



# Status report on harmonisation implementation

May 2005



euroclear



## **MEMORANDUM**

### **EUROCLEAR GROUP STATUS REPORT ON HARMONISATION IMPLEMENTATION**

As a result of the mergers between the Group's (I)CSDs in recent years, Euroclear is implementing a strategy of platform consolidation which will result in the replacement of the existing five legacy platforms of the Group with a new single platform. This is a major investment programme which is spurring significant harmonisation of market practices in the five domestic markets for which the Euroclear group acts as CSD (Belgium, France, Ireland, The Netherlands and the UK) both in terms of the functionality and services that will be provided by the new system and the external market practices which relate to them. This paper gives a short status report on Euroclear's harmonisation programme. It summarises the significant progress which has been made in reaching agreement on detailed proposals and the work now being done to turn those agreements into reality. This progress is directly attributable to the strong leadership of key market participants in these markets and the very active support and collaboration of both users and central banks to reach acceptable solution applicable across the five markets.

#### **Harmonisation objectives**

Euroclear is strongly committed to the Giovannini Group agenda. Currently, around 60% of the Group's development capability is devoted to delivering it in one fashion or another. It is a clear objective on Euroclear's part to deliver as high a degree of harmonisation as we are able to achieve in order to fulfil our mission of delivering a Domestic Market for Europe. Moreover, the goal of harmonisation is itself implicit in the process of platform consolidation: it would be illogical to build a new platform which continues to operate each of its functions in subtly different ways according to their nationality.

The achievement of a high degree of harmonisation on the new platform will mean that the majority of back-office processes for Belgian, Dutch, French, Irish and UK securities settlement and asset servicing (and to some extent Eurobonds) would become identical. This would mean that a customer currently operating only in one market would be enabled to access the other four markets without additional investment and that many of the practical barriers to cross-border activity identified in the first Giovannini Report would have been removed and their associated high cross-border costs reduced to low domestic levels.

## **Approach to market consultation**

As a user-owned, user-governed market infrastructure provider, Euroclear is committed to a process of open consultation to determine how to implement harmonisation at the practical level. Euroclear is therefore engaged in an intensive stakeholder dialogue with its customers both through expert cross-border working groups on each functional area and by publishing detailed proposals to the entire customer-base in order to maximise the transparency of the process and ensure that market debate is fully informed.

In seeking to determine the optimum harmonised solution it is necessary first to understand today's starting point and have a clear view of what constraints there are, be they legal/regulatory factors or, more often, the historical accident of the way that market practice has evolved to meet identical requirements in different ways due to previously operating as separate markets.

By its very nature, lack of harmonisation today is found at very low levels of detail and it is rare that the harmonisation debate can remain at a high level of generality. This means that the process of first understanding and then agreeing is complex and makes many demands on people's time. Nevertheless, customers across the whole of the Euroclear Group have committed expert resource and have engaged actively and enthusiastically in harmonisation work. Euroclear has greatly benefited from this expert input to the process and the dialogue has generated a strong market-wide buy-in to the goals of harmonisation.

Additionally, Euroclear has engaged closely with other key European harmonisation initiatives, including those of the ECSDA, ESF, FBE and SWIFT, in order to ensure that there is the closest possible alignment between our own harmonisation work and that affecting other European markets.

To date, Euroclear has published the following detailed consultation papers:

Mandatory cash distributions (Nov 2004)	Consultation closed 4 February 2005
Market claims (Jan 2005)	Consultation closed 11 March 2005
Stock distributions and distributions with options (Jan 2005)	Consultation closed 15 April 2005
Central bank money payments (euro) (Feb 2005)	Consultation closed 1 April 2005
Transaction lifecycles (phase 1) (Mar 2005)	Consultation closed 20 May 2005
Reorganisations and transformations (phase 1) (Apr 2005)	Ongoing - Reply due 10 June 2005

As described further below, Euroclear's migration from its legacy platforms to a new single platform will take place in phases. The first phase relevant for harmonisation purposes will be to provide an interim single platform for the Euronext markets (Belgium, France, the Netherlands) at the end of 2007. Remarkably, agreement was reached mid 2004 on the key harmonisation features for

this phase not only by Belgian, Dutch and French banks, but also by the Irish and US user representatives. Consequently, the emphasis of current consultation has been on this delivery (in which partial harmonisation will be achieved) before completing consultation on the final harmonised solutions for the single platform (to include also Ireland, UK and relevant international markets). All proposals for the Euronext-related phase are on track to be published by the end of June 2005. Consultation on the future single platform is targeted to be completed in the first half of 2006. All consultation papers are publicly available on the Euroclear website.

### **Harmonisation agreements**

Already the scale of agreement on harmonisation has been significant and has enabled Euroclear to begin work on detailed IT specifications in order to build the new systems. Key areas of agreement already achieved on long term harmonisation for all Group markets (some of which will be delivered in 2007) include:

- **Settlement and transaction lifecycles**
  - Settlement windows;
  - The principle features of account structures;
  - The principle matching protocols;
  - Partialling;
  - Own account transfers; and
  - Fails management and recycling.
- **Payments**
  - The euro payment model in central bank money.
- **Corporate action processing**
  - The definition, sequencing and use of dates (ex dates, record dates and payment dates);
  - The type of resource to be used in distributions in the long term; and
  - The process for identifying, generating and settling market claims (including the timing of doing so).
- **Messaging**
  - The use of ISO 15022 message protocol for use across all instrument types and transaction types.

These are important components of the barriers identified in the Giovannini reports which these agreements address, in particular:

- Barrier 1        Interfaces
- Barrier 3        Corporate actions
- Barrier 4        Settlement finality
- Barrier 5        Remote access
- Barrier 7        Opening hours
- Barrier 11       Withholding tax procedures

These agreements are highly significant. Not only have they been achieved against the background of the great technical complexity of the issues themselves but they also demonstrate the willingness of every market involved to make changes to their existing practices (and incur investment cost in doing so) in order to benefit from the long term achievements and opportunities of operating in a single harmonised environment. It is worth stressing that the dialogue across markets has been highly constructive, thanks in large part to the leadership of the chairmen of the user groups (Market Advisory Committees) of each of the five markets. This cross-market collaboration is a critical element of the credibility of the harmonisation effort.

### **Timetable for implementation**

The process of migrating from five legacy platforms to one new one is complex and it is imperative that it be controlled effectively. In particular, market infrastructure providers have an obligation to ensure that system changes do not disrupt the markets they serve. For this reason, and also for reasons of programme management best practice, the Euroclear migration path is arranged in a series of phases. Those which will deliver key components of harmonisation will be as follows:

- **2007: Euronext-zone settlement (Belgian, Dutch and French markets only)**
  - An interim solution which will combine changes to existing systems on a short term basis and the early introduction of strategic components of the future single platform, delivering:
    - The large majority of the harmonised ISO 15022 message interface;
    - The fully harmonised solution for central bank money payments;
    - Partial harmonisation of settlement; and
    - Partial harmonisation of corporate actions.
- **2008: corporate actions**
  - The delivery of full harmonisation for the Belgian, Dutch, French, Irish and UK markets and partial harmonisation for international Eurobond markets addressing:
    - Corporate action data;
    - Cash and stock distributions;
    - Distributions with options;
    - Market claims;
    - Reorganisations;
    - Automatic transformations;
    - Buyer and seller protection; and
    - Corporate governance.
- **2009: settlement and payment**
  - The delivery of full harmonisation for the Belgian, Dutch, French, Irish and UK markets and partial harmonisation for international Eurobond markets addressing:
    - Transaction input;
    - Matching protocols;
    - Settlement windows;
    - Sequencing and positioning;

- Fails management;
- Transaction status reporting and settlement control tools; and
- The extension of the central bank money payment model to Ireland, UK (for sterling payments) and its availability in Euroclear Bank.

### **Conclusion**

The momentum behind harmonisation in Euroclear is high and there is a credible timetable and programme plan for its implementation. The task is huge and in many areas Euroclear and its customers are dependent upon reform and change in legal, tax and regulatory areas over which we do not have direct influence. In addition, we are dependent on the delivery of other major European infrastructure projects like Target 2. Given the size and complexity of the programme, coupled with the many external dependencies which exist, we strongly believe that the speed of implementation is as fast as it is possible to achieve. To go faster would mean that markets would not be given adequate opportunity to participate in designing the harmonised solutions and that the systemic risk of launching new systems in a more concentrated way would be much greater. At the same time, it is remarkable that this ambitious multi-year harmonisation effort (whether conducted in Euroclear or coordinated across a larger number of European markets by organisations like ECSDA, EBF, ESF and others) enjoys the strong support of the markets (banks, central banks) notwithstanding that the significant investments they will require will yield savings only in future years. This programme of reform is making a genuine and worthwhile contribution towards the creation of a Single Market in financial services in Europe, and it is crucial that all efforts be made to continue to sustain the current momentum.

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