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Dear Mr Godeffroy

TARGET 2 SECURITIES ("T2S")

CONSULTATION ON THE USER REQUIREMENTS DOCUMENT

You published the Target 2 Securities User Requirement Document in December 2007 and asked for comments by 2 April 2008. HSBC Holdings plc and its subsidiaries ("HSBC") are grateful and very pleased to have been given this opportunity to comment on the important developments addressed in the document. I set out below the comments of HSBC, and we look forward to commenting on any further papers supporting the Eurosystem's T2S initiative as they are issued. We have liaised with the UK National User Group, the European Banking Federation and the Association of Global Custodians in connection with the document, although our views may differ from theirs in some respects.

GENERAL

HSBC undertakes many activities involving securities settlement, notably as broker dealer, investment manager and sub-custodian. The HSBC Group is headquartered in the United Kingdom but has securities operations in many countries of the eurozone including Germany, France, Ireland, Luxembourg, Greece and Malta, and furthermore in the UK processes many transactions carried out and settling in Euro. The Group also routes major volumes of Euro trades from its major markets in Asia.

HSBC ranks amongst the world's largest custodians and is a significant custodian in Europe and one of the UK's largest custodians by assets under custody. To this end HSBC is closely interested in the T2S project and is pleased to have a representative on the T2S Advisory Group.

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In principle, HSBC supports the proposals and any initiatives to integrate and harmonise cross-border settlement to the extent that such initiatives offer the likelihood of reducing the cost and risk of cross-border settlement without increasing costs and risks elsewhere. Accordingly HSBC supports T2S subject to the issues set out in this letter. Our comments are not exhaustive, but we set out below some significant matters we would like addressed both before any decision to progress by the Governing Council and during the next stage, should T2S progress. In addition we set out some detailed considerations on the attached template.

1. CORPORATE ACTIONS: FURTHER DETAIL MUST BE PROVIDED ON HOW CORPORATE ACTIONS WILL BE EFFICIENTLY PROCESSED AND DISSEMINATED IN T2S.

We support T2S's lean approach in limiting the project scope to settlement, so do not believe that the scope should be extended to include corporate actions processing. However, we do see the interaction of corporate actions (including income processing) with T2S as a complex area, and we ask the project team to pay particular attention to this subject in order to minimise operational risk during both the build and subsequent operation of T2S.

We harbour concerns that the separation of settlement and asset servicing will only serve to increase the operational risk involved in the execution of corporate actions by creating additional (as yet undefined) steps in the information dissemination chain.

We note that in the T2S proposals a CSD may either:

- (a) rely on holdings balances at T2S to execute corporate actions; or
- (b) replicate holdings balances at T2S, and then rely on the balance on the CSD's own systems.

In both cases T2S creates an extra layer in the chain of data transmission before a broadcast can be carried out to the holders of the securities. In addition, under (b) above instant update and reconciliation of holdings balances between the CSD and T2S will be necessary to ensure that all parties are basing their administration of the corporate action upon the same balance.

We are also concerned that attention is paid to maintaining the current level of country-specific expertise of agents and CSDs (in such matters as taxation and reduced deadlines) under the T2S regime until such time as true harmonisation is brought about. It would be a backward step for local agents and CSDs to be forced by cost structures following infrastructure reshaping to lose such expertise in the interim.

Processing corporate actions and providing reliable, constantly updated information to and on behalf of clients is a key function performed by custodian banks. Any set of proposals to remove settlement to T2S that does not deal with the specifics on how corporate action information is disseminated efficiently and cost effectively will be a major concern to market participants and a major risk to the proposals themselves.

2. SECURITIES LENDING: FURTHER DETAIL MUST BE PROVIDED ON HOW SECURITIES LENDING WILL BE ADEQUATELY RECORDED IN T2S.

Securities lending is principally addressed in chapter 9 section 9.2.6. We would like to see more detail on the synchronisation with the settlement process in order to ensure that there is no increase in operational risk.

In particular, European markets all tend to have their own peculiarities for securities lending including recording, interaction with entitlements arising from corporate events, the taking and use of collateral, laws, and the consent required by borrower and lender to return the securities on loan. The T2S model must be tested against the provisions of each relevant country for adequacy.

We note also that the “automatic” closing of lending operations as described could be extended to instructions for closing on a date that differs from the opening date. The case described of opening and closing dates being the same will often apply to securities borrowed for intra-day fail coverage, so a description could usefully also be given for the general case.

3. ECONOMIC IMPACT: THE ECONOMIC IMPACT OF T2S ON TRANSACTION COST SHOULD NOT BE ADVERSE TO THE CURRENT MARKET SITUATION.

Market participants have invested heavily in their own technology in the past few years to service multiple markets on behalf of clients, and to cut through the market inefficiencies that exist at CSD and national market level. They should not be penalised with an additional layer of cost as a result of T2S infrastructure development until any calculated benefits (cost savings from infrastructure reshaping and additional revenues generated) have materialised and been clearly demonstrated. As a principle, transaction costs at the CSD level should not be allowed to rise, and should indeed be capped at current levels. In particular we are interested to learn at an early opportunity the expected costs for direct participants, especially in implementing interfaces to T2S.

We consider that T2S should only be implemented if it is predicted to reduce settlement unit costs (cross-border and domestic) for users within a reasonable period of time. Reasonable time, we take to be within the boundaries of industry average return on investment cycles of say 3 years.

We support and are participating in the data collection exercise currently being conducted to substantiate the expected economic impact of T2S. However, we request that rigorous sensitivity analysis is conducted on the results in order to ensure the robustness of any decision to proceed with T2S based upon the data collected. In addition, a further sweep for more detailed data to feed into cost/benefit analysis will need to be considered before major investment is undertaken.

4. SETTLEMENT CURRENCIES: THE FULL DESIRED IMPACT OF T2S WILL NOT BE REALISED UNTIL ALL MAJOR EU SETTLEMENT CURRENCIES ARE INCLUDED

We note particularly that T2S as currently specified is scheduled to begin operations in respect of securities traded in euro, not the currencies of all EU countries. We are pleased to note however that T2S will have the functional capability to settle in currencies other than euro, as the greater the volumes of trades that are settled then the lower will be the unit cost of trades settled. In addition, until the eventual inclusion of other currencies, market participants will need to maintain their different national interfaces and settlement processes.

It is unusual in today's markets to design and build a single currency platform despite the desire for simplicity. To do so could in HSBC's view be seen as divisive and contra to the spirit of the Community. We stress however that at this stage HSBC is not pressing for non-eurozone national authorities to transfer securities settlement in their currencies into T2S.

5. LEGAL FRAMEWORK: CLEAR AND DEFINITIVE RECORDS OF TITLE AND FINALITY OF CROSS-BORDER SETTLEMENT ARE VITAL TO AN EFFECTIVE T2S PLATFORM

There are many legal issues to be resolved before such a wide-ranging undertaking as T2S can go live, but some must be addressed well before the planned live date in 2013. In particular we consider it essential that a detailed timetable and major steps for clearance of outstanding legal issues is published before any decision is made by the ECB's Governing Council to proceed with T2S. In particular we are concerned that:

- (a) the definitive record of title in securities; and
- (b) the finality of cross-border settlement

are determined before any major commitment to build T2S is undertaken.

Title to securities and the finality of their settlement will be determined within each member country, but the T2S structure must be tested against each country's definitive record of title (for example the CSD, issuer records or registrar) and interaction with the settlement process. Similarly the jurisdiction governing finality of cross-border settlement and regulatory supervision must be addressed. In order to avoid wasted investment, such major issues must be resolved or at least substantially clarified before any major project build work is undertaken.

6. GOVERNANCE: MARKET PARTICIPANTS SHOULD BE THE DRIVING FORCE BEHIND T2S CHANGES. ONLY THROUGH COLLECTIVE INDUSTRY PARTICIPATION WILL THE TRUE BENEFITS BE REALISED

The existing governance structure of T2S has been effective in driving and controlling the project so far, and accordingly we support the continuation of the advisory and technical groups during the creation of the functional specification. Within this continued structure we believe it is necessary that the users are represented to at least

their current proportional level in order to monitor and advise upon the impact T2S will have upon the costs and potential risks passed onto users by the infrastructure organisations.

We are at your disposal to discuss any of these issues if you wish, for which please telephone me or my colleague Henry Raschen on + 44 20 7005 8282.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'B Scrimgeour', with a stylized flourish at the end.

Bill Scrimgeour
Global Head of Regulatory and Industry Affairs
Institutional Fund Services