COMPETITION IN EU SECURITIES TRADING
AND POST-TRADING
ISSUES PAPER

FBF’S RESPONSE

EXECUTIVE SUMMARY

1. The French Banking Federation (FBF) is the professional body representing over 500 commercial, cooperative and mutual banks operating in France. It includes both French and foreign-based organizations.

As universal banks, FBF’s members strongly support European financial market integration and harmonisation of post-trading activities. Thus they welcome the DG Competition consultation paper entitled “Competition in EU securities trading and post-trading – issues paper”.

2. From FBF’s point of view, fair competition in trading and post-trading have always been essential to the safety and fairness of financial markets. More than anything else, competition is key to reducing costs for investors and improving market efficiency. The other key element of integration is the management of systemic risks.

In this context, post-trading activities are as important as trading activities, and the FBF draws attention to the second Giovaninni reports in 2003 which highlighted three public policy objectives for a future regulation: cost reduction\(^1\), fair competition and systemic risk prevention\(^2\).

Commissioner McCreevy’s conclusions on September 13\(^{th}\) 2005 were on-target when he considered that:
- Cross border transactions remain too expensive for investors;
- The creation of a pan-European clearing infrastructure would bring significant benefits in terms of increased efficiencies and cost savings, which would contribute to the decrease in cross-border transaction costs;
- Legislation will be needed if market players cannot move forward alone.

3. Considering this landscape, the FBF stresses that the DG Competition consultation paper is largely focused on trading issues, while the competition issues in trading activities have already been regulated by MiFID.

The FBF agrees with the DG Competition on two main points:
- That trading costs account for the bulk of the fees paid by end investors;

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\(^1\) An investor pays two to four times more for a cross-border equity transaction than for a domestic transaction in the European Union. 
\(^2\) The infrastructures have to manage a strong operational risk while banks have to manage a systemic credit and counterparty risk.
That fair competition between brokers is key stone to lower costs.

However, trading activities have been harmonised by MiFID, which is to enter into force in a few months. There has been fierce competition between brokers as well as an undeniable decrease in trading costs since the remote membership on regulated markets became possible and online brokers were allowed to offer their services in the European Economic Area. This competition exists in the interest of users, exchanges and investors.

The FBF thus recalls that MiFID has implemented a full European passport for investment services providers (i.e. investment firms and credit institutions licensed to provide investment services, including the management of a multilateral facility), and a European passport for regulated markets. MiFID is expected to structurally modify the landscape at trading level.

The competition analysis done by DG competition in its issues paper in this area is hence premature given the significant expected changes on the market structure. We would therefore suggest to initiate in due time a Call for Evidence in order to evaluate the efficiency of the framework shaped by MiFID, as it is done at present by CESR for the Market Abuse Directive, and wait until that evaluation to draw any conclusion in terms of competition at the trading level.

FBF’s response therefore focuses on the competition in post-trading issues.

4. Regarding post-trading issues, the FBF underlines that full market integration is impossible without a harmonised framework for the post-trade finalisation of transactions, i.e. clearing and settlement. The FBF therefore strongly supports a European directive that would provide an essential complement to the Market in Financial Instruments Directive (MiFID) implemented on the April 21st 2004, and would set forth the basic principles of these post-trade activities, namely to organise an orderly, fair and secure competitive environment in the mutual interest of issuers, users and investors.

Indeed, systemic risk and competition issues related to clearing and settlement infrastructures are critical and cannot be solved by market users alone as it has been done in other network industries such as Energy or Telecommunications.

As recognised by DG Internal Market draft working paper on clearing and settlement, “CSDs are characterised by economies of scale, economies of scope (horizontal) and network effects”. “Similarly to CSDs, CCPs are characterised by economies of scale, economies of scope (horizontal) and network effects.”

5. DG competition also rightly recognises that “settlement implies an irreplaceable role for Central Securities Depositaries (CSDs). Once securities are deposited, there can no longer competition for the settlement activity in the issuer register. Such primary settlement is often considered a natural monopoly activity.” DG competition also states that “there are no indications, that competition in agency settlement reduces the level of rents available to the CSD, which will in any case retain an irreplaceable role.”

Given this market structure we remain doubtful that interoperability could deliver actual and sustainable competition between CCPs and between CSDs. Indeed DG competition analysis does not take into account the current market structure and in particular the current significant positions of some players both at clearing and settlement level. Dominant positions already exist not only at national level but also at European level in both the clearing and settlement sphere.

3 The French banking industry has given the DG Competition many precise data concerning the trading costs at the occasion of the previous consultation.

4 The Euroclear group provide the primary settlement for 57% of EU-25 listed securities and Clearstream group 13% (market share calculated based on Stock exchange capitalisation – source FESE website). In terms of value of settlement the Euroclear group represent 60% of EU flows and the Clearstream group 8,5% (source ECB blue book)
We believe that interoperability will in fact reinforce the existing dominant positions and will further increase competition issues.

6. In addition, exchanges are in a consolidation trend which will inevitably influence post-trading activities and accelerate the consolidation trend in the clearing and settlement sphere.

The French banking industry considers that the competition landscape will experience the following trends:
- Fierce competition in trading activities, already regulated by MiFID;
- Dominant position in CCP clearing activity;
- Dominant position in CSD settlement activity;
- Strong competition between users of clearing and settlement infrastructures.

FBF therefore believes that competition in clearing and settlement need to be actively monitored and that ex ante rules have to be implemented.

7. We understand that DG competition would like to promote competition between infrastructures using interoperability as a tool. DG competition seems also to imply that infrastructures would need to develop intermediary activities to foster competition between infrastructures. DG competition indeed recognises that when accessing the incumbent CSD or incumbent CCP, a CSD or respectively a CCP is in fact acting as an intermediary. DG Competition also recognises that that “there are no indications, that competition in agency settlement reduces the level of rents available to the CSD, which will in any case retain an irreplaceable role.”

FBF would like to states that competition between infrastructures should not lead to a reduction of competition on intermediaries activities (more traditionally associated with those carried out by banks). Intermediary services are already offered on a competitive basis by banks. Should infrastructures want to develop intermediary services and commercial activities, the Commission should ensure that infrastructures would be prevented from leveraging their infrastructure position and the network effects they benefit from to promote their commercial activities and foreclose existing competition between banks.

Whilst we do not necessarily position ourselves against such a scenario we remind the Commission that there are minimum conditions required to avoid foreclosure of competition in commercial activities, such as transparency, unbundling, segregation between core infrastructure functions and commercial activities in terms of governance, management, operations and accounting.

8. Therefore whatever the evolution of the market (consolidation towards a single CCP and a single CSD) or competition between infrastructures, FBF believes that ex ante competition rules are necessary to allow the market to deliver a safe and efficient post trading environment. The future Directive should focus exclusively on post-trading infrastructures. Trading activities are to be excluded from the scope of the regulation as it has already been addressed by MiFID.

9. It must be stressed that the FBF, the London Investment Banking Association (LIBA), the French Association of Investment Firms (AFEI) and the Italian Association of Financial Intermediaries (ASSOSIM) issued an important call for consolidation on February 20th 2006. In this document, the four associations made two statements.

Firstly, the core activities must be completely separated: i.e. trading, clearing, settlement, because there are strong benefits from further horizontal consolidation of market infrastructures (exchanges, CCPs and CSDs), while vertical consolidation, with silos, creates potential for severe competitive distortions (use of dominant position on one segment distorting competition at other levels, risks of restricted access, bundling and cross-subsidies, lack of transparency in pricing structures, and unfair prices).

5 “Post-trading in Europe: calls for consolidation”, FBF, LIBA, AFEI and ASSOSIM, February 20th 2006.
Secondly the core activities have to be segregated from intermediary activities to ensure a level playing field between providers. Where group provides both central market infrastructure services and value added services there is a strong risk that it will compete unfairly. Segregation between those two types of activities will prevent potential bundling and cross-subsidies from creating competitive distortions for other banking players. A further dimension, which is risk related, also supports this view, as systemic risk tends to increase when both banking and infrastructure activities are combined in a single entity.

Thirdly, concerning the governance rules applicable to infrastructures, the associations considered that “governance provides one means by which the objectives of a structure may be pre-specified, its performance monitored and shared, and the effects of potential conflicts of interests between stakeholders minimised. In the absence of effective competition, strict governance arrangements, together with close regulators scrutiny, must be implemented to avoid any abuse of dominant position and ensure appropriate risk management and fair treatment of users (...). Most examples around the world of clearing and settlement infrastructures are organised as utilities, user-governed. Those broad characteristics should apply to unified pan-European infrastructures. Relevant arrangements should be incorporated in the bye-laws of the new merged entities and implemented:

• Clear and transparent rules for decision-making, ensuring a proper focus on price efficiency and cost reduction, together with sufficient attention to risk management,
• Composition of Boards of Directors and Advisory Committees, based on the following principles: Majority of users, proper representation of types of users and geographies covered (in accordance with the importance of the different financial communities and marketplaces) and reserved seats for independent directors.
• Rules for profit allocation, depending on the capital structure defined.

Relevant independent audits on access, prices and services should also be regularly conducted to ensure there is no abuse of dominant position. Open consultations, complementary to the work of the advisory committees, should also be organised.”

10. In such a context, FBF strongly believes that a framework directive is needed to ensure that competition and risk issues are adequately addressed for the market to deliver a safe, efficient and competitive post trading environment.

Therefore the Directive should be written around three themes:
- A clear definition of post-trading activities: clearing, settlement distinguishing custody and banking
- Segregation between infrastructure activities and commercial activities
- Enforcement of mandatory rules for infrastructures:
  . Price transparency (unbundling of services and structures)
  . Equal access for all players through non-discriminatory rules
  . Governance rules in order to ensure proper user representation.

11. FBF’S position may be summed up as follows: the best way to achieve financial market integration is to ensure fair competition at custody level and horizontal consolidation at clearing and settlement levels. Thus the FBF asks for the implementation of a binding legal framework for post-trading activities in order to reach the objective set in the Financial Services Action Plan for fair and efficient European financial market integration.

The following detailed comments focus on this matter.
II. DETAILED COMMENTS

II.1. Current level of competition

12. The best way to enforce relevant rules on competition issues is to draw the shape of the current situation on both clearing, settlement and custody activities.

In preamble, FBF wishes to express two regrets:
- First, the current competition situation on these activities isn’t really described by the DG Competition in its consultation paper;
- Second, the DG Competition does not acknowledge current existing dominant position of infrastructures that requires already competition watch.

13. Current competition in clearing activities.

The clearing function provided by Clearing infrastructures market (CCPs) consists in becoming the central guarantor of counterparty risk, interposing itself between market counterparties, thereby becoming the buyer to every seller and the seller to every buyer. This activity is exclusively performed by the Central Counterparty, through a novation process or its legal equivalent\(^6\). Thus the main CCP function is counterparty risk management.

Clearing is by nature a multilateral activity. By interposing itself to every trade, the CCP replaces the need for bilateral risk management obligations amongst market participants with a single exposure towards the CCP.

In order to perform its clearing function, the CCP engages in a broad range of activities, such as central position-keeping, central risk management, cross margining, collateral management, management of settlement instructions. Clearing may also be combined with netting, although this is not compulsory. In such a case, the CCP calculates the net obligations of the clearing members, setting off the clearing members’ debit and credit obligations, and achieving a smaller net exposure.

The use of a CCP has been recommended by the Group of Thirty (recommendation 6)\(^7\) as a tool to provide substantial risk reduction and efficiency improvements for the market. In 2004, CPSS-IOSCO\(^8\) confirmed that “a CCP has the potential to reduce significantly risks to market participants by imposing more robust risk control on all participants and in many cases by achieving multilateral netting of trades.”

In practice, the size of the market dictates the need and the cost-benefit of implementing a CCP. CCPs were originally introduced in conjunction with derivatives exchanges and expended their activities to serve securities exchanges and multilateral trading systems. For instance, Germany and Portugal recently introduced a CCP in relation with the securities exchange. Lately, CCPs also engaged in serving over-the-counter markets. According to our latest information, 11 out of the 25 EU countries currently have a CCP in place, whereas 14 do not.

CCPs are characterized by strong network effects and polarisation of the EU market within regional hubs. The main European players at this level are LCH-Clearnet and Eurex Clearing.

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\(^6\) An alternative definition was done by the European Parliament in Mrs Kauppi’s report: clearing is the calculation of the mutual obligations of the parties to the transaction i.e. working out who owes what to whom. This definition does not take into account the guarantor responsibility of the CCP.

\(^7\) Group of Thirty, “Global Clearing and Settlement – A plan of Action”, Washington DC 2003

\(^8\) CPSS-IOSCO, “Recommendations for Central Counterparties”, March 2004
Competition for the clearing of the same security is limited by the fact that it would lead to the fragmentation of the clearing and settlement process, which would reduce efficiency and generate switching costs for clearing members. As a result, market participants are incited to remain with the incumbent participant.

As reflected by OXERA in its report to the Office of Fair trading “economies of scale and network effects apply to CCPs. In particular, the more trades that are cleared by the same CCP, the greater the potential for netting efficiencies. The strength of these effects can be illustrated by the history of the national Securities Clearing Corporation” (the US CCP).

14. Current competition in Settlement activities

Central Securities Depositaries (CSDs) perform the settlement and central register functions. As CCPs, they play an essential role in the smooth functioning of financial markets, and are characterized by strong network effects.

15. Settlement corresponds to the completion of a transaction through the transfer of securities and the payment of cash between the counterparties. In modern securities markets, securities are either immobilised or dematerialised, which brings the benefit of avoiding the movement - or even the existence - of any physical certificates. As a result, the recording of securities issued and the transfer of securities occur through electronic debit and credit entries into securities accounts. These accounts are maintained in a central book. The entity in charge of maintaining the central book and registering the book-entries on this central book is usually named a CSD, although there are a few exceptions.

As stated by DG Competition, “a CSD is an entity which administers securities and enables securities transactions – such as the transfer between two parties – to be processed”. OXERA confirms: “Settlement refers to the activities of a central securities depository (CSD), which maintains an electronic record of the holders of securities”.

16. To be more precise, for a given security, the CSD provides the root of title by maintaining the accounting balance between the debit position on the issuer account and the credit positions on the participants’ accounts. As a result, the CSD ensures that any traded securities – be it via exchanges, trading platforms or over the counter does exist and that transfers are duly realised. In order to perform its function, the CSD operates a system, which is a formal agreement between participants, with common rules and standardised arrangements for the execution of transfer orders, and enacts the regulations governing such system.

CSDs are characterized by the polarisation of the EU market within regional hubs. The main European players at this level are:

- The Euroclear Group, which totals over 38% of EU-25 CSD volumes by number of transactions settled and 60% by value of transaction settled (Euroclear Bank Brussels, CREST in the UK, Euroclear France, CIK in Belgium, Necigef in Netherlands).

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9 This function is sometimes referred to under the name of book-entry settlement.
10 In the case of Crest in the UK, the maintenance of the register is outsourced to commercial entities; in the case of Eurobonds, the name CSD was not used for the entities in charge of the central deposit and settlement of the issues, although legally speaking they enjoy a CSD status.
11 Commission press release IP/03/462, 31 March 2003
13 The only instance where two CSDs share the same responsibility for a given security is the Eurobonds segment. In order to solve the specific reconciliation difficulties inherent to this set-up, some aspects have been outsourced by the ICSDs to commercial entities which are named common depositories.
14 This definition is based on the Settlement Finality Directive.
15 Source ECB Blue Book March 2006, table 17.
- The Deutsche Börse Group, which totals over 15% of EU-25 CSD volumes by number of transactions settled and 8.5% in terms of value of transactions settled (Clearstream Banking Frankfurt, Clearstream Banking International)¹⁶

- The remaining 22 CSDs share 47% of EU-25 transaction volumes and 31% of capital volumes, with SCLV in Spain and Monte Titoli in Italy processing the most significant volumes¹⁷.

17. **Competition for the settlement of the same security is limited.** There are efficiency benefits and economies of scale in the concentration of settlement with a single CSD, leading historically such CSD to hold a dominant position. Market liquidity and network effects tend to concentrate all flows on a single CSD.

As reflected by OXERA in its report to the Office of Fair Trading “The market for clearing and settlement services is characterised by significant economies of scale and network effects. For instance, efficient transacting requires that buyers and sellers link into the same CSD [...] In other words the market has natural monopoly characteristics”¹⁸

The only exception to this situation is the exclusive position of ICSDs¹⁹, Euroclear Bank Brussels and Clearstream Banking International, which:

- Share a “duopoly” on the (historically offshore) Eurobonds market,
- Bundle the provision of settlement infrastructure services with competitive custody and banking activities, and have extended their “duopoly” to such activities,
- Take benefit from existing privileged arrangements with Exchanges and CCPs to attract business away from the CSDs - fragmenting settlement liquidity - and from competing custody and banking providers - foreclosing competition.

The Eurobonds activity is not equally shared among the two ICSDs, since Euroclear Bank concentrates the majority of deposits, as well as most transaction volumes.

18. The ICSDs leverage their infrastructure network when competing in custody and banking. ICSDs extract a large portion of their revenues from tying banking and custody revenues. Indeed, where custodian banks usually compete for the provision of services, ICSDs are the sole providers of banking and custody for clients who are captive of the Eurobond infrastructure.

It is estimated that ICSDs earn 10% of their revenues in settlement services and up to 60% in securities financing (securities lending and tri party repos).

“In Europe, in particular, tri-party financing has long seemed a closed shop. Clearstream and Euroclear have built dominant positions in European fixed income tri-party, while JPMorgan Chase and The Bank of New York have concentrated primarily on equity (that is a smaller market altogether). This is still a market with too few contenders and only a handful with meaningful market shares.

The Brussels-based (I)CSD is easily the largest provider in European tri-party. Euroclear did best in areas where efficiency counts and relatively badly on the human qualities (responsiveness of staff) and prices (fees charged and access to low cost finance), also coming last on the accuracy of collateral valuations.”²⁰

The prices charged on a captive clientele tend to be disconnected from market practice:

- The spreads charged on automatic lending and borrowing are worth 60 basis points, where market fees are 10 basis points,

¹⁶ Source ECB Blue Book March 2006, table 17.
¹⁷ Source ECB Blue Book March 2006, table 17.
¹⁹ The use of the generic term (I)CSD effectively creates confusion by failing to reflect the dual nature of these institutions, which provide at the same time infrastructure services and custody and banking activities, as a result of their unique historical positioning in the Eurobond market under the auspices of the European Central Bank.
Similarly, no spread is paid on credit cash balances and the spread charged on debit cash balances is higher than competitive market fees, equating to a 3% spread on customer deposits and overdrafts.

Global Custodian magazine sums up the situation as follows: "Despite much talk of rebates, sliding scale tariffs, and price reductions ... the lack of transparency makes it impossible to judge what any client of an ICSD is actually paying for services. Both (ICSDs) are notoriously expensive intermediaries into local markets ... and have a reputation for paying low rates on cash while charging high prices for credit."  

The Giovaninni report stated also that the ICSDs costs are far much higher than those practiced by the CSDs, especially in case of external settlements. Furthermore, it would be necessary, in order to have a complete sight of the global costs paid for a cross border transaction, to integrate the costs of the local/global custodians.

Their unique positioning also creates a strong incentive for ICSDs to leverage their position in Eurobonds, and to a lesser extent in debt instruments such as government bonds, to attract institutional investors and consolidate the equity market on their platforms, in direct competition with banks and custodians who are not in a position to compete at the infrastructure level. In a review, Global Custodian magazine stated the following: "Even as they become increasingly similar to each other, the ICSDs remain different in terms of clients and by comparison with their non (I)CSD rivals. Structured and operated like global custodians, and enjoying utility revenues, they compete principally with agents banks. It is a position which ought to be of even greater interest to regulators than it already is, and they may or may not oblige them one day to choose a single entity."

19. They also benefit from exclusive arrangements with Exchanges. The unique relationship which the ICSDs enjoy with the LSE, DG and Euronext also contributes to such a strategy. To illustrate, Euronext designed Euroclear Bank at its preferred settlement solution, facilitated Euroclear Bank’s entry to Clearnet board (then LCH. Clearnet) in 2001, established privileged links feeding into Euroclear Bank and sold all CSD activities to Euroclear Bank. This, together with the development of a ‘single settlement engine’ to facilitate cross-market settlements, is designed to concentrate European settlements at Euroclear Bank.

20. Competition in Custody and Banking market

Finally, custody and banking are two other fundamental and very distinct functions in the post-trade organisation. They differ from the clearing and settlement functions both in nature and in their functioning since they are - under normal market circumstances - not provided for centrally.

21. The custody function is defined as an ancillary service under section B of the MiFID. It encompasses account-keeping (holding sufficient securities on the central register or on the books of another custodian; safekeeping securities in the name of customers, which involves ensuring that the number of securities held by the account-keeper is equal to the number of securities belonging to the customers. The account-keeper is under the obligation to maintain a book of accounts in compliance with the regulatory rules and to maintain the balance on its books), transmitting securities transfer instructions that is orders to transfer a security by means of a debit or credit to a securities account, processing corporate actions. As described in the Oxera report to the OFT, “custody services typically involve safekeeping and servicing assets.”

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21 Winter 2002 issue Page 73.
22 “Comparison of trading costs in Europe and the USA, and future outlook”, Study by Eurogroup Consulting, for and under the guidance of the International Group of AFTI, November 5th 2002.
23 Global Custodian- Fall 2004- Review of agent banks in major markets- ICSD section
22. Custody is provided by a broad range of entities, such as custodians and investment services providers. “Custodian services are primarily purchased by institutional investors and brokers”\(^{25}\).

It is market practice to use various names, such as local custodian, sub-custodian, agent bank, regional custodian or global custodian, to indicate the scope of markets covered, although these names relate to the same underlying function. Beyond the services provided to investors, custodians serve issuers, by covering their asset servicing requirements. They also serve other financial intermediaries, by supporting their back and middle office operations.

23. **Competition in custody is thriving.** Custody activities and securities processing at large lie at the heart of most financial activities such as trading, brokerage, corporate banking, investment management, retail and private banking or insurance. There is clear evidence that competition is fierce to service domestic or cross border investors and competitors engage at domestic, regional and global level.

US custodians have expanded in the EU over the recent years by following their clients and buying market share: “The custody market – which is global in nature – is moderately concentrated at present, with an HHI below 1,000. However, the trend is towards increasing consolidation. The top four global custodians (State Street, Bank of New-York, JP Morgan and Citigroup) already account for almost 60% of assets in custody worldwide.”\(^{26}\)

In all cases, the level playing field in custody activities depends on the equal and non discriminatory access to post-trade infrastructures, since, as mentioned by Oxera: “Custodians act as an intermediary between the investor and the CSD.”\(^{27}\)

24. **The banking function** is distinct from the custody function. Unlike Deutsche Börse in its white paper on European Post trade market, we would contend that so called “ancillary banking services” form an integral part of post trade services.

The banking function defined under the 2000/12/EC Directive relating to the taking up and pursuit of the business of credit institutions. In the context of post-trade, it involves maintaining cash accounts on behalf of the customers, taking deposits, taking credit and liquidity exposure, managing the related risks and limits, providing liquidity, lending and borrowing cash and/or securities, acting as principal or as agent in securities lending, managing foreign exchange services, and managing the bank’s treasury positions. One of the major roles of banks consists in providing liquidity, for instance to support investment firms in their trading and investment strategies or to support issuers in primary issues or corporate actions. This is particularly relevant in the Eurobonds market.

25. **Competition in banking services provides choice and maintains the pressure on prices and on the quality of services.** Competition for instance, strongly influences the remuneration of credit balance, the fees charged on debit balances or the pricing of securities lending and tri-partite repurchase agreements, since there is clearly an opportunity in such an open market for clients to change provider or negotiate fees.

26. **Custodian Banks cannot challenge Infrastructures and / or ICSDs.** Custodian banks are not in a position to substitute CCPs and CSDs. It is often argued as in the white paper issued by DB on the European Post Trade market that custodian banks can challenge national CSDs by avoiding the transmission of a large number of orders to the CSDs. These services are of a different nature and incidental\(^{28}\), since individual custodian banks, unlike ICSDs, depend on the rules set up by the CCPs and

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\(^{28}\) Section 2.2.2 of the final report by London economics to the European Commission Competition DG- Overview of the EU 25 securities trading, clearing, central counterparties and securities settlement – February 2004: “Unlike
by the CSDs, they serve a limited range of customers which they do not control. They transfer client orders whether they stem from retail or wholesale transactions. DG competition recognises in its issues paper that “there are no indications that competition in agency settlement reduces the level of rents available to the CSD, which will in any case retain an irreplaceable role.”

CCPs traditionally appoint the national CSD as unique settlement location. They recently started appointing ICSDs as their “preferred settlement provider”. In addition to reducing the CSD revenues, this may lead to the fragmentation of settlement between retail and wholesale flows and potentially deteriorate the economic environment for CSDs serving retail flows, leading to price increases. The foreseen implementation of single settlement platforms encompassing the central deposit and settlement functions, together with the custody and banking functions, are likely to reinforce this trend.

CSDs and ICSDs are too often presented as if they both were similar infrastructures although they do not perform the same functions. This fails to clearly distinguish where ICSDs act as infrastructures (settlement platform for Eurobonds in particular) and where they act in all other activities where in fact they act as custodians or bankers.

II.2 The way to remove barriers to competition

27. General statement.

The DG Competition considers (point 5-2-4 interoperability, § 80) that: “Competition both in and for the market could be encouraged through interoperability. Competition in the market has usually been interpreted as meaning that a single exchange would allow several CCPs to be its service providers. The current example of two infrastructures providing CCP services to MTS is an interesting example, especially since it appears that this has been developed at quite a low cost to users and infrastructure. However, other ways of organizing competition in the market, such as allowing additional CCPs to access the incumbent CCP on fair terms in order to act as a clearing agent, are also possible and should not be disregarded prematurely”.

The FBF doesn’t share DG Competition’s view on this point. As a matter of fact, the French banking industry firmly believes that:
- Consolidation is preferable to interoperability;
- Creation of vertical silos involves severe distortions in competition;
- A clear segregation between infrastructures and banking services has to be implemented.

28. Barrier to competition in clearing services.

The DG Competition seems to consider that interoperability is a good way to reach the objectives of cost savings and fair competition, and doesn’t see any issue in vertical silos situations.

As it is stated in the executive summary, FBF doesn’t share DG Competition’s view and estimates that the interoperability is not even a short term solution regarding the movements of financial markets concentration observed in Europe for five or six years.

The FBF recognises that the main advantage of the interoperability is to avoid high investment costs. Indeed, in it not necessary to consolidate every technical system to implement an interoperability, nor to

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29 According to our estimates, the potential impact of a single custodian bank on CSD volumes and/or revenues is below 1%. This has to be placed in a perspective where CSDs have the capacity to increase prices, which occurred lately in a number of European markets.

**Note:**

*a CSD whose key function is to provide book entry settlement, an intermediary settles customer transactions in its own books only if the transferor and the recipient of the securities happen to be its customer and then only if both customers’ positions are held in the same account at CSD level.*
harmonise the legal and tax framework on securities. But as the investments will be limited with interoperability, the economic benefit for every actor in a long term view will also be very limited.

29. Furthermore, FBF wishes to underline that **consolidation in post-trading is a far better way than interoperability** to achieve the objectives of reduction of costs.

30. **Firstly, to link all the post-trading systems, CCPs would require many separate bilateral connections**, all of which would ultimately be paid by users. Establishing even a proportion of them reduces significantly the costs savings.

31. **Secondly, interoperability will not allow effective competition between infrastructures.** In addition to the underlying costs involved in maintaining separated but interconnected CCPs, there is good reason to believe that competition between them may not actually be achieved and the benefit that one could expect would actually not be materialised. Due to the network effect the process of competition may be distorted by the existing market power of the infrastructure providers. Clearing and settlement have the characteristics of “Tippy markets”, i.e. where there are significant consumer advantages to being part of the biggest network because of the extended range of transactions that can be made (or there are significant pure economies of scale). In such a market there is a tendency for there to be a “winner takes all” outcome. There is no effective competition once one network has clearly become the biggest. Competition will be transitory at best, since the end result is likely to be a monopolistic market for any particular set of securities traded by the same intermediaries. Finally in the intense competition at the start of the process to establish a “winner”, there is no guarantee that the best long term outcome for consumer will prevail.

32. From an economic point of view and from a competition point of view, FBF considers that consolidation is the only way to achieve a fair, cost savings and efficient integration of the post-trading activities.

Furthermore, it is indisputable that the immediate costs of a full consolidation will be significantly lower than long-term benefits for both intermediaries and investors.

33. **Another issue to be highlighted is the distortion in competition involved by the “Vertical Silos”.** Several examples of vertically integrated business models exist in Europe, including in Germany (the Deutsche Börse group), Spain (Bolsas y Mercados Españoles, BME) and Italy (Borsa Italiana), based on potential economies of scope between trading, clearing and settlement.

However, such economies of scope and the advantages of vertical integration are hotly debated. More importantly, silos create potential for severe **competitive distortions**:
- Use of dominant position on one segment distorting competition at other levels,
- Risks of restricted access, bundling and cross-subsidies,
- Lack of transparency in pricing structures and unfair prices.

Additionally, silos represent a **hurdle to European financial integration** because they:
- Limit competition for trading by restricting participants’ access to post-trade infrastructures and increasing the costs of moving liquidity,
- Prevent horizontal consolidation.

This view was supported in the statement of the European trade associations published in February 2005 and in the conclusions of the Bourse Consult survey conducted this fall. The report indicates that “**The majority view was that exchanges should not control the post-trade process**”. It concludes with the following: “**The existence of vertically-integrated structures is an obstacle to rationalising the European post-trade infrastructure.**”
34. **Barrier to competition in settlement services.**

As it is stated about clearing activities, consolidation is the best way to reach the objectives of fair competition and cost-savings in settlement activities.

In addition to the abovementioned observations made on interoperability, it must be underlined that interoperability would also involve costs due to additional activities such as reconciliation and controls that must be carried out to allow for example electronic share certificates to flow between CSDs.

35. Furthermore, from an historical point of view, it seems useful to recall the SEC analysis wrote in 1975. The SEC considered the merits of three options:
- Introduce interoperability by linking seven existing settlement systems - estimated to produce cost savings of 9.6%;
- Maintain and link three of the existing systems – estimated to produce cost savings of 32.7%
- Move to one settlement system, properly regulated – estimated to produce cost savings of 63.5%.

Thus the SEC opted for a single settlement system despite strong opposition of individual CSDs (which were owner by the exchanges at that time). There is no reason to believe that the underlying structure of costs has fundamentally changed since 1975.

So an intersystem settlement is likely to remain significantly more costly than a consolidated settlement system, even with an efficient link. A cross-border trading grow securities will keep moving back and forth between CSDs and the higher intersystem link cost has to be incurred. Fragmentation of settlement across a number of CSDs may also significantly affect the possibilities of efficient netting at the clearing level.

36. We agree with DG competition that standards would facilitate interoperability. It would also facilitate the consolidation process. FBF fully supports the development of industry standards to which it actively participates. However FBF would like to stress that remote membership at CSD level is possible and is used as it is demonstrate for example in the French CSD Euroclear France. Easy access to central bank money and the implementation of Target 2 would facilitate further the use of those remote memberships.

37. **Possible foreclosure of agency settlement and custody.** Although the observations on interoperability made on clearing activities practices are also relevant on settlement activities, the distortions in competition involved in the settlement area are even more sensitive.

As stated previously there are, in the settlement sphere, already dominant providers not only at national level but also at European level. Euroclear group and Clearstream group accounts together for more 70% of settlement of listed securities and for more 68% of settlement flows in EU- 25 in terms of value.

Due to the network effect, characteristics of this market, the process of competition may be distorted by the existing market power of the infrastructure providers and in particular by the dominant position of these groups. Clearing and settlement have the characteristics of Tippy markets, i. e. where there are significant consumer advantages to being part of the biggest network because of the extended range of transactions that can be made (or there are significant pure economies of scale).

38. The two ICSDs, which combine both infrastructures and commercial activities, belong to those two groups. The ICSD already leverage their infrastructure network when competing in custody and banking which raises competition concerns. The risk of foreclosure of competition in commercial activities is even higher, as competition between infrastructures is most likely to be to their exclusive benefit. Interoperability will reinforce the competition issues unless adequate safeguard are implemented.
From the banks’ perspective, competition between infrastructures should not lead to a reduction of competition on commercial activities (more traditionally associated with those carried out by banks). We believe that there are minimum conditions required to avoid foreclosure of competition in commercial activities, such as transparency, unbundling, segregation between core infrastructure functions and commercial activities in terms of governance, management, operations and accounting. The Commission has recognised the necessity and implemented those conditions in other network industries such as Telecom or in the Energy sector. We would strongly recommend the Commission to follow the same consistent approach.

39. FBF considers the DG Competition have to ensure that the foreclosure of agency settlement in custody will not be possible, for it is obvious that the settlement agents shall have access to the same level of services without any discrimination. On this particular point, the FBF fully agrees with the paragraph 88 of the DG Competition consultation paper: “Certain (I)CSDs acting as intermediaries, have obtained a direct feed from certain CCPs while other intermediaries may not be able to do so. A direct feed means that an investor can specify that a trade which needs to be settled after CCP clearing can be routed either to the CSD or to the intermediary concerned. This enables the intermediary to capture trades which it may be able to internalise. Whilst this offers a service to the investor, it appears to give an intermediary with a direct feed an advantage over other settlement agents”. Such a situation is indeed unacceptable from a competition point of view.

In theory two possible remedies could be implemented: either forbidding such links CCP and intermediaries or opening the links to all intermediaries. However, extending such links to the competing banks has no sense. First it would fragment over more the liquidity and hence the efficiency both at clearing and settlement side. Moreover from an operational view such link would imply for a bank to open an account with all other banks active in the market for settlement. What would be the point to replace the CSD account where all participants are already registered? Hence this links can only work for CSDs or ICSDs who already have the entire market in their books, but it creates strong competition issues for competing intermediaries. We therefore believe that the Commission should prohibit direct feed from CCP to any institution providing intermediaries activities including ICSDs. Direct CCP feed should be restricted to infrastructures services and to the providers of those services where a clear segregation with other commercial activities has been implemented.

40. **ESES Project.** The ESES project (Euro Settlement for Euronext-zone Securities) is the single platform concept for the Euronext zone. It was initiated by the Euroclear group at the behest of banks in the Euronext zone. Its aim is to establish a single settlement system for the markets in Belgium, France and the Netherlands. Users of the system will have harmonised access to central securities depositories (CSDs), and settlement will be made in central bank money through a TARGET 2 connection.

ESES is consistent with the infrastructure model advocated by the French financial community. It has the following benefits:

- The solution relies solely on the CSD model, i.e. a domestic service for Europe, rather than solutions based on optimising cross-border processes (ICSD).
- The infrastructures used for the project (the Belgian, Dutch and French CSDs) are risk less, and settlement is in central bank money. The solution is based on the integrated model.
- The infrastructures provide general-interest services only, thereby avoiding conflicts of interest and maintaining a level playing field among participants in the competitive sector.

When implemented, the ESES project will cut the cost of access to CSDs by enabling participants to settle their transactions through a zone-wide domestic process by accessing a single technical platform. ESES will permit optimised management of the single order book in the Euronext zone, for the benefit of investors.

The FBF fully support the ESES project which implements in practice the general principles that FBE advocates for.
However the extension of single platform to an IC SD can raise specific competition and systemic risks concerns. The Users community is still waiting for clear answers on how the ICSD will not benefit from a privilege access and treatment within the platform. Legal and risk issues need also to be addressed.

41. **Price sensitivity and transparency.** FBF agrees with DG competition that there is a lack of transparency on infrastructures prices. As it was stated in Mrs Pia-Noora Kauppi final report on clearing and settlement adopted in the ECON Committee of the European Parliament on the may 24th 2005, “whereas the current concentration of stock exchanges and the tendency for clearing and settlement functions to develop into monopolies demonstrate a need for increased transparency in the cross-border clearing and settlement market”. Furthermore, it is mentioned in this report, and the FBF fully agrees with this assertion, that “the central providers of clearing and settlement services should take full account of the interests of all users and maximise user consultation and transparency of pricing structures, and ensure zero cross-subsidy between their central services and those offered in competition with other market participants, especially custodian banks, as is already the case in other industries”.

42. A recent EUROFI study to which major French banks participated concluded that: Prices of the central providers part of the scope have generally not been significantly reduced for users over the last 3 to 5 years despite processing optimizations and partial consolidation): The historical evolution of prices between 2000 and 2005 shows in particular that neither horizontal consolidation (e.g. Euronext / LSE zone central providers) nor vertical silo organizations (e.g. Deutsche Börse Group) have enabled so far to reduce post-trading prices significantly for users.

The profits made by the central providers surveyed appear to be quite high for companies that run a relatively low risk business in a centralized way and users consider that they do not benefit at present sufficiently from these profits:
- Direct and indirect fees have not significantly gone down on average during the last 3 to 5 years and user rebates are only distributed by a limited number of central providers
- Distribution of dividends cannot be considered as a direct cost reduction factor for users as ownership and usage are not aligned
- The positive impacts for users of investments related to platform developments are usually presented by infrastructures as potential back office cost reductions but these future savings are difficult to evaluate and are partly offset by the investments required to adapt their back offices.

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

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

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

44. FBF would therefore support greater transparency on infrastructures pricing. However publishing fees schedule on a website would not be sufficient to ensure fair and equal treatment of users and avoiding cross subsidues. A strict accounting separation between commercial activities and infrastructures activities as well as a breakdown of revenues and costs for infrastructures would be necessary. Similar approach has been taken by the Commission in the Telecom sector for example.
45. **Role of users, users’ governance and consolidation.**

The role of users on infrastructure’s governance is a key element of the efficiency and the fairness of the financial market integration. CCPs and CSDs are in a dominant position and competition among infrastructures is not likely to materialise and not desirable. There is no doubt that **competition rules** for markets infrastructures will be decisive. They should be coordinated and/or decided at European level. The European Commission should provide input in advance, particularly with regard to the status and regulation of infrastructures operating as dominant companies, thereby providing visibility to all stakeholders.

That’s why three FBF strongly believes that:
- Infrastructures should be regulated as “essential facilities”;
- Infrastructures should be user owned and user governed

46. **The “essential facility” qualification**

The way of a global consolidation of the financial markets and post-trading systems is always unpredictable. Notwithstanding this observation, the debate must now focus on the mechanism of integration of the post-trading infrastructures at a European level.

The current clearing and settlement situations look like “natural monopolies”. The Clearing Houses and Central Securities Depositaries have the same characteristics as the infrastructures on electricity, gas, or telecommunications, which are considered as “essential facilities”.

In order to define the “essential facility” concept, the European Commission noticed that when applying the rules on competition to services of general economic interest a distinction must be made between the infrastructures and the services providers. Although for economic reasons it would often be very difficult to establish a second infrastructure to compete with the existing one, it is possible to create conditions of competition in respect of the service provided.

47. The European Commission has therefore developed the concept of separating infrastructure from commercial activities. The infrastructure thus becomes a means of creating a market for competing services. While the right to exclusive ownership may persist as regards the infrastructure (the telephone or electricity network, for example), monopolists must grant access to third parties as regards the services offered (telephone communications or supply of electricity). This was the principle behind the liberalisation of the following sectors: Energy (i.e. gas and electricity production and distribution), Postal services, Telecommunications, Transport.

48. It is useful to refer to the OECD study entitled “The essential facilities concept”\(^{30}\). The OECD considered that Essential facility cases are not exceptions to normal rules, but specialized examples of general rules about discrimination and handicaps created by dominant companies; the concept may be merely a useful label for some types of cases rather than an analytical tool. In brief, the principle is that dominant companies must make facilities available when this is essential to enable competitors to compete. In the European Commission’s first statement of a general principle using the phrase “Essential facility”, explicitly based, it is said that “a dominant undertaking which both owns or controls and itself uses an essential facility, i.e. a facility or infrastructure without access to which competitors cannot provide services to their customers, and which refuses its competitors access to that facility or grants access to competitors only on terms less favourable than those which it gives its own services, thereby placing the competitors at a competitive disadvantage, infringes Article 86, if the other conditions of that Article are met. A company in a dominant position may not discriminate in favour of its own activities in a related market (...) without objective justification.”

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Determining what essential facilities are is a question of estimating the extent of the handicap to competitors, and whether it would be permanent or merely temporary. There are no specific legal rules to resolve these cases; it requires application of basic principles of antitrust economics. The duty to provide access to a facility arises if the effect of the refusal to supply on competition is objectively serious enough: if without access there is, in practice, an insuperable barrier to entry for competitors of the dominant company, or if without access competitors would be subject to a serious, permanent and inescapable competitive handicap which would make their activities uneconomic.

Hence, access to a facility is “essential” when refusal to supply would exclude all or most competitors from the market. In most cases, the dominance will be largely due to owning or controlling the essential facility. Although the company need not be dominant on both markets, if it is dominant also on the downstream market, the arguments for a duty to provide access are very much stronger.

Situations raising issues concerning essential facilities. The duty requiring access to be granted to an essential facility can arise in any industry. Ten years ago, the OECD estimated this concept was of increasing importance in telecommunications, the transmission of energy, transport, while these industries were progressively deregulated. However, it should be noted that the European Commission had considered that these industries could not be satisfactorily liberalized using only Community antitrust law, and that it was necessary to adopt general measures of which access to networks and grids would be only one aspect.

Cases which may raise issues concerning essential facilities include, for instance:
- Car ferry companies which provide harbours for other ferry companies;
- Railways which both transport goods and provide haulage for other companies which transport goods;
- Banks which control cheque clearing facilities;
- Airlines which operate airports;
- Telephone companies which provide mobile telephones, and long-distance wire telephone lines;
- Companies which own electricity grids and power lines and gas pipelines;

The cases on telecommunications show that, in general, a company in a dominant position in one market may not use its power to extend its dominance or monopoly into other markets. This principle is relevant to, but not to be confused with, the principle that dominant companies must make facilities available when this is essential to enable competitors to compete. Access issues have arisen in many Commission cases concerning the liberalised markets in the telecommunications, media and information technology sectors. In the field of media, the central issue in several cases has been access to program content.

CCPs and CSDs are in the same situation: they are indispensable to allow their users to provide their services and their replication is quite impossible or at least extremely difficult because of economic, legal and technical constraints.

In the case of CSDs, another comparison may be done with central banks. A central bank is fully responsible for keeping bank accounts and for bringing the guarantee of the value of fiduciary change in circulation in the system. The central bank acts as a “solicitor”. For example the European Central Bank and the national central banks have this responsibility for the eleven countries who have adopted the Euro as single currency. The Credit institutions in the Euro system are in competition for the distribution of this currency, via credit cards, cheques or fiduciary change.

The situation of the CSDs on securities is exactly the same. They keep account for issuers and custodians and have the full responsibility to verify whether the securities in circulation and kept on the custodians account correspond to the securities registered in the issuers account kept by the CSD. It is also a “solicitors” responsibility.

They should have the same responsibility on the securities registration and control as the central banks on currencies. On this particular point the FBF fully agrees with the DG Competition who wrote that
“from a central bank’s point of view the post-trading infrastructure also pays a crucial role in the smooth functioning of payment systems and in maintaining the integrity of financial markets”. That’s why it is necessary to separate these infrastructures from the intermediaries.

An exhaustive overview of capital markets in European shows that there is in most countries a complete separation between infrastructures and intermediaries. CSDs do not compete with banks on custody, which is completely under the competition market between banks.

54. **The distortions in competition may appear on several points.**

First, the infrastructure which has developed a vertical integration (i.e. act as both provider and user of the system, both infrastructure and intermediary) may refuse the access to its system to intermediaries, or discriminate between the users, or propose tied services, or increase access prices;

Second, while the infrastructure (CSDs) could be allowed to provide banking services such as loans, custodians couldn’t act as a central securities depositary. It implies that the infrastructure might offer a full vertical range of services the intermediaries can’t provide. Such a situation would create a significant breach to the European principle of the level playing field and the fair competition.

Moreover, a macroeconomic view of the existing vertical integration (ICSDs Euroclear and Clearstream on the Eurobonds market) let see the following landscape:
- The ICSD has three kinds of clients: institutional investor, commercial bank acting for the account of retail investors, and investment banks (including brokers-dealers and hedge funds);
- The institutional investors and commercial banks acting for the account of retail investors represent weak flow but high stocks: on the contrary, investment banks represent high flows and weak stocks.

It would be highly profitable for the infrastructure to discriminate between the different users by offering better prices to the users who have high flows (investment banks). This would be detrimental to the equality between users and especially for retail investors and institutional investors.

55. **The Governance.**

*The infrastructure governance* provides one means by which the objectives of a structure may be pre-specified, its performance monitored and shared, and the effects of potential conflicts of interests between stakeholders minimised.

In the absence of effective competition, strict governance arrangements, together with close regulators scrutiny, must be implemented to avoid any abuse of dominant position and ensure appropriate risk management and fair treatment of users.

56. A majority of settlement infrastructures around the world are organised as utilities, user-governed. Those broad characteristics should apply to unified pan-European infrastructures. Relevant arrangements should be incorporated in the bye-laws of the new merged entities and implemented:
- Clear and transparent rules for decision-making, ensuring a proper focus on price efficiency and cost reduction, together with sufficient attention to risk management,
- Composition of Boards of Directors and Advisory Committees, based on the following principles:
  - Majority of users,
  - Proper representation of types of users and geographies covered (in accordance with the importance of the different financial communities and marketplaces)
  - Reserved seats for independent directors.
- Rules for profit allocation, depending on the capital structure defined.
- Relevant independent audits on access, prices and services should also be regularly conducted to ensure there is no abuse of dominant position. Open consultations, complementary to the work
of the advisory committees, should also be organised.

57. In terms of Capital, the consolidation process in European clearing and settlement infrastructures will require sizeable changes in ownership. Given the principles for strong user governance outlined in the previous section, two options could be considered:
- User-owned, user-governed entities, which could be organised as cooperatives, or as private companies; ownership and profit allocation would be roughly aligned with usage; new users would be allowed to participate in the capital of the entity;
- User-oriented entities with open shareholdings: users could remain a part of the shareholders base of the clearing and settlement infrastructures, but other investors (possibly including exchanges, with proper limitations) could participate:
  . Clear and transparent financial policies will then have to be defined, providing guidelines for the sharing of financial surpluses between owners and users and giving priority to users.
  . More specifically, returns for users should be based on usage, with clearly defined calculations. Sufficient returns for non-user shareholders should be agreed on in advance and capped. Two sets of shares could therefore be defined.

58. Beyond competition issues, the other reason why it is obvious that infrastructures and banking services have to be separate is the risk management. The risk management for infrastructure is essentially summed up to the operational risk, while banks have to manage a global credit and counterparty risk. In order to maintain the system safe, the CSDs should not assume any credit risk and should be required to settle in central bank money.

III. Recommendations and way forward

59. The limits of DG Competition existing power and the need for ex-ante provisions

The DG Competition seems hesitant to propose a Directive on post-trading activities. Indeed such a Directive concerns primarily the DG Internal Market. Nevertheless, the FBF believes that existing competition power of DG competition will not be sufficient to resolve the current competition issue. Indeed as stated by the Commission in the meeting between Mc Crevey and industry players on February 21° 2006, DG competition can only act ex post with the exception of merger cases. Creating a competitive environment for infrastructures and preserving competition in commercial activities requires some clear guidelines to ensure infrastructures will not leverage their dominant position into other related markets. The Commission in other network industries such as Energy or Telecom has enforced principles such as segregation between infrastructures and commercial activities, unbundling, accounting separation… to develop competition in this area. We urge the Commission to follow the same approach for clearing and settlement. There is no doubt that a Directive on Clearing and Settlement is necessary to encourage the Financial Market Integration.

As it was highlighted on Mrs Piia-Noora Kauppi final report on clearing and settlement adopted in the ECON Committee of the European Parliament on the may 24th 2005, “the creation of efficient clearing and settlement systems will be a complex process and notes that a true European integration and harmonisation will require combine efforts of different stakeholders, and that the current public policy debate should take into account of the principles underpinning Directive 2004/39/EC (MiFID) and focus on (a) bringing down the cost of cross-border clearing and settlement, (b) ensuring that systemic on any other remaining risk in cross border clearing and settlement is properly managed and regulated, (c) encouraging an integration of clearing and settlement by removing competitive distortions and (d) ensuring proper transparency and governance arrangements”.

60. The DG Internal Market highlighted in its “Draft working document on post-trading” the necessity of a strong legal framework. Indeed it is recalled that the coexistence of “various national
post-trading systems combine and communicate less efficiently and potentially less safely across borders, which means that an international investor faces higher costs and higher risk when making a cross-border transaction”. This observation is very close to the conclusion of the European Parliament report.

It is essential to act on these activities in order to achieve the regulatory architecture applicable to the actors implicated in any financial instrument transaction. Post-trading activities are the last financial activities which are not regulated by a European Directive.

After having regulated the most important issues concerning the relations between the final investors, the intermediaries and the markets with the MiFID, the Prospectus Directive and the Market Abuse Directive, the post-trading activities remain the last scope to be regulated at a European level. As the DG Internal Market underlines, “without efficient post-trading services an efficiently functioning securities market could not exist”.

61. Last but not least, the FBF estimates it’s a matter or urgency to communicate a Directive proposal and to initiate the legislation process on post-trading, for the Regulated Markets, the Clearing Houses and the Central Securities Depositaries are involved into a concentration process. So it is essential to act rapidly in order to avoid vertical concentration which would create severe distortions in competition.

To sum-up the FBF’s position, the Directive should focus on three aspects:
- Open and fair access to market infrastructures;
- A common regulatory framework that will facilitate horizontal consolidation of CCPs and CSDs;
- Unbundling and accounting separation, to prevent cross-subsidisation which has the effect of distorting competition.

The whole French banking industry would very welcome such a legal framework and therefore ask for a clear position from the DG Competition.

62. **Principles for infrastructures.**

The objective of the framework directive would be to define guiding principles for clearing and settlement infrastructures and in particular to ensure a clear delineation between clearing and settlement services as well as between infrastructures and commercial services, to prevent any risk or competition issues. The scope would cover financial instruments defined in MIFID, except derivatives, with a “grandfathering” clause for existing Eurobonds. This framework directive would need to address the following sections:

1. **Definitions**

   Definitions of clearing and settlement infrastructures and functions are necessary at EU level in order to lay a regulatory framework which shall foster market infrastructures consolidation and ensure an integrated efficient and safe European post trade organisation. Clear definitions should be proposed for CCPs, CSDs, and ICSDs with a clear differentiation between CSD and ICSD, as well as CCP and CSD. The functions to cover are clearing, central register, and settlement.

2. **Risk management / Regulation principles**

   Clearing and settlement infrastructures are central to the financial system. EU wide minimum safety standards are critical to ensure financial stability and avoid systemic risk. CCPs and CSDS should not assume more financial and credit risks than is necessary in their function as central provider.
The main CCP function is counterparty risk management. Strong credit risk management should be imposed by regulators. CPSS-IOSCO recommendation on CCP could form the basis of EU standards.

The main function of CSDs is to immobilise securities, guarantee their existence and settle transactions by exchanging securities against cash. Operational risk is the only risk inherent to this function. Credit and liquidity risks are not essential to the provision of the core function and settlement in central bank money is the best protection against risk concentration. Risk generating services should be strictly ring-fenced (unbundling principles) to prevent any spill over risk to the CSD.

**Competition principles / Governance principles**

Clearing and settlement market infrastructures benefit from natural monopoly position and enjoy strong network effects. In order to ensure a level playing field for all commercial activities – i.e. non core infrastructure functions such as trading and banking- segregation between the infrastructures and commercial activities should be imposed, along the lines applied in other network industries:

- Legal and functional unbundling between infrastructures and commercial services: Independence of legal form, organisation (operation and IT), decision making (management and board).
- Accounting separation based on costs and revenues

Structural measures such as divestment are unnecessary if appropriate ring-fencing and governance measures are in place.

For infrastructures services the following principles would need to be enforced:

- Fair access to infrastructure services and equal treatment of users accessing these services
- User oriented governance with fair representation of all type of users
- CCPs or CSDs must be duly authorised and combination of the two roles by a single entity is inappropriate.