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**Market Development:
European Regional Cooperation**

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Market Development: European Regional Cooperation

Overview

- Exchanges
 - Clearing and Settlement
 - Analysis
 - Regulation
 - **Conclusions**
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Market Development: European Regional Cooperation

1) Exchanges

Exchanges

A Short History

- Single Municipal Exchange
 - Multiple Competing Municipal Exchanges
 - Single National Exchange
 - Multiple Competing National Exchanges
 - **Multiple Competing ATs**
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Exchanges

Current Situation

- 3 Large Ones: Deutsche Börse, Euronext, LSE
 - Instability of Troika
 - Intense Competition?
 - NOREX
 - Other National Silos
 - **Political Nature of Corporate Activity**
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Exchanges

Euronext

- 2000: France, Belgium & Netherlands Cash Markets
 - 2002: Portugal Cash & UK Futures Markets
 - Aim: Operational Integration
 - 4 Business Units:
 - Cash Markets & Listing, Derivatives, Clearing, Information Services
 - **National Subsidiaries for Regulatory Reasons**
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Exchanges

NOREX

- Alliance between All 5 Scandinavian Exchanges:
Sweden, Norway, Denmark, Iceland & Finland
 - Nordic Exchanges A/S services NOREX Exchanges
 - Jointly Owned & Financed – no Staff
 - **Obstacles Remain to Cross-Border C&S**
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Exchanges

NOREX Core Principles

- Cross-Membership Encouraged
 - Single Point of Liquidity – One Listing Encouraged
 - Common Trading System
 - **Harmonized Trading and Membership Rules**
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2) Clearing and Settlement

Clearing and Settlement

CCPs: Current Situation

- LCH.Clearnet Merger
 - Eurex Clearing
 - New CCPs being Developed
 - **Primarily National Silo Model**
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Clearing and Settlement

LCH.Clearnet Structure

- **Ownership**
45.1% Euronext, 45.1% Members, 9.8% Euroclear
 - **Voting Structure**
Caps: 24.9% Euronext (Balance in Trust), 9.8% Euroclear, 3.0% Individ.
 - **Governance**
16 Directors - 5 Exchanges (including 4 Euronext, 2 Executives), 5 Users, 1 Euroclear, 3 Independents, LCH.Clearnet CEO, LCH.Clearnet Deputy CEO
 - **Technology**
Supplier is Atos-Euronext – 50% owned by Euronext
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Clearing and Settlement

LCH.Clearnet Benefits

- Netting Externality
 - Collateral Optimisation
 - Single Technology Platform
 - Lower Guarantee Fund
 - Consolidated Regulatory Information
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Clearing and Settlement

LCH.Clearnet Questions

- Is LCH.Clearnet a Monopoly?
 - Is it Independent of Euronext?
 - **If Not, Then What?**
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Clearing and Settlement

CSDs: Current Situation

- Dominance of Euroclear and Clearstream
 - Other National Monopolies
 - **Competition between ICSDs and Agent Banks**
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Clearing and Settlement

Euroclear's "Domestic Market for Europe"

- **Belgium, France, Ireland, Netherlands & UK**
 - Integrated Platform Goal
 - Choice of Service Package
 - Full Service provided by Euroclear Bank
 - Choice of Commercial or Central Bank Money
 - **User Owned/Governed**
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3) Analysis

Analysis

Different Contractual Procedures for Linkages Possible

- Joint Venture
 - One Exchange Purchases from Other Exchange
 - Third-Party Provision
 - **Alternative Business Relationships**
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Analysis

Potential Cost Savings

- Economies of Scale
- Easier Access to More Markets
- Greater Liquidity by Pooling Order Flow
- Lower User Costs:

Technology
Standards
Regulation

Analysis

Most Linkages Have Failed

- Over-Optimistic IT Assumptions – Cost & Speed
 - Exchange Governance Implications
 - Lack of Credibility of Contractual Commitments
 - Cross-Jurisdictional Legal Issues
 - **Still Relatively Small**
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Analysis

M&A: Difficulties of Agreement & Implementation

- Technological
 - Commercial
 - Legal
 - Regulatory
 - Political
 - **Cultural**
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Analysis

M&A: Advantages over Linkages

- Distribution of Gains not likely to Lead to Conflict
 - Credibility of Implicit Contract Commitments
 - **Contracts do not have to be Comprehensive**
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Analysis

M&A: Lessons

- Retention of National Identities Possible
 - Anticipated Technological Efficiencies take Time
 - Regulatory Efficiencies Difficult to Achieve
 - **Politics of Mergers Important**
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Analysis

Exchange Industry Structure

- Not Constant
 - Not Contestable
 - Monopoly, Not Fragmentation, Main Regulatory Issue
 - Network Externality Powerful, But Not All-Powerful
 - **Large Exchanges Dominate, Small Ones Remain**
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4) Regulation

Regulation

Major European Initiatives

- MIFID
 - EU-USA Dialogue – Mutual Recognition?
 - Giovannini Reports 1 & 2
 - EU Commission Draft Communication on C&S
 - EU Commission Competition Intervention
 - **ECB-CESR Standards on C&S**
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Regulation

Key Issues Relevant for Exchanges

- Competition/Fragmentation
 - Transparency
 - Internalization
 - Access
 - Pricing
 - **Monopoly**
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Regulation

Key Issues Relevant for CCPs and CSDs

- Excessive Costs and Excessive Fragmentation
 - Access
 - Monopoly
 - Internalization
 - Governance
 - **Systemic Stability**
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Regulation

Institutional Regulatory Structure & Problems

- Cooperation, MOUs and a Regulatory College
 - Multiplicity of Regulators
 - Diversity of Views
 - Allocation of Responsibilities Unclear
 - European SEC Currently Impractical
 - **Lead Regulator Possible but Difficult**
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5) Conclusions

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Conclusions

- Most Infrastructures Linkages will Fail
 - Mergers Hard to Implement, But Success More Likely
 - Politics Matters
 - Consolidation brings Greater Antitrust Scrutiny
 - Regulatory Infrastructure is Difficult
 - **Politics Matters**
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