietary platforms or re-designed new core functionalities. All these aspects added an extra complexity, risks and dependency.

The governance of the whole project was very complex as the project involves many stakeholders: the European Central Bank, the T2S Operator and the four CBs, the trading venues, CCPs, CSDs and clients.

1.2

Challenges

Given the high number of accounts and positions, ensuring that all the static and dynamic data was ready and accurate entailed an enormous workload.

In addition, according to the T2S project plan, Monte Titoli and the other T2S Wave1 CSDs had only three months

of community testing for a real end-to-end performance check; while following waves will have six months.

Finally the community testing phase, involving all participants, revealed not only different needs in terms of profile and accounts configuration, but also some unexpected impacts on already developed functionalities.

1.3

Success Factors

Governance constituted one of the most complex aspects of the T2S project, due to the large number of different stakeholders involved.

Monte Titoli started involving all the various stakeholders from the very beginning in 2011; coordinating the preparatory work with clients, CCPs, markets participants, IT providers and independent software houses supporting our clients in order to share knowledge and encourage market awareness on the forthcoming European project.

The work of managing the project's governance has been supported by the setting up of ad-hoc working groups, such as the Technical User Group (TUG) and National User Group (NUG) coordinated by Bank of Italy, which shared and discussed all the major relevant issues. Transparency and client involvement in key decisions were the rules of the game.

By introducing Jira, an end-to-end web-based problem tracking system, Monte Titoli provided a useful tool for sharing problems, actions and solutions with the entire community. And a dedicated task force was also available to support this learning process.

Across the different stages of Community Testing, Monte Titoli paid serious attention to constant coordination with the market; this was a key factor in avoiding any waste of time and resources.

Finally, as soon as clients highlighted a potential delay, Monte Titoli moved from a project management to crisis management methodology by implementing a daily interaction with Bank of Italy and ECB and an equivalent alignment with clients' top management.

To ensure that the migration took place within the agreed terms, it was crucial to focus on priorities and work with clients to de-scope certain functionalities in a completely transparent manner.

2. Key issues for future waves



Static Data.

The new settlement system requires a precise and careful set-up of market participants' T2 and T2S accounts, reflecting different services and functionalities. The static and dynamic static data set-up needs to be replicated in the production

environment, after being tested in the community one, as there is no functionality to migrate it. Monte Titoli has provided its clients with a new web-based tool to check all the static data input first in the testing and then in the production environment.



Standard Settlement Instructions.

In T2S, SSI must be given out to the community in advance to ensure that they are updated in due time by all the market participants, preventing a mismatch of settlement instructions. With the next waves in mind, it is important to make sure that the new SSI are properly updated by each

market participant up to and including the final clients. Should this become a market issue, it may be useful to evaluate solutions aimed at concentrating all this information at T2S level in order to have a single repository for all the participants.



Education.

Education was crucial to: ensuring that all clients acquired a full understanding of the new settlement platform and processes; preparing for the community test; and, finally, migrating on time. Monte Titoli made significant efforts to train clients and stakeholders on the features and the

impacts of the new settlement platform. Monte Titoli also established an ad-hoc group on testing and migration for DCPs, since they represent the majority of the settlement volumes and therefore the highest potential impact on the outcome of the testing and migration process.



Liquidity.

The availability of cash is the most critical issue for a settlement system's efficient operation. Even though Monte Titoli made sure that clients with major volumes were ready to inject additional cash if necessary, in the first two weeks there were two interoperable CCPs for wholesale bonds (CC&G and LCH) facing severe liquidity issues. This caused the slowing down of the settlement process due to

insufficient cash. The two CCPs had to inject a considerable amount of cash at the beginning of the daily RTGS in their DCAs to facilitate regular settlement activity. Monte Titoli promptly escalated the issue with the ECB which decided to introduce two additional partial settlement cycles in the morning on 14 September, considerably improving the settlement ratios and easing the needs of the CCPs.



Penalties.

As expected, with the change of the settlement system the fail rate went up. There were various reasons for this, but in general it was due to a shortfall in understanding and knowledge of the new processes by the different users. In order to avoid an

increase in costs for the market, Monte Titoli and CC&G (the Italian central counterparty) worked with the authorities on the establishment of a grace period. This led to the application of settlement penalties being waived until further notice.



Testing.

The need to support clients in executing a large number of test cases in a short period required the implementation

of a clear test plan and, above all, strong governance in terms of defects prioritisation.

3. The upcoming future

The T2S platform will reach its anticipated operating speed only in September 2017 when all the CSDs have joined, contributing to the achievement of a fully integrated financial sector in Europe.

However, after six months of activity in T2S, a few observations can be made.

Treasurers have found real added value in the advanced functionalities of T2S for collateral management, thanks to centralised management of cash through dedicated cash accounts and the avoidance of fragmentation in several systems.

For instance, the opportunity to manage a single pool of collateral is certainly much appreciated by Italian operators, being not only a contributor to cost saving

through simplified operational management, but also a mechanism for moving collateral quickly among systems. Should the need for collateral keep growing in the coming years, as is generally predicted, firms will require more, and better integrated, tools to manage this need.

The technical standards for CSDR will be approved in the coming months and all CSDs in the Euro area will have to implement them. Record keeping, reporting to authorities and management of settlement discipline are some of the main topics.

Through its centralised processes, T2S should certainly be able to support CSDs in implementing these technical standards. They can expect to be relieved of the need to develop similar procedures, leading to potentially significant savings and a major enhancement of the standardisation process.

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