

# CESAME Group

## Synthesis Report of the meeting held on 24 October 2005

### 1. INTRODUCTORY ADDRESS AND INITIAL COMMENTS

The Chairman welcomed the group members to the fifth CESAME Group meeting appreciating their continuous support. Postings of CESAME documents on the internet continue to show many hits and as before, all meeting documents will be available on the website after the meeting.

He reminded members that timing is becoming crucial as over the next six months policy choices have to be made. The Commission has chosen the harder way trying to dismantle the Giovannini barriers together with the industry instead of easier ways like capping prices by regulatory means, but now the industry has to make progress in solving the problems.

A member remarked that the industry already did a lot, but that not all parties involved liked consolidation; that the debate should be focused on providers instead to refer to utilities which may be contrary to a market driven competitive environment and welcomed that the differentiation between equity and derivatives (the latter posing less problems) is maintained. Being asked, the Chairman interpreted the recent speeches of Commissioner McCreevy in a way that substantial progress within all barriers has to be achieved. The Commissioner wants to catalyse the debate to know next year if there is progress in view of taking his decision on an informed basis; thus possibly avoiding legislative means if industry presents solutions, particularly on industry barriers. Alberto Giovannini remarked that a number of market participants do want to consolidate and integrate but only on a higher level and not necessarily on Clearing and Settlement (C&S).

The Chairman also presented the **updated timetable of the project**. As announced, 2005 is spent on working on the Impact Assessment which should be finished in the first quarter of 2006. If the case for a proposal of a directive were to be proven, and Commission were to decide in favour of legislative action, such a proposal could be prepared in mid 2006 and could be officially proposed in the third quarter of 2006.

He then briefly informed the group about the **latest political developments**. The European Parliament adopted the report on C&S prepared by Ms Kauppi on 7 July. In the report the EP a) recognised the importance of C&S as well as the existence of potential for increased efficiency in the area of cross-border clearing and settlement, b) supported the Impact Assessment which should be linked to any decision to get on with a Directive, c) supports the work of the different C&S groups, in particular CESAME group and Legal Certainty Group, d) is critical about ESCB-CESR standards and e) encouraged the Commission to use its general powers under competition law in the area of competition.

## 2. SOME USERS' VIEWS ON CLEARING AND SETTLEMENT BARRIERS

### 2.1. Siemens AG

*Presentation:* **Dr. Peter Moritz**, Corporate Vice President and Treasurer of Siemens AG, presented the position of a major industrial company and active user of financial services with headquarters in Germany but internationally active with actually more business and operations outside Germany. Therefore, Siemens has a view on why efficient financial markets are needed. Siemens is listed on 3 exchanges outside Germany (but also de-listed already from other 4 exchanges). It holds the view that ultimately, in the times of the internet, one listing on an internationally accepted – competitive and cost efficient - exchange should suffice to provide ample trading possibilities in its stock. As Siemens is a direct user of financial services it has a high interest in seeing costs of these services lowered. The perception is that the present situation on C&S is based on historically fragmented national markets where the complexity is directly related to the number of actors involved as well as the use of non-standardised various platforms, different rules of transfer and governance standards. Deals which are not settled on the same day of trading, e.g. due to different settlement cycles, cost time and money and are inefficient. Siemens sees a need for an efficient EU market structure where investors can choose where to locate their post-trading activities as well as for competition between C&S providers which would give users the liberty to access the service of their choice (prices to be determined in freely accessible markets which should keep prices close to costs). Thus, increased competition based on harmonised standards could bring on consolidation which facilitates integration in the provision of C&S services and helps to reduce service cost via economies of scale. Siemens' internal experience supports the feasibility of this view for the future: some years ago, accounting, IT, and other services were seen as impossible to be provided by central service centres in charge of more than one country. Today it is done, thereby streamlining administration, reducing cost and execution speed, enhancing quality and providing more transparency. A convincing example is the area of payments: an external payment now costs Siemens about 1.80 € while an internal payment accounts for only 0.43 €

*Discussion:* Answering questions, Dr. Moritz explained that Siemens expects the efficiency of C&S to be greatly enhanced in a harmonized environment. That would allow meaningful competition between C&S agents. As a result of better competition Siemens expects a better transparency between different product offerings and their respective prices. For Siemens it is not possible to put an exact figure on its potential savings in C&S because C&S is only one single element in the whole value chain associated with e.g. pension management or treasury investments. Siemens expects that lower cost for transactions, e.g. due to more efficient infrastructures, in EU securities (compared to non-EU securities) would create higher liquidity in the EU markets and that this – in addition to cost savings – might broaden the shareholder base of EU companies. One member underlined the importance of delisting possibilities, transparent and efficient markets and the possibility for companies to identify their shareholders.

### 2.2. Survey on Retail Prices

*Presentation:* A small – not scientific and non-econometric - survey done by the Commission on retail prices during the summer 2005 was [presented](#). It covers data on overall costs (excluding custody cost and taxes) for three different sizes (small,

medium and large) of retail equity trades carried out with a high-street bank in 14 EU Member States. For comparison, some data on the prices of online-brokers was also gathered (both, for EU and US). The overall picture shows that for small-sized trades, the cost for a complete transaction (buy and sell) can reach up to 20% of the trade value; thus severely limiting the incentive for such trades. Although the costs decrease relatively rapidly with an increase of trade size, they can still represent up to 4% of the value of a complete large-sized retail trade.

*Discussion:* Alberto Giovannini cautioned that the cross-border variation could be just a consequence of the countries being represented by a single bank. However, for the country where two banks were represented, fees were roughly the same. Since the transaction fees of bank are not transparent (no indication on websites as for online-brokers), more samples could not be easily included, nevertheless the search for such data continues.

Some participants agreed with the findings of the survey, while others questioned the basis and methodology (e.g. different spreads in markets, C&S being only a part of overall cost). The participants offered some explanations for the high levels and large differences for fees for retail investors:

- banks may have only domestic customers, who invest predominantly in the domestic market, so the charges for cross-border operations are higher,
- there are different investor cultures in the different countries (especially relevant for EU vs. US comparison),
- trading spreads are different for different sizes of trades,
- fees may be high because they include advisory costs.

Some participants pointed out to the existence of online-brokers which are cheaper for retail trading than banks. Referring to his own experience, one participant commented that there are only small differences between trading costs worldwide and suggested to broaden the exercise to real portfolios; another participant asked about adding custody cost.

Some participants warned that one should be very careful to draw the wrong conclusion from the results of the survey, i.e. high trading costs for retail investors are caused by high C&S fees, given that these represent only a small fraction of the final costs. However, such a conclusion has not been made and the Commission is aware that the value of the survey is only to provide some interesting evidence of the end-investor cost of buying domestically or cross-border, without disentangling its components.

### **3. OPERATIONAL CONCLUSIONS – “GOING THROUGH THE BARRIERS”**

The group then assessed progress made on the elimination of all the barriers identified in the two “Giovannini” Reports based on the Operational Conclusions prepared after the last meeting. For the industry barriers, the discussion was conducted on the basis of reports presented by the bodies involved in that process.

### 3.1. *Barrier 1 (differences in information technology and interfaces)*

Presentation: The [presentation](#) centred on an update on the SWIFT<sup>1</sup> Draft Protocol Recommendation<sup>2</sup>, in particular the significant progress achieved regarding methodology, terminology, scope of application as well as the implementation plans. As announced, an “Independent Advisory Group” (IAG) has been set up to further define the protocol content<sup>3</sup>. IAG determined the scope of the protocol, and more specifically the areas where the use of the protocol should be made mandatory (distinguishing between a data layer and transfer layer). The protocol should apply to equity, bonds and exchange traded funds. Contacts with the derivatives industry have been established which is interested to check a possible use of the protocol. Since there are other areas where now new ways of communication have to be established (e.g. due to MiFID), it should be ensured that only standard complying solutions are envisaged which do not hinder straight-through processing. At the end, the biggest benefit for the industry will be the use of a single protocol based on ISO standards from pre-trade right through to the end of process servicing. A gap analysis identifying missing functionalities now has to be done to have as complete standards as possible; this has started by contacts will all (I)CSDs to list all the activities and protocols they support.

On 25 October 2005 a document for industry review shall be made available for a second round of consultation; final publication is envisaged to take place in March 2006. Implementation by all EU market infrastructures (and for exchange traded funds) should be achieved within the following two years; all cross-border participants should be compliant by end of the 5<sup>th</sup> year after publication. This timeframe should be in line with the usual time-span for projects thereby easing justification of the implementation. However, a cross-benefits analysis shows that the entities incurring the cost are not necessarily deriving the benefits. Notwithstanding, the protocol shall include a statement of compliance from major market players. Probably, ISSA will take responsibility to monitor implementation – implementation which cannot be imposed but is recommended to the industry.

Discussion: Members recognized the complexity caused by different standards, protocols and processes which should be diminished by the new standards. Most of them welcomed the draft which takes account of the fact that industry wants to leverage existing investments which will allow flexibility for domestic markets to migrate, too. Many proposed a time horizon of five years with some entities (ready and with cross-border business) starting immediately and others to follow within five years time, however, problems to convince domestic markets with no cross-border business to implement may occur. Some members wanted infrastructures to give their customers the choice to use the new protocol as well as the

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<sup>1</sup> *N.B. SWIFT standards (not SWIFT network) have been approved as the global repository for the securities industry globally by ISO. Thus, SWIFT has become the service provider for standards business models for the XML-protocol which is key to the whole industry.*

<sup>2</sup> Reference document: SWIFT Consultation Paper “The proposal for the removal of Barrier 1 of the Giovannini Report” of January 2005; the document as well as a summary of consultation comments of July 2005 is available at [http://www.swift.com/index.cfm?item\\_id=43429](http://www.swift.com/index.cfm?item_id=43429)

<sup>3</sup> for more details and members list see [http://www.swift.com/index.cfm?item\\_id=57398](http://www.swift.com/index.cfm?item_id=57398)

domestic set-up. But one member also remarked that double use of protocols is costly and against the aim to be achieved, therefore thorough consultation with domestic users should take place and be followed by a rather short switching period. Members called for a co-ordinated migration plan of infrastructures (Central Securities Depositories/CSDs, Central Counter Parties/CCPs) and central banks for adoption of the new protocol – on cross-border and at domestic level, in particular because the gap analysis will not be finished before implementation is supposed to start. Central banks will be able to support the adoption of the new protocol to the extent that this would be a real support to the local banking community. While some participants supported the proposed monitoring by ISSA only, one thought SWIFT monitoring to be sufficient (with ISSA involvement) and others wanted ISSA to be involved but that the monitoring should probably be carried out by a larger group, not ISSA alone which is a world-wide organisation focused on business and not exclusively on Europe. They claimed that - also in order to have leverage on infrastructures - ECSDA, the Eurosystem and the FBE should be involved (possibly via COGESI group). Timing problems for implementation could occur according to one observer in countries which do presently not use the SWIFT protocol and are not familiar with it. New issues could emerge in the industry consultation until February. Overall, SWIFT should make sure that all possibly relevant entities (e.g. also involving local providers/users and the futures/derivatives industry) are heard and consulted to make the protocol as encompassing as possible and smoothen implementation. Also introduction of the protocol by the Eurosystem will have more impact on the cash side while its use on the securities side can be promoted by the CSDs. While one member supported the level of prescription (scope of application, mandatory/voluntary) as striking a good balance, it was also remarked that the transfer layer is very close to the present area of activities of SWIFT which could pose a competition issue for other providers – SWIFT reiterated its sensitivity to this point and its view that the protocol should be a blueprint with no obligation to buy it from a single source/SWIFT. The proposed use of Public Key Infrastructure (PKI) for authentication/data integrity was not seen as appropriate for retail users. Alberto Giovannini resumed that this much organised process of developing the standards has been pushed through with a lot of energy and that it is essential to achieve a high degree of support to implement it. SWIFT was invited to report on the response regarding implementation.

### **3.2. *Barrier 2 (restriction on location of Clearing and Settlement) and Barrier 9 (restrictions on location of securities)***

Presentation: Public sector barriers 2 and 9 both address restrictions related to the location of functions and therefore should be considered together. The overview started with barrier 9, the issuer's choice to establish securities available in book-entry form which can either be based on market rules or national law. The assessment of the latter barrier is also part of the mandate of the Legal Certainty group. This group has already gathered raw material on the legal regime existing in the 25 EU Member States and will make a written advice on the issues. Preliminary research – which focused on domestic securities in the countries (and not rules for foreign securities to enter the country) shows that some 9 countries seem not to apply restrictions; some 16 seem to have them, however with different regimes regarding equity

and debt securities as well as physical and dematerialised securities. Mainly dematerialised equities are required to be issued domestically in these Member States. Some 4 out of the 16 countries seem to lift the restriction if equity is materialised – to note that market trend does not favour physical securities. For dematerialised bonds, some 4 countries seem to apply restrictions; some 8 countries have restrictions for dematerialised equity. The Legal Certainty group’s work preliminary confirms the existence of barrier 9 with a focus on dematerialised equity. However, the experts of this group feel that practical solutions for the market exist, for instance links between Securities Settlement Systems (SSSs). Barrier 2 is not on the agenda of the Legal Certainty Group since it is referring to connections between exchanges and settlement system, thus being rather a market structure or business issue.

*Discussion:* Alberto Giovannini asked about the rationale behind these barriers. These are probably on one hand purely historical reasons (local law applies domestically), on the other hand rules aiming at the preservation of the integrity of the issue (to control how many shares are circulating). Then, it was remarked, a similar question as on barrier 10 evolves, *i.e.* what are the implications of removing the barriers. One member pointed out the difference between equity and bonds asking for the reasons to forbid putting government bonds of one particular Member State in the (I)CSD of the investor’s choice. Here, small practical steps could be made by banks, (I)CSDs, the Eurosystem and Member States in respect of the fixed income market. One observer asked about restrictions across states, however, only few answers to the Legal Certainty Group questionnaire mentioned this aspect. Since legal changes may take a long time and complex issues are touched, one member suggested a paper for the next meeting indicating the biggest benefits and what the biggest constraints in achieving them are. But this request may go beyond the capabilities of the Group where legal experts are gathered which do not necessarily have an overview about the economic impact of any changes; the Group may nevertheless aim at indicating priorities. Upon an observer’s question on tackling barrier 2 it was mentioned that location of C&S is one aspect of the issue while another one is access which is to a certain extent addressed in Art. 34 MiFID (access for investment firms to CSDs) but the issue of the links between CSDs and CCPs is still unresolved (see also barrier 5).

### 3.3. **Barrier 3** (corporate actions)

*Presentation:* ESF gave an update [report](#) on the work by ECSDA, CEECSDA, ECSAs (European Credit Sector Associations, *i.e.* FBE, ESBG, EACB) and ESF jointly with EALIC on barrier 3 (mandatory and voluntary corporate actions)<sup>4</sup>. ECSDA and CEECSDA are about to merge, the new association will then cover all Member States’ CSDs. The process continues to be divided in two parts: i) working out recommendations and standards, and ii) overall gap analysis and implementation plans. The coordinated complementary work of all associations is based on a common methodology and the use of a uniform and consistent glossary. Cooperation with the Legal Certainty and FISCO group shall be intensified and reporting on the work

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<sup>4</sup> For a basic overview on the issues and processes on barrier 3, please refer to the Synthesis report of 7 March 2005.

shall continue in CESAME group. Since the last meeting, efforts focused on a comprehensive gap [analysis](#) regarding distributions and further work on the yet unfinished areas. A snapshot on achievements, work in progress as well as planned issues was presented:

**Distributions:** The standards on *cash distributions* are agreed; the gap analysis and implementation plan has been completed by ECSDA (with monitoring instruments jointly set up by ECSDA and EBF). On *stock distributions* standards have been proposed by ECSDA (but not finished by EBF/ECSAs) and a gap analysis/implementation plan has been completed by ECSDA (but not by EBF/ECSAs/EALIC). Monitoring instruments will be jointly set up by ECSDA and EBF. Regarding *interest payments and redemption on maturity* only the standards are agreed. Work on *Optional distributions* is currently carried out by ECSDA.

**Reorganisations:** A *set of default rules standards* is proposed by ESF and presently in discussion with the other associations. ECSDA, EBF/ECSAs and EALIC will develop the gap analysis/implementation in this area.

**Shareholders' Rights:** The establishment of a joint EALIC/EBF/ECSDA/ESF working group has been agreed.

**Transaction Management:** In this area, ECSDA proposed standards on *Market claims* and is now developing an implementation plan while ESF proposed standards on *Voluntary corporate action processes* which are presently discussed with the other associations. ESF is also working on standards for *Buyer protection rules*.

**Consistency and implementation:** A *joint spreadsheet of standards* has been established and EALIC is (as part of the gap analysis) working on a comparison on the effect of cash dividend standards on issuers. EBF will organize an implementation workshop in December 2005.

Discussion: All participants agreed that a lot of work has already been carried out. One member inquired about how to balance the needs of issuers to find creative solutions to corporate events and the need for harmonisation across markets. The associations involved meet this need by intensive consultation of all parties/stakeholders and the approach to limit the scope to the processes. Also, the experts' groups test the model on real market situations.

On the timing and overlap with the work of the Legal Certainty Group members were informed that there is indeed some overlap, however, contacts between the groups will be intensified. Also, as distributions happen more frequent (they represent about 80% of all corporate actions, both in numbers and in value) as reorganisations, so the level of detail on the latter issue will be less and most of the transactions will be covered when the distribution points have been worked out. Some legal issues (e.g. announcement of only the payment date) may also be overcome by a code of good practice. One key concern for the issues in regard to the work of the Legal Certainty group was mentioned: the determination of the moment when the purchasing investor is considered to be the owner of the securities (for the purpose of payment of dividends, exercising voting rights and the control of the voting rights for other purposes). The Legal Certainty Group is looking into this matters.

On timing and implementation plans, the work on reorganisations is not advanced enough to address this issue now; on distributions, ECSDA has

already made implementation plans (which were distributed to members before the meeting) which show that some markets are well advanced while others need a longer implementation period. For the next CESAME group meeting, the associations plan to present an exhaustive table (synopsis) where all individual implementation plans and gaps will be indicated. The more successful the associations are in working out the standards together with the agreement and backing of their constituencies, the higher the chances of adoption of the standards is, but the legal and regulatory area is probably the more crucial compared to harmonisation of market practices. Mario Nava pointed out that on barrier 3 a huge amount of work has been done to clarify the issues which were previously very intricate. It is now also evident who is working on which aspect of barrier 3. However, there may be margins to be gained regarding the proposed timetable for the different actions. One member remarked that many of the processes are very complex also on the technical side which cannot be changed 'over night'. In addition, about 50 % of the gaps identified have a legal cause and barriers are linked, e.g. if barrier 1 will be lifted, many issues in barrier 3 will disappear. To one member, dismantling of barrier 1 seems more important than speeding up barrier 3 work; therefore the work schedule should prioritise which barriers should be tackled with urgency. Another member recalled that the majority of the projects which are now going on (including related areas as TARGET 2) are large ones which take time (mostly about 2 years including about 1/3 of the time used just for testing). Therefore, hurrying some issues on top of this large workload could risk finding some parts of the market not being able to cope with the changes. Thus it seems preferable to push for quick agreement on the standards (i.e. setting the ultimate aim) and a reasonable timetable for implementation which is then strictly applied.

#### **3.4. Barrier 4 (intra-day settlement) and Barrier 7 (settlement deadlines and operating hours/days)**

*Presentation:* At the last CESAME group meeting in June 2005 the ECSDA status report<sup>5</sup> of April 2005 (regarding the ECSDA consultative report of April 2004 which recommends the adoption of specific standards to address these two barriers) has been [presented](#) showing 85% compliance of ECSDA members with the recommended standards. Some CSDs are not yet compliant with some standards because they envisage implementation together with other projects, mainly a) the arrival of TARGET 2, b) changes due to recent mergers (e.g. introduction of Euroclear's Single Settlement Platform), and c) ongoing discussions on implementation with local users. Therefore, ECSDA expects only slightly more compliance with the standards during next year which should improve in 2007. The next ECSDA report will be more comprehensive in view of country coverage due to the merger with CEECSDA.

*Discussion:* One observer remarked that TARGET 1 is in place, so it is not necessary to wait for TARGET 2 to implement the standards. The recommended standards should also not only be met at domestic level but also for links (which does sometimes not seem to be the case for links between CSDs today). Further, the recommended ECSDA standards were foreseen to be enforced through the ESCB-CESR standards (see standard 8

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<sup>5</sup> <http://www.ecsda.com/attachments/publications/wgpublications/harmonisation/ECSDA%20final%20report%20of%20WG5%20on%20Barriers%204%20&%207.pdf>

ESCB-CESR asking for intra-day finality and batch processing every two hours) which cannot be done as long as the ESCB-CESR standards are not adopted. However, presently standards 7 and 8 of the Eurosystem User standards for securities settlement systems (SSSs) can serve for enforcement, but only regarding SSSs which are used for collateral for Eurosystem credit operations. The Eurosystem also does not use links between CSDs which are not in line with the ECB User standards. A member commented on ECSDA encouraging its members to adhere to the standards and stated good compliance on the level of ECSDA members but a lack of compliance on the level of individual users. Also, industry in his view insists on a crucial point, *i.e.* aligning the opening hours of SSSs with TARGET 2 – and *vice versa*: SSS should not settle in central bank money when TARGET 2 is closed; an item which should – according to this member - be considered in a possible directive. For illustration, another member described a practical example which exists today, namely the ongoing efforts to "unblock the (cross-border) tubes" in intra-day/same-day settlement with finality in a certain instrument which requires talks between several (I)CSDs and multiple central banks in order to facilitate continuous C&S with finality and to avoid failed transactions.

### **3.5. *Barrier 5 (impediments to remote access)***

Presentation: The Commission gave a brief presentation on developments relating to the removal of barrier 5 which addresses the “practical impediments to remote access to national C&S systems”. Remote access is technically feasible and necessary when market participants want to interface with multiple post-trading systems. In the absence of remote access, market participants have to bear exacerbated costs to the extent that they would need to establish a presence (through a subsidiary, a branch) or use an intermediary/local agent at additional cost in each of the countries concerned. A number of impediments stand in the way of remote access including (a) the diversity of the systems themselves (addressing this issue is the subject of a number of other Giovannini barriers such as barriers 1, 6, 7 etc.), (b) market rules that put remote members at a disadvantage compared to local members and, therefore rendering nominal remote access unworkable.

The Giovannini group proposed that these impediments should be removed through the action of public authorities who need to ensure that remote access is obtained on a strictly non-discriminatory basis. Member States were therefore invited to draw up a set of conditions to be imposed on local and remote members in that respect. The EU authorities’ contributions in these efforts take the form of specific regulatory measures and the effective enforcement of the EU competition law provisions.

On the regulatory side, the recently adopted Directive on Markets in Financial Instruments (MiFID) provides a legal framework which addresses some of the issues raised by that barrier, namely the non-discriminatory access of remote participants to local C&S systems (Article 34 MiFID). Thus investment firms from another Member State should not be discriminated against local participants when remotely accessing foreign CSDs and CCPs. The Directive also disentangles remote access to CCPs and CSDs from access to the local trading platform. However, the MiFID does not define what a CCP or a C&S system is. It also does not specify the nature of the

criteria to be used by CCPs or CSDs to grant access to their participants, either local or remote ones. What those criteria might be or their characteristics/limitations remain a matter of national law/regulation/market practice, as appropriate to each market.

MiFID also stipulates that CSDs and CCPs may refuse access to remote participants based on “legitimate commercial grounds”. Again, there is no definition as to what a “commercial ground” might be or who is to decide on its “legitimacy”. These issues are left to national/regulation/decision by supervisors etc., as reflected by the rules applicable to each system.

That is not to say that the MiFID has no bearing on the issues left to the discretion of the national authorities. Considering the purpose of the MiFID in this respect, namely to open and to facilitate access to remote participants, any non-discriminatory national or local policy decision on access should not deprive the MiFID of its intended effects by, for instance, allowing practices or criteria which will make remote access unattainable. With this in mind, local rules or supervisory practices which may limit the reasons for refusal of access go towards meeting the MiFID objectives, as for instance policies which might impose that only risk related criteria may be invoked for refusing access. This seems indeed to be the line adopted by the ESCB-CESR standard 14 on access.

The Commission also intends to tackle issues relating to the remote access of CCPs and CSDs to foreign CCPs and CSDs. As it announced in its second Communication on C&S of April 2004, the Commission intends to provide access rights for the benefit of CCPs and CSDs and thus to create a coherent and consistent set of rights for remote access applicable throughout all the chain of intermediation. The Commission is however still assessing these issues; it will hopefully be able to announce its decisions and concrete proposals in one of the future CESAME group meetings. In addition to its regulatory intervention, the Commission is also involved, through the enforcement of the EU competition policy, in the ex-post assessment of the access policies of the institutions concerned in order to sanction any relating abusive behaviours and unlawful discriminatory treatments. In essence, decisions on, and conditions for, access should not contravene EU competition law as well as national competition laws.

Another key issue that the Giovannini reports mentioned as an impediment to remote access was the fact that market participants need to employ a local agent bank for cash settlement; this was necessary in order for them to have an account at the local central bank with access to intra-day liquidity, and this impediment remains often applicable to date.

*Discussion:* In the discussion that followed, an observer clarified that one needs to distinguish between (a) remote access to central bank **money** (which is today available by the possibility to open accounts with other central banks on a remote basis), and (b) remote access to central bank **credit**. On the latter, the Eurosystem and each non-Eurosystem central bank can decide itself on its policy, i.e. to whom it wants to give this credit facility and under which conditions. This is due to internal risk considerations and the policy of central banks to select their own counterparties for their monetary policy operations – a policy applied also by credit institutions (not giving credit to

anybody). Within the Euro-area, the problem will however disappear with TARGET 2 because it features a liquidity pool which will allow each participant to get liquidity from its own central bank and use it in whatever country is connected to TARGET 2 (*i.e.* if one participant wants to have liquidity in another Member State, it does not need to obtain liquidity there but can use its domestic liquidity via the shared liquidity pool).

### **3.6. *Barrier 6 (differences in standard settlement periods)***

Presentation: In view of ESF giving a [presentation](#) on this barrier, it is linked to barrier 1, not in terms of messaging but in terms of standardising content and processes in order to make the entire settlement process more efficient. Barrier 6 is more particular on changing, *i.e.* shortening settlement cycles. Not expressly mentioned in barrier 6 but related thereto is the initiative of ESF and ECSDA on harmonising and standardising the pre-settlement matching process. In the last year the two associations have developed a set of some 20 standards aiming at reducing risk and improving matching rates/settlement efficiency and certainty on the status of transactions. Ultimately, only one matching instruction by each party should be required for a transaction and to avoid the requirement of availability of cash/securities as a condition for matching. For the time being, the scope of the standards is limited to the (I)CSDs and their members, but it could be extended later to the wider industry, *e.g.* the buy-side. Scope primarily focuses on OTC transactions (equities and fixed income) since the matching processes described are usually provided for the exchanges (for exchange traded transactions). In order to meet the aims described above, a two phase concept for matching and settlement has been developed (see presentation for details). However, some legal issues will have to be clarified together with the Legal Certainty Group. In the future, the final agreement with ECSDA on the proposed standards is expected to be reached by the end of November 2005, then the broader consultation is planned for the first quarter of 2006, simultaneously and together with ESCDA, ESF will pursue a gap analysis and implementation plan.

Discussion: Alberto Giovannini remarked that present work does not cover the practical problems which result from the different settlement periods. However, it was replied that without the implementation of these standards, in particular for OTC transactions, barrier 6 could never appropriately be solved. One member pointed out the TRAX system under ICMA (*ex-ISM*A) where banks – in particular in the UK according to rules of the FSA – have to pre-notify all securities transactions; however, the system was not entirely efficient since banks in other Member States did not use it and participants could disregard instructions when the time of settlement came. A working group within ICMA is now working on a TRAX pre-notification system routing instructions for all OTC-deals to direct settlement with all (I)CSDs in order to prevent unwinding of pre-notified transactions. This system is now in the testing phase (with 6 banks in London) and shall be rolled-out next year by ICMA. However, this will not improve the T+2/T+3-debate. Another member and one observer confirmed that the crucial issue to prevent mistakes/failures and improve safety is to prevent participants to unwind transactions after matching took place. But it was noted by another member that market practices have to be taken into account in order to prevent the standards from encouraging undesirable market behaviour, *e.g.* in practice,

customers often cancel instructions, particularly where a trade has to be (re-) allocated. Additionally, if a trade is locked in it becomes an irrevocable settlement commitment which reduces the intermediary's ability to react in the case of a severe financial deterioration of a customer; consequently instructions may not be put into the system until the last minute – providing the opposite of what was intended with the standards. Another member confirmed this division for transactions on the market either being non-binding and thus allowing for the risk of cancellation etc. or the other extreme – binding transactions (on securities/cash, i.e. liquidity)– where institutions tend to wait as long as possible before entering these transactions into the system. For another observer, barrier 6 was also on reducing replacement cost risk (which is smaller with shortened settlement periods), this aim is not achieved if parties to a transactions are allowed to cancel it, thus re-inserting replacement cost risk at the charge of the (possibly non-expecting) counterparty.

In the presenting association's point of view, inserting incentives and penalties into the system will improve the practical application. An observer commented that the proposed standards are in line with ESCB-CESR standard 2 on early confirmation and the use of electronic systems for confirmation and matching and welcomed the coverage of OTC transactions which provide for a bulk of transactions and where basically a settlement cycle does not exist.

Further in the debate, it was criticised that the present standards' concept misses out the role of CCPs and the interaction of a CCP with CSDs; the relevant member would like to see this issue addressed since presently it is difficult for some CCPs to interact with certain CSDs. Depending on the model, matching is (already) done by the CCP and the latter has a respective timeframe for sending matched instructions to CSDs. Ultimately, a CCP should be able to send out matched instructions on behalf of its participants. This criticism was acknowledged by the association, nevertheless, next year it will be discussed if the scope of application of the standards should be wider than bilateral matching only.

### **3.7. *Barrier 8 (securities issuance practice)***

While barrier 8 as such is considered to be removed, a dispute with Standard & Poors (S&P) was brought to the attention of CESAME members upon the last meetings regarding the charging of fees for the use of U.S. ISINs<sup>6</sup>. Alberto Giovannini just informed CESAME members that the week before this CESAME meeting, the Association of National Numbering Agencies (ANNA)<sup>7</sup> and the CUSIP (Committee on Uniform Security Identification Procedures) Service Bureau<sup>8</sup> had a meeting to work on resolving the dispute between them. However, no information as to the outcome of this meeting has been obtained, so an update will probably follow in the next meeting.

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<sup>6</sup> More background information on the U.S. ISIN-issue is contained in the Synthesis Report of the CESAME group meeting of 10 June 2005.

<sup>7</sup> <http://www.anna-web.com/>

<sup>8</sup> <http://www.cusip.com/NASApp/cusipweb/com/sp/apps/cusipaccess/html/whats.html>

### 3.8. *Barrier 10 (restrictions on the activity of primary dealers and market makers)*

Presentation: Barrier 10 relates to possible restrictions on the settlement activity of primary dealers with responsibility of the public sector for removal. CESAME group was given mixed news on this barrier which receives higher priority with some issuers and in particular many primary market dealers. One reason for slow progress is the procedure: First, the issuers – i.e. national governments – were asked to report and auto-assess to which extend these restrictions (still) exist and have an impact on primary dealers; secondly, this report is to be reviewed by three groups: EPDA (European Primary Dealers Association)<sup>9</sup>, ICMA (International Capital Market Association<sup>10</sup> - a merger of the International Securities Market Association (ISMA) and the International Primary Market Association (IPMA) in July 2005) and AMTE (Association Marchés Taux Euro)<sup>11</sup> which should thirdly be followed by a joint review of the two positions in the CESAME group. A letter from the chairman of the EFC (Economic and Financial Committee) sub-committee on EU government bills and bond markets<sup>12</sup> addressed to the national debt offices and to EPDA, IPMA (now ICMA, see above) and AMTE has been sent in May 2005. The letter requests information in four main areas: 1. a review of the relevant primary dealership arrangements, 2. the existence of any restriction, 3. the reasons for the restrictions, and 4. implications for primary dealers and national governments as issuers if restrictions were to be removed. Unfortunately, the response rate is low – up to now only half of the issuers have replied (representing less than 50% in terms of issuance volumes), i.e. a few large issuers have not yet replied. The sub-committee met on 4 October 2005 and members were reminded of the urgency of their replies. Now the aim is to finalise the report for the next sub-committee meeting in February 2006. It was agreed not to divulge individual responses until all replies are received. So far replies vary across issuers: the problem does not seem to be very wide-spread; some issuers do not impose any restrictions, other have issued recommendations which they argue should not be classified as restrictions and only a few have so far indicated restrictions – these being justified mainly by public good considerations. During a presentation made at the last sub-committee meeting, EPDA indicated that they are working on their own report, so these two initiatives will proceed in parallel (saving time). Thus, first results might be available for the next CESAME group meeting.

Discussion: One member asked if there are any public documents on the issue. Due to the confidentiality of EFC work, there are presently no documents available to the public. However, it is proposed that the report by the EFC sub-committee will ultimately be made public. This procedure will also apply to the EPDA report which shall first be discussed – in confidentiality – with the EFC. Another member also remarked that the introduction of TARGET 2 will resolve some aspects of barrier 10 related to national central banks requirements.

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<sup>9</sup> <http://www.bondmarkets.com/>

<sup>10</sup> <http://www.icma-group.org/>

<sup>11</sup> <http://anf.actufinance.fr/association-des-marches-de-taux-en-euro-S10656/>

<sup>12</sup> [http://www.europa.eu.int/comm/economy\\_finance/efc\\_en.htm](http://www.europa.eu.int/comm/economy_finance/efc_en.htm)

### **3.9. Barrier 11 (restrictions on withholding agents) and Barrier 12 (restrictions on tax collection)**

Presentation: The Secretary of the Fiscal Compliance Experts' Group (FISCO) gave a [presentation](#) on the issues at stake as well as on the current state of play of FISCO works and in particular progress as regards work on the Giovannini barriers 11 and 12. FISCO Group will prepare at least two reports: first a fact finding study of the different fiscal compliance procedures in place across MS and the US by the end of 2005 and then a report by the end of 2006 on possible solutions to align the fiscal compliance procedures in MS so that the many different rules, which raise the cost of cross-border settlement, could be eliminated or substantially reduced. Also, a study on liquidity implications of transaction taxes may be put forward and there will be a section on the implications of major tax rulings of the European Court of Justice (ECJ). While staff of DG TAXUD participates at FISCO group meetings, the findings of the group will be discussed with Member States in accordance with the established policy of prior consultation on tax issues. If subsequent action on EU level is considered appropriate, the Commission may bring forward proposals to the Commission Working Party IV on Direct Taxation where all Member States are represented. Of course, all comments from CESAME group members giving evidence, facts and solutions are most welcome. The documents related to FISCO are available on the new FISCO website<sup>13</sup>.

Discussion: One member suggested that FISCO group also looks at developments within Shell Corporation. Shell has recently restructured and maintains two listings (in Amsterdam and London) and two types of shares; however, now Dutch consumers have to pay UK stamp duty on their transactions. The chairman of FISCO group asked the member to provide more information on this issue. Another member asked for a clear indication by FISCO group on the priority points within all tax issues and he suggested that the tax element should also be taken into account by the Commission when deciding on a possible directive. The Commission explained that this is not on the Agenda and a possible directive will not contain fiscal elements.

### **3.10. Barrier 13 (absence of EU-wide framework of laws)**

Presentation: A general update was given on the work of the Legal Certainty Group (LCG) - which provides full transparency through its website<sup>14</sup> - and the UNIDROIT draft convention. On the LCG, the Commission has noted the clear support for this group voiced by the European Parliament in its recent report on C&S. LCG held its third meeting on 13 September 2005. Over 600 pages of information on the existing legal infrastructure of the 25 Member States have been collected and about a dozen research notes on selected topics have been prepared to support the analytical work done. Central issues were the EU regulatory regime, dematerialisation, interaction with company law, concepts of finality, derivatives, Nordic systems, etc. The first report of the LCG will focus on the perceived problems, will validate whether they

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<sup>13</sup> [http://europa.eu.int/comm/internal\\_market/financial-markets/clearing/compliance\\_en.htm](http://europa.eu.int/comm/internal_market/financial-markets/clearing/compliance_en.htm)

<sup>14</sup> [http://europa.eu.int/comm/internal\\_market/financial-markets/clearing/certainty\\_en.htm](http://europa.eu.int/comm/internal_market/financial-markets/clearing/certainty_en.htm)

indeed exist and constitute a barrier, and will give advice on ways to resolve the problems, taking into account the specifics of the existing EU environment.

On the basis of draft horizontal assessments on the degree of divergences in the Member States, LCG identified core issues which are deemed to constitute the main source of legal barriers for cross-border C&S in the EU. These include:

- Scope: securities, securities accounts
- Legal effects of a book-entry: nature of rights, effect (root of title, evidencing function, etc.), conditional transfers and reversals
- Corporate actions and voting rights: acquiring and enacting of such rights
- Recognition of status of indirect (and direct) holdings: interoperability, holding in pooled manner, who is recorded as holder, nominee and omnibus accounts
- Transfer requirements: legal and operational steps, effectiveness between parties and against third parties
- Moment of transfer: moment of entitlement, certainty for settlement purposes, shareholders' rights, finality etc.
- Priority rules: allocation of shortfalls, ranking of competing rights (claims), liens, and good-faith.

When the preparatory work of the LCG on a first draft report is finished, the meeting of LCG will be held, probably early next year.

UNIDROIT: The LCG is mandated to liaise and follow closely the activities of UNIDROIT. 16 of the 36 members of the LCG and 3 Commission observers have been participating in the UNIDROIT conference of governmental experts which took place in Rome in May 2005 and focused on the draft convention on harmonisation of substantive law relating to the holding and transfer of securities held with an intermediary. UNIDROIT identified the interoperability and consistency of legal systems as being the most important achievement to be reached. Other important issues discussed were a) the interplay of rules regarding priorities, b) different positions on allocation of shortfalls, c) treatment of corporate actions and voting rights (not addressed yet in detail), and d) issues regarding systemic risk and interaction with the Settlement Finality Directive (not yet discussed as well upon request of the EU Member States in order to avoid UNIDROIT provisions which would jeopardise the existing EU structure). The May UNIDROIT meeting resulted in a new draft convention released in June 2005<sup>15</sup>. However, the convention is still at a preliminary stage and may be targeted also at less developed markets. Thus it is not yet clear whether it will provide suitable solutions to the EU issues. The Council still has to adopt a proposed mandate to the Commission to negotiate issues covered by existing EU directives within UNIDROIT on behalf of the Member States.

*Discussion:* Alberto Giovannini remarked positively on the unprecedented analytical work carried out both by LCG and FISCO group as only very detailed descriptions of the situation will allow subsequent action. Upon a

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<sup>15</sup> <http://www.unidroit.org/english/publications/proceedings/2005/study/78/s-78-24-e.pdf>

question of a member it was said that no precise date for publication of the first LCG report can be given yet.

### **3.11. Barrier 14 (legal treatment of netting)**

Presentation: Netting is of utmost importance in the context of C&S and collateral. In the second communication on C&S of April 2004 the Commission stated that by virtue of the adopted Collateral Directive (which addressed close-out netting), netting related issues have been resolved. This is mostly true, particularly in taking into account the Settlement Finality Directive (dealing with netting in connection with systems) and some rules related to insolvency aspects contained in the Winding-up of Banks Directive and the Insolvency Regulation. However, repeatedly concerns have been raised by market participants, e.g. by ISDA asking for a netting directive<sup>16</sup> (upon the consultation of the Green Paper on Financial Services Policy) or the European Financial Markets Lawyers Group<sup>17</sup> (EFMLG). According to ISDA's view, a European instrument similar to the Financial Collateral Directive is needed for close-out netting, particularly to promote convergence of, and elimination as far as possible of, inconsistencies between existing close-out netting regimes in Europe and also to provide a set of core principles to guide the new Member States and accession countries in implementing netting legislation. Other issues mentioned are the netting of commodities or physical transactions or the recognition of cross-product netting in a regulatory context, e.g. capital requirements. When looking at these matters one has to separate carefully policy issues and legal and technical aspects. LCG will follow the issues.

Discussion: One member pointed out the importance of netting and the fact that Member States apply different rules and asked about actions by the Commission. In fact, there is one infraction procedure<sup>18</sup> initiated for non-implementation of the Financial Collateral Directive and further procedures in the pipeline. Another member remarked that there is still an issue on netting of transactions which ultimately lead to the fulfilment of a residual obligation. Also bilateral netting-provisions need backing by legal opinions which can however not give 100% certainty until a relevant case has been decided by the courts. It was clarified by the Commission that the Settlement Finality Directive deals with the netting within systems while the close-out netting in the case of default is addressed by the Financial Collateral Directive. There is evidence (also in Legal Opinions) that both directives improved the legal certainty in this area, but Commission remains attentive to any unresolved issues which might be left.

### **3.12. Barrier 15 (conflict of laws)**

Presentation: The oral presentation focused on the current situation in the conflict of laws field and in particular in the Hague Securities Convention

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<sup>16</sup> [http://www.isda.org/speeches/pdf/EU\\_GrP\\_Resp\\_August-01-2005.pdf](http://www.isda.org/speeches/pdf/EU_GrP_Resp_August-01-2005.pdf)

<sup>17</sup> [http://www.efmlg.org/Docs/report\\_on\\_netting\\_final\\_301004.pdf](http://www.efmlg.org/Docs/report_on_netting_final_301004.pdf)

<sup>18</sup> <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/05/1300&format=HTML&aged=0&language=EN&guiLanguage=en>

which is particularly intricate. The current framework for conflict of laws within the EU defined by the Settlement Finality Directive (SFD) and the Financial Collateral Directive (FCD) is in place. In the area of conflict of laws, both directives interact. A report on the application of the SFD based on a questionnaire is expected to be finalised by the Commission before the end of the year. As the SFD was adopted in 1998 the report may possibly conclude that the SFD has clearly improved the legal situation but it could still be further improved. The Hague Convention has a broader coverage, both in geographical terms and regarding content. At present the Council is still considering the decision for signing the Convention in view of some concerns that have been raised by some Member States and the ECB. In June 2005 the Council agreed to invite the Commission to report on 4 questions regarding a) the scope of application, b) the extend of third party rights, c) the consequences on substantive and public law (e.g. insolvency, market abuse and anti-money-laundering) and d) the impact of diversity of laws on settlement systems and prudential regimes by the end of the year. The Commission is now working on such legal assessment for the Council. Based on that analysis the Council will continue its deliberations and decide whether to go ahead with the signature. The Council also requested the Commission to consult, before the completion of the study, as widely as possible with all interested parties. In view of that the members of the CESAME group were invited to contact the Commission and express their views on this Convention and the related issues.

*Discussion:* CESAME group members did not comment on the presentation.

#### **4. CESAME SUB-GROUP ON DEFINITIONS AND DATA REQUEST**

##### **4.1. CESAME Sub-Group on Definitions**

*Presentation:* The Chairman welcomed the [document](#) presented by the sub-group while stressing that these functional definitions are designed solely to clarify certain issues but are not tested in a legal sense. Subsequently, the report on definitions was [presented](#) which was carried out with the assistance of an *ad hoc* Sub-Group established by CESAME members' representatives about a year ago. The presentation focussed on the background of the work and on the actual contents of the proposed definitions. It was stressed that the aim of the work has been the development of functional technical definitions for use in future discussions and that the functional definitions are not intended to appear, as such, in any future Community legislation – should there be any. The efforts have been focused on securities; therefore there might be a need to adapt the report to cover derivatives as well in the future. Also, the group preferred to speak of "post-trading activities" instead of "clearing and settlement". A basic division was made between flow related and stock related activities. In the future, some more work may be envisaged, e.g. to cover derivatives or to assist the Commission when developing definitions in other regards.

*Discussion:* Some observers warned that definitions should remain close to current understanding of terms and that existing glossaries should be properly taken into account. A market practitioner member of the Sub-Group replied

that current understanding of terms does not give an unequivocal answer which is valid in all markets – albeit, as pointed out by an observer, EU-wide definitions may be found in the ECB's Blue Book<sup>19</sup>. The Commission further replied that existing glossaries have been properly taken into account (in fact the first Commission note, which has not been made public, had compared the existing definitions). Another member remarked that the definitions are helpful to clarify processes and welcomed that they do not contain any requirement.

A member criticised the proposed definitions as they tend to confuse functional and institutional aspects. Other members commented on the inappropriateness of the proposed definition of settlement, which covers both the CSD' and other financial institutions' activity. They added that there is a need to be more precise on the different ways to provide services in the post-trading area, in particular as regards the role of market infrastructures. Other comments concentrated on: (a) the relation between the CCP activity, in particular with respect to derivatives, and some of the proposed definitions; (b) the inappropriateness of some of the specific definitions being proposed, e.g. clearing.

On the basis of the discussion, the Commission concluded that the sub-group should continue its work on the document, complementing it with background material and updating it as and when discussion progresses.

#### **4.2. *Industry analysis: Commission's data collection sheet***

Presentation: Some meetings ago the Commission started an exercise to try to gather information on settlement internalisation by agent banks in a two step approach: first by looking at the level of concentration at CSDs, secondly but based on the initial results, to gather information on settlement internalisation itself. Accordingly, ECSDA has been asked to provide such information (on a 10% threshold in terms of assets under custody as well as volumes and value of transfers). 2/3 of the (confidential) answers to this questionnaire have now been received, but some big countries are still missing. Preliminary analysis has started, which shows that the data are not homogeneous, e.g. the level of concentration. As in most cases data were provided on an anonymous basis, it will be difficult to start the second phase. Therefore, all banks beyond the thresholds were encouraged to get in informal contact with the Commission's services in order to proceed with the second phase.

Discussion: It was suggested that a simpler way to gather information as regards the extent of settlement internalisation by agent banks would be to bring it to a macro level and compare market turnover with the CSD turnover, *i.e.* to take market/trading activity, then look at what is being cleared at CSD level and the difference of the two is cleared by definition by agent banks. However, this approach might be limited, e.g. due to the impact

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<sup>19</sup> *N.B.* ESCB is presently preparing a glossary aiming at incorporating all existing glossaries contained in publications of central banks. Once the draft is finalised, ESCB plans to consult the markets to ensure that the selection is appropriate.

of CCP clearing (the netting effect ensured by CCPs decreases the number of settlements at the CSD level in some markets by 95%).

## 5. PUBLIC AUTHORITY ACTION

### 5.1. *Update on CESR's work and ESCB-CESR standards*

CESAME group was briefly informed about the CESR Chairmen meeting of 17 October 2005. The Chairmen decided that further work on some of the ESCB-CESR standards<sup>20</sup> was needed and that a final position would not be adopted before the beginning of 2006. This final position would then take the form of a third consultation of the markets. In the meantime work was split in two parts: one part being settlement, the other part dealing with clearing. Chairmen hope that the position of the Commission on C&S will be known in the beginning of 2006 which will allow the CESR Chairmen to take a position on the proposal for their standards which should be in accordance with any proposal by the Commission. A letter to the Commission on this topic is planned to be sent out soon. In the meantime work continues in other areas. CESR expects that the consultation on the standards could start around February/March 2006.

On the other side, the Eurosystem has decided to put its work on the CESR-ESCB standards on hold until CESR concludes its debate. In the meantime, the ECB will review its user standards applied to SSSs used for Eurosystem operations.

The Chairmen referred to the sensitivity of the European Parliament on ESCB-CESR standards fearing that this work will prejudice any level 1 directive and in relation with the debate on the Lamfalussy process, specifically the call-back right of the European Parliament. One member welcomed the decision to pursue the work while putting the adoption of the standards on hold.

### 5.2. *Update on ECB work*

Members were informed that the ECB just published the second progress report on TARGET 2<sup>21</sup> which includes information on the envisaged starting date, on the migration process, the envisaged pricing scheme and other operational details such as night-time settlement. Pricing on ancillary systems will be published in the near future. The open issue of links to Securities Settlement Systems will be discussed in November 2005.

One member asked about one open issue for the securities industry which is the issue of interfaced and/or integrated model for ancillary systems to TARGET. This is one of the issues which will be discussed in November as well.

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<sup>20</sup> ECB-Website: <http://www.ecb.int/paym/pol/secover/escbcesr/html/index.en.html>;

CESR-Website: [http://www.cesr-eu.org/contenu\\_groups.php?id=36](http://www.cesr-eu.org/contenu_groups.php?id=36)

<sup>21</sup> Report: <http://www.ecb.int/pub/pdf/other/target2progressreport200510en.pdf>

Press release: <http://www.ecb.int/press/pr/date/2005/html/pr051021.en.html>

## 6. OTHER ISSUES

### 6.1. *Update on DG Competition's Questionnaire*

The DG Competition thanked all market participants including CESAME group members for their contributions and input to fact finding on securities, trading and C&S. This is not a sector inquiry according to Article 17 of Regulation 1/2003<sup>22</sup> which governs anti-trust work in DG Competition. Instead a questionnaire has been sent out to selected market participants over summer on the background of Article 18 of this Regulation which allows requesting information from institutions and markets to see how competition is working and whether competition rules are respected. The Commission and the European Parliament agree that an active implementation of competition policy in this sector is fundamental for a correct assessment of other aspects and it is indeed a priority area in DG Competition's current work plan. The answers to the questionnaire are confidential and for the exclusive use of this DG, so not to be shared with other DGs, e.g. DG Markt or other entities. However, the knowledge gained through this exercise will be used for a general report which DG Competition is going to present at the end of 2005. DG Competition encourages all interested parties to provide their views and to get in contact with them.

Since the 1 May 2004 EU competition law can be directly implemented by national competition authorities. There are regular meetings between the national competition authorities and DG Competition to discuss the application of EU rules. Some national competition authorities – which are in many instances better placed to look into the national situations- have made their own investigations in this area from their specific angle, e.g. a sector enquiry.

Upon request, it was clarified that the answers to the questionnaire are not being communicated to national competition authorities nor is the sector enquiry launched by a national authority part of the current DG Competition fact finding. One member suggested extending the scope of the exercise beyond securities also to exchange traded derivatives.

### 6.2. *Update on the work on the impact assessment, in particular the econometric seminar on Annex 2*

*Presentation:* A [presentation](#) on the econometric seminar held at the end of September 2005 was given. This seminar was held with university professors and industry participants to test the economic assumptions underlying Annex 2. It was the first occasion this was done because the Commission believed that it was appropriate for this particular Impact Assessment (*i.e.* should not expect such seminars to be introduced as a standard practice in every impact assessment, but its use should rather be judged on a case by case basis). Comments were mainly received on three issues: data issues (sample, period), choice of variables (dividends) as a proxy for capital cost and endogeneity (*i.e.* establishing cause and effect), and reporting on test specifications of the models. The results of the discussions are being

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<sup>22</sup> [http://europa.eu.int/comm/competition/publications/publications/modernisation\\_en.pdf](http://europa.eu.int/comm/competition/publications/publications/modernisation_en.pdf)

incorporated in the new version which has now become more complicated; however the statistical results so far are similar to the previous outcome.

Discussion: Two participants raised some issues (which they raised already on 30 September at the seminar). They did not agree with the conclusion about the seminar, *i.e.* they argued that while the approach taken by the Commission was appropriate *per se*, they questioned its relevance for the decision on a possible Directive. Indeed, the Commission underlined that Annex 2 looks at the impact of a reduction in trading costs (not necessarily C&S) on costs of capital and consequently on investment and GDP. It takes a macro view aimed at calculating (within a reasonable margin of confidence) and demonstrating the impact of the reduction of transaction costs (of any nature) on liquidity and overall economic activity. It does not take a micro view aimed to justify or not a Directive (see also below).

They also questioned some of the assumptions used in the paper - more specifically the use of a value of -1 for the cost of capital elasticity. It was replied that a sensitivity analysis was carried out which features in the Annex and which proved that using different values for the parameter did not cause significant changes in the end result.

Furthermore, they pointed out that the data set used by the Commission may be too restrictive. It was replied that any data set chosen has drawbacks and advantages and no period can be considered superior to others. Using the same database as the study by London Economics has the clear advantage of offering comparable results. These participants also expressed doubts about the estimated size of the impact of a reduction in trading costs on GDP, saying that it is too big and suggesting that a qualitative approach would be preferable to a quantitative one. The Commission is aware of the uncertainty regarding the size of the impact, but that is precisely why Annex 2 does not resort to a single value, but a confidence interval. Furthermore, when the London Economics study on the impact of financial markets integration on GDP was presented to economists, they in fact argued that the Commission was actually far too timid in its forecasts, saying that the benefits would be far larger. A large number of studies/papers published since then seem to confirm their argument. Another comment pertained to the size of the result which assumes that the EU economy would become an equity based society and that far more cross-border activity would need to take place which was considered improbable due to the “home bias” of investors. It was replied that a significant portion of the “home bias” may be caused by the existence of the Giovannini barriers; hence if these were to be removed, a substantial increase in cross-border investing could take place.

Another member wanted to know what this paper (*i.e.* Annex 2) will be used for, *i.e.* will the decision on whether or not to propose a Directive be based upon it. The Commission replied that this will not be the case: Annex 2 will be used exclusively to assess whether a reduction of C&S cost would matter for the EU economy or not – and if so, to what extent. The overall Impact Assessment will serve to form a judgement on whether a directive is needed or not. It was also clarified that Impact Assessments are an integral part of legislative proposals by the Commission, therefore prior publication and consultation only on an impact assessment is not possible. One member requested to distribute a written comment on Annex 2 which was agreed.

Nevertheless it was stressed that for transparency reasons, papers should preferably be distributed in advance of the meetings or tabled in the beginning of the meeting instead of during the debate. To conclude, the Chairman thanked participants for their active input and reiterated the policy of open debate about the Regulatory Impact Assessment. The Commission will look carefully to all arguments taking comments seriously and accordingly modify, if necessary, the text.

### **6.3. *Date of the next meeting***

The next CESAME meeting will take place on Monday 20 February 2006. The subsequent meeting will take place on Monday, 12 June 2006.