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Code of Conduct on Clearing and Settlement

Eleventh meeting of the Monitoring Group (MOG)

29 October 2009

The purpose of the eleventh meeting of the Monitoring Group of the Code of Conduct (MOG) was to reassess Code implementation and take stock of recent developments in the Code's three areas: price transparency, access and interoperability and service unbundling and accounting separation. In view of this Commission's mandate coming to an end and the Code having been in force for two years, the meeting was closed with an open discussion about the Code's achievements and shortcomings.

Price transparency

Price comparability remains the main issue. The MOG considers that there are three largely complementary tools that may improve comparability and transparency provided that they are well designed: price examples, conversion tables and price simulators, with the latter two being outside the direct scope of the Code. The MOG encourages CSDs to incorporate ECB suggestions on examples and simulators. In addition, to enhance comparability further, the MOG considers that, notwithstanding differences in business models, it is necessary to further harmonise the definition of services. This does not mean harmonising business models, service offerings or prices.

The MOG further considers that invoices should contain all the information necessary for users to understand the prices they are being charged. To that effect it encourages infrastructures and users to continue their discussions to make invoices as informative as possible in order to deliver billing reconcilability. The MOG considers that the request made by users on invoices to include value traded where applicable in order to understand costs as proportion of value traded is reasonable. This is important information for the Commission as well, as illustrated by Oxera study.

Access and interoperability

The MOG believes that access and interoperability links between infrastructures are key to achieve user choice and competition. Existing links have delivered these benefits. In order to provide guidance to infrastructures involved in ongoing link requests, the MOG would like to reiterate a number of principles that (i) are enshrined in the Code and the Access and Interoperability Guideline and (ii) have been confirmed by previous discussions in the MOG and which have a bearing on ongoing link requests. These principles are generally applicable to all ongoing link requests but have a particular bearing on the requests discussed at this MOG (e.g. competitive clearing for NASDAQ OMX's Nordic market as well as for Chi-x, BATS, Turquoise and NASDAQ OMX Europe).

- **Standard access is a right:** Provided that there are no regulatory concerns, infrastructures that receive a request for standard access from another infrastructure should grant that access without any conditions according to Article 23 of the Access and Interoperability Guideline. Therefore, CCPs have a right under the Code to become general clearing members of another CCP (e.g. pending interoperability), unless specific risk concerns have been identified.¹
- **Reciprocity principle:** Article 50 of the Access and Interoperability Guideline states that a receiving organisation can deny a link request if the requesting organisation is itself demonstrably impeding an actual parallel request for a reciprocal link. The MOG considers that it is natural that a CCP seeking to provide competing services in the market of another CCP at the same time strives to ensure reciprocal market access to the market it is currently clearing.
- **Business case:** A loss of market share is not a valid excuse for refusing a link request. Therefore, the business case requested by the Access and Interoperability Guideline is *effectively* for the requesting party, as the receiving party is unlikely to have a business case for opening up to competition.
- **Receiving party principle:** The MOG would like to reiterate that as a general principle, Article 51 of the Guideline highlights that the burden of adaptation broadly falls on the requesting party. Accordingly, the requesting party should pay for any additional costs related to setting up a link.
- **Risks related to links:** In line with ESCB-CESR Recommendation 11 for CCPs and 19 for securities settlement systems (SSSs) on risks in cross-system links, the MOG considers that links between infrastructures may give rise to risks but that these risks are manageable. Therefore links do not decrease safety provided that the risks are identified and addressed. In view of these risks, the MOG considers that linked infrastructures should be transparent vis-à-vis regulators, other infrastructures with which they are linked and users about the risks they identify as a result of the link and how they address them. Moreover, the MOG takes note of ongoing work by some infrastructures in the CCP area to (i) streamline interoperability agreements, e.g. by means of a convention, in order to increase transparency on risks and legal certainty, and (ii) harmonise communication standards (e.g. process rules, information flows and syntax).
- **Safety first:** The Code does not operate in isolation. Legislation takes precedence over self-regulation. Therefore, if there are regulatory concerns, these have to be addressed before links can become operable. The MOG acknowledges that some regulators have expressed concern as regards some of the ongoing interoperability requests involving CCPs. The Commission is in contact with these regulators, who value the increased choice and competition brought by interoperability and are working to ensure that interoperability continues to go hand in hand with safety. The MOG invites concerned infrastructures and their users to liaise proactively with these regulators to determine the exact nature of their concerns and come forward with suggestions for solutions in order to move forward in a timely manner. The MOG will continue to follow this matter very closely.
- **Competition rules:** The MOG reminds infrastructures that their handling of link requests also needs to respect competition rules. The MOG would like to draw the attention to the Court of First Instance's recent judgement regarding a Commission decision against

¹ According to ESCB-CESR Recommendation 2 for CCPs on participation requirements and Recommendation 14 for SSS on access, a CCP or SSS can only deny access to its system on risk-related criteria, which should be explained in writing.

Clearstream which is enlightening in this respect.² While each case has to be assessed individually, the judgment clearly illustrates the special obligations of incumbent infrastructures that enjoy dominant positions in a given market when dealing with market access requests from other infrastructures wishing to compete.

- **Mediation:** Mediation is foreseen under the Access and Interoperability Guideline but has so far never been used. The MOG encourages parties involved in stalled link requests to seek mediation if there is no immediate prospect of the situation opening up.
- **Reporting template:** the MOG believes that the quarterly reports provided by infrastructures have improved the transparency about how requests progress but considers that the template can be further enhanced.

Service unbundling and accounting separation

The MOG welcomes the information provided by infrastructures on how they have complied with the external audit procedure. It invites infrastructures to ensure that each organisations public statement and summary of audit report is made publicly available.

The MOG welcomes CESR's presentation on the information its members have received under the external audit. This will serve as a base for further evaluating whether all the relevant information has been provided and to address any remaining shortfall.

As the first external audit procedure has now been broadly completed, the MOG will shortly invite a selection of infrastructures, auditors, regulators and users to review the procedure in light of first experiences with the view to minimise costs and ensure a focus on the core purpose of making transparent the relation between revenues and costs of different services as well as potential cross-subsidies between services.

The Code three years down the line – achievements, shortcomings

In view of three years having passed since the Code was signed and it having been in force for two years, the MOG initiated a debate on the Code's achievements and shortcomings to date. Broadly, participants agreed that the Code has achieved a lot but that more is needed in all three pillars of the Code. More specifically:

- The Code has significantly increased transparency, was a catalyst for link requests and has allowed a much deeper understanding of the barriers to cross-border service provision, be they of operational, commercial, risk or regulatory kind.
- The Code has provided a voluntary framework and contributed to significantly improve dialogue between infrastructures, users and regulators. The Code has therefore contributed to an environment where investors have gotten better results on a consistent basis. The Code has contributed to a decrease in costs per transaction, as documented by the Oxera study.³
- Interoperability is key in reducing frictional costs and it is therefore important that the momentum is kept. Even if the future landscape will be more complex it will for the *first time*, after the implementation of the interoperability links at virt-x in 2003 and the London Stock Exchange in 2008, deliver user choice and competition. Moreover, a

² Press Release No 72/09, 9 September 2009, Judgment of the Court of First Instance in Case T-301/04, Clearstream Banking AG and Clearstream International SA v Commission.

³ Oxera (2009), Monitoring prices, costs and volumes of trading and post-trading services, July 2009, http://ec.europa.eu/internal_market/financial-markets/clearing/communication_en.htm#monitoring

future interlinked post-trade system with common standards may well be more resilient.

- The Code has achieved significant results in the absence of a common legislative framework. It put the emphasis, and the projectors' lights, on action by the industry preventing protracted discussions, and the resulting inertia, during a lengthy legislative process. The Code also helped to reveal additional regulatory problems that need to be properly addressed. In that respect, the Code was a success; it achieved tangible results in a relatively short period of time and provided a wealth of practical experience.
- Nonetheless, there are limits to what the Code can achieve as regards regulatory and commercial barriers. To address regulatory barriers, some participants called for a more proactive involvement of regulators as well as closer coordination. Other participants supported the Commission's recent decision to propose Community legislation for CCPs.

Next meeting and future steps

The next meeting of the MOG takes place on 16 February. Further meetings will be held on 17 June and 28 October. The agenda for the next meeting will follow the usual format.

Time	Topic
9.45	General introduction
10.00	Price transparency
11.00	Access and interoperability
12.30	Service unbundling and accounting separation
13.00	Lunch
14.15	MOG deliberations (in camera)
15.30	End of meeting