



The ECB should not monopolise securities settlement

Karel Lannoo¹

Just as the EU is bringing more competition in securities markets with the implementation of the MiFID directive, and the adoption by the settlement industry of a code of conduct, the ECB is going in the other direction with the creation of a monopoly for securities settlement in the EU. Apart from the standardization of settlement procedures against central bank money in the EU, one could wonder whether it is the task of the ECB to run a euro-wide settlement system. Settlement services are better subject to open competition, and this initiative would certainly not be market-neutral.

The performance and efficiency of securities settlement systems in the EU has been the subject of a fierce debate since the start of EMU. Domestic settlement systems function efficiently within national boundaries, but are ill-adapted to the European framework. Proposals made within several fora to overcome these inefficiencies have apparently not lead to much result, as cross-border settlement remains burdensome. The European Commission was therefore pressed to take the initiative to open-up the central securities depositories (CSDs) to competition and set minimum performance criteria.

Commissioner McCreevy however announced in July last year that he would not propose an EU directive on CSDs, but that it would strongly encourage the sector to adopt a code of conduct. The Markets in Financial Instruments Directive (MiFID) would bring sea change, with the abolition of the monopoly of exchanges and the introduction of the free choice of settlement platform. Another reason for not regulating the sector was for the Commissioner the ECB's surprise announcement a few days before that it was exploring to create a new service to provide efficient settlement of securities transactions in the euro area.

The ECB's plans have in the meantime been further clarified. The ECB expects that its platform will eliminate the need for any other settlement platform for securities transactions in the euro area. The market will benefit from economies of scale, it argues and replace the national CSDs which are in fact 'small local monopolies'. But it is creating a new monopoly, which raises the question whether this is a monopoly function.

Like payment transfers, settlement services are better not carried out by a single operator. Although network economies are at work, meaning that the potential for economies of scale is high, these networks need to be subject to competition to improve their services to clients and to ameliorate their technology. A monopoly settlement provider will eliminate these processes, and thus overtime reduce the efficiency of settlement in Europe and the attractiveness of its capital markets. It

¹ Karel Lannoo is Chief Executive of the Centre for European Policy Studies (CEPS). This article appeared in Financial News in January 2007.



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suffices to look at the US model, which is not seen to have the agility or innovativeness of its European counterparts. Indeed, if one compares the cost per transaction (post netting), *domestic* settlement in Europe is about as expensive as in the US, but European CSDs realize much higher margins than their US counterpart.

The way forward is thus not to monopolise settlement, but open up national CSD to competition, as was done with other network industries in the EU. The MiFID already allows (as its precursor the ISD) cross-border access to CSDs, but does not allow CSDs to actively provide their services on a cross-border basis. The aforementioned code, which was unveiled on November 7th, intends to achieve this, as it extends MiFID's access rights to the infrastructures (CSDs, central counterparties). Harmonised prudential standards for CSDs have also not been agreed upon, despite the efforts by central bankers and securities regulators.

The ECB initiative is also not market neutral, in the sense that it would bring an abrupt halt or change to the restructuring process underway in the settlement industry and that it would benefit custodian banks. As the ECB would not provide non-settlement operations, such as tax and corporate actions, CSDs would be likely to lose this business to custodian banks, or would have to re-orient their business to become custodians themselves.

The question could finally be raised whether it is opportune for the ECB to be involved in securities settlement. It could expose the ECB to operational risk it would better not have to carry, or it could increase the vulnerability of the European settlement system as a result of having a single system.