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**Market Development:  
European Regional Cooperation**

Ruben Lee  
Oxford Finance Group

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# Market Development: European Regional Cooperation

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## Overview

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

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## 1) Exchanges

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# Exchanges

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## 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

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## 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

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## 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

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## 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

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## 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

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# Clearing and Settlement

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## CCPs: Current Situation

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

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## 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

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## LCH.Clearnet Benefits

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

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## LCH.Clearnet Questions

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

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## CSDs: Current Situation

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

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## 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

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# Analysis

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## 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

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## Potential Cost Savings

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

Technology  
Standards  
**Regulation**

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# Analysis

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## 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

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## M&A: Difficulties of Agreement & Implementation

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

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## 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

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## 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

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## 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

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# Regulation

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## 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

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## Key Issues Relevant for Exchanges

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

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## Key Issues Relevant for CCPs and CSDs

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

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## 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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