

# The Regulatory Impact Assessment in the Area of Post-trading

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European Commission   
Internal Market & Services DG

# The Agenda

1. Background on post trading
2. The RIA – Two practical examples
3. Conclusions



# A bit of history...

- The post-trading sector has received a fair amount of attention in the last few years:
  - July 1988: Kessler report (COM)
  - November 2001: 1<sup>st</sup> Giovannini Report
  - May 2002: 1<sup>st</sup> Commission Communication
  - January 2003: Andria Report (EP)
  - April 2003: 2<sup>nd</sup> Giovannini report
  - February 2004: DG Competition report (London Economics)
  - April 2004: 2<sup>nd</sup> Commission Communication
  - July 2005: Villiers/Kauppi report (EP)



# What Is Post-trading?

- Two sets of functions/activities
  - those that lead to the completion of a transaction in financial instruments (**clearing and settlement**)
  - those that are related to the holding of financial instruments (**custody**)

# Who Are the Main Stakeholders?

- **Post-trading infrastructures**

- (International) Central Securities Depositories – (I)CSDs
- Central Counterparties – CCPs

- **Users**

- banks
- brokers
- stock exchanges, etc.

- **Final investors**

- **Public authorities** (at national and EU level)



# The Agenda

## 2. The RIA: Two practical examples



# The Agenda

## 2.1 Example One: A safer and more efficient post-trading sector



# What Is the Wider Objective?

- The challenge: increase growth potential of the EU economy and create more jobs  
➔ **Lisbon agenda**
- Financial market integration plays an important role in this process ➔ **FSAP**
- Integrated post-trading landscape part of the solution ➔ **?**





# What is the current situation?

- Inadequate post-trading landscape:
  - **domestic**: efficient and safe
  - **cross-border**: fragmentation → costly and, potentially, more risky
- Reason: **barriers** to cross-border provision
  - national differences in **technical requirements/market practice**
  - national differences in **tax procedures**
  - issues of **legal certainty** that may arise between national jurisdictions

# What can the Commission do? (1)

**2004 Communication:** the Commission's main objective is

"...to foster an EU-wide securities post-trading environment which is **efficient** and **safe** and which ensures a **level playing field** among the different post-trading service providers."



# What can the Commission do? (2)

Objectives	Specific objectives	Policies and measures	Rationale	Practical initiatives	
Efficiency	Level playing field	Integration	Ex-post competition policy	Tackle abuses of dominant positions, including discriminatory practices	Investigations and decisions by the Commission and national competition authorities
			Dismantling of market, legal and fiscal barriers	Liberalisation of the cross-border distribution of post-trading services, increase of competition and cost reduction	CESAME group (market barriers)
					Legal Certainty group (legal barriers)
					FISCO group (fiscal barriers)
					Directive (access and location issues) - To be tested in the RIA
Ex-ante competition legislation	To increase pricing and cost transparency as a means to make the detection of possible abuses of market power, and therefore distortions of competition by CSDs/CCPs, easier.	Directive (governance rules, i.e., account separation and unbundling of services) - To be tested in the RIA			
Safety	Financial stability and investor protection	Common regulatory and supervisory framework	Facilitate the integration of systems. Addressing the issue of diverging treatment of similar concerns by national authorities	Directive -To be tested in RIA	
			To increase financial stability and investor protection.		



# What can the Commission do? (3)

The Communication indicated that the Commission would have to play **three distinct roles** to achieve this objective:

## 1. **"Honest broker"**

- ➔ experts' groups (CESAME, Legal Certainty Group, FISCO)

## 2. **Enforcer**

- ➔ DG Competition

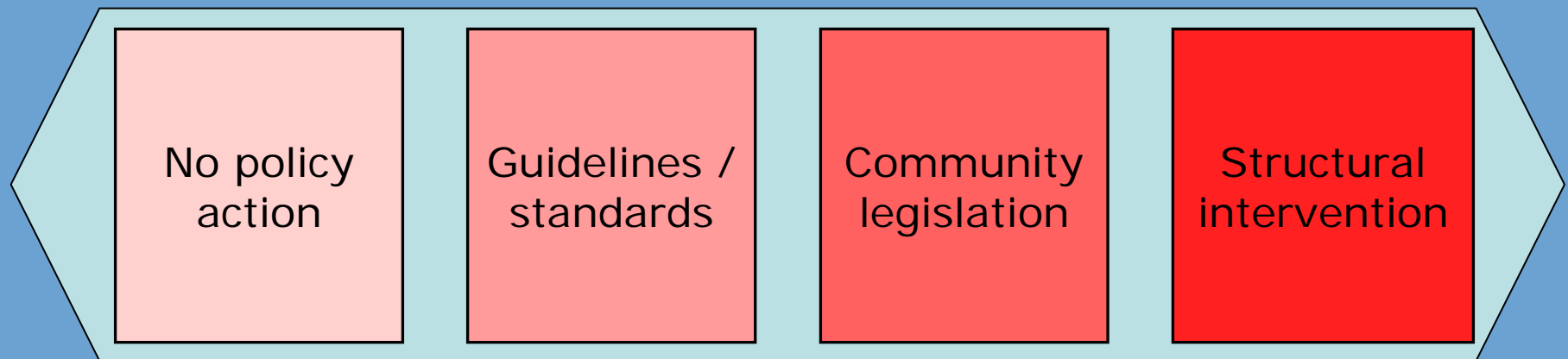
## 3. **Legislator**

- ➔ DG Internal Market and Services (directive ⇒ **RIA**)



# The Policy Options

- Four possible options were considered:



- Each of them needed to be analysed for its merits and its drawbacks ➔ **RIA**

# The Steering Group

- The **role** of the Steering Group (SG)
- The **composition** of the SG
  - Representatives from six different Directorates General (Internal Market and Services, Competition, Economic and Financial Affairs, Joint Research Center, BEPA, Secretariat General)
- Regular **meetings** to discuss progress on the RIA
- Division of labour in terms of drafting the RIA



# Consultations

- In our case (numerous groups of stakeholders with very different and often conflicting interests) **extensive consultations were of paramount importance**
- The 2004 Communication served as the basis for a first broad consultation with the various stakeholders
- In addition, during the RIA drafting process, there were constant contacts with the various stakeholders



# Verification

- **Internally:** within the SG
- **Externally:** presentations of parts of RIA to various stakeholders
  - particularly important in the case of the economic analysis





# The Main Parts of the RIA

- Definitions
- Characteristics of the industry
- The current state of play in the industry
- The economic analysis
  - static ➡ existing studies
  - dynamic ➡ econometric paper
- Analysis of pros and cons of the different policy options



# Estimating the benefits (1)

Three questions were asked:

1. Are there **extra costs in cross-border post-trading** when compared to domestic post-trading?
2. If so, **how big** are they?
3. If these extra costs were reduced (or even eliminated), what would be the **benefits for the EU economy?**



## Estimating the benefits (2)

- The answers to the first two questions are provided by the analysis in **Annex I**.
- The Annex reviews and, if possible, updates and refines all **existing studies** examining post-trading costs.



## Estimating the benefits (3)

- The answer to the third question is provided in **Annex II**.
- To answer the question, an **econometric model** is used.
- The **data** used in the econometric model consists of 14,902 traded shares at 21 major OECD stock (more than 90 percent of the world stock market capitalization). The frequency of the data is monthly over the period 2000-2001.



# Estimating the benefits (4)

The analysis in Annex II uses a three step approach:

1. How does a reduction in transaction costs impact on market liquidity?

**It increases liquidity.**

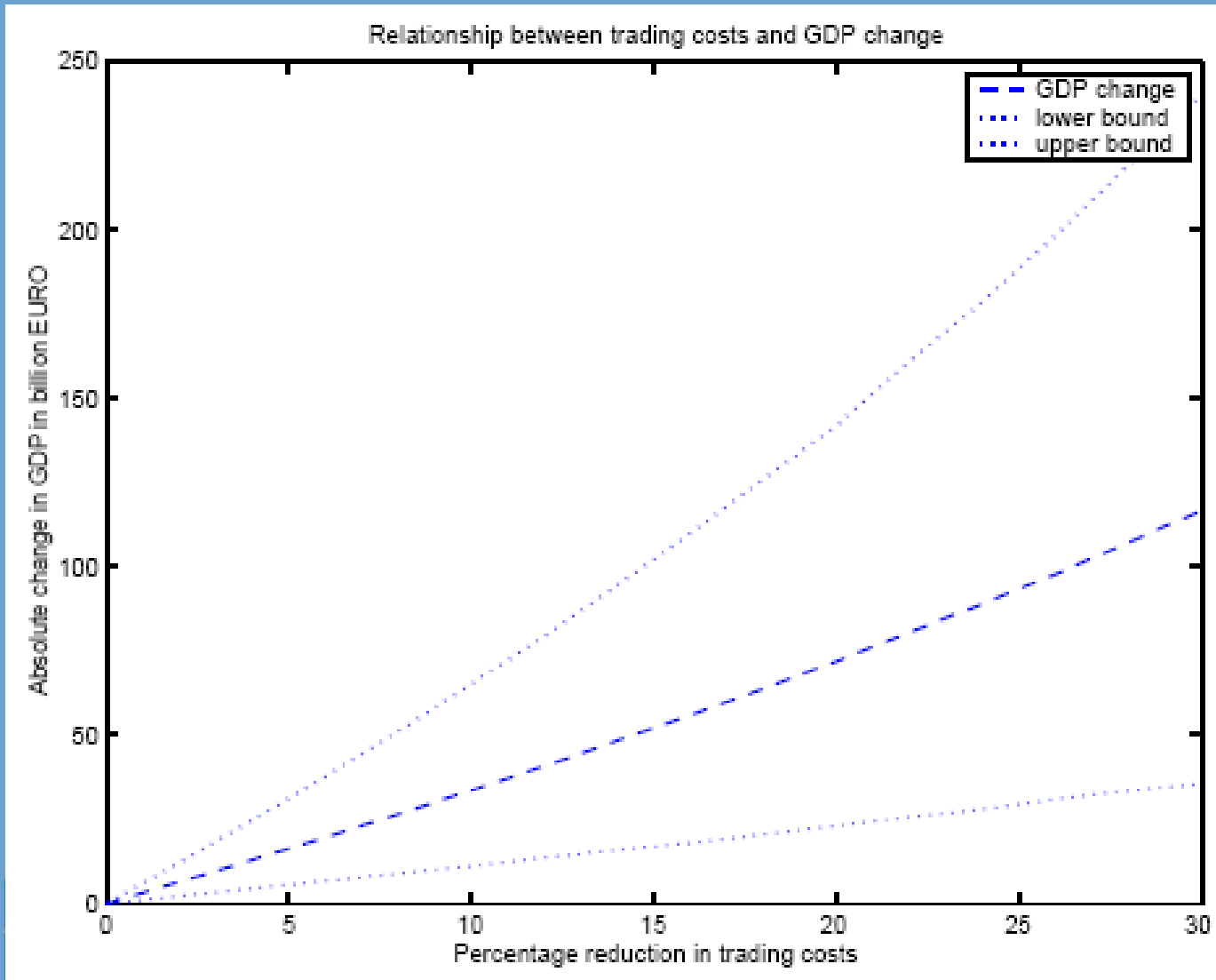
2. What is the effect of increased liquidity on cost of capital?

**Cost of capital falls.**

3. What is the impact of lower cost of capital on GDP? **GDP increases.**



# Estimating the benefits (5)



# The Final Result

Criterion / Option	"Doing nothing"	Guidelines/ Standards	Community legislation	Structural intervention
Benefits (size, likelihood and timeframe)				
Costs of compliance				
"Stability" and flexibility of the regulatory, supervisory and oversight regime				
Transparency and the ability to monitor prices				
Subsidiarity/ Proportionality				



# The Agenda

## 2.2 Example Two:

**Financial collateral and the safety of securities settlement systems**





# Background (1)

- The **Settlement Finality Directive** (SFD)
  - a response to the need to **minimise systemic risk** and to ensure the stability of payment and securities settlement systems
  - provides that **transfer orders** (for both payments and securities) entered into such systems cannot be revoked or otherwise invalidated
  - covers other dimensions as well (e.g. collateral provided to systems)



# Background (2)

- The **Financial Collateral Arrangements Directive** (FCD)
  - divergent national rules applied to the use of collateral were frequently impractical and often not transparent
  - the FCD created a **uniform EU legal framework** for the (domestic and cross-border) use of financial collateral
  - abolished most of the formal requirements traditionally imposed on collateral arrangements



# Consultations

- **External consultations**
  - both directives underwent an evaluation process which resulted in the publication of two evaluation reports
  - general satisfaction with the functioning of the two directives
  - however, some improvements possible
- **Internal consultations**
  - informal approach preferred to formal SG



# The Structure of the RIA

- **Problem definition**
- **Definition of objectives**
- **Policy options and policy instruments**
- **Analysis of impact**
- **Monitoring and evaluation**

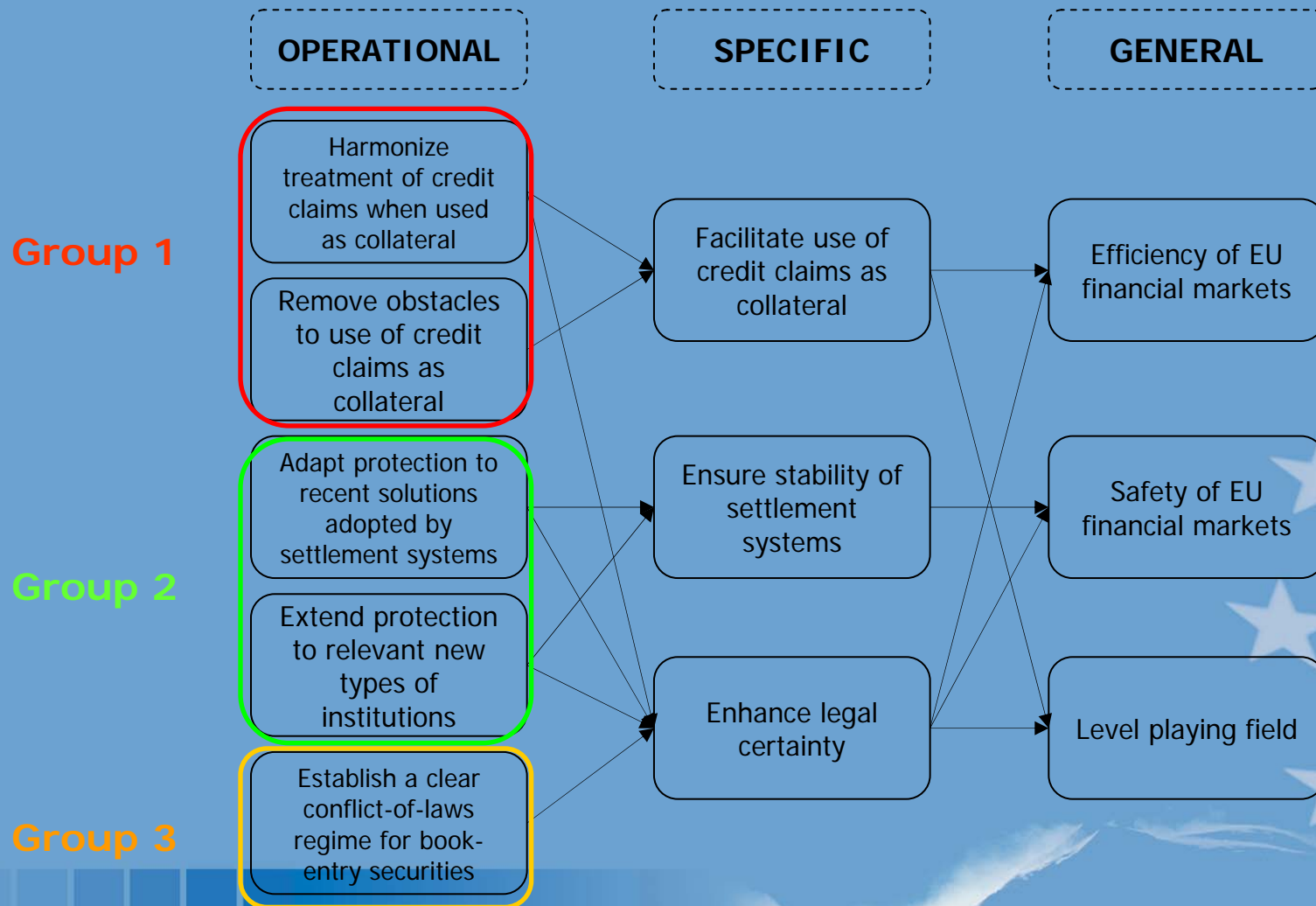


# Problem Definition

- **Relative scarcity of high-quality collateral in the EU economy**
  - no harmonised framework for using credit claims as collateral
  - formal requirements discouraging the use of credit claims as collateral
- **Problems related to settlement systems**
  - lack of clarity regarding moment of entry/irrevocability of transfer orders
  - finality in case of night-time settlement
  - lack of level playing field in the payments area
- **Problems related to the conflict-of-laws regime**



# Definition of Objectives



# Policy Options

- Defining the policy options
  - **Group 1** (credit claims) – 3 sets of options
    - use of credit claims
    - formal requirements
    - additional measures**10 options**
  - **Group 2** (settlement systems) – 3 sets of options
    - moment of entry/irrevocability
    - night-time settlement
    - ELMIs**10 options**
  - **Group 3** (conflict of laws) **3 options**



# Policy Instruments

- ~~No action~~
- ~~Self regulation~~
- ~~Communication~~
- ~~Recommendation~~
- **Directive**
- ~~Regulation~~

Selection of preferred policy instrument done before impact analysis in order to simplify the latter





# Policy instruments

Policy instrument/ Specific objective	Facilitate use of credit claims as collateral		Ensure stability of settlement systems		Enhance legal certainty	
	<i>Effectiveness</i>	<i>Efficiency</i>	<i>Effectiveness</i>	<i>Efficiency</i>	<i>Effectiveness</i>	<i>Efficiency</i>
<b>Regulation</b>	++	+	++	+	++	+
<b>Directive</b>	+ / ++	++	+ / ++	++	+ / ++	++
<b>Recommendation</b>	≈ / +	≈ / +	≈ / +	≈ / +	≈ / +	≈ / +
<b>Communication</b>	? / ≈	? / ≈	? / ≈	? / ≈	? / ≈	? / ≈

*Notes: ++ = strongly positive; + = positive; ≈ / + = slightly positive; ≈ = neutral/marginal; ≈ / - = slightly negative; - = negative; -- = strongly negative; ? = uncertain.*

# Impact Analysis (1)

Option / Affected parties	Credit institutions	Collateral takers	Debtors		Member States
			Consumers	Others	
<i>Option 1.1 - do not extend FCD to credit claims</i>	n.a.	n.a.	n.a.	n.a.	n.a.
<i>Option 1.3 - extend FCD to all credit claims</i>	+ / + + : ↑ benefits as more collateral available to secure both domestic and cross-border transactions (in latter case due to harmonised legal framework) (I) + : easier mobilisation of dormant capital on balance sheets (D) - : ↑ cost of implementing systems for handling credit claims in case they are not already in place (D)	+ + : ↑ legal certainty as credit claims provided as collateral would enjoy the same protection as cash and securities (D) ? / + : potentially ↑ benefits as the higher amounts of collateral available, the clients of the collateral taker may conduct more business with the latter (I) - : ↑ cost of implementing systems for handling credit claims in case they are not already in place (D)	- / - : in case of default on his loan, a consumer would not be able to renegotiate its terms or would have to accept more unfavourable terms than if the claim remained with the original bank (I)	- : in case of default on his loan, a consumer would not be able to renegotiate its terms or would have to accept more unfavourable terms than if the claim remained with the original bank (I)	- : ↑ costs of modifying legislation (D) + : ↑ liquidity in financial markets (I)

Notes: ++ = strongly positive; + = positive; -- = strongly negative; ≈ = neutral/marginal; ? = uncertain; n.a. = not applicable.  
D = Direct impact. I = Indirect impact. ↑ = increase/rise. ↓ = decrease/fall.



# Impact Analysis (2)

- The preferred options were selected on a **group-by-group** basis
- Nevertheless, potential **interdependencies** between the different groups were taken into account in the analysis
- Final proposal was constructed by putting together all the preferred options



# Monitoring and Evaluation

- The implementation of the amending directive will be monitored by the Commission
- The changes introduced will be subject to ex-post evaluation
- Some potential **indicators** and **sources** which could be used in the evaluation process were identified



# The Agenda

## 3. Conclusions



# The Main Lessons (1)

- **Plan** carefully
- Gather as **many minds** as practically possible...
- ... but have only **one hand** holding the pen
- **Be transparent** about your work...
- ... but do not disclose too many details
- **Consult** as widely as possible...
- ... but do not overdo it...



## The Main Lessons (2)

- ... and keep in mind that your interlocutors' **interests** may differ from yours
- Be careful about **the data**
- Remember: whereas the RIA is a technical document, the final decision is political



**Thank you !**

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