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Dear Jean-Michel,

Attached to this letter is the official The Bank of New York Mellon (BNYM) response to the Eurosystem December 2007 consultation paper on User Requirements for TARGET2-Securities (T2S).

With this letter, I would like to set out BNYM's high-level evaluation of the T2S project; at the same time, and as specifically requested in the December 2007 "T2S User Requirements – Management Summary" document, I would like to set out both BNYM's support, and BNYM's views "as to the desirability of the (T2S) vision becoming reality".

BNYM's High-Level Evaluation

In my letter dated June 28, 2007, I identified two fundamentally different visions of the T2S project :

One vision is that T2S is fundamentally just a technical platform that supplies technical services to CSDs. In this vision, T2S may bring benefits to market participants; it may reduce costs, and it may contribute to harmonisation; but such benefits are relatively marginal as T2S does not bring about any substantive changes in the existing structure and mode of operation of European securities markets.

The alternative vision is that T2S will function for market participants (i.e. for CSD users) as an element of core centralised European securities market infrastructure. Under such a vision, there will be substantive changes, very significant cost reductions, and considerable increases in efficiency, as T2S will contribute to eliminating the segregation between different European securities markets, and to creating a single, unified European securities market.

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In my letter, I stated that I shared this second vision of T2S.

Based on BNYM's analysis of the December 2007 T2S User Requirements documents, I am happy to say that BNYM views these documents as contributing toward this second vision.

BNYM believes that T2S as set out in the User Requirements will – in the words of the Management Summary document – represent a “potentially transformational change” in the direction of this second vision.

However, BNYM believes that T2S as set out in the User Requirements is not in itself sufficient. A fully “transformational change” will not be achieved unless a number of other conditions have been met.

These conditions include the following :

(i) Appropriate governance arrangements

As it is an element of core market infrastructure, it is critical that T2S in the continuing elaboration of its design and in its future operation meet the real and evolving needs of all market participants. Accordingly, T2S governance arrangements should ensure that all market participants are able to exercise appropriate influence.

Two particular market segments that play a key role, and whose influence may be underrepresented, are global custodians and issuer agents.

T2S governance arrangements should grant to global custodians a degree of influence that is commensurate with their market size, with the significance of their role as intermediary, and with the contribution that they can make to the T2S project.

Global custodians are key players by the size of the security positions that they hold in custody, by the variety of services that they offer that underpin the proper functioning of securities markets (custody, collateral management, securities lending etc), and by the wide range of market participants (underlying investors, broker-dealers, institutional fund managers etc) who are their clients.

Global custodians have a unique pan-European perspective on and experience with the difficulties created by segmented national processes and infrastructures. They are specialists in the field of securities processing, and they are committed to working towards a more effective and efficient securities market in Europe.

Issuer agents (acting as intermediaries on behalf of issuers) are on T2S the mirror image of custodians (acting as intermediaries on behalf of investors). Issuer agents will have direct or indirect connectivity with T2S, and – very probably – they will (based on a Power of Attorney) process corporate action events directly on T2S. T2S functionalities, and their evolution, will be of critical importance both to issuers and issuer agents.

(ii) Further substantive work on harmonisation

The future success of T2S will stand or fall depending on further work on achieving harmonisation, and on eliminating those national specificities that do not stand up to a test of market best practice, and that are not capable of being generalised across a single European securities market.

BNYM believes further work on harmonisation, and on the elimination of legal, fiscal, and market practice barriers, must continue during the T2S development period, and after the start of T2S operations.

BNYM believes that as this work is of key importance to the T2S project, and as the ECB is in a unique position to foster this work, the ECB should put in place a structure and a process to ensure that the work is carried forward.

(iii) Potential for a further evolution of T2S functionalities

The T2S functionalities should not be set in stone.

There are at least two reasons why this has to be the case. First of all, it is important to emphasise the degree to which T2S represents a radical innovation in CSD design and structure (notably, for example, in the split between custody and settlement processing). There are risks inherent in any such radical innovation. T2S has to have the ability to evolve, in order to manage any problems that may be identified during the life of the project.

A second point is that T2S is built very largely on the basis of current industry best practice and standards. But such best practice and standards have grown up in the context of segregated, national securities markets. In a unified, pan-European securities market with T2S as core market infrastructure, such best practice and standards may undergo substantial revision.

From a user's perspective, it is important that there not be any artificial dogma or rule preventing T2S over time developing functionalities that are appropriate at the level of core market infrastructure, and that meet real evolving market needs.

BNYM's Support and Views on the Desirability of T2S

As may be understood from the above, BNYM supports the T2S project. BNYM sees T2S as representing a major step forward in the achievement of a unified European securities market.

BNYM believes that for T2S and for the European securities market to continue to evolve in an appropriate manner a number of conditions have to be attached to the T2S project. As set out above, these include :

- (i) appropriate governance arrangements;
- (ii) further substantive work on harmonisation; and
- (iii) potential for a further evolution of T2S functionalities.

As set out in the attached detailed response to the User Requirements, BNYM has also concerns about some of the proposed T2S technical functionalities.

Two areas of particular concern are in relation to level playing-field issues (i.e. where T2S gives functionalities to CSDs as custodial intermediaries that are not open to other intermediaries), and in relation to unharmonised processes and national specificities.

As a concluding note, I would like to pay homage to the quality and transparency of the work that has gone into elaboration of the User Requirements. The initial conception of T2S, the development of the User Requirements, and the associated documentation, represent a fascinating intellectual achievement.

I look forward over the years to come to the furtherance of our discussions on the topic.

With my very best regards,



Paul Bodart

Appendices :

- (i) Commentary on BNYM input to the User Requirements response spreadsheet
- (ii) Completed User Requirements response spreadsheet