Market Development:

European Regional Cooperation

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Overview

- Exchanges
- Clearing and Settlement
- Analysis
- Regulation

- Conclusions
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 ATSs
Exchanges

Current Situation

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

- **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
Clearing and Settlement

LCH.Clearnet Benefits

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

LCH.Clearnet Questions

- Is LCH.Clearnet a Monopoly?

- Is it Independent of Euronext?

- If Not, Then What?
Clearing and Settlement

CSDs: Current Situation

- Dominance of Euroclear and Clearstream
- Other National Monopolies
- Competition between ICSDs and Agent Banks
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
3) Analysis
Analysis

Different Contractual Procedures for Linkages Possible

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

M&A: Difficulties of Agreement & Implementation

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

M&A: Lessons

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

Key Issues Relevant for Exchanges

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

Key Issues Relevant for CCPs and CSDs

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