VIA EMAIL

Deutsche Bank

27 March 2008

Deutsche Bank AG London
Winchester House
1 Great Winchester Street
London EC2N 2DB

Mr Jean Michel Godeffroy
European Central Bank
Kaiserstrasse 29

D-60311 Frankfurt am Main

TARGET2-Securities (T2S) User Requirements Document (URD) consultation – Statement from Deutsche Bank

Dear Mr Godeffroy,

Please find enclosed the comments prepared by Deutsche Bank with regard to the URD consultation.

In addition to the points made in the enclosed excel sheet, we should herewith also like to highlight our principal findings and considerations based on the documentation that is currently available:

- We feel that NCBs also should harmonise their credit operations, for instance with respect to auto-collateralisation. From a present day perspective, but also in the future according to the present URD draft, varying legal structures (repo, pledge), and more importantly, potentially also different rulings (funding of haircuts), are and will be offered. In order to protect the level playing field in terms of all market participants, this needs to be harmonised.

- The direct connectivity concept foresees flexibility on the part of CSDs to configure the respective service offering. It is our opinion, however, that direct connectivity should be subject to the same, common and mandatory service levels, offering non-discriminatory access for directly connected users, compared to the access CSDs receive to service indirectly connected users.

- Several aspects of the URD touch on cash and liquidity issues. More profound and formal involvement of the established cash expert groups would be needed to finalise the URD i.e. this cannot be left solely to the securities experts.

- We feel that there is still some confusion surrounding the practical and economical feasibility of the cross-border settlement service envisaged by T2S. In this regard, we would encourage the ECB to provide an end-to-end business case which puts into perspective the proposals defined in the URD and the financial impact on both users and infrastructures.

- We would disagree with making mandatory certain functions as described in the URD - for instance partial settlement for OTC transactions - and we therefore request changes which need to be made in the document.

We are hopeful that the ongoing engagement with the market will help to address the above issues appropriately.

We are also enclosing detailed comments on the framework for the T2S Economic Impact Analysis (EIA).

Finally, we should like to note that it is agreeable to us that the ECB may make public our comments.

Yours sincerely,

Contacts:

Swen Werner
Domestic Custody Services
Tel: +44(20)754-50575
Email: swen.werner@db.com

Stephen McGoldrick
Global Markets Equities
Tel: +44(20)754-75552
Email: stephen.mcgoldrick@db.com

Comments on T2S Economic Impact Analysis (EIA)

- General remarks:

From our perspective, demonstrating a clear business case is the most important aspect within the context of the current consultation process. Since macro-analysis or calculation focused on very long term changes in the market field are insufficient, we would expect "evidence-based" and not an "assertion-based" analysis.

In order to create the maximum benefit in order to understand the project, we would propose making amendments to the methodology in terms of several important aspects with a view to preventing a misinterpretation of the business case for T2S. We believe the goal of this exercise must be to define end-to-end costs, this meaning the total costs throughout the lifecycle, even if the related services are not directly processed on the T2S platform. The current EIA proposal to some extent indicates the intention to disregard costs for processes not directly offered by T2S. Such a perspective, however, is in contradiction of the end-to-end calculation which we think is expected by the market.

The sensitivity analysis, surrounding the number of CSDs joining T2S, should be expanded to cover issues such as risk of delivery, or at the very least, delays in migration to T2S since one cannot expect all CSDs to join on the very first day. Economics of scale would thus only become available in a phased approach, which has not yet been provided for in the present methodology. We understand from recent presentations given by the ECB that the business case could be reconsidered in the event that fewer CSDs than expected were to join the platform.

- Page 4:

We feel that the ECB has underestimated some of those areas where costs will be associated with harmonisation. Examples with existing harmonisation projects, driven by platform changes and the related working streams regarding the removal of the Giovannini barriers, have shown that significant investment on the part of the users is required, which then needs to be recouped before a truly positive impact in terms of the cost base can be realized. This aspect should therefore be catered for in the chapter on additional costs for users, especially since the direct comparison is valid for the refinancing period only.

We do not understand the statement that this exercise it is not aimed at anticipating the fees that T2S will charge to CSDs in future. We believe this should form a core part of the study given that this will be a key driver in determining the end-costs from a user's perspective. Preferably, up-to-date tariffs for T2S services, and the impact on the existing CSD tariffs, would need to be provided for the purpose of the EIA.

- Page 5:

We welcome the intention that the ECB has not included in its calculation process the volume of non-EUR settlement since the availability of this flow for processing purposes on T2S is not clear. However, the ECB needs to make provision for impacts on the UK market which alone would bear the costs in future of an infrastructure currently servicing five markets.

  - Footnote 4:

We fail to understand the opinion given in footnote 4 which states that even in the event of the non-participation of a CSD, customers could use alternative channels. We cannot imagine any circumstances under which such indirect access could represent the same service level and as such would be considered insufficient for the majority of customers. We would therefore suggest excluding this aspect from the EIA.

- Page 7:

We think that a refinancing period of six years, especially when applied to banks, is too long - three years would appear more realistic.

In the previous draft regarding methodology, the ECB stated that T2S may charge for other services e.g. account keeping. We would be interested in hearing whether this is still the case and what significance such costs would have. This should also form part of the study whereby we should like to refer to our previous comments in respect of page 4.

- Page 8:

The explanation on the development of T2S costs per settlement instruction is unclear, specifically in how far this relates to the current study. On page 4 in chapter 1.1., it is stated that changes in the settlement volume are not foreseen for the purposes of this study. We think that the ECB should assume only a conservative growth in settlement volume.

- Page 9:

We strongly disagree with the approach taken here, specifically excluding cost components for national specificities. This is precisely the concern from a user perspective with a view to ensuring that the total ownership costs of the new T2S process are more cost efficient than is the case today. By focusing on cost components which make the system operational as opposed to those costs that a user would be faced with when active in the securities processing business in a given market, the study becomes somewhat meaningless.

  - Footnote 10:

    We do not understand how the ECB will be in a position to enforce that CSD costs related to directly connected users will only be charged to those users. Since the ECB has no control over the pricing policies, we do not consider such an assumption to be sound unless confirmed by all participating CSDs.

- Page 10:

We disagree with the proposal to exclude investment costs unrelated to settlement in T2S, and made by CSDs after mid-2008, as unrelated to T2S since this is unrealistic. For instance, how would investments that are needed for the harmonisation that T2S requires be reflected?

Currently, both the annualised investment costs and the running costs of the CSDs are defined too restrictively. The investments required in order to build non-domestic asset-servicing capabilities, as well as the acquisition of sufficiently trained staff for this new service, need to be included since the cross-border functionality of T2S requires the creation of links for CSDs for which they also need to be able to process foreign asset-servicing. Otherwise, the platform would continue to service separate national liquidity pools.

Whilst we do not believe that this represents the best way forward, given that this would increase the risk profile of CSDs, which would be in contradiction to the ECB's intentions, the potential financial consequences of such an approach need to be detailed.

- Explanation on business impact:

  In this regard, we should like to highlight our interpretation of the T2S model, which is decisive in this regard. T2S cannot provide settlement (which usually means discharging obligations in respect of fund or securities transfers between two or more parties) on account of the fact that from a legal perspective, securities accounts are only maintained with the CSD where settlement actually takes place. What T2S potentially could deliver is to make "primary settlement" possible at an investor CSD level i.e. provide competition in terms of settlement subject to effective links being established. This requires an efficient solution on asset servicing which is questionable in light of differing market standards. Although T2S monopolises the technical application only, it thereby has a significant impact on the service and cost structure of CSDs.

  As a result of the very distinct tax and legal structures in each market, a foreign CSD will not be able to mirror the asset servicing of the issuer CSD in terms of servicing levels, pricing and timeliness. Within this context, we do not consider it realistic to assume that this can be sufficiently addressed in the short term. Therefore, as far as CSDs are concerned, T2S will not necessarily put CSDs on a level playing field in order to compete with each other.

  Even today, custodian banks compete in the provision of asset services in various markets whereby this is likely to continue, with or without T2S. In terms of T2S, a number of CSDs may wish to develop foreign asset servicing capabilities when competing with agents, thereby, however, assuming more risk-taking functions (systemic risk).

- Page 11:

We do not understand the rationale behind the proposal to exclude the costs for additional matching at CSD level - we consider this to be material from an end-to-end perspective.

The running costs of CSDs also need to make provision for the remaining settlement-related services e.g. processing of registered shares in Germany, which will continue to be mandatory processes even after the introduction of T2S.

The costs also need to include a profit margin which will be paid for by the users. We are not convinced that CSDs would pass on services without generating adequate returns for their owners.

Under point 1.4, the ECB asserts that the definition presented in this chapter would cover the full costs of DVP settlement. However, in the absence of adequate pricing transparency, we are not convinced that costs would not be passed on to other services provided by CSDs, which would in turn negatively impact the business case.

Without full clarity on the pricing policy of all connected CSDs within a T2S environment, the cost comparison may not reflect actual reality.

- Page 13:

Transaction cost savings should not attempt to make comparisons to custodian bank services. The goal should rather be to compare transaction costs as the difference between CSD fees with and without T2S. This should not only take place based on an average, but as a necessary precondition, this should be compared for each national market in order to ensure that, in the short term, today's domestic cost levels will not increase as a result of the introduction of T2S.

More detail is required on how the ECB wishes to calculate collateral related savings when compared to the previous study. We would like to understand how one will ensure that CCBM2 savings are not double-counted (since CCBM2 aims at optimising collateral mobilisation, etc.).

The reasoning behind back-office savings is unclear in the absence of a harmonised market environment which T2S will not itself deliver. Overall, cost savings on account of a lesser number of interfaces appears marginal since this is thought to be highly automated. We also believe that such savings only apply to directly connected users – this needs to be clearly indicated in the methodology.

- Page 15:

The impact on other stakeholders is too generic in order for us to confirm the scenarios. For instance, the ECB refers to a valuation gap between US and European securities. Attribution of such observations to post-trading costs appears unrealistic. Other reasons, such as differing levels of investor optimism or even financing models (i.e. capital market versus banking/credit), appear more likely explanations within this context.

Since it is unclear from the text whether the ECB intends to make any calculations in this regard, we would propose to disregard this aspect for the purpose of this exercise.

- Page 15 f.:

We do not feel able to judge the calculations made on the part of certain CSD organisations mentioned in the text since these will have been prepared solely by the respective organisation. We do not agree, however, that they should become a benchmark for policy decisions where a project of the significance of T2S is concerned.

The Euroclear figures especially relate to a set-up which would include both an ICSD and several CSDs servicing different markets and customer types. Although the ECB proposes to apply certain unspecified adjustment factors, T2S cannot be compared to the Single Platform project and we do not believe that any reliable conclusions can be drawn from such a comparison.

- Page 18:

We also do not feel that the dynamic effects of T2S can be determined on the basis of the regulatory impact assessment undertaken by the EU Commission.

The study has, for instance, been analysed by NERA Economic Consulting, who have indicated that “the [EU Commission report’s] authors appear to choose to adopt a model that is subject to […] statistical problems” (for further details, please see page 33 ff http://213.86.34.248/NR/rdonlyres/84CD860D-8177-4154-8C39-757F3B3F3A6C/0/PostTradingfullversion.pdf).

We would therefore propose refraining from making studies, which have been undertaken at different times and for different purposes, relevant for any decision-making process on the economic feasibility of T2S.