

Position paper

Evaluation
of the
effects of the
MiFID and Code of Conduct
on the
European securities clearing landscape

January 2010

Autoriteit Financiële Markten and De Nederlandsche Bank



List of abbreviations:

| | |
|-----------------|---|
| AFM | Autoriteit Financiële Markten; the conduct of business regulator in the Netherlands |
| CESR | Committee of European Securities Regulators |
| CCP | Central Counterparty; an entity that interposes itself between the counterparties to the contracts traded in one or more financial markets, becoming the buyer to every seller and the seller to every buyer. |
| CDS | Credit Default Swaps |
| Code of Conduct | European Code of Conduct for Clearing and Settlement, signed by exchanges, CCPs and CSDs in November 2006 |
| Commission | EU commission |
| DNB | De Nederlandsche Bank; the national central bank of the Netherlands |
| DTCC | The Depository Trust & Clearing Corporation |
| ESCB | The European System of Central Banks comprises the ECB and the national central banks (NCBs) of all EU Member States, whether they have adopted the euro or not. |
| ESMA | European Securities and Markets Authority |
| FISCO | The EU clearing and settlements Fiscal Compliance experts' group; created in March 2005 to give advice on the removal of the fiscal barriers identified by the Giovannini Group. |
| FSAP | Financial Services Action Plan of 1999 |
| Guideline | Access and Interoperability Guideline; defines the principles and conditions for access and interoperability in line with the Code of Conduct as required by end of June 2007 |
| ISD | Investment Services Directive |
| MiFID | Markets in Financial Instruments Directive |
| MoU | Memorandum of Understanding |
| MTF | Multilateral Trading Facility |
| RTGS | Real Time Gross Settlement |
| SSS | Securities Settlement Systems |
| T2 | TARGET2 is the RTGS system for the euro, offered by the Eurosystem. It provides real-time processing, settlement in central bank money and immediate finality. |
| T2S | Target2Securities is a service based on a single technical platform provided by the ECB allowing for pan-European securities settlement in central bank money It is scheduled for 2013. |

1 INTRODUCTION

This paper outlines the position of the AFM and DNB on the effects of the MiFID¹, the Code of Conduct² and the Guideline³ for the securities post-trade market as well as the way forward.

The paper takes into account the communication from the Commission of 20 October 2009. The Commission proposes legislation on requirements for central counterparties (CCPs), covering the following key requirements:

1. Conduct of business, governance, access and business continuity
2. Rules to ensure that CCPs do not employ low risk-management standards. This may require the European Securities Markets Authority (ESMA) to develop technical standards, following the regime currently being finalised by the Basel Committee. In view of their key role in managing risks, CCPs should be subject to adequate capital requirements.
3. Legal protection to collateral and positions provided by clearing members' customers. The rules should ensure segregation of assets and portability of client assets and positions.
4. Authorisation granted; under this proposal CCPs are allowed to provide their services in all Member States. The Commission proposes that the ESMA should give CCPs authorisation to operate in the EU. With a view to ensure adequate on-going supervision at European level, the Commission will seek an appropriate allocation of responsibilities between ESMA and national supervisory authorities.
5. ESMA should also assist the Commission in preparing decisions for recognising third country CCPs.

The European securities clearing and settlement landscape has changed rapidly during the last couple of years. Competition, facilitated by the MiFID, the Code of Conduct and the Guideline has led to increased competition between trading platforms, clearing and settlement institutions. New trading platforms and new CCPs have been established. Competition has led to pressure on fees, pressure on the strategy of incumbents and recently to interoperability. In the same period the clearing and settlement systems have been tested to safely handle the default of Lehman Brothers.

¹ Markets in Financial Instruments Directive

² European Code of Conduct for Clearing and Settlement, signed by exchanges, CCPs and CSDs in November 2006

³ Access and Interoperability Guideline; defines the Principles and Conditions for Access and Interoperability in line with the Code of Conduct as required by end of June 2007, <http://www.dnb.nl/betalingsverkeer/oversight/index.jsp>

The AFM and DNB have been amidst these changes, especially where they concern CCPs. AFM and DNB are of the opinion that the efficiency of the clearing and settlement sector in Europe has improved, which is beneficial to the market as a whole. However, the conditions for competition should be improved to ensure a level playing field and financial stability within Europe.

AFM and DNB are competent authorities with respect to EMCF, LCH.Clearnet SA (and its holding company LCH.Clearnet Group Ltd), EuroCCP and ECC. LCH.Clearnet Ltd is soon expected to be added to this list. In the context of interoperability AFM and DNB have had discussions with CC&G, Eurex Clearing and SIX X-Clear and/or (some of) their supervisors.

2 THE INITIAL PROBLEM: HIGH COST CROSS BORDER TRADES

For years Europe strives for an integrated and efficient financial market, to bring down capital costs in order to be able to better compete with other financial regions. For example, the Financial Services Action Plan of 1999 and the Lisbon agenda of 2000 express this intention. The Report of the High level group 'Facing the challenge', from November 2004 positions clearing and settlement of transactions as the backbone of the financial system. The report states that at EU level the clearing and settlement of securities should become integrated and efficient to process cross-border trades in securities as if they were domestic transactions⁴.

Even though the EU pursues a single internal market, its financial market is still fragmented along the borders of its member states. Until recently this resulted in high cost for cross-border securities transactions. In comparison to the internal market of the United States the costs of trading in Europe used to be high, caused by this fragmentation, augmented by the monopoly position of its infrastructure-providers. The Giovannini reports of 2001 and 2003 identified 15 barriers to an efficient and integrated clearing and settlement market in Europe. Subsequently, the European Commission started a range of activities like the Legal Certainty Group and the FISCO to resolve these barriers. Also market participants have started to work on removing these barriers.

⁴ 'Facing the challenge, The Lisbon strategy for growth and employment Report from the High Level Group chaired by Wim Kok, November 2004

In addition the EU adopted the 'Markets in Financial Instruments Directive (MiFID)' which promotes competition between trading platforms with effect from November 2007 in most of the EU countries. In addition to the traditional stock exchanges, the so-termed regulated markets, alternative trading platforms are assigned a new formal status under this directive, i.e. that of 'multilateral trading facilities' (MTFs). A few sections in the MiFID are dedicated to clearing and settlement, providing that a market party is entitled to access a foreign clearing and/or settlement institution and that a regulated market or MTF is free to contract any clearing and/or settlement institution. Double supervision/oversight on that clearing and/or settlement institution is in principle not permitted.

In 2005 an anti-legislation lobby advocated an industry-led action towards harmonising rules and removing barriers. The ISD and the MiFID were considered by this lobby to be a proper implementation of FSAP legislation, so further clearing and settlement legislation would not be needed.

EU Commissioner Charlie McGreevy stated in June 2006 that self-regulation is to be preferred over a separate directive for clearing and settlement. In November 2006, the sector for trading, clearing and settlement signed the Code of Conduct to promote competition and, hence, cut cross-border costs. Among the code's spearheads is interoperability, i.e. the criterion that clearing and settlement institutions set up links in order to be able to serve the same trading platforms or clearing institutions at competitive conditions. Additional principles and conditions on interoperability have been defined in the Guideline, which was published by end of June 2007.

A third objective of European policy makers is to ensure and promote safety in the European post-trade market. For example, the main aim of the ESCB-CESR Recommendations is to promote competitive, efficient, safe and sound pan-European post trading arrangements. This should ultimately lead to greater confidence in securities markets and better investor protection and should in turn limit systemic risk. In addition, these recommendations seek to improve the efficiency of the market infrastructure, which should in turn promote and sustain the integration and competitiveness of the European markets⁵.

⁵ See for example the Introduction to the ESCB-CESR Recommendations for Securities Settlement Systems and Central Counterparties, May 2009.

The next chapter analyses to what extent the MiFID⁶, the Code of Conduct and the Guideline have succeeded in enhancing the **efficiency, integration** and **safety** of the European market.

3 THE DEVELOPMENTS IN THE SECURITIES CLEARING MARKET

The regulatory measures described in the above chapter have helped to realise changes with regard to the participants, fees and structure of the securities clearing market. The AFM and DNB evaluate the current situation as follows:

Table 1 Analysis of changes in the European post-trade landscape

| Main objectives | Changes in the European post-trade landscape |
|------------------------|--|
| Efficiency | <ul style="list-style-type: none"> ▪ Increased competition between trading platforms and CCPs (§ 3.1) ▪ Increased use of CCP services (§ 3.2) ▪ Pressure on fees (§ 3.3) |
| Integration | <ul style="list-style-type: none"> ▪ Interoperability taking off (§ 3.4) ▪ Increased cross border trading possibilities (§ 3.5) ▪ Increased number of MTFs and CCPs (§ 4.2) |
| Safety | <ul style="list-style-type: none"> ▪ No level playing field (§ 4.1) ▪ No common access criteria to infrastructures (§ 4.1.3) ▪ Increased complexity (§ 4.3) ▪ Lack of supervisory framework (§ 4.1.1) ▪ No common risk requirements (§ 4.1.2) |

3.1 Increased competition between trading platforms and CCPs

An important development seen during the last years is the establishment of a range of MTFs, and in their wake, a number of new CCPs. The entrance of these new trading and clearing institutions, as well as their success in gaining market share, indicates that competition has increased between trading platforms and CCPs. International competition in (equities) trading was possible under the ISD. The most successful MTF, Chi-X, started its operations before the introduction of MiFID in March 2007. Also its CCP, EMCF, started operations before the advent of MiFID. MiFID

⁶ As far as MiFID is applicable to the post-trading of securities, which is limited.

facilitated this competition further by providing a European passport mechanism for these new trading platforms.

The newcomers indeed seem to be breaking the monopolies of existing stock exchanges and clearing houses for the most heavily traded European stocks. Figures 1 and 2 show the new coming MTFs and the new coming CCPs.

The new MTFs gained a significant share of the incumbent exchanges. In 2009 the market share of MTFs increased from 15% to 20% in the Pan European stocks⁷ ⁸. Chi-X gained the largest share of the MTFs with 15% in December 2009. To compare, the market share of London Stock Exchange (LSE and Borsa Italiana) decreased in 2009 from 28% in early January to 21%, Euronext decreased from around 23% to 18% and Deutsche Börse decreased from 17% to 12% over the same period. It has to be reminded that the MTFs only compete on the securities composing the major indexes of the regulated markets. The regulated markets still enjoy a close to 100% share of the trading in the smaller, more local, securities.

Existing CCPs as well as new CCPs have been competing for the trade feeds from regulated markets as well as the trade feeds from MTFs. The European Multilateral Clearing Facility (EMCF) is a newly established CCP, an initiative of Fortis Bank Nederland, which operates as clearing house for Chi-X, BATS, NasdaqOMX Europe, Quote, Burgundy and the Nordic stock markets of NasdaqOMX. EuroCCP, a daughter company of DTCC, is also a new clearing house, which provides its services to Turquoise, NYSE-ARCA and Smartpool. But also incumbent CCPs started to attract new business from the MTFs and other regulated markets. LCH.Clearnet SA provides for example clearing services to Smartpool and the Luxembourg Stock Exchange. In 2009 the market share of EMCF increased from 10% to 20% in the clearing of Pan European blue chips for Chi-X, BATS, and NasdaqOMX Europe. With the addition of the NasdaqOMX markets, Burgundy and Quote the market share of EMCF will increase to over 28%. The market share of EuroCCP was stable around 4% from January to December 2009⁹.

⁷ Pan European stocks include the stocks in the AEX, AMX, BEL20, CAC40, CAC Next20, DAX, FTSE100, FTSE 250, FTSE MIB, IBEX35, MDAX, OBX, OMXC20, OMXH25, OMXS30, PSI20, SMI, SMIM

⁸ Source BATS Trading

⁹ Source BATS Trading

Figure 1: CCP clearing for securities MTFs, November 2009

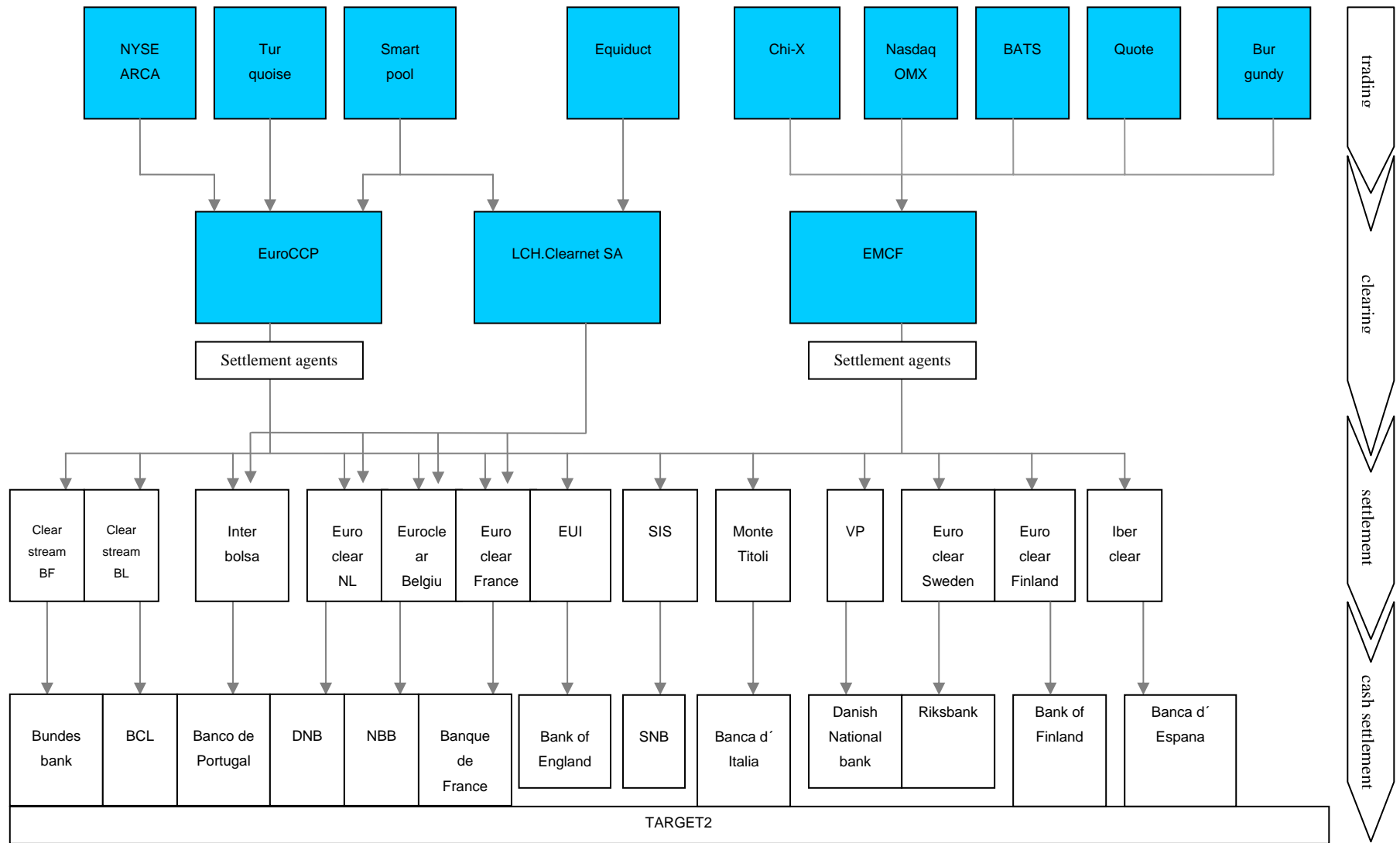
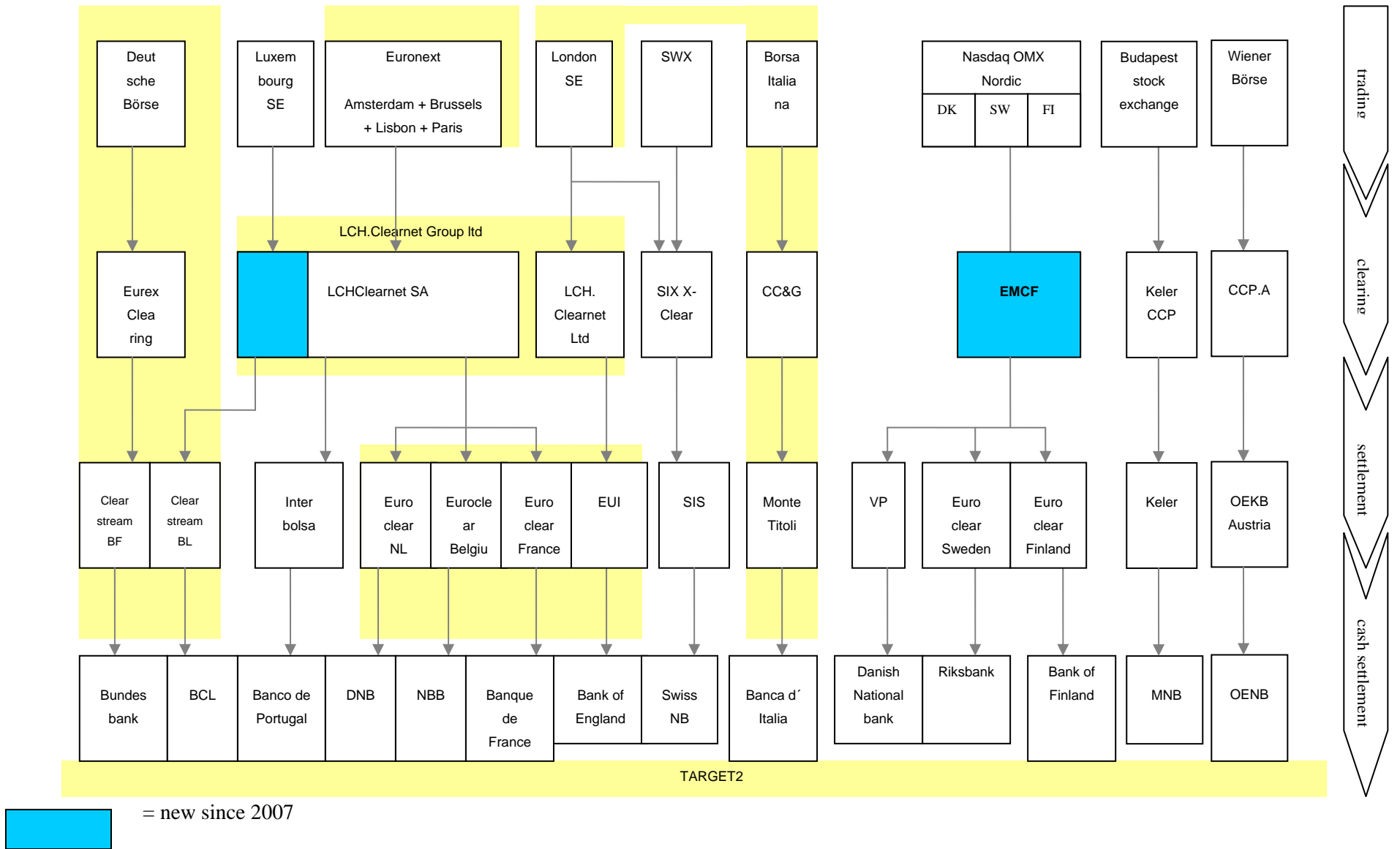


Figure 2: Changes to CCP clearing of regulated securities markets since 2007



IT developments have contributed to the increased competition. The switch to screen based trading made trading independent of the trading place. The increase in speed of communication of data and processing power has made trading international and even global. At the same time, IT has drastically lowered costs to run a trading platform, clearing system or settlement system. IT improvements make it possible to run an MTF with much less people than the incumbent trading platforms. This 'technology jump' has favoured new entrants over incumbents with expensive legacy systems.

Increased competition is not (yet) visible in the exchange-listed derivatives (equities, futures, commodities) trading and clearing, where far higher values and volumes are involved than within the securities trading, clearing and settlement area. Derivatives trading and clearing is still organised in 'silo's' throughout Europe, although equities trading and derivatives trading in equities are strongly linked (e.g. through hedging of positions).

Also, increased competition has not yet touched the settlement institutions. Target2Securities aims to increase efficiency and integration in this area. However, there still seem to be large barriers existing to effectively change the current monopolistic situation.

3.2 Increased use of CCP services

Some existing regulated markets, which until 2008 traded without a CCP, decided that a CCP would add value to their existing cash market. Bourse du Luxembourg has chosen LCH.Clearnet SA to clear its cash market, while NASDAQOMX, operator of the Nordic market, chose EMCF to clear its cash markets. Figure 2 visualises these recent adaptation of CCPs by incumbent exchanges.

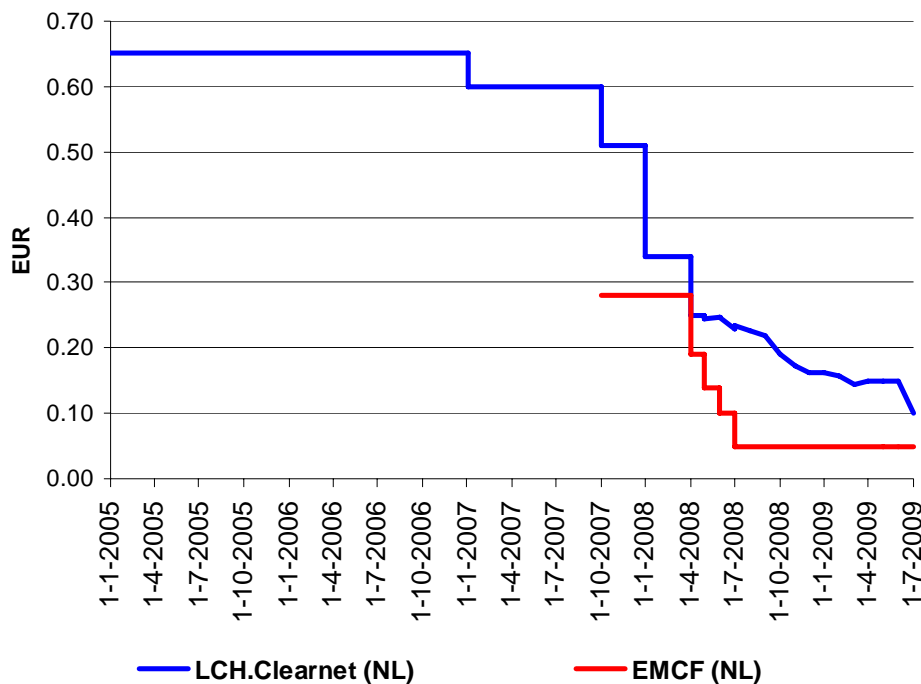
3.3 Pressure on fees

Since 2006, trading and clearing fees have declined under the pressure from (expected) competition. Figure 3 shows the development of clearing fees in the Netherlands charged by LCH.Clearnet SA, Euronext markets' incumbent CCP, and by EMCF. While as recently as in 2005, LCH.Clearnet SA charged EUR 0.65 per cleared trade, in the intervening years this fee dropped to EUR 0.10. As from January 2010 LCH.Clearnet SA will charge a fixed fee of EUR 0.05 for the blue chips traded on the Euronext markets. This is the same level as the clearing fees

of EMCF. A similar trend is seen in other markets, for example in the UK, France, Belgium and Portugal. These fees are now made transparent and public thanks to the provisions under the Code of Conduct. These results are in line with the first findings of the study on prices, costs and volumes carried out by Oxera Consulting Ltd, on the request of the European Commission.

However, it is notable that the total cost of post-trading have not always decreased for the trading firms (and their clients). This is due to the existing trend of decreasing transaction size. Orders are matched on trading platforms in increasingly smaller sizes. This has increased the number of transactions which compensates for the lower fees. Also the fragmentation over various CCPs has lowered the netting effect of the CCPs and increased the overall margin requirements. This has caused an increase in the capital costs for clearing members. The financial crisis has additionally increased the cost of collateral. These developments may have fuelled the need for interoperability.

Figure 3: CCP clearing fees for securities clearing in the Netherlands



3.4 Interoperability taking off

In 2007, the Guideline resulted in about ninety applications for links between trading platforms and clearing and settlement houses. None of these links have been established so far. The one working link in European equity markets is between LCH.Clearnet Ltd and the Swiss CCP SIX X-Clear and was already planned before the introduction of the Code of Conduct. Recently, interoperability seems to start off anyway. A few links are announced to be established, for example between EMCF and LCH.Clearnet Ltd, LCH.Clearnet Ltd and EuroCCP, and EMCF and SIX X-Clear. Now that clearing fees are increasingly converging to the same low level, traders and clearing members are beginning to experience the downside of the many different MTFs and CCPs trading and clearing the same equities. This compels them to pledge collateral with several parties, without profiting from netting effects. Interoperability makes it possible to gain access to various trading platforms via one CCP. Positions will be netted across trading platforms and clearing members no longer need to place collateral with more than one institution.

Interoperability means in general additional risks for CCPs¹⁰. These risks can stem either directly as a consequence of a link and/or indirectly from being a part of a network of CCPs. Risks which may increase include counterparty credit risk, legal risk, liquidity risk, operational and settlement risk, as well as contagion risk. If CCPs and their regulators are aware of these risks and properly mitigate them in a co-ordinated and compatible way, CCPs should be resilient to the effects of extreme market conditions. This condition may however be considered questionable, given the lack of a supervisory framework in Europe.

However, if managed properly, linked CCPs and a network of interlinked CCPs could also decrease systemic risk in the markets they service since a single CCP will not function as a 'single point of failure'.

Following the concerns voiced by the AFM and DNB in relation to the proposed link between EMCF and LCH.Clearnet Ltd, the Dutch, Swiss and UK authorities are currently engaged in on-going reviews of the proposals for interoperation that have been submitted to them by their respective trading venues and clearing houses. In these reviews, the authorities follow the general

¹⁰ See also 'Investigation of risks arising from the emergence of multi-cleared trading platforms', Joint Regulatory Authorities of LCH.Clearnet Group, July 2008, <http://www.dnb.nl/betalingsverkeer/oversight/index.jsp>

principles outlined in the CPSS-IOSCO Recommendations for CCPs (with reference also to the equivalent ESCB-CESR Recommendations). The authorities share concerns about a number of potential issues raised by interoperability. A main concern is whether counterparty exposures between CCPs are appropriately managed and whether and how these exposures are collateralised. It is proposed to the CCPs involved in each interoperability proposal to consider these risks collectively and engage with their relevant regulatory authorities to seek to address these issues. Such a collective solution would be valuable and applicable in the near future since a network of CCPs is envisaged for 2010.

3.5 Increased cross border trading

The European financial market has become more integrated, since it has become easier to trade cross-border through the rise of the MTF's. The new MTFs all offer trading opportunities in a broad range of Pan-European equities. Access to such an MTF means access to this broad range of equities at once. Before the introduction of MTFs trading members had to become (client of) a member of the different European national exchanges to gain access to this range of equities. The new CCPs found ways to access the different CSDs in Europe to be able to settle this broad range of Pan-European equities. EMCF uses several commercial banks as settlement agent to access the different CSDs. In the Nordic markets EMCF has opened direct accounts in the CSDs and central banks. EuroCCP also uses several commercial banks to access the different European CSDs.

4 DRAWBACKS OF THE CURRENT MARKET STRUCTURE

4.1 Lack of level playing field

The increase in competition comes however with a lack of level playing field. This lack is caused by a lack of supervisory framework, no common risk requirements, and no common access criteria of CSDs and central banks.

4.1.1 Lack of supervisory framework

The diversity of national supervisors – each with their own supervisory framework – is not conducive to competition in cross-border trading. In the absence of a European directive for securities clearing and settlement a stock exchange, CCP or CSD based in one state and offering its services in another state cannot do so on the kind of European passport available to credit

institutions and investment firms. It must comply with all of the mutually divergent requirements of the different national supervisors involved. Sometimes requirements are even contradictory.

The lack of a regulatory framework has the following disadvantages:

- It is not efficient, since it may bring additional cost and efforts to CCPs offering cross border services;
- If requirements are contradictory it may paralyse the cross border offering of a CCP. For example, in one country a CCP is obliged to be a credit institution. In another country a CCP in its nature cannot become a credit institution.
- There is a lack of a single and strong supervisor in case of systemic disruptions. A regulator with competences in one state needs to liaise with regulators in other states to handle a crisis affecting a CCP offering cross border services. Regulators are concluding bilateral or multilateral MoUs in case of a common interest with regard to a specific CCP. In the MoU the regulators express their intention to inform the other regulators on relevant issues concerning the specific CCP. These MoU's are however only covering information sharing, not the sharing of supervisory responsibilities. A whole network of MoU's exists within Europe, see table 2.

4.1.2 *No common risk requirements*

Especially with regard to risk management, the lack of a harmonised supervisory framework is of concern, since this might lead – in the worst case - to either regulatory arbitrage or to pressure on regulators to soften their requirements, causing a so called 'run to the bottom'. Competition on risk management is already seen in the UK market. Both EuroCCP and EMCF have changed their margin model by reducing the assumed liquidation period. The value of the collateral received from clearing members will be reduced, bringing it more in line with the margin calculation of LCH.Clearnet Ltd. One could however argue that the current competition is beneficial in highlighting differences between CCPs which were not visible before. Through competition it becomes clear that CCPs use different models with different costs and only now there is a case for assessing these models. This will give an incentive to design and use the model with the best risk management versus cost ratio.

Another example of different approaches in risk management is the use of settlement agents by CCPs. CCPs, like EMCF and EuroCCP, need to have access to different European CSDs and central banks to be able to settle a range of European equities. The safest way for CCPs is to open

direct accounts with CSDs and central banks. It is however easier and cheaper for CCPs to make use of the settlement services of a commercial bank, which opens accounts in CSDs and central banks on behalf of the CCP. The use of a commercial bank as the settlement agent of the CCP introduces however settlement bank risk to the CCP and thus increases the risk profile of the CCP. Different CCPs currently use different ways, pressed or not by their regulator.

4.1.3 *Access criteria*

A lack of level playing is also caused by a lack of harmonisation criteria to access different CSDs, central banks and trading platforms in Europe. This is costly, inefficient and may be less safe in case a CCP is not allowed to open a direct account in the CSD or the central bank, but has to rely on commercial intermediaries. Also, not all CSDs are equipped to support multiple CCPs or the clearance of multiple MTFs. In the absence of a clear enforcement of the Code of Conduct trading platforms may refuse to offer their trade feed to specific CCPs for strategic and nationalistic reasons.

Target2Securities may help CCPs to settle their cross border trades at one platform, however, access to the different CSDs is still needed. Also, the ESCB is currently considering a harmonised approach to provide CCPs access to liquidity facilities in Target2, which may harmonise the access criteria for CCPs to central bank money.

4.2 **Fragmentation**

The market is currently more fragmented than before the implementation of the MiFID and the Code of Conduct. Besides the existing national regulated markets and clearing and settlement institutions in Europe, at least ten new trading platforms and two new CCPs have entered the market. The goal of European authorities to stimulate the integration of the post-trade market has led to more institutions. On the other hand, integration does not necessarily mean fewer institutions; on the contrary, the fact that new institutions enter the market offering a trading and clearing in a range of European equities, may indicate a market which is more integrated and less divided by national borders.

4.3 Complexity

The increased number of MTFs and CCPs offering cross border trading and clearing services creates an opaque market structure. Interoperability will make the market structure even more complex. A complex market structure hampers ex ante risk assessments of MTFs and CCPs, of their participants and supervisors and overseers. As such increased complexity is an undesirable element of the current market structure and a threat to financial stability.

Table 2 MoU's – shared competences on CCPs

| CCP | Lead supervisor | Other authorities cooperation |
|-------------------------|--|--|
| CC&G | Italy: Banca Italia, Consob | <ul style="list-style-type: none"> ▪ French authorities – MoU on link SA-CC&G for MTS |
| ECC | Germany: Bundesbank, Bafin | <ul style="list-style-type: none"> ▪ AFM and DNB – MoU on clearing services for Endex |
| EMCF | The Netherlands: DNB AFM | <ul style="list-style-type: none"> ▪ FSA – MoU on ROCH status EMCF and clearing services British MTFs Chi-X, BATS and Nasdaq OMX Europe ▪ Danish, Finnish, Icelandic and Swedish authorities – MoU regarding EMCF clearing services for Nasdaq OMX ▪ Swiss authorities – Exchange of Information Letters regarding expected link EMCF and SIX X-clear ▪ Hungarian authorities – MoU regarding EMCF clearing services MTF Quote |
| EuroCCP | United Kingdom: FSA | <ul style="list-style-type: none"> ▪ AFM and DNB – MoU on EuroCCP clearing services for Dutch MTF NYSE ARCA ▪ Danish, Finnish, Icelandic and Swedish authorities – MoU regarding expected EuroCCP clearing services for Nasdaq OMX |
| Eurex Clearing | Germany: Bundesbank, Bafin | <ul style="list-style-type: none"> ▪ FSA – MoU on ROCH status Eurex Clearing |
| LCH.Clearnet Ltd | United Kingdom: FSA | <ul style="list-style-type: none"> ▪ Belgian, Dutch, French and Portuguese authorities – MoU on LCH.Clearnet Group Ltd following the merger between LCH.Clearnet SA and LCH.Clearnet Ltd |
| LCH.Clearnet SA | France: AMF, Banque de France | <ul style="list-style-type: none"> ▪ Belgian, Dutch and Portuguese authorities – MoU on LCH.Clearnet SA ▪ Belgian, Dutch, Portuguese and UK authorities – MoU on LCH.Clearnet Group Ltd following the merger between LCH.Clearnet SA and LCH.Clearnet Ltd ▪ Italian authorities – MoU on link SA-CC&G for MTS |
| SIX X-clear | Switzerland: FINMA SNB | <ul style="list-style-type: none"> ▪ FSA – MoU on ROCH status SIX X-Clear ▪ AFM and DNB – Exchange of Information Letters regarding expected link EMCF and SIX X-clear ▪ Danish, Finnish, Icelandic and Swedish authorities – MoU regarding expected X-Clear clearing services for Nasdaq OMX |

5 POSITION AFM AND DNB ON THE SECURITIES POST-TRADE MARKET

The AFM and DNB support the goal as stated by several European authorities to realise an **efficient, integrated and safe** market for clearing and settlement of securities in the EU. Based on the analysis in the above chapter the AFM and DNB evaluate the effects of the MiFID and Code of Conduct and the way forward for the securities post trade market as follows:

5.1 Effects of MiFID and Code of Conduct

- **Efficiency** in the market has increased. Competition has been the driving force in bringing down the cost of cross-border clearing. MiFID has increased the focus on competition and facilitated it.
- Competition has proven to be a powerful source to initiate change. An integrated financial market does not necessarily equal a single European trading, clearing and/or settlement platform.
- The professional trading market (large institutions, (high frequency) traders), have mostly profited from the lower costs.
- The Code of Conduct has increased price transparency. The Code of Conduct does provide a basis to increase competition between clearing and settlement platforms through interoperability. However, this has not materialized yet.
- Less success has been booked in enabling and bringing down the cost of cross-border settlement.
- The market in derivatives has not gone through any similar development as the cash market. Only in CDS clearing progress has been made.
- The effect on market **integration** is twofold. The European financial market has become more integrated, since it has become easier to trade cross-border through the rise of the MTF's. However, the number of trading platforms and CCPs has increased making the market appear more fragmented than before the implementation of the MiFID and the Code of Conduct. If interoperability will be realized on a larger scale, the complexity of the market will increase and so the inherent risk within the market.
- With regard to **safety**, less success has been booked in ensuring that any systemic risk in cross-border clearing and settlement is properly managed and regulated.
- Access criteria of exchanges, central banks and CSDs are not supportive to fair competition and safety of CCPs.

- The current situation shows that a level playing field is not ensured in the market for clearing and settlement. Clearing and settlement providers are faced with differences in legislation and regulation throughout Europe. This cannot be resolved using effective enforcement of existing legislation or self regulation.

5.2 Way forward for the securities post-trade market

- The current market structure may be seen as an intermediate situation. Ongoing competition may lead to consolidation of trading platforms. A lack of critical volumes may lead to an exit of current MTFs, where successful MTFs might be bought and integrated in existing regulated markets. The same might be the case for the (new) CCPs. This expected consolidation may reduce the current fragmentation in the market.
- Europe's clearing and settlement industry has been responsive towards the issues in the Code of Conduct. Users of clearing and settlement services tend to be large firms which are able to negotiate firmly with service providers to defend their interests, thereby promoting competition. However, the response is not sufficient to realise an efficient, integrated and safe market.
- There is momentum to address the drawbacks of the current situation, for example by legislation as is suggested in the Communication COM (2009) 563 of the European Commission.
- The AFM and DNB support the proposal of the European Commission to grant CCPs authorisation to provide their services in all member states via legislation. Pass porting rights for providers of clearing and settlement services should be given using the country of origin principle to determine the relevant regulatory regime based on a European regulatory regime. This will enhance the level playing field and increase safety in the post-trade market.
- The recently adopted ESCB-CESR Recommendations for CCPs and SSS can serve as the basis for the content of the EU legislation. Additional risk management requirements are however necessary, for example on counterparty credit risk and settlement agent risk for CCPs.
- The AFM and DNB support the proposal of the Commission to issue legislation on CCP requirements, governing
 - Conduct of business, governance, access and business continuity (which seem to broadly address ESCB-CESR Recommendations 2, 8, 12, 13 and 14 for CCPs),

- Minimum risk management standards (which seem to broadly address ESCB-CESR Recommendations 3, 4 and 5 for CCPs).
- Collateral and account segregation (which seem to broadly address ESCB-CESR Recommendations 6 and 7 for CCPs)

These measures will provide for a supervisory framework and as such enhance the level playing field and increase safety in the post-trade market.

- The proposal of the European Commission should be extended to also cover the physical and money settlement arrangements. More specifically, legislation should re-confirm and strengthen access rights of CCPs towards trading platforms, CSDs and possibly to central bank systems. It should also provide guidance on the use of commercial settlement agents to access a range of CSDs in Europe, including an outline of the risks involved. This will address the content of ESCB-CESR Recommendations 9 and 10.
- The current objections of regulators to inter-CCP risk management should be addressed by the proposed legislation by providing more guidance in general towards interoperability. This will address the content of ESCB-CESR Recommendation 11.
- The minimum financial risk management requirements within the proposed legislation should take into account the complexity of modelling counterparty credit risk. It should set parameters without imposing a fixed model. It should offer the flexibility and incentive to CCPs (and CSDs) to improve risk management and use this to their competitive advantage.
- The determination of these minimum requirements and parameters should be conducted by a central European entity. This entity should have sufficient technical expertise to analyse the risk models, to conduct model validation and to assess the models against the minimum standards and parameters. Their independent report should serve as the basis for the assessment of the entity responsible for the ongoing supervision. In this respect there is no need for a representation of member states, focus should be on objectivity and subjective interest should be avoided in order not to influence the technical outcome of the model validation entity.
- ‘Best execution’ requirements should be improved and made enforceable. Brokers/dealers and financial institutions (both professional and retail) will then be forced to provide the best deal and compete with each other.
- Exchange-listed derivatives trading and clearing has to be targeted by new initiatives to create a more integrated European financial market, since volumes are higher and equity trading and

derivatives trading are strongly linked (e.g. through hedging of positions). Interoperability and the ownership of open interest are items to be addressed.

- Competition between CSDs needs to be further facilitated since CSDs are still positioned as de-facto monopolies. T2S may increase efficiency and reduce the cost of settlement. However, the deposit and safekeeping of securities is still insufficiently touched by competition.

Table 3 summarizes the analysis and the position of the AFM and DNB outlined in this paper.

Table 3 Summary of analysis, position and identified gaps

| Main European Objectives | Analysis of changes in the European post-trade landscape since 2007 | Position of DNB and AFM |
|--------------------------|---|--|
| Efficiency | <ul style="list-style-type: none"> ▪ Increased competition between trading platforms and CCPs ▪ Increased use of CCP services ▪ Pressure on fees ▪ Interoperability taking off | <p style="text-align: center;">} Competition has proven to be a powerful source to initiate change</p> <ul style="list-style-type: none"> ▪ Interoperability addresses the draw backs of fragmentation, but should be safe. <i>Gap</i>: interoperability provisions to be included in legislation |
| Integration | <ul style="list-style-type: none"> ▪ Increased cross border trading possibilities ▪ Increased number of MTFs and CCPs | <ul style="list-style-type: none"> ▪ Current market structure intermediate situation. Consolidation may reduce fragmentation. |
| Safety | <ul style="list-style-type: none"> ▪ No level playing field ▪ No common access criteria to infrastructure ▪ Increased complexity ▪ Lack of supervisory framework ▪ No common risk requirements | <ul style="list-style-type: none"> ▪ Proposed legislation is expected to enhance level playing field ▪ <i>Gap</i>: common access criteria to be included in legislation ▪ Legislation and market consolidation are expected to reduce complexity ▪ Proposed legislation is expected to provide for a supervisory framework ▪ Proposed legislation covers risk management standards. <i>Gap</i>: need for the establishment of a central, technical risk management validation entity. |