

T2S ECONOMIC IMPACT ANALYSIS

MONTE TITOLI'S REPLY

The present document intends to provide Monte Titoli's remarks on the "T2S Economic Impact Analysis" published by the T2S Project Team on December 18th, 2007.

The first paragraph provides general comments on the major aims that we deem the methodology drawn by the Project Team should pursue. The other paragraphs raise some issues at different levels faced in the document on methodology and on which we would like to draw the attention of the Project Team.

1. Remarks on the scope of the methodology

The document on the methodology should highlight that its scope is neither to quantify a possible pricing for users of CSDs nor to provide a basis for the definition of the business case of T2S but it only intends to estimate the potential impact of the introduction of T2S in terms of benefits and costs for the whole financial community.

It seems to Monte Titoli that the document drawn by the Project Team does not provide a clear description of the aim the methodology intends to pursue.

Monte Titoli deems that the Project Team should clearly affirm that the proposed methodology intends neither to quantify a possible pricing that final users should expect to pay for settlement services nor a basis for the definition of the business case of T2S.

On the contrary the Project Team should clarify that the only objective of the exercise is to estimate the potential impact in terms of benefits and costs for the whole financial community of the introduction of T2S.

From this perspective it becomes clear that any statistical data on costs provided by CSDs should not be considered as the factual basis for the calculation of pricing that the same CSDs would charge on their clients. As confirmed by the Eurosystem in several occasions, the T2S is to be considered as an outsourcing platform whose facilities should be considered as part of the internal procedures of each CSD. Therefore, each CSD should retain the full control of their marketing levers, including the cost for the outsourcing.

2. Internalisation and estimation of volumes with T2S (Paragraph 1.1 – Page 4)

The introduction of T2S would significantly change the way of doing business in the post-trading and the role that different actors would be expected to play. Therefore, we believe that T2S can not be considered neutral with reference to possible changes in present volumes and that the impact of its introduction should be carefully estimated.

In particular, the idea that T2S would imply the consolidation of volumes due to the choice of many medium and small entities to outsource their activity seems to be widely shared in the market.

As the robustness of the business case for T2S will very closely depend on volumes estimated we believe that the Project Team should clearly investigate impacts on volumes deriving from the introduction of T2S.

The T2S-Project Team deems that the introduction of T2S would not have any impact on how the market and volumes may evolve. In particular, in the document it is affirmed that any increase in internalisation of settlement at the level of custodian banks would be independent from the launch of the new platform.

Nevertheless, there is a widely shared understanding, agreed by the same Project Team, that the new platform would change significantly the way of doing business in the post-trading and the role that different actors would be expected to play. Therefore, we believe that T2S can not be considered neutral with reference to possible changes in present volumes and that the impact of its introduction should be carefully estimated.

With specific reference to internalisation, Monte Titoli has a strong impression that the launch of the new platform would significantly increase this phenomenon. T2S would require all market participants to deeply change and adapt their internal structure from an operational and organisational point of view. These major expenses can be considered as fix costs and therefore their impact would be higher for intermediaries with lower volumes than on major custodian banks. This would happen whatever type of efforts CSDs may decide to do in order to minimise the impact on their clients. T2S follows a scheme and a functional structure which is completely different from the one already adopted by single CSDs and the interaction with it would require changes both for participants choosing the direct connectivity and for participants who prefer to be supported by their CSDs.

Moreover, if we consider that medium and small entities would anyway need the support of global custodians to reach no euro zone countries as the activity of many CSDs is limited from providing them all the services they need (such as credit provision, securities lending, collateral management, fiscal services, etc.) it is easily understandable that for many of them the decision to outsource their post-trading activities would represent an obliged choice.

As a consequence, it is quite easy to predict that many market participants would outsource their back office to major custodian banks that in this way would centralise and volumes in their hands.

The direct consequence of that would be a strong increase in the internalisation of volumes within the books of fewer and bigger custodians. From this point of view we share the opinion expressed by the ECSDA according to which the introduction of T2S would make the European situation similar to the one experienced by the Fedwire where only 15% of US government bonds transactions settle on the books of Fedwire while the remaining part takes place in two large custodian banks.

3. Impact of T2S on the competitiveness of the Italian financial market (Paragraph 2.1.2)

Monte Titoli pricing has been assumed by the Eurosystem as benchmark to define the fee of T2S.

We note that the fees applied by the Italian CSD already include costs for communication, held desk and reporting, that many activities would not be able to be decommissioned and that a mark up for CSDs should be anyway foreseen. Therefore, Monte Titoli has the impression that the introduction of T2S could increase the Italian post-trading costs.

We remind that, as underlined by the same Project Team, an increase in the fees of settlement would negatively impact on the overall efficiency of the national financial market.

Therefore, when evaluating a possible pricing for T2S, we would suggest the Project Team to take as benchmark the unit costs that cheapest CSD presently sustain and not its fees.

The Project Team works on the assumption that “CSDs will transfer the benefits of T2S to the T2S Users”. Monte Titoli would like to draw the attention of the Eurosystem on the fact that, by adopting this approach, CSDs should be required to also transfer to their clients the additional costs deriving from the introduction of T2S.

This would be particularly true for Monte Titoli as its fees have been taken, as done in a first draft of the Economic Impact Analysis published in March 2007, as benchmark for the definition of the T2S pricing.

We remind that the fees applied by the Italian CSD already include costs for communication, held desk, reporting services. We note that Monte Titoli would not be able to decommission all its costs but it should continue to provide some services such as information, help desk and monitoring activities. We remark that we have not been provided with a clear indication of

possible fees charged by T2S and on the type of activities included in this fee. We observe that Monte Titoli should anyway apply a mark up to preserve the present efficiency level of our system, to finance new projects, to adequately remunerate our shareholders and to keep growing.

Considering all above, we have the impression that the introduction of T2S would not imply a reduction of fees for settlement services but on the contrary it would significantly increase the Italian post trading costs.

Nevertheless, the same Project Team is fully aware that any change in the fees of post-trading would greatly impact on the overall functioning of the financial capital market. Therefore, from our point of view any increase of our fee would impact and could compromise the competitiveness of the Italian system.

The only way to ensure that the introduction of T2S would not imply any adverse impact our clients is for the Project Team to assume Monte Titoli's unit costs and not its unit pricing as benchmark for the definition of the fee of the new platform. Any other hypothesis would adversely affect the level of efficiency and competitiveness that Monte Titoli is presently able to provide to its clients.

4. Higher involvement of domestic banks (Par. 2.1.3)

The introduction of T2S would require significant changes to all settlement agents even though possible efforts from CSDs to minimise the impact on them.

These updates should be required not only to intermediaries dealing on across the borders but also participants with a domestic activity only.

Monte Titoli would suggest the Project Team to evaluate also the impact on only domestic entities in order to correctly value the impact of T2S.

According to the methodology proposed by the Project Team, the evaluation of impacts of T2S on users should be based on two different sources: a first source would be represented by the answers directly provided by custodian banks participating in the Advisory Group and in the technical groups (so-called "active banks"). A second type source would be represented by information obtained by interviewing a sample of less active banks "across the euro area" (that the Project Team has called "less active group").

At Monte Titoli we believe that these two sources are not enough to adequately represent the whole post-trading industry and to concretely appreciate the effective impact of T2S as it does not take into account market participants who mainly or exclusively operate on the domestic market. Then, we would strongly suggest to also consider the impact on these entities. As

mentioned above, the introduction of a new settlement platform always requires users to make significant organisational and operational changes; CSDs are able to minimise the impact of these adjustments but not to avoid them.

Moreover, we consider that the Project Team should carefully consider the impact of T2S on domestic banks also to better evaluate the potential influence of the introduction of the new platform on the internalisation. Only by estimating the incentives of these entities to outsource their activity it becomes easier to build a strong business case for T2S and to adequately set up the platform and to suit its IT capability in the most appropriate way.

5. Implementing new facilities not from scratch and social benefits (Paragraph 2.3)

It is always very difficult to quantify the impacts of specific measures in terms of overall increase of GDP. We note that in the past very often such exercises led to wrong estimates.

We observe that any social benefit would come not from T2S in particular but by any shared platform able to provide settlement services at a centralised level.

We think that development of a system from scratch would imply on the one hand that a lot of excellent implementations (and investments) would be thrown away while on the other hand a major allocation of time, resources and investments would be required to the market.

Therefore we would like to invite you to evaluate the opportunity of leveraging on state of the art existing systems and IT solutions

Monte Titoli has no elements to evaluate the correctness of the estimates provided. We only note that the same results may be achieved by any share platform and that these benefits are not specific of T2S.

We strongly support the idea to implement in Europe a single shared platform. We presented this proposal first in 2005 during the Eight Conference of CSDs in New York and then promoted it in several other occasions.

We are convinced that exploiting the existing solutions would benefit of the experience accumulated by the CSDs in building their systems, would allow to use a system which has proved to be robust and efficient, and would also speed up the process of delivery, save resources and dramatically reduce the overall costs for users.