

Jos presented much of what I wanted to say. However I wanted to add this to Andrew's invitation to join LCH.Clearnet: The reverse invitation holds true as well. Anybody can join x-clear!

With regard to fragmentation and consolidation: Today, we have many more CCPs than we anticipated a few years ago. Why is that so? We do not have more CCPs in the derivatives world where they actually started. There we have even fewer. Indeed, with the entry of Eurex into the US, we saw a merger between CBOT and the CME clearing arrangement. We have not seen many tangible benefits yet, but the approach in the US has changed to one of consolidation. Before the LCH.Clearnet merger, we saw the SOFFEX/DTB merger which resulted in the Eurex environment.

Why do we have more fragmented CCPs today? The CCPs created new services, particularly cash market clearing. The cash markets are still heavily domestically oriented and, if we look at Europe, nowhere near the pan-European market that many people would like to believe. At best, maybe 20% of the equity market is international, typically a small number of blue chip companies. Most listed stocks attract domestic interest only. If you have a nationally focused market, you need to cater to domestic requirements. Many emerging markets established a CCP service, that is why the total number has grown. The next step will be an consolidation into an international CCP. I believe that in the next five to ten years, we will have again fewer CCPs than we do today.

The second aspect is where the CCPs should focus today. A CCP is like the ham in a sandwich: On one side you have the members which are the CCP's clients, on the other side you have the exchanges which are clients, too. This is true no matter if a market place is organised horizontally or vertically.

Each CCP has a third client category to cater to. A CCP is a central risk manager; it does not fulfil the obligations between buyer and seller in terms of the ownership change. That is the domain of the CSDs. For that reason, the CCPs also have to work very closely with the CSDs. One of the next challenges for the CCPs, in particular in the vertically oriented national cash markets, is to work more efficiently with the CSDs to streamline the settlement process. In many newly emerging markets, CCPs are not established as independent entities. They are often set up by the CSD. Take x-clear as an example, it is owned by SIS. Many CSDs have established CCPs, that is also why we have more CCPs today. Those may be a step ahead of the older CCPs which only have links to the CSD but are independent from them and therefore less integrated.

Something else needs to be considered in the fragmentation/consolidation debate. A CCP is a valuable asset to an exchange in that it shields the exchange from competition. That is why exchanges have a certain interest in controlling a CCP. Whether control is established on a vertical or horizontal level, does not matter. Exchanges like to prevent CCPs from going into competition with a particular customer, namely themselves.

Some exchanges have direct control over a CCP. That means - among other things - that if the exchange decides to expand its product range, the associated CCP has no choice but to expand its own correspondingly. Deutsche Börse is a typical model for this.

A totally new challenge for the CCPs is the OTC business. We talked about derivatives, bonds, repos, equities, but not about the OTC business. On one side, it is very attractive to bring it into a CCP because the CCP manages the counterparty risk and introduces netting efficiency. But in the OTC business, particularly on the bond side, a CCP is also a threat to its members. In that market, the rating of the counterparty is a very important element of product pricing and therefore of the profit and loss to be made. A CCP of course takes out that element of the bilateral business relationship. So, those models will have to be very carefully analysed to make sure a CCP still adds value before it expands into the non-regulated exchange business.

Further, we should understand that consolidation is very much driven by political interests. We made that experience in our US initiative. We discussed a link with The Clearing Corporation to bring Europe closer to the US, in order to expand our business in Europe. The reverse would have been true as well. We wanted to bring the US closer to Europe by leveraging US execution and clearing into Europe. We quickly discovered huge conflicts with our members' interests. First, we have global members which have established a global clearing business. To a certain extent, we are now competing against them - our clients - even though we only wanted to enable them to become more efficient!

Second, we have the local members. They have no interest in adapting to any changes which might be the consequence of an international link, particularly on the regulatory side. Those things are very difficult to sort out in cross-border CCP relationships. We are working very hard on that with the US and the German regulators.

One of our key observations is that CCP consolidation over the next five to ten years will not be driven that much by the will of the CCPs to work together more closely. They are much more interested in working together than many people would believe!

It will be driven by national regulatory regimes and their desire to protect national interests. It will also be driven by the members. Our members pursue three different business lines and that leads to different interests: local business, global business and proprietary trading. We also see very different expressions of interest between the global management of those firms, and their execution management which works closer to the CCPs. We get quite different messages from those sides. These are the challenges we have to sort out first, before really big changes can happen.

* * *