

Pricing policy of central post-trading service providers

Executive summary (May 2006)

Context and objectives of the study:

The objective of this study was to evaluate with a representative panel of users (investment banks, broker dealers, custodians) the pricing practices of EU securities post-trading central providers (CCPs, CSDs and ICSDs) and to recommend possible progress areas. It complements the existing studies by highlighting the point of view of users on these issues.

The scope of this study covers a representative group of EU countries: UK, Germany, France, Belgium, NL, Italy, Spain, Switzerland, Poland, Austria and is focused on domestic bonds, equities and Eurobonds. Concerning ICSDs our analysis is limited to the services for which ICSDs act as infrastructures (settlement and central deposit of Eurobonds) and the impact that the banking services they provide (cash and securities financing in particular) can have on the pricing of these activities.

This study was monitored by a representative group of post-trading central provider users: Bank of New York, BNP Paribas, Citigroup, Crédit Agricole (CACEIS), HSBC, JPMorganChase, Société Générale, Unicredito / HVB / BankAustria CreditAnstalt and chaired by Andrew Crockett.

Main conclusions of the study:

1. The total costs incurred by different types of users need to be taken into account when analyzing the prices of post-trading central providers:

Direct infrastructure costs related to clearing, settlement and safekeeping fees represent only part of the total external post-trading costs incurred by users. To these fees must be added indirect fixed or variable fees (membership, reporting and queries, connectivity,...), cost of capital or collateral needed to operate with a CCP, CSD or ICSD, additional opportunity costs such as the lack of compensation for mistakes made and for investment banks cash and securities financing costs (ICSDs and certain CSDs). In addition users incur the internal costs related to their back office operations.

As a result settlement and safekeeping fees only represent 30% of the average external costs of an investment bank within an ICSD.

2. Prices of the central providers part of the scope have generally not been significantly reduced for users over the last 3 to 5 years despite processing optimizations and partial consolidation (1):

The historical evolution of prices between 2000 and 2005 shows in particular that neither horizontal consolidation (eg Euronext / LSE zone central providers) nor vertical silo organizations (eg Deutsche Börse Group) have enabled so far to reduce post-trading prices significantly for users.

3. The profits made by the central providers surveyed appear to be quite high for companies that run a relatively low risk business in a centralized way and users consider that they do not benefit at present sufficiently from these profits:

- Direct and indirect fees have not significantly gone down on average during the last 3 to 5 years and user rebates are only distributed by a limited number of central providers
- Distribution of dividends cannot be considered as a direct cost reduction factor for users as ownership and usage are not aligned
- The positive impacts for users of investments related to platform developments are usually presented by infrastructures as potential back office cost reductions but these future savings are difficult to evaluate and are partly offset by the investments required to adapt their back offices.

4. Users consider not to benefit from enough information or leverage on pricing decisions at present to have an impact on the level of prices charged by post-trading central providers:

The public information (financial statements, pricing policy), when available, is considered insufficient at present to enable users to assess the reasonableness and equitability of prices. In addition, it is not possible to draw conclusions from the direct comparison of pricing schedules across different markets due to the differences in scale and scope of the markets and to the heterogeneity of schedules.

(1) Users part of the panel are aware of certain recent price reductions decided in 2006 (for example reduction of Eurobonds safekeeping fees by Euroclear)

Users part of our panel consider also not to be sufficiently involved in the pricing decisions of the central providers surveyed in most cases to have an impact on pricing decisions (no formal regular price consultation process, insufficient consultation on price changes in many cases).

5. It can be argued that the competitive advantage enjoyed by ICSDs in the form of a de facto duopoly regarding infrastructure activities (such as Eurobonds settlement and central deposit), provides an advantage in competitive markets (ie commercial services) that could impact prices.

ICSDs are considered to be in a favourable position to sell to their customers (who buy settlement services) securities financing services for which they compete with banks. This could potentially lead to cross-subsidies between the activities where ICSDs act as central providers with a de facto duopoly (settlement and central deposit) and the commercial activities they sell (cash and securities financing services).

Recommended actions that could have an impact on the pricing policy of post-trading central providers:

Recommendations are focused on proposals that could have a strong impact on prices independently from potential changes in the structure or overall governance of the post-trading market or from progress made in the lifting of the Giovannini barriers. As a result they are mainly focused on increasing the transparency of central providers and on clarifying and increasing the involvement of users in decision processes related to pricing.

We have distinguished recommendations according to their estimated feasibility.

1) Recommendations considered feasible in the short term:

- Generalizing the public availability of fee schedules to all including non-members
- Generalizing the availability of pricing policies to all including non-members describing the pricing methodology and rationale and articulating any principles of equitability between different user segments based on usage of services
- Systematic disclosure of the breakdown of revenues by main services provided (eg settlement, safekeeping, connectivity, reporting, membership fees and other services (1))
- Setting up a formal consultation process within each central provider involving representative users to (i) validate pricing schedules and (ii) discuss specific decisions that impact prices and infrastructure costs with the related business case. This consultation could take place either through existing user groups or user groups to be set up and would require the clarification of the governance of user groups related to pricing issues

2) Recommendations considered feasible in the medium / long term recognizing potential technical or political feasibility issues:

- Disclosure of the breakdown of costs by main services provided and of the breakdown between recurring costs and investments (2)
- Transparency of the rebates distribution policy (calculation and allocation) and of the balance between rebates and dividends distributed
- Clarity in the policy of board composition and selection
- Clarity in the roles of the management, the board and users in the determination and validation of prices

(1) To be detailed further if necessary

(2) Users part of the panel acknowledge that this recommendation raises significant technical feasibility issues that need to be investigated further. In particular an appropriate and transparent methodology and commonly accepted accounting principles need to be developed and disclosed to produce figures that accurately reflect the reality.

If the feasibility issues mentioned above can be solved users consider it would be possible and useful that central providers publish P&Ls by main standard activities eg infrastructure services (clearing, settlement, safekeeping) and other services.