



**Restrictions on the location of clearing and settlement  
in the EU government bond markets**

**Summary**

1. As part of its tasks to promote further the integration and better functioning of EU government bond markets, the EFC has been invited to provide its opinion regarding obstacles in clearing and settlement possibilities in the primary markets and related restrictions, which was one of the barriers identified by the so called Giovannini Group (Barrier 10). These issues are being addressed by the Commission in response to the mandate by the Ecofin Council in November 2004.<sup>1</sup>
2. Restrictions on clearing and settlement activities in the primary markets exist in most Member States.<sup>2</sup> While these restrictions have not been seen as major obstacles to financial integration of the bond markets as such, they may cause inefficiencies and **should be removed as part of the overall efforts to reduce barriers and to create safe and efficient integrated financial markets**. Any restrictions on clearing and settlement activities in the primary or secondary market cannot be removed in isolation, but only in a broader context also considering restrictions related to rules and regulations in securities markets.

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<sup>1</sup> The Ecofin Council identified that developing clearing and settlement functions for securities transactions should be a key priority area in developing the EU financial markets. The Commission was invited propose possible actions and prepare an impact assessment on how to overcome the specific barriers. In this context, the Commission established three working groups. See annex 1 for further background to about the request made to the EFC.

<sup>2</sup> Annex 2 specifies the existence of these restrictions in the EU Member States.

## Assessment

3. In a large majority of the Member States, government securities markets are based on a **Primary Dealer (PD) system**. Even in Member States where primary dealerships do not formally exist, relations between the government debt management office and its counterparties in the primary market are determined by some type of formal arrangement. Accordingly, while Barrier 10 refers specifically to PDs, the scope of the barrier can be interpreted as applying to all active dealers in the primary markets for government debt. **This broad definition implies that Barrier 10 is relevant to all 25 Member States**, including those which do not have defined primary dealer arrangements in their government securities markets.<sup>3</sup>

4. Most EU government issuers currently have a majority of international primary dealers in their government bond markets and there is a corresponding trend among dealers towards participation in multiple markets. In light of this growing cross-border dimension, the issue of national restrictions on clearing and settlement activities in the government debt markets was identified as a barrier to financial integration in the Giovannini Reports. In order to establish the nature and extent of the barrier 10, a stock-taking was carried out among the EU Member States in 2005, with a request to *describe the relationship between their national debt management office and primary dealers and, more specifically, to highlight the existence of any restrictions on the location of clearing and settlement activities in their government bond markets*.

5. In the examination, the Member States were broadly categorised as follows: (a) those where settlement of primary market and secondary transactions in government

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<sup>3</sup> The Giovannini report determines the Barrier 10 as follows: the “*Restrictions on the activity of primary dealers and market makers requiring the setting-up of local securities operations and the settlement of primary market transactions in the local settlement system. Such restrictions prevent primary dealers and market makers whose activity spans several markets from centralising their settlement in fewer systems. The inability to centralise cross-border settlements raises the cost of their operations because they are prevented from using their preferred settlement location for these operations and, by implication, they must bear additional expense of settlement in a remote Central Securities Depository (CSD). National restrictions on the activities of primary dealers and market-makers are difficult to justify in the context of an integrated EU financial system, where market making across borders will become the norm. Accordingly, member states should re-consider the need for such restrictions and take the necessary steps to remove them.*”

bonds is restricted to the local settlement system; (b) those where settlement of primary market transactions only is restricted to the local settlement system; (c) those where settlement of primary market transactions takes place exclusively in the local settlement system but no formal restrictions apply; and (d) those where settlement of primary market transactions takes place via multiple settlement systems. An overview of current restrictions on market participants by Member State is presented in the Annex 2.

6. On the basis of the stock-taking, it is evident that clearing and settlement activities in the primary market are **restricted in the majority of the Member States**. Such restrictions derive either from a (1) formal obligation to clear and settle government securities transactions in the local system or from (2) technical difficulties in linking the local system to other systems located outside of the Member State. To a lesser extent, such restrictions are also to be found in secondary markets.

7. In more general terms, key infrastructures for the trading of bonds, depository and registry services as well as the settlement of transactions remain largely based on domestic infrastructures, and efforts have been taken in recent years to build inter-linkages within the EU. A smoothly functioning clearing and settlement infrastructure is essential to the efficiency of a government bond market, where inadequacies imply not only higher transaction costs but also considerable risk. In this respect, the government bond market is no different from other securities markets.

8. Historically, the clearing and settlement system for the government bond market has been established as an independent system devoted only to government securities with all transactions cleared and settled in that system. In more developed financial systems, however, there may be scope to move to a more integrated system (i.e. providing settlement for several securities markets) and this has been a particular feature of EU Member States – although the nature of integration reflects ownership structure rather than the creation of single settlement platforms. In many Member States, the concentration of clearing and settlement of government bond transactions in a single national system continues. This was an efficient arrangement

in the context of segmented markets. As the government bond market is among the most integrated markets in the EU – giving rise to high investor demand for cross-border transactions – segmentation in the location of clearing and settlement is a source of inefficiency. This applies not only to the primary market, but also more broadly. In the context of further development in this area, the relatively higher technical efficiency of more integrated clearing and settlement must be assessed against the economic efficiency, level playing field, transparency as well as soundness and security aspects.

### **Conclusions and next steps**

9. In assessing the rationale for the remaining restrictions on the location of clearing and settlement activity in government bond markets, it is noted that many Member States already have taken steps to remove barriers, but many of the remaining restrictions relate to rules and regulations applying more broadly to securities markets. These rules and regulations relate, in particular, to securities registration and tax compliance. They could not envisage any specific reason why restrictions on the location of clearing and settlement activity in government bond markets would be needed, if the objectives of these broader rules and regulations could be accommodated otherwise.

10. Accordingly, **restrictions on the location of clearing and settlement in government bond markets, to the extent that such restrictions exist in Member States, should be removed as part of a broader reform of clearing and settlement arrangements at the EU level that maintain competition, the provision of adequate market information and the highest standards in terms of soundness and security.**

11. As a next step, in order to ensure progress, the EFC invites the Commission and Financial Services Committee to take the outcome of this examination into account in considering further actions in the area of clearing and settlement; and its Sub-Committee on EU Government Bonds and Bills markets to monitor the development as regards bond markets - and prepare further analysis if needed.

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## **Annex 1: The Giovannini Barriers and the ongoing work by the CESAME Group**

The Giovannini Group has published two reports on the arrangements for clearing and settlement in EU securities markets.<sup>4</sup> Responding to problems of segmentation among the various national post-trading systems, the first report (2001) identified 15 barriers to creating a more integrated and efficient clearing and settlement industry. These so-called “Giovannini barriers” relate to market practice/regulation, legal certainty and taxation, and the responsibility for removing them is shared between the public and private sectors. The second report (2003) returned to the 15 barriers and laid out a strategy and timetable for their removal. The strategy reflected several considerations, including the need to prioritize among barriers and the need to properly sequence their removal insofar as they may be inter-related. A further consideration in designing the strategy was the importance of identifying clearly the specific action(s) required to remove each barrier and allocating responsibility for these action(s) to the appropriate private-sector or public-sector agent(s).

Since the publication of the second Giovannini Group report, the Commission has established its approach to integration of the EU clearing and settlement industry on the basis of a broad public consultation. Work is currently underway within the Commission services on assessing the need for legislative action at the EU level.<sup>5</sup> More specifically, a standing group of industry experts and EU officials – the Clearing and Settlement Advisory and Monitoring Expert Group or CESAME - has been established to monitor efforts to eliminate the 15 barriers and to provide technical input to the Commission’s thinking on matters relating to clearing and settlement. The CESAME has met at regular intervals since mid-2004 and has witnessed the first steps to remove many of the barriers in the areas of information technology interfaces and market practices.<sup>6</sup>

In the context of the CESAME’s work, the EFC Sub-Committee on EU Government Bonds and Bills Markets was invited to report on the Giovannini Barrier 10, which relates to the existence of restrictions on the clearing and settlement activities of primary dealers and market makers in EU government bond markets. In this sense, Barrier 10 can be regarded as a specific manifestation of Barrier 2, which relates more generally to restrictions on the location of the clearing and settlement activities of financial market participants.

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<sup>4</sup> The Giovannini Group consists of private-sector experts, under the chairmanship of Alberto Giovannini, which advises the European Commission on matters relating to the evolution EU capital markets. The Group published two reports entitled “Report on Cross-border clearing and settlement arrangements in the European Union” (2001) and “Second Report on EU Clearing and Settlement” (2003), respectively.

<sup>5</sup> In 2004, the Commission published a Communication to the Council and Parliament entitled “Clearing and Settlement in the European Union: The Way Forward”. Based on responses to that consultation, the Commission services are preparing an impact assessment to determine whether Community legislation is necessary and justified to promote a more integrated EU market for clearing and settlement services.

<sup>6</sup> Two additional groups have been established to focus more specifically on the removal of barriers relating to legal certainty and taxation.

**Annex 2: Restrictions on the location of clearing and settlement activities in EU government bond markets.**

Issuance into Domestic CSD			Issuance into multiple systems, incl. ICSDs
Restrictions in primary and secondary markets	Restrictions in primary market only	No restrictions	
Cyprus Czech Republic Greece Spain Latvia Lithuania Poland Slovakia Slovenia	France Finland Sweden UK Hungary Malta Italy	Belgium Estonia <sup>7</sup> Ireland Germany Luxembourg	Austria Denmark Netherlands Portugal

<sup>7</sup> Estonia has not disclosed any restrictions on the clearing and settlement activities due to the fact that Estonia is not at all active in the market for past few years and also in the near future and in addition, there were no set practices in the earlier times on the subject when Estonia was issuing.