

**So no C&S directive, but an ECB run settlement system?**Karel Lannoo <sup>1</sup>

What started to be expected by many observers was formally confirmed by Commissioner McCreevy for the European Parliament on 12 July: for the time being, there will be no draft EU directive on clearing and settlement. McCreevy preferred to let the markets and the member states show that they can ease the environment for cross-border clearing and settlement. But what was not expected was the ECB announcement some days before that it is exploring to create a new service to provide efficient settlement of securities transactions in the euro area. More details than the announcement are not yet known – a decision is expected in early 2007.

McCreevy based his decision on 3 facts: 1) the environment of C&S is complex and rapidly changing, which makes any policy response difficult to tailor but also eventually constraining; 2) there is the implementation of MiFID, which bring more competition to exchanges and opens the possibility for direct membership of a settlement facility to investment firms; and 3) there is progress on dismantling the Giovannini barriers, although more remains to be done. In addition, the EU Commissioner also referred to the ECB initiative, which should generate large cost savings. Instead, the Commissioner took comfort from the commitment of the industry to enact a code of conduct to improve price transparency in and ease access to C&S systems. The industry also committed to unbundle accounting and pricing of clearing and settlement activities by the end of 2007.

The Commissioner is probably right to let the markets decide on improving the efficiency of C&S. The interests at stake had become so high that it would be very difficult to guarantee a good end-result, something of which the Commissioner is also aware ('It could lead to an outcome far less optimal than letting things evolve...'). But whether a code of conduct will bring results is another question. Issues such as price transparency in C&S are to some extent illusory, as prices always depend on negotiations with clients. Announced prices are therefore only indicative. Access to C&S will depend on strict enforcement of the provisions of the MiFID directive, but it should be recalled that the 1993 Investment Services Directive (ISD) already had an article (Art. 15) similar to the one in the MiFID, which had limited effect.

The ECB initiative is still in its initial phase, and subject to economic, technical and legal assessments for a formal decision to be made in early

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2007. In principle; it would be limited to C&S systems in the euro area and to fixed income securities issued in euro in the euro area, which already raises questions. The ECB sees its initiative in prolongation of the Target 2 initiative, if banks use securities in collateral for liquidity providing operations by the ECB, why not providing at the same time a single settlement engine next to a single payment system, and in this sense create one integrated platform.

The ECB initiative would certainly bring more competition to the C&S world, but not necessarily put them out of business. As with Target in payments, other private initiatives would stay in competition with the ECB's final settlement facility. In addition, the ECB would not go for the related services which private C&S offer. It may on the other hand render the competition between C&S facilities and custodian banks fiercer.

The current situation still leaves 2 issues unsolved, i.e. the minimum prudential rules for and the freedom to provide services by C&S organisations. The former has been addressed to some extent by the CESR-ESCB, but does not provide a harmonized framework. And the decision not to have a directive also prevents C&S organizations from actively providing their services on a cross-border basis within the EU.