

Introducing the parameters: the application of competition law to the EU clearing and settlement sector

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Introduction

- Importance of competition in debate of EU clearing and settlement (C&S) sector
- Outline of preliminary competition analysis
- Analogies with other network industries
- Possible lessons for EU C&S sector

Importance of competition in debate

- Competition a recognised role:
 - Clearstream decision (June 2004)
 - Communication on C&S – the way forward (April 2004)
 - Study on exclusive arrangements in the EU25 member states (August 2004)
 - Review of LSE bids (January 2005 -)
- Critical to have structured debate

Preliminary competition analysis - relevant markets in C&S

■ Core services

● Clearing

- activity of becoming the central guarantor of counterparty risk on every trade

● Settlement

- satisfactory delivery of securities and the payment of cash, constituting the discharge of counterparties
- the main function of a CSD is to ensure a record of title maintained on central register
- book-entry settlement by a custodian confers different legal rights to book-entry settlement by a CSD

Preliminary competition analysis - relevant markets in C&S

■ Non-core services

● Custody

- holding and safekeeping securities for customers as an intermediary in the books of a higher-tier record keeper
- transmitting transfer orders
- processing corporate actions

● Banking services

- provision of credit and liquidity services related to securities settlement and securities finance

Preliminary competition analysis – competitive dynamics in C&S

- Core services characterised by monopolies:
 - network effects
 - economies of scale
 - high switching costs
- Non-core services are contestable:
 - custodians and certain CSDs compete in the provision of intermediary custody and security finance services
- Competitive dynamics in provision of core services impact along chain of complementary non-core services

Preliminary competition analysis – competition issues

- Monopolies give rise to various competition risks:
 - unreasonable bundling/tying of services
 - excessively high prices
 - predatory pricing
 - discrimination
 - refusal to supply
 - anti-competitive flows of information















Analogy with other EU network industries

- How can risks be mitigated?
 - Mixture of *ex ante* provisions and effective *ex post* competition enforcement
 - Some or all of the competitive dynamics in EU C&S sector also present in other EU network industries
 - Solutions from other EU network industries possible 'guidance'

Analogy with other EU network industries

- Possible regulatory responses to potential concerns:
 - price regulation
 - governance
 - account segregation
 - unbundling
 - transparency
 - consultation
 - divestment

Analogy with other EU network industries

Obligation	EU Network industry		
	Electricity	Postal	Telecommunications
Basis for preparation/cost allocation prescribed			
Obligation for regulatory accounts to be audited			
Appointment of auditor by regulator	-		
Publication of regulatory accounts			
Explanation of accounting methodology / allocation of costs and revenues published			

Analogy with other network industries - UK telecommunications sector

- Sophistication of tools used by Ofcom in UK telecommunications sector provide guidance
- Similar factual background:
 - BT, the incumbent, high market shares in both UK and wholesale markets for retail fixed line telephony
 - wholesale market characterised by economies of scale and network externalities
 - retail market contestable
 - due to dominance in upstream market, BT allegedly been able to restrict, or delay, access to wholesale products

Analogy with other network industries – UK telecommunications sector

- Effective equality of access required i.e. access:
 - on same wholesale products
 - at same prices
 - to same transactional processes
- More effective accounting separation to ensure equality of access
- Additional behavioural changes to support effective equivalence

Possible lessons for EU C&S sector

- The Commission flagged in Communication need for:
 - Appropriate balance between *ex ante* legislation and *ex post* intervention
 - Transparent, non-discriminatory access provisions
 - Specified and transparent governance arrangements
 - Segregated accounts with standards on cost allocation
 - Unbundling of non-core services

Possible lessons for EU C&S sector

- Does Ofcom's notion of equivalent access and related measures guide as to the type of *ex ante* provisions required in the EU C&S sector?
 - operational, technical and accounting separation between core and non-core services
 - obligation to apply equivalent conditions in equivalent circumstances
 - obligation not to discriminate in favour of subsidiaries or partners
 - transparent pricing policies
 - barriers to exchange of competitively sensitive information
 - balancing the interests of users and shareholders

Summary

- Importance of structured debate on competition in C&S
- Guidance from other EU network industries valuable
- Detailed *ex ante* regulation/agreed “best practices” would appear necessary

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