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EUROPEAN STOCK MARKET IN THE PERIOD OF GLOBALIZATION

The process of globalization which changes not only quantitatively but qualitatively the system of international economic relations, has significant influence on the radical change of the European stock market infrastructure. Tangling with the inter-European integrational processes they lead to creation of extremely specific situation. It seems that gradually, step by step, the financial equilibrium between the Old World and the New World is building itself. Moreover, it is happening not so much as a result of the weakening of the transoceanic financiers' positions but as a result of strengthening position of their European competitors. Three types of institutional investors (investment and mutual funds, pension funds and insurance companies) get considerable financial support among other private investors. It is characteristic of modern Europe that the ever increasing number of people who own «extra money» are ready to take risk of it to become richer. The number of millionaires in Europe totals about 2.2 mln people (out of 7 mln in the whole world); western part of the continent covers one-quarter of all individual investment funds at the rate of 1 mln dollars and higher. Availability of free funds is stipulated by high profitability of western European corporations and banks. Significant part is taken by the process of liquidation (sale) of the family enterprises by representatives of the new generation (in Germany it is called «erbengeneration», that is «generation of heirs») who prefer just to invest inherited funds into somebody else's business instead of being engaged in such troublesome business as being a corporate manager. The reverse side of this process is unprecedented interest of the largest investors in private companies' unlisted stock which was first noted in 1930's; it is mentioned in the British governmental Myners report. In some European countries, especially in Germany, this interest together with other factors resulted in refusal of the companies from their stock quotation. «We observe more and more cases of transition of public companies into private ones and refuse from listing», notices one of German experts. «This began from the family business, but big conglomerates also sell subdivisions included in listing». According to the data of the Center of Management «Buy-out Research of the University of Nottingham', in 1999 in the Continental Europe there were registered 27 cases of «unlisting» companies, the market value of which amounted above $3,8 bln[1].

All this contributed to the growth of stock markets fed by the new demand (called by stockers «wall of money»); in rich European West it reaches two-digit numbers in annual statement. Difficult times caused by the Asian-Russian crisis of 1998 and aggravated by the crash of the huge British investment fund Long Term Capital Management, at present seem to be the history.

Meanwhile, upsurge of economy in Europe (we should not forget that relative weakness of euro is explained not by the difficult business situation in the EU countries but by the fact that in the USA business situation is much better) led to the situation when traditional sources could not meet the capital requirements on the part of big west European corporations. These companies do not want to be content with the national banking system services any more: many of the corporations have credit ratings which make it possible to attract cheaper financial resources by means of securities issue.

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[1] Financial Times, May 1, 2001, p. 9.

And, naturally, they fix their eyes on more liquid capital markets and are interested in reducing expenditures for such operations. New possibilities of the stock market, stipulated by the growth in demand on the part of emitters and growth of supply as a result of integration of the national markets of the EU-countries, together with competition characterized by openness and globalization, gave a powerful impetus to its development. Not only the numerical growth of the volume of the concluded bargains, but also qualitative changes in their structure are noted. Investments into corporate shares replace investments in state and corporative bonds (which at the end of 1999 amounted 55% of all investments)[2]. This tendency is observed both on separate national markets and the world markets. In 1999, on the global stock market the volume of secondary jobbing increased by 48%. International issues of shares in Europe increased for this year by 66%, and amounted over 83 billion dollars that is more than half of the world emission[3]. Government bonds of the 11 EU countries for today are mutually exchangeable, so their circulation ranks the second in scope market of government shares (after the bond market of the US Treasury). At present, the tendency towards creation of a similar situation on the European stock market is clearly outlined, and in the course of this tendency the plan of separate stock markets unification should be considered. First of all, there is no doubt about two most important stock markets in London and in Frankfurt. Located in the heart of the City, the London Stock Exchange is the biggest in Europe. And the German Stock Exchange is considered to be the most aggressively developing.

It should be noted that Europe has a centuries-old tradition of corporate right trade. In the annals of the French stock exchange there is information which states that back in 1250 (more than three fourths of a millennium ago) a Sociètè des Moulins du Bazcle flour-grinding concern issued 96 «shares» in the form of property certificates for their sale «at the price which changes according to the economic conditions and whether the mill functions well or badly». That is why it can hardly be considered that devotion of Europeans to savings in the form of shares is accidental, and what is more, this disposition rescued many people during hyperinflation in the 1920's. At present, an «equity cult» typically characteristic for Anglo-Saxon investors, rather quickly turns into peculiar general European religion. This cult is obliged for its appearance to G. Goobey, president of the Imperial Tobacco Pension Fund, who definitely stated fifty years ago that diversification of the funds' means into shares was not risky. As a result, nowadays, most of the British pension funds place 75–80% of their assets into shares. Now such approaches became normal for other European countries. To initially devoted to this cult Great Britain, the Netherlands and Sweden, a new wave of «neophytes» joined headed by France, Germany and Italy. Besides pension funds, mutual funds entered into the game. In Germany, for example, for the last three years of the past century this led to a considerable growth in the number of investors in corporate stock – from 8.2 to 11.3 million people (that is 18% of the adults). As a result, this tended towards increase of investment into stock (in 1996 Europeans invested into stock about 1.9 trillion Euro, by the end of 1999 the number reached 3.6 trillion Euro, or 3.4 trillion dollars with the growing reverse tendency in respect of investment into bonds (which reduced from 1.3 trillion Euro in 1996 to less than 1.1 trillion Euro in 1999). According to the calculations of the JP Morgan American Bank, in recent years these tendencies will strengthen and it could be expected that in 2004 investment in bonds will fall lower than 1 trillion Euro and into shares it will reach 6.3 trillion Euro. In general, this will be achieved as a result of increase of investment in stock on the side of mutual funds: from 2 trillion in 1999 to 4 trillion in 2004[4]. Almost nobody takes the risk to predict what will happen some years later. The fact is that after 2010 a new generation after the next baby boom (so-called baby boomers) would have to use their savings to carry out long-range investments. It is more than difficult to foresee what kind of assets these investments will be allocated in. Obviously, the behavior of private pension funds will play an important role in this process. Increase of longevity against the decline of total fertility could cause the growth of the ration of pensioners (population in the age of about 65) from today's 16% to 25% in 2030 and almost 30% in the middle of the century. In relation with this, the growth of importance of the private pension funds role is obvious. They would have to take care of granting comfortable senility. This task is getting more exhausting even for European countries which pay 75% of all pensions (in comparison with 40% analogous indice in the USA)[5]. In securing their senility, European citizens, to the opinion of Joe Grano, president of Pain Webber American Investment Company, which was recently bought by UBS Swiss bank, should more and more rely on themselves, as they already do in the USA, where this process

[2] Financial Times, Jan. 20, 2000, p.23.
[3] Financial Times, Jan. 28, 2000, FT Survey, p. I.
[4] Financial Times, Jan. 26, 2001, Europe reinvented. Section., p. 12.
[5] Ibid.

began earlier. And Europe, as he thinks, is moving from the system of securing their old-age citizens with pensions to the mechanism of securing them at the cost of securities.

Activation of «retail investors» who feel uncertain in their new role when preferring more protected kinds of investment, like mutual funds or converted stock. Qualitative development of the stock market, to a considerable extent, is stipulated by widening the volumes and scope of operations with «derivative instruments», derivatives to which different investment funds and companies often resort with the aim to diversify their risks. Considerable factor, effecting the above said, was also a high-tech companies' boom rolled from the USA to Western Europe. However, investment into their corporate stock is not only profitable but also a risky business. In relation with this, many investors began to secure such investment by means of different derivatives. This is furthered by the wide use of lock-in stocks issue while issuing securities of such companies.

Derivatives are not usual commodities but their value is «derivative» from other market investments: interest rate of the government bonds, currencies and credits. Though some stock exchanges admit internal derivatives trade in their areas, over-the-counter derivatives trade becomes widely spread. The example of such system is Londex system which began functioning in June last year. Its serious competitor is Swapswire system founded in April. Among its promoters together with the biggest American investment Deutsche Bank are Swiss UBS Warburg, CS First Boston, and also French BPN Paribas. In the frames of this system London Clearing House will act as a central counteragent in the process of trade in such areas as London Stock Exchange, International Financial Futures Exchange-Liffe, London Metal Exchange, International Petroleum Exchange. It is possible that in the sphere of this activity, there will be involved Euronext and Tradepoint clearing systems in addition to French Marif futures market and Monep options market. In this case it will turn into the biggest European central counteragent (CCA). Within the system of such clearing, 5 banks – among which are such European giants as Italian IMI, British by its «registration» but European by its substance and HSBC – are already involved. Existence of CCA for clearing of derivatives in Europe is not a novelty in contradiction to clearing of shares and other securities. The system of central counteragent means that partners should settle not directly but through the Clearing House; and therefore, there is no need for traders to worry about their counteragents solvency. Naturally, the more markets will be using the central counteragent mechanism, the more users will be able to open positions on different markets and in such way provide economy with insurance capital, reserved in relations with every trader. Core advantages of such concept, except economy of the capital, are the operational effectiveness and increase of credit lines volumes.

Development of derivatives' markets, established not in the last turn to get round the limitations on operations with securities, puts on the agenda the problems of its regulation order. The problem how to regulate the derivatives market is aggravated by disputes whether it should be regulated. The votes calling to strengthening or introducing some kind of regulation were louder in the times of crisis, for example, on the background of the Long Term Capital Management hedge-fund crash, and also of problems with Sumitomo Bank or Russian crisis. Each of them was related with unpredictable circumstances or simple incompetence of the market participants (for example, in the case of the Barings British Bank's failure). As a result, regulative bodies in the whole world are concerned with this problem. Basel Committee, Congress of the USA, and the market participants discuss widely the problems of the correlation of capital and warrant. In turn, the US Securities Commission and British Financial Services Authority continue to regulate this sphere quite severely. But the nature of this regulation undergoes considerable changes to the extent of introduction of different technological novelties. David Clementi, deputy governor of the British Bank, noted, «In the world where the German broker can trade on the London Stock Exchange with the US partner who uses a French technological provider and Belgium settlement agent, the problem of being confident that all participants of the process are regulated effectively is quite complicated»[6].

The discussion about necessity and possibility of the derivatives market regulation became more complicated in relation with proposals of the Western European stock market regulation. These proposals began to originate from the famous banker (former governor of the bank of International Payments and Belgium General Bank) Baron A. Lamfalussy who prepared his report with the group of experts on this subject in 2000. Then he underlined the existence of complications in the European regulative system and suggested the necessity of the new legislation on these problems. In particular, it went about the necessity to modernize the financial markets regulation system, establish an open and transparent

[6] Financial Times, Junes 28, 2000, FT Survey, p. II.

European stock market, create common European financial products, and create the necessary protection level for users of such products, etc.

In the second report, published in February 2001, there were already concrete proposals on the establishment of a powerful EU Commission on securities which in the authors' opinion, should create real conditions that will ensure European capital market competitiveness in competition with the trans-oceanic counterparts. This, however, does not revoke the necessity of creation – considering the practicers' position and practically new national bodies of controlling and supervising the stock market in regards of A. Lampfalussy's point of view – the integration and regulation of the European financial market which represents «remarkable mixture of Kafkian stupidity that does not serve anybody»[7].

Nevertheless, the four-level system of decision-making on problems of stock-market functioning in the frames of the EU offered by the baron does not seem to be simple neither for understanding nor for quick introduction. But it is suggested to be introduced before March 2004.

More and more importunate presence of the transoceanic competitors, who more and more often switch from principle «think local, act global» to global thinking, is a constantly acting factor for the European stock market development. It is very difficult for Europeans who used to concentrate their attention, basically, on home markets to compete with Americans under the conditions where American investment banks and companies operate covering Europe as a whole.

During the last few years European leaders of the investment business have developed their «muscles» at the cost of smaller but active and experienced American banks and companies. Thus, in June 1999, Deutsche Bank invested 10 bln. dollars in New-York Bankers Trust which controls the interbank investment operations market. Some time later it announced its intention to merge with three investment houses of Lazard group with the aim of operations globalization. Credit Suisse First Boston (CSFB) which earlier entered the investment market at the expense of the famous Boston Bank purchase, last year bought the broker company Donaldson, Lufkin, Jenrette in the USA. Second Swiss bank – Union Bank of Switzerland (UBS) which earlier bought Warburg British investment bank, in summer 2000 confirmed its investment character by purchasing Paine Webber, the biggest American investment company. But these European «heavyweights» (perhaps with the exception of CSFB) can not compete with American «jumbos» (three investment banks-billionaires by the size of their operations) Goldman Sachs, Morgan Stanley Dean Witter and Merrill Lynch.

Meanwhile, the leaders heading the campaign to penetrate the American market «for goods» were followed by other European financial institutions. They look across the ocean not only with the aim of pirating highly qualified specialists, but with purpose of purchasing investment managers of huge companies. As examples of American companies purchased by European bank and insurance groups can serve the following: Pimco and Nicholas-Applegate by Allianz German group, Pioneer by Italian Unicredito Italiano, Nvest by French Caisse des Depots, United Assets Management by British Old Mutual, and Alleghany Assets Management by the ABN Armo Netherlands bank. However, American competitors also understand that soon a severe struggle for the European investor will take place and in their turn take retaliatory measures. The example is the purchase by the Morgan Stenley investment Bank of Quilter British funds manager and AB Asesores Spanish broker company.

Nevertheless, many banks, among which are Dresdner Bank and French Societe Generale should be mentioned. Suppose that it is not as important to increase volumes – believing quite reasonably that it is impossible to catch up with Americans – as search for the new market strategy. For example, specializing in providing services to fewer large corporations but more medium size companies which are typical for Europe. Investment managers (banks and specialized companies) more often pay attention to investors with liquid funds up to 100–500 thousand dollars; lately it was considered unprofitable to cooperate with them. Special attention was paid to them by the tandem of Merill Lynch investment company and Hong-Kong – Shanghai bank Corporation (HSBC).

All European stock markets would like to obtain shares of the leading European companies in their listing. Understanding that in this struggle there will be much more of those who will lose than those who will win makes think not only about competition getting more acute but, on the contrary, about consolidation of their efforts. P. Kent, executive chairman of the European Securities Forum noted, «Stock exchanges are big and important everywhere, but nevertheless, they are in danger for their lives. Like all other forms which are under threat they gather together for their defense»[8]. Continuation of the capital concentration and globalization of the business activity lead to the development of similar processes also in organization of securities turnover.

[7] Financial Times, Feb. 16, 2001. p. 2.

Internationalization of stock market institutions is a rightful answer to internationalization of the corporate sector taking place during several last decades. Transnational companies become not so much exceptions as norms. And characteristic for the last years mergers and agglomerations prove this fact. «Merges destructed significance of the national borders», says Tom Nadbielny, president of the research group in Salomom Smith Barney. «Many companies cannot any more be identified by the flag of their country, but by their sphere»[9]. «The market just calls for the necessity of the stock exchanges consolidation», as one of the managers of London Stock Exchange says[10]. In the integration of the European stock markets, as a remarkable event can be considered a statement made in July 1998 by London Stock Exchange and Frankfurt Deutsche Börse that expressed intention to build a «single European stock market for the single European market». Such merge of the two leading European stock exchanges may result in creation of a huge structure concentrating about half of the European capitalization: in London about one third of 300 of the main European shares is quoted, and 12% of «cream» is concentrated in Frankfurt. However, remarkable is not only the intention by itself, which is quite logical development of the idea to establish a single European monetary market, but implementation of this intention reflecting complexity of integrational processes in modern Europe.

Naturally, English and German initiative was not set aside by other stockbrokers who began to establish alternative alliances. Almost all European markets are more modern and effective in comparison with the American ones. This is also encouraged by such factors as the introduction of a single European currency, widening of the privatization practice, wave of pan-European merges and amalgamations, and also increasing number of small («retail») investors. All these factors promote integration of the European financial markets. Thus, in September 1999, presidents of eight leading financial markets announced the plan to establish by November 2000 a single pan-European broker system representing common electronic «area» for 300–400 «blue chips» trading today on different national markets. In principle, this meant direct challenge to the global leader – New-York stock exchange. Soon, unforeseen circumstances (though they could be anticipated) brought changes to this plan, namely in working out, for the beginning, of single standards for operational activity. «Tasks of the alliance changed», explained M. Capuano, president of Milan Italian stock exchange (CEO of Milan's Borsa Italiana). «Now we work in the direction of standardization of the market trade model and then turn to other problems, such as settlements»[11]. Simultaneously, the presidents of only three stock exchanges – Amsterdam, Brussels and Paris – in March 2000 announced amalgamation of their stock exchanges in «the first European stock exchange» called Euronext. That same month a group of institutional investors which consisted of Barclays Global Investors and Merrill Lynch Mercury Asset Management introduced E-Crossnet common system of calculations. Regardless of them, other big companies, American investment bank Morgan Stanley Dean Witter and Swiss OM Grippen technological company, began setting up of Jiwy electronic exchange for retail trade.

In March 2000, the German stock exchange also announced their shares initial public offer (IPO). So, the tendency, of deviation from the principle of establishment of stock exchanges as institutions of common property (this process was called «demutalization») and their transformation into joint-stock companies oriented on profits making (that is commercionalisation of their activity), was confirmed. According to some estimates, by the end of 2003 80% of stock exchanges will undergo this process. Obviously, the clearing offices of these stock exchanges should also be oriented on profit making.

In August 2000, amalgamation of stock exchanges was intensified again. When the above mentioned OM Gruppen Swiss Company began the procedure of the «hostile» take-over of London Stock Exchange, this meant beginning of a game by new rules. This attempt failed, but nevertheless, now merging of one stock exchange with another one is not considered any more to be the only possible way of their consolidation. Moreover, in late May 2001, Swiss group announced about repeated attempt of London Stock Exchange merge, but that time «friendly». They do not waste time in Frankfurt either. In the end of May 2001, together with Eurex, Frankfurt stock exchangers made the next innovative step offering merger with Dowes Jones Company to meet the requirements of the European market in the process of amalgamation in a new universal index which would surmount the national indices restrictions (such as British FTSE 11 – «Footsie» or German DAX). Everything seems to indicate that Clearstern clearing system will also be involved in this project.

One cannot say that amalgamation of stock

[8] Financial Times, Jan. 26. 2001, Europe reinvented. Separate section, p. 8.
[9] Financial Times, June 28, 2000, FT Survey, p. II.
[10] Institutional Investor, May 2000, p. 37.
[11] Ibid, p. 35.

exchanges in Europe is caused by the development of alternative trade systems which came to Europe from America. Taking advantage of ineffectiveness of stock exchange markets and absence of single liquid pool, electronic communication networks (ECN's), such as Island or Archipelago, force them out more and more. Island and Archipelago have already applied to grant them status of stock exchanges to the US Commission on Securities and Stock Exchanges. Taking into account that about 30% of transactions of such stock exchanges like NYSE and Nasdaq are made through ECNs, their request could be met. Though, the problematic character of such a decision is explained not by insufficient volume of operations but the rules of their making. Such precedent conceptually, may lead to levelling of their trade rules on the organized trading pits facilitated with Internet innovations. In the USA, the majority of investment banks support 11 separate ECNs, but the biggest insitutional investors and companies oriented a small retail clients stand up for establishment of a centralized trade system in the country. Meanwhile, in Europe, with stock markets which develop according to their own laws, the boom is observed in creation of such systems oriented to serve high-tech, fast growing companies (representatives of «new economy»): Easdaq, the Neuter Market, Euro NM, techMark, etc. For today, the biggest potential market among them is Tradepoint. Usually they offer dual listing that means a possibility of quoting in these companies the shares of those companies which have come through listing on the markets of Europe, USA or Israel. Naturally, this enhances their competitiveness and accelerates integration into the Common European stock market. Nevertheless, there is no special disturbance among traditional organizers of trade yet. President of German Stock Exchange noted in this regard, «I see no way for any ECN or new stock exchange to be able to steal at least 5% of our primary market on trade of «blue chips» shares»[12]. Though in the circles of ECNs there is strong confidence that consolidation is inevitable, as C. Pedder, Easdaq executive vice-president noted, «I believe personally that no later than in 10 years there will be no single dominating pan-European stock exchange structure»[13].

Meanwhile, despite its apparent logic, the process of «mega stock exchanges» began to slip. Some experts argue that this unification does not promise reduction in clients' costs, as it does not presuppose the use of cheaper mechanisms of settlements in comparison with the existing ones. It should be noted that the mechanism of settlements differs considerably from what is peculiar for other segments (let's say monetary) of the same financial market. If the general market principle says, «pay and carry out», on the stock exchange the principle «buy now, pay later» acts due to the number of reasons, analysis of which goes beyond the bounds of this paper. One of three most widely used models is used for such kind of settlements.

The basic elements of Model 1 are the transfer of instructions in relation with both securities transfer and monetary funds on trade-by-trade gross basis and, final transfer of securities carried out together with money transfer.

Model 2 foresees the transfer of instructions about trade-by-trade gross basis, but transfers of securities from seller to buyer are carried out only in the end of the cycle, when transfer of money on «netto» conditions is made.

At last, Model 3 contains instructions about transfer both of securities and monetary funds are transformed on the basis of «net» information (that is, considering possible counter transactions which reduce volumes of transfers), and financial transfers are carried out in the end of the cycle.

Considering given models applied by standard requirements, the processes of clearing and settlements on securities operations are the following:

1. Achievement of agreement on buying-selling which is concluded on stock exchanges or in electronic out-of-stock exchange trade systems.

2. Trade matching, that is comparison of information on price, volume of transactions, etc. received additionally but not from buyer and seller.

3. If parts of the agreement act on behalf of their clients, then it is necessary for them to obtain the clients' trade confirmation as for the agreement details.

4. After receiving confirmation and positive results of trade matching, clearance is made that is the process of calculation of mutual obligations agreement participants, it is accompanied by bilateral or multilateral agreement.

5. After that, participants of the agreement prepare instructions on securities and monetary funds, respectively.

6. Money order is handled through representative markets, and securities by means of transfer of securities and certificates on them, or by means of making entries on the clients' accounts (depositaries) in the central securities

[12] Ibid., p. 39.
[13] Euromoney, February 2000, p. 125.

depositaries (CSDs) which affected so-called «dematerialization» of securities.

Bulkiness of the used systems of settlements is the reason why in many European countries, like in the USA, up to present all settlements on purchasing of securities end only on the third day after closing the transaction (T+3). In recent years one of the main tasks of the central depositaries of accelerated settlements is the delivery versus payment. Solving this problem becomes more urgent because of internationalization and globaization of securities operations as, by the experts evaluations, about 15% of cross-border transactions with securities are frustrated as a result of nonfulfilment of obligations by one of the parties.

For a long period of time the European market was content that internal settlements on business investment were realized by national central depositories, and on the international level by Cedel International Luxemburg Clearing Bank and Euroclear Belgium Clearing Company.

Clearstream European Clearing House, established after unification of Cedel International and Deutsche Börse Clearing of Frankfurt Stock Exchange in 1999, initiated the process of considerable structural changes.

Brussels Euroclear tries to meet the challenge of competitors by establishment of tight technological relations with the biggest national central securities depositories (CSDs). French Sicovam became the first one. However, they do not even try to create a common area. Moreover, Euroclear creates a new area for German shares trade in hope to finish this work by the end of 2002. Scale of consolidation plans scares Euro sceptics whose arguments mainly come to the statement that if creation of one international area is so much time-consuming than one can imagine how much time it will take to merge with the Luxemburg International Depositary, Frankfurt Stock Exchange, and then with many other organizers of stock exchange trade in Europe. For this statement the unificators reply, «Complexity [of the task] is a week argument for doing nothing at all»[14].

At the same time their British counterparts serving London Stock Exchange, i. e. Crest Company, are relying on establishing proper relations among independent central securities depositaries (on the basis of interbank relations) that would provide the clients of one system with free access to the system of any other European country included in this system. There is no sole decision yet. There exists only general comprehension of the fact that Europe does not need such a great number of stock exchanges and central depositaries. Against this background central depositaries of some countries wish more strongly to transform into international CSDs that could be realized via expanding international services, like establishing reciprocal appropriate relations creating international settlement centers (so called «hubs», where like hubs in a wheel the payment settlement lines converge), merging and striking the operations that were monopolized by International CSD (for example, securities loans).

Besides, it is obvious that further merging could be hardly possible without local support of the market consolidation process. The first currency exchange in Frankfurt emerged in 1585, and it took four hundred years to become a financial center in Germany that at present successfully competes the exchanges of Dusseldorf, Hamburgh, Munich and Schtutgart. Evidently, the consolidation of German Exchange with other European market structures will not produce desirable effect if «German domestic issue» is not solved. Some other European countries have already started the consolidation processes. Thus, Belgian local central depository BXC-CIK merged with the International Depository Euroclear located in Brussels. Two (out of existing six) largest Spanish payment systems also merged. In Italy Monte Titoli Depository having started its payment system EXPRESS DvPRTGS late last year and this year it manages Bank of Italy's operations on clearing government bonds system. In Great Britain the depository absorption of corporate securities (Crest) of special central governmental liabilities depository Central Gilts Office (CGO) led to similar consequences.

Moreover, the consolidation process seems neither cheap, nor uniquely positive even for its participants. The president of London Crest Depositary, well-known and respected among business circles Ian Saville notes, that market, nevertheless, provides better and long-term results than the command policy does. And besides, they are cheaper. Also, the guarantor of fair price for clearing payment system services is not their consolidation but competition. And last, the very discussion of merging projects distracts the CSDs from the solution of such urgent issues as shortening of payment terms, price reducing for international operations, improvement of trust services (i.e. getting dividends, voting by proxy, etc.) Stressing that he is not «a theological opponent» of the consolidation idea, Ian Saville draws attention to the fact that endless merging could turn into «planned fading of the European

[14] Global Custodian/Winter 2000, p. 125.

clearing payments infrastructure»[15]. Concerning numerous merging, it is yet early to speak about their danger as far as the process has only started, and nobody knows how the tendency will change in future. The perspective of Crest and Clearstream merging causes great concern. It could be possible through merging of London and Frankfurt Exchanges that are being served by above mentioned systems. The basics of their mutual functioning is supposed to be the CCA concept, i.e. the Crest clients will settle trade operations payments at the incorporated exchange iX via CCA, located in London, while the Clearstream clients respectively will settle via another CCA in Frankfurt. At present, both payment systems are creating the mentioned Central Counteragents. Crest is implementing relevant project together with London Clearing Chamber while Clearstream cooperates with Eurex that is Swiss-German joint venture. By the way, London CCA is also oriented in Swiss direction. Crest (together with Euroclear and London Clearing Chamber) actively cooperates with Swiss clearing system SIS Segal INTERSETTLE in creating Central Counteragent for Virt-X, that is common trading pits created by Swiss Stock Exchange and Tradepoint Company. Taking it into account, we can assume that a real reason for concern is not the merging itself but the role of existing clearing payment systems within the new structure. London CCA is viewed by its creators as a universal model, i.e. effecting payments in real-time gross settlement – RTGS, and Cress is viewed by its authorities as more appropriate for providing credits according to transatlantic operations and managing loans. Actually Ian Saville doubts that the Clearstream Banking service system will be popular among future clients, since the clients will have opportunity to chose a bank for getting credits, managing cash flows, and raising securities loans. They would prefer one of the famous investment banks in London. Additional difficulties could emerge because Great Britain yet abstains from joining the European Monetary Union and, consequently, a new structure will have to keep accounts not only in euro, but also in pounds (and the British partners see their advantage in it).

Before the latest structural changes there were about thirty National and International CCAs in Western Europe. Working with each of them required the users to set separate lines of information technology links (IT links). Clearing and settlement securities transaction will total 90% of the transaction cost if its participants are on opposite sides of «translucent' borders within Europe. And naturally, great attention is focused on reducing these costs. Moreover, essential reduction of investment and operation costs is declared to be one of the principal objectives for further consolidation as it was noted in the Statement of Key Principles created in 1998 at European Security Forum, which represented collective opinion of 24 leading world investment establishments. Many practitioners also regard this task real. Thus, Clearstream International leader Andre Lussi claims, «We are absolutely sure that further consolidation within the industry of effecting payments will lead to even greater cost economizing»[16].

Cost reduction is an essential argument for choosing European model of share market clearing payment system. According to estimates of Price Warehouse experts (made in 1994), payment effect costs on trade operations with German shares through sub-custodial bank and national CCA exceeded by 50 times those on similar domestic operations, and by 8 times when being paid through Euroclear. Nevertheless, comprehensive analysis of gross services shows that payment cost through European National CCA does not exceed those settled through American payment and depository system of Depository Trust & Clearing Company (DTCC). Its functions are similar to those of International Central Depositories in Europe (ICDS), but services of International Depositories in general are much more highly priced. One of the Euroclear leaders admitted it by saying, «It is true that International CDS, being more expensive accumulate great profit… But one of the reasons of International CDS being so highly priced consists in the fact that they should cover the cost for the use of Central Depositories and Sub-custodial banks net that provide them access to CDS»[17]. Consequently, expenditures for services of two international depositories two and a half times exceed those of 15 European CDS services. This ratio is not surprising as far as the operation expenditures for one transaction after the expert estimations exceed seven times expenditures for an American competitor and nine times respectively for the European CDS[18]. This difference will be even greater in case when the sole European Central Depository is created, and the European Security Forum stands for it ever more and more definitely.

By the way, the issue of even greater importance is that of a single European CCA creation. The matter is, that fragmentary western European clearing payment system is strained to such extent that it is almost going to pieces. So, it is clear that urgent measures should be taken to reduce excessive financial flows and to avoid a

[15] Ibid., p.68.
[16] Ibid., p.66.
[17] Ibid., p.74.
[18] Ibid., p.72.

crisis of the system. Numerous regulative organizations are creating now ad hoc task forces to study these problems. European Governments advocate for pan-European capital market creation having set the term (2005 year) for abolishing all regulatory barriers to achieve this goal, thus providing financial services development in EC (EU's Financial Services Action Plan). And the shortest way to hit the target is viewed by creating a single European CCA. Actually, the real advantage for clients would be the clearing costs reduction that could be achieved specifically due to CCA use which functions like intermediate and «clearing house» between a buyer and a trader. Under this approach trading pits merging will become an additional element for a reform allowing to put an end to investment operations as well as operation and administrative expenditures duplications.

On December 6, 2000, the European Security Forum issued the project of that organization establishment. The project called upon immediate actions aimed at creating the single European CCA that will represent clearing payments services on the European capital market with the following principles at its basis:

- market of «wholesale» capital transactions will concentrate all the settlements including clearing and netting in one establishment that would ensure considerable saving of administrative expenditures;
- users will be in the majority who own property and manage this structure;
- the structure's services tariffs will reflect the services self-cost.

The Project regards the CCA creation as the priority task for serving the corporate shares market, but later it should embrace with its services the operations with all securities and their derivatives. In 1975, the USA Securities Commission made relevant research showing that consolidation of seven existing at that time clearing chambers into a single one would provide 60% cost saving. By expert estimates that saving could total in Europe about 1 bln. euro per year.

The cost and volume reduction of payment transactions (due to avoiding their duplication) is not the only advantage expected from the creation of a single CCA. Millions could be saved on account of capital risk reduction caused by so called «portfolio effect». The matter is that clearing chambers charge settlement participants margin and pledge to cover the default risks.

Successful development of the European CCA needs switching operations from stock exchanges, and consequently, it requires mutual understanding and close cooperation with the latter ones. Moreover, at present, there is no European regulatory procedure available for clearing chambers (vs. banks or investment companies, for example), and single CCA could hardly exist without it. Usually operating companies of trading pits are owners (or co-owners) of clearing payment units that provide an opportunity to get additional profit through artificial price raise for their services (since they usually are monopolists on the market). The European Security Forum stands up for the single CCA to be a property of its users. The opponents of this approach argue their viewpoint by the fact that the entities like the one mentioned above are often not able to face competition, and they lose the incentives for innovations. And after all, such organization by its characteristics will be a monopoly, and it will cause continuous reprimands on the side of market environment. The ESF will have nothing to do but to agree with this situation. In particular, Pen Kent and Darren Fox at the European Sucurity Forum keep to this viewpoint. Though it is obvious that monopolization means not only opportunity for security or other abuses, but also inadmissible risk concentration in one unit. Consequently, the problem could be hardly regarded as closed.

The CCA idea is successfully probed in the USA where since 1976 National Securities Clearing Corporation (NSCC) has been carrying out the CCA functions for the domestic Central Depository, i. e. Depository Trust Company (DTC). This corporation was created by merging of three regional CCA, and at present it is the major corporation providing corporate shares services. Besides, it takes the leading positions in the sphere of serving operations with other securities, since it is a great shareholder of other CCA and includes: 24% shares in Government Securities Clearing Corporation providing services to government bonds market, 14% in Emerging Markets Clearing Corporation created for the operations with Brady bonds, and 10% in MBS Clearing Corporation. In 1999 the Corporation merged with Depository Trust Company (creating Depository Trust & Clearing Corporation), and in November it began to show its interest in the European market. Thus, together with Euroclear and London Clearing Chamber it created European Securities Clearing Corporation (ESCC), providing CCA services on the European government securities market. Incidentally, Americans operating and covering client service network throughout the world are supposed to globalize the CCA functions, that is to create Clearing Chamber for other CCA or to repeat the operation on setting up joint venture with other CCA on the world level.

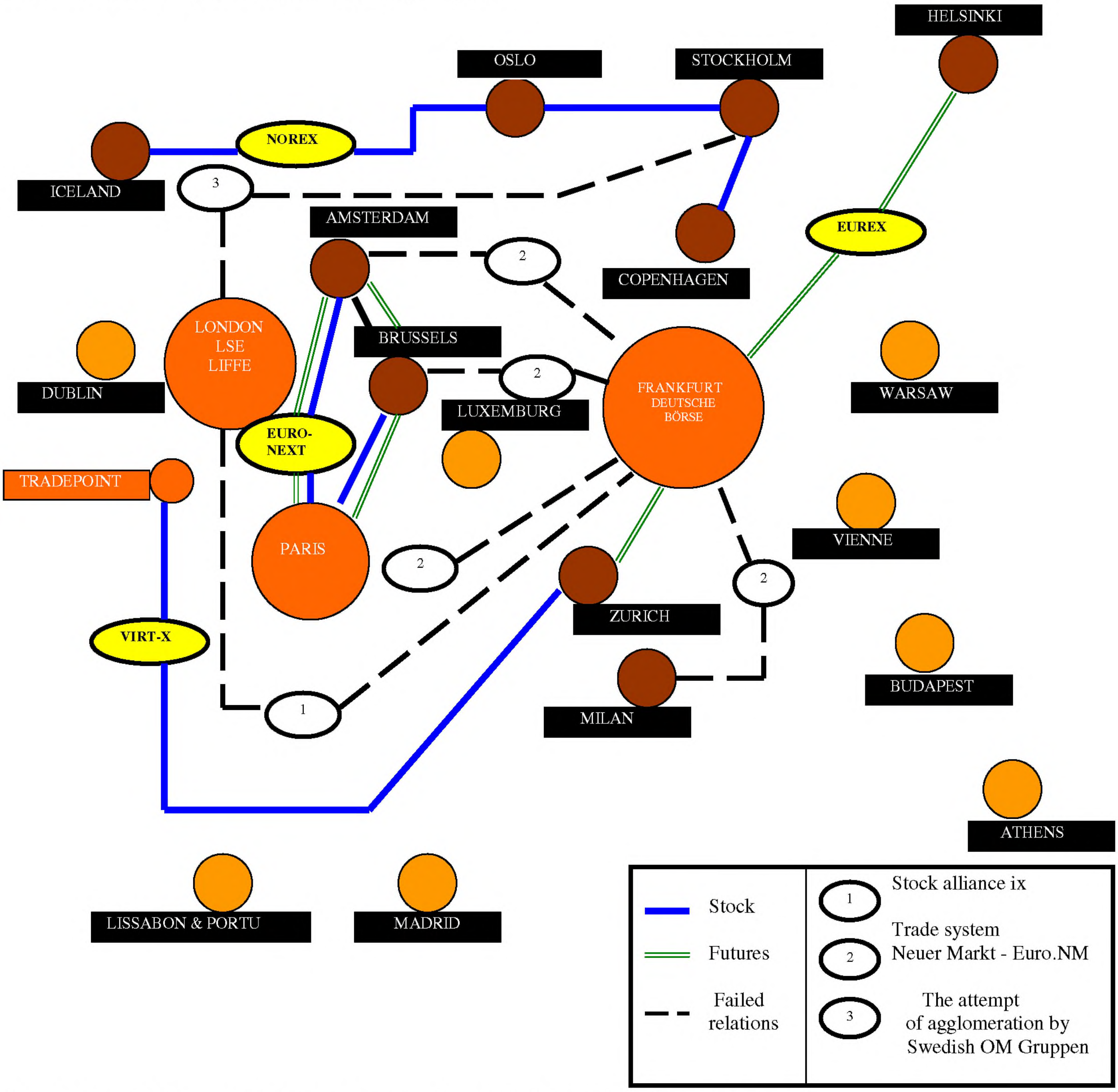
Hereby, summing up the short review of new tendencies on European share market we can define the principal ones as follows:

- **securing** financial operations with the accent on development of the corporate financial instruments (specifically, shares and their derivatives);

- activating participation of European monetary institutions in **global** operations (to a great extent under the influence of American competitors);
- **integrating** the European countries' share market (and not only within the EU) which will result in international **consolidation** of share market infrastructure institutions.
- **commercializing** principles of activity of share trading organizers;
- enhancing **segmentation** of the European share market due to emerging a large number of new national markets, which trying to integrate into European economic environment at this stage need to solve problems of their development, and because of that they risk to lag behind the group of leading countries (in quantity, and what is more important, in quality).

Now the European share market for sure is enjoying its «hour of triumph», and its transformation effects could define its future for many years ahead.

***Chart 1.* The European stock exchange system**



Source: Financial Times, 26.01.01., Europe reinvented. Separate section.,pp.8-9

London and Frankfurt on the financial market in Europe (bln. euro)

	London	Frankfurt
Market cost of domestic companies' quoted shares	2.300,0	1.000,0
Market cost of international companies' quoted shares	4.400,0	31,0
Market cost of new developing companies' shares	7,0	38,0
Cost of shares being at institutional investors' disposal	1.600,0	307,0
Scope of national government bonds market	443,0	732,0
Scope of international bonds market	3,200,0	317,0
Scope of daily currency circulation market	637,0	94,0
Limits of international bank crediting	1.800,0	708,0
Nominal amount of daily derivative circulation	339,0	174,0
Number of daily derivative contracts	520.213	1.500.000
Banking sector assets (in % ratio to GDP)	128%	145%
Number of available foreign banks	555	280
Number of personnel busy in a financial sector	1000.000	175.000

Source: Institutional Investor, May 1999, p. 37.