# What is going on in the post-trade industry in Europe?

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# Agenda

- **Current European landscape**
- Current CCP landscape
- Current CSD landscape
- Some CSD initiatives in Europe
- Conclusion

# European challenges in the post-trading industry

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- The introduction of the Euro has changed rules and behaviours:
  - ✓ One set of collateral eligible throughout Europe for monetary policy operations
  - ✓ Investors now have a more European vision: sector-based approach rather than a domestic approach
- Clearing and settlement activities in the EU are cost effective and safe at domestic level, but cross-border arrangements are still complex and fragmented (40 different legal systems)

# Objective

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- Creation of a single European Financial Market. Already:
  - ✓ A single currency for 16 countries
  - ✓ European Union = 27 countries
  - ✓ Impact even on those countries that are not EMU or EU members
- How to achieve that?
  - ✓ Integration
  - ✓ Interoperability
- Main challenge is harmonisation
  - ✓ Systems / market practices
  - ✓ Legal / regulatory environment
- Process driven by public initiatives
  - ✓ European Commission / European Parliament
  - ✓ European Central Bank
- But also by initiatives from the private sector

# Current Trading / Post Trading landscape in Europe

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- Fragmented situation
- Mix of “silos” / “independent organisations”

  with technical / regulatory constraints that make integration / interoperability difficult
- Mix of user-owned / listed organisations

# Current CCP landscape in Europe

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- There are currently more than 20 CCPs in Europe

- These CCps serve a wide range of markets, clearing financial instruments traded on organised multilateral platforms or bilaterally (OTC): financial and commodity derivatives, cash equities, bonds/repos

- The relative advantage of using CCPs vary according to the characteristics of each market, but fall into three main categories:
  - ✓ Managing counterparty credit risk; this is particularly important for derivatives markets where risk can build up over a period of years and should be fully collateralised
    - Benefits are realised both from netting exposures and substituting the enhanced credit quality of the CCP for the exposure to the original counterparty
  - ✓ Enabling multilateral netting of settlement obligations; this encourages efficiency and reduces internal and external costs
  - ✓ Encouraging greater standardisation and automation of trade confirmation, reconciliation and collateralisation procedures, which in turn enable further use of CCP clearing

- European and international regulators are encouraging – even mandating - greater use of CCPs for OTC derivatives

# Current CCP landscape in Europe

- In Europe, CCPs have been developed for clearing cash equity trades in different ways, each state building CCP to leverage its existing infrastructure
- In many cases (France, Germany, Italy, UK) these CCPs developed from established CCPs for derivatives
- Some are exchange-owned (Germany, Italy, Switzerland): others are independent (LCH.Clearnet) or combined with CSDs (Eastern Europe)
- The Markets in Financial Instruments Directive (MiFID) abolished “concentration rules” in the EU and encouraged the proliferation of alternative execution venues, primarily Multilateral Trading Facilities (MTFs)
- In order to serve the MTFs, new CCPs have entered the market – EMCF and EuroCCP
- At the same time, the European Commission’s Code of Conduct has encouraged CCPs to establish “interoperable” links so that firms can trade on the multiple venues but consolidate clearing in the CCP of their choice

# Current CCP landscape in Europe

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- There is no harmonised EU regime for CCPs in the EU and no binding standards for risk management
- EACH, the European Association of CCPs, has established its own standards for CCP links, which seek to ensure CCPs do not compete on risk management grounds
- CCPs are currently working to establish links from trading venues and to CSDs, each of which needs intense discussions with supervisors to ensure that market integrity is preserved
- Competition between MTFs and CCPs has led to significant fee cuts, at both trading and clearing level
- As further links are established, one potential outcome is that each of the major banks dealing in the pan-European market will be able to choose the CCP provide they prefer and be able to switch between them

# Current CSD landscape

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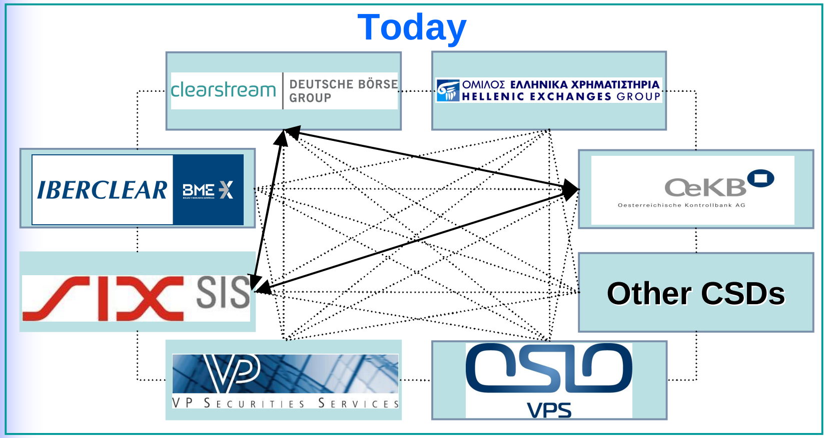
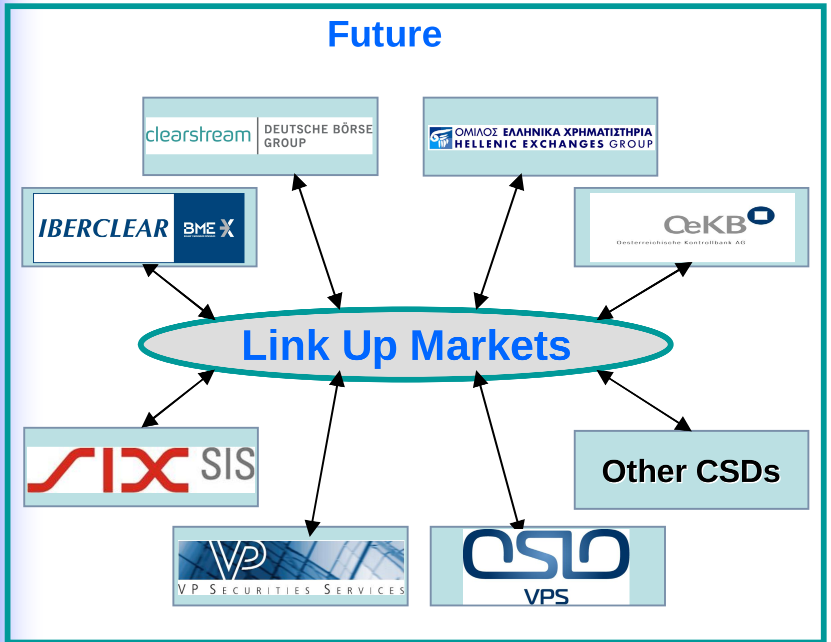
- Similarities with CCPs
- CSDs were first developed for equity markets, then for government bonds
- Some are exchange-owned (Germany, Greece, Italy, Poland, Spain, Switzerland), independent (Euroclear), owned by public sector (Hungary)
- Some are listed companies or belong to listed companies (Germany, Italy) or user-owned (Euroclear, Switzerland)
- Links developed by CSDs to facilitate implementation of a single monetary policy in the Euro-zone
- But a major obstacle: lack of harmonisation
  → major initiative from the European Commisssion in 2001/2003: elimination of “barriers” → Giovannini Report
- The European Commission’s Code of Conduct also encouraged CSDs to further develop interoperable links
- Already lots of initiatives: mergers/sharing of technical platforms
- A major initiative from the European Central Bank: Target2-Securities

# Link Up Markets

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## Link Up Markets model will replace current inefficient set-up

- ✓ Single point of access for CSDs to participating markets
- ✓ Easy implementation of enhanced CSD links in Central Bank Money leveraging TARGET2-Cash
- ✓ Reuse of efficient local infrastructures
- ✓ Absorbing differences in market standards
- ✓ Best-in-class CSD services for all asset classes (excluding derivatives) and multiple currencies
- ✓ Continuous harmonisation of market practices
- ✓ Flexible extension of market coverage in Europe and beyond
- ✓ Launch on March 30, 12 months after announcement of project

**DIRECT CROSS-BORDER ACCESS via local CSD infrastructures**

# An example

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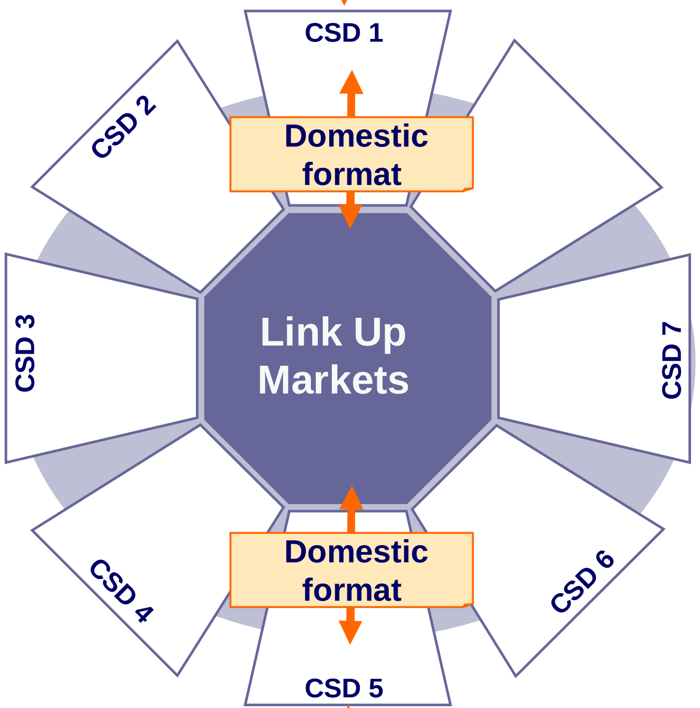
Domestic client

Domestic format

**Client:**

- Single account relationship with Investor CSD
- Use existing systems/interfaces
- Cross-border DvP settlement
- Payment via Target 2 or cash correspondent




Domestic client

Domestic format

**Investor CSD:**

- Settlement on accounts in each Issuer CSD (omnibus or segregated)
- Handling of corporate actions, income payments and tax services on individual customer accounts

**Issuer CSD:**

- Settlement on Investor CSD accounts
- Support to Investor CSD for corporate actions, income payments and tax services
- Support to Investor CSD for market specific services

# Key achievements to date

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Link Up Markets
DIRECT CROSS-BORDER ACCESS

- ✓ Successful launch in March 2009 with just 12 months time-to-market
- ✓ Development cost well within announced budget of EUR 10 million
- ✓ 6 CSDs live: CBF, Helex, Iberclear, OeKB, SIX SIS, VP
- ✓ Production running smoothly
- ✓ 2 new members – CSE and Strate – joined already, strong interest from other CSDs globally with highest focus in Europe
- ✓ Solution well positioned as showcase for interoperability as well as facilitator for T2S

# Euroclear Group structure

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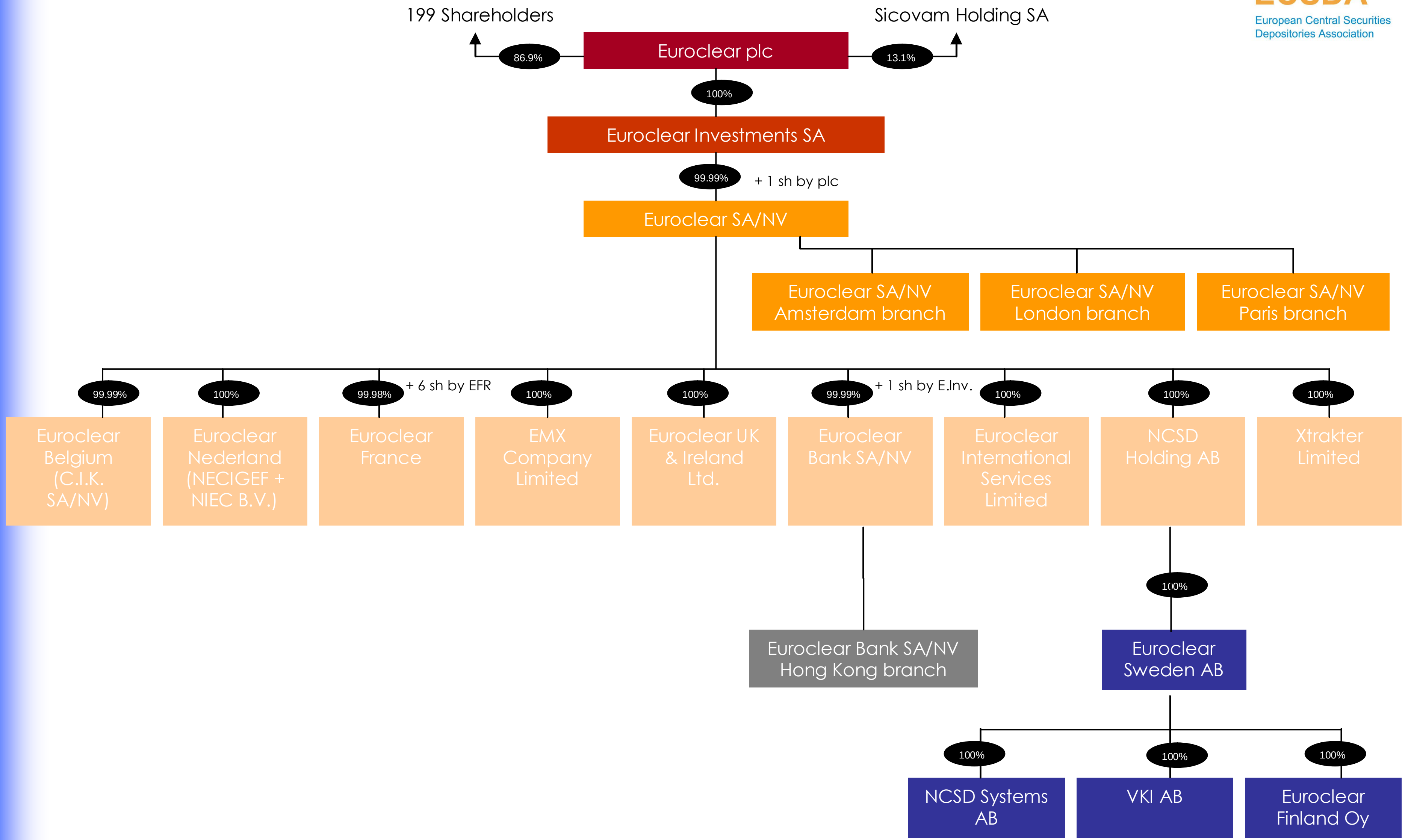

# NASDAQ OMX group ownership of the Baltic CSDs:

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- 100% of equity in Estonian (EVK) and Latvian (LCD) CSDs – through local stock exchanges, respectively: NASDAQ OMX Tallin and NASDAQ OMX Riga
- 40% of CSD of Lithuania (CSDL) – through stock exchanges NASDAQ OMX Helsinki and NASDAQ OMX Vilnius
- The remaining 60% stake in CSDL is owned by the Bank of Lithuania (BoL) and is currently for sale
- The CSDL is an associated company of NASDAQ OMX group

# Main developments

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- The current ownership of all Baltic CSDs from 2005 enabled them to accomplish the following:
  - ✓ multilateral Baltic CSD links based on ECSDA model agreement
  - ✓ trading and settlement information flows organised by using special databases for:
    - transaction feeds from SAXESS trading system jointly used by the Baltic Stock Exchanges (TRAXESS)
    - information interchange on securities settlement between the Baltic CSDs (LinkGW)
  - ✓ Joint functional model allowing enriched trading orders, changes in securities and cash custodians during the settlement cycle
  - ✓ Harmonisation of settlement fees for automatched transactions concluded on the Baltic stock exchanges (0.29 EUR) and cross-border FOP transfers (4.34 EUR)

# Results of the Baltic CSDs integration

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- Baltic links are widely used. In CSDL, the number of securities transfers between Baltic CSD accounts when settling exchange trades made up 33% and 27% of the total number of transfers in 2007 and 2008, respectively

- Transfer costs of exchange-based automatched trades is the same: 0.29 EUR, irrespective of whether the transfer is made in the local participant's CSD or in another Baltic CSD's account. This can serve as a real-life example of T2S's most promoted principle: the same price for settlement of local and cross-border transactions

- Custody of securities within the Baltic countries using the Baltic CSDs corresponding accounts has become a widespread practice. Almost all listed securities on the Vilnius stock-exchange are held by Estonian and Latvian investors using the Baltic links and vice versa; Lithuanians are active investors in Latvian and Estonian securities

# Conclusion

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- Creation of a single European Financial Market represents a considerable challenge
- Harmonisation (legal and regulatory frameworks/market practices) is definitely the key element
- Progress is slow: “the devil is in the details”
- But there is progress!
  - ✓ Market standards on corporate actions
  - ✓ SWIFT Protocol
  - ✓ Securities Law Directive in preparation
  - ✓ …
- Momentum is there (both in public and private sectors): cf market initiatives