



Global Investment Technology Leadership Roundtable

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European Trading and Settlement Landscape: A CEO's Perspective

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European Central Counterparty is a subsidiary of
The Depository Trust & Clearing Corporation



MiFID in Perspective

- Markets in Financial Instruments Directive
- Part of the Financial Services Action Plan
- Objective is to integrate:
 - 27 Member States
 - 23 official languages
 - 13 currenciesinto a single capital market that is globally competitive
- Eliminate barriers for investment firms via *passporting*
- Break down stock exchange monopolies via *competition*
- Protect investors via *best execution*



Trading landscape one year after MiFID

Block Trading Networks

- Liquidnet Europe
- ITG Posit
- NYFIX Euro Millenium
- Pipeline Europe (to be launched)

Exchange-owned Dark Pools

- SmartPool (NYSE Euronext)
- SIX Swiss Block (SIX Swiss Exchange)
- Baikal (London Stock Exchange)

Independent MTFs

- Chi-X (Instinet / Nomura)
- Turquoise (9 global banks)
- BATS Europe (BATS)
- Burgundy (10 Swedish banks, brokers)

Exchange-owned MTFs

- NASDAQ OMX Europe
- NYSE Arca Europe (aka Octopus)
- Equiduct (Börse Berlin)
- SIX Europe (aka virt-x, aka Tradepoint)



What is “best execution” in Europe?

- No equivalent National Best Bid and Offer system
- MiFID requires firms “to execute orders on terms most favourable to the client”:
 - Using all reasonable steps
 - To obtain the best possible result for their clients
 - Taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant....
 - Unless under specific instruction from the client
- Firms create an execution policy that the client must agree to, then measure it in real time



How much does it cost to trade?

- Pricing transparency is required, but
 - Simplicity is discretionary
 - Clarity is optionalso comparability is difficult
- Vertical structures are especially problematic
 - “Vertical silos” of exchange groups that have 3 pockets: trading, clearing and settlement
 - “Virtual verticals” of trading platforms with an economic interest in clearing



Post-trade services are critical

- Central Counterparty (CCP) clearing
 - Guarantees that price agreed at execution is honored, even if trading counterparty defaults
 - Intermediation services provided by General Clearing Participants
- Central Securities Depository (CSD) settlement
 - Ensures that securities and payment are exchanged without principal risk
 - Intermediation services provided by custodians



MiFID has limited post-trade provisions

- Investment firms have the right of remote access to clearing and settlement infrastructures, and to settlement location
- MTFs have the right to designate clearing and settlement infrastructures in another jurisdiction
- Infrastructures have the right to refuse access on legitimate commercial grounds
- Regulators have the right to refuse arrangements if the smooth and orderly functioning of markets they supervise is not assured



Code of Conduct intended as a remedy

- The European Code of Conduct on Clearing and Settlement was drafted and adopted by market infrastructures to avoid a C&S directive
- Includes provisions on price transparency, access and interoperability, accounting separation and unbundling of services
- Guidelines on access and interoperability – the most difficult part of the Code, especially in clearing:
 - Competition barriers
 - Risk barriers
 - Legal barriers



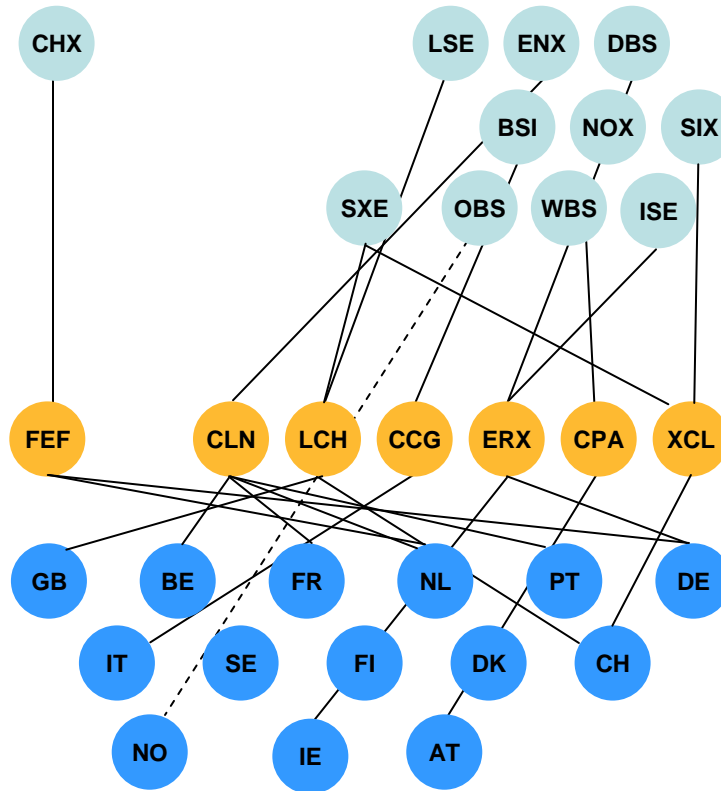
Competition in trading.....complications in post-trading

Trading

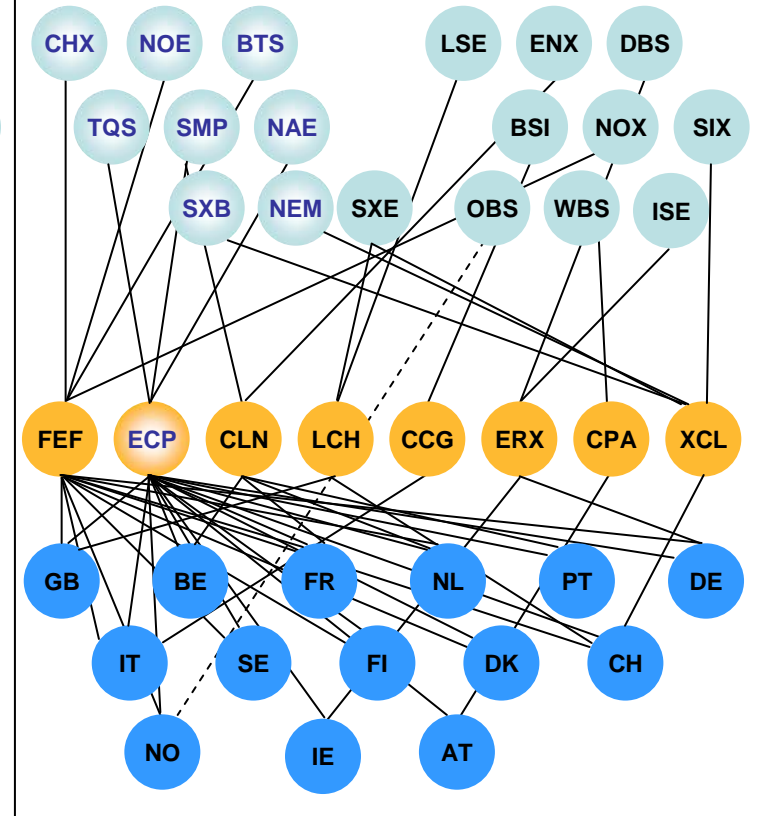
Clearing

Settlement

Europe before MiFID

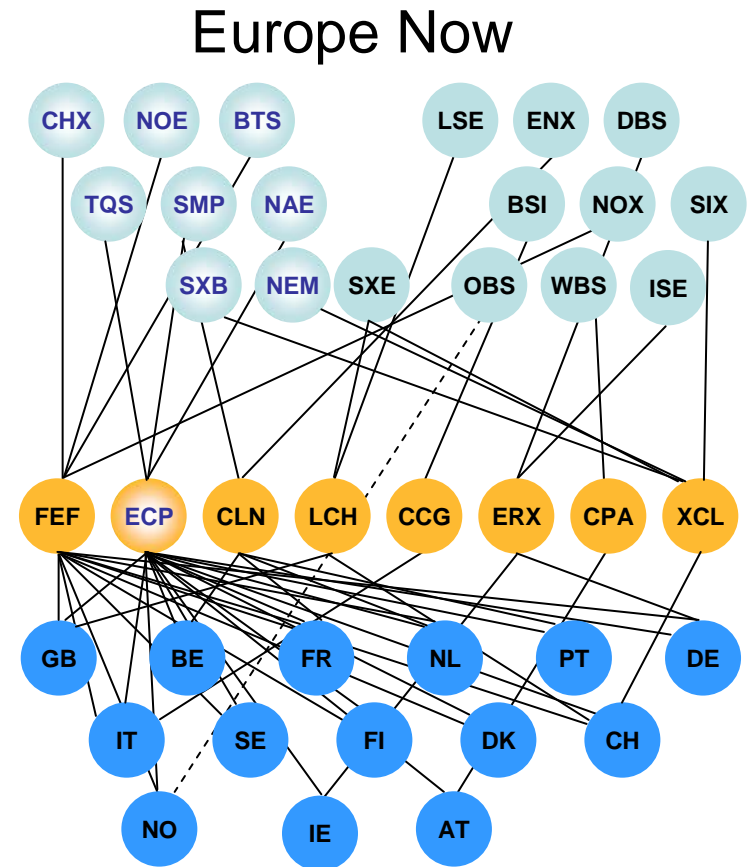
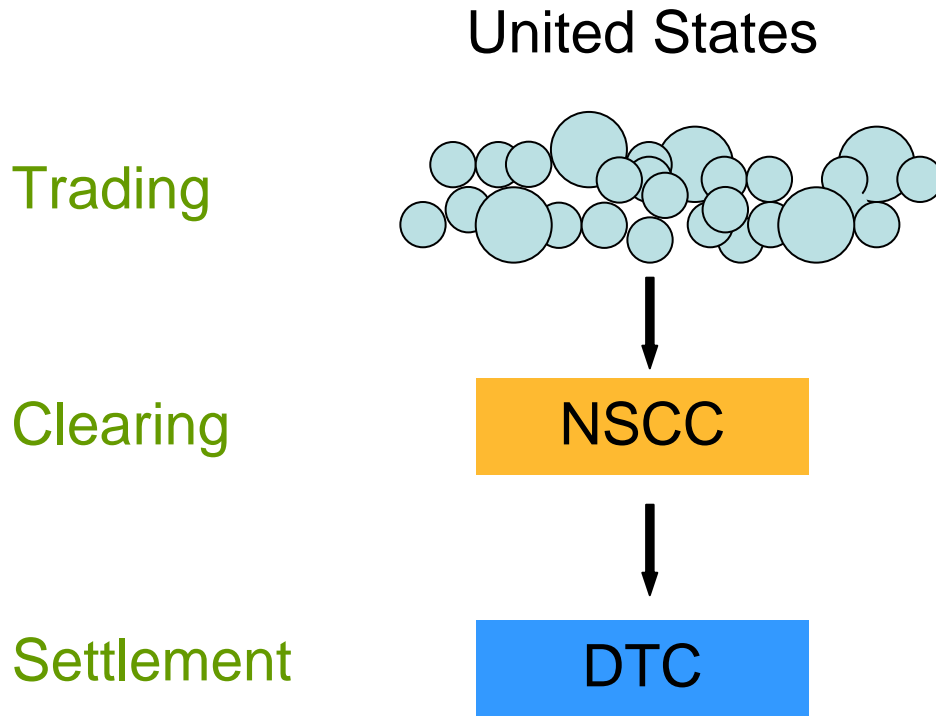


Europe Now





Market structure affects cost



Clearing cost	\$ 0.003	\$ 0.34
per side	€ 0.002	€ 0.26

Exchange rate €0.77 to \$ as of 31 Oct 08



What users want in clearing

- Low clearing fees
- Assured protection from counterparty default
- Efficient margining and collateral process
 - Operational efficiency
 - Optimisation of collateral usage
- Freedom of choice in trading venue
 - Netting across trading platforms for settlement
 - one settlement per stock per day
 - Netting across trading platforms for margin –
 - on one net position per stock per day

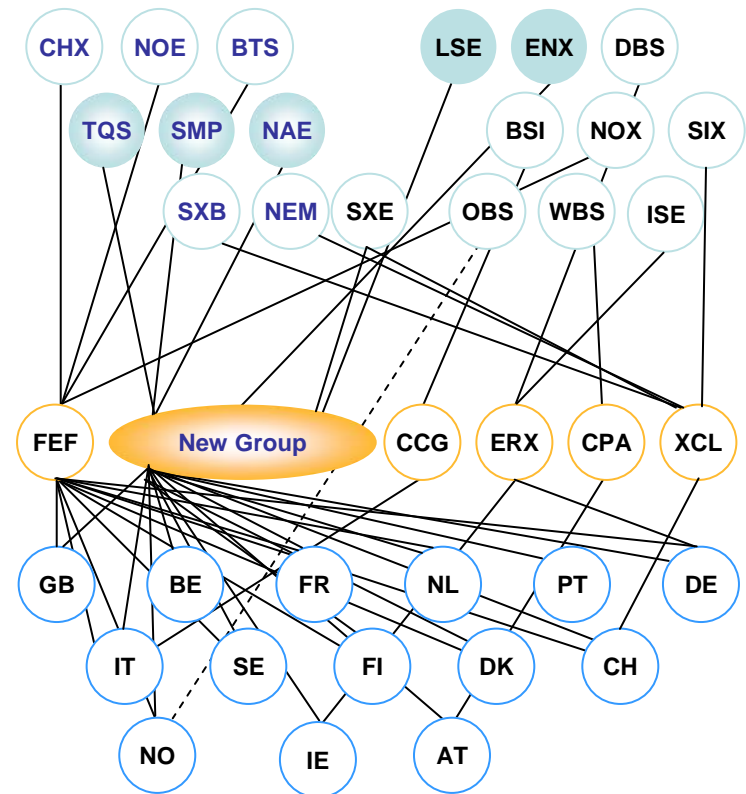
Delivering what users want:
Interoperate or Consolidate



DTCC – LCH.Clearnet proposed merger

- Announced on 22nd October 2008
- Combined entity would clear 53% of exchange-traded volumes globally, 50% in Europe
- LCH.Clearnet Group to become “at-cost” within 3 years of merger
- The combined group would:
 - Be user-owned and governed
 - Have significant risk management expertise, capacity, and market-leading technology
 - Have capabilities in equities, fixed income, exchange-traded derivatives and commodities, mutual funds, annuities, OTC interest rate swaps, credit default swaps, carbon emissions, freight contracts

After Merger - 2009





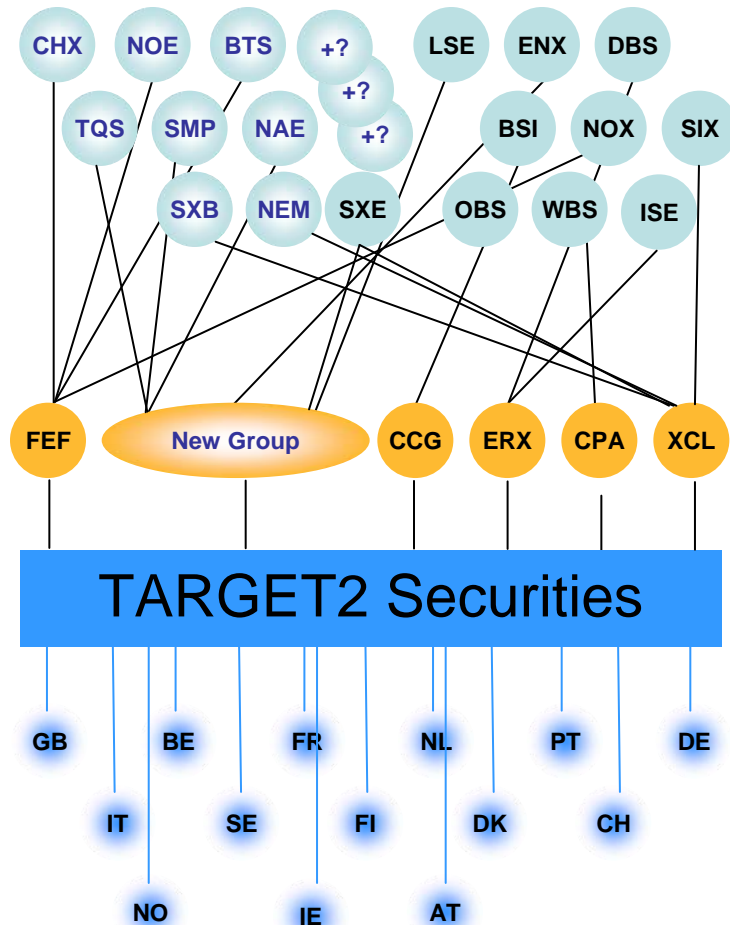
Settlement: TARGET2 Securities

Trading

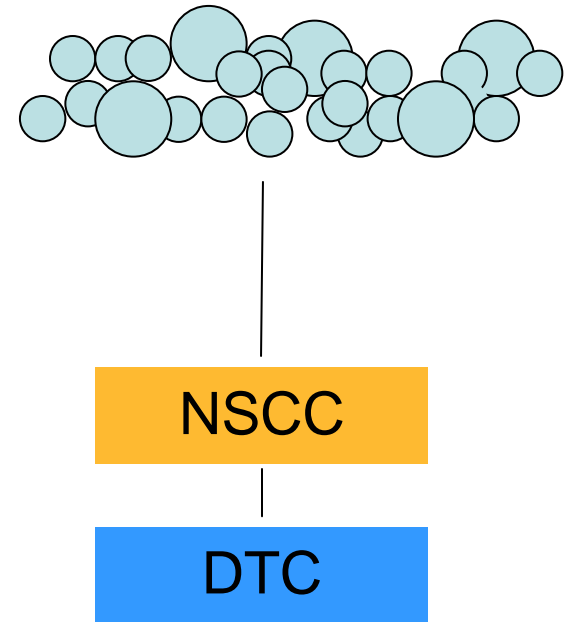
Clearing

Settlement

After T2S – 2013*



United States



* Assuming all CSDs join T2S



In summary.....

Trading

- Competition to national exchanges has emerged, MiFID is doing what is intended
- Successful launch of MTFs and dark pools with CCP clearing enables new trading strategies, more liquidity, more volume

Clearing

- 2 distinctive clearing strategies of trading venues:
 - Clearing as additional source of income
 - Clearing to reduce all-in cost of trading

Settlement

- TARGET2 Securities should reduce costs
- More importantly, it will improve liquidity and risk management



Discussion questions

- Will fragmented clearing affect the ability of new MTFs to succeed?
- What are the benefits and risks of competition among CCPs?
- Is monopoly always bad and competition always good for users?
- How will the market turmoil change priorities in trading, clearing and settlement for policy makers? For market participants?