

To get to the heart of the real issues

The evolution of securities post-trading activities in Europe

Luxembourg - 10 March 2005

The evolution of post-trading activities is a major challenge for EU market players and policy makers

Activities	Players
Trading	Stock Exchanges Broker Dealers
Post-trading	
Clearing	CCP Brokers Dealers
Settlement	CSDs, ICSDs Banks
Registrar	CSDs Banks Registrars
Related banking services	CSDs, ICSDs Banks

- Huge stakes:
 - Fragmentation within EU but some significant concentration initiatives (Euroclear, Clearstream, NCSD...)
 - Cross border trades support extra-costs estimated between 1,6 and 5 B€
 - Target II roll out in the Euro zone
 - Many initiatives:
 - Cesame Group, Legal Certainty Group, Fiscal compliance Group
 - Andria report, communication of the Commission, Th. Villiers report, CESR/ECB standards
 - On-going initiatives to remove the 15 technical, legal and tax related barriers identified by the Giovannini group
 - Lack of consensus among market players on:
 - Possible evolutions of the market
 - Risk and competition stakes and related requirements
 - Need for a EU regulation
- ▼
- EUROFI study to:
 - Provide a complete and objective review of the status of securities post-trading issues
 - Identify avenues and methods for achieving progress
 - Define if possible, a short and medium term vision

3 key questions to address the issues prioritized by the participants to the study (12 Institutions)

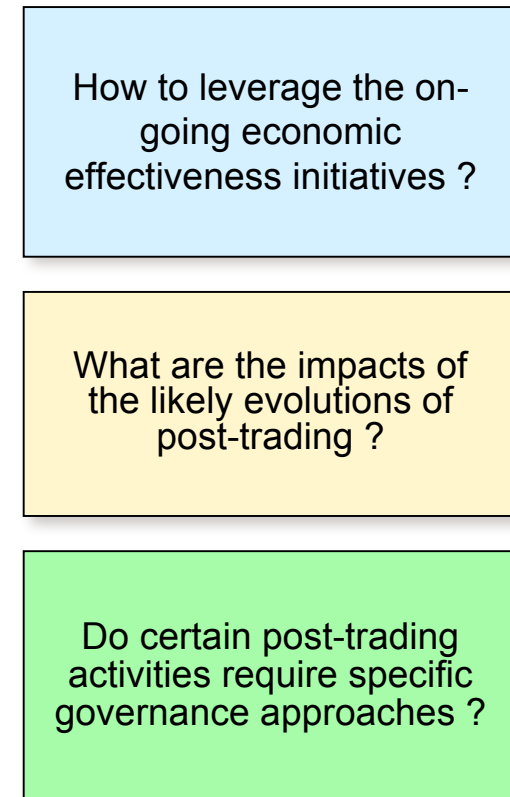


69 issues organized around 5 themes

by Brokers Dealers, domestic and global Custodians, domestic Retail Banks, Investors and Issuers, (I)CSDs



3 key questions



The on-going Giovannini process is beneficial and essential, but additional actions are necessary to ensure support from all the stakeholders



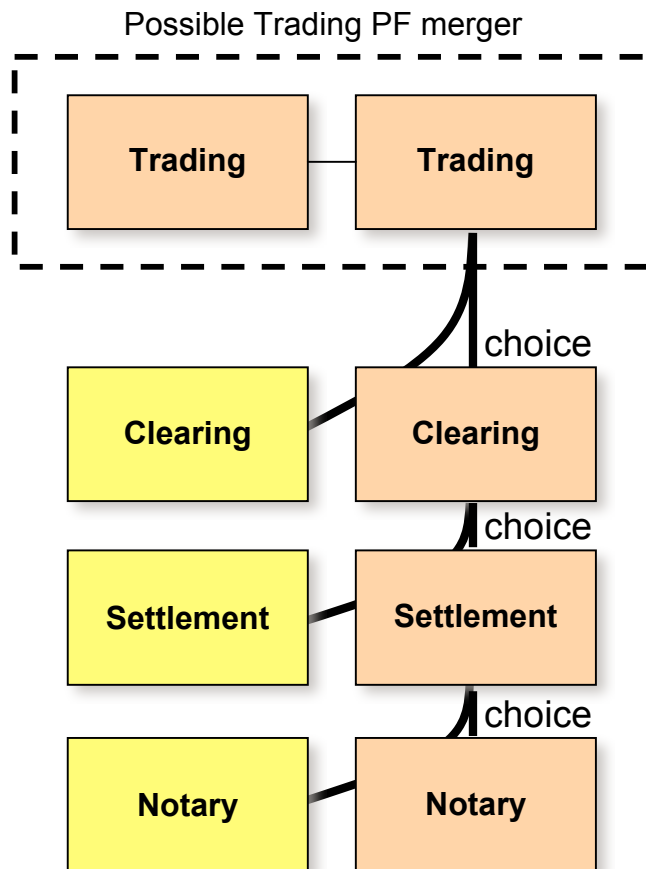
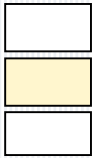
Beneficial on-going initiatives...

- **On-going EU initiatives are recognized as essential by all market players :**
 - Cesame Group, Legal Certainty Group, Fiscal compliance Group...
- **Progress has already been made :**
 - Removing certain barriers
 - Putting forward a certain number of additional market-led initiatives

...that need support from all stakeholders

- **Widespread understanding of the stakes needed among all market players** including domestic retail custodians that do not always see the benefit at this stage
- **Mobilization of political representatives of Member States** to transform the “table of actions and deadlines” identified in the second Giovannini report into a binding timeframe
- **Make integration of the European Financial Market attractive for individual investors,** taking into account in particular the necessary evolution of the funds market

Giovannini barriers removal, Target II rollout and trading platforms mergers discussions suggest focused interlinking



Likely evolution scenarios

- Option 1 : regional hubs
- Option 2 : regional hubs with systematic interlinking (spaghetti model)
- Option 3 : increased use of a few key links between regional hubs**

Most likely evolution ?

The economic viability of option 3 has to be assessed*

- What could be the relevant scope of interlinking ?
- What are the technical impacts and what is the underlying timeframe ?
- What are the investments required ? Who pays for those investments ?
- What is the business case (investments required, network effect, economy of scale, impact on the vertical silo model, expected impact on price levels...) ?
- What are the potential casualties (e.g. possible impact on domestic intermediaries and small players) and do market players accept them ?

Some participants to the study put forward the need to review the specific stakes related to post-trading activities



- **Beyond the improvements in the economic efficiency of the post-trading market, some participants identified additional issues on risk, competition and governance requirements. These issues are closely related to the nature of the post-trading activities concerned:**
 - For the activities they consider as "core" :
 - specific regulatory and governance requirements and unbundling should be imposed
 - users are legitimate to recommend the necessary requirements
 - For other activities, it is up to the boards or user groups to manage such issues, as long as there is no systemic risk involved
- **For other participants, the distinction of “core” activities is not relevant and the focus should be put on “where and how do we want to go”. Possible risk, competition and governance concerns should be analysed and addressed on these potential future scenarios**



• **"Core" activities** are those for which the players have no substitute to operate in the market

- **Regardless of the post trading integration process, some participants consider that risk, competition and governance issues already exist and should be addressed as they impact the on-going consolidation process**

For settlement and registrar activities a heated debate opposes (I)CSDs to Custodian Banks and Sub-Custodian Banks. A further in-depth assessment is necessary at the level of each country.



Post-trading activities

« Core » activity ?

Clearing

Yes for certain markets

Settlement

Disagreement



Registrar

Disagreement

- **CSD Settlement is core to the securities market**
 - Settlement is essential for end-users and intermediaries to finalize trades
 - CSDs have been set up in all major EU markets to enable trades to be settled. Financial Institutions can choose their custodian to access the CSDs, but only CSDs have all the counterparties in their books, making CSD settlement a « core » activity for the market.
 - Settlement outside CSDs may exist (book entry settlement) in some markets, but it is marginal, incidental and fragmented among many intermediary institutions (Banks, Broker Dealers, Investment Firms); so this cannot be considered as an alternative to CSD settlement.

- **CSD Settlement is not core**
 - Custodian Bank Internal book entry can be a substitute to CSD settlement in many EU markets
 - CSDs are in a competitive market

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Post-trading activities

« Core » activity ?

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Registrar

Disagreement



• Registrar is core to the securities market

- Having the guarantee of the existence of the securities is necessary to ensuring investors protection.
- The common tracking of ownership enables issuers to have a clear view of who has rights against them and to whom they owe obligations
- Although the arrangements can differ from a country to another, a common vision of ownership is performed through a central tracking or through a mirror common tracking (Crest) and this is considered as a “core” activity

• Registrar is not core

- Registrar can be considered as a “core” activity for ISSUERS once they have decided that they want to get their finance from issuing securities and have also decided which security to issue and which investors to target.
- The registrar function is organised differently in each country and should be therefore analysed separately for each individual country. As a consequence for example these activities are not always carried out exclusively by one single type of organisation or by one central single entity

Opinions on the stakes of post-trading activities and related evolution are very diverse and are reflected by 4 main positions



	Position 1 Removal of Giovannini barriers is sufficient	Position 2 More effective involvement of users	Position 3 Regulation of certain post-trading activities needed but no target model	Position 4 Regulation of certain post-trading activities needed as well as input on target model
Giovannini process sufficient	Yes		To be completed on risk and competition issues	
Existing requirements sufficient	Yes – Enforce existing legislation	Improve user involvement	Specific requirements needed on risk and competition issues	
Enforcement approach	Market or Governance driven Ex-post intervention		Ex-ante regulation	
Need for political action	No – Existing initiatives and regulations are sufficient		Yes - To provide the conditions for an EU- wide safe integrated market where competition can thrive	Yes - No political action leads to irreversible monopoly in post-trading related banking activities
Need for a target structure	No	Proposed by users	No – If specific risk and competition requirements are defined	Yes - Input to be given to EU policy makers

The « evolution of securities post-trading activities in Europe » study is performed by ADS Consulting and ICME Management Consultants on the behalf of Eurofi

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- ADS Consulting and ICME Management Consultants cooperate in the field of Financial Services to help financial institutions and market place associations better anticipate and leverage the on-going evolutions of the financial and capital markets in the EU such as:
 - Securities post-trading activities
 - Pan-European payment systems
 - Development of a European retail marketplace
 - ...
- In particular, they help their clients to prepare the strategic and operational changes triggered by the evolutions of the EU marketplace:
 - Understanding of related stakes
 - Strategic positioning
 - Preparation and implementation of changes with the operational teams
- ADS Consulting and ICME Management Consultants operate throughout Europe out of offices based in France, Switzerland and Germany

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