

1.1 Case - Clearing & Settlement

Refusal to deal based on essential facility: the “uniqueness” matters, and in this case the German law conferred a key role to Clearstream as CSD depository. Euroclear was then harassed by Clearstream Frankfurt. *While the Commission ultimately concluded that demand-side substitution was the principal determinant,¹ supply-side substitution was a relevant factor in various security clearing services markets.²*

Infringement, without fines because first time in the C&S industry, now the case is under appeal by defendants. Also, use of “discriminatory pricing” abuse.

1.1.1 Final decision in Clearstream case

In a decision adopted today³, 2 June 2004, the Commission finds that Clearstream Banking AG and its parent company Clearstream International SA (“Clearstream”) infringed competition rules by refusing to supply cross-border securities clearing and settlement services and by applying discriminatory prices. The Commission’s investigation revealed that Clearstream refused to supply Euroclear Bank SA (“Euroclear Bank”) with certain clearing and settlement services and applied discriminatory prices to the detriment of this customer.

Competition Commissioner Mario Monti said: “Which regulatory and business models should be adopted in the future? Today’s decision does not favour one particular model, it is not directed against Deutsche Börse’s business model or any other.”

The Commission’s enquiry into this case identified two types of abuse: refusal to supply and discriminatory pricing.

1.1.2 Refusal to supply.

Clearstream refused to supply to Euroclear Bank clearing and settlement services for registered shares⁴ issued under German law. While competition law recognises the freedom of companies to freely choose their trading partners, companies in a dominant position have a special responsibility. In the present case, Clearstream’s behaviour qualified as refusal to supply because:

- Clearstream Banking AG is the only final custodian of German securities kept in collective safe custody, which is the only significant form of custody today for securities traded. New entry into this activity is unrealistic for the foreseeable future. Therefore, Clearstream Banking AG is an unavoidable trading partner;
- Euroclear Bank could not duplicate the services that it was requesting; and
- Clearstream’s behaviour had the effect of impairing Euroclear Bank’s ability to provide efficient cross-border clearing and settlement services to clients in the single market.

Euroclear Bank eventually obtained the clearing and settlement services from Clearstream Banking AG in November 2001 - more than two years after it requested those services. During the entire period Clearstream Banking AG denied Euroclear Bank clearing and settlement for services registered shares. The dilatory behaviour of Clearstream vis-à-vis Euroclear Bank contrasts with the usual delay of a maximum four months within which other comparable customers were supplied with clearing and settlement services.

¹ Clearstream, supra note [x], paras 135-137.

² Ibid, para 200.

³ Source: [IP/04/705](#) Date: 02/06/2004

⁴ The most widely internationally-traded German shares (blue chip shares such as Daimler Chrysler, Siemens, Allianz, Deutsche Post, Deutsche Telekom, Deutsche Bank, Lufthansa and others) are registered shares, as opposed to bearer shares.

1.1.3 Price discrimination.

Between January 1997 and January 2002, Clearstream, for equivalent clearing and settlement services, charged a higher per transaction price to Euroclear Bank than to other securities depositories outside Germany. The Commission examined in detail the content of the services and the costs of providing them in order to establish whether the price difference could be justified and concluded that it was not.

The infringements have ceased

While the infringements have meanwhile come to an end, the Commission adopted today's decision in order to clarify the legal situation. The decision should provide the necessary clarity to Clearstream and to other companies active in clearing and settlement. The decision comes at a moment when cross-border trade in securities is becoming more important within the EU.

The Commission decided not to impose a fine. Among other factors, the Commission took into account that there is no Community case law or jurisprudence dealing with the competition analysis of clearing and settlement. In addition, there has been a wide-ranging debate on clearing and settlement within different institutions and fora in order to better define the role of the different protagonists in the industry.

1.1.4 Background

Securities clearing and settlement are necessary steps for a securities trade to be completed.

Clearing is the process by which the contractual obligations of the buyer and the seller are established.

Settlement is the transfer of securities from the seller to the buyer and the transfer of funds from the buyer to the seller.

The procedure that led to the adoption of the decision originated in a Commission enquiry aimed at examining if EU competition law is properly applied in the clearing and settlement sector, in particular as regards access and prices.

Clearstream Banking AG is Germany's only *Wertpapiersammelbank* (Central Securities Depository⁵). The Commission considered that during the reference period concerned, 1997 through 2001, Clearstream held a dominant position for providing cross-border clearing and settlement services to intermediaries situated in other Member States. The investigation therefore focused on a specific cross-border market and the decision does not set out findings that go beyond that relevant market.

Clearstream: Questions and Answers on the Commission Decision

Brussels, 02 Jun 2004

1. SECTOR

What is clearing and settlement?

These are terms on which different parties in the industry itself have different interpretations. However, broadly speaking, clearing and settlement are two important steps which are needed to complete a securities transaction. Clearing is the process by which the obligations of the buyer and seller are established. In some systems a central counterparty may fulfil a special function in this process but this was not the case in Germany at the time the infringements took place. Settlement is the transfer of the securities from the seller to the buyer, the transfer of funds from the buyer to the seller and the corresponding entries in the securities accounts.

⁵ Central Securities Depositories hold securities and enable securities transactions to be processed through book entry. In its home country, the Central Securities Depository provides processing services for trades of those securities that it holds in final custody. It can also offer processing services as an intermediary in cross-border clearing and settlement, where the primary deposit of securities is in another country.

Why is the Commission interested in clearing and settlement now?

The Commission monitors the compliance with competition law of all aspects of financial services in the same way as it monitors other industry sectors. Securities trading and post-trading activities are an integral part of this monitoring. The Commission intervenes when there is an issue of Community interest and significance, as with any industry.

Securities trading and post-trading has traditionally been organised on a national basis. However, there have been significant changes since the introduction of the euro and the progressive implementation of the Financial Services Action Plan. On the one hand there is an increase in the volume of cross-border trading, and therefore the need for the associated services of clearing, settlement and custody, and on the other there has been consolidation of service providers.

In 2001, the Commission started examining the securities trading and post-trading sector to identify if the Treaty competition rules were being correctly implemented. The Commission enquired inter alia on access and prices, two areas where the Commission identified abuses in the Clearstream decision. It continues to monitor the evolution in this sector from the point of view of competition, in cooperation with National Competition Authorities.

Does this decision mean that the Commission favours the Euroclear model over the Deutsche Borse model?

No, the decision makes no comments on different types of growth strategies. The Commission is aware that both Euroclear and Deutsche Borse, Clearstream's parent, are contributing to important developments in the EU securities markets. These are business decisions which are evaluated by the market.

The Commission is also aware that Deutsche Borse has recently taken several initiatives which are favourable to a more efficient functioning of EU securities operations in markets where it operates (for example in creating links to facilitate cross-border settlement). These are welcome developments. They cannot however erase the past infringements that have been the subject of this case.

2. CLEARSTREAM

Who and what is Clearstream?

Clearstream International SA is a fully owned subsidiary of the Deutsche Borse Group. Clearstream International SA is a holding company which owns Clearstream Banking AG (also called Clearstream Banking Frankfurt or CBF) and Clearstream Banking Luxembourg. Clearstream Banking AG is the Central Securities Depository for securities issued under German law and kept in collective safe custody, which is the only significant form of custody today for securities traded. In other words, it is the primary custodian for the vast majority of securities which are traded in Germany today. Clearstream Banking Luxembourg writes of Clearstream Banking Frankfurt that "all German fungible securities - representing more than 90% of existing German securities - are deposited in the vaults of CBF, allowing prompt and secure book-entry settlement.

As the final Central Securities Depository 1 (CSD) for these securities, Clearstream Banking AG occupies a pivotal place in the functioning of securities settlement in Germany. For example, during the period considered in the decision, the rules of the Frankfurt Stock Exchange (Borsenordnung) stated that the condition of orderly settlement set by the Exchange Act (Borsengesetz) is fulfilled if the applicant for admission to trading on the Frankfurt Exchange conducts the settlement of its exchange transactions through Clearstream Banking AG for the securities leg (that is, the transfer of the securities) and through a state central bank for the cash leg (the payment).

3. DECISION

Was Euroclear a complainant in this case? No, this was an ex-officio enquiry.

What is the relevant market?

The Commission found that Clearstream Banking AG enjoyed a dominant position in the market for the provision of primary clearing and settlement services for securities issued according to German law to CSDs in other Member States and to International Central Securities Depositories (ICSDs).

While clearing and settlement may generally be carried out by different types of financial institutions, each institution may only perform "primary" clearing and settlement for the securities that it keeps in final custody. As all securities issued under German law and kept in collective safe custody are deposited with Clearstream Banking AG, only it can conduct the primary clearing and settlement for these securities. Intermediaries perform secondary clearing and settlement on their own books, either in the form of mirror operations that reflect in the accounts of their customers the result of primary clearing and settlement or as a

result of internalised transactions in cases where the buyer and seller happen to hold accounts with the same intermediary.

No intermediary is able to internalise all transactions with all potential counterparties for all securities safekept in the Clearstream Banking AG. During the procedure the question however arose as to whether having recourse to a further intermediary could be a substitute to the primary clearing and settlement performed by Clearstream Banking AG. For the category of customers concerned (financial intermediaries who desire to provide efficient and competitive secondary clearing and settlement services to their own clients), indirect access to Clearstream Banking AG through another intermediary is not a substitutable alternative for direct access, as the use of an intermediary results in poorer deadlines, greater risk and complexity, and may also entail additional costs and a potential conflict of interests 3 .

Why does the Commission talk about 'primary' and 'secondary' clearing and settlement?

Companies involved in clearing and settlement may not always use the terms primary and secondary clearing and settlement, but they recognise the functions. Certain players refer to the function of CSDs as public notaries for securities, because they register the ownership of the different securities that they keep in final custody. Others call this role a root function. CSDs can also act as intermediaries (and compete with other intermediaries) as regards securities kept in final custody in another CSD.

In its recent Communication on Clearing and Settlement 4 , the Commission noted that institutions may be performing functions which could be referred to by the same name (e.g. clearing and settlement) but that because the institutions conduct this function at different levels of the value chain, aspects of this function may differ. This is consistent with the Commission's findings in the Clearstream case.

What does 'securities kept in collective safe custody' mean?

Each national law has procedures and functions by which it organises the way in which securities are issued, safekept, traded and transferred. In Germany, securities which are intended for trading are safekept in collective safe custody, as opposed to individual custody. In collective safe custody, fungible securities of the same type are kept in a single collective holding. The customer acquires fractional co-ownership in the CSD's collective holdings and transactions can be settled by book entry, without physical movement of the securities.

4. EU CONTEXT

How does this decision fit in with other Commission initiatives such as the Communication on Clearing and Settlement 5?

The Commission Communication on Clearing and Settlement is a consultative document that proposes a number of actions which will ensure that this sector will become more efficient and integrated in a fully functioning internal market. It is wide in scope and is forward looking.

The Clearstream decision concerns the application of EU competition law. It addresses a specific series of events at a specific moment in time and applies competition rules to them. It does not in any way prescribe a proposed regulatory environment or standards. The common objective of both competition and internal market policies is to deliver efficiency gains and therefore consumer welfare. Internal market legislation aims at ensuring a level playing field by making it possible for companies to compete on the merits without being protected by artificial barriers, while the application of competition law ensures that companies will not behave in a manner that hampers the good functioning of the internal market.

How does this case fit with the Giovannini reports and the Group of Thirty (G30) reports?

The first Giovannini report, of November 2001, identified existing barriers for an efficient clearing and settlement environment in the EU, and the second Giovannini report, of April 2003, provided possible solutions to the problems identified in the first report.

The G30 groups high-ranking representatives of major financial institutions worldwide, including central banks, and has produced many reports on key issues concerning the financial sector. It published a report on securities clearing and settlement in January 2003, recommending further harmonisation of global regulatory environments and improved governance.

As in the case of the Commission Communication on Clearing and Settlement of 28 April 2004, these reports are much wider in scope than the specific matters addressed in the Clearstream decision.

How does this case fit with the work undertaken by the joint ECB/CESR 6 working group?

The ECB/CESR working group, which is currently finalising a revised draft report on securities clearing and settlement, focuses on standards for the industry. Its main concern is for operational and technical aspects and does not address competition law issues.

5. EFFECTS FOR CONSUMERS

What difference will the decision make to the consumer?

Clearing and settlement are necessary to complete a securities trade, but are not purchased in isolation. Many final consumers are not even aware of the cost of these services. However, when an individual buys or sells securities, the fees paid include those for clearing and settlement.

Anti-competitive practices committed by market players in the area of cross-border clearing and settlement area are a major source of inefficiencies that harm consumers. As affirmed by the first Giovannini Report 7: '[i]t is perhaps no exaggeration to conclude that inefficiencies in clearing and settlement represent the most important barrier to integrated financial markets in Europe. The removal of these inefficiencies is a necessary condition for the development of a large and efficient financial infrastructure in Europe'.

By identifying certain practices as a violation of EU competition law, the decision ensures that Clearstream refrains in the future from similar actions to the detriment of financial institutions who wish to provide an efficient cross-border clearing and settlement service. Companies in a similar position to Clearstream in the clearing and settlement business will also receive guidance for their future behaviour.

Financial institutions conduct many thousands of securities trading transactions per day in the course of their normal business. The costs they incur form part of their overall overheads and diminishing these costs should in turn enable service providers to pass on a benefit to end users.

1 Central Securities Depositories hold securities and enable securities transactions to be processed through book entry. In its home country, the Central Securities Depository provides processing services for trades of those securities that it holds in final custody, and in this function it is referred to as is the issuer Central Securities Depository. A Central Securities Depository can also offer processing services as an intermediary in cross-border clearing and settlement, where the primary deposit of securities is in another country.

2 An ICSD's core business is clearing and settling securities - traditionally Eurobonds - in an international environment. There are at present two ICSDs in the EU: Euroclear Bank, based in Belgium, and Clearstream Banking Luxembourg. ICSDs can provide other services such as intermediary services for equities.

3 The use of a local agent bank as an intermediary may create conflicts of interest, as the intermediary is informed of the operations of the customer against which it is competing or might start competing in the downstream market.

4 See next footnote.

5 Clearing and Settlement in the European Union . The way forward. Communication from the Commission to the Council and the European Parliament, of 28 April 2004.

6 European Central Bank / Committee of European Securities Regulators working group.

7 The Giovannini Group . Cross-Border Clearing and Settlement Arrangements in the European Union. Brussels, November 2001. The quote is taken from the foreword.

Item source: http://europa.eu.int/comm/competition/an_titrust/cases/decisions/38096/clearstream_en.pdf