

ZENTRALER KREDITAUSSCHUSS

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**Comments of the
Zentraler Kreditausschuss¹
on Competition DG Working document
“Competition in EU securities trading and post-trading”
Published by the European Commission on 24 May 2006**

Berlin, 30 June 2006

¹The ZKA is the joint committee operated by the central associations of the German banking industry. These associations are the *Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR)*, for the cooperative banks, the *Bundesverband deutscher Banken (BdB)*, for the private commercial banks, the *Bundesverband Öffentlicher Banken Deutschlands (VÖB)*, for the public-sector banks, the *Deutscher Sparkassen- und Giroverband (DSGV)*, for the savings banks financial group, and the *Verband deutscher Pfandbriefbanken (vdp)*, for the mortgage banks. Collectively, they represent more than 2,300 banks.

The Zentraler Kreditausschuss very much welcomes the excellently prepared issues paper “Competition in EU securities trading and post-trading”, dated 24 May 2006, and would like to thank you for the opportunity to submit our comments on it.

We especially welcome the date of publication, while the outcome of other initiatives in the area of clearing and settlement like the RIA of DG Internal Markets and the work on the Giovannini-barriers is still open. Since our members, more than 2,300 banks of different size, are active in the area of securities services all along the value chain from trading to custody, we try to give all possible support to efforts to promote the integration of EU financial markets in the future and see the issues paper as a solid basis for finding the necessary measures to achieve this aim.

General remarks

We strongly endorse the Commission’s envisaged goal of “ensuring that the cross-border trading and post-trading of securities is both safe and works as efficiently as at domestic level” (p. 2). In this context, we regard two measures as the key to efficiency and, last but not least, cost reduction in cross-border business – for service providers as well as their users and (retail) investors:

- the removal of obstacles highlighted in the reports of the Giovannini group and
- competition for centrally offered trading, clearing and settlement/custody services. This includes free access and exit especially for other central service providers, as well as choice – with the help of transparent pricing of basic services.

Like the Commission, we come to the conclusion that a well-balanced combination of private and public efforts (as already successfully started on Giovannini-barriers, see remarks on chapter 5.3) is needed to achieve this. Which measures we regard as appropriate will be explained in detail later on, summarized in our comments on the table on page 25 of the consultation paper.

Finally, we wish to support the Commission’s conclusions that (1) market failures identified are neither restricted to specific market structures, since exclusive arrangements exist not only in vertically integrated structures (par. 64) and (2) competition is a more appropriate way to address cost issues of central service providers than the call for user owned utilities as mentioned in par. 92. Only if a system of one or a few service provider(s) with inherent market power evolves will user governance become important as one possible means of preventing monopoly pricing. We would welcome it if the first conclusion on vertical integration were described as clearly under bullet point 4 of the Executive Summary of the consultation paper as it is in the subsequent text. In contrast to

the Competition DG Working document, the DG Markt discovered even benefits of vertical structures in its paper “Draft Working Document on Post-Trading” and compared pros and cons of this form of organisation (cf. chapter 2.2.3 and 2.3.3).

Having made these general conclusions, we would like to focus our further comments mainly on the areas where specific input is requested:

Chapter 4.2.1 All-in cost of trading and post trading

In par. 36 the Commission asks for explanations of the difference in magnitude of fees between the exchanges examined (p. 12 f). This seems very difficult without knowledge of the assumptions on which these results are based and how these figures have been collected. We therefore believe that it is impossible to provide an explanation. Perhaps the only reliable conclusion that can be drawn from this exercise is that it is not only in the area of clearing services that “it may be impossible for the user to have a clear appreciation of the cost of the service and to make an informed decision about alternative ... channels” (par. 38). It appears very difficult to compare prices even of basic services provided by the different central service providers.

We would therefore welcome a price table for common defined central services provided by exchanges, clearing houses and CSDs, which allows users to compare prices on objective means (such as that which banks are required to make available for retail clients today) to make an informed decision about alternative channels. We are aware, that this will not be an easy task due to the different business models of the service providers.

Chapter 4.2.2 Costs to final investors

We share the Commission’s impression that, due to a lack of analytical data, it is difficult to judge figures on costs arising in trading and post trading. This includes the cited study by Morgan Stanley and Mercer Oliver Wyman (par. 42 ff). The impression supported by this single study that banks are responsible for the bulk of costs is clearly misleading. It should be borne in mind that a large portion of banks’ costs are accounted for by services provided during custody, i.e. they have nothing to do with clearing and settlement. Under custody agreements, banks not only have to forward issuer information to customers and make dividend and interest payments but also to provide a number of other services such as issuing tax certificates or further “support services” for government, particularly fiscal, purposes. Especially important in this connection is that banks deal with a much larger number and types of customers (e.g. institutional and retail) than CSDs. In addition, banks are required to handle securities that are not held by CSDs (physical securities). Custody

costs and pure transaction costs should therefore be dealt with separately and thoroughly in any assessment.

Chapter 5.1 Barriers to competition in trading services

The Markets in Financial Instruments Directive (MiFID) is very complex and addresses many issues that are regarded as barriers to competition in trading services (concentration rule, reporting, access). We therefore strongly recommend awaiting implementation of this directive before drawing any conclusions from a new market analysis on possible further steps needed to foster competition. This includes the accounting transparency mentioned (par. 60) as well as possible competition-enhancing trading tools (par. 75). Even though transparency seems a desirable goal in most of the cases, we regard it as a possible solution if in the context of the yearly audit correct accounting of the different business lines is ensured. This seems an appropriate way to prevent cross-subsidization of value-added services through revenues earned by offering central services (rents). If not yet in place it is particularly essential that those infrastructures under public law which are not subject to the IFRS accounting and transparency obligations are required to have an independent auditor's attestation in this regard.

We are aware of diverse transaction volume counting arrangements in several secondary markets (par. 61) which might penalize transactions conducted on specific trading platforms. While we do not favour competition impediments of this kind, it should be taken into consideration that those procedures are oftentimes chosen due to reasons of practicability and data reliability.

Nevertheless, we can confirm that competition is hampered "where exchanges control the services offered by post-trading institutions" (par. 62). This situation is by no means limited to vertically integrated entities; comparable structures through contractual relationships (par. 64, 66) are standard in all markets. We therefore endorse the conclusion that "equal access to CCPs would facilitate more competition between trading platforms" (par. 65). The possibility described to put an exclusive service contract out to tender (par. 77) seems a likely way to create some kind of competition in a hitherto closed market whereas it has to be taken into account that a smooth shift from one to another clearing house also depends on the task sharing of CCPs and CSDs.

In order to achieve a real cost reduction and foster the integration of the EU market in the medium term, we believe it is necessary to go one step further and ask not only for free access to CCPs but also for free exit. We would like to have the possibility to choose

between the clearing services of each of the central clearing houses in Europe, independent of the trading platform selected. This does not seem an unrealistic goal by any means, since trading on virt-x already offers today the services of two competing clearing houses (LCH.Clearnet, SIS x-clear). The London Stock Exchange is currently planning an equivalent choice of clearing houses.

It is true that some kind of interoperability or rather interfaces is/are a necessary prerequisite for this, which would require investment initially. But the advantage for central service providers would be access to new markets and the competition created would ultimately cut the costs for users. This scenario could be created regardless of ownership structures.

Moreover, we do not share the view that today's restrictions on access to CCPs are necessary for security and safety reasons for a specific market (par. 68). The possibility to choose a CCP or the creation of links between CCPs or other central service providers is not a risk in itself. There is no reason why two central service providers running efficiently and safely should constitute an additional risk by establishing common links. Even though the operational issues for an efficient link between CCPs cannot be easily compared to links in other fields, these might still serve as an example. The successful bridge between the two European ICSDs (Clearstream International and Euroclear Bank) shows that links between infrastructure providers work. A link between CCPs would also make risk management more efficient for the single user, who would have to provide collateral only for the CCP he chooses and not for the different ones chosen by the market providers. In particular, benefits from cross-collateralization could be generated.

Chapter 5.2. Barriers to competition in clearing services

In paragraph 77 and 81 the lack of competition at clearing level and a possible shifting of rents from clearing to trading if exclusive service contracts are put out to tender is described and solutions are sought. To avoid putting a single service provider at a disadvantage, it seems necessary in our view to simultaneously require all exchanges to provide access to different clearing houses if reasonably wished for by users. Necessary links established between the CCPs could be used regardless of the exchange where the trade has been made. We feel that this is an important step to create competition at clearing level. We share the Commission's view that interoperability is another important key for more competition. It should be noted that the private sector has taken effective steps to improve interoperability (e.g. SWIFT Protocol Recommendation). Once a level playing field has been created on clearing services, this will lead to further integration and

possible consolidation of the market. This may even lead to the existence of one or only a few European Central Counterparty/ies, through which connection to the different national CSDs can be granted.

This solution would lead to a much more integrated European financial market in one big step that seems achievable in the medium term – as already described above in our comments on chapter 5.1.

Chapter 5.3 Barriers to competition in settlement services

In paragraph 83 it is stated that “competition may be prevented either by the behaviour of CCPs or of CSDs.” We take the view that competition at settlement level is at least to the same degree impeded by the behaviour of exchanges which often predetermine the way of clearing and settlement. Competition at settlement level can only occur when the Giovannini barriers – especially the fiscal and legal ones – are removed as well. Another notable barrier is the impediments to settlement in the cash leg, which should be solved for euro-denominated securities with the implementation of TARGET2.

A comparable solution could be sought for other European currencies.

The lack of competition in this area can only be solved in the long term, since tax, regulatory and legal barriers can only be removed by sovereign acts. The necessary initiatives led by DG Internal Market are underway and remarkable progress has been achieved, as the first report of the FISCO Group published in April shows. Nevertheless, market participants are by no means leaving things to the Commission in this area either. They are advising the Commission in the groups set up by it (CESAME, Legal Certainty Group and FISCO). We would like to express our appreciation of the Commission’s initiative in this area. Even though harmonisation of these regimes is a large-scale undertaking, efforts to achieve progress in this area must not be allowed to flag, since harmonisation of the entire legal framework is of great importance also for efficient technical processes, which are now the focus of market participants trying to remove the Giovannini barriers identified here.

Nevertheless, the lack of integration at settlement level would hamper the market less if further integration at clearing level were achieved, giving users access to the different CSDs through their chosen CCP.

Chapter 5.4 Other issues

As already stated in our general remarks, we fully endorse the Commission's position on the call by some market participants for user owned utilities in trading, clearing and settlement and that "encouraging the development of more competition would seem a more appropriate way of addressing the root issue than imposing a specific corporate structure" (par. 92). We therefore welcome the conclusion drawn in par. 98 that "The Commission has no a-priori position about ownership of final market structure."

On the issue of accounting separation, we would like to refer to our remarks on chapter 5.1, where we describe the possibility to embed this issue in the yearly audit.

Chapter 6 Consultation on possible ways forward

Since easiest achievable improvements on the way to an integrated financial market are the aim of all market participants and public authorities, we do not see new regulation/legislation as a necessary first step. To foster competition, especially at clearing level, we would support self-regulation by service providers, e.g. via FESE, EACH and ECSDA, as a first measure within a set timeframe of one to two years. The content of this self-regulation should be:

- free access/exit to exchanges for CCPs and vice versa
- coherent public pricing tables for defined basic functions of exchanges, CCPs and CSDs
- standard for audit on accounting separation to prevent cross-subsidization via rents.

Only if this initiative monitored by the Commission fails, should legislative action by the Commission be considered.

Concerning the Giovannini barriers, necessary private and public actions are on the way. If private initiatives reach their limits, e.g. due to national legal impediments which are not tackled by the responsible national authorities, the Commission should prepare legal steps to foster harmonization – besides the action necessary anyway on legal and tax barriers, where fact-finding will take more time.

We do not share the opinion that ECB/CESR could promote transparency and competition through further proposals for standards (par. 102). A democratically legitimated basis for both tasks is lacking.

Specific remarks on the table on page 25:

Concern	Possible reactions	ZKA remarks
<p>1. Restrictive clauses in agreements between exchanges and CCPs relating to the freedom of the latter to provide services to competitors</p>	<p>Assurance from the actors concerned that such clauses have been or will rapidly be eliminated.</p> <p>Relevant measures to avoid the risk of participants in closed systems free-riding on open ones.</p> <p>Market participants may wish to draw DG Competition's attention (or the attention of a national competition authority) to failures to provide non-discriminatory access.</p>	<p>Assurance from the actors via their European associations (FESE, EACH) that such clauses will be eliminated within a set timeframe (1-2 years).</p>
<p>2. Idem between CCPs and providers of agency settlement services</p>	<p>Idem.</p>	<p>Analogous to 1.</p>
<p>3. Opacity of arrangements and agreements throughout the industry</p>	<p>Industry could reflect on its information requirements to allow greater competition and propose solutions (codes of conduct, regulatory constraints...)</p>	<p>We cannot understand this undifferentiated concern of the Commission. A need for action is only required in areas, where so far no sufficient competition exists.</p>
<p>4. Lack of transparency in infrastructure pricing</p>	<p>Service providers might agree guidelines with users</p>	<p>Development of common defined basic functions of</p>

	<p>on price transparency.</p> <p>User groups or other bodies might propose to publish regular comprehensive surveys of fees for investors.</p> <p>Possible regulatory solution.</p>	<p>central service providers and an assurance from the actors via their European associations (FESE, EACH, ECSDA) to publish a price table accordingly within a set timeframe (1 year).</p>
<p>5. Lack of accounting unbundling within vertically integrated service providers leading to difficulty in detecting abusive cross-subsidies</p>	<p>Market or regulatory solution.</p>	<p>Acceptance and application of standards for auditors by the actors via their European associations (FESE, EACH, ECSDA) to prove accounting unbundling and prevent cross-subsidization via rents within a set timeframe (1 year). The outcome however needs to find the approval of user associations.</p>
<p>6. The same issue also in non-vertically integrated structures, as it concerns information services and trade reporting fees</p>	<p>Market or regulatory solution.</p>	<p>See 5.</p>
<p>7. Elimination of concentration rules and other measures with equivalent effect</p>	<p>The measures in question, certainly where they are private in origin, should be eliminated without awaiting the entry into force of MiFID.</p>	<p>This problem should be solved sufficiently once the MiFID is implemented.</p>

	<p>Market participants may wish to draw DG Competition's attention to other instances of similar rules and to failure to remove them going forward.</p>	
<p>8. State measures prescribing specific platforms in order to qualify for primary dealer status in government bonds</p>	<p>Elimination of these measures.</p>	<p>In general we support the elimination of these measures, even though we are aware that some result out of practical reasons. A possible solution could be the alternative introduction of specific standards to openly state what are the requirements to become a primary dealer (e.g. use of central bank money, settlement timing) rather than demanding a specific platform.</p>
<p>9. Possible market failure in provision of technology interfaces allowing integrated trading on competing market platforms</p>	<p>Views on this are sought, including on how such a market failure might be addressed in addition to the measures foreseen under MiFID.</p>	<p>This problem should be solved in conjunction with no. 1 when free access and exit are guaranteed.</p>
<p>10. Lack of CCP and CSD interoperability undermining access</p>	<p>Market or regulatory action.</p>	<p>See 9. Technical aspects of interoperability in the post-trade area are tackled by the private sector.</p>

<p>11. Intransparent bundling of execution and other services by brokers</p>	<p>Under MiFID, the Commission is of the view that such practices should be appropriately reformed.</p>	<p>We share the Commission's view that, under the MiFID, such practices should be appropriately reformed.</p>
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