4 January 2007

Target 2-Securities

Structure of the Economic Part of the Feasibility Study
Input for the Pre-Project Team of the European Central Bank

1. Description of the current situation

- The description of the current situation should highlight the rationale of T2S, i.e. explain the economic reasons that induced the ECB to propose a non-market led solution to overcome current inefficiencies.

2. Objectives of the Economic Part of the Feasibility Study

- The Economic Part of the Feasibility Study should demonstrate the *economic strength of T2S as a solution* to contribute to the overall objective of creating a pan-European capital market characterised by significant post trading efficiency increase, such strength compared to alternative options like
    - continued consolidation facilitated by (i) increased competition caused by the Code of Conduct and (ii) harmonisation and standardisation fostered by the work carried out to eliminate the Giovannini Barriers,
    - extended interoperability among CSDs fostered by the implementation of the Code of Conduct,
    - the status quo.

- The proof of cost efficiency should thereby *not be limited to the book entry settlement functionality* but also take into consideration *the entire post-trading value chain front to back* as market users need to be convinced of the overall economic benefit in terms of reduced overall cost of post-trading within the Euro-zone markets. This takes into account that T2S, by introducing an additional layer, will cause significant changes in the European post-trading infrastructure.

- The Economic Part of the Feasibility Study should thus also be in a position to indicate to what extent T2S would contribute to a narrowing of the cost gap between the European and the US markets and to a reduction of the current excess costs as quantified by the Regulatory Impact Assessment of the European Commission in March 2005.

3. Scope of T2S

- With reference to the operational and the technical part of the Feasibility Study the division of labour between T2S and the participating CSDs should be described in reasonable detail to allow an adequate assessment of the economic feasibility.

4. Assumptions on which the Economic Part of the Feasibility Study is based

- The following assumptions, including assumptions of the evolution of the broader post-trading environment in Europe by the time of T2S being implemented should be described in reasonable detail such description being based on scenarios (best, most likely, worst case):
  - the number (and size) of CSDs participating in T2S,
  - areas and extent to which CSDs will expand their services across multiple markets and the respective expected impact on the CSD landscape, such expansion of services across multiple markets depending also on whether regulators will allow issuer CSDs to become investor CSDs
  - the extent to which market users will likely take up services offered by CSDs across multiple markets (one-stop-shop-offer by home CSD or ICSDs), this will inter alia depend on whether it is anticipated that CSD participants will be able to use their existing account structure at the existing home CSD to access all eligible T2S securities
  - the expected extent to which the Giovannini Barriers (*including the legal, regulatory and fiscal barriers*) have been removed and the resulting efficiency increase,
  - the impact of the Code of Conduct, in particular in respective of increased competition among infrastructure service providers,
  - the likely impact on post-trading of (trans-Atlantic) mergers and competition in the trading space.

5. Identification and evaluation of alternative options

- Alternative options to achieve the goal of significant efficiency increase in settlement services across multiple markets, including but not limited to those mentioned in 2. above, should be identified and *strategically* evaluated; the comparative evaluations in terms of risk, costs and benefits should be part of chapter 6., 7. and 8. below.

6. Risk assessment

- The following project risks should be addressed
  - scope-related risks
  - technological risks
  - external dependencies, particularly in respect of required cooperation with CSDs and dependencies on external know-how and experience
  - impact of delays / failure of T2S on overall settlement systems in Euro area.

- The respective risk reduction measures should be outlined.

- Moreover, the risks arising from CSDs providing additional services across multiple markets, in particular in the area of asset servicing, should be assessed.

7. Quantified comparative costs

Costs to be incurred by the Eurosystem (T2S), the participating CSDs, and by market users should be quantified:

- Direct T2S project costs including inter alia
  - development and implementation cost related to T2S platform
  - development and implementation cost of connectivity based on scenarios (see 4. above)

- Comprehensive costs of change to be incurred by participating CSDs, including but not limited to disinvestment costs arising from decommissioning settlement activities and investment costs (shared data base, connectivity), based on individual estimates obtained from CSDs

- Operating and maintenance costs of T2S and connectivity to participating CSDs

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- Investment costs at the level of market participants caused by T2S and by respective changes at CSD level (estimate based on projections by industry sample)

8. Quantified and qualitative comparative benefits

- Operative cost reduction at CSD level resulting from decommissioned settlement functionality including abandonment of necessary system updates resulting from harmonisation and standardisation (based on individual estimates obtained from CSDs)

- Projected T2S settlement fee including calculation modus (flat or volume based) compared to current fees charged for domestic and cross border settlement

- Operative settlement cost reduction at the level of market participants based on projections by industry sample taking into account the following diverse business models
    - primarily domestic activities
    - cross-border post trading activities in EU largely outsourced to agent bank(s)
    - mixture of direct CSD membership and outsourcing to agent bank(s)
    - direct CSD membership as a rule

- In addition to the quantifiable benefits qualitative benefits should be evaluated compared to the implied implementation costs.

9. Implementation

- The implementation plan (timelines, milestones, sequenced parts of implementation) should be indicated as precisely as reasonably possible.

- An indication should be provided on the timeline in respect of the treatment of requests from
    - non-Euro zone CSDs to participate for their Euro settlements (including access to Euro Central Bank Money)
    - non-Eurozone National Central Banks to integrate their settlement activities in respective national currencies into T2S.

10. Financing

- The ECB should indicate the rate at which it calculates the cost of financing the development and the implementation of T2S.
- The volume projection (including the expected effect of netting) should be indicated.
- Information should be provided, whether the ECB intends to indemnify CSDs for the cost of disinvestment / investment (see 7. above).