

EU Stock Exchanges: Competition, Governance, Settlement and Derivatives

Recent meetings of GrahamBishop.com fora have underlined the continuing confusion about some aspects of the possible combinations of EU stock exchanges. This short paper attempts to set out some "competition" issues that still need to be clarified before policy-makers and stakeholders can develop a considered view about the desirability of possible combinations. Most market participants are unfamiliar with the details of EU competition policy, yet it could easily have a decisive influence on the future shape of financial markets. This note is intended to form a basis for discussions at future meetings.

Executive Summary and Conclusions

The debate on the future of the EU's stock exchanges – and the associated downstream infrastructure – is moving to fever pitch as reports swirl around about possible combinations, quite apart from the formal offers. But the very strength in trading revenues from the boom has created an unintended side-effect: the revenues of Europe's leading exchanges have risen to a point where the EU competition authorities could well have jurisdiction over several possible exchange combinations, most particularly over any Deutsche Börse/Euronext merger. What might they decide? Is competition law the best way to organise the economics of the EU's financial system?

The "vertical silo" structure of Europe's largest (measured by its trading revenues) stock exchange operator – Deutsche Börse (DB) - lies at the heart of this problem. The EU competition authorities have already made clear their concern about several aspects of this structure and are unlikely to pass up an opportunity to examine it in great detail and propose remedies for any competitive defects they may find. All stakeholders need to take account of this possibility in any combinations that include DB with Euronext or the London Stock Exchange (LSE). Surprisingly, links with US exchanges (Euronext/NYSE or the reported DB/CME link) may well avoid this scrutiny.

What factors might be weighed up?

- A combination of the **cash equities trading** of many EU exchanges – including DB and Euronext (as proposed in the Lachmann Report from Paris) – might well be approved if the European Commission takes the same line as the UK's Competition Commission 2005 analysis and sees the relevant market as being global. However, the European Commission might well then follow the CC and condition approval on the sale of at least part of Deutsche Börse's interest in Eurex Clearing and Euronext's holding in LCH.Clearnet to facilitate competition in trading.

- o **Central Counterparty:** Indeed, Deutsche Börse has already proposed to the European Commission the sale of its cash equities clearing business, and believes the offer should be acceptable. However, that limited offer may not be sufficient because the logic of the divestment is not carried through to include its derivatives clearing business.
- o The **Central Securities Depository function** may be under threat from the ECB's recent proposal for a possible securities settlement system based on its own TARGET money transmission system. Divestment could be a remedy but who would pay a full price for these assets ahead of such an upheaval?
- o **Derivatives** may be the biggest problem of all as DB and Euronext are fierce competitors. The historic example of the Bund contract moving from LIFFE to Eurex shows the power of competition – and Euronext.LIFFE has just announced a renewed challenge with a new family of products. Competition also covers French and Dutch equity options and, potentially, spans the entire range of securities. The two exchanges account for virtually 100% of bond/STIR contracts and between 76-96% in relevant equity products. The European Commission would need to weigh up carefully any improved efficiencies versus the loss of actual or potential competition, including in clearing the trades after their execution.

Who will do the weighing?

Internal Market Commissioner McCreevy has made it abundantly clear that he has no “Gosplan ... for the future structure of exchanges” and that it is for “the markets” to decide. How can the impersonal markets weigh up the factors as the exchange companies are small ones (despite their vast trading turnover) and key stakes have been acquired by a few hedge funds who give every sign of putting their private interests ahead of any EU public interest by pushing for quick solutions. That push could easily put the solution into the hands of the competition authorities alone, making execution risk a real issue for all stakeholders.

Is the time ripe for decisions?

In just 13 months the Markets in Financial Instruments Directive (MiFID) will come into force. The intention is to open up trading in securities across the EU to new competition, rather than maintaining some of the historic monopolies. Despite its poor image in the media, this measure should be expected to have a major impact. Correspondingly, the new Code on Clearing and Settlement should be functioning on the same timescale, shaking up the providers of those services. Finally, the ECB should have decided whether to proceed with its own ideas for maximising the safety of securities settlement.

If big exchange mergers are pressed now, it could end with ownership of two-thirds of the business of Deutsche Börse and half of Euronext's being put into question. The need for careful consideration of almost every aspect of Europe's capital markets points to a long, thoughtful process. That should not be incurred on a timetable to suit the private interests of a couple of shareholders alone. Rather, it should be determined by the EU public interest in a well-functioning capital market.

NOTE: This paper includes a compilation of publicly available data on some listed companies and comments on EU competition law. These comments are not a recommendation for action and do not constitute legal or investment advice (as defined by Article 4 (1) (4) of MiFID). Readers interested in any significance for the valuation of these listed companies should consult their authorised investment and legal advisers as *GrahamBishop.com* does not give investment or legal advice.

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Introduction

It is just 13 months until the starting gun is formally fired for the race for positions in the market for trading EU securities – but a market that is now global due to the impact of modern technology. Given the importance of that process in allocating capital effectively within the European economy, that will be a vital race. No-one can possibly forecast the winners at this stage but it seems certain that when we complete the first decade of monetary union, the racetrack will look very different from today.

However, some political voices argue that the choice of combination should reflect nationalistic sentiments – the creation of some sort of “national champion” at the EU level. But the 13 month period is the time left until MiFID comes into force. Just ticking compliance boxes is likely to obscure the fundamental purpose of MiFID: opening up the trading of securities to any qualified player, rather than forcing trading to be concentrated on to a monopoly stock exchange. So the concept of a politically-chosen European national champion might fly in the face of the open, competitive market model of evolution just endorsed by the EU’s political system when enacting MiFID.

The EU's competition authorities have stepped up their involvement in financial services infrastructure since 2001 and the release (in May 2006) of the report on "Securities trading and post trading" clearly marks a determination to ensure that competition rules are observed. Moreover, the staffing up of the relevant unit within DG Competition now ensures that appropriate personnel are in place for any investigations.

Governance has also emerged as a major factor in this debate. Some of the companies involved are investor-owned, listed companies. The directors have clear duties to their shareholders but if their existence reflects the issuance of licences by their home state, then that state should have the right to consider if the original public policy purpose is still being fulfilled. So other stakeholders may also have a legitimate involvement. At the end of these technical discussions, there is a question to be answered: who weighs up the public interest of Europe in optimising the conditions for the EU's economic growth? Should decisions on vital parts of the infrastructure be left to the particular, private interests of one or two hedge funds which manifestly cannot reflect the totality of "the market's" view? But how can the interests of all users – pension funds, life companies, UCITS, individuals etc – be taken into account?

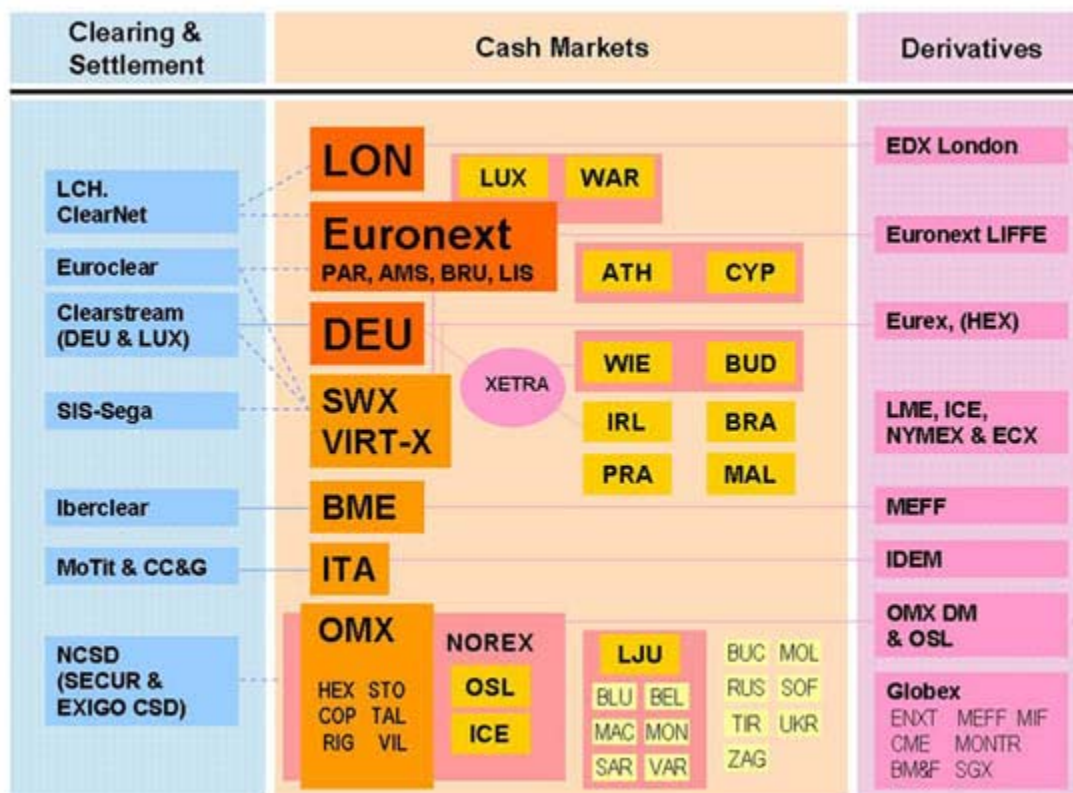
Settlement is also a key factor. Given the radical changes in the systems of trading that are likely to flow from MiFID, Commissioner McCreevy's decision to postpone any decision on Clearing and Settlement (C&S) legislation is welcome. Instead, the proposed Code of Conduct should come into force in parallel with MiFID. But there are very serious questions to be resolved before this policy will succeed. Will their "governance" arrangements permit listed companies to volunteer to reduce their short-run profits? Can "interoperability" be made to work technically if all the players are not powerfully motivated to make it work?

Derivatives could become the single most critical area for competition policy. These markets will not be fundamentally changed by MiFID and the leading continental exchanges generate more than 30% of their revenue from these markets and nearer 40% of their earnings. But Euronext and Deutsche Börse have settled into a position where they compete fiercely in some products areas, but not at all in others where the competitive battle has been resolved between them – though recent moves from Euronext in fixed income derivatives show that new ideas can still come forward.

Each combination of exchanges will throw up a different series of problems in each of these fields. Some combinations may produce such fundamental difficulties that they may be insoluble over any reasonable time period, thus making that combination unattractive to at least some of the stakeholders.

The stock exchange landscape in the EU is still complex – despite the consolidation that has already taken place. The Federation of European Securities Exchanges (FESE) has developed a chart to show the key groupings, together with their derivative markets and settlement systems. The latest version is set out below. That is the starting point for the round of consolidation that appears to be imminent.

Figure 1. Who are the players¹? The FESE chart (October 2004)



Competition Policy

The key Articles and Regulations

The competition policy of the EU is based on two key articles in the Treaty on European Union: Articles 81 and 82. These can be summarised:

- **Article 81 - Anti-competitive agreements:** It includes the classical prohibitions on price-fixing and/or market allocation, cartels or bid-rigging among competitors.
- **Article 82 – Abuse of dominant position**

Dominance: ability to act independently of competitors and customers (in EU practice so far, primarily a market share issue, which means that the definition of the relevant market is key)

Abuse: excessive pricing, tying or foreclosure, exclusivity arrangements, predatory pricing, refusal to supply, discriminatory pricing, etc

But some agreements are seen as legitimate and are permitted under Article 81 (3). This permits the exemption of agreements that:

- Promote a public benefit
- Give consumers a fair share of the benefits
- Do not contain unnecessary restrictions or
- Do not allow parties to eliminate competition

¹ Link to FESE website: [Legend to the FESE Diagram of the European Exchange Landscape](#)

However, the system was significantly changed in May 2004:

- **Regulation 1/2003**
 - abolition of the notification system; retrospective analysis of compliance in infringement proceedings and civil litigation
 - National Competition Authorities (NCAs) and courts can apply Art. 81 (in full)
 - universal primacy of EU rules in cases affecting inter-state trade
 - co-operation between NCAs
- **Merger regulation 139/2004**
 - Unchanged turnover thresholds but new substantive test. Mergers shall be banned if they "significantly impede effective competition"
 - new cross-referral rules, with an exclusive right offered to parties at the pre-notification stage (NCAs keep a 2-week challenge option)
 - extended and flexible deadlines
 - horizontal guidelines acknowledge efficiency claims (albeit in a restrictive way)

Recent developments

Until 2001, EU competition authorities had paid little attention to the infrastructures of the financial markets partly as there was little consolidation, but also the thresholds for EU jurisdiction were set at a level that excluded most of these firms as they are quite small businesses despite their vast trading, and economic significance.

However, recent years have seen a boom in turnover that is now bringing the largest firms up to the thresholds, and implementation of the Financial Services Action Plan (FSAP) effectively demands a degree of consolidation. **But how much consolidation and whose choice?** The Commission has given a clear answer that this is for the market to maximise efficiency – but underlined that it must still respect competition laws. Commissioner McCreevy put this powerfully in his statement on Clearing and Settlement on 11 July 2006: *"One thing I am absolutely sure about is: whatever we do, we should work with the grain of the market. The role of the Commission is not to pick winners nor dictate a particular outcome. Nor determine the final architecture."*

He re-inforced this approach in a speech on 3rd October: *"There are those who would like the Commission to intervene in some way and to somehow determine the future structure of exchanges in Europe. Shape markets. With a sort of new Gosplan for Europe. My answer to that is: NO."* But this speech also focussed heavily on the benefits of competition *"Far from wishing to clamp down on consolidation, I see advantages to consolidation as long as competition rules are fully respected. After all, significant economies of scale are there to be realised, to the benefit of users and shareholders alike. And we should remember that mergers have the potential to increase innovation in terms of the products and services that are offered to investors, especially in the area of cross-trading of cash and derivative instruments."*

Commissioner McCreevy may have been speaking specifically for "internal market" policy, but the statement should apply equally to competition policy. The latter starts from legal doctrines and may not be well suited to dealing with systems where most national economies had evolved to a series of monopolies in the various links in the chain of activities that constitute securities trading. The uncertainties about market forces may be particularly strong at a moment when MiFID is about to unleash many new forces and abolish many of the old national monopolies.

To assist their analysis, DG Competition initiated a study to consider whether there were any grounds for their involvement in the infrastructure and published a [report](#) in June 2005 'Securities trading, clearing, central counterparties and settlement in EU 25 – an overview of current arrangements'. The report concluded that *'in most cases, participants in equity and bond cash markets have no choice with regards to clearing and settlement service providers that are to be used for clearing and settling trades on a given market for a given trade. The reasons for such a situation are manifold and include country-specific historical developments, recent EC and national regulatory developments aimed at ensuring straight-through processing, and the natural monopoly characteristics of certain activities in the trading, clearing and settlement process.'* As a result, DG Competition is now

heavily involved and Commissioner Kroes is acting jointly with Commissioner McCreevy in this area.

Markets and competition authorities (at both EU and national level) are gingerly feeling their way forward in these uncharted waters, though guided by recent decisions at the EU and national levels. There have been a number of decisions in the sector – though mainly at the national level – that have contributed to competition authorities understanding of the businesses. The key decisions include:

1. **Consideration by the UK's Competition Commission (CC) of the possible acquisition of the LSE by Deutsche Börse or Euronext.** It published a [major report](#) in November 2005 and made a number of important findings:
 - a. Identifying a global market for on-exchange equities trading;
 - b. Recognising the importance of MiFID in facilitating competition between different trading venues; and
 - c. Stressing the importance of non-discriminatory access to clearing infrastructure to permit competition between exchanges.The CC approved potential acquisitions of the LSE but conditioned it on the buyers reducing their shareholding in their clearing service providers to less than 14.9% because the CC found that Deutsche Börse controlled Eurex Clearing and that Euronext exerted "material influence" over LCH.Clearnet via its minority shareholding and Board seats. The CC also required a package of behavioural commitments to ensure that rival exchanges would have competitive access to Eurex Clearing and LCH.Clearnet.
2. **European Commission investigation of the LSE's Dutch Trading Service (DTS) in 2004.** The Commission looked at the scope for competition between the exchanges and concluded there was indeed scope for competition – despite the business failure of the DTS to attract liquidity away from Euronext Amsterdam.
3. **Derivatives trading:** The topic was considered by the European Commission in 1998 when Eurex was created and in 2001 by the UK's Office of Fair Trading (OFT) when it looked at the Euronext purchase of LIFFE. In a brief decision, the OFT found that "*the principal competitive dynamic in on-exchange derivatives trading in the EU is between Eurex and LIFFE... and that to the extent that LIFFE is constrained by competition from rival exchanges, such constraints come largely from Eurex.*" ([Report](#)) This decision would probably be the starting point for any investigation of the effects of a Deutsche Börse/Euronext combination in derivatives trading.
4. **Settlement has also had two examinations.** The first was by the OFT when Euroclear bought CRESTCo in 2004. The second was the 2004 review by DG Competition of Deutsche Börse's subsidiary, Clearstream. They concluded that Clearstream had infringed EU competition rules by refusing to supply settlement services on fair and competitive terms to rivals of Deutsche Börse.

National decisions, such as those by the UK, have no formal authority at the EU level, merely providing a careful analysis which may have some relevance if the issues of any eventual case happen to be similar. Nonetheless, they can provide some intellectual precedents that will stand unless the facts of the market place change.

With these cases now firmly in mind and with DG Competition paying increasing attention to the sector, the infrastructure providers must focus carefully on the implications of competition policy. It has the potential to de-rail proposed combinations that may be deemed to be against the interests of the EU public – no matter what the short-run nationalistic appeal. As an example, the recent report by Henri Lachmann (for Paris Europlace) took the interests of the Paris financial market place as the starting point for its analysis – though it did note the customers' "*commitment to continuing the process of European construction*".

What are the triggers that require a cross-border bid to be referred to DG Competition, rather than the national competition authorities?

DG Competition has exclusive jurisdiction over transactions that have a "Community dimension" because prescribed global and Community turnover thresholds are exceeded (Council Regulation (EC) No.139/2004). Given the small size of financial infrastructure businesses, the relevant text will be Article 1 paragraph 3.

A concentration that does not meet the thresholds laid down in paragraph 2 has a Community dimension where:

- (a) The combined aggregate worldwide turnover of all the undertakings concerned is more than EUR 2500 million;
 - (b) In each of at least three Member States, the combined aggregate turnover of all the undertakings concerned is more than EUR 100 million;
 - (c) In each of at least three Member States included for the purpose of point (b), the aggregate turnover of each of at least two of the undertakings concerned is more than EUR 25 million; and
 - (d) The aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than EUR 100 million,
- unless** each of the undertakings concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State.

So the key jurisdictional test for several possible combinations is that each company has EU-wide turnover above €100 million and national revenues in at least three Member States that exceeds €25 million. This complex article is made even more complex by the definition of turnover. It is not the published turnover of the trading company but the turnover that originates from a particular Member State. As an example, a London-based trader - using remote access - can create UK turnover for a merger candidate based elsewhere that would be relevant for this test. So an external observer may not be able to determine the jurisdiction question in marginal cases.

Figure 2 sets out the turnover of the major exchanges in the EU and the other international exchanges that are known to be interested in consolidation. Despite the vast values of daily turnover on the stock exchanges, they are actually quite modest- sized businesses. Most of the exchanges make up their accounts with a December year-end so any investigation that starts next year could well use 2006 data as Art 5 prescribes the relevant period as "the preceding financial year". We have made a crude estimate of 2006 turnover for the purposes of this analysis.

Figure 2. Turnover of key Stock Exchanges (euro millions);

Exchange	Turnover	
	Current	2006 (estimated)
Deutsche Börse	956 for 1H2006	2000 (annualise 1H)
Euronext	558 for 1H 2006	1100 (annualise 1H)
LSE	125 for Q to June 2006	600 (annualise current Q)
OMX	190 for 1H 2006	400 (annualise 1 H)
SWX Group	253 for 2005	300 (say + 20%)
BME Spain	138 for 1H 2006	275 (annualise 1H)
Borsa Italiana	228 for year of 2005	275 (say + 20%)
Memo		
NYSE Group	711 for 1H 2006	1400 (annualise 1H)
NASDAQ	592 for 1H 2006	1200 (annualise 1H)
Tokyo SE	130 for Q to June 2006	600 (annualise 2Q)

Sources: Company financial reports, own estimate

Would the EU have jurisdiction?

Figure 2 shows that the question of meeting the EU turnover thresholds varies, depending on the exchanges involved. In this author's opinion, the following classification is possible:

- A Deutsche Börse merger with Euronext would probably fall within EU jurisdiction. As it would be such an industry-transforming event – in several areas of activity - it would be remarkable if it were not subjected to detailed scrutiny at the EU level.
- Any combination of Deutsche Börse with another European exchange **other than LSE or Euronext** would probably fall to national regulation.
- Euronext combining with any exchange **other than Deutsche Börse** would probably also fall to national regulation.
- The proposed Euronext/NYSE would seem likely to fall to national jurisdiction as NYSE does not have any "EU turnover". This assessment is also supported in the Lachmann Report. Recent press reports have suggested a link between Deutsche Börse and CME and that might correspondingly fall to national jurisdiction as it seems unlikely that €100 million (equivalent to more than 10%) of CME's annual revenues would come from EU-based investors.
- The LSE/NASDAQ situation is below the threshold for turnover and there is only one MS involved, so there would not seem to be an automatic EU jurisdiction.

Regardless of whether the jurisdiction falls to DG Competition or a national authority, the assessment of the competition issues is likely to be broadly similar.

What are the competition issues?

DG Competition published its [Report](#) in May 2006, reflecting the responses to a wide-ranging questionnaire. This is a remarkably powerful document and suggests that actions are likely to follow sooner rather than later. Key findings include:

- There is scope for competition between exchanges in trading services that may today be impeded
- **access to fungible clearing arrangements is a pre-requisite for effective competition** [*author's emphasis*] and must be assured on a non-discriminatory basis
- **vertical integration may result in foreclosure at all levels of the value chain** [*author's emphasis*] and therefore lead to welfare losses and
- a combination of regulatory measures, action by the industry and the application of competition rules is likely to be the most efficient way of achieving integrated financial market structures.

Amidst many noteworthy comments, several stand out that are especially relevant to this paper - using the report's paragraph numbers:

52. Banks considered that the difficulty of moving liquidity was the single most important barrier to market entry in trading... underlying causes – inadequate penetration of virtual order book/ smart order routing software ...inability to access post-trading arrangements – may explain why liquidity is apparently sticky. Where these barriers are eliminated (e.g. US/Canada equity trading) so is the issue.

70. Banks and brokers have expressed dissatisfaction with fee schedules ... should allow a user to evaluate the cost of trading ex-ante... Without such transparency an investor may not be able to make a sufficiently informed decision on where to trade.

71. Pricing transparency in trading is necessary to enable trading intermediaries to be able to price their own services... traders rightly expect to be able to reconcile their actual trading to their billed execution. Banks also need this information to make their trading choices... venues...

72. In the US, best execution rules require brokers to compare different trading platforms... Less stringent EU requirements may be one reason why few European banks have made this investment... As a result, tend to send orders to the dominant trading infrastructure ... without checking other venues as ... (prior to MiFID)... considered consistent with best execution.

73. As many users noted, what is lacking is consolidated pre and post-trade information to allow a trader to check on the same screen prices, transaction costs (explicit and implicit) ...

99. The Commission services believe that the best way to proceed is by making markets contestable so that the value of [infrastructure] assets readjusts to exclude the present value of future [long-term monopoly] rents.

100. ...Important shortcomings to a normal competitive process in securities trading and post trading... conditions such as lack of transparency in governance, lack of transparency in pricing and billing, disproportionate restrictions imposed on service providers, and bundling of services between activities (vertically) and within activities (horizontally) are not conducive to competition.

Interaction with the Clearing & Settlement debate

On July 11, Commissioner McCreevy gave a [speech](#) to the European Parliament about his proposed action on the vexed question of cost reduction in cross-border clearing and settlement. His proposal was to avoid legislative action for the time being if the industry could resolve many of the problems – by complying with his Code of Conduct. He explained “*In only a couple of years’ time the structure of stock trading, and inevitably clearing and settlement, will be different from what it is today. In addition to the takeover/mergers of Exchanges there are a number of factors that will provide a different landscape in a relatively short period of time.*”

Firstly, there is the impact of the Market in Financial Instruments Directive – or MiFiD, as it is known. This Directive, which comes into force in November of next year, provides for the first time competition to the trading of shares on Stock Exchanges. The monopoly enjoyed by Exchanges will go. This will be a major change.

In addition, article 34 of that Directive provides that investment firms from one Member State have the right of access to counterparty clearing and settlement systems in another Member State. Firms should exercise those rights. This should reduce costs.

Secondly, all regulated markets must offer their members or participants the right to designate the system for the settlement of transactions. This will introduce more competition and drive down costs. Regulated markets should exercise these rights.”

The combination of the DG Competition Report and Commissioner McCreevy’s speech laid out many major issues that need to be worked through. The Federation of European Securities Exchanges welcomed the Code and hopes that it can be signed by all its members at CEO level and on time i.e. by 31 October. However the President of FESE “*also stressed that the industry needs a stable and predictable environment to launch such a wide-reaching and potentially cost intensive agreement.*”

Failure to implement the Code successfully could bring competition rules into play quickly, quite apart from eventual legislation. Given the close co-operation between Commissioners McCreevy and Kroes, it seems reasonable to assume that compliance with the Code will be a “safe harbour” and be competition-compliant. McCreevy laid down the principles clearly:

“In this code of conduct I want the industry to commit itself unequivocally to deliver the following results:

- *By the end of this year a series of measures to improve price transparency will be in place.*
- *By 30 June next year agreement on a roadmap and conditions for ensuring effective rights of access on a fair, transparent, non-discriminatory basis, so that the conditions are set for implementing interoperability between Exchanges/CCPs/CSDs etc as soon as possible thereafter.*
- *By 30 December 2007, there will be separate accounting of the main clearing and settlement activities.*
- *By the same date there will be price unbundling of the main services and activities.*

These issues were aired at the September 12 meeting of *GrahamBishop.com's* European Finance Forum: The issues around interoperability dominated the discussion as it would certainly foster competition – but who will pay for it? There are not yet any ideas about costs but it can be argued that those seeking access should bear all the costs. Why should a private company such as an exchange volunteer to pay the costs of its competitors? Indeed, how are the managers of listed companies going to get agreement from their shareholders to give away short-term profits? Nonetheless, an exchange ought to reply quickly and give prompt access where it is presented with a reasonable business case for giving access. But the fact remains that a proven breach of Article 82 (abuse of dominant position) may bring with it an obligation to fund competitors' attempts to interact.

Without appropriate economic incentives, companies may find it difficult to justify complying with the Code and such a technical matter as interoperability could be frustrated at quite a low level within a company – despite the apparent commitment of the senior executives. How long will it take before the success of interoperability can be judged? Concerns about the practicality of the concept were clearly apparent.

Despite the commitment of the two Commissioners to implementing the Code, it is clearly a softer and less definitive solution to the known problems than a structural break-up of "vertical silos" following on from a full "Article 82" enquiry. The critical business question for Deutsche Börse is whether the Commission would take the opportunity of its jurisdiction over a Deutsche Börse/Euronext combination to achieve a structural solution. The vigour of the language in its Report suggests that might be a strong possibility. **So any approval of such a combination might be conditioned on some divestiture of their clearing service providers. But would the structural change stop there?** As an example of other possibilities, the Lachmann report suggested an idea *"for Deutsche Börse to contribute its equity business to Euronext in exchange for Euronext shares. This option would allow the merger of Euronext and Deutsche Börse's equity markets..."*

Governance of the consolidation process

Several different stakeholders can be identified and these should include at least the following:

- **The public interest of the citizens of the EU.** The European Commission would normally regard it as their duty to represent this interest, but the European Parliament may well wish to express the views of its electorate.
- **The national interest of the Member States.** The national governments will certainly act in the Council to ensure these are taken account of.
- **The users.** Both DG Competition and DG Markt have made great efforts to find out what users need from the financial infrastructure. Naturally, the investment banks who are the direct customers of the exchanges have played a large role – either individually or via their trade associations. But it is not always so easy to hear the views of the end-users: fund managers, life companies, pension funds and (most difficult of all) individual investors.
- **The owners.** All the players are constituted as limited companies so the Board of Directors should ensure that the objects of the company are achieved. For a listed company, the objectives may be simple to define in terms of profitability. But many of the players in the industry are wholly or partly user-owned. Even if it is entirely shareholder-owned, the views of users are vital. So they may be represented on the Board. Perhaps a classic arrangement is Euroclear, but more relevant are the constraints placed on LCH.Clearnet and the reduction in ownership by Euronext.

However, one of the features of the debate about the shape of Europe's financial infrastructure is the role of a handful of hedge funds who have acquired a degree of ownership – and additional influence through lobbying other shareholders – that enable them to push Boards of Directors to behave in a manner that suits the private interests of the hedge funds, rather than necessarily acting in the wider public interest of EU citizens.

An outside observer can only monitor this influence via press reports – that may have been inspired by the players themselves. Presumably these funds are taking legal advice to remain within the bounds set by the Market Abuse Directive. But the fact remains that they are pushing management to take specific actions that may not be in the long term interests of all the stakeholders. This may be most apparent from the pressure to consecrate deals while the landscape is so uncertain – given both MiFID implementation and now that of the Code of Conduct for C&S. So competition law may be forced into the role of economic arbiter - for which it may not be well suited. **Until the consequences of these two developments are clear, the time may not be ripe for fundamental decisions.**

What are the implications for any SE combinations that may be called in for a competition review?

The review of any transaction would focus on areas where the merging companies compete – either currently or possibly in the future. As there is virtually no overlap between US exchanges (NYSE/NASDAQ) and EU exchanges, there is limited scope for any review. In sharp contrast, the review of possible mergers amongst EU exchanges would focus on the product areas where the candidates provide similar services in the EU and there might be a risk of a lessening of competition. These might include:

- o Cash equities trading
- o Central counterparty facilities
- o Settlement and depository functions
- o Listing services
- o Derivatives

So the remainder of this paper will not look at US/EU exchange mergers but focus instead on examining these factors with respect to Euronext and Deutsche Börse as there is a proposal for a combination (by Deutsche Börse). As they compete in so many of these areas, it will illustrate the points more generally.

Figure 3. Revenue/EBITDA comparison, 1H 2006, in euro millions

Deutsche Börse AG			Euronext		
Sector	Revenue	EBITDA	Revenue	EBITDA	Sector
Xetra	168	100	155	92	Cash trading
Eurex ²	317	210	215	109	Derivatives (LIFFE)
Market data	74	29	39	20	Info services
Clearstream	354	167	7	5	Settlement /custody
IT	44	47	90	15	Software sales
			23	11	Listing fees
			15	4	MTS fixed income
Corporate		(7)		(35)	unallocated
TOTAL	956	548	558	220	

Source: Deutsche Börse and Euronext financial statements. The sectors are those used by the companies so may not be directly comparable e.g. Eurex includes the clearing business as well as derivatives.

NOTE: Totals may not add due to rounding

Cash equities trading

Today, there is little competition between EU exchanges for the same cash instrument. Although both the UK's CC and DG Competition reports (on LSE/DB/Euronext and DTS respectively) concluded that there is scope for potential competition between exchanges, the limited competition currently suggests that further consolidation should be permitted.

However, the competitive situation of exchanges is about to be transformed by MiFID – at least that is what the Commission expects. Indeed the Member States and the Parliament legislated explicitly to create the opportunity for major change – driven by market forces. So the potential radical change in contestability of these markets from off-exchange trading (providing the necessary flanking steps are taken downstream in the settlement area) might

² Deutsche Börse does not appear to break out the contribution of Eurex Clearing from the derivatives business

well be a persuasive influence on the competition authorities to permit such businesses to combine.

But the chances of that may be increased once MiFID is in force and the reality can be observed, rather than just be a gleam in the eye. It would not be the first time that market-opening legislation has not had the intended/expected effect!

Figure 4. Equities trading (% of European total, Jan/Aug 2006)

Exchange	Total	Electronic order book
Deutsche Börse	13%	15%
Euronext	18	23
London SE	35	21
OMX	6	7
BME Spain	9	10
Borsa Italiana	7	11

Source: FESE

In terms of **on-exchange trading**, Figure 4 showed that Deutsche Börse and Euronext combined have a 38% market share in European cash equities trading – versus the 21% share of LSE. But this figure also highlights the scale of **OTC trading** – nearly 40% of the total, and more than half of which is reported via the LSE. The recent announcement by a group of large investment banks that they will create a new trade reporting system for their deals suggests that the competition offered by OTC trading will become much more visible. So a combination of Deutsche Börse and Euronext cash equities business (the Lachmann report idea) would still only account for 31% of European trading. In the global market, the share would be quite minor.

Figure 4 certainly underlines why the UK's CC distinguished trading from other services – importantly separating out derivatives. *"We considered the substitutability of different trading platforms provided by exchanges, and, more importantly, the degree to which other forms of trading, such as off-book trading (including trading both off the order book and off the exchange altogether), were substitutable for trading on an exchange's order book. We concluded that equities trading services should not form part of the same relevant market as derivatives trading and bond trading services."*

A crucial part of the CC's analysis of the competitive situation of the LSE was the finding that the relevant market should include all exchanges exercising a competitive restraint on the LSE – actual or threatened *"As these constraints are exercised by the major exchanges in Europe and the USA, and because of the history of actual and planned expansion and entry, the geographic market should be defined to include Europe and the USA."*

If DG Competition were to follow this analytical approach, then a combination of the cash equities business of Deutsche Börse and Euronext might well be permissible, but that would leave open the question of clearing the trades.

Central counterparty facilities

In the May report, DG Comp makes a strong point about CCPs in vertical silos: Paragraph 79 *"As far as we can see, under current arrangements CCPs in vertical silos would not be subject to competition either for, or in, their home market. Consequently competition appears to be foreclosed in this case."* So combining Deutsche Börse with Euronext may pose problems with LCH.Clearnet and Eurex Clearing.

Three types of issue can be identified:

1. Merging the parent companies would bring together their interests in their clearing subsidiaries. That might easily chill any emerging competition between the subsidiaries.

2. If Deutsche Börse moved the clearing of Euronext's trades to Eurex Clearing, then the long-term viability of LCH.Clearnet as an independent CCP might be jeopardised, thus increasing the market position of Eurex Clearing.
3. Competition in trading might be foreclosed by moving Euronext's cash trading into Deutsche Börse's vertical silo. This would insulate the Euronext exchanges from competition in the same way that Deutsche Börse's cash trading is today.

So DG Competition might well seek structural remedies that would involve the break-up of Deutsche Börse's vertical silo. In its 19th May proposal for a merger with Euronext, Deutsche Börse suggested a solution by offering **"to contribute its cash equity clearing to a truly European cash equity clearing organisation operated as an independent, privately run service provider"**. It went further on 19th June, stating that *"Deutsche Börse has initiated the pre-notification process to obtain antitrust clearance from the European Commission. Deutsche Börse is prepared to make far-reaching proposals with regards to cash equities clearing in order to satisfy antitrust concerns and discussions with the Commission have been held in a constructive atmosphere."*

This proposal may turn out to be historic because it begs the question: If it is inappropriate to have a vertical silo in cash equities, why would it be right to have a vertical silo in other business areas, perhaps most obviously in derivatives – where these two exchanges already dominate trading?

Having made this proposal on CCPs, Deutsche Börse then states baldly that it *"believes its proposal does not entail significant execution risk"* but other commentators may not be so sanguine as other elements may be brought into the review which could pose serious execution risk to the whole transaction. Indeed, Lachmann states that the proposed merger *"entails serious implementation risks ... - the risk that the new group's dominance of derivative markets could be considered excessive might put a question mark over the project."* [Author's emphasis]

However, Deutsche Börse might not have to go as far as full divestiture of Eurex Clearing. The UK's Competition Commission took seven months to go through the evidence about a possible merger between the LSE and Deutsche Börse or Euronext. Their conclusion was that the possible clearing and settlement arrangements represented a potential Substantial Lessening of Competition (SLC). Their proposed remedy for a Deutsche Börse takeover stopped short of a complete divestiture of Eurex Clearing but proposed limits of Deutsche Börse's shareholding and board representation.

The background analysis of the UK CC is worth keeping in mind:

Post-trade services: Foreclosure of trading services

23. The overwhelming majority of the evidence that we received, including evidence from LSE and Euronext, suggests that fully fungible access to the incumbent exchange's post-trade services is of critical importance for successful entry or expansion at the trading level, primarily because of the infrastructure costs of connecting to multiple systems and the costs associated with clearing trades through more than one CCP.

Deutsche Börse /LSE merger

24. We concluded that the proposed Deutsche Börse /LSE merger would be more likely than not to lead to the introduction of Eurex Clearing (or another company under Deutsche Börse's control or influence) as LSE's provider of clearing services, and that Deutsche Börse had control over Eurex Clearing. Deutsche Börse /LSE would have the incentive and ability to foreclose entry and expansion in the UK at the trading level. Given the importance of the threat of entry or expansion at the trading level as one of the constraints on LSE's behaviour, we expect that control by Deutsche Börse /LSE over clearing services would result in an increase in costs to trading firms of switching trading platforms, raising entry barriers and hence reducing the threat of entry or expansion at the trading level.

25. Such foreclosure would allow Deutsche Börse /LSE to reduce the attractiveness of LSE's offer, by increasing prices or reducing levels of service or innovation beyond the levels they would otherwise have been at in the absence of the proposed Deutsche Börse/LSE merger. We concluded that the proposed acquisition of LSE by Deutsche Börse may be expected to give rise to an SLC in the market for the

provision of on-book trading services within the UK because of the ability and incentive to foreclose entry or expansion to other providers of trading services.

Euronext/LSE merger

26. We considered Euronext/LSE's influence over LCH.Clearnet should Euronext acquire LSE. LSE does not currently have any material influence over LCH.Clearnet. Euronext has a 41.5 per cent shareholding in LCH.Clearnet, with its voting rights capped at 24.9 per cent. It has four of the 18 board seats. Over 60 per cent of LCH.Clearnet's total fee income is currently dependent on the clearing of trades made on exchanges owned by Euronext. Despite its importance to LCH.Clearnet as a customer, Euronext told us that it had no ability or interest in controlling LCH.Clearnet.

27. In recognition of user concern about the possible ongoing influence of Euronext over LCH.Clearnet, strict governance arrangements were put in place at the time of the LCH.Clearnet merger. We acknowledged that the governance arrangements between Euronext and LCH.Clearnet, taken in isolation, appeared to be robust. However, we have taken account of Euronext/LSE's significant shareholding and four seats on the board."

Settlement and depositary functions

Cutting cross-border trading costs has been a central issue for the EU since 2001 when the first Giovannini Report³ was published. So any combination of exchanges that found itself subject to a full competition enquiry should probably assume that a pre-requisite for agreement would be comprehensive and demonstrable compliance with the new Code. However, the discussion at our Forum on September 12th made it clear that any particular firm cannot necessarily comply by itself as it may require the co-operation of others within the industry.

The DG Comp report identifies that barriers to competition in settlement services are also key: *"(83) Competition may be prevented either by the behaviour of CCPs or of CSDs. (84) The following observations which make competition in settlement services more difficult or even impossible have been noted. Feedback from the industry would be appreciated concerning both the causes and possible ways forward."*

The identified problems include "interoperability issues, price sensitivity and transparency, possible foreclosure of agency settlement and custody, lack of user incentives and accounting transparency." It is worth noting the wide ranging issues that are discussed in this section of the report – with the general conclusion that opening up more competition might be helpful.

"(90) As the main users of securities infrastructures, banks are vocal in calling for lower costs. Nevertheless, it is not clear that they currently are in a position to take action to achieve this (for example, if they are able to pass costs on to final investors, or if they have difficulty establishing the level of these costs in the first place).

(91) One important issue that users face is that they are captive customers of infrastructures that they no longer (in most cases) own. Even where they do have a voice on the Board of infrastructure service providers, they may be unable effectively to influence the direction of commercial policy due to free-rider problems and limitations related to their fiduciary duty. The same applies when specific provisions have been made for user representation, which may not always be satisfactory. In this context, increased competition appears to be the most appropriate way to solve these problems.

User ownership of clearing and settlement *(92) Some market participants claim that CCPs and CSDs should be user owned utilities and that for-profit ownership raises costs. Clearly, this problem only arises if one takes as given that these structures are natural monopolies as opposed to mere "incumbent monopolies". Encouraging the development of more competition would seem a more appropriate way of addressing the root issue than imposing a specific corporate structure.*

Consultation on possible ways forward *(100) The preceding overview raises complex and important shortcomings to a normal competitive process in securities trading, and post trading. If competition is to be allowed to contribute to facilitating market integration it needs to be allowed to develop at each level. In general, conditions such as lack of transparency in governance, lack of transparency in pricing and*

³ The author has been a core member of the Giovannini Group since its foundation in 1996

billing, disproportionate restrictions imposed on service providers, and bundling of services between activities (vertically) and within activities (horizontally) are not conducive to competition.”

Many of these issues have re-surfaced in Commissioner McCreevy's Code of Conduct so it may be fanciful to think they will be overlooked in a competition review and that it will be restricted merely to CCPs. The significance to shareholders is immediately clear by considering the sectoral breakdown of revenues and profits at Deutsche Börse and Euronext.

Deutsche Börse does not appear to split out Eurex Clearing from Clearstream as a whole but the May 19th proposal to sell the cash equities clearing business may turn out to be of fundamental significance if it finally had to include the whole of Clearstream – roughly a third of the company's activities.

Listing services

Despite its efforts, Deutsche Börse has not succeeded in becoming a major force in listing new securities for international issuers. Whilst Euronext has had some success, it is the LSE that has made the running this year. So a Deutsche Börse/Euronext combination may not lessen the current competition in this field. Indeed, The UK's CC concluded that *“there was little, if any, competition between the parties in the provision of primary listing services to domestic companies, and that competition takes place on a global basis for secondary listing services and primary listing services to companies seeking listings outside their domestic market.”*

Derivatives

These two groups have been fierce competitors for the last decade – to the great benefit of European capital markets – and they continue to provide the main competitive dynamic in EU derivative markets. The result is that these markets are crucial to both exchanges: Figure 3 shows that derivatives contribute 40% of Deutsche Börse's EBITDA and 50% of Euronext's.

There has not been a subsequent instance of the same competition as there was in the Bund contract but the competitive pressure has manifested itself in several ways, including in the trading of some French and Dutch equity options as well as indirect competition on fees and product innovation. However, the 5th September announcement by Euronext.LIFFE of a new family of bond futures may be highly significant as it is clearly a head-on challenge to the dominance of the Eurex Bund contract.

A number of distinct segments of competition can be identified – both in time and by product:

Government Bond Futures and Options

- Perhaps the classic battle was that in long term government bonds where LIFFE took an early advantage but failed to respond to Eurex electronic trading platform until it was too late. In 1997/1998, competition between Eurex and LIFFE saw the major European long term interest rate futures and options contracts (Bund and Bobl) move to the German exchange from LIFFE.
- In 2002 Euronext.LIFFE launched a two year government bond contract (Schatz) in competition with Eurex, offering customers finer pricing than the Eurex contract. But Eurex responded and accounts for a significant share of the Schatz contract.
- **September 2006** – Euronext.LIFFE announced a family of futures contracts based on EuroMTS government bond indices. These are designed to overcome some of the problems that have always been inherent in the Eurex Bund contract – that the deliverable German government bonds are too small in relation to the vast volume of trading in the whole of the EU's interest rate risk, rather than just in German interest rate risk. **This may be a key innovative step in re-igniting competition in this economically-vital sector.**

Currently, Figure 5 shows that Euronext.LIFFE and Eurex dominate totally the fixed income derivatives markets. These are vital markets for the pricing of government and corporate bonds, as well as all other fixed income products. Strong competition in these areas seems necessary as they provide the crucial pricing for observations about the evolution of monetary policy.

Figure 5. Bond Options and Futures Turnover, Year to Date (Aug 2006)

Derivative Exchange	Country	Bond Options		Bond Futures	
		Contracts Traded	Notional Turnover (EUROm)	Contracts Traded	Notional Turnover (EUROm)
Euronext.Liffe		65 330 016	57 368 800.0	212 455 408	181 898 304.0
Warsaw Stock Exchange		//	//	11 134	291.8
OMX Exchanges	Denmark/Sweden/Finland	18 000	1 927.8	9 132 207	732 697.2
EUREX	Germany/Switzerland	52 022 460	5 874 164.0	443 265 024	50 236 824.0

Source: FESE

Short Term Interest Rates

- In 1999, with the birth of the Euro, both LIFFE and Eurex listed a European short term interest rate contract (Euribor). Since then, short and long term instruments have been split between LIFFE and Eurex, quite possibly reflecting an industry preference to have two major European derivatives exchanges.
- In 2003, Euronext.LIFFE and Eurex simultaneously launched a short term interest rate contract for the European overnight swaps market (EONIA). After Euronext.LIFFE developed an early lead in market share, EONIA trading on both exchanges waned and trading on Eurex is now minimal.
- The Short Term Interest Rate contract (STIR) is now dominated by Euronext.LIFFE's Euribor contract.

Index Futures and Options

- Eurex and Euronext.LIFFE offer different pan-European equity index contracts: DJ Eurostoxx and FTSEurofirst. Currently, Eurex accounts for a larger share of trading with the DJ Eurostoxx contract but the development of the FTSEurofirst contract, by Euronext, has provided users with a genuine alternative for the pan-European equity market.

Individual Equity Options

- During 2002, Eurex began to develop a growing and significant market share in Dutch Equity Options compared to Euronext.LIFFE in Amsterdam. Eurex accounts for about an 11% market share in Dutch Equity Options.
- During 2003, Eurex entered the French Equity Options market, taking a 25% market share by the end of 2004. Eurex's market share is still around 25%.

Equity Futures

- In 2001 LIFFE launched an innovative new product line in Equity Futures (USFs), but it was 2005 before Eurex launched its Equity Futures product. With the two major European derivatives exchanges now offering different alternatives, the combined Equity Futures market trading has more than tripled in size since 2005.

Figure 6. Stock/Index Options and Futures Turnover, Year to Date (Aug 2006)

Derivative Exchange	Country	Stock Options		Single Stock Futures		Stock Index Options		Stock Index Futures	
		Contracts Traded	Notional Turnover (EUROm)	Contracts Traded	Notional Turnover (EUROm)	Contracts Traded	Notional Turnover (EUROm)	Contracts Traded	Notional Turnover (EUROm)
Euronext.Liffe		109 080 544	321 038.0	22 901 670	176 544.0	33 534 324	2 000 040.0	47 473 632	3 200 361.0
derivatives market.at	Austria	563 259	2 470.0	10 731	128.2	18 094	1 340.0	101 951	6 831.5
OMX Exchanges	Denmark/Sweden/Finland	45 261 520	53 082.6	4 905 521	2 250.4	9 082 800	79 946.1	15 946 678	114 735.6
EUREX	Germany/Switzerland	192 709 072	532 330.5	31 604 512	151 435.9	141 768 992	4 800 719.0	176 868 336	9 468 426.0
ATHEX Derivatives Market	Greece	12 113	28.9	1 747 898	3 065.0	512 459	5 763.0	1 920 949	21 591.5
Budapest Stock Exchange	Hungary	350	3.9	507 300	4 941.5	1 075	8.1	506 559	4 293.4
Borsa Italiana	Italy	10 027 313	45 387.4	5 504 544	27 615.6	1 798 119	163 196.9	3 852 013	535 467.5
Oslo Børs	Norway	3 924 269	9 089.0	n/a	n/a	972 665	1 153.8	1 518 060	1 607.6
Warsaw Stock Exchange	Poland	8 956	62.2	91 911	509.1	247 818	1 847.6	4 372 079	32 390.4
Spanish Exchanges (BME)	Spain	8 064 360	13 958.0	12 876 630	16 170.8	308 924	35 964.7	4 172 014	486 668.4

Source: FESE

Eurex is the largest market in three of the four equity segments; accounting for 39% to 68% of trading. Whilst there is often little direct overlap between Eurex and Euronext.LIFFE in specific products, the two exchanges account for 76% to 96% of trading. They are potential competitors in virtually every sector. So a combination of these two markets would point to a serious lessening of competition in equities – unless the authorities took substantial steps to avoid it. The same applies to fixed income and STIR contracts, as these two firms have virtually 100% market shares in the different segments already.

With such a history of competition in refining existing products as well as creating new ones, it is difficult to see how the competition authorities could accept that the two exchanges could come under the same ownership. What “undertakings” could be given that would produce - with complete certainty - the same visceral competitive urge?

Could OTC trading be an effective competitor? Financial stability arguments point to bringing more trading on-exchange where prices can be readily marked-to-market and settlement systems are more robust – a major source of concern to regulators in recent years. Whilst OTC markets can tailor-make products for a particular client, the dealers need the exchange products to hedge their risks quickly and simply. So on- and off- exchange are complementary. Any move to push trading on-exchange might simply cement the power of Deutsche Börse and Euronext.

- o **Could other exchanges enter the market?** The example of Eurex’s attempt to enter the US market underlines the difficulties of penetrating an established, mature market. Perhaps there are major new innovations that would enable a newcomer to get a foothold. But the derivatives markets may well be approaching a more mature phase – though bringing credit default swaps onto an exchange might be welcome by the regulators of financial stability.

Execution risk

Deutsche Börse specifically raised the issue of execution risk for any of these contemplated combinations, commenting that it felt this risk could be resolved by its “far-reaching proposal” on cash equity clearing to the Commission. However, the Lachmann report was much more cautious, largely reflecting the two exchange’s dominance of derivative trading. There may be other issues that should be examined. These could include the following:

1. Time taken for any review

The first component of execution risk may be the classic problem of the time needed for an in-depth review of the entire economics of the affected companies and their impact on market activities. The M&A field is littered with bids which did not proceed because the competition authorities took so long to decide that the markets diverged and the ardour cooled. In this particular case, MiFID is just 14 months away and management may need to focus on the clear problems posed there. Any investigation by the European Commission of a Deutsche Börse/Euronext combination would quite easily take at least six months and quite possibly even longer.

2. Divestment to end vertical silos

DG Competition’s May report was crystal clear that vertical integration is a specific problem, so divestiture of the relevant parts of a vertical silo would seem an obvious remedy to be required as part of any approval process. That would be a high risk for any combination that included Deutsche Börse as it has already crossed swords with the competition authorities in the Clearstream case. The same risk might apply to any review of combinations involving both the Italian and Spanish markets as they also operate vertical silos.

Deutsche Börse has already offered to sell Eurex Clearing’s cash equity business but made no mention of the derivatives clearing business. It seems quite possible that the European Commission would require a sale of that business as well, so as to foster competition in derivatives trading.

But that would magnify the implication of permitting the combination of the two derivatives trading business – the starting point of real product innovation and competition (as Euronext.LIFFE is just demonstrating with its new bond index contracts). **It would seem inconsistent for the Commission to seek to break up the vertical silo in equities trading and simultaneously sanction a combination of the only two significant derivatives trading businesses in the EU.** A reading of Commissioner McCreevy’s 3rd October speech would suggest that such a combination would be very carefully reviewed by DG Markt, at least, to ensure that competition rules were not being infringed.

3. Uncertainty of asset values during changes in market

Divestiture as a remedy might be hard to implement in the next year or two as MiFID comes into operation and shakes the market structures. As the DG Comp report put it in paragraph 99 *“The Commission services believe that the best way to proceed is by making markets contestable so that the value of [infrastructure] assets readjusts to exclude the present value of future [long-term monopoly] rents.”* Commissioner McCreevy’s comments about the likelihood of structural change were quoted on page 8.

4. Possible new competition

Moreover, the European Central Bank has just announced that it is studying the addition of a securities settlement component to its TARGET II project. This brought serious questioning from Euroclear – Clearstream’s deadly rival. *“This fragmentation of current CSD activities would raise the question of whether T2S is therefore intended to be only a first step towards consolidation of other CSD activities within the ECB, with a view to ensuring over time that there be a coherent set of*

rules and governance of the various interconnected services that market participants currently enjoy from CSDs. This would transform the ECB from a supplier of outsourced services (T2S) into a full CSD which would replace eurozone CSDs altogether. The Eurosystem's intentions in this respect should be made clear to the market." Clearstream's comments were less direct but nonetheless questioning the ECB's approach. For example, how will the notary function continue to be achieved? Or would that also be taken over by the ECB?

If Euroclear and Clearstream fear that the ECB may turn into a full-blown competitor in some major segments of its business, who would be the buyer of divested settlement or clearing assets until the surrounding circumstances are much clearer?

Appendix 1: History of attempts to enter the European securities markets

APPENDIX H

History of entry and expansion in Europe from 1995*

Name of firm or venture	Established	Customer sponsorship	Post-trade infrastructure provider	Characteristics of the offer and differentiation from incumbent	Incumbent's response	Progress
Tradepoint/virt-x	1995 in London/ relaunched as virt-x in 2000.	Customer sponsored. SWX took complete ownership in 2003.	LCH, CRESTCo and SIS X-Clear	Tradepoint: electronic trading. virt-x: European blue chips under a single rule book, regulatory regime and post trade infrastructure.	Contributed to LSE introducing electronic trading.	In operation: minimal trading volume on non-Swiss equities.
EASDAQ/ NASDAQ EUROPE	1996 in Brussels/ relaunched as NASDAQ Europe in 2001.	Customer sponsored with a minority stake held by NASDAQ.	EuroCCP† for Clearing, Euroclear and Clearstream ICSD to settle trades.	EASDAQ: European high-growth companies. NASDAQ Europe: US and European technology companies traded at European trading hours.		Stopped operating in 2003.
Jlway	2000 in London	Joint venture by OM Group and customer Morgan Stanley Dean Witter (MSDW). OM acquired MSDW stake in 2001.	Trading and post-trading infrastructure provided by OM.	Cross-border trading, clearing and settlement of over 2,500 European and US equities.		Stopped operating in 2002.
NASDAQ Deutschland	2003 in Bremen/ Berlin	Customer sponsored. NASDAQ as stakeholder.	Clearstream.	User netting (which DBAG did not offer at that time).		Stopped operating in August 2003.
Xetra Stars (DBAG)	2003 in Frankfurt.	'Encouraged' by customers.	Eurex Clearing and link to Euroclear Nederland.	No significant differentiation.		In operation: minimal trading volume.
DTS-Eurosets (LSE)	2004 in London.	'Encouraged' by customers.	LCH.Clearmet, Euroclear CRESTCo.	Lower fees, better service, better reliability.	Euronext cut fee by up to 50 per cent	In operation: minimal trading volume.
Project Tiger (Euronext)	2004 in London.	Detailed discussions with customers.	—	Lower fees.	—	Never went into operation.

Source: CC analysis.

*In this table we consider only entry and expansion by regulated exchanges.

†European Central Counterparty Limited (EuroCCP) is a wholly-owned subsidiary of DTCC, which was created to provide post-trade services for NASDAQ Europe.

Source: Appendix H of Competition Commission report, November 2005

Appendix II: Graham Bishop - Biographical details

GrahamBishop.com was founded in 2000 to bring direct to its clients the insights that flow from Graham Bishop's standing as a leading technical analyst of economic and structural developments in the financial markets of Europe.

The deregulation of Europe's financial markets due to the Single Market programme and EMU create business and investment opportunities. So his publications, articles and speeches provide an informed commentary from the practical perspective of a market participant, but with a political grounding. So he has worked extensively with both European and UK political authorities.

- **European Institutions**

European Commission: Mr. Bishop currently is a member of the Commission's Consultative Group on the Impact of the Euro on Capital Markets (the Giovaninni Group). He was a Member of the Commission's Strategy Group on Financial Services (1998 – creating the Financial Services Action Plan) and the Committee of Independent Experts on the preparation of the changeover to the single currency (1994/5).

European Parliament: He was nominated by the European Parliament to be one of its two members of the first Inter-Institutional Monitoring Group, as foreseen by the Lamfalussy Report, and was Rapporteur for the spring 2003 and November 2004 Reports.

Kangaroo Group: He was elected to the Board in November, 2005

- **United Kingdom**

House of Commons: Mr. Bishop was a Special Advisor to the Treasury Select Committee in its examination in 2003 of the implications for United Kingdom membership of the Single Currency. He advised the Treasury Committee on the corresponding reports in 1998 and 1996.

House of Lords: He was a Specialist Adviser to the House of Lords Select Committee on the European Union in its 2003 inquiry into *The Barriers to Competition in the Internal Market for Financial Services*.

- **Other Activities**

He is a Council Member, Federal Trust; a member of the European League for Economic Co-operation (ELEC) - British Section; Member, European Policy Centre. During the debates on UK membership of EMU, he was a Council Member of both Britain in Europe and City in Europe; Chairman, London Investment Banking Association (LIBA) Committee on converting London's capital markets to the single currency; and Deputy Chairman of the Kingsdown Enquiry of the Action Centre for Europe (ACE) on the implications of EMU for Britain (1995 and 1997 update).

He participates in studies and meetings of research institutes such as the Royal Institute of International Affairs; Centre for the Study of Financial Innovation (CSFI); SUERF and ELEC. In addition, Mr. Bishop was a member of the Advisory Board of the European Financial Services Round Table and a Member of the CBI's working group on the MFR.

Several continuing themes have dominated his work on monetary union at Citigroup (and subsequently) since the "1992" Single Market programme commenced. They cover the technical nature of the financial system and then build up to the political impact of modern markets: the Impact on Financial Institutions and the Structure of Financial Markets; the Role of Financial Markets in the Drive to EMU; the Role of Market Discipline in maintaining Fiscal Sovereignty; as well as EMU and Political Sovereignty

Mr. Bishop graduated from Sheffield University in 1972 with a degree in Jurisprudence and worked for UK stockbrokers, Phillips & Drew, as an international economist with particular reference to equity markets. In 1979, he joined S G Warburg to manage pension fund portfolios. His emphasis moved from European equity markets to bonds and currencies, culminating in a move to Salomon Brothers/Citigroup in 1983. Initially, his economic commentaries covered the bond and currency markets of Europe. He authored Citigroup research on the issues surrounding monetary union after it became a serious possibility in 1988. As Adviser on European Financial Affairs at Citigroup in London, he reported to the Co-Chief Executives in Europe.