

MONITORING COMPLIANCE WITH THE CODE OF CONDUCT DATED 7TH NOVEMBER 2006

A Joint Report by European Forum of Securities Associations incorporating: London Investment Banking Association Association Française des Entreprises d'Investissement Assosim Swedish Securities Dealers Association European Primary Dealers Association European Securities Forum International Capital Markets Association

Introduction and summary

1. The associations named above (the Associations) welcome the opportunity to report to the European Commission, as secretary of the Monitoring Group (“MOG”). We have carried out independent work in relation to the Code of Conduct and our conclusions can be summarised as follows:
 - a. On **transparency**, we think that the infrastructures made a creditable effort at the end of 2006. Clearly, lessons will be learned and the 2007 transparency arrangements will be improved as the year progresses. The infrastructures, and in particular the CSDs, have acknowledged that significant work remains outstanding, particularly on price comparability. We shall be very disappointed if we do not see a significant improvement in the quality and quantity of published data in 2008. The infrastructures’ recognition that users need to use published material to reconcile invoices and activity is also welcome. But the published material is only part of the story. We encourage the infrastructures to continue to work with their clients to understand clients’ needs and to give those needs a top priority, in this as in other areas.
 - b. On **access**, we think it remains important for the infrastructures to make progress in two specific areas:
 - i. Providing access to new entrants. Commissioner Kroes made clear that she saw this as a test for the Code in her speech on 30 November 2006. The action of Borsa Italiana in complying with its undertaking to the Italian Competition authority (AGCM) is a good example for the rest of the industry.
 - ii. Resolving the commercial and ‘business case’ issues in relation to access. UK infrastructures, including x-clear, LCH.Clearnet and Crest have hard-won experience in this area which we encourage them to share. The Associations stand ready to assist in helping infrastructures clarify user requirements.
 - c. On **interoperability**, we think that there is a need to distinguish between the general and the particular. There are a number of specific

examples where infrastructures are pursuing interoperability. We would like to see these brought to fruition and the lessons shared with colleagues before setting general standards. We acknowledge that there is a risk that difficulty in making progress towards specific goals could delay general progress. We will continue to monitor both aspects closely; this is the core of the Code.

- d. **Unbundling and accounting separation** are beginning to be a matter of concern. Early in the process, we urged individual infrastructures to begin work on this at an early stage; we have had only a small number of reports of progress since those early contacts. We think it is essential that individual infrastructures share their project plans with representatives of market participants in each member state and that a dialogue is established at European level, designed to ensure that progress is being made and that this is being reported to the MOG.

Individual association reports

2. **LIBA** has discussed progress in relation to the Code of Conduct with the London Stock Exchange, Euronext, the Deutsche Börse group and Borsa Italiana. In relation to clearing and settlement, we have been in touch with LCH.Clearnet, x-clear, Crest and the Euroclear group, as well as Monte Titoli and CC and G. Much of this work has been informal. We have discussed the monitoring work with our members and with other associations, including the Associations, as well as the BBA and the European Banking Federation. We have encouraged our members to emphasise to the infrastructures the importance of the Code of Conduct initiative. In addition, we organised and hosted a joint meeting of the Associations with FESE EACH and ECSDA, which is discussed separately below.
3. **AFEI** expressed strong support for the process initiated by Commissioner McCreevy and played an active part for many months in all European-level discussions on these issues. As the Commissioner has pointed out, the main challenges now are to ensure that market infrastructure providers actually implement the Code and to supervise compliance with the commitments they have made. AFEI continues to pay careful attention to monitoring progress and to forthcoming developments in this area. AFEI has set up a specific working group with its members in order to follow the progress on the code of conduct.
4. **Assosim** has activated working groups with its members discussing implementation of the Code by Monte Titoli and CC &G on transparency. Although progress has been judged as broadly satisfactory, we have recently asked Monte Titoli to make more effort as far as billing reconciliation is concerned. The ASSOSIM groups will also consider the effectiveness of the implementation of the other commitments in the Code.
5. **SSDA** continues to work closely with its members and with LIBA on matters of common concern. SSDA receives reports on progress from both VPC and OMX regularly (at least every second month) which until now have been satisfactory and have not given rise to any concerns on SSDA's part as to the infrastructures' devotion to solve these issues.

6. **EPDA**, the group representing primary dealers in European government bond markets, continue to monitor developments carefully, working constructively with other associations. The EPDA works mostly on this matter through its Clearing and Settlement Working Group which has representatives from 15 of its 21 executive members. The EPDA has monitored the progress of the Code from the beginning and has consistently advocated that it be extended to other asset classes in multi-participant forums such as the CESAME group as well as in bilateral meetings with infrastructures. This is a principle that is endorsed unanimously by its members who represent more than 85% of the Euro government bond trading volume.
7. **ESF** has engaged with individual infrastructures at a high level, in particular with Borsa Italiana Group, Deutsche Börse Group, ECSDA, Iberclear, LCH.Clearnet, London Stock Exchange and SIS Group and provided a forum for discussion of matters of common concern. In addition, it initiated and coordinated the work of the Associations on a statement of principles, which was sent to the infrastructures associations on 5 April; the final draft thereof was also made available to the members of the Joint Steering Group of EACH, ECSDA and FESE at their initial meeting of 4 April. The text is attached as Annex 1.
8. **ICMA** monitors progress primarily through its European Repo Committee (ERC). The members of the ERC are aware that the Code currently applies only to post-trade processes in cash equity markets and have appreciated the decision by one of the ICSDs to apply the Code's principles also to fixed income. In their contacts with national CSDs, they continue to work towards the removal of barriers that stand in the way of seamless transfer of collateral across borders. In the context of tri-party repo, the repo community is watching with interest the discussion between the ICSDs about the feasibility of a solution whereby each ICSD would become a participant in the other ICSD's tri-party solution.

The joint meeting

9. We wrote to the Commission on 2nd March, setting out our proposals in relation to a dialogue. Following that, we organised a joint meeting in London between the Associations and the infrastructure associations. We remain willing to work with other user groups.
10. The **joint meeting between the Associations and FESE, EACH and ECSDA** was held in London on 28th March 2007. The Associations made the following general points by way of introduction:
 - a. We attach great importance to achieving the lowest possible front-to-back costs of trading clearing and settlement in Europe and the Code is an important part of the way we intend to reach that objective. At the same time, the Associations also regard it as essential that the infrastructures give the needs of users a top priority. We referred to the ICSA Principles for the governance of market infrastructures, developed jointly by a number of the Associations.
 - b. For us, the ideal consequences of the meeting are:

- i. that we can give a clear report to the monitoring group, which next meets in Brussels on 20th April, of our understanding of the intentions and capabilities of the infrastructures; and
- ii. that the infrastructure associations and the securities sector associations agree on methods of co-operation which will enable the infrastructure associations to say with confidence that their proposals meet the industry's expectations. The users emphasised that this meeting should be the first in a series.

11. On specific areas, the Associations said:

- a. Transparency: we appreciate that all the infrastructures will have learned from each other. We are prepared to regard the efforts made so far as a good first attempt; we expect that further improvements will be developed in the second half of the year and we are happy to discuss these with you.
- b. Access: the provision of access to other Code signatories is an important piece of the picture. Our members also attach great importance to the availability of practical access solutions for new entrants to the market. We recall the remarks of Commissioner Kroes on 30th November 2006; although she referred to 'Project Turquoise' directly, she also said similar considerations apply to other platforms - like Equiduct and Chi-X. The actions of Borsa Italiana in opening their clearing and settlement infrastructure to a competing fixed income trading platform set a good example.
- c. Interoperability: we know that the CCPs in particular are having difficulty with interoperability, particularly with commercial issues. We suspect that this is an area where the best is the enemy of the good. Our emphasis is on practical, robust, business-like solutions. We want to see progress. We are ready to discuss the difficulties with you in more detail. 30th June is quite close now. It remains important not to miss this deadline.
- d. Unbundling and accounting separation: we feel we must be given an opportunity to discuss and validate your proposals.

12. The infrastructure associations presented the material which they had previously presented to the European Credit Sector associations (ECSAs). They reported that, in relation to the work on access and interoperability, the kick-off meeting for a single protocol for access and interoperability is scheduled for the week beginning 2nd April and agreement between EACH, ECSDA and FESE should be reached by mid May.

13. The infrastructure associations accepted the points we had made and undertook to discuss them further in their individual associations and in the joint Code structure. They also undertook to arrange the next meeting in the series; it was hoped that this could be done jointly with the ECSAs.

14. In the discussion of specific areas, the following points were made:

- a. On **transparency** the work was most advanced. FESE – and to a lesser extent EACH – members had implemented a number of measures to comply with the Code. We noted that EACH regard themselves as largely unaffected by this part of the Code. The users agreed that

ECSDA members still had substantial work outstanding, particularly on price comparability where members were still developing meaningful conversion tables and comparable price examples which they intended to share with market users as soon as possible. We regard the efforts made so far as a good first attempt; we expect that further improvements will be developed in the second half of the year and we are happy to discuss these with the infrastructure associations. This is about *how* the providers comply with the Code, not *whether or not* they are complying

- b. We emphasised that in the users' view, **access and interoperability** is the most challenging and demanding of the Code's issues. We noted that after three months of deliberations the infrastructure organisations had appointed a joint steering committee to lead this work. The Associations made it very clear to the infrastructure side that we are ready to discuss the difficulties with them in more detail at an early date and that meeting the deadline of 30th June, which is very close, remains very important.
 - c. In relation to **service unbundling and accounting separation**, FESE said that it intended to act merely as the co-ordinator of a process primarily between those of its members integrated with other infrastructure layers on one side, and national competent authorities on the other. EACH said that they considered this aspect of the Code of limited relevance for them because the CCP layer is generally separate from the trading and settlement layers. ECSDA, on the other hand admitted that this is a significant issue for its members. A task force on the issue would kick-off its work on 30th March, aiming to deliver unbundling proposals for ECSDA Board approval by 30th June.
15. In the subsequent question and answer session, the focus of user questions was on the need to ensure early user participation in the infrastructure work to comply with the Code – presenting users with finished and immovable solutions close to delivery deadlines would not be acceptable. The user side appreciates that infrastructures accepted this message and agreed to co-operate and share early drafts as much and as soon as possible.
16. It remains important to the securities sector associations that the infrastructures involve the users early in the process of developing their proposals, so that the infrastructures can say with confidence that their proposals have support from market users. We repeated the offer made in our letter of 2nd March, to co-operate with the infrastructure associations and their members *ex ante*.
17. In conclusion, the Associations declared themselves broadly satisfied with the meeting which had given a clearer picture of infrastructure capabilities and intentions and commitment to user involvement although the details of the latter remained to be worked out.

Conclusion

18. While we are broadly satisfied with progress, we believe that the spirit of constructive engagement shown at the meeting on 28th March should be harnessed so as to ensure that the goals of users are achieved in practice. We

will continue to do what we can and we welcome the close involvement of the MOG and its members. In the users' view, **access and interoperability** is the most challenging and demanding of the Code's issues.

London, Paris, Milan and Stockholm

11th April 2007

5 April 2007

By e-mail

To

- EACH: Ann Flodström
- ECSDA: Joël Mérére
- FESE: Jukka Ruuska, Judith Hardt

Code of Conduct

Key elements of the access and interoperability conditions – the market users' view

The undersigned securities associations remain committed to contribute actively to the successful implementation of the European Code of Conduct for Clearing and Settlement.

Following our offer of 2nd March of an ex ante **cooperation with the infrastructure** in defining the access and interoperability conditions and procedure, you agreed to meet us on 28th March. We thought the meeting constructive, providing us with a good understanding of your intentions and capabilities. We also believe that price transparency will be enhanced once service unbundling and accounting separation comes into effect in December this year.

At that meeting we urged the infrastructure to establish an institutionalised dialogue with us. In the immediate context, our objectives are to reach (ideally by 30th June) solutions supported by both the infrastructure and market users and to establish a means to overcome conflicts of views within and among the infrastructure associations.

In the light of your agreement to cooperate we set out below the **key elements** of the access and interoperability conditions and procedure from the view of market users:

1. Our goal remains more efficient, more integrated markets, achieved through the reduction of cost and complexity. **The access and interoperability provisions are the core part of the Code of Conduct** because price transparency, service unbundling and accounting separation will remain of little value without competition and users' choice, facilitated in this way.
2. Our members attach great importance to the establishment of a **competitive environment for CCP services at the major European securities exchanges**. In the short term, creating real choice for users between several **interoperable CCPs** at Deutsche Börse, Euronext and The London Stock Exchange complemented by the choice of **interoperable (I) CSDs** should therefore be a primary target in implementing the Code of Conduct.
3. The Code distinguishes between access and interoperability solutions. For us, **access solutions** are (i) adequate solutions for less transaction intense relations between infrastructures or (ii) a first and swift step towards interoperability. Providing access to new entrants to the market in trading, clearing or settlement is certainly an important test of whether or not the market in question has become more competitive.

4. In the context of the Code of Conduct, we understand there has been extensive discussion of the term '**business case**'. For us, actual (or expected) **market demand** is an essential element in any business case for a provider of infrastructure services. Practical interoperability solutions should be supported by market users with an adequate aggregate market share.
5. **Interoperability** requires a **truly level playing field** for the partners of such interoperability and their customers; in the case of CCPs this extends to margining and collateralisation. In this context our members attach great importance to an early agreement for effective interoperability between LCH.Clearnet and x-clear in the context of the London Stock Exchange, virt-x and SWX, building on the experience of existing arrangements for multiple clearing houses.
6. Access and interoperability must not be jeopardised nor rendered impossible by currently existing **legal, fiscal and regulatory arrangements**. Rather, such legal, fiscal and regulatory arrangements should be changed to allow easy implementation of access and interoperability. In the spirit of the Code, infrastructure providers and market users should cooperate to contribute to such change.

The undersigned associations remain committed to contribute actively to the successful implementation of the Code of Conduct and are ready to continue to work with you on these and other issues.

Kind regards

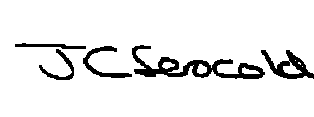
EPDA
European Primary
Dealers Association

ESF
European Securities
Forum

ICMA
International Capital
Market Association

LIBA
London Investment
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