



Giovannini Barrier 10

Mark Austen

European Primary Dealers Association

Clearing and Settlement Advisory and Monitoring Experts'
Group

12 June 2006

EPDA Mission

EPDA Mandate

- Provide a representative forum for EMU government primary dealers
- Address, seek consensus and resolve primary and secondary market issues in EMU government bond markets
- Focus on integration and efficiency of European government bond markets

EPDA Objectives

Consult with key market participants, including EU DMOs/Treasuries, Central Banks, EU Commission and ECB on:

- Recommendations for efficient primary market procedures and practices
- Promotion of an efficient, integrated, transparent and liquid secondary market
- Providing best practice recommendations
- Issuing comment letters on regulatory and legal proposals
- Information, education and research projects and conferences

EPDA Governance

- **EPDA Members**

Voting Members are entities who act as Primary Dealers (“PDs”) in at least 3 EMU countries (one of which must be either France or Italy), in addition to assumed activity in the German market; they represent over 85% of dealer volume in Europe. Other PDs can join as Members.

- **EPDA Leadership**

Co-Chairmen: UBS & JPMorgan
Treasurer: HSBC

- **EPDA Resources**

- 8 professional and 6 support staff
- Competition and regulatory counsel from Clifford Chance
- Office and conference facilities in London

21 EPDA Executive Members

Executive members represent 164 dealerships in the EMU

- | | |
|---|--|
|  ABN Amro |  ING Bank |
|  Barclays Capital |  J.P. Morgan |
|  BNP Paribas |  Lehman Brothers |
|  Calyon |  Merrill Lynch |
|  IXIS CIB |  Morgan Stanley |
|  Citigroup |  Nomura Securities |
|  Credit Suisse |  RBS |
|  Deutsche Bank |  Société Générale |
|  Dresdner Bank |  UBS |
|  Goldman Sachs |  Unicredit Banca Mobiliare |
|  HSBC | |

15 EPDA Clearing and Settlement Working Group

Representatives from Operations (Clearing and Settlement) departments

 **Barclays Capital**

 **HSBC**

 **BNP Paribas**

 **ING Bank**

 **IXIS CIB**

 **J.P. Morgan**

 **Citigroup**

 **Lehman Brothers**

 **Credit Suisse**

 **Merrill Lynch**

 **Deutsche Bank**

 **Nomura Securities**

 **Dresdner Bank**

 **UBS**

 **Goldman Sachs**

Barrier 10

Giovannini Barrier 10 (“Barrier 10”)

- “National restrictions on the activity of primary dealers and market makers”
- One of the barriers related to technical requirements and/or market practice
- Interpretation: impediments imposed on a country-specific basis by the debt management offices/treasuries which hinder the seamless functioning of the market

The EPDA Project

EPDA Project

- Identify primary and secondary market national restrictions on Primary Dealers with respect to clearing and settlement
- Follow on from our February 2006 presentation to the Cesame group where we described the current practices within the space of clearing and settlement in the Euro-zone for fixed income instruments
- We surveyed 25 countries, however, the focus inevitably is on the larger volume players; the results have been distributed
- We reviewed contracts required to be executed by Primary Dealers and/or DMO regulations, where available
- We also surveyed market participants with a view to identifying practical non-legal impediments to seamless clearing and settlement which stem from national restrictions

Countries Surveyed



Austria



Belgium



Cyprus



Czech Rep.



Denmark



Estonia



Finland



France



Germany



Greece



Hungary



Ireland



Italy



Latvia



Lithuania



Luxembourg



Malta



Netherlands



Poland



Portugal



Slovakia



Slovenia



Spain



Sweden



UK

Format of the Presentation

Direct Barrier 10 Impact

- Observations regarding national restrictions that impact on Primary Dealer clearing and settlement activity
- Recommendations on removing country specific obstacles and on improving market practice

Indirect Barrier 10 Impact

- General observations regarding national restrictions that impact on Primary Dealer clearing and settlement activity

General Observations

- Although we aim to be inclusive of all EU Member States, due to the later accession of the new Members, it is inevitable that the original EU Members have had more experience in those markets
- The traditional large players attracted the largest amount of comments
- Most countries have established a system of primary dealership
- Certain countries, including Germany of original 15 EU Member States (the “original 15”) and many of the new accession states, operate without such a system

Direct Barrier 10 Restrictions on Primary Dealer Activity

- Direct Restrictions on Primary Dealer activity are of two types (i) expressed legal restrictions found in contracts, regulations or evaluation criteria and (ii) *de facto* restrictions which arise out of market practice and/or perceptions.
- To identify the particular national restrictions we (a) reviewed Primary Dealer contracts, regulations or evaluation criteria on a country-by-country basis and (b) examined actual market practice.

Direct Barrier 10 Restrictions on Primary Dealer Activity (cont)

Primary Market Settlement – The Issue

- Most Member States require that Primary Dealers to settle primary issuance transactions (through auctions or syndications) in the domestic system.
- A few Member States impose requirements that a Primary Dealer have a local account if acting on the primary market.
- This provides a preference for local settlement over other ICSDs or CSDs.
- This requires Primary Dealers to move bonds/cash (sometimes through an agent) to the ICSDs if acting on the primary market for onward movement to the ultimate customer, which can be inefficient and costly.

Direct Barrier 10 Restrictions on Primary Dealer Activity (cont)

Primary Market Settlement – The Solution

- Certain Primary Dealers recognise the benefits of the use of central bank money in this process.
- More flexibility in settling the bonds in the ICSD systems after an auction or syndication would be welcomed.
- The Euro-zone market should be structured in such a way that accounts could be used interchangeably; where allocations are taken ought to be of no significance but should be the prerogative of the particular dealer where it does not impact on the safety or security of the system.
- Primary Dealers would welcome discussions with the DMOs/Treasuries in this aspect.

Direct Barrier 10 Restrictions on Primary Dealer Activity (Cont'd)

Secondary Market Trading Platforms – The Issue

- Primary Dealer evaluation criteria frequently specify or give preference to volume traded or market making in the secondary market on a particular trading platform in the overall evaluation of weighted market activity. The evaluation impacts their ability to retain their status of Primary Dealer.
- Primary Dealer evaluation criteria/contracts may either directly designate a particular platform, or indirectly designate one by taking into account only, or giving preference to, activity effected on authorised markets (e.g., a “regulated market”) for which in practice only one (or occasionally two) platform(s) have been so authorised.
- Primary Dealer evaluations (and their resulting rankings) are important as they, in turn, may affect future allocations (e.g., syndications, privatisations) and the DMO-Primary Dealer relationship.
- Where volumes are concentrated by actions of the DMOs/Treasuries, the clearing and settlement solution selected by the authorised platform is indirectly favoured in that market.
- The European Commission – DG Competition has recently acknowledged this issue in “Competition in EU securities trading and post-trading – Issue Paper” released on 24 May 2006.

Direct Barrier 10 Restrictions on Primary Dealer Activity (Cont'd)

Secondary Market Trading Platforms – The Solution

- Review together with DMOs the necessity for such practices including whether proper monitoring can be achieved cost effectively and efficiently across many platforms
- Remove barriers to effective competition where they are not justified so that equal treatment is given to all secondary market volumes and market making requirements on all trading platforms
- PDs should be able choose the platform on which they wish to make markets to encourage competition, reduce costs, improve technology and innovation
- “Split” liquidity is avoided by real-time commercialised data disclosure to the market via data vendors, and by the common practice of Primary Dealers to aggregate prices from various trading platforms on one screen of a trader’s desk
- Trading platforms should encourage the effective building of links/bridges between ICSDs and CSDs so their members can settle across various institutions

Direct Barrier 10 – Restrictions on Primary Dealer Activity

Other Observations

- Auto-lending and auto-borrowing requirements are not uniform across Member States.
 - Some Member States “*recommend*” that Primary Dealers become auto-lenders, which is burdensome as firms are compelled to allocate extra resources to this activity.
- Lending Agreements between DMOs and Primary Dealers don’t always conform to the market standard agreements such as GMRA, GMSLA. Firms then need to put additional resources into the execution of, and compliance with these non-standard agreements.

Table – Primary and Secondary Market Restrictions

| | Primary Market Restrictions | Secondary Market Restrictions |
|-----|-----------------------------|-------------------------------|
| AU | ✓ | ✗ |
| BEL | ✓ | ✓ |
| CYP | NA | NA |
| CZ | NA | NA |
| DEN | ✓ | ✓ |
| EST | NA | NA |
| FIN | ✓ | ✓ |

| | Primary Market Restrictions | Secondary Market Restrictions |
|-----|-----------------------------|-------------------------------|
| F | ✓ | ✗ |
| GER | ✓ | ✗ |
| GR | ✓ | ✓ |
| H | ✓ | ✓ |
| I | ✓ | ✓ |
| IRE | ✗ | ✗ |
| LAT | NA | NA |

Table – Primary and Secondary Market Restrictions

| | Primary Market Restrictions | Secondary Market Restrictions |
|-----|-----------------------------|-------------------------------|
| LIT | NA | NA |
| LUX | NA | NA |
| MAL | NA | NA |
| NL | ✓ | ✓ |
| POL | ✓ | ✓ |
| POR | ✓ | ✓ |

| | Primary Market Restrictions | Secondary Market Restrictions |
|-----|-----------------------------|-------------------------------|
| SLV | NA | NA |
| SLN | NA | NA |
| SP | x | ✓ |
| NL | ✓ | ✓ |
| SWE | ✓ | ✓ |
| UK | x | ✓ |

- ✓ Restrictions to the market
- x No restrictions to the market
- NA Non applicable

Indirect Barrier 10 – Restrictions on Primary Dealer Activity

General Observations

- Settlement Days Inconsistencies - (e.g., T+ 2 or T+3) both for T-Bonds and T-bills, across instruments and across countries
- No uniform settlement deadline – need to comply with different standards, some deadlines “soft” and others “hard”
- Settlement circles work well only in circumstances where all trades settle domestically – ICSDs and CSDs work differently: *i.e.*, each has different infrastructure and set-up which impacts how it does business
- Interest Accrual - differences in interest accrual methods (e.g., Actual/Actual vs. Actual/360)
- Improved links between the two ICSDs (Euroclear and Clearstream) - links are not seamless enough; preference for real-time until late in the day; client firms still face (i) credit risk and (ii) credit line issues
- Withholding tax variations - uniform procedures and the possibility to gross-up (in all jurisdictions) would smooth out the process

Barrier 10 – Conclusion

Direct Barriers

- Removal of unjustified barriers, within the Primary Dealer criteria/contracts, which undermine a cost-effective, efficient, safe and secure harmonised European clearing and settlement system
- EPDA prepared to work with the DMOs/Treasuries in identifying barriers and solutions thereto

Indirect Barriers

- These differences are not national “restrictions” *per se*. However, to the extent that they create a hindrance to perfectly smooth market functioning, they deserve attention since they vary from country to country