



**Eurofi 2008 -
Thursday 11/09/08**

**Session [11B] - PRIORITIES
FOR EU SECURITIES
INFRASTRUCTURES
AND PROSPECTS OF
TRANSATLANTIC
INFRASTRUCTURES**

The Panel

Moderator: **Tommaso Padoa-Schioppa**, Former Italian Minister of the Economy and Finance

Panellists: **Diana Chan**, Chief Executive, European Central Counterparty (Euro CCP);

Alain Closier, Global Head of Securities Services, Société Générale;

Jean-François Théodore, Deputy Chief Executive Officer, NYSE EuroNext;

Bob Wigley, Chairman EMEA, Merrill Lynch International;

Piia-Noora Kauppi, MEP, Committee on Economic and Monetary Affairs, European Parliament;

David Wright, Deputy Director General, DG Internal Market and Services, European Commission

Gertrude Tumpel-Gugerell, Member of the Executive Board, European Central Bank (ECB);

The Debate

Securities infrastructures are a key component of European capital markets and have been a major area of focus of Eurofi's work over the last years. A summary of the latest assessments conducted and proposals made by Eurofi was distributed to all the participants in the conference. Two sessions were dedicated to securities infrastructures in Europe, outlining the progress made over recent years and the main priorities for ensuring the competitiveness of EU securities infrastructures in increasingly global markets. This first session, moderated by **Tommaso Padoa-Schioppa**, former Italian Minister of the Economy and Finance, gave a general and strategic perspective on these issues and examined prospects of transatlantic infrastructures.

Mr Padoa-Schioppa opened the discussion by asking what were the priorities for increasing the competitiveness of EU securities infrastructures and what were the challenges. Could global infrastructures emerge one day? And what evolution was required in post-trading to support the development

of trans-Atlantic infrastructure? He said the Eurofi document had revealed the languid pace of progress as much as anything. The responsibility for this was probably attributable to both public and private actors. Consolidation had not moved further within the euro area, but towards trans-Atlantic deals, which is in line with global consolidation. This was a positive, but had made further consolidation with the EU more complex.

The speakers on the panel generally agreed that the priority was to improve the competitiveness of EU post-trading infrastructure and to further consolidation as a final objective.

Diana Chan, Chief Executive, European Central Counterparty (Euro CCP), initially addressed the issue of competitive priorities, pointing out that a number of multi-lateral trading facilities had increased competition. Entities such as Euro CCP, which was launched in Europe in August, had provided a challenge to the incumbents. "This is a clear indication that the model is not only possible, but is likely to thrive," said Ms Chan. The requirement was now to remove cross-border barriers, since there were a number of legal impediments in some national markets to providing cross-border post-trade services.

To increase competition and lower costs it was necessary to return to fundamentals, Ms Chan said. This was essential if Europe was to be competitive globally. There was a clear desire to achieve this, going back to 2000 when a number of investment banks got together to produce a study entitled: "A Single Pan-European CCP". It was agreed that the most cost-efficient solution was one clearing infrastructure across the whole of Europe. That was when many CCPs that exist today had not even been set up, Ms Chan added. Despite this, stock exchanges still went ahead and built their own CCPs.

However, the past had shown what users needed. In clearing, the most economic model was for everybody to use the same structure, which allowed for the maximum netting down of transactions and the lowest cost of settlements and risk management. It would be possible to offset both long and short positions across multi-lateral trading venues that traded the same securities. The introduction of MTFs had shown the possibilities here.

But because clearing arrangements had been developed separately in many EU countries, unit costs were much higher in Europe than they should be, owing to the high fixed costs. Competition would eventually reduce costs, though, as CCPs started to consolidate, Ms Chan believed. This process would be speeded by a trans-Atlantic approach, such as that demonstrated by Euro CCP, a fully-owned subsidiary of US clearing house DTCC. "Post-trade trans-Atlantic infrastructure is more than an idea, it is already here," said Ms Chan.

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For trans-Atlantic trading to work, the next stage had to be trans-Atlantic clearing. Where two markets were already collaborating, the obvious way forward was inter-operability at the clearing level, which should be co-operative in nature. "I would like to make the prediction that this will materialise," said Ms Chan. It was easier to turn into reality when each clearing party was collaborating, than when they were in competition, which was what the Code of Conduct had envisaged. "The Code of Conduct suggests competitive links, but I think it will be different," said Ms Chan.

She acknowledged that the idea of a monopoly in European clearing would be unpalatable to some. But she pointed out that competition was not always meaningful. "If there are two inter-operating CCPs and one offers transactions at 20 cents and the other at 19 cents, then that is not real competition," said Ms Chan. She would prefer to see a not-for-profit monopoly, which was industry-owned and governed. Such an organisation would have no incentive to abuse its monopoly position, she argued.

Alain Closier, Global Head of Securities Services, Société Générale, agreed that European efforts should be working towards a more global context. This should be helped by the benefits conferred by MiFID. The merger of the New York Stock Exchange and Euronext had created a "domestic" area for banks such as Société Générale, with other European countries now considered as "international" areas. With this new axis in place, there was the possibility of more post-trade consolidation, possibly on a global basis. But Mr Closier warned those who believed consolidation should take place step-by-step that there was less time than they thought. "There is not time in Europe, we can't be patient," he said. "We cannot wait until 2013 to obtain reduced costs, greater simplicity and consolidation."

He pointed out that a new reality had already arrived, whether the industry wanted it or not, and the NYSE/Euronext merger had created an "alternative scenario" in Europe. If consolidation was done quickly, it would lead to greater fragmentation and higher costs to users, he believed. "We may have more competition but there will also be more and more complexity for users trying to access liquidity," Mr Closier said.

Jean-François Théodore, Deputy Chief Executive Officer, NYSE Euronext, was asked to consider whether trans-Atlantic deals were a genuine step towards greater consolidation or a consequence of continuing European fragmentation.

"With the dynamics of MiFID, we find ourselves in a new world, where there are new entrants, innovation and consolidation," Mr Theodore answered. In a fixed cost industry, economies of scale were key, he said. Bringing maximum flows to a given platform was one way of reducing cost. This was especially true in a fragmented landscape like Europe and was even truer in post-trade where the costs were higher.

The feeling in the industry, said Mr Theodore, was that post-trading was lagging behind the front office in consolidation and in building infrastructure. Euronext, OMX and the LSE had led the way in trading consolidation and had lowered the cost of capital for transactions. The cost of transactions in NYSE/Euronext countries was expected to fall by 30 per cent and liquidity to increase by 25 per cent by next year. 200 Mio \$ cost synergies were also expected.

But Mr Theodore was frustrated that similar efforts had not been made among post-trading providers. "Each time there is a front office move, we are left waiting for a post-trading solution." Euronext had been key to delivering a single order book and creating a domestic, unified space, and was an example for the rest of Europe.

In post-trade, Europe was fragmented into national, vertical silos. But this was the natural consequence of a past desire to develop domestic infrastructures to create efficiency in local markets. However, it was now time to move on. In the US, the environment had been unified by the SEC, not for cost reasons, but to make sure there was harmonisation between East and West coasts and everything in between them.

The Code of Conduct was designed to achieve interoperability, but there remained key questions to answer. These included making sure the time for getting post-trade solutions to market was brought forward from 2013. "The time is now," said Mr Theodore. "Competition is here now and market share is moving now." In addition, it must be recognised that the name of the game was to bring down unit cost from 20 cents now to around 2, 4 or 6 cents a trade. The problem was there was little incentive for platforms to merge and there was a reasonable possibility of ending up with a "spaghetti network" rather than genuine consolidation.

In the absence of widespread consolidation, competition was the next best tool to achieve tariff reductions in the short-term, said **Bob Wigley**, Chairman EMEA, Merrill Lynch International.

But consolidation had to happen at some stage because clearing and settlement were natural monopolies. The more there were of them, the higher the aggregate costs were likely to be. Mr Wigley asked if the absence of a pre-determined model, encompassing a vision shared by all users, was a major issue. He thought it was important to agree common principles, but unrealistic to expect full agreement on the end game given the different ownership structures that existed and differing interests of the players involved.

Some infrastructures are purely user-owned, user-governed entities; some operate their own clearing infrastructure on a full-profit basis; the commercial banks operate fully-owned custodian services competing with some elements of the infrastructure. So it was unlikely they would ever come together and share one vision. But it was important that all parties

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could stick to a set of principles that would maximise safety and efficiency, and deliver cost reduction and harmonisation. We all need to keep focused on breaking down the remaining Giovannini barriers that threaten the effectiveness of MiFID and the Code. "As other speakers have said, it is time to get impatient. This has been going on too long," said Mr Wigley.

He noted in particular the significant impact of Barrier 3 of Giovannini (on asset servicing). Merrill Lynch's own large corporate actions department could increase efficiency and save a huge amount of cost if there was just one set of rules for dividends and rights issues as opposed to differing rules in each European country, Mr Wigley said.

In clearing and settlement more widely, there was also much work to be done. Merrill Lynch had "pushed hard" for T2S, but tough decisions still needed to be made that not every country would like. "One of T2S's principles is to support national specificities, where the national CSD is prepared to pay. But there needs to be a test of the impact on users here, and users should decide. CSD's willingness to pay for specific development on T2S should not be the only criterion for allowing it to go ahead." Merrill Lynch would continue to push for a single harmonised process in this respect.

In terms of the Code of Conduct, national specificities had a big impact on providers accessing each others' markets. Barriers needed to be addressed with local regulators with reference to the Treaty and to MiFID, which provide ample guidance to allow interoperability to succeed. The industry needs help with this: these parties are difficult for users to influence from the outside. There were open applications for infrastructure for interoperability but there had been much foot-dragging, Mr Wigley said. He applauded the Commission for encouraging a rapid response and for asking CESR to address the issue, but the process had still been too leisurely.

The global situation was moving on apace and the industry needed to take more notice, he added. The decision by Turquoise to award a contract to DTCC rather than to LCH was a significant development for European infrastructure. "If Europe does not get its act together it will be the US or institutions from elsewhere that will lead the way," said Mr Wigley. "This should cause Europe to sit up and take notice, and encourage interoperability applications to progress as well as encouraging individual countries to deal with the issues more rapidly."

Piia-Noora Kauppi, MEP, Committee on Economic and Monetary Affairs, European Parliament, prefaced her remarks by agreeing with the moderator that Ecofin should have been represented at the debate. Ecofin members ought to look beyond their borders more often and think in a more pan-European way, she said.

Addressing the issue of infrastructure, she said that EU trading and post-trading infrastructure was competitive in some ways but not in others. In post-trading, for instance, European technology was "ten to 20 years"

ahead of the US. Europe also used to be the leader in electronic trading for the front office, but the US had since caught up. The lack of competition was seen in cost-efficiency, where the gains made in technology could not be rolled out across a sufficiently wide area. In creating links between two infrastructures, 50 per cent of the costs were legal, she said. "We just cannot use our great technology for the benefit of end users."

There needed to be consistent implementation of the existing frameworks, including MiFID and CRD, if competition was to work effectively. Consolidation should be the ultimate goal, but the industry had not reached that point yet. So the key was to link infrastructures and make sure there were no loopholes so that competition was seen as fair. There should be common standards for risk management in clearing. But there should not necessarily be one consolidated infrastructure – that would pose many potential risks, Ms Kauppi added.

"The infrastructure should be European and I do not say that lightly. I am a true fan of international and open standards, but this is critical, politically, for Europe." She was concerned that the end users had yet to see any benefits of MiFID even though unit costs had come down. The industry had started to feel the effects, but ordinary citizens had been untouched so far.

On the transatlantic debate, Ms Kauppi lauded the Commission for having created a dialogue and a culture of mutual trust. This must now be used to create a level of convergence and greater mutual recognition. The momentum to create a US-European axis was now, because other financial centres, particularly those in Asia and the Middle East, would occupy the vacuum if it were not filled. It was not just a question of transatlantic clearing, but clearing in Shanghai, Dubai and elsewhere that was up for grabs. "The window is open now, let's not wait until it is shut again," Ms Kauppi added.

There had been progress made on many fronts, said **David Wright**, Deputy Director General, DG Internal Market and Services, European Commission. There had been great steps forward in competition and in the growth of capital markets. The US landscape had been forced to change to keep pace after the advent of MiFID. MiFID, in particular, had been a resounding success. "I have not had armies of lobbyists and firms saying they cannot do cross-border business, so something must be right," Mr Wright said. But the missing element revolved around the complexity of post-trade. Even there, progress had been made and transparency had improved. By the end of the year, the Commission hoped to be able to post real and comparable prices on its website so the market could see how much each firm was paying and in which market. This would create pressure for further competitive change, he said.

Interoperability was also a difficult subject. The industry had to realise that the Code did not belong to the Commission or the Parliament, but to the industry and it represented the acid test of whether the industry was able

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to regulate itself. "If the industry can't deliver, policy makers will draw their own conclusions," Mr Wright said.

While costs were coming down, there was not currently enough competition to continue that process. The logical outcome was a pan-European horizontal clearing mechanism but the market needed to achieve that for itself. The competition authorities would judge the progress and view with a critical eye whether blocking mechanisms were being put in place or whether there was sufficient focus on delivery. "Neither are there acceptable excuses for a lack of progress on interoperability," said Mr Wright. With the industry facing huge losses due to the current state of markets, he could see why they might wish to avoid incurring costs at the moment, but this would be a mistake. The economies of scale achievable in clearing and settlement would outweigh the short-term costs, he believed.

On transatlantic co-operation, the Commission wished to move forward on creating mechanisms for mutual recognition, but this was not a simple process. The US had launched a pilot scheme with Australia and was currently testing that. This showed a more outward-looking approach from the current SEC. The opportunity should be seized because it was not clear what the outlook of the SEC would be under a new US administration.

Gertrude Tumpel-Gugerell, Member of the Executive Board, European Central Bank (ECB), agreed with the majority of speakers that it was time to become more impatient about the general lack of progress. The ECB's preoccupation was to help overcome fragmentation and bring down industry costs, she said. TARGET2-Securities (T2S) would contribute to this and would be a catalyst for harmonisation. But the size of the task of harmonisation should not be underestimated. All forces needed to act together to bring it about. "A political push could also be helpful in this respect," Ms Tumpel-Gugerell said.

In securing a more competitive marketplace, it was necessary to rethink the risk involved, particularly the robustness and resilience of the infrastructure and the possible need to revise the regulatory framework in light of the growing interdependencies of national capital markets. Work was being done on this under the auspices of Ecofin and this should be finalised soon. "This is important, because we have seen how quickly problems can spread from one market to another," said Ms Tumpel-Gugerell. "So the development from a more systemic perspective is important," she added.

Ms Tumpel-Gugerell thought that a balance was necessary between regional and global needs and that this could be brought by interoperability between regional EU and US infrastructures. There should be interoperability of regional infrastructures, not necessarily a single global infrastructure. The greater integration of US markets and consolidated infrastructure had helped bring some cost savings to Europe too. But there was no obvious way of overcoming the question of fragmentation in Europe.

For co-operation to work, supervisors in Europe needed to change the way they worked. There needed to be some common regulatory views to aid dialogue with the US. Transatlantic infrastructures indeed required establishing effective cooperation arrangements and partnerships among supervisory authorities to develop common practices without losing sight of regional priorities. Looking into the future she thought that a kind of European SEC would be particularly helpful in dealing with US authorities. After all, consolidation and integration in the US markets had not happened entirely by themselves, they had required help by the authorities, which had imposed clear deadlines and responsibilities.

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